

Explanation of Allowing Foreign Institutional Investors (“FINIs”) to Use Taiwan Listed Stock as Collateral for Offshore Investment Activities

To attract international capital into Taiwan’s capital market, the Financial Supervisory Commission (“FSC”) issued an order on March 30, 2023 (Order No.1120335161) to further allow FINIs to use Taiwan listed stock as collateral for offshore investment activities. This means that, in the future, if there is a need for a FINI to obtain funding for conducting offshore investment activities, it may use onshore listed stock as collateral to obtain such offshore funding without the need to sell its holdings in Taiwan listed stock. Permitting FINIs to use onshore stock as collateral will increase the flexibility of FINIs’ capital use.

Based on the FSC’s instruction, the Taiwan Stock Exchange (“TWSE”) has developed onshore stock collateral operation and supervision methods and promulgated the “Operating Rules for Overseas Chinese and Foreigners Using Onshore Securities as Collateral for Offshore Investment Activities” (the “FINI Collateral Rules”). The FINI Collateral Rules will be implemented on August 28, 2023.

1. Basic Structure

In order for a collateral provider (“Collateral Provider”) to provide a collateral receiver (“Collateral Receiver”) with onshore listed stock as collateral for offshore investment activities between the Collateral Provider and Collateral Receiver outside Taiwan, an offshore collateral manager (“Offshore Collateral Manager”) must be appointed to be responsible for collateral management. The Offshore Collateral Manager must, inter alia, appoint a Taiwan custodian to handle custody of the onshore stock collateral (“Taiwan Collateral Custodian”).

2. Restrictions on offshore investment activities and use of funds

- (1) Offshore investment activities between a Collateral Provider and a Collateral Receiver are limited to three types of activities: (i) offshore derivatives transactions, (ii) offshore securities borrowing and lending transactions and (iii) offshore foreign currency loans.
- (2) Funding acquired by a Collateral Provider using Taiwan stocks as collateral must be in a currency other than NT Dollars, must be used outside Taiwan, and is not permitted to be used for any activities in Taiwan.

3. Scope of Eligible Onshore Collateral

Eligible onshore stock collateral is limited to TWSE listed stock and Taipei Exchange ("TPEX") listed stock which are eligible for margin trading transactions in Taiwan. Onshore borrowed stock is not permitted to be used as collateral.

4. Qualification criteria for participants in the onshore collateral operations

(1) Collateral Provider

- (i) A Collateral Provider must be an offshore institutional investor which has been approved by the FSC as a qualified foreign institutional investor ("QFII") prior to September 30, 2003 or registered as a FINI on or after September 30, 2003 under the Regulations Governing Investment in Securities by Overseas Chinese and Foreign Nationals (the "FINI Regulations").
- (ii) The Collateral Provider will be required to issue a declaration that the funding acquired by using the onshore stock as collateral is in a currency other than NT Dollars, will be used outside Taiwan, and will not be used for any activities in Taiwan. The Collateral Provider shall issue and provide such declaration to its Taiwan custodian ("Collateral Provider's Taiwan Custodian") for record so that the Taiwan Collateral Custodian can check with the Collateral Provider's Taiwan Custodian to confirm such declaration to TWSE via the designated online platform.

(2) Collateral Receiver

- (i) A Collateral Receiver must be a QFII approved by the FSC prior to September 30, 2003 or registered as a FINI on or after September 30, 2003.
- (ii) If a Collateral Receiver is a lender of foreign currency loan(s) to a Collateral Provider, such Collateral Receiver must be licensed by the relevant offshore financial authority to operate as a bank or securities firm. The Collateral Receiver, as fund provider, will be

required to issue a declaration that it is licensed by the offshore financial authority as a bank or securities firm. The Collateral Receiver will be required to issue and deliver such declaration to its Taiwan custodian ("Collateral Receiver's Taiwan Custodian") for record so that the Taiwan Collateral Custodian can check with the Collateral Receiver's Taiwan Custodian to confirm such declaration to TWSE via the designated online platform.

(3) Collateral Manager

- (i) A Collateral Manager must be licensed by the relevant offshore financial authority as a bank.
- (ii) Prior to engage in Collateral Manager activities under the FINI Collateral Rules, the Collateral Manager will be required to appoint a Taiwan Collateral Custodian to handle the registration of the Collateral Manager with TWSE.
- (iii) The Collateral Manager will be required to issue a declaration that it will comply with the FINI Collateral Rules and confirm that it has been licensed by the relevant offshore financial authority as a bank. Such declaration is to be submitted to TWSE by the appointed Taiwan Collateral Custodian via internet connection.

(4) Taiwan Collateral Custodian

- (i) A Taiwan Collateral Custodian must be a bank or securities firm licensed in Taiwan to conduct custody business which is currently acting as a regulatory agent for one or more FINIs under the FINI Regulations.
- (ii) Prior to engage in Taiwan Collateral Custodian activities under the FINI Collateral Rules, the Taiwan Collateral Custodian shall submit an application to TWSE for approval.

5. Scope of responsibility of the Collateral Manager and Taiwan Collateral

Custodian

(1) Collateral Manager

The Collateral Manager will be required to handle matters such as confirmation of suitability of collateral, allocation, replacement, mark to market, bookkeeping of the collateral, notice of providing additional collateral and issuing post default disposal instructions, etc.

(2) Taiwan Collateral Custodian

The Taiwan Collateral Custodian will be required to handle matters such as custody, delivery and receipt and disposal of collateral, etc.

6. Custody and Ownership of the Collateral

(1) The Taiwan Collateral Custodian is required to open a dedicated “collateral custody account” with the Taiwan Depository & Clearing Corporation to take custody of the collateral. The collateral shall be kept separately from the Taiwan Collateral Custodian’s own assets and shall not be used for any other purpose.

(2) The notional holder of the collateral remains the Collateral Provider and title (ownership) of the collateral will not be transferred to the Taiwan Collateral Custodian or the Collateral Receiving as a result of provision of the collateral.

7. Disposal of the Collateral

(1) The Taiwan Collateral Custodian will be responsible for dispose of the collateral in accordance with the instructions of the Collateral Manager and to report to the TWSE prior to such disposal.

(2) A Taiwan Collateral Custodian is required to open a special trading account for collateral disposal (“Collateral Disposal Account”) with the head office of a securities broker in order to sell stock collateral in the securities market via a securities broker. The Taiwan Collateral Custodian is permitted to open only one Collateral Disposal Account with the same securities

dealer.

- (3) Securities brokers will only be permitted to accept long sale orders placed by the Taiwan Collateral Custodian for selling the collateral via the Collateral Disposal Account and such sales will not be permitted to be made via the securities broker's omnibus trading accounts for transaction allocation.
- (4) After the collateral has been disposed of by the Taiwan Collateral Custodian, the proceeds will be required to be applied to the debt owed by the Collateral Provider to the Collateral Receiver. The Taiwan Collateral Custodian will be required to remit the relevant portion of the sale proceeds to the Collateral Receiver's account on the first business day following the day on which the sale proceeds are credited to the account of the Taiwan Collateral Custodian. If there is any surplus, such surplus will be required to be returned to the Collateral Provider.
- (5) The amount paid to the Collateral Receiver will be deemed as inward remittance of investment capital by the Collateral Receiver and as repatriation of investment capital or earnings by the Collateral Provider, and be reported to the Central Bank of the Republic of China (Taiwan) ("Central Bank") by the Collateral Receiver's Taiwan Custodian and the Collateral Provider's Taiwan Custodian, respectively.
- (6) If at the time such proceeds are received, the relevant Collateral Receiver or Collateral Provider has an existing obligation to settle securities trades which have been executed and matched by TWSE or TPEx, such Collateral Receiver or Collateral Provider may retain the NT Dollar proceeds from sale of the collateral for settlement of such trades with any remaining funds being converted into foreign currency and remitted out of Taiwan on the first business day after the relevant amount is credited to the account of the Collateral Receiver or Collateral Provider, as applicable.

8. Information Reporting

- (1) The Taiwan Collateral Custodian will be required to report to TWSE before 5 p.m. on the first business day after receiving any collateral, by uploading a checklist in the TWSE prescribed

form to the designated online system confirming compliance with the FINI Collateral Rules by the Collateral Provider, Collateral Receiver and Collateral Manager (i.e. each of the Collateral Provider, Collateral Receiver and Collateral Manager meets the required qualifications and declares that it will comply with relevant restrictions). The above reporting for any given Collateral Provider, Collateral Receiver or Collateral Manager only needs to be made once by one Taiwan Collateral Custodian (i.e. reporting is not required to be made on a collateral delivery by collateral delivery basis).

- (2) Each Collateral Provider will be required within fifteen (15) days after the end of each month to prepare the following information on the collateral provided by it for the previous month, and provide such information to the Collateral Provider's Taiwan Custodian for reporting to the Central Bank with copy to TWSE for record:
 - (i) Name of the Collateral Provider, Collateral Receiver and Collateral Manager;
 - (ii) Names, quantity, market value (i.e. closing price of the relevant stock, as of the end of the relevant month) and the collateral value (i.e. the value of collateral after haircut);
 - (iii) The amount of required collateral, the total collateral value, the commencement date of the contract and the type of contract for the relevant offshore investment activities between the Collateral Provider and Collateral Receiver; and
 - (iv) Other information as may be specified by the Central Bank from time to time.
- (3) Each of the FSC, the Central Bank and TWSE may, if it deems necessary, require a Collateral Provider, Collateral Receiver and/or Collateral Manager to provide additional relevant information and/or documents.

9. Sanctions on Participant for Violation of the FINI Collateral Rules

- (1) Each Collateral Provider and Collateral Receiver will be

required to comply with all applicable laws or regulations. In the case of violation of applicable laws or regulations, TWSE may impose restriction on provision of collateral or providing additional collateral or request the Taiwan Collateral Custodian to notify the relevant Collateral Provider and Collateral Receiver to take back/return the collateral within a prescribed period.

- (2) Each Collateral Manager and Taiwan Collateral Custodian will be required to comply with all applicable laws or regulations. In the case of violation of the applicable laws or regulations by a Collateral Manager or Collateral Custodian, TWSE may notify the Taiwan Collateral Custodian to cease accepting new collateral or require delivery of the collateral held by such Taiwan Collateral Custodian to another Taiwan Collateral Custodian within a prescribed period or notify the relevant Collateral Provider and Collateral Receiver to arrange return of collateral and TWSE may also revoke the registration of the relevant Collateral Manager or approval of the relevant Taiwan Collateral Custodian.

10. Collateral Regulatory Fee

Each Collateral Provider will be required to pay a collateral regulatory fee to TWSE which shall be paid by the Collateral Provider's Taiwan Custodian for and on behalf of the Collateral provider. Such fee will be based on the following formula:

Market value of collateral X 0.0004 ÷ 365

If the daily service fee amount is less than NT\$100, it will be charged as NT\$100.