2. The Recent Deregulation of Foreign Portfolio Investment in Taiwan

Foreign investment in Taiwan's securities market began in the early 1980s. To prevent rapid capital inflows, the qualified foreign institutional investor (QFII) system was established in 1992. After implementing this system for more than a decade, it was abolished in October 2003 and a new foreign portfolio investment regulatory system was adopted. This annex provides a brief review of the deregulation of foreign portfolio investment in Taiwan.

A Sequential Opening Policy and the Implementation of the QFII System

In order to open the securities market in an orderly and gradual way, the following three-phase deregulation was taken to allow more foreign portfolio investment in Taiwan. In the first phase, the government permitted local securities investment trust companies to raise funds overseas for investing in the domestic securities market. In other words, it allowed indirect investment in the domestic securities market by overseas Chinese and foreign nationals.

The second phase granted QFIIs permission to make direct investments in the local securities market. The QFII system provided the local securities market's access to foreign capital while limiting the impact of volatile capital flows on the local securities market was set up in 1992. In order to oversee the market, the authorities also introduced reporting procedures regarding foreign portfolio investment.

In the beginning, only a few well-known foreign banks, insurance companies and fund management companies could apply to be QFIIs. However, to promote the internationalization and liberalization of the local market, the application requirements on QFIIs were gradually relaxed, resulting in an increase of QFII accounts and inward remittances in 1993. Qualifications were also relaxed to include securities firms and other investment institutions in August 1995. Since inception, foreign institutional investors have played an important role in introducing advanced investment strategies and professional skill to the market as well as in deepening and widening market.

The third phase authorized direct investment in securities by overseas Chinese and foreign nationals (i.e., general foreign individual investors, or GFII). In 1996 the regulation on foreign investments was revised to allow non-resident individuals to invest directly in local securities, and the regulation went through several revisions later on to simplify the application procedures, and to gradually remove the investment quota as well as the limitations on capital remittances. Except for a few specific industries, the ceiling on share holding of a listed company by foreign investors was lifted in 2001.

Recent Abolishment of the QFII system

The QFII system in Taiwan was launched in the early 1990s to keep the progress of the local stock market in line with domestic financial development. It also acted as a buffer to prevent rapid flows of capital in and out of the country, by regulating foreign investors' capital movements in a stable and orderly way. In fact, Taiwan's gradual deregulation on foreign portfolio investment was one of the key factors that served to shield Taiwan from the Asian financial crisis of 1997.

After implementing the QFII system for more than ten years, Taiwan's securities market has become more mature. Therefore, following a series of liberalization measures on foreign portfolio investment, including the removal of the investment cap, mandatory remittance validity of approved investment quota, and restrictions on foreign ownership of listed stocks, the QFII system was finally abolished on October 2, 2003.

The abolishment of the QFII system is intended to attract more foreign investors into Taiwan's securities market, and to extend its scale and integration with international markets. This also puts Taiwan on the same footing as other advanced economies that allow freer movement of foreign portfolio investment.

Current Regulations on Foreign Portfolio Investment

Current regulations on foreign portfolio investment in Taiwan are summarized as follows: Firstly, foreign investors are reclassified into two groups, namely foreign institutional investors (FINI) and foreign individual investors (FIDI). The FINIs are exempted from investment caps and have no quota restrictions, while FIDIs continue to be bound by a US$5 million cap. Both FINIs and FIDIs need to register with the Taiwan Stock Exchange (TSE) for an investment identification, and FINIs are further required to obtain an approval from the Bank.

Second, foreign investors may invest in the following securities: (1) TSE-listed stocks, GreTai Securities Market (GTSM) shares or private placements of shares, certificates of entitlement to new shares from convertible bonds, and Taiwan depositary receipts (TDR); (2) beneficiary certificates of securities investment trust funds; (3) government bonds, financial debentures, corporate bonds, convertible bonds and corporate bonds with warrants; (4) public placements or private placements of beneficiary certificates issued by trustee companies, and public placements or private placements of asset-backed securities; (5) warrants; and (6) other securities approved by the competent authorities of securities.

Finally, besides investing in the above-mentioned securities, foreign investors may allocate their funds into the following assets: Repo government bonds, time deposits, money market instruments, money market mutual funds, futures contracts, options contracts, and interest rate derivatives for the purpose of hedging; however, total investment of the these assets should not exceed 30 percent of the inward remittances of principal.

In sum, the recent deregulation of foreign portfolio investment in Taiwan intends to extend market scale and treat foreign investors the same way as domestic investors, thus leading to further integration with international markets.