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**Banking Bureau
Financial Supervisory Commission, Executive Yuan
7F., No.7, Sec. 2, Sianmin Blvd., Banciao City, Taipei County 22041,
Taiwan, R.O.C.**

Attn: Mr. Wang Li Chun, Deputy Director, Division 5
王立群副組長, 第五組

Dear Mr. Wang,

Financial Supervisory Commission Order dated 17 June 2008

Thank you very much for meeting us in June and sharing your views with us on some topical regulatory issues in Taiwan. We truly enjoyed the conversation and were delighted to know that the Banking Bureau is dedicated to developing a healthy and robust derivatives market in Taiwan.

On behalf of the members of the International Swaps and Derivatives Association, Inc. ("ISDA"), we respectfully present to you this submission in relation to the "Guidelines for Trust Enterprise Engaging in Specified Trust of Money Business for Investing in Offshore Securities" issued by the Financial Supervisory Commission on 17 June 2008 ("FSC Order"). This submission mainly addresses the issues surrounding article 1(c) of the FSC Order. We understand from our members that this article has raised a lot of concerns in the market.

Article 1(c) of the FSC Order provides that:

"Trust enterprises shall not actively recommend specific offshore securities or actively provide or deliver information memoranda/prospectuses to customers or the general public unless the manager (or issuer) of such offshore securities has not imposed limitations as to whom the offshore securities may be sold, the principal guarantee ratio of such offshore securities is 100% at maturity, and such recommendation, provision or delivery is made to existing specified trust of money customers."

We understand that this article is intended to protect the interest of Taiwan retail customers, in particular, to reduce misselling cases where retail customers are sold complex structured products which they do not understand. We appreciate the concern of the Banking Bureau and we also believe that necessary guidelines on risk disclosure, product distribution and client suitability are needed in order to ensure fair treatment of individual investors. However, we have some comments and questions on the FSC Order and would like to share those with you in this letter.

1. Principal Protection

Pursuant to article 1(c) of the FSC Order, Taiwan trust enterprises should not actively recommend specific offshore securities unless the securities satisfy certain requirements including a requirement for principal protection. The principal protection requirement seems to be based on the presumption that non-principal protected products are too risky to sell to retail investors. We would like to point out that non-principal protected structured products may not be necessarily riskier than many investment products which are readily available for Taiwan retail investors.

There are many examples of non-principal-protected products that have similar risky payout profiles as standard investment products such as stocks, mutual funds, etc. To give but one example, a common product in the market is a yield enhancement note in which the note purchaser effectively sells an out-of-the-money put option on an underlying stock or index. At maturity, the client either gets back par on the note plus an enhanced interest income (interest plus option premium) or receives the current market value of the reference asset if it has fallen below the pre-specified strike price. As far as the exposure to the underlying assets is concerned, the note purchaser has no more downside risk than if they had purchased the underlying asset directly. Investing in such a yield enhancement note is equivalent to possible investment in a stock at a targeted lower price at a later date; and if the stock price did not fall to the targeted level, investor gets back his principal sum plus an enhanced yield. It offers investors, who have a view on the stock market an alternative investment strategy while not increasing the investors' exposure to the underlying assets.¹

Principal-protected products involve an opportunity cost for the purchaser (foregone interest). In a low interest rate environment, product maturities have to be quite long in order to structure attractive products with principal protection features. Investors of principal protected note, regardless of the tenor of the note, will invariably have to unwind the note at a price below par before maturity, which is one of the sources of discontent among retail structured product purchasers. Many non-principal-protected products offer investors the potential for yield enhancement in return for taking what they consider a reasonable view on an underlying asset. Without these products, yield-starved investors would be deprived of alternative investment choices in a low interest rate environment.

Experience from many jurisdictions has proved that the most effective way of protecting retail investors' interest is to require proper suitability check and accurate risk disclosure. In this respect, we note that most jurisdictions regulate securities markets on a distribution basis rather than by way of limiting the product types which may be offered to investors. For example, in the EU, structured products are subject to disclosure requirements concerning the issuer of the debt (financial information and other details) under the Prospectus Directive, while the MIFID (Markets in Financial Instruments Directive) focuses disclosure requirements at the level of distribution, including disclosure of potential conflicts of interest, appropriate information around the distributing firm and its services, instruments deployed and proposed investment strategies, costs and associated charges, as well as execution policies. Under MIFID, distributors are required to assess the suitability for particular customers of particular products, with sales and disclosure determined accordingly. MIFID itself does not set out whether a particular product can be sold to retail customers or not. We believe that investors should have access to different investment products as long as they understand the risks inherent in the products (so that the decision is made on an informed basis) and have the capacity to accept the risks.

¹ We note that an additional risk which the investors are taking on when investing in yield enhancement notes is the credit risk of the issuer or guarantor (if any) of the notes. However, as far as the exposure to the underlying assets (e.g., stocks in equity linked notes) is concerned, investing these notes are not riskier than investing in the underlying assets.

2. General Public

Article 1(c) of the FSC Order restricts the active marketing of offshore securities targeting "general public". Article 1(c), however, includes a carve-out to this restriction: the trust enterprises may actively market to their existing customers provided that (1) the manager or issuer of the offshore securities has not imposed limitations as to whom the securities may be sold to and (2) the securities are principal protected. Article 1(e)(i) further provides that "if the manager (or issuer) of certain offshore securities states that there are restrictions regarding to whom the securities may be sold, the trust enterprises cannot accept an investment entrusted by general clients". The definition of "general public" or "general client" is key to understanding how these two clauses will apply in practice. What constitutes a "limitation as to whom the securities may be sold to" under provision (1) above will have to be construed in light of the meaning of "general public".

Under article 1(c) of the FSC Order, it is clear that if certain type of securities is intended for institutional investors only, the securities should not be sold to individual investors. What is not clear under this article is whether any type of qualification or description of investors will constitute a selling restriction under provision (1) mentioned above and thus cannot be actively marketed by the trust enterprises. For example, term sheets of structured products often include a sentence saying that the products are only appropriate for individuals who have detailed knowledge and understanding of structured products and the associated risk factors, have experience in investing in sophisticated financial products and can accept the risks of investments in structured products and have the financial capacity to absorb investment losses. Would this constitute a "limitation as to whom the securities may be sold to" under provision (1)? We hope that the Banking Bureau could clarify to the industry the meaning of "general public" and what constitutes a selling restriction under clause 1(c) of the FSC Order.

Further, the restriction put in place by the FSC Order does not recognize the fact that within the category of general public, there should be acknowledgment of different sub-categories with varying capacity to invest in different products. Article 1(c) prohibits all active marketing activities targeting retail customers (including high net worth individuals) unless the marketing activity satisfies the carve out mentioned above. It is common globally to have a category for sophisticated or high-net worth individuals who have investing experience and the capacity to sustain large losses on investments. The regulation should acknowledge the difference between normal retail customers and more sophisticated high net worth individuals and differentiate accordingly.

ISDA fully supports the objective of the Banking Bureau in introducing regulation to protect interest of the retail customers in Taiwan's structured product market. ISDA also believes that it is important that the regulatory framework continues to foster innovation and flexibility and does not lead to legal uncertainty. The current environment is very challenging for industry participants and regulators in many places. ISDA is working with all constituents across the industry to realize swift and smooth resolution to a number of market events which have occurred recently. We hope that we could also work closely with the Banking Bureau and the Taiwan market participants to tackle the current difficulties together and provide assistance whenever you think necessary.

ISDA would be pleased to discuss the issues further with the Banking Bureau. In the meantime, should you or your colleagues have any questions regarding the guiding principles of structured securities transactions or this letter, please do not hesitate to contact Mr. Keith Noyes (knoyes@isda.org) in Hong Kong at telephone number +852 2200 5909 or Ms. Jing Gu (jgu@isda.org) at +852 2200 5908, or Mr. Way Yee Bay (wyybay@isda.org) in Singapore at telephone number +65 6538 3879.

Yours sincerely,

For The International Swaps and Derivatives Association, Inc.



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