

21

The Taiwan Stock Exchange (Taipei, China)

Wanpo (Mina) Wang¹

21.1 Ownership Structure of Taiwan Stock Exchange Corporation

Pursuant to Taiwanese *Securities and Exchange Law (SEL)*, a stock exchange may be organized in either membership or company form. A membership stock exchange is a non-profit juridical person, while a company type stock exchange is a company limited by shares.

For the establishment of a stock exchange, a permit or approval must be obtained from the Securities and Futures Commission (SFC) before the registration.

The Taiwan Stock Exchange Corporation (TSEC) was set up in 1961 in the form of private company limited by shares with the restriction on the duration of a operation and funded by various private and state-owned enterprises.

Article 124 of the SEL: A company-type stock exchange shall be a company limited by shares.

Article 125 of the SEL: The article of incorporation of a company-type stock exchange shall contain, in addition to those requirements of the *Company Law*, the following particulars:

- the seats in the centralized securities exchange market of brokers and dealers and their qualification; and
- duration of existence.

The duration of existence referred to in the second bullet of the preceding paragraph shall not exceed a period of ten years; should the

¹ Vice-President, Research and Planning, Taiwan Stock Exchange.

development of local securities transactions warrant, an application for extension may be filed with the competent authority within three months prior to expiration of the duration.

21.2 Listing Data

Public-issued companies that want to be listed on the exchange and raise capital from the public through TSEC must meet certain criteria with respect to their financial and operational conditions to qualify as listed companies. The applicant companies are screened by TSEC staff and listing screening committees according to the relevant listing criteria based on the *SEL*.

At present, common stocks, preferred stocks, government bonds, corporate bonds, foreign bonds, beneficial certificates, covered warrants and Taiwan Depository Receipts are available to trade on the TSEC. Related regulations governing the listing of warrant bonds and preferred stocks with warrants have been established. The exchange traded fund (ETF) is under a feasibility study and will soon be submitted to SFC.

As of the end of July 2001, there are a total of 539 companies listed on TSEC with the market capitalization of NT\$7,170 billion (US\$204.8 billion).

21.3 Corporate Governance

TSEC is a private corporation with the shareholders meeting as its highest policy-making body, under which are three supervisors and a board of directors composed of fifteen directors, whose major responsibility is to oversee business operations. As stipulated by the *SEL*, at least one third of the directors are securities professionals appointed by the SFC. These directors do not have to be shareholders of TSEC as required under the *Company Law*. The remaining positions are elected from among the shareholders at the shareholders meeting.

The term of office for directors and supervisors is three years, and they may be re-designated or re-elected. The directors choose among themselves a chairman of the board of directors who represents TSEC. The supervisors choose among themselves one resident supervisor.

Article 126 of the SEL: Securities firms, their shareholders, and managers shall not serve concurrently as managers of a company-type stock exchange. At least one third of the directors and supervisors of a company-type stock exchange shall be non-shareholder experts appointed by the competent authority.

21.4 Business of the Exchange

In accordance to Article 98 of the *SEL*, the business of a stock exchange is to provide a centralized securities exchange market. A stock exchange shall not operate nor invest in any other businesses without the approval of the competent authority.

Pursuant to the Articles of Incorporation of TSEC, the operational scope includes setting up a marketplace and facilities for contracting brokers and dealers to operate the business of centralized securities trading, clearing and settlement, and any other relevant business or investment in a related institution as approved by SFC.

TSEC now has fifteen departments/offices under the supervision of three senior executive vice presidents (that is, Listing, Trading, Clearing, Market Surveillance, Audit, System Development, Computer Operation, Market Information, International Affairs, Public Relations, Research & Development, Finance, Administration, Secretariat and Internal Audit).

The following are securities related institutions, approved by the SFC, invested in by TSEC:

- Taiwan Securities Central Depository Company
- Fuh-Hwa Securities Finance Co., Ltd.
- Taiwan Futures Exchange
- Taipei International Finance Center Company
- Taiwan Ratings Corporation
- Taiwan-CA.com Inc.
- R.O.C. over-the-counter Securities Exchange

21.5 Trading Rights

According to Article 129 of the *SEL*, securities brokers and dealers engaged in transactions of a company-type stock exchange shall enter into a contract with the stock exchange for the usage of the centralized securities exchange market; the contract, together with other relevant materials, shall be registered with the competent authority for its records.

Article 5 of TSEC Operational Rules stipulates that participants in trading on TSEC shall be limited to securities brokers and securities dealers (collectively securities firms) that have executed a contract for the usage of the centralized securities exchange market (market usage contract). Securities firms that have the permission of the competent authority to concurrently engage in other securities businesses or related businesses, or securities underwriters that have engaged TSEC to process business matters shall execute their businesses in accordance with the relevant rules and regulations.

21.6 Risk Management

21.6.1 Common-Bond Settlement Fund

Based on Article 153 of the *SEL*, if any transacting party fails to fulfill its delivery obligations for securities transactions undertaken by members of a stock exchange or by securities brokers or dealers in a stock exchange, the stock exchange shall designate other members or other securities brokers or dealers to deliver the securities in substitution. The resultant price differences and the expenses incurred therefrom shall be indemnified by the settlement and clearing fund; in case the fund is insufficient, the stock exchange shall advance payment and thereafter claim such compensation from the breaching party.

According to Article 154 of the *SEL*, a stock exchange may set aside a default damage reserve out of the fees charged from securities transactions to cover the payments specified in the preceding article; the method of assessing the reserve, the rate of assessment, the conditions for suspension of the lodgment, and the method of custody and management of the reserve shall be prescribed by the competent authority. Claimants in cases arising from transactions on the centralized securities exchange market shall have preferential rights to the securities

clearing and settlement fund as specified in Articles 108 and 132 in the following order of priority:

- (i) the stock exchange;
- (ii) the principal in consigned transactions; and
- (iii) securities brokers or dealers.

In the event the securities clearing and settlement fund is insufficient to meet such claims, the unsatisfied portion of the claims may be compensated for in accordance with the provisions of Paragraph 2 of Article 55 of the *SEL*.

Article 55 of the SEL: Following the incorporation and registration process, a securities firm shall, in accordance with the regulation prescribed by the competent authority, deposit an operation bond.

Creditors whose claims arise from the specially approved business of a securities firm shall have preferential right of payment from the deposited operation bond referred to in the preceding paragraph.

Therefore, as required by the SFC, TSEC makes quarterly cash contributions, equal to 20% of the amounts of handling fees, to a default damages reserve which would be used to settle shortfalls that might result from defaults by securities firms.

In May 1996, the SFC approved the mutual responsibility system for the securities settlement fund put into effect September 2, 1996. The fund is administered by a deposit in the name of TSEC Common-Bond Settlement Fund Committee with a total deposit of approximately NT\$8 billion from contributions by securities firms and TSEC.

The enabling rules include Article 153 of the *SEL*, Article 10 of Regulations Governing Securities Firms, Article 20 of Regulations Governing Stock Exchanges, TSEC Rules governing the Administration of Common-Bond Settlement Fund and TSEC Operational Rules Governing the Increase of Deposit of Settlement Fund.

According to Article 10 of Regulations Governing Securities Firms, securities brokers are required, upon establishment, to maintain a securities settlement fund, with TSEC, in NT\$15 million cash plus NT\$3 million for each branch office. Within ten days after the end of each quarter, each broker is also required to deposit additional cash to the fund, equal to a certain ratio (decided by the SFC each year) of entrusted trading value of the previous year. After establishment, the prior deposit of NT\$3 million for each branch office shall be lowered to NT\$2 million in the

following year. For a securities dealer, NT\$10 million shall be deposited with TSEC upon establishment.

Pursuant to the TSEC Rules Governing the Administration of Common-Bond Settlement Fund, TSEC shall establish a special settlement fund of NT\$1 billion. When TSEC default damages reserve reaches NT\$1 billion, TSEC shall cease contributions to this reserve and, instead, deposit periodically such contributions to a special settlement until these additional contributions reach NT\$2 billion.

When a securities firm defaults, its obligations and related expenses shall be settled by its own contributions to the fund and income thereon. If such fund is insufficient, TSEC shall advance the settlement from the aforementioned additional contributions to the special settlement fund, and any shortfall shall be paid by TSEC and the securities firms proportionately based on the amounts of the contributions by TSEC to the special settlement fund and the contributions by the securities company to the common-bond settlement fund. After settlement, the securities firm and TSEC shall replenish their respective funds in due time.

21.6.2 Securities Investors Protection Fund (SIPF)

This fund was established in accordance with *SFC Administrative Ordinance*, to be used to compensate securities investors unpaid credits for the purpose of protecting securities investors interests and strengthening the stock market, with the fund size of NT\$1.03 billion, to protect investors in case of broker default.

The SIPF was established by the main securities institutions of the market and administered by a board of appropriation. This board was organized by these institutions and the fund is financed by the contributions from each of these institutions. In case of a broker default, the board of appropriation will meet to discuss the issues of legal matters, including issues of investors claiming procedures.

Only investors who have properly completed their settlement obligations and are unable to receive their entitled rights due to broker default can file their claims with the board. The limitation on each account is NT\$1 million, and NT\$100 million for the accounts of each broker.

21.7 Statutory Regulatory Role

The SFC, under the Ministry of Finance, is responsible for the development, regulation, and supervision of the capital market and is also the regulator of the futures industry. The statutory mandates of the SFC are to facilitate national economic development and to protect investors' interests. To achieve these goals, the SFC has laid out four general policy directives:

- (i) to foster the sound development of the capital markets and to encourage fund raising through the offering of securities to the investing public;
- (ii) to improve the operation of the securities and futures markets and to ensure a fair and efficient market environment;
- (iii) to promote the development of the securities services industry and to facilitate the flow of savings into investment; and
- (iv) to regulate certified public accountants and to enhance their professional standards.

The SFC exercises its authorities through the mandates of the Securities and Exchanges Law and the Futures Trading Law. According to Article 127 of the *SEL*, a company type stock exchange shall not issue bearer stocks. Transferees of its shares shall be limited to the securities firms incorporated under this law. The shareholding percentage of each securities firm in the stock exchange shall be prescribed by the competent authority (up limit is 5%).

The SFC stipulated rules *Governing Administration of Stock Exchanges* pursuant to Articles 93, 99, 102, 137 and 154 of the *SEL* to regulate the establishment, management, supervision, etc., of stock exchanges.

21.8 Stock Exchange Seeking to Demutualize

Since TSEC was organized in the company form in 1961, no demutualizing plan is needed. However, according to Article 127 of the *SEL*, the stocks of a company-type stock exchange shall not be listed on its own centralized securities exchange market or on a stock exchange owned by any other person.