

Taiwan

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Securitization in Taiwan off to a Strong Start

As anticipated, market participants are responding very positively to the implementation of a new legal framework for securitization in Taiwan. The Ministry of Finance (MOF) has already approved one major asset-backed deal since promulgation of the long-awaited *Financial Asset Securitization Law* (the FASL) in mid-2002, and a good many more are in the offing. Conditions for strong securitization market development in Taiwan are favourable: a workable legal framework is in place; a considerable pool of securitizable assets exists; there is strong interest from originators and investors; groundbreaking deals are already underway; and by most accounts the government, keen to modernize its financial services sector and resolve a mounting non-performing loan problem, has been supportive and responsive. Market analysts point out, however, that this development is contingent upon the government's commitment to continue financial sector reforms and clear existing and emerging hurdles to securitization in a timely manner.

Groundbreaking Deals

Taiwan's first securitization product, a US\$103 million collateralized loan obligation issued through private placement by the trustee, the state-owned Land Bank of Taiwan, consists of a portfolio of assets originating with the Taiwan Industrial Bank (ITB). The deal was approved by the MOF in January and closed in late February this year.

It is anticipated that in June 2003, Taiwan's second asset securitization product will be issued publicly in the local securities market with Credit Lyonnais as the originator. The size of the asset pool is estimated around NT\$6 billion, and it has

received an AA rating.

A number of local financial institutions are teaming up with professional arrangers to pursue the securitization of their respective housing loans, including: First Bank with Deutsche Bank; China Trust with Lehman Brothers; Taishin Bank with Citibank; E. San Bank with ING Bank; and Chang Hwa Bank with Citibank. The asset pool of the first four local banks is estimated to be NT\$25 billion. Most of these securitization products should be issued in mid-2003. Chang Hwa Bank's deal reportedly comprises US\$144 million in securitized mortgages and is slated for completion in the fourth quarter this year.

FASL Fundamentals

The FASL, largely based on the Japanese Securitization Act, provides the legal basis for securitization in Taiwan. A package of related laws and regulations further facilitates the securitization process and covers bank mergers, the establishment of financial holding, asset management and special purpose companies, among others.

Under the FASL, financial institutions such as banks, bill financing companies and insurance companies may pool together specified financial assets for securitization. Securitizable assets include: (i) vehicle loans and other chattel mortgages and security interests thereon; (ii) house mortgages or other real estate mortgages and security interests thereon; (iii) leasing receivables, credit card receivables, accounts receivables or other receivables; (iv) beneficial rights to said assets that originate from the trust agreement between the originator and a trust institution; and (v) other (debt or creditor's) claims approved by the competent authority. The last category gives the government wide latitude to approve the introduction of new securitization products.

Two vehicles for financial assets securitization are permitted under the FASL. An originator may entrust its pool of assets to a trust institution (SPT) through a special purpose trust arrangement, or transfer such assets to a special purpose company (SPC). Having obtained MOF approval, an SPT or SPC may then publicly or through private placement issue securities based on the pools of assets entrusted or transferred. An SPT must be a trust enterprise under the *Trust Enterprise*

Law, and must have a credit rating higher than those specified by the MOF. An SPC should be set up by a financial institution under the FASL. Based on Taiwan's initial deals, the SPT seems to be the vehicle of choice.

Tax incentives are also provided for securitizations conducted under the FASL. Assets transferred under a securitization plan are free from stamp tax, deed tax and VAT. Official fees for recording the transfer of financial assets are also exempted. Incremental land tax on a plot of land that has been transferred may be deferred until the SPVs dispose of the properties. The transfer of the asset-backed securities is free from security exchange tax. The VAT applied to banks also applies to revenues from SPV assets. VAT for banks is currently 2%, but VAT levied on banks will be abolished beginning in 2006. Interest from asset-backed securities is subject to 6% withholding tax for local and foreign investors, and is separated from the other income of each investor for the purpose of calculating income tax.

The Way Forward

The MOF's recent approval of a groundbreaking securitization product is an encouraging sign. A number of issues, however, will require swift and effective resolution if Taiwan's securitization market is to flourish and the ancillary benefits are to be realized. For example, what constitutes "true sale" under the FASL? How exactly can SPCs be used for securitization? Is a 6% withholding tax applicable on cross-border securitizations? Finally, are revolving structures allowed?

Many of the issues will be addressed in the implementing guidelines to the FASL and other laws and regulations. Unfortunately, the drafting and approval of such laws can be time consuming in a civil law jurisdiction such as Taiwan. The Bureau of Monetary Affairs has indicated that its draft guidelines for the FASL have been submitted to the MOF for review. If these are approved, they will then be forwarded to the legislature for passage. We look forward to further clarification of this important legislation.

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