13. Foreign Exchange Management

Foreign Exchange Market Operations

The Bank kept on pursuing a managed floating exchange rate regime in 2003. Even though affected by various international and domestic disturbances, the NTD exchange rate remained dynamically stable due to the Bank's appropriate management. At the end of the year, the NT dollar exchange rate against the US dollar was 33.978, a slight appreciation of 2.28 percent compared to the end of 2002.

In order to enhance financial discipline and to promote the stable development of the local foreign exchange market, the Bank 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.

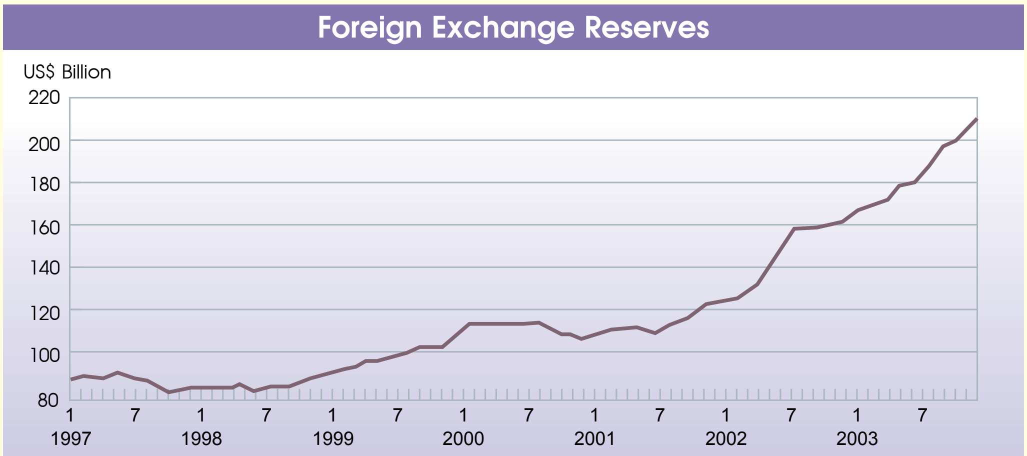
Foreign Exchange Market Management

The Bank approved 42 foreign exchange bank licenses and 147 new financial product operations during 2003.

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 and to meet the foreign currency needs of the financial system, the Bank appropriated seed funds of US$20 billion, 1 billion euros and 15 billion yen for the foreign exchange call-loan market.

Foreign Exchange Reserve Management

At the end of 2003, total foreign exchange reserves amounted to US$206.6 billion, a US$45 billion increase from the end of 2002. In addition to maintaining liquidity, security and profitability, the Bank's objectives of foreign reserve management also included promoting economic development and upgrading industries. In this regard, a portion of foreign exchange reserves have been utilized in the following ways:



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

(2) The Bank has appropriated seed funds for the 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 NT$ 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) with prior approval by the government have also been liberalized. As of 2003, there were restrictions remaining on only a few short-term financial transactions. For example, 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 2003 included:

(1) Effective October 2, 2003, the qualified foreign institutional investor (QFII) system was abolished. Instead of obtaining official approval, all foreign investors from then on could invest in Taiwan's securities market after registration. The registration process was on a once-and-for-all basis. Foreign investors are registered as Foreign Institutional Investors (FINI) and Foreign Individual Investors (FIDI). FINI do not have an upper investment limit and should still obtain consent from the Bank. The abolition of the QFII system symbolized the government's major change of attitude toward foreign investment regulation. Foreign investors can now invest on a level playing field with local investors.

(2) Besides abolishing QFII system, the Bank also agreed with the Ministry of Finance (MOF) to adopt various other liberalization measures regarding capital inflows as follows: (i)Effective February 26, foreign investors were authorized to invest in the options derived from convertible corporate bonds; and to purchase securities through tender offers, including the securities of exchange-listed companies, OTC-listed companies, and Taiwan Innovation Growing Entrepreneurs (TIGER)-listed companies. (ii)Effective May 5, foreign institutional investors were authorized to purchase or redeem exchange-traded funds (ETF). (iii)Effective June 27, foreign institutional investors were authorized to invest in Taiwan's stock lending business operated by the Taiwan Stock Exchange. (iv)Effective December 17, foreign investors were authorized to engage in government bond futures trading to hedge their investment risk.

(3) Some international financial institutions, including the European Investment Bank (EIB), the Northern European Investment Bank (N1B), the Central American Bank for Economic Integration (CABEI) and the European Bank for Reconstruction and Development (EBRD) were allowed to issue a total of NT$71 billion bonds in Taiwan. To facilitate overseas financing of domestic companies, the Bank approved issues of global depositary receipts of US$10.6 billion by 25 local companies and offshore convertible bonds totaling US$12.3 billion by 136 local companies.

(4) The ceiling on the total amount of capital that domestic securities investment trust enterprises (SITEs) were allowed to invest in overseas markets was abolished in July 2003, with the Bank's consent. Nonetheless, a new regulation in June required the SITEs to hedge their overseas investments with Forex Swaps or Cross Currency Swap for an amount no less than 50 percent of remittances. In August, to keep the above requirement intact, the SITEs were allowed to use Forex Options for hedging purposes.

(5) The Regulation Governing the Declaration of Foreign Exchange Receipts and Disbursements or Transactions was revised on April 30, 2003 with the following key points: (i) After filing out a Declaration Statement, a declarant may go through one of three procedures, depending on the nature of the foreign exchange activities. That is, directly process the settlement; not process the settlement until the banking enterprise has confirmed that the Declaration Statement is consistent with relevant contracts and letters of approval; and not process the settlement until the declarant has received approval from the Bank by submitting the declaration statement along with evidencing document through banking enterprises. (ii) A declarant shall not change the Declaration Statement after making a declaration of foreign exchange settlement, unless the declarant has unintentionally submitted untruthful information or has already been penalized for intentionally making an untruthful declaration. (iii) Where a declarant has not made foreign exchange settlement, the certificate of transaction prepared by a banking enterprise shall serve as the Declaration Statement.

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 violate foreign exchange regulations were rectified and required to improve. The Bank also endorsed the proposal made by the Ministry of Finance to allow 12 domestic commercial banks to set up their representative offices in mainland China by the end of 2003.

Surveillance on Foreign Exchange Transactions

(1) Large-amount purchases/sales of foreign exchange were reported to the Bank in order to detect abnormal transactions or dishonest declarations.

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

(3) The Bank reinforced the investigation on illegal foreign exchange transactions and money laundering activities.

Promotion of Offshore Banking Business

Offshore banking units (OBUs) of local banks have been set up since December 1983 to enhance Taiwan's international financial activities and to establish Taipei as an Asian financial center. During 2003, the following measures were adopted to increase the efficiency of OBUs: (1) Effective May 9, domestic banking units (DBUs) of banks were allowed to act as agents on behalf of their OBUs to conduct offshore lending business; and effective July 21, forex deposit business was also included. (2)Effective August 6, OBUs were allowed to engage in the business of non-deliverable forwards and options (NDF and NDO) of US dollar against Chinese Renminbi.