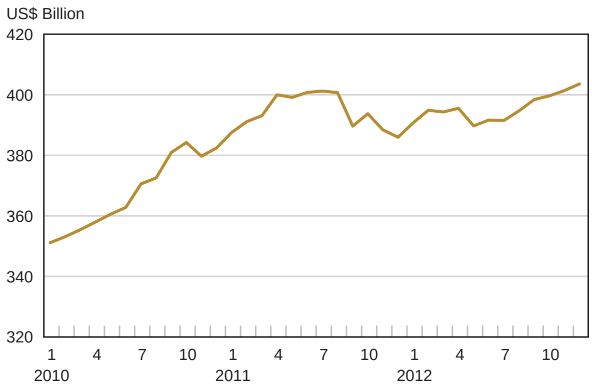
3. Foreign Exchange Management

For the year 2012, the Bank followed the established managed float regime to maintain an orderly foreign exchange (FX) market. Sufficient seed funds were provided by the Bank for foreign currency swaps and call loans. The Bank's foreign exchange reserves increased by US$17.6 billion owing to a higher return on investments and the portfolio appreciation of the euro and other currencies against the US dollar. The Bank also loosened regulations regarding foreign exchange remittances. Moreover, the Bank and the People's Bank of China jointly signed the *Memorandum on Cross-Strait Currency Clearing Cooperation*, an important step in establishing a bilateral currency clearing mechanism.

Foreign Exchange Market Management

Taiwan's exchange rate is in principle guided by the market mechanism; the Bank only steps in when there is excessive exchange rate volatility. At the end of 2012, the NT$/US$ exchange rate appreciated by 3.96 percent from the previous year end's 30.290 to 29.136, relatively stable as compared to the euro's 2.4 percent appreciation against the US dollar, the renminbi's 0.97 percent, the won's 7.58 percent, the yen's 10.14 percent and the Singapore dollar's 6.17 percent.

Foreign Exchange Reserves



Source: Department of Foreign Exchange, CBC.

In 2012, the Bank continued to implement the Real-Time Reporting System for Large-Amount Foreign Exchange Transactions to keep the market in order. Moreover, examination efforts were reinforced to ensure that forward transactions were based only on actual transactions. The Bank also urged authorized banks to enhance their exchange rate risk management. In addition, the Bank strengthened target examinations related to foreign exchange activities. The Bank also broadened the foreign exchange market by approving 905 new FX authorized banks and eight new FX derivatives, and providing liquidity for FX call loan and swap markets.

Management of the Foreign Currency Call Loan and Foreign Exchange Swap 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 seed funds* for the Taipei Foreign Currency Call Loan Market.

* The seed funds include US$20 billion, €1 billion and ¥ 80 billion.

Furthermore, the Bank continued to conduct foreign currency swap transactions with banks and extended foreign currency call loans to banks so as to facilitate smooth corporate financing. During 2012, the volume of foreign exchange call-loan transactions reached US$1,806.5 billion, while that of foreign currency-NT dollar swap transactions reached US$1,130 billion.

Foreign Exchange Reserve Management

In 2012, the Bank's foreign exchange revenues amounted to US$1,053.6 billion, while foreign exchange expenditures were US$1,036 billion. At the end of 2012, total foreign exchange reserves stood at US$403.2 billion, a US$17.6 billion increase from the end of 2011. The increase was mainly attributable to a higher return from foreign exchange reserves management and the appreciation of euro- and other currencies-denominated assets in the portfolio.

Capital Flow Management

The Bank's foreign exchange management mainly relies on the market mechanism, and capital can , in principle, flow freely in and out of Taiwan. As of 2012, foreign currency capital not involving NT dollar conversion can flow freely; neither is there any restriction on financial flows involving NT dollar conversion for commodity and service trade, as well as direct and securities investments approved by the competent authorities. However, regulation exists for short-term remittances. Annual remittances for an individual resident within US$5 million and for a juridical person within US$50 million can be settled by banks directly, while annual remittances above the aforementioned amounts require the approval of the Bank. Each transaction for a non-resident within US$0.1 million can be settled by banks directly, whereas any amount of transactions above that threshold require the approval of the Bank.

Key measures with regard to the management of capital flows in 2012 included:

(1) In order to promote the internationalization of Taiwan's capital markets, the Bank approved the following in 2012:

A. The issuance of overseas depositary receipts by seven domestic corporations with a total issuance amount of US$1.4 billion, and the issuance of European Convertible Bonds by nine domestic corporations with a total of US$1.5 billion raised;

B. Seventeen foreign corporations to launch initial public offerings on the TWSE or GTSM, with a total amount of NT$13.2 billion raised; the issuance of NT Dollar Convertible Bonds by five foreign corporations, which combined to raise a total amount of NT$2.1 billion; the offering and issuance of NT dollar-denominated bonds by the Central American Bank for Economic

Integration (CABEI), raising NT$5 billion; the offering and issuance of foreign currency international bonds by BNP Paribas Bank for a total of no more than US$1 billion.

(2) The Bank gave consent to an increase in residents' investments in foreign securities, detailed as follows:

A. Twenty-nine domestic securities investment trust companies were allowed to offer 42 securities investment trust funds domestically that invest in foreign securities, with a total of NT$537.5 billion raised;

B. Two domestic securities investment trust companies were allowed to offer domestically two futures trust funds that invest in foreign futures trust funds and securities funds, with a total of NT$2 billion raised;

C. Life insurance companies were approved to invest in foreign securities with the amount totaling US$1.5 billion through non-discretionary money trusts managed by financial institutions. Their own investments in foreign securities amounted to US$2.6 billion, while their interest earned on foreign securities investments were hedged by forward foreign exchange contracts totaling US$1.78 billion;

D. Four major government pension funds, including labor pension fund, invested a total amount of US$4.1 billion in foreign securities.

(3) The Bank loosened the following regulations regarding foreign exchange remittances:

A. Starting from August 23, securities investment trust companies may hedge the exchange rate risk for their foreign securities investments via FX swap or cross-currency swap transactions based on the funds' hedging strategies;

B. In step with the amendments by the Financial Supervisory Commission (FSC) to the "*Guidelines Governing Applications by Securities Investment Trust Enterprises for Offering and Issuing Trust Funds Denominated in Foreign Currencies,*" starting from October 26, the Bank approved that banks may process the exchange declaration of the NT dollar payments of foreign currency (except renminbi) denominated funds offered by securities investment trust enterprises. The Bank also issued an official letter to inform banks of the items for attention and verification for such settlements.

Management of the Foreign Exchange Business of Financial Institutions

(1) Authorized Banks

At the end of 2012, there were 3,249 authorized foreign exchange banks in total, which included

38 head offices and 3,160 branches of domestic banks, 49 branches of 28 foreign banks, two branches of Mainland Chinese banks, as well as 1,605 authorized money exchangers, post offices and financial institutions authorized to engage in basic foreign exchange business. In 2012, the Bank approved six cases for authorized banks to establish branches in Mainland China, 15 cases for domestic banks to set up branches abroad, and two cases for Mainland Chinese banks to establish branches in Taiwan.

(2) Insurance Companies

Up until the end of 2012, 19 insurance companies had been allowed to engage in foreign currency investment-linked insurance business, and 22 had been permitted to conduct business in relation to traditional foreign currency insurance products.

(3) Securities Firms

In 2012, the Bank approved three securities firms to be agents for foreign bond trading, 39 to be entrusted as agents for foreign securities trading, 17 for underwriting international bonds, three for proprietary trading of and investments in international bonds, six for proprietary foreign securities trading neither belonging to investment with their own funds nor for hedging needs, eight to issue warrants linked to foreign securities or indexes, one to issue overseas warrants linked to domestic securities, eight to conduct non-discretionary individually managed money trust wealth management business, 22 to deal onshore foreign currency bills, and five as participating dealers of offshore exchange traded funds. The Bank also permitted 43 securities firms and investment trust or investment consulting firms to be master agents for offshore public funds, 21 institutions to be mandated to place private offshore funds in Taiwan; the Bank also gave permission to 20 investment trust or investment consulting firms to conduct foreign currency discretionary investments in foreign securities, 13 as mandated institutions to publicly offer or place foreign currency-denominated funds in Taiwan, and two to be master agents for offshore exchange traded funds.

(4) Promoting Renminbi Exchange Transactions

In response to the needs for consumption purchases by Mainland Chinese and Taiwanese tourists traveling to the other side of the Taiwan Strait, renminbi (RMB) notes have been allowed to be exchanged in Taiwan since June 30, 2008.

Along with the steady increase in cross-strait activities, and the permission of Mainland Chinese free and independent travel in June 2011, banks' RMB cash exchange businesses grew markedly. Between June 30, 2008, and the end of 2012, the government approved 227 financial institutions (3,908 branches) and 238 authorized money exchangers to conduct RMB cash exchange business. The amount of RMB purchased totaled around RMB25.02 billion, while the sale was almost identical at about RMB25.02 billion.

(5) Establishing a Cross-Strait Currency Clearing Mechanism

A. In order to promote cross-strait commercial activity and financial cooperation, on August 31, 2012, the Bank and the People's Bank of China jointly signed the *Memorandum on Cross-Strait Currency Clearing Cooperation*. On September 7, 2012, the Bank promulgated the "*Regulations Governing the Selection of Designated NTD Clearing Bank in the Mainland Area*." After the process of evaluation and selection, on September 17, the Bank announced the Shanghai branch of the Bank of Taiwan as the NTD clearing bank in the mainland area; then on December 11, the People's Bank of China designated the Taipei branch of the Bank of China as the RMB clearing bank in the Taiwan area.

B. As a result, domestic banking units (DBUs) may conduct RMB business once the clearing banks sign the clearing and settlement agreement, finish preparation work, and the relevant regulations are amended and promulgated by the Bank. This will help increase the flexibility of Taiwanese firms' funding arrangements and support the government's efforts to implement the "Program to Develop Financial Services with Cross-Strait Characteristics."

C. The Bank has begun talks with the People's Bank of China to establish a cross-strait currency swap mechanism, which will form a part of future discussions on cooperation.

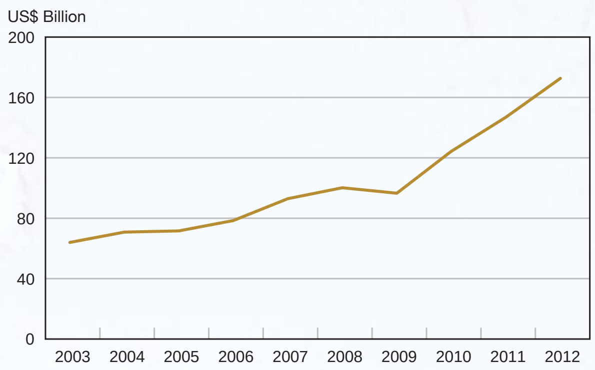
(6) Offshore Banking Units

A. On September 11, 2012, the Bank and the FSC jointly repealed the *Regulations Governing the Conduct of RMB Business for the OBUs and Overseas Branches of Taiwan's Domestic Banks*, which would then allow Offshore Banking Units (OBUs) to conduct RMB business in compliance with the Offshore Banking Act, without the need for the FSC's prior approval.

B. The OBU business continued to grow in 2012, and by the end of the year, there were 62 OBUs in operation, with total assets worth US$170.9 billion, which was a 17.8 percent increase from the previous year end. Non-financial institutions' deposits reached US$44.1 billion, a 17.1 percent increase from a year ago. However, 2012 cross-strait remittances decreased by 1.9 percent from those in 2011 and registered a total of US$277.4 billion.

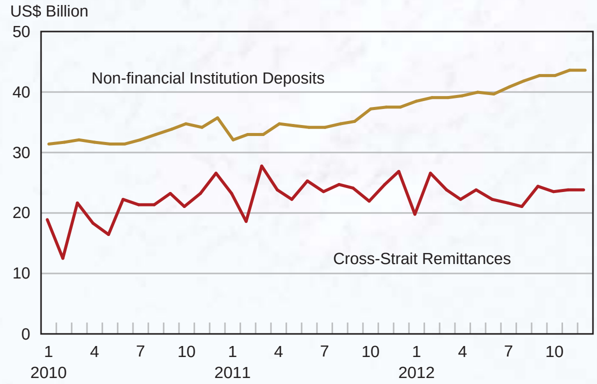
By the end of 2012, 50 out of 62 OBUs had launched RMB business, with their total assets amounting to RMB57.5 billion, an increase of 616.8 percent from the previous year end. The RMB deposit balance reached RMB24 billion, growing by 326.9 percent from the end of 2011. These developments demonstrated OBU's increasing importance as funding centers for overseas Taiwanese firms.

OBU Assets



Source: Department of Foreign Exchange, CBC.

Non-financial Institution Deposits and Cross-Strait Remittances Through OBUs



Source: Department of Foreign Exchange, CBC.