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Local Insights: Taiwan

Like its peer in the region, South Korea, Taiwan has elements of a developed market economy, even if some of the investable indices still classify it as emerging. At $875.9 billion, Taiwan's real GDP makes it the 20th-largest economy in the world, more than twice as large as the economies of Belgium or Austria.[1]

It also enjoys a low 4.4% unemployment rate, and only 1.2% of the population lives below the poverty line.[2] Taiwan's GDP growth in 2012 is 1.1% accompanied by CPI of 1.8%. Taken together, these factors show that even under this challenging market momentum, Taiwan still offers a stable and healthy economy. As Citi Securities Country Manager Taiwan Hsiao-chi Wang puts it, "Taiwan is a developed Asian country that has an active and internationalized stock market, a stable FX rate and a low funding cost."

Growth of Asset Management

While Taiwan's retail fund market has future potential, it has already enjoyed moderate success. At US$175.6 billion in mutual fund assets as of September 30, 2012, Taiwan's fund market is already larger than more populous countries, such as India or Mexico.[3]

On balance, as GDP has grown, so too have financial assets in Taiwan. Taiwanese tend to own a mix of financial assets (stocks, bonds and deposits) as well as physical assets (including real estate and durables). However, widespread ownership does not necessarily translate into long holding periods: reflecting their fast-trading mentality, retail domestic investors account for 63% of all trading value.[4]

On the institutional side, Taiwan's pension market is fast evolving. However, due to concerns about scale and recent performance, the finance ministry has proposed merging four state-run pension funds – the Labor Insurance Fund, the Public Services Pension Fund, the Labor Pension Fund and the Postal Savings Fund. If approved, the merger would create a $240 billion sovereign fund, which would increase scale, and foster larger long-term investments.

In the meantime, there are some good opportunities for external managers. For example, the Public Service Pension Fund (PSPF) recently awarded six managers local equity mandates of NT$4 billion (US$135 million) each.[5] PSPF also issued three US$200 million mandates for global emerging market debt in October.[6]

[1] World Fact Book, Central Intelligence Agency, November 14, 2012.
[2] Ibid.
[3] SITCA, R.O.C., The Cerulli Edge – Global Edition, September 2012.
[4] Securities and Futures Bureau.
[5] "Taiwan's PSPF Awards Six Local Equities Mandates," Ignites Asia, November 23, 2012.
[6] Ibid.

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Globalization

In terms of inflowing capital, Taiwan is relatively open to foreigners, particularly on the equity side. Taiwan has a registration process for investors that has been in place for more than 20 years, a process that China emulated, albeit more restrictively. By comparison, "In China, about 1% of equity market capitalization is foreign-owned," observes Wang, "whereas in Taiwan, it's closer to 30%." Foreign participation in the bond market, however, is relatively quiet, as the Central Bank is concerned about foreigners investing in fixed income. Since local interest rates are currently very low, the Central Bank tends to view foreigners with fixed income positions as currency speculators.

The fund market is quite open to foreign firms. "Actually, it's been so open as to almost be detrimental to the growth of the local industry," notes Wang. As of 3Q 2012, there were 621 onshore funds holding US$60.0 billion in AUM, compared to 1,032 offshore funds totaling US$81.7 billion in AUM. A number of observers have pointed to Taiwan as a promising target for global managers.[7] "Locals are fine with investing in offshore products," state Wang, "[but] local asset managers are lobbying for assistance to level the playing field." Whereas local managers are limited in what they can do, offshore managers spend more money on marketing and payments to distributors. Taiwan's Financial Supervisory Committee (FSC) has tried to address this imbalance by encouraging new fund launches from onshore managers, and by requiring all funds to disclose commissions paid to bank distributors.

There are also signs that local-to-global flows are also on the rise. Starting in 2011, a number of Taiwanese managers received qualified foreign institutional investor (QFII) approvals, allowing them to invest in mainland Chinese A-shares. Taiwanese regulators also eased restrictions on local insurers, allowing these institutions to invest a greater portion of their assets in overseas markets.

Next Steps for the Market

Whether measured by the relative openness of the local market or by the high ratio of financial assets to GDP, it is clear that Taiwan is a fairly mature market. Nevertheless, there are a few additional developments on the horizon that could improve market efficiency.

First on that list are proposed changes regarding securities lending. Citi Taiwan is leading the effort in communication with the local tax authority for calculations on securities borrowing and lending (SBL) manufactured dividends. This initiative aims to address the current reclaim caused by different tax rates being applied to borrowers and lenders.

Corporate actions, or specifically, reporting on corporate actions, are another area for future development. Citi is currently developing a report that shows clients detailed information on uninstructed balances for voluntary events.

[7] See for example, "Taiwan a good Asia entry point; India challenging," Ignites Asia, April 27, 2012 or "Taiwan most promising Asia retail market: Cerulli," Ignites Asia, February 1, 2012.

Breakdown of the entitlement by settled and traded positions will also be provided, allowing clients to better monitor and reconcile their uninstructed position for voluntary events.

Longer term, alternatives remain an area to watch. Hedge fund sales to the general public are not permitted, and can only be accessed through foreign platforms or private placements. Private equity funds have raised assets solely through the pension market. And while real estate has been booming since 2003 (fueled in part by successful entrepreneurs from Hong Kong and mainland China), most of the interest has come in the form of physical property, as opposed to real estate investment trusts (REITs).

Market Entry: Don't Go It Alone

Taiwan is one of the most open markets in all of Asia, yet even here, asset managers would be hard-pressed to go it alone. For example, offshore asset management companies must engage a local master agent in order to sell funds to the general public. Private placement agents are also required for sales to sophisticated investors, and take responsibility for conducting Know Your Client (KYC) checks and suitability evaluations. Other service providers, such as law firms, consultants and asset servicers, can shed light on distribution dynamics and offer insight on institutional channels.

Citi is a leading player in market advancement efforts with active communication with regulators and infrastructures for market developments. In 2012, for example, Citi became the first custodian bank to complete system enhancements to connect to the Taiwan Depository and Clearing Corp (TDCC) platform, allowing brokers, banks and securities trust enterprises to exchange settlement details for trade matching purchases. "The Citi Taiwan team will keep focus on delivering client solutions with ongoing technology developments and continuing innovation on a number of industry regulatory and infrastructural issues," states Wang.

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