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Liberalization of Taiwan's Securities Markets – The Case of Cross-Taiwan-Strait Listings

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Abstract

The purpose of this paper is to examine the liberalization of Taiwan's capital market regarding cross-Taiwan-Strait listing of securities. Taiwan is in an advantageous position to compete with other Asian rivals to attract issuers and capital from China. However, the long political hostility ensures that there is little regulatory cooperation on both sides of the Taiwan Strait. Assuming that the creation of a cross-strait capital market is an unstoppable trend, this paper examines from the perspective of regulatory competition several regimes that may facilitate Taiwan to overcome regulatory obstacles arising from the special Sino-Taiwan relationship. This paper argues that regulatory cooperation or even harmonization of Sino-Taiwan laws will be very difficult. However, the cooperation of stock exchanges in China and Taiwan may be a first step toward further official collaboration. Another approach is to strengthen domestic supervision in Taiwan with a sponsorship program. Nevertheless, such a program may be very expensive to maintain. Given the regulatory obstacles between Taiwan and China, a better approach seems to open an alternative trading market with more flexible rules designed for Chinese securities in Taiwan. Such a market-oriented approach may liberalise Taiwan's capital market to Chinese and foreigners, while still maintain the level of domestic investor protection without raising much regulatory and compliance costs.

I. Introduction

This article will explore how the Taiwanese government could best supervise the public listing and trading of overseas companies within Taiwan. It will particularly focus on the listing of firms operating in China which are controlled by Taiwanese or

Chinese owners. In light of Taiwan's growing economic ties with China, development of a cross-strait capital market presents a number of advantages and challenges for both sides.

To begin with, economic ties between Taiwan and China are substantial and significant. The Taiwan Investment Commission of the Ministry of Economic Affairs ("MoEAIC") reports that total approved investment in China by Taiwanese firms reached over US\$9 billion annually in both 2007 and 2008.¹ This fell to around US\$6 billion in 2009 following the global economic slowdown but rebounded in the first four months of 2010 with total indirect investment reaching over US\$3.5 billion; a 90% jump compared to the same period in 2009.² According to the Financial Supervisory Commission ("FSC"), 910 listed companies in Taiwan had collectively invested more than US\$20.7 billion³ in China in the third quarter of 2008 alone. Cross-straits trade was in excess of US\$77 billion annually in both 2007 and 2008.⁴ Taiwan's trade surplus with Mainland China was over US\$4.7 billion in the first quarter of 2010.⁵ As of 2009, China accounted for over 40% of Taiwan's export market, making China Taiwan's biggest trade partner.⁶ Besides these economic numbers a considerable number of Taiwanese nationals work in China.

Notably these economic achievements have come about under restrictive laws enacted by Taiwan preventing capital flows between China and Taiwan. Direct exchange of New Taiwan Dollars and Chinese Renminbi was prohibited until June 2008 while

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¹ Investment Commission statistics online: <<http://www.moeaic.gov.tw/>>. According to the same statistics, between 1991 and the end of 2009, there were a total number of 37,771 applications made by Taiwanese firms and approved by the Investment Commission to invest in Mainland China and the total amount of investment reached over 64 billion US dollars. *Id. See also* Chien-min Chao, *Will Economic Integration between Mainland China and Taiwan Lead to a Congenial Political Culture?*, (2003) 43 *Asian Surv.* 280, 280 .

² Investment Commission, *ibid.*

³ See FSC press release on Nov. 18, 2008, online:

<<http://www.fscey.gov.tw/ct.asp?xItem=5086937&ctNode=17&mp=2>>.

⁴ Statistics provided in the monthly report (for the month of April 2010) of the Bureau of Foreign Trade, Ministry of Economic Affairs, published on Jun. 3, 2010, online:

<<http://cweb.trade.gov.tw/kmi.asp?xdurl=kmif.asp&cat=CAT322>>.

⁵ *Ibid.*

⁶ Statistics provided in the annual report of the Bureau of Foreign Trade for the year of 2009, online:

<<http://cweb.trade.gov.tw/kmi.asp?xdurl=kmif.asp&cat=CAT322>>.

direct cross-strait financial services are still illegal.⁷ Nevertheless, Taiwanese merchants have been resourceful in circumventing these restrictions by establishing offshore holding companies to conduct business in China.⁸

While closer economic ties and the establishment of a cross-strait capital market appears to be an unstoppable trend, the Sino-Taiwan relationship involves complexities seldom seen in other contexts. The political impasse and concerns about sovereignty impair cross-strait diplomacy and prevent communication and functional regulatory cooperation between the two governments. This occurs despite Taiwan's seemingly ironic need to embrace the Chinese market. Taiwan also faces the significant task of establishing itself as a player in the global capital markets to ensure their continued economic progress. Under the current administration's peaceful development of economic and political ties, it now appears possible to form a previously unimaginable cross-strait capital market. But such a market raises concerns over how the Taiwanese government can best regulate securities issuers whose main business operations are in China. A friendlier economic environment does not necessarily mitigate difficulties in market supervision and investor protection across the strait.

As will be argued below, the Sino-Taiwan relationship offers a tremendous opportunity to design and create a new cross-strait capital market. This article will not enter into the fray of examining the structure and composition of international securities regulations. Instead, our focus will be on the issues surrounding the establishment of cross-strait listing from the Taiwanese perspective. In particular we will address how Taiwan can maximize its comparative advantage via a regulatory design that attracts foreign capital while at the same time effectively supervising the listing and trading of Chinese securities and ultimately improving Taiwan's competitiveness in the global capital market.

⁷ See Taiwan Central Bank press release on Jun. 26, 2008, online: <http://www.cbc.gov.tw/ct.asp?xItem=31807&ctNode=302&mp=1>.

⁸ E.g., Honghai, one of the most well-known high-tech companies in Taiwan, shifted its mobile phone manufacturing operations in China to Foxconn International Holding Ltd, a subsidiary incorporated in Cayman Islands and listed in Hong Kong, so that Honghai might have more liberty to conduct business in China without the wrath of Taiwan government.

Thus, the purpose of this article is to identify key policy concerns of the Taiwanese government and to discuss possible regulatory mechanisms for the offering and listing of Chinese securities in Taiwan. Part II will introduce the Sino-Taiwan relationship, the legal restraints preventing a cross-strait capital market, and the current state of the cross-strait securities market. Part III will examine the theoretical underpinning behind cross-border listings and regulatory competition. From this perspective, we will also discuss the strategic position of Taiwan in competing for cross-border listings and Chinese capital. Part IV will offer some perspectives for the design of Taiwanese law to maximize Taiwan's advantages and successfully supervise cross-strait listings. We will contemplate an array of policies, including harmonization and mutual recognition between Taiwan and China, stock exchange cooperation, third party oversight, and creation of a separate trading platform for Chinese shares. In part V we conclude.

II. The Backdrop: The Sino-Taiwan Relationship and Current State of Cross-Strait Listings

A. A Brief History: 1945 - 2010

The modern division of Taiwan and Mainland China occurred in 1949, when the People's Republic of China (P.R.C.), led by Mao Zedong, was officially established in Beijing and the Republic of China (R.O.C.), led by Chiang Kai-shek, retreated to Taiwan. Since then, Taiwan and China have had a hostile relationship with occasional escalations to military conflict. Both governments claim that they are the sole legitimate "China" with authority to rule both Taiwan and the Chinese Mainland.

The death of Taiwan President Chiang Ching-kuo, (son of Chiang Kai-shek) in 1987 marked a turning point in Taiwan's relationship with China. The island embraced democratic practices, and its people increasingly identified themselves as being

“Taiwanese”, rather than “Chinese”. This gradual change of attitude challenged the long-standing “one China” ideology on both sides of the Strait.

With the ease in hostilities, each government established private entities to facilitate cross-strait dialogue: the “Strait Exchange Foundation” (“SEF”) in Taiwan, and the “Association for Relations Across the Taiwan Straits” (“ARATS”) in China.⁹ Both are government-funded quasi-official entities, aiding in the communication and negotiation of administrative matters. However, interactions between the two were halted in 1999 when then-President Lee Teng Hui of Taiwan announced his “special state to state theory,” a policy whose implied thrust at sovereignty rankled Chinese officials.

The surprise election of President Chen Shui-bian to two successive terms from 2000 to 2008 was a critical period in cross-strait relations. During this time, Mainland China made huge economic strides while Taiwan became increasingly marginalized. As a longtime supporter of Taiwan independence, President Chen easily drew enmity from the Beijing government.¹⁰ Yet even while President Chen was anti-China in the political sense, from an economic perspective he was fairly progressive. As the demands of globalization required businesses to become more flexible internationally¹¹ he abandoned President Lee’s “practice patience and make no haste” policy (a policy designed to limit the amount of investment in China¹²) in favor of the less restrictive “proactive opening with effective management” approach.¹³ This move reflected the shifting of Taiwan’s commerce from traditional manufacturing sectors to hi-tech industry and the concomitant need for outward investment.

Taiwan’s China policy was again altered by the presidential election in 2008 which saw a return to power for Ma-Ying Jeou’s victorious KMT party. Ma’s government has adopted a much friendlier attitude toward China which has led to increased cross-

⁹ Both were established in 1991. See <<http://www.sef.org.tw/english/index.html>>.

¹⁰ See online: <<http://www.sef.org.tw/english/index.html>>.

¹¹ Lee, *supra* note 12, at 282-287.

¹² Fu-lung Lee, *On Policy, Law and Suggestion of Taiwanese Enterprise to Go Public in the Mainland Area* (2005) 34(3) N.T.U. L.J. 277, 279.

¹³ See policy description of the Mainland Affairs Council, online: <<http://www.mac.gov.tw/big5/cnews/empl01.htm>>.

straits exchange and the resumption of talks between SEF and ARATS.¹⁴ In addition to allowing direct currency exchange,¹⁵ raising the maximum investment in China to 60% of a company's capital,¹⁶ and establishing direct air and sea travel between Taiwan and China, the FSC is now proposing to ease restrictions on foreign firms seeking to list securities and raise capital in Taiwan.¹⁷ The Taiwan government will also allow Chinese funds to be invested in certain public construction projects and the Taiwan stock market.¹⁸

At the top of the political agenda in 2010 is the negotiation of an Economic Cooperation and Framework Agreement (ECFA), which many see as a prelude to the creation of a free trade zone between China and Taiwan. ECFA's driving motive is to avoid Taiwan's marginalization in the aftermath of the free trade agreement between China and the Association of Southeast Asian Nations (ASEAN).¹⁹ While ECFA was signed between the two parties in Chongqing, China on June 20th, 2010, and it was ratified by the Taiwanese legislature on August 17th, 2010. However, to what extent the financial industry will be covered is yet to be revealed.

How the story between Taiwan and China will unfold remains to be seen. Although President Ma faces criticism for appearing to concede sovereignty to Beijing and for Taiwan's presumed over reliance on China's economy, it is clear that the current administration's policies have made it possible to further integrate Taiwan and China's capital markets.²⁰ Under the current framework, direct cross-strait capital and monetary flows is an unstoppable and rising trend.

¹⁴ The first meeting took place in China in June, 2008. The second meeting took place on Nov. 3, 2008, which marked for the first time that a highly ranked Chinese official (who was also the chairman of the ARATS) was allowed to visit Taiwan. The third meeting was held on April, 2009 in Nanking, China.

¹⁵ Financial Supervision Commission (FSC) press release on Jun. 27, 2008, online: <<http://www.fscey.gov.tw/ct.asp?xItem=4448781&ctNode=2660&mp=2>>.

¹⁶ See MoEAIC press release on Aug. 26, 2008, online: <http://www.moeaic.gov.tw/system_external/ctrl?PRO=NewsLoad&id=608>.

¹⁷ See *infra* II.B.

¹⁸ However, how far Taiwan is willing to allow Chinese funds to invest in public construction projects remain to be decided. See online: <<http://udn.com/NEWS/FINANCE/FIN2/4884166.shtml>>.

¹⁹ The ASEAN had an Framework Agreement on Comprehensive Economic Cooperation on Nov. 5, 2002. See online: <<http://www.aseansec.org/13196.htm>>. It has been argued that a free-trade zone between China and the ASEAN might have huge impact to Taiwan's economy.

²⁰ The criticism is best summarized by the Minister of Mainland Affairs defending publicly the government's policy on Feb. 19, 2009. See online: <<http://www.mac.gov.tw/english/index1-e.htm>>.

B. Legal Restraints on Cross-strait Capital Flows

From a historical perspective, there are considerable legal restraints to the establishment of a functional cross-strait capital market. In Taiwan, special laws were first enacted in 1992 to regulate cross-strait communication and business activity.²¹ The key concepts of these special laws were two-fold: to prevent China from exerting influence on Taiwan through economic means, and to limit Taiwanese investment and business operations in China.²² They also prohibit Mainland citizens from becoming directors in Taiwanese companies.²³ Even travel into Taiwan and its territories by mainlanders is restricted.²⁴ At the same time, the laws place heavy restraints on Taiwanese investment in China. A firm is not qualified to list in Taiwan if it was funded by a certain amount of Chinese capital, if a Chinese entity held more than a 20% equity stake, or if the entity was a controlling shareholder. The transfer of key technology to Chinese parties²⁵ is also tightly controlled – complicated review procedures are applied to each potential transaction, and the subject matters are checked against a list of prohibited or restricted items based on “national security and industry development” concerns. Most importantly, neither local or foreign firms can use funds raised in Taiwan to invest either directly or indirectly in China.²⁶

This last measure in particular has stemmed all possibility of cross-strait capital flows. There is little doubt that these regulations have effectively forced Taiwan businesses and capital abroad; indeed, many businesses have already moved their assets to

²¹ The Act Governing Relationships between Peoples of the Taiwan Area and the Mainland (“AGRPTAM”)(last revised in 2008). Full English texts of the AGRPTAM could be found online: <<http://law.moj.gov.tw/Eng/Fnews/FnewsContent.asp?msgid=2662&msgType=en&keyword=undefined>>

²² AGRPTAM, article 40-1. A similar requirement is also placed for non-business entities. *See* AGRPTAM, article 40-2.

²³ AGRPTAM, article 72.

²⁴ AGRPTAM, articles 10, 11, 16, and 17.

²⁵ AGRPTAM, article 35.

²⁶ The listing rules of Taiwan Stock Exchange requires that a foreign firm meet requirements specified in the AGRPTAM and relevant regulations, which effectively subject foreign listed firms to the same restrictions as domestic firms. *See* Article 28-1 of the Taiwan Stock Exchange Corporation Rules Governing Review of Securities Listing (2008), online: <<http://eng.selaw.com.tw/FLAWDAT01.asp?LSID=FL007326>>.

offshore subsidiaries or holding companies (incorporated in Hong Kong, the British Virgin Islands, etc.) in order to enter the China market.²⁷

Heavy regulation has also had an impact on Taiwan's domestic financial industry. With entry into China similarly restricted, Taiwan's finance companies have lagged behind other foreign firms in penetrating the mainland. This late start would influence the competitive position of Taiwan's financial services firms in the service of cross-strait listing were it to occur. The offshore movement of Taiwan's businesses and listings abroad has also lessened the demand for financial services within Taiwan. This exodus of capital, coupled with a decline in Taiwan's domestic stock market²⁸ has given rise to arguments for relaxing restrictions on China investment as a means to lure overseas funds to return home.

For these reasons it is widely acknowledged in Taiwan that the foregoing laws create an undesirable state in which Taiwan is restricted from using its competitive advantages to attract money earned by overseas Taiwanese from their operations in China. In response to the foregoing, Taiwan has adopted two measures. First, the Taiwanese government announced its "1-2-3 program" in early 2008 which sought to increase "first-time listings" by foreign companies (though specifically geared towards overseas companies controlled by Taiwanese) in the "two stock markets" (Taiwan Stock Exchange and the over-the-counter market) to realize "three benefits": a closer connection between foreign enterprises and the Taiwan market; increased market diversification; and improved competitiveness and globalization of Taiwan's capital market.²⁹

Second, on July 31, 2008, Taiwan announced an ambitious plan to relax restrictions on foreign stock listings and Chinese investment in its domestic stock market.³⁰ This new policy aims to allow overseas firms controlled by Taiwanese to seek a primary or

²⁷ See Chyan Yang and Shiu-Wan Hung, *Taiwan's Dilemma across the Strait: Lifting the Ban on Semiconductor Investment in China* (2003) 43 *Asian Surv.* 681, 681-682. See also *supra* note 8.

²⁸ See Chia-chen Lee, *A Study on the Issue of Taiwanese Enterprises Listing in Hong Kong* (2008) 8 *Economic Research* 357, 371.

²⁹ See Taiwan Stock Exchange presentation on Program to promote listing of foreign companies in Taiwan, online: <http://www.twse.com.tw/ch/listed/alien_business/download/plan.pdf>.

³⁰ Financial Supervisory Commission press release on Jul. 31, 2008, online: <<http://www.fsc.gov.tw/ct.asp?xItem=4611074&ctNode=17&mp=2>>. See also Taiwan Stock Exchange presentation on Program to promote listing of foreign companies in Taiwan, *id.*

secondary listing or to issue Taiwan depository receipts (“TDR”) within Taiwan.³¹ However, this plan still has certain imperfections in practice. For instance, while firms incorporated in China are still prohibited from having primary or secondary listings in Taiwan,³² the FSC now allows foreign firms in which a Chinese entity owns more than a 20% equity stake to make a primary or secondary listing.³³ Moreover, foreign firms with investments in China can now be listed.³⁴ The new rules even allow certain Chinese entities, including qualified domestic institutional investors, to invest in the equity and futures market.³⁵ While direct listing of Chinese companies is still restricted, the above measures open up the possibility of Chinese firms’ creating a shareholding structure (such as establishing a third-country operation as the listing entity) to bypass restrictions. This creates a difficult task for regulators, who would have to penetrate a complex web of shareholding structure to discover the Chinese issuer.

Of course, we should be aware that a complete opening of capital markets will not take place in a single day, particularly given all the policy concerns still in existence between China and Taiwan.³⁶ While certain physical restraints may have been relaxed for the exchange of goods, a large part of the above restraints still exist to limit the inflow and outflow of capital across the Taiwan Strait.

C. Current State of Cross-Strait Listing of Taiwanese Enterprises

Over the past two decades, only a few enterprises have attempted to have securities traded on both sides of the Taiwan Strait. This was due to several factors. First, as we have seen, Taiwan prevented the primary listing of a company incorporated in China due to the restrictions mentioned above.³⁷ Similarly, a primary listing in China by a

³¹ See *supra* note 29.

³² FSC press release, *supra* note 30.

³³ *Ibid.*

³⁴ *Ibid.*

³⁵ See Financial Supervisory Commission press release on Apr. 29, 2009, online: <<http://www.fsc.gov.tw/ct.asp?xItem=5793655&ctNode=17&mp=2>>.

³⁶ See *infra* IV.A.

³⁷ See *supra* note 26 and 30.

company incorporated in Taiwan was also not possible due to the Chinese government's own requirements on corporate structure.³⁸ For example, PRC rules require a foreign firm to ensure that foreign capital will not represent more than 10% of outstanding shares after listing.³⁹ Thus, even absent Taiwan's already stringent regulations, any Taiwanese firms wishing to have securities listed in China must first establish a Chinese subsidiary. For the same reasons, secondary listings have not been possible for Chinese firms within Taiwan.

However, these obstacles towards direct primary and secondary listings did not thwart some Taiwan merchants from circumventing these prohibitions. One way used to accomplish this was to list on both sides of the Strait with different entities belonging to the same group. For example, in 2005 the Taiwan-listed company Shenzhen Globe Union Industrial Corp. listed in the A section of the Shenzhen Stock Exchange,⁴⁰ becoming the first enterprise to list in both Taiwan and the A section in China⁴¹. But the dual listing of Shenzhen Globe has not been emulated by any other Taiwanese companies who generally prefer to list in the Hong Kong market. Beijing's lack of enthusiasm for such listings post-2005 has also played a restrictive role.

One other way to participate in Taiwan's securities market is to issue Taiwan Depositary Receipts (TDR). This was encouraged by the Taiwanese government in the second half of 2008 in order to allow prominent Taiwanese businesses operating in the Mainland to enter Taiwan's capital markets and reverse the migration of Taiwanese capital. The campaign has been fairly successful in its short time, as there have been a total of 20 new listings of TDRs between October 2008 and October 2010.

Of the eighteen TDRs issued thus far, all have been related to Taiwanese businesses with operations outside of Taiwan with the exception of three TDRs issued by

³⁸ See China Securities Regulatory Commission, *Opinions on Certain Questions about Listing Companies with Foreign Investment* (2001), online: <<http://www.csrc.gov.cn/n575458/n776436/n804965/n3300690/n3300837/n3331795/3332267.html>> .

³⁹ *Ibid.*

⁴⁰ See press release of Shenzhen Stock Exchange on May 31, 2005, online: <<http://www.szse.cn/main/aboutus/sshd/ssys/200505317293.shtml>>. The trading code of Global Union is "002047".

⁴¹ The parent company of Global Union is listed from 1999 in the Taiwan Stock Exchange with the trading code "9934".

Singapore companies. Of the remaining fifteen, eleven share a common pattern. First, the company that applied for TDR issuance was established and controlled by Taiwanese merchants conducting business mainly in China. Second, shares deposited for the TDRs are the shares of a holding company typically incorporated in either the Cayman Islands or Bermuda. These holding companies are listed on the Hong Kong Stock Exchange.⁴² The Taiwanese food manufacturer Want Want provides a common example. Want Want's controlling shareholder, a local tycoon, first incorporated a holding company in the Cayman Islands: Want Want China Holding Ltd ("WWCH"). This holding company was then listed on the Hong Kong Stock Exchange. As controlling shareholder of WWCH, the tycoon then transferred a certain number of WWCH shares to a depository to support the TDRs offered in Taiwan.⁴³ Its TDRs were officially listed on April 28, 2009.⁴⁴

Demand for further cross strait company integration is evident and given China's rising economic clout, it is not surprising that certain Taiwanese firms would attempt to seek partnerships or linkages with Chinese firms. Thus, without the prevention afforded by regulatory restriction, it is fairly certain that a Chinese firm would attempt to buy into a listed Taiwanese company or have the securities of a third-country company listed in Taiwan. The latter has been accomplished through the issuance of TDRs by companies which are controlled by Chinese but incorporated and listed in Singapore. Yangzijian Shipbuilding (Holdings) Ltd ('Yangzijian'), a big shipbuilder in China and is listed in the Singapore Exchange, was approved to issue TDRs in Taiwan in July 2010. One point worth noting is that Yangzijian, though effectively controlled by Chinese, is a company registered in Singapore. Thus, Yangzijian's TDR issue could circumvent the rules against primary and secondary listing of securities of a company incorporated in China.

⁴² Examples include Want Want, Tingyi (Cayman Islands) Holding Corp., Sandmartin International Holdings Ltd, New Focus Auto Tech Holdings Ltd, Kith Holdings Ltd, Neo-Neon Holdings Ltd, Good Friend International Holdings Inc, Ju Teng International Holdings Ltd, Global Sweeteners Holdings Ltd, Solargiga Energy Holdings Ltd, and Yorkey Optical International (Cayman) Ltd.

⁴³ See Want Want press release on Oct. 14, 2008, online:
<<http://www.wantwant.com.cn/images/up/News/2008101417411418511.pdf>>.

⁴⁴ See Taiwan Stock Exchange press release on Apr. 15, 2009, online:
<http://www.twse.com.tw/ch/about/press_room/tsec_news_detail.php?id=2838>.

The approval for Yangzijian's TDR issuance marks the first time that a true Chinese-controlled company entered into Taiwan's stock market. However, like Want Want, the deposited shares were offered by a holding company of Yangzijian.⁴⁵ It is not clear who actually owns the second holding company. Nonetheless, the Yangzijian TDR issue is one significant step toward a cross-strait capital market. As of October 2010, at least two other Singaporean companies controlled by Chinese issued TDRs in the same manner.⁴⁶ While there are still political issues to be addressed, we should bear in mind that there is a strong demand for a more liberalized capital market across the Taiwan Strait. From a legal perspective, the issue is how the law could help recoup benefits from cross-strait listings while controlling any potential hazards. These issues can be explored and examined under existing theories regarding cross-border listing and regulatory competition.

III. Theoretical Underpinnings: from Taiwan's Perspective

As the Taiwan government increasingly realizes the benefits of cross strait listings for its own domestic economy, it must attract capital amidst competition from both regional and international capital markets. In this light, the Sino-Taiwan relationship can be viewed in the context of academic research regarding cross-border listing, regulatory competition, and ultimately, the competition between 'law markets'. We will adopt this perspective to address Taiwan's competitive advantage and envisage Taiwan's strategic position in the current state of globalization.

A. Taiwan's Advantage in Cross-Border

⁴⁵ See online: <<http://money.chinatimes.com/news/news-content.aspx?id=20100728001489&cid=1209>>.

⁴⁶ They are China Taishan Technology Group Holdings Ltd and Hu An Cable Holdings Ltd. See Taiwan Stock Exchange, online: <http://www.twse.com.tw/ch/listed/listed_company/apply_listing_tdr.php>.

Listing

Within the context of cross-border listings, Taiwan enjoys certain advantages that make it a good host. First, Taiwan's economy has grown steadily over the past three decades, which provides a sound base for capital market growth (notwithstanding the recent effects of the global financial crisis). Second, the overall capitalization of the Taiwan Stock Exchange in relation to Taiwan's national GDP is higher than that applicable to the New York and London Stock Exchanges.⁴⁷ This implies the Taiwanese have a significant amount of money available to invest in the capital market. Third, market interest rates in Taiwan are hovering near zero, which suggests that the domestic market has extra capital to support new listings.⁴⁸ Fourth, Taiwan is in a key geographical position between Northeast and Southeast Asia, making it an ideal place to conduct business in the Far East and listing in Taiwan is relatively cheap compared to Hong Kong or Singapore.⁴⁹ Fifth, Taiwan is a global leader in information technology industries, which should attract foreign firms engaging in such operations.⁵⁰ Finally, Taiwan has many individual investors eager to play the stock market. These advantages provide a fertile financing ground for capital-hungry firms to exploit.

However, in speaking of Taiwan's comparative advantages, we would be remiss if we did not mention its competitive position *vis-à-vis* Hong Kong. As one of the leading financial centres for Greater China and the Asia-Pacific region, Hong Kong has successfully attracted listings from many major Taiwanese and mainland firms. However, this leading role is far from impenetrable. To begin with, it is quite clear

⁴⁷ See Taiwan Stock Exchange, Advantages and Competition Strategy of Taiwan Capital Market, online: <http://www.twse.com.tw/ch/listed/alien_business/download/advantage.pdf>

⁴⁸ This has been illustrated where major U.S. and European banks issued structured notes in order to acquire cheap capital from Taiwanese retail investors seeking higher yields in a low interest rate environment. See "Thanks, Paulson" *The Economist* (Hong Kong 20 November 2008), online: <http://www.economist.com/finance/PrinterFriendly.cfm?story_id=12652247>.

⁴⁹ See also Yi-ju Liu and Hsiou-wei Lin, *Listing of Taiwanese Companies and the Development of Capital Market* (2008) 153 Taiwan L. Rev. 79, 88. Technically, Taiwan is in the mid-point between Singapore and Japan. Taiwan is also less than two hours from Shanghai and about an hour from Hong Kong by plane.

⁵⁰ For example, by 2007, Taiwan manufactured over 98% of the world's motherboards, over 93% of the world's notebooks and over 76% of the world's LCD panels. See *supra* note 47. In fact, electronic goods made in Taiwan constituted a significant part of Taiwan's export to China. See *supra* note 4.

that Taiwan's China-focused capital restrictions have been to the advantage of the Hong Kong stock exchange. There has been considerable research supporting the idea that the listing of Taiwan companies in Hong Kong has occurred not because of any particular advantage in the "law market" from Hong Kong, but rather as a way to avoid Taiwan's restrictions and secure capital for China based operations.⁵¹ It is also clear that this increase in the number of firms listing in Hong Kong has helped promote the Hong Kong market as the go-to destination for investors looking to share in mainland China's economic growth. However, given the amount and size of Taiwan corporate activity in the mainland, it is feasible that the Taiwan stock exchange could capture similar attention if relaxed capital rules lured these firms back. Further, the difference between the two exchanges within the "law market" does not appear to be very large. A study by JP Morgan on listing advantages between Taiwan, Hong Kong, and the US found the former two jurisdictions to be even in almost every category, with Hong Kong's "high" investor protection against Taiwan's "medium" the only significant aberration.⁵² Thus there is significant potential for the future growth of Taiwan's capital market if regulations are relaxed.

In terms of this market, we may analyze Taiwan's advantages from two dimensions. On the one hand, it is clear that Taiwan is capable of attracting any overseas firms (incorporated in any country) controlled by Taiwanese. This aspect is welcomed by the current Taiwan government and is certainly the main focus of Taiwan's present policy.

On the other hand, a more ambitious approach would be to attract firms (incorporated in any country) controlled by mainland and overseas Chinese. Such a listing in Taiwan could bring a number of advantages to Chinese firms. Chinese firms will likely receive positive media exposure if allowed to list in Taiwan and this might serve to allay fears over their products due to recent safety incidents concerning defectiveness or toxicity. Moreover, the abundance and far reach of Taiwan's print and television media could promote the firm's brand to the world's Chinese-speaking

⁵¹ Chang-hsien Tsai, *Law Market Forces Underlying International Jurisdictional Competition: The Case of Taiwan's Regulatory Evolution on Outward Investment in Mainland China, 1997-2008* 89-90 (2010).

⁵² *Ibid.*

population. Increased name recognition from a Taiwan listing could also help firms attract top Taiwanese talent.⁵³

Other benefits may also be derived from the shared culture across the Taiwan straits. Unlike Cantonese speaking Hong Kong, China and Taiwan share the use of the Mandarin language. Though small differences exist in written communication between Traditional and Simplified Chinese, Mainlanders and Taiwanese can generally understand each other without significant difficulty. The non-need to translate written documents into English further facilitates effective regulatory coordination between Taiwan and China.⁵⁴

Finally, Taiwan has a more established judicial system than China, with far more transparency in market disclosure and the freedom to transfer information. These qualities will draw firms seeking an evolved regulatory environment to help develop their corporate governance and investor protection mechanisms.⁵⁵

In the end, the inescapable fact is that Taiwan needs foreign capital to improve and grow its economy. Taiwan has the qualities and advantages to attract this capital from both Chinese and overseas Taiwanese businesses but current legal restraints prevent an effective cross-strait capital market. By proactively seeking a balance between these multiple conflicts, the Taiwanese government can further drive the development of the domestic capital markets, improve financial services and related industries, and allow Taiwan to position itself as a major regional and global financial player.

B. Regulatory Competition

The development of a Sino-Taiwan cross-strait market may be examined from the perspective of regulatory responses to cross-border securities listings following the globalization of financial markets. Considerable research exists on the territorial reach

⁵³ *See also supra* note 47.

⁵⁴ However, it has been observed that it is still immature to apply the regulatory competition structure to the Sino-Taiwan context due to the political problems and lack of mutual understanding of each others' laws. *See* Ching-ping Shao, *Regulatory Competition in Corporate Regimes: And Some Observations on Possible Regime Changes in Taiwan* (2009) 38(1) N.T.U. L.J. 1, 48.

⁵⁵ *Ibid*, at 47.

of securities regulation and its impact on domestic and international capital markets.⁵⁶ There has also been much research on the effects of regulatory competition, choice of securities law, and the global stock market's regulatory framework.⁵⁷ Such studies have fruitfully discussed the race-to-the-bottom or race-to-the-top trends caused by regulatory competition. We will take up these issues in Section IV.B of this paper.

Beyond domestic governmental regulation, some scholars have advocated a more market-oriented approach such as establishing a coherent global regulatory scheme or network,⁵⁸ to deal with problems from differences in securities regulation in different countries.⁵⁹ Within the American-European context, several studies have focused on the legal ramifications of U.S.- E.U. cross-border securities listings. In particular, with

⁵⁶ See e.g. Chris Brummer, *Stock Exchanges and the New Markets for Securities Laws* (2008) 75 U. Chi. L. Rev. 1435; Onnig H. Dombalagian, *Choice of Law and Capital Market Regulation* (2008) 82 Tul. L. Rev. 1903; Frederick Tung, *From Monopolists to Markets?: A Political Economy of Issuer Choice in International Securities Regulation* (2002) 2002 Wis. L. Rev. 1363; Merritt B. Fox, *The Political Economy of Statutory Reach: U.S. Disclosure Rules in a Globalizing Market for Securities* (1998) 97 Mich. L. Rev. 696; Stephen J. Choi and Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation* (1998) 71 S. Cal. L. Rev. 903; Stephen J. Choi and Andrew T. Guzman, *National Laws, International Money: Regulation in a Global Capital Market* (1997) 65 Fordham L. Rev. 1855.

⁵⁷ See e.g. Brummer, *id.*; Chris Brummer, *Corporate Law Preemption in an Age of Global Capital Markets* (2008) 81 S. Cal. L. Rev. 1067; Cheryl Nichols, *Mutual Recognition Based on Substituted Compliance: An Integral Component of the SEC's Mandate* (2008) 34 N.C. J Int'l L. & Com. Reg. 1; Stavros Gadinis, *The Politics of Competition in International Financial Regulation* (2008) 49 Harv. Int'l L.J. 447 (discussing the interplay between domestic politics and international financial regulatory framework); Howell E. Jackson, *Centralization, Competition, and Privatization in Financial Regulation* (2001) 2 Theoretical Inquiries L. 649; Stephen J. Choi and Andrew T. Guzman, *National Laws, International Money: Regulation in a Global Capital Market* (1997) 65 Fordham L. Rev. 1855; William L. Cary, *Federalism and Corporate Law: Reflection upon Delaware* (1974) 83 Yale L.J. 663.

⁵⁸ See Frederick Tung, *From Monopolists to Markets?: A Political Economy of Issuer Choice in International Securities Regulation* (2002) 2002 Wis. L. Rev. 1363, at 1430-1431 (discussion on the short supply of legal rules and harmonization as an alternative ending). For discussion on the approach of harmonization, see also Pierre-Hugues Verdier, *Transnational Regulatory Networks and Their Limits* (2009) 34 Yale J. Int'l L. 113; Onnig H. Dombalagian, *Choice of Law and Capital Market Regulation*, (2008) 82 Tul. L. Rev. 1903; Stavros Gadinis, *The Politics of Competition in International Financial Regulation* (2008) 49 Harv. Int'l L.J. 447; Bo Harvey, *Exchange Consolidation and Models of International Securities Regulation* (2007) 18 Duke J. Comp. & Int'l L. 151; Hal S. Scott, *Internationalization of Primary Public Securities Markets* (2000) 63 Law & Contemp. Probs. 71. For international efforts on harmonization of securities regulation, see for example, International Organization of Securities Commissions, *Objectives and Principles of Securities Regulation*, <<http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf>>.

⁵⁹ See Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation* (1998) 107 Yale L.J. 2359; Stephen J. Choi and Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation* (1998) 71 S. Cal. L. Rev. 903; Stephen J. Choi and Andrew T. Guzman, *National Laws, International Money: Regulation in a Global Capital Market* (1997) 65 Fordham L. Rev. 1855; Tung, *id.*, at 1380 *et seq.* (discussing Romano's and Choi & Guzman's proposals).

discussions on the impact of the *Sarbanes-Oxley Act*⁶⁰ in the U.S., and the introduction of the *Markets in Financial Instruments Directive*⁶¹ in Europe.⁶² regulatory competition. Moreover, there are researches on the impact of the creation of cross-Atlantic exchange groups (e.g. the NYSE-Euronext) on cross-border listings, securities regulation and competition.⁶³

Expanding on such bilateral cooperation, there is a further line of study addressing the competition of the “law market” in different jurisdictions.⁶⁴ From this perspective, the advantage of a country is more than its economic environment and industrial output. Its ‘law’ might, in some sense, become a commodity that firms may choose to shop around for in order to maximise their benefits. This has been exemplified by the many examples of harsh laws forcing out firms to other places and by the choice of governing law and forum.⁶⁵ In this sense, a country may seek to provide ‘better’ laws to attract business.⁶⁶ We will examine this argument in the next section of this paper.

Taiwan may be in a completely different circumstance, compared with the U.S. (where there is a federal government and fifty states) or the European Union (where laws of all member states have to be harmonized for the purpose of creating a single

⁶⁰ Pub. L. 107-204.

⁶¹ Directive 2004/39/EC.

⁶² See Dania S. Becker, *Less Can Be More: Recent Examples of Cooperation between the United States and European Union on Securities Regulation* (2009) 8 Wash. U. Global Stud. L. Rev. 139; Howell E. Jackson and Eric J. Pan, *Regulatory Competition in International Securities Market: Evidence from Europe -- Part II* (2008) 3 Va. L. & Bus. Rev. 207; Elizabeth F. Brown, *The Tyranny of the Multitude IS A Multiplied Tyranny: Is the United States Financial Regulatory Structure Undermining U.S. Competitiveness?* (2008) 2 Brook. J. Corp. Fin. & Com. L. 369; Kate Litvak, *Sarbanes-Oxley and The Cross-Listing Premium* (2007) 105 Mich. L. Rev. 1857; Kate Litvak, *The Effect of the Sarbanes-Oxley Act on Non-US Companies Cross-Listed in the US* (2007) 13 J. Corp. Fin. 195; Howell E. Jackson, *Centralization, Competition, and Privatization in Financial Regulation* (2001) 2 Theoretical Inquiries L. 649.

⁶³ See e.g. Ioannis Kokkoris and Rodrigo Olivares-Caminal, *Some Issues on Cross-border Stock Exchange Mergers* (2007) 29 U. Pa. J. Int'l L. 455; Ioannis Kokkoris and Rodrigo Olivares-Caminal, *Lessons from the Recent Stock Exchange Merger* (2008) 4 J. Competition L. & Econ. 837; Bo Harvey, *Exchange Consolidation and Models of International Securities Regulation* (2007) 18 Duke J. Comp. & Int'l L. 151; Chris Brummer, *Stock Exchanges and the New Markets for Securities Laws* (2008) 75 U. Chi. L. Rev. 1435; Onnig H. Dombalagian, *Choice of Law and Capital Market Regulation* (2008) 82 Tul. L. Rev. 1903; Mahmood Bagheri and Chizu Nakajima, *Competition And Integration Among Stock Exchanges: The Dilemma of Conflicting Regulatory Objectives And Strategies* (2004) 24 O.J.L.S. 69.

⁶⁴ See Erin A. O'hara & Larry E. Ribstein, *The Law Market* 13-14 (2009); Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle* (1985) 1 J. L. Econ. & Org. 225; Albert O. Hirschman, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States* (1970).

⁶⁵ *Ibid*, at Ch. 3.

⁶⁶ *Ibid*, at 26-31.

market). Due to space limitations, this article cannot discuss all the theories and arguments in full detail. Nonetheless, there are several lessons that Taiwan may learn from the U.S. and European experience.

C. Lessons for Taiwan

First, Taiwan enjoys a definite advantage over western capital markets in terms of attracting firms operated by Taiwanese or Chinese individuals. While attracting non-Taiwanese and non-Chinese foreign capital might be a long-term goal, given the close historical and trade ties across the Taiwan Strait, a more realistic short-term goal is to focus on attracting the listing within Taiwan of overseas firms operated by Taiwanese or Chinese individuals.

Second, if the economy provides the foundation, the law will provide solutions. In order to open up the market for firms doing considerable business in China (whether Taiwanese controlled or not), the legal restraints on Chinese investment or Chinese shareholding should be relaxed or abandoned. Taiwan would do well to lessen restrictions on the capitalization of firms and the use of Taiwan raised funds as they apply to foreign and domestic issuers. Allowing Chinese financial firms to operate in Taiwan (and *vice versa*) would also help service any potential cross-strait listing and compliance with both China and Taiwan law. Unfortunately, this aspect is subject to considerable political debate and the development of a mutual relationship between Beijing and Taipei, which is beyond the scope of this article.

Third, applying regulatory competition and international legal market theories, Taiwan may attract Chinese capital by designing securities regulation and listing rules which provide ‘better laws’ as an incentive to minimize compliance costs (assuming that other entry barriers can be reduced). It has been argued that “national securities regulators face intense pressure to provide cost-effective rules to draw foreign issuers to their home markets.”⁶⁷ Though it would be overreaching to suggest Taiwan can become a leading capital market by having extremely issuer-friendly laws, or by

⁶⁷ Chris Brummer, *Corporate Law Preemption in an Age of Global Capital Markets* (2008) 81 S. Cal. L. Rev. 1067, 1067-1068.

completely emulating another country such as the U.S.,⁶⁸ Taiwan could devise cost-effective capital market rules to fully realize its competitive advantages. It is from this perspective that this article will continue to analyze the liberalization of Taiwan's securities market in the context of cross-strait listing of securities.

IV.

Concerns and Legal Responses

There are a number of policy concerns raised by the liberalization of the cross-strait market. In the following sections we will discuss what Taiwan could achieve in the region through strategic policies, the possibilities for bilateral cooperation, and the ways in which Taiwan could strengthen its domestic supervisory regime. Lastly we propose the creation of a separate market for foreign listings within Taiwan for firms having considerable business in China.

A. Policy Concerns

The biggest concern regarding cross-strait listing relates to sovereignty and national security. The ultimate worry is that the growing economic connection across the Taiwan Strait is a prelude to reunification. As one Chinese scholar summarized: “[a free-trade agreement is] a start toward full cross-strait economic integration and a necessary condition for marching forward toward final unification.”⁶⁹ The fear of being relegated to “local-government” status under Beijing's rule (as in Hong Kong or Macau) has dominated the arguments of the opposition party in Taiwan. Nonetheless, a counter-argument is that the current amount of Taiwanese investment in China, accomplished in various roundabout ways, suggest that legal restraints do not prevent corporations from shifting their industrial base to China.

⁶⁸ See also Stephen J. Choi and Andrew T. Guzman, *National Laws, International Money: Regulation in a Global Capital Market* (1997) 65 Fordham L. Rev. 1855, 1866-1869.

⁶⁹ Ariana E. Cha, *Taiwan, China Negotiating a Landmark Free-trade Agreement*, Washington Post (Feb. 21, 2009), online: <<http://www.washingtonpost.com/wp-dyn/content/article/2009/02/20/AR2009022003388.html?sub=new>>.

Apart from the sovereignty issue, Taiwan has other policy concerns exacerbated by the lack of understanding and communication between China and Taiwan, even though those concerns are common to all cross-border listing of securities. Pursuant to the key objectives declared by the International Organization of Securities Commissions (“IOSCO”) in 2003 regarding cross-border markets⁷⁰, Taiwan needs to protect domestic investors; ensure market fairness, efficiency and transparency; and reduce systemic risk.⁷¹ Timely and accurate disclosure of financial results and other material information as well as maintenance of internationally accepted accounting and auditing standards are also important regulatory objectives.⁷²

However, while the existence of an information gap is a common regulatory problem for cross-border supervision,⁷³ the autocratic nature of the Chinese government does worsen the attainment of these objectives to a certain extent. Specifically, China’s lack of information transparency and a governmental tendency to interfere in the private market may lead to fraud and market abuse. Given China’s tight control on media and the internet, it is also doubtful whether material information could be disclosed in a timely manner whenever such materiality conflicts with sensitive political issues. Even if it is disclosed, its reliability raises a question mark. In addition, investigating and enforcing rules on a foreign firm can be very costly. Such costs make cross-border markets inefficient and could invite regulatory arbitrage of market participants from different countries.

Another issue in cross-strait listings is that Taiwan only accepts reports (and consolidated reports) prepared under Taiwanese accounting standards. This article would not venture too far into the differences between Taiwanese and Chinese accounting standards. Nevertheless, if it is to attract the listings of mainland companies, we suggest the government allow reports made under PRC accounting

⁷⁰ See IOSCO, Objectives and Principles of Securities Regulation, online: <<http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf>>.

⁷¹ IOSCO, *ibid*, at 5-6.

⁷² IOSCO, *ibid*, at 23-26.

⁷³ See Frederick Tung, *From Monopolists to Markets?: A Political Economy of Issuer Choice in International Securities Regulation* (2002) 2002 Wis. L. Rev. 1363, 1370-1372; Bo Harvey, *Exchange Consolidation and Models of International Securities Regulation* (2007) 18 Duke J. Comp. & Int'l L. 151, 159.

standards.⁷⁴ From a more global perspective, the Taiwan government could also consider adopting international accounting standards to attract more foreign listings.⁷⁵

In terms of regulatory supervision, one of the main issues bound to appear in any discussion of cross-strait listings is that Taiwanese investors may have no recourse against a wrongdoing Chinese firm since it is questionable how far a Chinese court or regulator would go to protect foreign investors. The Taiwan government would not be able to control how a Chinese issuer uses the money raised in Taiwan once the funds are dispatched overseas. Given the possibility of Chinese firms abusing Taiwan's financial market, this lack of official protection must be addressed.

Against this backdrop, Taiwan's government is likely to feel more comfortable expanding capital market opportunities initially to firms controlled by Taiwanese. It is easier to track these firms' assets and key personnel in Taiwan. On the other, Taiwan's government is certainly more familiar with local Taiwanese merchants, most of whom also have considerable business in Taiwan. Such familiarity is lost in the case of a Chinese controlled company.

Nevertheless, it is wrong to suggest that it is much easier to supervise firms established by Taiwanese in China or in other countries. As suggested earlier, it is common for Taiwanese merchants to conduct their main business in China by way of a company incorporated off-shore in the Caribbean. Taiwan's regulator thus faces a problem of accommodating relevant laws in at least four different countries (e.g. company law in Cayman Island, securities laws in Hong Kong, business laws in China and relevant laws in Taiwan). Piercing through complex shareholding structure (which might be designed to circumvent Taiwan's a harsh legal restraints over investment in China in the first place) may also be a challenging task.

As long as their main business is in China, the problem of transparency and accurate disclosure always exists, no matter whether the firm is controlled by Taiwanese,

⁷⁴ In fact, in China, the new accounting rules published by the Ministry of Finance (effective from 2007) are generally based on the IFRS principles.

⁷⁵ In February 2009, it was reported the FSC is prepared to adopt the IFRS rules; but unfortunately no timetable has been set. China Times (Feb. 19, 2009), online: <<http://chinatimes.com/CMoney/News/News-Page-content/0,4993,11050709+122009021900369,00.html>>.

Chinese or foreigners. Having noted the problems inherent in the cross-straits regulatory supervision, this article will offer several different perspectives to consider the resolution of potential legal problems arising from cross-strait listing of securities.

B. Regulatory Competition in the Greater China Area?

Having identified firms controlled by Taiwanese outside Taiwan or by Chinese inside or outside China as the main target for cross-strait listing, then the question is how to design laws to leverage Taiwan's advantage versus other forums such as Hong Kong and Singapore. Theories regarding regulatory competition and "race-to-the-bottom or top" scenarios might help benefit our perspective.

With the recent relaxation of restrictions on foreign firms with significant Chinese funds or shareholders, there are now two paths worth exploring in Taiwan's bid to increase its capital market's global competitiveness. First, one option is to make Taiwanese law more friendly to issuers than that of other regional competitors. This would resonate with firms seeking to list in a less regulated environment. However, this tactic might also result in a "race-to-the-bottom" scenario, which could ultimately backfire on Taiwan's ambitions.⁷⁶ From a political standpoint, it is unlikely Taiwan would amend its laws to cater to foreign firms at the expense of its domestic investors.⁷⁷ Moreover, although Taiwan has a more established and transparent legal system than China, it still falls behind Hong Kong and Singapore in several competitive aspects.⁷⁸

⁷⁶ See Choi and Guzman, *supra* note 68, at 1872-1874. In contrast, countries might also "race to the top" because the reduction of compliance costs (due to less regulation) might be outweighed by additional information costs and risk involved. *Ibid*, at 1870. See also Chris Brummer, *supra* note 67, at 1441-1446 (discussion of choice of law reform and pure regulatory market).

⁷⁷ As we will argue later, one way to circumvent this problem is to establish an alternative trading market in Taiwan to host Chinese and/or foreign securities so that Taiwan could still maintain local standards in the domestic stock market. See *infra* IV.E.

⁷⁸ For example, in the most recent Global Competitiveness Survey conducted by the World Economic Forum, Taiwan was ranked 17th, while Singapore was ranked 5th and Hong Kong 11th. See online: <<http://www.weforum.org/pdf/gcr/2008/rankings.pdf>>.

Were Taiwan not to pursue a race-to-the-bottom regulatory environment, another option would be to raise the quality of Taiwanese law so that Taiwan can gain an advantage in the ‘law market’ by “racing to the top”. One obvious way is to make Taiwanese law as close to international standards as possible, though this might also mean the abandonment of domestic rules. This approach has its own problem. On the one hand, it is always debatable which rule is ‘better’. Typically the definition of a “good” rule equates with “less regulation” which though sound in theory can be dangerous in practice (and which paradoxically may lead to more race-to-the-bottom arguments). The quality of relevant rules is more than merely about securities regulations and listing rules. The whole legal system, from contract law to the judiciary system, should be examined. Between Taiwan, Hong Kong, and Singapore, we will also face the difficulties of comparing common law and civil law systems in this analysis. At the same time, even if we can successfully define a ‘better’ rule, the costs to comply with such high standards might become too high to attract firms from listing in Taiwan.

In the end, it is a policy dilemma. Both the “race-to-the-bottom” and the “race-to-the-top” theories have their appeal, but it remains to be seen which approach would improve Taiwan’s competitiveness against other Asian countries. On this basis, this article believes Taiwan should conduct a comparative study of its laws with those of Hong Kong, China, and Singapore to understand its current advantages and disadvantages. Then we can hypothesize on the impact of regulatory competition – whether it is to the bottom or to the top – in the Greater China area.

C. Regulatory Cooperation

To help reduce regulatory arbitrage and coordinate securities laws from different jurisdictions, international organizations have attempted to harmonize rules governing capital markets.⁷⁹ This legalization has resulted in the following regulatory efforts: regulatory cooperation and communication, mutual recognition and convergence of

⁷⁹ For criticism of harmonization approach, see Bo Harvey, *Exchange Consolidation and Models of International Securities Regulation* (2007) 18 Duke J. Comp. & Int'l L. 151; Hal S. Scott, *Internationalization of Primary Public Securities Markets*, 63 Law & Contemp. Probs. (2000) 71, 77-80.

national regulators, and the harmonization of laws.⁸⁰ We will address each of these in turn. Unfortunately, most of these actions will surely meet political difficulty if exercised in the Sino-Taiwan context. Cooperation between stock exchanges may be one way to circumvent the political difficulties that normally overshadow any official talk between Taiwan and China.

First, regulatory cooperation and communication could be enhanced if the two countries signed a memorandum of understanding (“MOU”) to ensure better supervision of the capital markets and of public companies.⁸¹ According to the IOSCO, “[a] regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.”⁸² Thus, “[i]nternational cooperation between regulators is necessary for the effective regulation of domestic markets.”⁸³ The IOSCO has also published guidelines to ensure all MOUs share certain basic terms.⁸⁴

Such an understanding is not without historical precedent. The Financial Supervision Commission (“FSC”) in Taiwan signed three memorandums of understanding with Chinese banking, securities, and insurance regulators respectively on Nov. 16, 2009.⁸⁵ This may provide the foundation for supervision of financial institutions across the Taiwan Strait. However, these MOUs target the supervision of financial institutions and not individual firms; thus it is dubious whether they may provide an efficient vehicle to regulate listed firms located in China. Moreover, even the FSC admitted that the MOUs only provided a basis for voluntary cooperation and were not legally binding.⁸⁶ From this perspective, the signature of MOUs was a first step toward a higher level of official cooperation; but it will be imprudent to treat MOUs as a cure-

⁸⁰ Scott, *id.* at 78; Harvey, *id.*; Dombalagian, *supra* note 56, at 1928 *et seq.*; Tung, *supra* note 73, at 1378-1379 (discussion of global harmonization efforts).

⁸¹ Using Hong Kong for comparison, the Hong Kong Stock Exchange (“HKSE”) would consider an application for listing of a Chinese firm when there are communication and cooperation arrangements between the HKSE and Chinese regulators. See HKSE Listing Rules (Mainboard), § 19A.03, online: <http://www.hkex.com.hk/rule/listrules/vol1_2.htm>.

⁸² IOSCO, *supra* note 70, at 17.

⁸³ *Ibid.*

⁸⁴ See IOSCO, Principles for Memoranda of Understanding (1991), online: <<http://www.iosco.org/library/pubdocs/pdf/IOSCOPD17.pdf>>.

⁸⁵ See FSC press release on Dec. 4, 2009, online:

<http://web.fsc.gov.tw/Layout/main_en/News_NewsContent.aspx?NewsID=38541&frame=16&LanguageType=2&path=1878>.

⁸⁶ *Ibid.*

all as their enforceability is always subject to political good will in the Sino-Taiwan relationship.

As for mutual recognition and the convergence of regulators, sovereignty concerns and the improbability of reunification make such options near impossible. It is equally unlikely that Taiwan and China would want to form an EU-like organization over Greater China given the sensitive political environment.

Finally, harmonization of laws, i.e., having a blueprint for integrated laws, might improve simplicity and reduce compliance costs.⁸⁷ However, it is uncertain whether such measures, when applied to the Taiwan, China and Hong Kong legal systems, would create a better regulatory and investment environment.⁸⁸

Therefore, if direct official cooperation is difficult to achieve, an agreement between the Taiwan Stock Exchange and the Shanghai Stock Exchange / Shenzhen Stock Exchange might be considered. In a way, stock exchanges function as “facilitators of law”.⁸⁹ Since stock exchanges are in theory private business entities, an MOU between stock exchanges would not incur the many difficulties which arise from an MOU between two government bodies. Also, stock exchanges are usually a monopoly (as in Taiwan) or an oligopoly (as in China). Though the stock exchanges of both countries maintain government ties, their quasi-private nature ensures that steps taken towards cooperation would face a lessened amount of political significance and interference. If cooperative rules are introduced via the stock exchanges, they would have minimal effect on each nation’s laws. This provides more flexibility for cross-strait supervision of market participants.

Moreover, regulatory cooperation between stock exchanges may naturally result in the harmonization of exchange rules. Harmonization could reduce listing costs, and might also help construct a platform for cross-strait information disclosures, and

⁸⁷ Whether these so-called “transnational regulatory networks” (e.g. the IOSCO or Basel Committee, etc.) are effective is a lively issue. See Pierre-Hugues Verdier, *Transnational Regulatory Network and Their Limit* (2009) 34 Yale J. Int'l L. 113 (discussing the promise and perils of transnational regulatory networks). See also Stavros Gandinis, *The Politics of Competition in International Financial Regulation* (2008) 49 Harv. Int'l L.J. 447.

⁸⁸ See *supra* note 58.

⁸⁹ Brummer, *supra* note 76, at 1452-1455; Romano, *supra* note 59, at 2399 *et seq.* (discussing regulation by exchanges as an alternative to the market approach to securities regulation). See also Dombalagian, *supra* note 56 at 1942 *et seq.* (arguing exchanges as choice-of-law arbiters).

corporate governance practices, leading to more coherency and transparency in cross-strait listings.

In summary, there are considerable obstacles in having Taiwan and China's regulators officially agree to mutual recognition and supervisory cooperation to create a cross-strait market. Each party must be willing to compromise its sovereignty. Under such circumstances, cooperation between stock exchanges would be easier given the lessened political significance attached to such a partnership. Unfortunately, this option has not been widely proposed or discussed, but we hope this idea will soon be taken up.

D. Strengthening Domestic Supervision: An Independent Third-Party Sponsor?

Having addressed both regulatory competition and regulatory cooperation as possible avenues for cross-strait listing mechanisms we now turn our attention to two independent options: the use of a third-party sponsor, and the creation of an alternative market.

Currently, use of sponsors as corporate overseers has some precedent within Greater China. In Taiwan, an issuer is required by law to hire an underwriter for at least six months before filing for listing. The underwriter acts in an advisory capacity to ensure the company's application for offering or listing meets all regulatory requirements. This is achieved by assisting the firm on capital formation and its corporate structure and helping revise the firm's articles of incorporation, prepare the prospectus, and negotiate with the Taiwan Stock Exchange.⁹⁰ The underwriter must also file periodic reports to the Financial Supervisory Commission and the Taiwan Stock Exchange, and file a final recommendation report to the regulator before the issuer files for offering or listing.

⁹⁰ See generally Chinese Securities Association Guidelines for Information to be published in Assessments of Securities Underwriters for Offering and Issuance of Securities by Foreign Issuer (2009).

The function of underwriters in Taiwan is similar that of a sponsor in other countries. In Hong Kong, “[a] new applicant must appoint a sponsor to assist it with its initial application for listing”.⁹¹ A sponsor must be independent of an applicant and his underwriters and is expected to perform its duties with impartiality.⁹² As with the Taiwanese underwriter, a sponsor is closely involved in the preparation of the new applicant’s listing documents, conducts due diligence inquiries and ensures certain listing requirements are complied with.⁹³ This regime is practiced in the U.K.,⁹⁴ Singapore⁹⁵ and China (there called “recommendation party”).⁹⁶

Currently, the function of the underwriter in Taiwan is limited to the pre-listing stage. No regime exists to ensure that a firm would continue to meet all regulatory requirements after its listing application is approved. Thus there is considerable space to apply the pre-listing regulatory requirements of a sponsor to the post-listing stage. Such a system would also have advantageous carry-over effects towards the development of Taiwan’s own financial services industry. Given the mentioned difficulties in regulating a foreign-incorporated company, a sponsorship regime is well worth considering.

While currently the cost for an initial public offering in Taiwan is less than in Hong Kong, an increase in pre-listing application and post-listing compliance costs as a result of a sponsor-driven regulatory regime might affect that advantage and discourage foreign listings. However, this risk would be reduced if Taiwanese law followed international standards. The Taiwan government should consider adopting

⁹¹ HKSE Listing Rules (Main Board), § 3A.02, online:
<http://www.hkex.com.hk/rule/litrules/Chapter_3A.pdf>.

⁹² *Ibid*, at 3A.06 *et seq*.

⁹³ *Ibid*, at 3A.11.

⁹⁴ See Financial Services and Markets Act 2000 (c 8), section 88; FSA Handbook, LR 8.6 & 8.7 (2009).

⁹⁵ In Singapore, if a firm plans to list in the Catalist board of the Singapore Exchange (SGX), the firm has to hire a full sponsor or continuing sponsor pursuant to Catalist rules. See SGX Catalist Rules, Chapter 2, online:

<http://www.sgx.com/wps/portal/corporate/cpen/regulation/rulebooks_manuals/catalist_rules>.

⁹⁶ China Securities Act, art 11 (2005). Translation excerpted from online:

<http://www.chinadaily.com.cn/bizchina/2006-04/18/content_570077.htm>. In fact, the recommendation system has been adopted by the CSRC in 2003, even before the promulgation of the Securities Act in 2005. The rules are called “Provisional Rules of Recommendation Regime for Securities Issuance and Listing” (“Recommendation Rules”), issued pursuant to the CSRC Chairman’s Order No. 18 on 2003 (last revised on 2004). The full texts can be found online:
<<http://202.106.183.108/n575458/n870824/n8358456/10247389.html>>.

accounting standards⁹⁷ and corporate governance and disclosures rules that are in line with global principles to minimize such costs.⁹⁸

Another consideration is that a sponsorship scheme has limits. One cannot assume a sponsor can resolve all difficulties in cross-strait listings. It would be imprudent to completely rely on a sponsor to bridge the information gap between Taiwan regulators and a Chinese firm. It is also doubtful whether a sponsor could always reliably assess a firm's qualifications. If the sponsor is Taiwanese, the question is whether the sponsor is capable of determining a Chinese firm's compliance with Taiwanese laws. If the sponsor is Chinese, the question then becomes whether its recommendation is trustworthy. Ultimately, sponsorships will be pointless if the sponsor's sole function is to be a scapegoat or a deep pocket. Potential sponsors may be deterred by these associated liabilities.

In summary, we believe strengthening Taiwan's supervisory scheme by requiring an independent sponsor is one way to correct the regulatory deficiency in cross-strait listings. But it must be noted that this method has its limitations and cannot be a panacea to all issues in a cross-strait capital market.

E. An Alternative Market: Let the Market Decide?

If a direct official supervisory cooperation or a efficient regulatory scheme is not practical, why not let the market develop through investors' actions? The government could construct a separate platform with a different set of rules for Chinese listings under the Taiwan Stock Exchange,⁹⁹ while allowing overall regulatory standards to

⁹⁷ See also *supra* note 75.

⁹⁸ For example, see Organization of Economic Cooperation and Development, Principles of Corporate Governance (2004), online:

<http://www.oecd.org/document/49/0,3343,en_2649_34813_31530865_1_1_1_1,00.html>; IOSCO, International Disclosure Standards for Cross-border Offering and Initial Listings by Foreign Issuers (1998), online: <http://www.sec.gov/about/offices/oia/oia_corpfin/crossborder.pdf>.

⁹⁹ This is similar to a regime adopted by Bovespa of Brazil. The Bovespa installed three different listing and corporate governance standards for firms to follow. See International Chamber of Commerce, *How Brazil's Novo Mercado is changing the way companies access capital* (Feb. 15, 2006), online: <<http://www.iccwbo.org/iccifig/index.html>>. See also Shao, *supra* note 54, at 45-46.

remain the same.¹⁰⁰ This would be similar to establishing an off-shore free zone, “where issuers are free to issue securities to investors from any country under one set of rules”.¹⁰¹

If the rules for this market conform more to international standards, it might reduce listing and compliance costs for Chinese or foreign issuers while still allowing issuers to enjoy Taiwan’s advantages. Of course, foreign issuers may still have the option to list in the regular market to lure local investors if they so choose.

For investors, they can choose to invest in the regular market or in the alternative market where the government makes clear that it applies less control and supervision. This may lead to a change of the regulatory ideology in Taiwan: from a more merit-based approach to an informed risk-based regulatory system.

For regulators, they would have the chance to evaluate local and international supervisory standards, and observe the competition between the regular and alternative markets. If investors react conservatively to securities listed in the alternative market due to lack of transparency or higher risk, then Taiwan should maintain its current standards. If the alternative market is well received and even attracts domestic listings, it may be time for Taiwan’s regulators to reconsider its policies and regulations.

By creating a separate and more liberal market, Taiwan might be able to bypass political difficulties and attract foreign capital. Of course, it would be naïve to assume investors always judge wisely. An informed decision hinges on the full disclosure of material information and the corporation’s continued compliance with regulations. Additionally, an advanced supervisory scheme is essential for effective and efficient market regulation.

¹⁰⁰ This method is similar to a model proposed by Professor Jackson in Nepal. See Howell E. Jackson, *Centralization, Competition, and Privatization in Financial Regulation* (2001) 2 Theoretical Inquiries L. 649, 668-669.

¹⁰¹ Scott, *supra* note 79, at 78 & 92 *et seq.* Professor Scott argued that the off-shore free zones are the best and most realistic alternative for possibly dealing with the need for optimal standardization issuance in the global context. *Ibid.*

V. Conclusion

Though capital restrictions have stymied the development of Taiwan's capital markets over the past two decades, greater relaxation and opening should facilitate a return of local firms. At the same time, Taiwan's competitive advantages may also begin to attract other overseas firms. In sum, Taiwan is in a strategic position to attract not only money from overseas Taiwanese merchants but also Chinese capital.

In conjunction with the ongoing development of Taiwan's capital market, regulatory competition within the Greater China area is set to increase. We believe Taiwan should conduct a comparative study of its laws with those of Hong Kong, China, and Singapore to understand its current advantages and disadvantages. In a way, China and Taiwan, along with Hong Kong and perhaps Singapore, can offer genuine regulatory competition within the Greater China capital market. At the same time, the prospects for official regulatory cooperation between Beijing and Taiwan are less than bright given the long political deadlock and lack of mutual understanding between the two parties.

Assuming that the creation of the cross-strait capital market is an unstoppable trend, this paper examines several regimes that may facilitate Taiwan's attempt to control and supervise Chinese companies seeking to tap into Taiwan's capital market. This paper would argue that regulatory cooperation or even harmonization of Sino-Taiwan laws in the European model, may be an interesting idea but would prove to be very difficult in practice. A more viable approach is to strengthen domestic supervision in Taiwan with a sponsorship program like we have seen in Hong Kong. Such a system would improve Taiwan's competitive position and its investor protection reputation among international investors. However, the sponsorship program runs considerable risk that the sponsor will become either a rubber stamp or, if compliance costs are too high, simply too expensive. Given the regulatory obstacles between Taiwan and China, a better approach might be to open an alternative trading market containing more flexible rules for Chinese (or foreign) securities in Taiwan. This kind of market-oriented approach may maintain the level of domestic investor protection without imposing higher costs in terms of regulation and compliance.