3. Foreign Exchange Management

Foreign Exchange Market Management

Taiwan's exchange rate regime is a managed float, where in principle the exchange rate is determined by supply and demand in the foreign exchange market. If the market is disrupted by seasonal or irregular factors (e.g. large flows of short-term capital), causing the exchange rate to become excessively volatile, the Bank may step in to maintain an orderly foreign exchange market.

In 2010, due to massive amounts of international capital moving in and out of emerging economies, exchange rate fluctuations increased in many countries. Taiwan is a small and highly open economy, the Bank's flexible exchange rate policy can help mitigate the domestic impact of massive foreign capital movements.

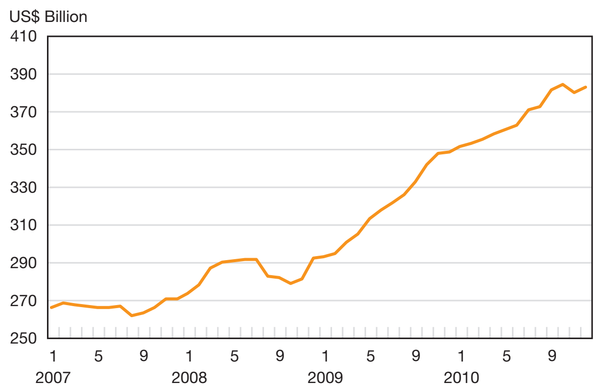
To monitor market activities, the Bank continued to implement the Real-Time Reporting System for Large-Amount Foreign Exchange Transactions. This may contain excessive volatility of the NT dollar exchange rate. In addition, the requirement that forward transactions should be made only upon actual transactions, such as trade and financing, was reinforced in order to curb foreign exchange speculation. The Bank also urged authorized banks to enhance their exchange rate risk management so as to lower their risk exposures and contain systemic risks. Moreover, the Bank strengthened target examinations to maintain an orderly foreign exchange market.

Management of Foreign Exchange Swap and Foreign Currency Call-Loan Business

In order to provide the financial system with sufficient foreign currency liquidity to meet funding needs, including corporate needs to venture into overseas markets, the Bank provided US$20 billion, 1 billion and ¥ 80 billion as seed funds for the Taipei Foreign Currency Call-Loan Market.

Furthermore, the Bank continued to carry out foreign currency swap transactions with banks and extended foreign currency call loans to banks so as to facilitate corporate financing smoothly. During 2010, the volume of foreign exchange call-loan transactions reached US $1,669 billion, while that of foreign currency-NT dollar swap transactions reached US$946.9 billion.

Foreign Exchange Reserves



Source: Department of Foreign Exchange, CBC.

Foreign Exchange Reserve Management

In 2010, the Bank's foreign exchange revenues amounted to US$1,133.5 billion, while foreign exchange expenditure was US$1,099.7 billion. At the end of 2010, total foreign exchange reserves stood at US$382 billion, a US$33.8 billion increase from the end of 2009. The increase was mainly attributable to a higher return on investment of foreign exchange reserves.

Capital Flow Management

The Bank's foreign exchange management mainly relies on the market mechanism, and capital can flow freely in and out of Taiwan. As of 2010, restrictions only remained on a few short-term financial transactions involving the conversion of the NT dollar. Key measures with regard to the management of the foreign exchange in 2010 included:

(1) to prevent massive international short-term capital movements destabilizing domestic economy, the Bank collaborated with the Financial Supervisory Commission to adopt the following measures:

(i) starting from August 2, foreign investors were required to use US dollar margins for securities lending;

(ii) starting from November 11, the amount of investment in government bonds by foreign investors would be included in the 30 percent limit of remittances, pursuant to the 1995 rule;

(iii) starting from December 27, the combined limit of non-deliverable forwards and NTD FX options managed by an authorized FX bank was lowered to 1/5 from 1/3 of its total position.

(2) In order to promote the internationalization of Taiwan's capital market, the Bank agreed to the following in 2010:

(i) the issuance of overseas depository receipts by 9 corporations with a total of US$1.99 billion and the issuance of European Convertible Bonds by 9 corporations with a total of US$3.48 billion;

(ii) seven foreign corporations may raise funds from the stock markets via TWSE listing or GTSM listing, with the total amount reaching NT$19.8 billion;

(iii) the issuance of Taiwan Depository Receipts (TDRs) by 27 foreign corporations, with the total amount reaching NT$44 billion;

(iv) Korean Export-Import Bank and U.S. Citi Bank may issue foreign currency corporate bonds, with the issuance totaling US$1.5 billion.

(3) The Bank agreed to an increase in residents' investments in foreign securities as follows:

(i) domestic securities investment trust companies were allowed to raise private funds via 62 securities investment trust funds domestically to invest in foreign securities with a total of NT$678 billion raised;

(ii) life insurance companies were given consent to invest in foreign securities with the amount totaling US$0.05 billion through non-discretionary money trusts managed by financial institutions, while their investment-linked insurance products accounted for a total of US$2.81 billion in foreign securities, and forward FX sale totaled US$3 billion;

(iii) three major government pension funds and the Postal Savings Fund invested in foreign securities with the total amount reaching US$2.52 billion.

(4) The Bank loosened the following regulations regarding foreign exchange remittances. The amended Regulations Governing the Declaration of Foreign Exchange Receipts and Disbursements or Transactions went into force on June 1, with the following key points:

(i) pursant to the Regulations Governing the Banking Activity and the Establishment and the Investment by Financial Institutions Between the Taiwan Area and the Mainland Area, outward remittances to Mainland China would begin to adopt a negative list approach, and the declaration of inward and outward remittances to Mainland China should follow the aforementioned amended Regulations from then on;

(ii) for nationals below the age of twenty, remittances above NT$0.5 million are required to be approved by the Bank before the settlement;

(iii) the documents regarding the declaration of foreign exchange receipts and disbursements or transactions must be kept by banks for five years;

(iv) pursant to relevant rules of the Bank's Directions for Banking Enterprises while Assisting Customers to Declare Foreign Exchange Receipts and Disbursements or Transactions and the Bank's other laws and provisions, corporations and individuals may, as entrusted parties, declare an NTD settlement in the name of a trustee, without prior consent of the Bank;

(v) banks shall produce electronic data on foreign exchange purchase-sale memos in a format prescribed by the Bank and submit them to the Bank, where the data submitted shall be treated as declarations made by declarants to the Bank.

Management of the Foreign Exchange Business of Financial Institutions

(1) At the end of 2010, there were 1,666 authorized foreign exchange banks in total, which included 37 head offices and 1,562 branches of domestic banks, 67 branches of 28 foreign banks, as well as 2,481 authorized money exchangers, postal offices and financial institutions authorized to engage in basic foreign exchange business. In 2010, the Bank approved, under prudent discretion and with an eye on broader scope of banking services and investor protection, the issuance of 20 new foreign exchange derivative products.

(2) Up to the end of 2010, 17 insurance companies were allowed to engage in foreign currency investment-linked insurance business, and 14 insurance companies were permitted to conduct

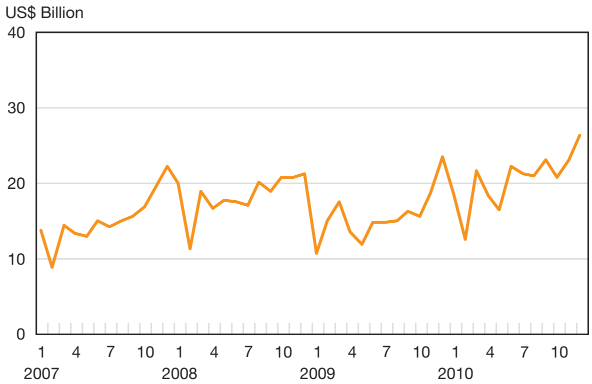
business in relation to traditional foreign currency insurance products.

(3) To facilitate corporate needs for short-term foreign currency funds, and to enlarge the scale of the domestic financial market, the Bank and the FSC agreed to open the market for US dollar bills financing and approved domestic US dollar settlement business. Therefore, beginning from December 6, Mega International Commercial Bank was the clearing bank and custodian for this business, and four banks including Bank of Taiwan were clearing and settlement banks. It is believed that domestic US dollar clearing will help banks to reduce financing costs.

(4) Domestic financial institutions used to rely on two Hong Kong commercial banks for the supply of Renminbi (RMB) cash; however, the supply was unstable and the exchange cost was high. From July 13, 2010 on, based on the currency management agreement from the Cross-Strait Financial Cooperation Agreement, Bank of China (Hong Kong) became the covering bank for Renminbi cash to provide two-way cashnote exchange of Renminbi and NTD in Taiwan; also on July 13, the Bank collaborated with the FSC to amend the Regulations Governing the Administration and Settlement of Renminbi in the Taiwan Area, so that financial institutions can, with the Bank's permission, sign an agreement with Bank of China (Hong Kong) with regard to the supply and reclamation of RMB banknotes. Between June 30, 2009, and the end of 2010, the government approved 47 financial institutions (with a total of 3,228 branches) and 174 authorized money exchangers to conduct RMB cash exchange business. The total amount of Renminbi purchased was RMB10.4 billion, while the total sale was RMB13.75 billion.

(5) Since June 2001, OBUs have been approved to conduct cross-Strait remittances. The steady growth had gradually turned OBUs into funding centers for overseas Taiwanese businessmen. In 2010, cross-Strait remittances increased from US$185.2 billion in the previous year to US$243.3 billion, an increase of 31.4 percent.

Cross-Strait Remittances through OBUs



Source: Department of Foreign Exchange, CBC.