TAIWAN 2019: ASIA'S MUTUAL FUNDS GIANT

For many years, the biggest secret of the Asian mutual funds industry was the size of Taiwan compared to the rest of Asia. While it's relatively easy to get set up in Hong Kong, taking the 83-minute flight north to Taipei has often been regarded as being too difficult (indeed the air route was named the World's Busiest for three years running from 2014 to 2017).[1] What's more, Taiwan's regulatory environment was thought to be cloaked in mystery, and getting to talk with the regulators was nearly impossible. And yet there were continuous stories about how much business was being done by the few global fund houses that persevered. But today, in 2019, Taiwan's a very different location for global fund houses than it used to be. And it's really no surprise.

Securities regulations are well defined, the opportunities are vast, and there's an openness that perhaps did not previously exist. On the political front, China and Taiwan continue to have their differences, but there are few restrictions on business. There are many Taiwanese-owned businesses located in China, which helps to greatly improve the dialogue between both sides. It's said that up to two million Taiwanese now live and work in Mainland China. The frequency of daily flights across the 160 kilometre-wide Taiwan Straits between Taiwan and more than 10 cities in China has risen from zero 10 years ago to over 20 a day now, and it's growing every year. Mainland Chinese are second only to Japanese in numbers of visitors to Taiwan, at nearly five million a year.[2]

For the fund and asset management industry, Taiwan offers opportunities across institutional and retail markets. Taiwan's institutional investors, pension funds, insurance companies and state institutions have continued to grow and have now become significant holders of offshore investments in global markets across all sectors.

The aggregate size of the Taiwan mutual funds market was reported to exceed USD250 billion at the end of December 2018.[3] This was made up of USD104 billion in offshore funds, USD84 billion in onshore local funds and USD62 billion in other investment mandates from pension funds and other investors. There was a further approximate USD23 billion in ETFs.[4] By any standards, this makes Taiwan a location of prime importance to the fund management industry globally.

The Taiwan institutional market has also grown substantially over the last 10 years. This is split between national pension funds, insurance companies and others. It's estimated that the current size exceeds USD300 billion, of which the five national pension funds exceed USD150 billion. A high proportion of the assets are invested globally, and they also use hedge funds and other alternative investments, giving many opportunities to institutional fund managers.

Taiwan, the perfect demographics for mutual funds

Compared to virtually all other markets in Asia, Taiwan has near-perfect demographics for the mutual funds industry. There's a large middle-aged, middle-class population, with high average earnings, a high savings rate, modest pension provision and a desire to invest and actively manage money overseas rather than retain it in the home market. Although marginally higher than Hong Kong, Singapore, Japan and South Korea, Taiwan also has one of the lowest birth rates in the world at 8.26 per 1,000, which has led to a rapidly aging population.[5]

Some key economic statistics for Taiwan also helps to convey why the location's so attractive.[6] GDP per capita is USD24,316, having grown at an average rate of 2.06% a year over the past

five years. Unemployment is 3.80% of the 23.5m population. And inflation is a low 1.2%.

Taiwanese investors are well known for their short-termism. Typically, the average hold period of an investment into funds can be around three to six months. Often it might just be until 5% or more gain has been made. Investors have been very willing to take an active role in managing their assets, in part due to the (usual) low level of initial charges applicable to sales of funds (up to 2%) and to the desire to take short-term profit rather than wait for long-term returns that might fluctuate more. This has led to the active use of mutual funds in a way very similar to equities to achieve sustained returns.

Even with the popularity of high-yield bond funds over the last five years, the term of holding this type of investment by many Taiwanese investors has averaged just nine months, according to many of the managers offering these products. Even more surprisingly, issuers of regular savings plans into mutual funds also report the average hold periods to be little more than 12 months.

The Financial Supervisory Commission (FSC) has similarly attempted to reduce the extent of turnover activity in mutual funds. In the last couple of years, it introduced a restriction on the extent of sales bonuses paid by banks to their sales staff for individual fund sales, which then extended to become a ban. In future, all such commissions or sales bonuses to staff have become based on retained AUM of client/customer holdings. The aim of this was to bring about a more "advisory-" than transaction-based service for mutual funds. While most non-Taiwan banks had already adopted this approach, local banks were impacted most.

The Taiwan mutual funds industry

The industry is judiciously split between onshore and offshore funds. The Taiwan FSC, the regulator of the industry, has made valiant efforts to encourage the development of a local asset management industry, while not stopping the growth in use of offshore funds. It has successfully balanced the ambitions of global fund managers with the need to increase the employment of local staff in all parts of the

fund management food chain. Its success in doing this could make an ideal role model for regulators elsewhere in Asia with high ambition to grow their domestic asset management industries.

In absolute terms, the market for mutual funds approximately exceeds that of both Hong Kong and Singapore. Over the last 10 years, the volume invested in funds has increased substantially, despite mixed market conditions. Forecasts for the next few years remain positive but challenging, and they're inevitably somewhat dependent on continuing to achieve positive returns.

Taiwan local funds and managers (SITEs)

Taiwan has a well developed local fund management industry that operates alongside offshore funds. Local managers offer funds that invest into the Taiwan stock, bond and money markets, and also funds that invest internationally. Money market funds have been a particular feature and have proved very popular with corporations and insurance companies as an alternative to provide daily liquidity and earning interest. This has been due to the loose New Taiwan dollar supply and some banks that refuse to take on large sums of deposits or offer lower deposit rates for amounts more than TWD3 million, leading investors to be attracted to higher rates and liquidity available via the funds.

In the last five years, local fund managers have also rapidly increased the number of ETFs offered. These have been popular with retail and insurance company investors, but for entirely different reasons.

While the local funds market is primarily used for domestic investing, its notable there are increasing numbers of global fund managers who also offer local fund choices in Taiwan. This can be expected to increase in the next few years, following FSC efforts to encourage the further development of a local fund management industry.

The Securities Investment Trust Enterprises or SITEs market is somewhat fragmented. There are many participants who have negligible

Figure 1. 10-year growth of Taiwan mutual funds market (US$bn)[7]

2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
85.0	132.7	140.3	127.4	146.5	157.2	168.0	160.5	162.6	196.5	187.3

market share, yet remain active. Some are relatively recent market entrants, but for others it can be assumed either that they believe there will be growth opportunities for their businesses or that they may be a candidate for acquisition by a foreign player wishing to get into the market.

ETF products and providers

ETFs have begun to capture a significant market share of assets. The AUM of listed ETFs has increased from TWD140 billion (USD4.5 billion) in 2013, to TWD723 billion (USD23 billion) in December 2018. The number of local providers of ETFs has increased from four to 13 over the last five years. The number of issued ETFs has also increased, from 19 to more than 130. There are no global or Asia-Pacific regional issuers of ETFs currently offering products in Taiwan. The popularity of ETFs has increased, however, as it has elsewhere in Asia, the use of ETFs by major fund distributors, such as banks and other financial services firms, has been limited, owing to a lack of commission rebates payable.

The Formosa Bond story

Formosa Bonds were first issued in 2006 but only became successful from 2014. These are foreign currency issues listed on the Taipei Exchange by non-domestic companies in Taiwan. In 2017, there were over 500 issuances of such bonds with an outstanding value worth over USD150 billion.[8] They represented an attractive investment for life insurance companies seeking to gain yield through foreign bonds. As these were listed/issued in Taiwan, they didn't count towards any restrictions that might have been imposed by the Insurance Bureau of the FSC on the proportion of assets insurance companies could invest outside Taiwan. Thus some of the local insurance companies invested as much as 50% or more of their assets in Formosa Bonds.

However, in 2017, the Insurance Bureau indicated it planned to scale back and, in November 2018, the Insurance Bureau amended the relevant regulations and included investments in Formosa Bonds into the calculation of foreign investment cap. As a result, a number of the leading insurance companies have sought to have ETFs created, listed in Taiwan and invested into foreign corporate bonds as an alternative to the Formosa Bonds. Taiwan-listed ETFs buying foreign corporate bonds are growing in excess of 30% per month with aggregate inflows of USD6 billion in their first year, and are forecast to generate USD40 billion in cumulative inflows before the end of 2020, at the current rate of growth.

Offshore funds in Taiwan

While having a well developed local fund management industry, AUM in offshore funds continues to have an upward trend and offers funds that invest mainly into global stock, bond, money markets and other alternative instruments. For much of the last five years, high-yield bond funds have been a particular feature that is very popular with retail investors. This has been due to the characteristic, which is less seen in the structure of local funds, of expected high return while maintaining a certain level of protection over the amount invested.

For most of the last 30 years, since offshore funds began being popular with local Taiwanese investors, there has been the occasional effort made to either restrict or prevent access to the market by offshore funds. Given their level of popularity, it's unlikely this would be able to succeed. Nevertheless, the Taiwan FSC announced its measures in 2013 aimed at slowing down the progress of obtaining a registration for new fund launches, so the rapid rate of growth of the numbers of funds did slow down. These measures, known as "The Deep Cultivation Plan" (the Plan), which we discuss below, serve to strongly encourage global fund managers to use their scale to build local businesses in Taiwan.

As at 31 December 2018, there were 1,035 (2013: 1,019) offshore funds registered for sale in Taiwan, from 69 (2013: 77) offshore fund managers (see overleaf). Dominant among these has been the UCITS products from Dublin and Luxembourg, which represent the vast majority of offshore funds approved for sale, although there are some US-domiciled mutual funds, too. The FSC has a clearly defined set of regulations applicable to the approval of offshore funds for sale in Taiwan, which has enabled UCITS products in particular to gain quick market access. The Deep Cultivation Plan has slowed down the influx of funds, especially from the same management group. This has led to marginally better opportunities for managers who might be new to the Taiwan market.

Figure 2. Taiwan offshore funds[9]

Number of managers	69
Number of funds	1,035
Fixed income	US$49,938m
Equity	US$36,089m
Balanced funds	US$16,381m
Money market	US$1,139m
ETFs	US$8m
Others	US$99m
AUM	US$103.7bn

Figure 3. Top 30 offshore fund managers in Taiwan (US$m)[10]

Rank	Fund	AUM	Rank	Fund	AUM	Rank	Fund	AUM
1	AB	21,154	11	UBS	1,827	21	Merian	471
2	Templeton	15,112	12	Neuberger Berman	1,679	22	Janus Henderson	461
3	Allianz	12,842	13	Baring	1,660	23	PineBridge	396
4	JPMorgan	10,463	14	Eastspring	1,274	24	MFS	313
5	BlackRock	7,612	15	Investec	1,236	25	Nomura	307
6	Fidelity	7,068	16	Aberdeen	1,081	26	T. Rowe Price	242
7	Amundi	5,104	17	Invesco	1,001	27	Legg Mason	233
8	Schroders	3,764	18	BNPP	791	28	Pictet	178
9	NN	2,845	19	Morgan Stanley	717	29	Vontobel	169
10	Pimco	2,068	20	HSBC	499	30	AXA	141

Hedge and alternatives funds

The FSC has generally restricted access by Taiwanese investors to hedge and alternatives funds sold on the island. Of course, many who have been able to establish overseas banking accounts with money held outside Taiwan may have had access via their private banking relationships. The Taiwanese regulators began allowing the development of offshore banking units (OBUs) by Taiwan banks, both local and global, from 2016/7. These are primarily aimed at high-net-worth individual (HNWI) investors, and through such accounts hedge and alternatives funds may be offered. Although this area hasn't gathered substantial assets to date, there are reports of this potentially being allowed to become onshore for the HNWI and professional investors, those defined as having over USD1 million to invest.

An evolving regulatory environment

The Deep Cultivation Plan

The Plan was introduced by the FSC in 2013 to encourage global fund managers who had a somewhat dominant presence in Taiwan to start building a local presence, with local staff managing local and global assets. In return for adhering to and delivering on a number of "local commitments", the FSC would then provide incentives, under a type of pick-and-mix approach.

The Plan is reviewed annually by the FSC to assess the results achieved under the three main categories. Subject to these, eligible fund managers may select which incentives meet their business requirements for the following year. In 2018, seven global fund managers achieved sufficient criteria under

the Plan to be eligible to select one incentive. Of these managers, four achieved four or more criteria and thus could choose two of the incentives.

Online distribution

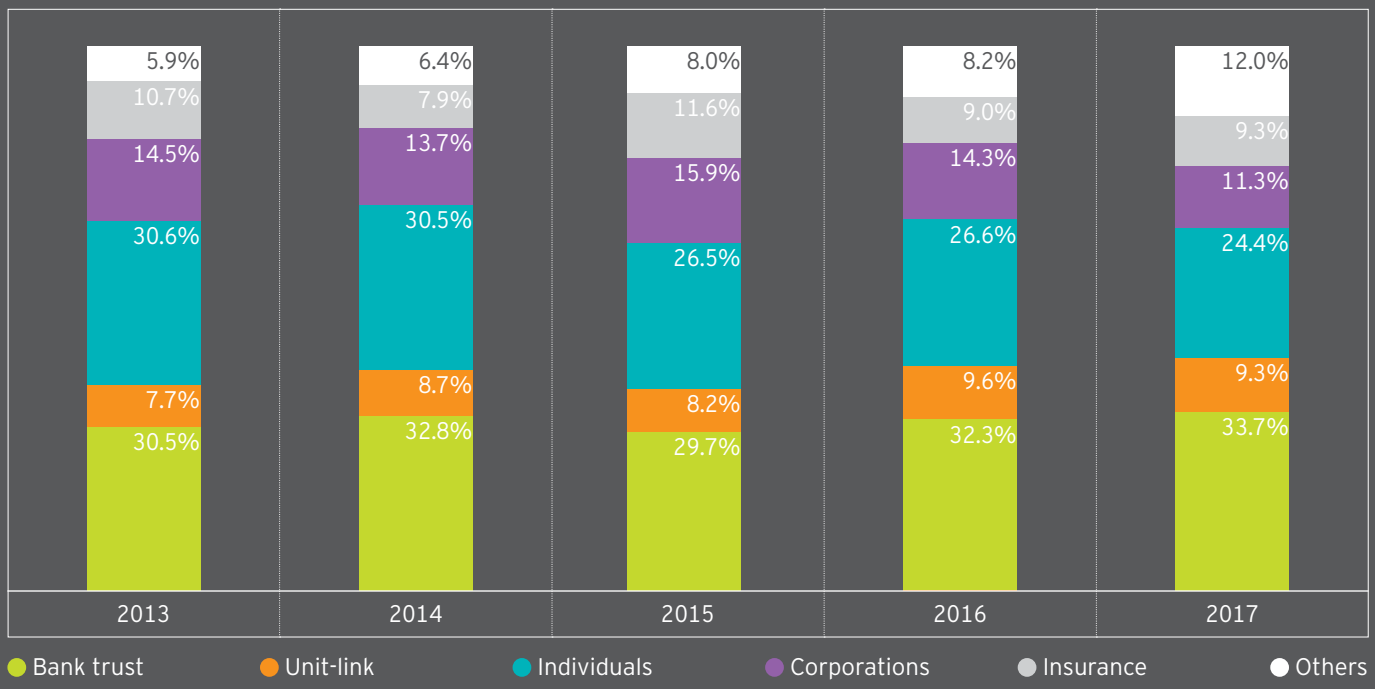
Online fund distribution in Taiwan hasn't yet taken off. While there remain some regulatory restrictions on what may be done, these have been reduced in recent years, with a view to making a greater choice available to local retail investors. Only a few online fund distributors have set up and are offering products via their service. One of these, FUNDRICH, is well supported by the TDCC and TPEx and has 34 fund managers as additional shareholders.

Distribution dynamics

How is the distribution of funds in Taiwan achieved?

Fund distributors and sub-distributors in Taiwan include local and global banks, SITEs, Securities Investment Consulting Enterprises (SICEs), securities companies, insurance companies and other financial advisers (see overleaf). Given the broad reach of branch networks across the island of Taiwan, banks represent a significant majority of the volume of funds sold. Most banks maintain restricted lists of managers and funds they're willing to distribute, often after undertaking due diligence and compliance checking, and ensuring the fund fits within their platform. Some of the local banks in Taiwan also have their proprietary range of funds, which may get priority when seeking shelf space.

Figure 4. Taiwan mutual fund sales percentage by distribution channel[11]



Insurance companies represent around 20% of fund sales when combining sales of funds and unit-linked insurance policies. They're taking a greater market share, as their sales forces increase in size and gain more confidence in using mutual fund products. Many sales are made in conjunction with investment-linked assurance schemes (ILAS), which continue to increase in popularity. Due to a slowdown in the ability to introduce new funds to the market, "hot" or "flavour-of-the-month" type of fund promotions, similar to IPO-type promotions, no longer occur.

Types of products allowed

A significant majority of the offshore funds sold in Taiwan are either Luxembourg or Dublin UCITS products. The FSC has accepted the UCITS regulations as being equivalent to its own and thus doesn't try to reinvent the wheel when reviewing these products for the Taiwan market. However, in the last five years, the FSC has become increasingly concerned that there's a proliferation of offshore fund products, and so it has sought to impose additional restrictions on those seeking to enter the market, both in terms of individual funds and the investments they make.

Figure 5. Top distributors of mutual funds[12]

Local banks	Insurance companies	Global/international banks
CTBC	Cathay Life	Citibank
E.Sun Commercial	Shin Kong Life	Standard Chartered
Cathay	Cardif Life	UBS
First	Fubon Life	HSBC
Bank of Taiwan	Allianz Life	BNPP
Fubon	Taiwan Life	ANZ
Mega International	China Life	DBS
Hua Nan	Mercuries Life	Deutsche
Taiwan cooperative	Chubb Life	
Taishin	PCA	

Furthermore, except where a fund manager qualifies under the Plan, it has slowed down the approval processes considerably, by restricting each Master Agent to a one-fund-at-a-time policy, thus Master Agents can't apply for multiple fund approvals, whether for a single fund house or for multiple fund houses, if they represent more than one. This has led to many offshore fund managers choosing to set up their own Master Agent businesses rather than rely on third-party firms. Reports from the market indicate the time frame over which approval is given for new funds has also been greatly extended, exceeding six to nine months in many instances, even where the new product might be an additional sub-fund of an existing umbrella vehicle.

Local funds are generally dealt with very promptly by the FSC. This is designed to help develop local fund companies. A few of the global fund managers with a local SITE licence have begun to build their local product ranges. Where they have, however, the FSC has rewarded them with a faster-track processing of offshore fund registrations.

Target date funds (TDFs)

One of the most recent developments in Taiwan has been the introduction of TDFs to the market. The first of these appeared in 2016, and by late 2018, there had been 30+ similar funds launched, raising around USD3.8 billion.

TDFs are designed to provide relatively lower risks (than other traditional mutual funds) by using a dynamic asset-allocation process, across the usual asset classes of equities, bonds, fixed income and money market investments, with the objective of maximising investment returns over selected time periods, which could be between five and 30 years. Generally TDFs will invest directly into securities markets. However, there are many these days that also manage assets using a range of index funds or ETFs. These have been popular with investors who perceive they provide lower costs.

In Taiwan, the majority of TDFs have been set up for three- to six-year time periods, with a high proportion invested into emerging-market fixed-income bonds, to achieve higher levels of income. Both local and global fund managers offer these products in Taiwan.

Master Agents

Taiwan's Regulations Governing Offshore Funds require offshore fund managers to appoint a single onshore Master Agent. The regulations require such Master Agents and sales organisations to provide prospective investors into offshore funds with copies of a prospectus and investor information factsheets. SICEs as well as Securities Investment Trust Enterprises (SITEs) and other organisations are able to act as Master Agents for offshore fund management companies. Authorising a qualified domestic Master Agent, responsible for all business plans and executions within Taiwan, is essential for all offshore fund managers.

Over the last 10 years, many global fund managers established their own SITE businesses. However, care needs to be taken on whether this will prove to be the best route in building a fund management distribution business in Taiwan, especially for smaller, less committed organisations.

During 2017and 2018, a number of foreign-owned SITEs changed ownership. Often this has been a result of scale issues, the existing owner maybe failing to achieve economic size, selling to a new foreign owner perhaps with greater resources, wishing to enter the Taiwan market. This certainly provides a fast-track route to getting established, but often this doesn't resolve the issue of scale, not without a strong line-up of funds to support the business.

Greater China opportunities

Taiwan is anxious to be seen as a major business partner for China. It already has one of the largest inward investments to that market – manufacturing. It's said there are more than two million Taiwanese people now working and/or living in China, involved in many different businesses. The past political differences remain, but both sides are seen to want to work together.

It's understood that the FSC adopts a "China-is-for-Taiwan" policy as far as the asset management industry's concerned. This, in effect, means that only Taiwan-owned fund managers can offer 100% China-invested funds to Taiwanese investors, and they'll need to do so via domestic funds. Foreign fund managers wishing to use their China expertise are restricted, and need to qualify under The Deep Cultivation Plan to gain allowance to increase the proportion that China represents in any fund offered in Taiwan. In January 2019, the FSC announced an increase from 10% to 20% in the maximum normal proportion an offshore fund may invest into Mainland China securities.

Pension reform can fuel the growth of local SITEs

The retirement system in Taiwan is still developing. Despite it being one of the first in Asia to achieve nearly 100% coverage for all citizens, the terms were relatively modest. Many plans remain underfunded. Due to widespread concerns about inadequate retirement savings, many Taiwanese are active in creating their own pool of accumulated savings, usually via mutual funds.

There continue to be further developments to encourage a greater number of individual pension plans, which could include greater use of defined contribution schemes. Of these, "Member Choice Pensions" is most likely to succeed and has the support of the government to proceed. The initial intention of this is to offer products with multiple fund options, offering a wide choice of stock markets into which they may be allowed to invest and include use of TDFs designed for the retirement market.

Institutional fund management

There are five major "national" pension schemes – Labor Pension Fund (Old), Labor Pension Fund (New – 2005), Public Service Pension Fund, Labor Insurance Fund and National Pension Insurance Fund – each of which outsources part of its assets to international fund managers (see figure 6).

It's estimated that up to 50% of the AUM of these pension funds has been allocated to global or overseas securities, with a high proportion as third-party mandates with foreign fund managers, investing into equities, global bonds and fixed income, hedge funds, absolute-return funds and other alternatives funds. Recently some allocation has occurred to ESG and private equity mandates, too.

Challenges, opportunities and rewards for fund managers

Taiwan's mutual funds market provides a wide range of opportunities for fund managers willing and able to enter the market. As it's significantly larger than either Hong Kong or Singapore, and as it continues to provide an

Figure 6. AUM of five Taiwan pension funds[13]

	AUM (NT$bn)	AUM (US$bn)
Labor Pension Fund – New	2173.1	72.4
Labor Pension Fund – Old	928	30.9
Labor Insurance Fund	701.8	23.4
Public Service Pension Fund	561.1	18.7
National Pension Insurance Fund	313.6	10.5
Total	4,678	156

open-door policy for the entry of offshore funds, global fund managers seeking to expand into the Asian region should carefully consider how best they can participate.

As stated earlier, Taiwan has in the past adopted a cloak of mystery about its mutual funds business, but this has changed. Furthermore, Taiwan has a prime position in the line-up for participation in the (Mainland) China fund management business, not just because of its geographic proximity, but also because of the common language and familiarity it shares with many of the cultural and attitudinal issues that are prevalent.

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[1] "Hong Kong-Taipei, World's Busiest Airline Route 3 Years in a Row, Why?" at https://english.cw.com.tw. Link Here.

[2] "Taiwan Passengers Up 8.8% in 2017: China Airlines Remains Largest Carrier; Japan Is Top International Market" at www.anna.aero. Link Here.

[3] SITCA, December 2018. Note USD1 = TWD30.7.

[4] TWSE/Yuanta, December 2018.

[5] National Statistics, R.O.C. (Taiwan).

[6] IMF, 2017 figures.

[7] SITCA/Keystone Intelligence, December 2018 (figures exclude institutional mandates).

[8] Dealogic data, December 2018.

[9] SITCA/Keystone Intelligence, December 2018.

[10] SITCA/Keystone Intelligence, December 2018.

[11] SITCA/Keystone Intelligence, December 2018.

[12] Citi, Keystone Intelligence and Other Market Reports, December 2018.

[13] Government Service Pension Fund, Bureau of Labor Fund (USD1 = TWD30), 31 October 2018.

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