

Cathay United Bank
Financial Statements With
Independent Auditors' Report
For The Six-Month Periods Ended June 30,
2004 and 2005

The reader is advised that these financial statements have been prepared originally in Chinese. These financial statements do not include additional disclosures information that is required for Chinese-language reports under the “Regulations Guidelines Governing the Preparation of Financial Reports by Public Banks” by the Securities and Futures Bureau, Financial Supervisory Commission, Executive Yuan, ROC. If there is any conflict between these financial statements and the Chinese version or any difference in the interpretation of the two versions, the Chinese language financial statements shall prevail.

English Translation of Report Originally Issued in Chinese
Independent Auditors' Report

The Board of Directors
Cathay United Bank

We have audited the accompanying balance sheets of Cathay United Bank as of June 30, 2004 and 2005, and the related statements of income, changes in shareholders' equity and cash flows for the six-month periods ended June 30, 2004 and 2005. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the Republic of China and the "Guidelines for Certified Public Accountants' Examination and Reporting on Financial Statements". Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audits, the financial statements referred to above present fairly, in all material respects, the financial position of Cathay United Bank as of June 30, 2004 and 2005, and the results of its operations and its cash flows for the six-month periods then ended in conformity with the "Regulations Governing the Preparation of Financial Reports by Public Banks", the "Guidelines Governing the Preparation of Financial Reports by Securities Issuers" and accounting principles generally accepted in the Republic of China.

As discussed in Note III to the financial statements, effective from January 1, 2005, the Bank has adopted the Republic of China Statement of Financial Accounting Standards No. 35, "Accounting for Asset Impairment" to account for the impairment of its assets.

DIWAN, ERNST & YOUNG
Taipei, Taiwan
The Republic of China
August 1, 2005

Notice to Readers

The accompanying financial statements are intended only to present the financial position and results of operations and cash flows in accordance with accounting principles and practices generally accepted in the Republic of China and not those of any other jurisdictions. The standards, procedures and practices to audit such financial statements are those generally accepted and applied in the Republic of China.

English Translation of Financial Statements Originally Issued in Chinese

Cathay United Bank

Balance sheets

June 30, 2004 and 2005

(Expressed in thousands of dollars)

ASSETS	NOTES	June 30, 2004		June 30, 2005	
		NT	US (Note II)	NT	US (Note II)
Cash and cash equivalents	IV	\$17,501,055	\$519,936	\$19,052,385	\$602,161
Due from the Central Bank and call loans to banks	IV, V and X	55,111,864	1,637,310	58,115,449	1,836,772
Securities purchased-net	II, IV, VI and X	187,377,554	5,566,772	213,356,087	6,743,239
Receivables-net	II, IV, V and X	48,774,537	1,449,036	57,961,834	1,831,916
Prepayments	IV and V	1,567,759	46,577	1,330,316	42,046
Bills and loans-net	II, IV, V and X	551,276,132	16,377,782	612,539,747	19,359,663
Long-term investments	II, IV, V, VI and X				
Equity method		4,848,604	144,046	4,987,834	157,643
Cost method		5,743,394	170,630	5,212,572	164,746
Others		28,375,691	843,009	31,465,300	994,479
Premises and equipment	II, V, VII and X				
Cost:					
Land		14,931,817	443,607	14,053,397	444,166
Buildings		9,062,912	269,249	9,213,164	291,187
Furniture and fixtures		3,715,600	110,386	3,670,369	116,004
Transportation equipment		88,487	2,629	69,658	2,202
Miscellaneous equipment		3,817,788	113,422	4,347,252	137,397
Total Cost		31,616,604	939,293	31,353,840	990,956
Less:Accumulated depreciation		(6,793,162)	(201,817)	(7,042,175)	(222,572)
Construction in progress and procurement		721,054	21,422	814,396	25,739
Less:Allowance for asset impairment		-	-	(77,302)	(2,443)
Premises and equipment-net		25,544,496	758,898	25,048,759	791,680
Other assets	II, IV and V	5,651,720	167,906	3,716,151	117,451
TOTAL ASSETS		\$931,772,806	\$27,681,902	\$1,032,786,434	\$32,641,796

The accompanying notes are an integral part of the financial statements.

English Translation of Financial Statements Originally Issued in Chinese

Cathay United Bank

Balance sheets

June 30, 2004 and 2005

(Expressed in thousands of dollars)

LIABILITIES AND SHAREHOLDERS' EQUITY	NOTES	June 30, 2004		June 30, 2005	
		NT	US (Note II)	NT	US (Note II)
Due to the Central Bank and call loans from banks	IV, V and X	\$79,077,377	\$2,349,298	\$75,554,475	\$2,387,942
Payables	IV and V	16,143,949	479,618	15,639,948	494,309
Advances		1,131,148	33,605	1,104,065	34,895
Deposits and remittances	IV, V and X	690,108,960	20,502,346	775,019,105	24,494,915
Financial debentures payable	IV and X	27,050,000	803,625	52,050,000	1,645,069
Banker's acceptances and funds borrowed	IV and X	2,361,784	70,166	1,103,010	34,861
Other liabilities	IV	41,136,476	1,222,118	31,656,852	1,000,533
TOTAL LIABILITIES		857,009,694	25,460,776	952,127,455	30,092,524
Capital stock	IV	43,182,407	1,282,900	43,182,407	1,364,804
Stock dividend to be distributed	IV	-	-	3,238,112	102,342
Capital reserves	II and IV				
Additional paid-in capital		13,449,023	399,555	13,449,023	425,064
Others		14,051	417	14,690	464
Retained earnings					
Legal reserve	IV	9,951,639	295,652	14,115,413	446,126
Unappropriated earnings		8,106,651	240,839	6,645,698	210,041
Unrealized losses on long-term investments	IV	(95,426)	(2,835)	-	-
Foreign currency translation adjustment	II	154,767	4,598	13,636	431
TOTAL SHAREHOLDERS' EQUITY		74,763,112	2,221,126	80,658,979	2,549,272
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		\$931,772,806	\$27,681,902	\$1,032,786,434	\$32,641,796

The accompanying notes are an integral part of the financial statements.

English Translation of Financial Statements Originally Issued in Chinese
Cathay United Bank
Statements of income
for the six-month periods ended June 30, 2004 and 2005
(Expressed in thousands of dollars, except per share amounts)

ITEMS	NOTES	January 1- June 30, 2004		January 1- June 30, 2005	
		NT	US (Note II)	NT	US (Note II)
OPERATING INCOME:					
Interest income	II and V	\$15,478,041	\$459,835	\$18,675,023	\$590,235
Commission and handling fees	II and V	3,140,412	93,298	3,349,091	105,850
Gains on sales of securities-net	II	319,198	9,483	364,982	11,535
Investment income-net	II and IV	319,460	9,491	181,933	5,750
Foreign currency exchange gain-net	II	221,774	6,588	144,262	4,560
Other operating income	V	456,111	13,551	867,103	27,405
Total operating income		19,934,996	592,246	23,582,394	745,335
OPERATING COST:					
Interest expense	V	(3,853,583)	(114,485)	(5,623,747)	(177,742)
Commissions and handling charges	V	(475,198)	(14,118)	(669,781)	(21,169)
Provisions for possible losses	II	(811,299)	(24,103)	(865,330)	(27,349)
Operating expenses	IV and V	(5,680,315)	(168,756)	(6,823,611)	(215,664)
Other operating cost		(274,530)	(8,156)	(554,218)	(17,516)
Total operating cost		(11,094,925)	(329,618)	(14,536,687)	(459,440)
NET OPERATING INCOME		8,840,071	262,628	9,045,707	285,895
NON-OPERATING INCOME:					
Gains on disposal of premises and equipment	II	1,167,313	34,680	24,008	759
Others		89,101	2,647	20,620	651
Total non-operating income		1,256,414	37,327	44,628	1,410
NON-OPERATING LOSS:					
Losses on disposal of premises and equipment	II	(31,930)	(949)	(14,174)	(448)
Losses on asset impairment	II	-	-	(372,751)	(11,781)
Others		(60,904)	(1,809)	(3,712)	(117)
Total non-operating loss		(92,834)	(2,758)	(390,637)	(12,346)
INCOME BEFORE INCOME TAX		10,003,651	297,197	8,699,698	274,959
INCOME TAX EXPENSES	II and IV	(1,897,000)	(56,358)	(2,054,000)	(64,918)
NET INCOME		\$8,106,651	\$240,839	\$6,645,698	\$210,041
EARNING PER SHARE (IN DOLLARS)					
INCOME BEFORE INCOME TAX	IV	\$2.16	\$0.064	\$1.87	\$0.059
INCOME TAX EXPENSES		(0.41)	(0.012)	(0.44)	(0.014)
NET INCOME		\$1.75	\$0.052	\$1.43	\$0.045

The accompanying notes are an integral part of the financial statements.

English Translation of Financial Statements Originally Issued in Chinese

Cathay United Bank

Statements of changes in shareholders' equity

for the six-month period ended June 30, 2004

(Expressed in thousands of dollars)

ITEMS	Retained Earnings								Unrealized Loss on		Foreign Currency		Total	
	Capital Stock		Capital Reserve		Legal Reserve		Unappropriated Earnings		Long-term Investments		Translation Adjustment			
	(NT)	(US)	(NT)	(US)	(NT)	(US)	(NT)	(US)	(NT)	(US)	(NT)	(US)	(NT)	(US)
Balance, January 1, 2004	\$43,182,407	\$1,282,900	\$13,461,820	\$399,935	\$9,122,517	\$271,020	\$2,763,742	\$82,107	\$(116,783)	\$(3,469)	\$170,503	\$5,065	\$68,584,206	\$2,037,558
Appropriation and distribution of 2003 earnings (Note IV.17):														
Legal reserve	-	-	-	-	829,122	24,632	(829,122)	(24,632)	-	-	-	-	-	-
Cash dividends	-	-	-	-	-	-	(1,934,620)	(57,475)	-	-	-	-	(1,934,620)	(57,475)
Net Income for the six-month period ended June 30, 2004	-	-	-	-	-	-	8,106,651	240,839	-	-	-	-	8,106,651	240,839
Foreign currency translation adjustment (Note II)	-	-	-	-	-	-	-	-	-	-	(15,736)	(467)	(15,736)	(467)
Unrealized losses on investments in equity investees (Note IV.7)	-	-	-	-	-	-	-	-	21,357	634	-	-	21,357	634
Capital reserves of equity investees (Note IV.16)	-	-	1,254	37	-	-	-	-	-	-	-	-	1,254	37
Balance, June 30, 2004	\$43,182,407	\$1,282,900	\$13,463,074	\$399,972	\$9,951,639	\$295,652	\$8,106,651	\$240,839	\$(95,426)	\$(2,835)	\$154,767	\$4,598	\$74,763,112	\$2,221,126

The accompanying notes are an integral part of the financial statements.

English Translation of Financial Statements Originally Issued in Chinese

Cathay United Bank

Statements of changes in shareholders' equity

for the six-month period ended June 30, 2005

(Expressed in thousands of dollars)

ITEMS	Retained Earnings															
	Capital Stock		Stock Dividend to be Distributed		Capital Reserves		Legal Reserve		Unappropriated Earnings		Unrealized Loss on Long-term Investments		Foreign Currency Translation Adjustment		Total	
	(NT)	(US)	(NT)	(US)	(NT)	(US)	(NT)	(US)	(NT)	(US)	(NT)	(US)	(NT)	(US)	(NT)	(US)
Balance, January 1, 2005	\$43,182,407	\$1,364,804	\$-	\$-	\$13,463,074	\$425,508	\$9,951,639	\$314,527	\$13,879,247	\$438,662	\$(104,653)	\$(3,308)	\$(11,556)	\$(365)	\$80,360,158	\$2,539,828
Appropriation and distribution of 2004 earnings (Notes IV. 15 and 17):																
Legal reserve	-	-	-	-	-	-	4,163,774	131,599	(4,163,774)	(131,599)	-	-	-	-	-	-
Cash dividends	-	-	-	-	-	-	-	-	(6,467,361)	(204,404)	-	-	-	-	(6,467,361)	(204,404)
Stock dividends	-	-	3,238,112	102,342	-	-	-	-	(3,238,112)	(102,342)	-	-	-	-	-	-
Bonus to shareholder	-	-	-	-	-	-	-	-	(8,000)	(253)	-	-	-	-	(8,000)	(253)
Compensation to directors and supervisors	-	-	-	-	-	-	-	-	(500)	(16)	-	-	-	-	(500)	(16)
Special bonus to employees	-	-	-	-	-	-	-	-	(1,000)	(32)	-	-	-	-	(1,000)	(32)
Contribution to welfare fund	-	-	-	-	-	-	-	-	(500)	(16)	-	-	-	-	(500)	(16)
Net Income for the six-month period ended June 30, 2005	-	-	-	-	-	-	-	-	6,645,698	210,041	-	-	-	-	6,645,698	210,041
Foreign currency translation adjustment (Note II)	-	-	-	-	-	-	-	-	-	-	-	-	25,192	796	25,192	796
Unrealized losses on investments in equity investees (Note IV.7)	-	-	-	-	-	-	-	-	-	-	104,653	3,308	-	-	104,653	3,308
Capital reserves of equity investees, etc. (Note IV.16)	-	-	-	-	639	20	-	-	-	-	-	-	-	-	639	20
Balance, June 30, 2005	<u>\$43,182,407</u>	<u>\$1,364,804</u>	<u>\$3,238,112</u>	<u>\$102,342</u>	<u>\$13,463,713</u>	<u>\$425,528</u>	<u>\$14,115,413</u>	<u>\$446,126</u>	<u>\$6,645,698</u>	<u>\$210,041</u>	<u>\$-</u>	<u>\$-</u>	<u>\$13,636</u>	<u>\$431</u>	<u>\$80,658,979</u>	<u>\$2,549,272</u>

The accompanying notes are an integral part of the financial statements.

English Translation of Financial Statements Originally Issued in Chinese
Cathay United Bank
Statements of cash flows
for the six-month period ended June 30, 2004 and 2005
(Expressed in thousands of dollars)

ITEMS	NOTES	January 1 - June 30, 2004		January 1 - June 30, 2005	
		NT	US (Note II)	NT	US (Note II)
CASH FLOWS FROM OPERATING ACTIVITIES:					
Net income		\$8,106,651	\$240,839	\$6,645,698	\$210,041
Adjustments to reconcile net income to net cash provided by operating activities:					
Depreciation and amortization	II	555,986	16,518	604,571	19,108
Provisions for possible losses	II	811,299	24,102	865,330	27,349
Gains on disposal of premises and equipment	II	(1,135,383)	(33,731)	(9,834)	(311)
Losses on asset impairment	II and IV	-	-	372,751	11,781
Investment income recognized by the equity method	II and IV	(210,387)	(6,250)	(88,389)	(2,793)
Cash dividends received from equity investees		222,397	6,607	327,015	10,335
Gain on long-term investments		(63,412)	(1,884)	(72,859)	(2,303)
Adjustment of changes in exchange rates		12,054	358	15,474	489
Increase in receivables		(630,133)	(18,720)	(2,707,130)	(85,560)
Decrease in prepayments		224,273	6,663	52,205	1,650
(Increase) decrease in securities purchased for trading purposes		(533,771)	(15,858)	5,345,238	168,939
Decrease in payables		(3,200,760)	(95,091)	(1,611,185)	(50,922)
Decrease in advances		(545,651)	(16,211)	(81,531)	(2,577)
Increase (decrease) in other liabilities		14,005,591	416,091	(18,495,754)	(584,569)
Net cash provided (used in) by operating activities		17,618,754	523,433	(8,838,400)	(279,343)
CASH FLOWS FROM INVESTING ACTIVITIES:					
Proceeds from disposal of premises and equipment and non-operating assets		1,756,344	52,179	128,716	4,068
Acquisition of premises and equipment		(565,465)	(16,799)	(839,576)	(26,535)
Increase in long-term investments in bonds		(17,144,476)	(509,343)	(4,555,225)	(143,970)
Proceeds from disposal of investments		5,090,397	151,230	246,616	7,795
Decrease (increase) in securities purchased for non-trading purposes		(8,409,407)	(249,834)	21,382,059	675,792
Net increase in bills and loans		(32,325,007)	(960,339)	(26,097,737)	(824,834)
Decrease in other assets		2,664,687	79,165	529,152	16,724
Increase in due from the Central Bank and call loans to banks		(807,490)	(23,990)	(2,518,067)	(79,585)
Increase in deferred charges		(70,564)	(2,096)	(60,359)	(1,908)
Net cash used in investing activities		(49,810,981)	(1,479,827)	(11,784,421)	(372,453)
CASH FLOWS FROM FINANCING ACTIVITIES:					
Decrease in due to the Central Bank and call loans from banks		(1,915,316)	(56,902)	(4,625,040)	(146,177)
Increase in deposits and remittances		30,152,040	895,783	29,730,539	939,651
Increase in financial debentures payable		2,000,000	59,418	3,500,000	110,620
Increase (decrease) in banker's acceptances and funds borrowed		608,260	18,071	(311,676)	(9,851)
Increase in guaranty and marginal deposits		118,425	3,518	7,182	227
Distribution of cash dividends		-	-	(6,467,361)	(204,405)
Compensation to directors and supervisors, bonus to shareholder, special bonus to employees, and contribution to welfare fund		-	-	(10,000)	(316)
Net cash provided by financing activities		30,963,409	919,888	21,823,644	689,749
EFFECT OF CHANGES IN FOREIGN EXCHANGE RATES		(25,018)	(744)	(8,631)	(273)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		(1,253,836)	(37,250)	1,192,192	37,680
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD		18,754,891	557,186	17,860,193	564,481
CASH AND CASH EQUIVALENTS AT END OF THE PERIOD		\$17,501,055	\$519,936	\$19,052,385	\$602,161
SUPPLEMENT DISCLOSURES OF CASH FLOWS INFORMATION:					
Interest expenses paid		\$4,196,120	\$124,662	\$5,485,104	\$173,360
Income tax paid		\$146,181	\$4,343	\$206,738	\$6,534

The accompanying notes are an integral part of the financial statements.

Cathay United Bank

Notes to financial statements

for the six-month periods ended June 30, 2004 and 2005

(Amounts in thousands except for share and per share data and unless otherwise stated)

The reader is advised that these financial statements have been prepared originally in Chinese. These financial statements do not include additional disclosure information that is required for Chinese-language reports under the “Regulations Governing the Preparation of Financial Reports by Public Banks” by the Securities and Futures Bureau, Financial Supervisory Commission, Executive Yuan, Republic of China (the “ROC”). If there is any conflict between these financial statements and the Chinese version or any difference in the interpretation of the two versions, the Chinese language financial statements shall prevail.

I. Business

Cathay United Bank (the “Bank”), originally named United World Chinese Commercial Bank (“UWCCB”), was enfranchised by the government of the ROC in January 1975. The Bank started its operations on May 20, 1975 and is engaged in the following operations: (1) all commercial banking operations authorized by the ROC Banking Law (the “Banking Law”); (2) international banking business and related operations; (3) trust business; (4) off-shore banking business; and (5) other financial operations related to the promotion of investments of overseas Chinese.

The Bank’s stock was traded on the Taiwan Stock Exchange (the “TSE”) until December 18, 2002. On December 18, 2002, the Bank became a wholly-owned subsidiary of Cathay Financial Holding Co., Ltd. (“Cathay Financial Holdings”) through a conversion transaction and was delisted from the TSE.

As approved by the board of directors of the Bank on April 21, 2003 and by the ROC Ministry of Finance (the “MOF”) on June 26, 2003, the Bank merged with the former Cathay United Bank, a wholly-owned subsidiary of Cathay Financial Holdings, under the Financial Institution Merger Law. The record date for the merger was October 27, 2003, at which date the former Cathay United Bank was dissolved and UWCCB was renamed Cathay United Bank.

As of June 30, 2004 and 2005, the Bank employed 3,673 and 3,927 employees, respectively.

II. Summary of significant accounting policies

The financial statements were prepared in conformity with the “Regulations Governing the Preparation of Financial Reports by Public Banks”, the “Guidelines Governing the Preparation of Financial Reports by Securities Issuers” and accounting principles generally accepted in the ROC. The significant accounting policies are summarized as follows:

1. Basis for preparation of financial statements

The accompanying financial statements include the accounts of the head office, domestic and foreign branches and a representative office. All inter-branch and inter-office account balances and transactions have been eliminated when the financial statements were prepared.

2. Foreign currency transactions

Transactions in foreign currencies are initially recorded in New Taiwan dollars (“NT dollars” or “NT\$”) using the applicable exchange rate in effect as at the date of each transaction. At each month-end, assets and liabilities denominated in foreign currencies, except for those derived from trading of forward foreign exchange contracts (see note 3 below), are translated into NT dollars at the applicable exchange rates as at the balance sheet date. Income and expenses denominated in foreign currencies are translated into NT dollars at the exchange rates in effect as at the time of each transaction. The exchange gains or losses are credited to or charged against current income.

The differences in exchange rates for equity securities accounted for by the equity method are recorded as foreign currency translation adjustments in the shareholders’ equity. The differences in exchange rates for equity securities accounted for by the cost method are recorded as foreign currency translation adjustments in the shareholders’ equity if the restated New Taiwan dollar amounts are lower than the carrying amounts.

Assets and liabilities denominated in foreign currencies of the foreign branches are translated into NT dollars using the method described in the preceding paragraph. The foreign branches’ income and expenses denominated in foreign currencies are translated at the applicable weighted-average exchange rates. Gains or losses resulting from the translation are treated as foreign currency translation adjustment in the shareholders’ equity.

3. Derivative financial instruments

Forward foreign exchange

Assets and liabilities denominated in foreign currencies derived from the trading of forward foreign exchange contracts are recorded at the applicable contract rates on the trade date. Realized gain and loss on settlement of forward contracts are recognized as current gain and loss. At each financial reporting date, the Bank adjusts outstanding forward contracts by comparing the spot rates at the reporting date with the contract rates. The resulting unrealized gain or loss is recognized in the statements of income. On the balance sheet date, the carrying amounts of the receivables and payables from forward contracts are netted regardless of whether the receivables or payables are with the same counterparty, and the net difference is reported as an asset or liability.

Interest rate swaps

There is no physical exchange of notional amounts for interest rate swaps. Memo entries are made on the trade date. For interest rate swap transactions undertaken for trading purposes, mark-to-market value is calculated based on the discounted present value of all future cash flows using the applicable market rates at the balance sheet date. Any difference between the carrying amount and mark-to-market value is recognized as a gain or loss. For swaps entered into for hedging purposes, interest income and expense are recognized upon settlement.

Cross-currency swaps

For cross-currency swap contracts undertaken for non-trading purposes, the amounts to be exchanged on settlement date are recorded at the contract forward rates. The interest portions of the swaps, e.g., exchange of fixed-rate interest payment for floating-rate interest receipt calculated based on the determined notional amounts to be exchanged, are recorded as interest expense and income on the settlement date.

Options

For options, only memo entries of the notional amounts are recorded on the trade date. Premiums paid or received are recorded as an asset or liability. On the balance sheet date, outstanding options are marked-to-market and the gain or loss is recognized in the statements of income. Gains or losses on the exercise of options and premiums paid or received are recognized in the statements of income. If counterparty exercise by physical delivery, the transaction will be recorded as spot transaction.

Forward rate agreements (“FRAs”)

Only memo entries of the notional amounts are recorded on the trade date for forward rate agreements. The present value of the differences between the market interest rate and the contract interest rate is recognized as a gain or loss on the balance sheet date.

Futures

Margin deposits paid by the Bank for futures contracts entered into for trading or hedging purposes are recognized as assets and nominal amounts are made as memo entries. On the balance sheet date, outstanding futures contracts are marked-to-market and any gain or loss is recognized in the statements of income. Unrealized gain or loss from marking-to-market and realized gain or loss from settlement of futures contracts are classified as hedging or non-hedging based on the initial intentions when the contracts were entered into.

4. Securities purchased

Securities purchased are stated at the lower of cost or market value. Except for the parent company’s equity shares held by the Bank, the lower of cost or market value is determined based on a portfolio basis with similar securities. A provision is made when the market value is lower than the cost. When the market value rises, the gain is offset against the provision to the extent of the provision made previously.

When stocks and mutual funds are sold, the cost is calculated based on the weighted-average method. For other securities, the cost is calculated using specific identification method.

Securities purchased under resell agreements are presented in the balance sheets as part of “Securities purchased” and securities sold under repurchase agreements are presented as part of “Other liabilities.” Interest income from securities purchased under resell agreements and interest expense from securities sold under repurchase agreements are recognized on an accrual basis.

5. Allowances for doubtful accounts

Allowances for doubtful accounts on receivables, bills and loans is provided based on the results of collectibility reviews conducted in accordance with the guidelines set forth in the relevant regulations. When receivables are considered uncollectible, a write-off is made after it is approved by the Bank’s board of directors.

6. Long-term investments

(i) Investments in equity securities

Investments in other companies with voting rights of at least 20% but no more than 50%, or less than 20% but the Bank and related parties in the aggregate hold more than 20% of the common stock and have significant influence over the investee are accounted for under the equity method. The difference between the cost of investment and the company’s share of the investee company’s equity at acquisition is deferred and amortized over five years.

Other long-term equity investments are accounted for by the cost method. For investments in listed stocks, an allowance for decline in market value is made when the carrying amounts of the investments are below the market value, with the same amount debited to shareholders' equity. For investments in unlisted stock, provisions are made and recognized immediately as an expense when the carrying amounts are not expected to be fully recovered. Stock dividends are not recognized as investment income but instead are recorded as increases in the number of shares held.

(ii) Investments in debt securities

Long-term investments in debt securities represent investments in government bonds, financial bonds, first to default credit linked notes and callable corridor notes linked to US dollar LIBOR issued by internationally recognized financial institutions. Investments in debt securities are stated at cost, adjusted for the amortization of premiums or discounts over the periods from the acquisition to maturity on a straight-line basis. The amortization of premiums or discounts is included as part of interest income or interest expense. Devaluations are made and recognized immediately as an expense when the carrying amounts are not expected to be fully recovered. Costs of bonds upon maturity or disposal are determined by the specific identification method.

7. Premises and equipment

(i) Premises and equipment are stated at cost. Improvements, additions, and major renewals that extend the life of an asset are capitalized, while repairs and maintenance are expensed as incurred. ROC SFAS No.35 should be applied if an impairment has been found. Upon disposal of premises and equipment, the related cost, accumulated depreciation and accumulated impairment loss are removed from the account. Any gains or losses thereafter are charged to non-operating income or loss.

(ii) Depreciation is provided by the straight-line method over the following estimated useful lives:

Buildings	8~60	years
Furniture and fixtures	3~ 6	years
Transportation equipment	3~ 6	years
Miscellaneous equipment	3~10	years

When an impairment loss on a specified asset is identified, the related depreciation is recalculated based on the adjusted value over the estimated useful lives.

The residual value of a property that is still in use at the end of the original service life is depreciated using the straight-line method over its newly estimated service life.

8. Deferred charges

Computer software and electric wiring costs are amortized by the straight-line method over three to five years.

Costs associated with the Pacific SOGO co-branded credit card business are amortized on a straight-line basis over an estimated economic life of 48 months.

9. Foreclosed properties

Foreclosed properties represent assets acquired by repossession of collateral for realization and are stated at the lower of cost or net realizable value on the balance sheet date.

10. Asset impairment

The Bank assesses impairment for all its assets within the scope of ROC SFAS No. 35 if indicators for impairment are found. Accordingly, the Bank compares the carrying amount with the recoverable amount of the assets or the cash-generating unit (“CGU”) and writes down the carrying amount to the recoverable amount where applicable. The recoverable amount is defined as the higher of the net fair value or value in use.

For recognized impairment loss, the Bank assesses, at each balance sheet date, whether there is any evidence indicating that the impairment may no longer exist or may have decreased. If such evidence is found, the Bank re-estimates the recoverable amount of the asset. If the recoverable amount increases, the Bank reverses the recognized impairment loss to the extent of the carrying amount as if no impairment loss had been recognized with respect to such asset.

Impairment loss(reversal) is classified as non-operating loss(income).

11. Reserves for losses on guarantees

Reserves for losses on guarantees are provided at the maximum limit allowed by the relevant laws and regulations pertaining to guarantees provided for customs duties, commodity taxes and contract performance obligations.

12. Reserves for losses on stock brokerage transactions

Pursuant to the “Regulations Governing Securities Firms”, a reserve for possible losses is provided based on 0.0028% of the amount of total stock brokerage transactions each month until such reserve has reached the amount of NT\$200 million.

13. Reserves for losses on trading securities

Pursuant to the “Regulations Governing Securities Firms”, a reserve for possible losses on trading securities is provided based on 10% of the gain derived from trading securities each month until such reserve has reached the amount of NT\$200 million. The reserve cannot be used for other purposes except to offset trading losses.

14. Pension plans

The Bank has a pension plan covering all full-time employees. Under the plan, pension benefit payments for each employee are based on such employee’s years of service and final average compensation. The Bank has established two employee retirement fund committees to supervise the employees’ retirement fund based on the regulations of the employee retirement plan. Contribution to the pension fund is made to the separate accounts of the above two committees monthly. The Bank makes contributions to the pension plan, which is administered and operated by an independent employee retirement fund committee. The pension plan is not reflected in the Bank’s financial statements.

The Bank adopted ROC SFAS No. 18, “Accounting for Pensions” on January 1, 1995, which requires the actuarial determination of pension assets or obligations. The unrecognized assets or obligations at transition are amortized by the straight-line method over the employees’ average remaining service period. As the employees’ average remaining service period is shorter than 15 years, such amortization is by straight-line method over a 15- year period.

The Labor Pension Act of the ROC (the “Act”), which adopts a defined contribution scheme, takes effect from July 1, 2005. In accordance with the Act, employees of the Bank may elect to be subject to either the Act, and maintain their seniority before the enforcement of the Act, or the pension mechanism of the Labor Standards Law. For employees subject to the Act, the Bank shall make monthly contributions to the employees’ individual pension accounts on a basis no less than 6% of the employees’ monthly wages.

15. Recognition of interest income and service fees

Interest income is recognized on an accrual basis except for loans classified as delinquent accounts. The accrual of income from delinquent accounts is discontinued; subsequent interest payments are credited to income when received.

Service fees are recognized on an accrual basis.

16. Income tax

The Bank has adopted ROC SFAS No. 22, "Accounting for Income Taxes", for interperiod and intraperiod income tax allocation. Deferred income taxes are recognized for tax effects of temporary differences. Tax effects on deductible temporary differences, operating loss carryforwards and investment tax credits are recognized as deferred tax assets. Valuation allowance is provided for deferred tax assets when their realization is in doubt.

The adjustments of prior years' income tax are included in the current year's income tax calculation.

The Bank's tax credits are recognized in the current period according to ROC SFAS No.12, "Accounting For Income Tax Credits".

Income tax at a rate of 10% on undistributed earnings is assessed if the Bank does not distribute all its current year profits. Taxes on undistributed earnings are recorded as expense in the year the shareholder approves the retention of earnings.

Cathay Financial Holdings has adopted the Integrated Income Tax System for income tax filings with its qualified subsidiaries, including the Bank, since 2003.

17. Contingencies

A loss is recognized if it is probable that an asset will be impaired or a liability will be incurred and the amount of loss can be reasonably estimated. If the amount of loss cannot be reasonably estimated and the loss is possible, the obligation is disclosed as a contingent liability in the footnotes to the financial statements.

18. The interim financial statement

The Bank's interim financial statements are prepared according to ROC SFAS No.23, "Interim Financial Report and Disclosures".

19. Basis for converting financial statements

The Bank's financial statements are stated in NT dollars. Translation of the June 30, 2004 and 2005 NT dollar amounts into US dollar amounts is provided solely for the convenience of the readers, using the noon buying rate of NT\$ 33.66 and NT\$31.64 to US\$1.00 on June 30, 2004 and 2005, respectively, as provided by the Federal Reserve Bank of New York. Such translation amounts are unaudited. Such currency translation should not be construed as representations that the NT dollar amounts have been, could have been, or could in the future be, converted into U.S. dollars at this rate or any other rate of exchange.

III. Accounting Changes

The Bank has adopted the ROC SFAS No. 35, "Accounting for Asset Impairment", which took effect on January 1, 2005, to account for the impairment of its assets. No retroactive adjustment is required under SFAS No. 35. Such change in accounting principles reduced the Bank's premises and equipment and non-operating assets by NT\$77,302(US\$2,443) and NT\$295,449(US\$9,338), respectively, as of June 30, 2005 and reduced net income and earnings per share before tax by NT\$372,751 and NT\$0.08, respectively, for the six-month period ended June 30, 2005.

The Bank has adopted the amended ROC SFAS No. 5(r3), "Long-term Investments in Equity Securities", which took effect on January 1, 2005. Under the SFAS No. 5(r3), deferring recognition of income (loss) from investments in equity securities as a result of delays in obtaining the financial statements of equity investees is no longer allowed. No retrospective adjustments are required. Such change in accounting principles reduced the Bank's long-term investments accounted for by the equity method and capital reserves by NT\$12,997 (US\$411) and NT\$97 (US\$3), respectively, as of June 30, 2005 and net income by NT\$12,900 (US\$408) for the six-month period ended June 30, 2005.

IV. Breakdown of Significant Accounts

1. Cash and cash equivalents

	June 30,			
	2004		2005	
	NT	US	NT	US
Cash on hand	\$7,694,268	\$228,588	\$9,260,413	\$292,680
Checks for clearance	5,120,741	152,131	5,529,466	174,762
Due from commercial banks	4,686,046	139,217	4,262,506	134,719
Total	\$17,501,055	\$519,936	\$19,052,385	\$602,161

2. Due from the Central Bank and call loans to banks

	June 30,			
	2004		2005	
	NT	US	NT	US
Bank overdraft	\$-	\$-	\$1,430	\$45
Statutory revenue on deposits	20,107,987	597,385	21,432,861	677,398
General account	4,000,184	118,841	16,069,376	507,882
Deposits in the Central Bank	6,536,000	194,177	-	-
Call loans to banks	24,467,693	726,907	20,611,782	651,447
Total	\$55,111,864	\$1,637,310	\$58,115,449	\$1,836,772

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3. Securities purchased-net

	June 30,			
	2004		2005	
	NT	US	NT	US
Stocks	\$5,183,779	\$154,004	\$5,288,390	\$167,142
Mutual funds	3,271,377	97,189	2,071,657	65,476
Government and corporate bonds	46,267,849	1,374,565	69,002,006	2,180,847
(1) (2)				
Certificates of deposit (1)	118,643,112	3,524,751	128,453,296	4,059,839
Commercial papers (2)	8,070,714	239,771	6,294,329	198,936
Securities purchased under agreements to resell	6,261,652	186,026	2,360,774	74,614
Others	91,714	2,725	-	-
Total	187,790,197	5,579,031	213,470,452	6,746,854
Less: Allowance for decline in market price of securities	(412,643)	(12,259)	(114,365)	(3,615)
Net balance	<u>\$187,377,554</u>	<u>\$5,566,772</u>	<u>\$213,356,087</u>	<u>\$6,743,239</u>

(1) NT\$17,015,329 and NT\$21,169,455 of the securities purchased as of June 30, 2004 and 2005, respectively, were pledged to other parties as collateral for business reserves and guarantees.

(2) As of June 30, 2004 and 2005, certain of the Bank's investments in government and corporate bonds were pledged under repurchase agreements with notional amounts of NT\$30,213,600 and NT\$24,903,700, respectively. Such repurchase agreements amounting to NT\$32,456,165 and NT\$26,633,384, respectively, were posted to the "Other liabilities" account on the Bank's balance sheets. Repurchase agreements entered prior to June 30, 2004 and 2005 were settled at NT\$32,494,403 and NT\$26,679,132 prior to December 27, 2004 and December 26, 2005, respectively.

4. Receivables-net

	June 30,			
	2004		2005	
	NT	US	NT	US
Accounts receivable	\$43,017,373	\$1,277,997	\$50,800,712	\$1,605,585
Accrued interest receivable	3,689,271	109,604	4,121,979	130,277
Forward exchange bought	435,915	12,951	1,641,737	51,888
Notes receivable	485,879	14,435	474,313	14,991
Tax refundable	435,140	12,928	308,138	9,739
Account receivable from the Cathay Financial Holdings	728,717	21,649	571,606	18,066
Others	738,542	21,941	954,810	30,177
Total	49,530,837	1,471,505	58,873,295	1,860,723
Less: Allowance for doubtful accounts	(756,300)	(22,469)	(911,461)	(28,807)
Net balance	<u>\$48,774,537</u>	<u>\$1,449,036</u>	<u>\$57,961,834</u>	<u>\$1,831,916</u>

Please refer to Note IV.6 (4) for details of the allowance for doubtful accounts.

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5. Prepayments

	June 30,			
	2004		2005	
	NT	US	NT	US
Interbank clearing funds	\$946,174	\$28,110	\$801,516	\$25,333
Others	621,585	18,467	528,800	16,713
Total	<u>\$1,567,759</u>	<u>\$46,577</u>	<u>\$1,330,316</u>	<u>\$42,046</u>

6. Bills and loans-net

	June 30,			
	2004		2005	
	NT	US	NT	US
Inward-outward documentary bills purchased	\$1,090,654	\$32,402	\$864,022	\$27,308
Loans	552,385,261	16,410,733	611,584,425	19,329,470
Overdrafts	723,112	21,483	397,338	12,558
Delinquent accounts	3,274,188	97,272	5,682,234	179,590
Total	<u>557,473,215</u>	<u>16,561,890</u>	<u>618,528,019</u>	<u>19,548,926</u>
Less: Allowance for doubtful accounts	(6,197,083)	(184,108)	(5,988,272)	(189,263)
Net balance	<u>\$551,276,132</u>	<u>\$16,377,782</u>	<u>\$612,539,747</u>	<u>\$19,359,663</u>

(1) As of June 30, 2004 and 2005, the accounts with no interest accrued were NT\$6,001,784 and NT\$8,176,600, respectively. The non-accrued interest on such accounts amounted to NT\$115,142 and NT\$93,368 for the six-month periods ended June 30, 2004 and 2005, respectively.

(2) For the six-month periods ended June 30, 2004 and 2005, the Bank did not write off any bills and loans unless legal proceedings to collect these bills and loans had been initiated.

Please refer to Note X.2 (1) for details on bills and loans by industries and geographic regions.

(3) Information on bad and doubtful accounts (including receivables, bills and loans) is as follows:

	January 1 - June 30, 2004					
	Allocated Allowance		Unallocated Portion		Total	
	NT	US	NT	US	NT	US
Balance, beginning of the period	\$4,012,984	\$119,221	\$3,518,370	\$104,527	\$7,531,354	\$223,748
Provision for doubtful accounts	801,687	23,817	-	-	801,687	23,817
Write-offs	(4,484,030)	(133,215)	-	-	(4,484,030)	(133,215)
Recoveries	3,105,453	92,259	-	-	3,105,453	92,259
Reclassification	1,816,428	53,964	(1,816,428)	(53,964)	-	-
Effects of exchange rates change	-	-	(1,081)	(32)	(1,081)	(32)
Balance, end of the period	<u>\$5,252,522</u>	<u>\$156,046</u>	<u>\$1,700,861</u>	<u>\$50,531</u>	<u>\$6,953,383</u>	<u>\$206,577</u>

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	January 1 - June 30, 2005					
	Allocated Allowance		Unallocated Portion		Total	
	NT	US	NT	US	NT	US
Balance, beginning of the period	\$4,744,621	\$149,956	\$2,140,887	\$67,664	\$6,885,508	\$217,620
Provision of doubtful accounts	855,007	27,023	-	-	855,007	27,023
Write-offs	(4,145,374)	(131,017)	-	-	(4,145,374)	(131,017)
Recoveries	3,305,510	104,473	-	-	3,305,510	104,473
Reclassification	234,419	7,409	(234,419)	(7,409)	-	-
Effects of exchange rates change	-	-	(918)	(29)	(918)	(29)
Balance, end of the period	<u>\$4,994,183</u>	<u>\$157,844</u>	<u>\$1,905,550</u>	<u>\$60,226</u>	<u>\$6,899,733</u>	<u>\$218,070</u>

The Bank's financial statements include provisions for possible credit losses and guarantee losses based on information available to the Bank, including defaults to the extent they can be determined or estimated. Changes in operating or financial performance of customers and general economic conditions of the market may have an impact on the debtors' ability to repay their loans and uncertainty related to the future realizable value of collateral may cause the amounts of actual losses to differ from those presently determined or estimated.

7. Long-term investments

	June 30,					
	2004			2005		
	NT	US	% of ownership	NT	US	% of ownership
(i) Investments in Equity Securities:						
Seaward Card Co., Ltd.	\$51,435	\$1,528	99.99	\$49,097	\$1,552	100.00
Seaward Leasing Ltd. (1)	2,220,268	65,962	99.97	2,271,939	71,806	100.00
Cathay Futures Corp. (2)	726,444	21,582	99.82	720,329	22,766	99.99
Cathay Life Insurance Agent Corp., Ltd. (3)	79,744	2,369	99.90	78,702	2,487	99.98
Cathay Property Insurance Agent Corp., Ltd.	8,169	243	99.80	8,800	278	99.97
Indovina Bank (4)	427,449	12,699	50.00	476,787	15,069	50.00
Taiwan Real-estate Management Corp.	51,947	1,543	30.15	20,612	652	30.15
Taiwan Finance Corp.	1,269,428	37,713	24.57	1,354,722	42,817	24.57
Vista Technology Venture Capital Corp. (5)	15,087	448	5.00	8,521	269	4.76
Cathay Venture Capital Corp. (5)	29,471	875	3.33	30,171	954	2.00
Subtotal	<u>4,879,442</u>	<u>144,962</u>		<u>5,019,680</u>	<u>158,650</u>	
Less: Unrealized gain from intercompany transactions	(31,850)	(946)		(31,846)	(1,007)	
Prepayment of investment:						
Indovina Bank	<u>1,012</u>	<u>30</u>		<u>-</u>	<u>-</u>	
Investments accounted for under equity method	<u>4,848,604</u>	<u>144,046</u>		<u>4,987,834</u>	<u>157,643</u>	

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Chunghwa Telecom Co., Ltd.	438,037	13,014	0.09	-	-	-
Taiwan Cooperative Bank	116,435	3,459	0.21	116,435	3,680	0.21
International Securities Investment Trust Co., Ltd.	4,900	146	4.74	-	-	-
Wallant International Trade Inc. (6)	-	-	2.51	-	-	2.51
Central Deposit Insurance Corp.	10	-	-	10	-	-
Chinese Products Promotion Center	1,850	55	4.87	1,850	58	4.87
Han Tech Venture Capital Corp.	154,927	4,603	8.03	154,927	4,897	8.03
Taiwan Securities Central Depository Co., Ltd.	1,850	55	0.18	1,850	58	0.18
Taipei Forex Inc.	8,000	238	4.04	8,000	253	4.04
Global Securities Finance Corp.	161,930	4,811	2.45	161,930	5,118	2.45
An Feng Enterprise Co., Ltd.	4,500	134	15.00	4,500	142	15.00
Euroc II Venture Capital Corp.	40,000	1,188	5.00	40,000	1,264	5.00
Taiwan International Merchandise Exchange Corp.	12,500	371	0.63	12,490	395	0.62
Strategic Value Fund, Limited Partnership (6)	164,305	4,881	-	96,430	3,048	-
Chan Sheng Investment Development Co., Ltd. (6)	7,400	220	4.90	7,400	234	4.90
CDIB & Partners Investment Holding Corp.	500,000	14,854	4.95	500,000	15,803	4.95
Financial Information Service Co., Ltd.	45,500	1,352	1.14	45,500	1,438	1.14
IBU Securities Co., Ltd.	1,045,000	31,046	10.31	1,045,000	33,028	10.31
Sheng-Hua Venture Capital Corp.	50,000	1,485	2.50	50,000	1,580	2.50
Latin America Development Co., Ltd.	6,250	186	1.79	6,250	198	1.79
Capital Venture Fund II Corp.	30,000	891	5.00	30,000	948	5.00
Fu Yu Venture Capital Investment Corp.	50,000	1,485	3.70	50,000	1,580	3.70
Taipei Smart Card Corp.	25,000	743	5.00	25,000	790	5.00
New Century InfoComm Co., Ltd.	864,000	25,668	1.68	864,000	27,307	1.68
Harbinger Venture Capital Corp.	67,000	1,990	3.35	67,000	2,118	3.35
United Venture Capital Corp.	40,000	1,188	4.52	40,000	1,264	4.52
Centillion Venture Capital Corp.	60,000	1,783	5.00	60,000	1,896	5.00
Taiwan Asset Management Corp.	1,020,000	30,303	5.79	1,020,000	32,238	5.79
Taipei Financial Center Corp.	400,000	11,884	2.35	400,000	12,642	2.35
Taiwan Financial Asset Service Corp.	100,000	2,971	5.88	100,000	3,161	5.88
Mondex Taiwan Inc. (6)	25,000	743	6.47	5,000	158	6.47
Kaohsiung Rapid Transit Corp.	299,000	8,883	2.99	299,000	9,450	2.99
Investments accounted for under cost method	5,743,394	170,630		5,212,572	164,746	
Subtotal	10,591,998	314,676		10,200,406	322,389	
(ii)Others (7)(8)						
Government bonds	12,090,150	359,185		11,161,910	352,778	
Financial bonds	100,000	2,971		80,000	2,528	
First to default credit linked notes	2,025,000	60,160		1,424,700	45,028	
Callable corridor notes	9,427,303	280,074		9,795,261	309,585	
Collateralized debt obligation	1,349,361	40,088		1,170,979	37,010	
Collateral mortgage obligation	2,015,411	59,876		5,235,500	165,471	
Foreign government bond	668,466	19,859		1,263,750	39,942	
Forward rate linked notes	-	-		633,200	20,013	
Preferred stock	400,000	11,884		400,000	12,642	
Other bonds	300,000	8,912		300,000	9,482	
Subtotal	28,375,691	843,009		31,465,300	994,479	

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Total

\$38,967,689

\$1,157,685

\$41,665,706

\$1,316,868

- (1) As of June 30, 2004, the Bank recorded unrealized losses in the shareholder's equity for its long-term investment in Seaward Leasing Ltd. in the amount of NT\$95,426.
- (2) On December 24, 2003, the shareholders of Seaward Futures Corp. resolved to reduce its outstanding capital stocks by NT\$950,000, or 95,000 shares, and change its name to Cathay Futures Corp. The reduction of capital was approved by the relevant governmental authority on January 16, 2004 with effect on February 16, 2004.
- (3) Seaward Insurance Agent Corp. merged with Cathay Life Insurance Agent Corp., Ltd. on February 5, 2004, with Cathay Life Insurance Agent Corp., Ltd. as the surviving company. The merger was approved by a vote of the shareholders of Seaward Insurance Agent Corp. at a meeting duly convened on November 28, 2003.
- (4) Indovina Bank increased its capital by US\$2,500 in cash, which was to be used for working capital purposes. The increase was approved by the MOF.
- (5) The equity method of accounting was applied to Cathay Venture Capital Corp. and Vista Technology Venture Capital Corp. due to the fact that the Bank and its related parties held more than 20% of such companies' common stock.
- (6) Due to the recurring losses incurred by Wallant International Trade Inc., Chan Sheng Investment Development Co., Ltd., Strategic Value Fund Limited Partnership and Mondex Taiwan Inc., the Bank has recognized losses for these investees based on their net equity. The shareholders of Chan Sheng Investment Development Co., Ltd. resolved in their special meeting held on April 26, 2005 to stop its operations and the relevant liquidation procedures commenced on July 1, 2005.
- (7) As of June 30, 2004 and 2005, certain of the Bank's investments in government bonds were pledged under repurchase agreements with notional amounts of NT\$7,875,000 and NT\$3,764,000, respectively. Such repurchase agreements amounting to NT\$7,504,224 and NT\$4,109,444 were posted to the "Other liabilities" account on the Bank's balance sheets. Repurchase agreements entered prior to June 30, 2004 and 2005 were settled at NT\$7,510,290 and NT\$4,116,725 prior to August 24, 2004 and July 29, 2005, respectively.
- (8) As of June 30, 2005, NT\$159,645 of the Bank's investments in government bonds

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were pledged to other parties as collateral for business reserves and guarantees.

8. Other assets

	June 30,			
	2004		2005	
	NT	US	NT	US
Refundable deposits	\$857,597	\$25,478	\$1,026,443	\$32,441
Foreclosed properties-net	1,872,417	55,627	610,406	19,292
Deferred tax assets-net	1,587,754	47,171	385,236	12,176
Non-operating assets-net	700,806	20,820	1,196,510	37,816
Deferred charges	508,663	15,112	476,155	15,049
Others	124,483	3,698	21,401	677
Total	\$5,651,720	\$167,906	\$3,716,151	\$117,451

9. Due to the Central Bank and call loans from banks

	June 30,			
	2004		2005	
	NT	US	NT	US
Due to the Central Bank	\$159,554	\$4,740	\$380,724	\$12,033
Due to commercial banks	40,821,195	1,212,751	33,090,753	1,045,852
Overdrafts from banks	813,718	24,175	224,938	7,109
Call loans from banks	37,282,910	1,107,632	41,858,060	1,322,948
Total	\$79,077,377	\$2,349,298	\$75,554,475	\$2,387,942

10. Payables

	June 30,			
	2004		2005	
	NT	US	NT	US
Accounts payable	\$8,039,629	\$238,848	\$7,503,122	\$237,140
Accrued interest payable	2,032,666	60,388	2,603,096	82,272
Accrued expenses	1,130,703	33,592	1,761,783	55,682
Income tax payable	-	-	133,307	4,213
Notes payable	495,242	14,713	500,535	15,820
Collection received on behalf of customers	290,446	8,629	272,280	8,606
Dividends payable	2,138,289	63,526	200,375	6,333
Others	2,016,974	59,922	2,665,450	84,243

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Total	\$16,143,949	\$479,618	\$15,639,948	\$494,309
<u>11. Deposits and remittances</u>				
	June 30,			
	2004		2005	
	NT	US	NT	US
Check deposits	\$12,181,259	\$361,891	\$11,481,668	\$362,885
Demand deposits	79,667,888	2,366,842	80,830,674	2,554,699
Time deposits	134,103,973	3,984,075	165,497,707	5,230,648
Savings deposits	425,311,094	12,635,505	469,141,750	14,827,489
Foreign currency deposits	38,546,931	1,145,185	47,779,397	1,510,095
Outward remittances	2,430	72	121,091	3,827
Remittances payable	295,385	8,776	166,818	5,272
Total	\$690,108,960	\$20,502,346	\$775,019,105	\$24,494,915

12. Financial debentures payable

	June 30,			
	2004		2005	
	NT	US	NT	US
Financial debentures payable	\$14,700,000	\$436,720	\$39,700,000	\$1,254,741
Subordinated Financial debentures payable	12,350,000	366,905	12,350,000	390,328
Total	\$27,050,000	\$803,625	\$52,050,000	\$1,645,069

On May 23, 2002, the Bank issued five-year subordinated financial debentures totalling NT\$5,000,000 with a stated interest rate of 4.15%. Subsequently on September 10, 2002, the Bank issued five-year and six-month subordinated financial debentures totalling NT\$5,000,000 with a stated interest rate of 5.9% minus the six-month LIBOR rate. The subordinated financial debentures are repayable at maturity, and the interest is payable semi-annually.

On April 28, 2003, the Bank issued five-year subordinated financial debentures totalling NT\$2,350,000 with a stated interest rate of 2%. The subordinated financial debentures are repayable at maturity, and the interest is payable annually.

Each subordinated financial debenture has a lower priority claim on assets and income than other debts, that is, its principal and interest are repayable only after more senior debt with higher priority has been satisfied. These subordinated financial debentures are, however, senior to common stock.

On June 20, 2003, the Bank issued five-year and six-month financial debentures amounting to NT\$5,000,000 with inverse floating interest rate. On December 4, 2003, December 10, 2003 and December 11, 2003, the Bank issued five-year financial debentures amounting to NT\$3,200,000, NT\$2,700,000 and NT\$1,800,000, respectively, with floating interest rates. Subsequently on March 29, 2004, the Bank issued six-year financial debentures amounting to NT\$2,000,000 with a floating interest rate. These financial debentures are repayable at maturity, and the interest is payable quarterly or semi-annually.

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On July 8 and July 15, 2004, the Bank issued five-year to seven-year financial debentures amounting to NT\$1,000,000, NT\$3,500,000, NT\$2,000,000 and NT\$1,000,000, respectively, with inverse floating interest rates or specific structure rates. These financial debentures are repayable at maturity, and the interest is payable quarterly or semi-annually. On November 10, November 25, November 26, December 9, December 10, December 22, December 23 and December 29, 2004 and on January 14 and February 22, 2005, the Bank issued five-year to seven-year financial debentures amounting to NT\$2,500,000, NT\$1,500,000, NT\$1,500,000, NT\$2,500,000, NT\$1,500,000, NT\$2,500,000, NT\$1,000,000, NT\$1,000,000, NT\$2,000,000 and NT\$1,500,000, respectively, with fixed interest rates. These financial debentures are repayable at maturity, and the interest is payable quarterly.

These financial debentures are senior in priority to the subordinated financial debentures and common shares, but are equal to other debts of the Bank.

13. Banker's acceptances and funds borrowed

	June 30,			
	2004		2005	
	NT	US	NT	US
Borrowed funds-the Central Bank	\$1,657,949	\$49,256	\$791,500	\$25,016
Borrowed funds-others	703,835	20,910	311,510	9,845
Total	<u>\$2,361,784</u>	<u>\$70,166</u>	<u>\$1,103,010</u>	<u>\$34,861</u>

14. Other liabilities

	June 30,			
	2004		2005	
	NT	US	NT	US
Reserve for losses on guarantees	\$28,795	\$856	\$28,554	\$903
Reserve for losses on stock brokerage transactions	42,820	1,272	-	-
Reserve for losses on trading securities	130,981	3,891	142,670	4,509
Securities sold under repurchase agreements	39,960,389	1,187,178	30,742,828	971,644
Guarantee and margin deposits	817,608	24,290	679,870	21,488
Others	155,883	4,631	62,930	1,989
Total	<u>\$41,136,476</u>	<u>\$1,222,118</u>	<u>\$31,656,852</u>	<u>\$1,000,533</u>

15. Capital Stock

The Bank had issued and outstanding capital stock of NT\$43,182,407 divided into 4,318,241 thousand common shares, par value NT\$10 per share.

On April 22, 2005, the Bank's board of directors on behalf of the shareholders resolved to increase its capital by transferring NT\$3,238,112 from unappropriate earnings in form of stock dividends. After the capitalization, the issued and outstanding capital stock amounted to NT\$46,420,519 divided into 4,642,052 thousand common shares, par value NT\$10 per share.

The above capitalization has been approved by the Securities and Futures Bureau.

16. Capital reserves

	June 30,			
	2004		2005	
	NT	US	NT	US
Capital reserves from the merged Bank	\$9,199,927	\$273,319	\$9,199,927	\$290,769
Additional paid-in capital	4,249,096	126,236	4,249,096	134,295
Capital reserves from equity investees, etc.	3,654	108	4,293	136
Capital reserves derived from treasury stocks transactions	10,397	309	10,397	328
Total	<u>\$13,463,074</u>	<u>\$399,972</u>	<u>\$13,463,713</u>	<u>\$425,528</u>

17. Retained earnings

(1) The Bank's articles of incorporation provide that its annual net income shall be appropriated and distributed in the following order:

- (a) 30% thereof shall be set aside as legal reserve;
- (b) special reserve;
- (c) regular dividends; and
- (d) the remainder, if any, shall be distributed and appropriated as follows: extra dividends: 80%, compensation to directors and supervisors: 5%, employees' special bonus: 10% and contribution to welfare fund: 5%.

- (2) The government's regulations stipulate that the Bank must retain part of its annual net income as legal reserve, and cash dividend declaration, if any, should not exceed the limit of 15% of paid-in capital until such retention of legal reserve reaches the amount of paid-in capital. The legal reserve may be used at any time to offset the accumulated deficit, if any. Once the legal reserve reached one-half of the paid-in capital, up to 50% of the reserve may be transferred to capital stock.
- (3) The Bank's directors proposed to allocate and distribute the earnings for the year 2003 on February 6, 2004 in the following manner:
- (a) legal reserve of NT\$ 829,122;
 - (b) dividends to shareholders of NT\$ 1,934,620.

The above allocation and distribution were approved by the Bank's board of directors on behalf of the Bank's shareholder on April 23, 2004.

- (4) The Bank's directors proposed to allocate and distribute the earnings for the year 2004 on February 2, 2005 in the following manner:
- (a) legal reserve of NT\$ 4,163,774;
 - (b) dividends to shareholders of NT\$ 9,713,473;
 - (c) compensation to directors and supervisors, bonus to employees and contribution to welfare fund of NT\$ 2,000.

The above allocation and distribution were approved by the Bank's board of directors on behalf of the Bank's shareholder on April 22, 2005.

18. Pension

The Bank has adopted the ROC SFAS No.18, "Accounting for Pension", which requires actuarial determination of pension assets or obligations.

19. Certain components of operating expenses

As of June 30, 2004 and 2005, the amounts of personnel, depreciation and amortization expenses were as follows:

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	January 1-June 30,			
	2004		2005	
	NT	US	NT	US
Personnel expenses				
Salary expenses	\$2,127,179	\$63,196	\$2,623,894	\$82,930
Insurance expenses	170,943	5,078	227,095	7,177
Pension expenses	178,968	5,317	185,097	5,850
Others	219,145	6,511	202,765	6,409
Depreciation expenses	450,087	13,372	494,751	15,637
Amortization expenses	105,899	3,146	110,058	3,478
Total	<u>\$3,252,221</u>	<u>\$96,620</u>	<u>\$3,843,660</u>	<u>\$121,481</u>

20. Income tax

Under a direction issued by the MOF, any financial holding company and any of its domestic subsidiaries over 90% of the shares of which are held by such financial holding company for 12 months within the same tax year may choose to adopt the Integrated Income Tax System for income tax filings. Cathay Financial Holdings has adopted the Integrated Income Tax System for income tax filings with respect to its qualified subsidiaries, including the Bank, since 2003.

(1) The reconciliation between income tax payable and income tax expenses for the six-month periods ended June 30, 2004 and 2005 is as follows:

	January 1-June 30,			
	2004		2005	
	NT	US	NT	US
Income tax payable:				
Domestic income tax:				
General (tax rate 25%)	\$-	\$-	\$1,731,122	\$54,713
Interest on short-term negotiable instruments (tax rate 20% or 6%)	7,609	226	23,601	746
Foreign branches' income tax	17,652	525	42,043	1,329
Deferred tax (benefits) expenses:				
Allowance for bad debts	216,703	6,438	54,634	1,727
Allowance for pledged assets taken-over	(12,509)	(372)	178,856	5,653
Provisions for possible losses	(843)	(25)	-	-
Foreign investment income recognized by the equity method	(1,955)	(58)	6,768	214
Operating loss carryforwards	2,088,594	62,050	-	-
Others	(17,995)	(539)	(43,029)	(1,360)
10% additional income tax on unappropriated earnings	-	-	70,458	2,227
Adjustment of prior period's income tax	(389,326)	(11,562)	(10,453)	(331)
The apportionment of income tax in the Integrated Income Tax System	(10,930)	(325)	-	-
Income tax expenses	<u>\$1,897,000</u>	<u>\$56,358</u>	<u>\$2,054,000</u>	<u>\$64,918</u>

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(2) Deferred tax liabilities and assets resulting from the following timing differences:

	June 30,			
	2004		2005	
	NT	US	NT	US
Taxable temporary differences:				
Unrealized losses from intercompany transactions	\$24,544	\$729	\$23,785	\$752
Others	78,382	2,329	121,172	3,830
Deductible temporary differences:				
Allowance for bad debts	963,575	28,627	349,422	11,044
Allowance for pledged assets taken-over	2,112,254	62,753	694,322	21,944
Unrealized gain from intercompany transactions	19,391	576	18,780	594
Pension expenses exceed the limit of tax law	75,809	2,252	75,809	2,396
Provisions for possible losses	60,314	1,792	20,000	632
Others	127,176	3,778	365,359	11,547
Operating loss carryforwards	\$2,818,129	\$83,723	\$-	\$-
Investment credit	\$27,616	\$820	\$-	\$-
Deferred income tax assets of foreign branches	\$41,708	\$1,239	\$40,552	\$1,282
	June 30,			
	2004		2005	
	NT	US	NT	US
(3) Deferred tax assets	\$1,613,486	\$47,936	\$421,475	\$13,321
Deferred tax liabilities	(25,732)	(765)	(36,239)	(1,145)
Net deferred tax assets	<u>\$1,587,754</u>	<u>\$47,171</u>	<u>\$385,236</u>	<u>\$12,176</u>

(4) The Bank's income tax returns for the years from 1994 through 2001 were assessed by the tax authority, and the Bank had accrued appropriate tax provisions for those years. However, the Bank disagreed with the assessments and appealed to the tax authority. After further review, the tax authority upheld its previous decisions and re-determined the income tax obligations of the Bank for the years from 1994 through 1998 and 2000 in 2004 and for the years 1999 and 2001 in 2005, respectively.

(5) For the tax years 1994, 1995 and 2001 with respect to the former Cathay United Bank, withholding tax on interest income from bonds held by other investors (the "bond withholding tax") was disallowed by the tax authority as a deduction. The Bank disagreed with the tax authority's decision and after accruing appropriate tax provisions, filed for administrative remediation. In 2004, the tax authority upheld its original decisions and the Bank made appropriate accounting treatment to reflect the outcome. In 2004, the Bank entered into a settlement with the tax authority. In the same year, the Bank also settled the tax dispute arising from the withholding tax on interest income from bonds pertaining to the above relevant periods in its 2002 tax returns.

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- (6) The Bank's income tax returns for the years prior to 2001 have been assessed by the tax authority.
- (7) The former Cathay United Bank's income tax returns for the years prior to 2002 have been assessed by the tax authority.
- (8) The related information on shareholders' deductible income tax is as follows:

	June 30,			
	2004		2005	
	NT	US	NT	US
Shareholders' deductible income tax account	\$50,113	\$1,489	\$106,426	\$3,364
Unappropriated earnings	8,106,651	240,839	6,645,698	210,041

The following is the rate of tax credit available for dividends to the Bank's shareholders for 2004:

	2004
Cash dividends	1.04%
Stock dividends	3.28%

21. Earnings per share

- (1) The computation of earnings per share is as follows:

	January 1-June 30,			
	2004		2005	
	In thousands of shares			
Shares issued at beginning of the year	\$4,318,241	\$4,318,241	\$4,318,241	\$4,318,241
Stock dividends in 2004 and retroactive adjustment	323,811	323,811	323,811	323,811
Weighted-averaged number of shares	\$4,642,052	\$4,642,052	\$4,642,052	\$4,642,052

	January 1-June 30,			
	2004		2005	
	NT	US	NT	US
Income before income tax	\$10,003,651	\$297,197	\$8,699,698	\$274,959
Income tax expenses	(1,897,000)	(56,358)	(2,054,000)	(64,918)
Net income	\$8,106,651	\$240,839	\$6,645,698	\$210,041

Earning per share (Expressed in dollars)				
	2004	2005	2004	2005
Income before income tax	\$2.16	\$0.064	\$1.87	\$0.059
Income tax expenses	(0.41)	(0.012)	(0.44)	(0.014)
Net income	\$1.75	\$0.052	\$1.43	\$0.045

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- (2) No earning distributions of the Bank were appropriated to employees, directors and supervisors for the year 2003. According to the regulations issued by the Securities and Futures Bureau, the Bank should calculate estimated earnings per share for the current year assuming that the dividends for the year 2004 would be appropriated to employees, directors and supervisors, as follows:

	<u>2004</u>
A. Distribution:	
Employees' bonus and contribution to welfare fund	<u>\$1,500</u>
Directors and supervisors' remunerations	<u>\$500</u>
B. Estimated earnings per share (In New Taiwan Dollar)	<u>\$2.99</u>

The formula for calculating estimated earnings per share is as follows:

$$\text{Estimated earnings per share} = \frac{\text{Net income} - \text{employees' bonus and contribution to welfare fund} - \text{directors' and supervisors' remunerations}}{\text{Weighted-averaged number of common stock outstanding}}$$

V. Related parties transactions

1. Names and relationships of related parties are as follows:

<u>Name of related parties</u>	<u>Relationship</u>
Cathay Financial Holding Co., Ltd.	Parent company
Cathay Life Insurance Co., Ltd. and other subsidiaries of Cathay Financial Holdings	Subsidiaries of Cathay Financial Holdings
Sanching Engineering Corp. and other affiliated companies of Cathay Financial Holdings	Related parties of Cathay Financial Group
Cathay Securities Investment Co., Ltd.	Related party of Cathay Financial Group
Cathay Real Estate Corp.	Related party of Cathay Financial Group
Cathay Futures Corp.	Equity investee
Seaward Leasing Ltd.	Equity investee
Taiwan Real-estate Management Corp.	Equity investee
Taiwan Finance Corp.	Equity investee
Seaward Card Co., Ltd.	Equity investee
Indovina Bank	Equity investee
Cathay Life Insurance Agent Co., Ltd.	Equity investee
Seaward Insurance Agent Corp.	Equity investee (Note 1)
Cathay Property Insurance Agent Co., Ltd.	Equity investee
Cathay Venture Capital Corp.	Equity investee
Vista Technology Venture Capital Corp.	Equity investee
Taipei Smart Card Corp.	Investee company
China England Company Ltd. and etc.	Investee companies of the Bank's subsidiaries
Culture and Charity Foundation of Cathay United Bank	The Bank is the major sponsor of the foundation

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2. Significant transactions with the related parties are summarized as follows:

(1) Loans and Deposits

Accounts / Related Parties	June 30, 2004			January 1-June 30, 2004	
	Account Balances			Interest Income (Expense)	
	NT	US	% of Account	NT	US
Bills and loans	\$4,869,926	\$144,680	0.91%	\$56,989	\$1,693
Deposits	35,756,517	1,062,285	5.18%	(68,391)	(2,032)

Accounts / Related Parties	June 30, 2005			January 1-June 30, 2005	
	Account Balances			Interest Income (Expense)	
	NT	US	% of Account	NT	US
Bills and loans	\$1,988,963	\$62,862	0.32%	\$20,192	\$638
Deposits	39,316,355	1,242,616	5.07%	(237,819)	(7,516)

2005

Call loans to banks	Maximum Balance		June 30 Balance		Interest Income		Interest Rate
	NT	US	NT	US	NT	US	
Indovina Bank	\$680,690	\$21,514	\$569,880	\$18,011	\$7,437	\$235	2.48%~ 3.84%

2005

Due to commercial banks	Maximum Balance		June 30 Balance		Interest Income		Interest Rate
	NT	US	NT	US	NT	US	
Indovina Bank	\$34,275	\$1,083	\$9,401	\$297	\$-	\$-	-

Transaction terms with the related parties are similar to those with third parties.

(2) Lease

Accounts / Related Parties	January 1-June 30,			
	2004		2005	
	NT	US	NT	US
<u>Rental income</u>				
Seaward Leasing Ltd.	\$941	\$28	\$66	\$2
Taipei Smart Card Corp.	2,854	85	2,854	90
Culture and Charity Foundation of Cathay United Bank	500	15	500	16
Cathay Securities Investment Co., Ltd.	-	-	4,785	151
<u>Rental expense</u>				
Cathay Life Insurance Co., Ltd.	122,097	3,627	133,475	4,219
Cathay Real Estate Corp.	6,942	206	6,942	219
Seaward Leasing Ltd.	-	-	1,380	44
	June 30,			

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Accounts/Related Parties	2004		2005	
	NT	US	NT	US
<u>Refundable deposits</u>				
Seaward Leasing Ltd. (Note 2)	\$42,000	\$1,248	\$42,000	\$1,327
Cathay Life Insurance Co., Ltd	71,262	2,117	75,907	2,399
Cathay Real Estate Corp.	3,408	101	3,408	108
<u>Guarantee deposits</u>				
Cathay Securities Investment Co., Ltd.	-	-	3,129	99

Transaction terms with the related parties are similar to those with third parties. Contract price for related-party contracts are consistent with market prices, and payments are duly made and received in accordance with the terms of the contracts.

Accounts/Related Parties	January 1-June 30,			
	2004		2005	
	NT	US	NT	US
(3) <u>Commissions and handling fees</u>				
Cathay Futures Corp.	\$1,839	\$55	\$-	\$-
(4) <u>Credit card processing charges</u>				
Seaward Card Co., Ltd.	297,995	8,853	517,495	16,356
(5) <u>Insurance expense</u>				
Cathay Life Insurance Co., Ltd.	104,793	3,113	109,434	3,459
Cathay Century Insurance Co., Ltd.	17,089	508	18,150	574
(6) <u>Credit card processing expenses</u>				
Cathay Life Insurance Co., Ltd.	32,053	952	58,476	1,848
Cathay Century Insurance Co., Ltd.	42,265	1,256	56,877	1,798
(7) <u>Other expense</u>				
Cathay Real Estate Corp.	3,000	89	3,600	114
Accounts/Related Parties	June 30,			
	2004		2005	
	NT	US	NT	US
(8) <u>Account receivables</u>				
Cathay Futures Corp.	\$382	\$11	\$-	\$-
Cathay Financial Holdings	728,717	21,649	571,606	18,066
(9) <u>Prepaid rental expense</u>				
Cathay Life Insurance Co., Ltd.	180	5	180	6
(10) <u>Refundable deposit</u>				
Cathay Futures Corp.	4,072	121	4,072	129
(11) <u>Accrued expenses</u>				
Seaward Card Co., Ltd.	40,346	1,199	90,673	2,866
(12) <u>Account payables</u>				
Cathay Financial Holdings	1,934,620	57,475	1,524,385	48,179

(13) Others

- a. The Bank paid project and construction management fees to Taiwan Real-estate Management Corp. in the amount of NT\$168 during the six-month period ended June 30, 2004.
- b. The Bank purchased automated systems for its 24-hour self-service banking centers from Sanching Engineering Corp. for the amounts of NT\$87,519 and NT\$3,820 during the six-month periods ended June 30, 2004 and 2005, respectively.
- c. The Bank paid construction planning and design maintenance services fees to Lin Yuan Property Management Co., Ltd. in the amount of NT\$6,865 during the six-month period ended June 30, 2005.
- d. As of June 30, 2004 and 2005, the notional amount of the forward, interest rate swap contracts and cross-currency swaps the Bank entered into with Cathay Life Insurance Co., Ltd. were US\$980,000 and US\$570,000, respectively.
- e. The Bank paid information maintenance services fees to Symphox Information Co., Ltd. in the amount of NT\$36,404 during the six-month period ended June 30, 2005.

The terms of the foregoing transactions with related parties are similar to those with third parties. Contract prices for related-party contracts are consistent with market prices, and payments are duly made and received in accordance with the terms of the contracts.

Combined disclosures have been made for transactions with related parties that are under a certain percentage of the total amount for all transactions with related parties and non-related parties.

(14) Spin-off

In accordance with the board of directors' resolutions on April 23, 2004, the Bank spun off its securities brokerage division to Cathay Securities Corp. on August 13, 2004. In accordance with the spin-off agreement, all assets and liabilities of the securities brokerage division were transferred at their book value, which in the aggregate amounted to NT\$414,930, and resulted in no gain or loss. All related receivables were settled in 2004.

Note1: Seaward Insurance Agent Corp. merged into Cathay Life Insurance Agent Co., Ltd. of Association on February 5, 2004.

Note 2: Interest from refundable deposits was used to offset against rental expense payable to Seaward Leasing Ltd.

VI. ASSETS PLEDGED OR MORTGAGED

See Notes IV.3 and 7.

VII. COMMITMENTS AND CONTINGENT LIABILITIES

As of June 30, 2005, the Bank had the following commitments and contingent liabilities, which are not reflected in the financial statements:

	NT	US
1. Entrusted Items and Guarantees:		
Trust and security held for safekeeping	\$605,597,329	\$19,140,244
Travelers checks for sale	675,707	21,356
Bills for collection	51,742,544	1,635,352
Guarantees on duties and contracts	15,800,838	499,394
Unused commercial letters of credit	3,809,051	120,387
Irrevocable loan commitments	25,203,457	796,569
Credit card lines	285,121,188	9,011,416
Stamp tax, securities and memorial currency consignments	1,757	56

2. As of June 30, 2005, the Bank had various lawsuits, claims and proceedings. The significant ones are summarized below:

- (1) In 1997, the Bank, as requested by Polaris International Securities Investment Trust Co., Ltd., paid Chung Shing Bank (had been merged with Union Bank of Taiwan) in an amount of NT\$600,000 for the purchase of certain certificate of time deposit. Such certificate of time deposit was later found to have been forged by Mr. Chung-For Su (a clerk of another bank). The Bank filed a lawsuit against Chung Shing Bank for the return of personal gains obtained by Mr. Chung-For Su. The Bank obtained a judgment rendered by the Taiwan High Court in favor of Chung Shing Bank. The Bank appealed and the Taiwan High Court reversed its previous decision. This case is pending as Chung Shing Bank subsequently has filed an appeal to the Supreme Court.

- (2) In 1996, several clients of the Bank filed a lawsuit against the Bank, claiming restitution in the amount of NT\$24,000 for theft of their properties stored in a safe at Chung-Li Branch. The High Court has held the Bank responsible for making restitution. The Bank has subsequently filed an appeal and the case is being reviewed by the High Court. The Bank has also filed an insurance claim against Taiwan Secom Co., Ltd. in relation to the loss mentioned above.

- (3) In 2001, embezzlement and illegal acts involving the amount of NT\$60,204 was committed by one of the Bank's employees. The Bank has filed a motion of injunction against such employee's personal properties.

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- (4) On January 1, 2004, Pacific SOGO began to issue its own SOGO membership card, which the Bank believes constitutes a breach of Pacific SOGO's co-branded card contract with the Bank. The Bank has filed a motion of injunction against certain of Pacific SOGO's properties and the issuance of its own membership cards.
- (5) On December 25, 2004, a charge of embezzlement in the amount of NT\$24,971 by one of the Bank's employees was brought to the Taipei District Prosecutors Office.
3. As of June 30, 2005, the Bank entered into certain contracts to purchase premises and equipment totalling NT\$941,513 with down payments of NT\$814,396.
4. Derivative financial instruments

In the normal course of business, the Bank enters into various derivative contracts, including forward foreign exchange contracts, interest rate swaps, cross-currency swaps, options, and futures and other similar instruments. These financial instruments involve varying degrees of risks. The related information is as follows:

- (1) The contract (nominal) amounts, credit risks, and fair values of derivative transactions were as follows(in thousands of US dollars)

Derivative financial instruments	June 30, 2004		
	Contract (Nominal) Amount	Credit Risk	Fair Value
<u>For the purpose of customers' hedging needs or hedging the Bank's exposures</u>			
Forward foreign exchange contracts	\$2,362,667	\$219,742	\$6,706
<u>For trading purpose</u>			
Interest rate swap contracts	172,963	1,376	74
Options	10,873	11	10
<u>For non-trading purposes</u>			
Interest rate swap contracts	963,200	7,828	16,816
Cross-currency swap contracts	577,707	8,419	(1,908)

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Derivative financial instruments	June 30, 2005		
	Contract (Nominal) Amount	Credit Risk	Fair Value
<u>For the purpose of customers' hedging needs or hedging the Bank's exposures</u>			
Forward foreign exchange contracts	\$2,815,976	\$15,128	\$19,364
<u>For trading purpose</u>			
Interest rate swap contracts	1,078,642	4,620	(184)
Options	193,884	301	13
<u>For non-trading purpose</u>			
Interest rate swap contracts	1,592,150	13,829	39,030
Cross-currency swap contracts	573,171	10,723	16,824

Credit risk is the risk of loss if a counterparty fails to perform its obligations under the contractual terms of a derivative financial instrument. The balance of credit risk above represents losses which the Bank would suffer if counterparties failed to meet their obligations according to the contractual terms, after taking into consideration the netting effects under the master netting agreements.

Forward foreign exchange contracts represent agreements to exchange designated currencies on a specified date at a predetermined exchange rate. Forward foreign exchange contracts are useful for the purposes of hedging risks resulting from transactions with customers or hedging the Bank's exposure. For contracts entered into with customers, prior approval of the credit facility limit is required before a transaction can be executed. The credit limit approval process is similar to policies and procedures applied to lending activities to ensure that the risk and exposure to all customers are properly monitored and managed. Certain customers are required to provide collateral (generally cash) for entering into such forward contracts. Such collateral is deemed necessary by the Bank to reduce its credit exposure incurred during the life of the contract.

Forward rate contacts made with major international financial institutions are under pre-approved credit limits that are based on each financial institution's worldwide ranking and credit rating. In addition, the settlement amount of forward rate contacts is the present value of interest differences between the market rate and the contract rate. The Bank monitors and adjusts its exposure to and believe its credit risks associated with forward rate contacts are limited.

As of June 30, 2005, the maturities of the Bank's outstanding interest rate swaps contracts ranged from seven months to four years. Those interest rate swap contracts represent agreements between two parties to exchange periodic interest payments, usually fixed versus floating, based on a notional principal amount. Some of them are Euro Convertible Bond related asset swaps.

As of June 30, 2005, the Bank's outstanding cross-currency swap contracts had remaining maturities from one year and seven months to six years and one month. Cross-currency swap contracts involve an exchange of principal balance denominated in two different currencies at the inception of the contract, exchange of interest payments during the life of the contract, and re-exchange of the principal balance at a specified future date. The above non-trading swap transactions are used to hedge the exchange rate risk or interest rate risk resulting from the Bank's foreign currency securities investment, foreign currency liquidity gap and financial debentures payable. Since the swap contracts are entered into with major international financial institutions with pre-approved credit limits based on each financial institution's world ranking and credit rating, the Bank believes that risks associated with these swap contracts are limited.

All the option transactions are designed to match the Bank's structured deposit business or other commercial needs. The option counterparties are either the Bank's depositors or major international financial institutions. Due to the fact that the options are linked to customers' deposits, the paid premiums are supported by interest income from their own deposits with the Bank. Consequently, the credit risks are considered limited.

(2) Market risk

Market risk is the potential loss arising from adverse movements of market rates, such as interest rates and foreign exchange rates. The related risks for the Bank's derivative financial instruments are as follows (in thousands of US dollars):

Items	June 30,	
	2004	2005
Interest rate risk exposures	\$412,418	\$309,981
Foreign exchange risk exposures	144,686	201,543

The overall market risk exposure from the Bank's derivative financial instruments is less than the aggregate market risk of individual instruments mentioned above.

(3) Liquidity risk, cash flow risk and the uncertainty of future cash flow

The liquidity of forward foreign exchange contracts, which are entered into by the Bank with customers, could be low. When the Bank entered into such financial instruments with its customers, usually for hedging purposes, it requires customers to provide supporting documents to process the trades. Since such contracts are not speculative in nature and both contracting parties will often hold on to their contract positions until the maturity of such contracts, the liquidity risk of forward foreign exchange contracts should be immaterial. The Bank also manages the forward rate risk through the interbank market. The liquidity risk of this type of transaction is very low because interbank forward markets are very liquid. The liquidity risk of interest rate swap contracts and cross-currency swap contracts is more limited because most of the trades are made for the purpose of holding to maturity. The use of derivative financial instruments by the Bank is mainly driven by customers' demands as well as the Bank's funding or hedging investment purposes. They did not involve any degree of high leverage.

As for the asset-backed swap contracts, the cash flow is determined by the difference between the fixed rate of the underlying bonds and floating rate index. The Bank's current asset-backed swap contract portfolio does not require additional significant cash flow demand.

(4) The policies for disclosing gains or losses of derivative financial instruments on the financial statements are summarized in Note II.

The gains and losses on derivative financial instruments were as follows (in thousands of US dollars):

Account	January 1 - June 30,		
	2004	2005	
<u>For Trading Purpose</u>			
Forward foreign exchange contracts			
-Realized	Interest income	\$5,241	\$11,387
-Realized	Interest expense	3,317	3,937
Interest rate swap contracts			
-Realized	Gain (loss) of derivative financial instruments	487	(171)
-Unrealized	"	80	(138)
Options			
-Realized	"	10	18
-Unrealized	"	10	7
Futures contracts			
-Realized	"	-	56

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	Account	January 1 - June 30,	
		2004	2005
<u>For Non-trading Purpose</u>			
Interest rate swap contracts			
-Realized	Interest income	18,955	19,170
-Realized	Interest expense	4,145	11,448
Cross-currency swap contracts			
-Realized	Interest income	5,316	6,844
-Realized	Interest expense	1,954	8,069

(5) Off-balance sheet credit risk

The Bank enters into certain transactions with customers to repurchase or resell securities or short-term notes for business purposes from time to time. The Bank also provides various types of loans and credit card services. The terms for the related loans vary with the credit status of the borrowers. The highest interest rate the Bank charged for credit card loans is 19.7%. The Bank also provides guarantees for loans and commercial letters of credit services. These guarantees represent an irrecoverable obligation to pay a third-party beneficiary in the event that a customer fails to meet a financial or performance obligation and the dates of guarantees for maturity are not in one particular period.

(6) A summary of the contract amount of each significant class of off-balance sheet credit related financial instruments outstanding is set forth in the table below:

	June 30,			
	2004		2005	
	NT	US	NT	US
Irrevocable loan commitments	\$19,119,713	\$568,025	\$25,203,457	\$796,569
Credit card lines	228,848,020	6,798,812	285,121,188	9,011,416
Guarantees and commercial letters of credit	20,460,280	607,851	19,609,889	619,782

These financial instruments may not be fully paid before or at maturity. Therefore, the total amount of these contracts does not necessarily represent future cash demand. The maximum amount of possible losses from the above off-balance sheet credit related financial instruments is approximately equal to the total contract amount if borrowers fail to perform the contracts.

The Bank maintains a strict policy to evaluate customers' credit ratings when providing loan commitments and commercial letters of credit transactions. Certain customers are required to provide appropriate collateral for the related loans, and the Bank retains the legal right to foreclose on or liquidate the collateral. Generally, the collateral includes cash, real estate, securities or other properties. However, credit card lines are not secured and may be cancelled by the Bank following periodic review of the customers' credit status.

VIII. Significant disaster losses

None.

IX. Significant subsequent event

None.

X. Others

1. Fair value of non-derivative financial instruments

As of June 30, 2004 and 2005, except as shown in the table below, the carrying amounts of financial assets and liabilities reported on the balance sheets were approximately equal to their carrying values:

Financial Assets	June 30,							
	2004				2005			
	Carrying Value		Fair Value		Carrying Value		Fair Value	
	NT	US	NT	US	NT	US	NT	US
Securities purchased	\$187,377,554	\$5,566,772	\$187,361,142	\$5,566,285	\$213,356,087	\$6,743,239	\$214,381,713	\$6,775,655
Long-term investments	38,967,689	1,157,685	39,005,244	1,158,801	41,665,706	1,316,868	41,680,006	1,317,320

Fair values of securities purchased and long-term investments were based on quoted market prices, if available. If quoted market prices did not exist, fair values were estimated according to book values or other financial sources.

2. Others

(1) Information on concentrations of credit risk

Concentrations of credit risk exist when the counterparties to financial instrument transactions are either concentrated in certain individuals or groups of individuals or engaged in business activities in the same region or industry, which would impair their ability to meet contractual obligations under negative economic or other conditions. The Bank does not believe it has high levels of risk concentration with regard to any single customer or transaction. However, the Bank is likely to be exposed to industry concentration risk. The Banks' information on concentration of credit risk is as follows:

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	June 30,			
	2004		2005	
	NT	US	NT	US
Bills and loans, customers' liabilities under acceptances and guarantees account				
Geographic region				
Domestic	\$546,882,162	\$16,247,241	\$599,310,111	\$18,941,533
South east asia	12,043,100	357,787	9,770,154	308,791
North east asia	254,974	7,575	21,839	690
North america	7,770,855	230,863	9,719,797	307,200
Others	7,664,372	227,700	15,981,269	505,097
Total	<u>\$574,615,463</u>	<u>\$17,071,166</u>	<u>\$634,803,170</u>	<u>\$20,063,311</u>
Industry type				
Manufacturing	\$71,324,283	\$2,118,963	\$71,364,279	\$2,255,508
Financial institutions and insurance	33,006,325	980,580	42,595,519	1,346,255
Leasing and real estate	65,389,817	1,942,656	66,698,111	2,108,031
Individuals	292,726,793	8,696,577	343,680,676	10,862,221
Others	112,168,245	3,332,390	110,464,585	3,491,296
Total	<u>\$574,615,463</u>	<u>\$17,071,166</u>	<u>\$634,803,170</u>	<u>\$20,063,311</u>

The credit risk represents the maximum accounting loss that would be recognized at the reporting date if counterparties failed completely to perform as contracted and any collateral or security proved to be of no value.

(2) Average balances and average interest rates of interest-earning assets and interest-bearing liabilities

	January 1-June 30, 2004		
	Average Balance		Average Rate
	NT	US	(%)
Assets			
Due from the Central Bank	\$34,878,079	\$1,036,188	1.16%
Time certificates, discounted bills and others	129,233,553	3,839,381	1.28%
Due from commercial banks and call loans to banks	30,238,639	898,355	1.22%
Bills and loans	540,601,714	16,060,657	3.71%
Government and corporate bonds	70,542,840	2,095,747	3.54%
Receivables-credit card	29,931,794	889,239	14.80%
Liabilities			
Due to banks	\$79,873,386	\$2,372,947	1.17%
Demand deposits	91,307,190	2,712,632	0.16%
Saving deposits	433,120,304	12,867,508	0.72%
Time deposits	138,685,208	4,120,178	1.04%
Negotiable certificates of deposits	14,099,632	418,884	1.06%
Financial debentures payable	26,082,967	774,895	3.56%
Bank's acceptances and funds borrowed	2,131,273	63,318	1.75%

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	January 1-June 30, 2005		
	Average Balance		Average Rate
	NT	US	(%)
Assets			
Due from the Central Bank	\$21,144,341	\$668,279	1.49%
Time certificates, discounted bills and others	160,126,945	5,060,902	1.27%
Due from commercial banks and call loans to banks	23,222,879	733,972	1.73%
Bills and loans	592,269,291	18,719,004	4.04%
Government and corporate bonds	92,172,273	2,913,157	3.22%
Receivables-credit card	35,159,298	1,111,229	14.97%
Liabilities			
Due to banks	\$76,535,591	\$2,418,950	2.08%
Demand deposits	91,044,662	2,877,518	0.24%
Saving deposits	455,898,675	14,408,934	0.78%
Time deposits	158,651,176	5,014,260	1.45%
Negotiable certificates of deposits	31,099,719	982,924	1.12%
Financial debentures payable	51,475,414	1,626,909	2.50%
Bank's acceptances and funds borrowed	1,280,532	40,472	2.68%

(3) Regulatory capital ratio

Pursuant to the regulations of the Banking Law, the ratio of a bank's shareholders' equity to its risk-weighted assets may not be less than 8%. If such ratio is less than the prescribed ratio, the Bank's ability to distribute surplus profits may be restricted by the authority in charge.

As of June 30, 2004 and 2005, the ratio of the Bank's shareholders' equity to its risk-weighted assets was 11.43% and 11.11% (not including subsidiaries), respectively. The formula to calculate such ratio is as follows:

$$\frac{\text{Eligible capital-Deduction item}}{\text{Weighted risk assets + Capital charges for market risk positions} \times 12.5}$$

(4) As of June 30, 2004 and 2005, the amounts of insurance coverage over the Bank's premises and equipment were NT\$7,508,225 and NT\$8,143,749, respectively.

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- (5) Certain accounts of the financial statements for the six-month period ended June 30, 2004 have been reclassified to conform to the current presentation.
- (6) In accordance with Article 17 of the Trust Laws, the assets and liabilities managed under the Bank's trust are as follows:

Balance Sheet Based on Trust
June 30, 2004

	Trust Assets			Trust Liabilities	
	NT	US		NT	US
Cash and cash equivalents	\$3,441,032	\$102,229	Trust capital		
			Trust capital-money	\$74,064,507	\$2,200,372
Short-term investments			Trust capital-trading securities	958,655	28,481
Bonds	15,334	456	Trust capital-real estate	2,831,307	84,115
Common stock	17,498	520			
Mutual funds	16,477	490	Reserve and accumulated earnings		
Designated-purpose funds	70,672,342	2,099,594	Commitment	(23,498)	(698)
Personal estate			Net loss	(862)	(26)
Trading securities	957,660	28,451			
Real estate					
Land	2,708,970	80,480			
Buildings	796	24			
Total	<u>\$77,830,109</u>	<u>\$2,312,244</u>	Total	<u>\$77,830,109</u>	<u>\$2,312,244</u>

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Balance Sheet Based on Trust
June 30, 2005

	Trust Assets		Trust Liabilities	
	NT	US	NT	US
Cash and cash equivalents	\$3,547,029	\$112,106	Trust capital	
			Trust capital-money	\$91,504,457
Short-term investments			Trust capital-trading securities	1,865,306
Bonds	23,413	740	Trust capital-real estate	
Common stock	18,697	591		
Mutual funds	56,327	1,780		
Designated-purpose funds	87,835,558	2,776,092		
Personal estate				
Trading securities	1,863,506	58,897	Reserve and accumulated earnings	
Real estate			Commitment	(112,713)
Land	3,081,944	97,407	Distribution	(19,509)
Buildings	6,164	195	Net Income	51,703
Total	<u>\$96,432,638</u>	<u>\$3,047,808</u>	Total	<u>\$96,432,638</u>
				<u>\$3,047,808</u>

Details of Trust Properties
June 30, 2005

Investment Items	Amount	
	NT	US
Short-term investment		
Bonds	\$23,413	\$740
Common stock	18,697	591
Mutual fund	56,327	1,780
Assigned fund	87,835,558	2,776,092
Personal estate		
Deposits	3,547,029	112,106
Trading securities	1,863,506	58,897
Real estate		
Land	3,081,944	97,407
Buildings	6,164	195
Total	<u>\$96,432,638</u>	<u>\$3,047,808</u>