Financial Supervisory Commission, Taiwan

2005 ANNUAL REPORT

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FROM THE CHAIRMAN

Since its inception, the Financial Supervisory Commission (FSC) has been pushing ahead with reform and working towards a new service-driven financial supervisory culture that embodies professionalism, team spirit, and a strong sense of mission and international vision. The goals of the FSC are to maintain financial stability, implement financial reforms, encourage the sound development of the financial industry and strengthen protection and education for investors and consumers.

The FSC made considerable progress on various fronts in the past year. In terms of keeping financial regulations up-to-date, we have amended a number of financial acts: The Compulsory Automobile Liability Insurance Act, Banking Act, Securities & Exchange Act, Insurance Act, Financial Holding Company Act, The Act Governing Bills Finance Business, Trust Enterprise Act, Credit Cooperatives Act, and The Act for the Establishment and Administration of the Financial Restructuring Fund. In pushing for financial industry consolidation, we completely honor the market mechanism and have implemented differential regulatory measures as well as offered incentives to create a more conducive environment for consolidation. In an effort to improve the securities markets, we have strengthened corporate governance, brought in the independent director and auditing committee system, broadened the business scope of securities firms, implemented a new underwriting system, and pushed for the adoption of accounting principles that are in line with international practice.

One of the top priorities for the FSC in the last year was helping and addressing troubled financial institutions in Taiwan. We adopted a strategic segmented approach and were able to auction off Chung Shing Bank, which had been a troublesome problem. We also brought about the smooth exit of two other troubled financial institutions without drawing on the Financial Restructuring Fund. Furthermore, we passed the amended Act for the Establishment and Administration of the Financial Restructuring Fund to expand the fund's size to NTD250 billion, in hopes of encouraging poorly-run financial institutions to increase capital or seek merger opportunities.

Other challenges that the FSC addressed last year include issues related to bond funds and credit card debt. To address bond fund issues, we completed the disposal of NTD 440 billion worth of structured notes that had been held by the Restructuring Fund since October 2004. This move did much to restore investor confidence. To deal with credit card debt, we adopted a series of different measures to help steer us towards a soft landing. Some measures included calling for a more prudent card issue process, rigorously regulating the promotion of student credit cards, rectifying advertising and marketing activities and improper collection practices, ensuring full information disclosure, and accelerating bad debt write-off by card issuing banks. The FSC also took the initiative in asking cardholders with full intention to repay their debts to participate in debt negotiation.

Investors recognized the FSC's professionalism and hard work , and it has boosted foreign investor confidence in our stock market. The TAIEX (Taiwan Capitalization Weighted Stock Index) closed at 6,548.34 points on December 30, 2005, surpassing the ten-year high of 6,412 points. In 2005, foreign investors had a net buy of NTD 719.4 billion on the Taiwan Stock Exchange (TSE) and held a historical high of 31% equity in TSE-listed stocks. The MSCI raised the weighting of Taiwan stocks from 0.75 to 1, while the FTSE index company put Taiwan on a Watch List for developed markets. Beginning in 2006, Lehman Brothers started to include Taiwan's government bond market in its Global Aggregate Bond Index and Asia-Pacific Aggregate Bond Index. These developments are solid evidence of public recognition and support for the FSC.

In other good news, the average non-performing loan ratio (NPL) of domestic banks dropped to 2.24% at the end of December 2005 from a high of 11.76% in April 2002. Bank's coverage ratio (bad debt reserve to past due loans) also climbed to 49.89% at the end of December 2005 from an earlier 14.29% in April 2004, suggesting that our reform efforts have had positive preliminary results.

Rapid economic development has pushed Taiwan to evolve into a service-oriented economy. The financial sector is now the flagship of the service industry. As the output of financial services sector accounts for an increasing share of GDP, its importance to Taiwan's economic development is also rising. Amidst the trends towards globalization and liberalization, Taiwan will be opened to the world as will the world be opened to Taiwan. To be prepared for the prospect, we must boost the overall competitiveness of our financial industry.

The FSC is involved in countless different tasks, but from an overall perspective I see our work falling into three basic categories as our top priority tasks: (1) building social consensus; (2) establishing competition mechanisms and an environment conducive to the long-term development of Taiwan's financial industry; and (3) implementing collective decision-making and adopting recusal rules within the FSC.

(1) Building social consensuses from the Conference on Sustaining Taiwan's Economic Development

Scholars and experts from all walks of life carried out in-depth discussions at the recently concluded month-long Conference on Sustaining Taiwan's Economic Development, and reached a broad-ranging consensus regarding financial reform. It was quite a remarkable and valuable achievement. The FSC's first task is therefore to move quickly in translating the points of consensus into concrete plans. We need to act right away on ideas that are immediately feasible. For ideas requiring medium to long-term research or legislative amendments, we need to set schedules, roll up our sleeves, and get to work.

(2) Establishing competition mechanisms and a development environment conducive to the long-term development of Taiwan's financial industry

The FSC is mainly responsible for establishing systems to ensure that financial institutions can engage in financial activities in a fair, reasonable, and transparent competitive environment free of excessive curbs on their freedom. With this in mind, in addition to the points of consensus that emerged from the Conference on Sustaining Taiwan's Economic Development, the FSC also needs to focus on the following four issues:

Further consolidation is still needed in Taiwan's financial sector. In the future, the FSC will encourage financial institution mergers and the formation of financial holding companies. At the same time, however, we must take care to avoid bringing about monopolies or oligopolies. In other words, we must avoid the emergence of firms that are "too big to fail," so as to avert any possible damage to consumer rights and interests.

We need to engage in overarching discussion regarding the form of universal banking in Taiwan and its regulatory framework, in order to work out a clearer idea of what direction we want our financial sector to be heading as it continues to develop.

We need to consider ways to reduce opportunities for regulatory arbitrage in different branches of the financial sector, so as to exercise more effective supervision and avoid unfair competition between different types of institutions.

In addition to adopting a negative list approach for the review of financial products, in order to give business firms greater discretion in deciding how to run their operations and manage their risks, we must also discuss doing away with outdated rules that too often require the competent authority (the risk monitor) to act as if it were a business firm (a risk manager).

(3) Implementing collective decision-making and recusal rules within the FSC

The FSC is designed to operate on the basis of a collective decision-making process to ensure that policies are well considered and feasible. We will therefore seek to have every FSC commissioner deeply involved in the decision-making process. In addition, we must also implement recusal rules to avoid conflict of interests, and to safeguard the independence and fairness of policy-making.

In Western societies, they often say that "honesty is the best policy." In Chinese society, as well, we say "an untrustworthy person is good for nothing." Honesty and self-restraint are very important in the financial industry, because the relationship between financial institutions, the competent authorities, and the general public are founded on trust. The final point I would like to emphasize, therefore, is the importance of establishing a financial culture characterized by honesty and self-restraint. Building a financial culture of honesty and self-restraint would increase the confidence of depositors, investors, and insurance consumers, and foreign investors would have greater confidence in Taiwan's financial environment. The competent authorities and the general public, moreover, would be more willing to grant business firms greater managerial discretion. This would be a boon to our financial industry. The FSC will strictly abide by this principle in the future, and will use this standard in assessing the performance of financial institutions and the people who run them.

Our ultimate goal is to create a fair, sound and competitive financial environment and boost the overall competitiveness of our financial industry in the international markets.

Chairman Jun-ji Shih

ORGANIZATION AND FUNCTIONS

Since our establishment, the Financial Supervisory Commission (FSC) has been working vigorously to create a fair, sound, and profitable environment for the financial industry under an impartial and reasonable system. Armed with professional and practical experiences, the FSC aims to maintain financial stability, implement financial reforms, promote further development of the financial industry, strengthen investor protection and enhance financial education of the public. Ultimately, the objectives of the FSC aspire to increase the competitiveness of Taiwan's financial industry.

A. Organization

1. Background

The Financial Supervisory Commission (FSC) was officially established on July 1, 2004, in part to stay in line with the rest of the developed world (where one nation after another in recent years has established a single financial supervisory authority to consolidate the oversight of banking, securities, and insurance), and to meet the needs of Taiwan's financial institutions operating in cross-sector businesses. As a result, Taiwan's former system of sector regulations, with different regulatory authorities in charge of supervision and examination for the separate arms of the financial sector, was replaced by a single unified system under the FSC. The establishment of the FSC signifies more than just the transfer or consolidation of financial regulation. It represents the birth of a new service-driven culture of financial supervision in Taiwan.

2. Organizational structure

As required under the Organic Act Governing the Establishment of the Financial Supervisory Commission Executive Yuan (the "FSC Organic Act"), FSC is headed by nine commissioners where one serves as the chairperson and two others serve as vice chairpersons. All commissioners are nominated by the Premier to the President for appointment, and possess academic expertise or professional experience in a relevant field such as law, economics, banking, public finance, accounting, or management. Each commissioner serves for a fixed term of office, ensuring that policies are well thought out and that their public authority is exercised in an impartial manner.

In order to ensure professionalism, fairness, and independence in the setting and implementation of policy, the FSC Organic Act mandates that commissioners belonging to a single political party shall not exceed one-third of the total number of commissioners. Further, the Act bars commissioners from taking part in the activities of any political party during their term in office. Financial systems and supervisory policies shall be submitted to the commissioners for deliberation and resolution. A board resolution is adopted only if it is approved by a majority vote at the meeting, which must be attended by at least two thirds of the commissioners. The commissioners shall hold meetings once a week, and extraordinary sessions may be convened when necessary. In addition, the FSC and the Central Bank shall hold financial supervisory cooperation meetings, in which other government agencies may be invited to attend if necessary, to strengthen financial stability.

The FSC is comprised of four departments, four offices and four bureaus, as follows:

Departments: Planning; International Affairs; Legal Affairs; Information Management.

Offices: Secretarial; Personnel; Accounting; Civil Service Ethics.

Bureaus: Banking; Securities and Futures; Insurance; Financial Examination.

In addition, the FSC established a Financial Supervisory Fund to bolster the funding of financial supervisory activities, ensure our development as a regulator of the financial markets and financial service enterprises, and guarantee our independence in the performance of supervision and financial examination.

Organizational Chart

3. Commissioners and officers

Chairman

Jun-ji Shi

Vice Chairperson (Administrative)

Susan S. Chang

Commissioner

Shyan-Yuan Lee

Commissioner

Cheng-Fern Wu

Commissioner

Chung-Cheng Lin

Commissioner

Guo-Quan Lin

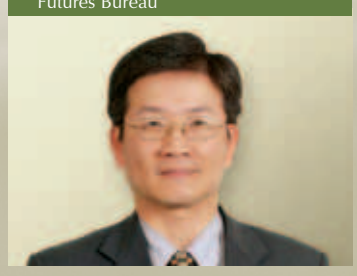
Commissioner

Shih-Chieh Bill Chang

Director General of Banking Bureau

Gary K. L. Tseng

Director General of Securities and Futures Bureau



Tang-Chieh Wu

Director General of Insurance Bureau

Tien-Mu Huang

Director General of Examination Bureau

Ming-Chung Tseng

Chief Secretary

Ting-Jeng Chan

B. Business Functions and Authority

1. Services

Pursuant to Article 2 of FSC Organic Act, the FSC shall be the competent authority for development, oversight, regulation, and examination of financial markets and financial service enterprises. The terms "financial markets" and "financial service enterprises" are defined as the following:

i.Financial markets include the banking market, money market, securities market, futures and derivatives market, insurance market, and their respective settlement systems.

ii.Financial service enterprises include financial holding companies, Financial Restructuring Fund, Central Deposit Insurance Corporation, banking enterprises, securities enterprises, futures enterprises, insurance enterprises, electronic financial transaction enterprises, and other financial service enterprises. However, the Central Bank shall be the competent authority in charge of the payment system.

2. Authority and responsibility

Pursuant to Article 2 of FSC Organic Act, the FSC is in charge of the following affairs:

Managing financial systems and supervisory policy issues;

1. Drafting, amending and repealing financial laws and regulations;
2. Supervising and regulating the following matters in connection with financial institutions: establishment, termination, revocation, changes, mergers, business suspensions, dissolutions, and approval of business scope;
3. Development, supervision, and regulation of financial markets;
4. Examination of financial institutions;
5. Examination of matters relating to public companies and securities markets;
6. Handling of international financial matters;
7. Protection of financial consumers;
8. Enforcement of financial laws and regulations, punishment of violators and handling of matters related thereto;

9. Collection, processing and analysis of statistical information relating to financial supervision, regulation and examination;
10. Inspection of other matters relating to financial supervision, regulation and examination.

3. Commissioners Meeting

The FSC Board of Commissioners meets once a week. Meetings are chaired by the FSC Chairperson, and resolutions are adopted once approved by a majority vote at the meeting, attended by at least two thirds of the commissioners. In addition to abiding by the provisions of recusal in the Administrative Procedure Act, a FSC commissioner (and/or FSC personnel who assists in the handling of a case) must exercise recusal when there is a proposal or deliberation regarding a case involving an organization or enterprise connected to the commissioner, the commissioner's spouse, a blood relative of the commissioner within the third degree of kinship, or a relative of the commissioner by marriage within the second degree of kinship.

Pursuant to Article 10 of the FSC Organic Act, the following matters related to financial markets and financial services shall be implemented only upon the resolution of a commissioners meeting:

1. Adoption and review of financial systems and supervisory policies;
2. Proposal of the enactment, amendment, or repeal of financial laws or regulations;
3. Review and approval of any plan for a financial institution's establishment, termination, revocation, change, merger, business suspension, or dissolution;
4. Review and approval of any material sanction or handling of a violation of a financial law or regulation;
5. Deliberations on proposals by commissioners;
6. Deliberations upon any other measures of material importance to the financial industry;
7. Any other matters requiring adoption by a resolution of a commissioners meeting.

4. Functions

The functions of the FSC bureaus, departments and offices are as described below:

1. Banking Bureau: Supervises and regulates the banking market, money market, and banking enterprises; formulating, planning, and implementing policies, laws, and regulations connected therewith.

2. Securities & Futures Bureau: Supervises and regulates the securities and futures markets as well as securities and futures enterprises; formulating, planning, and implementing policies, laws, and regulations connected therewith.
3. Insurance Bureau: Supervises and regulates the insurance markets and insurance enterprises; formulating, planning, and implementing policies, laws, and regulations connected therewith.
4. Financial Examination Bureau: Supervises and examines financial institutions; formulating, planning, and implementing policies, laws, and regulations connected therewith.
5. Department of Planning: Drafts and proposes financial systems and supervisory policies; performs research and development work related to the improvement of the financial industry; performs research and analysis of domestic financial dynamics; performs research and analysis of international financial dynamics, including mainland China; prepares and disseminates FSC books and periodicals.
6. Department of International Affairs: Acts as liaison to international financial organizations and foreign supervisory bodies; supervises FSC overseas offices; in charge of research and promotion of major international financial projects and international promotional activities.
7. Department of Legal Affairs: In charge of the integration, drafting, research, revision, interpretation, and consulting of financial supervisory laws and regulations, as well as the collection, processing, editing, and translation of financial supervisory laws and regulations.
8. Department of Information Management: Performs the development, planning, and administration of information systems; Processes and performs analysis of data related to financial supervision, regulation, and examination.
9. Secretariat Office: Responsible for confidential matters, research and evaluation, meeting logistics, manuscript review, documents and files, official seals, cashier operations, general affairs, public relations, and other matters that do not fall under the authority of other departments or offices.
10. Accounting Office: Responsible for the budgeting, accounting, and statistical matters.
11. Personnel Office: Responsible for personnel management matters.
12. Civil Service Ethics Office: Responsible for ethics-related matters.

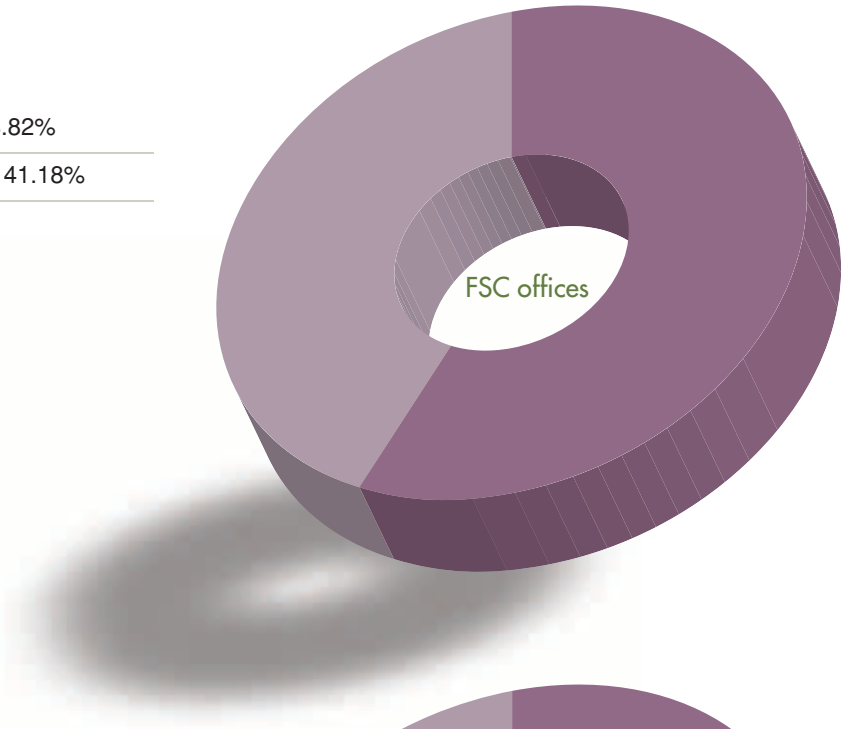
C. Workforce

According to the FSC Organic Act, the authorized size of FSC workforce totals 1,056 persons, which includes 146 persons from the FSC offices and 910 persons from all the FSC bureaus. As of the end of 2005, the FSC offices had 85 employees and the FSC bureaus had 707 persons, totaling 792 persons.

1. Gender distribution

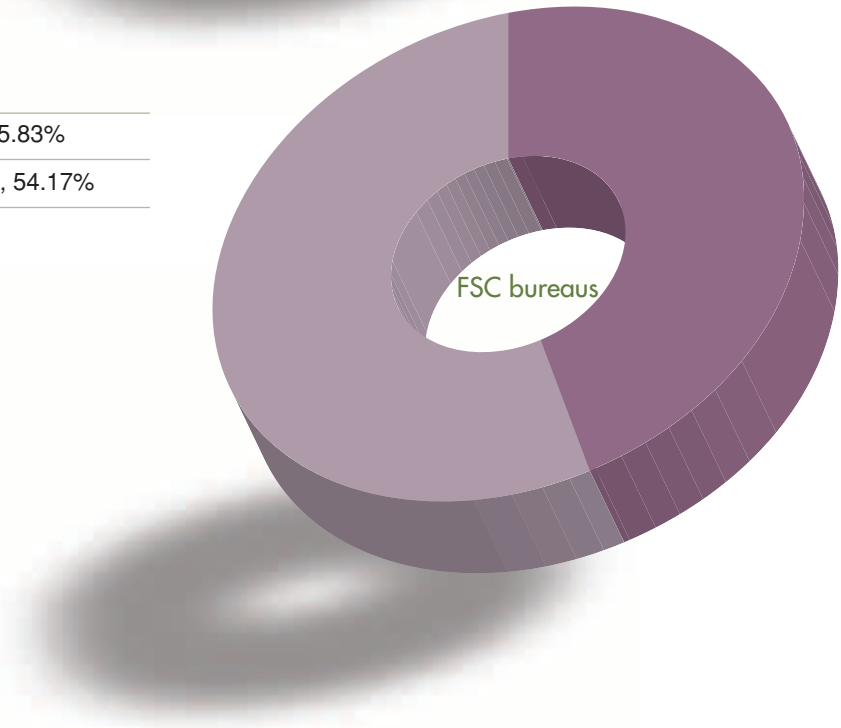
FSC offices:

- **Male:** 50 persons, 58.82%
- **Female:** 35 persons, 41.18%



FSC bureaus:

- **Male:** 324 persons, 45.83%
- **Female:** 383 persons, 54.17%

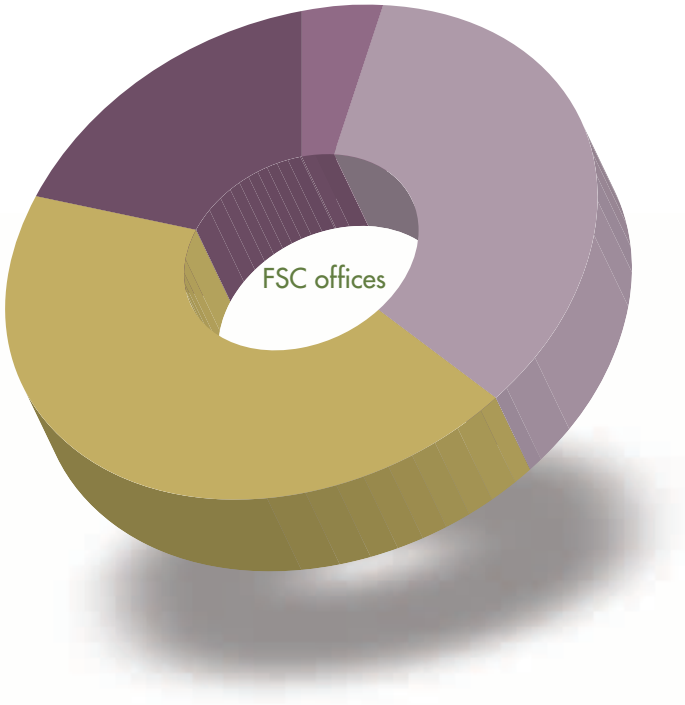


2. Age distribution

FSC offices:

29 and younger	4.71%
30 to 39	34.12%
40 to 49	43.53%
50 and older	17.64%

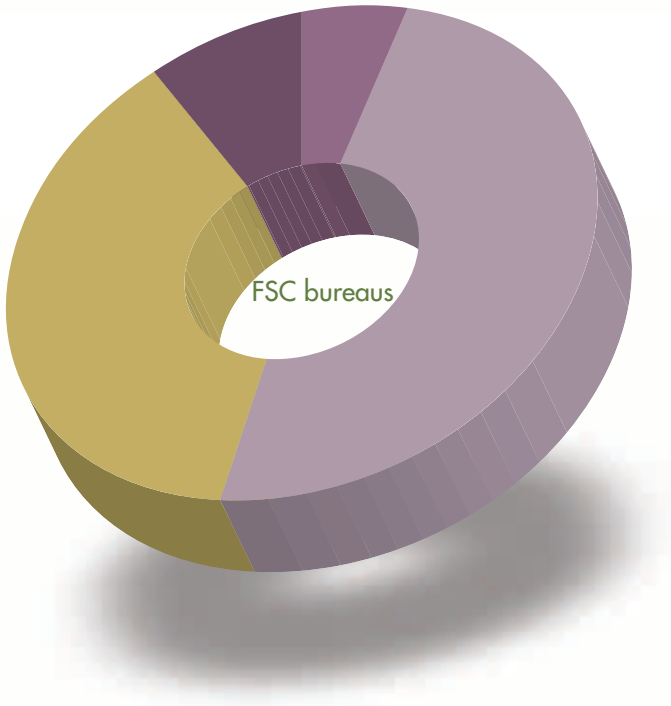
(Average age: 42 years)



FSC bureaus:

29 and younger	5.94%
30 to 39	48.65%
40 to 49	37.19%
50 and older	8.22%

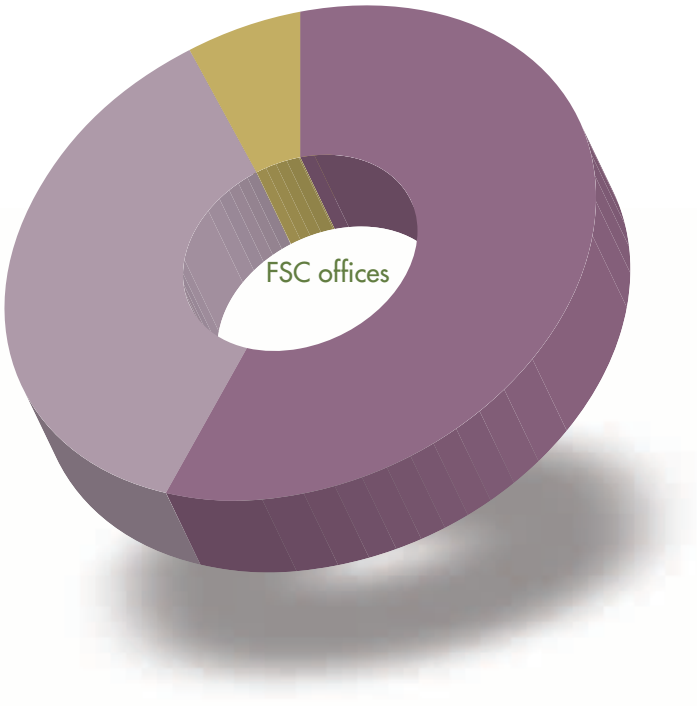
(Average age: 39 years)



3. Education

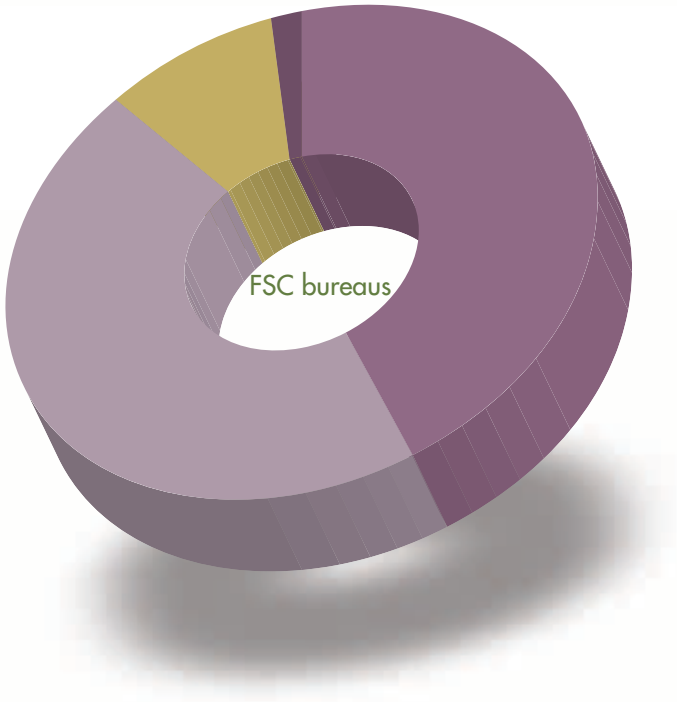
FSC offices:

Master or higher	57.64%
University	36.48%
College	5.88%



FSC bureaus:

Master or higher	44.13%
University	45.26%
College	9.05%
High school (vocational)	1.56%



FSC ACTIVITIES IN 2005

In 2005, the FSC continued to push for financial reforms, promote the development of a healthy financial market, and help strengthen the competitiveness of financial institutions. The FSC also endeavored to maintain financial stability, to push for globalization of our financial markets, and to improve consumer and investor protection and public education; all were efforts to provide an environment conducive to the sound development of the financial industry and markets, as well as to build up momentum for economic growth.

A. Foster Development of Financial Markets

1. Improving the regulatory environment for financial markets

In order to build a good regulatory environment conducive for the sound development of the financial industry, the FSC completed amendments to the Securities and Exchange Act, seven financial acts (Banking Act, Securities and Exchange Act, Insurance Act, Financial Holding Company Act, The Act Governing Bills Finance Business, Trust Enterprise Act, Credit Cooperatives Act), the Act for the Establishment and Administration of the Financial Restructuring Fund and the Compulsory Automobile Liability Insurance Law. The essence of each amendment is presented below:

1. The Securities and Exchange Act: The amendment of the Securities and Exchange Act took effect on January 13, 2006. The amendment focused on the following: promoting corporate governance, introducing an independent director and audit committee system, expanding the business scope of securities firms while simplifying underwriting procedures, strengthening liability for persons preparing company financial reports, enhancing proxy management, establishing closer cooperation with overseas authorities (example: by signing information sharing agreements), preventing market manipulation and insider trading, and constituting more explicit governance or regulations of aforementioned securities crimes.
2. Seven Financial Acts: The penalties were raised sharply; there will be either a specialty court or an appointed official designated to take charge of the examination of cases on financial crime. Under certain conditions, financial institutions can petition to the court to cancel prior transfer(s) of property by financial criminals. Non-banking entities are barred from using names that others might easily construe as a bank.
3. The Act for the Establishment and Administration of the Financial Restructuring Fund: The restructuring fund was expanded to NTD 110 billion in order to urge the capital increase or merger of poorly run financial institutions.
4. Compulsory Automobile Liability Insurance Act: The Act expands coverage, strengthens the protection for the injured parties in automobile traffic accidents, and enhances government's supervisory ability.

We also issued 79 regulatory decrees, 95 administrative rules, and 273 administrative actions. Given the privatization of International Commercial Bank of China, the Farmers Bank of China, and the Chiao Tung Bank, each of the respective statutes (Statute for the International Commercial Bank of China, Statute for the Farmers Bank of China, Statute for the Chiao Tung Bank) were revoked by the Legislative Yuan on December 21, 2005.

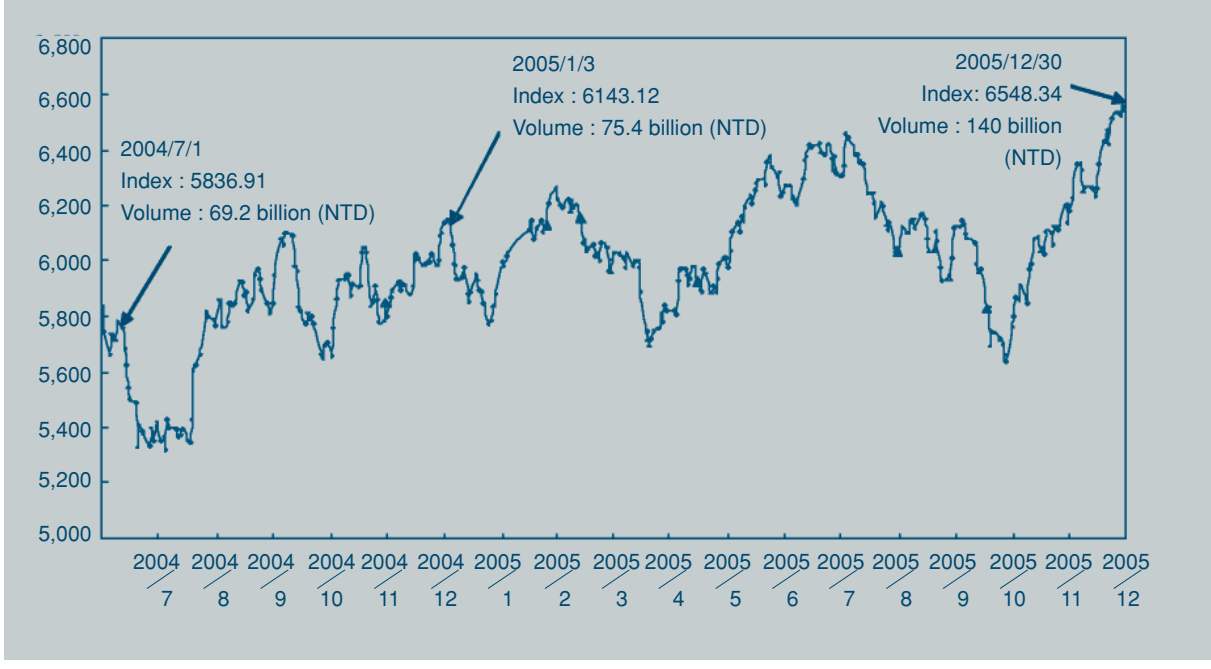
2. Implementing the new securities underwriting system

To improve the securities market and to upgrade the quality of the primary market, a new securities underwriting system was launched in 2005. According to the new system, the regular daily 7% fluctuation limit is lifted for the first five business days of an IPO. As of the end of 2005, there were several companies whose IPO's applied to the new securities underwriting system, including companies listed on TSEC such as Inventec Appliances , E-Life MALL , and Genius Electronic Optical Co. Ltd., and companies listed on Gre-Tai Securities Market such as Kenmos Technology , Microcosm Technology , Taiwan IC Packaging , Shin Zu Shing , and Wellypower Optronics Corporations.

3. Stimulating the securities markets

FSC has taken a lot of measures to invigorate the securities markets and set up second securities markets, which include: implementing the new underwriting system, strengthening corporate governance, introducing the independent directors system and audit committee system, enhancing the regulation governing market insider trading, expanding the business scope of securities firms, and improving accounting principles to be in line with international standards.

July 2004 to December 2005 Total Stock Index Trend Chart



4. Invigorating the bond market

In order to increase market efficiency and enhance the bond-shorting trade mechanism, the GreTai Securities Market (GTSM) implemented a repo-trading function for its Electronic Bond Trading System. During the period that repo-trading function incorporating in EBTS introduced on March 1, 2005 till the end of year, the trading value reached to NTD 4.2 trillion, satisfying a demand for short selling. Strip government bonds and corporate bonds, which separate into interest and principal bonds, were introduced to facilitate retailers' engagement in the secondary market and to increase the liquidity of coupon-bearing bonds.

By the end of 2005, a total of NTD 138.3 billion strip bonds were issued (including NTD 611 million of government bonds, NTD 41.89 billion of corporate bonds and NTD 95.84 billion of financial debentures), which facilitated the disposal of structured bonds.

5. Promoting the development of the futures market

To offer diversified channels for investment and hedging, the Taiwan Futures Exchange launched the "Electronic Sector Index Option" and the "Financial Sector Index Options". To reduce traders' cost, the collection of less net margin for the combined position of long and short index futures contracts after trading hours was conducted. To accelerate the rationalization of the futures trading cost and the standardization of taxation on existing products and interest rate-related futures contracts, the "Futures Transaction Tax Act" was amended and promulgated on December 14, 2005 and became effective beginning January 1, 2006.

6. Promoting the development of securitization markets

The draft of the amended Real Estate Securitization Act, which allows for the securitization of real estate development projects and provides the industry an additional financing alternative, was submitted to the Legislative Yuan for review on October 13, 2004. In 2005, 18 securitization cases that involved NTD 183,970 million were approved and took effect, registering 2.5 and 4.6 times more growth compared to 2004 and 2003 respectively, and surpassed the target of NTD 135 billion that was set for 2008 under the Regional Financial Center Initiative.

Total Amount Issued of Securitization Products/Commodities

Units : NTD 100 million

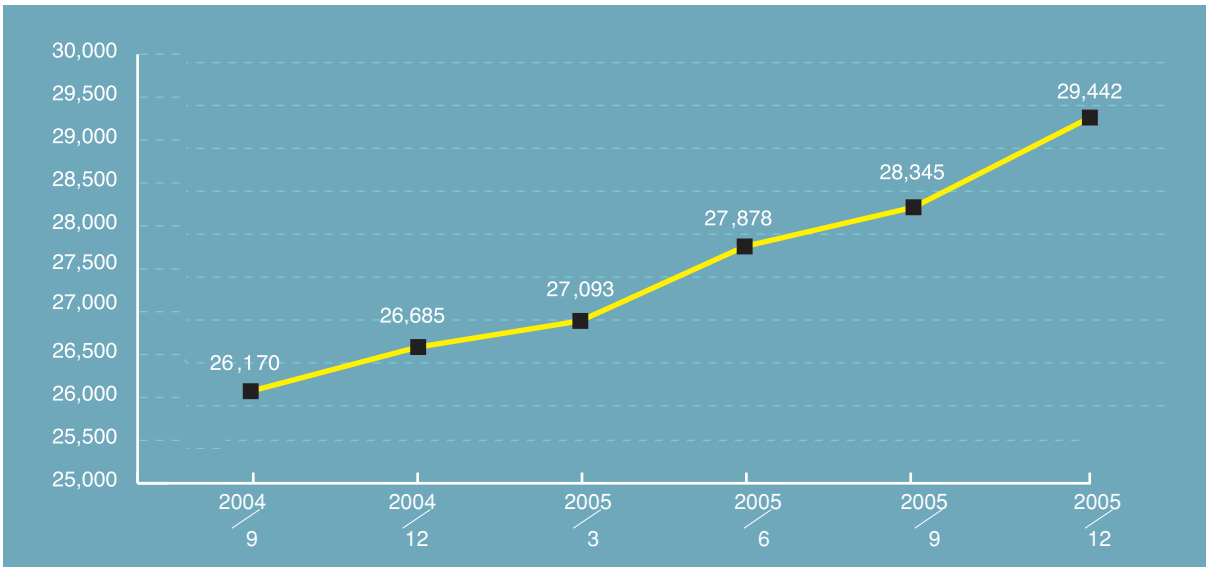
Year	Financial Asset Securitization			Real Estate Securitization			Total		
	Quantity Approved	Quantity Issued	Remaining Total	Quantity Approved	Quantity Issued	Remaining Total	Quantity Approved	Quantity Issued	Remaining Total
2003	326.9	269.8	158.8	0	0	0	326.9	269.8	158.8
2004	396.9	421.5	478.2	133.8	99.8	99.2	530.7	521.3	577.4
2005	1498.3	1418.6	1653.3	341.4	375.4	463.7	1839.7	1794.0	2117.0
Total	2222.1	2109.9		475.2	475.2		2697.3	2585.1	

7. Encourage lending to Small Medium Enterprises (SMEs)

On July 1st 2005, the FSC announced and put into practice the Program to Encourage Lending by Domestic Banks to Small and Medium Enterprises. The program is meant to encourage domestic banks to offer lending to SMEs, enhancing the function of domestic banks as financial intermediaries. It is expected that lending to SMEs may increase by NTD 200 billion within one year of the program's adoption. As of the end of December 2005, the lending balance to SMEs reached NTD 2,944 billion, which is an increase of NTD 156.4 billion compared to that of June 30 2005 and an increase of NTD 275.7 billion or 10.33% compared to the same period in the previous year. The program is designed to build a long-term relationship between banks and SMEs, balancing the development of consumer banking and SMEs financing while benefiting the financial industry as a whole.

Total SME Financing From Domestic Banks

Units : NTD 100 million



8. Promoting the sound development of the insurance market

The FSC amended "the auto-adjust actuarial formula of the reserve valuation rate for new life insurance policy" in order to help bring about a more appropriate product structure in Taiwan's insurance market, as well as encourage the insurance industry to promote protection-type products in the market. In order to provide the proper assessment of risks associated with emerging investment, the FSC modified the RBC calculation. For those companies with a RBC ratio less than 200%, the FSC will continue to carefully supervise their financial soundness and provide capital injection if necessary.

9. Improving the efficiency and security of clearing and settlement processes

In order to improve the efficiency and security of the clearing and settlement processes as well as to prepare the capital market for international development, DIDC (Debt Instruments Depository and Clearing) and TSCD〔Taiwan Securities Central Depository〕merged to create the new Taiwan Depository & Clearing Corporation (TDCC). Additionally, the TDCC is going to promote short-term debt instruments without a physical certificate and promote an electronic process for ABS settlement and depository. Furthermore, the TDCC is going to review the service fee for the depository, clearing and settlement of short-term debt instruments.

B. Enhance Competitiveness of Financial Institutions

1. Encouraging financial industry consolidation

The government pushed forward the second phase of financial reform by conducting a differential supervisory policy, providing incentives of financial consolidations and removing the legal obstacles of consolidation. Based on market mechanisms, the government takes relevant measures to encourage the consolidation of financial institutions and, in turn, promotes the sustainable development of the financial market.

Remove obstacles in M&A laws and regulations:

1. Allow subsidiaries on a capital adequacy basis of a Financial Holding Company (FHC) to reduce their capital to FHC levels, in order to ensure the efficiency of capital allocation.
2. Release FHC's minimum investment threshold from 25% to 5%, to eliminate the obstacle of hostile takeovers.
3. Revise the regulation of public tender and enhance the hostile takeover mechanism.
4. Revise M&A Laws to pave a friendly M&A environment.
5. Amend the guidelines for the approval of foreign FHC application documents and review the requirements.
   - Suitable and appropriate requirements of the foreign FHC or financial institution.
   - Capital adequacy, management skill and experience in managing FHC group.
   - Home country financial institution as a source of strength for the bank it plans to control.

Table of M&A Activity in 2005

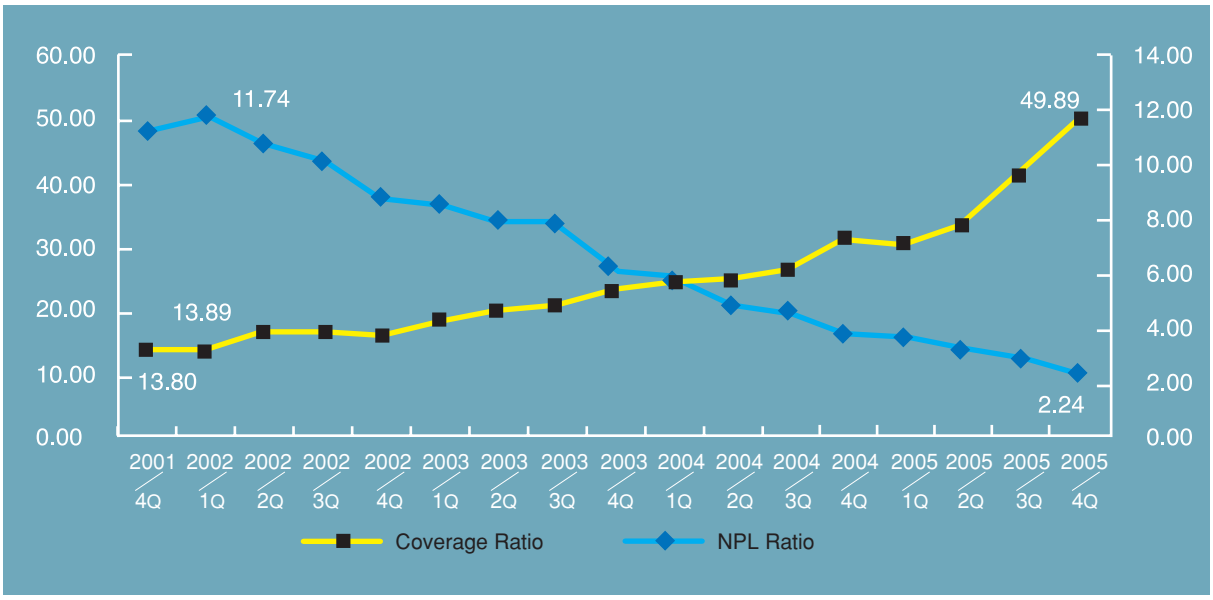
	Existing Entity	Acquired Entity	Merging Date
1	Taipei Bank, rename: Taipei Fubon commercial bank	Fubon Commercial Bank	2005.01.01
2	Bank of Panhsin	The First Credit Cooperative of Chiayi	2005.03.07
3	Union Bank of Taiwan	Chung Shing Bank	2005.03.19
4	Fuhwa Commercial Bank	The Seventh Credit Cooperative of Chiayi	2005.06.17
5	JIN SUN Financial	Taiwan Development & Trust Holding Co., Ltd	2005.08.06 Corporation (Trust Department)
6	Shin Kong Financial Holding Co., Ltd	Macoto Bank	2005.10.03
7	Cathy Financial Holding Co., Ltd	Lucky Bank	Cathy FHC investment 81.35% shares of Lucky Bank
8	Sunny Bank	Kao Shin commercial Bank	2005.11.26
9	SinoPac Financial Holding Co., Ltd	International Bank of Taipei	2005.12.26
10	Fuhwa Financial Holding Co., Ltd	The Tainan Sixth Credit Cooperative	2005.12.23
11	Macoto Bank, rename: Taiwan Shin Kong Commercial Bank	Taiwan Shin Kong Commercial Bank	2005.12.31
12	Cota Bank	Feng Yuan Credit Cooperative	2006.01.01
13	The International Commercial Bank of China, rename: Mega Commercial Bank	Chiao Tung Bank	Planned merging date : 2006.06.26
14	Taiwan Cooperative Bank	The Farmersbank of China	2006.05.01

2. Improving the asset quality of banks

In order to reduce the NPL ratio and improve the asset quality of banks, the FSC amended the Measure for Accelerating the Reduction of Non-performing Loans of Domestic Banks and promulgated the amendments on February 5, 2005. The supervisory indicators were revised in correlation with improvements of the NPL ratio. The average NPL ratio for domestic banks was reduced from 3.80% in December 2004 to 2.24% by the end of December 2005. Over the same period, the coverage ratio was raised from 30.34% to 49.89%.

NPL Ratio and Coverage Ratio of Domestic Banks

Units：NTD 100 million



As of December 2005, the average NPL ratio of credit cooperatives was 2.09, which was a decrease from 3.17% in December 2004 and was lower than the 2.24% average NPL ratio of domestic banks in December 2005. Furthermore, the coverage ratio of the allowance for NPLs was 61.30%, which was an increase from 35.25% in December 2004 and was higher than domestic banks average coverage ratio of 49.89% in December 2005. Among all the 29 credit cooperatives, 26 had NPL ratios lower than 5%. Even better, 19 cooperatives had NPL ratios below 2.5%, showing that the asset quality and the managerial efficiency of the cooperatives have significantly improved.

3. Adopting differential supervision

1. FSC wants to encourage the further improvement in asset quality, streamlining of the application process, as well as encourage more innovation from banks. In order to do so, there shall be less restrictions on the business of certain financial institutions in compliance with the given criteria set forth in the "Measures Expediting the Write-offs of Non-Performing Loans for Domestic Banks" (revised on February 5, 2005) and "Regulations Governing the Negative listings of Banking Business" (promulgated on March 23, 2005).

2. Establishing the differential management for the underwriting system:

In order to strengthen the professional function of underwriters, the FSC will apply differential management based on the performance of underwriters.

a. Allowing securities firms to engage in financial management and consulting services.

b. Enabling securities firms to get green light to offer trading services for GTSM contract-based call and put warrants.

c. Enabling securities brokers to invest their own capital in REIT funds listed in Taiwan Stock Exchange.

d. Expanding the business scope of securities service enterprises, which will include: (1) allowing for securities and investment trust enterprises (SITEs) to issue principal protected funds; (2) allowing SITEs and securities and investment consulting enterprises (SICEs) to act as the master agent of offshore fund institutions for the offshore fund public offering in Taiwan; (3) allowing for public service pension funds, labor pension funds, labor insurance funds or Chunghwa Post Co. Ltd to be the provider and purchaser of private placement fund.

With respect to the futures industry, FCMs are allowed to invest in foreign enterprises and engage in GTSM-options trading for hedging. In addition, futures proprietary merchants are allowed to borrow ETFs that are listed on the Taiwan Stock Exchange for hedging purposes. Securities firms with concurrent operations in futures are allowed to invest in constituent stocks of the Taiex-50 index and ETF.

As to discretionary account operations of managed futures enterprises, the FSC lowered the minimum amount for which managed futures enterprises accept funds from principles to NTD 2.5 million, in order to attract more retail customers. In addition, the FSC permitted managed futures enterprises to possess foreign currency deposits and to invest in bond funds.

3. Amended "Regulations Governing Pre-sale Procedures for Insurance Products"

The FSC revised the directions governing the review of applications for approval of insurance products to extend the categories of insurance products that are subject to "file and use" and "use and file" system. In August 2005, issuance of the product review process was to establish a rating-based review system and simplify regulatory approval of insurance products. In addition, the FSC continues to promote the liberalization of non-life insurance premium structure, allow the non-life insurers to adjust the risk premium within the approved range, and design a professional policy. We also deregulated premium and insurance products gradually through the rating-based regulation.

4. Deregulating the wealth management business

To enlarge the business scope of financial institutions, the FSC allows banks, securities firms and insurance firms engaging in wealth management businesses, to provide customers with service of assets allocation and financial planning. In addition, the FSC amended "Guideline for Banks Engaging in Wealth Management Business", and issued "Guideline for Banks Selling Financial Products to Customers Other Than the Clients of its Wealth Management Department", "Guideline for Securities Firms Engaging in Wealth Management Business" as well as "Guideline for Insurance Firms Engaging in Wealth Management Business" to regulate the qualifications of wealth managers and request institutions to establish KYC procedures, internal control procedures, risk management system, product suitable policy and the mechanism of handling disputes. These guidelines enhance the risk management system and internal control procedures of financial institutions to engage in wealth management business, govern their conduct for the sale of financial products, protect the rights of their customers, and promote a sound development of the wealth management business in Taiwan.

In 2005, the FSC granted approvals for 38 banks (including 7 foreign banks) to provide wealth management services. The FSC expects financial institutions to improve self-regulation and protect the rights and benefits of their customers.

5. Broadening business scope and fund utilization

In regards to the customer base of credit cooperatives, the credit limit for governments would be widened and government-run enterprises would be allowed to borrow from credit cooperatives. Furthermore, credit cooperatives with better financial criteria could extend their business operations to 1 or 2 neighboring counties. Considering the use of idle capital, the FSC also loosened the credit cooperatives' investment limits for the securities offered by a single issuer. The credit cooperatives with lower NPL ratios would be allowed to invest more in mutual funds. The amendments should improve the credit ratings of securities.

With regard to bills finance business, bills finance companies are allowed to invest in stock-related products to diversify their asset portfolio risks. They may also engage in stock-linked derivatives for their own accounts. Moreover, to reduce credit risks that bills finance companies may encounter by holding on or off-balance-sheet positions, these companies are allowed to engage in transactions of credit derivatives for both their own accounts or for their customer accounts.To provide consumers with a more efficient investment service, the FSC allowed banks to apply for the underwriting and brokerage of beneficiary securities and asset-backed securities, pursuant to Financial Asset Securitization Act and Real Estate Securitization Act.

In the area of the securities business, the FSC opened up asset allocation and financial planning businesses to securities firms, allowed securities firms to engage in over-the-counter contract-based warrant business, and allowed securities brokers to invest in listed real estate trust fund with their core capital. The FSC also expanded the business scope of securities service industry by the following: allowing securities investment and trust enterprises (SITE) to issue principal-protected fund; allowing SITE and securities investment consulting enterprise (SICE) to act as general agent for offshore fund institutions in Taiwan and engage in the sales of offshore funds; and allowing Public Service Pension Fund, Worker Retirement Fund, Worker Insurance Fund, and Chunghwa Post Co. to become targets of private placement funds.

In the area of the futures business, the FSC allowed futures commission merchants (FCM) to invest in foreign business and engage in over-the-counter options trading for hedging purposes. Futures dealers may borrow ETF for hedging purpose. Domestic institutions concurrently engaging in futures dealing may use core capital to buy the constituent stocks and ETF of Taiwan 50 index. The FSC lowered the minimum investment requirement for investors who open a discretionary account with a managed futures enterprise to NTD 2.5 million, and allowed managed futures enterprises to hold foreign currency deposits and invest in bond funds.

To help insurance companies reap greater returns on their investment of funds, the FSC has allowed insurance companies to take part in debenture and corporate bond repo-transactions, invest in privately placed funds and securitization products, and engage in lending of overseas securities.

Table of Insurance Fund

Units: NTD million

Year	Non-Life Insurance	Life Insurance	Total Amount
2003	129,140	4,217,539	4,346,679
2004	154,471	4,972,240	5,126,711
2005	166,204	5,876,211	6,042,415

Director General Tseng of the Banking Bureau speaking at the seminar on "Overview of The Bank of New York's Basel II Implementation".

6. Implementing Basel II measures

In order to facilitate banks in the preparation for implementation of Basel II and improve the level of sophistication of banks' risk management practices, the FSC jointly set up a Basel II working group with the Bankers Association of the Republic of China. Up to the end of 2005, the working group had proposed the tentative draft of the capital requirement for banks' operational risk, credit risk, and securitization. All domestic banks have done preparation work for implementing Basel II measures and have conducted the quantitative impact studies, according to the tentative draft of the capital requirement.

7. Implementing the new labor pension scheme

According to the Labor Pension Act enacted in July 2005, the rate of contribution by an employer to each employee shall not be less than 6% of the employee's monthly wages. The Individual Retirement Account managed by the Bureau of Labor Insurance is the primary labor pension plan for enterprises while those with over 200 employees and with 50% employee consensus could choose a qualified annuity as their labor pension plan instead. Employees who choose the Individual Retirement Account may voluntarily contribute up to 6% of his/her monthly wages into his/her personal Individual Retirement Account. The full amount of such voluntary pension contribution is eligible for deduction from the employee's taxable income.

8. Adopting a practical approach for financial dealings across the Strait

The FSC amended the regulation governing the approval of the financial operation dealings between China and Taiwan on March 3, 2005. The amendment not only eases the remittance to China and the credit to Taiwanese businessmen in China, but also allows overseas bank subsidiaries of Taiwanese financial holding companies to establish representative offices in China.

The FSC also amended the regulation governing the approval of the security and future operation dealings between China and Taiwan in February 2005, which creates access for security firms to set up new security firms in China.

The financial operation dealings between China and Taiwan amounted to USD 170.829 billion in 2004, an increase by 42.69% from a total of USD 119.719 billion in 2003.

C. Maintain Financial Stability and Integrity

1. Fostering sound development of the domestic bond fund market

To improve the asset allocation of bond funds and solve the liquidity crisis, the SITEs are required to dispose structured bonds held by bond funds. At the end of 2005, structured bonds with a total value of NTD 442.8 billion were disposed. Compared with Korea which spent USD 5 billion to solve a similar problem, we did it smoothly without damaging any investors' interest or causing systematic crisis. Beginning 2006, the SITEs are required to distinguish bond funds into real bond funds or money market funds, and adjust the investment portfolio of bond funds accordingly.

The Amount of Structure Bonds Held by Domestic Bond Funds

Percentage of Liquid Assets Ratio of Domestic Bond Funds

2. Strengthening market exit mechanisms for financial institutions

The Financial Restructuring Fund (the Fund), since establishment, has dealt with the exit of 48 financial institutions from the market. In 2005, Chung-Shing Bank and Taiwan Development & Trust Corporation, both problematic financial institutions, were divided and disposed under the strategic arrangement of the Fund. In addition, Development & Trust Corporation and Tainan Second Credit Cooperative have been withdrawn from the market without a public fund injection. Furthermore, the Statute of the Establishment and Management of the Executive Yuan's Financial Restructuring Fund (the Statute) was amended and made effective on June 22, 2005 to expand the scale of the Fund amount to NTD 110 billion. Such amendments strengthened the capacities of the Fund to promote mergers and acquisition activity. Accordingly, Value-Added and Non-Value-Added Business Tax Law was amended to increase the insurance reserve fund.

3. Ordering the close-of-business and liquidation of Kuo Hua Insurance Company

Poor management and rapidly amounting losses eroded the Kuo Hua Insurance Company's solvency and threatened the rights and interests of policyholders. Thus the FSC ordered Kuo Hua Insurance to suspend its business and dispatched a rehabilitator to the company on November 18, 2005. The FSC commissioned the Taiwan Insurance Institute to act as a rehabilitator and advised the Protection Fund of Non-life Insurance to compensate the insured. This was a prime example where the authority was able to deal with the problematic insurance company and maintain order in the insurance market.

4. Improving the effectiveness of financial examinations

Limited examination resources have been focused on financial institutions and businesses with higher risk to improve the effectiveness of financial examinations. The FSC conducted the consolidated examinations of financial holding companies to adequately monitor their overall operational risks. In 2005, the Financial Examination Bureau carried out routine examinations on 256 financial institutions and 686 targeted examinations, which were mostly conducted on financial institutions with excess dummy accounts or were requested by judicial inspection agencies.

The Performances of On-site Examinations in 2005

Routine examination						Targeted examination					
Financial Holding Company	Bank	Securities Firm	Insurance Company	Other	Total	Financial Holding Company	Bank	Securities Firm	Insurance Company	Other	Total
10	105	32	37	72	256	2	58	3	4	619	686

Minister Shi of the Judicial Yuan together with Former Chairman Kong at the opening ceremony of the prosecutor's office.

5. Effectively curtailing financial crimes

In recent years, the involvement of listed companies in embezzlement, insider trading, and other illegal financial dealings had caused grave concern among investors and consumers in the stock market. To enhance the effectiveness of investigating financial criminal activity, the FSC dispatched examiners working with the Investigation Supervision Unit for Financial Crimes of the High Court Prosecutor to investigate financial crimes and coordinate with the Judicial Yuan, which assigned the prosecutor and assistant prosecutor to be stationed at the FSC for combating such offenses.

The FSC established a Mobile Inspections Unit and a Suspicious Cases Reviewing Group in charge of significant suspected illegal cases. The FSC and the Judicial Yuan also set up "Consulting Group for Courts Hearing Major Financial Crime Cases" to help judges quickly sort out the technical details in court cases, bring proceedings to a quick close and achieve equitable justice.

In 2005, 43 cases of significant suspected financial criminal activity were referred to prosecutors by various government agencies. Among them, 19 cases were of insider trading, while the other 24 cases involved illegally transferring company assets or disclosing fake financial statements.

D. Promote the Internationalization of the Financial Industry

1. International cooperation in financial supervision

In October 2005, the FSC and the United Kingdom's Financial Services Authority (FSA) concluded the fourth round of bilateral dialogue in London. In March 2005, the FSC held its first bilateral dialogue with Germany's Federal Financial Supervisory Authority (BAFIN) in Taipei. In addition, the FSC and United States Federal Reserve (FED) set up a mutual visit mechanism and held a bilateral talk in Taipei in July 2005.

FSC senior officials always use the opportunity at international meetings or visits to establish a direct communication channel with the financial authorities of other countries. In the past year, FSC officials have visited the US, UK, Germany, Italy, Japan, South Korea, Singapore, Vietnam, Australia, Spain, and Switzerland and have met with senior officials of the countries' financial supervisory agencies.

In light of the increasing prevalence of cross-border financial activity, prevention of cross-border financial crimes has become a high priority concern of almost all financial regulators. The FSC has been actively seeking the signing of memorandums of understanding (MOU) addressing cooperation in the field of financial supervision. In 2005, the FSC signed or confirmed MOU for cooperation in single-sector or cross-sector supervision with the UK, Spain Australia, Japan, Thailand, Malaysia and Vietnam.

FSC visits Citibank Korea Inc. CEO, Mr. Yung-Ku Ha, of South Korea.

2. Transparency of information disclosure

Taiwan's accounting practices are now more in line with international standards as the newly enacted "Statement of Financial Accounting Standards No.35: Accounting for Impairment of Assets (SFAS No.35)" and amended "Statement of Financial Accounting Standards No.7: Consolidated Financial Statements (SFAS No.7)" entered into force on January 1, 2005. The amended "Statement of Financial Accounting Standards No.34: Accounting for Financial Instruments (SFAS No.34)" and the new enacted "Statement of Financial Accounting Standards No.36: Financial Instruments: Disclosure and Presentation (SFAS No.36)" took effect on January 1, 2006. The implementation of fair value accounting was completed in 2006, along with the newly enacted "Statement of Auditing Standards No.42: Auditing fair value measurements and disclosures (SAS No.42)".

In order to enhance transparency of financial information and to stay in line with international norms, beginning 2005, all TSEC and GTSM listed companies must announce semi-annual consolidated financial reports. Additionally, public companies, not listed on TSEC or GTSM, and emerging stock board companies shall announce semi-annual consolidated financial reports beginning from first half of the 2006 fiscal year.

Along with SFAS No.34 and SFAS No.36 having taken effect on January 1, 2006, the FSC established an ad hoc team to assist enterprises in switching to the fair value method and amended the "Guidelines Governing the Preparation of Financial Reports by Securities Issuers" and "Rules Governing Auditing and Certification of Financial Statements by Certified Public Accountants".

3. Attracting foreign investors into the securities markets

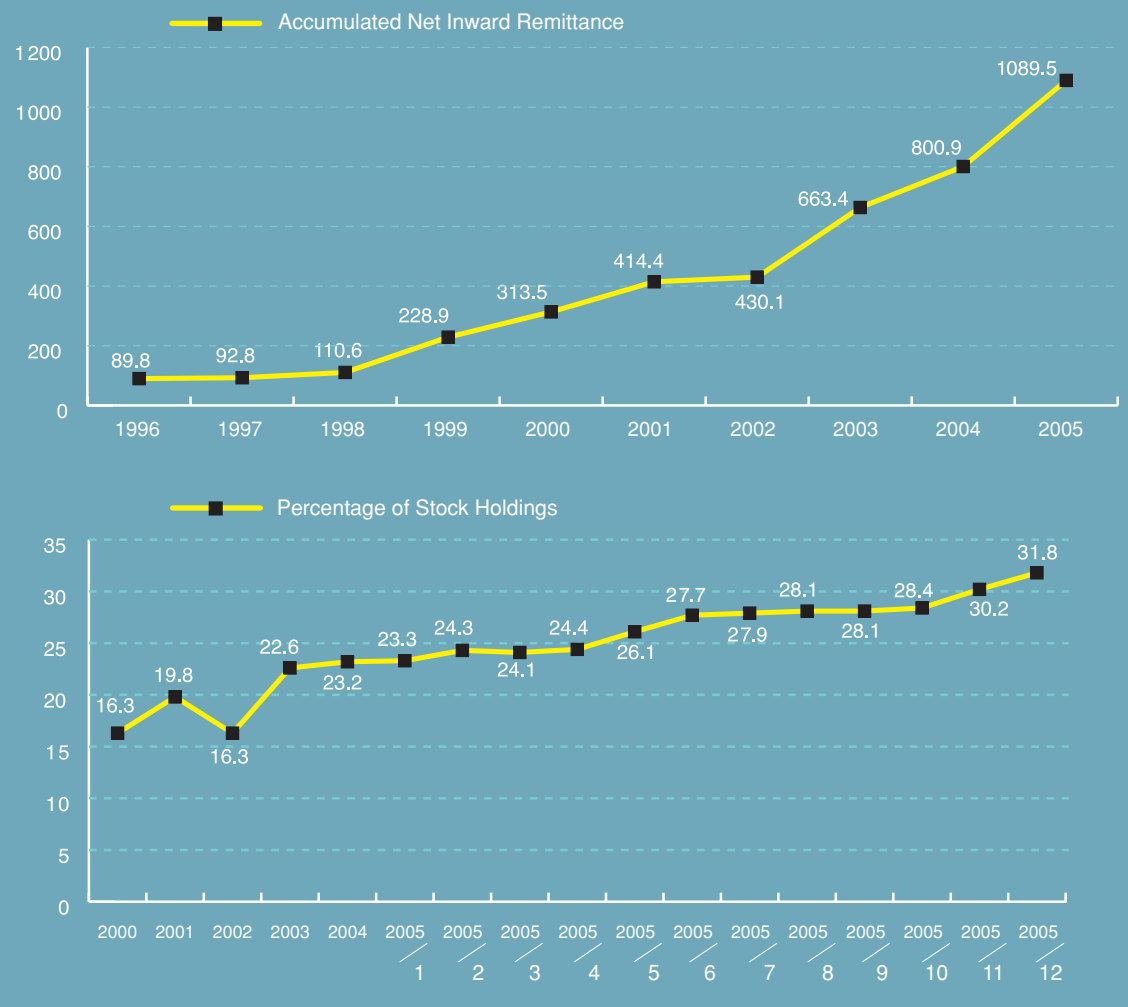
The FSC launched a series of improvements aimed at further deregulating and internationalizing the market to encourage foreign investment in Taiwan's securities markets. On April 1st 2005, under the permission of the FSC, the Taiwan Stock Exchange Corp. (TSEC) unveiled measures to simplify the registration procedures and required documents for foreign investment. Key reforms included the following:

1. The TSEC could send the certificates of registration as soon as foreign investors finished registrationonline via the TSEC system.
2. If the applicant declared the investment or trading strategy was for hedging purposes, it would be unnecessary for the applicant to submit documents explaining the investment strategy.
3. The criteria for foreign institutional investors to open multiple trading accounts with a single securities broker (including individual branch offices) were relaxed.

Moreover, the FSC deregulated trading procedures, to encourage foreign investment in Taiwan, with the following measures: introducing a settlement grace period mechanism for foreign investors, easing requirements for foreign investors to participate in the securities borrowing and lending system, permitting foreign investors to engage in odd-lot trading, and allowing foreign institutions to engage in risk management, mandated by the issuer of a call (put) warrant to transfer funds from their domestic accounts to warrant exercise accounts of the issuers at their banks.

As of the end of December 2005, the net yearly inward remittance of foreign investors was USD 28.8 billion, an increase of USD 15.1 billion over 2004 (USD 13.7 billion), and the net accumulated remittance was over USD 108.9 billion, setting a historical record. In 2005, the securities overbought position of foreign investors totaled NTD 719.4 billion, an increase of NTD 437.1 billion from 2004 (NTD 282.3 billion) with an increase rate 154%. Furthermore, at the end of December 2005, the market capitalization of the shareholdings of foreign investors was 31.84% of the total market capitalization, also setting a historical record.

Foreign Investment in Taiwan's Stock Market



4. Raising international recognition of Taiwan's capital market

Taiwan's deregulation of its capital market in recent years has received positive recognition by international financial institutions and foreign investors.

For example:

1. The U.S. Securities and Exchange Commission (SEC) recognized the Taiwan Stock Exchange Corporation as a "designated offshore securities markets" in December 2004.
2. At the end of May 2005, Morgan Stanley Capital International (MSCI) announced to raise the Limited Investability Factor (LIF) for the MSCI Taiwan Index from 0.75 to 1.0, gaining Taiwan securities markets a developed status. In the MSCI report, Taiwan's country weighting in the MSCI Emerging Markets World Index was raised from 13.07% to 16.87%, below South Korea's 17.15%, ranking Taiwan No. 2 in the MSCI Emerging Markets World Index. The adjustment will attract more foreign investment.
3. The Taiwan Futures Exchange (TAIFEX) received the No Action Letter from the Commodity Futures Trading Commission on May 2005, permitting the offer and sale of TAIFEX's futures contracts, based on the Taiwan Stock Exchange Electronic Sector Index (TE) and the Taiwan Stock Exchange Finance Sector Index (TF), in the United States.

   TAIFEX received the "Risk Management House of The Year" award at the Asia Risk Awards in October 2004.
4. On June 29, 2005 Citigroup compiled a "Taiwan Government Bond Index" (TGBI) for Taiwan. Furthermore, starting in 2006, the Taiwan government bonds index was compiled into Lehman Brothers' "Lehman Global Aggregate Index" and "Asian-Pacific Aggregate Index", raising Taiwan's position in international financial markets as well as attracting international investors to participate in Taiwan government bonds market.

On December 19, 2005, Lehman Brothers announced the compilation of Taiwan government bonds index into the Lehman Global Aggregate Index and Asian-Pacific Aggregate Index.

5. Participating in international organizations and activities

To bring our financial market systems more in step with international practice, we actively participated in activities of international organizations to better grasp the new trends of financial regulations in the international community. We also negotiated with more countries about market liberalization in order to create more business opportunities for our financial industry. Our interactions with major international organizations in 2005 are as follows:

1. International Organization of Securities Commissions (IOSCO)

   In addition to attending the IOSCO annual conference in Sri Lanka, the IOSCO Emerging Markets Committee Meeting in Barbados, and IOSCO Asia-Pacific Regional Committee in Bangkok, the FSC was again invited to attend the IOSCO 2005 Global Financial Regulators Summit Meeting in Frankfort, organized by BAFIN of Germany. The FSC also attended the regional training seminars, sponsored by the IOSCO Emerging Markets Committee in February 2005, and made a formal application to be a signatory of the IOSCO Multilateral Memorandum of Understanding (MMOU) in August 2005.

2. International Association of Insurance Supervisors (IAIS)

   IAIS was founded in 1994 and it is the most important international organization for insurance supervisors. Taiwan is one of the initial members of the IAIS. In 2005, the FSC sent representatives to attend the IAIS Annual Conference in Austria and obtained permissions to join working groups of the IAIA. The FSC now participates actively in the Technical Committee, Implementing Committee, Accounting Subcommittee, Insurance Fraud Subcommittee, Solvency & Actuarial Issues Subcommittee and Regional Coordination Subcommittee. Mr. Yoshihiro Kawai, General Secretary of IAIS, was invited to attend the 5th CEO Insurance Summit held in Taipei in March 2005.

3. Organization of Economic Cooperation and Development (OECD)

   In our ongoing efforts to intensify relations with the OECD, the FSC continued to attend OECD meetings in 2005, including the Roundtable on Capital Market Reform in Asia and the Asian Corporate Governance Roundtable. For the first time, the head of OECD Directorate for Financial and Enterprise Affairs was invited to visit Taiwan and speak at an international forum held in Taiwan. In addition, OECD appointed a FSC employee in December 2005 to work at OECD headquarters in Paris. Such experiences will undoubtedly help Taiwan understand the direction of the various financial issues under OECD discussion.

4. World Trade Organization (WTO)

   The FSC was an active participant in the WTO Doha round of multilateral trade negotiations for the service sector. In June 2005, Taiwan was invited by the US to join the countries of US, Japan, Australia, and Switzerland in co-signing a joint statement calling for liberalization of the financial service sector. This participation exemplifies Taiwan's fortitude in multilateral negotiations and Taiwan's resolve to proceed with further liberalization.

5. The European Bank for Reconstruction and Development (EBRD)

A vice president of EBRD was invited to speak at the FSC on the topic of EBRD's trade promotion programs, syndicated loan and trade financing for recipient countries. The EBRD also agreed in October 2005 to have a FSC employee work at the bank for one year.

In 2005, senior officials of the FSC were invited to attend and speak at the meetings of a myriad of government and private international financial organizations. A few examples include: annual meetings of the World Bank, meetings of the International Council of Securities Associations, bond market development conference of ABAC, annual meeting of Life Office Management Association (LOMA), and the annual Asia meeting of Investment Company Institute (ICI).

6. Enhancing international profile

According to the statistics from the World Federation of Exchanges at the end of 2005, Taiwan ranked third in the Asia Pacific Region for stock market turnover, placing Taiwan only behind Japan and South Korea. In terms of financial liberalization, Taiwan also ranked among the top in East Asia. Such achievements should be well publicized to increase international recognition of our financial markets' strength.

The FSC was invited to the Taiwan Global Investment Forum, held by Euromoney and the Taiwan Stock Exchange as well as nineteen Taiwanese companies listed in New York and London, to discuss the reform measures for liberalizing and globalizing Taiwan's financial and capital markets. The Forums were attended by over six hundred investors and senior managers of leading financial institutions, with more than a total of USD 5.82 trillion of assets or approximately 70% of investment assets worldwide under their management.

FSC at the Taiwan Global Investment Forum, held on October 17, 2005 in London.

The FSC Chairperson Kong Jaw-Sheng led the market opening ceremony for the New York Stock Exchange on October 14 ,2005 and the London Stock Exchange on October 19 ,2005.

FSC and Taiwan business representatives lead market opening ceremonies at the NYSE and LSE.

The FSC, together with the Taiwan Stock Exchange and other institutions made visits to the UK, US, Singapore, and Hong Kong in May of 2005 to introduce the reforms of our capital market to international investors, in the hope that FTSE would advance our capital market from "developing market" to "developed market". The FSC was invited to attend the First US-Taiwan Financial Meeting in New York, held by the US-Taiwan Business Council and ROC-USA Economic Council, and introduce the status of financial reforms in Taiwan to American investors.

FSC visits the Federal Reserve Bank of New York and its Senior Vice President Robert O'Sullivan.

Former Vice Chairman Lu speaking at the 2005 IOSCO Emenging Market Committee Regional Training Seminar.

7. Holding international conferences

Holding international conferences is an effective vehicle to advance exchanges with other countries and gain insight on the global trends of financial supervision. The FSC sponsored the 2005 IOSCO Emerging Markets Committee Regional Training Seminar in February 2005. Both IOSCO and OECD representatives attended to give lectures while securities regulators and self-regulatory organizations from thirty countries attended the training seminar. The 5th CEO Insurance Summit, the most important annual meeting to enhance the interaction between supervisors and enterprises, was held in Taipei in March of 2005. Each main enterprise and regulatory organization all sent representatives to participate in the conference. Mr. Kawai, Secretary General of the International Association of Insurance Supervisors, also attended the conference. As part of our efforts to encourage financial institutions in Taiwan to enhance their international competitiveness through consolidation, the FSC along with Taiwan Financial Services Roundtable and Taiwan Academy of Banking and Finance held a forum on financial consolidation in Japan in September of 2005. Leading Japanese banks, including Mizuho Financial Group, Mitsubishi Tokyo Financial Group, Sumitomo Mitsui Banking Corporate and Shinsei Bank were all invited to discuss their experiences in consolidation and future development in Japan.

President Chen of Taiwan receives attending international public figures of The 5th CEO Insurance Summit in March 2005. The international attendees include IAIS Secretary General, IIS President, Geneva Association Secretary General, US CPCU President, and US ACE Group Vice Chairman.

8. Establishing the New York Representative Office

The FSC established its first overseas representative office in New York on October 13, 2005, with the aims to strengthen cooperation with international financial organizations and financial regulators in North America, assist in the supervision of local offshore banking units of Taiwan-based banks, understand the development of major financial markets in the world, and publicize Taiwan's financial markets. In addition, the establishment of the FSC London Representative Office has been approved by the Executive Yuan and the office is planned for opening in mid-2006.

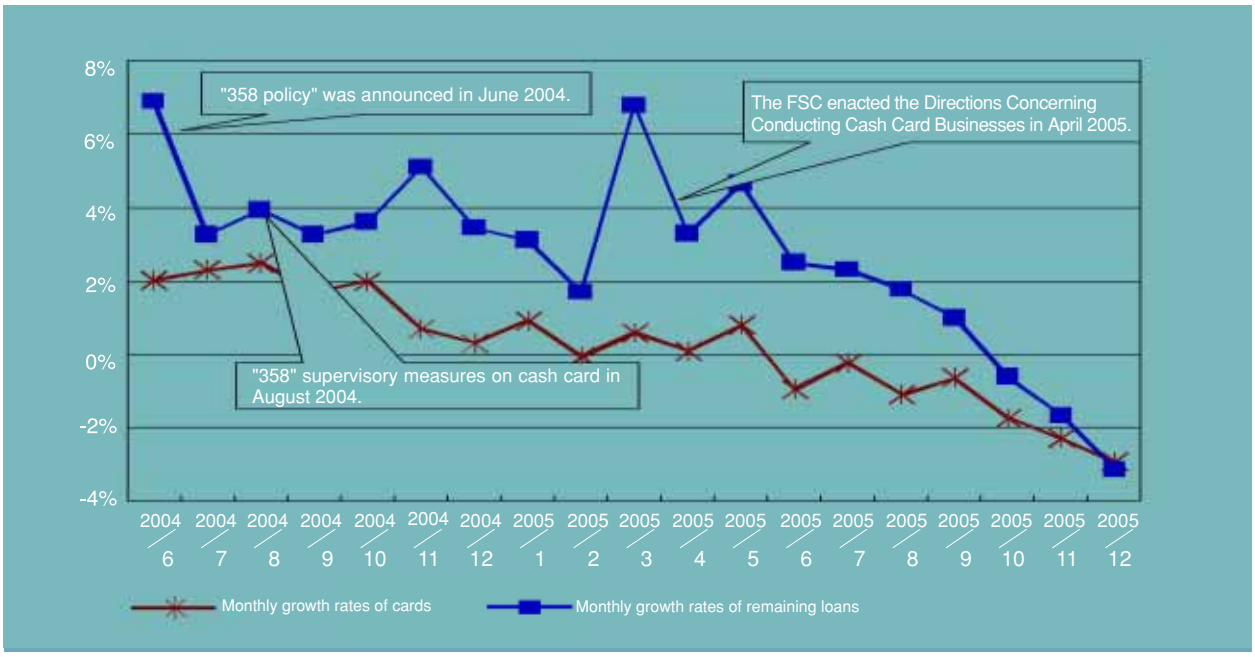
E. Improve Protection and Education of Consumer and Investors

1. Steering the Cash Card and Credit Card Business

1. The FSC has adopted a series of soft landing measures for sound development of the financial market and for better consumer protection. These measures include: higher qualifications for student card applications, limitation on advertisement and promotion activities, accelerated write-offs of bad debt, better information disclosure, consumer consulting and education awareness.
2. Following the Rules Governing Cash Card Businesses by Financial Institutions of April 2005, the number of cash cards has been constantly decreasing and appeared as negative growth in October 2005.

3. To assist consumers with debt repayment difficulties, the FSC in June 2005, instructed the Bankers Association to develop a consumer debt negotiation platform and put it into practice by November 2005. In addition, a so-called "one stop service by the agent bank"mechanism was officially adopted since January 1, 2006. Under the mechanism, the largest creditor bank is authorized to negotiate with the debtor on debt repayment terms and conditions, on behalf of all creditor banks, in order to assist debtors in resolving financing difficulties and in rebuilding their credibility.

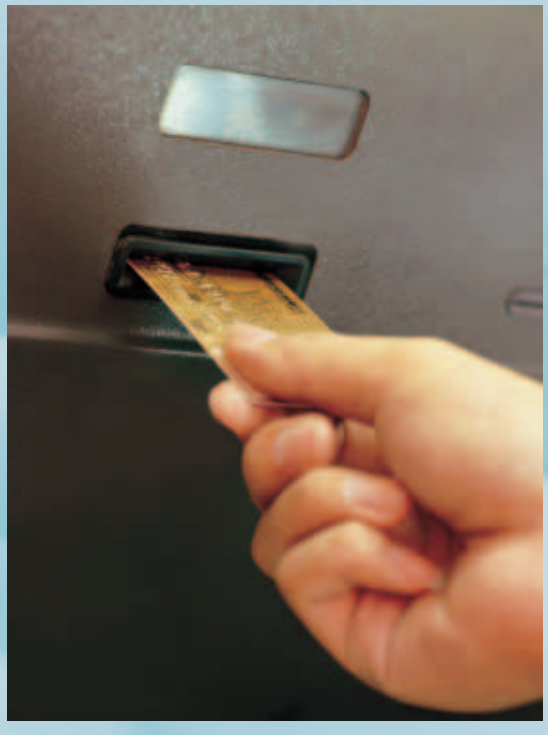
Monthly Growth Rates of Cash Cards and Remaining Loans



2. Actively promoting the financial literacy prevalence program

Since our establishment, FSC has actively promoted the financial literacy prevalence program. Meanwhile, the Executive Yuan approved our proposal of the program in April 2005, and requested the related departments to coordinate and fully support the program. The progress of our three-year financial literacy program is as follows:

1. Holding seven circulating forums around Taiwan.
2. Providing fundamental financial education in school textbooks, while giving lectures at universities and holding financial literacy workshops at all levels of schools, to firmly boost financial literacy.
3. Conducting forums and conferences as well as participating in various fairs held by the Consumer Protection Commission, Council of Indigenous People, and Ministry of Economy in order to achieve financial literacy prevalence.
4. Producing promotional videos and materials about financial literacy for nation-wide TV broadcasts as well as for free download on the FSCEY website.
5. Cooperating with the National Youth Commission, Consumers' Foundation, Consumer Protection Commission, and Teacher Chan Foundation on the development of financial literacy among Taiwan teenagers.



3. Combating financial fraud

In a move to curb financial fraud, the Executive Yuan decided that as of June 1, 2005, ATM transfers to non-designated accounts are limited to NTD 30,000 each time. The related support measures, drafted by the FSC, include: (1) Public utility payments (water, electricity and gas) and payments to state-run enterprises or government agencies (tax and transportation expenses) are not subject to the NTD 30,000 transfer restriction; (2) In light of the now prevalent practice to pay tuition, telecommunication expenses, credit card, and insurance premiums through ATM, schools and private enterprises may entrust a bank to collect such payments and set up a special account for such purposes where the account would be considered as a designated account.

As a proactive move to prevent financial frauds committed using dummy accounts, the FSC has adopted the following measures: (1) Conducting special examination of financial institutions with relatively more dummy accounts; (2) Asking financial institutions to observe the "Know Your Customer" rules when opening accounts for potential customers; (3) Asking financial institutions to instruct their internal auditing units to intensify the auditing of account opening processes and self-check operations; (4) Increasing the publicity of new fraud techniques to raise public awareness.

4. Enhancing the function to protect investor rights

In assisting protection of investor rights, the FSC has asked the Securities and Futures Investors Protection Center to represent 48,934 investors in 17 class-action civil lawsuits against accountants, underwriters, board directors and public companies that engaged in illegal activities. The center reached settlement agreements with the above-mentioned parties and received NTD 180 million from accountants and underwriters, NTD 100 million from some directors and supervisors, and NTD 15 million from public companies, resulting in a total compensation amounting near NTD 300 million.

5. Amend Compulsory Automobile Liability Insurance Act and related regulations

Compulsory Automobile Liability Insurance Act was amended on February 5, 2005. The FSC also amended 18 related regulations to help decrease the burden on automobile-owners, such as increasing insurable items, expanding the scope of persons that may claim insurance benefits as well as decreasing the premium. An estimated NTD 15.5 million owners of car and motorcycle can get benefits and protection.

An annual premium-examining mechanism of the Compulsory Automobile Liability Insurance has been established. It is readjusted every year, based on the actual loss experienced in former years, to correctly reflect fair premium rates.

Table of Changes in the Premium Rates of Compulsory Automobile Liability Insurance (effective from March 1, 2006)

Units: NTD

Type of Vehicles	Former premium	Adjusted premium	Difference	Change ratio (%)
Light Weight motorcycle (2 years)	1,027	1,024	-3	-0.29
Heavy Weight motorcycle (2 years)	1,436	1,432	-4	-0.28
Private sedan (male, age 30-60, level 4)	2,053	1,964	-89	-4.34
Private sedan (female, age 30-60, level 4)	1,918	1,836	-82	-4.28

FUTURE PROSPECTS

Guided by a service-driven supervisory culture and the principles of differential management, the FSC will continue to push forward with financial reform in view of Taiwan's economic development and trends in financial internationalization and liberalization. The FSC will work to keep financial regulations and systems up-to-date with international trends, bolster financial supervision, and promote the liberalization and internationalization of our financial markets. Our ultimate goal is to create a fair, sound and competitive financial environment in Taiwan while strengthening the overall competitiveness of our financial industry in international markets.

A. Continue to Update Financial Regulations

The draft of the amended International Financial Business Act was submitted to the Legislative Yuan for review on May 9, 2005. The draft amendment was approved on January 6, 2006, and then promulgated under Presidential Decree on January 27, 2006. The amended Act opens up the OBU business to DBU, in order to enhance the operating efficiency of OBU. We plan to push for the passage of another eleven bills in 2006.

1. Drafted amendments pending approval from the Legislative Yuan

1. The Financial Institutions Merger Act

   In order to facilitate the foreclosure proceedings entrusted by the courts to a fair third party, an amendment to the Financial Institution Merger Act has been proposed. Besides, the amendment aims to enhance the transparency of NPL transactions, to follow accounting principles and to build up M&A infrastructure.

2. Amending the Certified Public Accountant Act

   The FSC proposed to amend the Certified Public Accountant Act to improve the environment, quality, and management of the CPA practice. Major amendments include: allowing the establishment of an accounting firm as a legal person with limited partnership, introducing the professional indemnity insurance mechanism, establishing a single nationwide CPA association, and strengthening independence and management of CPAs.

3. Personal Property Secured Transaction Act

   The amended Act stipulates the claim priority of creditors and non-hostile lien-holders, in order to improve the movable property secured transaction system. The Personal Property Secured Transaction Act is a special civil law, and principally involves debt dispute, in which the creditor should resort to civil action for compensation. Thus, the penalty clauses in the Act have been abolished to save judicial resources.

4. Depository Insurance Act

   The amendment to the Act aims to strengthen the financial safety net centered on the depository insurance mechanism, bolster the risk management mechanism and payoff ability of the Central Deposit Insurance Corp, and replenish the depository insurance fund. The amendment will ensure that problematic financial institutions are dealt with swiftly and effectively, allowing Taiwan to maintain financial stability.

5. Real Estate Securitization Act

The draft amendment to the Real Estate Securitization Act aims to further include developing property as securitized assets. The amendment was sent to the Legislative Yuan for deliberation last year. In 2005, a total of 18 real estate securitization cases with an amount of NTD 183.97 billion have been approved by the FSC. The volume of approved securitization cases evidenced a growth of 2.5 times from 2004 and a growth of 4.6 times from 2003, surpassing the 2008 Regional Financial Center Program target amount of NTD 135 billion under. The amended Act will also facilitate the funding of industries from the market.

2. Bills under deliberation

1. Drafting the Financial Services Act that will put into effect functional supervision and financial consumer/investor protection.
2. Studying the amendment to the Financial Holding Company Act to help improve fund utilization and business operations of financial holding companies as well as to intensify the supervision of business groups.
3. Studying the amendment to the Banking Act, which aims to establish capital-based disciplinary measures and a debt equity swap mechanism, as well as set up a dedicated mediation organization to reinforce the self-regulation of banks and better protection of consumer interests.
4. Drafted an amendment to the Insurance Law, in order to strengthen management of insurance funds, deregulate fund investments, expand permitted insurance business, adjust legal procedures and measures of dealing with exiting insurers, and to enhance self-discipline of the insurance industry.
5. Studying the amendment to the Trust Enterprise Act with the intent to allow securities investment trusts and consulting enterprises to operate in the trust business, to reinforce regulation over trust business operation and to adjust the supervision authority.
6. Studying the amendment to the Financing Company Act with the intent to regulate the management of financing companies, in order to promote diversity of financing channels.

B. Create a Secure and Efficient Financial Environment

1. Building a secure payment environment with information technology

We will encourage financial institutions to construct a secure payment system with innovative information technology. For instance, we will urge the Banking Association along with Taiwan financial institutions to complete the National Fees and Tax Payment Mechanism - ATM Transfer Project by March 1, 2006. In light of the fact that magnetic strip ATM cards will only be accepted by ATM machines installed by the card issuer starting on March 1, 2006, we will plan supporting procedures to safeguard the interest of magnetic strip card users for shared check list and ATM transfer project.

2. Preparation for implementing Basel Capital Accord II

The FSC set up a joint Basel II working group with the Bankers Association of the Republic of China to facilitate banks in adopting appropriate measures for Basel II implementation, and to foster more sophistication of banks' risk management practices. Up to the end of 2005, the working group has proposed the tentative draft of the capital requirement for banks' operational risk, credit risk, and securitization. All domestic banks have made preparations for implementing Basel II and have conducted quantitative impact studies according to the tentative capital requirement.

3. Setting up an off-site monitoring mechanism and the early warning system

Utilizing the "One-Stop Window for Reporting of Financial Supervisory Information" information system, the FSC set up a financial supervisory database that integrates with the early warning system to improve daily supervision. By reviewing the analytic information, FSC can efficiently supervise business activities and operational risks of financial institutions as well as determine the priority and rule of varying examination frequency, depending on the level of risk. In addition, the FSC conducts risk-focused financial examinations to effectively allocate examination resources, enhance the efficiency of financial examinations, and maintain the reliability of the financial system.

4. Integrating all securities and futures affiliates

In order to boost the international competitiveness and service quality of Taiwan capital markets, as well as reduce transaction costs of securities firms, futures commission merchants, and investors, the FSC is planning to establish a holding company that will bring the four current operators, Taiwan Stock Exchange Corporation (TSEC), Taiwan Futures Exchange (TAIFEX), GreTai Securities Market (GTSM), and Taiwan Depository & Clearing Corporation (TDCC) together as subsidiaries of the FSC by the end of 2006.

The holding company will be in charge of mapping out integrated business plans and schedules for the subsidiaries, in order to achieve synergy of integration.

5. Continuing to develop the Taiwan ETF market

To enhance strategic allocation among different ETFs and to diversify ETF products, helping investors achieve better return, the Taiwan Stock Exchange licensed the Mid Cap 100 index and IT index to SITEs for the issuing of two new ETFs. The FSC will work closely with the SITEs to launch new ETFs and invigorate the Taiwan ETF market.

C. Continue to Encourage Consolidation of Financial Institutions

The second phase financial reform hopes to help Taiwan develop into a regional financial service center through consolidation of financial institutions, creating one to three big banks with regional competitiveness and co-existing with small niche banks. We have adopted different regulatory measures to provide incentives for consolidation and have formulated supporting regulatory measures. In supervising the consolidation process, the FSC will focus on maintaining the steady development of our financial system and markets while safeguarding the interests of the public and bank employees.

In 2005, twelve M&A cases involving banks and credit cooperatives were completed. Several cases of foreign investment in local banks also transpired last year. These events substantiate the preliminary good results of the measures we have taken so far. Our plans for consolidation of the financial industry are summed up as follows:

1. Providing more incentives for consolidation while honoring the market mechanism to build a fair and transparent environment for consolidation.
2. Increasing competitive pressures through promoting differential management and financial transparency, as well as increasing the prevalence of financial services and enhancing social responsibilities of financial institutions while concurrently promoting consolidation.
3. Allowing quality financial institutions with good performance and strong competitiveness to form financial holding companies through M&A.
4. Applying pressure for consolidation, through the market mechanism, on existing financial holding companies that have demonstrated poor performance yet lack intention to merge.

Former Chairman Kong speaking at The Japan Financial Industry Consolidation Seminar on September 19, 2005.

D. Speed Up Internationalization of the Financial Industry

1. Promoting and internationalizing Taiwan's capital market

The FSC continues to promote and internationalize Taiwan's capital market through the development of the foreign currency denominated international bond market and by aligning Taiwan's financial environment and systems in line with international standards. We hope to attract reputable foreign companies to list in Taiwan and encourage foreign portfolio investors to participate in our markets, which will both enhance the competitiveness of Taiwan's capital market. These efforts will facilitate Taiwan's ascension into becoming a regional fund-raising and assets management center as well as increase employment opportunities and tax revenues in Taiwan.

2. Launching USD-denominated futures products

The FSC will supervise the launching of USD-denominated futures products, such as gold futures and MSCI Taiwan Index futures and options, by the Taiwan Futures Exchange in order to attract foreign investors to engage in futures trading as well as create an environment conforming to international practice. At the same time, the FSC will loosen restrictions placed on overseas Chinese and foreign nationals by allowing them to trade futures in the Taiwan market for all purposes and conduct futures trading through omnibus accounts, which will expand the scale of our futures market. (Note: The aforementioned 3 USD-denominated products and 2 new measures took effect on March 27, 2006.)

3. Promoting corporate governance

In connection with the amendment to the Securities and Exchange Act, the FSC has promulgated the "Regulations Governing the Installation of Independent Directors of Public Companies and Related Compliance Matters", the "Regulations Governing the Exercise of Powers by Audit Committees of Public Companies", the "Regulations Governing the Proceedings of Board of Directors Meetings of Public Companies" to facilitate implementation of various corporate governance measures and provide public companies with compliance requirements. The FSC will continuously hold international conferences, such as the Taipei Corporate Governance Forum, to give guidance on improving corporate governance and information transparency as well as to boost investor confidence.

4. Stepping up international exchange and cooperation

The FSC aims to establish more communication channels with the financial regulators of other countries and bring about the signing of bilateral cooperation agreements, such as MOU or exchange of notes, to ensure fast access to relevant information when a cross-border financial incident occurs, in order to protect the interests of our consumers.

The FSC will also actively participate in WTO talks to negotiate with more countries about market liberalization. This will essentially create more business opportunities for our financial industry and help domestic financial institutions develop in international markets. In addition, as the securities market of several major developing countries are still in the budding stages, Taiwan is moving steadily towards the rank of developed markets. The FSC is willing and ready to share our experiences with developing countries to aid the development of their securities market while taking the opportunity to help our financial institutions enter into overseas markets.

E. Strengthen Supervision of the Insurance Industry

1. Amendment to the Insurance Law

To improve supervision of the insurance industry and develop the insurance market, the FSC has proposed amendments to the Insurance Law. The main amendments include: loosening regulations on insurance business, enhancing financial soundness of insurance industry, promoting transparency of business management, strengthening the management of insurance funds while deregulating their investments, maintaining orderly financial markets, and reassessing the rationality of the insurance contract law. The Executive Yuan has finished reviewing the drafted amendments, and we hope the Legislative Yuan will pass them as soon as possible.

2. Strengthen the mechanism of solvency

The FSC continued to review the RBC system (Risk-Based Capital system), implemented the appointed actuary system, and amended the reserve setting procedure. The FSC also reviewed the accounting rules to cope with the current developments of Taiwan and international accounting standards. In order to strengthen the financial structure of insurance companies, the FSC required insurance companies to enhance risk management procedures and to establish an appropriate asset-liability allocation system.

3. Reviewing and amending insurance product review system

In order to implement the objective of the rating-based review system, the FSC will continue to revise the product filing system and minimize the categories of insurance products that are subject under the "file and use" system. To strengthen the internal control system of product development, the FSC places more responsibilities onto the company and persons who signed the product filing documents. Also, the FSC promotes better consumer protection and wants to create a more stable environment for the operation of the insurance industry. This system procedure will be implemented with the two-phase review process. The first stage will adapt the directions governing the negative list approach, to simplify the review process, and receive responses from insurance companies and product designers to develop products. The second stage will depend on the results from the first.

4. Continue to review the Taiwan Residential Earthquake Insurance system

Vice Chairperson Chang speaking at the Insurance Crime Prevention Seminar on December 6, 2005.

The take-up rate for the Taiwan Residential Earthquake Insurance scheme reached 19.05% as of the end of 2005. Compared to a rate of 2% (of 921 earthquakes) in 1999, the take-up rate at the end of 2005 shows substantial growth. In order to ensure the smooth operation of the insurance scheme, the FSC has identified the Residential Earthquake Insurance Fund with the primary responsibility and as the final risk taker for the insurance scheme. The FSC also plans to advocate the independent operation of the Residential Earthquake Insurance Fund, separate from the Central Reinsurance Corporation, on July 1, 2006. Additionally, in order to provide citizens with better property protection, the FSC plans to establish the Standard Claim Procedure of Residential Earthquake Insurance and continue to review the Residential Earthquake Insurance risk-bearing mechanism.

F. Contiune to Enhance Financial Knowledge and Literacy

Because consumption activities are directly related to a person's daily activities, it is essential to cultivate healthy consumption habits and responsible financial investing. In addition to proceeding with current efforts, future projects will entail:

1. Realization of financial literacy on school campuses through the inclusion of financial education in school textbooks, distribution of edited supplemental materials and mandates for school teachers, encouragement of teaching financial literacy in school, and informational seminars for school teachers.
2. Collaboration with the ROC Bankers Association, Society of Credit Unions, Taiwan Academy of Banking and Finance, and ROC Consumer's Foundation to carry out financial literacy campaigns on school campuses and throughout the community. We plan to hold a total of 213 events showing educational videos and holding lectures to help students and the public develop correct attitudes toward consumption and personal financial planning.
3. Cooperation with volunteer groups, serving the indigenous communities of Taiwan, to raise financial literacy and competence among indigenous people.
4. Sponsorship of financial literacy activities organized by qualified universities and associations.
5. Consolidation of all related resources from financial licensing and training agencies to effectively foster the development of financial talents.

Vice Chairperson Chang and Taiwanese youth pictured here at the "Young Financier Development Camp", held at the Cathay Dan Shui Educational Center.

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