13. Foreign Exchange Management

Foreign Exchange Market Operations

The Bank kept on adopting a managed floating foreign exchange rate regime in 2002. Even though affected by various international and domestic disturbing factors, the New Taiwan Dollar (NTD) exchange rate remained dynamically stable due to the Bank's appropriate management. At the end of the year, the NTD exchange rate against the USD was 34.753, a slight appreciation of 0.71 percent as compared to that of the end of 2001.

In order to enhance financial discipline and to promote the stable development of the local foreign exchange market, the Bank has implemented a real-time reporting system on large-amount foreign exchange transactions to monitor the market and facilitate the balance of demand and supply. In addition, the Bank ensured that forward transactions were made only upon real demand, conducted on-site examination and audit of abnormal transactions, and urged banks to enhance exchange rate risk management to effectively eliminate foreign exchange speculation and ensure sound functioning of the foreign exchange market.

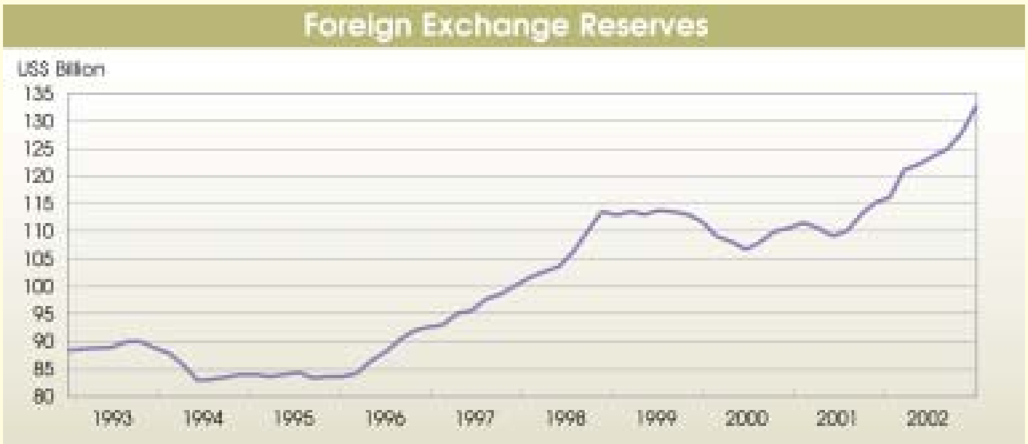
Foreign Exchange Market Management

The second article of the Key Points Governing the Admittance of Foreign Exchange Brokers was amended and promulgated on April 26, 2002, allowing foreign exchange brokers to conduct NTD derivatives transactions. In June, the Taipei Forex Inc. and the Cosmos Foreign Exchange International Co., Ltd. were permitted to conduct interbank NTD interest rate swap (IRS) brokerage business.

The Bank carried out swap transactions and foreign currency call-loan transactions to provide banks with sufficient foreign exchange liquidity to meet their corporate clients' funding needs. Moreover, to comply with the government's policy to encourage companies to expand their overseas business, such as in Southeast Asia, and to meet the foreign currency needs of authorized banks and their overseas branches, the Bank appropriated additional money to the USD seed fund of the interbank foreign currency call-loan market so that the size of the fund increased from US$10 billion to US$20 billion.

Foreign Exchange Reserve Management

At the end of 2002, total foreign exchange reserves amounted to US$161.7 billion, a US



$39.4 billion increase from the end of 2001. In addition to maintaining liquidity, security and profitability, the Bank's objectives of foreign exchange reserve management also included promoting economic development and upgrading industries. In this regard, a portion of foreign exchange reserve has been mainly utilized in the following ways:

(1) Through the local foreign exchange market, the Bank accommodated the foreign currency funds needed in large amounts by local enterprises to import machinery and equipment.

(2) In compliance with policies of developing the Southeast Asian market and providing sufficient foreign currency funds to the financial system, the Bank has appropriated US$20 billion, 1 billion euros and 15 billion yens as seed fund for the interbank foreign currency call-loan market.

(3) The Bank has deposited a portion of foreign exchange reserves in the overseas branches of domestic banks in order to promote their international financial business and to support Taiwanese firms operating overseas.

(4) The Bank has appropriated US$10 billion from foreign exchange reserves as refinancing funds for local banks to finance major investment projects related to domestic industrial upgrading and economic development.

Capital Flow Management

With the progress of financial liberalization and internationalization, the Bank manages the foreign exchange market according to the market mechanism. Capital movements not involving NTD transactions are allowed to flow in and out of Taiwan freely. Capital flows related to the trade of goods and services as well as capital transactions (including direct investment and securities investment) under prior approval by the government have also been liberalized. There were restrictions remaining on a few short-term financial transactions. For example, each qualified foreign institutional investor (QFII) could invest in domestic securities of a value up to US$3 billion; each overseas Taiwanese and foreign natural person could invest up to US$5 million; a foreign legal entity and a non-company fund could invest up to US$50 million. Each domestic company and resident could conduct inward or outward remittances of up to US$50 million and US$5 million, respectively.

Key measures with regard to capital flows in 2002 included:

(1) Effective October 1, 2002, foreign investors were authorized to invest in the domestic equities through private placement, including the equities of exchange-listed companies, OTC-listed companies, and Emerging Stock Board companies. Foreign investors were also permitted to invest in the above companies' privately placed overseas corporate bonds, global depository receipts, and stocks listed in foreign markets.

(2) Some international financial institutions, including the Council of European Development Bank (CEDB), Inter-American Development Bank (IADB), European Investment Bank (EIB) and Asian Development Bank (ADB), were allowed to issue a total of NT$47 billion bonds in Taiwan, with maturities up to 7 or 10 years. To facilitate overseas financing of domestic companies, the Bank approved issues of global depository receipts of US$4 billion by 12 local companies and eurodollar convertible bonds (ECB) totaling US$8.7 billion by 55 local companies.

(3) To support internationalization of local asset management business and sound long-term development of domestic investment trust companies, and to meet investors' needs, in July 2002, the Bank approved an additional amount of NT$100 billion to be raised locally by domestic investment trust companies to invest in foreign securities.

(4) Furthermore, in November, those companies that managed the earmarked trust funds for investing in foreign securities were allowed to invest in exchange traded funds (ETFs) and depository receipts in international stock exchanges and OTC markets.

(5) In compliance with the E-signature Law, and in response to the web-based development of banks' foreign exchange business, qualified declarers were allowed to use the Internet

via authorized foreign exchange banks to file foreign exchange transactions, effective March 30, 2002.

(6) With prior approval, local banks were allowed to conduct direct remittances and export/import foreign exchange business between Taiwan and Mainland China, effective February 13, 2002.

Management of Authorized Foreign Exchange Banks

The Bank continued to approve banks' applications for becoming authorized foreign exchange banks and to approve authorized banks' applications for conducting derivatives business. To maintain financial discipline, authorized banks that violated foreign exchange regulations were rectified and required to improve. The Bank also endorsed the proposal made by the Ministry of Finance to allow 9 domestic commercial banks to set up representative offices in Mainland China.

Foreign Exchange Auditing

(1) Immediate auditing was conducted on large-amount purchase/sale of foreign exchange by individuals and companies to detect abnormal transactions or dishonest declaration.

(2) The Bank audited forward transactions valued at above US$1 million to ensure that real demand was met and to prevent speculation.

(3) The information auditing system of web-based foreign exchange transactions was established. A database of foreign exchange transactions between Taiwan and Mainland China was under construction and the Bank was setting up criteria for checking cross-strait transactions.

Offshore Banking Business

Offshore banking units (OBUs) of local banks have been set up since December 1983 to enhance the country's international financial activities and to establish Taipei as an Asian financial center. Effective August 2, 2002, OBUs were allowed to conduct loan and factoring business with Taiwanese companies in Mainland China. After the opening of cross-strait financial business, remittances between Taiwan and Mainland China have been increasing, which helped OBUs become funding centers for overseas Taiwanese businessmen.