

Research of TDCC' s Cross-Border Delivery Custodial Business on the Basis of Shanghai-Hong Kong Stock Connect Cross-Border Delivery Model

Abstract

I. Content

Due to globalized economic development, capital market is developing toward internationalization. Cooperation among exchanges and clearing houses can facilitate convenience of cross-border investment and lower risks and complexity of cross-border trade; besides, it can also stimulate market development. Shanghai-Hong Kong Stock Connect, launched in November 2014, has become the successful model of cooperation and cross-border connection among exchanges, clearing houses, and custodian agents of the two markets. The new cross-border connection has a positive effect on internationalization of Mainland China and Hong Kong capital markets. International capital is attracted and companies are listed, which allows international capital to be invested in Shanghai Stock and the capital market to open gradually to facilitate businesses for listing. In addition, the flow of two sides' capitals speeds up, and funds from Mainland China can be invested in Hong Kong stocks through this way; therefore, capital flow in Mainland China and Hong Kong will be more liberated. Besides, risks of cross-border delivery will be reduced. Through the connection between custodian agents of the two places, settlement and delivery risks of both sides are separated, and costs of securities firms conducting direct cross-border trade are decreased.

To improve internationalization of Taiwan's capital market and assist securities firms in entering international financial market, this research investigates practical trade and back-office operation mode of each cross-border trade and discusses services that TDCC can offer. The focuses are as follows:

1. Collecting data regarding trade, delivery, stock affairs, and legal framework of northbound and southbound trade of Shanghai-Hong Kong Stock Connect and analyzing factors in its success.
2. Investigating and collecting data on channels and relevant operations of foreigners' investments in Taiwanese stocks (inbound) as well as natural persons' and legal persons' investments in offshore securities (outbound). Analyzing different conditions and feasible approaches to cross-border market investments.
3. Through the discussion on development of TDCC's cross-border and delivery payment services, a feasible framework for interconnection among exchanges, clearing houses, and custodian agents can be created in response to changes in multi-market connection. Based on each current cross-border operation and TDCC's core business, TDCC's measures for cross-border trade can be developed as reference for future planning.

II. Conclusion and Recommendation

After researching Shanghai-Hong Kong Stock Connect's cross-border delivery and examining domestic cross-border investment operation, TDCC's focus and plan for future cross-border trade delivery and custody are as follows:

1. The focus is on indirect connection and should respond to market and comply with government policy in assisting custody and account management of cross-border investment.

Shanghai-Hong Kong Stock Connect is the milestone of recent global market connection development, and the markets of the two sides adopt direct connection. However, this success is an exception. A successful direct connection lies in the parity of two market scales, level of requirements, and market connection design such as parallel framework and average division of income. Therefore, the two markets need to secure comprehensive infrastructure for direct connection. When seeking potential market for direct connection, TDCC can take Shanghai-Hong Kong Stock Connect as reference and take into serious consideration the two markets' infrastructure and preferable conditions. In this way, direct connection can be confirmed as a feasible option in two sides' markets.

As a back-office corporation of Taiwan's capital market, TDCC is obligated to comply with government policies and fulfill market demands; the company shall provide custody and account management for international investment. TDCC's current cross-border business is conducted through global custodian agents (including custodian banks and ICSDs) and the basis of indirect connection has been built. TDCC adopts the same mode of indirect connection as Korea's KSD sub-brokerage business, ASEAN Trading Link, and SGX-ASX co-trading link built by Singapore Exchange and Australian Securities Exchange. The above models show that as each market is aggressively expanding connections, indirect connection is usually the major operation model in use. Therefore, TDCC will take indirect connection as core development.

2. Prepare for direct connection for suitable markets.

As a market that is more suitable for direct connection emerges, account management regarding custody and stock affairs derived from custody should also be prepared as supporting mechanism. The preparation can be divided into two parts as below:

(1) Account setting and management

From Shanghai-Hong Kong Stock Connect, we know that regardless of the original market framework, setting an omnibus account under the name of the custodian agency can reduce the difficulties result from differences in both parties' account management. As TDCC works as the trustee, the company needs to gain more understanding of the counterpart's account framework, regulations, and account management operation so as to maintain the protection of Taiwanese investors' rights.

In addition, within the custodian framework and under the name of custodian agency, TDCC needs to keep track of the other market's asset security management and handle front-office trade connection and non-trade account transfer so as to provide comprehensive back-office account registration and protect rights of substantial investors whose names are under omnibus account.

(2) Stock affairs handling

Stock affairs handling can be prepared in two aspects: stock information and stock affairs operation. As Shanghai-Hong Kong Stock Connect demonstrates, stock information is provided by the other party's custodian agency or exchange, so TDCC can conduct research on technology for transmitting files format of stock information and database construction. In addition, in terms of stock affairs operation, TDCC also needs to understand the market's stock events and operation so as to design supporting mechanism for immediate management.

To sum up, TDCC can take advantage of current and future opportunities of communication with other custodian agencies and categorize markets, set phases and priorities. The company should also study each market connection's custodian account setting and stock affairs (events), analyze the acquisition, curation, and provision of stock information so that it can provide efficient back-office custodial services in case of future direct connection to any market.

3. Actively expand cross-border custodial business, providing domestic professional investment institutions with secure and efficient custodial services.

Cross-border connection services should not only be carried out in response to market demand but also create an opportunity to build connection for relevant back-office services such as custody. Since 2002, TDCC has created connections with international clearing and custodian agencies Euroclear and Clearstream. From 2017, international bond business has been conducted through the cooperation, and experience on international custody of securities has been accumulated. In compliance with financial import substitution policy, TDCC has expanded the custodial services since August 2015. The company has also taken Regulations Governing Foreign Investments by Insurance Companies as reference and has added foreign investment subjects to the range of custody.

At the moment, TDCC's cross-border custodial services include: fixed-income securities custody, DVP data transmission, delivery money receipt/payment, delivery and account statement provision, corporate action (shareholder service), tax preference and tax return application. Other services such as valuation for assets, securities lending, and currency exchange can be offered to meet the demands of professional investment institutions such as insurance companies. To provide comprehensive services for domestic professional investment intuitions, TDCC has also actively developed equity securities services. Services for developed markets such as the USA, the UK, Hong Kong and Japan will come first and emerging markets

with higher demands will follow. As for clients, in addition to insurance industry, the services have also reached securities firms, banks, and custodian banks dealing with domestic investment and trust companies' international funds.

Stock affairs operation is also one of the crucial items of cross-border custodial business, and processing issues involving equity securities services is far more dynamic and complex than those involving fixed income securities. Therefore, stock affairs issues in each market, operation mode, and investors' execution of rights should be included in TDCC's market service. The company will continue to construct stock affairs modularity and create a more comprehensive and automated stock affair handling procedure.

4. Expand cross-border custodial business, researching and planning asset management services such as securities lending and collateral management

Services provided by global custodian agencies include asset custody, collateral management services from derivatives, and securities lending. Due to regulation amendments in European countries, trading of derivatives need to come with collaterals, so investors have to be compliant when trading cross-border derivatives. When buying or selling cross-border securities, if professional investment institutions hold securities as source of securities lending or employ collateral management mechanism for derivatives trading, the flexibility of the investment and opportunity of returns can be increased. As the custodial services provider, TDCC will estimate market demands and expansion of cross-border custodial business; it will also study the feasibility of asset management services including securities lending and collateral management.

All in all, TDCC's book-entry mechanism has provided securities market with complete securities delivery services and payment/receipt mechanism for some financial instruments. As for international investment services, TDCC will continue to focus on custody of foreign securities and stock affairs services for the subjects of custody. The company will also strive to expand services for securities lending and collateral management. When Taiwan's market is still looking for a suitable market for connection, Shanghai-Hong Kong Stock Connect can serve as a reference for another way of connection. However, more importantly, TDCC will meet the demand for international services with a positive attitude and apply the company's experiences and knowledge on each kind of connection to provide the most secure, efficient, and comprehensive cross-border custodial services.