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# TAIWAN'S EVOLVING STOCK MARKET: POLICY AND REGULATORY TRENDS

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## I. INTRODUCTION

Over the past five years, Taiwan's stock market has matured and grown dramatically. The number of companies listed on the Taiwan Stock Exchange ("TSE") expanded from 163 at year-end 1988<sup>1</sup> to 275 as of September 30, 1993,<sup>2</sup> a 170% increase. In contrast, market value of the Taiwan Stock Exchange Index ("TAIEX") during this period actually shrank from approximately US\$119 billion to US\$108 billion.<sup>3</sup> Together, these

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1. T'AI WAN GU P'IAO SHIH CH'ANG, CHENG CH'UAN T'UNG CHI TZU LIAO 1992 [TAIWAN STOCK EXCHANGE, STATISTICAL DATA 1992] 250 (1992) [hereinafter STATISTICAL DATA].

2. T'AI WAN GU P'IAO SHIH CH'ANG, SHANG SHIH CHENG CH'UAN K'AI K'UANG [TAIWAN STOCK EXCHANGE, STATUS OF SECURITIES LISTED ON THE TAIWAN STOCK EXCHANGE] 3 (1993) [hereinafter STATUS OF SECURITIES].

3. See STATUS OF SECURITIES, *supra* note 2, at 3; STATISTICAL DATA, *supra* note 1, at 2. Market value on the TSE was NT\$3.383 trillion on December 29, 1988, and NT\$2.928 trillion on September 30, 1993. The rate of exchange between the New Taiwan dollar and the U.S. dollar has fluctuated considerably in recent years. See, e.g., NATIONAL TRADE DATA BANK MARKET REPORT U.S. DEP'T OF COMMERCE, TAIWAN OVERSEAS BUSINESS REPORT (1992) (noting that the New Taiwan dollar appreciated against the U.S. dollar by 40% from 1985 to 1988). At the end of the fourth quarter of 1988 the New Taiwan dollar traded at 28.5:1 against the U.S. dollar. At the end of the fourth quarter 1993 the New Taiwan dollar traded at 27:1 against the U.S. dollar.

figures portray a telling story of a shift from over-inflated values to more rational expectations.

Market activity in recent years has been characterized by high volume trading, extreme price volatility, and optimistic earnings forecasts. Price swings have often been dramatic. The TAIEX increased by 275% from 2,341 to 8,789 over a nine-month period in 1988,<sup>4</sup> with a more or less repeat performance in 1989.<sup>5</sup> The market climbed to a five-year peak of 12,495 in February 1990 at which point the TAIEX traded at over seven times its value,<sup>6</sup> with a turnover rate of 459%.<sup>7</sup> It then crashed to a low of 2,560 in October of the same year, thereby losing eighty percent of its value in eight months.<sup>8</sup> Nevertheless, investor interest appears to have remained resilient despite such historic price volatility. Securities firms in 1993 reported forecasted P/E ratios at between 20 and 23.<sup>9</sup>

In response to the immense growth, activity, and interest in the Taiwan stock market, Taiwan's lawmakers and financial regulators have recently begun to take an increasingly active role in shaping its development. This Article will discuss significant policy and regulatory trends developing in Taiwan's capital mar-

4. See STATISTICAL DATA, *supra* note 1, at 2.

5. *Id.*

6. See STATUS OF SECURITIES, *supra* note 2, at 3. In 1990, the TSE had a market value of NT\$2.681 trillion and a trading value of NT\$19.031 trillion. *Id.*

7. *Id.* Turnover rate is defined as the total volume of shares listed divided by the total volume of shares traded. Turnover rates on the TSE for 1989, 1990, 1991, and 1992 were, respectively, 524%, 459%, 285%, and 135%. *Id.* By comparison, NYSE turnover rates for the same years were, respectively, 52%, 46%, 48%, and 48%. LIBRARY OF CONGRESS, THE NYSE FACT BOOK FOR THE YEAR 1992, 82 (1993) [hereinafter NYSE FACT BOOK].

8. *Id.* at 119. The following are the high, low, and closing prices per share on the TAIEX for the past five years in NT dollars:

Year	High	Low	Close
1988	8,789.73	2,341.06	5,119.11
1989	10,773.11	4,873.18	9,624.18
1990	12,495.34	2,560.47	4,530.16
1991	6,305.22	3,316.26	4,600.67
1992	5,391.63	3,327.67	3,377.06
1993	5,013.28	3,135.56	N/A

*Id.* at 95. The high and low share price data for 1993 was provided in a Letter from Nate Emerson, Core Pacific Investment Consulting, to Jeffrey Chen, Associate at Jones, Day, Reavis & Pogue (Oct. 28, 1993) (on file with the UCLA Pac. Basin L.J.) [hereinafter Core Pacific Investment Letter].

9. Telephone Interview with Jonathan M. Ross, Taiwan Country Manager, HG Asia Taiwan Securities Ltd. (Jan. 17, 1994). By comparison, P/E ratios for Standard & Poor's 500 have ranged between 6.3 and 26 over the past 50 years. (The average P/E ratio was 21 just prior to the October 1987 crash.) STANDARD & POOR'S CORP., STANDARD & POOR'S SECURITY PRICE INDEX RECORD STATISTICAL SERVICE 120-126 (1992). P/E ratios for the NYSE in 1990, 1991, and 1992 were 14.8, 25.8, and 22.7, respectively. NYSE FACT BOOK, *supra* note 5, at 66.

kets.<sup>10</sup> It will focus on regulatory efforts to liberalize and stabilize capital markets on several fronts: Part II discusses issues attendant to increased institutional investment in the Taiwan Stock Exchange; Part III discusses direct investment by foreign institutional investors, cross border instruments such as global depository receipts, and various avenues for the sale of foreign securities in Taiwan; and Part IV discusses cross-strait capital markets phenomena, such as the listing of Taiwanese-invested companies on mainland exchanges and the purchase of mainland "B" shares by Taiwanese investors. The effect of foreign exchange controls on market development will be considered throughout. The Article concludes that the trend toward liberalization of the capital markets in Taiwan is reason for optimism, but that capital market liberalization will not be fully effective unless there is concomitant liberalization of exchange controls.

## II. MOVES TO RATIONALIZE MARKET BEHAVIOR THROUGH INSTITUTIONAL-PARTICIPATION

Investment in the Taiwan stock market has historically been dominated by individuals. Even at present, it is estimated that ninety percent of stock listed on the TSE is controlled by individual investors.<sup>11</sup> This investment pattern is generally considered a primary cause for the stock market's highly volatile behavior.<sup>12</sup> As such, the Securities and Exchange Commission ("SEC") of the ROC Ministry of Finance ("MOF") has in recent years encouraged more participation in the market by institutional investors.<sup>13</sup> The MOF and SEC believe that institutional investors will

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10. These trends are reflected in very active rule making activity over the past few years, most of these rules having been promulgated pursuant to the ROC Securities and Exchange Law. CHENG CH'UAN CH'IAO I FA [Securities and Exchange Law] (1988) (Taiwan) [hereinafter SEL].

11. No official or precise figures exist as to the percentage of individual versus institutional investment on the TSE. Certain practices prevalent in Taiwan, such as the opening of brokerage accounts in the names of individuals through which institutional money is invested, or the use by individuals of institutional fronts for investment, would make somewhat meaningless any precise division by names under which securities are held. Nevertheless, it is generally estimated that 90% of investment on the TSE is actually controlled by individuals. See, e.g., Chiang Kuo-P'ing, *Chiang Shou Fa K'ai Fang T'ou Hsin, T'ou Ku Tai K'o Tsao Tso Yeh Wu* [Amendment of the Law is Expected to Liberalize Investment and the Operation of Investment Consulting Enterprises], COM. TIMES, Jan. 14, 1994, at 25 (estimating that Institutional Investors account for only 8.1% of the investment on the TSE).

12. *Taiwan: Local Stock Market Movement Was Related to Political Development*, BUS. TAIWAN, Dec. 6, 1993, available in LEXIS, World Library, TXTFE File (noting that the Taiwan stock market's abnormally high ratio of individual investors are a major destabilizing factor for the local bourse).

13. See, e.g., C.P. Chang, A Pragmatic Approach to Market Internationalization, Address Before Seminar on Securities Market Internationalization (Sept. 25, 1990) (transcript on file with the *UCLA Pac. Basin L.J.*) [hereinafter Pragmatic Ap-

bring more stability to the market through disciplined investment based on market fundamentals.<sup>14</sup>

### A. INVESTMENT MANAGEMENT COMPANIES

Until recently, only four investment companies managing mutual funds, known as "securities investment trust enterprises" ("SITE"s) were licensed to do business in Taiwan.<sup>15</sup> SITEs were licensed pursuant to regulations promulgated by the SEC.<sup>16</sup> In a conscious effort to increase the amount of institutional investment on the TAIEX, the SEC in December 1992 licensed eleven new investment management companies<sup>17</sup> under the SITE Regu-

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proach] (in which the Chairman of Taiwan's SEC discusses plans to increase institutional investor participation in the Taiwan stock market).

14. See Ts'ai Cheng Pu P'an Ch'ueh [Ministry of Finance Ruling], Tai-Tsai-Shui Tze 800,382,289 (Nov. 4, 1991) [hereinafter MOF Ruling]; Pragmatic Approach, *supra* note 13 (in which the Chairman of Taiwan's SEC notes that the presence of institutional investors will "introdu[ce] more mature investment behavior"); Lin Rong-Guang, *Hsin Chi Chin Ch'i Ku Pi Li Chih Shao Ch'i Ch'eng Wu [75% Minimum Stock Holding Ratio for New Investment Funds]*, COM. TIMES, Dec. 24, 1992, at 1 (noting that the presence of institutional investors was expected to stabilize the stock market in Taiwan).

15. The four investment companies, established between 1983 and 1987, are: (i) International Investment Trust Co., Ltd.; (ii) China Securities Investment Trust Co., Ltd.; (iii) National Investment Trust Co.; and (iv) Kwang Hua Securities Investment Trust Co., Ltd.

16. See generally CHENG CH'UAN T'OU TZU HSIN T'O SHIH YEH KUAN LI KUI TSE [Regulations Governing Securities Investment Trust Enterprises], (Executive Yuan as amended 1991) (Taiwan) [hereinafter SITE Regulations].

17. Lin Rong-Guang, *11 Chia Hsin T'ou Hsin Huo Ying Yeh Chih Chao: Ming Nien Ch'u Chan K'ai Chi Chin Mu Chi [11 New Investment Companies Obtain Licenses: Collection of Funds Will Begin at the Start of Next Year]*, COM. TIMES, Nov. 27, 1992, at 3. The eleven new SITEs and their major shareholders are as follows:

Fund	Shareholders
1. Grand Pacific Fund	Shearson Lehman, Gadmure Fund Management, Yasuda
2. Yuanta - Duo Yuan Fund	Wellington, Yuanta Securities
3. Yung Chong Fund	Royal Trust, Banque Pacibas, Yung Chong Securities
4. President Tung Hsin Fund	Klainworth Banson, Scudder Stevens, President Securities
5. Fubon Fund	AIG, Mitsubishi Bank, Fubon Securities
6. Core Pacific Pioneer Fund	Core Pacific Securities, Standard Chartered Bank, Pioneer Fund Management
7. Jardine Fleming Fund	Jardine Fleming Hong Kong, Jardine Fleming Taiwan, T. Rowe Price
8. Diamond Fund	United Investment Trust, Banker's Trust (U.S.), Banker's Trust (Australia)
9. Master Line Fund	Masterlink Securities, Deutsche Bank, Kankaku Securities
10. Taiwan Fu-Kuei Fund	S.G. Warburg, Nomura Securities, Sanyo
11. Chronicle Fund	Keystone

Letter from Stan Shpetner, Grand Cathay Securities Corp., to Jeffrey Chen, Associate at Jones, Day, Reavis & Pogue (Oct. 30, 1993) (on file with the *UCLA Pac. Basin L.J.*) [hereinafter Grand Cathay Securities Letter].

lations.<sup>18</sup> As a condition for keeping their licenses, the eleven new companies were each required to raise, from domestic sources, NT\$4 billion (approximately US\$150 million) within a forty-five-day period commencing within six months of being instructed to do so by the SEC pursuant to granting of the license.<sup>19</sup> All eleven companies succeeded in raising the prescribed capital within the first quarter of 1993, a time period popularly described as a "Warring States" period.<sup>20</sup> All of the funds, in total about US\$2 billion, had to be invested on the TSE, and all except one were listed as closed-end funds.<sup>21</sup>

One of the main goals of licensing new mutual fund companies was to introduce foreign-style professional management principles on the Taiwan stock market.<sup>22</sup> Accordingly, the SITE Regulations require that each new SITE have prescribed amounts of foreign equity shareholding<sup>23</sup> by at least two established foreign financial institutions (i.e., a bank or a fund management institution)<sup>24</sup> and that a one of those foreign institutions

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18. SITE Regulations, *supra* note 16.

19. SITE Regulations, *supra* note 16, art. 13. The SITE Regulations also required the NT\$4 billion to meet prescribed investor dispersal and small investor requirements, i.e., out of the NT\$4 billion: (i) each investor is limited to an investment ceiling of NT\$200 million; and (ii) there must be at least 3,000 investors each holding less than NT\$1 million, and the aggregate value held by such small investors must be at least NT\$800 million. *Id.*

20. In the "Warring States" period in Chinese history (450 - 300 B.C.) six states contended for supremacy amid extremely chaotic conditions. Commentators consider this an appropriate analogy to the competition among eleven new mutual fund companies contending for domestic funds as a condition to their survival. See William Ke, *Taiwan: Domestic Banks - High Hopes Amid Fiercer Competition*, Reuter Textline, Jan. 11, 1993, available in LEXIS, World Library, TXTTFE File.

21. See Grand Cathay Securities Letter, *supra* note 17.

22. See Lin, *supra* note 14.

23. The SITE Regulations provide that each foreign shareholder meeting the prescribed qualifications must hold at least 5% of the SITE's equity, but that each foreign shareholder and its related entities may not hold more than 25% of the SITE's total outstanding shares and that total foreign shareholding in the aggregate may not exceed 49% of the SITE's outstanding shares. SITE Regulations, *supra* note 16, arts. 5, 8.

24. SITE Regulations, *supra* note 16, art. 5. The SITE Regulations do not prescribe that the equity requirement must be "foreign" as such; however, under the SITE Regulations' vigorous qualification requirements (i.e., 10 years' longevity, managerial and operational experience in international securities investment trust funds, no sanctions imposed by a home country authority over the past three years, and total assets under management of at least US\$5 billion, half of which must be in the form of publicly raised mutual funds, unit trusts, or public investment trust funds as well as requirements that banks must rank among the top 200 banks in the "free world" by assets), virtually no domestic institution could qualify in these respects. *Id.* The SITE Regulations also require at least one-fifth of a new SITE's promoters must comply with the aforesaid requirements. *Id.* Combined with the minimum seven-promoter requirement for a "company limited by shares" prescribed in the ROC Company Law, KUNG SSU FA [Company Law] art. 128 (1983) (Taiwan), the SITE Regulations effectively require at least two qualified foreign shareholders. See

enter into a technology transfer agreement for fund management know-how with the newly established SITE.<sup>25</sup>

Since becoming players in the market, the eleven new SITES have proved to be relatively cautious about investing in equities.<sup>26</sup> Given its policy of increasing institutional participation on the stock market, the SEC has found this disappointing.<sup>27</sup> In August 1993 the SEC issued a letter to the Taipei Securities Investment Trust Association, agreeing that, for new funds listed for a period of six months which were not at least 75% invested in equities, the amount by which such funds were short of 75% equity utilization should be subject to a reduction in management fee rate from 1.2% to 0.7%.<sup>28</sup>

## B. FOREIGN INSTITUTIONAL INVESTORS

In 1991, foreign institutional investors emerged as a new force on the TSE pursuant to a government program to internationalize the market.<sup>29</sup> Since initiation of this program, some fifty-eight foreign institutions have applied, many filing multiple applications, aggregating over US\$1.8 billion of approved and remitted investments as of November 1993, about half of which has already been utilized for purchases on the TSE.<sup>30</sup>

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*supra* note 17 for a list of the foreign bank and fund management shareholders of each new SITE.

25. SITE Regulations, *supra* note 16, art. 10. Explanatory information issued by the SEC required the technology transfer to cover fund sales and marketing, design of fund instruments, management of fund investments, and fund administration. See CHENG CH'UAN T'OU TZU HSIN T'O SHIH YEH SHE LI SHUO MING TZU LIAO [Explanatory Information for Establishing Securities Investment Trust Enterprises] art. 9 (Ministry of Fin. 1991) (Taiwan) [hereinafter Establishment Explanatory Information].

26. Su Yi-Jen, *Chiang Ssu Chi Chia Ma Chih 75% I Fu Piao Chun [SITES Watch for Chance to Increase Equity Holdings to 75% to Meet Standards]*, COM. TIMES, June 5, 1993 at 15; Telephone Interview with Stan Shpetner, Brokerage Department Manager, Grand Cathay Securities Corp. (Dec. 13, 1993).

27. Su, *supra* note 26, at 25; Lin, *supra* note 14.

28. Chiang Kuo-P'ing, *Cheng Kuan Hui T'ung I Kuan Li Fei Chiang Wei Ch'ien Feng Chih Ch'i [SEC Agrees That Management Fees Should Be Lowered to 0.7%]*, COM. TIMES, Aug. 26, 1993, at 27.

29. Applications by foreign institutional investors are handled under HUA CH'IAO CHI WAI KUO JEN T'OU TZU CHENG CH'UAN CHI CH'I CHIEH HUI PAN FA [Regulations for Investments in Securities by Overseas Chinese and Foreign Nationals and Their Exchange Settlement] (Executive Yuan as amended 1993) (Taiwan) [hereinafter QFII Regulations].

30. Letter from Karen Lu, Chase Manhattan Bank N.A. (Taipei Branch), to Jeffrey Chen, Associate at Jones, Day, Reavis & Pogue (Nov. 23, 1993) (on file with the UCLA Pac. Basin L.J.). The Government of Singapore Investment Commission (GSIC) is among the largest and the most ambitious investors. GSIC has made three QFII applications of US\$50 million each, and its fourth application is for US\$350 million. *Id.*

The TAIEX steadily dropped from the second quarter of 1993, with a sharp upturn at the end of the year.<sup>31</sup> Throughout most of 1993, as domestic investors shied away, buying action on the TSE was dominated by foreign institutional investors.<sup>32</sup> The bullish outlook of foreign institutions on Taiwan's stock market may in part be attributed to record highs on exchanges in other countries,<sup>33</sup> and in part to restrictions on utilization of funds remitted in under the foreign institutional investor program.<sup>34</sup>

### III. INTERNATIONAL ACCESS

#### A. DIRECT INVESTMENT BY FOREIGN INSTITUTIONS

Indirect foreign investment through various "Taiwan funds" trading on offshore exchanges as closed-end funds has occurred since 1983.<sup>35</sup> In December 1990, Taiwan promulgated regulations allowing qualified foreign institutional investors to directly invest in Taiwan-listed securities.<sup>36</sup> The landmark QFII Regulations ushered in the second phase of a three-phase government

31. CORE PAC. INVESTMENT CONSULTING, TAIWAN STOCK MARKET OUTLOOK 1 (1993).

32. WARDLEY JAMES CAPEL TAIWAN, VEHICLES AVAILABLE FOR FOREIGN INVESTMENT 43 (1993) [hereinafter WJC TAIWAN] (noting that monthly buying by foreign institutional investors consistently exceeded selling in 1993 and that net buying generally increased, especially in the second half of the year).

33. *Taiwan: Stock Market Starting to Show Strong Rebound*, China Economic News Service, Nov. 4, 1993, available in LEXIS, World Library, ALLWLD File (noting that the upturn of share prices on major foreign stock markets have combined to goad the Taiwan stock market into bullish action).

34. Once the approved amount of investment has been remitted in, restrictions exist on how foreign institutional investors may utilize such funds. Under the QFII Regulations, foreign institutional investors may purchase most TSE-listed securities (including listed shares, listed beneficiary trust certificates, government bonds, financial institution debentures, straight bonds, and other securities approved by the SEC). QFII Regulations, *supra* note 29, art. 13; WAI KUO CH'UAN YEH T'OU TZU CHI KOU SHEN CH'ING CHIH CHIEH T'OU TZU KUO NEI CHENG CH'UAN SHUO MING TZU LIAO [Explanatory Information for Foreign Institutional Investors Applying for Direct Investment in ROC Securities] art. 10 (Ministry of Fin. 1990) (Taiwan) [hereinafter Application Explanatory Information]. However, severe restrictions exist on utilization of funds for purchasing money market instruments. For example, foreign institutional investors may only park their cash in demand deposit or 3-month time deposit accounts which cannot be rolled over. Ts'ai Cheng Pu Shuo Ming Shu [Ministry of Finance Explanatory Letter], Tai-Tsai-Jong Tze 801,667,554 (Dec. 23, 1991) [hereinafter MOF Letter]. In addition, investment in other money market instruments by foreign institutional investors is restricted to instruments having at least 180-day maturities (this has recently been liberalized from 90-days); Cheng Ch'uan Kuan Li Wei Yuan Hui Kung Pao [Securities and Exchange Commission Bulletin], Tai-Tsai-Jong Tze 51,262 (Feb. 24, 1992), and the total amount of cash funds kept in time deposit accounts cannot exceed 10% of the total SEC-approved investment amount. MOF Letter, *supra*.

35. *ROC Fund Plans to Trade in New York, Hong Kong, May 1*, Central News Agency, May 1, 1989, available in LEXIS, World Library, ALLWLD File.

36. See generally QFII Regulations, *supra* note 29.



policy to liberalize Taiwan's stock market for access by foreigners.<sup>37</sup> Under the QFII Regulations and accompanying explanatory information published by the SEC, foreign banks, insurance companies, and fund management institutions meeting prescribed longevity, experience, and asset requirements were eligible to apply for approval to make direct investments in TSE-listed securities.<sup>38</sup> Further liberalization came in January 1993, when the SEC announced, pursuant to its discretionary powers under the QFII Regulations, that qualified foreign brokerages could also apply for direct investment on the TSE.<sup>39</sup> The SEC's announcement also lowered certain prescribed longevity, experience, and asset requirements.<sup>40</sup>

In addition to SEC approval, the QFII Regulations require investors to obtain consent of the Central Bank of China ("CBC") for inward remittance of each SEC-approved amount.<sup>41</sup>

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37. In 1982 the ROC Executive Yuan (Cabinet) initiated a three-phase plan to internationalize the Taiwan capital markets. The first stage was to permit foreign indirect investment through "Taiwan funds" listed on foreign exchanges. The second, current phase, among other forms of restricted investment, allows direct investment by foreign institutional investors under the QFII program. The third and final phase envisions complete market access to foreigners. See Pragmatic Approach, *supra* note 13.

38. MOF Ruling, *supra* note 14; QFII Regulations, *supra* note 29, art. 8.

39. Ts'ai Cheng Pu Cheng Ch'uan Kuan Li Wei Yüan Hui Kung Kao [Announcement of the Securities and Exchange Commission of the Ministry of Finance], Tai-Tsai-Jong Tze 11,274 (Jan. 16, 1993) [hereinafter SEC Announcement]. Although the SEC has not yet allowed direct investment by foreign individuals, some have observed that the SEC's allowing foreign brokerages to qualify under the QFII program constitutes in effect a limited tolerance of direct investment by foreign individuals, since individuals who are clients of a foreign brokerage participating in the QFII program may make orders to trade in TSE securities. Practically, however, this would only be feasible for a limited number of wealthy individuals, since each foreign institutional investor participating in the QFII program is limited to five trading sub-accounts per QFII application, each of which must be opened in the name of a legal person. QFII Regulations, *supra* note 29, art. 15. Thus, the individual would have to trade under the guise of a foreign legal person. Moreover, since qualified foreign institutional investors must trade on the TSE through a designated Taiwan broker, brokerage fees would have to be split between the foreign broker and the Taiwan broker, although this would not be burdensome given extremely low brokerage fees charged by Taiwan brokers (approximately 0.1425%). See T'ai Wan Chen Ch'uan Chiao I So Ku Fen Yu Hsien Kung Ssu Kung Pao [Taiwan Stock Exchange Public Announcement], Tai-Cheng-Chiao Tze 7,642 (June 29, 1990).

40. The SEC Announcement provides that: (i) banks need to rank only among the top 1,000 banks in the "free world" by assets and have experience in "the international finance, securities, or trust business" (no dollar amount of securities assets is prescribed); (ii) fund management institutions need to have been established only for a minimum of three years and must be managing securities investment funds in excess of US\$300 million; and (iii) insurance companies need to have been established only for five years, although they still must have total securities assets of over US\$500 million. SEC Announcement, *supra* note 39, arts. 1, 4.

41. QFII Regulations, *supra* note 29, art. 9.

Accordingly, the pace of QFII investment approvals and the permitted size of single investments tend to be linked to CBC monetary policy, a phenomenon that has proved to be one of the most problematic and unpredictable aspects of implementing the QFII investment program. Timing is an important factor for investors; however, in the past, foreign institutions have had to wait months before obtaining CBC consent for inward remittance.<sup>42</sup> In February 1992, Taiwan newspapers reported that the CBC had imposed a suspension until further notice on all approvals for inward remittance of funds under the QFII program.<sup>43</sup> Although the CBC denied these reports,<sup>44</sup> they had a chilling psychological effect at the time on many foreign institutions.<sup>45</sup> Sometime around March 1992, the CBC began requiring foreign institutional investors to submit a timetable for inward remittance on a staggered basis.<sup>46</sup> Throughout most of 1992, the CBC practice was to allow foreign institutional investors to remit inward up to a limit of US\$5 million per week.<sup>47</sup> During most of 1993, given the depressed state of the Taiwan stock market and a weaker NT dollar,<sup>48</sup> this practice apparently was liberalized.<sup>49</sup>

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42. See Grand Cathay Securities Letter, *supra* note 17.

43. Hsu Yuen-Ch'un, *Kuo Wai Fa Jen Chi Kou T'ou Tzu Kuo Nei Ku Shih Yang Hang Ch'ueh Chan Huan Ho Chun* [The Central Bank Decides to Delay Permitting Foreign Institutional Investors Investment in the Domestic Market], COM. TIMES, Feb. 17, 1992, at 1; Hsu Yuen-Ch'un, *He Chih Wai Tzu Ta Liang Yung Ju Yang Hang Ch'ueh Shih T'ieh Wan* [The Central Bank Uses an Iron Fist to Prevent Large Scale Inward Foreign Investment], COM. TIMES, Feb. 17, 1992, at 2.

44. Telephone Interview with Anonymous, Official with the Central Bank of China (Jan. 23, 1992). It is common in ROC legal practice to seek the advice or confirmation of government officials particularly when interpreting ambiguities in new laws or in confirming published reports. While such officials will opine accurately for the most part on a wide range of legal issues they will rarely agree to be cited by name or to issue an official report.

45. In 1992 Jeffrey Chen was involved in servicing several foreign institutional clients, one of whom was actually in the process of making a QFII application, and others who were contemplating similar applications. The newspaper reports on CBC suspension provoked surprise and alarm among all these clients and caused them to be apprehensive about proceeding with their Taiwan investment plans.

46. These requirements have never been formally promulgated. In 1992 a verbal agreement was reached over the telephone with the CBC pursuant to a QFII application in which Jeffrey Chen was involved. In accordance with this agreement a schedule of inward remittances of investment funds into Taiwan had to be submitted to the CBC and said remittances had to be staggered with no more than US\$5 million remitted in each week. Officials at custodian banks for the QFII program have also anonymously confirmed that the CBC practice in 1992 was to limit inward remittances to US\$5 million per week.

47. See *supra* note 46 and accompanying text.

48. See Core Pacific Investment Letter, *supra* note 8.

49. Although a schedule of remittances must still be filed with the CBC, the authors have detected no inclination on the part of the CBC to impose a US\$5 million per week remittance limit in any of the 1993 QFII applications in which the authors have been involved. Custodian banks for the QFII program confirm that the CBC practice throughout most of 1993 has been liberalized. According to anon-

One of the most closely followed issues surrounding the QFII program has been the frequency of profit repatriation. Under the current QFII Regulations, foreign institutional investors may only remit out profits once per year.<sup>50</sup> This provision has been criticized as unreasonably restrictive.<sup>51</sup> Along with restrictions on money market investments,<sup>52</sup> the provision effectively forces the investor to plow profits back into the stock market, irrespective of the investor's market judgment. Furthermore, the provision locks profits into NT dollars, thus obliging the investor to hedge foreign exchange risks until time of annual repatriation.<sup>53</sup>

Until very recently, foreign institutional investors repatriating their investment principal, or portions thereof, were required to liquidate their investments *pro tanto*.<sup>54</sup> In November 1993, the QFII Regulations were amended to allow repatriated principal to be reinjected into Taiwan up to the ceiling of the original amount remitted in, provided that reinjection occurs within three months of repatriation.<sup>55</sup> It is anticipated that lifting principal investment remittance restrictions under the QFII pro-

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ymous officials at the QFII custodian banks the CBC in 1993 regularly allowed remittances of up to US\$20 million per week and greater remittance limits may be set pursuant to special arrangements.

50. QFII Regulations, *supra* note 29, art. 12.

51. Lin Jung-Kuang, *Wai Tzu Chi Kou T'ou Tzu Kuo Nei Ku Shih Cha Men Ta K'ai* [Gates Open for Foreign Institutional Investors in Domestic Stock Market], COM. TIMES, July 23, 1993, at 3. Liberalizing repatriation of profits and capital gains would require amendment to QFII Regulations Article 12. See QFII Regulations, *supra* note 29, art. 12. However, amendment would involve implementing a shift in statutory authority. The QFII Regulations were promulgated pursuant to two ROC foreign investment statutes: (i) WAI KUO JEN T'OU TZU T'IAO LI [Statute for Investment by Foreign Nationals] (Executive Yuan as amended 1989) (Taiwan) [hereinafter Foreign Investment Statute]; and (ii) HUA CH'IAO T'OU TZU T'IAO LI [Statute For Investment By Overseas Chinese] (Executive Yuan as amended 1989) (Taiwan) [hereinafter Overseas Chinese Investment Statute]. See QFII Regulations, *supra* note 29, art. 1. Under these statutes, a foreign or overseas Chinese investor may only apply for repatriation of profits and capital gains once a year. Foreign Investment Statute, *supra* art. 13; Overseas Chinese Investment Statute, *supra* art. 12. To allow amendment of the QFII Regulations to provide for repatriation of profits and capital gains more often than once per year, the QFII Regulations must be taken outside the authority of the investment statutes. The SEC is arranging to have the QFII Regulations re-promulgated under the authority of the SEL after the next amendment to the SEL, which is scheduled for 1994. Lin, *supra*.

52. See *supra* note 34 and accompanying text.

53. See QFII Regulations, *supra* note 29, art. 12.

54. HUA CH'IAO CHI WAI KUO JEN T'OU TZU CHENG CH'UAN CHI CH'I CHIEH KOU PAN FA [Regulations for Investments in Securities by Overseas Chinese and Foreign Nationals and Their Settlement] art. 12 (Executive Yuan 1990) (Taiwan) [hereinafter Old QFII Regulations].

55. QFII Regulations, *supra* note 29, art. 12.

gram will increase the number of foreign institutional investors in Taiwan as well as the total amount of foreign investment.<sup>56</sup>

Under the QFII program, foreign institutional investors have also been subject to percentage limits on their investments in target companies.<sup>57</sup> Recently, however, the MOF and the SEC have considered lifting these percentage limits on investment pursuant to their authority to do so under the QFII Regulations,<sup>58</sup> and it appears that some liberalization in this respect may be imminent.<sup>59</sup>

## B. CROSS-BORDER INSTRUMENTS

### 1. Euro-Convertible Bonds

Beginning in 1989, the SEC has allowed certain large qualified Taiwan companies to begin issuing Euro-convertible bonds to foreign investors.<sup>60</sup> Euro-convertible bonds are corporate bonds issued by Taiwan-listed companies in U.S. dollar denomi-

56. Chiang Kuo-P'ing, *Wai Tzu Chin Ch'u Hsian Chih Chin Fang K'uan* [Recent Liberalization of Inward and Outward Remittance Restrictions on Foreign Investments], COM. TIMES, Nov. 8, 1993, at 25. The view expressed in this article was confirmed in Telephone Interview with Anonymous, Securities and Exchange Commission Director of Division IV (Nov. 18, 1993) [hereinafter SEC Interview].

57. Investment by each foreign institution may not exceed five percent of the target company's shares, and the total amount of foreign institutional investment in the aggregate may not exceed ten percent of the target company's shares. QFII Regulations, *supra* note 29, art. 14.

58. QFII Regulations, *supra* note 29, art. 4 (providing that the MOF has the authority to adjust percentage shareholding limits "in view of the domestic economic and financial situation and the conditions of the securities markets").

59. See Chiang Kuo-P'ing, *Wai Kuo Fa Jen T'ou Tzu Shang Shih Kung Ssu Chih Ku Pi Li Chiang Ch'u Hsiao Hsien Chih* [Share Percentage Restrictions for Foreign Institutional Investors Will Be Lifted], COM. TIMES, Oct. 29, 1993, at 1. The accuracy of this article was confirmed in SEC Interview, *supra* note 56.

60. Jeremy Mark, *Taiwan Funds Targeting Eurobond Market*, ASIA WALL ST. J., May 28, 1991, at 1. Euro-convertible bonds may be issued pursuant to the same statutory authority and procedures that apply to the issuance of local currency denominated bonds. Company Law, *supra* note 24, arts. 246-65. Issuance of corporate bonds requires SEC approval. Company Law, *supra* note 24, art. 248. The SEC has not promulgated any formal regulations on the issuance of Euro-convertible bonds, although it maintains internal guidelines for approval of their issuance. Telephone Interview with Jimmy C.M. Lin, Chief Corporate Legal Counsel, Yuen Foong Yu Mfg. Co., Jan. 13, 1994 [hereinafter Lin Interview]. To date, the Taiwan companies that have issued Euro-convertible bonds (with conversion years) are as follows:

- YFY Paper (1999)
- ACER (2001)
- Tung Ho Steel (2001)
- Pacific Electric Wire & Cable (2001)
- Microtek (2001)
- Walsin Lihwa (2002)
- Sincere Navigation (2003)
- Far Eastern Textile (2006)

See WJC TAIWAN, *supra* note 32, at 43.

nations, which give the bond holder a conversion right after expiry of a specified period of time. The bonds are most commonly converted into equity shares of the issuing company. Conversion from debt to equity in the indenture agreement is made conditional on regulatory permission at the time when the conversion privilege may be exercised.<sup>61</sup> To date, no such conversion has taken place, since foreign individuals and non-QFII approved institutions are not yet allowed to directly invest in Taiwan-listed securities.<sup>62</sup>

Until very recently, Taiwan issuers of Euro-convertible bonds were not allowed by the CBC to exchange foreign capital raised thereby into NT dollars for use in the ROC. In October 1993, the CBC significantly liberalized this policy by allowing Taiwan-listed companies to remit in the entire amount of foreign capital raised through Euro-convertible bond issues on condition that concrete plans existed to use such proceeds for investment in domestic expansion of new manufacturing facilities.<sup>63</sup> Commentators believe that the CBC's new policy will significantly affect the pattern of international corporate finance activities in Taiwan.<sup>64</sup>

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61. Lin Interview, *supra* note 60.

62. See Pragmatic Approach, *supra* note 13. In theory, a qualified foreign institutional investor approved under the QFII Regulations could effect the conversion from its own holdings or purchase Euro-convertible bonds to effect such conversion. However, foreign securities (including Euro-convertible bonds denominated in U.S. dollars) are included within the definition of "foreign exchange" under the ROC Foreign Exchange Control Law. MIN CHIEN HUI JU K'UAN HSIANG CHIA HUI PAN FA [Foreign Exchange Control Law] art. 2 (1987) (amended 1990) (Taiwan). Therefore, the foreign institutional investor seeking to make such conversion would, for inward remittance purposes, be required to include the conversion transaction as part of its investment quota under the QFII Regulations. QFII Regulations, *supra* note 29, art. 11.

63. Yu Mei-Ling, *K'e Tui Huan T'ai Pi Tsung O Hsien 30 Yi Mei Yüen [Convertible Bonds and GDRs May Be Exchanged for NT Dollars Up to Aggregate of US\$3 Billion]*, COM. TIMES, Oct. 14, 1993, at 3. Confirmed in Telephone Interview with Anonymous, Official with the Central Bank of China (Nov. 16, 1993).

64. The corporate bond market in Taiwan has historically been insignificant, primarily because certain restrictions contained in the ROC Company Law impose ceilings on corporate debt and make public issuance of corporate debt very cumbersome. See, e.g., Company Law, *supra* note 24, arts. 246-65. There is talk of loosening up some of these restrictions. For example, one commentator has proposed that the ceiling imposed on corporate debt issuance should be raised from the currently prescribed one times net worth of the company to twice the net worth of the company. See, e.g., Chiang Kuo-P'ing, *Fa Hsing Kung Ssu Chai Mu Tzu Chin Cheng Kuan Hui Sung Ta Hung Pao [Raising Funds by Corporate Debt Issuance - SEC Grants Big Bonus]*, COM. TIMES, Oct. 23, 1993, at 14. However, such measures would require amendment to the ROC Company Law, which must therefore await action by the ROC Legislative Yuan.

## 2. Global Depository Receipts

In April 1992, the SEC promulgated regulations ("GDR Regulations")<sup>65</sup> permitting Taiwan-listed companies to make a sponsored issuance of global depository receipts ("GDR"s). The GDR Regulations contemplate an arrangement whereby the issuing company deposits shares with a domestic custodian bank, pursuant to which an offshore depository institution issues depository receipts, each representing a fixed number of the underlying shares.<sup>66</sup> The GDRs, denominated in foreign currency, may then be traded on overseas exchanges or OTC markets. Each offering of GDRs requires SEC approval,<sup>67</sup> for which the issuing company must demonstrate viability, financially and otherwise.<sup>68</sup>

China Steel Corporation in 1992 became the first Taiwan company to implement a GDR program by making a secondary offering of five percent of its common stock as part of the ROC government's privatization campaign.<sup>69</sup> Close on the heels of China Steel, President Enterprises Corporation sponsored an issuance of GDRs as part of a primary offering of new shares, made in part to finance its acquisition of Wyndham Foods in the U.S.<sup>70</sup> Both of these issuances involved a private placement of

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65. SHANG SHIH FA HSING KUNG SSU TS'AN YU FA HSING HAI WAI TS'UN T'O P'ING CH'ENG SHEN HO YAO TIEN [Key Points for Review of Listed Issuer Companies Sponsoring Issuance of Depository Receipts] (Ministry of Fin. 1992) (Taiwan) [hereinafter GDR Regulations].

66. GDR Regulations, *supra* note 65, art. 2.

67. GDR Regulations, *supra* note 65, art. 6. Each new issuance of GDRs requires SEC approval, with one exception: if the number of GDRs is increased due to new shares issued pursuant to cash injections or capitalization of retained earnings (e.g., stock dividends) or pursuant to capitalization of capital reserves (e.g., stock splits), then no additional SEC approval is required, although the increase in number of GDRs must be reported to the SEC within two days of issuance thereof. *Id.*

68. Along with the GDR application, the issuing company must submit to the SEC, *inter alia*, audited financial statements for the past two years, a plan for issuance of depository receipts (including a plan for utilization of proceeds), and underwriters' opinions. GDR Regulations, *supra* note 65, arts. 3, 7.

69. Currently, the ROC Commission of National Corporations of the ROC Ministry of Economic Affairs is arranging for sales of a second tranche of China Steel GDRs, representing some 15% of the company's issued and outstanding shares.

70. Telephone Interview with Emil Liang Chen, Vice President, Investment Banking Division, Paine Webber Taipei (Dec. 3, 1993). To date, four TSE-listed companies have sponsored an issuance of GDRs:

- China Steel (US\$360 million)
- Asia Cement (US\$66 million)
- President Enterprises (US\$90 million)
- Chia Hsin Cement (US\$36 million)

*See* Grand Cathay Securities Letter, *supra* note 17. Thus far, all GDRs sponsored by Taiwan issuers have been equity GDRs. The GDR Regulations do not prohibit debt GDRs or GDRs representing other types of securities; however, other legal or regulatory restrictions have made non-equity or hybrid GDRs less feasible.

ADRs<sup>71</sup> in the United States in reliance upon Section 4(2) of the U.S. Securities Act of 1933 and Rule 144A.<sup>72</sup>

As with the QFII program, one of the most restrictive aspects of the GDR program has been the necessity of obtaining CBC consent for all foreign exchange transactions related to implementation of the program. Inward remittance by issuing companies was a problem in 1992. Neither China Steel nor President Enterprises could obtain CBC consent to exchange foreign currency raised through their respective GDR programs into NT dollars.<sup>73</sup> Very recently, however, the CBC adopted a more liberal policy. In October 1993, the CBC announced that Taiwan companies may exchange into NT dollars the foreign capital raised (i) pursuant to issuance of Euro-convertible bonds or GDRs, provided the proceeds are used to finance concrete plans for domestic investment in expanding new manufacturing, or (ii) pursuant to issuance of GDRs by state-owned corporations as part of the ROC government's privatization efforts up to an aggregate limit of US\$3 billion (or more, depending on economic conditions).<sup>74</sup> Outward remittance of dividends and of capital gains (upon cancellation of the GDRs) remains a potential problem, since the CBC still takes an essentially case-by-case approach to approving such outward remittances.<sup>75</sup>

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For example, restrictions in the ROC Company Law make the issuance of corporate debt very cumbersome, so that listed ROC companies generally have very few corporate debt securities outstanding. See, e.g., Company Law, *supra* note 24, arts. 246-65.

71. ADRs and GDRs are identical from a legal, operational, technical, and administrative standpoint. The term "GDR" is a conceptual term used for purposes of marketing on a global scale. THE BANK OF NEW YORK, GLOBAL OFFERINGS OF DEPOSITORY RECEIPTS (1992).

72. *President Enterprises to Issue GDRs*, Reuter Textline, Aug. 21, 1992, available in LEXIS, World Library, ALLWLD File. Section 4(2) of the U.S. Securities Act of 1933, as further clarified by Regulation D promulgated pursuant thereto, provides for exemptions from registration under the Securities Act of 1933, by which offerings may be privately placed. 15 U.S.C. § 77a-aa (1988). Rule 144A, adopted by the U.S. Securities and Exchange Commission on April 19, 1990, establishes the parameters for resale of exempt securities. Under Rule 144A, unregistered securities, which are non-fungible, may be traded only among "qualified institutional buyers" for the first two to three years after offering. 17 C.F.R. § 230.144A (1993). Non-U.S. companies may meet reporting requirements under the U.S. Securities and Exchange Act of 1934 by establishing and maintaining an exemption under Rule 12g3-2(b). *Id.* § 240.12g3-2(b).

73. Jeffrey Chen was involved in advising the underwriters of both the China Steel and President Enterprises GDR offerings. The CBC was approached in 1992 on the question of inward remittance of proceeds raised pursuant to these offerings. At the time, the CBC advised that it would not approve such remittances.

74. Yu, *supra* note 63. Confirmed in Telephone Interview with Anonymous, Official with the Central Bank of China (Nov. 16, 1993).

75. KUAN LI WAI HUI T'IAO LI [Statute For Foreign Exchange Control] art. 20 (Executive Yuan as amended 1987) (Taiwan) [hereinafter Foreign Exchange Control Statute].

Redemption of GDRs is prohibited for three months from time of issuance.<sup>76</sup> Thereafter, holders of GDRs wishing to redeem their GDRs may still not acquire the underlying stock, but must cash out their investment.<sup>77</sup> Upon redemption, the depository institution must sell the underlying stock on the open market and pay the sale proceeds to the investor after deducting tax and other expenses.<sup>78</sup> The restriction in the GDR Regulations against holders acquiring underlying stock will probably remain in place until Taiwan's financial authorities fully liberalize international direct investment on the TSE.<sup>79</sup>

Many of the inaugural GDR offerings devoted considerable attention to working out issues related to the taxation of GDRs, some of which may require further resolution.<sup>80</sup> For example, in 1991 the ROC government decided that dividends paid to GDR holders would be taxed at a 35% rate of withholding.<sup>81</sup> While this remains the current rule, there is considerable pressure to reduce the withholding rate for dividends to 20%, given the fact that the government has granted the favored 20% rate treatment for dividends to foreign investors generally under the ROC's more traditional non-portfolio foreign investment application

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76. GDR Regulations, *supra* note 65, art. 13.

77. *Id.*

78. *Id.*

79. Initiation of the GDR program in Taiwan gave rise to novel questions of first impression under ROC securities laws and regulations. Some of these questions led to lobbying of Taiwan regulatory authorities. One such issue involved the question of whether the stabilization of prices of depository receipts on foreign exchanges during the offering period constitutes illegal manipulation of the underlying stock in Taiwan under the ROC Securities and Exchange Law. See SEL, *supra* note 10, art. 155. Unlike the United States, the ROC has no recognized "stabilization" exception to illegal price manipulation. The Taiwan SEC was lobbied on this issue and unofficially adopted the equivalent of a "no action" position.

80. One of the most complex issues involved the question of how capital gains should be taxed upon redemption of GDRs. For example, should gains realized by the redeeming GDR holder be taxed in the ROC on the basis of the price the holder paid for the GDRs, or the price at which the GDRs were originally issued? Also, do GDRs constitute ROC securities for tax purposes, so that transactions in GDRs amongst foreign GDR holders should also be subject to ROC tax, and if so, how could such a tax program be feasibly implemented? Because capital gains from securities transactions have been exempt in the ROC since January 1, 1990, these questions were left unresolved in 1992; however, the issues may well arise again in the near future, given active discussions among financial regulators about reimposing a capital gains tax on securities transactions.

81. KO LEI SO TE K'OU CHIAO LU PIAO CHUN [Standard Income Withholding Tax Rates] art. 6 (1991) (Taiwan).



("FIA") program<sup>82</sup> as well as to foreign institutional investors under the QFII program.<sup>83</sup>

### C. SELLING FOREIGN SECURITIES IN TAIWAN

Since limited liberalization of foreign exchange controls in July 1987,<sup>84</sup> Taiwanese have invested heavily in foreign stock markets by remitting monies offshore. At the same time, various avenues are being explored to allow Taiwan investors more opportunity to make investments in foreign securities from within Taiwan.<sup>85</sup> These avenues are discussed below.

#### I. Private Placements

Over the years, it has been possible to make private sales of foreign securities in Taiwan by structuring placement activities so as to legally avoid having to comply with ROC public offering requirements. Structuring a private placement of foreign securities in Taiwan in this manner involves a two-prong analysis, one pertaining to offshore activities, the other pertaining to activities conducted inside Taiwan.

##### a. Offshore Component

With the exception of securities fraud, the ROC Ministry of Finance has essentially disclaimed extra-territorial jurisdiction of

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82. See generally Foreign Investment Statute, *supra* note 51; Overseas Investment Statute, *supra* note 51. The 20% withholding rate on dividends is granted pursuant to TS'U CHIN CH'AN YEH SHENG CH'I T'IAO LI [Statute for Promoting Industrial Upgrade] art. 11 (Executive Yuan 1990) (Taiwan) [hereinafter Industrial Upgrade Statute].

83. The QFII Regulations were promulgated pursuant to the Foreign Investment Statute and the Overseas Chinese Investment Statute. Foreign Investment Statute, *supra* note 51, art. 13; Overseas Chinese Investment Statute, *supra* note 51, art. 12. Under Article 11 of the Industrial Upgrade Statute, non-resident companies approved to make investment in the ROC under either of the two above mentioned investment statutes are entitled to a 20% tax on dividends. Industrial Upgrade Statute, *supra* note 82, art. 11. As such, foreign institutional investors approved under the QFII program are entitled to the 20% dividend tax rate as their investments are deemed to have been made either under the Overseas Chinese or Foreign Investment Statute.

84. Foreign Exchange Control Statute, *supra* note 75, art. 26; MIN CHIEN HUI CH'U K'UAN HSIANG CHIEH HUI PAN FA [Exchange Regulations on the Amount of Civilian Outward Remittance] art. 4 (Central Bank of China 1987). Since the 1987 amendment in the Statute For Foreign Exchange Control, non-trade-related foreign exchange has been administered by the CBC on an annual quota system whereby each ROC company or resident is permitted, without prior CBC approval, to remit out a specified maximum dollar amount (currently US\$5 million) per year, and each ROC resident (and, since 1993, each ROC company) is permitted to remit in a specified maximum dollar amount (currently US\$5 million) per year.

85. *Taiwan to Ease Broker Rules*, N.Y. TIMES, Feb. 8, 1993, at D3.

the ROC securities laws and regulations.<sup>86</sup> Accordingly, the offshore prong of analysis focuses on cross-border placement activities (e.g., international telephone calls)<sup>87</sup> and on precisely what aspects of the resulting securities transaction must occur offshore (e.g., offer, acceptance, payment, and delivery).

### b. Onshore Component

The onshore component of private placements require that placement activities be structured so that the instruments offered do not fall within the ROC Securities and Exchange Law definition of "securities".<sup>88</sup> Unlike the U.S. regime, no well-defined and recognized "private placement" exception exists under ROC securities laws and regulations. Instead, a *de facto* private placement may be achieved by virtue of the fact that the SEL (which defines "securities" to mean only public-offered securities)<sup>89</sup> applies only to the offering, issuance, or trading of publicly offered securities, so that the ROC securities laws and regulations do not apply with respect to the offering, issuance, or trading of *non*-publicly-offered securities. Whether or not an offering or sale of securities is considered a private placement in any particular instance depends on how such a placement was structured. Specifically, the placement must be structured so that it may be characterized as non-public,<sup>90</sup> made in an individualized man-

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86. Ministry of Finance Public Announcement, Tai-Tsai-Jong Tze 00,900 (Sept. 9, 1987) (finding "Public offerings, issuances, transactions, or rendering of services with respect to [foreign-issued] securities within the territory of the Republic of China shall be governed by the laws, regulations, and rulings of [the Republic of China]"). By inference, this would mean that the ROC securities laws and regulations do not apply to the activities quoted above if conducted offshore, i.e., outside the territory of the Republic of China.

87. Unlike U.S. securities laws, there is no "use of interstate mail" requirement for application of the ROC securities laws and regulations, so that the use of international mail to reach Taiwan investors would not automatically trigger application of the ROC securities laws and regulations.

88. SEL, *supra* note 10, art. 6.

89. SEL, *supra* note 10, art. 6 (stating "the term 'security' or 'securities' as used in this Law shall include any government bonds, corporate stocks and/or corporate bonds publicly offered or issued, and any other securities approved by the Ministry of Finance").

90. SEL, *supra* note 10, art. 6. It seems clear that ROC legal thinking in the securities context regards the term "public" to have a plain meaning, so that any activities relating to a securities offering having a "public" nature (e.g., announcements in the financial news media, widespread advertising, high-profile seminars, solicitation of a large number of persons) would be regarded as a public offering of securities and thus trigger the application of the ROC securities laws and regulations. See LAI YING-CHAO, CHENG CH'UAN CHIAO YI FA CHU T'IAO SHIH YI [ANNOTATION OF SECURITIES TRADING LAW], 104-06 (1990).

ner,<sup>91</sup> to knowledgeable and wealthy persons,<sup>92</sup> and preferably via the services of a licensed financial intermediary.<sup>93</sup>

## 2. Investment Advisors

In October 1983, the SEC promulgated regulations for the establishment of licensed securities investment advisory companies, so-called "securities investment consulting enterprises" ("SICE"s).<sup>94</sup> Unlike SITEs, SICEs are not permitted to manage security assets.<sup>95</sup>

A SICE may be 100% foreign owned<sup>96</sup> and may advise on investment in both domestic and foreign securities.<sup>97</sup> However, the range of foreign securities on which a SICE may offer advice is subject to a number of significant restrictions. At present, SICEs may only advise on foreign stocks, corporate bonds, government bonds, beneficiary certificates issued by major mutual funds,<sup>98</sup> which are listed on one of twenty designated foreign ex-

91. SEL, *supra* note 10, art. 7 (defining "offering" as "acts of publicly soliciting [securities] from unspecified persons." Based on this definition, there seems to be a consensus in ROC legal thinking that one of the critical elements of a public offering of securities is that it should be solicited from "unspecified persons." LAI, *supra* note 90, at 104-06. By negative inference, this would mean that soliciting a purchase of securities from specified persons (i.e., from individually identifiable persons) would make the securities transaction and all activities related thereto non-public in nature.

92. SEL, *supra* note 10, art. 7. SEC rulings in other contexts on the meaning of the term "specified persons" have indicated that such persons should have a thorough understanding of the issuer's financial affairs and business as well as the issuer's concrete investing ability (i.e., wealth). Ts'ai Cheng Pu Cheng Kuan Hui Han [Ministry of Finance Securities and Exchange Commission Letter Ruling], Tai-Tsai-Jong Tze 7,642 (Mar. 11, 1988).

93. A distinct and separate issue is whether or not activities conducted inside Taiwan in connection with a private placement would constitute the "operation of a securities business" under Article 44 of the SEL, the "operation of securities-related activities" under Article 18 of the SEL, or other activity for which a special license is required from the SEC or MOF. See SEL, *supra* note 10, arts. 18, 44. To minimize the risk of exposure in this regard, it is often prudent, in structuring a private placement, to shelter the activities conducted in Taiwan within the scope of business of a locally licensed financial intermediary or other entity.

94. CHENG CH'UAN T'OU TZU KU WEN SHIH YE KUAN LI KUI TZU [Securities Investment Consulting Enterprise Regulations] (Executive Yuan 1983) (Taiwan) [hereinafter SICE Regulations].

95. SICE Regulations, *supra* note 94, art. 10.

96. The SICE regulations place no limitations on the nationality of the SICE Enterprise owners. By contrast, the SITE Regulations limit foreign and overseas Chinese ownership of the SITE enterprise to 49%. SITE Regulations, *supra* note 16, art. 8.

97. Cheng Ch'uan T'ou Tzu Ku Wen Wei Jen Ch'i Yüeh Ying Hsing Ch'i T'sai Shih Hsiang [Items to Be Included in Contracts Appointing Securities Investment Consultants], Tai-Tsai-Jong Tze 2,675, ¶ 2 (July 22, 1984) (Taiwan).

98. Mutual funds advised on by SICEs must have been in existence for at least two years, and the manager of such funds must be managing at least US\$1 billion worth of securities assets. Cheng Ch'uan T'ou Tzu Ku Wen Shih Yeh Pan Li Wai

changes,<sup>99</sup> and other securities approved by the SEC.<sup>100</sup> All information on foreign securities provided by the SICE must be filed and maintained with the SEC,<sup>101</sup> thus making it quite burdensome for a SICE to advise on a large portfolio of foreign securities.

The authorized business scope of a SICE is limited to giving investment advice.<sup>102</sup> A SICE is prohibited from soliciting funds from its clients and from directly concluding a securities transaction for its clients (i.e., it cannot broker the transaction).<sup>103</sup> On the other hand, a SICE is permitted to collect a commission for securities transactions purchased by its clients on which the SICE had provided advice.<sup>104</sup> It is precisely the ability of a SICE to provide advice on a commission basis that has blurred the distinction between the mere giving of advice and the illegal solicitation of funds. Through this large gray area, many foreign securities have been introduced and sold to Taiwan investors.

### 3. Mutual Funds

Several SITES in Taiwan have been managing international funds that issue beneficiary certificates listed on the TSE.<sup>105</sup> Most of these international funds are closed-end funds, although it is expected that open-end funds will become increasingly available.<sup>106</sup>

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Kuo Yu Chia Cheng Ch'uan T'ou Tzu Ku Wen Ye Wu Ying Hsing Chu Yi Shih Hsiang [Key Issues for Securities Investment Consulting Enterprises Handling Valuable Foreign Securities Investment Consulting Business], Tai-Tsai-Jong Tze 01,157, ¶ 4 (Nov. 23, 1987) (Taiwan) [hereinafter Key SICE Issues].

99. *Id.* art. 4 (designating the following twenty exchanges: NYSE, UASE, London Securities Exchange, Tokyo Securities Exchange, Osaka Securities Exchange, Frankfurt Securities Exchange, Amsterdam Securities Exchange, Paris Securities Exchange, Luxembourg Securities Exchange, Toronto Securities Exchange, Sydney Securities Exchange, Zurich Securities Exchange, Brussels Security Exchange, Milan Securities Exchange, Wellington Securities Exchange, Madrid Securities Exchange, Montreal Securities Exchange, NASDAQ, Johannesburg Securities Exchange, and Singapore Securities Exchange).

100. *Id.*

101. *Id.* art. 3.

102. SICE Regulations, *supra* note 94, art. 10.

103. *Id.* art. 10.

104. *Id.* art. 2.

105. See Huang Shi-Hu, *Mei Kuo T'ou Tzu Jen Ch'iang Chin Wo Hai Wai Chi Chin* [American Investors Enter Taiwan Overseas Funds], COM. TIMES, Nov. 19, 1993, at 27 (noting that the Taiwan Fund managed by China Securities Investment Trust Co. and the ROC Fund managed by International Investment Trust Co. both list on the NYSE, thus allowing indirect foreign investment in the TSE).

106. See Grand Cathay Letter, *supra* note 17; Wu Mei-Hui, *Ko Tang Feng Pi Chi Chin Kai Hsin Ya Li Pei Ts'eng* [Pressure Increases For Closed-End Funds to Change into Open-End Funds], COM. TIMES, Nov. 4, 1993, at 27.

As their first project, the eleven newly licensed SITEs were required to establish domestic funds for investment on the TSE.<sup>107</sup> This requirement arose out of the more immediate need between mid-1992 and mid-1993 to shore up Taiwan's ailing stock market. Given the government's policy of increasing Taiwanese investor participation in overseas markets under sophisticated professional management,<sup>108</sup> it was also hoped that Taiwan's current SITEs would increasingly participate in the establishment of international funds.<sup>109</sup> However, this expectation has been tempered by the perceived lack of competence of SITEs in managing overseas funds in comparison with foreign fund managers.<sup>110</sup>

#### 4. Bank Trust Departments

Ten local banks<sup>111</sup> have been authorized by the CBC to raise monies locally for direct investment in specified types of foreign securities (including equity, bonds, and foreign mutual funds) as trustees for their local customers.<sup>112</sup> Under internal CBC regulations trust certificates denominated in NT dollars must be issued by a bank to its customers, trust certificates are issuable for any period not exceeding five years, and all returns of principal and profits (dividends, interest, and capital gains) must be in NT dollars.<sup>113</sup> Furthermore, amounts used to purchase bank trust certificates are not subject to the investor's annual CBC quota.<sup>114</sup> Accordingly, foreign issuers or underwriters wishing to tap Taiwan capital may market foreign securities to one or more of these authorized local banks.

#### 5. Taiwan Depository Receipts

In June 1992, the SEC promulgated regulations governing the issuance of Taiwan Depository Receipts ("TDRs").<sup>115</sup> The

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107. See SITE Regulations, *supra* note 16, art. 13.

108. See, e.g., SITE Regulations, *supra* note 16, art. 5 (requiring, *inter alia*, that the SITE possess experience in managing an international securities investment trust fund and that an agreement be executed whereby the SITE will transfer securities management skills to the ROC).

109. Telephone Interview with C.Y. Huang, Vice President of Corporate Finance, Jardine Fleming Taiwan Ltd. (Jan. 17, 1994).

110. *Id.*

111. Telephone Interview with Mr. Kuo, Section Chief of Foreign Exchange Bureau, Central Bank of China (Jan. 15, 1994).

112. *Id.*

113. *Id.*

114. *Id.*

115. MU CHIH YÜ FA HSING T'AI WAN TS'UN T'O P'ING CHENG CH'U LI CHUN TZU [Criteria For Administering the Raising of Monies For and Issuance of Taiwan Depository Receipts] (Ministry of Fin. 1992) (Taiwan) [hereinafter TDR Regulations].

TDR Regulations contemplate essentially the reverse of the GDR structure, i.e., a foreign company listed on specified foreign exchanges may appoint a depository institution in Taiwan to issue TDRs for investment by Taiwanese.<sup>116</sup> The foreign company must meet requirements prescribed in the TDR Regulations, including profitability requirements.<sup>117</sup> TDRs are listed on the TSE and denominated in NT dollars.<sup>118</sup>

To date, no foreign company has issued any TDRs. There seems, in fact, to be a singular lack of interest in the TDR program. Although technically well-conceived as a cross-border investment instrument, the TDR program failed entirely in assessing global market realities. For example, the TDR Regulations specified only certain major foreign bourses on which a foreign company must be listed in order to qualify under the TDR program<sup>119</sup> and stipulated strong capital and profitability requirements.<sup>120</sup> However, few, if any, blue chip companies on major foreign exchanges would even consider listing their shares on the TSE in the form of TDRs. For a major blue chip company on a major bourse, the relatively modest amount of capital tapped on a market such as the TSE would simply not be worth the effort and expense. As a global market reality, it would appear that only medium-sized companies listed on medium-sized exchanges would be interested in a TDR issuance. Thus, until the SEC lowers requirements in the TDR Regulations to allow access by such companies, Taiwanese investors will most likely see little action in the way of TDRs.

## 6. Foreign Brokerage Branches

In May 1988, the SEC promulgated regulations on the establishment of securities firms allowing qualified foreign securities

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116. *Id.* arts. 2, 3, 7.

117. *Id.* art. 7. Profitability requirements are discussed below at *infra* note 120 and accompanying text.

118. *Id.* art. 17 (requiring that TDRs be listed on the TSE in NT dollars); T'AI WAN CHENG CH'UAN CHIAO I SO KU FEN YU HSIEN KUNG SSU TS'UN T'O P'ING CHENG MAI MAI PAN FA [Taiwan Stock Exchange Corporation Depository Receipt Trading Regulations] art. 5 (Ministry of Fin. 1993) (Taiwan) (requiring that TDRs be denominated in NT dollars).

119. T'AI WAN TS'UN T'O P'ING CHENG SHANG SHIH SHEN CH'A CHUN TZU [Review Criteria for Listing of Taiwan Depository Receipts] art. 5 (Taiwan Stock Exchange 1993) [hereinafter TDR Listing Criteria] (requiring that foreign issuers be listed on an SEC approved stock exchange). *See supra* note 99.

120. TDR Listing Criteria, *supra* note 119, arts. 3, 4. TDR issuers must have shareholders' equity in excess of NT\$2 billion (approximately US\$75 million). *Id.* art. 3. The issuer's before-tax earnings for the most recent two fiscal years must be positive and must not be lower than 8% of the shareholder's equity over the same period (i.e., earnings must be at least US\$6 million over the preceding two fiscal years). *Id.* art. 4.

firms to operate a branch in Taiwan to broker foreign securities for Taiwanese investors.<sup>121</sup> Through duly established foreign brokerage branches, Taiwan investors are able to trade in the following instruments listed on the stock exchanges of New York, London, and Tokyo: stocks, central government bonds, corporate bonds, and beneficiary trust certificates.<sup>122</sup>

In 1989, one year after the promulgation of the Foreign Brokerage Establishment Criteria, prospective foreign brokerage branches faced extremely stringent qualification requirements under both the Establishment Criteria and associated SEC guidelines. Foreign brokerage branches were required, *inter alia*, to have working capital of NT\$200 million (approximately US\$8 million).<sup>123</sup> Thus far only two foreign securities firms have applied to establish a foreign securities branch.<sup>124</sup> Both firms received Taiwan branch licenses, but one, Shearson Lehman, withdrew in early 1993.<sup>125</sup>

The marginal performance of foreign brokerage branches in Taiwan may be attributed to several factors: first, the imposition of rigid trading restrictions;<sup>126</sup> second, the fact that Taiwanese investors wishing to trade in foreign securities have been able to do so freely from offshore accounts since the partial liberalization of foreign exchange controls in 1987;<sup>127</sup> and finally, the fact that foreign brokerages in Taiwan have been barred from engaging in related businesses such as the underwriting, brokering, and deal-

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121. CHENG CH'UAN SHANG SHIH CHIH PIAO CHUN [Criteria For Establishment of Securities Firms] (Ministry of Fin. as amended 1993) (Taiwan) [hereinafter Foreign Brokerage Establishment Criteria].

122. Cheng Ch'uan Sh'ang Shou T'o Mai Mai Wai Kuo Yu Chia Cheng Ch'uan Kuan Li Kui Tzu [Regulations Governing Brokers Trading in Valuable Foreign Securities], Tai-Tsai-Jong Tze 00,046, ¶ 2 (Jan. 7, 1991) [hereinafter Foreign Securities Broker Regulations].

123. Wai Kuo Cheng Ch'uan Shang Shih Li Fen Chih Chi Kou Sheng Ho Yao Tien [Key Points for Establishment of Foreign Securities Brokerage Branches], Tai-Tsai-Jong Tze 0,127, ¶ 6 (June 21, 1988) [hereinafter Old Foreign Brokerage Establishment Criteria]. In addition, the applicant securities firm had to: have paid-in capital of US\$2 billion, and total assets in excess of US\$20 billion; to be ranked among the top ten securities firms in its home jurisdiction over the past three years; could not have been cited by the securities regulatory authority in its home jurisdiction in the last three years; and had to possess advanced information processing facilities. *Id.* The Old Foreign Brokerage Establishment Criteria were suspended in July of 1993. Ts'ai Cheng Pu Cheng Kuan Hui Han [Ministry of Finance Securities and Exchange Commission Letter Ruling], Tai-Tsai-Jong Tze —, ¶ 1 (July 22, 1993) [hereinafter 1993 SEC Letter Ruling].

124. The two applicants in 1991 were: Merrill Lynch, Pierce, Fenner & Smith, Inc. and Shearson Lehman Brothers. Telephone Interview with Philip Fang, past Taipei Branch Manager, Shearson Lehman Bros. (Jan. 17, 1994).

125. *Id.*

126. See *supra* note 123 and accompanying text.

127. See *supra* note 84 and accompanying text.

ing of local securities, which might serve to diversify their revenue sources.<sup>128</sup>

In July 1993, the SEC significantly expanded the scope of allowable activities for Taiwan-based foreign securities broker branches.<sup>129</sup> Following the 1993 SEC Ruling, foreign securities branches were permitted to engage in the same activities as local securities firms, including underwriting, brokering, and dealing.<sup>130</sup> In addition, working capital requirements were significantly reduced.<sup>131</sup> The SEC has indicated that further liberalization is currently under consideration and may be implemented in the near future.<sup>132</sup>

### 7. Foreign Representative Offices

Since a January 1991 revision in the Foreign Brokerage Establishment Criteria, foreign securities firms have been allowed to establish representative offices in Taiwan.<sup>133</sup> Foreign representative offices may not engage in business operations in Taiwan,<sup>134</sup> and such offices have generally limited their activities to the conduct of market research and liaison activities. However, after a foreign securities firm has established and maintained a representative office in Taiwan for two years, it becomes eligible to apply for a branch license.<sup>135</sup> Several foreign securities firms

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128. The Foreign Brokerage Establishment Criteria do not prohibit foreign brokerage branches from underwriting, brokering and dealing in local securities. In fact, such activities are now expressly sanctioned by the SEC. See, e.g., 1993 SEC Letter Ruling, *supra* note 123. However, the business scope specified in foreign securities branch licenses issued to date by the SEC have limited branch activities to the brokering of foreign securities. Telephone Interview with Lu Shu-Ling, Division II, ROC Securities and Exchange Commission, (Jan. 17, 1994).

129. See generally 1993 SEC Letter Ruling, *supra* note 123.

130. *Id.* art. 3.

131. Capital requirements for fully integrated operations (underwriting, brokering, and dealing) remain relatively high at between NT\$150 and NT\$240 million depending on the scope of activities. *Id.* art. 7. However, capital requirements for brokering-only operations have been reduced to between NT\$100 and NT\$170 million, depending on whether the brokerage branch is to engage in securities finance activities. *Id.* art. 1.

132. SEC Division II Section Chief Kuei Hsien-Nung, Address before the Capital Markets Committee of the Taipei American Chamber of Commerce (Nov. 18, 1993) [hereinafter Capital Markets Address] (noting that the SEC was considering eliminating the "top 10 asset" ranking requirement and allowing foreign branches to broker securities listed on 30 foreign exchanges or traded on certain OTC markets such as the NASDAQ).

133. Foreign Brokerage Establishment Criteria, *supra* note 121, art. 33.

134. *Id.* arts. 15, 33. Representative offices of foreign companies, whether or not they are foreign securities firms, are established pursuant to Article 386 of the ROC Company Law. Under this provision, representative offices are not full-fledged juristic persons in Taiwan and, as such, are not empowered to conduct business operations in Taiwan. Company Law, *supra* note 24, art. 386.

135. 1993 SEC Letter Ruling, *supra* note 123, art. 3.



with representative offices in Taiwan are scheduled to apply for branch licenses in the near future.<sup>136</sup>

### 8. Foreign Futures Brokerages

In July 1992, the Foreign Futures Trading Law was enacted,<sup>137</sup> providing the statutory basis upon which Taiwanese may trade designated types of futures contracts and/or options<sup>138</sup> on designated foreign futures exchanges<sup>139</sup> through a futures broker licensed by the SEC in Taiwan.<sup>140</sup> Local as well as foreign entities (in the form of branches established in Taiwan) can apply for licenses to act as brokers for such foreign futures business.<sup>141</sup> On July 12, 1993, the deadline for filing futures brokerage applications with the SEC, 25 applications were submitted, 15 local and 10 foreign.<sup>142</sup> It is expected that these applications will be processed over the next several months, and that the newly-licensed foreign futures brokerages will be operating after the 1994 Chinese Lunar New Year.<sup>143</sup>

## IV. REGULATING CAPITAL FLOWS TO MAINLAND CHINA

Among the most significant developments in Taiwan over the past two years has been the sharp increase in economic intercourse with mainland China.<sup>144</sup> As of June 1993, Taiwanese investment in the mainland has been conservatively estimated at around US\$3 billion by almost 10,000 companies.<sup>145</sup>

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136. Capital Markets Address, *supra* note 132 (in which SEC Section Chief Kuei noted that six foreign securities firms are slated to apply for branch licenses in June and July of 1994: Barings, S.G. Warburg, Deutsche Bank, Standard Chartered Asia, Morgan Stanley, and Goldman Sachs).

137. KUO WAI CH'I HUO CHIAO I FA [Foreign Futures Trading Law] (1992) (Taiwan).

138. Types of futures contracts include currencies, interest rate futures, crude oil, precious metals, stock indices, and grains. See Letter from Paul Moran, Quantum Financial Services, to Jeffrey Chen, Associate at Jones, Day, Reavis & Pogue (Nov. 3, 1993) (on file with the *UCLA Pac. Basin L.J.*) [hereinafter QFS Letter].

139. Futures exchanges approved by the SEC include: the Chicago Mercantile Exchange and the Chicago Board of Trade; COMEX and NYMEX in New York; the LIFFE, IRE, and IME in London; the MATIF in Paris; the DTB in Germany; SIMEX in Singapore; and the Hong Kong Futures Exchange. *Id.*

140. Foreign Futures Trading Law, *supra* note 137, arts. 2, 6.

141. *Id.* art. 6.

142. QFS Letter, *supra* note 138.

143. *Id.*

144. Vincent C. Siew, *Taiwan: The Challenges to ROC Economic Development and Our Strategies*, BUS. TAIWAN, Nov. 29, 1993, available in LEXIS, World Library, ALLWLD File (noting that increasing numbers of Taiwan based investors are investing in production facilities in mainland China).

145. Hsu Wei-Chiang, *Ta Lu T'ai Shang Chin Wan Chia T'ou Tzu Tsung O 30 I Mei Yuan* [The Number of Taiwanese Commercial Entities in the Mainland Nears Ten

The ROC government is very concerned about the impact that such a development will have on Taiwan's economy, and is taking measures to regulate the flow of cross-strait commercial activity. A special law was enacted,<sup>146</sup> with enforcing regulations, requiring that all mainland investment by Taiwanese over US\$1 million be channelled through third countries.<sup>147</sup>

A natural offshoot of cross-strait economic activity is the development of cross-strait capital markets. Although still nascent, certain events have begun to set the course of possible trends.

### A. MAINLAND CONCEPT SHARES

The term "mainland concept shares" (*ta lu kai nien ku*), coined in the Taiwan securities industry, refers to Taiwanese investment in shares of ROC companies that are perceived to be making significant investments in the mainland. The purchase of such shares by Taiwanese is perfectly legitimate.

The government is, however, attempting to regulate the amount and type of mainland investments that are being made on the company level, at least with respect to public companies. One measure is simply to restrict the amount of bank loans that an ROC company may acquire for use in mainland investment.<sup>148</sup> Another is to require that ROC public companies obtain the approval of shareholders for each investment made in the mainland,<sup>149</sup> thus opening the investment decision to a second approval process on the shareholder level, and to a wider set of corporate policies. Finally, in the course of SEC approval for new issues by public companies, the government may prohibit or

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*Thousand - Total Investment is US\$3 Billion*], COM. TIMES, June 12, 1993, at 1 (citing official Ministry of Economic Affairs statistics on mainland China investment).

146. T'AI WAN TI CH'U YU TA LU TI CH'U JEN MIN KUAN HSI T'IAO LI [Special Act on Relations Between Peoples on the Territories of Taiwan and Mainland] (1992) (Taiwan) [hereinafter Relations Act].

147. Tsai Ta Lu Ti Ch'ü Ts'ung Shih T'ou Tzu Huo Chi Hsü He Tso Hsü K'o Pan Fa [Regulations on Permits for Engaging in Investment or Technical Cooperation on the Mainland], Tai-Tsai-Jong Tze 03,297 (Feb. 10, 1992) (Taiwan) [hereinafter IC Regulations]. The Relations Act requires that all investments by Taiwanese entities "engaging in investments on mainland territory" must be approved by the Investment Commission. Relations Act, *supra* note 146, art. 35. The Investment Commission keeps a Negative List of industries in which mainland investment is prohibited. The IC Regulations require that all Taiwanese investment over US\$1 million be channelled through a third country. IC Regulations, *supra*, art. 4.

148. See, e.g., Tang Mu-Chiang, *Yang Hang Chüeh Tao Cheng Yin Hang Fang K'uan Liu Hsiang* [Central Bank Decides to Adjust the Direction of Bank Loans], COM. TIMES, June 25, 1993, at 2.

149. Hsi Wei-Chiang, *T'ou Tzu Ta Lu Hsiang Mu Chin Ch'eh Chin Yi Pu K'ai Fang* [Mainland Investment Item - Recent Resolution to Take Another Step in Liberalization], COM. TIMES, Aug. 18, 1993, at 2.

limit the use of proceeds raised thereby for purposes of mainland investment.<sup>150</sup>

## B. CROSS-STRAIT LISTINGS

Early in 1993 a pattern of cross-strait investment began when Lien Hwa Fibre Compound Co., a partially Taiwanese-invested company established in Shanghai, listed mainland "A" shares<sup>151</sup> on the Shanghai stock exchange.<sup>152</sup> Lien Hwa was the first-ever listing in mainland China of a Taiwanese-invested company.<sup>153</sup> Lien Hwa was followed, in June 1993, by Tsan Kuenn (China) Holdings, Ltd., a Taiwanese-invested company established in the city of Xiamen, Fuzhou Province, and engaged in the business of manufacturing household appliances. Tsan Kuenn succeeded in listing its shares on the Shenzhen stock exchange as part of an initial public offering of mainland "B" shares.<sup>154</sup> Tsan Kuenn was the first-ever listing in mainland China of a company wholly owned by Taiwan investors and the first-ever listing of "B" shares by a Taiwanese-invested company.<sup>155</sup> A third cross-strait listing occurred in September 1993, when Hau Sheng Ceramic Tile Co., a Taiwanese-invested company established in the city of Kuang Chou, obtained permission from mainland authorities to list "A" shares on the Shanghai stock exchange.<sup>156</sup>

The above listings of Taiwanese-invested companies in mainland China may well portend a pattern of Taiwanese investment on the mainland, in which venture capital investment in a start-up enterprise in China is followed by a public offering on a mainland exchange.

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150. Wang Guan-Ping, *Hsien Chin Cheng Tzu Fa Hsing Kung Ssu Chai T'ou Tzu Ta Lu Pu Chun [Increases in Capital Investment - Issuance of Corporate Debt to Invest in Mainland Not Allowed]*, COM. TIMES, Sept. 7, 1993, at 25.

151. Mainland "A" shares are denominated in Renminbi (the domestic currency used in mainland China) and restricted for investment by mainland entities. By contrast, "B" shares, which are also denominated in Renminbi, are only available to foreign investors (i.e., non-PRC entities). For a detailed discussion of "B" shares, see *infra* notes 157-58 and accompanying text.

152. Li Meng-Zhou, *T'ai Shang Hau Sheng Tzu Ch'uan Ts'ai Min Fa Hsing A Ku Chi Tzu [Hau Sheng Ceramic Tile, a Taiwanese Company, Offers A Shares in Fujian to Raise Funds]*, COM. TIMES, Nov. 9, 1993, at 2.

153. *Id.*

154. Chen Chieh-Wu, *Tsan Kuenn Shih Yeh Ku P'iao Chin Yü Shen Chen Kua P'ai [Tsan Kuenn Enterprises Stock Begins Listing Today in Shenzhen]*, COM. TIMES, June 30, 1993, at 2.

155. Li Meng-Zhou & Chen Chieh-Wu, *Ta Lu Shou Chia T'ai Wan T'ou Tzu Ch'i Yeh Shang Shih Hsia Yüeh Fa Hsing B Ku [First Mainland Enterprise Wholly-Owned by Taiwan Investors Will List - "B" Shares to be Issued Next Month]*, COM. TIMES, May 14, 1993, at 2.

156. Li, *supra* note 152.

### C. MAINLAND "B" SHARES

The Investment Commission of the MOEA interprets the IC Regulations to prohibit Taiwanese entities from purchasing mainland "B" shares and will not at this point approve any application by Taiwanese for investment in mainland "B" shares.<sup>157</sup> It is apparent that much of the current Taiwanese investment in "B" shares may be in violation of the IC Regulations.<sup>158</sup> Nevertheless, it may still be possible to conceive of scenarios of indirect investment in "B" shares by Taiwanese that are not in violation of the rules, such as the use of offshore discretionary trusts.<sup>159</sup>

### V. CONCLUSION

This Article has traced a general trend toward liberalization in the capital markets. Policies such as increasing institutional participation, international access, and cross-strait ties all enjoy the support of capital market regulators and are all essential for the development of Taiwan as a financial center in the Asia region. The same liberal trend is not apparent in the area of for-

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157. Under the IC Regulations, Taiwanese investment in the mainland in excess of US\$1 million must be made indirectly via a company established in a third-country. IC Regulations, *supra* note 147, art. 4. The third-country company's investment on the mainland may take one of four forms: (i) start up; (ii) increasing the capital of a pre-existing mainland company; (iii) share acquisition of pre-existing mainland company and operations management; or (iv) establishment of a branch. *Id.* The IC Regulations restrict investments in company shares under (iii) to investments in shares of unlisted companies. *Id.* A purely textual interpretation of Article 4 of the IC Regulations finds the above restriction pertinent only to share investments which involve management of operations. Under such an interpretation the restriction makes sense especially given the current cross-strait political policy, as active management of a mainland listed company by Taiwanese investors would be regarded as excessive entanglement. However, in response to a verbal inquiry, the Investment Commission revealed that the IC regarded the restriction in Article 4 of the IC Regulations as a bar against all purchases of shares of listed mainland companies regardless of the form of the investment and irrespective of whether management of operations is involved. Telephone Interview with Anonymous, Official with Investment Commission (May 6, 1993). In effect, this amounts to an outright prohibition by the Investment Commission of any Taiwanese purchase of "B" shares even via a third-country company.

158. *See supra* note 157.

159. The IC Regulations apply to Taiwanese institutions or individuals "engaging in investments on mainland territory." This phrase is defined to mean: (i) putting forth capital on mainland territory; (ii) putting forth capital on mainland territory jointly with mainland individuals, legal persons, associations, or other entities; or (iii) investing in a pre-existing third-country company that performs the acts indicated in items (i) or (ii), and in which the Taiwanese investor is a director, supervisor, or shareholder and "effectively exercis[es] controlling influence over operations." IC Regulations, *supra* note 147, art. 4. Thus, if the Taiwanese investor puts his money into a third-country investment vehicle over which he has no control, such as a mutual fund or discretionary trust (which then purchases "B" shares), then such an investment would not constitute "engaging in investments on mainland territory" as defined under the IC Regulations.

eign exchange controls. An early 1994 surge in the TSE, for example, met with immediate CBC curbs on foreign capital inflows.<sup>160</sup>

Many in the ROC securities industry are convinced that Taiwan's capital markets can never fully develop so long as foreign exchange control is not liberalized. If this conviction is correct, then the release of the CBC's discretionary grip on exchange controls would prove, in the end, to be the *sine qua non* to the full maturation of the Taiwan stock market.

There is a growing sentiment in Taiwan that failure to bring about the quick liberalization of the capital and money markets may harm the island's ability to achieve and then sustain its status as a significant financial player in the Asia-Pacific region. This sentiment hardly seems out of place as the rapid growth of developing markets such as Shanghai and Shenzhen may quickly bring their value into rough parity with the TSE. It is the authors' view that, in order to emerge as a regional financial player, Taiwan must address its apprehensions regarding loosening the reins of capital controls. Taiwan's government appears to be going through a difficult soul-searching process in this respect, and its future role as a regional financial player depends heavily on the outcome of this process.

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160. Cynthia Edwards, *CBC Curbs Foreign Funds as Stocks Soar 346 Points*, CHINA NEWS, Jan. 2, 1994, at 1.