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Modernization of the financial sector

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As Taiwan heads into an election year in 2008 and beyond, market observers may look back at the last 12 months as an important watershed period for the modernization of Taiwan's financial sector. There is abundant and growing interest from foreign investors, particularly private-equity investors, and mergers and acquisitions, together with other domestic and cross-border deal-making, are at an all time high.

The important developments which have occurred in Taiwan, however, are built on important changes and attitudes which have been introduced since the formation of the Financial Supervisory Commission, and further shaped by the regulators' reactions to the opportunities in the market which such changes have opened. This article will focus on the principal factors which have affected the record-breaking deal-making in Taiwan.

The second financial reform

Taiwanese banks over the years have been plagued by over-competition. This has encouraged, on the one hand, price-cutting – which has resulted in poor service and internal controls – and, on the other, risk-taking and unsound credit policies.

In 2004, President Chen Shui Bien initiated the second financial reform programme, a centrepiece of which is the reduction of the total number of financial holding companies and banks in Taiwan. In the first financial reform programme, the government aimed to reduce non-performing loans in the market and, as that first phase came to a successful close, the government aimed to improve the services and health of local commercial banks by encouraging consolidation. In the same

year, the Financial Supervisory Commission (FSC) was established as the central regulator of banks, insurance companies, securities firms and the capital markets in general. The establishment of the FSC ushered in numerous regulatory changes and, perhaps more importantly, a willingness to facilitate deal-making in the interest of furthering the consolidation of the banking sector.

Although the second financial reform programme and the FSC were roughly modelled after the experience of South Korea, the inherent factors for banking in South Korea were not present in Taiwan since Taiwanese banks, while in general not healthy, were not as distressed as their Korean counterparts were during the Korean crisis. Therefore, to encourage deal-making, the first term commissioners of the FSC had to rely largely on regulatory changes and more dialogue with the market.

There were at least three very important sets of changes initiated by the first-term commissioners of the FSC, the effects of which are being seen quite clearly in the markets today: (i) encouragement of dialogue between market participants and regulators and growing experience in deal-making; (ii) gradual relaxation of investment and financing restrictions to allow more sophisticated financing structures; and (iii) more emphasis on enforcement and monitoring of corporate governance and insider trading.

A buoyant deal-making environment

The willingness of the FSC to interface with market participants culminated in the ground-breaking takeover by Standard Chartered Bank of Hsinchu International Bank. This was the first ever takeover by a foreign institution of a Taiwanese bank, and Standard Chartered leaptfrogged many of its competitors with the deal.

The takeover served as a catalyst in many respects. Firstly, the premium paid by Standard Chartered Bank was a jolt to the market and provided further evidence that listed companies in Taiwan were being undervalued compared with other jurisdictions. At the time of the

announcement of the takeover just nine months before the time of writing, the Taiwan Stock Exchange composite index was less than 7000, and the index has gained almost 40% since (not coincidentally, the composite index figure at the announcement date of the takeover is still the nine-month low).

Secondly, the takeover employed numerous legal and deal-making techniques which had been previously dismissed as too complex and innovative, but when the techniques were successfully executed, other firms began to follow suit.

Thirdly, the takeover was not only the most successful M&A in Taiwan, it also resulted in the delisting of Hsinchu International Bank. The delisting, which required the approval of the Taiwan Stock Exchange, was a signal to deal-makers that the exchange and the FSC are both open to going-private transactions.

Following the Standard Chartered deal, numerous takeovers were initiated, most of which were successful. Additional deals have been approved since then which represent further developments in terms of deal-making sophistication, including the first foreign-led leveraged buyouts of Taiwan listed companies. Overall, the execution risk for undertaking significant mergers and acquisitions activities has been greatly decreased because of the growing experience from these transactions.

Growing financial sophistication

In addition to the growing list of successful large-scale M&A transactions, the FSC has continued to enable better deal financing structures which help both the local economy and foreign investors. For example, since November 15 2006, foreign nationals and overseas Chinese investing in Taiwanese securities are allowed to borrow new Taiwanese dollar (NTD) loans from domestic financial institutions.

This new provision is an exemption from the restrictions of Article 21, subparagraph 3 of the Regulation Governing Investment in Securities by Overseas Chinese and Foreign Nationals which would otherwise prohibit extending loans

or providing collateral. Since the interest rate on NTD is low compared to the region and the government is wary of additional weakening of the currency due to the increased inflow of US dollars, enabling more borrowing of NTD for acquisition purposes seems to be a win-win situation.

Such loans have been utilized in the most recent takeover deals which represent the first leveraged buyouts in Taiwan. These M&A activities, in turn, have served to educate and provide valuable know-how for domestic banks on structuring sophisticated term loans. So far, NTD loans are not open to use for working capital and refinancing purposes – further regulatory changes in this area could set off a banking boom in Taiwan.

Corporate governance and enforcement

Another welcome development is the increasing attention on corporate governance and enforcement introduced by the first-term commissioners of the FSC. The effects of such attention are now beginning to show.

In terms of corporate governance, the requirement for listed companies to have independent directors on their boards took effect this year, and this development, together with the increased M&A activity, has resulted in growing shareholder activism in Taiwan. In addition, the regulators have increased their focus on conflicts of interests and in many cases have required public disclosure of board abstentions due to such conflicts during significant board approvals (for example, with respect to an approval or recommendation of a takeover offer).

Finally, regulators have been especially active in pursuing insider trading cases. These developments should be welcomed by all investors as they will improve investor confidence and further upgrade Taiwan's stock markets and financial sector.

Capital markets

Recommended firms

Tier 1

Baker & McKenzie
Lee and Li

Tier 2

Jones Day
LCS & Partners
Russin & Vecchi
Tsar & Tsai

Tier 3

Chen & Lin
K&L Gates
Lexcel Partners

Banking and project finance

Recommended firms

Tier 1

Baker & McKenzie
Lee and Li
Russin & Vecchi
Tsar & Tsai

Tier 2

Jones Day
LCS & Partners

Tier 3

Formosa Transnational
K&L Gates
Liang & Associates
Yangming Partners

Mergers and acquisitions

Recommended firms

Tier 1

Baker & McKenzie
Jones Day
Lee and Li

Tier 2

LCS & Partners
Lexcel Partners
Tsar & Tsai

Tier 3

Chen & Lin
Formosa Transnational
K&L Gates
Russin & Vecchi
Yangming Partners

Restructuring and insolvency

Recommended firms

Tier 1

Baker & McKenzie
Lee and Li
Tsar & Tsai

Tier 2

Formosa Transnational
Formosan Brothers
Jones Day
Russin & Vecchi

Tier 3

Huang & Partners
K&L Gates
LCS & Partners
Liang & Associates
Yangming Partners

The government's drive to tackle overbanking and restructure the financial institutions sector in Taiwan to raise competitiveness interna-

tionally has prompted M&A activity in the last year. October 2006 saw Standard Chartered acquire majority ownership of Hsinchu International Bank in a landmark deal which will see the first ever subsidiary set up by a foreign bank in Taiwan, and Standard Chartered's number of branches rocket from three to 86. Citibank then announced in April 2007 that it is to acquire 100% of Overseas Chinese Bank in a cash-out merger which is expected to close in the second half of 2007. And other foreign banks are now expressing interest in the domestic market, attracted by the opportunity to expand further in the region.

Low interest rates and asset values have also drawn private-equity funds to the island, where they have been targeting listed companies with mixed success. The acquisitions of the top three cable television companies by MBK, Carlyle and Macquarie drew a positive reaction from the authorities. But in April 2007, Carlyle withdrew its offer to take over ASE, the world's largest integrated circuit assembling and testing company, officially citing pricing issues. The aborted deal has led some to speculate that regulatory issues and government reluctance to allow leading Taiwanese companies to de-list may be a hurdle to future private-equity investment, and future negotiations between funds and their targets will be closely observed.

Baker & McKenzie

Baker & McKenzie's Taipei office is ranked in the top tier across the practice areas for another year, thanks to an impressive deal portfolio and wealth in talent which includes Justin Liang in banking and finance and Michael Wong in M&A.

The firm's banking department is a favourite among local lenders and one highlight here saw Liang lead a team advising Taipei Fubon as the agent of a NT\$961 million (\$29.1 million) loan facility for a consortium of borrowers belonging to the Carlyle Group to finance the acquisition of Eastern Multimedia. The Bank of Taiwan has also retained the firm on two key matters, the first involving a NT\$1.8 billion loan facility to finance the borrower's new computer monitor manufacturing line, the most heavily leveraged Taiwanese transaction of the past year. The firm then guided its client through the arrangement of NT\$292 million of facilities for the construction and operation of an independent power plant, the only deal of its type last year.

At the time of writing the firm's M&A department was advising on a number of complex deals, including the restructuring of 10 local entities owned by Illinois Tool Works,

which involves the firm providing highly localized advice. Dolomatrix International has also retained the firm as counsel in connection with the establishment of a local subsidiary which will act as a vehicle for the acquisition of a waste disposal plant. Another mandate came from Lite On IT with regard to its acquisition of Philips's car radio division for €30 million.

Leading lawyers

Lindy Chern
Justin Liang
Michael Wong

Jones Day

Partner-in-charge Jack Huang heads up the firm's M&A department, which has seen a share of the private-equity interest in the Taiwanese cable industry by representing New Bridge in the CNS cable TV deal until MBK outbid the rest. Up-and-coming Tommy Chen worked on the firm's other notable deals, including representing Uniwill Computer Corporation on its merger via a share swap with Elitegroup Computer Systems, a deal valued at more than NT\$4 billion. Chen also led the team acting for Webs-TV, a Taiwanese online television service, in its 100% acquisition of Blockbuster BEI Taiwan along with 89 stores and 39 franchise locations. Both deals closed in December 2006.

For banking and debt matters, partner William Bryson is the firm's best-known talent. Recent highlights here include a NT\$5.7 billion syndicated loan facility for CLSA provided by Taishin Bank as acquisition financing for real-estate investment, with the first draw-down expected in July 2007. The banking department has also advised Shinsei Bank on the acquisition of non-performing loans from Jih Sun Bank worth NT\$1.3 billion.

Leading lawyers

William Bryson
Jack Huang

LCS & Partners

LCS & Partners has gone from strength to strength in the last year and its practice has expanded further with the addition of eight new associates. The firm receives a promotion into the top tier this year for M&A where it has made a name for itself by scoring a role on Standard Chartered Bank's precedent-setting acquisition of Hsinchu International Bank. Victor Chang led a team acting as primary deal counsel to Standard Chartered in its tender offer for Hsinchu of \$1.2 billion and at the time of closing the bank had obtained

95.4% of Hsinchu. Another deal that has hit headlines is Oaktree Capital Management's tender offer for Fu Sheng Industrial Co, a producer of golf clubs. Head of department Rich Lin and partner David Chuang represented Fu Sheng on the takeover bid, which was worth \$851 million and was completed on June 27 2007, with Oaktree acquiring more than 80% of Fu Sheng's outstanding shares.

The market recognizes the firm's securitization and structured finance department as being one of the best in the country with department head David Chuang known among rivals as "the king of Reits". One client praised Chuang for his "creativity in coming up with the right solution for us". The whole team was commended for being very efficient and responsive. Standout deals include acting for the Industrial Bank of Taiwan as arranger on the Gallop No 1 Real Estate Investment Trust (Reit) and ABN Amro, also as arranger, on the Land Bank of Taiwan's asset-backed commercial paper project, which was valued at NT\$14.8 billion.

Rivals in the market note the firm's head of banking, Mark Harty, as a prominent practitioner. The firm saw activity in this area with Pijan Wu advising both Taishin International Bank and Bowa Commercial Bank on the disposal of non-performing loans. In debt capital markets, the firm represented JS Cresvale as lead manager on Wonten Technology's issue of credit-enhanced convertible bonds worth \$30 million. Department heads Brian Yu and Amy Chin are well known in the market – Chin previously held a position as commissioner of the Financial Supervisory Commission.

Leading lawyers

Amy Chin
David Chuang
Rich Lin

Lee and Li

The Taiwanese powerhouse Lee and Li deservedly retains its top-tier ranking across the practice areas again following another outstanding year which saw the firm again win *IFLR's* national law firm award.

The firm has a reputation as a pioneer in M&A, clearly backed by the quality and size of the deals. One standout deal involved the firm acting as local counsel to Carlyle on its acquisition of Eastern Multimedia Corp, a deal worth \$1.3 billion which hit headlines globally. The firm also scored a role on Standard Chartered Bank's acquisition of Hsinchu International Bank with leading lawyer Lilian Kou leading the team that advised HIB. Clients are particularly impressed with the firm's depth of experience

compared to competitors and also single out Kou for her "professionalism, enthusiasm, thoroughness and sincerity". The first quarter of 2007 then saw the firm busy on deals in the hi-tech sector, acting for Fairchild Semiconductor International in its tender offer of \$200 million for Taiwanese listed company System General in February, and then representing Taiwan Green Point Enterprises in its acquisition by Jabil Circuit in April.

The firm prides itself on its involvement in innovative first-of-a-kind deals and the past year has been no different. In October 2006 the capital markets department advised Deutsche Bank on Taiwan's first-ever foreign-currency denominated issuance of corporate bonds. The transaction was worth \$250 million and entailed negotiations with the Financial Supervisory Commission to amend its rules covering such issuances. On the equity side the firm acted as local counsel for ProMOS Technologies in its \$333 million offering of global depository receipts in July 2006 which had already been postponed once due to the company's share price fluctuations and was two times oversubscribed. September 2006 also saw the year's largest American depository receipt offering by a Taiwanese company, in which the firm advised Goldman Sachs as the joint bookrunner.

Lee and Li boasts one of the nation's leading securitization departments. The group is led by Abe Sung, who advised Hsinchu International Bank as the originator on the issue of €240 million residential mortgage-backed securities, due 2028. The firm also represented another key client Citigroup Global Market as the arranger and underwriter on an asset-backed securities programme, structured into two tiers, offshore and onshore. The transaction was also Taiwan's first cross-border securitization involving collateralized loan obligations and the first to allow the local issuance of a US dollar-denominated certificate.

Leading lawyers

CT Chang
Lilian Kou
Abe Sung

Lexcel Partners

This corporate boutique has built further on its excellent reputation in the market, focusing on M&A and financial services. Partner Echo Yeh is the firm's best-known personality and leading lawyer.

Despite its smaller size when compared with rivals, Lexcel Partners has taken a significant proportion of M&A work in the financial services sector, identified by many as a key

trend in the market. The second half of 2006 saw the firm act for ING Insurance International in its acquisition of ABN Amro Asset Management (Taiwan). Most significant though was the firm's involvement in Citibank's acquisition of Bank of Overseas Chinese, a high-profile deal that hit headlines worldwide and was worth \$427 million.

In the financial services sector the firm is involved in compliance and due diligence proceedings for clients such as Citibank, Fidelity, Merrill Lynch, Lehman Brothers and UBS. In the past year the same department has also been advising on a spin-off of Citibank Global Market and the establishment of a subsidiary bank, also by Citibank.

Leading lawyers

Echo Yeh

Russin & Vecchi

Russin & Vecchi enjoys an excellent reputation both among other firms in the market and among clients for its banking practice in particular, which is headed by leading lawyer Thomas McGowan. One client said: "Thomas McGowan really knows the market and Taiwan but his biggest advantage is that he really understands how investment banks work. He's able to deliver a clear message in a very efficient way and so we are always able to keep our senior managers up to date".

For the most complex banking transactions both in the country and with a cross-border element the firm is a natural choice, having advised on all of the key private-equity buyouts in the country. Most recently the firm acted for the local lenders on MBK Partners' acquisition of CNS for \$1.5 billion. The firm has also seen roles on the country's key securitizations acting for Deutsche Bank (Taipei) as trustee on Hsinchu International Bank's issuance of €240 million of guaranteed secured floating-rate notes, and Citibank's master trust securitization program, worth \$1 billion. Following overwhelming market feedback the firm also moves up the second tier for capital markets work this year.

Leading lawyers

Thomas McGowan

Tsar & Tsai

Tsar & Tsai is a highly respected firm in the Taiwan legal market, with particular praise going to leading lawyers CY Huang and Jackie Lin. The past year has seen the firm further consolidate its reputation by acting on a number of high-profile transactions, one highlight being its role as counsel to MBK Partners in

connection with the financing aspects and acquisition of China Network Systems, a cable television provider. The firm also represented Jabil Circuit in a similar capacity with regard to its tender offer and merger with Green Point Enterprise. Sunrider Group also retained the firm to advise on a syndicated loan to finance its acquisition of Asiaworld Hotel, and a final highlight involved advising the lenders on the financing for the Taiwanese component of a multi-jurisdictional acquisition and restructuring of Hanjin Shipping's marine terminal business. The firm also advised Macquarie and Hanjin Shipping on the transaction, which involved the establishment of a joint venture between the two companies.

At the start of 2007, the firm's capital markets team received a boost with Richard Chuang rejoining the firm from Yangming Partners. On the debt side the firm counts issuers such as Winstron and Winbond as clients on the issuer side and has represented Goldman Sachs as underwriter.

Leading lawyers

CY Huang

Jackie Lin