

This article was published in the *Global Banking & Financial Policy Review 2014/2015*.

## **New Developments in Offshore Financing (OBUs/OSUs/OIUs) Regime in Taiwan**

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### **New OBU Deregulation**

The Financial Supervisory Commission (FSC), the Taiwan financial regulator, announced its deregulation policy on offshore banking units (OBUs) on January 29, 2014, just one day ahead of the Chinese New Year holidays this year in Taiwan. This significant development, in the view of local bankers, is a big "red envelope" to local banking industry because this is the most advanced relaxation of rules on financial products offered by OBUs since December 12, 1983, the enactment date of the Offshore Financing Act (Act). This breakthrough in deregulation comes from Taiwan government's another significant economic stimulation policy: Free Economic Pilot Zones (FEPZs), but this new policy applies to all OBUs of local banks, regardless of location of these OBUs (in FEPZs or elsewhere).

### **Background of OBUs in Taiwan**

The OBUs, which are the "offshore booking centers" of local banks, focus on foreign customers generally. The term "foreign customers" refer to (i) foreign individuals holding the passport of other countries and having no domicile in Taiwan and (ii) foreign entities incorporated under foreign laws other than Taiwan laws. OBUs used to be the main offshore funding centers of Taiwanese individuals and companies for their investments in the PRC before 2008 when Taiwanese individuals and companies generally were subject to various prohibitions on making direct investment in the PRC.

### **Summary of New OBU Deregulation**

The FSC issued the first letter (Ref. No.: Jin-Guan-Yin-Wai-10300017351) dated January 29, 2014 in connection with OBU's new business, which was superseded by another letter (Ref. No.: Jin-Guan-Yin-Wai-10300071870) issued by the FSC dated April 11, 2014 (OBU Letter). The OBU Letter sets forth the FSC's new deregulation policy that OBUs are permitted to engage in the foreign-currency trust business of their head office (or Taiwan branches of foreign banks) as approved by the FSC under the Act.

More importantly, the OBU Letter expressly indicated that the abovementioned new OBU trust business is exempt from the restrictions under the Trust Enterprise Act, Securities Investment Trust and Consulting Act and Futures Trading Act, including: (i) types and scope of the qualified trust assets for management, utilization and disposition of OBUs; (ii) qualification requirements on professional investors; (iii) requirements that the products must be reviewed, approved, filed for record or registration by or with the relevant industry associations or the competent authorities; and (iv) regulations regarding recommendation, advertisement, solicitation and marketing. The above exemptions take away the troublesome compliance, regulatory and registration requirements for offering and sale of financial products to offshore investors by OBUs. Local banks may therefore offer a wide range of foreign currency denominated products (including RMB structured products and derivatives), which were not allowed before, to their OBU customers.

The OBU Letter also reiterates that the qualified customers under this deregulation are limited to

offshore customers outside the territory of Taiwan only. As above mentioned, the term "foreign customers" includes (i) foreign individuals holding the passport of other countries and having no domicile in Taiwan and (ii) foreign entities incorporated under foreign laws other than Taiwan laws. However, the products to be invested through the OBUs' trust structure shall be subject to the following restrictions unless otherwise approved by the FSC: (x) the denomination currency must not be New Taiwan dollar ("NTD"); (y) the underlying assets of the financial products shall not be linked to NTD exchange rate, NTD interest rate index or NTD-denominated products; and (z) the investment portfolio must not involve any NTD-denominated product. In other words, the products to be offered by OBUs to their customers shall not involve NTD.

However, the following two types of funds are exempted from the prohibition relating to NTD denominated products available to OBU customers if the aggregate amount of each fund's investments in "Taiwan securities market" does not exceed 30% of its net asset value: (i) offshore funds; and (ii) foreign currency tranche of securities investment trust funds (SITE Funds) with multiple currency tranches (including NTD tranche) issued by domestic securities investment trust enterprises. Additionally, investment in foreign-currency denominated international bonds (including Formosa Bonds) by each fund above shall not be included in the 30% threshold calculation of "Taiwan securities market" as required.

To enhance OBUs' compliance when conducting the above new business, the FSC requires OBUs to exercise their due care of a good administrator and perform duty of loyalty when engaging in such new business. In addition, the OBUs shall explain to their customers the details of the products and services they offer and the material content of their contracts with those customers with full risk disclosure. Although there is no prior regulatory review, approval, filing or registration requirement for a product offering, OBUs shall adopt their internal rules on the items listed below, submit the same to their board of directors (or the head office or regional office if they are Taiwan branches of foreign banks) for approval and implement accordingly: (i) criteria for acceptance of customers and Know Your Customer (KYC) review procedure; (ii) types and scope of products to be offered to customers; (iii) product suitability rules; (iv) review and approval mechanism for product offering; and (v) guidelines on recommendation, advertising, solicitation and marketing. The FSC also requires all requirements stipulated in the OBU Letter be incorporated into the internal control and audit system of the OBUs for thorough implementation.

With respect to financial disclosure, this new OBU business should be booked at the OBUs of a bank and disclosed in a note to the financial statements of the trust department of the bank's head office (or Taiwan branches of foreign banks).

In conclusion, the FSC with this new policy delegates its strict regulatory power in the past (including prior review, approval, filing for record or registration by or with the relevant industry associations or the competent authorities and product requirements) to the self-regulation of the board of directors of a bank and requires the board of directors to monitor this new trust business under supervision of the OBU's internal control and audit system.

### **Further Requirements for OBUs' Operations**

Local media reported in February 2014 that some banks provided their assistance to Taiwanese investors in establishing foreign companies and making investments through OBUs' new trust business

in order to circumvent the restrictions applicable to DBUs and obtain the tax benefits offered under the Act. The FSC therefore issued another letter on March 28, 2014 (Ref. No.: Jin-Guan-Yin-Wai-10350001180) to set forth further regulatory rules for OBUs on providing offshore financial products. The key points in this FSC letter are summarized as follows:

- OBUs shall establish KYC procedures and not encourage local customers to set up offshore entities in order to convert their "domestic customer" status to "offshore customer" status and open accounts with OBUs for the purpose of investing in offshore financial products not approved by the FSC for domestic customers.
- OBUs shall thoroughly implement (i) their own standards for accepting customers, product suitability rules, types and scope of products to be offered to customers, as well as review and approval mechanism for product offering to ensure that such financial products are in compliance with the customers' needs and their abilities to bear relevant risks and (ii) their information disclosure to customers effectively.
- Any promotion, advertisement, solicitation, or marketing activities (including public announcement or commercial advertisement via the mass media, road-shows and seminars) should not solicit domestic investors to invest in financial products that are not approved by the FSC.
- When offering financial products not reviewed and approved by the FSC, OBUs shall include the following wordings in product statements and sales documents and explain to their customers thoroughly:
  - (i) The financial products offered by the OBU have not been reviewed or approved by the competent authorities and are not subject to the requirements for reviewing or filing for record;
  - (ii) The financial products may only be promoted or sold to offshore customers by OBUs; and
  - (iii) The financial dispute handling mechanism under the Financial Customer Protection Act does not apply to OBU customers.

There are 62 OBUs in Taiwan as of the end of June 2014. According to the FSC's news release on July 3, 2014, the aggregate amount of the earnings before tax of all OBUs in Taiwan from January 1, 2014 to May 31, 2014 was NT\$39.1 billion, significantly up 42.4% from NT\$27.5 billion for the same period in 2013. This fact serves to underscore the driving force of OBUs in local banking sector after the announcement of this deregulation.

### **New developments of OSUs/OIUs in Taiwan**

The Legislative Yuan passed the amendments to the Act on June 19, 2013, with the main purpose of permitting local securities firms to establish their Offshore Securities Units (OSUs), which are similar to OBUs established by local banks, to conduct offshore securities business. So far 13 local securities firms have obtained approval from the FSC to set up their OSUs as of July 1, 2014 and are developing their OSU business. The OSUs' targeted businesses include underwriting, dealing and brokerage of foreign securities, new omnibus securities account, derivatives and wealth management business. Unlike the OBUs which have been present in Taiwan for about 30 years, the OSU business in Taiwan is quite new but with huge development potential as envisaged from the development pattern of OBU business locally.

Also, the FSC is planning to expand the OBU and OSU models for local insurance companies to create new offshore insurance business in the insurance industry. If local insurance companies may establish their Offshore Insurance Units (OIUs) to offer insurance products to their offshore customers, the offshore financing regime in Taiwan will be more systematic and comprehensive to cover three main financial sectors: banking, securities and insurance, in Taiwan. The OIUs will also target customers from China to meet their wealth management needs, benefiting from not having a language barrier and leveraging the close economic relations and tourism prospects between Taiwan and China.

### **Conclusion**

The OBU business has been in Taiwan for about 30 years. With local banks' and regulators' efforts and expertise accumulated over decades, OBU business has become one of the most developed and profitable businesses of local banks now. The OBU deregulation in January this year provides more flexibility to OBUs' operations and offers better product diversification to OBU customers. This new policy is essential for the development of Taiwan offshore financial market.

The new OSU business and the OIU mechanism being planned are expected to inject new momentum in Taiwan offshore financial market. The OBUs/OSUs/OIUs regime, when all established, will provide enhanced offshore financing services with a "one-stop shop" solution to their customers.

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