

T+2 DVP Q&A

說明書

Taiwan Securities Association

Trust Association of R.O.C.

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Background

Current Practice

At present, the exchange-traded securities settlement cycle in Taiwan is two-staged, i.e. investors settle with brokers on T+1; and brokers settle with Taiwan Stock Exchange / Gre Tai Securities Market (the “Exchanges”) on T+2.

Taiwan Depository and Clearing Corp. (TDCC) is responsible for clearing and safekeeping of exchange-traded securities. The Exchanges maintains a special account with the Central Bank for TWD settlement. As you can see, TWD and securities are settled / cleared separately.

For sell trades, selling brokers, upon receipt securities from sellers, will move securities to TDCC on T+1. TWD payment for buy trades, however, as market practice has evolved, does not move to brokers’ account until T+2.

To further elaborate, before brokers settle the TWD with the Exchanges on T+2, TDCC had moved securities from selling brokers to buyers’ account at the Beginning of Day (BOD) on T+2.

Under the current practice, settlement risks are in the following areas:

- (1) There is an overnight exposure from seller’s perspective: The seller delivers sold securities on T+1 but receives selling proceeds on T+2; and
- (2) There is an intra day exposure from the Exchanges’ perspective: The bought securities are delivered to the buyer directly by TDCC at BOD on T+2 before the buyer pays TWD to the buying broker at 10:00 AM on T+2.

The New T+2 DVP Settlement Cycle

The new T+2 DVP settlement flow the Exchanges are to implement aims to mitigate the above cited risks with further elaboration that it is the broker’s responsibility to complete market settlement with the Exchanges.

- (1) Change the settlement of securities from T+1 12:00pm to T+2 10:00am
- (2) Change the processing of purchased securities into two steps:
 - Step 1: TDCC moves securities to buying brokers upon the Exchanges’ confirmation of TWD receipt from buying brokers.
 - Step 2: The broker moves securities to the buyer’s account after broker has settled with the market.

Frequently Asked Questions & Answers On T+2 DVP

Part A: Fundamental Questions:

1. What is the effective day of this T+2 DVP settlement?

This T+2 DVP settlement is scheduled to be effective from the trades on February 2, 2009. All trades prior this date are subject to existing settlement cycle.

Please be noted that:

- January 26 – 30, 2009 are Chinese New Year Holidays. There'll be neither trades nor settlement during this Holiday period.
- The last trade day prior this Holiday period is January 21, 2009. On January 22 & 23, Taiwan market will be open **only for** the settlement process of the January 21 Trades.

2. What is the cut-off time for an investor to deliver TWD and/or securities to its broker on T+2?

An investor should deliver the securities/TWD to its broker by 10:00 AM on T+2.

3. What is the cut-off time for brokers to settle with the Exchanges?

Brokers are required to settle the securities with the Exchanges by 10:00 AM and TWD by 11:00 AM on T+2.

4. When can I expect to receive my TWD and securities from my brokers?

An investor can expect to receive the TWD/Securities from its brokers after 11:00 AM on T+2 once he has fulfilled its delivery obligation stated in Q1.

Please be noted that: This is subject to the lead time required by TDCC and the Exchanges to make the TWD/securities transfer to brokers.

5. What my broker will do if I fail my delivery obligation (in part or full) indicated in Q2 above?

Per regulations, the broker has to settle your trades with the market on T+2 while you failed the delivery obligation; and

By 10:00 AM on T+2, your broker will have to decide if he wants to report your trades as "error trade".

After 10:00 AM and by 11:00 AM on T+2, your broker can only report your trades as either “fail trade” or “trade default”.

Whether to report your trades as “error trade” “fail trade” or “trade default” is at your broker’s discretion.

It is therefore very important for you to communicate with your broker on the action to be taken once you found that you may miss the cut-off time to fulfill your delivery obligation indicated in Q2 above.

6. What will be the respective consequences to my broker if he reports my T day trades as “error trade”, “fail trade” or “trade default”?

- (i) to report error trade:
 - (a) If the error is found before the market close on T day, your broker can report and unwind your trades immediately. Trading cost and possible loss in associate with this unwinding could happen to your broker.
 - (b) If the error is found after the market close on T day, then your broker has to settle your T day trades on T+2 and unwind those trades on T+1 or T+2. Trading cost, possible loss in associate with this unwinding plus either TWD financing cost and/or securities borrowing cost (for T+2 settlement) could happen to your broker.
- (ii) to report fail trade: Your broker has to settle your T day trades with the Exchanges on T+2 and report to the Exchanges for delaying your settlement to T+3. Then, either TWD financing cost and/or securities borrowing cost for 1 day (between T+2 and T+3) could happen to your broker.
- (iii) to report trade default:
 - (a) Your broker has to settle your T day trades on T+2 and unwind same trades on the day he reports to the Exchanges. Then, either TWD financing cost and/or securities borrowing cost from settlement plus trading cost and possible loss from this unwinding could happen to your broker.
 - (b) Your broker has to report to the Exchanges for this trade default and close your account with him.

7. What will be the respective consequences to me if my broker has reported my T day trades as “error trade”, “fail trade” or “trade default”?

- (i) to report error trade: If the error was because of your mistake, your broker may claim the possible loss from unwinding the trades and the associated costs from you.
- (ii) to report fail trade: Your broker may claim the financing cost and/or the securities borrowing cost from you.
- (iii) to report trade default:
 - (a) Your broker may claim the possible loss, financing cost and/or the securities borrowing cost from you;
 - (b) You'll be suspended from trading in Taiwan until you have successfully settled (a) above with your broker: and
 - (c) Your accounts with all other brokers in Taiwan will be suspended as well.
 - (d) After you have successfully settled (a) above with your broker, you are required to re-process the account opening procedure with the broker who reported the trade default. Your old accounts with other brokers will be re-activated after the Exchanges notify all brokers that you have successfully settled (a) above with the reporting broker.

8. When will my custodian to send the settlement confirmations to me?

The custodian will send settlement confirmations to its clients on T+2 upon settlement and receipt of securities/TWD.

Part B: “Trade Affirmation” Process

While you have understood the consequences to you in Q7, in order to avoid the situation described in Q5 to be happening to you and to make sure you can meet your delivery obligation mentioned in Q2, there is a “Best Practice” to ensure your timely settlement with your brokers by 10:00 AM on T+2.

We call this Best Practice: “Trade Affirmation” process.

9. Is there a “Trade Affirmation” mechanism under the new regulation to ensure my timely settlement with my brokers on T+2? Please describe in details.

Per regulation, custodians are required to perform “trade affirmation” with FINIs’ execution brokers.

Given that the T+2 settlement window is extremely short from 9:00 AM to 10:00 AM, the current practice of “trade affirmation” between custodians and brokers on T+1 will remain in place to ensure that securities and TWD are available for settlement in the early morning on T+2.

10. Will the cutoff time for settlement instructions be change?

In order to complete the “Trade Affirmation” with brokers on T+1 afternoon, settlement instructions should arrive your custodian by 12:00 noon on T+1 the latest.

11. What if my settlement instructions came in after the cutoff time mentioned in Q10 above for delivering my Trade Affirmation to my brokers on T+1 or the instructions simply fail to arrive? What actions a broker or my custodian may take?

Without settlement instructions, available TWD and securities are all there, your custodian bank will not be able to proceed the Trade Affirmation with your brokers.

In the event of missing settlement instructions:

- Your brokers will need to clarify with you if your T day trades are good trades. To prevent fails on T+2, your brokers may take proper actions, such as pushing you to sent instructions, or reporting it as an error trade, etc.
- Your custodian bank will continue to follow its existing procedures to trace missing instructions, short of TWD and securities with you and/or your

global custodian and advise the brokers regarding the broker-alleged trades.

In the event of missing/discrepancy settlement instruction, short of TWD and securities, it will be at the broker's discretion for further actions by 3:30 PM on T+1.

- Your broker may report an error trade or a failed trade to the Exchanges; or
- Your broker may wait with hope that Trade Affirmation to come in by 6:00 PM on T+1
- If your Trade Affirmation to come in after 3:30 PM on T+1, it will be processed manually.
- For the instructions arrive on T+2 before 10:00 AM, the trade will be manually settled in the market.

12. If TWD or securities are not available on T+1 when Trade Affirmation is being done, what are the consequences?

If there is no sufficient TWD or securities available on T+1 for T+2 settlement, custodians will not proceed the Trade Affirmation with brokers. It will be at the broker's discretion to take further action (reporting it as an error trade or a failed trade or taking the risk of waiting for the funding or securities until T+2).

13. What penalties I will be facing once I have been reported a trade default?

Please see answers (iii) (b) (c) & (d) to Q7.

The current penalty on defaulted trade will apply:

- Your brokerage account with the reporting broker will be closed until the case has been settled with the broker or 5 years later. (New trading account can be opened when the failed transaction is remedied).
- Your brokerage accounts with other brokers will be suspended from trading for 5 years or the time until you have settled the case with the reporting broker.
- Please be noted that according to Article #19 of Taiwan Securities Exchange Corporation Rules Governing Brokerage Contracts of Securities Brokers, the reporting broker may collect a sum no greater than 7% of the transaction amount as penalty for breach of contract.

14. Will my brokers still be able to check TWD availability with my custodian bank, and securities availability on TDCC system?

If you have authorized your brokers to check TWD and/or securities availability before trade execution based on the consent letter signed by you to your custodian bank/and TDCC, it will be at the broker's discretion to do so.

15. Is pre-funding requirement eliminated under T+2 environment?

Please be noted that pre-funding is not a regulatory requirement for trading Taiwan market. However,

- (i) A broker may ask an investor to pre-fund its trades for credit reason. If you are not comfortable on your broker's such request, of course you can deny it. We will suggest you to discuss with you broker about this.
- (ii) You can also authorize your broker to check your cash position with your custodian and the securities position with TDCC (for your own control reason) as long as you have issued such authorization to your custodian and TDCC.
- (iii) No matter for reason (i) or (ii), your custodian and TDCC will not honor broker's checking request until they have received your authorization.
- (iv) As you can see, the so-called "pre-funding" issue is really up to your discussion and negotiation with your brokers.

16. Can I do FX (spot/tom/same day) with value T+2?

FX must be done prior to or on T+1 and value for T+1, the latest, for your custodian to credit TWD to your cash account, and to affirm the trades to the execution brokers.

17. Can I sell on T of my buy trades executed on T-1?

Yes.

18. Is turnaround trade (day trade) allowed?

No. The purchased position cannot be used to cover same day sell position, such that turnaround trade cannot be done.

19. Can the sell proceeds received to fund the buy trades of same value day (netting buy and sell trades for funding arrangement)?

This can apply to the buy and sell trades **only** if executed through the same broker on the same trade day.

20. Can I repatriate my T day sell trade proceeds on T+2?

If you plan to utilize the T day sell trade proceeds on T+2 (e.g. repatriation), you should advise the executing broker to wire the proceeds to your

custodian before 2:00 pm on T+2. So that your custodian can book/settle the FX in the FX market afternoon session (14:00 to 16:00)

21. How is the calculation of Corporate Action entitlement?

After implementation of T+2, the settlement cycle in Taiwan becomes T+2. The entitlement is calculated on the ending balance as of record date (i.e.T+2).

22. Is there any change to the process of shares requiring pre-delivery? (new)

No change

Part C: SBL (Securities Borrowing & Lending) questions:

23. Can I, as a lender, sell the shares under a SBL recall on T and use the shares returned by borrower who has purchased them from the market on T for settlement?

TWSE is working on a solution for this situation.

24. Can I, as a borrower, use the position purchased on T-2 to cover T day delivery, e.g. for securities collateral or (lender's) sell trade settlement?

It may be achieved for securities loan collateral purpose, depending on when the purchased positions are actually received from the execution broker. However it is not workable for sell trade settlement

25. Will the SBL T+1 delivery mechanism, i.e. borrow on T/ delivery on T+1 change to T+2?

Pending TWSE confirmation

Definition of terminology used:

Broker	The securities firm in Taiwan which accepts your buy/sell order consignment on Taiwan securities and execute your orders according to your instructions.
Custodian	Your local agent in Taiwan which execute the settlement on your behalf with your brokers.
Exchanges	There are two exchanges in Taiwan. they are Taiwan Stock Exchange (TWSE) and Gre-Tai Securities Market (GTSM). We collectively call them the “Exchanges”.
Error trade	The order consignment you placed with your broker was executed mistakenly which you do not accept (in part or whole) the execution result.
Fail trade	You could not settle the T day trades with your broker on T+2 but will be able to settle on T+3, so would like to have your broker to report to the Exchanges for delaying your settlement to T+3.
Securities	The listed instruments for buy/sell in the Exchanges in Taiwan.
Settlement instructions	The message you send to your custodian to confirm your willingness to settle the trades with a particular broker.
T, T+1, T+2	<p>T (Trade day): The business day your broker successfully execute the buy/sell of Taiwan listed securities for you.</p> <p>T+1: The following business day after the Trade day.</p> <p>T+2: 2 business days after the Trade day.</p> <p>“The business day” we mean here is the day the exchanges in Taiwan operate.</p> <p>For example: December 25, 2008 (Thursday) is a holiday in most of western countries. However, this day is a business day in Taiwan. Taiwan exchanges are working on this day. Therefore, December 25, 2008 is a business day in Taiwan. This day is the T+1 day of your December 24, 2008 Taiwan trades; and the T+2 day of your December 23, 2008 Taiwan trades.</p>
TDCC	Taiwan Depository and Cleaning Corp., the organization which is responsible for cleaning and safekeeping of Taiwan exchange-traded securities.

Trade Affirmation	The process you ask your custodian to confirm to your brokers that you'll settle the trades with your brokers with sufficient TWD and securities to be delivered to your brokers by 10:00 AM on T+2.
Trade default	You decline to settle the trades your broker has executed.
TWD	New Taiwan Dollar. The currency calculating the price of the securities traded in the Exchanges in Taiwan.