

Cathay United Bank
Financial Statements With
Independent Auditors' Report
For The Years Ended December 31,
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, Republic of China. 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 (the "Bank") as of December 31, 2004 and 2005, and the related statements of income, changes in shareholders' equity and cash flows for the years ended December 31, 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 ("ROC") and the "Rules Governing Auditing and Certification of Financial Statements by Certified Public Accountants". Those rules and 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 the Bank as of December 31, 2004 and 2005, and the results of its operations and its cash flows for the years 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 ROC.

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.

In addition, we have also audited the consolidated financial statements of the Bank as of and for the year ended December 31, 2005, on which we have issued an unqualified opinion thereon.



DIWAN, ERNST & YOUNG
Taipei, Taiwan
The Republic of China
January 26, 2006

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

December 31, 2004 and 2005

(Expressed in thousands of dollars)

ASSETS	NOTES	December 31, 2004		December 31, 2005	
		NT	US (Note II)	NT	US (Note II)
Cash and cash equivalents	IV	\$17,860,193	\$562,703	\$29,450,099	\$897,869
Due from the Central Bank and call loans to banks	IV, V and X	55,597,382	1,751,650	49,970,575	1,523,493
Securities purchased, net	II, IV, VI and X	240,083,384	7,564,064	217,952,751	6,644,901
Receivables, net	II, IV, V and X	56,933,442	1,793,744	65,418,677	1,994,472
Prepayments	IV and V	1,382,521	43,558	1,321,976	40,304
Bills and loans, net	II, IV, V and X	585,618,279	18,450,481	616,026,087	18,781,283
Long-term investments	II, IV, V, VI and X				
Equity method		5,123,460	161,420	5,115,939	155,974
Cost method		5,365,686	169,051	4,865,864	148,349
Others		26,910,075	847,829	53,468,413	1,630,135
Premises and equipment	II, V, VII and X				
Cost:					
Land		14,004,736	441,233	14,007,206	427,049
Buildings		9,130,407	287,663	9,167,742	279,504
Furniture and fixtures		3,662,697	115,397	3,453,194	105,280
Transportation equipment		79,700	2,511	66,149	2,017
Miscellaneous equipment		4,071,163	128,266	4,473,552	136,389
Total Cost		30,948,703	975,070	31,167,843	950,239
Less: Accumulated depreciation		(6,751,064)	(212,699)	(7,138,232)	(217,629)
Construction in progress and procurement		596,560	18,795	791,605	24,135
Less: Allowance for asset impairment		-	-	(77,666)	(2,368)
Premises and equipment, net		24,794,199	781,166	24,743,550	754,377
Other assets	II, IV and V	4,696,134	147,956	5,727,092	174,606
TOTAL ASSETS		\$1,024,364,755	\$32,273,622	\$1,074,061,023	\$32,745,763

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 (continued)

December 31, 2004 and 2005

(Expressed in thousands of dollars)

LIABILITIES AND SHAREHOLDERS' EQUITY	NOTES	December 31, 2004		December 31, 2005	
		NT	US (Note II)	NT	US (Note II)
Due to the Central Bank and call loans from banks	IV, V and X	\$80,179,515	\$2,526,135	\$70,825,308	\$2,159,308
Payables	IV and V	17,251,133	543,514	25,014,534	762,638
Advances		1,185,596	37,353	1,202,129	36,650
Deposits and remittances	IV, V and X	745,288,566	23,481,051	794,041,906	24,208,595
Financial debentures payable	IV and X	48,550,000	1,529,616	68,456,296	2,087,082
Banker's acceptances and funds borrowed	IV and X	1,414,686	44,571	1,132,010	34,513
Other liabilities	II, IV and V	50,135,101	1,579,556	35,460,765	1,081,121
TOTAL LIABILITIES		944,004,597	29,741,796	996,132,948	30,369,907
Capital stock	IV	43,182,407	1,360,504	46,420,518	1,415,260
Capital reserves	IV				
Additional paid-in capital		13,449,023	423,725	13,449,023	410,031
Others		14,051	443	15,253	465
Retained earnings	IV				
Legal reserve		9,951,639	313,536	14,115,413	430,348
Unappropriated earnings		13,879,247	437,279	3,852,743	117,462
Unrealized losses on long-term investments	II and IV	(104,653)	(3,297)	(10,307)	(314)
Foreign currency translation adjustment	II	(11,556)	(364)	85,432	2,604
TOTAL SHAREHOLDERS' EQUITY		80,360,158	2,531,826	77,928,075	2,375,856
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		\$1,024,364,755	\$32,273,622	\$1,074,061,023	\$32,745,763

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 years ended December 31, 2004 and 2005
(Expressed in thousands of dollars, except per share amounts)

ITEMS	NOTES	2004		2005	
		NT	US (Note II)	NT	US (Note II)
OPERATING REVENUES:					
Interest income	II and V	\$31,990,552	\$1,007,894	\$39,491,864	\$1,204,020
Commission and handling fees	II and V	6,910,192	217,712	6,834,740	208,376
Gain on sales of securities, net	II	515,548	16,243	914,499	27,881
Investment income, net	II and IV	694,072	21,867	101,481	3,094
Foreign currency exchange gain, net	II	316,177	9,962	363,503	11,082
Other operating income	II and V	1,424,486	44,880	1,179,635	35,965
Total operating revenues		41,851,027	1,318,558	48,885,722	1,490,418
OPERATING EXPENSES:					
Interest expense	V	(8,295,883)	(261,370)	(12,912,355)	(393,669)
Commissions and handling charges	V	(1,003,986)	(31,632)	(1,378,413)	(42,025)
Provisions for possible losses	II	(2,555,113)	(80,501)	(14,974,833)	(456,550)
Selling, general and administrative expense	IV and V	(12,503,201)	(393,926)	(13,364,079)	(407,441)
Other operating expense		(964,424)	(30,385)	(808,023)	(24,635)
Total operating expenses		(25,322,607)	(797,814)	(43,437,703)	(1,324,320)
NET OPERATING INCOME		16,528,420	520,744	5,448,019	166,098
NON-OPERATING INCOME					
Gain on disposal of premises and equipment	II	1,168,129	36,803	55,325	1,687
Others		119,357	3,760	96,368	2,938
Total non-operating income		1,287,486	40,563	151,693	4,625
NON-OPERATING LOSS					
Loss on disposal of premises and equipment	II	(41,233)	(1,299)	(56,106)	(1,711)
Impairment loss of assets	II	-	-	(422,926)	(12,894)
Others		(106,426)	(3,353)	(7,937)	(242)
Total non-operating loss		(147,659)	(4,652)	(486,969)	(14,847)
INCOME BEFORE INCOME TAXES FROM CONTINUING OPERATIONS					
		17,668,247	556,655	5,112,743	155,876
INCOME TAX EXPENSES	II and IV	(3,789,000)	(119,376)	(1,260,000)	(38,414)
NET INCOME		\$13,879,247	\$437,279	\$3,852,743	\$117,462
EARNINGS PER SHARE (IN DOLLARS)					
INCOME BEFORE INCOME TAXES FROM CONTINUING OPERATIONS					
		\$3.81	\$0.120	\$1.10	\$0.033
INCOME TAX EXPENSES		(0.82)	(0.026)	(0.27)	(0.008)
NET INCOME		\$2.99	\$0.094	\$0.83	\$0.025

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

English Translation of Financial Statements Originally Issued in Chinese

Cathay United Bank

Statement of changes in shareholders' equity

for the years ended December 31, 2004 and 2005

(Expressed in thousands of dollars)

ITEMS	Retained Earnings								Unrealized Losses on		Foreign Currency		Total	
	Capital Stock		Capital Reserves		Legal Reserve		Unappropriated Earnings		Long-term Investments		Translation Adjustment		(NT)	(US)
	(NT)	(US)	(NT)	(US)	(NT)	(US)	(NT)	(US)	(NT)	(US)	(NT)	(US)	(NT)	(US)
Balance, January 1, 2004	\$43,182,407	\$1,360,504	\$13,461,820	\$424,128	\$9,122,517	\$287,414	\$2,763,742	\$87,074	\$(116,783)	\$(3,679)	\$170,503	\$5,372	\$68,584,206	\$2,160,813
Appropriation and distribution of 2003 earnings (Note IV):														
Legal reserve	-	-	-	-	829,122	26,122	(829,122)	(26,122)	-	-	-	-	-	-
Cash dividends	-	-	-	-	-	-	(1,934,620)	(60,952)	-	-	-	-	(1,934,620)	(60,952)
Net income for the year ended December 31, 2004	-	-	-	-	-	-	13,879,247	437,279	-	-	-	-	13,879,247	437,279
Foreign currency translation adjustment (Note II)	-	-	-	-	-	-	-	-	-	-	(182,059)	(5,736)	(182,059)	(5,736)
Capital reserves of equity investees (Note IV)	-	-	1,254	40	-	-	-	-	-	-	-	-	1,254	40
Unrealized loss on investments in equity investees (Note IV)	-	-	-	-	-	-	-	-	12,130	382	-	-	12,130	382
Balance, December 31, 2004	\$43,182,407	\$1,360,504	\$13,463,074	\$424,168	\$9,951,639	\$313,536	\$13,879,247	\$437,279	\$(104,653)	\$(3,297)	\$(11,556)	\$(364)	\$80,360,158	\$2,531,826
Balance, January 1, 2005	\$43,182,407	\$1,316,537	\$13,463,074	\$410,459	\$9,951,639	\$303,404	\$13,879,247	\$423,148	\$(104,653)	\$(3,191)	\$(11,556)	\$(352)	\$80,360,158	\$2,450,005
Appropriation and distribution of 2004 earnings (Note IV):														
Legal reserve	-	-	-	-	4,163,774	126,944	(4,163,774)	(126,944)	-	-	-	-	-	-
Cash dividends	-	-	-	-	-	-	(6,467,362)	(197,176)	-	-	-	-	(6,467,362)	(197,176)
Stock dividends	3,238,111	98,723	-	-	-	-	(3,238,111)	(98,723)	-	-	-	-	-	-
Bonus to shareholders	-	-	-	-	-	-	(8,000)	(244)	-	-	-	-	(8,000)	(244)
Compensation to directors and supervisors	-	-	-	-	-	-	(500)	(15)	-	-	-	-	(500)	(15)
Special bonus to employees	-	-	-	-	-	-	(1,000)	(31)	-	-	-	-	(1,000)	(31)
Contribution to welfare fund	-	-	-	-	-	-	(500)	(15)	-	-	-	-	(500)	(15)
Net income for the year ended December 31, 2005	-	-	-	-	-	-	3,852,743	117,462	-	-	-	-	3,852,743	117,462
Foreign currency translation adjustment (Note II)	-	-	-	-	-	-	-	-	-	-	96,988	2,956	96,988	2,956
Capital reserves of equity investees, etc. (Note IV)	-	-	1,202	37	-	-	-	-	-	-	-	-	1,202	37
Unrealized loss on investments in equity investees (Note IV)	-	-	-	-	-	-	-	-	104,653	3,191	-	-	104,653	3,191
Unrealized losses on long-term investments (Note II)	-	-	-	-	-	-	-	-	(10,307)	(314)	-	-	(10,307)	(314)
Balance, December 31, 2005	\$46,420,518	\$1,415,260	\$13,464,276	\$410,496	\$14,115,413	\$430,348	\$3,852,743	\$117,462	\$(10,307)	\$(314)	\$85,432	\$2,604	\$77,928,075	\$2,375,856

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 years ended December 31, 2004 and 2005
(Expressed in thousands of dollars)

ITEMS	NOTES	2004		2005	
		NT	US (Note II)	NT	US (Note II)
CASH FLOWS FROM OPERATING ACTIVITIES:					
Net income		\$13,879,247	\$437,279	\$3,852,743	\$117,462
Adjustments to reconcile net income to net cash provided by operating activities:					
Depreciation and amortization	II	1,153,500	36,342	1,236,202	37,689
Provisions for possible losses	II	2,555,113	80,501	14,974,833	456,550
Loss (gain) on disposal of premises and equipment and non-operating assets	II	(1,127,354)	(35,518)	781	24
Impairment loss of assets	II and IV	-	-	422,926	12,894
Investment income recognized by the equity method	II and IV	(437,287)	(13,777)	(205,726)	(6,272)
Cash dividends received from equity investees		222,397	7,007	325,935	9,937
Loss (gain) on long-term investments		(247,309)	(7,792)	258,182	7,871
Adjustment of changes in exchange rates		36,042	1,135	12,000	366
(Increase) decrease in receivables		2,970,753	93,597	(11,698,668)	(356,667)
Decrease in prepayments		409,511	12,902	60,545	1,846
(Increase) decrease in securities purchased for trading purposes		3,113,509	98,094	(1,406,347)	(42,876)
Increase (decrease) in payables		(158,956)	(5,008)	7,763,401	236,689
Increase (decrease) in advances		(491,203)	(15,475)	16,533	504
Increase (decrease) in other liabilities		23,151,118	729,399	(14,703,867)	(448,289)
Net cash provided by operating activities		45,029,081	1,418,686	909,473	27,728
CASH FLOWS FROM INVESTING ACTIVITIES:					
Proceeds from disposal of premises and equipment and non-operating assets		1,767,915	55,700	285,485	8,704
Acquisition of premises and equipment		(1,223,598)	(38,550)	(1,159,685)	(35,356)
Increase in long-term investments		(18,784,955)	(591,839)	(26,554,921)	(809,601)
Proceeds from disposal of investments		8,619,098	271,553	235,044	7,166
(Increase) decrease in securities purchased for non-trading purposes		(64,762,516)	(2,040,407)	23,536,980	717,591
Net increase in bills and loans		(79,749,710)	(2,512,593)	(42,156,507)	(1,285,260)
(Increase) decrease in other assets		4,111,946	129,551	(1,429,883)	(43,594)
(Increase) decrease in due from the Central Bank and call loans to banks		(1,293,009)	(40,738)	5,626,807	171,549
Increase in deferred charges		(193,429)	(6,094)	(336,142)	(10,248)
Net cash used in investing activities		(151,508,258)	(4,773,417)	(41,952,822)	(1,279,049)
CASH FLOWS FROM FINANCING ACTIVITIES:					
Decrease in due to the Central Bank and call loans from banks		(813,178)	(25,620)	(9,354,207)	(285,189)
Increase in deposits and remittances		85,331,646	2,688,458	48,753,340	1,486,382
Increase in financial debentures payable		23,500,000	740,391	19,906,296	606,899
Decrease in banker's acceptances and funds borrowed		(338,838)	(10,676)	(282,676)	(8,618)
Increase (decrease) in guaranty and marginal deposits		(26,496)	(835)	16,830	513
Cash dividends paid		(1,934,620)	(60,952)	(6,467,362)	(197,176)
Payment of compensation to directors and supervisors, bonus to shareholders, special bonus to employees, and contribution to welfare fund		-	-	(10,000)	(305)
Net cash provided by financing activities		105,718,514	3,330,766	52,562,221	1,602,506
EFFECT OF CHANGES IN FOREIGN EXCHANGE RATES					
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		(134,035)	(4,223)	71,034	2,166
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		(894,698)	(28,188)	11,589,906	353,351
CASH AND CASH EQUIVALENTS AT END OF YEAR		18,754,891	590,891	17,860,193	544,518
SUPPLEMENT DISCLOSURES OF CASH FLOWS INFORMATION:					
Interest expenses paid		\$8,186,611	\$257,927	\$11,856,950	\$361,492
Income tax paid		\$347,065	\$10,935	\$1,208,219	\$36,836

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 years ended December 31, 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 Republic of China (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 December 31, 2004 and 2005, the Bank employed 4,050 and 4,190 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. All inter-branch and inter-office account balances and transactions have been eliminated when the financial statements were prepared.

2. Foreign currency transaction and translation for the statements of foreign branches

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 first 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 a 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 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 market value changes 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 Bank'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. 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 Statements of Financial Accounting Standards ("SFAS") No.35 should be applied if 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

English Translation of Financial Statements Originally Issued in Chinese

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, electric wiring and royalty 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 (the defined benefit plan). 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 Labor Pension Act of the ROC (the "Act"), which adopts a defined contribution pension plan, 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 salaries. Monthly contributions are recognized as pension costs.

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 for the defined benefit plan. 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.

14. Recognition of interest income and service fees

Interest income is recognized when incurred except for delinquent accounts and troubled accounts whose interest is recognized 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 carry forwards 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 expenses in the year the shareholder approves the retention of earnings.

Cathay Financial Holdings has adopted the consolidated income tax return 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. Basis for converting financial statements

The Bank's financial statements are stated in NT dollars. Translation of the December 31, 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\$31.74 and NT\$ 32.80 to US\$1.00 on December 31, 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\$77,666(US\$2,368) and NT\$345,260(US\$10,526), respectively, as of December 31, 2005 and reduced net income and earnings per share before tax by NT\$422,926 (US\$12,894) and NT\$0.09(US\$0.003), respectively, for the year ended December 31, 2005.

The Bank has adopted the amended ROC SFAS No.5, "Long-Term Investments in Equity Securities", which took effect on January 1, 2005. Under the SFAS No.5, 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\$363) and increased the capital reserves by NT\$639 (US\$19), respectively, as of December 31, 2005 and reduced net income before tax by NT\$12,529 (US\$382) for the year ended December 31, 2005.

IV. Breakdown of Significant Accounts

1. Cash and cash equivalents

	December 31,			
	2004		2005	
	NT	US	NT	US
Cash on hand	\$8,033,338	\$253,098	\$9,794,346	\$298,608
Checks for clearance	4,611,189	145,280	9,303,740	283,651
Due from commercial banks	5,215,666	164,325	10,352,013	315,610
Total	<u>\$17,860,193</u>	<u>\$562,703</u>	<u>\$29,450,099</u>	<u>\$897,869</u>

English Translation of Financial Statements Originally Issued in Chinese

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

	December 31,			
	2004		2005	
	NT	US	NT	US
Statutory revenue on deposits	\$20,610,504	\$649,354	\$21,380,715	\$651,851
Deposits in the Central Bank	12,233,263	385,421	7,518,081	229,210
Call loans to banks	22,753,615	716,875	21,071,779	642,432
Total	<u>\$55,597,382</u>	<u>\$1,751,650</u>	<u>\$49,970,575</u>	<u>\$1,523,493</u>

3. Securities purchased, net

	December 31,			
	2004		2005	
	NT	US	NT	US
Stocks	\$4,039,299	\$127,262	\$6,378,326	\$194,461
Mutual funds	2,273,417	71,626	2,356,106	71,833
Government and corporate bonds	52,751,821	1,661,998	66,776,716	2,035,875
Certificates of deposit	164,190,335	5,172,979	131,573,036	4,011,373
Commercial papers	10,022,952	315,783	9,794,871	298,624
Securities purchased under agreements to resell	6,849,350	215,796	1,192,252	36,349
Others	71,171	2,242	-	-
Total	<u>240,198,345</u>	<u>7,567,686</u>	<u>218,071,307</u>	<u>6,648,515</u>
Less: Allowance for decline in market price of securities	<u>(114,961)</u>	<u>(3,622)</u>	<u>(118,556)</u>	<u>(3,614)</u>
Net balance	<u>\$240,083,384</u>	<u>\$7,564,064</u>	<u>\$217,952,751</u>	<u>\$6,644,901</u>

(1) NT\$16,001,506 and NT\$16,833,168 of the securities purchased as of December 31, 2004 and 2005, respectively, were pledged to other parties as collateral for business reserves and guarantees.

(2) As of December 31, 2004 and 2005, certain of the Bank's investments in securities purchased were pledged under repurchase agreements with notional amounts of NT\$38,039,900 and NT\$28,439,300, respectively. Such repurchase agreements amounting to NT\$40,360,354 and NT\$29,784,935, respectively, were posted to the "Other liabilities" account on the Bank's balance sheets. Repurchase agreements entered prior to December 31, 2004 and 2005 were settled at NT\$40,411,884 and NT\$29,841,045 prior to June 29, 2005 and June 28, 2006, respectively.

English Translation of Financial Statements Originally Issued in Chinese

4. Receivables, net

	December 31,			
	2004		2005	
	NT	US	NT	US
Accounts receivable	\$50,622,877	\$1,594,924	\$59,631,793	\$1,818,043
Accrued interest receivable	3,779,600	119,080	4,093,669	124,807
Forward exchange bought	1,210,747	38,146	709,504	21,631
Notes receivable	540,923	17,042	534,880	16,307
Tax refundable	431,818	13,605	276,679	8,435
Consolidated income tax return receivable	571,606	18,009	571,606	17,427
Others	633,500	19,959	692,927	21,126
Total	57,791,071	1,820,765	66,511,058	2,027,776
Less: Allowance for doubtful accounts	(857,629)	(27,021)	(1,092,381)	(33,304)
Net balance	\$56,933,442	\$1,793,744	\$65,418,677	\$1,994,472

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

5. Prepayments

	December 31,			
	2004		2005	
	NT	US	NT	US
Interbank clearing funds	\$807,414	\$25,439	\$801,763	\$24,444
Others	575,107	18,119	520,213	15,860
Total	\$1,382,521	\$43,558	\$1,321,976	\$40,304

6. Bills and loans, net

	December 31,			
	2004		2005	
	NT	US	NT	US
Inward-outward documentary bills purchased	\$1,197,272	\$37,721	\$702,792	\$21,427
Loans	584,706,602	18,421,758	622,754,068	18,986,404
Overdrafts	561,781	17,699	664,912	20,272
Delinquent accounts	5,180,503	163,217	7,673,637	233,952
Total	591,646,158	18,640,395	631,795,409	19,262,055
Less: Allowance for doubtful accounts	(6,027,879)	(189,914)	(15,769,322)	(480,772)
Net balance	\$585,618,279	\$18,450,481	\$616,026,087	\$18,781,283

English Translation of Financial Statements Originally Issued in Chinese

- (1) As of December 31, 2004 and 2005, the accounts with no interest accrued were NT\$6,306,697 and NT\$9,122,549, respectively. The non-accrued interest on such accounts amounted to NT\$95,596 and NT\$170,837 for the years ended December 31, 2004 and 2005, respectively.
- (2) For the years ended December 31, 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 - December 31, 2004					
	Allocated Allowance		Unallocated Portion		Total	
	NT	US	NT	US	NT	US
Balance, beginning of the period	\$4,012,984	\$126,433	\$3,518,370	\$110,850	\$7,531,354	\$237,283
Provision for doubtful accounts	2,547,508	80,262	-	-	2,547,508	80,262
Write-offs	(9,189,043)	(289,510)	-	-	(9,189,043)	(289,510)
Recoveries	6,008,825	189,314	-	-	6,008,825	189,314
Reclassification	1,364,347	42,985	(1,364,347)	(42,985)	-	-
Effects of exchange rates change	-	-	(13,136)	(414)	(13,136)	(414)
Balance, end of the period	<u>\$4,744,621</u>	<u>\$149,484</u>	<u>\$2,140,887</u>	<u>\$67,451</u>	<u>\$6,885,508</u>	<u>\$216,935</u>

	January 1 - December 31, 2005					
	Allocated Allowance		Unallocated Portion		Total	
	NT	US	NT	US	NT	US
Balance, beginning of the period	\$4,744,621	\$144,653	\$2,140,887	\$65,271	\$6,885,508	\$209,924
Provision for doubtful accounts	5,962,132	181,772	9,000,000	274,390	14,962,132	456,162
Write-offs	(10,768,694)	(328,314)	-	-	(10,768,694)	(328,314)
Recoveries	5,776,997	176,128	-	-	5,776,997	176,128
Reclassification	(515,828)	(15,727)	515,828	15,727	-	-
Effects of exchange rates change	-	-	5,760	176	5,760	176
Balance, end of the period	<u>\$5,199,228</u>	<u>\$158,512</u>	<u>\$11,662,475</u>	<u>\$355,564</u>	<u>\$16,861,703</u>	<u>\$514,076</u>

English Translation of Financial Statements Originally Issued in Chinese

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

	December 31,					
	2004			2005		
	NT	US	% of ownership	NT	US	% of ownership
(i) Investments in Equity Securities (9):						
Seaward Card Co., Ltd.	\$70,031	\$2,206	100.00	\$52,847	\$1,611	100.00
Seaward Leasing Ltd.	2,247,640	70,814	100.00	2,267,697	69,137	100.00
Cathay Futures Corp. (1)	722,812	22,773	99.99	710,402	21,659	99.99
Cathay Life Insurance Agent Co., Ltd. (2)	160,941	5,071	99.98	123,627	3,769	100.00
Cathay Property Insurance Agent Co., Ltd. (6)	10,676	336	99.97	10,774	328	100.00
Indovina Bank (3)	500,047	15,754	50.00	537,398	16,384	50.00
Taiwan Real-estate Management Corp.	51,947	1,637	30.15	15,734	480	30.15
Taiwan Finance Corp. (6)	1,353,601	42,647	24.57	1,391,169	42,414	24.57
Vista Technology Venture Capital Corp. (4)	9,825	310	5.00	8,157	249	4.76
Cathay Venture Capital Corp. (4)	27,788	875	3.33	29,978	914	2.00
Subtotal	5,155,308	162,423		5,147,783	156,945	
Less: Unrealized gain from intercompany transactions	(31,848)	(1,003)		(31,844)	(971)	
Investments accounted for under equity method	5,123,460	161,420		5,115,939	155,974	
Han Tech Venture Capital Corp.	154,927	4,881	8.24	154,927	4,723	8.03
An Feng Enterprise Co., Ltd.	4,500	142	15.00	4,500	137	15.00
Euroc II Venture Capital Corp. Strategic Value Fund, Limited Partnership (5)	40,000	1,260	5.00	40,000	1,219	5.00
IBU Securities Co., Ltd.	95,787	3,018	-	86,551	2,639	-
Capital Venture Fund II Corp.	1,045,000	32,924	10.31	1,045,000	31,860	10.31
Taipei Smart Card Corp.	30,000	945	5.00	30,000	915	5.00
Centillion Venture Capital Corp.	25,000	788	5.00	25,000	762	5.00
Taiwan Asset Management Corp.	60,000	1,890	5.00	60,000	1,829	5.00
Taiwan Financial Asset Service Corp.	1,020,000	32,136	5.79	1,020,000	31,098	5.79
Mondex Taiwan Inc. (5)	100,000	3,151	5.88	100,000	3,049	5.88
Others (5)	25,000	788	6.47	5,000	152	6.47
Investments accounted for under cost method	2,765,472	87,128	-	2,294,886	69,966	-
	5,365,686	169,051		4,865,864	148,349	

English Translation of Financial Statements Originally Issued in Chinese

(ii) Others (7)(8)

Government bonds	11,273,370	355,179	11,100,453	338,429
First to default credit linked notes	1,432,125	45,121	3,610,010	110,061
Callable corridor notes	6,028,838	189,945	17,696,136	539,516
Collateralized debt obligation	1,654,377	52,123	327,824	9,995
Collateral mortgage obligation	5,109,250	160,972	18,005,720	548,955
Foreign government bond	632,115	19,915	1,311,870	39,996
Forward rate linked notes	-	-	656,400	20,012
Preferred stock	400,000	12,602	400,000	12,195
Other bonds	380,000	11,972	360,000	10,976
Subtotal	<u>26,910,075</u>	<u>847,829</u>	<u>53,468,413</u>	<u>1,630,135</u>
Total	<u>\$37,399,221</u>	<u>\$1,178,300</u>	<u>\$63,450,216</u>	<u>\$1,934,458</u>

- (1) On December 24, 2003, the shareholders of Seaward Futures Corp. (Seaward) resolved to reduce Seaward's capital by NT\$950,000, or 95,000 shares, and change Seaward's name to Cathay Futures Corp. The effective date of capital reduction was February 16, 2004.
- (2) 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.
- (3) 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.
- (4) 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.
- (5) Due to the value in investments of Taipei Financial Center Corp., New Century InfoComm Co., Ltd., Chan Sheng Investment Development Co., Ltd., Strategic Value Fund, Limited Partnership and Mondex Taiwan Inc., were impairment, 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.

English Translation of Financial Statements Originally Issued in Chinese

- (6) Certain of the above long-term investments and related investment gains (losses) accounted for by the equity method as of and for the years ended December 31, 2004 and 2005 were recognized based on the investees' unaudited financial statements. No material adjustments were anticipated, have those financial statements been audited.
- (7) As of December 31, 2004 and 2005, certain of the Bank's investments in government bonds were pledged under repurchase agreements with notional amounts of NT\$8,752,000 and NT\$3,965,000, respectively. Such repurchase agreements amounting to NT\$8,894,000 and NT\$4,080,000 were posted to the "Other liabilities" account on the Bank's balance sheets. Repurchase agreements entered prior to December 31, 2004 and 2005 were settled at NT\$8,902,955 and NT\$4,089,158 prior to March 9, 2005 and January 27, 2006, respectively.
- (8) As of December 31, 2004 and 2005, NT\$205,439 and NT\$501,941 of the Bank's investments in government bonds were pledged to other parties as collateral for business reserves and guarantees.
- (9) The Bank did not prepared consolidated financial statement due to a 10% exception rule provided by the original SFAS No.7, "Consolidated Financial Statements". The exception rule has been nullified in the amended SFAS No.7. In the Bank's 2005 consolidated financial statements included the accounts of the Bank, Cathay Futures Corp., Seaward Leasing Ltd. and Indovina Bank, subsidiaries not included in the 2005 consolidation were because of immateriality.

8. Other assets

	December 31,			
	2004		2005	
	NT	US	NT	US
Refundable deposits	\$916,588	\$28,878	\$999,804	\$30,482
Foreclosed properties, net	1,063,014	33,491	543,002	16,555
Deferred tax assets, net	582,677	18,358	2,455,206	74,854
Non-operating assets, net	1,597,643	50,335	1,086,648	33,129
Deferred charges	525,854	16,568	637,923	19,449
Others	10,358	326	4,509	137
Total	<u>\$4,696,134</u>	<u>\$147,956</u>	<u>\$5,727,092</u>	<u>\$174,606</u>

English Translation of Financial Statements Originally Issued in Chinese

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

	December 31,			
	2004		2005	
	NT	US	NT	US
Due to the Central Bank	\$159,988	\$5,041	\$161,501	\$4,924
Due to commercial banks	35,754,096	1,126,468	35,684,684	1,087,947
Overdrafts from banks	1,094,745	34,491	170,421	5,196
Call loans from banks	43,170,686	1,360,135	34,808,702	1,061,241
Total	<u>\$80,179,515</u>	<u>\$2,526,135</u>	<u>\$70,825,308</u>	<u>\$2,159,308</u>

10. Payables

	December 31,			
	2004		2005	
	NT	US	NT	US
Accounts payable	\$9,541,264	\$300,607	\$14,268,229	\$435,007
Accrued interest payable	2,479,484	78,119	3,587,310	109,369
Accrued expenses	2,019,595	63,629	2,240,478	68,307
Income tax payable	12,305	388	171,752	5,236
Notes payable	557,990	17,580	539,769	16,456
Collection received on behalf of customers	589,774	18,581	610,456	18,612
Dividends payable	200,597	6,320	200,006	6,098
Consolidated income tax return payable	508,186	16,011	2,245,837	68,471
Others	1,341,938	42,279	1,150,697	35,082
Total	<u>\$17,251,133</u>	<u>\$543,514</u>	<u>\$25,014,534</u>	<u>\$762,638</u>

11. Deposits and remittances

	December 31,			
	2004		2005	
	NT	US	NT	US
Check deposits	\$13,009,491	\$409,877	\$13,744,865	\$419,051
Demand deposits	78,341,712	2,468,233	75,256,794	2,294,415
Time deposits	155,152,351	4,888,228	164,734,230	5,022,385
Savings deposits	451,837,992	14,235,601	490,357,954	14,949,938
Foreign currency deposits	46,506,552	1,465,235	49,315,041	1,503,507
Outward remittances	222,061	6,996	327,421	9,982
Remittances payable	218,407	6,881	305,601	9,317
Total	<u>\$745,288,566</u>	<u>\$23,481,051</u>	<u>\$794,041,906</u>	<u>\$24,208,595</u>

English Translation of Financial Statements Originally Issued in Chinese

12. Financial debentures payable

	December 31,			
	2004		2005	
	NT	US	NT	US
Financial debentures payable	\$36,200,000	\$1,140,517	\$39,700,000	\$1,210,366
Subordinated Financial debentures payable	12,350,000	389,099	28,756,296	876,716
Total	<u>\$48,550,000</u>	<u>\$1,529,616</u>	<u>\$68,456,296</u>	<u>\$2,087,082</u>

On May 23, 2002, the Bank issued five-year subordinated financial debentures totaling 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 totaling 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.

On April 28, 2003, the former Cathay United Bank issued five-year subordinated financial debentures totaling 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.

The Bank issued a 15-year US\$500 million subordinated bonds with a stated interest rate of 5.5% on October 5, 2005, and the interest is payable semi-annually. The Bank can redeem the bond after 10 years by exercising the call option.

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, inverse floating interest rates or specific structure 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.

English Translation of Financial Statements Originally Issued in Chinese

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

	December 31,			
	2004		2005	
	NT	US	NT	US
Borrowed funds-the Central Bank	\$795,625	\$25,067	\$820,500	\$25,015
Borrowed funds-others	619,061	19,504	311,510	9,498
Total	\$1,414,686	\$44,571	\$1,132,010	\$34,513

14. Other liabilities

	December 31,			
	2004		2005	
	NT	US	NT	US
Reserve for losses on guarantees	\$28,573	\$900	\$28,688	\$875
Reserve for losses on trading securities	132,347	4,170	145,048	4,422
Securities sold under repurchase agreements	49,254,354	1,551,807	33,864,935	1,032,468
Bonds purchased under resale agreements-short sale	-	-	691,924	21,095
Guarantee and margin deposits	672,687	21,194	689,517	21,022
Others	47,140	1,485	40,653	1,239
Total	\$50,135,101	\$1,579,556	\$35,460,765	\$1,081,121

English Translation of Financial Statements Originally Issued in Chinese

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 authority.

16. Capital reserves

	December 31,			
	2004		2005	
	NT	US	NT	US
Capital reserves from the merged				
Bank	\$9,199,927	\$289,853	\$9,199,927	\$280,485
Additional paid-in capital	4,249,096	133,872	4,249,096	129,546
Capital reserves from equity				
investees, etc.	3,654	115	4,856	148
Capital reserves derived from				
treasury stocks transactions	10,397	328	10,397	317
Total	<u>\$13,463,074</u>	<u>\$424,168</u>	<u>\$13,464,276</u>	<u>\$410,496</u>

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%.

English Translation of Financial Statements Originally Issued in Chinese

On October 31, 2005, the board of directors of the Bank revised its articles; the annual net income shall be appropriated and distributed in the following 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%
- (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) On April 23, 2004, the following appropriations and distribution approved by the Bank's board of directors (According to the Company's Law, the authority of the Bank's shareholder meeting acts by board of directors).
- (a) legal reserve of NT\$ 829,122;
 - (b) dividends to shareholders of NT\$ 1,934,620.
- (4) On April 22, 2005, the following appropriations and distribution approved by the Bank's board of directors (According to the Company's Law, the authority of the Bank's shareholder meeting acts by board of directors).
- (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.

English Translation of Financial Statements Originally Issued in Chinese

18. Pension

(1) The following is a summary of the components of net pension expenses for 2004 and 2005:

	2004		2005	
	NT	US	NT	US
Defined contribution pension plan	\$-	\$-	\$45,341	\$1,382
Defined benefit pension plan:				
Service cost	305,810	9,635	227,825	6,946
Interest cost	110,822	3,492	93,650	2,855
Expected return on plan assets	(92,480)	(2,914)	(86,686)	(2,643)
Net amortization	32,498	1,024	32,498	991
Subtotal	356,650	11,237	267,287	8,149
Total	\$356,650	\$11,237	\$312,628	\$9,531

(2) The following is a reconciliation of the defined benefit pension plan between the funded status and amounts recognized on the Bank's balance sheets, etc.:

	December 31,			
	2004		2005	
	NT	US	NT	US
Pension benefit obligation:				
Vested	\$(1,433,581)	\$(45,167)	\$(790,898)	\$(24,113)
Non-vested	(68,439)	(2,156)	(100,555)	(3,066)
Accumulated benefit obligation	(1,502,020)	(47,323)	(891,453)	(27,179)
Value of future salary projections	(1,531,928)	(48,265)	(684,088)	(20,856)
Projected benefit obligation	(3,033,948)	(95,588)	(1,575,541)	(48,035)
Fair value of plan assets	2,887,610	90,977	901,328	27,480
Projected benefit obligation in excess of plan assets	(146,338)	(4,611)	(674,213)	(20,555)
Unrecognized net obligation at transition	183,324	5,776	150,826	4,598
Unrecognized net loss (gain)	(36,986)	(1,165)	533,666	16,270
Prepaid pension cost	\$-	\$-	\$10,279	\$313

English Translation of Financial Statements Originally Issued in Chinese

The actuarial assumptions used are:

	December 31,	
	2004	2005
Discount rate	3.5%	3.5%
Growth rate in compensation levels	4.0%	3.0%
Expected long-term rate of return on plan assets	3.5%	3.5%

As of December 31, 2004 and 2005, the vested benefit, based on the Bank's defined benefit pension plan, amounted to NT\$1,433,581 and NT\$1,113,941, respectively.

19. Certain components of operating expenses

The following is a summary of the components of personnel, depreciation and amortization expenses for the years ended December 31, 2004 and 2005.

	January 1- December 31,			
	2004		2005	
	NT	US	NT	US
Personnel expenses				
Salary expenses	\$4,580,482	\$144,313	\$4,537,783	\$138,347
Insurance expenses	427,061	13,455	468,492	14,283
Pension expenses	357,549	11,265	315,542	9,620
Others	370,289	11,666	411,230	12,538
Depreciation expenses	941,928	29,676	1,012,129	30,858
Amortization expenses	211,572	6,666	224,073	6,831

20. Income tax

Under a directive issued by the MOF, a financial holding company and its domestic subsidiaries that hold over 90% of shares issued by the financial holding company for 12 months within the same tax year may choose to adopt the consolidated income tax return for income tax filings. Additional tax and tax receivable resulting from the consolidated income tax return are recorded in the account of consolidated income tax return payable or receivable. SFAS No.22 remains applicable to the Bank.

English Translation of Financial Statements Originally Issued in Chinese

(1) The reconciliation between income tax payable and income tax expenses for the years ended December 31, 2004 and 2005 is as follows:

	January 1- December 31,			
	2004		2005	
	NT	US	NT	US
Income tax payable:				
Domestic income tax:				
General (tax rate 25%)	\$829,749	\$26,142	\$2,751,393	\$83,884
Interest on separation tax (tax rate 20% or 6%)	19,489	614	161,845	4,934
Foreign branches' income tax	27,706	873	69,287	2,112
Deferred tax (benefits) expenses:				
Allowance for bad debts	315,607	9,943	(2,358,877)	(71,917)
Allowance for pledged assets taken-over	163,118	5,139	233,401	7,116
Provisions for possible losses	9,235	291	(31,250)	(953)
Foreign investment income recognized by the equity method	1,974	62	7,536	230
Operating loss carry forwards	2,370,769	74,694	-	-
Others	(6,934)	(218)	3,824	116
Valuation allowance	-	-	283,806	8,653
10% additional income tax on unappropriated earnings	-	-	70,458	2,148
Adjustment of prior period's income tax	58,287	1,836	68,577	2,091
Income tax expenses	<u>\$3,789,000</u>	<u>\$119,376</u>	<u>\$1,260,000</u>	<u>\$38,414</u>

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

	December 31,			
	2004		2005	
	NT	US	NT	US
Taxable temporary differences:				
Unrealized losses from intercompany transactions	\$24,088	\$759	\$23,481	\$716
Others	94,098	2,965	124,242	3,788

English Translation of Financial Statements Originally Issued in Chinese

Deductible temporary differences:

Allowance for bad debts	\$567,959	\$17,894	\$10,003,465	\$304,984
Allowance for pledged assets taken-over	1,409,747	44,415	476,144	14,517
Unrealized gain from intercompany transactions	19,086	601	18,475	563
Pension expenses exceed the limit of tax law	75,809	2,388	75,809	2,311
Provisions for possible losses	20,000	630	145,000	4,421
Others	193,243	6,088	177,949	5,425

Deferred income tax assets of foreign

branches	\$40,763	\$1,285	\$51,732	\$1,577
----------	----------	---------	----------	---------

	December 31,			
	2004		2005	
	NT	US	NT	US
(3) Deferred tax assets	\$612,224	\$19,289	\$2,775,943	\$84,633
Deferred tax liabilities	(29,547)	(931)	(36,931)	(1,126)
Valuation allowance	-	-	(283,806)	(8,653)
Net deferred tax assets	\$582,677	\$18,358	\$2,455,206	\$74,854

(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.

English Translation of Financial Statements Originally Issued in Chinese

- (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:

	December 31,			
	2004		2005	
	NT	US	NT	US
Shareholders' deductible income tax account	\$126,066	\$3,972	\$71,196	\$2,171
Unappropriated earnings	13,879,247	437,279	3,852,743	117,462

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) Earnings per share are computed by dividing net income available to common shares by the weighted average number of common shares outstanding for the year. The computation of earnings per share is as follows:

	January 1- December 31,	
	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-average shares outstanding	4,642,052	4,642,052

	January 1- December 31,			
	2004		2005	
	NT	US	NT	US
Income before income tax from continuing operations	\$17,668,247	\$556,655	\$5,112,743	\$155,876
Income tax expenses	(3,789,000)	(119,376)	(1,260,000)	(38,414)
Net income	\$13,879,247	\$437,279	\$3,852,743	\$117,462

English Translation of Financial Statements Originally Issued in Chinese

Earnings per share (in dollars)

Income before income tax from				
continuing operations	\$3.81	\$0.120	\$1.10	\$0.033
Income tax expenses	<u>(0.82)</u>	<u>(0.026)</u>	<u>(0.27)</u>	<u>(0.008)</u>
Net income	<u>\$2.99</u>	<u>\$0.094</u>	<u>\$0.83</u>	<u>\$0.025</u>

(1) 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 Dollars)	<u>\$2.99</u>

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

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

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. ("Cathay Financial Holdings")	Parent company
Cathay Life Insurance Co., Ltd. and other subsidiaries of Cathay Financial Holdings	Subsidiaries of Cathay Financial Holdings
San Ching Engineering Co., Ltd. and other affiliated companies of Cathay Financial Holdings	Affiliate
Cathay Futures Corp.	Subsidiary of the Bank

English Translation of Financial Statements Originally Issued in Chinese

Seaward Leasing Ltd.	Subsidiary of the Bank
Indovina Bank	Subsidiary of the Bank
Taiwan Real-estate Management Corp.	The investee is accounted for using the equity method
Taiwan Finance Corp.	The investee is accounted for using the equity method
Seaward Card Co., Ltd.	The investee is accounted for using the equity method
Cathay Life Insurance Agent Co., Ltd.	The investee is accounted for using the equity method
Seaward Insurance Agent Corp.	The investee is accounted for using the equity method(Note 1)
Cathay Property Insurance Agent Co., Ltd.	The investee is accounted for using the equity method
Cathay Venture Capital Corp.	The investee is accounted for using the equity method
Vista Technology Venture Capital Corp.	The investee is accounted for using the equity method
Taipei Smart Card Corp.	The investee is accounted for using the cost method
China England Company Ltd. and etc.	Investee companies of Seaward Leasing Ltd.
Culture and Charity Foundation of Cathay United Bank	The Bank is the major sponsor of the foundation

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

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

(1) Loans and Deposits

Accounts / Related parties	December 31 Account balance			January 1- December 31 Interest income (expense)	
	NT	US	% of Account	NT	US
<u>2004</u>					
Bills and loans	\$1,997,390	\$62,930	0.34%	\$32,619	\$1,028
Deposits	39,539,917	1,245,744	4.77%	(251,452)	(7,922)
<u>2005</u>					
Bills and loans	2,582,525	78,736	0.42%	50,134	1,528
Deposits	15,222,926	464,114	1.92%	(437,057)	(13,325)

English Translation of Financial Statements Originally Issued in Chinese

Call loans to banks	January 1-December 31		December 31		January 1- December 31		
	Maximum balance		Account balance		Interest income		
	NT	US	NT	US	NT	US	Interest rate
<u>2004</u>							
Indovina Bank	\$1,087,680	\$34,268	\$588,763	\$18,550	\$12,063	\$380	1.44%-2.90%
<u>2005</u>							
Indovina Bank	689,220	21,013	588,951	17,956	19,521	595	2.48%-7.8%
<u>2005</u>							
Due from commercial banks	January 1-December 31		December 31		January 1- December 31		
	Maximum balance		Account balance		Interest income (expense)		
	NT	US	NT	US	NT	US	Interest rate
Indovina Bank	\$504,231	\$15,373	\$24,704	\$753	\$4	\$-	0.5%-1.2%
Lucky Bank	43,676	1,332	21,117	644	5	-	0.1%
<u>Bank overdraft</u>							
Indovina Bank	24,246	739	-	-	-	-	-
<u>Due to commercial banks</u>							
Indovina Bank	34,275	1,045	26,578	810	-	-	-
Lucky Bank	28,222	860	15,262	465	(4)	-	0.1%-1.8%

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.

	December 31					
	Maximum balance		Account balance		Service fees	
	NT	US	NT	US	NT	US
January 1- December 31, 2004	\$412,165	\$12,986	\$-	\$-	\$-	\$-

English Translation of Financial Statements Originally Issued in Chinese

(3) Lease

<u>Accounts / Related parties</u>	January 1- December 31,			
	2004		2005	
	NT	US	NT	US
<u>Rental income</u>				
Seaward Leasing Ltd.	\$1,482	\$47	\$447	\$14
Taipei Smart Card Corp.	5,707	180	5,707	174
Culture and Charity Foundation of Cathay United Bank	1,000	32	1,000	30
Cathay Securities Corp.	3,933	124	6,992	213
<u>Rental expense</u>				
Cathay Life Insurance Co., Ltd.	250,536	7,893	262,969	8,017
Cathay Real Estate Development Co., Ltd.	13,884	437	13,884	423
Seaward Leasing Ltd.	-	-	6,670	203

<u>Refundable deposits</u>	December 31,			
	2004		2005	
	NT	US	NT	US
Seaward Leasing Ltd. (Note 2)	\$42,000	\$1,323	\$43,393	\$1,323
Cathay Life Insurance Co., Ltd.	73,516	2,316	65,845	2,007
Cathay Real Estate Development Co., Ltd.	3,408	107	3,395	104

Note2: Interest from refundable deposits substituted for rental expense payable to Seaward Leasing Ltd.

<u>Guarantee deposits</u>				
Cathay Securities Investment Corp.	2,334	74	1,238	38
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.

English Translation of Financial Statements Originally Issued in Chinese

Accounts/Related parties	December 31,			
	2004		2005	
	NT	US	NT	US
(12) <u>Accrued expenses</u>				
Seaward Card Co., Ltd.	\$92,394	\$2,911	\$42,441	\$1,294
(13) <u>Consolidated income tax return payable</u>				
Cathay Financial Holdings	508,186	16,010	2,245,837	68,471

(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 year ended December 31, 2004.
- b. The Bank purchased automated systems for its 24-hour self-service banking centers from San Ching Engineering Corp. for the amounts of NT\$88,575 and NT\$3,820 during the years ended December 31, 2004 and 2005, respectively.
- c. The Bank paid construction planning and design maintenance services fees to Lin Yuan Property Management and Maintenance Co., Ltd. in the amount of NT\$10,865 and NT\$17,822 during the years ended December 31, 2004 and 2005, respectively.
- d. As of December 31, 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\$380,000 and US\$560,000, respectively.
- e. The Bank paid information maintenance services fees to Symphox Information Co., Ltd. in the amount of NT\$45,104 during the year ended December 31, 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.

VI. ASSETS PLEDGED OR MORTGAGED

See Notes IV.3 and 7.

VII. COMMITMENTS AND CONTINGENT LIABILITIES

As of December 31, 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	\$549,209,361	\$16,744,188
Travelers checks for sale	620,290	18,911
Bills for collection	51,854,375	1,580,926
Guarantees on duties and contracts	14,588,644	444,776
Unused commercial letters of credit	3,302,943	100,699
Irrevocable loan commitments	26,034,126	793,723
Credit card lines	290,194,193	8,847,384
Stamp tax, securities and memorial currency consignments	1,727	53

2. As of December 31, 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 unjustified benefits. 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. On September 8, 2005, the Supreme Court rendered a judgement in favor of Chung Shing bank. This lawsuit 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 (the 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 had held the Bank responsible for making restitution. The Bank subsequently appealed and the appeal is being reviewed by the High Court. The Bank also filed claim (the claim) against Taiwan Secom Co., Ltd. in relation to the loss mentioned above. The High Court has suspended the claim until the High Court has a determination on the lawsuit.
 - (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 the employee's personal properties. The Central Insurance Co., Ltd. has compensated for the loss in the amount of NT\$39,900. The District Prosecutors Office has take a public prosecution. The Bank also filed an incidental civil procedures.
 - (4) On January 1, 2004, Pacific SOGO issued 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. About provisional measures, this lawsuit is pending in the Taipei District Court. The Bank also has filed an incidental civil procedures and claim against Pacific SOGO.
 - (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 December 31, 2005, the Bank entered into certain contracts to purchase premises and equipment totaling NT\$1,045,485 with down payments of NT\$791,605.
 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:

English Translation of Financial Statements Originally Issued in Chinese

- (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>December 31,</u>		
	<u>Contract (Nominal) amount</u>	<u>Credit risk</u>	<u>Fair value</u>
<u>2004</u>			
<u>For the purpose of customers' hedging needs or hedging the Bank's exposures</u>			
Forward foreign exchange contracts	\$4,851,586	\$84,465	\$356,599
<u>For trading purpose</u>			
Interest rate swap contracts	337,934	3,170	(45)
Options	109,409	779	396
<u>For non-trading purposes</u>			
Interest rate swap contracts	1,505,642	12,426	37,242
Cross-currency swap contracts	573,171	11,182	15,355
<u>2005</u>			
<u>For the purpose of customers' hedging needs or hedging the Bank's exposures</u>			
Forward foreign exchange contracts	4,122,206	14,026	19,221
<u>For trading purpose</u>			
Interest rate swap contracts	2,510,472	6,378	(67)
Options	539,116	53	15
Futures	6,645	-	7,066
<u>For non-trading purpose</u>			
Interest rate swap contracts	2,038,442	10,191	(10,663)
Cross-currency swap contracts	573,171	6,562	(10,351)

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 that 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.

As of December 31, 2005, the maturities of the Bank's outstanding interest rate swaps contracts ranged from five months to nine years and nine 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.

As of December 31, 2005, the Bank's outstanding cross-currency swaps contracts had remaining maturities from one year and eight months to five years and seven 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.

English Translation of Financial Statements Originally Issued in Chinese

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	December 31,	
	2004	2005
Interest rate risk exposures	\$451,984	\$404,658
Foreign exchange risk exposures	92,093	462,577

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.

English Translation of Financial Statements Originally Issued in Chinese

(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 - December 31,	
		2004	2005
<u>For trading purpose</u>			
Forward foreign exchange contracts			
-Realized	Interest income	\$10,046	\$28,253
-Realized	Interest expense	7,400	13,737
Interest rate swap contracts			
-Realized	Gain (loss) of derivative financial instruments	711	(307)
-Unrealized	"	(46)	(22)
Options			
-Realized	"	230	(322)
-Unrealized	"	16	(5)
Futures contracts			
-Realized	"	118	(576)
-Unrealized	"	-	(422)
<u>For non-trading purpose</u>			
Interest rate swap contracts			
-Realized	Interest income	30,662	43,615
-Realized	Interest expense	12,324	30,334
Cross-currency swap contracts			
-Realized	Interest income	12,500	12,289
-Realized	Interest expense	7,572	18,729

(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.

English Translation of Financial Statements Originally Issued in Chinese

- (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:

	December 31,			
	2004		2005	
	NT	US	NT	US
Irrevocable loan commitments	\$29,325,137	\$923,917	\$26,034,126	\$793,723
Credit card lines	279,345,149	8,801,044	290,194,193	8,847,384
Guarantees and commercial letters of credit	20,820,593	655,973	17,891,587	545,475

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

None.

X. Others

1. Fair value of non-derivative financial instruments

As of December 31, 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	December 31,							
	2004				2005			
	Carrying value		Fair value		Carrying value		Fair value	
	NT	US	NT	US	NT	US	NT	US
Securities purchased	\$240,083,384	\$7,564,064	\$240,859,150	\$7,588,505	\$217,952,751	\$6,644,901	\$218,473,482	\$6,660,777
Long-term investments	37,399,221	1,178,300	37,471,333	1,180,571	63,450,216	1,934,458	63,450,216	1,934,458

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:

English Translation of Financial Statements Originally Issued in Chinese

	December 31,			
	2004		2005	
	NT	US	NT	US
Bills and loans, customers' liabilities under acceptances and guarantees account				
Geographic Region				
Domestic	\$574,862,475	\$18,111,609	\$610,686,961	\$18,618,505
South East Asia	11,954,704	376,645	10,400,952	317,102
North East Asia	34,178	1,077	40,493	1,235
North America	9,751,533	307,232	9,757,586	297,487
Others	12,612,691	397,375	16,032,941	488,809
Total	<u>\$609,215,581</u>	<u>\$19,193,938</u>	<u>\$646,918,933</u>	<u>\$19,723,138</u>
Industry type				
Manufacturing	\$73,569,084	\$2,317,867	\$75,480,780	\$2,301,243
Financial institutions and insurance	32,402,571	1,020,875	36,776,019	1,121,220
Leasing and real estate	65,152,469	2,052,693	68,322,909	2,083,016
Individuals	322,070,197	10,147,139	369,265,755	11,258,102
Others	116,021,260	3,655,364	97,073,470	2,959,557
Total	<u>\$609,215,581</u>	<u>\$19,193,938</u>	<u>\$646,918,933</u>	<u>\$19,723,138</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- December 31, 2004		
	Average balance		Average rate
	NT	US	(%)
Assets			
Due from the Central Bank	\$34,176,874	\$1,076,776	1.11%
Time certificates, discounted bills and others	133,387,884	4,202,517	1.22%
Due from commercial banks and call loans to banks	26,436,737	832,915	1.34%
Bills and loans	553,283,497	17,431,742	3.75%
Government and corporate bonds	73,363,668	2,311,395	3.34%
Receivables-credit card	30,910,026	973,851	14.79%

English Translation of Financial Statements Originally Issued in Chinese

	January 1- December 31, 2004		
	Average balance		Average rate
	NT	US	(%)
Liabilities			
Due to banks	\$77,125,320	\$2,429,909	1.37%
Demand deposits	92,877,492	2,926,197	0.16%
Saving deposits	434,998,223	13,705,048	0.72%
Time deposits	133,386,857	4,202,484	1.07%
Negotiable certificates of deposits	24,049,974	757,718	1.01%
Financial debentures payable	31,074,590	979,036	3.40%
Bank's acceptances and funds borrowed	2,072,660	65,301	1.87%
	January 1- December 31, 2005		
	Average balance		Average rate
	NT	US	(%)
Assets			
Due from the Central Bank	\$21,309,603	\$649,683	1.50%
Time certificates, discounted bills and others	148,277,754	4,520,663	1.33%
Due from commercial banks and call loans to banks	24,153,090	736,375	2.20%
Bills and loans	602,927,715	18,381,943	4.14%
Government and corporate bonds	100,400,161	3,060,981	3.40%
Receivables-credit card	36,956,828	1,126,733	14.59%
Liabilities			
Due to banks	77,770,084	2,371,039	2.41%
Demand deposits	90,073,224	2,746,135	0.29%
Saving deposits	464,845,673	14,172,124	0.83%
Time deposits	169,789,002	5,176,494	1.63%
Negotiable certificates of deposits	21,225,957	647,133	1.15%
Financial debentures payable	55,794,192	1,701,042	2.51%
Bank's acceptances and funds borrowed	1,204,894	36,735	3.00%

(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.

English Translation of Financial Statements Originally Issued in Chinese

As of December 31, 2004 and 2005, the ratio of the Bank's shareholders' equity to its risk-weighted assets was 11.69% and 13.65%, 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 December 31, 2004 and 2005, the amounts of insurance coverage over the Bank's premises and equipment were NT\$7,667,978 and NT\$7,964,959, respectively.
- (5) Certain accounts of the financial statements for the year ended December 31, 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
December 31, 2004

	Trust Assets			Trust Liabilities	
	NT	US		NT	US
Cash and cash equivalents	\$2,934,295	\$92,448	Trust capital		
Short-term investments			Trust capital-money	\$77,284,463	\$2,434,923
Bonds	26,638	839	Trust capital-securities	1,619,460	51,023
Common stock	18,542	584	Trust capital-real estate	3,166,545	99,765
Mutual funds	28,806	908	Reserve and accumulated earnings		
Designated-purpose funds	74,349,248	2,342,446	Commitment	(62,003)	(1,953)
Personal estate			Distribution	(19,508)	(615)
Securities	1,617,660	50,966	Net Income	50,919	1,604
Real estate					
Land	3,062,253	96,479			
Buildings	2,434	77			
Total	\$82,039,876	\$2,584,747	Total	\$82,039,876	\$2,584,747

English Translation of Financial Statements Originally Issued in Chinese

Balance Sheet Based on Trust
December 31, 2005

	Trust Assets			Trust Liabilities	
	NT	US		NT	US
Cash and cash equivalents	\$2,945,282	\$89,795	Payables		
Short-term investments			Redemption charge		
Bonds	20,613	628	payable	\$4,398	\$134
Common stock	20,654	630	Service fee payable	30	1
Mutual funds	155,710	4,747	Management for		
Designated-purpose funds	111,917,835	3,412,129	payable	64	2
Short-term bills or			Trust capital		
repurchase investment	56,022	1,708	Trust capital-money	114,947,767	3,504,505
Receivables			Trust capital-securities	1,470,296	44,826
Accrued interest receivable	11	1	Trust capital-real estate	3,872,204	118,055
Personal estate			Reserve and accumulated earnings		
Securities	1,468,496	44,771	Distribution	(89,522)	(2,729)
Real estate			Net Income	110,041	3,355
Land	3,724,491	113,552			
Buildings	6,164	188			
Total	<u>\$120,315,278</u>	<u>\$3,668,149</u>	Total	<u>\$120,315,278</u>	<u>\$3,668,149</u>

Details of Trust Properties
December 31, 2005

Investment Items	Amount	
	NT	US
Short-term investment		
Bonds	\$20,613	\$628
Common stock	20,654	630
Mutual fund	155,710	4,747
Assigned fund	111,917,835	3,412,129
Short-term bills or repurchase		
investment	56,022	1,708
Personal estate		
Securities	1,468,496	44,771
Real estate		
Land	3,724,491	113,552
Buildings	6,164	188
Total	<u>\$117,369,985</u>	<u>\$3,578,353</u>