

Cathay United Bank
Financial Statements With
Independent Auditors' Review Report
For The Nine-Month Periods Ended September 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 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' Review Report

The Board of Directors
Cathay United Bank

We have reviewed the accompanying balance sheets of Cathay United Bank as of September 30, 2004 and 2005, and the related statements of income and cash flows for the nine-month periods ended September 30, 2004 and 2005. These financial statements are the responsibility of the Bank's management. Our responsibility is to issue a review report on these financial statements based on our review.

Our review was made in accordance with the statements for auditing standards No.36 "Review of Financial Statements" generally accepted in the Republic of China, which consist principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the Republic of China, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with the "Regulations Governing the Preparation of Financial Reports by Public Banks", "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 ROC 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
October 17, 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 review 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

Unaudited balance sheets

September 30, 2004 and 2005

(Expressed in thousands of dollars)

ASSETS	NOTES	September 30, 2004		September 30, 2005	
		NT	US (Note II)	NT	US (Note II)
Cash and cash equivalents	IV	\$16,576,802	\$487,696	\$17,537,552	\$528,558
Due from the Central Bank and call loans to banks	IV, V and X	52,736,394	1,551,527	49,869,891	1,503,011
Securities purchased-net	II, IV, VI and X	185,864,690	5,468,217	193,572,453	5,834,010
Receivables-net	II, IV, V and X	50,401,664	1,482,838	60,616,743	1,826,906
Prepayments	IV and V	1,479,362	43,523	1,832,027	55,215
Bills and loans-net	II, IV, V and X	566,324,853	16,661,514	617,430,382	18,608,511
Long-term investments	II, IV, V, VI and X				
Equity method		5,029,484	147,970	5,079,446	153,087
Cost method		5,737,749	168,807	4,890,726	147,400
Others		28,935,720	851,301	38,563,384	1,162,248
Premises and equipment	II, V, VII and X				
Cost:					
Land		14,910,991	438,688	14,051,197	423,484
Buildings		9,063,004	266,638	9,206,986	277,486
Furniture and fixtures		3,807,772	112,026	3,706,861	111,720
Transportation equipment		81,615	2,401	66,224	1,996
Miscellaneous equipment		3,997,949	117,621	4,442,920	133,903
Total Cost		31,861,331	937,374	31,474,188	948,589
Less:Accumulated depreciation		(6,994,412)	(205,779)	(7,221,810)	(217,656)
Construction in progress and procurement		796,458	23,432	742,285	22,372
Less:Allowance for asset impairment		-	-	(77,302)	(2,330)
Premises and equipment-net		25,663,377	755,027	24,917,361	750,975
Other assets	II, IV and V	4,459,099	131,189	3,725,830	112,291
TOTAL ASSETS		\$943,209,194	\$27,749,609	\$1,018,035,795	\$30,682,212

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

English Translation of Financial Statements Originally Issued in Chinese

Cathay United Bank

Unaudited balance sheets

September 30, 2004 and 2005

(Expressed in thousands of dollars)

LIABILITIES AND SHAREHOLDERS' EQUITY	NOTES	September 30, 2004		September, 2005	
		NT	US (Note II)	NT	US (Note II)
Due to the Central Bank and call loans from banks	IV, V and X	\$75,085,702	\$2,209,053	\$73,956,117	\$2,228,936
Payables	IV and V	14,559,282	428,340	24,067,437	725,360
Advances		979,694	28,823	1,235,073	37,223
Deposits and remittances	IV, V and X	703,318,830	20,691,934	757,378,680	22,826,362
Financial debentures payable	IV and X	34,550,000	1,016,475	52,050,000	1,568,716
Banker's acceptances and funds borrowed	IV and X	1,997,029	58,754	1,141,386	34,400
Other liabilities	II, IV and V	34,409,555	1,012,343	24,454,754	737,033
TOTAL LIABILITIES		864,900,092	25,445,722	934,283,447	28,158,030
Capital stock	IV	43,182,407	1,270,445	46,420,518	1,399,051
Capital reserves	IV				
Additional paid-in capital		13,449,023	395,676	13,449,023	405,335
Others		14,051	413	14,690	443
Retained earnings	IV				
Legal reserve		9,951,639	292,781	14,115,413	425,419
Unappropriated earnings		11,637,433	342,378	9,630,586	290,253
Unrealized losses on long-term investments	IV	(95,426)	(2,807)	-	-
Foreign currency translation adjustment	II	169,975	5,001	122,118	3,681
TOTAL SHAREHOLDERS' EQUITY		78,309,102	2,303,887	83,752,348	2,524,182
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		\$943,209,194	\$27,749,609	\$1,018,035,795	\$30,682,212

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

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

ITEMS	NOTES	January 1- September 30, 2004		January 1- September 30, 2005	
		NT	US (Note II)	NT	US (Note II)
OPERATING INCOME:					
Interest income	II and V	\$23,564,581	\$693,280	\$28,856,834	\$869,706
Commission and handling fees	II and V	5,031,330	148,024	5,122,085	154,373
Gains on sales of securities-net	II	407,769	11,997	752,561	22,681
Investment income-net	II and IV	557,584	16,404	45,107	1,359
Foreign currency exchange gain-net	II	337,562	9,931	218,690	6,591
Other operating income	II and V	715,031	21,037	973,353	29,336
Total operating income		<u>30,613,857</u>	<u>900,673</u>	<u>35,968,630</u>	<u>1,084,046</u>
OPERATING COST:					
Interest expense	V	(5,994,830)	(176,371)	(8,906,242)	(268,422)
Commissions and handling charges	V	(700,064)	(20,596)	(1,021,728)	(30,794)
Provisions for possible losses	II	(922,419)	(27,138)	(2,431,148)	(73,271)
Operating expenses	IV and V	(8,930,253)	(262,732)	(10,111,316)	(304,741)
Other operating cost		(493,646)	(14,523)	(606,586)	(18,282)
Total operating cost		<u>(17,041,212)</u>	<u>(501,360)</u>	<u>(23,077,020)</u>	<u>(695,510)</u>
NET OPERATING INCOME		<u>13,572,645</u>	<u>399,313</u>	<u>12,891,610</u>	<u>388,536</u>
NON-OPERATING INCOME					
Gains on disposal of premises and equipment	II	1,167,794	34,357	25,053	755
Others		103,002	3,030	27,217	820
Total non-operating income		<u>1,270,796</u>	<u>37,387</u>	<u>52,270</u>	<u>1,575</u>
NON-OPERATING LOSS:					
Losses on disposal of premises and equipment	II	(31,968)	(940)	(14,609)	(440)
Losses on asset impairment	II	-	-	(372,751)	(11,234)
Others		(83,040)	(2,443)	(6,934)	(209)
Total non-operating loss		<u>(115,008)</u>	<u>(3,383)</u>	<u>(394,294)</u>	<u>(11,883)</u>
INCOME BEFORE INCOME TAX		<u>14,728,433</u>	<u>433,317</u>	<u>12,549,586</u>	<u>378,228</u>
INCOME TAX EXPENSES	II and IV	<u>(3,091,000)</u>	<u>(90,939)</u>	<u>(2,919,000)</u>	<u>(87,975)</u>
NET INCOME		<u>\$11,637,433</u>	<u>\$342,378</u>	<u>\$9,630,586</u>	<u>\$290,253</u>
EARNING PER SHARE (IN DOLLARS)					
INCOME BEFORE INCOME TAX	IV	\$3.17	\$0.093	\$2.70	\$0.081
INCOME TAX EXPENSES		(0.66)	(0.019)	(0.63)	(0.019)
NET INCOME		<u>\$2.51</u>	<u>\$0.074</u>	<u>\$2.07</u>	<u>\$0.062</u>

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

English Translation of Financial Statements Originally Issued in Chinese
Cathay United Bank
Unaudited statements of cash flows
for the nine-month periods ended September 30, 2004 and 2005
(Expressed in thousands of dollars)

ITEMS	NOTES	January 1- September 30, 2004		January 1- September 30, 2005	
		NT	US (Note II)	NT	US (Note II)
CASH FLOWS FROM OPERATING ACTIVITIES:					
Net income		\$11,637,433	\$342,378	\$9,630,586	\$290,253
Adjustments to reconcile net income to net cash provided by (used in) operating activities:					
Depreciation and amortization	II	848,510	24,963	920,261	27,735
Provisions for possible losses	II	922,419	27,138	2,431,148	73,272
Gains on disposal of premises and equipment	II	(1,135,826)	(33,416)	(10,444)	(315)
Losses on asset impairment	II and IV	-	-	372,751	11,234
Investment income recognized by the equity method	II and IV	(303,815)	(8,938)	(153,445)	(4,625)
Cash dividends received from equity investees		222,397	6,543	325,935	9,823
Loss (gain) on long-term investments		(195,723)	(5,758)	253,662	7,645
Adjustment of changes in exchange rates		8,036	236	(3,772)	(114)
(Increase) decrease in receivables		1,604,678	47,210	(5,425,880)	(163,529)
(Increase) decrease in prepayments		312,670	9,199	(449,506)	(13,547)
Decrease in securities purchased for trading purposes		18,144,399	533,816	4,553,472	137,236
(Increase) decrease in payables		(2,850,807)	(83,872)	6,816,304	205,434
Increase (decrease) in advances		(697,105)	(20,509)	49,477	1,491
Increase (decrease) in other liabilities		7,426,887	218,502	(25,716,197)	(775,051)
Net cash provided by (used in) operating activities		35,944,153	1,057,492	(6,405,648)	(193,058)
CASH FLOWS FROM INVESTING ACTIVITIES:					
Proceeds from disposal of premises and equipment and non-operating assets		1,767,725	52,007	130,132	3,922
Acquisition of premises and equipment		(971,410)	(28,579)	(976,911)	(29,443)
Increase in long-term investments in bonds		(18,899,868)	(556,042)	(11,681,809)	(352,074)
Proceeds from disposal of investments		6,299,015	185,320	226,617	6,830
(Increase) decrease in securities purchased for non-trading purposes		(25,574,712)	(752,419)	41,957,459	1,264,541
Net increase in bills and loans		(51,349,287)	(1,510,717)	(32,489,117)	(979,178)
Decrease in other assets		3,878,366	114,103	618,950	18,655
Decrease in due from the Central Bank and call loans to banks		1,567,979	46,131	5,727,491	172,619
Increase in deferred charges		(108,171)	(3,183)	(207,600)	(6,257)
Net cash provided by (used in) investing activities		(83,390,363)	(2,453,379)	3,305,212	99,615
CASH FLOWS FROM FINANCING ACTIVITIES:					
Decrease in due to the Central Bank and call loans from banks		(5,906,991)	(173,786)	(6,223,398)	(187,565)
Increase in deposits and remittances		43,361,910	1,275,726	12,090,114	364,380
Increase in financial debentures payable		9,500,000	279,493	3,500,000	105,485
Increase (decrease) in banker's acceptances and funds borrowed		243,505	7,165	(273,300)	(8,237)
Increase (decrease) in guaranty and marginal deposits		(26,618)	(783)	24,295	732
Distribution of cash dividends		(1,934,620)	(56,918)	(6,467,361)	(194,917)
Compensation to directors and supervisors, bonus to shareholder, special bonus to employees, and contribution to welfare fund		-	-	(10,000)	(301)
Net cash provided by financing activities		45,237,186	1,330,897	2,640,350	79,577
EFFECT OF CHANGES IN FOREIGN EXCHANGE RATES		30,935	910	137,445	4,142
NET DECREASE IN CASH AND CASH EQUIVALENTS		(2,178,089)	(64,080)	(322,641)	(9,724)
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD		18,754,891	551,776	17,860,193	538,282
CASH AND CASH EQUIVALENTS AT END OF THE PERIOD		\$16,576,802	\$487,696	\$17,537,552	\$528,558
SUPPLEMENT DISCLOSURES OF CASH FLOWS INFORMATION:					
Interest expenses paid		\$5,914,444	\$174,005	\$8,405,311	\$253,325
Income tax paid		\$252,122	\$7,418	\$422,485	\$12,733

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

English Translation of Financial Statements Originally Issued in Chinese

Cathay United Bank

Notes to financial statements

as of and for the nine-month periods ended September 30, 2004 and 2005

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

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 by 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. (the “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 September 30, 2004 and 2005, the Bank employed 3,981 and 4,120 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 exchange rates of the last day in every month. 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 a counterparty exercise by physical delivery, the translation will be recorded as spot translation.

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 the 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 are 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 more than 20%, 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. Impairment loss is recognized when the Bank write down the carrying amounts of the investments to the recoverable amount.

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 (the “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 customers' duties, commodity taxes and contract performance obligations.

12. 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.

13. 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 the 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. For employees under defined contribution pension plans, the related net periodic pension costs are recorded based on the actual contributions made to the pension funds.

The Labor Pension Act of the ROC (the "Act"), which adopts a defined contribution scheme, took 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.

14. 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.

15. Income tax

The Bank has adopted the 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 the 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.

16. 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.

17. The interim financial statement

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

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18. Basis for converting financial statements

The Bank's financial statements are stated in NT dollars. Translation of the September 30, 2004 and 2005 NT dollar amounts into US dollar amounts are provided solely for the convenience of the readers, using the noon buying rate of NT\$33.99 and NT\$33.18 to US\$1.00 on September 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 US 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\$2,330) and NT\$295,449(US\$8,904), respectively, as of September 30, 2005 and reduced net income and earnings per share before tax by NT\$372,751 and NT\$0.08, respectively, for the nine-month period ended September 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 by NT\$11,890 (US\$359) and increased the capital reserves by NT\$639 (US\$19), respectively, as of September 30, 2005 and reduced net income by NT\$12,529 (US\$378) for the nine-month period ended September 30, 2005.

IV. Breakdown of Significant Accounts

1. Cash and cash equivalents

	September 30,			
	2004		2005	
	NT	US	NT	US
Cash on hand	\$7,851,445	\$230,993	\$9,513,326	\$286,719
Checks for clearance	4,311,258	126,839	5,572,134	167,936
Due from commercial banks	4,414,099	129,864	2,452,092	73,903
Total	<u>\$16,576,802</u>	<u>\$487,696</u>	<u>\$17,537,552</u>	<u>\$528,558</u>

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

	September 30,			
	2004		2005	
	NT	US	NT	US
Statutory revenue on deposits	\$20,069,432	\$590,451	\$21,631,152	\$651,934
General account	12,782,961	376,080	14,753,796	444,659
Deposits in the Central Bank	6,536,000	192,292	-	-
Call loans to banks	13,348,001	392,704	13,471,910	406,025
Bank overdraft	-	-	13,033	393
Total	<u>\$52,736,394</u>	<u>\$1,551,527</u>	<u>\$49,869,891</u>	<u>\$1,503,011</u>

3. Securities purchased-net

	September 30,			
	2004		2005	
	NT	US	NT	US
Stocks	\$4,757,773	\$139,976	\$5,851,530	\$176,357
Mutual funds	2,882,921	84,817	1,361,470	41,033
Government and corporate bonds	49,198,522	1,447,441	65,141,667	1,963,281
(1) (2)				
Certificates of deposit (1)	116,604,721	3,430,560	110,575,407	3,332,592
Commercial papers (2)	8,411,206	247,461	7,593,387	228,854
Securities purchased under agreements to resell	4,354,403	128,108	3,168,902	95,507
Others	79,714	2,345	-	-
Total	186,289,260	5,480,708	193,692,363	5,837,624
Less: Allowance for decline in market price of securities	(424,570)	(12,491)	(119,910)	(3,614)
Net balance	<u>\$185,864,690</u>	<u>\$5,468,217</u>	<u>\$193,572,453</u>	<u>\$5,834,010</u>

(1) NT\$16,127,907 and NT\$17,819,886 of the securities purchased as of September 30, 2004 and 2005, respectively, were pledged to other parties as collateral for business reserves and guarantees.

(2) As of September 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\$27,886,400 and NT\$20,789,900, respectively. Such repurchase agreements amounting to NT\$29,572,759 and NT\$22,050,539, respectively, were posted to the "Other liabilities" account on the Bank's balance sheets. Repurchase agreements entered prior to September 30, 2004 and 2005 were settled at NT\$29,608,173 and NT\$22,090,033 prior to March 28, 2005 and March 29, 2006, respectively.

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4. Receivables-net

	September 30,			
	2004		2005	
	NT	US	NT	US
Accounts receivable	\$45,074,871	\$1,326,122	\$53,694,984	\$1,618,294
Accrued interest receivable	3,617,164	106,418	3,786,618	114,124
Forward exchange bought	210,804	6,202	1,278,471	38,531
Notes receivable	681,786	20,058	736,897	22,209
Tax refundable	421,474	12,400	274,430	8,271
Account receivable from the Cathay Financial Holdings	571,606	16,817	571,606	17,227
Others	613,296	18,043	964,732	29,076
Total	51,191,001	1,506,060	61,307,738	1,847,732
Less: Allowance for doubtful accounts	(789,337)	(23,222)	(690,995)	(20,826)
Net balance	<u>\$50,401,664</u>	<u>\$1,482,838</u>	<u>\$60,616,743</u>	<u>\$1,826,906</u>

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

5. Prepayments

	September 30,			
	2004		2005	
	NT	US	NT	US
Interbank clearing funds	\$811,131	\$23,864	\$802,433	\$24,184
Others	668,231	19,659	1,029,594	31,031
Total	<u>\$1,479,362</u>	<u>\$43,523</u>	<u>\$1,832,027</u>	<u>\$55,215</u>

6. Bills and loans-net

	September 30,			
	2004		2005	
	NT	US	NT	US
Inward-outward documentary bills purchased	\$1,236,847	\$36,389	\$742,439	\$22,376
Loans	567,000,355	16,681,387	615,634,995	18,554,400
Overdrafts	438,232	12,893	631,148	19,022
Delinquent accounts	3,666,727	107,877	6,889,247	207,633
Total	572,342,161	16,838,546	623,897,829	18,803,431
Less: Allowance for doubtful accounts	(6,017,308)	(177,032)	(6,467,447)	(194,920)
Net balance	<u>\$566,324,853</u>	<u>\$16,661,514</u>	<u>\$617,430,382</u>	<u>\$18,608,511</u>

(1) As of September 30, 2004 and 2005, the accounts with no interest accrued were NT\$8,250,524 and NT\$9,135,104, respectively. The non-accrued interest on such accounts amounted to NT\$102,254 and NT\$140,231 for the nine-month periods ended September 30, 2004 and 2005, respectively.

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(2) For the nine-month periods ended September 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.

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

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

	January 1 - September 30, 2004					
	Allocated Allowance		Unallocated Portion		Total	
	NT	US	NT	US	NT	US
Balance, beginning of the period	\$4,012,984	\$118,063	\$3,518,370	\$103,512	\$7,531,354	\$221,575
Provision for doubtful accounts	916,009	26,949	-	-	916,009	26,949
Write-offs	(6,241,313)	(183,622)	-	-	(6,241,313)	(183,622)
Recoveries	4,600,159	135,339	-	-	4,600,159	135,339
Reclassification	1,019,391	29,991	(1,019,391)	(29,991)	-	-
Effects of exchange rates change	-	-	436	13	436	13
Balance, end of the period	\$4,307,230	\$126,720	\$2,499,415	\$73,534	\$6,806,645	\$200,254

	January 1 - September 30, 2005					
	Allocated Allowance		Unallocated Portion		Total	
	NT	US	NT	US	NT	US
Balance, beginning of the period	\$4,744,621	\$142,997	\$2,140,887	\$64,523	\$6,885,508	\$207,520
Provision of doubtful accounts	2,419,593	72,923	-	-	2,419,593	72,923
Write-offs	(6,825,445)	(205,709)	-	-	(6,825,445)	(205,709)
Recoveries	4,670,924	140,775	-	-	4,670,924	140,775
Reclassification	(381,233)	(11,490)	381,233	11,490	-	-
Effects of exchange rates change	-	-	7,862	237	7,862	237
Balance, end of the period	\$4,628,460	\$139,496	\$2,529,982	\$76,250	\$7,158,442	\$215,746

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.

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7. Long-term investments

	September 30,					
	2004			2005		
	NT	US	% of ownership	NT	US	% of ownership
(i) Investments in Equity Securities:						
Seaward Card Co., Ltd.	\$59,635	\$1,755	99.99	\$56,973	\$1,717	100.00
Seaward Leasing Ltd. (1)	2,237,710	65,835	99.97	2,271,753	68,468	100.00
Cathay Futures Corp. (2)	721,533	21,228	99.82	714,889	21,546	99.99
Cathay Life Insurance Agent Corp., Ltd. (3)	117,846	3,467	99.90	100,373	3,025	100.00
Cathay Property Insurance Agent Corp., Ltd.	9,388	276	99.80	9,921	299	100.00
Indovina Bank (4)	527,149	15,509	50.00	526,729	15,875	50.00
Taiwan Real-estate Management Corp.	51,947	1,528	30.15	20,955	632	30.15
Taiwan Finance Corp.	1,296,483	38,143	24.57	1,373,304	41,389	24.57
Vista Technology Venture Capital Corp. (5)	9,825	289	5.00	7,909	238	4.76
Cathay Venture Capital Corp. (5)	29,817	877	3.33	28,486	858	2.00
Subtotal	5,061,333	148,907		5,111,292	154,047	
Less: Unrealized gain from intercompany transactions	(31,849)	(937)		(31,846)	(960)	
Investments accounted for under equity method	5,029,484	147,970		5,079,446	153,087	
Chunghwa Telecom Co., Ltd.	438,037	12,887	0.09	-	-	-
Taiwan Cooperative Bank	116,435	3,426	0.21	116,435	3,509	0.21
International Securities Investment Trust Co., Ltd.	4,900	144	4.74	-	-	-
Wallant International Trade Inc. (6)	-	-	2.51	-	-	2.51
Central Deposit Insurance Corp.	10	-	-	10	-	-
Chinese Products Promotion Center	1,850	54	4.87	1,850	56	4.87
Han Tech Venture Capital Corp.	154,927	4,558	8.03	154,927	4,669	8.03
Taiwan Securities Central Depository Co., Ltd.	1,850	54	0.18	1,850	56	0.18
Taipei Forex Inc.	8,000	235	4.04	8,000	241	4.04
Global Securities Finance Corp.	161,930	4,764	2.45	161,930	4,880	2.45
An Feng Enterprise Co., Ltd.	4,500	132	15.00	4,500	136	15.00
Euroc II Venture Capital Corp.	40,000	1,177	5.00	40,000	1,206	5.00
Taiwan International Merchandise Exchange Corp.	12,490	368	0.63	12,490	377	0.62
Strategic Value Fund, Limited Partnership (6)	158,670	4,668	-	101,105	3,047	-
Chan Sheng Investment Development Co., Ltd. (6)	7,400	218	4.90	7,400	223	4.90
CDIB & Partners Investment Holding Corp.	500,000	14,710	4.95	500,000	15,069	4.95
Financial Information Service Co., Ltd.	45,500	1,339	1.14	45,500	1,371	1.14
IBU Securities Co., Ltd.	1,045,000	30,744	10.31	1,045,000	31,495	10.31
Sheng-Hua Venture Capital Corp.	50,000	1,471	2.50	50,000	1,507	2.50
Latin America Development Co., Ltd.	6,250	184	1.79	6,250	188	1.79
Capital Venture Fund II Corp.	30,000	883	5.00	30,000	904	5.00
Fu Yu Venture Capital Investment Corp.	50,000	1,471	3.70	50,000	1,507	3.70
Taipei Smart Card Corp.	25,000	736	5.00	25,000	754	5.00
New Century InfoComm Co., Ltd.(6)	864,000	25,419	1.68	669,934	20,191	1.68
Harbinger Venture Capital Corp.	67,000	1,971	3.35	67,000	2,019	3.35
United Venture Capital Corp.	40,000	1,177	4.52	40,000	1,206	4.52
Centillion Venture Capital Corp.	60,000	1,765	5.00	60,000	1,808	5.00
Taiwan Asset Management Corp.	1,020,000	30,009	5.79	1,020,000	30,742	5.79
Taipei Financial Center Corp.(6)	400,000	11,768	2.35	267,545	8,063	2.35
Taiwan Financial Asset Service Corp.	100,000	2,942	5.88	100,000	3,014	5.88
Mondex Taiwan Inc. (6)	25,000	736	6.47	5,000	151	6.47
Kaohsiung Rapid Transit Corp.	299,000	8,797	2.99	299,000	9,011	2.99
Investments accounted for under cost method	5,737,749	168,807		4,890,726	147,400	
Subtotal	10,767,233	316,777		9,970,172	300,487	

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(ii) Others (8)(9)

Government bonds	12,054,929	354,661	11,131,182	335,479
Financial bonds	80,000	2,354	60,000	1,808
First to default credit linked notes	1,529,550	45,000	3,153,323	95,037
Callable corridor notes	9,494,557	279,334	9,940,115	299,582
Collateralized debt obligation	1,766,879	51,982	895,844	26,999
Collateral mortgage obligation	2,635,636	77,542	10,693,079	322,275
Foreign government bond	674,169	19,834	1,325,941	39,962
Forward rate linked notes	-	-	663,900	20,009
Preferred stock	400,000	11,768	400,000	12,055
Other bonds	300,000	8,826	300,000	9,042
Subtotal	<u>28,935,720</u>	<u>851,301</u>	<u>38,563,384</u>	<u>1,162,248</u>
Total	<u>\$39,702,953</u>	<u>\$1,168,078</u>	<u>\$48,553,556</u>	<u>\$1,462,735</u>

- (1) As of September 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 stock by NT\$950,000, or 95,000 shares, and change its name to Cathay Futures Corp. The reduction of the capital was approved by the relevant governmental authority on January 16, 2004 with effect from 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) In 2004, 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 Taipei Financial Center Corp., New Century InfoComm Co., Ltd., 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.

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- (7) Certain of the above long-term investments and related investment gains (losses) accounted for by the equity method as of and for the nine-month periods ended September 30, 2004 and 2005 were recognized based on the investees' unreviewed financial statements. No material adjustments were anticipated, have those financial statements been reviewed.
- (8) As of September 30, 2004 and 2005, certain of the Bank's investments in government bonds were pledged under repurchase agreements with notional amounts of NT\$3,979,800 and NT\$1,360,000, respectively. Such repurchase agreements amounting to NT\$3,962,232 and NT\$1,500,000 were posted to the "Other liabilities" account on the Bank's balance sheets. Repurchase agreements entered prior to September 30, 2004 and 2005 were settled at NT\$3,967,123 and NT\$1,501,589 prior to October 15, 2004 and November 3, 2005, respectively.
- (9) As of September 30, 2004 and 2005, NT\$144,746 and NT\$499,632 of the Bank's investments in government bonds were pledged to other parties as collateral for business reserves and guarantees.

8. Other assets

	September 30,			
	2004		2005	
	NT	US	NT	US
Refundable deposits	\$901,576	\$26,525	\$1,040,392	\$31,356
Foreclosed properties-net	1,541,327	45,347	522,813	15,757
Deferred tax assets-net	767,273	22,574	380,129	11,456
Non-operating assets-net	736,000	21,653	1,203,004	36,257
Deferred charges	494,525	14,549	569,139	17,153
Others	18,398	541	10,353	312
Total	\$4,459,099	\$131,189	\$3,725,830	\$112,291

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

	September 30,			
	2004		2005	
	NT	US	NT	US
Due to the Central Bank	\$918,738	\$27,030	\$161,148	\$4,857
Due to commercial banks	40,258,731	1,184,429	31,644,310	953,716
Overdrafts from banks	337,487	9,929	365,152	11,005
Call loans from banks	33,570,746	987,665	41,785,507	1,259,358
Total	\$75,085,702	\$2,209,053	\$73,956,117	\$2,228,936

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10. Payables

	September 30,			
	2004		2005	
	NT	US	NT	US
Accounts payable	\$7,142,636	\$210,139	\$8,182,542	\$246,611
Accrued interest payable	2,486,608	73,157	3,006,571	90,614
Accrued expenses	1,288,276	37,901	1,834,471	55,288
Income tax payable	-	-	125,351	3,778
Notes payable	688,759	20,264	744,837	22,448
Collection received on behalf of customers	1,483,615	43,649	5,638,677	169,942
Dividends payable	203,367	5,983	200,029	6,029
Accounts payable - Cathay Financial Holdings	100,582	2,959	2,057,130	61,999
Others	1,165,439	34,288	2,277,829	68,651
Total	\$14,559,282	\$428,340	\$24,067,437	\$725,360

11. Deposits and remittances

	September 30,			
	2004		2005	
	NT	US	NT	US
Check deposits	\$11,854,038	\$348,751	\$11,705,096	\$352,776
Demand deposits	74,927,369	2,204,395	69,284,978	2,088,155
Time deposits	138,492,320	4,074,502	156,373,198	4,712,875
Savings deposits	435,449,840	12,811,116	469,564,525	14,152,035
Foreign currency deposits	42,268,099	1,243,545	50,069,833	1,509,036
Outward remittances	715	21	258,559	7,793
Remittances payable	326,449	9,604	122,491	3,692
Total	\$703,318,830	\$20,691,934	\$757,378,680	\$22,826,362

12. Financial debentures payable

	September 30,			
	2004		2005	
	NT	US	NT	US
Financial debentures payable	\$22,200,000	\$653,133	\$39,700,000	\$1,196,504
Subordinated Financial debentures payable	12,350,000	363,342	12,350,000	372,212
Total	\$34,550,000	\$1,016,475	\$52,050,000	\$1,568,716

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%, and the interest is payable annually. Subsequently on September 10, 2002, the Bank issued five-year and six-month subordinated financial debentures totalling NT\$5,000,000 with a floating interest rate or inverse floating interest rate, and the interest is payable semi-annually. The subordinated financial debentures are repayable at maturity.

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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.

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 floating interest rates, 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

	September 30,			
	2004		2005	
	NT	US	NT	US
Borrowed funds-the Central Bank	\$1,297,658	\$38,178	\$829,875	\$25,011
Borrowed funds-others	699,371	20,576	311,511	9,389
Total	<u>\$1,997,029</u>	<u>\$58,754</u>	<u>\$1,141,386</u>	<u>\$34,400</u>

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14. Other liabilities

	September 30,			
	2004		2005	
	NT	US	NT	US
Reserve for losses on guarantees	\$28,823	\$848	\$28,731	\$866
Reserve for losses on trading securities	131,152	3,859	143,902	4,337
Securities sold under repurchase agreements	33,534,991	986,613	23,550,539	709,781
Guarantee and margin deposits	672,565	19,787	696,983	21,006
Others	42,024	1,236	34,599	1,043
Total	\$34,409,555	\$1,012,343	\$24,454,754	\$737,033

15. Capital Stock

As of January 1, 2004, 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\$3,238,111 from unappropriated earnings in the form of stock dividends. After the capitalization, the issued and outstanding capital stock amounted to NT\$46,420,518 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

	September 30,			
	2004		2005	
	NT	US	NT	US
Capital reserves from the merged Bank	\$9,199,927	\$270,666	\$9,199,927	\$277,273
Additional paid-in capital	4,249,096	125,010	4,249,096	128,062
Capital reserves from equity investees, etc.	3,654	107	4,293	130
Capital reserves derived from treasury stocks transactions	10,397	306	10,397	313
Total	\$13,463,074	\$396,089	\$13,463,713	\$405,778

17. Retained earnings

- (1) The Bank's original 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%.

On August 3, 2005, the board of directors of the Bank revised its articles, the annual net income shall be appropriated and distributed in the follows order:

- (a) 30% thereof shall be set aside as legal reserve;
- (b) special reserves;
- (c) regular dividends; and
- (d) the remainder, if any, shall be distributed and appropriated as follows: extra dividends: 85%, employees' special bonus: 15%

The above revised articles will become effective after the approval by the shareholders' meeting.

- (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 reaches 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 shareholders 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:

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- (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

The following is a summary of the components of personnel, depreciation and amortization expenses for the nine-month periods ended September 30, 2004 and 2005.

	January 1- September 30,			
	2004		2005	
	NT	US	NT	US
Personnel expenses				
Salary expenses	\$3,246,122	\$95,502	\$3,686,080	\$111,094
Insurance expenses	277,027	8,150	335,927	10,124
Pension expenses	268,377	7,896	282,486	8,514
Others	293,427	8,633	284,706	8,581
Depreciation expenses	690,867	20,326	756,184	22,790
Amortization expenses	157,643	4,638	164,315	4,952
Total	<u>\$4,933,463</u>	<u>\$145,145</u>	<u>\$5,509,698</u>	<u>\$166,055</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.

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

	January 1- September 30,			
	2004		2005	
	NT	US	NT	US
Income tax payable:				
Domestic income tax:				
General (tax rate 25%)	\$352,704	\$10,377	\$2,479,616	\$74,732
Interest on separation tax (tax rate 20% or 6%)	13,592	400	93,295	2,812
Foreign branches' income tax	28,680	844	68,510	2,065
Deferred tax (benefits) expenses:				
Allowance for bad debts	271,204	7,979	8,306	250
Allowance for pledged assets taken-over	8,198	241	190,968	5,756
Provisions for possible losses	9,235	272	-	-
Foreign investment income recognized by the equity method	517	15	1,026	31
Operating loss carryforwards	2,793,126	82,175	-	-
Others	10,492	309	4,002	121
10% additional income tax on unappropriated earnings	-	-	70,458	2,123
Adjustment of prior period's income tax	(396,748)	(11,673)	2,819	85
Income tax expenses	<u>\$3,091,000</u>	<u>\$90,939</u>	<u>\$2,919,000</u>	<u>\$87,975</u>

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

	September 30,			
	2004		2005	
	NT	US	NT	US
Taxable temporary differences:				
Unrealized losses from intercompany transactions	\$24,088	\$709	\$23,633	\$712
Others	88,271	2,597	98,204	2,960
Deductible temporary differences:				
Allowance for bad debts	745,569	21,935	534,735	16,116
Allowance for pledged assets taken-over	2,029,431	59,707	645,874	19,466
Unrealized gain from intercompany transactions	19,238	566	18,628	561
Pension expenses exceed the limit of tax law	75,809	2,230	75,809	2,285
Provisions for possible losses	20,000	588	20,000	603
Others	123,389	3,630	177,237	5,342
Deferred income tax assets of foreign branches	\$42,004	\$1,236	\$42,518	\$1,281

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	September 30,			
	2004		2005	
	NT	US	NT	US
(3) Deferred tax assets	\$795,363	\$23,400	\$410,588	\$12,374
Deferred tax liabilities	(28,090)	(826)	(30,459)	(918)
Net deferred tax assets	<u>\$767,273</u>	<u>\$22,574</u>	<u>\$380,129</u>	<u>\$11,456</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 2004 and 2005, 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 and 2003 tax returns.

(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 2003 have been assessed by the tax authority.

(8) The related information on shareholders' deductible income tax is as follows:

	September 30,			
	2004		2005	
	NT	US	NT	US
Shareholders' deductible income tax account	\$91,508	\$2,692	\$38,417	\$1,158
Unappropriated earnings	11,637,433	342,378	9,630,586	290,253

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%

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21. Earnings per share

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

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

	January 1- September 30,			
	2004		2005	
	NT	US	NT	US
Income before income tax	\$14,728,433	\$433,317	\$12,549,586	\$378,228
Income tax expenses	(3,091,000)	(90,939)	(2,919,000)	(87,975)
Net income	<u>\$11,637,433</u>	<u>\$342,378</u>	<u>\$9,630,586</u>	<u>\$290,253</u>
Earning per share (Expressed in dollars)				
Income before income tax	\$3.17	\$0.093	\$2.70	\$0.081
Income tax expenses	(0.66)	(0.019)	(0.63)	(0.019)
Net income	<u>\$2.51</u>	<u>\$0.074</u>	<u>\$2.07</u>	<u>\$0.062</u>

(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:

	2004
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:

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

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V. Related parties transactions

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

Name of related parties	Relationship
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

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

(1) Loans and Deposits

Accounts / Related Parties	September 30, 2004			January 1- September 30, 2004	
	Account Balances			Interest Income (Expense)	
	NT	US	% of Account	NT	US
Bills and loans	\$2,039,973	\$60,017	0.37%	\$28,759	\$846
Deposits	41,836,195	1,230,838	5.95%	(253,645)	(7,462)

Accounts / Related Parties	September 30, 2005			January 1- September 30, 2005	
	Account Balances			Interest Income (Expense)	
	NT	US	% of Account	NT	US
Bills and loans	\$2,509,151	\$75,622	0.41%	\$37,167	\$1,120
Deposits	21,301,083	641,986	2.81%	(341,809)	(10,302)

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Call loans to banks	Maximum Balance		September 30 Balance		January 1- September 30 Interest Income		Interest Rate
	NT	US	NT	US	NT	US	
	Indovina Bank	\$697,095	\$21,009	\$514,523	\$15,507	\$13,040	

Bank overdraft	Maximum Balance		September 30 Balance		January 1- September 30 Interest Income		Interest Rate
	NT	US	NT	US	NT	US	
	Indovina Bank	\$13,033	\$393	\$13,033	\$393	\$-	

Due to commercial banks	Maximum Balance		September 30 Balance		January 1- September 30 Interest Income		Interest Rate
	NT	US	NT	US	NT	US	
	Indovina Bank	\$34,275	\$1,033	\$-	\$-	\$-	
Lucky Bank	12,295	371	937	28	-	-	0.10%

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

(2) Guarantees

The Bank had stood guarantees for Cathay Life Insurance Co., Ltd.

	Maximum balance		September 30 balance		Service Fees	
	NT	US	NT	US	NT	US
	January 1- September 30, 2004	\$412,165	\$12,126	\$-	\$-	\$-

(3) Lease

Accounts / Related Parties	January 1- September 30,			
	2004		2005	
	NT	US	NT	US
<u>Rental income</u>				
Seaward Leasing Ltd.	\$1,412	\$42	\$99	\$3
Taipei Smart Card Corp.	4,280	126	4,280	129
Culture and Charity Foundation of Cathay United Bank	750	22	750	23
Cathay Securities Investment Co., Ltd.	1,573	46	5,882	177
<u>Rental expense</u>				
Cathay Life Insurance Co., Ltd.	185,099	5,446	201,795	6,082
Cathay Real Estate Corp.	10,397	306	10,413	314
Seaward Leasing Ltd.	-	-	3,908	118

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	September 30,			
	2004		2005	
	NT	US	NT	US
<u>Refundable deposits</u>				
Seaward Leasing Ltd. (Note 2)	\$42,000	\$1,236	\$42,000	\$1,266
Cathay Life Insurance Co., Ltd.	71,532	2,105	75,102	2,263
Cathay Real Estate Corp.	3,408	100	3,408	103
<u>Guarantee deposits</u>				
Cathay Securities Investment Co., Ltd.	2,334	69	3,572	108
Seaward Leasing Ltd.	-	-	400	12

Transaction terms with the 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.

Accounts/Related Parties	January 1- September 30,			
	2004		2005	
	NT	US	NT	US
(4) <u>Commissions and handling fees</u>				
Cathay Futures Corp.	\$2,146	\$63	\$471	\$14
Cathay Life Insurance Co., Ltd.	-	-	96,000	2,893
(5) <u>Credit card processing charges etc.</u>				
Seaward Card Co., Ltd.	515,353	15,162	745,227	22,460
(6) <u>Insurance expense</u>				
Cathay Life Insurance Co., Ltd.	158,801	4,672	161,050	4,854
Cathay Century Insurance Co., Ltd.	24,310	715	29,131	878
(7) <u>Credit card processing expenses etc.</u>				
Cathay Life Insurance Co., Ltd.	137,889	4,057	192,376	5,798
Cathay Century Insurance Co., Ltd.	61,642	1,814	87,921	2,650
(8) <u>Other expense</u>				
Cathay Real Estate Corp.	4,800	141	5,400	163

Accounts/Related Parties	September 30,			
	2004		2005	
	NT	US	NT	US
(9) <u>Account receivables</u>				
Cathay Financial Holdings	\$571,606	\$16,817	\$571,606	\$17,227
Cathay Futures Corp.	242	7	-	-
Cathay Life Insurance Co., Ltd.	-	-	96,000	2,893
(10) <u>Prepaid rental expense</u>				
Cathay Life Insurance Co., Ltd.	72	2	72	2
(11) <u>Refundable deposit</u>				
Cathay Futures Corp.	4,072	120	4,072	123
(12) <u>Accrued expenses</u>				
Seaward Card Co., Ltd.	47,753	1,405	85,308	2,571

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(13) Account payables

Cathay Financial Holdings	100,582	2,959	2,057,130	61,999
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(14) Others

- a. The Bank paid project and construction management fees to Taiwan Real-estate Management Corp. in the amount of NT\$217 during the nine-month period ended September 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\$88,422 and NT\$3,820 during the nine-month periods ended September 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\$10,246 during the nine-month period ended September 30, 2005.
- d. As of September 30, 2004 and 2005, the notional amounts of the forward and cross-currency swaps the Bank entered into with Cathay Life Insurance Co., Ltd. were US\$550,000 and US\$870,000, respectively.
- e. The Bank paid information maintenance services fees to Symphox Information Co., Ltd. in the amount of NT\$39,293 during the nine-month period ended September 30, 2005.
- f. The Bank sold 1,000 shares of Taiwan International Merchandise Exchange Corp. to Cathay Securities Corp., a subsidiaries of Cathay Financial Holding Co., Ltd., at NT\$18.07 per share for the Cathay Securities Corp.'s commencement of futures business in 2004.

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.

(15) 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.

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

Note2: 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 September 30, 2005, the Bank had the following commitments and contingent liabilities, which are not reflected in the financial statements:

	<u>NT</u>	<u>US</u>
1. Entrusted Items and Guarantees:		
Trust and security held for safekeeping	\$605,040,013	\$18,235,082
Travelers checks for sale	684,663	20,635
Bills for collection	53,520,165	1,613,025
Guarantees on duties and contracts	14,602,887	440,111
Unused commercial letters of credit	3,723,101	112,209
Irrevocable loan commitments	26,114,029	787,041
Credit card lines	289,177,948	8,715,429
Stamp tax, securities and memorial currency consignments	1,727	52

2. As of September 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 (which merged with Union Bank of Taiwan) in an amount of NT\$600,000 for the purchase of a 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. The Chung Shing Bank subsequently filed an appeal to the Supreme Court. The Bank obtained a judgment rendered by the Supreme Court in favor of Chung Shing Bank on September 8, 2005. This case is pending as the Bank subsequently filed an appeal to the Taiwan High 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 also has filed an insurance claim against Taiwan Secom Co., Ltd. in relation to the loss mentioned above.

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- (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.
- (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 September 30, 2005, the Bank entered into certain contracts to purchase premises and equipment totalling NT\$1,095,887 with down payments of NT\$742,285.

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)

<u>Derivative financial instruments</u>	<u>September 30, 2004</u>		
	<u>Contract (Nominal) Amount</u>	<u>Credit Risk</u>	<u>Fair Value</u>
<u>For the purpose of customers' hedging needs or hedging the Bank's exposures</u>			
Forward foreign exchange contracts	\$2,382,810	\$199,961	\$(3,812)
<u>For trading purpose</u>			
Interest rate swap contracts	314,320	4,384	(10)
Options	90,247	1,797	706
Futures contracts	294	-	(1)
<u>For non-trading purposes</u>			
Interest rate swap contracts	952,991	7,858	25,846
Cross-currency swap contracts	577,707	9,935	7,866
Options	370	-	(52)

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Derivative financial instruments	September 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	\$2,598,229	\$18,083	\$45,158
<u>For trading purpose</u>			
Interest rate swap contracts	1,384,413	4,095	(145)
Options	229,067	227	61
Futures	10,494	-	10,429
<u>For non-trading purpose</u>			
Interest rate swap contracts	1,522,017	8,352	(7,046)
Cross-currency swap contracts	573,171	6,618	(7,851)

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 believes its credit risks associated with forward rate contacts are limited.

As of September 30, 2005, the maturities of the Bank's outstanding interest rate swaps contracts ranged from five months to six years and three months. 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.

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As of September 30, 2005, the Bank's outstanding cross-currency swaps contracts had remaining maturities from four months to five years and ten months. 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.

The futures in the domestic market are wholly traded in Taiwan Futures Exchange and the overseas futures deals are mainly transaction at CBOT that is clearing house. Therefore, there is no counterparty default risk.

(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	September 30,	
	2004	2005
Interest rate risk exposures	\$415,986	\$390,756
Foreign exchange risk exposures	363,700	177,770

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 - September 30,	
		2004	2005
<u>For Trading Purpose</u>			
Forward foreign exchange contracts			
-Realized	Interest income	\$7,342	\$18,531
-Realized	Interest expense	5,465	7,322
Interest rate swap contracts			
-Realized	Gain (loss) of derivative financial instruments	685	(296)
-Unrealized	"	31	(172)
Options			
-Realized	"	397	(81)
-Unrealized	"	13	(11)
Futures contracts			
-Realized	"	153	272
-Unrealized	"	(1)	65

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For Non-trading Purpose

Interest rate swap contracts				
-Realized	Interest income	21,074		28,117
-Realized	Interest expense	7,897		14,738
Cross-currency swap contracts				
-Realized	Interest income	8,145		9,337
-Realized	Interest expense	4,343		12,823

(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 was 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:

	September 30,			
	2004		2005	
	NT	US	NT	US
Irrevocable loan commitments	\$20,186,154	\$593,885	\$26,114,029	\$787,041
Credit card lines	253,783,202	7,466,408	289,177,948	8,715,429
Guarantees and commercial letters of credit	21,975,056	646,516	18,325,988	552,320

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 failed 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

The Bank issued 15-year US\$500 million subordinated bonds with a stated interest rate of 5.5% on October 5, 2005. The bond has listed at the Luxemburg Stock Exchange. The Bank can recall the bond after 10 years by exercising the call option.

(1) Others

(1) Fair value of non-derivative financial instruments

As of September 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	September 30,							
	2004				2005			
	Carrying Value		Fair Value		Carrying Value		Fair Value	
	NT	US	NT	US	NT	US	NT	US
Securities purchased	\$185,864,690	\$5,468,217	\$185,975,328	\$5,471,472	\$193,572,453	\$5,834,010	\$194,330,326	\$5,856,851
Long-term investments	39,702,953	1,168,077	39,729,141	1,168,848	48,533,556	1,462,735	48,538,917	1,462,897

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.

(1) 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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	September 30,			
	2004		2005	
	NT	US	NT	US
Bills and loans, customers' liabilities under acceptances and guarantees account				
Geographic Region				
Domestic	\$557,541,494	\$16,403,103	\$603,128,615	\$18,177,475
South East Asia	12,682,716	373,131	10,708,526	322,740
North East Asia	252,133	7,418	28,426	857
North America	8,911,243	262,172	9,660,164	291,144
Others	10,331,077	303,945	15,711,882	473,535
Total	<u>\$589,718,663</u>	<u>\$17,349,769</u>	<u>\$639,237,613</u>	<u>\$19,265,751</u>
Industry type				
Manufacturing	\$72,089,905	\$2,120,915	\$75,145,339	\$2,264,778
Financial institutions and insurance	31,623,145	930,366	35,872,369	1,081,144
Leasing and real estate	65,892,910	1,938,597	66,916,303	2,016,766
Individuals	302,959,380	8,913,191	356,220,558	10,736,003
Others	117,153,323	3,446,700	105,083,044	3,167,060
Total	<u>\$589,718,663</u>	<u>\$17,349,769</u>	<u>\$639,237,613</u>	<u>\$19,265,751</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- September 30, 2004		
	Average Balance		Average Rate
	NT	US	(%)
Assets			
Due from the Central Bank	\$35,064,501	\$1,031,612	1.13%
Time certificates, discounted bills and others	130,092,278	3,827,369	1.24%
Due from commercial banks and call loans to banks	27,052,479	795,895	1.29%
Bills and loans	546,154,322	16,068,088	3.72%
Government and corporate bonds	72,100,402	2,121,224	3.38%
Receivables-credit card	30,415,344	894,832	14.79%
Liabilities			
Due to banks	\$78,215,847	\$2,301,143	1.28%
Demand deposits	91,757,529	2,699,545	0.16%
Saving deposits	432,263,708	12,717,379	0.72%
Time deposits	133,599,529	3,930,554	1.05%
Negotiable certificates of deposits	20,979,861	617,236	1.01%
Financial debentures payable	28,568,248	840,490	3.52%
Bank's acceptances and funds borrowed	2,134,702	62,804	1.83%

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	January 1- September 30, 2005		
	Average Balance		Average Rate
	NT	US	(%)
Assets			
Due from the Central Bank	\$21,274,569	\$641,187	1.50%
Time certificates, discounted bills and others	154,039,041	4,642,527	1.30%
Due from commercial banks and call loans to banks	21,903,626	660,145	1.89%
Bills and loans	598,247,180	18,030,355	4.13%
Government and corporate bonds	94,925,202	2,860,916	3.33%
Receivables-credit card	36,061,049	1,086,831	14.88%

	January 1- September 30, 2005		
	Average Balance		Average Rate
	NT	US	(%)
Liabilities			
Due to banks	\$77,372,175	\$2,331,892	2.26%
Demand deposits	90,973,731	2,741,824	0.27%
Saving deposits	461,308,312	13,903,204	0.81%
Time deposits	163,664,198	4,932,616	1.54%
Negotiable certificates of deposits	25,366,718	764,518	1.14%
Financial debentures payable	51,669,048	1,557,235	2.39%
Bank's acceptances and funds borrowed	1,224,456	36,903	2.88%

(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 relevant governmental regulatory authority.

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:

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

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- (4) As of September 30, 2004 and 2005, the amounts of insurance coverage over the Bank's premises and equipment were NT\$7,614,120 and NT\$8,172,872, respectively.
- (5) Certain accounts of the financial statements for the nine-month period ended September 30, 2004 have been reclassified to conform to the current presentation.
- (6) The assets and liabilities managed under the Bank's trust are NT\$105,357,218.