



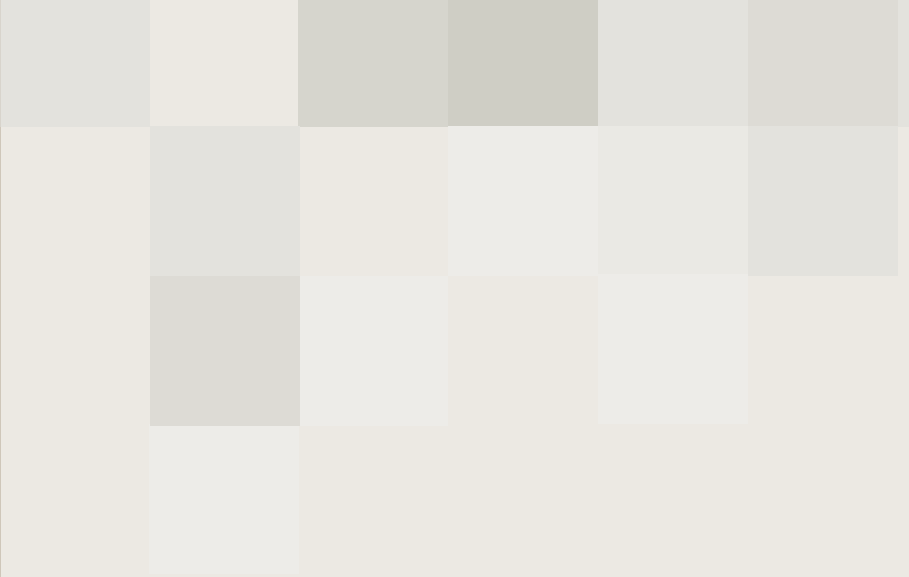
Financial Supervisory Commission
Taiwan

2006
Annual Report



**Financial Supervisory Commission
Taiwan**

2006
Annual Report



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FROM THE

Ever since its establishment, the Financial Supervisory Commission (FSC) has strived to implement financial policy and carry out reforms. Our efforts have been characterized by a focus on the big picture, a service-oriented approach, and a high standard of professionalism. Achieving our core goals of developing the financial sector, maintaining financial stability, implementing financial reforms, and strengthening the protection of consumers and investors, we are working together to establish a diversified, international, secure, and stable financial market in Taiwan.

The year 2006 brought many significant improvements. In the area of legislative reform, the FSC proposed a number of financial reform bills. Draft amendments to the Banking Act and the Credit Cooperatives Act were forwarded to the Executive Yuan for review, and an amendment to the Deposit Insurance Act was passed by the Legislative Yuan. Successful passage of the Deposit Insurance Act amendment was due in no small part to vigorous efforts by the FSC to build support within the legislature. In addition to its efforts to upgrade financial legislation, the FSC continued taking steps to reform and open up Taiwan's banking, capital, and insurance markets.

In the banking and insurance markets, the FSC continued to encourage banks to improve asset quality, and considerable success was achieved. The average NPL ratio was lowered from 2.24% at the end of 2005 to 2.13% at the end of 2006, while the average NPL coverage ratio rose from 49.90% to 58.83% during the same period. At the same time, the FSC continued to push ahead financial consolidation while fully respecting market mechanisms. In addition to creating a level playing

CHAIRMAN

field with transparent rules, we worked to eliminate legal barriers to facilitate and encourage mergers and acquisitions among financial institutions. A total of six M&A deals were completed in 2006, while nine foreign institutions acquired stakes in six domestic financial institutions. Enforcement of the market exit mechanism also played a role in the cleanup of troubled financial institutions, as one institution succeeded in self-rescue efforts, and the FSC designated the Central Deposit Insurance Corporation to take over the operations of Taitung Business Bank. The FSC also took steps to promote the securitization market, setting up a one-stop window for product review and expanding the range of assets eligible for securitization. Accumulated approved securitization deals stood at NT\$518.7 billion at the end of 2006. In addition, we continued to ease restrictions on insurance companies with respect to funds allocations and business scope, and adopted a negative list approach to narrow the range of products requiring prior approval. The idea behind these changes is to move toward greater reliance on industry self-regulation and help our insurers become more competitive.

Changes were also made in the area of capital markets. The FSC has completed the codification of corporate governance, which has helped to ensure the adoption of independent directors and audit committees. To promote healthy development of our capital markets, we pushed to bring our accounting standards in line with international standards, to expand the range of businesses open to securities services companies, and to prevent insider trading. In the meantime, we

continued to internationalize our market by relaxing restrictions on the scope of investments and capital allocations by foreign entities. Since foreign investors first began trading on our stock exchange in 1992, the accumulated net inward remittances had reached US\$130.6 billion at the end of 2006. The holdings of foreign investors accounted for 32% of the total market capitalization. We also embarked a foreign currency denominated international bond market in 2006. Deutsche Bank Frankfurt carried out a US\$250 million bond issue in October 2006, and the bonds were officially listed and began trading on the GreTai Securities Market on 1 November 2006.

Looking ahead, the FSC intends to follow the guiding principles of "openness," "innovation," and "efficiency" to implement the Financial Market Package Project, strengthen supervision of conglomerates, establish an early warning mechanism, and crack down on financial crime. By safeguarding the interests of depositors, investors, and insurance policy holders, and by deregulating and internationalizing our markets, the FSC will build a stronger, more competitive financial environment that enables us to develop Taiwan into a regional financial services center.



Sheng-Cheng Hu, Chairman
Financial Supervisory Commission, Taiwan

May 2007



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 experience, 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 objective of the FSC is to increase the competitiveness of Taiwan's financial industry.

A Organization

I. Background

The 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 sectoral regulation, 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"), the FSC is headed by nine commissioners, one of whom serves as the chairperson and two others 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 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 must be submitted to the commissioners for deliberation and resolution. A board resolution is adopted only if it is approved by a majority vote at a meeting attended by at least two thirds of the commissioners. The commissioners are required to hold meetings once a week, and extraordinary sessions may be convened when necessary. In addition, the FSC and the Central Bank must hold financial supervisory cooperation meetings, which other government agencies may be invited to attend, if necessary, to strengthen financial stability.

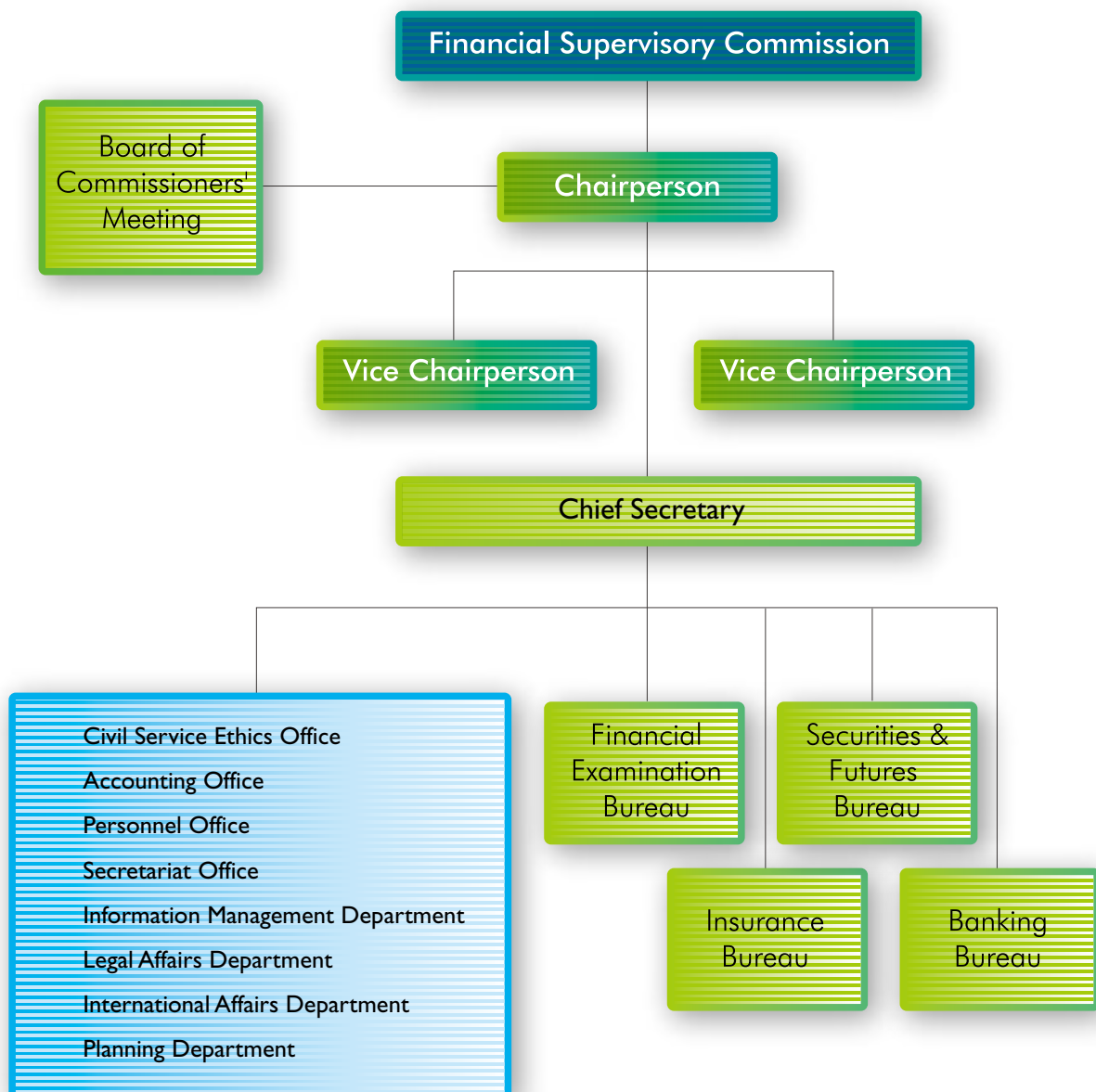
The FSC comprises four departments, four offices, and four bureaus, as follows:

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

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

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

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



3. Commissioners and officers



Chairperson

Sheng-Cheng Hu



**Administrative Vice Chairperson
and Acting Director General of
Banking Bureau**

Susan S. Chang



Commissioner

Chung-Fern Wu



Commissioner

Shyan-Yuan Lee



Commissioner

Kuo-Chuan Lin



Commissioner

Shih-Chieh Bill Chang



Commissioner

Ya-Hwei Yang



**Director General of Securities and
Futures Bureau**

Tang-Chieh Wu



**Director General of Insurance
Bureau**

Tien-Mu Huang



**Director General of Financial
Examination Bureau**

Ming-Chung Tseng



Chief Secretary

Austin Chan

B Functions and Authority

I. Services

Pursuant to Article 2 of FSC Organic Act, the FSC is 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 follows:

- (1) Financial markets include the banking market, money market, securities market, futures and derivatives market, insurance market, and their respective settlement systems.
- (2) Financial service enterprises include financial holding companies, the Financial Restructuring Fund, the 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 is 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:

- (1) Managing financial systems and supervisory policy issues;
- (2) Drafting, amending and repealing financial laws and regulations;
- (3) Supervising and regulating the following matters in connection with financial institutions: establishment, termination, revocation, changes of registered information, mergers, business suspensions, dissolutions, and approvals of business scope;
- (4) Development, supervision, and regulation of financial markets;
- (5) Examination of financial institutions;
- (6) Examination of matters relating to public companies and securities markets;
- (7) Handling of international financial matters;
- (8) Protection of financial consumers;



- (9) Enforcement of financial laws and regulations, punishment of violators and handling of matters related thereto;
- (10) Collection, processing and analysis of statistical information relating to financial supervision, regulation and examination;
- (11) Inspection of other matters relating to financial supervision, regulation and examination.

3. Commissioners Meetings

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 a meeting attended by at least two thirds of the commissioners. In addition to abiding by the provisions of recusal in the Administrative Procedure Act, an FSC commissioner 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. For any given case, recusal requirements also apply to other FSC personnel involved in the handling of that case.

In order to implement a collective decision-making system, the FSC in November 2006 adopted the "Directions for Meetings of the Financial Supervisory Commission, Executive Yuan." The Directions require that the entire proceedings of commissioners meetings be preserved in audio and/or video recordings. In addition, for the sake of due process and full disclosure of government information, the Directions allow for an individual commissioner to submit a concurring or dissenting opinion for posting on the Internet along with any given FSC resolution.

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) Proposals for 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 of registered information, 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

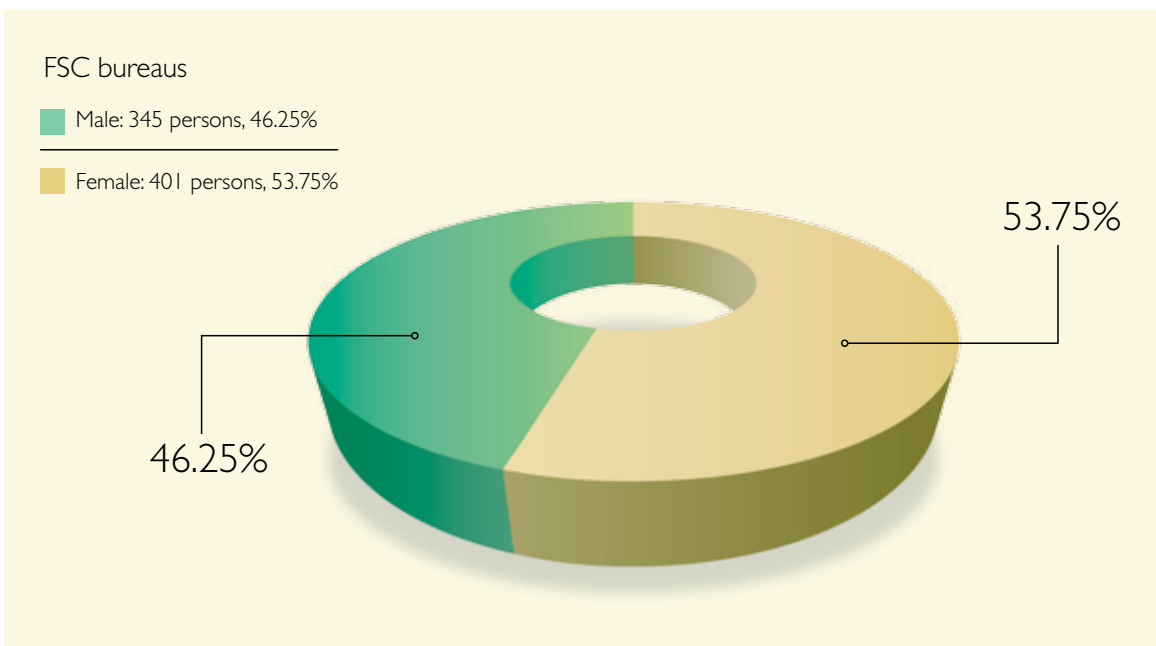
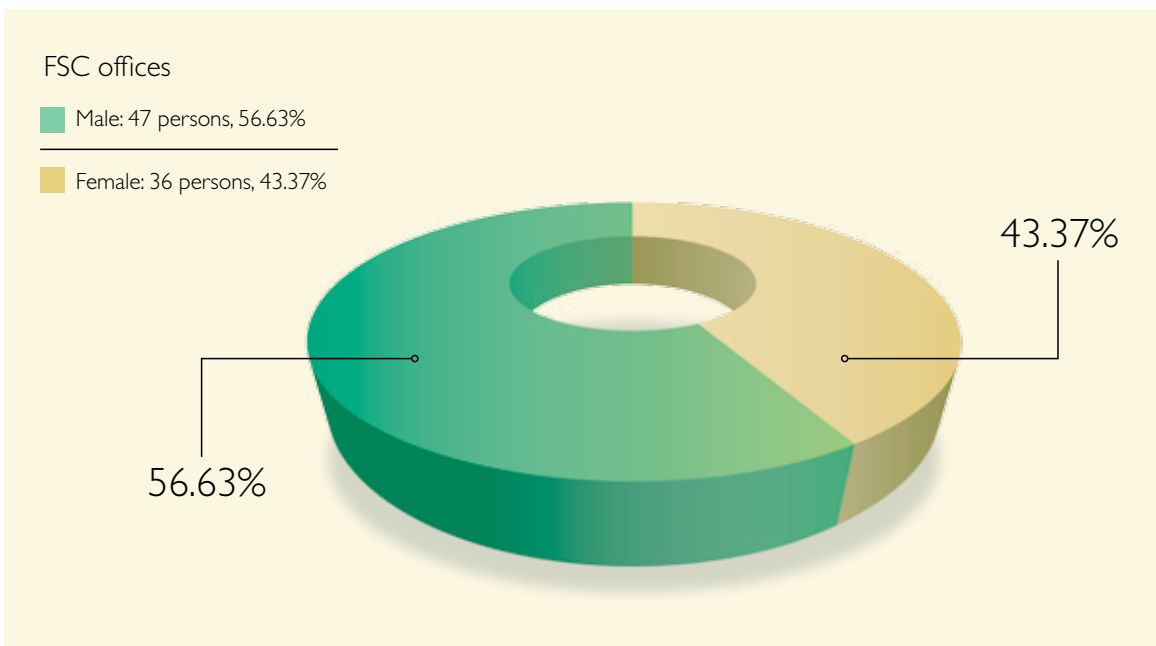
The functions of the FSC bureaus, departments and offices are as described below:

- (1) Banking Bureau: Supervises and regulates the banking market, money market, and banking enterprises; formulates, plans, and implements 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; formulates, plans, and implements policies, laws, and regulations connected therewith.
- (3) Insurance Bureau: Supervises and regulates the insurance market and insurance enterprises; formulates, plans, and implements policies, laws, and regulations connected therewith.
- (4) Financial Examination Bureau: Supervises and examines financial institutions; formulates, plans, and implements 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; researches and promotes major international financial projects; and carries out international promotional activities.
- (7) Department of Legal Affairs: In charge of the integration, drafting, research, revision, and interpretation of financial supervisory laws and regulations, consulting regarding the same, 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 budgeting, accounting, and statistical matters.
- (11) Personnel Office: Responsible for personnel management matters.
- (12) Civil Service Ethics Office: Responsible for ethics-related matters.

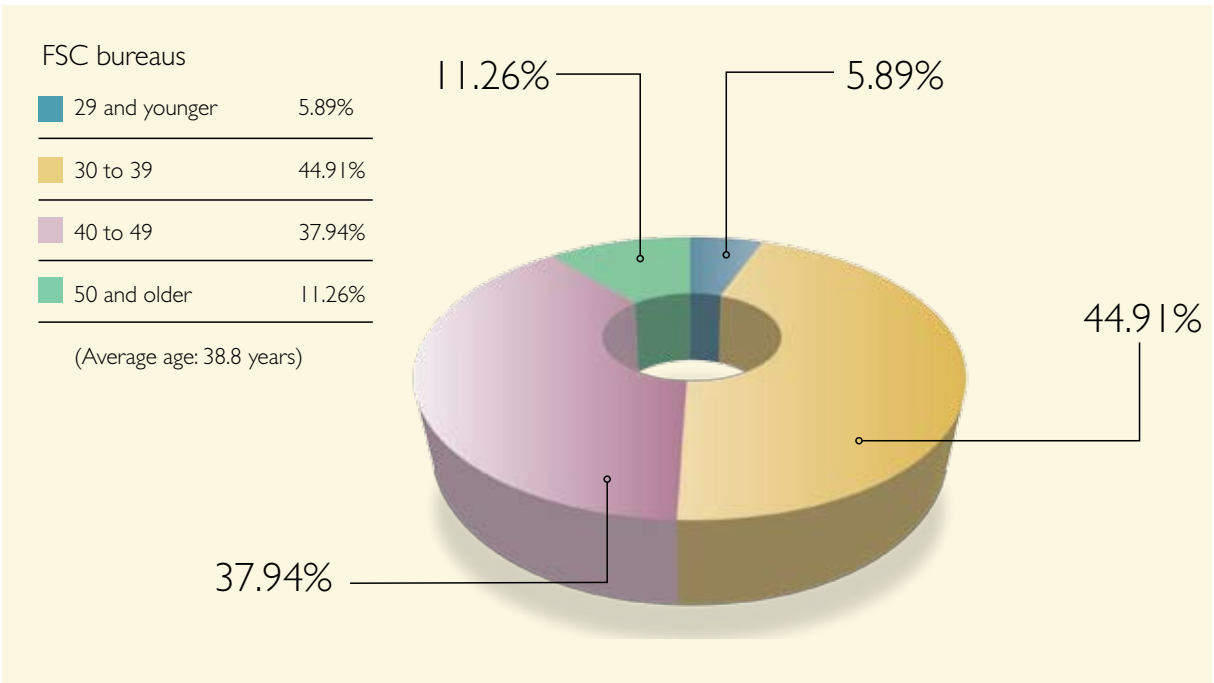
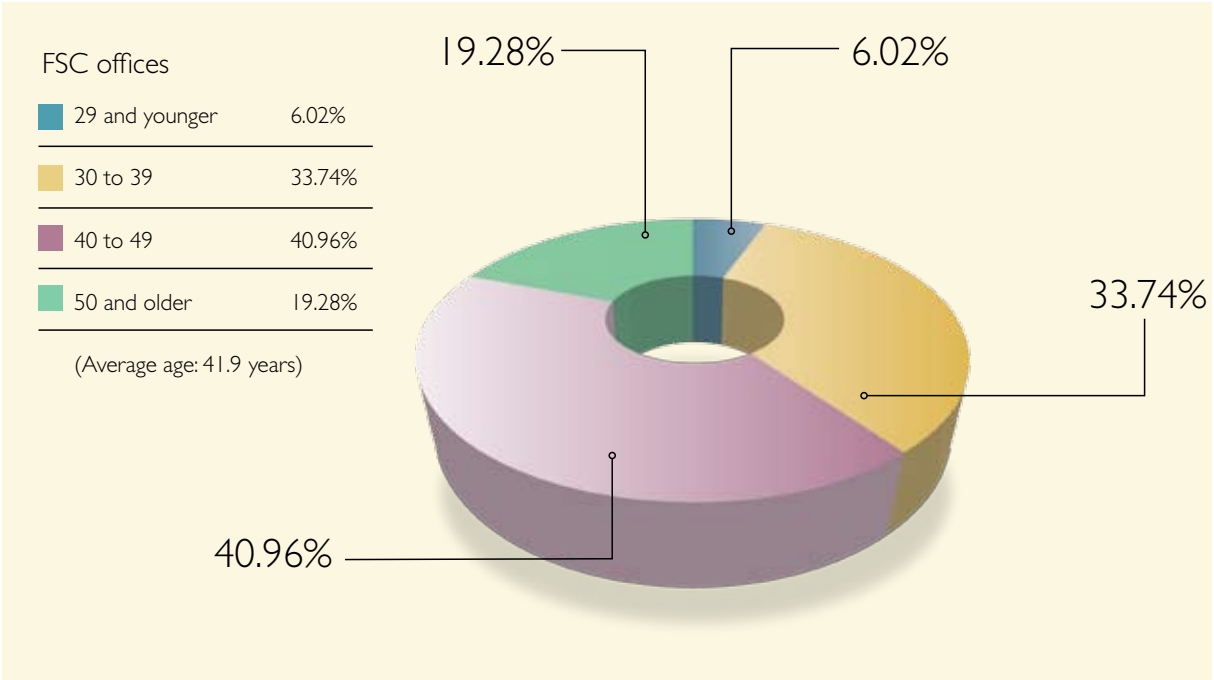
C Workforce

According to the FSC Organic Act, the authorized size of the FSC workforce totals 1,056 persons, which includes 146 persons for the FSC offices and 910 persons for all bureaus under the FSC. As of the end of 2006, the FSC offices had 83 employees while the bureaus employed 746 persons, totaling 829 persons.

I. Gender distribution



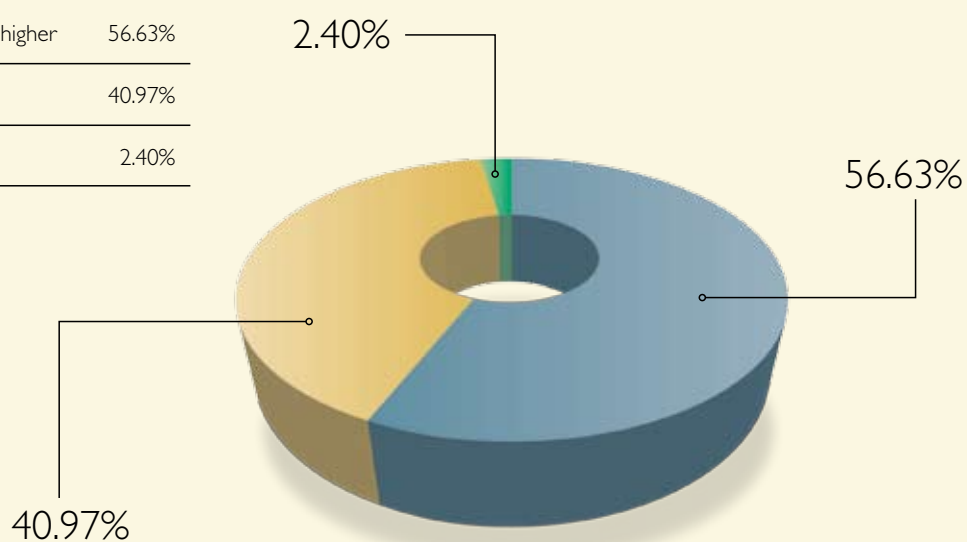
2. Age distribution



3. Education

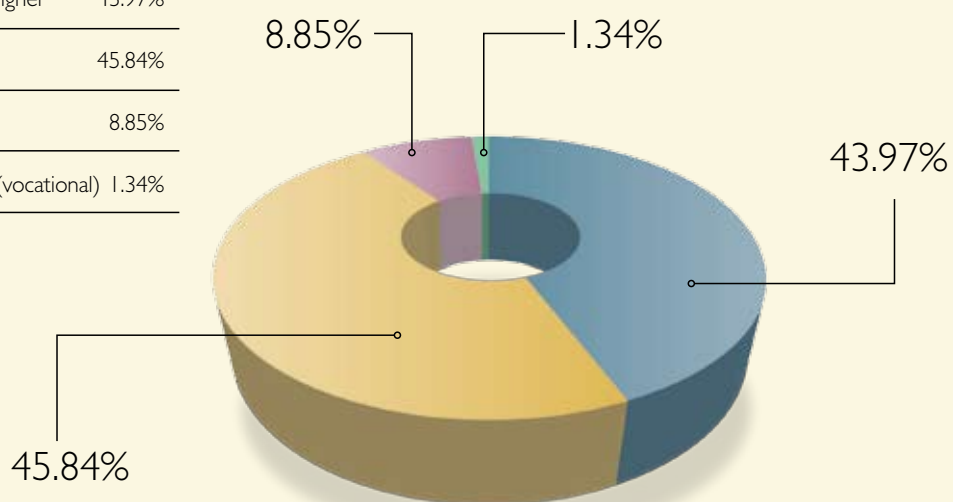
FSC offices

Master's or higher	56.63%
Bachelor's	40.97%
Jr. College	2.40%



FSC bureaus

Master's or higher	43.97%
Bachelor's	45.84%
Jr. College	8.85%
High school (vocational)	1.34%





FSC ACTIVITIES IN 2006

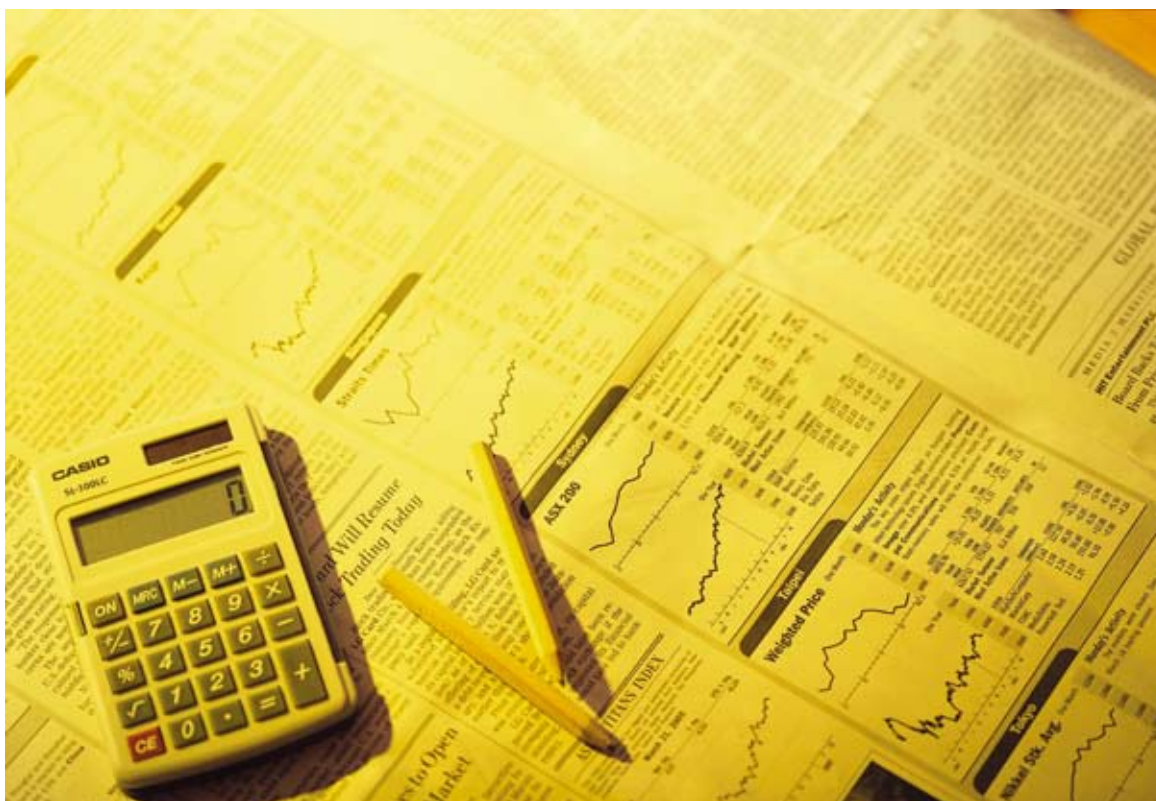
In 2006, the FSC continued to push forward with financial reforms, promote the development of a healthy financial market, and help strengthen the competitiveness of financial institutions. The FSC also endeavored to maintain financial stability, to push for globalization of our financial markets, and to improve consumer and investor protection and public education. All these efforts were designed 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 Development of Financial Markets

I. Improving the regulatory environment for financial markets

In order to build a good regulatory environment conducive to sound development of the financial industry, the FSC completed amendments to eight financial acts (Banking Act, Offshore Banking Act, Securities and 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. The key points of the amendments are presented below:

- (1) Eight Financial Acts: Penalties were raised sharply; there will be either a specialty court or an appointed official designated to hear financial crime cases; under certain conditions, financial institutions can petition to the court to cancel prior transfer(s) of property by financial criminals; and non-banking entities are barred from using names that others might easily construe as a bank. Among the eight financial acts, the Securities and Exchange Act and the Offshore Banking Act deserve further description, as follows:



- i. Securities and Exchange Act: The amendment of the Securities and Exchange Act took effect on January 13, 2006, and 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 (e.g. by signing information sharing agreements), preventing market manipulation and insider trading, establishing more explicit governance requirements, and fleshing out legal provisions governing a wide range of securities crimes.
 - ii. Offshore Banking Act: The amendment of the Offshore Banking Act took effect on January 29, 2006, and focused on the following: prohibiting banks from accepting foreign currency deposits from ROC residents within the territory of the ROC, allowing offshore banking units to designate an authorized foreign exchange bank to handle business activities on its behalf, and raising penalties to adequate amounts.
- (2) Act for the Establishment and Administration of the Financial Restructuring Fund: The restructuring fund was expanded to NTD 110 billion in order to give the FSC a freer hand in its efforts to urge troubled financial institutions to increase capital or be merged.

2. Stimulating the securities markets

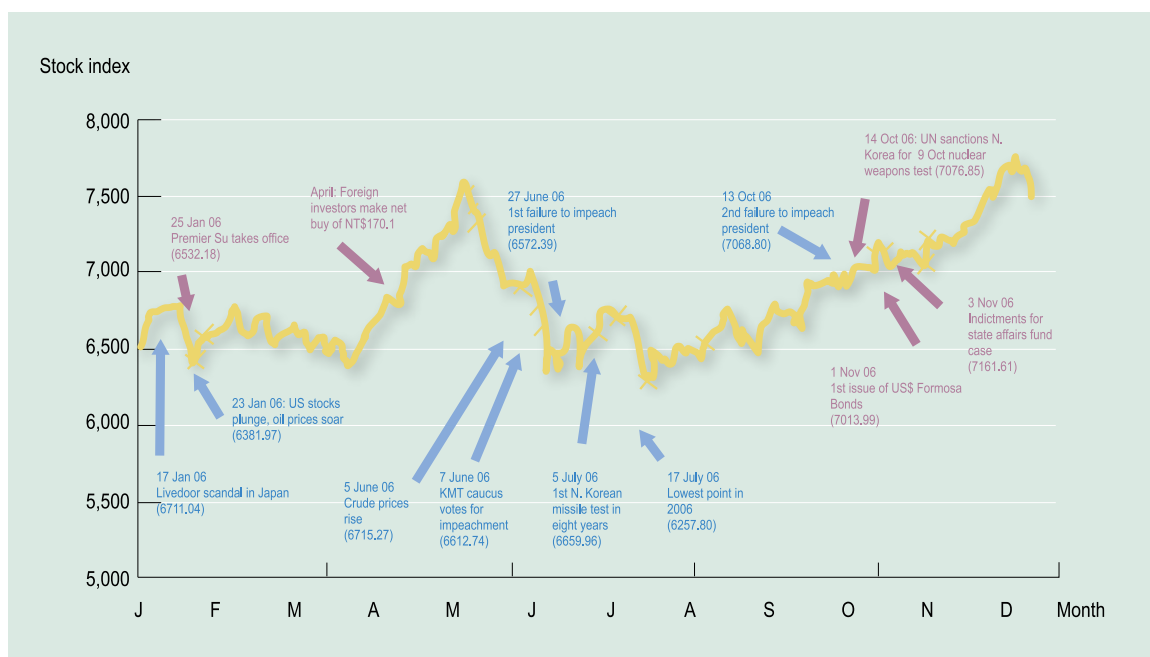
FSC has taken a number of measures to stimulate the securities markets, which include: implementing a new underwriting system, strengthening corporate governance, introducing an independent directors system and audit committee system, enhancing regulations governing market insider trading, expanding the business scope of securities firms, and revising accounting principles to bring them in line with international standards.

3. Permitting bills finance companies to deal in brokerage and proprietary trading of fixed-income securities

In order to develop the market for fixed-income assets and enhance the role of fixed income market makers, the FSC now allows bills finance companies to deal in brokerage and proprietary trading of fixed-income securities.



TAIEX movements in 2006



4. Invigorating the bond market

In order to increase market efficiency and enhance the bond shorting mechanism, the GreTai Securities Market implemented repo trading on its Electronic Bond Trading System. During the period from March 1, 2005 (when repo trading was introduced) till the end of that year, the trading value totaled NTD 13.55 trillion, satisfying a demand for short selling. Strip government bonds and corporate bonds, which separate into interest and principal bonds, were introduced to facilitate participation in the secondary market by retail investors, and to increase the liquidity of coupon-bearing bonds.

By the end of 2006, a total of NTD 133.7 in billion strip bonds were issued (including NTD 21.6 million in government bonds, NTD 39.62 billion in corporate bonds, and NTD 93.88 billion in financial debentures), which facilitated the disposal of structured bonds.

5. Promoting development of the futures market

Taiwan's futures market marked its 8th consecutive record-breaking year in 2006. Annual trading volume reached a new high of 114,603,379 contracts, surpassing the previous record of 92,659,768 contracts set in 2005. This represents a growth of 23.68% as compared to 2005. In addition, the market introduced three US dollar denominated futures products and adopted two new trading mechanisms, while a number of regulations were amended to deepen the futures market.

6. Promoting development of the securitization market

A draft amendment to the 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, 2005. In 2006, 22 securitization deals worth a total of over NTD 233 billion were approved by the FSC.



Total Amount Issued of Securitization Products/Commodities

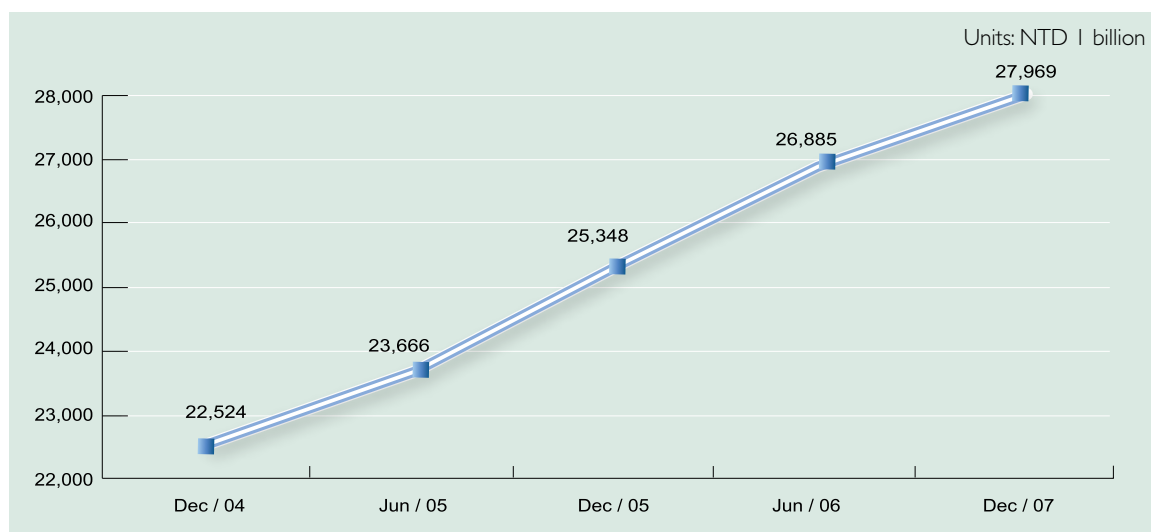
Units: NTD 1 billion

Year	Financial Asset Securitization			Real Estate Securitization			Total		
	Amount Approved	Amount Issued	Outstanding Balance	Amount Approved	Amount Issued	Outstanding Balance	Amount Approved	Amount Issued	Outstanding Balance
2003	32.69	26.98	15.88	-	-	-	32.69	26.98	15.88
2004	39.69	42.15	47.82	13.38	9.98	9.92	53.07	52.13	57.74
2005	165.19	141.86	165.34	34.14	37.54	46.34	199.33	179.40	211.68
2006	211.40	411.94	282.88	22.17	20.82	62.70	233.57	432.77	345.58
Total	448.97	622.94		69.69	68.34		518.66	691.28	

7. Increasing loans to small and medium enterprises (SMEs)

On July 1, 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, thereby enhancing the function of domestic banks as financial intermediaries. Lending to SMEs was expected to increase by NTD 200 billion within one year of the program's adoption. As of the end of December 2006, the balance of lending to SMEs reached NTD 2,797 billion, an increase of NTD 108 billion compared to that of June 30, 2006 and an increase of NTD 262 billion, or 10.33%, compared to the same period in the previous year. The program was 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



8. Promoting sound development of the insurance market

The FSC amended “the auto-adjust actuarial formula for the reserve valuation rate for new life insurance policies” 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 mortality protection products in the market. In order to provide the proper assessment of risks associated with new and unconventional types of investments, the FSC modified the formula for RBC calculations. For those companies with an RBC ratio of less than 200%, the FSC will continue to carefully supervise their financial soundness and require capital injections if necessary.

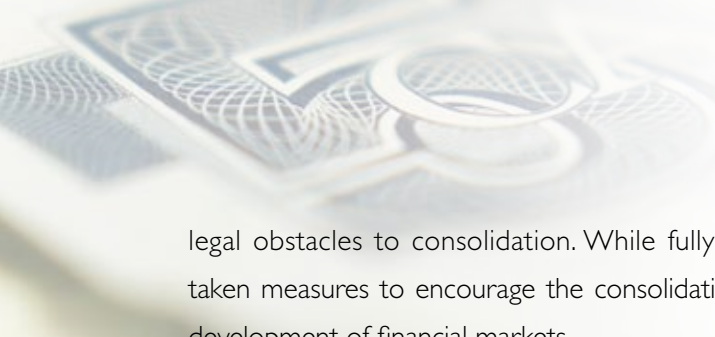
9. Improving efficiency and security of the clearing and settlement processes

In order to improve the efficiency and security of the clearing and settlement processes as well as to prepare the capital market for further internationalization, the Debt Instruments Depository and Clearing (DIDC) and the Taiwan Securities Central Depository (TSCD) merged to create the new Taiwan Depository & Clearing Corporation (TDCC) on March 27, 2006.

B Increased Competitiveness of Financial Institutions

I. Encouraging financial industry consolidation

The government has pushed forward with the second phase of financial reform by conducting a differential supervisory policy, providing incentives for financial consolidation, and removing




legal obstacles to consolidation. While fully respecting market mechanisms, the government has taken measures to encourage the consolidation of financial institutions and promote the sustainable development of financial markets.

The FSC has taken many actions to remove obstacles in M&A laws and regulations, including the following:

- (1) Financial holding company (FHC) subsidiaries with surplus capital are now allowed to reduce capital and transfer the surplus to the holding company, in order to ensure the efficiency of capital allocation.
- (2) An FHC intending to make a strategic investment was formerly required to acquire a stake of no less than 25% in the target company, but to eliminate the obstacle to hostile takeovers this threshold has now been reduced to 5%.
- (3) Legal provisions governing the public tender process have been revised to enhance the hostile takeover mechanism.
- (4) Guidelines for the approval of foreign FHC application documents and review requirements have been amended, as follows:
 - i. Suitable eligibility requirements have been adopted for foreign applicants.
 - ii. New provisions require that an applicant's management team have adequate experience and expertise in handling capital adequacy matters and managing an FHC group.
 - iii. The capital strength of the home country financial institution is now allowed to be factored in when assessing the strength of the bank it plans to control.

Banking consolidation policy (Measures for accelerating banking industry restructuring):

- (1) M&A-related regulations have been amended:
 - i. An FHC subsidiary with excess capital may reduce capital and transfer the difference to the parent company.
 - ii. Measures concerning tender offers will be amended to expand the range of assets treated as consideration acceptable for tender offer.
 - iii. The FSC has eased the rule requiring that a foreign financial holding company making a strategic investment in a domestic bank must acquire a stake of more than 25% of the shares.
 - iv. Cash and other property may now be used as consideration payable to the shareholders of merged institutions.
- 

(2) Incentives Available:

- i. Financial institutions with a non-performing loan ratio (NPL ratio) lower than 2.5% and a market share of 10% or more will receive priority processing of applications for approval to establish offshore branches or to merge foreign financial institutions.
- ii. Where a financial institution merges with another financial institution, the removed branches of the latter may apply for re-establishment and relocation.
- iii. Financial institutions with an NPL ratio lower than 2.5% receive automatic approval to engage in a set list of 12 lines of business.
- iv. New provisions in the Financial Institutions Merger Act and the Financial Holding Company Act allow for consolidated tax treatment and provide various tax incentives.

(3) M & A deals :

i. New M&A deals:

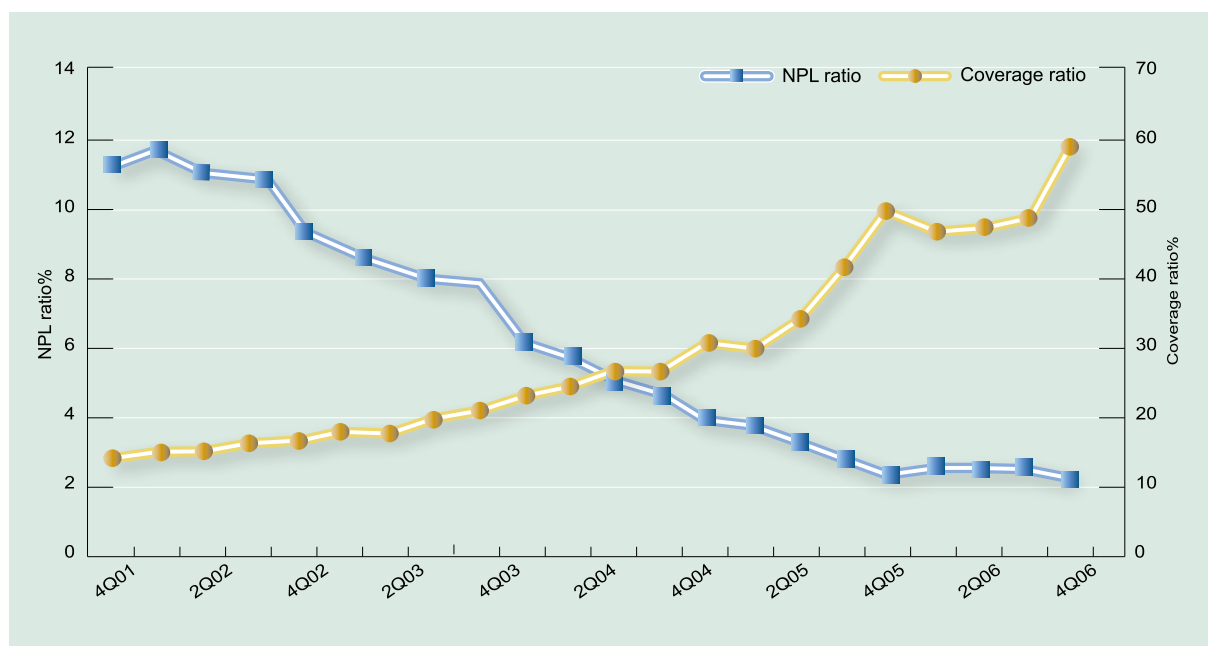
	Existing Entity	Acquired Entity	Merger Date
1	Cota Bank	Feng Yuan Credit Cooperative	2006.01.01
2	Taiwan Cooperative Bank	The Farmers Bank Of China	2006.05.01
3	The International Commercial Bank of China Renamed: Mega International Commercial Bank	Chiao Tung Bank	2006.08.21
4	Bank SinoPac	International Bank of Taipei	2006.11.13
5	Taipei Fubon Bank	Fubon Bills Finance Corporation	2006.12.25
6	E. Sun Bank	E.Sun Bills Finance Corporation	2006.12.25
7	Cathay United Bank	Lucky Bank	2007.1.1

- ii. The FSC granted approval for the Standard Chartered Bank to acquire up to 100% of the ordinary shares of Hsinchu International Bank (HIB). This is the first case in which an international bank has been allowed to directly hold more than 51% of the equity of a domestic bank. The FSC will continue working to facilitate the internationalization of domestic financial institutions.
- iii. The FSC has granted approval for the Tainan Business Bank to reorganize as a commercial bank, renamed King's Town Bank. It is expected the reorganization will enable the bank to achieve better financial structure and provide improved services to both business and retail customers.

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 Measures to Accelerate the Reduction of Non-performing Loans of Domestic Banks and promulgated the amendments on February 5, 2005. The amended Measures allow for supervisory indicators to be adjusted to reflect improvements in a bank's NPL ratio. The average NPL ratio for domestic banks was reduced from 3.80% in December 2004 to 2.38% by the end of February 2007. Over the same period, the coverage ratio was raised from 30.34% to 53.30%.

NPL Ratio and Coverage Ratio of Domestic Banks



As of December 2006, the average NPL ratio of credit cooperatives was 1.55, which was a decrease from 2.09% in December 2005 and was lower than the 2.13% average NPL ratio of domestic banks in December 2006. Furthermore, the coverage ratio of allowances for NPLs was 82.04%, up from 61.30% in December 2005 and higher than the average coverage ratio of 58.83% among domestic banks in December 2006. All 28 of Taiwan's credit cooperatives had NPL ratios lower than 5%. What is better, 20 cooperatives had NPL ratios below 2.5%, showing that the asset quality and the managerial efficiency of the cooperatives has significantly improved.

3. Adopting differential supervision

- (1) FSC wants to encourage further improvements in asset quality, streamline the application procedures, as well as encourage more innovation from banks. In order to do so, there shall be fewer restrictions on the business of certain financial institutions in compliance with the criteria

set forth in the “Measures to Accelerate the Reduction of Non-Performing Loans of Domestic Banks” (revised on February 5, 2005) and “Directions Concerning the Negative List for Banks Conducting Finance-Related Business” (promulgated on March 23, 2005).

(2) Establishing differential regulatory treatment for the underwriting system:

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

- i. Steps have been taken to expand the business scope of securities service enterprises, including the following: (1) Securities and investment trust enterprises (SITEs) are now allowed to concurrently run the type of business heretofore reserved to securities investment consulting enterprises (SICEs), and vice versa. (2) SITEs, SICEs, and securities firms are now allowed to act as the master agent of offshore fund institutions for the offering of offshore funds in Taiwan. (3) Securities brokers are now allowed to concurrently conduct discretionary investment business. (4) Securities finance enterprises are now allowed to engage in securities settlement financing.
- ii. The FSC has amended the “Regulations Governing the Offering of Securities Investment Trust Funds by Securities Investment Trust Enterprises (SITEs)” in order to provide a clear definition of what constitutes an onshore funds distributor and to apply consistent treatment to onshore and offshore funds distributors.
- iii. With respect to the futures industry, futures commission merchants (FCMs) are allowed to invest in foreign enterprises and engage in OTC-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 component stocks of ETFs and the Taiwan 50 index.
- iv. As to discretionary account operations of managed futures enterprises, the FSC has lowered the minimum amount that managed futures enterprises are allowed to accept from principals to NTD 2.5 million, in order to attract more retail customers. In addition, the FSC has granted permission for managed futures enterprises to possess foreign currency deposits and to invest in bond funds.

(3) FSC amends the “Regulations Governing Pre-sale Procedures for Insurance Products”

The FSC launched a new insurance product review system on September 1, 2006. The new system features greater emphasis on the self-regulatory function of insurers, and less reliance on external intervention by the regulator. Major changes of the new system include a significant reduction in the scope of insurance products subject to pre-approval, the setting

of specific deadlines for completion of product reviews, and strengthening the internal control mechanism for product development and management within insurance companies. From September to December 2006, the ratio of product filings subject to prior approval fell sharply to 5.19%, much lower than the 31.85% figure for the same period of the previous year. To enhance consumer protection, the FSC has also required the Actuarial Institute of the R.O.C. to prescribe the Actuarial Standards of Practice for life and non-life insurance products and has rigorously conducted random inspections on insurance products that are subject to the “use and file” system.

4. Increasing the competitiveness of the futures market:

An amendment to the Futures Transaction Tax Act was passed by the Legislative Yuan on November 22, 2005 and became effective on January 1, 2006. Among the approved tax rates, the minimum tax rates under the amended Act now apply to equity futures contracts, 30-day commercial paper interest rate futures contracts, and options contracts, thus reducing the tax rates on equity futures and options by 60% and 20%, respectively.

To attract foreign participation and speed the internationalization of Taiwan's futures market, the FSC has adopted the following measures:

- (1) The FSC now allows overseas Chinese and foreign investors to pay in US dollars for current NT dollar denominated contracts with US dollars.



- (2) Under FSC supervision, the TAIEX has launched 3 US dollar denominated futures and options products, namely, Gold Futures, MSCI futures and MSCI options.
- (3) Non-hedge futures trading is now allowed: When the FSC began allowing foreign investors to engage in futures hedge trading on May 21, 2004, it was with the proviso that such trading was only allowed in connection with short hedge or long hedge strategies. On March 27, 2006, however, the FSC opened Taiwan's futures market for speculative and arbitrage trading by foreign investors.
- (4) Foreign traders allowed to participate in Taiwan's futures market through omnibus account: For offshore Chinese or foreign nationals who may have difficulties opening direct accounts with local futures commission merchants (FCMs), omnibus accounts provide easier access to Taiwan's futures market. The omnibus account can be treated and processed as a single account regardless how many traders are behind it. Overseas FCMs can choose whether or not to disclose their clients' identification and trading information to TAIEX FCMs.

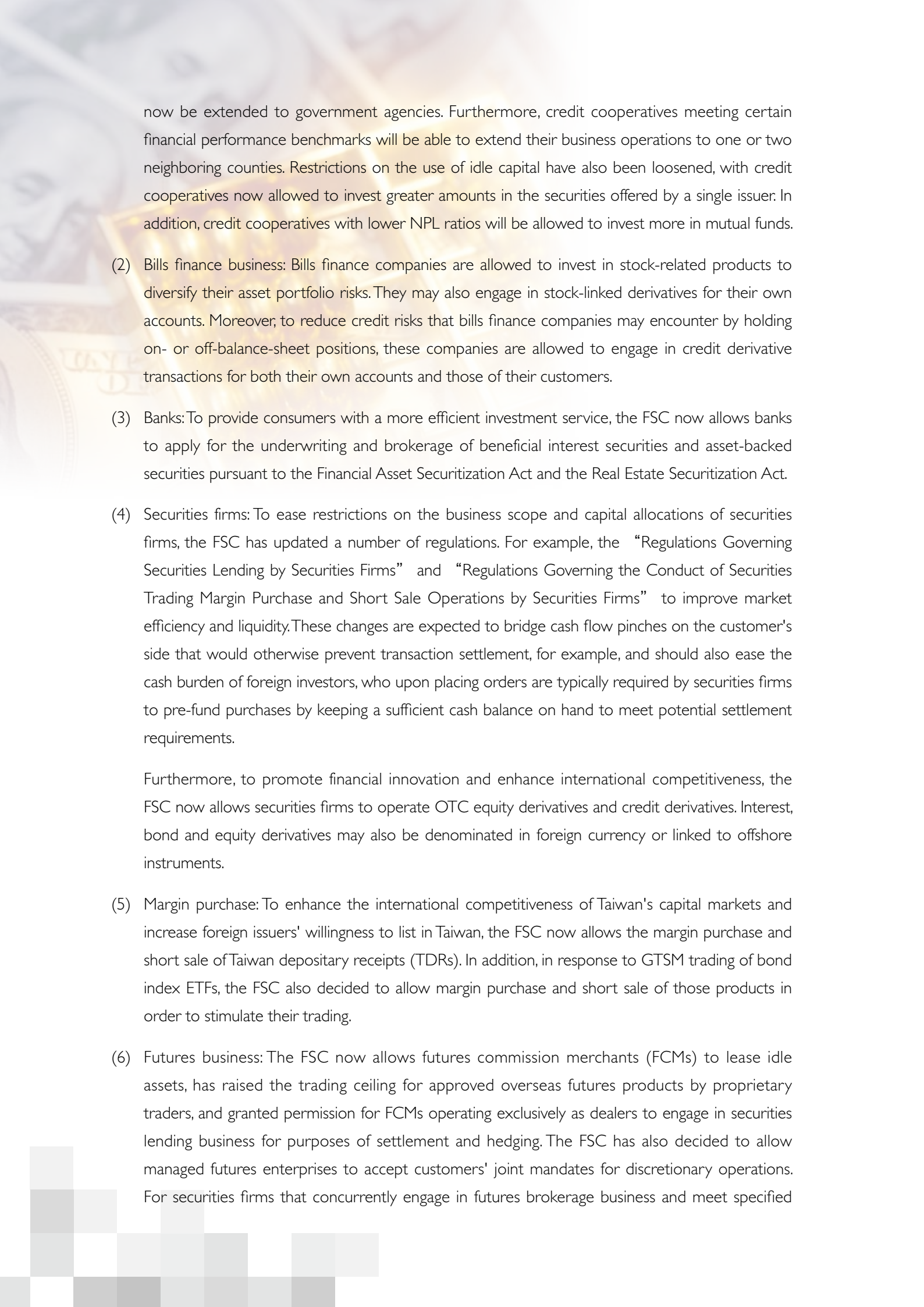
5. Deregulating the wealth management business

To enlarge the business scope of financial institutions, the FSC now allows banks, securities firms, and insurance firms engaging in wealth management businesses to provide customers with assets allocation and financial planning services. In addition, the FSC amended the “Guideline for Banks Engaging in Wealth Management Business”, and issued the “Guideline for Banks Selling Financial Products to Customers Other Than the Clients of its Wealth Management Department”, the “Guideline for Securities Firms Engaging in Wealth Management Business” as well as the “Guideline for Life Insurance Companies Engaging in Wealth Management Business” to regulate the qualifications of wealth managers and request institutions to establish know-your-customer (KYC) procedures, internal control procedures, risk management systems, product suitability policies, and mechanisms for handling disputes. These guidelines enhance the risk management systems and internal control procedures of financial institutions that engage in wealth management business, govern their conduct in the sale of financial products, protect the rights of their customers, and promote sound development of the wealth management business in Taiwan.

As of December 2006, the FSC had granted approvals for 37 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.

6. Broadening business scope and easing capital allocation restrictions

- (1) Credit cooperatives: Credit cooperatives are now allowed to serve a broader customer base, including government-run enterprises for the first time, while higher credit limits can



now be extended to government agencies. Furthermore, credit cooperatives meeting certain financial performance benchmarks will be able to extend their business operations to one or two neighboring counties. Restrictions on the use of idle capital have also been loosened, with credit cooperatives now allowed to invest greater amounts in the securities offered by a single issuer. In addition, credit cooperatives with lower NPL ratios will be allowed to invest more in mutual funds.

- (2) 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 credit derivative transactions for both their own accounts and those of their customers.
- (3) Banks: To provide consumers with a more efficient investment service, the FSC now allows banks to apply for the underwriting and brokerage of beneficial interest securities and asset-backed securities pursuant to the Financial Asset Securitization Act and the Real Estate Securitization Act.
- (4) Securities firms: To ease restrictions on the business scope and capital allocations of securities firms, the FSC has updated a number of regulations. For example, the “Regulations Governing Securities Lending by Securities Firms” and “Regulations Governing the Conduct of Securities Trading Margin Purchase and Short Sale Operations by Securities Firms” to improve market efficiency and liquidity. These changes are expected to bridge cash flow pinches on the customer's side that would otherwise prevent transaction settlement, for example, and should also ease the cash burden of foreign investors, who upon placing orders are typically required by securities firms to pre-fund purchases by keeping a sufficient cash balance on hand to meet potential settlement requirements.

Furthermore, to promote financial innovation and enhance international competitiveness, the FSC now allows securities firms to operate OTC equity derivatives and credit derivatives. Interest, bond and equity derivatives may also be denominated in foreign currency or linked to offshore instruments.

- (5) Margin purchase: To enhance the international competitiveness of Taiwan's capital markets and increase foreign issuers' willingness to list in Taiwan, the FSC now allows the margin purchase and short sale of Taiwan depositary receipts (TDRs). In addition, in response to GTSM trading of bond index ETFs, the FSC also decided to allow margin purchase and short sale of those products in order to stimulate their trading.
- (6) Futures business: The FSC now allows futures commission merchants (FCMs) to lease idle assets, has raised the trading ceiling for approved overseas futures products by proprietary traders, and granted permission for FCMs operating exclusively as dealers to engage in securities lending business for purposes of settlement and hedging. The FSC has also decided to allow managed futures enterprises to accept customers' joint mandates for discretionary operations. For securities firms that concurrently engage in futures brokerage business and meet specified

criteria set by the FSC, the FSC has eased restrictions on their business scope such that they are now allowed to engage in the full range of domestic futures and options and commodity products approved. In addition, in order to increase the capital efficiency of the Taiwan Futures Exchange and futures clearing houses, the FSC has set upper limits on the accumulated amount of the compensation reserves and special reserves that they set aside.

- (7) Insurance companies: To help insurance companies reap greater returns on their investment of funds, the FSC has decided to allow insurance companies to purchase international bonds through the International Bond Trading System of the GreTai Securities Market and to carry out repurchase transactions through bond dealers.

Table of Insurance Funds

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
2006	178,056	6,967,725	7,145,781

7. Implementing the new labor pension scheme

According to the Labor Pension Act enacted in July 2005, the rate of contribution by an employer for 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, but enterprises with over 200 employees may opt in favor of a qualified annuity as their labor pension plan instead if 50% of the employees express consent. Employees who choose the Individual Retirement Account may voluntarily contribute up to 6% of their monthly wages into account. The full amount of such voluntary pension contribution is eligible for deduction from the employee's taxable income.

8. Practical approach to financial dealings across the Taiwan Strait

The FSC amended the regulation governing the approval of the financial dealings between China and Taiwan on March 3, 2005. The amendment not only eases restrictions on remittances to China and credit extensions to Taiwanese businesses in China, but also allows overseas banking 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 futures dealings between China and Taiwan in February 2005. Under the amended regulation, Taiwanese security firms are allowed to set up new security firms in China.

Financial dealings between China and Taiwan amounted to USD 240.876 billion in 2006, an increase of 36.05% over the figure of USD 177.048 billion in 2005.

C Financial Order and Stability

1. Fostering sound development of the domestic bond fund market

To improve the asset allocation of domestic bond funds, SITEs are required to clarify whether their domestic bond funds are to be treated as real bond funds (RBF) or quasi money market funds (QMMF). As of the end of 2006, 69 domestic bond funds had been transformed into QMMFs with a total net asset value of NT\$1,044.3 billion, and 6 domestic bond funds had been transformed into RBFs with a total net asset value of NT\$10.885 billion. The last remaining domestic bond fund was transformed into a QMMF on January 31, 2007.

2. Strengthening market exit mechanisms for financial institutions

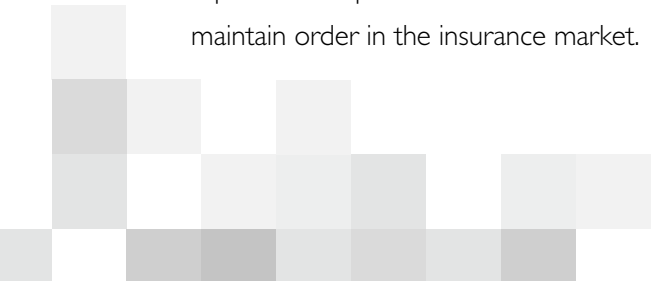
Since its establishment, the Financial Restructuring Fund has been involved in the cleanup of 48 distressed financial institutions. To make use of the limited fund, the FSC requires problem financial institutions to submit a self-rescue plan, including a timetable for capital injection and/or merger, and to fulfill the plan under supervision. In order to protect depositors and maintain financial stability, problem financial institutions that fail to complete the plans will be taken over by the government and exit from the market. In 2006, Taitung Business Bank was taken over by the Central Deposit Insurance Corporation after it failed to carry out a scheduled capital injection.

3. Strengthening the deposit insurance mechanism

In order to maintain financial stability, the Deposit Insurance Act was amended (effective January 18, 2007). The major amendments to the Act include moves to strengthen the financial safety net centered on the depository insurance mechanism, bolster the risk management mechanism and solvency of the Central Deposit Insurance Corp., and replenish the insurance reserve fund. The amendment will ensure that problem financial institutions are dealt with promptly and effectively.

4. Close-of-business and liquidation of Kuo Hua Insurance Company

The FSC has 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 rehabilitator and notified the Non-life Insurance Stabilization Fund to compensate insured parties. The operations and assets of Kuo Hua Insurance Co. were auctioned off on April 6, 2006 by Taiwan Insurance Institute. The winning bid was submitted by Taiwan Life Insurance Co., which agreed under the terms of its bid to retain at least 50% of Kuo Hua's original employees. The sale of Kuo Hua Insurance Co. (renamed Dragon Insurance after rehabilitation) was closed on May 16, 2006. This was a prime example of where the authority was able to deal with a distressed insurance company and maintain order in the insurance market.



5. Monitoring of overall operational risks of financial institutions

To improve the effectiveness of financial examinations, limited examination resources have been focused on financial institutions and businesses with higher risks. In 2006, the Financial Examination Bureau carried out 857 on-site examinations, including 246 full-scope examinations and 611 targeted examinations.

On-site examinations in 2006

Full-scope examinations						Targeted examinations					
Financial Holding Companies	Banks	Securities firms	Insurance companies	Others	Total	Financial Holding Companies	Banks	Securities firms	Insurance companies	Others	Total
7	117	42	21	59	246	1	68	8	3	531	611

6. Cooperation between financial and law enforcement agencies

The FSC established the Special Inspections Unit to review major cases of suspected crime, and to conduct targeted examinations to promptly collect evidence to be referred to prosecutors. In 2006, 43 cases of significant suspected financial criminal activity were referred to prosecutor's offices or the Investigation Bureau of the Ministry of Justice. Among them, 24 cases have been investigated by the Investigation Bureau, 18 cases have been reviewed by prosecutors, and one case resulted in an indictment.

7. Setting up “One-Stop Window for Reporting of Financial Supervisory Information” and an information sharing platform to enhance supervisory effectiveness

Utilizing a “One-Stop Window for Reporting of Financial Supervisory Information” system, the FSC has set up a financial supervisory database and an information sharing platform to simplify the process for the sending of call reports by financial institutions and improve off-site monitoring procedures. Through the platform, supervisory authorities are able to obtain necessary information to produce supervisory reports according to their various requirements.





D Financial Globalization

I. International cooperation in financial supervision

In February 2006, the FSC received the visit of New York State Banking Department. In May 2006, the FSC and the Philippine Anti-Money Laundering Council held a bilateral dialogue in Taipei. In July 2006, the State Bank of Vietnam visited the FSC to discuss issues of banking supervision. In August 2006, the FSC received a delegation from Bank of Thailand to discuss banking supervisory issues in Taipei.

FSC senior officials always use the opportunity at international meetings or visits to establish direct communication channels with the financial authorities of other countries. In 2006, FSC officials visited the US, UK, Japan, Singapore, Vietnam, Australia, Spain, and Switzerland and have met with senior officials of financial supervisory agencies in those countries.

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 to sign memorandums of understanding (MOUs) addressing cooperation in the field of financial supervision. In 2006, the FSC signed or confirmed MOUs for cooperation in single-sector or cross-sector supervision with South Africa, Vietnam, France, the US, the Netherland and Turkey.

2. Information disclosure

Taiwan's accounting practices are now more in line with international standards as the amended "Statement of Financial Accounting Standards No. 30: Accounting for Treasury Stocks (SFAS No. 30)" entered into force on January 1, 2006. During 2006, the "Statement of Financial Accounting Standards No. 37: Accounting for Intangible Assets (SFAS No. 37)" and "Statement of Financial Accounting Standards No. 38: Non-Current Assets Held for Sale and Discontinued Operations (SFAS No. 38)"

were adopted, along with amendments to the “Statement of Financial Accounting Standards No. 1: Conceptual Framework for Financial Accounting and Preparation of Financial Statements (SFAS No. 1)” , “Statement of Financial Accounting Standards No. 7: Consolidated Financial Statements (SFAS No.7)” , “Statement of Financial Accounting Standards No. 8: Accounting Policies, Changes in Accounting Estimates and Errors (SFAS No. 8)” , “Statement of Financial Accounting Standards No. 25: Accounting for Business Combinations (SFAS No. 25)” and “Statement of Financial Accounting Standards No. 35 Accounting for Impairment of Assets. (SFAS No. 35)” . These Statements took effect on January 1, 2007. In addition to the Statements of Financial Accounting Standards, the “Statement of Auditing Standards No.43: Consideration of Fraud in a Financial Statement Audit (SAS No.43)” has also been published to bring Taiwan's auditing practices more closely in line with international auditing standards.

In order to enhance transparency of financial information and harmonize with international norms, all TSEC and GTSM listed companies have been required since 2005 to announce semi-annual consolidated financial reports. Additionally, non-listed public companies and companies on the emerging stock board are required to announce semi-annual consolidated financial reports beginning from first half of the 2006 fiscal year.

In coordination with the implementation of SFAS No. 34 and SFAS No. 36 from January 1, 2006, the FSC has established an ad hoc team to assist enterprises in switching to the fair value method, and has amended the "Regulations Governing the Preparation of Financial Reports by Securities Issuers" and “Regulations Governing Auditing and Certification of Financial Statements by Certified Public Accountants” .

3. Attracting foreign investors into the securities markets

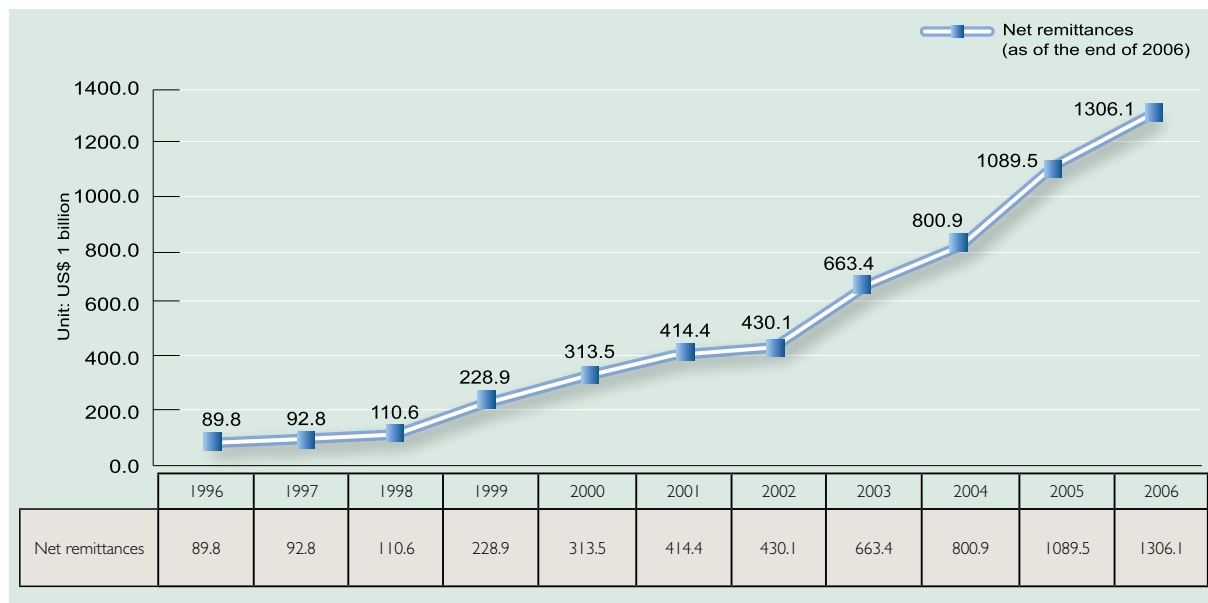
The FSC launched a series of improvements in 2006 aimed at further deregulating and internationalizing the market and encouraging foreign investment. During 2006, the FSC issued several decrees ordering that the restrictions of Article 21 of the Regulations Governing Investment in Securities by Overseas Chinese and Foreign Nationals will not apply under certain circumstances, as follows:

- (1) As of November 15, 2006, foreign nationals without domicile in Taiwan are allowed to borrow New Taiwan Dollars from financial institutions.
- (2) As of September 13, 2006, securities finance enterprises are allowed to provide securities settlement financing to foreign investors.
- (3) As of August 13, 2006, foreign investors are allowed to borrow securities from securities firms.
- (4) As of June 20, 2006, securities firms are allowed to provide securities settlement financing to offshore overseas Chinese and foreign nationals for transactions involving exchange-listed or OTC securities.

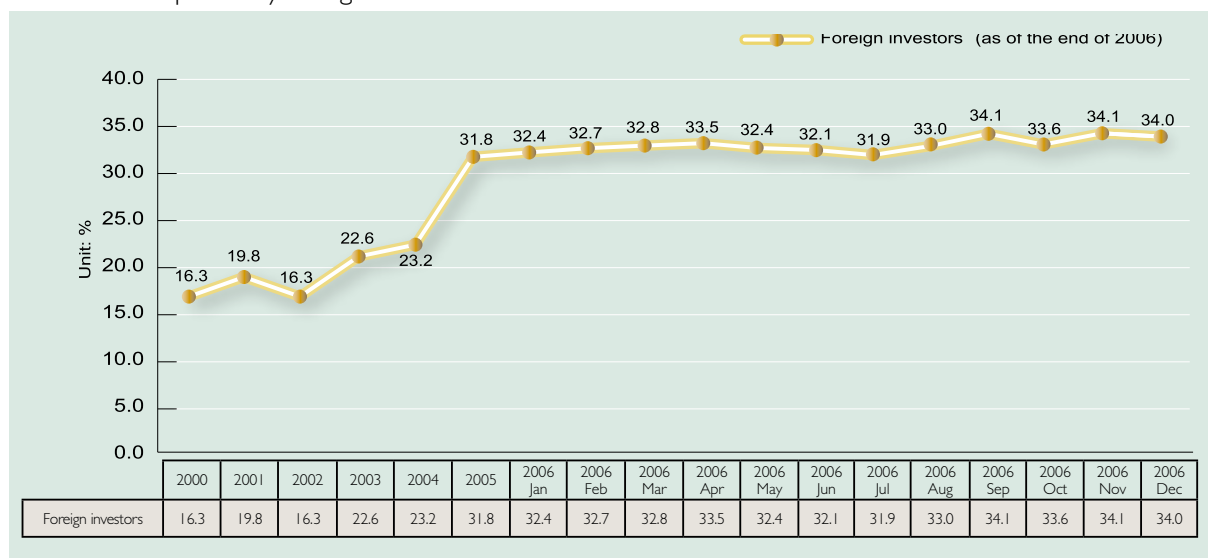
Another step taken in 2006 to encourage foreign investment in Taiwan is a decision to allow offshore overseas Chinese and foreign nationals to: (1) invest in Formosa Bonds and foreign-currency-denominated funds issued by securities investment trust enterprises; (2) engage in non-hedging futures transactions; and (3) invest in call (put) warrants during the underwriting period prior to an initial public offering.

As of the end of December 2006, net inward remittances of foreign investors on the year in connection with stock purchases on the TSEC was USD 21.6 billion, an decrease of USD 7.2 billion over 2005 (USD 28.8 billion), while net accumulated remittances since 1992 were over USD 130.4 billion. In 2006, foreign investors were net purchasers of NTD 554.8 billion worth of securities in Taiwan, a decrease of NTD 164.5 billion, or 23%, from the 2005 figure of NTD 719.4 billion. Furthermore, at the end of December 2006, foreign investors held 33.9% of the total market capitalization, also setting a historical record.

Fig. I: Net inward remittances on foreign investments in TSE-listed shares



TSE market cap held by foreign investors



Foreign investment in the banking market

Foreign Investor		Domestic Financial Institution	Stake acquired (Common + preferred)	Amount (NTD billion)
1	GE Capital	Cosmos Bank	10% + 0 %	2.75
2	New Bridge Capital	Taishin Financial Holdings	6.61% + 9.92%	27
3	Nomura Securities	Taishin Financial Holdings	1.65% + 1.65%	4
4	Temasek	E-Sun Financial Holdings	6.3% + 0 %	4.37
5	Shinsei Bank	Jih Sun Financial Holdings	26.58% + 15.51%	11.34
6	Integral	Jih Sun Financial Holdings	1.55% + 0.9%	0.66
7	The Dai-ichi Mutual Life	Shin Kong Financial Holdings	6.34% + 0 %	7
8	Standard Chartered Bank	Hsinchu International Bank	95.39% + 0 %	38.66
9	QE International Limited	Taishin Financial Holdings	3.97% + 0%	4
Total:				99.79

4. Raising international recognition of Taiwan's capital market

Taiwan's deregulation of its capital market in recent years has received positive recognition from 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 plans 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) According to statistics from the Futures Industry Association, our futures market's global ranking on total trading volume rose to 18th in 2006 from 57th in 1998. In terms of trading volume, the TAIEX Options (TXO) ranked 4th. In addition, the TAIEX was named the "Derivatives Exchange of the Year 2004" by Asia Risk Magazine.

TAIFEX also 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 the market for Taiwan government bonds.

5. Participating in international organizations and activities

To bring our financial market systems more in step with international practice, we actively participate in the activities of international organizations to keep abreast of the latest international trends in the area of financial regulations. We have also been negotiating with a number of countries on market liberalization in order to create more business opportunities for our financial industry. Our interactions with major international organizations in 2006 are as follows:

(1) International Organization of Securities Commissions (IOSCO)

The FSC has attended the IOSCO annual conference in Hong Kong, the 2006 IOSCO Technical Committee Conference in London, and the IOSCO Asia-Pacific Regional Committee in Bangkok. In addition, we have made a formal application to become a signatory of the IOSCO Multilateral Memorandum of Understanding (MMOU) in August 2005, and also answered all of the questions raised by the verification team and screening group. We expect that the IOSCO MMOU regulatory reviewing process will be completed in the first quarter of 2007.

(2) International Association of Insurance Supervisors (IAIS)

IAIS was founded in 1994 and is the most important international organization for insurance supervisors. Taiwan is one of the initial members of the IAIS. In 2006, the FSC sent delegates to attend the IAIS Triannual Meetings in Basel, Switzerland and Ottawa, Canada. FSC Administrative Vice Chairperson Susan Chang led a delegation to the IAIS Annual Conference in Beijing and obtained the right to host 2010 IAIS Triannual Meetings in Taipei. The FSC now participates actively in the Technical Committee, Implementing Committee, Accounting Subcommittee, Insurance Fraud Subcommittee, Solvency & Actuarial Issues Subcommittee, Financial Conglomerates Subcommittee, and Regional Coordination Subcommittee.

(3) Organization of Economic Cooperation and Development (OECD)

In our ongoing efforts to establish stronger ties with the OECD, the FSC continued to attend OECD meetings in 2006, including the Roundtable on Capital Market Reform in Asia and the Asian Corporate Governance Roundtable.

(4) World Trade Organization (WTO)



The first Trade Policy Review since Taiwan became a WTO member in 2002 was held from June 20 to 22, 2006. To prepare for the aforementioned meeting, the WTO Secretariat had visited Taiwan's competent authorities several times and on three occasions requested Taiwan to provide further information. Prior to the meeting, China, U.S., the European Communities, Canada, Australia, and Colombia submitted written questions on financial issues addressed in the WTO Secretariat report and our government report. The FSC received some documentary financial questions on trade policy report provided by WTO Secretariat and on government report provided by Taiwan.

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

The EBRD and the FSC co-hosted the “EBRD Syndication, Trade Finance, and Risk Management Seminar” in July 2006 in Taipei. The EBRD sent a delegation of senior management to speak to the seminar while the FSC organized the seminar including inviting financial institutions to attend the seminar. The FSC continued to send a staff to work for the EBRD in 2006.

(6) Asian Development Bank

The FSC and the ADB Secretariat for the APEC Financial Regulators Training Initiative (FRTI) held the "APEC FRTI Regional Seminar on Risk Management for Securities Regulators" in October 2006 in Taipei. The seminar featured six lecturers from APEC economies including the United States, Australia, Singapore and Taiwan, and was attended by participants from a number of APEC economies, including Singapore, the United States, India, Indonesia, Australia, Malaysia, Thailand, Sri Lanka and Taiwan.

(7) In 2006, senior officials of the FSC were invited to attend and speak at the meetings of a number of government and private international financial organizations. A few examples include the annual meeting of APEC FRTI advisory group, the annual meeting of the Life Office Management Association (LOMA), and the annual Asia meeting of the Investment Company Institute (ICI).

6. Enhancing international profile

According to statistics from the World Federation of Exchanges at the end of 2006, Taiwan Stock Exchange ranked forth in the Asia Pacific Region for stock market turnover. In terms of financial liberalization, Taiwan also ranked among the top in East Asia.

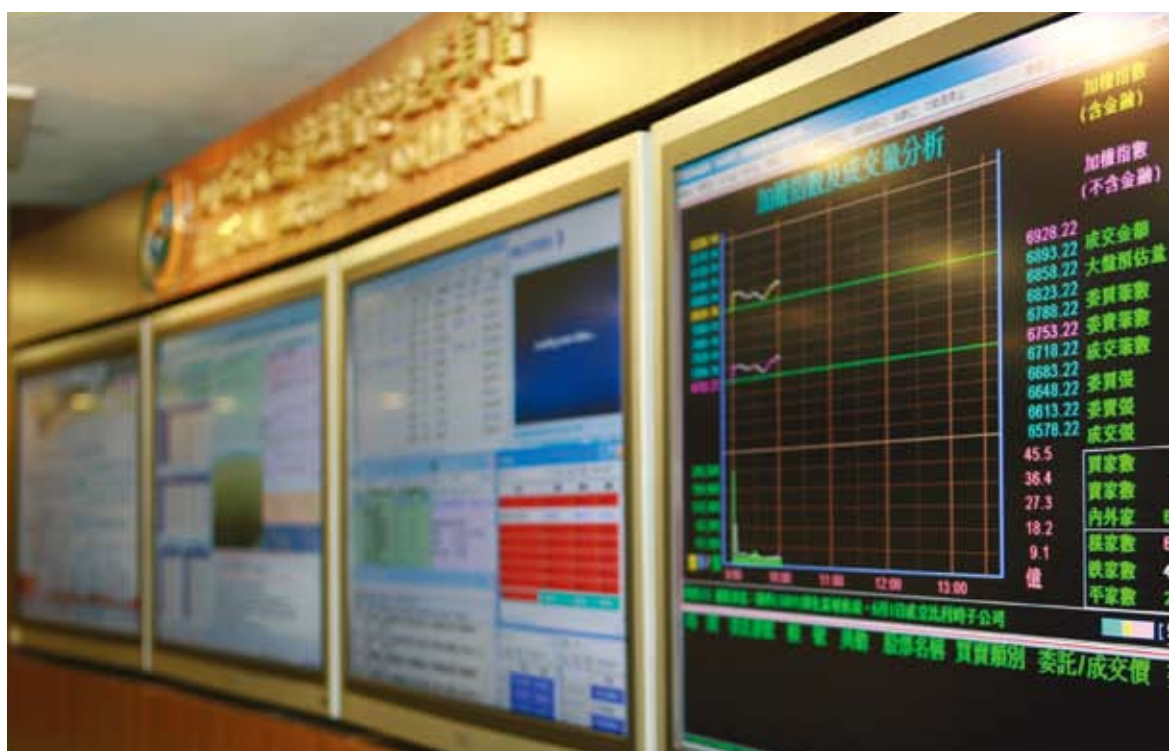
The FSC was invited to the Taiwan Global Investment Forums held in Tokyo by Daiwa Securities and the Taiwan Stock Exchange, to discuss reform measures for liberalizing and globalizing

Taiwan's financial and capital markets in September 2006. The Forums were attended by over seventy institutional investors with more than a total of US\$4 billion of assets worldwide under their management.

7. Holding international conferences

Holding international conferences is an effective vehicle to advance exchanges with other countries and gain insight on global trends in financial supervision.

On 10 February 2006, the FSC held the 3rd Taipei Corporate Governance Forum in Taipei, featuring distinguished speakers and panelists including Mr. William Witherell, current senior advisor and former director of the Directorate for Financial, Fiscal, and Enterprise Affairs of the OECD; Mr. Jeremy Cooper, Deputy Chairman of the Australian Securities and Investments Commission; Dr. Hasung Jang, Executive Director of the Asian Institute of Corporate Governance; Mr. Rodney Ward, Chairman of UBS Investment Bank, Asia; Dr. Stefan Mai, Head of Market Policy, Deutsche Börse AG; Mr. Eisuke Nagatomo, Managing Director of the Tokyo Stock Exchange, and Mr. Joe Longo, General Counsel, Asia Deutsche Bank. Over 750 participants took part in the forum, including directors, supervisors, and senior executives of local listed companies, securities firms, and financial enterprises. The highly successful forum made substantial contributions to strengthening corporate governance concepts among the management of Taiwan's listed companies, and furthered our efforts to bring local corporate governance more closely in line with international standards.



8. London Representative Office

After setting up its first overseas office in 2005 in New York, in July 2006 the FSC sent staff to the UK in order to prepare the establishment of its second overseas representative office in London. Our aim in doing so is to strengthen cooperation with international financial organizations and financial regulators in the Europe, understand the development of one of the world's leading financial markets, and publicize Taiwan's financial markets.

E Consumer and Investor Protection

1. Card Debt Issues

- (1) To help consumers resolve their unsecured consumer debt, the FSC joined forces with the Bankers Association to establish the Individual Debt Restructuring Program, which provided one-stop service for a period of one year begin from January 1, 2006. As of December 31, 2006, a total of 273,979 applications had been accepted and processed and 229,218 cases (NTD 334.2 billion) had been negotiated successfully.
- (2) A Consumer Debt Assistance Team has been established to provide employment placement assistance, business financing assistance, psychological counseling services, and nursing care to card debtors. By the end of December 2006, the Assistance Team had received 36,848 applications for assistance and forwarded 34,985 applications to appropriate agencies for handling.
- (3) The Sunshine Asset Management Company was set up to put the debts of low-income households and households on unemployment benefits under the management of one entity and help those households to obtain social assistance. As of the end of 2006, the company had assumed from 42 major banks the debts of 17,123 cardholders in the amount of NT\$5.8 billion.
- (4) The FSC has commissioned Teacher Chang Foundation to provide psychological counseling service. As of the end of 2006, Teacher Chang Foundation had provided counseling to 5,959 cardholders.
- (5) The FSC has amended regulations to promote the sound development of credit card and cash card business.

2. Financial literacy program

Since our establishment, the FSC has actively promoted a financial literacy program. The Executive Yuan approved our proposal for 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) A series of seven touring forums have been held around Taiwan.
- (2) Basic information about the financial system has been added to school textbooks, and the FSC has been giving lectures at universities and holding financial literacy workshops at all levels of the school system.
- (3) The FSC has conducted forums and conferences as well as participated in various fairs held by the Consumer Protection Commission, Council of Indigenous Peoples, and Ministry of Economic Affairs.
- (4) Promotional videos and materials about financial literacy have been produced for nation-wide TV broadcasts as well as for free download on the Financial Supervisory Commission website.
- (5) The FSC has worked together with the National Youth Commission, Consumers' Foundation, Consumer Protection Commission, and Teacher Chang Foundation on the development of financial literacy among Taiwan teenagers.
- (6) The FSC held activities at 194 schools and communities as part of its "School and Community Financial Literacy Campaign" in 2006. A total of 104,230 participants attended financial literacy events last year. In addition, the FSC provided financial support for 58 financial literacy activities organized by 30 qualified universities and junior colleges.

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 the following: (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 of paying tuition, telecommunication expenses, credit card bills, and insurance premiums through ATM, schools and private enterprises may contract with a bank to collect such payments and set up a special account for such purposes, with the account treated as a designated account.

As a proactive move to prevent the use of dummy accounts for financial fraud, the FSC has adopted the following measures: (1) Conducted special examinations of financial institutions with a relatively large number of dummy accounts. (2) Asked financial institutions to observe the "Know Your Customer" rules when opening accounts for potential customers. (3) Asked financial institutions to instruct their internal auditing units to intensify the auditing of account opening

processes and self-audits. (4) Increased publicity concerning new fraud techniques to raise public awareness.

4. Enhanced investor protection

The FSC has asked the Securities and Futures Investors Protection Center to represent 56,000 investors in 18 class action suits against accountants, underwriters, board directors and public companies that engaged in illegal activities. The center has reached settlement agreements with the above-mentioned parties and received NTD 330 million from accountants and underwriters, NTD 170 million from directors and supervisors, and NTD 51 million from public companies, resulting in a total compensation of some NTD 551 million.

For the purpose of protecting investors' rights and disseminating financial knowledge, the FSC has requested the Securities and Futures Institute to arrange a series of "Investing in the Future" seminars, inviting industry experts and professionals to help cultivate correct investment concepts and impart financial product knowledge to investors.

5. Amendment of the Compulsory Automobile Liability Insurance Act and related regulations

The 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. Among other measures, the number of insurable items has been increased, the range of persons that may claim insurance benefits has been expanded, and premiums have been cut. An estimated 16 million owners of cars and motorcycles stand to benefit from the changes.

An annual review of compulsory automobile liability insurance premiums has been established. Premiums are readjusted every year, based on actual losses experienced in former years, to correctly reflect fair premium rates.

Changes in Compulsory Automobile Liability Insurance Gross Premiums and Premiums (effective 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 regulatory treatment, the FSC will continue to push forward with financial reform in order to facilitate Taiwan's economic development and keep in step with the trend toward 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 Continued Updating of Financial Regulations

I. Drafted bills under the review in the Legislative Yuan

(1) Financial Institutions Merger Act

In order to facilitate foreclosure proceedings commissioned by the courts to an impartial third party, an amendment to the Financial Institutions Merger Act has been proposed. The amendment also aims to enhance the transparency of NPL transactions, to follow accounting principles, and to build up M&A infrastructure.

(2) Certified Public Accountant Act

The FSC has proposed to amend the Certified Public Accountant Act to improve the environment in which CPAs practice their jobs, the quality of their performance, and the regulation of their profession. 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 the independence and regulation of CPAs.

(3) Personal Property Secured Transaction Act

The amended Act establishes the claim priority of creditors and non-hostile lien-holders in order to improve the personal 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, criminal sanctions formerly provided for in the Act have been abolished to save judicial resources.

(4) Real Estate Securitization Act

A draft amendment to the Real Estate Securitization Act which would add development property to the list of asset types eligible for securitization was sent to the Legislative Yuan for deliberations in 2005. Legislative review of the draft amendment remains ongoing at this point. In 2006, a total of six real estate securitization cases worth a combined total of NTD 22.17 billion were approved by the FSC. The amended Act would further improve the ability of businesses to raise capital directly from the market.

(5) Trust Enterprise Act

A draft amendment of the Trust Enterprise Act was sent to the Legislative Yuan for deliberations in March 2006. The amendment was drafted to further promote the development of the trust business and allow securities firms and securities investment trust and consulting enterprises to engage in trust business.

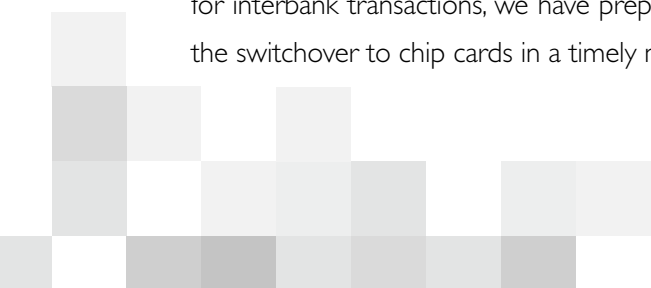
2. Amendments currently being drafted

- (1) A Financial Services Act currently being drafted would introduce functional supervision, seek to better safeguard the interests of financial consumers and investors, and integrate cross-industry participation in financial services.
- (2) The FSC is studying an amendment to the Financial Holding Company Act to help improve the capital allocations and business operations of financial holding companies as well as to exercise tighter supervision of business groups.
- (3) The FSC is studying an amendment to the Banking Act which would establish capital-based disciplinary measures such as prompt corrective action and a market exit mechanism, as well as set up a dedicated mediation organization to reinforce the self-regulation of banks and better protect consumer interests.
- (4) An amendment to the Insurance Act has been drafted to strengthen management of insurance funds, deregulate fund investments, permit insurers to engage in more types of businesses, adjust legal procedures and measures for dealing with exiting insurers, and enhance self-discipline in the insurance industry.
- (5) The FSC is studying an amendment to the Trust Enterprise Act that would allow securities investment trusts and consulting enterprises to engage in trust business, provide for tighter regulation over trust business operations. The current wording of the amendment would also specify the ways in which the competent authority would be authorized to regulate the conduct of trust business by such enterprises.
- (6) The FSC is working on the draft bill for a Financing Company Act which would regulate the management of financing companies in order to promote diversity of financing channels.

B Efforts to Create a Secure and Efficient Financial Environment

I. Creating a secure payment environment with information technology

We are encouraging financial institutions to construct a secure payment system with innovative information technology. For instance, at the urging of the FSC, the Banking Association joined hands with Taiwan financial institutions to expand the functionality of the national Bill Payment System. As a result, ROC residents have been able to use ATMs to pay their taxes since March 1, 2006. In light of the fact that, since March 1, 2006, holders of magnetic strip ATM cards have not been able to use them for interbank transactions, we have prepared a checklist to ensure that financial institutions implement the switchover to chip cards in a timely manner.



2. Implementation of the Basel Capital II Accord

All domestic banks are required to implement Basel II from 2007, as called for by the BIS.

The FSC has prescribed capital requirements for credit risk, operational risk, market risk and securitization on January 4, 2007. In addition, the FSC has also issued requirements concerning Pillar 2 and Pillar 3.

3. Enhancing financial examinations and investigations of financial crime

The FSC actively detects illegal activities (such as unusual transactions) through financial examinations to maintain financial order and stability. In addition, the FSC helps law enforcement agencies investigate financial crime and designates financial professionals as "consulting commissioners" to promptly collect relevant evidence of significant financial crimes and help judges bring proceedings to a quick close.

4. Integration of all securities and futures self-regulatory organizations

In order to boost the international competitiveness and service quality of Taiwan's capital markets, as well as reduce the transaction costs of securities firms, futures commission merchants, and investors, the FSC is planning to establish a holding company that will bring the 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.

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. Continued development of the Taiwan ETF market

To diversify ETF products, enhance strategic allocation among different ETFs, and to help investors achieve better returns, the Taiwan Stock Exchange introduced two new ETFs to the market in 2006. One is the Polaris Taiwan Mid-Cap 100 Tracker Fund; the other is the Fubon Taiwan Technology Tracker Fund. The FSC will work closely with SITEs to launch new ETFs and invigorate the Taiwan ETF market.

6. Creation of a sound legal environment for futures trust business

Securities investment trust funds governed by the "Securities Investment Trust and Consulting Act" may currently only invest in securities-related derivatives, and especially strict restrictions apply to any investments in futures. However, the fact that more and more investors are using futures and derivatives as investment vehicles has prompted the industry to call on the authorities



to formulate appropriate regulations. In response, the FSC is formulating regulations to govern futures trust enterprises and futures trust funds. In the future, the FSC will allow the establishment of futures trust enterprises and the offering of futures trust funds.

7. Outlook for Taiwanese banks (competitiveness):

(I) Nine consensual opinions reached at the Conference on Sustaining Taiwan's Economic Development (COSTED) regarding the building of a sound financial market:

In accordance with the conclusions reached at the COSTED, the FSC will continue to improve conditions in the banking industry (including facilitation of M&As and establishment of a market exit mechanism), with an eye toward achieving the objective of financial market restructuring. The nine consensual opinions are as follows:

- i. Fair competitive environment: Review regulations regarding the set-up of new branches and financial holding companies.
- ii. Unfair takeover tactics: Improve the transparency of information, prevent the inappropriate use of human resources, information and capital, enhance corporate governance, and require the set up of audit committees.

iii. Ensure that the welfare of employees, community residents, and small and medium enterprises is given consideration in the M&As of financial institutions.

iv. International competitiveness: Encourage financial innovation and diversification, introduce professional know-how and financial products, and encourage tie-ups between foreign capital and local financial institutions.

- v. Governance of financial holding company investments: Increase the transparency of information.
- vi. Excessively leveraged buyouts: Prevent major shareholders taking over other business by means of high financial leverage.
- vii. Rules on the usage of proxy: Prevent proxies from being used as a takeover tool.
- viii. Financial safety net: Amend the Deposit Insurance Act to establish prompt corrective action as a supervisory tool, and to improve the market exit mechanism as a means of dealing with problem financial institutions. Encourage domestic institutions to develop a more diversified range of capital instruments.
- ix. Tighten supervision on problem financial institutions and strengthen the RTC mechanism for dealing with insolvent financial institutions.

(2) Wealth Management Business

In recent years, banks in Taiwan have actively sought to build up their asset management businesses, utilizing abundant market funds to develop wealth management business and designing new financial products to satisfy demand from the growing population of elderly people, and from the growing number of younger families choosing not to have many children. At the end of December 2005, the total assets of the wealth management market in Taiwan stood at NT\$6,315 billion, and the scale of the market expanded to NT\$7,263 billion in December 2006 (annual growth rate: 15.02%). The wealth management market in Taiwan is expected to keep growing in 2007.

(3) Overseas Branches and Offshore Business Units (OBUs)

Domestic banks in Taiwan have continued to increase the number of overseas branches, raising revenue generated from cross border business and developing OBU business. Under the Financial Market Package Project proposed by the FSC in 2006, the banking bureau plans to broaden the scope of cross-strait financial activities conducted by OBUs and to promote OBUs as the Asia capital management center for mainland China-based Taiwanese businesses, ethnic Chinese, and foreigners.

At the end of December 2006, the amount of sales revenue of all overseas branches of domestic banks and OBUs was NT\$208 billion, and the before-tax earnings of all overseas branches of domestic banks and OBUs was NT\$40 billion. Over the next three years, the sales revenue of all overseas branches of domestic banks and OBUs is projected to achieve 22% average annual growth, while before-tax earnings are expected to grow 21% per year.

C Consolidation of Financial Institutions

The second phase financial reform is intended to help Taiwan develop into a regional financial service center through consolidation of financial institutions. Ideally, we will have one to three big banks with regional competitiveness 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 2006, six M&A deals involving banks and credit cooperatives were completed. Several cases of foreign investment in local banks also transpired last year. These events show that the measures we have taken so far have borne fruit. Our plans for consolidation of the financial industry are summed up as follows:

1. We will provide more incentives for consolidation while honoring the market mechanism to build a fair and transparent environment for consolidation.
2. We will tap into the power of market competition by adopting differential regulatory treatment and promoting greater financial transparency, as well as increasing the availability of financial services and holding financial institutions to a higher standard of social responsibility.
3. Quality financial institutions with good performance and strong competitiveness will be allowed to form financial holding companies through M&A.
4. We will rely on the market mechanism to put pressure on existing financial holding companies that have demonstrated poor performance yet lack intention to merge.

D Internationalization of the Financial Industry

I. Pushing for internationalization of 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 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 enhance the competitiveness of Taiwan's capital market. These efforts will help Taiwan to become a regional fund-raising and assets management center, and will also increase employment opportunities and tax revenues in Taiwan.



2. 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”, and 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 hold international conferences, such as the Taipei Corporate Governance Forum, on an ongoing basis to give guidance on improving corporate governance and information transparency as well as to boost investor confidence.



3. 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 MOUs or exchanges 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 markets of several major developing countries are still in the budding stages, Taiwan is moving steadily towards joining the ranks of developed markets. The FSC is willing and ready to share our experiences with developing countries to aid the development of their securities markets while taking the opportunity to help our financial institutions enter into overseas markets.

E Supervision of the Insurance Industry

I. Amendment to the Insurance Act

To improve supervision of the insurance industry and develop the insurance market, the FSC has proposed amendments to the Insurance Act. The main amendments include: easing regulatory

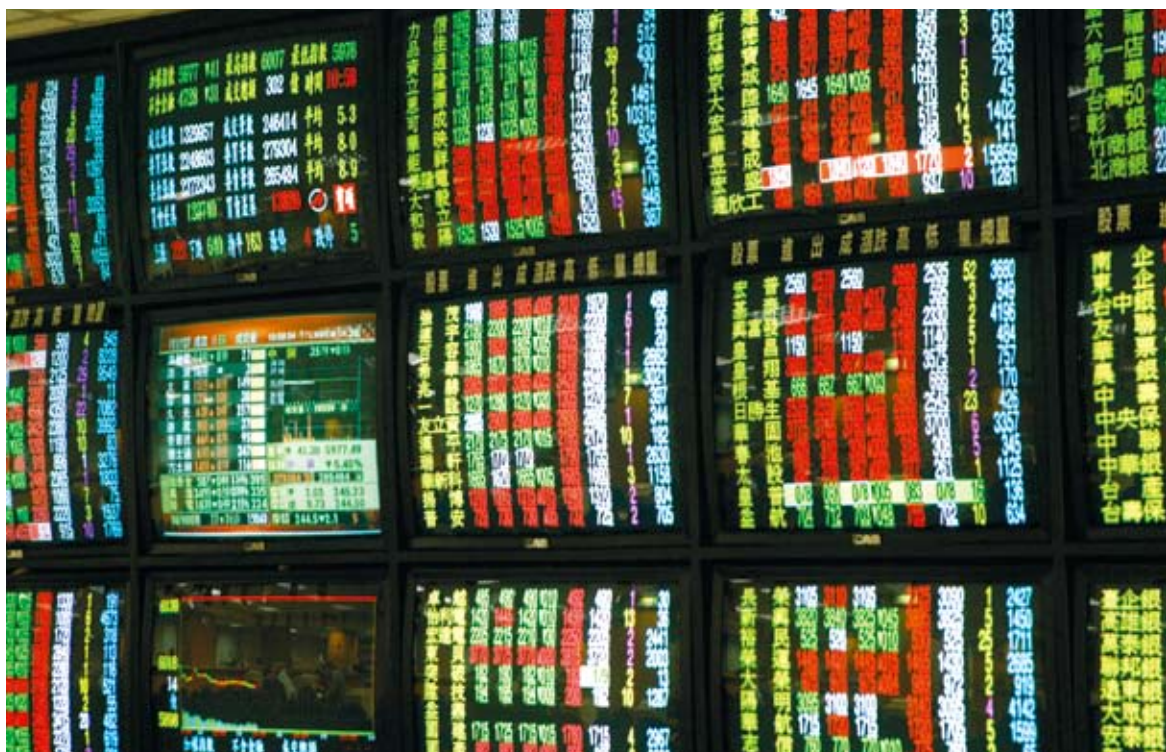
restrictions on the lines of business that insurers are allowed to engage in, enhancing the financial soundness of the insurance industry, promoting transparency of business management, strengthening the management of insurance funds while deregulating their investments, maintaining orderly financial markets, and reassessing the rationality of the insurance contract law. The drafted amendments have passed out of committee in the Legislative Yuan.

2. Strengthening solvency

The FSC has continued to review the RBC system, implemented the appointed actuary system, and amended the procedure for setting aside of reserves. The FSC also reviewed accounting rules in response to recent changes in Taiwanese and international accounting standards. In order to strengthen the financial structure of insurance companies, the FSC has required insurance companies to enhance risk management procedures and to establish an appropriate asset-liability allocation system.

3. Amending the insurance product review system

To cope with the ageing of society and a low birth rate, the FSC will actively promote mortality protection and annuity insurance products to ensure adequate insurance coverage for consumers. Major initiatives include plans to execute supervisory measures to encourage insurers to develop various types of mortality insurance and annuity insurance products and promote awareness of the need for mortality protection and old-age planning to encourage the general public to make necessary arrangements.



4. Continued review of the Taiwan Residential Earthquake Insurance system

The take-up rate for the Taiwan Residential Earthquake Insurance scheme reached 22% as of the end of 2006. Compared to a rate of 0.2% prior to the earthquakes of September 1999, the take-up rate at the end of 2006 shows substantial growth. The residential fire and earthquake policy provisions were modified and took effect on January 1, 2007. The amendment extends the scope of coverage to include tsunami, tidal waves or flood following earthquake. In addition, the Regulations Governing Implementation of the Residential Earthquake Co-insurance and Risk Bearing Mechanism were amended in December 2006 to increase the Taiwan Residential Earthquake Insurance Pool risk assumption limit to NT\$60 billion from NT \$50 billion starting from January 1, 2007.

F Financial Literacy Initiatives

Because consumption activities are directly related to a person's daily life, it is essential to cultivate healthy consumption habits and responsible attitudes toward 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 for 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 Taiwan, and to extend the activities further for the benefit of military personnel and indigenous communities. We plan to hold 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 resources scattered among different financial licensing and training agencies to effectively foster the development of financial talent.

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