

introduction of new AIs and technologies that are much needed by the many small growers in this country.

ASSET MANAGEMENT

The Asset Management Committee appreciates the substantial progress made by the Financial Supervisory Commission (FSC) and its Securities and Futures Bureau (SFB) in relaxing various regulations and taking incremental steps towards making Taiwan a robust regional financial services center. Particularly welcome has been the relaxation of China-investment limits for onshore and offshore funds and the efforts made to sign Memorandums of Understanding (MOUs) with various other jurisdictions so as to make Taiwan a more accessible market. In addition, the SFB has been working with the industry to devise a mechanism for allowing Securities Investment Trust Enterprises (SITEs) to delegate trade-execution functions for Taiwan securities to an offshore trading desk, as well as allowing centralized trading in Taiwan of domestic securities on behalf of overseas fund companies or offshore funds. The Committee is grateful for SFB's open attitude in making the regulatory framework more flexible, and looks forward to early results on these issues.

Despite the progress in certain areas, however, some of the Committee's major concerns still remain on the table. In order to reach our common goal of establishing an effective regulatory regime that balances investor protection with making Taiwan's asset management industry globally competitive, we believe that appropriate attention needs to be given to the priority issues outlined below. The Committee remains committed to work constructively with the regulators to resolve these highly important issues.

Issue 1: Exempt the capital gains and dividend income of offshore funds from the AMT system.

The Alternative Minimum Tax (AMT) system, under which offshore income is to become taxable beginning in 2010, has already brought serious adverse impact to the offshore mutual fund market in Taiwan, including immense outflows of private capital to Hong Kong, Singapore, and other destinations. Those interested in investing in foreign securities and assets are becoming reluctant to do so through Taiwan's offshore fund distribution intermediaries because of the potential tax liabilities under the AMT system, and instead are choosing to invest through financial entities overseas, even unregistered underground channels. Large-scale redemptions are occurring even before the AMT regulations take effect, as existing investors in offshore funds opt to realize their profits. The problem is exacerbated by the lack of clear definitions on how offshore income is to be calculated; given that uncertainty, customers are even more likely to redeem their investments. As a result, broadening the AMT system to take offshore income into account from 2010 will lead to significant capital outflow and cause irrevocable damage to the participants and investors in Taiwan's asset management industry.

The Committee notes that the government has recently adopted a series of tax-reform measures, such as a significant reduction in the estate tax and a lowering of the income tax rate, aimed at improving the investment climate and generating greater capital inflow. Extending the AMT system to offshore income will have the opposite effect, however, undermining those efforts to create a more favorable tax regime. Compared with Hong Kong and Singapore, where offshore income is not taxable, Taiwan will be in a disadvantageous position – and it will also become less competitive against other countries in the Asia-Pacific region.

The Committee further notes that the Income Basic Tax Act exempts capital gains derived from onshore funds from the AMT system. If the AMT system is implemented and offshore income becomes taxable, the different tax treatment for the income generated by onshore and offshore funds will result in an unfair competitive environment that discriminates against participants in offshore funds. This would be contradictory to the FSC's intention of treating onshore funds and offshore funds equally.

We are concerned that adoption of the AMT system would set back Taiwan's efforts to establish itself as a regional asset-management center. In addition, if heavy redemptions force portfolio managers to sell off underlying securities, the negative effect on global stock markets, including Taiwan's, could be enormous.

The Committee therefore repeats its recommendation in last year's *White Paper* that the government revoke the decision to cover offshore-fund capital gains and dividend income within the AMT system. The Income Basic Tax Act should be amended accordingly to exempt such income from the AMT system's purview.

Issue 2: Simplify the offshore fund registration/approval process and remove restrictions on SITE fund size.

Facilitating the offshore fund registration/approval process is always an important area of concern for the Committee. According to our understanding, the FSC has taken acceleration of the review process as a short-term goal. The Committee appreciates the FSC's effort and looks forward to seeing this goal achieved shortly.

In looking at how to simplify the fund-registration process, the FSC may wish to employ a differentiation strategy. With regard to master agents, the FSC could expedite the review procedure when applications are submitted by master agents who are in good standing and have no record of violations. For offshore funds, it could consider treating applications differently according to the type of fund. For example, funds invested mainly in developed countries could be registered immediately after the Securities Investment Trust & Consulting Association (SITCA) completes its document review, as long as the application meets all of the FSC's standard requirements. In such cases, no further substantial review by the FSC would be necessary; it would be sufficient for reports to be filed afterwards to the FSC so that the FSC is kept posted as

to the status of the application. Along the same lines, the Committee suggests that the FSC waive the substantial review requirement for new funds whose characteristics are similar to other registered funds represented by the same master agent. The Committee believes such differentiation measures would reduce the burden on the FSC and increase investment opportunities for Taiwan investors.

With respect to onshore funds launched by SITEs, the Committee suggests removing the regulation setting a maximum number of units that may be issued by SITE funds (or allow the maximum to be set as “unlimited”), regardless of whether the fund invests domestically or offshore, and remove the upper limit of the minimum SITE fund-raising requirement. Although fund-size threshold requirements for money market funds have already been removed, other types of SITE funds are still subject to a limit on the number of units that may be issued, a restriction that is inconsistent with the concept of an “open-ended” fund or unit trust and therefore not found in major fund domicile jurisdictions. In addition, SITE funds that invest offshore are unfairly subject to a lower maximum fund-size limit than SITE funds that invest domestically, due to exchange remittance restrictions set by the Central Bank of the Republic of China. This requirement brings no investor-protection benefits, and serves only to create an unnecessary administrative burden on both the industry and the SFB. The minimum SITE fund-raising requirement should accordingly be fixed at NT\$600 million rather than the current regulation of either NT\$600 million or 10% of the maximum fund size, whichever is greater.

Issue 3: Accelerate the adoption of standards under UCITS III regulations and the process of signing MOUs.

The Committee appreciates the FSC’s decision last year to remove certain regulatory restrictions on mutual funds and it commends the FSC for its contribution to improving the environment for the asset management industry in Taiwan. To further pursue the objective of becoming a regional asset-management center, however, it will be vital to adopt internationally accepted industry practices and to amend existing regulations accordingly.

We encourage the FSC to accelerate this process, setting a specific timetable for early acceptance of the standards under UCITS III regulations, including but not limited to raising the limit on the total value of a mutual fund’s open long positions in derivatives to 100% and removing the one-year track record requirement for offshore funds applying to register in Taiwan.

In addition, the Committee recognizes that the FSC has devoted considerable effort to building firmer relations with jurisdictions such as Luxembourg where most offshore funds are domiciled. In this regard, we believe that the most efficient way to deepen mutual understanding with such jurisdictions would be for the FSC to sign an MOU with their competent authorities. Since the FSC would undoubtedly be more comfortable in accepting UCITS III standards and

further liberalizing regulations on mutual funds once these MOUs are signed, we urge the FSC to proactively seek to enter into negotiations to execute such MOUs. The members of this Committee, as major international asset managers, would be pleased to help facilitate these negotiations.

Issue 4: Further relax China-investment restrictions.

The Committee is delighted to see that the improvement in the cross-strait atmosphere has contributed to the relaxation of China investment limits. For example, in July 2008, the FSC announced that the 0.4% limitation for onshore/offshore funds’ investment in securities listed in mainland China was relaxed to 10%. Moreover, the October 14, 2008 amendment of Articles 23 and 26 of the “Regulations Governing Offshore Funds” exempted offshore Exchange Traded Funds (ETF) with passive management from the above-mentioned China limitation. The Committee applauds the government’s action and considers these to be important steps in the right direction. We encourage the government to further review and relax other China-holding restrictions and eventually remove them entirely.

BANKING

In the aftermath of last autumn’s global financial crisis, the banking industry and bank regulators throughout the world are currently facing unprecedented challenges. Taiwan’s banking system is weathering the crisis better than most, and the Committee commends the Financial Supervisory Commission (FSC) and its Banking Bureau for its openness to reform and to due consideration of the recommendations given in this annual position paper.

Currently the Committee’s number-one concern, discussed in Issue 1 below, is the possibility that the Legislative Yuan, out of a basic misunderstanding of the workings of the credit market, will lower the maximum interest-rate to an unrealistic and harmful level. Proponents of the measure envision it as assisting hard-pressed consumers during a period of economic difficulty, but in fact the end result would be to deprive many members of the public and small businesses of the access to bank credit they currently depend upon.

Several of this year’s issues focus on standardizing and simplifying the regulatory process, and increasing the amount of transparency and consultation with industry. We are confident that attention to the points raised below will help to heighten Taiwan’s competitiveness as the world economy emerges from recession in the months ahead.

Issue 1: Maintain free-market principles regarding interest rates on lending.

As the 2009 *Taiwan White Paper* was going to press, the Legislative Yuan was still considering an amendment to the Civil Code to lower the statutory cap on interest rates from 20% to the Central Bank short-term financing rate plus