



Bank of Communications Co., Ltd.

(A joint stock company incorporated in the People's Republic of China with limited liability)

Stock Code: 3328

Bold Beginning
Strong Position
Withstand Challenges

Since medieval times, pioneers have relied on their mighty fleets to expand the territory of the motherland. The captain's leadership and the crew's cooperation usually draw the line between victory and defeat. With its deep-rooted foundation and outstanding team spirits, the Bank of Communications has been braving winds and waves since old times, taking its strides through the world and making advances in its already vast stronghold.

2005 Annual Report

Brief Introduction

Future Aspirations Definitive Plans

Founded in 1908, Bank of Communications Co., Ltd. (the “Bank”) is the successor of a century-old national financial brand in China. Having restructured in 1987, the Bank emerged as the first national joint-stock commercial bank in the country. The reformed Bank has played a significant role as a catalyst, motivator and model for China’s financial reform.

The Bank, through financial restructuring and forming strategic partnership with international banks, was listed on the Main Board of The Stock Exchange of Hong Kong Limited on 23 June 2005 with the support of the central government and shareholders. The move marked a milestone indicating its further joint-stock-system reform, as the Bank became the first overseas-listed commercial bank of mainland China. By following the further joint-stock-system reform and improving the operations management, the Bank continues to enhance its corporate governance. Its various structures of shareholders, businesses, clients and revenues have improved, and so have its capital strength and overall financial performance. The Bank also aims to enhance its risk management and internal controls. It also aims to

develop more innovative products and strengthen the cooperation with the Hongkong and Shanghai Banking Corporation Limited.

With its global network, the Bank is dedicated to providing excellent services to its clients. Currently, it has 137 branches and sub-branches, in addition to over 2,600 business outlets in China. It has also extended its branches to Hong Kong, New York, Tokyo, Singapore and Seoul and it has representative offices in London and Frankfurt. Today, the Bank has built up a network with approximately 900 correspondent banks in more than 100 countries and areas over the world.

The Bank aims to be a first-class international public bank. Looking ahead, the Bank will continue its reforms with a scientific mentality to accelerate its pace on strategic transformation, better its corporate governance, strengthen its risk management and internal controls, and implement an effective cost management. As a consequence, the Bank’s shareholders will enjoy stable and substantial returns.

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Financial Highlights

| Item | 2005 | 2004 | Change |
|--|--------------------|--------------------|---------------|
| Annual | RMB million | RMB million | +/(-)% |
| Net interest income | 31,591 | 25,192 | 25.40 |
| Profit before tax | 12,843 | 7,750 | 65.72 |
| Net profit | 9,249 | 1,604 | 476.62 |
| Per share | RMB | RMB | +/(-)% |
| Basic and diluted earnings per share | 0.22 | 0.06 | 266.67 |
| Net asset value per share | 1.81 | 1.33 | 36.09 |
| As at the end of the year | RMB million | RMB million | +/(-)% |
| Shareholders' equity | 83,082 | 52,103 | 59.46 |
| Issued and paid-up share capital | 45,804 | 39,070 | 17.24 |
| Total assets | 1,423,439 | 1,144,005 | 24.43 |
| Financial ratios | % | % | +/(-)% |
| Return on average assets (<i>Note 1</i>) | 0.72 | N/A | N/A |
| Return on average shareholders' equity (<i>Note 2</i>) | 13.68 | N/A | N/A |
| Cost-to-income ratio (<i>Note 3</i>) | 51.24 | 60.78 | (9.54) |
| Impaired loan ratio (<i>Note 4</i>) | 2.80 | 3.00 | (0.20) |
| Tier-1 capital adequacy ratio (<i>Note 5</i>) | 8.78 | 6.77 | 2.01 |
| Capital adequacy ratio (<i>Note 5</i>) | 11.20 | 9.72 | 1.48 |

Notes:

1. This is calculated based on net profit of the year divided by the average of total assets at the beginning and the end of the year;
2. This is calculated based on net profit of the year divided by the average of shareholders' equity balance at the beginning and the end of the year;
3. This represents other operating expenses as a percentage of the operating income (including net interest income, net fee and commission income, dividend income, gains less losses arising from trading activities, gains less losses arising from investment securities and other operating income);
4. This represents the balance of impaired loans at the end of the year divided by the total loan before provision;
5. This is calculated in accordance with China Banking Regulatory Commission ("CBRC") guidelines and based on PRC Generally Accepted Accounting Principles ("PRC GAAP").

Corporate Information

LEGAL NAME

交通銀行股份有限公司
Bank of Communications Co., Ltd.

DIRECTORS

Executive Directors

Zhang Jianguo
(Vice Chairman and President)
Li Jun
Peng Chun
Zhang Jixiang

Non-executive Directors

Jiang Chaoliang (Chairman)
Hu Huating
Peter Wong Tung Shun
William Fung Kwok Lun
Li Keping
Li Zexing
Gao Shiqing
Shen Weiming
Li Guanglin
Qian Ping

Independent Non-executive Directors

Xie Qingjian
Ian Ramsay Wilson
Thomas Joseph Manning
Herbert Hui Ho Ming
Chen Qingtai

SUPERVISORS

Cui Leiping
(Chairman of the Board of Supervisors)
Ning Jinbiao
Teng Tieqi
Ji Keliang
Liu Qiang
Cheng Zheng
Liu Sha
Chen Qing
Li Jun

COMPANY SECRETARY

Zhang Jixiang

AUTHORIZED REPRESENTATIVES

Zhang Jianguo
Zhang Jixiang

REGISTERED ADDRESS

18 Xian Xia Road
Shanghai 200336
PRC
Tel: 86-21-58766688
Fax: 86-21-58798398
E-mail: dongban@bankcomm.com
Website: www.bankcomm.com

PLACE OF BUSINESS IN HONG KONG

20 Pedder Street, Central, Hong Kong

AUDITORS

PricewaterhouseCoopers
Deloitte Touche Tohmatsu CPA Ltd.

HONG KONG LEGAL ADVISOR

Herbert Smith

PRC LEGAL ADVISOR

King & Wood

COMPLIANCE ADVISOR

Goldman Sachs (Asia) L.L.C.

H SHARE REGISTRAR

Computershare Hong Kong Investor Services
Limited
Rooms 1712-16, 17th Floor
Hopewell Centre
183 Queen's Road East
Hong Kong

LISTING INFORMATION

Listing place: The Stock Exchange of
Hong Kong Limited
Stock type: H share
Stock code: 3328

This report is prepared in Chinese and English respectively. The English version is for reference only. In case of any inconsistency, the Chinese version shall prevail.

Chairman's Statement



Jiang Chaoliang Chairman



2005 was an extraordinary year in the history of reform and development of Bank of Communications, and was also a remarkable year for China to achieve continuous economic growth and make major breakthrough in its banking reforms. Under the support and guidance of the central government, our shareholders from at home and abroad, our broad base of clientele as well as all circles of society, the bank turned a new chapter in deepening the reforms and became a one full of vigor and vibrancies. With joint efforts of all our staff, new progress was made in the Bank's strategic transformation as well as its business performance while sticking to a steady and well-coordinated development in compliance with the state laws, regulations as well as supervisions of various regulators.

On 23 June 2005, the Bank successfully issued H shares and was listed on the main board of the Hong Kong Stock Exchange, thus

to become the first commercial bank in mainland China entering the international capital market and symbolize that the Bank has fulfilled its milestone mission in the further joint-stock-system reform with financial restructuring, introduction of foreign investors and a public listing at its core. The Bank's success in the further joint-stock-system reform was not only epoch-breaking in the history of the Bank's development, but also offered valuable experiences for the Chinese Banking sector to explore ways of reform.

The Bank's corporate governance continued to improve in 2005. In a bid to establish a modern corporate governance structure, the Bank further optimized relevant internal rules and regulations regarding corporate governance and assured a good coordination among different functions of the Shareholders Meeting, the Board of Directors, the Board of Supervisors and the Senior Management. An investor relations management framework

Chairman's Statement (Continued)

modeling after the best international practice was also put in place by the Bank post its Initial Public Offering, besides, the Bank has also edited its financial reports in line with the International Financial Reporting Standards for the 4th consecutive year and has performed its information disclosure obligation in strict compliance with both internal and external regulatory requirements. In addition, at the time of actively exploring a long-term incentive and constrain mechanism bank-wide, the Bank had drawn on a long-term incentive program ahead of its Chinese industrial peers.

The strategic transformation launched by the Bank with its best efforts since 2004 has come into effect in 2005. Modern commercial banking concepts such as maximizing shareholders' value, capital restraints and risk management, became integrated into the management of operation. Retail business developed rapidly while contribution of revenue from intermediary business increased further. 15 key projects, including data centralization, management accounting and internal rating, were carried out smoothly. The setting up of Bank of Communications & Schroders Fund Management Co. Ltd. was approved following with the issue of its first fund, a major step forward in becoming an integrated bank.

The cooperation between the Bank and HSBC was furthered strengthened on the principle of mutual benefit, mutual understanding and concession and seeking long-term cooperation and mutual development. A three-tiered communicative mechanism between the Bank and HSBC was established and Technical Support Agreement was started to execute. The credit card business started to reaped fruit and other business cooperation also went on smoothly.

We attribute all those we have achieved to the continued support and guidance from the central government, all our shareholders, our clientele as well as all circles of society. On behalf of the Board, I would like to extend my great appreciation for their support at all times.

2006 is the first year for China to implement "**The Eleventh Five-Year Plan**" and also the first complete financial year post-IPO. Facing the changing economic and financial situation at home and abroad, the Bank will further improve its operation and management, expedite its strategic transformation and systematic overhaul by unswervingly adhering to the scientific way of development which focused on the sustainable and coordinated development in pursuing speed, quality and cost-efficiency. The Bank will further deepen its cooperation with HSBC and build a first class retail bank with good brand franchise, distinct corporate culture with harmonious environment, thus to ensure the realization of a sustainable growth of both Return on Assets and Return on Equity.

As a financial institution with hundred-year old history and a time-honored brand name, the Bank will continue to pursue its goal of developing together with the society, growing together with the staff, to reward our shareholders with sustainable and stable return. Looking ahead, we are full of confidence that through hard work and continued innovation, the Bank would be able to reach our destination of becoming a first-class international public bank in the very near future.

Chairman

A handwritten signature in black ink, appearing to be 'Jiang Chaoliang', written in a cursive style.

Jiang Chaoliang

President's Statement



Zhang Jianguo President



2005 was a year of historic significance for Bank of Communications. With the support and assistance of the shareholders and all circles of society, the Bank successfully achieved the milestone objective of the further joint-stock-system reform and became the first international public commercial bank in mainland China, with healthy business growth, smooth advancement of strategic transformation, positive transformation in systems and mechanisms, continuously enhanced management and remarkably improved profitability.

As of the end of 2005, the Group's total assets reached RMB 1,423.4 billion, increasing by 24.43% as compared with the beginning of the year. The balance of clients' deposit was 1,220.8 billion, up 18.53% as compared with the beginning of the year. The balance of clients' loans was RMB 771.4 billion, increasing by 20.52% as compared with the beginning of the year. Impaired loan rate was 2.80%, representing a decline of 0.20 percentage points as compared with the beginning of the year. NPL rate based on 5-category classification system was 2.37%, decreasing by 0.54 percentage points as compared with the beginning of the year. The Group realized a net profit of RMB 9.249 billion, increasing by 476.62% as compared with the previous year.

Having grasped opportunities and advanced in defiance of difficulties, the Bank achieved pleasing results as demonstrated in the following seven aspects.

Firstly, steady business growth and continued expansion of market share. Having brought the Bank adequate capital and escalated its company image, the listing in Hong Kong offered an opportunity for development, which the Bank grasped. With a firm resolve to expand the business size, improve the business quality and building the business brand, the Bank continued to extend and intensify the marketing for the clients. As a result, the capability in business growth and client service was remarkably strengthened and the market share of major business items rose steadily. In 2005 the market share of RMB deposit and loan of the domestic branches rose by 0.21 and 0.35 percentage points as compared with the previous year.

Secondly, continued optimization of business structure began to show the effects of strategic transformation. The Bank managed to improve its client structure by resolutely executing the macro-control policies of the central government and regulators' requirement concerning risk prevention.

President's Statement (Continued)

On the basis of 10-category classification system, the balance of loans extended to category 1-5 clients increased by 5.26 percentage points as compared with the beginning of the year. On the other hand, the balance of loans to category 6-7 clients declined by 5.43 percentage points over the beginning of the year. And the balance of loans extended to category 8-10 clients declined by 0.77 percentage points compared with the level at the beginning of the year. The strategic transformation began to show effects. The retail business income and net fee and commission income accounted for 11.70% and 6.00% respectively of the total income. Innovative business yielded good results. Offshore business reached a volume of USD 688 million. Short-term financing bond underwriting was launched with a good beginning, with a total issuance amount of RMB 13.75 billion, representing a market share of 10%. The bank had made breakthroughs in annuity business, signing annuity custody contracts with 13 companies, annuity account management contracts with 9 companies and intention of cooperation with 34 companies. Bank of Communications & Schroders Fund Management Co. Ltd. officially opened business and successfully issued the first fund. Seoul branch successfully opened business.

Thirdly, continued strengthening of financial foundation and remarkably improved profitability. Adhered to the principles of intensive operation with priority being given to profitability, we managed to increase the proportion of profit-generating assets and highly-yielding assets and to control the cost and expense effectively. As a result, the cost/income ratio continued to decline and the profitability improved remarkably. Capital Adequacy Ratio was 11.20% and Tier-1 CAR 8.78%, rising by 1.48 and 2.01 percentage points respectively as compared with the previous year. Provision coverage was 58.39%, up 14.38 percentage points as compared with the beginning of the year. ROA and ROE reached 0.65% and 11.13% respectively, up 0.51 and 8.05 percentage points as compared with the previous year, and the Return on Average Assets and Return on Average Shareholders' Equity reached 0.72% and 13.68% respectively.

Fourthly, further improved internal control and enhanced risk management. The Bank had preliminarily built up an independent, effective and authoritative risk warding and internal control system by enhancing the risk management awareness and importing risk management process and tools, resulting in the effective control of credit risks, market risks and operational risks. Advanced risk management technologies and tools such as Risk Filter, Watch List, Risk Alarm, Loan-by-loan Provision, Migration Analysis, Risk Orientation Auditing and Consecutive Auditing were commonly used. As a result, the impaired loan ratio continued to decline. As of the end of 2005 the Bank's impaired loan rate was 2.80%, which was 0.20 percentage points lower than the previous year.

Fifthly, continued execution of internal reforms and further enhanced regulation build-up. The organizational integration of various administrative functions at head office level was completed and their responsibilities re-defined. Following the principles of independence, specialization and authoritativeness in credit approving, we had set up 5 regional credit approving centers and 6 regional audit departments, which had started operating. We imported the concept of economic capital and improved the performance assessment system. The Bank's operation and management had stepped into the track of scientific development.

Sixthly, continued IT build-up and significantly enhanced product innovation. Phase One of Data Centralization Project was successfully put into operation in June 2005. Phase Two had been tested in 2 batches of branches and had been rolled out successfully in the first batch. Management Accounting System, Economic Capital Management System, Internal Rating System, Comprehensive Information Management System were periodically completed as scheduled. Thanks to the development of information technology, which provided product innovation with inexhaustible driving force, we launched market-proven products such as Credit Assets Buy-out, Dual-interest Account, Delibao (a wealth management product) linked with HSBC's SPOMS system and RMB-FX Swap.

Seventhly, closer cooperation with HSBC. The two banks set up a 3-tier communication mechanism at summit, leading and working level and established multi-level regular meeting system and responsibility tracking system for agreed matters. Technical Service and Assistance project were executed in an all-round way. It helped import advanced ideology of management, technologies and tools. Trainings of varied forms also proved effective. Business cooperation displayed remarkable results. By leveraging the respective advantages in management and distribution channels, the two banks achieved a total issuance of the credit cards of over 650,000 within only 6 months.

The achievement of the Bank's reform and development received extensive recognition, remarkably escalating its company image and brand value. Rating agencies including Standard & Poor's and Fitch consecutively raised the Bank's rating. The number of rewards that the Bank received from authoritative international organizations and financial medias hit the new-high in the Bank's history.

We owe all these achievements to the care and guidance of the Central Government and relevant authorities and to the support of our shareholders and all circles of society. On behalf of the senior management of Bank of Communications, I would like to express the heart-felt acknowledgement to our shareholders and all circles of society for the support to the Bank's reform and development!

2006 is the first year for the country to implement "**The Eleventh Five-Year Plan**", a year for the all-round open-up of the financial industry and continued deepening of financial reforms, as well as a critical year for the Bank to expedite strategic transformation from a brand-new starting point. Our operation will be facing the opportunities brought up by the continuous growth of macro economy and improvement of the financial environment as well as the challenges caused by the more uncertainties of the external environment and by the more vehement competition from the peers. Guided by the scientific development concept, we will adhere to the target of building a first-class international public bank. With the sustained growth of ROA and ROE as the core of our work, we will continue with the efforts to achieve the rapid and healthy business growth with strategic transformation as the fulcrum and business innovation as the lever. First, we will use economic capital to restrain and spur business growth so as to achieve maximized values. Second, we will strengthen retail business management to improve the quality of retail service. Third, we will accelerate the fee-based business. Fourth, we will expedite the follow-up reforms. Fifth, we will further strengthen product management to enhance product and technology innovation and to improve our core competitiveness. Sixth, we will support SME clients more strongly. Seventh, we will intensify human resources management reforms.

With the support from the shareholders and all circles of society, we are confident to grasp the opportunities firmly and face the challenges calmly. We believe that our reforms will be sustained and intensified by better operational results in the future, thus further achievement in strategic transformation, escalation of market position and breakthrough in brand construction. We believe that we will surely accomplish all the targets and achieve satisfactory results in the first year of the "**The Eleventh Five-Year Plan**" and the first complete fiscal year after the Bank's IPO.

President



Zhang Jianguo

Chairman of the Board of Supervisors



Cui Lei Ping Supervisors

Directors, Supervisors, Senior Management and Staff



Directors, Supervisors, Senior Management and Staff (Continued)

1 CURRENT DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

(1) Profile of Directors



Mr. Jiang Chaoliang

Aged 48, joined the Bank in June 2004. He is Chairman of the Board. Mr. Jiang has served as Deputy Governor of Hubei Province, Assistant Governor of the People's Bank of China ("PBC") and Director of the General Office of the PBC, Governor of the Guangzhou Branch of the PBC and Director of the Guangdong Division of State Administration of Foreign Exchange ("SAFE"), and Governor of the Shenzhen Branch of the PBC and Director of the Shenzhen Division of SAFE. Mr. Jiang holds a master's degree in Economics.



Mr. Zhang Jianguo

Aged 51, joined the Bank in September 2001. He is Vice Chairman of the Board and President of the Bank. Mr. Zhang has served as Executive Vice President of the Bank, General Manager of the International Business Department and Deputy President of the Tianjin Branch of the Industrial and Commercial Bank of China. Mr. Zhang holds a master's degree in Economics.



Mr. Li Jun

Aged 49, joined the Bank in October 1990. He is an Executive Director of the Board and Executive Vice President of the Bank. Mr. Li has served as Controller General of the Bank and President of the Bank's Wuhan Branch. Mr. Li holds a master's degree in Economics.



Mr. Peng Chun

Aged 44, joined the Bank in January 1994. He is an Executive Director of our Board and Executive Vice President of the Bank. He has served as Assistant President of the Bank, President of Guangzhou Branch, President of Nanning Branch, and President of Urumqi Branch. Mr. Peng holds a master's degree in Economics.



Mr. Zhang Jixiang

Aged 52, joined the Bank in July 2004. He is an Executive Director of the Board and Secretary of our Board. Mr. Zhang has served as Inspector and Deputy Director of the General Department and Deputy Director of the Basic Construction Department of the Ministry of Finance of China. Mr. Zhang holds a PhD degree in Economics.



Mr. Hu Huating

Aged 48, joined the Bank in September 2004. He is a Non-executive Director of the Board. Mr. Hu has served as Director of the Bureau for Retired Officials and Deputy Director of the Economic Construction Department of Ministry of Finance of China. He graduated from Dongbei University of Finance and Economics.



Mr. Peter Wong Tung Shun

Aged 54, is a Non-executive Director of the Board. Mr. Wong is currently the General Manager of HSBC Group and an executive director of the Hongkong and Shanghai Banking Corporation Limited. Mr. Wong has served as Head of Consumer Banking for Hong Kong and China, Chief Executive for Hong Kong and Director of Greater China of Standard Chartered Bank, Director of Sales, Services, and Distribution Channels for North Asia of Citibank, and Chairman of the Hong Kong Association of Banks in 2004. Mr. Wong holds a master's degree in computer science and another master's degree in marketing and finance. Mr. Wong has acted as a Non-executive Director of the Board since August 2005.



Mr. William Fung Kwok Lun

Aged 57, is a Non-executive Director of the Board, Managing Director of Li & Fung Limited, Deputy Chairman of the Hongkong and Shanghai Banking Corporation Limited and an independent non-executive director of HSBC Holdings plc. Mr. Fung holds an Honorary Doctorate of Business Administration from the Hong Kong University of Science and Technology. Mr. Fung has acted as a Non-executive Director of the Board since September 2004.



Mr. Li Keping

Aged 49, is a Non-executive Director of the Board and Director of the Investment Department of the National Council for Social Security Fund. Mr. Li has served as Deputy Chief and Assistant Inspector at the Department of Macro System of the State Office of System Restructuring of the State Council of China. Mr. Li holds a bachelor's degree in Economics. Mr. Li has acted as a Non-executive Director of the Board since September 2004.



Mr. Li Zexing

Aged 41, is a Non-executive Director of the Board and Deputy General Manager of the Legal and Research Department of China SAFE Investments Ltd. Mr. Li has served as Assistant Inspector of the Division of Reserve Management of SAFE. Mr. Li holds a master's degree in Economics. Mr. Li has acted as a Non-executive Director of the Board since September 2004.



Mr. Gao Shiqing

Aged 44, is a Non-executive Director of the Board and Deputy General Manager of Capital Airports Holding Company. Mr. Gao has served as Deputy Director of the Planning, Development and Finance Department of the Civil Aviation Administration of China. Mr. Gao holds a master's degree in Engineering. Mr. Gao has acted as a Non-executive Director of the Board since September 2004.



Mr. Shen Weimin

Aged 58, is a Non-executive Director of the Board and Chief Economist of Shanghai Tobacco (Group) Corp. Mr. Shen has served as Deputy Chief Accountant of Shanghai Tobacco (Group) Corp. Mr. Shen graduated from Shanghai Television University. Mr. Shen has acted as a Non-executive Director of the Board since June 2004.



Mr. Li Guanglin

Aged 41, is a Non-executive Director of the Board and Director and Chief Accountant of Yuxi Hongta Tobacco (Group) Co., Ltd. Mr. Li has served as Chief of the Accounting Office of Yunnan Provincial Tobacco Company. Mr. Li graduated from Yunnan College of Finance and Trade. Mr. Li has acted as a Non-executive Director of the Board since July 2003.



Mr. Qian Ping

Aged 41, is a Non-executive Director of the Board and Chief Accountant of Shandong Power (Group) Company and Deputy General Manager of Yingda International Trust and Investment Ltd. Mr. Qian has served as Deputy Chief Accountant and Director of Finance Department of Shandong Electric Power Corporation and Deputy Director of Jinan Power Supply Bureau. Mr. Qian holds a bachelor's degree in Engineering. Mr. Qian has acted as Non-executive Director of the Board since August 2005.



Mr. Xie Qingjian

Aged 62, is an Independent Non-executive Director of the Board and Counselor of the PBC. Mr. Xie has served as Governor of the Nanjing Branch, Deputy Governor of the Shanghai Branch and Governor of the Zhejiang Branch of the PBC. Mr. Xie holds a master's degree in Economics. Mr. Xie has acted as an Independent Non-executive Director of the Board since September 2004.



Mr. Ian R. Wilson

Aged 65, is an Independent Non-executive Director of the Board. Mr. Wilson has served as General Manager for the regions of Hong Kong, China and Northeast Asia, and General Manager for the regions of Middle East and South Asia of Standard Chartered Bank. Mr. Wilson has acted as an Independent Non-executive Director of the Board since September 2004.



Mr. Thomas J. Manning

Aged 50, is an Independent Non-executive Director of the Board and Chairman of China Board Directors LLC. Mr. Manning has served as Managing Director of Bain & Company, Chairman and CEO of Cap Gemini Ernst & Young Asia Pacific and Chairman and CEO of Ernst & Young Consulting Asian Pacific. Mr. Manning holds a master's degree in Business Administration. Mr. Manning has acted as an Independent Non-executive Director of the Board since September 2004.



Mr. Herbert Hui Ho Ming

Aged 47, is an Independent Non-executive Director of the Board, Deputy Chairman of Ocean Grand Holdings Ltd. and Ocean Grand Chemicals Holdings Ltd and Chairman of the Hong Kong Institute of Directors Ltd. Mr. Hui has served as Deputy Executive Director and head of the listing division of the Hong Kong Stock Exchange. Mr. Hui holds a bachelor's degree in Law. Mr. Hui has acted as an Independent Non-executive Director of the Board since April 2005.

Mr. Chen Qingtai

Aged 68, is an Independent Non-executive Director of the Board, researcher of the Development Research Center of the State Council and Dean of the School of Public Affairs of Tsinghua University. Mr. Chen has served as Deputy Director of the Development Research Center of the State Council. Mr. Chen graduated from the Tsinghua University. Mr. Chen has acted as an Independent Non-executive Director of the Board since April 2005.

Directors, Supervisors, Senior Management and Staff (Continued)

(2) Profile of Supervisors

Mr. Cui Leiping, 59, joined the Bank in September, 2004 and is Chairman of the Board of Supervisors. Mr. Cui has served as Chairman of the board of Supervisors for the Agricultural Bank of China, Chairman of the board of supervisors for the Bank of China, Special Envoy of the National Audit Office based in Shanghai and Xi'an, and Deputy Director of the Department of Petrochemical Industry of Shaanxi Province. Mr. Cui holds a master's degree in Business Administration.

Mr. Ning Jinbiao, 48, is a Supervisor of the Bank and a Deputy General Manager of Huaneng Capital Service Co., Ltd. Mr. Ning has served as Deputy Director of the Local Tax Bureau, Mayor of Qinhuangdao City and Deputy Director of the Finance Department of Hebei Province. Mr. Ning holds a PhD in Economics. Mr. Ning has acted as a Supervisor of the Bank since June 2004.

Mr. Teng Tieqi, 48, is a Supervisor of the Bank and a Director and Deputy General Manager of China FAW Group Corporation. Mr. Teng has served as Special Manager, Director and Director of the Department of Planning and Finance of China FAW Group Corporation. Mr. Teng holds a master's degree in Engineering. Mr. Teng has acted as a Supervisor of the Bank since September 2004.

Mr. Ji Kelian, 66, is a Supervisor of the Bank, Chairman and Chief Engineer of China Guizhou Maotai Liquor Company Limited, Director and Chief Engineer of Guizhou Maotai Co., Ltd. Mr. Ji has served as plant manager and Chairman of Guizhou Maotai Co., Ltd. Mr. Ji graduated from Wuxi Light Industry College. Mr. Ji has acted as a Supervisor of the Bank since September 2004.

Mr. Liu Qiang, 39, is an External Supervisor of the Bank and Chief Accountant of Daqing Petroleum Administration Bureau. Mr. Liu has served as Deputy Chief Accountant and Manager of the Financial Asset Department of Daqing Petroleum Administration Bureau. Mr. Liu holds a master's degree in Economics. Mr. Liu has acted as an External Supervisor of the Bank since June 2004.

Ms. Chen Zheng, 37, is an External Supervisor of the Bank and Manager of the Financial Assets Department of Nanjing State-owned Assets Investment Management Holding (Group) Co., Ltd. Ms. CHEN has served as Department Manager of Nanjing International Trust and Investment Corporation. Ms. CHEN holds a master's degree in Management. Ms. Chen has acted as an External Supervisor of the Bank since September 2004.

Ms. Liu Sha, 50, joined the Bank in November, 2004 and is an Employee Supervisor of the Bank and General Manager of the Department of Audit of Northern China. Ms. Liu has served as Secretary of our Board of Supervisors, a full-time Supervisor of the Bank designated directly by the State Council, a full-time Supervisor of China Galaxy Securities Company Limited designated directly by the State Council and Deputy Chief of the Local Tax Bureau of Jinan City, Shandong Province. Ms. Liu graduated from the Dongbei University of Finance and Economics.

Ms. Chen Qing, 45, joined the Bank in November, 2004 and is an Employee Supervisor and Director of the General Office of our Board of Supervisors. Ms. Chen has been designated by the State Council as a full-time Supervisor of Agricultural Bank of China and a full-time Supervisor of Bank of China. Ms. Chen holds a bachelor's degree in Economics.

Mr. Li Jun, 55, joined the Bank in September, 1994 and is an Employee Supervisor and Deputy Director of Labour Union Committee of the Bank. Mr. Li graduated from Marine Politics College in the People's Republic of China.

(3) Profile of Senior Management

Mr. Zhang Jianguo, 51, joined the Bank in September 2001. He is Vice Chairman of the Board and President of the Bank. Mr. Zhang has served as Executive Vice President of the Bank, General Manager of the International Business Department and Deputy President of the Tianjin Branch of the Industrial and Commercial Bank of China. Mr. Zhang holds a master's degree in Economics.

Mr. Li Jun, 49, joined the Bank in October 1990. He is an Executive Director of the Board and Executive Vice President of the Bank. Mr. Li has served as Controller General of the Bank and President of the Bank's Wuhan Branch. Mr. Li holds a master's degree in Economics.

Mr. Peng Chun, 44, joined the Bank in January 1994. He is an Executive Director of the Board and Executive Vice President of the Bank. He has served as Assistant President of the Bank, President of Guangzhou Branch, President of Nanning Branch, and President of Urumqi Branch. Mr. Peng holds a master's degree in Economics.

Mr. Qian Wenhui, 44, joined the Bank in October, 2004 and is Executive Vice President of the Bank and President of the Bank's Shanghai Branch. Mr. Qian has served concurrently as General Manager of the Assets and Liabilities Management Department and Director of Restructuring Office of China Construction Bank, and Deputy President of the Shanghai Branch of China Construction Bank. Mr. Qian holds a master's degree in Economics.

Mr. Wang Bin, 47, joined the Bank in January 2000. He is Executive Vice President of the Bank. Mr. Wang has served as President and Deputy President of the Beijing Branch and President of the Tianjin Branch of the Bank. Mr. Wang holds a master's degree in Economics.

Mr. Dicky Peter Yip, 59, joined the Bank in April 2005. He is Executive Vice President of the Bank. Mr. Yip has served as Chief Executive of China Business at China Representative Office, Senior General Manager of Personal Banking Services, and Assistant General Manager and Deputy Chief of Personal Financial Services of the Hongkong and Shanghai Banking Corporation Limited. Mr. Yip holds a master's degree in Business Administration.

Ms. Yu Yali, 48, joined the Bank in February 1993. She is Chief Financial Officer of the Bank. Ms. Yu has served as General Manager of the Budget and Finance Department and Deputy President of the Zhengzhou Branch of the Bank. She holds a master degree in Business Administration.

Mr. Hou Weidong, 46, joined the Bank in April 2002. He is Chief Information Officer of the Bank and has served as General Manager of the Information Technology Management Department of the Bank, Deputy General Manager of the Computer Department of the Bank, Deputy General Manager of the Technology Support Department, and General Manager of the Data Center of Industrial and Commercial Bank of China. Mr. Hou holds a PhD degree in economics.

Directors, Supervisors, Senior Management and Staff *(Continued)*

(3) Profile of Senior Management *(Continued)*



Mr. Zhang Jianguo
Vice Chairman, President

Mr. Peng Chun
Director
Executive Vice President

Mr. Wang Bin
Executive Vice President

Ms. Yu Yali
Chief Financial Officer



Mr. **Hou Weidong**
Chief Information Officer

Mr. **Dicky Peter Yip**
Executive vice President

Mr. **Qian Wenhui**
Executive Vice President

Mr. **Li Jun**
Director
Executive Vice President

Directors, Supervisors, Senior Management and Staff (Continued)

2 CHANGES OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT DURING THE REPORTING PERIOD

(1) Change of Directors

As Mr. Qiao Wei reached retirement age, he tendered his resignation as Vice Chairman and Vice President of the Bank with effect from 1 August 2005. Each of Mr. Or Ching Fai and Mr. Li Ruge tendered their respective resignations as Non-executive Director due to personal reasons with effect from 1 August 2005. In order to fill the above vacancies, on 22 August 2005, it was approved at the 9th Session of the 4th Board of Directors to appoint Mr. Peng Chun as an Executive Director, and Mr. Peter Wong Tung Shun and Mr. Qian Ping as Non-executive Directors with effect from the same date.

(2) Change of Supervisors

Ms. Yin Baoyu tendered her resignation to the 4th Board of Supervisors as Supervisor on 1 November 2005 for having reached her retirement age. Following an election by the Bank's employees in a democratic manner on 3 November, 2005, Mr. Li Jun was elected as an Employee Supervisor at the 4th Session of the Board of Supervisors for a term until the end of the tenure of the 4th Board of Supervisors.

(3) Change of Senior Management

On 5 April 2005, it was approved at the 6th Session of the 4th Board of Directors to appoint Mr. Dicky Peter Yip as Executive Vice President. On 31 May 2005, it was approved at the 8th Session of the 4th Board of Directors to appoint Mr. Wang Bin as Executive Vice President.

3 NUMBER, QUALIFICATIONS AND EDUCATION ATTAINMENT OF STAFF

As at the end of the reporting period, we employed a total of 57,323 staff members, among whom 599 (approximately 1.04%) were senior staff members, 14,615 (approximately 25.49%) were medium staff members. There were 1,221 employees (approximately 2.13%) who had postgraduate degrees, 19,539 employees (approximately 34.09%) who had undergraduate degrees and 30,014 (approximately 52.36%) who had college and professional training education.

Report of the Board of Directors

The Board of Directors hereby presents its report and the audited consolidated financial statements of the Bank and its subsidiaries for the year ended 31 December 2005.

1 PRINCIPAL ACTIVITIES

The Bank is principally engaged in banking and relevant financial service. An analysis of the Bank's turnover by activities for the year of 2005 (the "Year") is set out in note 6 of the unaudited supplementary financial information.

2 RESULTS AND DISTRIBUTION

The Bank's results for the Year are set out in the consolidated profit and loss accounts on page 83.

The Board recommends a final dividend of RMB 0.08 per share, subject to approval by the shareholders at the Annual General Meeting to be held on Thursday, 22 June, 2006. The dividend will be payable before Tuesday, 22 August, 2006 to shareholders whose names appear on the register of members of the Bank on Thursday, 22 June, 2006.

Dividends for shareholders of domestic shares will be paid in RMB, and those for H shares will be paid in Hong Kong dollars. RMB will be converted into Hong Kong dollars based on the average currency rates prevailing one week before the date of dividends declaration as announced by the People's Bank of China (the "PBC") for such conversion.

3 CLOSURE OF REGISTER OF MEMBERS

The register of members will be closed between Friday, 2 June, 2006 and Thursday, 22 June, 2006 (both days inclusive) to ascertain shareholders' entitlement to final dividend. To qualify for the final dividend, all transfers of share accompanied by the relevant shares certificates, must be lodged with the Bank's share registrar, Computershare Hong Kong Investor Services Limited at Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong not later than 4.00 p.m. on Thursday, 1 June 2006.

4 RESERVES

Details of movements in the reserves of the Bank are set out in the consolidated statement of changes in shareholders' equity on page 86.

5 CHARITABLE DONATIONS

The Bank's total amount of charitable donations for the year is RMB 9.6323 million.

Report of the Board of Directors (Continued)

6 FIXED ASSETS

Details of changes in the Bank's fixed assets are set out in note 20 of the consolidated financial statement.

7 SHARE CAPITAL

Details of the Bank's share capital are set out in note 29 of the consolidated financial statement.

As at the date of this annual report and according to the publicly available information, the public float of the Bank's H shares was approximately 50.35%. Accordingly, the Directors of the Bank believe that the Bank has maintained sufficient public float.

8 DISTRIBUTABLE RESERVES

As at 31 December 2005, pursuant to the relevant laws and regulations, the Bank's distributable reserves amounted to approximately RMB 8.991 billion of which RMB 3.664 billion has been proposed for the distribution of final dividend for the year.

9 FINANCIAL SUMMARY

The summary of results, assets and liabilities of the Bank for the past two financial years is set out on page 2.

10 DIRECTORS

Biographical details of the Directors, Supervisors and senior management of the Bank are set out on page 14 to page 19. The Bank has received an annual written confirmation of independence from each independent non-executive Director, and the Bank believes that each independent non-executive Director is independent.

11 BOARD COMMITTEES

For details, please refer to the Corporate Governance Report on page 38.

12 DIRECTORS' AND SUPERVISORS' SERVICE CONTRACTS

None of the Directors and Supervisors or the Directors and Supervisors who are proposed to be re-elected at the forthcoming Annual General Meeting has entered into any service contract which is not determinable by the Bank or any of its subsidiaries within one year without compensation, other than statutory compensation.

13 DIRECTORS', SUPERVISORS' AND THE FIVE HIGHEST PAID INDIVIDUALS' EMOLUMENTS

Details of the emoluments of the Directors and Supervisors of the Bank and of the five highest paid individuals of the Bank are set out in note 11 to the consolidated financial statements.

14 MATERIAL INTERESTS IN CONTRACTS OF THE DIRECTORS AND SUPERVISORS

No Director or Supervisor had, directly or indirectly, any material interests in any contract of significance to the business of the Bank to which the Bank, its subsidiaries or their respective fellow subsidiaries was a party during the Year.

15 THE COMPETING INTERESTS OF DIRECTORS AND SUPERVISORS IN COMPETITIVE BUSINESS OF THE BANK

None of the Directors or Supervisors of the Bank has any competing interests in any business or has any interest in any business that may constitute direct or indirect competition with the Bank.

16 DIRECTORS' AND SUPERVISORS' RIGHTS TO ACQUIRE SHARES

During the Year, the Bank had not granted any rights to acquire shares or debentures of the Bank or any of its associated corporations to any Directors, Supervisors or their respective spouse or their children under 18 years of age, nor any such rights to acquire the above shares or debentures had been exercised by them.

17 DIRECTORS' INTERESTS

As at 31 December 2005, the interests or short positions of the Bank's Directors, Supervisors, senior management and their associates in the shares, underlying shares and debentures of the Bank or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) which were required to notify the Bank and The Stock Exchange of Hong Kong Limited (the "**Hong Kong Stock Exchange**") pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which are taken or deemed to have been taken under such provisions of the SFO), or which were required to enter in the register pursuant to section 352 of the SFO, or which were required, pursuant to Model Code for Securities Transactions by Directors of Listed Issuers (the "**Model Code**") as set out in Appendix 10 of the Rules Governing the listing of Securities on The Stock Exchange of Hong Kong Limited (the "**Listing Rules**"), to notify the Bank and the Hong Kong Stock Exchange, are as follows:

| Name of Director | Capacity | Number of H shares | Approximate percentage of issued H shares of the Bank | Approximate percentage of issued shares of the Bank |
|------------------|------------------|--------------------|---|---|
| Mr. William Fung | Beneficial owner | 3,000,000 | 0.013% | 0.0065% |

Report of the Board of Directors (Continued)

17 DIRECTORS' INTERESTS (Continued)

Save as disclosed above, as at 31 December 2005, the Bank's Directors, Supervisors, senior management and their associates had no interests or short positions manager in the shares, underlying shares and debentures of the Bank or any of its associated corporations (within the meaning of Part XV of the SFO) which were required to enter in the register pursuant to section 352 of the SFO, or which were required, pursuant to Model Code, to notify the Bank and the Hong Kong Stock Exchange.

18 SUBSTANTIAL SHAREHOLDERS AND HOLDERS OF INTERESTS OR SHORT POSITIONS REQUIRED TO BE DISCLOSED UNDER THE PROVISIONS OF DIVISION 2 AND 3 OF PART XV OF THE SECURITIES AND FUTURES ORDINANCE

The shareholders (other than the Bank's Directors, Supervisors and Senior Management) who have interests in the share capital of the Bank as recorded in the register required to be kept pursuant to Section 336 of the SFO are as follows:

| Name of substantial shareholders | Capacity | Number of domestic shares | Nature of interest (Note 1) | Approximate percentage of issued domestic shares (%) | Approximate percentage of total issued shares (%) |
|---|------------------|---------------------------|-----------------------------|--|---|
| Ministry of Finance of the People's Republic of China | Beneficial owner | 9,974,982,648 | Long positions | 43.87 | 21.78 |

| Name of substantial shareholders | Capacity | Number of H shares | Nature of interest (Note 1) | Approximate percentage of issued H shares (%) | Approximate percentage of total issued shares (%) |
|---|--|--------------------|-----------------------------|---|---|
| Council for National Social Security Fund | Beneficial owner | 5,555,555,556 | Long positions | 24.09 | 12.13 |
| China SAFE Investments Limited | Beneficial owner | 3,000,000,000 | Long positions | 13.01 | 6.55 |
| The Hongkong and Shanghai Banking Corporation Limited | Beneficial owner | 9,115,002,580 | Long positions | 39.52 | 19.90 |
| HSBC Asia Holdings BV | Interest of controlled corporations (Note 2) | 9,115,002,580 | Long positions | 39.52 | 19.90 |

18 SUBSTANTIAL SHAREHOLDERS AND HOLDERS OF INTERESTS OR SHORT POSITIONS REQUIRED TO BE DISCLOSED UNDER THE PROVISIONS OF DIVISION 2 AND 3 OF PART XV OF THE SECURITIES AND FUTURES ORDINANCE *(Continued)*

| | | | | | |
|----------------------------|--|---------------|----------------|-------|-------|
| HSBC Asia Holdings (UK) | Interest of controlled corporations <i>(Note 3)</i> | 9,115,002,580 | Long positions | 39.52 | 19.90 |
| HSBC Holdings BV | Interest of controlled corporations <i>(Note 4)</i> | 9,115,002,580 | Long positions | 39.52 | 19.90 |
| HSBC Finance (Netherlands) | Interest of controlled corporations <i>(Note 5)</i> | 9,115,002,580 | Long positions | 39.52 | 19.90 |
| HSBC Holdings plc. | Interest of controlled corporations <i>(Note 6)</i> | 9,115,002,580 | Long positions | 39.52 | 19.90 |

Notes:

1. Long positions held through non-derivative.
2. HSBC Asia Holdings BV holds 89.81% equity of the Hongkong and Shanghai Banking Corporation Limited. Pursuant to SFO, HSBC Asia Holdings BV is considered to own the 9,115,002,580 H shares of the Bank which are held by Hong Kong and Shanghai Banking Corporation Limited.
3. HSBC Asia Holdings BV is wholly-owned by HSBC Asia Holdings (UK). Pursuant to Note (2) and SFO, HSBC Asia Holdings (UK) is considered to own the 9,115,002,580 H shares of the Bank which are held by the Hongkong and Shanghai Banking Corporation Limited.
4. HSBC Asia Holdings (UK) is wholly-owned by HSBC Holdings BV. Pursuant to Note (2), (3) and SFO, HSBC Holdings BV is considered to own the 9,115,002,580 H shares of the Bank which are held by the Hongkong and Shanghai Banking Corporation Limited.
5. HSBC Holdings BV is wholly-owned by HSBC Finance (Netherlands), which also directly holds 8.53% equity of the Hongkong and Shanghai Banking Corporation Limited. Pursuant to Note (2), (3), (4) and SFO, HSBC Finance (Netherlands) is considered to own the 9,115,002,580 H shares of the Bank which are held by the Hongkong and Shanghai Banking Corporation Limited.
6. HSBC Finance (Netherlands) is wholly-owned by HSBC Holdings plc, which also directly holds 2.61% equity of the Hongkong and Shanghai Banking Corporation Limited. Pursuant to Note (2), (3), (4), (5) and SFO, HSBC Holdings plc is considered to own the 9,115,002,580 H shares of the Bank which are held by the Hongkong and Shanghai Banking Corporation Limited.

Report of the Board of Directors (Continued)

19 TEN LARGEST SHAREHOLDERS AND THEIR SHAREHOLDINGS AS AT 31 DECEMBER 2005

Pursuant to the requirements of the CBRC, the Bank's ten largest shareholders and their shareholdings at the end of the reporting period are as follows:

| Rank | Name of shareholders | No. of shares | Approximate percentage of shareholding |
|------|---|---------------|--|
| 1 | Ministry of Finance of the People's Republic of China | 9,974,982,648 | 21.78% |
| 2 | The Hongkong and Shanghai Banking Corporation Limited | 9,115,002,580 | 19.90% |
| 3 | National Council for Social Security Fund | 5,555,555,556 | 12.13% |
| 4 | HKSCC Nominees Limited | 5,186,999,050 | 11.32% |
| 5 | China SAFE Investments Limited | 3,000,000,000 | 6.55% |
| 6 | Capital Airports Holding (Group) Company | 985,447,500 | 2.15% |
| 7 | Shanghai Tobacco (Group) Corp. | 378,328,046 | 0.83% |
| 8 | Yunnan Hongta Group Co. Ltd. | 345,215,314 | 0.75% |
| 9 | Shandong Electric Power Corporation | 300,000,000 | 0.65% |
| 10 | Huaneng Capital Services Company Limited | 198,041,710 | 0.43% |

Note: HKSCC Nominees Limited held the total shares of all shareholders registered in its name as a nominee as at 31 December 2005.

20 PURCHASE, SALE OR REDEMPTION OF SHARES OF THE BANK

During the Year, none of the Bank or any of its subsidiaries has purchased, sold or redeemed any shares of the Bank.

21 PRE-EMPTIVE RIGHTS AND SHARE OPTIONS ARRANGEMENTS

There are no provisions for pre-emptive rights under the Bank's Articles of Association or the relevant People's Republic of China ("PRC") law. Currently, the Bank does not have any arrangement with respect to share option.

22 SHARE APPRECIATION RIGHTS ("SARS")

As part of the incentive plan, the members of senior management have been granted Share Appreciation Rights ("SARS"). The issuing of SARS does not involve the issue of new shares. The shareholding of existing shareholders of the Bank will not be diluted. Details of the SARS are set out on pages 52 and 53.

23 MAJOR CUSTOMERS AND SUPPLIERS

The Bank's five largest customers accounted for less than 2% of the Bank's total turnover of interest revenue and other operating revenue for the year. None of the Directors, their associates or any shareholders who to the best knowledge of the Directors, own more than 5% of the Bank's issued share capital, of the Bank had any beneficial interest in the Bank's five largest customers.

24 CONTINUING CONNECTED TRANSACTIONS

HSBC and the HSBC Group are the connected parties of the Bank, as HSBC is the substantial shareholder of the Bank. The Bank and its subsidiaries have engaged in various kinds of transactions (one-off transactions and continuing transactions) in the normal course of banking business with the HSBC Group, such as foreign currency exchange transactions, capital markets (equity and debt securities) transactions, derivatives transactions (primarily interest rate swaps), guarantees, trade finance, credit card settlement services, electronic payment services (EPS), payment, reference agency services and agency services for syndicated loans.

To regulate these on-going transactions, the Bank has entered into the Interbank Transactions Master Agreement with HSBC on June 1, 2005, pursuant to which the HSBC Group and the Bank agreed to conduct interbank transactions in accordance with applicable normal interbank practices and on normal commercial terms. During the reporting period, the Bank and the HSBC have engaged in the following continuing connected transactions:

- (1) For the year ended 31 December 2005, the aggregate balance of deposit placed in HSBC by the Bank's branches amounted to RMB 4,654 million, and the interest income was approximately RMB 16 million in 2005.
- (2) For the year ended 31 December 2005, the aggregate balance of deposit and loans placed in the Bank by HSBC amounted to RMB 2,318 million, and the interest expenses were approximately RMB36 million.
- (3) For the year ended 31 December 2005, the aggregate balance of securities investments made by the Bank's branches to HSBC amounted to RMB 568 million, and interest income from these securities investments was approximately RMB 22 million in 2005.
- (4) For the year ended 31 December 2005, the major off balance sheet transactions namely guarantee operations, issuance of credit letters and derivative instruments entered between the Bank's branches and HSBC were amounted to RMB 7 million, RMB 347 million and RMB 28,768 million respectively.

Report of the Board of Directors (Continued)

24 CONTINUING CONNECTED TRANSACTIONS (Continued)

The Bank has applied to the Hong Kong Stock Exchange for, and the Hong Kong Stock Exchange has granted a waiver from strict compliance with the announcement and independent shareholders' approval requirements under the Listing Rules in respect of the above continuing connected transactions of the Group.

After careful examination of the above connected transactions, each independent non-executive directors of the Bank considers the above continuing connected transactions which have been entered into by the Bank as:

- (1) having been entered into by the Bank in the ordinary course of business;
- (2) having been entered into under normal business terms or no less favorable than that obtained by or given to the Bank by the independent third party; and
- (3) having entered into under the Interbank Transaction Master Agreement and are fair and reasonable to the Bank's shareholders and are consistent with the interests of the Bank's shareholders as a whole.

25 SIGNIFICANT EVENTS

As at 31 December 2005, the amount of pending litigation to which the Bank as a party was RMB 2.261 billion. The provision made to the liabilities on such litigation by the Bank was considered to be sufficient.

26 COMPLIANCE WITH THE CODE PROVISION IN THE CODE ON CORPORATE GOVERNANCE PRACTICES OF THE LISTING RULES

The Directors of the Bank confirm that in the year ended 31 December 2005, the Bank had been in compliance with the Code Provision in the Code on Corporate Governance Practices (the Code on Corporate Governance Practices being the "Code") set out in Appendix 14 of the Listing Rules. The Board has confirmed that the Audit Committee of the Board of the Bank had reviewed this Annual Result.

27 TAX RELIEF MATERIALS

The Bank was entitled to tax relief in accordance with the taxation policies based on performance, under which salary could be deducted before taxation. Please refer to the Notes to the Consolidated Financial Statement set out on section 12.

28 AUDITORS

The Bank's accounts prepared in accordance with International Financial Reporting Standards ("IFRS") were audited by PriceWaterhouseCoopers and the Bank's accounts prepared in accordance with PRC GAAP were audited by Deloitte Touche Tohmatsu. A resolution will be proposed at the forthcoming Annual General Meeting of the Bank for the reappointment of PriceWaterhouseCoopers and Deloitte Touche Tohmatsu as the Group's international and statutory auditors respectively for year 2006.

29 ANNUAL GENERAL MEETING

The 2005 Annual General Meeting will be held in 3/F., Shanghai Galaxy Hotel, No. 888 Zhongshan West Road, Shanghai, China on Thursday, 22 June, 2006. For more details, please refer to the Annual General Meeting notice set out on page 216.

30 PUBLICATION OF INFORMATION ON THE WEBSITE OF THE STOCK EXCHANGE

Information as required by Appendix 16 of the Listing Rules will be submitted to the Hong Kong Stock Exchange before the stipulated date and published on its website (www.hkex.com.hk) and the Bank's website (www.bankcomm.com).

By order of Board of Directors

Chairman



Jiang Chaoliang

Shanghai, the PRC
28 March, 2006



Striving for Global Connections



Report of the Board of Supervisors

1 DESCRIPTIONS OF THE MEETINGS OF THE BOARD OF SUPERVISORS AND ITS COMMITTEES

- (1) On 5 April 2005, the 6th Session of the 4th Board of Supervisors and the 2nd Session of the Nomination Committee and the Monitoring Committee were held in Shanghai. At the meeting, the Board of Supervisors passed unanimously the 2005 Work Plan of the Board of Supervisors and the Proposal on the Change of the Name of the Audit Committee of the Board of Supervisors and agreed to change the name of the Audit Committee to Monitoring Committee. At the meeting, the Committees passed the 2005 Work Plan of the Nomination Committee, the 2005 Work Plan of the Monitoring Committee and the 2005 Auditing Plan of the Monitoring Committee.

The supervisors attending the meetings reviewed the 2004 Report of Board of Directors, the 2004 President Report, the Proposals on the Final Accounts, Profit Distribution for 2004 and Financial Budget 2005, the 2004 Annual Report, the proposed measures regarding Connected Transactions Management, the Report on Risk Management for 2004 and 2005 Work Plan of Risk Management and the Summary of Comprehensive Risk Management for 2005-2007 during the 6th Session of the Board of Directors.

- (2) On 13 May 2005, the 7th Session of the 4th Board of Supervisors was held via written communications. At the meeting, the Board of Supervisors passed unanimously the 2004 Report of the Board of Supervisors and agreed to submit it to the General Meeting of shareholders.
- (3) On 29 June 2005, the 8th Session of the 4th Board of Supervisors and the 3rd Session of the Monitoring Committee were held in Shanghai. The Board of Supervisors passed unanimously the Measures on the Board of Supervisors Inquiries, discussed the training issues of the supervisors, was briefed by the office of the Board of Supervisors on Report on the Questionnaires on the Performance of the Directors, Supervisors and Senior Management, and by the finance department on the analysis of the Bank's operating condition during January to May. The 3rd Session of the Nomination Committee discussed the Opinion on the Introduction of Business Training in 2005 by the Board of Supervisors. At the 3rd Session, the Monitoring Committee was briefed by the audit department in respect of its internal control, risk elimination and the work of the department.
- (4) On 17 August 2005, the 9th Session of the 4th Board of Supervisors and the 4th Session of the Monitoring Committee were held in Shanghai and at those sessions, the 2005 Interim Report was considered and approved.

1 DESCRIPTIONS OF THE MEETINGS OF THE BOARD OF SUPERVISORS AND ITS COMMITTEES *(Continued)*

- (5) On 18 November 2005, the 10th Session of the 4th Board of Supervisors, the 4th Session of the Nomination Committee and the 5th Session of the Monitoring Committee were held in Shanghai. At the meeting, the Board of Supervisors agreed that Li Jun should replace Yin Baoyu as supervisor and passed the Resolution Relating to the Change of Certain Members of the Special Committee of the 4th Board of Supervisors, by which Li Jun, supervisor, replaced Yin Baoyu as member of the Nomination Committee and member of the Monitoring Committee of the 4th Board of Supervisors. The meeting also made inquiries to the senior management in respect of six aspects such as the overall condition of risk management, the impact of the change of special-mentioned loans which is of concern by the Board of Supervisors, market-oriented interest rate and the impact of reform of exchange rate on the Bank's future development. Mr. Peng Chun, Vice President of the Bank, made replies on behalf of the senior management. At the meeting, it was suggested that the senior management should strengthen its research activities on market risk avoidance instruments so as to timely eliminate and reduce the impact of changes of exchange rates on the Bank.

The scope of measures on risk tolerance should extend gradually from credit assets to non-credit assets and operating risk to ensure that comprehensive measures on risk control were in place. The Monitoring Committee also heard the report on the review of the Bank's financial statements for the first three quarters of 2005 from PricewaterhouseCoopers.

2 MAJOR SCOPE OF SUPERVISION OF THE BOARD OF SUPERVISORS

In 2005, the Board of Supervisors focused on adjusting its corporate governance structure and actively explored various means of supervision.

- (1) The Board of Supervisors reviewed the authenticity of the financial positions and operation indicators of 10 branches in Tiangin, Shanghai and Guangzhou and examined the granting of credits to corporate clients and securities management by Nanjin and Suzhou branch. More than 100 internal and external inspection reports were reviewed and analyzed and some regulatory recommendations were raised by the Board of Supervisors.
- (2) On 5 April, 2005, the Board of Supervisors conducted a survey on the performance of all directors, supervisors and senior management, a total of 30 people. It also submitted the Report on the Questionnaires on the Performance of the Directors and Senior Management of the Bank to the Chairman and senior management. The Board of Supervisors subsequently made its inquiries to the senior management about risk management on 18 November, 2005.

Report of the Board of Supervisors *(Continued)*

2 MAJOR SCOPE OF SUPERVISION OF THE BOARD OF SUPERVISORS *(Continued)*

- (3) The Board of Supervisors was briefed by the auditors about auditing on six occasions, discussed the nature of auditing and the main problems encountered, as well as supervised such auditing procedures.
- (4) Each supervisor also attended the board meetings for the current year and advised on the issues being presented at the meetings. The 2004 annual report, issues presented at the 2004 General Meeting and the 2005 Interim Report were all reviewed by the Board of Supervisors, which also reviewed and gave its advice on certain reports submitted by the senior management to the CBRC.

3 THE INDEPENDENT ADVICE PROVIDED BY THE BOARD OF SUPERVISORS ON RELATED MATTERS

(1) Compliance with law

During the reporting period, the Bank adhered to its legal operation, and strived to optimize its management scope by taking initiatives in accepting the opinions of regulatory bodies and domestic and overseas investors, as well as enhancing its transparency on information disclosure. The Bank strictly adopted its internal control measures. At the same time, the senior management carried out several internal controls, adopted risk elimination measures, and started to handle special cases in accordance with the instructions of the Central government and the CBRC. The Bank's decision-making procedures were legal and the directors and senior management performed their duties with trust and honesty. During the reporting period, no material breach of law and regulations or any actions against the interest of the Bank and the shareholders were found.

(2) Accuracy and Correctness of financial reports

These financial statements reflected the financial conditions and operating results of the Bank fairly and truly.

(3) Use of proceeds

During the reporting period, the Bank initially issued overseas listed shares, amounting to 6.734 billion shares (including 878 million shares under over-allotment) at the offer price of HK\$2.50 each. After deducting all related costs, the actual amount of net proceeds was RMB17.402 billion. Such proceeds were already received and the use of the proceeds was consistent with those set out in the Prospectus issued by the Bank.

3 THE INDEPENDENT ADVICE PROVIDED BY THE BOARD OF SUPERVISORS ON RELATED MATTERS *(Continued)*

(4) Acquisition and disposal of assets

During the reporting period, the Bank did not make any purchase or disposal of assets that could affect the shareholders' interest or result in a loss of assets.

(5) Connected transactions

During the reporting period, the Bank did not have any connected transactions that could damage the interest of the Bank or its shareholders.

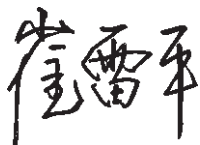
(6) Review of report

The financial condition and operating results of the Bank in 2005 as prepared by the auditors had been reviewed by the Board of Supervisors without opinion.

(7) The execution of resolutions passed in the General Meetings

The Board of Supervisors agreed with the reports and proposals which were submitted to the general meeting during the reporting period. The Board of Directors had effectively executed the resolutions made by shareholders.

By order of the Board of Supervisors

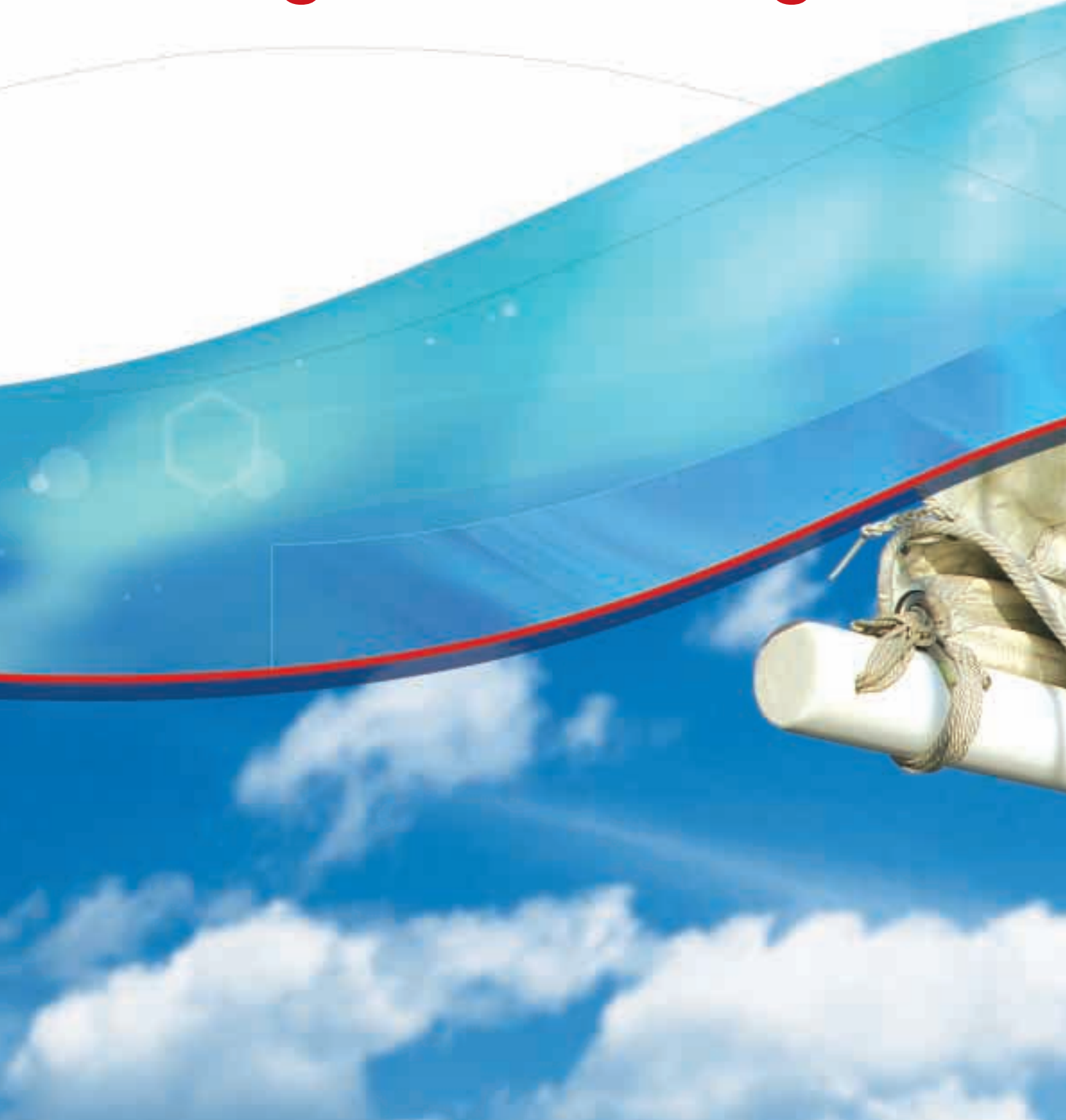


Cui Lei Ping
Chairman

Shanghai, the PRC
28 March, 2006



Solid Safeguards with Pragmatic Strategics



Corporate Governance Report

In 2005, the Bank has complied with the Code provisions in the Code set out in Appendix 14 of the Listing Rules, and endeavored to maintain corporate governance of a high standard, so as to continuously enhance its transparency and guarantee the interests of shareholders.

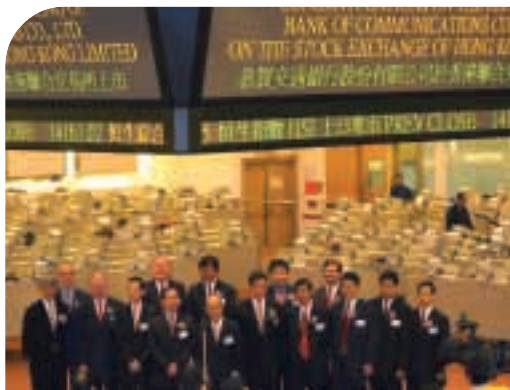
In accordance with the laws and regulations of the Company Laws of the People's Republic of China, the rules and guidelines issued by the domestic and overseas regulatory bodies, as well as the requirements under the Listing Rules and the Code provisions in the Code, the Bank has established an independent and modern corporate structure comprising shareholders' general meeting, the board of directors, the board of supervisors, and senior management to perform its check and balance functions. The Bank has also set up four special committees under the board of directors, including strategy committee, audit committee, risk management committee, and personnel & compensation committee. Two special committees under the board of supervisors are monitoring committee and nomination committee. Five special committees under the senior management include the asset and liabilities management, risk management, loans inspection, credit policies and financial review committees.

In 2005, the Bank committed to implementation of corporate governance policies and efficient and effective operations by adopting the best corporate standards of international public banks to guarantee the interest of shareholders and uplift the decision making power of the board of directors and the supervisory function of the board of supervisors. With the establishment of a long-term incentive plan, the Bank endeavored to enhance its operations and management level and to formulate a comprehensive regulatory system, so as to contribute a promising growth to the Bank.

1 GENERAL MEETING OF SHAREHOLDERS

General meeting of shareholders represents the core authority of a corporate governance structure of the Bank. The primary roles of general meetings include, but not limited to:

- Determining of business policy and investment plans;
- Electing directors and supervisors (except employee representatives), and determining of the remuneration of directors and supervisors;
- Considering and approving reports of the boards of directors and supervisors;
- Considering and approving annual budget, final accounts and profit distribution;
- Determining the size of registered capital and bond issuance;
- Revising of the Bank's articles of associations;
- Determining engagement, removal or non-renewal of the Bank's auditor.



1 GENERAL MEETING OF SHAREHOLDERS *(Continued)*

On 30 June 2005, the Bank's 2004 Annual General Meeting of Shareholders was held in Shanghai, China. There were in total 293 shareholders either present in person or by their proxies, representing a total of 38,323,597,606 shares and about 98.09% to the total number of shares as at the date of the register of the Bank, under the requirements of the Company Law of the People's Republic of China and the Articles of Associations of the Bank of Communications Co., Ltd.

At the meeting, shareholders considered and approved, by an open ballot, eight resolutions, namely the 2004 Report of Board of Directors, the 2004 Report of Board of Supervisors, the Proposals on the Final Accounts, Profit Distribution for 2004 and Financial Budget 2005, the Proposed Amendments to the Articles of Associations, the Proposal on the Adjustments of the Annual Remuneration of Independent Directors and External Supervisors, the Proposal on the Purchase of Liability Insurance Policy for Directors and Supervisors, the Proposal on the Change of Registered Address, and the Proposed Appointment of Herbert Hui Ho Ming and Chen Qingtai as Independent Directors.

Corporate Governance Report (Continued)

2 THE BOARD OF DIRECTORS

The Board of Directors comprised all directors and is the core power in the corporate governance structure of the Bank. The Board of Directors will report to the general meeting of shareholders and perform legally its primary duties in the following areas:

- Convening of shareholders' meetings, and reporting its work to shareholders at such meetings;
- Implementing of resolutions approved by shareholders;
- Determining of the Bank's business plans and investment proposals;
- Formulating of the Bank's dividend and bonus policy, and plans relating to capitalization; and
- Exercising any other powers conferred by shareholders meetings or under the Articles of Associations.

The Board currently comprises nineteen directors, four of whom are Executive Directors, ten are Non-executive Directors and five are Independent Non-executive Directors. The number of independent Non-executive Directors and their qualification comply with Rules 3.10 (1) and (2) of the Listing Rules. In addition, the Bank has received from each of the Independent Non-executive Directors an annual confirmation of his independence and considers each of them to be independent.

None of the Independent Non-executive Directors of the Bank has any interest in any business or financial interest of the Bank or its subsidiaries. Each of the Independent Non-executive Directors has confirmed to the Bank his independence and is not allowed to hold any administrative positions in the Bank. They owe also fiduciary duties to the Bank and its shareholders, in particular, they should protect the rights of minority shareholders. As a critical part in corporate governance, they play a significant role of "check and balance" during the decision-making process at board meetings. During the year 2005, Independent Non-executive Directors expressed their views and comments on various matters concerning the interest of the shareholders and the Bank as a whole at the board meetings.

Six meetings were held in 2005 of which four were physical meetings and two were by written communications. All these meetings were convened in accordance with the provisions of the Bank's Articles of Associations, individual attendance of directors is set forth as follows:

2 THE BOARD OF DIRECTORS *(Continued)*

Individual Attendance Rate of the Board Meetings during the Year 2005

| Directors | Number of Board meetings attended | Attendance rate (%) |
|--|-----------------------------------|---------------------|
| Executive Directors | | |
| Zhang Jianguo | 6/6 | 100% |
| Li Jun | 5/6 | 83.3% |
| Zhang Jixiang | 6/6 | 100% |
| Peng Chun <i>(Note 1)</i> | 2/2 | 100% |
| Qiao Wei <i>(Note 2)</i> | 2/3 | 66.7% |
| Non-executive Directors | | |
| Jiang Chaoliang | 5/6 | 83.3% |
| Hu Huating | 6/6 | 100% |
| William Fung Kwok Lun | 3/6 | 50% |
| Li Keping | 5/6 | 83.3% |
| Li Zexing | 6/6 | 100% |
| Gao Shiqing | 3/6 | 50% |
| Shen Weiming | 4/6 | 66.7% |
| Li Guanglin | 5/6 | 83.3% |
| Peter Wong Tung Shun <i>(Note 1)</i> | 1/2 | 50% |
| Qian Ping <i>(Note 1)</i> | 1/2 | 50% |
| Or Ching Fai <i>(Note 2)</i> | 2/3 | 66.7% |
| Li Ruge <i>(Note 2)</i> | 0/3 | 0% |
| Independent Non-executive Directors | | |
| Xie Qingjian | 6/6 | 100% |
| Ian Ramsay Wilson | 5/6 | 83.3% |
| Thomas Joseph Manning | 5/6 | 83.3% |
| Herbert Hui Ho Ming <i>(Note 3)</i> | 4/5 | 80% |
| Chen Qingtai <i>(Note 3)</i> | 3/5 | 60% |
| Average attendance rate | | 74.5% |

Notes:

1. Mr Peng Chun, Mr Peter Wong Tung Shun and Mr Qian Ping were appointed as the Bank's Directors on 22 August, 2005.
2. Mr Qiao Wei, Mr Or Ching Fai and Mr Li Ruge were resigned as the Bank's Directors on 1 August, 2005.
3. Mr Herbert Hui Ho Ming and Mr Chen Qingtai were appointed as the Bank's Independent Non-Executive Directors on 5 April, 2005.

Corporate Governance Report *(Continued)*

2 THE BOARD OF DIRECTORS *(Continued)*

Board Meetings and Major Resolutions

During the year under review, we held six board meetings in total, of which four were physical meeting and two were via written communications. Details are set out below:

- (1) On 5 April 2005, the 6th Session of the 4th Board of Directors was held in Shanghai. At the meeting, the Board considered and approved totally 14 resolutions, namely the 2004 Report of the Board of Directors, the President Report, the Proposals on the Final Accounts, Profit Distribution for 2004 and Financial Budget 2005, the 2004 Annual Report, the Proposed Appointment of Herbert Hui Ho Ming and Chen Qingtai as Independent Directors, the Proposal on Amendment to the Board Committees' Compositions, the Proposed Amendment to the Annual Remuneration of Independent Directors and External Supervisors, the Proposed Appointment of Dicky Peter Yip as the Executive Vice President, the Proposed Performance-based Incentive Program 2004 for Senior Executives, the Proposed Provisional Measures of the Performance-based Incentive Program for Senior Executives, the Proposed Measures regarding Connected Transactions management, the Proposal on the Purchase of Liability Insurance Policy for Directors and Supervisors, the Proposed Change of Registered Address, the Proposal on convening the 2004 Annual General Meeting of Shareholders.
- (2) On 8 May 2005, the 7th Session of the 4th Board of Directors was held via written communications, where the Board considered and approved two resolutions, namely the Proposal on confirming the time and venue of the 2004 Annual General Meeting of Shareholders with One Additional Agenda and the Proposed Amendments to the Articles of Association.

2 THE BOARD OF DIRECTORS *(Continued)*

Board Meetings and Major Resolutions *(Continued)*

- (3) On 31 May 2005, the 8th Session of the 4th Board of Directors was held in Shanghai. At the meeting, the Board considered and approved two resolutions, namely the Proposed Working Plan regarding the H-share Listing and the related issues and the Proposed Appointment of Wang Bin (王濱) as the Executive Vice President.
- (4) On 22 August 2005, the 9th Session of the 4th Board of Directors was held in Hong Kong. At the meeting, the Board considered and approved four resolutions, namely the Proposal on the 2005 Interim Report, the Proposed Appointment of Peng Chun, Peter Wong Tung Shun and Qian Ping as Directors, the Proposed Addition to Members of the Audit Committee of the Board and Proposal on the establishment of the Strategy Committee of the Board.
- (5) On 18 November 2005, the 10th Session of the 4th Board of Directors was held in Shanghai. At the meeting, the Board considered and approved seven resolutions, namely the Proposed 2005 Third Quarterly Report, the Proposal on the Implementation of the First Grant of SARS under the Long Term Incentive Plan, the Proposed Draft Rules of Procedures of Strategy Committee of the Board, the Proposed Amendment to the Rules of Procedures of Audit Committee of the Board, the Proposed Amendment to the Rules of Procedures of Risk Management Committee of the Board, the Proposed Amendment to the Rules of Procedures of Personnel and Compensation Committee of the Board and the Proposed Amendment to the Management of Disclosable Information.
- (6) On 26 December 2005, the 11th Session of the 4th Board of Directors was held via written communications, where the Board considered and approved two resolutions, namely the Proposal on Establishing Branches in Huhehot, Taizhou and Huizhou and the Proposed Acquisition of Wenzhou Taishun Jinxin Urban Credit Cooperative (溫州市泰順縣金鑫城市信用社) and the Establishment of Sub-branches in Rui An, Wen Zhou and Yue Qing, Wen Zhou.

All minutes of the meetings of the Board of the Directors were kept by the Secretary of the Board and delivered to directors for records.

Directors can seek independent professional opinions under appropriate circumstances. The related costs shall be paid by the Bank.

Corporate Governance Report (Continued)

2 THE BOARD OF DIRECTORS (Continued)

Financial Reporting

Senior management shall provide adequate and sufficient information to the Board, so as for them to make an informed view on the financial condition and additional information provided, which is subject for approval.

The Directors have confirmed they shall be responsible for preparing true and accurate financial statements of the Group for each financial year, and shall use their best endeavors to provide all shareholders with a well-balanced and understandable assessment on the current condition and future prospects of the Group when the quarterly, interim and annual financial statements and results announcements are delivered for approval. As far as were known to the Directors, there was no material uncertainty relation to any events or conditions that were considered to cause any material effect on the continuing operations of the Group.

The Directors have confirmed that they have the responsibilities to give a well-balanced, clear and understandable assessment on the annual and interim financial report and sensitive share prices movement announcements of the Bank as well as other financial disclosures required by the Listing Rules, and to report to the regulatory bodies.

Focus of the Board

- (1) *Successful listing of H shares.* The successful listing of H shares has embarked a historic development of the Bank, resulting in a sound foundation for the implementation of corporate governance structure, expanding the financing means, and enhancing value of the Bank.
- (2) *Active strategic transformation.* The Strategy Committee has been set up by the Board. This makes a good start of the Bank's transformation. Under the Board's leadership, the senior management has fully accomplished all the missions and operating targets for the year, with the best performance recorded in its operating history.
- (3) *Strengthening of the Bank's structure.* These measures comprise mainly decision-making formulation, continuous perfection on rules and regulations and streamlining the Group's structure, in order to fully capitalize the synergies created by various special committees in terms of policy-making and advisory. The decision-making capabilities of the Board were further reinforced accordingly.
- (4) *Increasing the Bank's transparency.* Adherence to the requirements of the regulatory bodies and the Listing Rules, the Bank has taken the initiatives to disclose its quarterly financial reports, build up investors' relationship and partnership, and maintain close communications with investors and analysts.
- (5) *Strengthening of risk management and internal control.* To set up and implement a system of regular analysis on risk management and internal control. An independent, effective and widely recognized system of internal control and risk prevention has been initially formed by the Bank, which has taken a leading position amongst other players in the industry.
- (6) *Continuous improvement on incentives system.* As a pioneer to implement a long-term incentive plan for senior management in the country, the Bank intends to enhance the quality of its performance-based incentive plan for senior management and shows its support for a performance-based plan focusing on economic interests and return on economic assets to be carried out among branches.

3 BOARD COMMITTEES

The Strategy Committee

The Strategy Committee is responsible for studying and formulating business strategies of the Bank, as well as assessing regularly the management of capital. It comprises five members, three of whom are executive directors namely Zhang Jianguo, Li Jun and Peng Chun, one is non-executive director Hu Huating, and the other is independent non-executive director Herbert Hui Ho Ming. Zhang Jianguo is the chairman of the Committee. In 2005, one meeting was held by the Committee to resolve the Proposed Draft Rules of Procedures of Strategy Committee of the Board and the Work Plan 2006 of the Strategy Committee.

Individual Attendance Rate of the Strategy Committee during the year of 2005

| Members | Number of meetings attended | Attendance rate (%) |
|-----------------------------------|------------------------------------|----------------------------|
| Zhang Jianguo (<i>Chairman</i>) | 1/1 | 100% |
| Li Jun | 1/1 | 100% |
| Peng Chun | 1/1 | 100% |
| Hu Huating | 1/1 | 100% |
| Herbert Hui Ho Ming | 0/1 | 0% |
| Average attendance rate | | 80% |

The Audit Committee

The Audit Committee is mainly responsible for reviewing and overseeing the Bank's financial reporting procedure. It also assists the Board in any matters in relation to appointment, remuneration and removal of auditor. The Committee evaluates the effectiveness of the Bank's internal control, including the undertaking of a regular internal review on the Bank's corporate governance practices and operational procedures, considers all potential risks prevailing to ensure a smooth operation, and fulfils the Bank's corporate objectives and strategies. The internal audit and review covers the areas in finance, operations, compliance requirements, and risk management. It also assesses the Bank's internal audit policy, reports regularly to the Board and gives recommendations accordingly.

Corporate Governance Report (Continued)

3 BOARD COMMITTEES (Continued)

The Audit Committee (Continued)

The Committee comprises five members, three of whom are independent non-executive directors namely Herbert Hui Ho Ming, Xie Qingjian, and Chen Qingtai, and two are non-executive directors namely Peter Wong Tung Shun and Li Zexing, and Mr. Herbert Hui Ho Ming is the Chairman.

In 2005, three meetings were held. On 4 April 2005, at the 3rd meeting, the Committee approved the Proposals on the Report of Final Accounts, Profit Distribution for 2004 and Financial Budget 2005 and the 2004 Annual Report. On 21 August 2005, at the 4th meeting, the Committee approved the 2005 Interim Report and the Report on the Operation of the Internal Control System during the first half year of 2005. On 17 November 2005, at the 5th meeting, the Committee approved the 2005 Thirdly Quarter Report, The (Revised) Rules of Procedures of Audit Committee, the 2006 Working Plan of the Audit Committee and Report of the Enhancement of the Internal Controls during the third quarter of 2005.

Individual Attendance Rate of the Audit Committee during the year of 2005

| Members | Number of meetings attended | Attendance rate (%) |
|--|------------------------------------|----------------------------|
| Herbert Hui Ho Ming <i>(Chairman) (Note 1)</i> | 2/2 | 100% |
| Xie Qingjian | 3/3 | 100% |
| Chen Qingtai <i>(Note 1)</i> | 1/2 | 50% |
| Peter Wong Tung Shun <i>(Note 2)</i> | 0/1 | 0% |
| Li Zexing <i>(Note 3)</i> | 2/2 | 100% |
| Average attendance rate | | 70% |

3 BOARD COMMITTEES *(Continued)*

The Audit Committee (Continued)

Notes:

1. Mr Herbert Hui Ho Ming and Mr Chen Qingtai were appointed as independent non-executive directors on 5 April 2005. On the same date, they were also appointed as members of the Audit Committee of the Board.
2. Mr Peter Wong Tung Shun was appointed as a non-executive director on 22 August 2005. On the same date, he was also appointed as a member of the Audit Committee of the Board.
3. Mr Li Zexing was appointed as a member of the Audit Committee of the Board on 5 April 2005.

In collaboration with senior management, the Audit Committee reviewed the accounting standards and practices adopted by the Bank and examined the internal controls and financial reporting policies, including reviewing the Bank's annual financial statements for the year 2004, condensed interim financial statements and annual financial statements for the year 2005.

The Risk Management Committee

The Risk Management Committee is responsible for monitoring and assessing risk management, as well as approving major connected transactions. It comprises four members, two of whom are independent non-executive directors namely Xie Qingjian and Ian Ramsay Wilson, and two are non-executive directors namely Li Keping and Gao Shiqing, and Mr. Xie Qingjian is the chairman.

In 2005, three meetings were held. On 4 April 2005, at the 3rd meeting, the Committee approved the 2004 Risk Management Report and its 2005 Working Plan, and the Outline of Comprehensive Risk Management 2005-2007. On 21 August 2005, at the 4th meeting, the Committee approved the Report of Risk Management Evaluation during the first half year of 2005. On 17 November 2005, the Committee issued a written approval for the Revised Rules of Procedures of Risk Management Committee, the 2006 Working Plan of the Risk Management Committee, the Report of the Risk Forbearance and the Report of Risk Management Evaluation during the third quarter of 2005".

Corporate Governance Report (Continued)

3 BOARD COMMITTEES (Continued)

The Risk Management Committee (Continued)

Individual Attendance Rate of the Risk Management Committee during the year of 2005

| Members | Number of meetings attended | Attendance rate (%) |
|--------------------------------|------------------------------------|----------------------------|
| Xie Qingjian <i>(Chairman)</i> | 3/3 | 100% |
| Ian Ramsay Wilson | 2/3 | 66.7% |
| Li Keping | 3/3 | 100% |
| Gao Shiqing | 2/3 | 66.7% |
| Average attendance rate | | 83.3% |

The Personnel and Compensation Committee

The Personnel and Compensation Committee is primarily responsible for proposing the nomination of directors and senior management to be considered by the Board, and advising the Bank's remuneration policy for directors and senior management. The Committee also evaluates performance of senior management and determines their remuneration packages. The Committee comprises four members: two are independent non-executive directors namely Thomas Joseph Manning and Chen Qingtai, and two are non-executive directors namely Hu Huating and William Fung Kwok Lun, and Mr. Thomas Joseph Manning is the chairman.

In 2005, two meetings were held. On 4 April 2005, at the 3rd meeting, the Committee approved the Report of the Proposed Appointment of Herbert Hui Ho Ming and Chen Qingtai as Independent Non-executive Directors, the Proposed Amendment to the Remuneration Policy of Independent Directors and External Supervisors, the Report of the Proposed Appointment of Dicky Peter Yip as the Executive Vice President, the Draft Performance-based Incentive Program 2004 for Senior Executives, and the Draft Proposal on the Provisional Measures of the Performance-based Incentive Program for Senior Executives. On 17 November 2005, at the 4th meeting, the Committee approved the Proposal on the Execution of the First Grant of SARS under the Long Term Incentive Plan, the Revised Rules of Procedures of Risk Management Committee, the 2006 Working Plan of the Personnel and Compensation Committee and the Report of the Human Resources Management Reform Update. In addition, the Committee issued a written approval for the Proposed Appointment of Wang Bin (王濱) as the Executive Vice President and the Proposed Appointment of Peng Chun, Peter Wong Tung Shun and Qian Ping as Directors.

3 BOARD COMMITTEES *(Continued)*

The Personnel and Compensation Committee (Continued)

Individual Attendance Rate of the Personnel and Compensation Committee during the year of 2005

| Members | Number of meetings attended | Attendance rate (%) |
|---|-----------------------------|---------------------|
| Thomas Joseph Manning <i>(Chairman)</i> | 2/2 | 100% |
| Chen Qingtai <i>(Note 1)</i> | 1/1 | 100% |
| Hu Huating | 2/2 | 100% |
| William Fung Kwok Lun | 1/2 | 50% |
| Average attendance rate | | 87.5% |

Note 1: Mr Chen Qingtai was appointed as the Bank's independent non-executive director on 5 April 2005. On the same date, he was also appointed as a member of the Personnel and Compensation Committee of the Board.

4 BOARD OF SUPERVISORS

The Board of Supervisors' major duties and powers include:

- Approving financial reports and other financial information compiled by the Board of Directors which are to be presented at shareholders meetings;
- Examining and reviewing the Bank's financial results; and
- Reviewing and monitoring of compliance with laws, administrative regulations and its Articles of Associations

The Board of Supervisors currently comprises nine members, two of whom are external supervisors. Monitoring Committee and Nomination Committee are established under the Board of Supervisors.

For details about the Board of Supervisors and its committees, please refer to section 7 "Report of the Board of Supervisors" of the annual report.

Corporate Governance Report (Continued)

5 SENIOR MANAGEMENT

Senior management consists mainly of the President, Executive Vice-president, Chief Financial Officer and Chief Information Officer. The President is accountable to the Board of Directors, whereas all senior executives from different departments and branch offices report directly to the President. Pursuant to the laws and regulations, the Articles of Associations and the authority granted by the Board, the President is able to operate and manage all affairs of the Company, including the powers to:

- oversee and manage daily operation, as well as report to the Board of Directors;
- implement resolutions approved by shareholders meetings and the Board;
- draft annual business and investment plans, annual budget estimates, final accounts, profit appropriations plans and others;
- appoint and remove department heads and branch officers, other than those who should be appointed or removed by the Board.

All members of the senior management have accumulated extensive expertise in banking, with 20 years of experience in average. They have a vision for globalization. In 2005, a dedicated employee of the HSBC, Dicky Peter Yip, joined the Bank as Executive Vice President. Wang Bin(王濱) was also appointed as Executive Vice President to enhance the competitiveness of the senior management team.

6 RULES AND REGULATIONS

As a crucial element to corporate governance, the Bank continued to focus on the establishment and consolidation of rules and regulations during 2005. Significant improvements had been achieved as follows:

Firstly, five regulations and rules were revised and modified, namely the Articles of Associations, the Rules of Procedures of Audit Committee of the Board of Directors, the Rules of Procedures of Risk Management Committee of the Board of Directors and the Rules of Procedures of Personnel and Compensation Committee of the Board of Directors, and the Measures for Information Disclosure Management.

6 RULES AND REGULATIONS *(Continued)*

Secondly, eleven new regulations and rules were developed respectively: the Rules of Procedures of the Board of Supervisors, the Rules of Procedures of Strategy Committee of the Board of Directors, the Rules of Procedures of Supervisory Committee of the Board of Supervisors, the Rules of Procedures of Nomination Committee of the Board of Supervisors, the Provisional Measures of Investor Relations Management, the Measures of Connected Transactions Management, the Measures of Internal Reporting on Major Disclosable Information, certain regulations in relation to disclosure of price-sensitive information, the Measures of Information and Archive Management, the Procedures and Measures of Selection and Election of Supervisors, the Measures of Interrogation of the Board of Supervisors.

Thirdly, to ensure all fundamental work procedures are lawful and effective, eight new regulations and rules were developed, namely the Regulations of Procedures of Planning and Arranging General Meetings of Shareholders, the Regulations of Procedures of Planning and Arranging Meetings of the Board and its Committees, the Regulations of Documentation Management of Regular Meetings of the Board, the Regulations of Regular Performance Presentations, the Rules of Daily Operations of Investor Relations Management, the Codes of Conduct for Investor Relations Management, the Conference Rules of Investor Relations Management System and the Regulations of Information Disclosure.

The above rules and regulations laid critical foundations for the Bank's corporate governance.

Corporate Governance Report (Continued)

7 INTERNAL CONTROL

During the Year, the Board of Directors has conducted review of the effectiveness of the system of internal control of the Bank each quarter during the year.

Under the direct leadership of the President of the Bank, the audit department is responsible for overseeing and assessing the internal control procedures of the Bank and to review its operations. It has the power to determine the number and scope of internal control reviews to the Bank's operations, and to make an independent review and estimate of any possible substantial risks or internal control procedures of any departments, in particular, on the following aspects:

- compliance with applicable laws and regulations;
- compliance with the internal policies or guidelines of the Bank and their validity;
- effectiveness of the risk management (including lending business management) and the accounting system;
- safety of the information technology system of the Bank;
- efficiency, applicability and effectiveness of the internal control procedures adopted by the Bank. The audit department takes all follow-up actions, and implement supervisory and remedial measures on any problems found, so as to enhance its risk prevention level.

The audit department reviews the financial and operating results, credit risk management, accounting issues, technology application and internal controls of the Bank every year, including internal audits on various branches and subsidiaries. In addition, the audit department also makes special reviews on any new issues. These reviews comprise internal and external audits.

The Bank has established a three-level framework, which includes audit department, regional audit department and branch audit department, operating independently with other departments.

8 LONG TERM INCENTIVE PLAN (SHARE APPRECIATION RIGHTS)

On 18 November 2005, the Board resolved to grant certain SARS under the Long Term Incentive Plan, to attract and retain quality staff of high caliber, and to encourage senior management to pursue long-term benefits for both shareholders and the Bank. The approval echoed the resolution made at the 2004 second extraordinary general meeting of shareholders, as well as that made previously by the Board concerning the adoption of SARS.

8 LONG TERM INCENTIVE PLAN (SHARE APPRECIATION RIGHTS)

(Continued)

According to the resolution, the initial grant of SARS targeted at senior executives of the head office as at 23 June 2005. The exercise price of each SARS is HK\$2.5, being the issue price of the H share at the time of its initial public offering (“IPO”). The amount of the initial grant of the SARS will be 7.5 million shares, representing approximately 0.11% of the total number of shares issued by the Bank upon listing. The SARS will be valid for a period of ten years from 23 June 2005, with a two-year vesting period.

The initial grant of SARS as a long-term incentive specifically for the senior executives of the head office is the first step of the entire Incentive Plan. Under the request from the Board, senior management should proactively develop and implement long-term incentive plans for key and other staff with thorough thought of both employees’ benefits and the Bank’s long-term development.

9 EQUITY TRANSACTIONS OF DIRECTORS

The Bank adopted the Model Code as set out in Appendix 10 of the Listing Rules, as the code of practice regarding its directors’ equity transactions. Based on the specific requests made to the Bank’s directors, all directors have complied with the required standards of the Model Code for the year under review.

The Board will revise from time to time the Bank’s corporate governance practices and operations, and observe relevant regulations of the Listing Rules to guarantee the rights and interest of shareholders.

10 AUDIT FEE

The Bank’s annual financial statements prepared in accordance with IFRS for the year 2005 were audited by PricewaterhouseCoopers and the Bank’s annual financial statements prepared in accordance with PRC GAAP were audited by Deloitte Touche Tohmatsu, at a total audit fee of RMB 38.0562 million. The statement of PricewaterhouseCoopers’ reporting responsibilities was set out on page 81 of the Auditor’s Report.

The Bank incurred a fee of RMB 2.8298 million for non-audit services provided by PricewaterhouseCoopers in 2005. Such non-audit services comprised:

Training services on IFRS amounted to RMB 1.3931 million;

Japanese translation services required for the interim and annual report in 2005 amounted to RMB292,400;

Listed bank simulation management training amounted to RMB 1.1443 million.

Investor Relations Management

1 OBJECTIVES

The Bank's investor relations aims to establish a platform of communication and exchange information between the Bank and investors and prospective investors through information disclosure and various ways in order to enhance the transparency of disclosure, that information is completely, accurately and timely delivered to the group of investors, increase investors' understanding and recognition of the Bank, increase the level of corporate governance, optimize shareholders' benefits and guarantee investors' legal interests.

2 INFRASTRUCTURE

The Bank has rapidly established a leading team of investor relations management after its successful listing. The leading team of investor relations management comprises the Chairman (team leader) and the senior management. It is responsible for stipulating the direction, policies, strategies and objectives of investor relations management. The Bank has formed a department specialized in the function of investor relations and established good internal coordination mechanism and information collection system.

In order to attain a higher standard of investor relations management, the Bank has stipulated and implemented a series of rule systems and operation procedures such as the Administrative Measures on Investor Relations, the Administrative Measures on Information Disclosure and the Rules on the Daily Tasks of Investor Relations Management based on the best practice standards and success stories of international public banks.

A healthy leading team system, a good coordination mechanism as well as organized rule systems and operation guidelines enable the Bank's investor relations team to move onto the right track within a short period and lay a solid foundation for the further enhancement of investor relations in the future.

3 REVIEW OF THE ACTIVITIES OF INVESTOR RELATIONS FOR 2005

As the first bank of mainland China listed in Hong Kong, the Bank is committed to showing the situation of China's economic development and the progress of financial reform to investors, to demonstrate the development prospect of China's banking sector and the Bank's competitive edges as well as its continuous improvement in such aspects as risk management and operation mechanism, and to enhance investors' understanding and recognition of China's banking sector and the Bank through such methods as road shows, investor promotional seminars and forums, ordinary meetings with investors and teleconferencing. The Bank's investor hotline and email mailbox maintain a relatively high rate of answer and reply as well as provide timely feedback to investors' requests; the Bank also improves and continues to keep an effective network of investor relations with the aim to provide more updated information sources to investors. The Bank's investor relations is widely recognized by international investment sector and numerous investors, and has been awarded the Best Investor Relations (IPO) for the region of Hong Kong and Taiwan by the authoritative international magazine Investor Relations in 2005.

4 FUTURE PROSPECTS

Looking ahead, the Bank will continue to improve further the means of communication and information exchange with investors, strengthen its measures on information disclosure pursuant to the requirements of investors to serve them better, as well as to increase investors' understanding of the Bank's operation and management. At the same time, the Bank also hopes to gain investors' continued support so as to enhance its operation and management capabilities, thus bringing sustainable and stable added value to investors.



United for Success



Management Discussion and Analysis

1. OPERATION OVERVIEW

Successful listing of the Group in 2005.

On 23 June 2005, the Group was successfully listed on the Main Board of the Hong Kong Stock Exchange and became the first international public listed bank in the PRC. Following the completion of the listing, reforms in respect of corporate governance, organizational structure, risk management and human resources management were proved to be effective.

The Group proactively responded to market changes, speeded up business development and focused on risk management, achieving satisfactory operating results in 2005.

As of the end of the reporting period, the Group's total assets amounted to RMB1,423.4 billion, representing an increase of 24.43% as compared with last year;

The Group's net profit amounted to RMB9.249 billion, representing an increase of 476.62% as compared with last year, and is 17.46% above the forecasted figure of RMB7.874 billion in the prospectus;

ROAA and ROAE reached 0.72% and 13.68% respectively;

Compared with the beginning of the year, impaired loan ratio accounted for 2.80%, which represented a decrease of 0.20 percentage point;

Provision coverage was 58.39%, which represented an increase of 14.38 percentage points;

CAR and Tier-1 CAR were 11.20% and 8.78%, which represented an increase of 1.48 percentage points and 2.01 percentage points respectively.

The effectiveness of strategic transformation was demonstrated with the constant optimization of the Group's operations.



1. OPERATION OVERVIEW *(Continued)*

As of the end of the reporting period, individual deposits balance increased by RMB66.817 billion, while individual loans balance also increased by RMB18.276 billion. Income from retail business reached RMB6.282 billion, accounted for 11.70% of total revenue and 1.60 percentage points up from the corresponding period of last year.

Net fee and commission income amounted to RMB2.109 billion, accounted for 6.00% of operating income. Among the RMB2.109 billion, net fee and commission income from bank cards amounted to RMB808 million, representing an increase of 24.12%. The underwriting business for short-term corporate bonds was doing well. Four short-term corporate bonds were issued by the Group with a total issue amount of RMB13.750 billion, accounting for approximately 10% of the market share.

The credit cards business unit under the cooperation with HSBC also operated well, and 657,000 dual-currency credit cards were issued.

The Group took an active approach in expanding its scope and line of business.

With the approval of the regulatory authorities, the Group was among the first group of banks which were in the list of market makers of the inter-bank foreign exchange market in the PRC and was licensed to carry out offshore guarantee business and wealth management of domestic and foreign currencies. We became one of the commercial banks which were granted approval to provide external financing guarantee for overseas investment enterprises following the Bank of China.

With the focus on global financial market, a new branch was established in Seoul, Korea and it commenced business on 18 August 2005.

Management Discussion and Analysis (Continued)

1. OPERATION OVERVIEW (Continued)

The integration of operation was making progress with the establishment of the Bank of Communications & Schroders Fund Management Co. Ltd. The company was duly set up on 12 August 2005 and has successfully launched its first fund product.

Our work has been widely recognized by the community.

The CBRC upgraded the supervisory rating of the Group.

International rating institutions, such as Standard & Poor's upgraded the Group's credit rating.

The Group was awarded "**The Best Transactions Award in China Region 2005**" and the "**Best Commercial Bank in China 2005**" in various assessments by international authoritative organizations and renowned financial media.

2. FINANCIAL RESULTS

The Group achieved a steady growth in profitability. During the reporting period, the Group's operating profit before tax amounted to RMB12.843 billion, representing an increase of RMB5.093 billion or 65.72% as compared with last year. Net profit amounted to RMB9.249 billion, representing an increase of RMB7.645 billion as compared with last year. Cost to income ratio was 51.24%, down by 9.54 percentage points as compared to last year. Net interest spread was 2.58%, representing a decrease of 3 basis points compared to last year. Net interest margin was 2.64%, representing an increase of 5 basis points compared to last year. Return on total asset was 0.65%, representing an increase of 0.51 percentage point compared to last year. Return on shareholders' equity was 11.13%, representing an increase of 8.05 percentage points as compared with last year.

(1) Profits

The principal sources of profits included: (1) net interest income of RMB31.591 billion, representing an increase of 25.40% as compared with last year; (2) non-interest income of RMB4.452 billion (excluding exchange losses of RMB890 million resulting from the appreciation of the RMB), representing an increase of 61.01% compared with last year, and non-interest income accounted for 12.35% of the revenue, representing an increase of 2.46 percentage points; (3) other operating expenses of RMB18.012 billion, representing an increase of 6.00% compared with last year, but was 19.74 percentage points lower than the growth rate of income.

2. FINANCIAL RESULTS *(Continued)*

(1) Profits *(Continued)*

The table below shows certain details of the Group's sources of profits as of the dates indicated:

| | 31 December 2005 Amount | 31 December 2004 Amount |
|---|--|-------------------------------|
| (in millions of RMB) | | |
| Net interest income | 31,591 | 25,192 |
| Non-interest income | 3,562 | 2,765 |
| Impairment losses on loans and advances | (4,298) | (3,215) |
| Other operating expenses | (18,012) | (16,992) |
| Operating profit before tax | 12,843 | 7,750 |

Segmental operating results by geographical segments

A geographical segment means a specific economical environment which generates risks and returns that are different from other economical environments in which the Group operates. The Group's primary sources of net profit are from Eastern China and Northern China, with an aggregate profit of RMB7.947 billion, which accounted for 85.98% of the Group's net profit.

The table below sets forth the net profit and total revenue from each of the Group's geographical segments for the dates indicated:

| | 31 December 2005 | | 31 December 2004 | |
|---|-------------------------|------------------------------|------------------|------------------------|
| | Total | | Total | |
| | Net profit | revenue⁽¹⁾ | Net profit | revenue ⁽¹⁾ |
| (in millions of RMB) | | | | |
| Northern China ⁽²⁾ | 2,122 | 8,880 | 715 | 6,549 |
| Northeastern China ⁽³⁾ | (547) | 4,174 | (851) | 3,541 |
| Eastern China ⁽⁴⁾ | 5,825 | 28,382 | 376 | 21,111 |
| Central and Southern China ⁽⁵⁾ | 1,076 | 9,954 | 1,475 | 8,117 |
| Western China ⁽⁶⁾ | (377) | 4,514 | (214) | 3,844 |
| Overseas ⁽⁷⁾ | 1,144 | 4,206 | 103 | 2,674 |
| Eliminations | – | (6,433) | – | (4,398) |
| Total⁽⁸⁾ | 9,243 | 53,677 | 1,604 | 41,438 |

Management Discussion and Analysis (Continued)

2. FINANCIAL RESULTS (Continued)

(1) Profits (Continued)

Segmental operating results by geographical segments (Continued)

- (1) Including interest income, fee and commission income, dividend income, gains less losses arising from trading activities, gains less losses arising from de-recognition of investment securities and other operating income.
- (2) Including Beijing Municipality, Tianjin Municipality, Hebei Province, Shanxi Province and Inner Mongolia Autonomous Region.
- (3) Including Liaoning Province, Jilin Province and Heilongjiang Province.
- (4) Including Shanghai Municipality, Jiangsu Province, Zhejiang Province, Anhui Province, Fujian Province, Jiangxi Province and Shandong Province.
- (5) Including Henan Province, Hunan Province, Hubei Province, Guangdong Province, Guangxi Autonomous Region and Hainan Province.
- (6) Including Chongqing Municipality, Sichuan Province, Guizhou Province, Yunnan Province, Tibet Autonomous Region, Shaanxi Province, Gansu Province, Qinghai Province, Ningxia Autonomous Region and Xinjiang Autonomous Region.
- (7) Including Hong Kong, New York, Singapore, Tokyo and Seoul.
- (8) Including minority interests.

Segmental operating results by business segments

The Group's business is mainly divided into four segments: corporate banking, retail banking, treasury and others. Our corporate banking segment was still the principal source of profit for our business, while the contribution from retail banking segments recorded significant growth. The table below sets forth the operating results of each of the Bank's business segments for the dates indicated:

| | Total revenue from external customers ⁽¹⁾ | | Operating profit before tax |
|-------------------|---|---------------------|-------------------------------------|
| | 31 December 2005 | 31 December 2004 | 1 October to 31 December 2005 |
| Corporate banking | 33,248 | 26,226 | 2,276 |
| Retail banking | 6,282 | 4,187 | 1,024 |
| Treasury | 13,323 | 10,324 | 649 |
| Others | 824 | 701 | (1,291) |
| Total | 53,677 | 41,438 | 2,658 |

(in millions of RMB)

- (1) Including interest income, fee and commission income, dividend income, gains less losses arising from trading activities, gains less losses arising from de-recognition of investment securities and other operating income.

2. FINANCIAL RESULTS *(Continued)*

(2) Net interest income

Net interest income amounted to RMB31.591 billion, representing an increase of RMB6.399 billion and an increase of 25.40% as compared with last year.

The table below sets forth the principal components of the Group's interest income, interest expense and the associated net interest margin and net interest spread, for the dates indicated:

| | As of 31 December | |
|---|---|-------------|
| | 2005 | 2004 |
| | (in millions of RMB, except percentages) | |
| Interest Income | | |
| Balances with central banks | 1,815 | 1,855 |
| Due from other banks and financial institutions | 3,375 | 2,231 |
| Trading securities | 9 | 6 |
| Loans and advances to customers | 36,305 | 28,287 |
| Investment securities | 8,114 | 5,885 |
| Others | 62 | 88 |
| Total interest income | 49,680 | 38,352 |
| Interest expense | | |
| Due to other banks and financial institutions | (1,548) | (1,129) |
| Due to customers | (16,541) | (12,031) |
| Total interest expense | (18,089) | (13,160) |
| Net interest income | 31,591 | 25,192 |
| Net interest spread ⁽¹⁾ | 2.58% | 2.61% |
| Net interest margin ⁽²⁾ | 2.64% | 2.59% |

⁽¹⁾ This represents the difference between the average yield on the Group's total average interest-earning assets and the average cost of total average interest-bearing liabilities.

⁽²⁾ This represents the ratio of net interest income to the average interest-earning assets.

The Group's net interest income was affected by the difference between the yields on the Group's interest-earning assets and the cost of the Group's interest-bearing liabilities, as well as the average volumes of these assets and liabilities. The average interest-earning assets increased by RMB227.585 billion as compared with last year and net interest spread decreased by 3 basis points to 2.58%. The decrease of net interest spread was mainly due to: (1) the impact of the "free currency, tight credit" macro environment, under which interest income was affected by the reduction in interest rate in the money market; and (2) the increase in the percentage of time deposits which brought up the cost of interest-bearing liabilities in the Group.

Management Discussion and Analysis (Continued)

2. FINANCIAL RESULTS (Continued)

(2) Net interest income (Continued)

The net interest margin increased by 5 basis points and reached 2.64%. This was primarily due to the Group's active adjustment by its assets and liabilities structure in response to the adverse impact imposed by the market's capital sufficiency on interest spread. Average loan deposit ratio grew significantly, and it brought up the net interest margin as well as the net interest income of the Group to a certain extent.

The table below shows the average daily balance and interest rates of our interest-earning assets and interest-bearing liabilities for the period indicated:

| | As of 31 December | | | | | |
|---|---|---|----------------------------|----------------------------|---|-----------------------|
| | 2005 Average balance ⁽¹⁾ | 2005 Interest income (expense) | Average yield (cost) | 2004 Average balance | 2004 Interest income (expense) | Average yield/cost |
| Assets | | | | | | |
| Cash and balances with central banks | 125,179 | 1,815 | 1.45% | 111,863 | 1,855 | 1.66% |
| Due from other banks and financial institutions | 112,776 | 3,375 | 2.99% | 98,115 | 2,231 | 2.27% |
| Loans and advances to customers | 694,903 | 36,305 | 5.22% | 572,411 | 28,287 | 4.94% |
| Investment securities and others | 265,921 | 8,185 | 3.08% | 188,807 | 5,979 | 3.17% |
| Total interest earning assets | 1,198,779 | 49,680 | 4.14% | 971,195 | 38,352 | 3.95% |
| Non interest earning assets | 50,988 | | | 58,759 | | |
| Total assets | 1,249,767 | | | 1,029,954 | | |
| Liabilities and Shareholders' equity | | | | | | |
| Due to customers | 1,095,578 | 16,541 | 1.51% | 936,230 | 12,031 | 1.29% |
| Due to other banks and financial institutions | 51,793 | 991 | 1.91% | 37,532 | 854 | 2.28% |
| Subordinated term debt | 12,210 | 557 | 4.56% | 6,117 | 275 | 4.50% |
| Total interest bearing liabilities | 1,159,581 | 18,089 | 1.56% | 979,879 | 13,160 | 1.34% |
| Shareholders' equity and non interest bearing liabilities | 90,186 | | | 50,075 | | |
| Total liabilities and shareholders' equity | 1,249,767 | | | 1,029,954 | | |

⁽¹⁾ Daily average balance calculated in accordance with the PRC GAAP and adjusted in accordance with IFRS.

2. FINANCIAL RESULTS *(Continued)*

(2) Net interest income *(Continued)*

The table below shows the changes in the Group's interest income and interest expense due to changes in volume and rates. Volume and rate variance have been calculated based on movements in average balances over these periods and changes in interest rates on interest-earning assets and interest-bearing liabilities.

| | 2005 vs. 2004 | | | 2004 vs. 2003 | | |
|---|----------------------------|---------------|------------------------------|----------------------------|---------------|------------------------------|
| | Increase/(decrease) due to | | Net | Increase/(decrease) due to | | Net |
| | Volume | Interest rate | Interest increase/(decrease) | Volume | Interest rate | Interest increase/(decrease) |
| | (in millions of RMB) | | | | | |
| Interest-Earning Assets | | | | | | |
| Cash and balances with central banks | 221 | (261) | (40) | 450 | (96) | 354 |
| Due from other banks and financial institutions | 333 | 811 | 1,144 | 86 | 130 | 215 |
| Loans and advances to customers | 6,053 | 1,965 | 8,018 | 5,465 | 647 | 6,113 |
| Investment securities and other interest-earning assets | 2,442 | (236) | 2,206 | 1,797 | (106) | 1,691 |
| Change in interest income | 9,049 | 2,279 | 11,328 | 7,798 | 575 | 8,373 |
| Interest-Bearing Liabilities | | | | | | |
| Due to customers | 2,048 | 2,462 | 4,510 | 2,365 | (50) | 2,315 |
| Due to other banks and financial institutions | 325 | (188) | 137 | 136 | 130 | 266 |
| Subordinated term debts | 274 | 8 | 282 | 275 | – | 275 |
| Changes in interest expenses | 2,647 | 2,282 | 4,929 | 2,776 | 80 | 2,855 |

Management Discussion and Analysis *(Continued)*

2. FINANCIAL RESULTS *(Continued)*

(3) Non-interest income

As of 31 December 2005, our non-interest income was RMB4.452 billion (excluding exchange losses of RMB890 million due to the appreciation of the RMB), representing an increase of RMB1.687 billion or 61.01% compared with last year.

Among the non-interest income, the Group's net fee and commission income was RMB2.109 billion, representing an increase of RMB434 million and 25.91% compared with last year. This increase was primarily due to the following reasons: (i) the Pacific Card business recorded simultaneous increase in card issuance and consumption per card, giving rise to an increase in the card business income. (ii) the Group's asset custody business recorded good results despite the relatively depressing Chinese securities market. As of 31 December 2005, the investment custody accounts increased by 35.15% as compared with last year, and the custodian fee income increased by 16% as compared with last year.

The Group's gains less losses arising from trading activities (excluding exchange loss of RMB890 million due to the appreciation of the RMB) were RMB1.310 billion, representing an increase of RMB985 million or 303.08% compared to last year. The Group's gains less losses arising from de-recognition of investment securities was RMB359 million, representing an increase of RMB282 million or 366.23% compared to last year. This was mainly due to the profit gained from the sale of investment securities as a result of active trading in securities and the fall in market interest rate.

(4) Other operating expenses

As of 31 December 2005, the other operating expenses of the Group were RMB18.012 billion, representing an increase of RMB1.020 billion or 6.00% compared to last year. The increase was mainly due to an increase in regulator's supervision fee, staff costs, business tax and surcharges, among which (i) regulator's supervision fee was RMB259 million, representing an increase of RMB74 million or 40.00% compared to last year. (ii) the staff costs (including salaries and bonuses, pension costs, housing benefits and subsidies and other social security and benefit costs) were RMB5.776 billion, representing an increase of RMB1.116 billion or 23.95% compared to last year. (iii) business tax and surcharges were RMB2.109 billion, representing an increase of RMB470 million or 28.68% compared to last year.

2. FINANCIAL RESULTS *(Continued)*

(4) Other operating expenses *(Continued)*

Our cost to income ratio decreased significantly from 60.78% to 51.24% as of the end of the reporting period, representing a decrease of 9.54 percentage points compared to last year. This decrease was mainly due to a substantial increase in operating income by 25.74%, which exceeded the increase in operating expenses of 6.00%. A series of cost control measures brought good results.

(5) Impairment losses on loans and advances

The Group's impairment losses on loans and advances consisted of impairment losses on impaired loans and advances to customers, less recovery of loans previously written off, and impairment losses on amounts due from other banks and financial institutions and securities purchased under resale agreements.

The impairment losses on loans and advances increased from RMB3.215 billion for last year to RMB4.298 billion as of the end of the reporting period.

(6) Income tax

The table below shows a breakdown of the Group's current tax and deferred tax for the period indicated:

| | As of 31 December | |
|--------------|----------------------|-------|
| | 2005 | 2004 |
| | (in millions of RMB) | |
| Current tax | 927 | 221 |
| Deferred tax | 2,673 | 5,925 |

For the periods ended 31 December 2005, the Group and its subsidiaries, which were established in the PRC, subject to the PRC statutory tax rate of 33%. The Group's Hong Kong branch and the subsidiaries, which were established in Hong Kong, subject to Hong Kong tax rate of 17.5% for the year ended 31 December 2005. The Group's other overseas branches is subject to the income tax rates of the respective jurisdictions where they are located.

Management Discussion and Analysis (Continued)

3. ASSETS

The Group's total assets as of 31 December 2005 were RMB1,423.4 billion, representing an increase of 24.43% from RMB1,144.0 billion for last year. The four principal components of our assets were loans and advances to customers, investment securities, due from other banks and financial institutions, and cash and balances with central banks, representing 53.31%, 22.08%, 11.95% and 9.86% respectively of the Group's total assets.

(1) Loan business

As of the end of the reporting period, our overall risk management strategy had been steadily implemented. The Credit Approval Centers in five regions were established successively, marking a critical step forward in establishing an independent, vertical and professional credit approval system. Under its risk control, the Group managed to maintain a moderate growth in its loan business and the loans/deposits ratio was 63.45% (excluding any interest receivable and payable), up by 1.03 percentage points from the beginning of last year. Among such loans, corporate loans had a net increase of RMB95.600 billion or 18.78% as compared with the beginning of the Year and accounted for 78% of loans, representing a decrease of 2 percentage points as compared with the beginning of the Year. Individual loans had a net increase of RMB18.276 billion or 21.31% as compared with the beginning of the Year and accounted for 14% of loans, representing an increase of 1 percentage point as compared with the beginning of the Year. The discounted bills business had a net increase of RMB16.880 billion or 38.37% and accounted for 8% of loans, representing an increase of 1 percentage point as compared with the beginning of the Year.

3. ASSETS *(Continued)*

(1) Loan business *(Continued)*

(i) Loan concentration by industries

Our corporate loan portfolio spanned a wide spectrum of industries, relatively concentrated in the industries of manufacturing, trading, real estate, transportation and utilities. Of such sectors, loans to the manufacturing industry had a net increase of RMB30.338 billion or 16.85% as compared to the beginning of the Year and accounted for 34.79% of our corporate loan portfolio, representing a decrease of 0.58 percentage points as compared to the beginning of the Year. Trading loans had a net increase of RMB5.131 billion or 7.56% as compared to the beginning of the Year and accounted for 12.07% of our corporate loan portfolio, representing a drop of 1.26 percentage points as compared to the beginning of the Year. Real estate loans had a net decrease of RMB2.408 billion or 3.80% as compared to the beginning of the Year and accounted for 10.07% of our corporate loan portfolio, representing a decrease of 2.37 percentage points as compared to the beginning of the Year. Loans to the transportation and utilities sectors had a net increase of RMB35.795 billion or 44.99% as compared to the beginning of the Year and accounted for 19.08% of our corporate loan portfolio, representing a rise of 3.45 percentage points as compared to the beginning of the Year.

(ii) Customer structure of corporate loans

Credit structure experienced a sustained optimization and the adjustment made to the credit structure proved to be effective. Customer structure for domestic branches also continued to display improvement. Compared with the beginning of the year, in the 10-category classification system, the proportion of outstanding loan to class 1 to 5 high quality customers increased by 5.26 percentage points to 67.55% while those of class 6 to 7 customers decreased by 5.43 percentage points to 26.77%, and those of class 8 to 10 decreased by 0.77 percentage point to 2.43%.

(iii) Borrower concentration

Under the current banking regulations in China, the aggregate amount of bank loans granted to any single borrower may not exceed 10% of its net capital, and the balance of bank loans granted to the top ten borrowers may not exceed 50% of its net capital. The Group currently complies with these regulatory requirements.

Management Discussion and Analysis (Continued)

3. ASSETS (Continued)

(1) Loan business (Continued)

(iii) Borrower concentration (Continued)

| As of 31 December 2005 | | | | |
|--------------------------------|---------------------------------|--|---------------------|------------------------|
| | Industry | Company category (in millions of RMB) | Outstanding balance | Internal credit rating |
| Customer A | Steel | Joint-stock | 3,617 | 4 |
| Customer B | Services | State-owned | 3,514 | 5 |
| Customer C | Transportation & warehousing | State-owned | 3,436 | 5 |
| Customer D | Petrochemical | Joint-stock | 3,152 | 2 |
| Customer E | Transportation & warehousing | State-owned | 2,400 | 5 |
| Customer F | Petrochemical | Sino-foreign joint venture | 2,097 | 5 |
| Customer G | Post and telecommunications | Wholly-foreign owned | 2,031 | 4 |
| Customer H | Post and telecommunications | State-owned | 2,020 | 5 |
| Customer I | Petrochemical | State-owned | 2,000 | 3 |
| Customer J ⁽¹⁾ | Finance and insurance | Limited liabilities | 1,924 | – |
| Total top ten customers | | | 26,191 | |

⁽¹⁾ According to Hong Kong Monetary Authority, our Hong Kong branches are required to classify its loans into five categories. Under such requirement, this credit customer was classified as the “pass” category, which is the highest class among the five, as of 31 December 2005.

3. ASSETS *(Continued)*

(1) Loan business *(Continued)*

(iv) Loan concentration by geographical locations

The table below shows the geographical distribution of the Group's loan balance excluding interest receivables, as of the dates indicated:

| | 31 December 2005 | 31 December 2004 |
|---|-----------------------------|---------------------|
| | (in millions of RMB) | |
| Northern China ⁽¹⁾ | 129,729 | 105,139 |
| North-east China ⁽²⁾ | 53,962 | 50,423 |
| Eastern China ⁽³⁾ | 320,533 | 260,251 |
| Central and Southern China ⁽⁴⁾ | 148,064 | 126,306 |
| Western China ⁽⁵⁾ | 71,027 | 60,213 |
| Overseas ⁽⁶⁾ | 46,225 | 36,452 |
| loan balance, excluding interest receivables | 769,540 | 638,784 |

⁽¹⁾ Including Beijing Municipality, Tianjin Municipality, Hebei Province, Shanxi Province, and Inner Mongolia Autonomous Region.

⁽²⁾ Including Liaoning Province, Jilin Province and Heilongjiang Province.

⁽³⁾ Including Shanghai Municipality, Jiangsu Province, Zhejiang Province, Anhui Province, Fujian Province, Jiangxi Province and Shandong Province.

⁽⁴⁾ Including Henan Province, Hunan Province, Hubei Province, Guangdong Province, Guangxi Autonomous Region and Hainan Province.

⁽⁵⁾ Including Chongqing Municipality, Sichuan Province, Guizhou Province, Yunnan Province, Xizang Autonomous Region, Shaanxi Province, Gansu Province, Qinghai Province, Ningxia Autonomous Region and Xinjiang Autonomous Region.

⁽⁶⁾ Including Hong Kong, New York, Singapore, Tokyo and Seoul.

Management Discussion and Analysis *(Continued)*

3. **ASSETS** *(Continued)*

(1) **Loan business** *(Continued)*

(iv) Loan concentration by geographical locations *(Continued)*

The Group has been focusing on the areas which are more economically developed, in particular, the Yangtze River Delta, the Bohai Rim Economic Zone and the Pearl River Delta. The Group's loans to borrowers from the Yangtze River Delta, the Bohai Rim Economic Zone and the Pearl River Delta accounted for 63.40% and 64.27% of the loan balance excluding interest receivables, as of 31 December 2004 and 2005, respectively. The increase in the Group's relative loan distributions to the Yangtze River Delta, the Bohai Rim Economic Zone and the Pearl River Delta was primarily due to the Group's focus on these areas.

(v) Loan Quality

The risk management and internal control structure, which were established by following an advanced international model, operates smoothly. The risk management committee of the Board properly played its role in monitoring and assessing the Group's overall risks and providing relevant strategic advice. Under the leadership of the president, the risk management committee is responsible for determining management policies on credit risks, market risks, liquidity risks and operation risks as well as significant events. Various risk management tools were introduced with the assistance of our working partner, HSBC, and continuous improvement had been made to our risk management.

Impaired loan is a concept under IFRS. A loan is impaired if there is objective evidence that not all amounts due will be recovered under the original contractual terms of such loan.

3. ASSETS *(Continued)*

(1) Loan business *(Continued)*

(v) Loan Quality *(Continued)*

The table below shows certain information regarding the Group's individually identified impaired loans and loans overdue by 90 days or more, as of the dates indicated:

| | 31 December 2005 | 31 December 2004 |
|--|--|---------------------|
| | (in millions of RMB, except percentage) | |
| Individually identified loans with impairment | 21,579 | 19,193 |
| Loans overdue by 90 days or more | 17,267 | 11,178 |
| Individually identified loans with impairment to loans and advances to customer (percentage) | 2.80% | 3.00% |

We control the quality of our loan portfolio in accordance with the five-category loan classification guidelines set by the PBC. According to the guidelines, commercial banks in the PRC are required to classify their loans into the following five categories of asset quality: (1) “**pass**”, (2) “**special-mentioned**”, (3) “**sub-standard**”, (4) “**doubtful**” and (5) “**loss**”. A loan is classified as a “**non-performing loan**” if it is classified as “**sub-standard**”, “**doubtful**” or “**loss**”.

Management Discussion and Analysis (Continued)

3. ASSETS (Continued)

(1) Loan business (Continued)

(v) Loan Quality (Continued)

The table below sets forth our five-category loan classification as of the dates indicated:

| | 31 December 2005 | | 31 December 2004 | |
|--|--|------------|------------------|------------|
| | Amount | % of Total | Amount | % of Total |
| | (in millions of RMB, except percentages) | | | |
| Pass | 652,653 | 85.52% | 521,203 | 81.67% |
| Special-mentioned | 92,473 | 12.11% | 98,395 | 15.42% |
| Sub-standard | 9,770 | 1.28% | 11,742 | 1.84% |
| Doubtful | 7,935 | 1.04% | 6,582 | 1.03% |
| Loss | 363 | 0.05% | 226 | 0.04% |
| Gross loans ⁽¹⁾ | 763,194 | 100.00% | 638,147 | 100.00% |
| Percentage of non-performing loans out of loan balance | | 2.37% | | 2.91% |

⁽¹⁾ Calculated under PRC GAAP

(2) Treasury business

The Group aimed at reinforcing the management of its funding operations by actively adjusting its investment strategies, making allocations to its investment portfolio and diversifying its operating risks based on the market conditions. Through inter-bank placements, note investment, bond investment and derivatives transactions, the Group can ensure the safety, liquidity and profitability of funds. In 2005, the Group's average balance of investment securities amounted to RMB265.9 billion with an increase of 40.84% over the corresponding period of last year, which is higher than the growth in the amounts due from Central Bank and other banks, thereby enhancing the profitability of the Group's assets.

3. ASSETS *(Continued)*

(2) Treasury business *(Continued)*

The table below sets forth the information of our treasury business as of the dates indicated:

| | 31 December 2005 | 31 December 2004 |
|---|----------------------|---------------------|
| | (in millions of RMB) | |
| Average balance of investment securities | 265,921 | 188,807 |
| Average balance of amounts due from other banks | 112,776 | 98,115 |
| Average balance of cash and amounts due from Central Bank | 125,179 | 111,863 |

With the development of the short-term bond market, there was a remarkable increase of 163.92% in the Group's holdings in securities issued by corporate entities.

The table below sets forth the components of our investment securities as of the dates indicated:

| | 31 December 2005 | 31 December 2004 |
|---|----------------------|---------------------|
| | (in millions of RMB) | |
| Securities – loans and receivables: | 28,372 | 31,205 |
| in which: Central governments and central banks | 26,527 | 28,911 |
| Public sector entities | 464 | 125 |
| Banks and other financial institutions | 1,381 | 2,169 |
| Securities-available-for-sale: | 285,971 | 215,523 |
| in which: Central governments and central banks | 115,653 | 108,582 |
| Public sector entities | 2,644 | 2,398 |
| Banks and other financial institutions | 154,734 | 99,640 |
| Corporate entities | 12,940 | 4,903 |

Management Discussion and Analysis (Continued)

4. LIABILITIES

As of 31 December 2005, the total liabilities of the Group were RMB1,340.3 billion, representing an increase of 22.75% from RMB1,091.9 billion for the last year. The amount due to our customers represented 91.09% of our total liabilities. The Group financed its funding for its lending and investment activities through various channels, both domestically and internationally. The principal sources of funds came from corporate and individual deposits. The sound deposits structure ensured a stable source of funds for the Group. During the reporting period, corporate deposits and individual deposits recorded an increase of 11.43% and 18.11% respectively.

The table below sets forth our corporate and individual deposits structure as of the dates indicated:

| | 31 December 2005 | 31 December 2004 |
|---------------------------------------|----------------------|---------------------|
| | (in millions of RMB) | |
| Corporate deposits | 642,735 | 576,783 |
| in which: Corporate current deposits | 407,228 | 385,556 |
| Corporate savings deposits | 4,232 | 5,011 |
| Corporate time deposits | 231,275 | 186,216 |
| Individual deposits | 435,718 | 368,901 |
| in which: Individual current deposits | 162,757 | 143,461 |
| Individual savings deposits | 9,725 | 14,879 |
| Individual time deposits | 263,236 | 210,561 |

5. CAPITAL ADEQUACY RATIO

As of 31 December 2005, The Group's CAR reached 11.20%, representing an increase of 1.48 percentage points from 9.72% for the last year. This increase was mainly due to an increase of RMB17.402 billion in Tier-1 capital raised in the Group's IPO. In addition, the Group's efforts to increase operating income and control rising costs, resulted in a net profit of RMB9.249 billion and an increase in Tier-1 capital accordingly. The Group has also strengthened its assets risk management, so that the growth rate of total weighted risk assets was lower than that of capital.

The CAR was calculated in accordance with the formula promulgated by CBRC and based on the financial data prepared under the PRC GAAP.

6. INITIATIVE TO COPE WITH THE IMPACT OF RMB APPRECIATION

On 21 July 2005, the PBC announced reforms on the RMB exchange-rate formulating mechanism whereby the Yuan to the US dollar pegging system was switched to one that referred to a basket of currencies. The exchange rate of the RMB to US dollar will be increased by 2%. To accommodate the impact, the Group has drawn up the "**Opinions on Coping with Changes in Exchange Rate Policies to ensure the Accomplishment of the Annual Operation Targets**". Pursuant to this document, aggressive steps will be taken to dilute the disadvantages and maximize the advantages of RMB appreciation, with focus on the impact on exchange rate risk, asset quality and international business. The conversion to RMB of capital raised from our IPO had been successfully completed. As of 21 October 2005, a total of HK\$16.8 billion raised from the IPO had been converted. As of the end of the reporting period, the Group had offset an exchange loss of RMB890 million arising from RMB appreciation, and reported satisfactory operating results.

Management Discussion and Analysis (Continued)

7. SMOOTH OPERATION OF THE BANK OF COMMUNICATIONS SCHRODERS FUND MANAGEMENT CO., LTD.

The Bank of Communications & Schroders Fund Management Co., Ltd. was jointly promoted and established by the Group, Schroder Investment Management Limited (UK) and China International Marine Container (Group) Limited in a shareholding ratio of 65%, 30% and 5% respectively. Founded on 12 August 2005, the company's headquarter was in Shanghai, with a registered capital of RMB200 million. Its establishment was an important step to the Group in its attempt to introduce comprehensive operations to improve the Group's revenue structure. It also represented an important opportunity for the Group to be further involved in a securities investment fund business. The Bank of Communications & Schroder Fund Management Co., Ltd. had its first product, the BoCom Schroders Core Fund launched on 26 August 2005, with a total subscription of 4.873 billion units as of 26 September 2005, the closing day of the issuance. As of 30 December 2005, which was the last trading day, the BoCom Schroders Core Fund had a net asset value of RMB1.0291 per unit and achieved outstanding results.

8. OUTLOOK FOR 2006

The year of 2006 is the first full operating year since the Group's listed. It is a year when the protection period set by the World Trade Organisation ("WTO") expires, the financial sectors should fully open up and financial reform should continue to be implemented. It is also a year for the Group to make strategic adjustments to the business structure and quicken the pace of strategic transformation. Sustained economic development and improvement in the financial environment offer opportunities for the Group's operation management. However, there are increased uncertainties as to the external environment and intensified challenges from competitors.

8. OUTLOOK FOR 2006 *(Continued)*

From a macro perspective, the financial sector of the PRC will be better regulated, and a sound financial environment will develop. Steady growth in domestic and global economy stimulates active investment and financing by domestic enterprises and individuals. The changes in the development model of enterprises and accumulation of national wealth facilitate business expansion in terms of scale and scope, as well as business transformation of the Group's banking operation. Strengthening of financial reform, changes in regulatory policies, regulating authorities' relaxation of restrictions on market entry and financial innovation, acceleration of market-oriented development of the financial sector and the expansion of the comprehensive operation network provide a more favourable environment for the Group to reinforce its core competitiveness.

In 2006, the banking industry in the PRC is experiencing intensified competition, and the Group will face considerable pressure. The Group will further consolidate its competitive edge with the continuous reform of state-owned commercial banks' shareholding system. However, the implementation of policy reform on the banking industry may divert business resources of commercial banks. In addition, following the expiry of the WTO protection period in the near future, foreign banks will, leveraging on their advantages of brand names and products, compete with PRC banks. This may cause a loss of high-end customers, talented professionals and quality businesses. Other joint-stock banks have also commenced reform. Development of retail business, fee-generating business and various innovative businesses has become the common objective of all banks. Increasingly intensive competition within the banking industry has brought much pressure on the business, human resources and profitability of the Group.

Management Discussion and Analysis *(Continued)*

8. OUTLOOK FOR 2006 *(Continued)*

The Group also faces many adverse impacts brought by changes in the market environment. The increasingly market-oriented interest rate leads to the continuous development of the bond market, gradual recovery of the stock market and rapid growth of the insurance and fund industry. The issue of short-term corporate bonds by the Central Bank reduces the role of commercial banks as intermediaries of funds and imposes a higher demand on the Group's pricing and risk management capability. The reform measures of the exchange rate-formulating mechanism of RMB have been promulgated and implemented. However, due to the absence of market-oriented risk hedging instruments, measures that can be taken to hedge RMB exchange risks are limited and the exchange risks may adversely affect the profitability of the Group. The increasing pace of reform for the deposit insurance system may increase the costs of the Group.

Adhering to the objective of developing into an outstanding international public bank, the Group will focus on the following aspects in 2006. Firstly, the Group will adopt a performance-based incentive system to stimulate the growth of business and profits. Secondly, the Group will utilise its sound nationwide service networks to improve the speed of service by consolidating its organizational structure, channel, information system, product and marketing system, so as to raise the service standard of retail business. Thirdly, the Group will speed up the development of fee-generating business. The Group will put more effort in developing core business and core brands and will set reasonable price strategy to increase its fees. Fourthly, the Group will speed up reform, implement its fifteen key projects and enhance the restructuring and integration of business and management flow. Fifthly, further measures will be taken to enhance management of financial products, increase the innovation capability of products and technologies, and to speed up such innovation. The Group will actively promote products, which are in line with market penetration, entry barrier relaxation and financial innovation, with an aim to improve its core competitiveness. Sixthly, the Group plans to provide strong support to small corporate customers by launching products that cater to their actual needs for development. Seventhly, the Group will take further reform in human resources management by setting up a new management framework for positions, salary and performance and developing a multi-form and multi-channel model for education and training to increase training efficiency. Eighthly, the Group will further promote the full implementation of risk management measures and exert its best efforts on lowering risks, in order to improve loan quality.

Auditors' Report



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AUDITORS' REPORT TO THE SHAREHOLDERS OF Bank of Communications Co., Ltd.

(A joint stock company incorporated in the People's Republic of China with limited liability)

We have audited the consolidated financial statements of Bank of Communications Co., Ltd. ("the Bank") and its subsidiaries (collectively "the Group") set out on pages 83 to 191 which have been prepared in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The directors are responsible for the preparation of financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion solely to you, as a body. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

BASIS OF OPINION

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the Bank and the Group, consistently applied and adequately disclosed.

Auditors' Report (Continued)

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

OPINION

In our opinion the consolidated financial statements give a true and fair view of the state of affairs of the Bank and the Group as at 31st December 2005 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board and the disclosure requirements of the Hong Kong Companies Ordinance.

PricewaterhouseCoopers

Certified Public Accountants

Hong Kong, 28th March 2006

Consolidated Financial Statement

Consolidated Profit and Loss Account

(All amounts expressed in millions of RMB unless otherwise stated.)

Group

| | Note | For the year ended 31 December | |
|---|------|-----------------------------------|----------|
| | | 2005 | 2004 |
| Interest income | | 49,680 | 38,352 |
| Interest expense | | (18,089) | (13,160) |
| Net interest income | 4 | 31,591 | 25,192 |
| Fee and commission income | | 2,544 | 1,996 |
| Fee and commission expense | | (435) | (321) |
| Net fee and commission income | | 2,109 | 1,675 |
| Dividend income | 5 | 45 | 55 |
| Gains less losses arising from trading activities | 6 | 420 | 325 |
| Gains less losses arising from de-recognition of investment securities | 19 | 359 | 77 |
| Other operating income | 7 | 629 | 633 |
| Impairment losses on loans and advances | 8 | (4,298) | (3,215) |
| Other operating expenses | 9 | (18,012) | (16,992) |
| Operating profit before tax | | 12,843 | 7,750 |
| Income tax | 12 | (3,600) | (6,146) |
| Net profit for the year | | 9,243 | 1,604 |
| Attributable to: | | | |
| Shareholders of the Bank | | 9,249 | 1,604 |
| Minority interest | 31 | (6) | — |
| | | 9,243 | 1,604 |
| Basic and diluted earnings per share (in RMB) | 13 | 0.22 | 0.06 |

The accompanying notes presented on pages 89 to 191 form an integral part of these consolidated financial statements.

Consolidated Financial Statement (Continued)

Consolidated Balance Sheet

(All amounts expressed in millions of RMB unless otherwise stated.)

Group

| | Note | As at 31 December | |
|---|------|----------------------------|---------------------------|
| | | 2005 | 2004 Restated |
| ASSETS | | | |
| Cash and balances with central banks | 14 | 140,309 | 128,501 |
| Due from other banks and financial institutions | 15 | 170,101 | 88,923 |
| Financial assets held for trading | 16 | 3,228 | 2,495 |
| Loans and advances to customers | 18 | 758,773 | 631,612 |
| Investment securities – loans and receivables | 19 | 28,372 | 31,205 |
| Investment securities – available-for-sale | 19 | 285,971 | 215,523 |
| Property and equipment | 20 | 25,164 | 23,863 |
| Deferred tax assets | 26 | 955 | 5,739 |
| Other assets | 21 | 10,566 | 16,144 |
| Total assets | | 1,423,439 | 1,144,005 |
| LIABILITIES | | | |
| Due to other banks and financial institutions | 22 | 84,094 | 31,711 |
| Financial liabilities held for trading | 23 | 9,555 | 5,086 |
| Due to customers | 24 | 1,220,839 | 1,029,941 |
| Other liabilities | 25 | 12,349 | 12,457 |
| Current taxes | | 751 | 39 |
| Deferred tax liabilities | 26 | 413 | 393 |
| Subordinated term debt | 28 | 12,292 | 12,275 |
| Total liabilities | | 1,340,293 | 1,091,902 |
| EQUITY | | | |
| Capital and reserves attributable to the Bank's shareholders | | | |
| Share capital | 29 | 45,804 | 39,070 |
| Capital surplus | 29 | 21,540 | 10,872 |
| Other reserves | | 6,555 | 2,307 |
| Retained earnings/(Accumulated losses) | 30 | 9,183 | (146) |
| Minority Interest | 31 | 83,082 64 | 52,103 – |
| Total equity | | 83,146 | 52,103 |
| Total equity and liabilities | | 1,423,439 | 1,144,005 |

These consolidated financial statements were approved for issue by the Board of Directors on 28 March 2006 and signed on its behalf by:

Chairman of Board: Jiang Chaoliang

Chief Financial Officer: Yu Yali

The accompanying notes presented on pages 89 to 191 form an integral part of these consolidated financial statements.

Balance Sheet*(All amounts expressed in millions of RMB unless otherwise stated.)***Bank**

| | | As at 31 December | |
|---|-------------|--------------------------|------------------|
| | <i>Note</i> | 2005 | 2004 Restated |
| ASSETS | | | |
| Cash and balances with central banks | 14 | 140,029 | 128,376 |
| Due from other banks and financial institutions | 15 | 170,101 | 88,923 |
| Financial assets held for trading | 16 | 3,228 | 2,495 |
| Loans and advances to customers | 18 | 758,773 | 631,612 |
| Investment securities – loans and receivables | 19 | 28,372 | 31,205 |
| Investment securities – available-for-sale | 19 | 285,658 | 215,432 |
| Investments in and due from subsidiaries | | 786 | 1,276 |
| Property and equipment | 20 | 23,681 | 22,322 |
| Deferred tax assets | 26 | 955 | 5,739 |
| Other assets | 21 | 10,264 | 15,315 |
| Total assets | | 1,421,847 | 1,142,695 |
| LIABILITIES | | | |
| Due to other banks and financial institutions | 22 | 84,094 | 31,711 |
| Financial liabilities held for trading | 23 | 9,555 | 5,086 |
| Due to customers | 24 | 1,220,839 | 1,029,941 |
| Other liabilities | 25 | 10,505 | 10,525 |
| Current taxes | | 751 | 39 |
| Deferred tax liabilities | 26 | 289 | 286 |
| Subordinated term debt | 28 | 12,292 | 12,275 |
| Total liabilities | | 1,338,325 | 1,089,863 |
| EQUITY | | | |
| Capital and reserves attributable to the Bank's shareholders | | | |
| Share capital | 29 | 45,804 | 39,070 |
| Capital surplus | 29 | 22,432 | 11,764 |
| Other reserves | | 6,150 | 1,998 |
| Retained earnings | 30 | 9,136 | – |
| Total equity | | 83,522 | 52,832 |
| Total equity and liabilities | | 1,421,847 | 1,142,695 |

The accompanying notes presented on pages 89 to 191 form an integral part of these consolidated financial statements.

Consolidated Financial Statement (Continued)

Consolidated Statement of Changes in Shareholders' Equity

(All amounts expressed in millions of RMB unless otherwise stated.)

| | Share capital <i>Note 29</i> | Capital surplus <i>Note 29</i> | Statutory reserve <i>Note 30</i> | Discretionary reserve <i>Note 30</i> | Other reserves | | | Retained earnings/ Accumulated losses) <i>Note 30</i> | Minority interest | Total | |
|---|---------------------------------|-----------------------------------|-------------------------------------|---|---|--|------------------------------------|---|-------------------|-------|---------|
| | | | | | Statutory welfare reserve <i>Note 30</i> | Revaluation reserve for AFS securities | Revaluation reserve for properties | | | | |
| Previously reported balance at 1 January 2004 | 17,108 | 11,035 | 4,598 | 5,403 | 972 | 242 | 481 | - | (21,758) | - | 18,081 |
| Reclassification into AFS securities (<i>Note 2A</i>) | - | - | - | - | - | 121 | - | - | - | - | 121 |
| Adjusted balance at 1 January 2004, restated | 17,108 | 11,035 | 4,598 | 5,403 | 972 | 363 | 481 | - | (21,758) | - | 18,202 |
| Losses from changes in fair value of AFS securities, net of tax | - | - | - | - | - | (1,635) | - | - | - | - | (1,635) |
| Revaluation of property and equipment | - | - | - | - | - | - | 3,098 | - | - | - | 3,098 |
| Restructuring transactions with government | 13,556 | 1,681 | - | - | - | - | - | - | - | - | 15,237 |
| Restructuring transactions with third parties | 8,406 | 7,191 | - | - | - | - | - | - | - | - | 15,597 |
| Reserves offset against accumulated losses | - | (9,035) | (4,598) | (5,403) | (972) | - | - | - | 20,008 | - | - |
| Net profit | - | - | - | - | - | - | - | - | 1,604 | - | 1,604 |
| Balance at 31 December 2004, restated | 39,070 | 10,872 | - | - | - | (1,272) | 3,579 | - | (146) | - | 52,103 |
| Previously reported balance at 1 January 2005 | 39,070 | 10,872 | - | - | - | 178 | 3,579 | - | (146) | - | 53,553 |
| Reclassification into AFS securities (<i>Note 2A</i>) | - | - | - | - | - | (1,450) | - | - | - | - | (1,450) |
| Adjusted balance at 1 January 2005, restated | 39,070 | 10,872 | - | - | - | (1,272) | 3,579 | - | (146) | - | 52,103 |
| Issue of shares | 6,734 | 11,259 | - | - | - | - | - | - | - | - | 17,993 |
| Issuance cost | - | (591) | - | - | - | - | - | - | - | - | (591) |
| Gains from changes in fair value of AFS securities, net of tax | - | - | - | - | - | 3,875 | - | - | - | - | 3,875 |
| Revaluation of property | - | - | - | - | - | - | 541 | - | - | - | 541 |
| Translation difference on foreign operations | - | - | - | - | - | - | - | (88) | - | - | (88) |
| Establishment of new subsidiary (<i>Note 31</i>) | - | - | - | - | - | - | - | - | - | 70 | 70 |
| Net profit | - | - | - | - | - | - | - | - | 9,249 | (6) | 9,243 |
| Revaluation reserve realization upon disposals | - | - | - | - | - | - | (80) | - | 80 | - | - |
| Balance at 31 December 2005 | 45,804 | 21,540 | - | - | - | 2,603 | 4,040 | (88) | 9,183 | 64 | 83,146 |

The accompanying notes presented on pages 89 to 191 form an integral part of these consolidated financial statements.

Consolidated Statement of Cash Flows*(All amounts expressed in millions of RMB unless otherwise stated.)*

| | For the year ended | |
|--|------------------------------|--------------|
| | 31 December | |
| | 2005 | 2004 |
| Cash flows from operating activities: | | |
| Net profit before taxation: | 12,843 | 7,750 |
| Adjustments for: | | |
| Impairment of loans and advances to customers (Write-back)/impairment of due from banks and financial institutions | 4,549 (149) | 3,041 324 |
| Impairment of other receivables | 327 | 394 |
| Depreciation of property and equipment | 2,364 | 2,471 |
| Revaluation of property and equipment | 9 | 389 |
| Amortization of prepaid staff subsidies | 38 | 84 |
| Amortization of prepaid rental expenses | 179 | 198 |
| Amortization of land use rights | 5 | 75 |
| Amortization of computer software | 105 | 77 |
| Net gains on investment securities | (359) | (77) |
| Gains on disposal of fixed assets | (66) | (214) |
| (Increase)/Decrease in the fair value of investment property | (46) | 32 |
| Interest expense on subordinated term debt | 557 | 275 |
| Net increase in due from central banks | (11,639) | (11,424) |
| Net (increase)/decrease in due from other banks and financial institutions | (55,578) | 5,440 |
| Net (increase)/decrease in financial assets held for trading | (733) | 1,573 |
| Net increase in loans and advances to customers | (131,710) | (120,058) |
| Net decrease/(increase) in other assets | 5,179 | (2,870) |
| Net increase in due to other banks and financial institutions | 52,383 | 10,561 |
| Net increase in financial liabilities held for trading | 4,469 | 1,623 |
| Net increase in due to customers | 190,898 | 155,782 |
| Net (decrease)/ increase in other liabilities | (352) | 3,641 |
| Net increase in business tax payable | 161 | 242 |
| Income tax paid | (215) | (603) |
| Net cash from operating activities | 73,219 | 58,726 |

Consolidated Financial Statement (Continued)

Consolidated Statement of Cash Flows (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

| | For the year ended | |
|---|--------------------|------------------|
| | 31 December | |
| | 2005 | 2004 |
| Cash flows from investing activities: | | |
| Purchase of investment securities | (408,379) | (203,919) |
| Disposal or redemption of investment securities | 346,965 | 101,105 |
| Purchase of computer software | (145) | (114) |
| Prepaid rental expenses | (172) | (167) |
| Purchase of land use rights | (72) | (337) |
| Disposal of land use rights | 108 | – |
| Purchase of property and equipment | (3,513) | (2,828) |
| Disposal of property and equipment | 610 | 414 |
| Net cash used in investing activities | (64,598) | (105,846) |
| Cash flows from financing activities: | | |
| Issue of shares | 17,402 | 33,597 |
| Issue of subordinated term debt | – | 12,000 |
| Interest paid on subordinated term debt | (540) | – |
| Minority interest | 70 | – |
| Dividends paid | (5) | (8) |
| Net cash from financing activities | 16,927 | 45,589 |
| Net increase/(decrease) in cash and cash equivalents | 25,548 | (1,531) |
| Cash and cash equivalents at the beginning of the period | 75,757 | 77,288 |
| Cash and cash equivalents at the end of the period (Note 36) | 101,305 | 75,757 |
| Major non-cash transactions | | |
| Capitalization of translation difference on foreign operations | 88 | – |
| Transfer from other assets to fixed assets | – | 261 |
| Transfer from fixed assets to other assets | – | 703 |
| Supplementary Information | | |
| Interest received | 49,120 | 37,527 |
| Interest paid | (16,122) | (12,227) |

The accompanying notes presented on pages 89 to 191 form an integral part of these consolidated financial statements.

Notes to the Consolidated Financial Statements

(All amounts expressed in millions of RMB unless otherwise stated.)

1 GENERAL

Bank of Communications Co., Ltd. (the “Bank”) is a commercial and retail bank providing banking services mainly in the People’s Republic of China (“PRC”). The Bank was reorganised as a joint stock national commercial bank on 1 April 1987, in accordance with the approval notice (Guo Fa (1986) No. 81) issued by the State Council of the PRC and the approval notice (Yin Fa (1987) No. 40) issued by the People’s Bank of China (“PBOC”). Headquartered in Shanghai, the Bank operates 92 city level branches in the PRC. In addition, the Bank has branches in Hong Kong, New York, Tokyo, Singapore and Seoul.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of the consolidated financial statements are set out below. These policies have been consistently applied to the periods presented unless otherwise stated.

A Basis of presentation

The consolidated financial statements of the Group has been prepared in accordance with the International Financial Reporting Standards (“IFRS”) The consolidated financial statements has been prepared under the historical cost convention as modified by the revaluation of investment securities classified as available for sale, financial assets and financial liabilities held at fair value through profit or loss, property and equipment, investment properties and all derivative contracts, which are revalued at fair value.

Critical accounting estimates and judgments in applying accounting policies

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Group’s accounting policies.

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

A Basis of presentation (Continued)

(1) Impairment losses on loans and advances

The Group reviews its loan portfolios to assess impairment on a quarterly basis, unless known circumstances indicate that impairment may have occurred as of an interim date. In determining whether an impairment loss should be recorded in the consolidated income statement, the Group makes judgments as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group (e.g. payment delinquency or default), or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when estimating expected future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

(2) Fair value of financial instruments

The fair values of financial instruments that are not quoted in active markets are determined by using valuation techniques. Valuation techniques used include discounted cash flows analysis and models. To the extent practical, models use only observable data, however areas such as credit risk (both own and counterparty's), volatilities and correlations require management to make estimates. Changes in assumptions about these factors could affect reported fair value of financial instruments.

(3) Income taxes

The Group is subject to income taxes in numerous jurisdictions; principally, however in the Chinese Mainland and Hong Kong. Significant estimates are required in determining the provision for income taxes. There are certain transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Group recognizes liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. In particular, the deductibility of certain items in the Chinese Mainland is subject to government approval. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred income tax provisions in the period during which such a determination is made.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

A Basis of presentation *(Continued)*

(4) Provision for outstanding litigation

The Group evaluates the losses, if any, arising from outstanding claims made by third parties on a regular basis. Provision for losses is made by the Group in the financial statements when it is probable that an outflow of resources is required to settle the claims. The Group believes that the provision made is adequate to meet the settlement obligations.

The Group adopted the following IAS and IFRS, which are effective for accounting periods commencing on or after 1 January 2005:

| | |
|-----------------------|---|
| IAS 1 (revised 2003) | Presentation of Financial Statements |
| IAS 8 (revised 2003) | Accounting Policies, Changes in Accounting Estimates and Errors |
| IAS 10 (revised 2003) | Events after the Balance Sheet Date |
| IAS 16 (revised 2003) | Property, Plant and Equipment |
| IAS 17 (revised 2003) | Leases |
| IAS 21 (revised 2003) | The Effects of Changes in Foreign Exchange Rates |
| IAS 24 (revised 2003) | Related Party Disclosures |
| IAS 27 (revised 2003) | Consolidated and Separate Financial Statements and Accounting for Investments in Subsidiaries |
| IAS 28 (revised 2003) | Investments in Associates |
| IAS 32 (revised 2003) | Financial Instruments: Disclosure and Presentation |
| IAS 33 (revised 2003) | Earnings per Share |
| IAS 39 (revised 2003) | Financial Instruments: Recognition and Measurement |
| IAS 40 (revised 2003) | Investment Property |
| IFRS 2 (issued 2004) | Share-based Payment |
| IFRS 4 (issued 2004) | Insurance Contract |
| IFRS 5 (issued 2004) | Non-current Assets Held for Sale and Discontinued Operations |

The Group also early adopted relevant amendments to IAS 32, IAS 37, IAS 39 and IFRS 4 up to 18 August 2005. They are amendments on accounting treatments of a) Financial Guarantee Contracts, b) Cash Flow Hedge Accounting of Forecast Intragroup Transactions, and c) The Fair Value Option, which are effective for accounting periods commencing on or after 1 January 2006.

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

A Basis of presentation (Continued)

The adoption of IAS 1, 8, 10, 16, 17, 21, 24, 27, 28, 32, 33, 40 (all revised 2003) and IFRS 2, 4, 5 (all issued 2004) did not result in changes to the Group's accounting policies. In summary:

- IAS 1, 8, 10, 16, 17, 27, 28, 32, 33, 40 (all revised 2003) and IFRS 2, 4, 5 (all issued 2004) had no material effect on the Group's policies.
- IAS 21 (revised 2003) had no material effect on the Group's policy. The functional currency of each of the consolidated entities has been re-evaluated based on the guidance to the revised standard.

All the Group entities have the same functional currency as their measurement currency.

- IAS 24 (revised 2003) has affected the identification of related parties and some other related-party disclosures.

The adoption of IAS 39 (revised 2003) has resulted in a change in the accounting policy for financial assets, especially the accounting policy for investment securities-originated loans. Until 31 December 2004, debt securities that were purchased at original issuance without the intent to sell immediately or in the short term were classified as originated loans. In accordance with the provisions of IAS 39 (revised 2003), except for certain originated loans that are not quoted in an active market would be classified as "investment securities – loans and receivables", the originated loans should be classified as available-for-sale securities or trading securities according to the management's intention. The impact of the reclassification and its retrospective impact on the financial position of the Group at 1 January 2004 and 2005 are set out below:

| | 1 January 2005 | 1 January 2004 |
|---|-------------------|-------------------|
| Decrease in originated loans | (159,826) | (104,670) |
| Increase in investment securities-available-for-sale | 125,495 | 92,058 |
| Increase in investment securities-loans and receivables | 31,205 | 12,793 |
| Increase in financial assets held for trading | 962 | – |
| (Decrease)/ Increase in revaluation reserve, net of tax | (1,450) | 121 |
| Increase in deferred tax assets/(liabilities) | 714 | (60) |

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

A Basis of presentation *(Continued)*

The early adoption of amended IAS 32, IAS 37, IAS 39 and IFRS 4 did not result in changes to the Group's current accounting policies, but provide more specific guidance on the accounting of financial guarantee contracts.

There was no significant impact on opening retained earnings at 1 January 2005 and 2004 from the adoption of any of the above-mentioned standards.

Except for the adoption of the above IAS and IFRS which are effective for accounting periods commencing on or after 1 January 2005 and the early adoption of amended IAS32, IAS37, IAS39 and IFRS4, the accounting policies and basis of preparation of the financial statements of the Group are consistent with those adopted in the Group's 2004 annual accounts.

B Subsidiary undertakings

Subsidiaries, which are those companies and other entities (including Special Purpose Entities) in which the Group, directly or indirectly, has control, are consolidated.

The Group controls another entity when the Group has the power to govern the financial and operating policies of the entity. The existence and effect of potential voting rights that are presently exercisable or presently convertible are also considered when assessing whether the Group controls the entity.

Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date that control ceases. The purchase method of accounting is used to account for the acquisition of subsidiaries. The cost of an acquisition is measured at the fair value of the assets given up, shares issued or liabilities undertaken at the date of acquisition, plus costs directly attributable to the acquisition. The excess of the cost of acquisition over the fair value of the net assets of the subsidiary acquired is recorded as goodwill. Inter-company transactions, balances and unrealized gains on transactions between group companies are eliminated; unrealized losses are also eliminated unless the loss cannot be recovered. Where necessary, accounting policies of subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

In the stand alone financial statements of the Bank, the subsidiaries are measured at cost less provision for impairment, as the fair value of these subsidiaries cannot be reliably measured. The amount of impairment loss is included in the net profit or loss for the year.

Notes to the Consolidated Financial Statements *(Continued)*

(All amounts expressed in millions of RMB unless otherwise stated.)

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

C Derivative financial instruments

Derivative financial instruments including foreign exchange contracts, currency and interest rate swaps, and other derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value. Fair values are obtained from quoted market prices, discounted cash flow models and options pricing models as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The best evidence of the fair value of a derivative at initial recognition is the transaction price (i.e., the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When such evidence exists, the Group recognises profits on day 1.

Certain derivatives embedded in other financial instruments are treated as separate derivatives when their risks and economic characteristics are not closely related to those of the host contract and the host contract is not carried at fair value with unrealized gains and losses reported in the profit and loss account. These embedded derivatives are measured at fair value with changes in fair value recognised in the profit and loss account.

Certain derivative transactions, while considered as hedges under the Group's risk management policies, do not qualify for hedge accounting under the specific rules in IAS 39 and are therefore treated as derivatives held for trading.

Changes in the fair value of derivatives held for trading are included in gains less losses arising from trading activities.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

D Financial assets at fair value through profit or loss

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are also categorized as held for trading unless they are designated as hedges.

Financial assets held for trading include securities which were either acquired for generating a profit from short-term fluctuations in price or dealer's margin, or are securities included in a portfolio in which a pattern of short-term profit taking exists. These securities are initially recognised at fair value and subsequently re-measured at fair value based on quoted bid prices. These securities are derecognised when the rights to receive cash flows from the trading securities have expired or when the Group has transferred substantially all risks and rewards of ownership. All related realized and unrealized gains and losses are included in gains less losses arising from trading activities. Interest earned whilst holding trading securities is reported as interest income. Dividends received are included in dividend income.

All purchases and sales of trading securities that require delivery within the time frame established by regulation or market convention ('regular way' purchases and sales) are recognised at trade date, which is the date that the Group commits to purchase or sell the asset. Otherwise such transactions are treated as derivatives until settlement occurs.

E Interest income and expense

Interest income and expense are recognised in the profit and loss account for interest-bearing instruments on an accruals basis using the effective interest method. Interest income includes coupons earned on fixed income investment and trading securities and accrued discount and premium on treasury bills and other discounted instruments. When loans become doubtful of collection, they are written down to their recoverable amounts and interest income is thereafter recognised based on the rate of interest that was used to discount the future cash flows for the purpose of measuring the recoverable amounts.

Notes to the Consolidated Financial Statements *(Continued)*

(All amounts expressed in millions of RMB unless otherwise stated.)

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

F Fee and commission income

Fees and commission are generally recognised on an accruals basis when the service has been provided. Loan origination fees for loans which are probable of being drawn down, are deferred (together with related direct costs) and recognised as an adjustment to the effective interest on the loan. Fees and commission arising from negotiating, or participating in the negotiation of a transaction for a third party, such as the acquisition of loans, shares or other securities or the purchase or sale of businesses, are recognised on completion of the underlying transaction. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts. Asset management fees related to assets held in a fiduciary capacity are recognised ratably over the period the service is provided.

G Sale/purchase and repurchase/resale agreements

Securities sold subject to a linked repurchase agreements ('repos') with banks and other financial institutions are retained in the financial statements as financial assets held for trading or investment securities, as the Group still retains controls of the contractual rights over these securities. The counterparty liability is included in amounts due to other banks and financial institutions.

Securities purchased under agreements to resell ('reverse repos') are recorded as due from other banks and financial institutions. The difference between sale and repurchase price (purchase and resale price) is treated as interest expense (income) and accrued over the life of repos (reverse repos) using the effective interest method.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

H Investment securities

The Group classifies its investment securities in the following categories: loans and receivables and available-for-sale securities. Management determines the classification of its investments at initial recognition. Due to a change in management's investment strategy, the Group re-designated all its investment securities originally classified as held to maturity to become available-for-sale during 2004. After such reclassification of investment securities, the Group may not recognise any held-to-maturity securities in the following two financial years. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership. Investment securities are initially recognised at fair value plus transaction costs and subsequently they are measured as follows:

(1) *Loans and receivables*

Loans and receivables are non-derivative debt securities with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivable. After initial recognition, loans and receivables are carried at amortised cost using the effective interest method, less any impairment allowances.

(2) *Available-for-sale*

Available-for-sale investments are those intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. After initial recognition, the available-for-sale securities are subsequently re-measured at fair value. The fair value is determined by the following hierarchy:

- the published quoted price is the best evidence of fair value when the financial instrument is quoted in an active market.
- the price used in recent transactions of similar financial instruments with adjustment when the market conditions have changed.
- valuation techniques, including: cash flow models etc.
- if fair value cannot be measured reliably, equity security investments are recognised at cost less impairment.

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

H Investment securities (Continued)

(2) Available-for-sale (Continued)

Gains and losses arising from changes in the fair value of available-for-sale securities are recognised as they arise in equity as revaluation reserve. When the securities are disposed of or impaired, the related accumulated fair value adjustments are included in the profit and loss account as gains and losses arising from investment securities.

The Group assesses at each balance sheet date whether there is objective evidence that an investment security or group of investment securities is impaired. An investment security or a group of investment securities is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the security (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the investment security or group of investment securities that can be reliably estimated. The amount of the impairment loss for assets carried at amortised cost is calculated as the difference between the asset's carrying amount and the present value of expected future cash flows discounted at the financial instrument's original effective interest rate. If an available-for-sale security is impaired, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the profit and loss account.

Interest earned whilst holding investment securities is reported as interest income. Dividends receivable are included separately in dividend income when a dividend is declared.

All regular way purchases and sales of investment securities are recognised at settlement date, which is the date that an asset is delivered to or by the Group. Any change in the fair value of the asset during the period between the trade date and the settlement date is accounted for in the same way as the Group accounts for the acquired asset. In other words, the change in value is not recognised for assets carried at cost or amortised cost; it is recognised in equity for assets classified as available for sale.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

I Loans and advances to customers and allowance for loan impairment

Loans originated by the Group by providing money directly to the borrower or to a sub-participation agent at drawdown are categorized as loans and advances originated by the Group and are carried at amortised cost. Third party expenses, such as legal fees, incurred in securing a loan are treated as part of the cost of the transaction.

All loans and advances are recognised when cash is advanced to borrowers. An allowance for loan impairment is established if there is objective evidence that the Group will not be able to collect all amounts due according to the original contractual terms of loans. The amount of the provision is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, including amounts recoverable from guarantees and collateral, discounted at the original effective interest rate of loans. The loan loss provision also covers losses where there is objective evidence that losses are present in components of the loan portfolio at the balance sheet date though not individually identified. These have been estimated based upon historical patterns of losses in each component, the credit ratings allocated to the borrowers and reflecting the current economic climate in which the borrowers operate.

When a loan is uncollectible, it is written off against the related allowance for impairment; subsequent recoveries are credited to the impairment losses on loans and advances in the profit and loss account. If the amount of the impairment subsequently decreases due to an event occurring after the write-down, the release of the allowance is credited as a reduction of the impairment losses on loans and advances.

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

J Property and equipment

Subsequent to initial recognition, the Group adopts a revaluation policy to carry all classes of property and equipment except for leasehold improvements at revaluation, being their fair value at the date of the revaluation, less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Leasehold improvements continue to be stated at cost less accumulated impairment losses and depreciation.

Increases in the carrying amount arising on revaluation of property and equipment are credited to revaluation reserves in shareholders' equity. Decreases that offset previous increases of the same asset are charged against revaluation reserves; all other decreases are charged to the profit and loss account. The revaluation reserves are transferred directly to retained earnings when the relevant items of property and equipment are retired or disposed of.

Depreciation is calculated on the straight-line method to write off the cost or revalued amount of each asset to their residual values over their estimated useful lives as follows:

| | |
|------------------------------|-------------|
| Buildings | 25-50 years |
| Leasehold improvements | 3-10 years |
| Equipment and motor vehicles | 3-8 years |

No depreciation is provided against construction in progress.

At each balance sheet date, both internal and external sources of information are considered to assess whether there is any indication that the Group's property and equipment are impaired. If any such indication exists, the recoverable amount of the asset is estimated and where relevant, an impairment loss is recognised to reduce the asset to its recoverable amount. Such impairment losses are recognised in the profit and loss account except where the asset is carried at valuation and the impairment loss does not exceed the revaluation surplus for that same asset, in which case it is treated as a revaluation decrease.

The gain or loss on disposal of a property or an equipment is the difference between the net sales proceeds and the carrying amount of the relevant asset, and is recognised in the profit and loss account. Any revaluation reserve balance remaining attributable to the relevant asset is transferred to retained earnings and is shown as a movement in reserves.

Repairs and maintenance are charged to the profit and loss account during the financial period in which they are incurred.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

K Foreclosed assets

Foreclosed assets are recognised at market value on a portfolio basis based on both internal and external sources of information. All related revaluation gains and losses are recognised in the profit and loss account.

L Land use rights

Land use rights are recognised initially at 'cost', being the consideration paid for the rights to use and occupy the land. Land use rights are amortised using the straight-line method to write off the cost over their estimated useful lives of 30 to 70 years.

Land use rights are not separately presented from building, when they are acquired together with the building at inception and the costs attributable to the land use rights cannot be reasonably measured and separated from that of the building.

M Computer software

Costs associated with maintaining computer software programs are recognised as an expense as incurred. However, expenditure that enhances or extends the performance of computer software program beyond their original specifications is recognised as capital improvement and added to the original cost of the software. Computer software development costs recognised as assets are amortised using the straight-line method over their estimated useful lives which are usually between 3 to 5 years.

N Investment property

Property held to earn rentals which is not occupied by the Group is classified as investment property. Investment property comprises land and buildings.

The Group adopts the fair value model to account for its investment property. Fair value is based on active market prices, adjusted, if necessary, for any difference in the nature, location or condition of the specific asset. Where active market price information is not available, the Group uses alternative valuation methods such as discounted cash flow projections or recent prices on less active markets. These valuations are reviewed annually by an independent valuer. Changes in fair values are recorded in the profit and loss account.

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

O Leases

The leases entered into by the Group as lessee or lessor have been determined to be operating leases. The lease payments/receipts made under operating leases are charged to/recognised in the profit and loss account on a straight-line basis over the period of the lease.

P Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than 90 days maturity from the date of acquisition including: cash and balances with central banks (after deduction of mandatory reserve deposits) and amounts due from other banks and financial institutions used for the purpose of meeting short-term cash commitments.

Q Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

R Deferred income taxes

Deferred income tax is provided, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements.

The principal temporary differences arise from depreciation of property and equipment, impairment of loans and advances, receivables and other assets, and revaluation of certain financial assets and liabilities. The rates enacted or substantively enacted at the balance sheet date are used to determine deferred income tax.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences, unused tax losses and unused tax credits can be utilized. Deferred tax liabilities are the amounts of income tax payable in respect of taxable temporary differences, which are measured at the amount expected to be paid to the tax authorities in the future.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

R **Deferred income taxes** *(Continued)*

Income tax payable on profits, based on the applicable tax law in each jurisdiction is recognised as an expense in the period in which profits arise. The tax effects of income tax losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.

Deferred tax related to fair value re-measurement of available-for-sale investments, which are charged or credited directly to equity, is also credited or charged directly to equity and is subsequently recognised in the profit and loss account together with the deferred gain or loss.

S **Borrowings**

Borrowings are recognised initially at fair value, being their issue proceeds (fair value of consideration received) net of transaction costs incurred. Borrowings are subsequently stated at amortised cost and any difference between net proceeds and the redemption value is recognised in the profit and loss account over the period of the borrowings using the effective interest method.

T **Share capital**

(1) *Share issue costs*

External costs directly attributable to the issue of new shares, other than on a business combination, are deducted from equity net of any related income taxes.

(2) *Dividends on ordinary shares*

Dividends on ordinary shares are recognised in equity in the financial period in which they are declared and approved.

U **Acceptances**

Acceptances comprise undertakings by the Group to pay bills of exchange drawn on customers. Acceptances are accounted for as financial guarantees and credit related commitments transactions and are disclosed as contingent liabilities and commitments.

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

V Staff benefit and retirement benefit obligations

The Group participates in various defined contribution retirement plans principally organised by municipal and provincial governments. The Group's contributions to these pension plans are charged to the profit and loss account in the financial period to which they relate.

W Foreign currency translation

(1) Functional and presentation currency

The Group's presentation currency is Renminbi ("RMB"), the legal currency of China. Items included in the financial statements of the entity of the Group are measured using the currency that best reflects the economic substance of the underlying events and circumstances relevant to that entity ("the functional currency"). The consolidated financial statements are presented in Renminbi which is the functional currency of the parent.

(2) Transactions and balances

Foreign currency transactions are translated into the functional currency at the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the profit and loss account. Profit and loss accounts and cash flows of foreign entities are translated into the Group's presentation currency at average exchange rates for the financial period and their balance sheets are translated at the exchange rates ruling at the balance sheet date.

Translation differences on debt securities and other monetary financial assets measured at fair value are included in foreign exchange gains and losses. Translation differences on non-monetary items such as equities held for trading are reported as part of the fair value gain or loss. Thus, underlying translation differences on available-for-sale equities are included in the revaluation reserve in equity.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

W Foreign currency translation *(Continued)*

(3) Group Companies

Exchange differences arising from the translation of the net investment in foreign entities and of borrowings and other currency instruments designated as hedges of such investments, are taken to shareholders' equity. When a foreign entity is sold, such exchange differences are recognised in the profit and loss account as part of the gain or loss on sale.

X Contingent liabilities and contingencies

A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. It can also be a present obligation arising from past events that is not recognised because it is not probable that an outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognised but is disclosed in the notes to the financial statements. When a change in the probability of an outflow occurs so that outflow is probable, it will then be recognised as a provision.

Y Financial guarantee contracts

The Group has the following types of financial guarantee contracts: letters of credit and letters of guarantees issued. These contracts provide for specified payments to be made to reimburse the holder for a loss it incurs when a guaranteed party defaults under the original or modified terms of a debt instrument.

The Group initially recognises all financial guarantee contracts at the proceeds received. They are recorded in loans and advances to customers in the balance sheet, which is amortised into profit and loss account ratably over the guarantee period. Subsequently, they are carried at the higher of amortised carrying value or the provision required to meet the Group's guarantee obligation. The changes in carrying value are recorded in the profit and loss account under fee and commission income.

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Z Fiduciary activities

Assets and income arising thereon together with related undertakings to return such assets to customers are excluded from the financial statements where the Group acts in a fiduciary capacity such as nominee, trustee or agent.

The Group grants entrusted loans on behalf of third-party lenders. The Group grants loans to borrowers, as agent, at the direction of the third-party lenders, who fund these loans. The Group has been contracted by these third-party lenders to manage the administration and collection of these loans on their behalf. The third-party lenders determine both the underwriting criteria for and all terms of the entrusted loans including their purposes, amounts, interest rates, and repayment schedule. The Group charges a commission related to its activities in connection with the entrusted loans which is recognised ratably over the period the service is provided. The risk of loss is borne by the third-party lenders.

AA Segment reporting

A geographical segment is engaged in providing products or services within a particular economic environment, which are subject to risks and returns that are different from those of segments operating in other economic environments. A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. In accordance with the Group's internal financial reporting format, the Group has determined that geographical segments be presented as the primary reporting format. The geographical segment reporting format is based upon location of assets, as the local branches mainly serve local customers with only a few customers from other regions. Business segments are presented as secondary segment reporting format, which is divided into corporate, retail, treasury and others.

AB De-recognition of financial assets and liabilities

Financial assets are derecognised only when the control of the contractual rights that comprise the financial assets is lost due to the realization of the rights to benefits specified in the contract, or the rights expired and surrendered, and where the Group has transferred substantially all risks and rewards of ownership.

Financial liabilities are derecognised only when the obligation specified in the contract is discharged, cancelled, or expires.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

AC Offset financial assets and liabilities

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legal enforceable right to offset the recognised amounts and there is an intention to settle on a net basis or realise the assets and settle the liability simultaneously.

AD Comparative

Where necessary, comparative figures have been adjusted to conform to changes in presentation in the current year.

3 USE OF FINANCIAL INSTRUMENTS

A Strategy in using financial instruments

By its nature, the Group is engaged in the extensive use of financial instruments including derivatives. The Group accepts deposits from customers at both fixed and floating rates, for various periods and seeks to earn above average interest margins by investing these funds in high quality assets. The Group seeks to increase these margins by consolidating short-term funds and lending for longer periods at higher rates whilst maintaining sufficient liquidity to meet all claims that might fall due. The Group predominantly operates its business in mainland China under an interest rate scheme regulated by the PBOC.

The Group also seeks to raise its interest margins by obtaining above average margins, net of provisions, through lending to commercial and retail borrowers with a range of credit standing. Such exposures involve not just loans and advances but also financial guarantees and credit related commitments such as letters of credit, performance, and other bonds.

B Credit risk

The Group takes on exposure to credit risk which is the risk that a counterparty will be unable to pay amounts in full when due. Credit risk is increased when counterparties are concentrated in the same industries or geographical regions. The majority of the Group's operation is located within China; however different areas in China have their own unique characteristics in economic development. Therefore, each area in China could present different credit risks.

The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower. Such risks are monitored on a regular basis and subject to an annual review.

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

3 USE OF FINANCIAL INSTRUMENTS (Continued)

B Credit risk (Continued)

Exposure to credit risk is managed through regular analysis of the ability of borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees.

The Group also maintains strict control limits on net open derivative positions, i.e. the difference between purchase and sale contracts, by both amount and term.

The Group further restricts its exposure to credit losses by entering into master netting arrangements for its interest rate swap transactions with counterparties with which it undertakes a significant volume of transactions. Master netting arrangements do not generally result in an offset of balance sheet assets and liabilities as transactions are usually settled on a gross basis. However, the credit risk associated with favorable contracts is reduced by a master netting arrangement to the extent that if an event of default occurs, all amounts with the counterparty are terminated and settled on a net basis. The Group's overall exposure to credit risk on derivative instruments subject to master netting arrangements can change substantially within a short period since it is affected by each transaction subject to the arrangement.

The Group has issued credit related commitments including guarantees and letters of credit. The primary purpose of these instruments is to ensure that funds are available to customers as required. These instruments represent irrevocable assurances that the Group will make payments in the events that a customer cannot meet its obligations to third parties. These instruments carry similar credit risk as loans.

3 USE OF FINANCIAL INSTRUMENTS *(Continued)*

B Credit risk *(Continued)*

Geographical concentrations of assets, liabilities and financial guarantees and credit related commitments:

Group

| | Total assets | Total liabilities | Financial guarantees and credit related commitments |
|-------------------------------|------------------|----------------------|--|
| As at 31 December 2005 | | | |
| Mainland China | 1,326,468 | 1,246,177 | 227,747 |
| Hong Kong | 84,085 | 81,263 | 14,304 |
| Others | 12,886 | 12,853 | 3,859 |
| Total | 1,423,439 | 1,340,293 | 245,910 |
| As at 31 December 2004 | | | |
| Mainland China | 1,038,044 | 988,055 | 152,330 |
| Hong Kong | 92,180 | 89,900 | 12,532 |
| Others | 13,781 | 13,947 | 2,773 |
| Total | 1,144,005 | 1,091,902 | 167,635 |

Bank

| | Total assets | Total liabilities | Financial guarantees and credit related commitments |
|-------------------------------|------------------|----------------------|--|
| As at 31 December 2005 | | | |
| Mainland China | 1,326,026 | 1,244,705 | 227,747 |
| Hong Kong | 82,935 | 80,767 | 14,304 |
| Others | 12,886 | 12,853 | 3,859 |
| Total | 1,421,847 | 1,338,325 | 245,910 |
| As at 31 December 2004 | | | |
| Mainland China | 1,037,545 | 986,573 | 152,330 |
| Hong Kong | 91,369 | 89,343 | 12,532 |
| Others | 13,781 | 13,947 | 2,773 |
| Total | 1,142,695 | 1,089,863 | 167,635 |

Total assets, total liabilities and financial guarantees and credit related commitments are based on the country/region in which the branch or the group entity is located.

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

3 USE OF FINANCIAL INSTRUMENTS (Continued)

B Credit risk (Continued)

Geographic sector risk concentration for loans and advances to customers (gross):

Group and Bank

| | 31 December 2005 | | 31 December 2004 | |
|--|------------------|-----|------------------|-----|
| | | % | | % |
| Domestic regions | | | | |
| – Jiangsu | 93,247 | 12 | 80,331 | 13 |
| – Shanghai | 86,122 | 11 | 68,611 | 11 |
| – Beijing | 84,298 | 11 | 71,565 | 11 |
| – Guangdong | 66,002 | 9 | 53,294 | 8 |
| – Zhejiang | 56,634 | 7 | 45,964 | 7 |
| – Shandong | 46,956 | 6 | 36,071 | 6 |
| – Henan | 29,867 | 4 | 28,579 | 4 |
| – Liaoning | 26,920 | 4 | 25,153 | 4 |
| – Others | 233,269 | 30 | 192,764 | 30 |
| Domestic regions total | 723,315 | 94 | 602,332 | 94 |
| Hong Kong and overseas countries | 46,225 | 6 | 36,452 | 6 |
| Interest receivables | 1,834 | – | 1,274 | – |
| Gross amount of loans and advances before allowance for impairment | 771,374 | 100 | 640,058 | 100 |

A geographical region is reported where it contributes 4% and more of the relevant disclosure item.

The above tables show the geographic sector risk concentration relating to loans and advances to customers, the most significant type of assets. The Group's financial guarantees and credit related commitments mainly comprise acceptances and credit related commitments (Note 33).

3 USE OF FINANCIAL INSTRUMENTS *(Continued)*

B Credit risk *(Continued)*

The economic sector risk concentration analysis for loans and advances to customers (gross):

Group and Bank

| | 31 December 2005 | | 31 December 2004 | |
|---|------------------|-----|------------------|-----|
| | | % | | % |
| Corporate loans | | | | |
| Manufacturing | | | | |
| – Steel | 24,540 | 3 | 19,267 | 3 |
| – Machinery | 22,763 | 3 | 18,711 | 3 |
| – Electronics | 27,035 | 4 | 24,001 | 4 |
| – Petroleum and chemical | 32,585 | 4 | 27,929 | 5 |
| – Textile | 18,076 | 2 | 18,850 | 3 |
| – Other manufacturing | 85,360 | 11 | 71,263 | 11 |
| Trading | 72,977 | 10 | 67,846 | 11 |
| Real estate | 60,913 | 8 | 63,321 | 10 |
| Transportation | 63,544 | 8 | 43,436 | 7 |
| Utilities | 51,812 | 7 | 36,125 | 6 |
| Services | 56,024 | 7 | 33,978 | 5 |
| Construction | 25,958 | 3 | 20,916 | 3 |
| Educations and scientific research | 24,934 | 3 | 26,367 | 4 |
| Post and telecommunications | 15,768 | 2 | 15,114 | 2 |
| Agriculture | 4,698 | 1 | 2,082 | – |
| Non-banking financial institutions | 9,753 | 1 | 8,063 | 1 |
| Others | 7,871 | 1 | 11,742 | 2 |
| Corporate loans total | 604,611 | 78 | 509,011 | 80 |
| Mortgage loans | 78,264 | 10 | 63,978 | 10 |
| Medium-term and long-term working capital loans | 13,685 | 2 | 10,821 | 2 |
| Car loans | 3,961 | 1 | 5,113 | 1 |
| Short-term working capital loans | 5,087 | 1 | 3,718 | – |
| Loans secured by deposits | 1,093 | – | – | – |
| Credit card advances | 696 | – | 107 | – |
| Others | 1,267 | – | 2,040 | – |
| Individual loans total | 104,053 | 14 | 85,777 | 13 |
| Discounted bills | 60,876 | 8 | 43,996 | 7 |
| Interest receivables | 1,834 | – | 1,274 | – |
| | 62,710 | 8 | 45,270 | 7 |
| Gross amount of loans and advances before allowance for impairment | 771,374 | 100 | 640,058 | 100 |

The economic sector risk concentration analysis for loans and advances to customers is based on the Group's internal classification system.

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

3 USE OF FINANCIAL INSTRUMENTS (Continued)

B Credit risk (Continued)

Loans and advances to customers analysed by customer type (gross):

Group and Bank

| | 31 December 2005 | 31 December 2004 |
|---|---------------------|---------------------|
| Domestic | | |
| Corporate entities | | |
| State owned entities | 198,276 | 178,533 |
| Collective owned entities | 11,022 | 11,484 |
| Private unlimited companies | 35,987 | 26,429 |
| Private limited companies | 163,673 | 132,148 |
| Joint stock companies | 63,723 | 56,894 |
| Foreign invested enterprises | 78,339 | 66,677 |
| Other domestic entities | 22,347 | 13,252 |
| | 573,367 | 485,417 |
| Individuals | 89,853 | 73,406 |
| | 663,220 | 558,823 |
| Hong Kong and Overseas | | |
| Corporate entities | 31,244 | 23,594 |
| Individuals | 14,200 | 12,371 |
| | 45,444 | 35,965 |
| Discounted bills | 60,876 | 43,996 |
| Interest receivables | 1,834 | 1,274 |
| | 62,710 | 45,270 |
| Gross amount of loans and advances before allowance for impairment | 771,374 | 640,058 |

C Market risk

Market risks arise from open positions in interest rate and currency products, which are exposed to general and specific market movements. The Group principally operates in the PRC, in which the interest rate is set by mirroring with PBOC suggested interest rates, and the Group manages its interest rate risks by maintaining a minimum level of net interest spread between interest bearing assets and liabilities. Starting from 21 July 2005, China has reformed by moving into a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies. The change of exchange regime lead to an increase in volatility, therefore, the Board sets limits on the level of exposure by the currency to monitor the Group's currency risk.

3 USE OF FINANCIAL INSTRUMENTS *(Continued)*

D Currency risk

The Group conducts the majority of its businesses in RMB, with certain foreign transactions in Hong Kong dollars and US dollars. The Group takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board set limits on the level of exposure by currency, which are monitored regularly. The tables below summarize the Group's exposure to foreign currency exchange rate risk at the end of each year. The tables show the Group's assets and liabilities at carrying amounts in RMB, categorized by the original currency.

Group

| | RMB | US Dollars | HK Dollars | Others | Total |
|--|--------------------|-----------------|-----------------|-----------------|--------------------|
| As at 31 December 2005 | | | | | |
| Assets | | | | | |
| Cash and balances with central banks | 136,606 | 2,401 | 848 | 454 | 140,309 |
| Due from other banks and financial institutions | 106,166 | 47,152 | 7,571 | 9,212 | 170,101 |
| Financial assets held for trading | 1 | 1,399 | 1,423 | 405 | 3,228 |
| Loans and advances to customers | 678,966 | 41,804 | 32,967 | 5,036 | 758,773 |
| Investment securities-loans and receivables | 26,527 | 1,845 | - | - | 28,372 |
| Investment securities-available-for-sale | 251,083 | 21,233 | 6,644 | 7,011 | 285,971 |
| Other assets, including deferred tax assets | 38,059 | (2,993) | 3,362 | (1,743) | 36,685 |
| Total assets | 1,237,408 | 112,841 | 52,815 | 20,375 | 1,423,439 |
| Liabilities | | | | | |
| Due to other banks and financial institutions | (62,974) | (14,613) | (3,916) | (2,591) | (84,094) |
| Financial liabilities held for trading | (12) | (3,962) | (5,548) | (33) | (9,555) |
| Due to customers | (1,091,403) | (73,122) | (41,085) | (15,229) | (1,220,839) |
| Other liabilities, including deferred tax liabilities | (22,973) | (1,400) | (974) | (458) | (25,805) |
| Total liabilities | (1,177,362) | (93,097) | (51,523) | (18,311) | (1,340,293) |
| Net position | 60,046 | 19,744 | 1,292 | 2,064 | 83,146 |
| Financial guarantees and credit related commitments | 184,775 | 45,206 | 9,867 | 6,062 | 245,910 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

3 USE OF FINANCIAL INSTRUMENTS (Continued)**D Currency risk** (Continued)**Bank**

| | RMB | US Dollars | HK Dollars | Others | Total |
|--|--------------------|-----------------|-----------------|-----------------|--------------------|
| As at 31 December 2005 | | | | | |
| Assets | | | | | |
| Cash and balances with central banks | 136,605 | 2,401 | 569 | 454 | 140,029 |
| Due from other banks and financial institutions | 106,166 | 47,152 | 7,571 | 9,212 | 170,101 |
| Financial assets held for trading | 1 | 1,399 | 1,423 | 405 | 3,228 |
| Loans and advances to customers | 678,966 | 41,804 | 32,967 | 5,036 | 758,773 |
| Investment securities-loans and receivables | 26,527 | 1,845 | - | - | 28,372 |
| Investment securities-available-for-sale | 250,987 | 21,233 | 6,427 | 7,011 | 285,658 |
| Investments in and due from subsidiaries | (851) | - | 1,637 | - | 786 |
| Other assets, including deferred tax assets | 37,575 | (2,993) | 2,061 | (1,743) | 34,900 |
| Total assets | 1,235,976 | 112,841 | 52,655 | 20,375 | 1,421,847 |
| Liabilities | | | | | |
| Due to other banks and financial institutions | (62,974) | (14,613) | (3,916) | (2,591) | (84,094) |
| Financial liabilities held for trading | (12) | (3,962) | (5,548) | (33) | (9,555) |
| Due to customers | (1,091,403) | (73,122) | (41,085) | (15,229) | (1,220,839) |
| Other liabilities, including deferred tax liabilities | (21,500) | (1,400) | (479) | (458) | (23,837) |
| Total liabilities | (1,175,889) | (93,097) | (51,028) | (18,311) | (1,338,325) |
| Net position | 60,087 | 19,744 | 1,627 | 2,064 | 83,522 |
| Financial guarantees and credit related commitments | 184,775 | 45,206 | 9,867 | 6,062 | 245,910 |

3 USE OF FINANCIAL INSTRUMENTS *(Continued)*

D Currency risk *(Continued)*

Group

| | RMB | US Dollars | HK Dollars | Others | Total |
|--|------------------|-----------------|-----------------|-----------------|--------------------|
| As at 31 December 2004 | | | | | |
| Assets | | | | | |
| Cash and balances with central banks | 125,535 | 1,772 | 637 | 557 | 128,501 |
| Due from other banks and financial institutions | 37,472 | 38,145 | 5,943 | 7,363 | 88,923 |
| Financial assets held for trading | – | 904 | 1,351 | 240 | 2,495 |
| Loans and advances to customers | 563,158 | 36,544 | 25,619 | 6,291 | 631,612 |
| Investment securities-loans and receivables | 28,911 | 2,294 | – | – | 31,205 |
| Investment securities-available-for-sale | 176,836 | 20,544 | 10,756 | 7,387 | 215,523 |
| Other assets, including deferred tax assets | 39,528 | 3,464 | 4,568 | (1,814) | 45,746 |
| Total assets | 971,440 | 103,667 | 48,874 | 20,024 | 1,144,005 |
| Liabilities | | | | | |
| Due to other banks and financial institutions | (18,437) | (5,623) | (2,471) | (5,180) | (31,711) |
| Financial liabilities held for trading | – | (1,944) | (2,999) | (143) | (5,086) |
| Due to customers | (900,469) | (78,131) | (39,970) | (11,371) | (1,029,941) |
| Other liabilities, including deferred tax liabilities | (14,376) | (6,586) | (3,569) | (633) | (25,164) |
| Total liabilities | (933,282) | (92,284) | (49,009) | (17,327) | (1,091,902) |
| Net position | 38,158 | 11,383 | (135) | 2,697 | 52,103 |
| Financial guarantees and credit related commitments | 110,034 | 42,077 | 9,376 | 6,148 | 167,635 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

3 USE OF FINANCIAL INSTRUMENTS (Continued)

D Currency risk (Continued)

Bank

| | RMB | US Dollars | HK Dollars | Others | Total |
|--|------------------|-----------------|-----------------|-----------------|--------------------|
| As at 31 December 2004 | | | | | |
| Assets | | | | | |
| Cash and balances with central banks | 125,535 | 1,772 | 512 | 557 | 128,376 |
| Due from other banks and financial institutions | 37,472 | 38,145 | 5,943 | 7,363 | 88,923 |
| Financial assets held for trading | – | 904 | 1,351 | 240 | 2,495 |
| Loans and advances to customers | 563,158 | 36,544 | 25,619 | 6,291 | 631,612 |
| Investment securities-loans and receivables | 28,911 | 2,294 | – | – | 31,205 |
| Investment securities-available-for-sale | 176,746 | 20,544 | 10,755 | 7,387 | 215,432 |
| Investments in and due from subsidiaries | 219 | – | 1,057 | – | 1,276 |
| Other assets, including deferred tax assets | 38,797 | 3,464 | 2,929 | (1,814) | 43,376 |
| Total assets | 970,838 | 103,667 | 48,166 | 20,024 | 1,142,695 |
| Liabilities | | | | | |
| Due to other banks and financial institutions | (18,437) | (5,623) | (2,471) | (5,180) | (31,711) |
| Financial liabilities held for trading | – | (1,944) | (2,999) | (143) | (5,086) |
| Due to customers | (900,469) | (78,131) | (39,970) | (11,371) | (1,029,941) |
| Other liabilities, including deferred tax liabilities | (13,048) | (6,586) | (2,858) | (633) | (23,125) |
| Total liabilities | (931,954) | (92,284) | (48,298) | (17,327) | (1,089,863) |
| Net position | 38,884 | 11,383 | (132) | 2,697 | 52,832 |
| Financial guarantees and credit related commitments | 110,034 | 42,077 | 9,376 | 6,148 | 167,635 |

3 USE OF FINANCIAL INSTRUMENTS *(Continued)*

E Interest rate risk

Interest sensitivity of assets, liabilities and off balance sheet items

The Group takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise.

Currently, the interest rate framework within mainland China is set by the PBOC. According to the PBOC regulations, the ceiling for loan interest rates was adjusted from 30% to 70% above the stipulated interest rates on 1 January 2004 and finally was removed on 29 October 2004, whilst the floor is 10% below the stipulated rates. The Group operates its business predominantly in mainland China under the interest rate scheme regulated by the PBOC. It is normal practice for the interest rates of both interest-bearing assets and liabilities to move in the same direction. Consequently, the Group has little exposure in terms of interest rate risk. However, there is no guarantee that the PBOC will continue this practice in future.

The Group conducts most of its domestic on-balance-sheet businesses including loans and deposits as well as the majority of financial guarantees and credit related commitments based upon basic interest rates. The basic interest rates for the loans and the deposits normally move in tandem. Under this regulated environment, the Group is not subject to significant interest rate risk exposure. The interest rate repricing risk for foreign currency denominated debt securities and the remaining part of financial guarantees and credit related commitments businesses which are not based upon these basic interest rates is not expected to be significant.

The interest rate for discounted bills is determined by reference to the PBOC/market re-discount interest rate. However, it is generally lower than the interest rate for a loan with same term (including the above floating rate).

The tables below summarise the Group's exposure to interest rate risks. The tables show the Group's assets and liabilities at carrying amounts, categorized by the earlier of contractual repricing or maturity dates.

Expected repricing and maturity dates do not differ significantly from the contract dates, except for the maturity of "Due to customers" up to one month represent balances on current accounts considered by the Group as a relatively stable core source of funding of its operations.

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

3 USE OF FINANCIAL INSTRUMENTS (Continued)**E Interest rate risk** (Continued)**Group**

| | Up to 1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | Non- interest bearing | Total |
|--|------------------|------------------|------------------|-----------------|-----------------|-----------------------------|--------------------|
| As at 31 December 2005 | | | | | | | |
| Assets | | | | | | | |
| Cash and balances with central banks | 131,290 | - | - | - | - | 9,019 | 140,309 |
| Due from other banks and financial institutions | 130,833 | 28,103 | 8,195 | 1,550 | 1,050 | 370 | 170,101 |
| Financial assets held for trading | 1,401 | 29 | 114 | 714 | 970 | - | 3,228 |
| Loans and advances to customers | 70,237 | 138,190 | 348,928 | 89,503 | 111,915 | - | 758,773 |
| Investment securities | | | | | | | |
| – loans and receivables | 175 | 878 | 1,683 | 25,152 | 484 | - | 28,372 |
| – available-for-sale | 10,655 | 37,026 | 80,170 | 105,177 | 52,824 | 119 | 285,971 |
| Other assets, including deferred tax assets | - | - | - | - | - | 36,685 | 36,685 |
| Total assets | 344,591 | 204,226 | 439,090 | 222,096 | 167,243 | 46,193 | 1,423,439 |
| Liabilities | | | | | | | |
| Due to other banks and financial institutions | (59,381) | (13,930) | (8,718) | - | (2,002) | (63) | (84,094) |
| Financial liabilities held for trading | (2,286) | (5,215) | (389) | (1,616) | (6) | (43) | (9,555) |
| Due to customers | (791,021) | (108,106) | (218,811) | (76,517) | (1,914) | (24,470) | (1,220,839) |
| Other liabilities, including deferred tax liabilities | (215) | - | (292) | (12,000) | - | (13,298) | (25,805) |
| Total liabilities | (852,903) | (127,251) | (228,210) | (90,133) | (3,922) | (37,874) | (1,340,293) |
| Total interest sensitivity gap | (508,312) | 76,975 | 210,880 | 131,963 | 163,321 | 8,319 | 83,146 |

3 USE OF FINANCIAL INSTRUMENTS *(Continued)*

E Interest rate risk *(Continued)*

Bank

| | Up to 1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | Non- interest bearing | Total |
|--|------------------|------------------|------------------|-----------------|-----------------|-----------------------------|--------------------|
| As at 31 December 2005 | | | | | | | |
| Assets | | | | | | | |
| Cash and balances with central banks | 131,290 | - | - | - | - | 8,739 | 140,029 |
| Due from other banks and financial institutions | 130,833 | 28,103 | 8,195 | 1,550 | 1,050 | 370 | 170,101 |
| Financial assets held for trading | 1,401 | 29 | 114 | 714 | 970 | - | 3,228 |
| Loans and advances to customers | 70,237 | 138,190 | 348,928 | 89,503 | 111,915 | - | 758,773 |
| Investment securities | | | | | | | |
| – loans and receivables | 175 | 878 | 1,683 | 25,152 | 484 | - | 28,372 |
| – available-for-sale | 10,655 | 37,026 | 80,170 | 105,177 | 52,511 | 119 | 285,658 |
| Investments in and due from subsidiaries | - | - | 60 | 6 | - | 720 | 786 |
| Other assets, including deferred tax assets | - | - | - | - | - | 34,900 | 34,900 |
| Total assets | 344,591 | 204,226 | 439,150 | 222,102 | 166,930 | 44,848 | 1,421,847 |
| Liabilities | | | | | | | |
| Due to other banks and financial institutions | (59,381) | (13,930) | (8,718) | - | (2,002) | (63) | (84,094) |
| Financial liabilities held for trading | (2,286) | (5,215) | (389) | (1,616) | (6) | (43) | (9,555) |
| Due to customers | (791,021) | (108,106) | (218,811) | (76,517) | (1,914) | (24,470) | (1,220,839) |
| Other liabilities, including deferred tax liabilities | (215) | - | (292) | (12,000) | - | (11,330) | (23,837) |
| Total liabilities | (852,903) | (127,251) | (228,210) | (90,133) | (3,922) | (35,906) | (1,338,325) |
| Total interest sensitivity gap | (508,312) | 76,975 | 210,940 | 131,969 | 163,008 | 8,942 | 83,522 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

3 USE OF FINANCIAL INSTRUMENTS (Continued)

E Interest rate risk (Continued)

Group

| | Up to 1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | Non- interest bearing | Total |
|--|------------------|-----------------|------------------|-----------------|-----------------|-----------------------------|--------------------|
| As at 31 December 2004 | | | | | | | |
| Assets | | | | | | | |
| Cash and balances | | | | | | | |
| with central banks | 119,885 | – | – | – | – | 8,616 | 128,501 |
| Due from other banks and financial institutions | 76,629 | 11,126 | 530 | 300 | – | 338 | 88,923 |
| Financial assets held for trading | 972 | 267 | 148 | 268 | 840 | – | 2,495 |
| Loans and advances to customers | 53,203 | 126,571 | 288,067 | 77,151 | 86,620 | – | 631,612 |
| Investment securities | | | | | | | |
| – loans and receivables | 512 | 952 | 2,423 | 26,656 | 662 | – | 31,205 |
| – available-for-sale | 13,175 | 34,517 | 76,695 | 61,282 | 29,830 | 24 | 215,523 |
| Other assets, including deferred tax assets | – | – | – | – | – | 45,746 | 45,746 |
| Total assets | 264,376 | 173,433 | 367,863 | 165,657 | 117,952 | 54,724 | 1,144,005 |
| Liabilities | | | | | | | |
| Due to other banks and financial institutions | (22,978) | (5,161) | (1,602) | – | (1,956) | (14) | (31,711) |
| Financial liabilities held for trading | (1,988) | (1,532) | (268) | (1,248) | (50) | – | (5,086) |
| Due to customers | (706,196) | (67,609) | (175,714) | (56,690) | (2,987) | (20,745) | (1,029,941) |
| Other liabilities, including deferred tax liabilities | – | – | (275) | (12,000) | – | (12,889) | (25,164) |
| Total liabilities | (731,162) | (74,302) | (177,859) | (69,938) | (4,993) | (33,648) | (1,091,902) |
| Total interest | | | | | | | |
| sensitivity gap | (466,786) | 99,131 | 190,004 | 95,719 | 112,959 | 21,076 | 52,103 |

3 USE OF FINANCIAL INSTRUMENTS *(Continued)*

E Interest rate risk *(Continued)*

Bank

| | Up to 1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | Non- interest bearing | Total |
|--|------------------|-----------------|------------------|-----------------|-----------------|-----------------------------|--------------------|
| As at 31 December 2004 | | | | | | | |
| Assets | | | | | | | |
| Cash and balances with central banks | 119,885 | – | – | – | – | 8,491 | 128,376 |
| Due from other banks and financial institutions | 76,629 | 11,126 | 530 | 300 | – | 338 | 88,923 |
| Financial assets held for trading | 972 | 267 | 148 | 268 | 840 | – | 2,495 |
| Loans and advances to customers | 53,203 | 126,571 | 288,067 | 77,151 | 86,620 | – | 631,612 |
| Investment securities | | | | | | | |
| – loans and receivables | 512 | 952 | 2,423 | 26,656 | 662 | – | 31,205 |
| – available-for-sale | 13,084 | 34,517 | 76,695 | 61,282 | 29,830 | 24 | 215,432 |
| Investments in and due from subsidiaries | – | – | 60 | 225 | – | 991 | 1,276 |
| Other assets, including deferred tax assets | – | – | – | – | – | 43,376 | 43,376 |
| Total assets | 264,285 | 173,433 | 367,923 | 165,882 | 117,952 | 53,220 | 1,142,695 |
| Liabilities | | | | | | | |
| Due to other banks and financial institutions | (22,978) | (5,161) | (1,602) | – | (1,956) | (14) | (31,711) |
| Financial liabilities held for trading | (1,988) | (1,532) | (268) | (1,248) | (50) | – | (5,086) |
| Due to customers | (706,196) | (67,609) | (175,714) | (56,690) | (2,987) | (20,745) | (1,029,941) |
| Other liabilities, including deferred tax liabilities | – | – | (275) | (12,000) | – | (10,850) | (23,125) |
| Total liabilities | (731,162) | (74,302) | (177,859) | (69,938) | (4,993) | (31,609) | (1,089,863) |
| Total interest sensitivity gap | (466,877) | 99,131 | 190,064 | 95,944 | 112,959 | 21,611 | 52,832 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

3 USE OF FINANCIAL INSTRUMENTS (Continued)

E Interest rate risk (Continued)

The tables below summarise the effective interest rate by major currencies for monetary financial instruments:

Group and Bank

| | RMB | US Dollars | HK Dollars | Others |
|---|-------|------------|------------|--------|
| As at 31 December 2005 | | | | |
| Assets | | | | |
| Cash and balances with central banks | 1.60% | 0.17% | 0.19% | 0.00% |
| Due from other banks and financial institutions | 1.64% | 4.23% | 4.08% | 3.88% |
| Loans and advances to customers | 5.34% | 4.38% | 5.55% | 2.20% |
| Investment securities | | | | |
| – loans and receivables | 2.98% | 5.15% | N/A | N/A |
| – available-for-sale | 2.85% | 4.32% | 3.44% | 3.79% |
| Liabilities | | | | |
| Due to other banks and financial institutions | 1.43% | 4.20% | 4.02% | 2.04% |
| Due to customers | 1.55% | 3.33% | 3.37% | 2.53% |
| As at 31 December 2004 | | | | |
| Assets | | | | |
| Cash and balances with central banks | 1.82% | 0.06% | 0.00% | N/A |
| Due from other banks and financial institutions | 2.21% | 2.16% | 0.35% | 2.37% |
| Loans and advances to customers | 5.34% | 2.94% | 2.25% | 2.36% |
| Investment securities | | | | |
| – loans and receivables | 2.96% | 4.41% | N/A | N/A |
| – available-for-sale | 3.62% | 3.35% | 2.01% | 2.26% |
| Liabilities | | | | |
| Due to other banks and financial institutions | 1.64% | 1.75% | 0.24% | 0.49% |
| Due to customers | 1.36% | 0.92% | 0.36% | 2.58% |

3 USE OF FINANCIAL INSTRUMENTS *(Continued)*

F Liquidity risk

The Group is exposed to daily calls on its available cash resources from overnight deposits, current accounts, matured deposits, loan draw downs, guarantees and from margin and other calls on cash settled derivatives. The Board set limits on the minimum proportion of funds to be made available to meet such calls and on the minimum level of interbank and other borrowing facilities that should be in place to cover different levels of unexpected withdrawals. In addition, the Group limits its loan to deposit ratio at below 75% as required by the PBOC. 7.5% of the Group's total RMB denominated deposits and 3% of the total foreign currency denominated deposits must be deposited with central banks. The tables below analyze the assets and liabilities of the Group into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date.

Maturities of assets and liabilities

Group

| | Up to 1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | Over due | Total |
|--|------------------|------------------|------------------|-----------------|-----------------|---------------|--------------------|
| As at 31 December 2005 | | | | | | | |
| Assets | | | | | | | |
| Cash and balances with central banks | 140,309 | - | - | - | - | - | 140,309 |
| Due from other banks and financial institutions | 130,844 | 28,315 | 8,272 | 1,550 | 1,050 | 70 | 170,101 |
| Financial assets held for trading | 1,321 | 42 | 93 | 762 | 1,010 | - | 3,228 |
| Loans and advances to customers | 57,479 | 111,693 | 346,722 | 112,901 | 113,799 | 16,179 | 758,773 |
| Investment securities | | | | | | | |
| – loans and receivables | 14 | 717 | 1,763 | 25,394 | 484 | - | 28,372 |
| – available-for-sale | 3,876 | 17,428 | 57,111 | 138,465 | 69,091 | - | 285,971 |
| Other assets, including deferred tax assets | 6,858 | 853 | 2,593 | 4,815 | 20,797 | 769 | 36,685 |
| Total assets | 340,701 | 159,048 | 416,554 | 283,887 | 206,231 | 17,018 | 1,423,439 |
| Liabilities | | | | | | | |
| Due to other banks and financial institution | (59,280) | (14,054) | (8,758) | - | (2,002) | - | (84,094) |
| Financial liabilities held for trading | (1,078) | (426) | (715) | (7,287) | (49) | - | (9,555) |
| Due to customers | (812,495) | (104,277) | (220,096) | (79,850) | (4,121) | - | (1,220,839) |
| Other liabilities, including deferred tax liabilities | (10,942) | (1,696) | (518) | (12,243) | (406) | - | (25,805) |
| Total liabilities | (883,795) | (120,453) | (230,087) | (99,380) | (6,578) | - | (1,340,293) |
| Net liquidity gap | (543,094) | 38,595 | 186,467 | 184,507 | 199,653 | 17,018 | 83,146 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

3 USE OF FINANCIAL INSTRUMENTS (Continued)

F Liquidity risk (Continued)

Bank

| | Up to 1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | Over due | Total |
|--|------------------|------------------|------------------|-----------------|-----------------|---------------|--------------------|
| As at 31 December 2005 | | | | | | | |
| Assets | | | | | | | |
| Cash and balances with central banks | 140,029 | - | - | - | - | - | 140,029 |
| Due from other banks and financial institutions | 130,844 | 28,315 | 8,272 | 1,550 | 1,050 | 70 | 170,101 |
| Financial assets held for trading | 1,321 | 42 | 93 | 762 | 1,010 | - | 3,228 |
| Loans and advances to customers | 57,479 | 111,693 | 346,722 | 112,901 | 113,799 | 16,179 | 758,773 |
| Investment securities | | | | | | | |
| – loans and receivables | 14 | 717 | 1,763 | 25,394 | 484 | - | 28,372 |
| – available-for-sale | 3,876 | 17,428 | 57,111 | 138,465 | 68,778 | - | 285,658 |
| Investments in and due from subsidiaries | - | - | 60 | 6 | 720 | - | 786 |
| Other assets, including deferred tax assets | 6,555 | 853 | 2,593 | 4,815 | 19,315 | 769 | 34,900 |
| Total assets | 340,118 | 159,048 | 416,614 | 283,893 | 205,156 | 17,018 | 1,421,847 |
| Liabilities | | | | | | | |
| Due to other banks and financial institution | (59,280) | (14,054) | (8,758) | - | (2,002) | - | (84,094) |
| Financial liabilities held for trading | (1,078) | (426) | (715) | (7,287) | (49) | - | (9,555) |
| Due to customers | (812,495) | (104,277) | (220,096) | (79,850) | (4,121) | - | (1,220,839) |
| Other liabilities, including deferred tax liabilities | (9,097) | (1,696) | (518) | (12,243) | (283) | - | (23,837) |
| Total liabilities | (881,950) | (120,453) | (230,087) | (99,380) | (6,455) | - | (1,338,325) |
| Net liquidity gap | (541,832) | 38,595 | 186,527 | 184,513 | 198,701 | 17,018 | 83,522 |

3 USE OF FINANCIAL INSTRUMENTS *(Continued)*

F Liquidity risk *(Continued)*

Group

| | Up to 1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | Over due | Total |
|--|------------------|-----------------|------------------|-----------------|-----------------|---------------|--------------------|
| As at 31 December 2004 | | | | | | | |
| Assets | | | | | | | |
| Cash and balances with central banks | 128,501 | – | – | – | – | – | 128,501 |
| Due from other banks and financial institutions | 76,503 | 11,470 | 650 | 300 | – | – | 88,923 |
| Financial assets held for trading | 974 | 254 | 145 | 286 | 836 | – | 2,495 |
| Loans and advances to customers | 43,804 | 104,553 | 285,017 | 97,181 | 87,421 | 13,636 | 631,612 |
| Investment securities | | | | | | | |
| – loans and receivables | 12 | 785 | 2,428 | 26,987 | 993 | – | 31,205 |
| – available-for-sale | 5,243 | 22,272 | 56,586 | 82,719 | 48,703 | – | 215,523 |
| Other assets, including deferred tax assets | 14,788 | 951 | 1,939 | 8,215 | 19,400 | 453 | 45,746 |
| Total assets | 269,825 | 140,285 | 346,765 | 215,688 | 157,353 | 14,089 | 1,144,005 |
| Liabilities | | | | | | | |
| Due to other banks and financial institutions | (22,992) | (5,161) | (1,602) | – | (1,956) | – | (31,711) |
| Financial liabilities held for trading | (830) | (240) | (173) | (3,534) | (309) | – | (5,086) |
| Due to customers | (724,497) | (68,546) | (175,982) | (56,552) | (4,364) | – | (1,029,941) |
| Other liabilities, including deferred tax liabilities | (10,903) | (197) | (913) | (12,000) | (1,151) | – | (25,164) |
| Total liabilities | (759,222) | (74,144) | (178,670) | (72,086) | (7,780) | – | (1,091,902) |
| Net liquidity gap | (489,397) | 66,141 | 168,095 | 143,602 | 149,573 | 14,089 | 52,103 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

3 USE OF FINANCIAL INSTRUMENTS (Continued)

F Liquidity risk (Continued)

Bank

| | Up to 1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | Over due | Total |
|--|------------------|-----------------|------------------|-----------------|-----------------|---------------|--------------------|
| As at 31 December 2004 | | | | | | | |
| Assets | | | | | | | |
| Cash and balances with central banks | 128,376 | – | – | – | – | – | 128,376 |
| Due from other banks and financial institutions | 76,503 | 11,470 | 650 | 300 | – | – | 88,923 |
| Financial assets held for trading | 974 | 254 | 145 | 286 | 836 | – | 2,495 |
| Loans and advances to customers | 43,804 | 104,553 | 285,017 | 97,181 | 87,421 | 13,636 | 631,612 |
| Investment securities | | | | | | | |
| – loans and receivables | 12 | 785 | 2,428 | 26,987 | 993 | – | 31,205 |
| – available-for-sale | 5,152 | 22,272 | 56,586 | 82,719 | 48,703 | – | 215,432 |
| Investments in and due from subsidiaries | – | – | 60 | 153 | 1,063 | – | 1,276 |
| Other assets, including deferred tax assets | 13,959 | 951 | 1,939 | 8,215 | 17,859 | 453 | 43,376 |
| Total assets | 268,780 | 140,285 | 346,825 | 215,841 | 156,875 | 14,089 | 1,142,695 |
| Liabilities | | | | | | | |
| Due to other banks and financial institution | (22,992) | (5,161) | (1,602) | – | (1,956) | – | (31,711) |
| Financial liabilities held for trading | (830) | (240) | (173) | (3,534) | (309) | – | (5,086) |
| Due to customers | (724,497) | (68,546) | (175,982) | (56,552) | (4,364) | – | (1,029,941) |
| Other liabilities, including deferred tax liabilities | (8,970) | (197) | (913) | (12,000) | (1,045) | – | (23,125) |
| Total liabilities | (757,289) | (74,144) | (178,670) | (72,086) | (7,674) | – | (1,089,863) |
| Net liquidity gap | (488,509) | 66,141 | 168,155 | 143,755 | 149,201 | 14,089 | 52,832 |

3 USE OF FINANCIAL INSTRUMENTS *(Continued)*

F Liquidity risk *(Continued)*

The matching and controlled mismatching of the maturities of assets and liabilities is fundamental to the management of the Group. It is unusual for banks ever to be completely matched since business transacted is often of uncertain term and of different types. An unmatched position potentially enhances profitability, but also increases risk of losses.

The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Group and its exposure to changes in exchange rates.

The Group provides guarantees and issues letters of credit based on a third party's creditability and deposit amount. Liquidity requirements to support calls under guarantees and letters of credit are considerably less than the amounts under commitments because the Group does not generally expect the third party to draw funds under those agreements. The total outstanding contractual amount of commitments to extend credit does not necessarily represent future cash requirements, since many of these commitments will expire or terminate without being funded.

G Fair values of financial assets and liabilities

The following table summarizes the carrying amounts and the approximate fair values of those financial assets and liabilities not presented on the Group's balance sheet at their fair value. Bid prices are used to estimate fair values of assets, whereas offer prices are applied for liabilities.

Group and Bank

| | 31 December 2005 | | 31 December 2004 | |
|---|------------------|------------|------------------|------------|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Financial assets | | | | |
| Due from other banks and financial institutions | 170,101 | 170,101 | 88,923 | 88,923 |
| Loans and advances to customers | 758,773 | 758,773 | 631,612 | 631,612 |
| Investment securities – loans and receivables | 28,372 | 29,189 | 31,205 | 31,130 |
| Due from subsidiaries | 136 | 136 | 66 | 66 |
| Financial liabilities | | | | |
| Due to other banks and financial institutions | 84,094 | 84,094 | 31,711 | 31,711 |
| Due to customers | 1,220,839 | 1,220,320 | 1,029,941 | 1,029,286 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

3 USE OF FINANCIAL INSTRUMENTS (Continued)

G Fair values of financial assets and liabilities (Continued)

The fair values of those financial assets and liabilities such as amounts due from/to other banks and financial institutions, loans and advances to customers and customer deposits are approximately equal to their carrying values as the interest rates of most of these assets and liabilities are instantaneously adjusted to changes in interest rates set by the PBOC and other regulatory bodies. The Group only has an insignificant amount of fixed rate deposits due to and from other banks and financial institutions, deposits due to customers and loans and advances due from customers.

Due from other banks and financial institutions

Due from other banks and financial institutions includes inter-bank placements and items in the course of collection. The fair values of floating rate placements and overnight deposits are their carrying amounts. The estimated fair value of fixed interest bearing deposits, which are normally less than one year, is based on discounted cash flows using prevailing money market interest rates for debts with similar credit risk and remaining maturities. Therefore, the fair value of due from other banks and financial institutions is approximately equal to its carrying value.

Loans and advances to customers

Loans and advances to customers are stated net of impairment allowance. All except a very insignificant portion of loans and advances to customers bear interest at a floating rate. Therefore, the carrying value of loans and advances to customers is a reasonable estimate of fair value.

Investment securities

Investment securities include only interest-bearing loans and receivables, as available-for-sale securities are measured at fair value. The fair value is determined by following the hierarchy given below:

- the price used in recent transactions of similar financial instruments with adjustment when the market conditions have changed.
- valuation techniques, including: cash flow models etc.
- if fair value cannot be measured reliably, equity and security investments are recognised at cost less impairment.

3 USE OF FINANCIAL INSTRUMENTS *(Continued)*

G Fair values of financial assets and liabilities *(Continued)*

Due to other banks and financial institutions and customers

The estimated fair value of liabilities due to other banks and financial institutions and customers with no stated maturity, which includes non-interest-bearing liabilities due to other banks and financial institutions and customers, is the amount repayable on demand. The fair value of floating rate liabilities due to other banks and customers is their carrying amount. The estimated fair value of fixed interest bearing liabilities due to other banks and financial institutions and customers without quoted market price, which are normally less than one year, is based on discounted cash flows using interest rates for new debts with similar remaining maturities. Therefore, the fair value of due to other banks and financial institutions and customers is approximately equal to its carrying value.

H Fiduciary activities

The Group provides custody and trustee services to third parties. Those assets that are held in a fiduciary capacity are not included in the financial statements.

Group and Bank

| | As at 31 December | |
|-----------------------------|-------------------|--------|
| | 2005 | 2004 |
| Investment custody accounts | 96,852 | 71,662 |

5 DIVIDEND INCOME

Group

| | Year ended 31 December | |
|-----------------|------------------------|------|
| | 2005 | 2004 |
| Dividend income | 45 | 55 |

Dividend income was from equity investments classified as available-for-sale securities or as financial assets held for trading.

6 GAINS LESS LOSSES ARISING FROM TRADING ACTIVITIES

Group

| | Year ended 31 December | |
|---------------------------|------------------------|-------|
| | 2005 | 2004 |
| Foreign exchange | 207 | 594 |
| Interest rate instruments | 213 | (269) |
| | 420 | 325 |

Net income on foreign exchange includes gains and losses from spot and forward contracts and from the translation of foreign currency monetary assets and liabilities into Renminbi.

Net income/(expense) on interest rate instruments mainly include the results of marking interest rate and currency swaps and other derivatives to market.

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

7 OTHER OPERATING INCOME

Group

| | Year ended 31 December | |
|--|------------------------|------------|
| | 2005 | 2004 |
| Profit on sales of land use rights and buildings | 66 | 214 |
| Sales of foreclosed assets and other assets | 38 | 46 |
| Revaluation surplus of investment property | 46 | — |
| Penalty income | 9 | 19 |
| Other miscellaneous income | 470 | 354 |
| | 629 | 633 |

Other miscellaneous income includes income arising from miscellaneous banking services provided to the Group's customers.

8 IMPAIRMENT LOSSES ON LOANS AND ADVANCES

Group

| | Year ended 31 December | |
|--|------------------------|--------------|
| | 2005 | 2004 |
| Due from other banks and financial institutions and securities purchased under resale agreements, net (Note 15(b)) | (149) | 324 |
| Loans and advances to customers (Note 18(b)) | 4,549 | 3,041 |
| Less: recovery of loans previously written off | (102) | (150) |
| | 4,298 | 3,215 |

9 OTHER OPERATING EXPENSES

Group

| | Year ended 31 December | |
|--|------------------------|---------------|
| | 2005 | 2004 |
| Staff costs (<i>Note 10</i>) | 5,776 | 4,660 |
| General and administrative expenses | 3,080 | 2,758 |
| Depreciation (<i>Note 20</i>) | 2,364 | 2,471 |
| Business tax and surcharges | 2,109 | 1,639 |
| Operating lease rentals | 737 | 747 |
| Write-down/Impairment of other receivables | 327 | 394 |
| Regulator's supervision fee | 259 | 185 |
| (Reversal of)/Provision for outstanding litigation | (51) | 633 |
| Revaluation deficit of property and equipment (<i>Note 20</i>) | 9 | 389 |
| Revaluation deficit of investment property | – | 32 |
| Professional fees | 34 | 159 |
| Others | 3,368 | 2,925 |
| | 18,012 | 16,992 |

10 STAFF COSTS

Group

| | Year ended 31 December | |
|---|------------------------|--------------|
| | 2005 | 2004 |
| Salaries and bonus | 3,678 | 2,717 |
| Pension costs | 431 | 392 |
| Housing benefits and subsidies | 535 | 609 |
| Other social security and benefit costs | 1,132 | 942 |
| | 5,776 | 4,660 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

11 DIRECTORS' EMOLUMENTS

(a) Directors' and supervisors' emoluments (In RMB Yuan)

| Name | Year ended 31 December | | | | | | 2004 Total |
|--------------------------------|------------------------|---------|--------------------------|-------------------|--|-----------|---------------|
| | 2005 | | | | | Total | |
| | Emoluments | Salary | Discretionary bonuses | Other benefits | Employer's contribution to pension scheme | | |
| Executive directors | | | | | | | |
| Mr. Zhang, Jianguo | - | 54,420 | 673,812 | 196,647 | 135,431 | 1,060,310 | 703,825 |
| Mr. Li, Jun | - | 44,372 | 555,680 | 82,728 | 117,073 | 799,853 | 982,613 |
| Mr. Peng, Chun | - | 17,320 | 201,580 | 33,752 | 48,781 | 301,433 | 251,646 |
| Mr. Zhang, Jixiang | - | 50,236 | 462,632 | 56,689 | 43,639 | 613,196 | 222,411 |
| Mr. Qiao, Wei | - | 24,278 | 307,162 | 43,308 | 58,537 | 433,285 | 986,804 |
| Mr. Xu, Junkang | N/A | N/A | N/A | N/A | N/A | N/A | 733,914 |
| Mr. Yin, Jieyan | N/A | N/A | N/A | N/A | N/A | N/A | 610,733 |
| Mr. Fang, Chengguo | N/A | N/A | N/A | N/A | N/A | N/A | 601,792 |
| Mr. Liu, Yuchang | N/A | N/A | N/A | N/A | N/A | N/A | 505,656 |
| Ms. Yin, Baoyu | N/A | N/A | N/A | N/A | N/A | N/A | 212,886 |
| Non-executive directors | | | | | | | |
| Mr. Jiang, Chaoliang | - | 54,420 | 673,812 | 96,647 | 135,431 | 960,310 | 646,944 |
| Mr. OR Ching Fai | 2,000 | - | - | - | - | 2,000 | 2,000 |
| Mr. Wang Dongshen | - | - | - | - | - | - | - |
| Mr. Fung Kwok Lun | 2,000 | - | - | - | - | 2,000 | 2,000 |
| Mr. Li Keping | 6,000 | - | - | - | - | 6,000 | 2,000 |
| Mr. Li Zexing | 10,000 | - | - | - | - | 10,000 | 2,000 |
| Mr. Hu, Huating | - | 46,612 | 462,632 | 54,359 | 36,754 | 600,357 | 160,169 |
| Mr. Gao Shiqing | 2,000 | - | - | - | - | 2,000 | 2,000 |
| Mr. Shen Weiming | 4,000 | - | - | - | - | 4,000 | 2,000 |
| Mr. Li Guanglin | 6,000 | - | - | - | - | 6,000 | 2,000 |
| Mr. Qian Ping | - | - | - | - | - | - | - |
| Mr. Xia Bin | N/A | N/A | N/A | N/A | N/A | N/A | 20,000 |
| Mr. Xie Qingjian | - | 150,000 | - | - | - | 150,000 | 25,000 |
| Mr. Ian Ramsay Wilson | - | 150,000 | - | - | - | 150,000 | 25,000 |
| Mr. Thomas Joseph Manning | - | 150,000 | - | - | - | 150,000 | 25,000 |
| Mr. Hui Ho Ming Herbert | - | 125,000 | - | - | - | 125,000 | N/A |
| Mr. Chen Qingtai | - | 125,000 | - | - | - | 125,000 | N/A |

11 DIRECTORS' EMOLUMENTS *(Continued)*

(a) Directors' and supervisors' emoluments (In RMB Yuan) *(Continued)*

| Name | Year ended 31 December | | | | | | 2004 Total |
|--------------------|------------------------|------------------|-----------------------|----------------|---|------------------|------------------|
| | 2005 | | | | | Total | |
| | Emoluments | Salary | Discretionary bonuses | Other benefits | Employer's contribution to pension scheme | | |
| Supervisors | | | | | | | |
| Mr. Cui Leiping | - | 49,256 | 674,160 | 97,151 | 135,431 | 955,998 | 251,730 |
| Ms. Liu Sha | - | 44,438 | 427,800 | 31,387 | 22,526 | 526,151 | 24,288 |
| Ms. Chen Qing | - | 44,438 | 427,440 | 31,387 | 22,526 | 525,791 | 27,871 |
| Mr. Lee Jun | - | 11,080 | 61,521 | 8,013 | 15,535 | 96,149 | N/A |
| Ms. Yin Baoyu | - | 46,499 | 415,467 | 37,696 | 84,098 | 583,760 | 330,318 |
| Mr. Ning Jinbiao | 6,000 | - | - | - | - | 6,000 | 6,000 |
| Ms. Dong Mei | N/A | N/A | N/A | N/A | N/A | N/A | 4,000 |
| Mr. Zhao Lijun | N/A | N/A | N/A | N/A | N/A | N/A | 2,000 |
| Mr. Teng Tieqi | 4,000 | - | - | - | - | 4,000 | 2,000 |
| Mr. Ji Kelian | 4,000 | - | - | - | - | 4,000 | 4,000 |
| Mr. Li Chao | N/A | N/A | N/A | N/A | N/A | N/A | 20,000 |
| Mr. Liu Qiang | 8,000 | 120,000 | - | - | - | 128,000 | 49,333 |
| Ms. Chen Zheng | 8,000 | 120,000 | - | - | - | 128,000 | 25,333 |
| Total | 62,000 | 1,427,369 | 5,343,698 | 769,764 | 855,762 | 8,458,593 | 7,475,266 |

Above listed amounts only include emoluments of the Directors or Supervisors during their tenure of Director or Supervisor in the related years.

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

11 DIRECTORS' EMOLUMENTS (Continued)

(b) Five Highest Paid Individuals

The five highest paid individuals in the Bank for the related years are senior management of Hong Kong branch listed as follows:

| | Year ended 31 December | |
|---|------------------------|------|
| | 2005 | 2004 |
| Salary | 5 | 5 |
| Discretionary bonuses | 1 | 1 |
| Employer's contribution to pension scheme | 1 | — |
| | 7 | 6 |

Emoluments of above five highest paid individuals in the Bank are within the following bands:

| | Number of employees | |
|---------------------------|---------------------|------|
| | 2005 | 2004 |
| RMB1,000,000-RMB1,500,000 | 4 | 4 |
| RMB1,500,000-RMB2,000,000 | 1 | 1 |
| | 5 | 5 |

During the year, no emoluments were paid by the Bank to any of the directors or supervisors as an inducement to join or upon joining the Bank or as compensation for loss of office.

12 INCOME TAX EXPENSE

Group

| | Year ended 31 December | |
|---------------------------------|------------------------|-------|
| | 2005 | 2004 |
| Current tax | | |
| – Mainland China income tax | 786 | 141 |
| – Hong Kong profits tax | 139 | 75 |
| – Overseas taxation | 2 | 5 |
| | 927 | 221 |
| Deferred tax (<i>Note 26</i>) | 2,673 | 5,925 |
| | 3,600 | 6,146 |

The provision for Mainland China income tax is calculated based on the statutory rate of 33% of the assessable income of the Bank and each of the subsidiaries established in Mainland China as determined in accordance with the relevant PRC income tax rules and regulations for the year ended 31 December 2005.

Profits earned by the Hong Kong branch or subsidiaries in Hong Kong are subject to Hong Kong profits tax at the rate of 17.5%, on the estimated assessable profit for the year ended 31 December 2005. Taxation on overseas profits has been calculated on the estimated assessable profit at the rates of taxation prevailing in the countries in which the Group operates during the year ended 31 December 2005.

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

12 INCOME TAX EXPENSE (Continued)

The taxation on the Group's profit before taxation differs from the theoretical amount that would arise using the taxation rate of the home country of the Bank at 33%. The reconciliation is as follows:

| | Year ended 31 December | |
|---|------------------------|---------|
| | 2005 | 2004 |
| Profit before tax | 12,843 | 7,750 |
| Tax calculated at a tax rate of 33% | 4,238 | 2,557 |
| Effect of different tax rates in other countries | (58) | 5 |
| De-recognition of deferred tax assets in relation to loans disposed of (Note 1) | – | 9,671 |
| Recognition of deferred tax assets in relation to tax loss (Note 2) | – | (3,588) |
| Tax credit arising from income not subject to tax (Note 3) | (1,020) | (3,747) |
| Tax effect of expenses that are not deductible for tax purposes (Note 4) | 440 | 1,248 |
| Income tax expense | 3,600 | 6,146 |

Notes:

- Prior to the disposal of the majority of impaired loans to an asset management company in June 2004, the Group had recognised deferred tax asset of RMB10,015 million for all temporary differences arising from loan impairment. Following the disposal of the impaired loans, all deferred tax assets in relation thereto of RMB9,671 million (Note 26) had been derecognised accordingly.
- The Group obtained written approvals from the Ministry of Finance (“the MOF”) and the tax authority on 10 January 2005 and 25 March 2005 respectively, which confirm the Group's accumulated losses to be RMB11,002 million, and the accumulated losses can be used to offset against future taxable profit from 1 January 2005 onwards. Therefore, the Group recognised deferred tax assets amounting to RMB3,631 million (Note 26), being 33% of RMB11,002 million at 31 December 2004.

12 INCOME TAX EXPENSE *(Continued)*

Notes: (Continued)

3. Included in the amount of RMB3,747 million of income not subject to tax for the year ended 31 December 2004 is an amount of RMB2,932 million being income tax on profit of the Bank for the year ended 31 December 2004. This amount of profit earned was income tax exempt in consideration of the loss incurred by the Bank on its disposal of impaired loans in June 2004.
4. Included in the amount of RMB1,248 million of expenses that are not deductible for tax purposes for the year ended 31 December 2004, is an amount of RMB756 million being the income tax on non-deductible staff cost & staff welfare. The Group obtained a written approval from the MOF and the tax authority on 7 February 2006, which granted a deductible limit for the Bank's staff cost of RMB3,315 million for the year ended 31 December 2005. Such approval led to a significant decrease of the income tax on non-deductible staff cost & staff welfare, approximately RMB1,050 million.

13 BASIC AND DILUTED EARNINGS PER SHARE

Basic and diluted earnings per share is calculated by dividing the net profit attributable to shareholders of the Bank by the weighted average number of ordinary shares in issue during the year.

| | Year ended 31 December | |
|--|------------------------|--------|
| | 2005 | 2004 |
| Profit attributable to shareholders of the Bank | 9,249 | 1,604 |
| Weighted average number of ordinary shares in issue | 42,581 | 26,396 |
| Basic and diluted earnings per share (expressed in RMB per share) | 0.22 | 0.06 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

14 CASH AND BALANCES WITH CENTRAL BANKS**Group**

| | As at 31 December | |
|---|--------------------------|-------------|
| | 2005 | 2004 |
| Cash | 9,280 | 8,616 |
| Balances with central banks other than mandatory reserve deposits | 57,720 | 58,215 |
| Included in cash and cash equivalents (Note 36) | 67,000 | 66,831 |
| Mandatory reserve deposits | 73,309 | 61,670 |
| | 140,309 | 128,501 |

Bank

| | As at 31 December | |
|---|--------------------------|-------------|
| | 2005 | 2004 |
| Cash | 9,000 | 8,491 |
| Balances with central banks other than mandatory reserve deposits | 57,720 | 58,215 |
| Included in cash and cash equivalents | 66,720 | 66,706 |
| Mandatory reserve deposits | 73,309 | 61,670 |
| | 140,029 | 128,376 |

The Group is required to place mandatory deposits with central banks. The deposits are calculated based on the amount of deposits placed with the Group by its customers.

| | As at 31 December | |
|---|--------------------------|-------------|
| | 2005 | 2004 |
| Mandatory reserve rate for deposits denominated in RMB | 7.5% | 7.5% |
| Mandatory reserve rate for deposits denominated in foreign currency | 3% | 2% |

Mandatory reserve deposits with central banks are not available for use by the Group in its day to day operations.

15 DUE FROM OTHER BANKS AND FINANCIAL INSTITUTIONS

(a) Due from other banks and financial institutions

Group and Bank

| | As at 31 December | |
|--|-------------------|--------|
| | 2005 | 2004 |
| Placement with other banks and included in cash equivalents (<i>Note 36</i>) | 34,305 | 8,926 |
| Securities purchased under resale agreement | 65,715 | 27,109 |
| Less: allowance for impairment losses on securities purchased under resale agreement | (10) | (82) |
| | 65,705 | 27,027 |
| Loans purchased under resale agreement | 11,062 | 2,395 |
| Loans and advances to other banks | 55,147 | 49,197 |
| Loans to other financial institutions | 4,615 | 2,300 |
| | 59,762 | 51,497 |
| Less: Individual impairment allowance on amounts due from other banks and financial institutions | (733) | (922) |
| | 59,029 | 50,575 |
| | 170,101 | 88,923 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

15 DUE FROM OTHER BANKS AND FINANCIAL INSTITUTIONS (Continued)**(b) Movements in allowance for impairment losses on amounts due from other banks and financial institutions and securities purchased under resale agreement****Group and Bank**

| | Year ended 31 December | |
|---|------------------------|-------|
| | 2005 | 2004 |
| Balance at beginning of the year | 1,004 | 968 |
| (Reversal of) /Provision for impairment, net (Note 8) | (149) | 324 |
| Amounts written-off/ transferred out during the year as uncollectible | (112) | (288) |
| Balance at end of the year | 743 | 1,004 |

(c) Impaired amount of due from other banks and financial institutions:**Group and Bank**

| | As at 31 December | |
|---|-------------------|-------|
| | 2005 | 2004 |
| Impaired amount of due from other banks and financial institutions | 743 | 1,004 |
| Impaired amount of due from other banks and financial institutions (percentage) | 0.44% | 1.12% |

16 FINANCIAL ASSETS HELD FOR TRADING

Group and Bank

| | As at 31 December | |
|---|-------------------|--------------|
| | 2005 | 2004 |
| Derivative financial instruments (<i>Note 17</i>) | 299 | 219 |
| Government bonds-listed in Hong Kong | 1,294 | 1,191 |
| Other debt securities | | |
| – Listed in Hong Kong | 611 | 310 |
| – Unlisted – corporate bonds | 146 | 166 |
| – Unlisted – public sector | 71 | 96 |
| – Unlisted – banking sector | 807 | 513 |
| | 3,228 | 2,495 |

17 DERIVATIVE FINANCIAL INSTRUMENTS

The following derivative instruments are utilized by the Group for trading purpose:

Currency forwards represent commitments to purchase/sell foreign exchanges including undelivered spot transactions.

Currency and interest rate swaps are commitments to exchange one set of cash flows for another. Swaps result in an economic exchange of currencies or interest rates (for example, fixed rate for floating rate) or a combination of all these (i.e. cross-currency interest rate swaps). The Group's credit risk represents the potential cost to replace the swap contracts if counterparties fail to perform their obligation. This risk is monitored on an ongoing basis with reference to the current fair value, the notional amount of the contracts and the liquidity of the market. To control the level of credit risk taken, the Group assesses counterparties using the same techniques as for its lending activities.

Foreign currency and interest rate options are contractual agreements under which the seller (writer) grants the purchaser (holder) the right, but not the obligation, either to buy (a call option) or sell (a put option) at or by a set date or during a set period, a specific amount of a foreign currency or a financial instrument at a predetermined price. The seller receives a premium from the purchaser in consideration for the assumption of foreign exchange or interest rate risk. Options may be either exchange-traded or negotiated between the Group and a customer (OTC).

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

17 DERIVATIVE FINANCIAL INSTRUMENTS (Continued)

The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognised on the balance sheet but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, do not indicate the Group's exposure to credit or price risks. The derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in market interest rates or foreign exchange rates relative to their terms. The aggregate fair values of derivative financial assets and liabilities can fluctuate significantly from time to time. The fair values of derivative instruments held are set out in the following tables.

Group and Bank

| | Contract/ notional Amount | Fair values | |
|--------------------------------------|---------------------------------|-------------|--------------|
| | | Assets | Liabilities |
| As at 31 December 2005 | | | |
| Foreign exchange derivatives | | | |
| Currency forwards | 11,215 | 51 | (43) |
| Currency swaps | 23,234 | 99 | (8) |
| OTC currency options bought and sold | 335 | 2 | (1) |
| Subtotal | | 152 | (52) |
| Interest rate derivatives | | | |
| Interest rate swaps | 24,791 | 108 | (220) |
| Cross currency interest rate swaps | 3,532 | 36 | (26) |
| OTC interest rate options | 565 | 3 | (3) |
| Subtotal | | 147 | (249) |
| Total recognised derivatives | | 299 | (301) |

17 DERIVATIVE FINANCIAL INSTRUMENTS *(Continued)***Group and Bank**

| | Contract/ notional Amount | Fair values | |
|---|--|--------------------|--------------------|
| | | Assets | Liabilities |
| As at 31 December 2004 | | | |
| Foreign exchange derivatives | | | |
| Currency forwards | 3,818 | 28 | (13) |
| Currency swaps | 45,234 | 94 | (176) |
| OTC currency options bought and sold | 360 | 7 | – |
| Subtotal | | 129 | (189) |
| Interest rate derivatives | | | |
| Interest rate swaps | 13,536 | 70 | (230) |
| Cross currency interest rate swaps | 3,759 | 17 | (158) |
| OTC interest rate options | 248 | 3 | – |
| Subtotal | | 90 | (388) |
| Total recognised derivatives | | 219 | (577) |

The tables above provide a detailed breakdown of the contractual or notional amounts and the fair values of the Group's derivative financial instruments outstanding at year end. These instruments, comprising foreign exchange and interest rate derivatives allow the Group and its customers to transfer, modify or reduce their foreign exchange and interest rate risks.

The Group undertakes its transactions in foreign exchange and interest rate contracts with other financial institutions and customers. Management has established limits of these contracts by counterparties, industry sectors and countries. Actual credit exposures and limits are regularly monitored and controlled by management.

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

17 DERIVATIVE FINANCIAL INSTRUMENTS (Continued)

Credit risk weighted amounts

Group and Bank

| | As at 31 December | |
|------------------------------|-------------------|------|
| | 2005 | 2004 |
| Derivatives | | |
| – Exchange rate contracts | 122 | 171 |
| – Interest rate contracts | 62 | 30 |
| – Other derivative contracts | – | 4 |
| | 184 | 205 |

The credit risk-weighted amount refers to the amount as computed in accordance with the Hong Kong Banking Ordinance and depends on the status of the counterparty and the maturity characteristics.

Replacement costs

Group and Bank

| | As at 31 December | |
|------------------------------|-------------------|------|
| | 2005 | 2004 |
| Derivatives | | |
| – Exchange rate contracts | 184 | 134 |
| – Interest rate contracts | 83 | 49 |
| – Other derivative contracts | – | 11 |
| | 267 | 194 |

Replacement cost is the cost of replacing all contracts which have a positive value when marked to market (should the counterparty default on its obligations) and is obtained by marking to market contracts with a positive value. Replacement cost is a close approximation of the credit risk for these contracts at the balance sheet date.

The above credit risk weighted amounts and replacement costs are calculated in accordance with the formula promulgated by the Hong Kong Monetary Authority (“HKMA”) because there are no relevant standards prescribed by IFRS. There was no relevant standard prescribed by the banking regulators for determining the credit risk weighted amounts of derivatives and the Group is not required to report credit risk weighted amounts of derivatives to the banking regulators.

17 DERIVATIVE FINANCIAL INSTRUMENTS *(Continued)*

The credit risk weighted amounts and replacement costs stated above have taken into account of the effects of bilateral netting arrangements.

Notional amounts of derivative financial instruments by original currency (net position)

Group and Bank

| | RMB | US Dollars | HK Dollars | Others | Total |
|---|-------|------------|------------|--------|--------|
| As at 31 December 2005 | | | | | |
| Notional amount of derivative financial instruments | 2,100 | 31,006 | 25,006 | 5,560 | 63,672 |
| As at 31 December 2004 | | | | | |
| Notional amount of derivative financial instruments | – | 57,833 | 5,294 | 3,828 | 66,955 |

18 LOANS AND ADVANCES TO CUSTOMERS

(a) Loans and advances to customers

Group and Bank

| | As at 31 December | |
|--|-------------------|---------|
| | 2005 | 2004 |
| Loans and advances to customers | 771,374 | 640,058 |
| Less: collective impairment allowances | (4,520) | (4,108) |
| individual impairment allowances | (8,081) | (4,338) |
| | 758,773 | 631,612 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

18 LOANS AND ADVANCES TO CUSTOMERS (Continued)**(b) Movements in allowance for losses on loans and advances****Group and Bank**

| | As at 31 December | |
|--|--------------------------|-------------|
| | 2005 | 2004 |
| Balance at beginning of year | 8,446 | 33,268 |
| Impairment allowances for loans | 4,549 | 3,041 |
| Loans written off during the year as uncollectible | (312) | (928) |
| Exchange difference | (82) | – |
| Written back on disposal of impaired loans | – | (26,935) |
| Balance at end of the year | 12,601 | 8,446 |

(c) Individually identified loans with impairment**Group and Bank**

| | As at 31 December | |
|--|--------------------------|-------------|
| | 2005 | 2004 |
| Individually identified loans with impairment | 21,579 | 19,193 |
| Individually identified loans with impairment to loans and advances to customers (percentage) | 2.80% | 3.00% |

19 INVESTMENT SECURITIES

Group

| | As at 31 December | |
|---|-------------------|------------------|
| | 2005 | 2004 restated |
| Securities – loans and receivables | | |
| Debt securities – at amortised cost | | |
| – Unlisted | 28,372 | 31,205 |
| Securities – available-for-sale | | |
| Debt securities – at fair value | | |
| – Listed in Hong Kong | 7,710 | 5,715 |
| – Listed outside Hong Kong | 47,003 | 33,274 |
| – Unlisted | 230,486 | 176,012 |
| Equity securities – at fair value | | |
| – Listed outside Hong Kong | 2 | 2 |
| – Unlisted | 764 | 429 |
| Equity securities at cost less impairment | | |
| – Unlisted | 6 | 91 |
| | 285,971 | 215,523 |

Bank

| | As at 31 December | |
|---|-------------------|------------------|
| | 2005 | 2004 restated |
| Securities – loans and receivables | | |
| Debt securities – at amortised cost | | |
| – Unlisted | 28,372 | 31,205 |
| Securities – available-for-sale | | |
| Debt securities – at fair value | | |
| – Listed in Hong Kong | 7,710 | 5,715 |
| – Listed outside Hong Kong | 47,003 | 33,274 |
| – Unlisted | 230,486 | 176,012 |
| Equity securities – at fair value | | |
| – Listed outside Hong Kong | 2 | 2 |
| – Unlisted | 451 | 429 |
| Equity securities at cost less impairment | | |
| – Unlisted | 6 | – |
| | 285,658 | 215,432 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

19 INVESTMENT SECURITIES (Continued)

As certain unlisted equity securities held by the Group have no published quoted prices available or are not able to be benchmarked with similar financial instruments, or valuation techniques are not cost effective, the Group states such unlisted equity securities at cost less impairment.

Gains less losses arising from investment securities comprise:

Group and Bank

| | As at 31 December | |
|--|-------------------|------|
| | 2005 | 2004 |
| Gains less losses arising from de-recognition of investment securities | 359 | 77 |

The movement in investment securities may be summarized as follows:

Group

| | Originated loans/ Loans and receivables | Available- for-sale | Total |
|--|---|------------------------|-----------|
| Previously reported balance at 1 January 2005 | 159,826 | 90,028 | 249,854 |
| Reclassification upon the adoption of revised IAS 39 | (127,659) | 127,659 | – |
| Transferred to financial assets held for trading upon the adoption of revised IAS 39 | (962) | – | (962) |
| Revaluation upon the adoption of revised IAS 39 | – | (2,164) | (2,164) |
| Adjusted balance at 1 January 2005, restated | 31,205 | 215,523 | 246,728 |
| Additions | 1,764 | 408,510 | 410,274 |
| Disposals (sale or redemption) | (4,540) | (342,066) | (346,606) |
| Gain from changes in fair value | – | 5,842 | 5,842 |
| Exchange differences | (57) | (1,838) | (1,895) |
| At 31 December 2005 | 28,372 | 285,971 | 314,343 |

19 INVESTMENT SECURITIES *(Continued)***Bank**

| | Originated loans/ Loans and receivables | Available- for-sale | Total |
|--|--|--------------------------------|--------------|
| Previously reported balance at 1 January 2005 | 159,826 | 89,937 | 249,763 |
| Reclassification upon the adoption of revised IAS 39 | (127,659) | 127,659 | – |
| Transferred to financial assets held for trading upon the adoption of revised IAS 39 | (962) | – | (962) |
| Revaluation upon the adoption of revised IAS 39 | – | (2,164) | (2,164) |
| Adjusted balance at 1 January 2005, restated | 31,205 | 215,432 | 246,637 |
| Additions | 1,764 | 407,815 | 409,579 |
| Disposals (sale or redemption) | (4,540) | (341,593) | (346,133) |
| Gain from changes in fair value | – | 5,842 | 5,842 |
| Exchange differences | (57) | (1,838) | (1,895) |
| At 31 December 2005 | 28,372 | 285,658 | 314,030 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

19 INVESTMENT SECURITIES (Continued)

The investment securities are analysed by issuer as follows:

Group

| | As at 31 December | |
|---|-------------------|----------------|
| | 2005 | 2004 |
| Securities – loans and receivables | | |
| – Central governments and central banks | 26,527 | 28,911 |
| – Public sector entities | 464 | 125 |
| – Banks and other financial institutions | 1,381 | 2,169 |
| | 28,372 | 31,205 |
| Securities – available-for-sale | | |
| – Central governments and central banks | 115,653 | 108,582 |
| – Public sector entities | 2,644 | 2,398 |
| – Banks and other financial institutions | 154,734 | 99,640 |
| – Corporate entities | 12,940 | 4,903 |
| | 285,971 | 215,523 |

Bank

| | As at 31 December | |
|---|-------------------|----------------|
| | 2005 | 2004 |
| Securities – loans and receivables | | |
| – Central governments and central banks | 26,527 | 28,911 |
| – Public sector entities | 464 | 125 |
| – Banks and other financial institutions | 1,381 | 2,169 |
| | 28,372 | 31,205 |
| Securities – available-for-sale | | |
| – Central governments and central banks | 115,653 | 108,582 |
| – Public sector entities | 2,644 | 2,398 |
| – Banks and other financial institutions | 154,734 | 99,640 |
| – Corporate entities | 12,627 | 4,812 |
| | 285,658 | 215,432 |

19 INVESTMENT SECURITIES *(Continued)*

The certificates of deposit held and included in investment securities are analysed as follows:

Group and Bank

| | As at 31 December | |
|-----------------------------------|-------------------|-------|
| | 2005 | 2004 |
| Available-for-sale, at fair value | | |
| – Unlisted | 2,254 | 3,221 |

The maturity profile of certificates of deposit held analysed by the remaining period as at year end to the contractual maturity dates is as follows:

Group and Bank

| | As at 31 December | |
|----------------|-------------------|-------|
| | 2005 | 2004 |
| Up to 3 months | – | 309 |
| 3 to 12 months | 796 | 846 |
| 1 to 5 years | 1,458 | 2,066 |
| | 2,254 | 3,221 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

20 PROPERTY AND EQUIPMENT

Group

| | Land and Buildings | Construction in Progress | Equipment | Motor Vehicles | Leasehold improvement | Total |
|--|-----------------------|-----------------------------|-----------|-------------------|--------------------------|---------|
| Cost or valuation | | | | | | |
| At 1 January 2005 | 19,133 | 1,146 | 2,629 | 272 | 1,569 | 24,749 |
| Additions | 162 | 1,190 | 1,829 | 43 | 270 | 3,494 |
| Disposals | (439) | (176) | (330) | (79) | (618) | (1,642) |
| Transfers | 1,102 | (1,024) | (78) | – | – | – |
| Revaluation | 89 | (11) | – | – | – | 78 |
| At 31 December 2005 | 20,047 | 1,125 | 4,050 | 236 | 1,221 | 26,679 |
| Accumulated depreciation | | | | | | |
| At 1 January 2005 | – | – | – | – | (886) | (886) |
| Charge for the period | (792) | – | (1,254) | (70) | (248) | (2,364) |
| Disposals | 155 | – | 301 | 68 | 574 | 1,098 |
| Revaluation | 637 | – | – | – | – | 637 |
| At 31 December 2005 | – | – | (953) | (2) | (560) | (1,515) |
| Net book value | | | | | | |
| At 31 December 2005 | 20,047 | 1,125 | 3,097 | 234 | 661 | 25,164 |
| Carrying amount at 31 December 2005, if at cost | | | | | | |
| | 11,835 | 975 | 3,001 | 211 | 661 | 16,683 |
| Cost at valuation | | | | | | |
| At 1 January 2004 | 14,845 | 1,270 | 2,780 | 349 | 1,931 | 21,175 |
| Additions | 103 | 1,387 | 1,272 | 60 | 6 | 2,828 |
| Disposals | (113) | – | (680) | (124) | (629) | (1,546) |
| Transfers | 747 | (1,450) | – | – | 261 | (442) |
| Revaluation | 3,551 | (61) | (743) | (13) | – | 2,734 |
| At 31 December 2004 | 19,133 | 1,146 | 2,629 | 272 | 1,569 | 24,749 |
| Accumulated depreciation at valuation | | | | | | |
| At 1 January 2004 | – | – | – | – | (1,194) | (1,194) |
| Charge for the year | (740) | – | (1,356) | (121) | (254) | (2,471) |
| Disposals | 63 | – | 613 | 108 | 562 | 1,346 |
| Revaluation | 677 | – | 743 | 13 | – | 1,433 |
| At 31 December 2004 | – | – | – | – | (886) | (886) |
| Net book value at valuation | | | | | | |
| At 31 December 2004 | 19,133 | 1,146 | 2,629 | 272 | 683 | 23,863 |
| Carrying amount at 31 December 2004, if at cost | | | | | | |
| | 11,508 | 948 | 2,409 | 256 | 683 | 15,804 |

20 PROPERTY AND EQUIPMENT *(Continued)*

Bank

| | Land and Buildings | Construction in Progress | Equipment | Motor Vehicles | Leasehold improvement | Total |
|--|--------------------|--------------------------|-----------|----------------|-----------------------|---------|
| Cost or valuation | | | | | | |
| At 1 January 2005 | 17,592 | 1,146 | 2,629 | 272 | 1,569 | 23,208 |
| Additions | 167 | 1,190 | 1,829 | 43 | 270 | 3,499 |
| Disposals | (103) | (176) | (330) | (79) | (618) | (1,306) |
| Transfers | 1,102 | (1,024) | (78) | – | – | – |
| Revaluation | (194) | (11) | – | – | – | (205) |
| At 31 December 2005 | 18,564 | 1,125 | 4,050 | 236 | 1,221 | 25,196 |
| Accumulated depreciation | | | | | | |
| At 1 January 2005 | – | – | – | – | (886) | (886) |
| Charge for the period | (792) | – | (1,254) | (70) | (248) | (2,364) |
| Disposals | 158 | – | 301 | 68 | 574 | 1,101 |
| Revaluation | 634 | – | – | – | – | 634 |
| At 31 December 2005 | – | – | (953) | (2) | (560) | (1,515) |
| Net book value | | | | | | |
| At 31 December 2005 | 18,564 | 1,125 | 3,097 | 234 | 661 | 23,681 |
| Carrying amount at 31 December 2005, if at cost | | | | | | |
| | 10,964 | 975 | 3,001 | 211 | 661 | 15,812 |
| Cost at valuation | | | | | | |
| At 1 January 2004 | 12,654 | 1,420 | 2,780 | 349 | 1,931 | 19,134 |
| Additions | 1,123 | 1,237 | 1,272 | 60 | 6 | 3,698 |
| Disposals | (113) | – | (680) | (124) | (629) | (1,546) |
| Transfers | 747 | (1,450) | – | – | 261 | (442) |
| Revaluation | 3,181 | (61) | (743) | (13) | – | 2,364 |
| At 31 December 2004 | 17,592 | 1,146 | 2,629 | 272 | 1,569 | 23,208 |
| Accumulated depreciation at valuation | | | | | | |
| At 1 January 2004 | – | – | – | – | (1,194) | (1,194) |
| Charge for the year | (740) | – | (1,356) | (121) | (254) | (2,471) |
| Disposals | 63 | – | 613 | 108 | 562 | 1,346 |
| Revaluation | 677 | – | 743 | 13 | – | 1,433 |
| At 31 December 2004 | – | – | – | – | (886) | (886) |
| Net book value at valuation | | | | | | |
| At 31 December 2004 | 17,592 | 1,146 | 2,629 | 272 | 683 | 22,322 |
| Carrying amount at 31 December 2004, if at cost | | | | | | |
| | 10,337 | 948 | 2,409 | 256 | 683 | 14,633 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

20 PROPERTY AND EQUIPMENT (Continued)

The Group's management had its land and buildings, construction in progress, equipment and motor vehicles revalued with reference to a valuation made on an open market and existing use basis by external valuer at 31 December 2004. Sallmanns (Far East) Ltd. (西門(遠東)有限公司) was the external valuer appointed for valuation at 31 December 2004. Pan-China Assets Appraisal Co., Ltd. (北京天健興業資產評估有限公司) was appointed as its external valuer for the Group's latest valuation exercise as at 31 December 2005 to revalue Land and buildings, construction in progress, while equipment and motor vehicles were not revalued due to their insignificance.

The revaluation reserve relating to revaluation of property and equipment is not distributable to shareholders.

Group

| | Year ended at 31 December | |
|---|---------------------------|--------------|
| | 2005 | 2004 |
| Revaluation surplus classified in equity, net of tax | 541 | 3,098 |
| Deferred tax liability (Note 26) | 164 | 1,458 |
| Revaluation deficit charged to profit and loss account (Note 9) | (9) | (389) |
| Exchange gain | 19 | — |
| | 715 | 4,167 |

Bank

| | As at 31 December | |
|--|-------------------|--------------|
| | 2005 | 2004 |
| Revaluation surplus classified in equity, net of tax | 339 | 2,789 |
| Deferred tax liability | 127 | 1,341 |
| Revaluation deficit charged to profit and loss account | (56) | (333) |
| Exchange gain | 19 | — |
| | 429 | 3,797 |

All land and buildings of the Group are located outside Hong Kong, except for those of Hong Kong branch.

| | As at 31 December | |
|--|-------------------|-------|
| | 2005 | 2004 |
| Net book value of land and buildings of Hong Kong Branch | 1,370 | 1,211 |

21 OTHER ASSETS

Group

| | As at 31 December | |
|---------------------------------|-------------------|---------------|
| | 2005 | 2004 |
| Settlement accounts | 1,171 | 5,124 |
| Other receivables | 4,731 | 4,383 |
| Less: impairment allowance | (2,167) | (2,209) |
| Foreclosed assets | 5,483 | 6,832 |
| Less: impairment allowance | (2,788) | (1,785) |
| Prepaid staff housing subsidies | 214 | 252 |
| Prepaid rental expenses | 349 | 356 |
| Land use rights | 589 | 630 |
| Computer software | 296 | 256 |
| Investment property | 720 | 708 |
| Others | 1,968 | 1,597 |
| | 10,566 | 16,144 |

Bank

| | As at 31 December | |
|---------------------------------|-------------------|---------------|
| | 2005 | 2004 |
| Settlement accounts | 1,171 | 5,124 |
| Other receivables | 4,451 | 3,723 |
| Less: impairment allowance | (2,167) | (2,209) |
| Foreclosed assets | 5,483 | 6,832 |
| Less: impairment allowance | (2,788) | (1,785) |
| Prepaid staff housing subsidies | 214 | 252 |
| Prepaid rental expenses | 349 | 356 |
| Land use rights | 589 | 630 |
| Computer software | 296 | 256 |
| Investment property | 720 | 708 |
| Others | 1,946 | 1,428 |
| | 10,264 | 15,315 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

22 DUE TO OTHER BANKS AND FINANCIAL INSTITUTIONS

Group and Bank

| | As at 31 December | |
|--|-------------------|--------|
| | 2005 | 2004 |
| Due to central banks | – | 28 |
| Deposits from other banks and financial institutions | 50,040 | 16,224 |
| Loans from other banks and financial institutions | 34,054 | 15,459 |
| | 84,094 | 31,711 |

23 FINANCIAL LIABILITIES HELD FOR TRADING

Group and Bank

| | As at 31 December | |
|---|-------------------|-------|
| | 2005 | 2004 |
| Derivative financial instruments (Note 17) | 301 | 577 |
| Short position of securities held for trading | 1,056 | 1,158 |
| Debt securities in issue | 8,198 | 3,351 |
| | 9,555 | 5,086 |

23 FINANCIAL LIABILITIES HELD FOR TRADING *(Continued)*

Debt securities in issue are:

Group and Bank

| | As at 31 December 2005 | | As at 31 December 2004 | |
|--|------------------------|--|------------------------|--------------------------------|
| | Amount | Interest rate per Annum (%) | Amount | Interest rate per Annum (%) |
| HKD short term Certificate of Deposit | 591 | 2.84 | – | Not Applicable |
| HKD medium term Certificate of Deposit | 2,546 | 3.25 | 760 | 3.23 |
| USD medium term Certificate of Deposit | 1,842 | 3.36 | 362 | 3.48 |
| HKD floating rate Certificate of Deposit (maturing in June 2006) | 417 | HIBOR+0.06% | – | Not Applicable |
| HKD floating rate Certificate of Deposit (maturing in September 2006) | 41 | HIBOR+0.2% | 426 | HIBOR+0.20% |
| HKD floating rate Certificate of Deposit (maturing in March 2007) | 178 | First year 1.95% Remaining year 3M HIBOR + 0.15% (capped at 4.75%) | – | Not Applicable |
| HKD floating rate Certificate of Deposit (maturing in August 2008) | 313 | HIBOR+0.18% | – | Not Applicable |
| HKD floating rate Certificate of Deposit (maturing in September 2008) | 105 | HIBOR+0.26% | 426 | HIBOR+0.26% |
| HKD reverse Certificate of Deposit (maturing in May 2009) | 6 | First year 6.20% Remaining years 6.90% less 3M HIBOR (minimum at 0%) | 138 | 6.9%-3M HIBOR |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

23 FINANCIAL LIABILITIES HELD FOR TRADING (Continued)**Group and Bank** (Continued)

| | As at 31 December 2005 | | As at 31 December 2004 | |
|---|------------------------|--|------------------------|--------------------------------|
| | Amount | Interest rate per Annum (%) | Amount | Interest rate per Annum (%) |
| USD floating rate Certificate of Deposit (maturing in May 2007) | 453 | First year 3.1% Remaining year 3M LIBOR + 0.15% (capped at 5%) | – | Not Applicable |
| USD floating rate Certificate of Deposit (maturing in June 2007) | 47 | LIBOR+0.12% | – | Not Applicable |
| HKD floating rate Certificate of deposit (maturing in November 2008) | 73 | HIBOR+0.10% | – | Not Applicable |
| HKD floating rate Certificate of deposit (maturing in November 2008) | 156 | HIBOR+0.18% | – | Not Applicable |
| USD floating rate Certificate of deposit (maturing in November 2006) | 35 | LIBOR+0.08% | – | Not Applicable |
| USD floating rate Certificate of deposit (maturing in November 2008) | 47 | LIBOR+0.05% | – | Not Applicable |
| USD floating rate Certificate of deposit (maturing in November 2008) | 162 | LIBOR+0.18% | – | Not Applicable |
| USD floating rate Certificate of Deposit (maturing in January 2007) | 1,186 | LIBOR+0.20% | 1,239 | LIBOR+0.20% |
| | 8,198 | | 3,351 | |

24 DUE TO CUSTOMERS

Group and Bank

| | As at 31 December | |
|---|-------------------|------------------|
| | 2005 | 2004 |
| Corporate current deposits | 407,228 | 385,556 |
| Corporate savings deposits | 4,232 | 5,011 |
| Corporate time deposits | 231,275 | 186,216 |
| Individual current deposits | 162,757 | 143,461 |
| Individual savings deposits | 9,725 | 14,879 |
| Individual time deposits | 263,236 | 210,561 |
| Pledged deposits | 105,781 | 53,705 |
| Certificates of deposit | 696 | – |
| Promissory notes | 2,708 | 3,055 |
| Customer margin deposits | 1,642 | 2,075 |
| Other deposits | 23,544 | 18,815 |
| Interest payable | 8,015 | 6,607 |
| | 1,220,839 | 1,029,941 |
| Including: | | |
| Pledged deposits held as collateral for letters of credit | 5,715 | 4,965 |

25 OTHER LIABILITIES

Group

| | As at 31 December | |
|--------------------------------------|-------------------|---------------|
| | 2005 | 2004 |
| Settlement accounts | 4,509 | 4,971 |
| Dividends payable | 136 | 141 |
| Staff benefits payables | 1,692 | 1,604 |
| Tax payable | 816 | 655 |
| Provision for outstanding litigation | 938 | 989 |
| Others | 4,258 | 4,097 |
| | 12,349 | 12,457 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

25 OTHER LIABILITIES (Continued)

Bank

| | As at 31 December | |
|--------------------------------------|-------------------|--------|
| | 2005 | 2004 |
| Settlement accounts | 4,509 | 4,971 |
| Dividends payable | 136 | 141 |
| Staff benefits payables | 1,692 | 1,604 |
| Tax payable | 816 | 655 |
| Provision for outstanding litigation | 938 | 989 |
| Others | 2,414 | 2,165 |
| | 10,505 | 10,525 |

26 DEFERRED INCOME TAXES

Deferred income taxes are calculated on all temporary differences under the liability method using an effective tax rate of 33% for the year for transactions in Mainland China.

Deferred income taxes are calculated on all temporary differences under the liability method using an effective tax rate of 17.5% for the year ended 31 December 2005 (Year 2004: 17.5%) for transactions in Hong Kong.

The movement in the deferred income tax account is as follows:

Group

| | Year ended 31 December | |
|--|------------------------|------------------|
| | 2005 | 2004 Restated |
| At beginning of the year | 4,632 | 11,650 |
| Reclassification into AFS securities | 714 | (60) |
| Adjusted balance at beginning of the year, restated | 5,346 | 11,590 |
| Charge to profit and loss account | (2,673) | (5,925) |
| Available-for-sale securities – fair value remeasurement | (1,967) | 806 |
| Property revaluation | (164) | (1,458) |
| Provision for investment | – | 336 |
| Exchange differences | – | (3) |
| At end of the year | 542 | 5,346 |

26 DEFERRED INCOME TAXES *(Continued)*

Bank

| | Year ended 31 December | |
|--|------------------------|------------------|
| | 2005 | 2004 Restated |
| At beginning of the year | 4,739 | 11,650 |
| Reclassification into AFS securities | 714 | (60) |
| Adjusted balance at beginning of the year, restated | 5,453 | 11,590 |
| Charge to profit and loss account | (2,673) | (5,935) |
| Available-for-sale securities – fair value remeasurement | (1,967) | 806 |
| Property revaluation | (147) | (1,341) |
| Provision for investment | – | 336 |
| Exchange differences | – | (3) |
| At end of the year | 666 | 5,453 |

Deferred income tax assets and liabilities are attributable to the following items:

Group

| | As at 31 December | |
|---|-------------------|---------|
| | 2005 | 2004 |
| Deferred income tax liabilities | | |
| Available-for-sale securities | (1,285) | (53) |
| Accelerated tax depreciation | – | (13) |
| Property revaluation reserve | (1,676) | (1,560) |
| Other temporary differences | (288) | (261) |
| | (3,249) | (1,887) |
| Deferred income tax assets | | |
| Provision for loan losses | 592 | 427 |
| Impairment allowances for investments | 392 | 480 |
| Decelerated tax depreciation | 128 | 125 |
| Impairment of other assets | 2,669 | 1,825 |
| Tax loss carried forward (<i>Note 12</i>) | – | 3,631 |
| Available-for-sale securities | 10 | 745 |
| | 3,791 | 7,233 |
| Net deferred income tax assets | 542 | 5,346 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

26 DEFERRED INCOME TAXES (Continued)**Bank**

| | As at 31 December | |
|--|--------------------------|----------------|
| | 2005 | 2004 |
| Deferred income tax liabilities | | |
| Available-for-sale securities | (1,285) | (53) |
| Accelerated tax depreciation | – | (13) |
| Property revaluation reserve | (1,543) | (1,443) |
| Other temporary differences | (287) | (261) |
| | (3,115) | (1,770) |
| Deferred income tax assets | | |
| Provision for loan losses | 592 | 427 |
| Impairment allowances for investments | 392 | 480 |
| Decelerated tax depreciation | 118 | 115 |
| Impairment of other assets | 2,669 | 1,825 |
| Tax loss carried forward (Note 12) | – | 3,631 |
| Available-for-sale securities | 10 | 745 |
| | 3,781 | 7,223 |
| Net deferred income tax assets | 666 | 5,453 |

26 DEFERRED INCOME TAXES *(Continued)*

The above net deferred income tax assets are disclosed separately on the balance sheet based on different responsible taxation authorities:

Group

| | As at 31 December | |
|--------------------------|-------------------|------------------|
| | 2005 | 2004 Restated |
| Deferred tax assets | 955 | 5,739 |
| Deferred tax liabilities | (413) | (393) |

Bank

| | As at 31 December | |
|--------------------------|-------------------|------------------|
| | 2005 | 2004 Restated |
| Deferred tax assets | 955 | 5,739 |
| Deferred tax liabilities | (289) | (286) |

The deferred tax charge in the profit and loss account comprises the following temporary differences:

Group

| | As at 31 December | |
|---|-------------------|----------------|
| | 2005 | 2004 |
| Provision for loan losses: | | |
| Additional provisions for loan losses | 198 | 879 |
| Utilization | (33) | (23) |
| De-recognition of deferred tax assets in relation to loans disposed of <i>(Note 12)</i> | – | (9,671) |
| Sub-total | 165 | (8,815) |
| Impairment allowances for investments | (88) | (85) |
| Impairment of other assets | 844 | (682) |
| (Utilization of)/ Provision of tax loss carried forward <i>(Note 12)</i> | (3,631) | 3,588 |
| Accelerated tax depreciation | 13 | – |
| Decelerated tax depreciation | 3 | 103 |
| Depreciation/disposal of property and equipment | 48 | – |
| Other temporary differences | (27) | (34) |
| | (2,673) | (5,925) |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

27 RETIREMENT BENEFIT OBLIGATIONS

The Group participates in various defined contribution retirement benefit plans organised by municipal and provincial governments in Mainland China under which it is required to make monthly contributions to these plans at rates ranging from 10% to 27% of the employees' basic salary for the period. The Group currently has no additional significant cost for the payment of retirement and other post-retirement benefits of employees other than the monthly contributions described above. The Group's contributions to these pension plans are charged to the profit and loss account in the period to which they relate.

Retirement benefit obligations of the Group in locations other than Mainland China, which are immaterial to the Group, are made in accordance with the relevant local policies and regulations. They are accounted for in the profit and loss account in the period when the payment is made.

| | Year ended 31 December | |
|--|------------------------|------|
| | 2005 | 2004 |
| Expenses incurred for retirement benefit plans | 431 | 392 |

28 SUBORDINATED TERM DEBT

Group and Bank

| | As at 31 December | |
|--|-------------------|--------|
| | 2005 | 2004 |
| Floating rate subordinated debt – 2009 | 12,000 | 12,000 |
| Interest payable | 292 | 275 |
| | 12,292 | 12,275 |

The floating rate subordinated term debt bears interest at the rate of 1 year fixed deposit rate set by the PBOC plus 2.52% and will mature in July 2009.

29 SHARE CAPITAL AND CAPITAL SURPLUS

Group

| | Number of shares (in millions) | Ordinary shares of RMB1 each (RMB million) | Capital surplus (RMB million) | Total (RMB million) |
|-----------------------------------|--------------------------------------|---|-------------------------------------|------------------------|
| At 1 January 2005 | 39,070 | 39,070 | 10,872 | 49,942 |
| Issue of shares (<i>Note 1</i>) | 6,734 | 6,734 | 11,259 | 17,993 |
| Issuance cost | – | – | (591) | (591) |
| At 31 December 2005 | 45,804 | 45,804 | 21,540 | 67,344 |

Bank

| | Number of shares (in millions) | Ordinary shares of RMB1 each (RMB million) | Capital surplus (RMB million) | Total (RMB million) |
|-----------------------------------|--------------------------------------|---|-------------------------------------|------------------------|
| At 1 January 2005 | 39,070 | 39,070 | 11,764 | 50,834 |
| Issue of shares (<i>Note 1</i>) | 6,734 | 6,734 | 11,259 | 17,993 |
| Issuance cost | – | – | (591) | (591) |
| At 31 December 2005 | 45,804 | 45,804 | 22,432 | 68,236 |

Note 1: On 23 June 2005, a total of 5,856 million shares were subscribed by various third parties at a price of HKD2.50 per share with a total consideration of HKD14,640 million (equivalent to RMB15,657 million). The excess over par value of RMB9,801 million was included in capital surplus while the issuance cost of RMB516 million was netted off against capital surplus.

On 4 July 2005, a total of 878 million shares were subscribed by the Hongkong and Shanghai Banking Corporation Limited (“HSBC”) at a price of HKD2.5 per share with a total consideration of HKD2,195 million (equivalent to RMB2,336 million) as a result of the exercise of the over-allotment option. The excess over par value of RMB1,458 million was included in capital surplus while the issuance cost of RMB75 million was netted off against capital surplus.

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

29 SHARE CAPITAL AND CAPITAL SURPLUS (Continued)

Note 1: (Continued)

The share issuance cost contains underwriting commission and a proportion of listing related costs, i.e. professional charges, registration charges etc, which is attributable to the newly issued shares.

All the newly issued shares together with the shares held by the HSBC, the National Council For Social Security Fund and the China SAFE Investments Limited., are listed on the Hong Kong Stock Exchange.

The shareholding structures of the Bank immediately after the issue by the Bank of the Over-allotment Shares is as follows:

Group

| | Number of shares (in millions) | Approximated percentage of the Bank's issued share capital |
|--|--------------------------------------|---|
| Domestic Shares in issue | 22,740 | 49.65% |
| H shares offered under the Global Offering and converted from Domestic Shares | 23,064 | 50.35% |
| Total number of shares | 45,804 | 100.00% |

Bank

| | Number of shares (in millions) | Approximated percentage of the Bank's issued share capital |
|--|--------------------------------------|---|
| Domestic Shares in issue | 22,740 | 49.65% |
| H shares offered under the Global Offering and converted from Domestic Shares | 23,064 | 50.35% |
| Total number of shares | 45,804 | 100.00% |

29 SHARE CAPITAL AND CAPITAL SURPLUS *(Continued)*

Note 1: (Continued)

Generally, transactions of the following nature are recorded in the capital surplus:

- (i) share premium arising from the issue of shares at prices in excess of their par value;
- (ii) donations received from shareholders; and
- (iii) any other items required by the PRC regulations to be so treated.

Capital surplus can be utilized to offset prior years' accumulated losses, for the issue of bonus shares or for increasing paid-up capital as approved by the Directors.

30 RESERVES AND RETAINED EARNINGS

Pursuant to the PRC regulations, the appropriation of profits to the discretionary reserve, the general and statutory reserve and the distribution of dividends in each year are based on the recommendations of the Directors and are subject to the passing of resolutions to be considered at the Bank's Annual General Meeting to be held subsequent to each year end.

In accordance with the PRC legislation, 10% of the net distributable profit of the Bank (Note 32), as determined under the PRC accounting regulations, is required to be transferred to a non-distributable statutory reserve until such time when this reserve represents 50% of the share capital of the Bank. On 28 March 2006, the Directors proposed to transfer 10% of its net income, as determined under the PRC accounting regulations, to the non-distributable statutory reserve with RMB899 million and such proposal has not been recognized in the balance sheet.

Pursuant to the PRC regulations, the Bank is required to transfer a certain amount of its net income, as determined based on the degree of overall unidentified loss exposure (normally no lower than 1% of the ending balance of risk assets by the end of 2009), to the general and statutory reserve through its profit appropriation. The general and statutory reserve is an integral part of equity interest but subject to dividend distribution. On 28 March 2006, the Directors proposed a general and statutory reserve of RMB4,428 million (2004: N/A) through its profit appropriation. The general and statutory reserve is subject to approval by the shareholders at the Annual General Meeting and has not been recognized in the balance sheet. Statutory reserve of Hongkong branch required by HKMA has been covered in above general and statutory reserve.

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

31 ESTABLISHMENT OF SUBSIDIARY

On 4 August 2005, the Bank has established the Bank of Communications Schroder Fund Management Co., Ltd. ("BOCOM Schroder") together with the other two third party investors. The BOCOM Schroder has a total paid in capital of RMB200 million, while the Bank holds its 65% equity interest.

32 DIVIDENDS

| | Year ended 31 December | |
|------------------|------------------------|------|
| | 2005 | 2004 |
| Paid in the year | 5 | 8 |

Under PRC Company Law and the Bank's Articles of Association, the net profit after tax as reported in the PRC statutory financial statements can only be distributed as dividends after allowances for the following:

- (i) Making up prior year's cumulative losses, if any;
- (ii) Allocations to the non-distributable statutory accumulation reserve of 10% of the net profit of the Bank;
- (iii) Allocations to general provision reserve;
- (iv) Allocations to the discretionary revenue reserve fund if approved by the Bank's Annual General Meeting. These funds forms part of the shareholder's equity.

In accordance with the relevant regulations, after the Bank's initial public offering, the net profit after tax of the Group for the purpose of profit distribution is deemed to be the lesser of (i) the retained profits determined in accordance with PRC GAAP and (ii) the retained profit determined in accordance with IFRS.

At 31 December 2005, the aggregate amount of profit available for profit distribution was RMB8,991 million (2004: N/A), being the retained profits determined in accordance with PRC GAAP. On 28 March 2006, the directors proposed a cash dividend of RMB0.08 per share (2004: N/A), amounting to RMB3,664 million (2004: N/A). The dividend is subject to approval by the shareholders at the Annual General Meeting and has not been recognized as a liability at the balance sheet date.

33 FINANCIAL GUARANTEES AND CREDIT RELATED COMMITMENTS, OTHER COMMITMENTS AND CONTINGENT LIABILITIES

Financial guarantees and credit related commitments

The following tables indicate the contractual amounts of the Group's financial guarantees and credit related commitments which the Group commits to extend to customers:

Group and Bank

| | As at 31 December | |
|--|-------------------|---------|
| | 2005 | 2004 |
| Guarantees | 49,623 | 30,867 |
| Letters of credit | 22,316 | 25,654 |
| Acceptances | 156,484 | 103,348 |
| Other commitments with an original maturity of | | |
| – Under 1 year | 10,044 | 2,573 |
| – 1 year and over | 7,443 | 5,193 |
| | 245,910 | 167,635 |

Capital expenditure commitments

Group and Bank

| | As at 31 December | |
|---|-------------------|------|
| | 2005 | 2004 |
| Capital expenditure commitments for buildings | 238 | 490 |

Operating lease commitments

Where the Group is the lessee, the future minimum lease payments under non-cancelable operating leases in respect of buildings are as follows:

Group and Bank

| | As at 31 December | |
|--|-------------------|-------|
| | 2005 | 2004 |
| Not later than 1 year | 555 | 499 |
| Later than 1 year and not later than 5 years | 1,320 | 1,141 |
| Later than 5 years | 466 | 532 |
| | 2,341 | 2,172 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

33 FINANCIAL GUARANTEES AND CREDIT RELATED COMMITMENTS, OTHER COMMITMENTS AND CONTINGENT LIABILITIES (Continued)

Legal proceedings

A number of legal proceedings are initiated by third parties against the Group as defendant. The total outstanding claims at end of the year are as follows:

Group and Bank

| | As at 31 December | |
|----------------------|-------------------|-------|
| | 2005 | 2004 |
| Outstanding claims | 2,261 | 2,601 |
| Provision for losses | 938 | 989 |

34 ASSETS PLEDGED

Assets are pledged as collateral under repurchase agreements with other banks and financial institutions and for security deposits relating to local futures, options and stock exchange memberships. Mandatory reserve deposits are also held with local central banks in accordance with statutory requirements. These deposits are not available to finance the Group's day to day operations.

Group and Bank

| | Pledged Assets | | Related Liabilities | |
|-----------------------------|-------------------|--------|---------------------|------|
| | As at 31 December | | As at 31 December | |
| | 2005 | 2004 | 2005 | 2004 |
| Balances with central banks | 73,309 | 61,670 | – | – |
| Investment securities | 200 | 400 | 200 | 400 |
| | 73,509 | 62,070 | 200 | 400 |

35 CREDIT RISK WEIGHTED AMOUNT OF FINANCIAL GUARANTEES AND CREDIT RELATED COMMITMENTS

Group and Bank

| | As at 31 December | |
|---|-------------------|---------|
| | 2005 | 2004 |
| Financial guarantees and credit related commitments | 179,746 | 124,156 |

The credit risk weighted amount refers to the amount as computed in accordance with the Hong Kong Banking Ordinance and depends on the status of the counterparty and the maturity characteristics. The risk weights used range from 0% to 100% for contingent liabilities and commitments.

The above credit risk weighted amounts are calculated in accordance with the formula promulgated by the HKMA because there are no relevant standards prescribed by IFRS.

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

36 NOTES TO CONSOLIDATED CASH FLOW STATEMENT**(a) Analysis of changes in financing during the year**

| | Dividends | Share capital | Capital surplus | Subordinated term debt | Minority Interest |
|--|------------|---------------|-----------------|------------------------|-------------------|
| At 1 January 2005 | 141 | 39,070 | 10,872 | 12,275 | – |
| Net cash inflow/(outflow) from financing | (5) | 6,734 | 10,668 | (540) | 70 |
| Interest expense recognised on subordinated term debt | – | – | – | 557 | – |
| Net loss attributable to minority interest | – | – | – | – | (6) |
| At 31 December 2005 | 136 | 45,804 | 21,540 | 12,292 | 64 |
| At 1 January 2004 | 149 | 17,108 | 11,035 | – | – |
| Net cash inflow/(outflow) from financing | (8) | 21,962 | 11,635 | 12,000 | – |
| Impact of a Restructuring Transaction on capital surplus | – | – | (2,763) | – | – |
| Reserves offset against accumulated losses | – | – | (9,035) | – | – |
| Interest expense recognised on subordinated term debt | – | – | – | 275 | – |
| At 31 December 2004 | 141 | 39,070 | 10,872 | 12,275 | – |

(b) Analysis of the balance of cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise the following balances with original maturities of less than 90 days used for the purpose of meeting short-term cash commitments:

| | As at 31 December | |
|---|--------------------------|-------------|
| | 2005 | 2004 |
| Cash and balances with central banks (Note 14) | 67,000 | 66,831 |
| Due from other banks and financial institutions (Note 15) | 34,305 | 8,926 |
| | 101,305 | 75,757 |

37 PRINCIPAL SUBSIDIARIES

(a) Particulars of the principal subsidiaries are as follows:

| Name of subsidiaries | Place of incorporation and operation | Date of incorporation | Issued and fully paid up share capital | Group equity interest % | Principal activities |
|--|--------------------------------------|-----------------------|--|-------------------------|---|
| Amiwell Company Limited | Hong Kong | 30 Apr 1982 | HKD2 | 100 | Property holding and investment |
| Bank of Communications Trustee Limited | Hong Kong | 13 Oct 1981 | HKD50,000,000 | 100 | Trustee Service |
| Bank of Communications (Nominee) Company Limited | Hong Kong | 21 Aug 1981 | HKD200,000 | 100 | Investment holding |
| BCOM Finance (Hong Kong) Limited | Hong Kong | 13 Mar 1979 | HKD90,000,000 | 100 | Deposit taking |
| BCOM Securities Company Limited | Hong Kong | 3 Jun 1998 | HKD175,000,000 | 100 | Security dealing and brokerage |
| China Communications Insurance Company Limited | Hong Kong | 1 Nov 2000 | HKD250,000,000 | 100 | General insurance and reinsurance |
| City Wisdom Limited | Hong Kong | 19 Jul 2000 | HKD10,000 | 100 | Property holding |
| Eastern Sky Limited | Hong Kong | 21 Aug 2000 | HKD10,000 | 100 | Property development |
| Expectation Investment Limited | Hong Kong | 29 Jan 1997 | HKD2 | 100 | Investment holding |
| Kiu Fai Company Limited | Hong Kong | 18 Mar 1967 | HKD3,000,000 | 100 | Property holding and investment holding |
| Right Master Investment Limited | Hong Kong | 23 Dec 1998 | HKD10,000 | 100 | Property development |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

37 PRINCIPAL SUBSIDIARIES (Continued)

| Name of subsidiaries | Place of incorporation and operation | Date of incorporation | Issued and fully paid up share capital | Group equity interest % | Principal activities |
|---|--------------------------------------|-----------------------|--|-------------------------|--|
| Star Wealthy Secretarial Company Limited | Hong Kong | 23 Aug 1999 | HKD2,000,000 | 100 | Investment holding |
| Unique Profit Limited | Hong Kong | 12 Jun 1998 | HKD10,000 | 100 | Property holding |
| Bank of Communications Charitable Foundation Limited | Hong Kong | 19 Jun 2002 | – | 100 | Charity fund |
| Creative Mart Limited | Hong Kong | 12 May 1999 | HKD100 | 100 | Property development |
| Chiao Tung Developments Limited | Hong Kong | 5 Feb 1985 | HKD50,000,000 | 100 | Investment holding |
| Career Computer (Shenzhen) Company Limited | PRC | 22 Dec 1997 | USD3,000,000 | 100 | Development of computer software and hardware, electronic equipments and communication network |
| Bank of Communications Schroder Fund Management Co., Ltd. | PRC | 4 Aug 2005 | RMB200,000,000 | 65 | Fund Management |

All above principal subsidiaries are private companies.

For the year ended 31 December 2004 and 2005, or 31 March 2005 or 2006, all principal subsidiaries incorporated in Hong Kong as stated above were audited by KPMG.

For the years ended 31 December 2004 and 2005, Career Computer (Shenzhen) Company Limited was audited by Shenzhen Peng Cheng CPAs Limited 深圳鵬城會計師事務所.

37 PRINCIPAL SUBSIDIARIES *(Continued)*

The Bank of Communications Schroder Fund Management Co., Ltd. is audited by PricewaterhouseCoopers Zhong Tian CPAs Limited Co., 普華永道中天會計師事務所有限公司.

(b) Investment costs and balances with subsidiaries:

| | Year ended 31 December | |
|--------------------------------|------------------------|---------|
| | 2005 | 2004 |
| Investment cost – subsidiaries | 922 | 1,210 |
| Amount due from subsidiaries | 1,207 | 1,262 |
| Amount due to subsidiaries | (1,343) | (1,196) |
| Total | 786 | 1,276 |

38 RELATED PARTY TRANSACTIONS

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. The Group is subject to the control of the State Council of the PRC Government.

(a) Financial Restructuring and Recapitalization with MOF in 2004

On June 24, 2004, the PBOC, with the approval of the State Council, issued Yin Fu 【2004】 “Approval on the Packaged Capital Restructuring Program of Bank of Communications Co., Ltd. by the PBOC” (the “Restructuring Package”), approving a series of financial restructuring transactions (each, individually, a “Restructuring Transaction”) intended to increase the Bank’s capital and resolve certain impaired loans. The aggregate effect achieved through the Restructuring Package was to increase outstanding shares and capital surplus by 21,962 million shares and RMB8,872 million, respectively.

The following Restructuring Transactions were conducted with entities wholly-owned or controlled by the PRC Government (the “Government Restructuring Transactions”). Together, these resulted in increases to outstanding shares and capital surplus of 13,556 million shares and RMB1,681 million, respectively.

- On 25 June 2004, the National Council For Social Security Fund subscribed 5,556 million shares at RMB1.8 per share with a total consideration of RMB10,000 million. The excess over par value of RMB4,444 million was included in capital surplus.

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

38 RELATED PARTY TRANSACTIONS (Continued)

(a) Financial Restructuring and Recapitalization with MOF in 2004 (Continued)

- On 27 June 2004, the Bank transferred impaired loans (the "Transferred Loans") with an aggregate original principal balance of RMB53,020 million to Cinda Asset Management Company in exchange for RMB20,700 million in a bill issued by the PBOC (the "Bills"). The Bills bear a fixed annual rate of 1.89% and will mature on 29 June 2009 with an early redemption right attached to the issuer. RMB2,763 million of carrying value of the Transferred Loans in excess of the fair value of the Bills of RMB20,017 million, net of tax, was offset against capital surplus.
- On 30 June 2004, under the authority of Cai Jin 【2004】 No. 58 issued by the MOF, the MOF subscribed 5,000 million shares at par with a total consideration of RMB5,000 million.
- On 30 June 2004, China Central Huijin Investment Co., Ltd., subscribed 3,000 million shares at par with a total consideration of RMB3,000 million.

The Transferred Loans related to the Group are summarized below.

| | Transferred Loans |
|--|--------------------------|
| Impaired loans: | |
| Doubtful loans | 41,415 |
| Loss loans | 8,300 |
| Loss loans written off previously but not yet approved by the tax authority | 3,305 |
| | 53,020 |
| Less: Allowance for impairment losses on loans and advances (Note 18(b)) | (26,935) |
| Allowance for impairment losses already written off | (3,305) |
| | 22,780 |
| Fair value of consideration received, net of tax | (20,017) |
| | 2,763 |

38 RELATED PARTY TRANSACTIONS *(Continued)*

(b) Transactions with the MOF

Apart from the above financial restructuring and recapitalization transaction with the MOF, the Group also enters into banking transactions with the MOF in the normal course of business. These include the purchase and redemption of investment securities issued by the MOF. The volumes of related party transactions, outstanding balances at the period end, and related income for the year are as follows:

Treasury bonds

| | Year ended 31 December | |
|--|------------------------|---------|
| | 2005 | 2004 |
| Purchase during the year | 36,646 | 16,634 |
| Redemption during the year | (22,091) | (8,305) |
| Interest income | 2,267 | 2,361 |
| | Year ended 31 December | |
| | 2005 | 2004 |
| Outstanding balance at beginning of the year | 59,281 | 50,023 |
| Outstanding at end of the year | 79,368 | 59,281 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

38 RELATED PARTY TRANSACTIONS (Continued)

(c) Transactions with other state controlled entities

The state controlled entities are those over which the PRC government directly holds over 50% of the outstanding shares or voting rights, and has the ability to control or the power to govern their financial or operational policies.

The Group is ultimately controlled by the PRC government, which also directly and indirectly controls a significant number of entities through its government authorities, agencies and affiliates. Accordingly, the Group is likely to have extensive transactions with other State-controlled entities. These transactions are conducted in the ordinary course of the Group's banking business on terms similar to those that would have been entered into with non-state-owned entities. The Group has also established its pricing strategy and approval processes for major products and services, such as loans, deposits, investment securities, money market transactions and financial guarantees and credit related commitments. Such pricing strategy and approval processes do not depend on whether the customers are state-owned entities or not. The volumes of related party transactions, outstanding balances and related provisions at the year end, and the related expense and interest ranges for the year are as follows:

(i) Loans and advances to customers

| | Year ended 31 December | |
|---|------------------------|---------------|
| | 2005 | 2004 |
| Outstanding balance at beginning of the year | 190,497 | 191,081 |
| Outstanding balance at end of the year | 207,715 | 190,497 |
| Less: allowance for impairment losses | (2,313) | (1,871) |
| | 205,402 | 188,626 |
| Including: discounted bills | 6,477 | 11,762 |
| Interest rate range for discounted bills | 3.24%~5.742% | 2.97%~5.742% |
| Interest rate range of loans and advances other than discounted bills | 0.57%~8.37% | 4.698%~6.732% |

The loan interest rate range stated above covers interest rates for loans granted in various currencies and periods.

38 RELATED PARTY TRANSACTIONS *(Continued)***(c) Transactions with other state controlled entities** *(Continued)**(i) Loans and advances to customers (Continued)*

| | Year ended 31 December | |
|---|-------------------------------|-------------|
| | 2005 | 2004 |
| Maximum balance during the year | 207,715 | 197,725 |
| Provision for impairment recognized/(reversed) during the year | 442 | (1,239) |

(ii) Investment securities

| | Year ended 31 December | |
|--|-------------------------------|-------------|
| | 2005 | 2004 |
| Purchase during the year | 206,665 | 141,297 |
| Redemption during the year | (17,463) | (14,210) |
| Sales during the year | (180,824) | (49,343) |
| Interest income | 3,132 | 2,543 |
| | Year ended 31 December | |
| | 2005 | 2004 |
| Outstanding balance at beginning of the year | 148,390 | 117,555 |
| Outstanding balance at end of the year | 137,424 | 148,390 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

38 RELATED PARTY TRANSACTIONS (Continued)**(c) Transactions with other state controlled entities** (Continued)*(iii) Due from other banks and financial institutions*

| | Year ended 31 December | |
|--|-------------------------------|-------------|
| | 2005 | 2004 |
| Outstanding balance at beginning of the year | 39,140 | 43,472 |
| Outstanding balance at end of the year | 101,504 | 39,140 |
| Less: allowance for impairment losses | (733) | (994) |
| | 100,771 | 38,146 |

| | Year ended 31 December | |
|---|-------------------------------|-------------|
| | 2005 | 2004 |
| Maximum balance during the year | 101,504 | 54,120 |
| Provision for impairment recognised/(reversed) during the year | (149) | 324 |

(iv) Due to other banks and financial institutions

| | Year ended 31 December | |
|--|-------------------------------|-------------|
| | 2005 | 2004 |
| Outstanding balance at beginning of the year | 20,894 | 10,125 |
| Outstanding balance at end of the year | 73,797 | 20,894 |

| | Year ended 31 December | |
|---------------------------------|-------------------------------|-------------|
| | 2005 | 2004 |
| Maximum balance during the year | 73,797 | 30,325 |

38 RELATED PARTY TRANSACTIONS *(Continued)***(c) Transactions with other state controlled entities** *(Continued)**(v) Due to customers*

| | Year ended 31 December | |
|--|-------------------------------|-------------|
| | 2005 | 2004 |
| Outstanding balance at beginning of the year | 112,197 | 60,646 |
| Outstanding balance at end of the year | 560,549 | 112,197 |

| | Year ended 31 December | |
|---------------------------------|-------------------------------|-------------|
| | 2005 | 2004 |
| Maximum balance during the year | 848,417 | 134,520 |

(vi) Financial guarantees and credit related commitments

| | As at 31 December | |
|-----------------------------------|--------------------------|-------------|
| | 2005 | 2004 |
| Guarantees | 22,954 | 5,432 |
| Letters of credit | 6,111 | 14,492 |
| Acceptances | 19,673 | 9,703 |
| Derivative transactions unsettled | 940 | 3,899 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

38 RELATED PARTY TRANSACTIONS (Continued)

(d) Transactions with directors and senior management

The Group enters into banking transactions with directors and senior management in the normal course of business. These include loans and deposits, which are carried out under commercial terms and at market rates except that loans and deposits have been made to and taken from senior management of the Hong Kong branch at preferential rates. The volumes of related party transactions during each of the years ended 31 December 2004 and 2005, outstanding balances at the balance sheet date are as follows:

(i) Loans

| | Year ended 31 December | |
|--------------------------------------|------------------------|------|
| | 2005 | 2004 |
| Outstanding at beginning of the year | 9 | 4 |
| Granted during the year | 16 | 8 |
| Repaid during the year | (15) | (3) |
| Outstanding at end of the year | 10 | 9 |

No interest income and allowance for impairment have been recognised in respect of loans granted to directors and senior management.

(ii) Deposits

| | Year ended 31 December | |
|--------------------------------------|------------------------|------|
| | 2005 | 2004 |
| Outstanding at beginning of the year | 29 | 18 |
| Deposited during the year | 129 | 92 |
| Repaid during the year | (124) | (81) |
| Outstanding at end of the year | 34 | 29 |

38 RELATED PARTY TRANSACTIONS *(Continued)*

(e) Transactions with HSBC

On 18 August 2004, according to the investment agreement between the Bank and the Hongkong and Shanghai Banking Corporation Limited (“HSBC”), HSBC subscribed 7,775 million shares of the Bank at an issue price of RMB1.86 per share with a total consideration of RMB14,461 million. The excess over par value of RMB6,686 million was included in capital surplus. On 23 June 2005 and 4 July 2005, HSBC further subscribed 462 million shares and 878 million shares at an issue price of HKD2.50 per share with a total consideration of HKD3,350 million (equivalent to RMB3,566 million). The excess over par value of HKD2,091 million (equivalent to RMB2,226 million) was included in capital surplus. Other transactions between the Group and HSBC are mainly banking activities under commercial terms and at market rates. Detail transaction volumes since the above share acquisition are set out below:

(i) Placement with HSBC

| | Year ended 31 December 2005 | Period from 18 August to 31 December 2004 |
|---|-----------------------------------|--|
| Outstanding at beginning of the period/year | 100 | 2,063 |
| Granted during the period/year | 231,869 | 57,658 |
| Repaid during the period/year | (227,315) | (59,621) |
| Outstanding at end of the period/year | 4,654 | 100 |
| Interest income | 16 | 4 |

(ii) Deposits from HSBC

| | Year ended 31 December 2005 | Period from 18 August to 31 December 2004 |
|---|-----------------------------------|--|
| Outstanding at beginning of the period/year | 1,218 | 985 |
| Deposited during the period/year | 60,778 | 14,530 |
| Repaid during the period/year | (59,678) | (14,297) |
| Outstanding at end of the period/year | 2,318 | 1,218 |
| Interest expense on deposits | 36 | 5 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

38 RELATED PARTY TRANSACTIONS (Continued)

(e) Transactions with HSBC (Continued)

(iii) Investment securities

| | Year ended 31 December 2005 | Period from 18 August to 31 December 2004 |
|---------------------|-----------------------------------|--|
| Interest income | 22 | 8 |
| | As at 31 December | |
| | 2005 | 2004 |
| Outstanding balance | 568 | 414 |

(iv) Financial guarantees and credit related commitments

| | As at 31 December | |
|-----------------------------------|-------------------|--------|
| | 2005 | 2004 |
| Guarantees | 7 | 8 |
| Letters of credit | 347 | 17 |
| Derivative transactions unsettled | 28,768 | 10,943 |

39 SEGMENTAL INFORMATION

(a) The following table sets out the segmental information of the Group's operating results, assets and liabilities. The geographical segments are:

- (i) Northern China – Including the following provinces: Beijing, Tianjin, Hebei, Shanxi, Inner Mongolia;
- (ii) North Eastern China – Including the following provinces: Liaoning, Jilin, Heilongjiang;
- (iii) Eastern China – Including head office and the following provinces: Shanghai, Jiangsu, Zhejiang, Anhui, Fujian, Jiangxi and Shandong;
- (iv) Central & Southern China – Including the following provinces: Henan, Hunan, Hubei, Guangdong, Guangxi, Hainan;
- (v) Western China – Including the following provinces: Chongqing, Sichuan, Guizhou, Yunnan, Tibet, Shanxi, Gansu, Qinghai, Ningxia and Xinjiang;
- (vi) Overseas – Including overseas subsidiaries and the following branches: Hong Kong, New York, Singapore, Tokyo and Seoul.

39 SEGMENTAL INFORMATION

(a) Geographical segment information

| | Northern China | North- eastern China | Eastern China | Central & Southern China | Western China | Overseas | Eliminations & Consolidated | Group Total |
|---|-------------------|----------------------------|------------------|--------------------------------|------------------|-----------------|-----------------------------------|--------------------|
| As at 31 December 2005 | | | | | | | | |
| Assets | | | | | | | | |
| Cash and balances with central banks | 11,289 | 4,361 | 108,266 | 10,427 | 5,360 | 606 | - | 140,309 |
| Due from other banks and financial institutions | 25,492 | 2,091 | 113,979 | 10,733 | 3,160 | 15,230 | (584) | 170,101 |
| Financial assets held for trading | - | - | 112 | - | - | 3,116 | - | 3,228 |
| Loans and advances to customers | 128,284 | 52,192 | 318,138 | 145,998 | 68,932 | 42,569 | 2,660 | 758,773 |
| Investment securities | | | | | | | | |
| – originated loans | 130 | 78 | 28,091 | 35 | 38 | - | - | 28,372 |
| – available-for-sale | 21,760 | 14,523 | 193,042 | 23,020 | 8,737 | 24,889 | - | 285,971 |
| Other assets | 23,315 | 8,732 | 7,568 | 15,723 | 8,039 | 10,561 | (37,253) | 36,685 |
| Total assets | 210,270 | 81,977 | 769,196 | 205,936 | 94,266 | 96,971 | (35,177) | 1,423,439 |
| Liabilities | | | | | | | | |
| Due to other banks and financial institutions | (32,262) | (4,297) | (34,104) | (7,192) | (2,368) | (3,912) | 41 | (84,094) |
| Financial liabilities held for trading | - | - | (141) | - | - | (9,414) | - | (9,555) |
| Due to customers | (217,460) | (115,118) | (462,960) | (245,324) | (119,951) | (63,408) | 3,382 | (1,220,839) |
| Other liabilities | (4,909) | (2,759) | (22,485) | (6,827) | (3,197) | (17,382) | 31,754 | (25,805) |
| Total liabilities | (254,631) | (122,174) | (519,690) | (259,343) | (125,516) | (94,116) | 35,177 | (1,340,293) |
| Net on balance sheet position | (44,361) | (40,197) | 249,506 | (53,407) | (31,250) | 2,855 | - | 83,146 |
| Acquisition cost of property and equipment (“PPE”) and intangible assets | 461 | 348 | 1,794 | 474 | 440 | 118 | - | 3,635 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

39 SEGMENTAL INFORMATION (Continued)

(a) Geographical segment information (Continued)

| | Northern China | North- eastern China | Eastern China | Central & Southern China | Western China | Overseas | Eliminations & Consolidated | Group Total |
|---|-------------------|----------------------------|------------------|--------------------------------|------------------|--------------|-----------------------------------|----------------|
| For the year ended 31 December 2005 | | | | | | | | |
| Interest income | 8,205 | 3,912 | 27,416 | 9,281 | 4,271 | 3,028 | (6,433) | 49,680 |
| Interest expense | (3,278) | (1,769) | (12,743) | (3,234) | (1,534) | (1,964) | 6,433 | (18,089) |
| Net interest income | 4,927 | 2,143 | 14,673 | 6,047 | 2,737 | 1,064 | - | 31,591 |
| Fee and commission income | 321 | 190 | 930 | 470 | 186 | 447 | - | 2,544 |
| Fee and commission expense | (50) | (38) | (128) | (81) | (33) | (105) | - | (435) |
| Net fee and commission income | 271 | 152 | 802 | 389 | 153 | 342 | - | 2,109 |
| Dividend income | - | - | 39 | 3 | - | 3 | - | 45 |
| Gains less losses arising from trading activities | 218 | 54 | (510) | 125 | 24 | 509 | - | 420 |
| Gains less losses arising from investment securities | 103 | - | 258 | 17 | - | (19) | - | 359 |
| Other operating income | 33 | 18 | 249 | 58 | 33 | 238 | - | 629 |
| Reversal/(Impairment) losses on loans and advances | (505) | (787) | (868) | (915) | (1,237) | 14 | - | (4,298) |
| Other operating expenses | (1,879) | (1,911) | (8,209) | (3,535) | (1,695) | (783) | - | (18,012) |
| Operating profit/(loss) before tax | 3,168 | (331) | 6,434 | 2,189 | 15 | 1,368 | - | 12,843 |
| Income tax | (1,046) | (216) | (609) | (1,113) | (392) | (224) | - | (3,600) |
| Net profit/(loss) for the year | 2,122 | (547) | 5,825 | 1,076 | (377) | 1,144 | - | 9,243 |
| Depreciation and amortization of property and equipment and intangible assets | 238 | 288 | 1,149 | 428 | 244 | 127 | - | 2,474 |

39 SEGMENTAL INFORMATION *(Continued)*

(a) Geographical segment information *(Continued)*

| | Northern China | North- eastern China | Eastern China | Central & Southern China | Western China | Overseas | Eliminations & Consolidated | Group Total |
|---|-------------------|----------------------------|------------------|--------------------------------|------------------|------------------|-----------------------------------|--------------------|
| As at 31 December 2004 | | | | | | | | |
| Assets | | | | | | | | |
| Cash and balances with central banks | 7,930 | 5,090 | 96,658 | 13,494 | 4,870 | 459 | – | 128,501 |
| Due from other banks and financial institutions | 10,518 | 425 | 44,472 | 2,730 | 1,841 | 30,604 | (1,667) | 88,923 |
| Financial assets held for trading | – | – | 47 | – | – | 2,448 | – | 2,495 |
| Loans and advances to customers | 104,316 | 49,447 | 258,112 | 125,272 | 59,325 | 33,976 | 1,164 | 631,612 |
| Investment securities | | | | | | | | |
| – loans and receivables | 114 | 7 | 30,711 | 225 | 148 | – | – | 31,205 |
| – available-for-sale | 18,957 | 11,793 | 128,227 | 19,257 | 9,642 | 27,647 | – | 215,523 |
| Other assets | 10,377 | 8,061 | 25,059 | 13,319 | 7,419 | 10,827 | (29,316) | 45,746 |
| Total assets | 152,212 | 74,823 | 583,286 | 174,297 | 83,245 | 105,961 | (29,819) | 1,144,005 |
| Liabilities | | | | | | | | |
| Due to other banks and financial institutions | (3,950) | (2,694) | (12,699) | (4,342) | (940) | (7,921) | 835 | (31,711) |
| Financial liabilities held for trading | – | – | (95) | – | – | (4,991) | – | (5,086) |
| Due to customers | (173,255) | (99,297) | (378,278) | (204,813) | (101,139) | (74,897) | 1,738 | (1,029,941) |
| Other liabilities | (4,111) | (2,841) | (21,056) | (5,508) | (2,856) | (16,038) | 27,246 | (25,164) |
| Total liabilities | (181,316) | (104,832) | (412,128) | (214,663) | (104,935) | (103,847) | 29,819 | (1,091,902) |
| Net on balance sheet position | (29,104) | (30,009) | 171,158 | (40,366) | (21,690) | 2,114 | – | 52,103 |
| Acquisition cost of property and equipment and intangible assets | 603 | 368 | 1,048 | 705 | 436 | 119 | – | 3,279 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

39 SEGMENTAL INFORMATION (Continued)

(a) Geographical segment information (Continued)

| | Northern China | North- eastern China | Eastern China | Central & Southern China | Western China | Overseas | Eliminations & Consolidated | Group Total |
|--|-------------------|----------------------------|------------------|--------------------------------|------------------|--------------|-----------------------------------|----------------|
| Year ended | | | | | | | | |
| 31 December 2004 | | | | | | | | |
| Interest income | 6,135 | 3,296 | 19,996 | 7,575 | 3,658 | 2,090 | (4,398) | 38,352 |
| Interest expense | (2,178) | (1,406) | (9,082) | (2,504) | (1,317) | (1,071) | 4,398 | (13,160) |
| Net interest income | 3,957 | 1,890 | 10,914 | 5,071 | 2,341 | 1,019 | - | 25,192 |
| Fee and commission income | 232 | 150 | 711 | 367 | 138 | 398 | - | 1,996 |
| Fee and commission expense | (42) | (31) | (105) | (70) | (23) | (50) | - | (321) |
| Net fee and commission income | 190 | 119 | 606 | 297 | 115 | 348 | - | 1,675 |
| Dividend income | - | 7 | 16 | 1 | - | 31 | - | 55 |
| Gains less losses arising from trading activities | 125 | 36 | 177 | 94 | 19 | (126) | - | 325 |
| Gains less losses arising from investment securities | 1 | - | 73 | - | - | 3 | - | 77 |
| Other operating income | 56 | 52 | 138 | 80 | 29 | 278 | - | 633 |
| Reversal/(Impairment) losses on loans and advances | (680) | (952) | (864) | 85 | (604) | (200) | - | (3,215) |
| Other operating expenses | (2,062) | (1,796) | (6,708) | (3,423) | (1,753) | (1,250) | - | (16,992) |
| Operating profit/(loss) before tax | 1,587 | (644) | 4,352 | 2,205 | 147 | 103 | - | 7,750 |
| Income tax | (872) | (207) | (3,976) | (730) | (361) | - | - | (6,146) |
| Net profit/(loss) for the year | 715 | (851) | 376 | 1,475 | (214) | 103 | - | 1,604 |
| Depreciation and amortization of property and equipment and intangible assets | 290 | 321 | 1,151 | 464 | 285 | 112 | - | 2,623 |

39 SEGMENTAL INFORMATION *(Continued)*

(b) Business segment information

The Group is engaged predominantly in banking and related financial activities. It comprises retail banking, corporate banking, treasury and other classes of business.

Corporate banking mainly comprises corporate loans, bills, trade finance, corporate deposits and remittance. Retail banking mainly comprises retail loans, retail deposits, credit card and remittance. Treasury mainly comprises money market placements and takings, investment in securities, and securities sold subject to linked repurchase agreements ('repos'). The 'Others' business mainly comprises other items which cannot be categorized as above business segments.

| | Corporate | Retail | Treasury | Others | Total |
|---|-----------|---------|----------|--------|-----------|
| As at 31 December 2005 | | | | | |
| Total carrying amount of segment assets | 612,441 | 112,593 | 663,733 | 34,672 | 1,423,439 |
| Segment revenue | 33,248 | 6,282 | 13,323 | 824 | 53,677 |
| Depreciation and amortization of PPE and intangible assets | – | – | – | 2,474 | 2,474 |
| Acquisition cost of PPE and intangible assets | – | – | – | 3,635 | 3,635 |
| As at 31 December 2004 | | | | | |
| Total carrying amount of segment assets | 524,732 | 90,780 | 487,125 | 41,368 | 1,144,005 |
| Segment revenue | 26,226 | 4,187 | 10,324 | 701 | 41,438 |
| Depreciation and amortization of PPE and intangible assets | – | – | – | 2,623 | 2,623 |
| Acquisition cost of PPE and intangible assets | – | – | – | 3,279 | 3,279 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

SUPPLEMENTARY UNAUDITED FINANCIAL INFORMATION

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1 CAPITAL ADEQUACY AND LIQUIDITY RATIOS

Group

| | As at 31 December | |
|---|-------------------|--------|
| | 2005 | 2004 |
| Capital adequacy ratio | 11.20% | 9.72% |
| Liquidity ratios: | | |
| RMB current assets to RMB current liabilities | 63.23% | 66.30% |
| Foreign currency current assets to foreign currency current liabilities | 110.74% | 57.05% |

The above capital adequacy and liquidity ratios are calculated in accordance with the formula promulgated by the PBOC and China Banking Regulatory Commission and based on PRC GAAP.

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

2 COMPONENTS OF CAPITAL BASE AFTER DEDUCTIONS

The capital base after deductions used in the calculation of the above capital adequacy ratio as at end of each period is analysed as below. All the figures included in the calculation are extracted from PRC GAAP statements of the Bank.

Group

| | As at 31 December | |
|--|-------------------|----------|
| | 2005 | 2004 |
| Core capital: | | |
| Paid up ordinary share capital | 45,934 | 39,070 |
| Reserves | 18,100 | 34,948 |
| Profit and loss account | 8,113 | (26,558) |
| Minority interest | 70 | – |
| | 72,217 | 47,460 |
| Supplementary capital: | | |
| Reserves on revaluation of land and interests in land | – | – |
| Impairment allowances for impaired assets and regulatory reserves. | 10,935 | 9,161 |
| Term subordinated debt | 9,600 | 12,000 |
| Reserve-net profit of overseas branches retained | – | – |
| | 20,535 | 21,161 |
| Eligible value of supplementary capital | 20,535 | 21,161 |
| Total capital base before deductions | 92,752 | 68,621 |
| Deductions: | | |
| Unconsolidated equity investments | (1,743) | (1,894) |
| Total capital base after deductions | 91,009 | 66,727 |

The “Unconsolidated equity investments” is calculated in accordance with the “Administrative Measures on the Capital Adequacy Ratio of Commercial Banks” issued by the China Banking Regulatory Commission on 23 February 2004.

3 CURRENCY CONCENTRATIONS

Group

| | US Dollars | HK Dollars | Others | Total |
|-------------------------------|------------|------------|----------|-----------|
| As at 31 December 2005 | | | | |
| Spot assets | 110,330 | 46,980 | 20,069 | 177,379 |
| Spot liabilities | (94,289) | (51,526) | (18,360) | (164,175) |
| Forward purchases | 16,052 | 264 | 4,994 | 21,310 |
| Forward sales | (14,821) | (337) | (7,630) | (22,788) |
| Net options position | 282 | – | – | 282 |
| Net long/(short) position | 17,554 | (4,619) | (927) | 12,008 |
| Net structural position | 3,704 | 5,838 | 356 | 9,898 |
| As at 31 December 2004 | | | | |
| Spot assets | 102,341 | 45,239 | 19,992 | 167,572 |
| Spot liabilities | (93,178) | (50,001) | (17,439) | (160,618) |
| Forward purchases | 26,649 | 21,886 | 1,679 | 50,214 |
| Forward sales | (23,238) | (20,938) | (6,124) | (50,300) |
| Net options position | 250 | 20 | 338 | 608 |
| Net long/(short) position | 12,824 | (3,794) | (1,554) | 7,476 |
| Net structural position | 2,132 | 4,722 | 133 | 6,987 |

The net options position is calculated using the model user approach as set out in the banking return of the HKMA. The net structural position of the Group includes the structural positions of the Bank's overseas branches, banking subsidiaries and other subsidiaries substantially involved in foreign exchange. Structural assets and liabilities include:

- Investments in fixed assets and premises, net of depreciation charges;
- Capital and statutory reserves of overseas branches;
- Investments in overseas subsidiaries and related companies; and
- Loan capital.

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

4 CROSS-BORDER CLAIMS

The Group is principally engaged in business operations within Mainland China, and regards all claims on third parties outside Mainland China as cross border claims.

Cross-border claims include loans and advances, balances and placements with banks and other financial institutions, holdings of trade bills and certificates of deposit and investment securities.

Cross-border claims have been disclosed by different country or geographical areas. A country or geographical area is reported where it constitutes 10% or more of the aggregate amount of cross-border claims, after taking into account any risk transfers. Risk transfer is only made if the claims are guaranteed by a party in a country which is different from that of the counterparty or if the claims are on an overseas branch of a bank whose head office is located in another country.

| | Bank and other financial institutions | Public sector entities | Others | Total |
|--|--|---------------------------------------|---------------|----------------|
| As at 31 December 2005 | | | | |
| Asia Pacific excluding Mainland China | 35,778 | 3,317 | 35,187 | 74,282 |
| – of which attributed to Hong Kong | 2,815 | 3,146 | 31,530 | 37,491 |
| North and South America | 11,447 | 1,462 | 4,351 | 17,260 |
| Europe | 37,036 | 196 | 162 | 37,394 |
| | 84,261 | 4,975 | 39,700 | 128,936 |
| As at 31 December 2004 | | | | |
| Asia Pacific excluding Mainland China | 29,201 | 500 | 4,550 | 34,251 |
| – of which attributed to Hong Kong | 22,219 | – | 1,724 | 23,943 |
| North and South America | 10,185 | 1,459 | 4,210 | 15,854 |
| Europe | 24,414 | 231 | 947 | 25,592 |
| Middle East and Africa | – | – | 49 | 49 |
| | 63,800 | 2,190 | 9,756 | 75,746 |

5 OVERDUE AND RESCHEDULED ASSETS

(a) Advances

(i) Gross amount of overdue loans

Group and Bank

| | As at 31 December | |
|---|-------------------|------------------|
| | 2005 | 2004 Restated |
| Gross advances to customers which have been overdue for: | | |
| – within 3 months | 5,250 | 5,215 |
| – between 3 and 6 months | 3,331 | 2,958 |
| – between 6 and 12 months | 4,912 | 3,278 |
| – over 12 months | 9,024 | 4,942 |
| | 22,517 | 16,393 |
| Percentage: | | |
| – within 3 months | 0.68% | 0.82% |
| – between 3 and 6 months | 0.43% | 0.46% |
| – between 6 and 12 months | 0.64% | 0.51% |
| – over 12 months | 1.17% | 0.77% |
| | 2.92% | 2.56% |
| Gross advances to banks and other financial institutions which have been overdue for: | | |
| – within 3 months | – | – |
| – between 3 and 6 months | – | – |
| – between 6 and 12 months | – | – |
| – over 12 months | 743 | 1,004 |
| | 743 | 1,004 |
| Percentage: | | |
| – within 3 months | – | – |
| – between 3 and 6 months | – | – |
| – between 6 and 12 months | – | – |
| – over 12 months | 0.43% | 1.12% |
| | 0.43% | 1.12% |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

5 OVERDUE AND RESCHEDULED ASSETS (Continued)

(a) Advances (Continued)

(ii) Overdue loans and advances to customers by geographical area

Group and Bank

| | As at 31 December | |
|----------------------------------|-------------------|------------------|
| | 2005 | 2004 Restated |
| Domestic regions | | |
| – Northern China | 2,748 | 2,054 |
| – North-eastern China | 3,646 | 4,274 |
| – Eastern China | 4,708 | 3,756 |
| – Central & Southern China | 5,710 | 3,426 |
| – Western China | 5,090 | 2,458 |
| | 21,902 | 15,968 |
| Hong Kong and overseas countries | 615 | 425 |
| | 22,517 | 16,393 |

(iii) Overdue and rescheduled loans

Group and Bank

| | As at 31 December 2005 |
|--|---------------------------|
| Total rescheduled loans and advances to customers | 9,781 |
| Less: total overdue rescheduled loans and advances to customers | (4,249) |
| Total normal rescheduled loans and advances to customers | 5,532 |
| Percentage of normal part in total rescheduled loans | 57% |

5 OVERDUE AND RESCHEDULED ASSETS *(Continued)*

(b) Investment securities-available-for-sale

Group and Bank

| | As at 31 December | |
|---------------------------|--------------------------|-------------|
| | 2005 | 2004 |
| Overdue for: | | |
| – three months or less | – | 41 |
| – between 3 and 6 months | – | – |
| – between 6 and 12 months | – | – |
| – over 12 months | – | 31 |
| | – | 72 |

Group and Bank

| | As at 31 December | |
|-------------------|--------------------------|-------------|
| | 2005 | 2004 |
| Foreclosed assets | 5,483 | 6,832 |

Notes to the Consolidated Financial Statements (Continued)

(All amounts expressed in millions of RMB unless otherwise stated.)

6 BUSINESS SEGMENT INFORMATION**Group**

| | Fourth Quarter ended December 31, 2005 | | | | Total |
|--|--|----------------|----------------|------------------------|------------------|
| | Corporate | Retail | Treasury | Others and unallocated | |
| External net interest income/(expense) | 5,488 | (160) | 3,125 | 47 | 8,500 |
| Internal net interest income/(expense) | 545 | 2,198 | (2,743) | – | – |
| Net interest income | 6,033 | 2,038 | 382 | 47 | 8,500 |
| Net fee and commission income | 297 | 336 | 11 | 37 | 681 |
| Dividend income | – | – | 2 | 23 | 25 |
| Gains less losses arising from trading activities | 187 | 56 | 303 | (7) | 539 |
| Gains less losses arising from investment securities | – | – | (18) | – | (18) |
| Other operating income | 8 | 1 | 108 | 261 | 378 |
| Impairment losses on loans and advances | (1,675) | 7 | 100 | – | (1,568) |
| Other operating expenses | | | | | |
| – depreciation and amortisation | – | – | – | (738) | (738) |
| – others | (2,574) | (1,414) | (239) | (914) | (5,141) |
| Operating profit before tax | 2,276 | 1,024 | 649 | (1,291) | 2,658 |
| Capital expenditure | – | – | – | 1,413 | 1,413 |
| Segment assets | 612,441 | 112,593 | 663,733 | 34,672 | 1,423,439 |
| Segment liabilities | 776,898 | 443,180 | 106,702 | 13,513 | 1,340,293 |

Reconciliation of Net Profit and Net Assets from PRC GAAP to IFRS

| | Net Assets | | Net Profit | |
|--|---------------------|---|--------------|--------------|
| | 31 December 2005 | 31 December 2004 Restated (in millions of RMB) | 2005 | 2004 |
| PRC GAAP figures | 78,336 | 52,489 | 8,991 | 915 |
| Adjustments for accounting standard differences: | | | | |
| 1. Interest income from investment securities | 809 | 643 | 166 | 525 |
| 2. Revaluation surplus from fixed assets and investment properties | 3,711 | 3,543 | (256) | (291) |
| 3. Differences arising from the transfer of the non-performing loans to China Cinda Asset Management Corporation | (760) | (966) | 206 | 1,243 |
| 4. Valuation of derivative products | 20 | (310) | 330 | (225) |
| 5. Valuation reserves increasing/(decreasing)/from AFS securities | 3,769 | (1,898) | – | – |
| 6. Consolidated adjustments | (801) | (1,018) | (19) | (308) |
| 7. Deferred taxes | (1,773) | (249) | 215 | (60) |
| 8. Translation difference on foreign currency net position | – | – | (371) | – |
| 9. Others | (165) | (131) | (13) | (195) |
| IFRS figures | 83,146 | 52,103 | 9,249 | 1,604 |

EXPLANATION OF THE ADJUSTMENTS FOR ACCOUNTING STANDARD DIFFERENCES:

1. Interest income from investment securities

In accordance with PRC GAAP, no interest income should be accrued on investment securities intended to be held for less than one year. Under IFRS, interest income is recognised on interest-bearing instruments on an accruals basis using the effective interest method. The impact on net profit of current period depends on the difference between the opening and ending accruals of interest income. If the accrual balance is bigger at opening than that of ending, the current profit will be reduced, and vice versa.

Reconciliation of Net Profit and Net Assets from PRC GAAP to IFRS (Continued)

2. Revaluation surplus/deficit from fixed assets and investment properties

In 2004, the Company carried out a further revaluation exercise on fixed assets and investment properties for the purpose of the preparation of its IFRS financial statements, which was not a statutory valuation nor was it approved by the Ministry of Finance of the PRC. The valuation surplus/deficit arising from the 2004 valuation have been reflected in IFRS accounts, while it is not recognised in PRC GAAP financial statements. The differences arising from fixed assets and investment property valuation exercise in 2004 has been reflected as an accounting standard difference accordingly. Such difference will be depreciated during the remaining beneficiary period.

3. Differences arising from the transfer of the non-performing loans to China Cinda Asset Management Corporation

On 27 June 2004, the Company disposed of non-performing loans (the “**Transferred Loans**”) to China Cinda Asset Management Corporation in exchange for a bill issued by the PBC (the “**Bills**”). The amount of carrying value of the Transferred Loans in excess of the fair value of the Bills, net of tax, was offset against capital surplus in its IFRS financial statements. The discount will be amortized and recorded as interest income during the remaining beneficiary period of the Bills.

4. Recognition of derivative financial instruments at fair value

In accordance with International Accounting Standards (the “**IAS**”) No.39, derivative financial instruments are initially recognized at cost and subsequently re-measured to fair value. Changes in fair value of derivatives held for trading are included in net trading income. However, such derivative financial instruments are still accounted for as off balance sheet items in the Company’s PRC GAAP financial statements.

5. Valuation reserves increasing/(decreasing) from AFS securities

In accordance with IAS No.39, Available For Sale (“**AFS**”) securities are accounted for at fair value, the fluctuation of fair value are recorded as revaluation reserves of shareholder’s equity. As of 1 January 2005, the bank has adopted revised IAS 39 and reclassified part of Investment securities – originated loans into AFS and recognized relevant negative revaluation reserves. As of 31 December 2005, the revaluation reserves of AFS is a positive balance of RMB2,603 million. Such revaluation reserves arising from the fluctuation of fair value are not accounted for under PRC GAAP.

6. Consolidation adjustments

Subsidiaries, which are those companies and other entities (including Special Purpose Entities) in which the Group, directly or indirectly, has control, are consolidated in the Company's IFRS financial statements. However, under PRG GAAP, it is allowed not to consolidate subsidiaries which are intended to be disposed of in the near future.

7. Deferred taxes

In both PRC GAAP and IFRS financial statements prepared by the Company, deferred income tax is provided, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Accordingly, all adjustments on accounting standard differences also gave rise to deferred taxation differences.

8. Translation difference on foreign currency net position

Translation difference on foreign currency net position under PRC GAAP is recognized in equity, while it is recognized as foreign exchange gain or loss in profit and loss under IFRS.

9. Others

All other differences are adjustments with minor amounts.

List of Branches

BRANCHES IN MAINLAND

- Beijing Branch
33 Jin Rong Da Jie,
Xi Cheng District, Beijing
TEL: (010)66101616
SWIFT: COMMCNSHBJG
P.C.: 100032
FAX: (010)88086008
- Tianjin Branch
35 Nan Jing Lu,
He Xi District, Tianjin
TEL: (022)23403701
SWIFT: COMMCNSHTJN
P.C.: 300200
FAX: (022)23302004
- Baotou Branch
24 Gang Tie Da Jie,
Qing Shan District, Baotou
TEL: (0472)5143280
SWIFT: COMMCNSHBTU
P.C.: 014030
FAX: (0472)5144698
- Shijiazhuang Branch
22 Zi Qiang Lu, Shijiazhuang
TEL: (0311)87026358
SWIFT: COMMCNSHSJZ
P.C.: 050000
FAX: (0311)87016376
- Tangshan Branch
103 Xin Hua Dong Dao, Tangshan
TEL: (0315)3720100
SWIFT: COMMCNSHTSN
P.C.: 063000
FAX: (0315)2849299
- Qinhuangdao Branch
174 Wen Hua Lu,
Hai Gang District, Qinhuangdao
TEL: (0335)3038260
SWIFT: COMMCNSHQHD
P.C.: 066000
FAX: (0335)3028046
- Taiyuan Branch
35 Jie Fang Lu, Taiyuan
TEL: (0351)4070074 4070094
SWIFT: COMMCNSHTYN
P.C.: 030002
FAX : (0351)4071457
- Jincheng Branch
878 Huang Hua Jie, Jincheng
TEL: (0356)2026882
P.C: 048026
FAX: (0356)2029840
- Shenyang Branch
100 Shi Yi Wei Lu,
Shen He District, Shenyang
TEL: (024)22719497
SWIFT: COMMCNSHSYG
P.C.: 110014
FAX: (024)22825238
- Anshan Branch
38 Er Yi Jiu Lu,
Tie Dong District, Anshan
TEL: (0412)5554790
SWIFT: COMMCNSHASN
P.C.: 114001
FAX: (0412)5554785

- Fushun Branch
2-1 Xi Yi Lu,
Xin Fu District, Fushun
TEL: (0413)2861877
SWIFT: COMMCNSHFNSN
P.C.: 113008
FAX: (0413)2648493
- Dandong Branch
68 Jin Shan Da Jie, Dandong
TEL: (0415)2125736
SWIFT: COMMCNSHDDG
P.C.: 118000
FAX: (0415)2131250
- Jinzhou Branch
42 Yun Fei Jie, Er Duan, Jinzhou
TEL: (0416)3124258
SWIFT: COMMCNSHJIN
P.C.: 121000
FAX: (0416)3125832
- Yingkou Branch
21 Bo Hai Da Jie Xi, Yingkou
TEL: (0417)2881234
SWIFT: COMMCNSHYKU
P.C.: 115003
FAX: (0417)2837764
- Liaoyang Sub-branch
114 Xin Yun Da Jie, Liaoyang
TEL: (0419)2126778
P.C.: 111000
FAX: (0419)2151178
- Changchun Branch
502 Tong Zhi Jie, Changchun
TEL: (0431)8928485
SWIFT: COMMCNSHCCN
P.C.: 130061
FAX: (0431)8579990
- Jilin Branch
4 Song Jiang Dong Lu, Jilin
TEL: (0432)2102998
SWIFT: COMMCNSHJLN
P.C.: 132001
FAX: (0432)2102996
- Yanbian Branch
172 Guang Ming Jie, Yanji
TEL: (0433)2520486
SWIFT: COMMCNSHYBN
P.C.: 133000
FAX: (0433)2520418
- Harbin Branch
242 Guo Ge Li Da Jie,
Nan Gang District, Harbin
TEL: (0451)82644467
SWIFT: COMMCNSHHEB
P.C.: 150001
FAX: (0451)82644448
- Qiqihar Branch
205 Bu Kui Da Jie,
Jian Hua District, Qiqihar
TEL: (0452) 2559771
SWIFT: COMMCNSHQQH
P.C.: 161006
FAX: (0452) 2559777

List of Branches (Continued)

- Daqing Branch
2 Re Yuan Jie Dong Feng Lu,
Dong Feng Xin Cun, Daqing
TEL: (0459)6688863
SWIFT: COMMCNSHDQG
P.C.: 163311
FAX: (0459)6688860
- Shanghai Branch
99 Zhong Shan Nan Lu, Shanghai
TEL: (021)63111000
TLX: 33438 COMSH CN
SWIFT: COMMCNSHSHI
P.C.: 200010
FAX: (021)63744799
- Nanjing Branch
124 Zhong Shan Bei Lu, Nanjing
TEL: (025)83278888
SWIFT: COMMCNSHNJG
P.C.: 210009
FAX: (025)83322050
- Xuzhou Branch
56 Zhong Shan Nan Lu, Xuzhou
TEL: (0516) 85608180
SWIFT: COMMCNSHIUZ
P.C.: 221006
FAX: (0516)85608186
- Lianyungang Branch
141 Hai Lian Zhong Lu,
Xin Pu District, Lianyungang
TEL: (0518)5414580
SWIFT: COMMCNSHLYG
P.C.: 222003
FAX: (0518)5411387
- Yangzhou Branch
2 Wen He Bei Lu, Yangzhou
TEL: (0514)7344635
SWIFT: COMMCNSHYAN
P.C.: 225002
FAX : (0514) 7348552
- Taizhou Branch
151 Qing Nian Bei Lu, Taizhou
TEL: (0523)6242741
SWIFT: COMMCNSHTAI
P.C.: 225300
FAX: (0523)6210456
- Nantong Branch
27 Ren Min Zhong Lu, Nantong
TEL: (0513)85058018
SWIFT: COMMCNSHNTG
P.C.: 226001
FAX: (0513)85058028
- Zhenjiang Branch
229 Jie Fang Lu, Zhenjiang
TEL: (0511)5021069
SWIFT: COMMCNSHZJG
P.C.: 212001
FAX: (0511) 5021124
- Changzhou Branch
171 Yan Ling Xi Lu, Changzhou
TEL: (0519)6607696
SWIFT: COMMCNSHCHA
P.C.: 213003
FAX : (0519)6607630

- Hangzhou Branch
173 Qing Chun Lu, Hangzhou
TEL: (0571)87216012 87216232
TLX: 351123 BOCOM CN
SWIFT: COMMCNSHHAN
P.C.: 310006
FAX: (0571)87082330
- Wenzhou Branch
Jiao Hang Plaza,
Che Zhan Da Dao, Wenzhou
TEL: (0577)88068797
SWIFT: COMMCNSHWEN
P.C.: 325000
FAX : (0577)88068567
- Jiaxing Branch
236 Zhong Shan Xi Lu, Jiaxing
TEL: (0573) 2052112
SWIFT: COMMCNSHJXG
P.C.: 314001
FAX: (0573)2052110
- Huzhou Branch
299 Ren Min Lu, Huzhou
TEL: (0572)2212138
SWIFT: COMMCNSHHUZ
P.C.: 313000
FAX: (0572)2214738
- Shaoxing Branch
283 Ren Min Zhong Lu, Shaoxing
TEL: (0575)5115890
SWIFT: COMMCNSHSXG
P.C.: 312000
FAX: (0575)5137247
- Hefei Branch
38 Hua Yuan Jie, Hefei
TEL: (0551)2637010
SWIFT: COMMCNSHHFI
P.C.: 230001
FAX : (0551)2637010
- Wuhu Branch
BoCom Tower, Bei Jing Xi Lu, Wuhu
TEL: (0553)3839500
SWIFT: COMMCNSHWHU
P.C.: 241000
FAX: (0553)3839531
- Bengbu Branch
88 Nan Shan Lu, Bengbu
TEL: (0552)2040377
SWIFT: COMMCNSHBBU
P.C.: 233000
FAX: (0552)2040376
- Huainan Branch
95 Chao Yang Zhong Lu, Huainan
TEL: (0554)6657888
P.C.: 232001
FAX: (0554)6651788
- Anqing Branch
99 Long Shan Lu, Anqing
TEL: (0556)5509699
SWIFT: COMMCNSHAQG
P.C.: 246004
FAX: (0556)5509641

List of Branches (Continued)

- Fuzhou Branch
No.116 Hu Dong Road, Fuzhou
TEL: (0591)87874839 87874850
SWIFT: COMMCNSHFUZ
P.C.: 350003
FAX : (0591)87874837
- Nanchang Branch
21 Yong Shu Lu, Nanchang
TEL: (0791)6281014
SWIFT: COMMCNSHNCG
P.C.: 330003
FAX: (0791) 6214486
- Jingdezhen Branch
1 Chang Nan Da Dao, Jingdezhen
TEL: (0798)8570699
P.C.: 333000
FAX: (0798)8570660
- Xinyu Branch
98 Bei Hu Xi Lu, Xinyu
TEL: (0790)6441577
P.C.: 338000
FAX: (0790)6441943
- Jiujiang Branch
139 Xun Yang Lu, Jiujiang
TEL: (0792)8231117
P.C.: 332000
FAX: (0792)8118426
- Jinan Branch
98 Gong Qing Tuan Lu, Jinan
TEL: (0531)86106389
SWIFT: COMMCNSHJNN
P.C.: 250012
FAX : (0531)86106390
- Zibo Branch
100 Jin Jing Da Dao,
Zhang Dian District, Zibo
TEL: (0533) 2186999
SWIFT: COMMCNSHZBO
P.C.: 255040
FAX: (0533) 2687150
- Weifang Branch
358 Dong Feng Dong Jie, Weifang
TEL: (0536) 8190228
SWIFT: COMMCNSHWFG
P.C.: 261041
FAX: (0536) 8190228
- Yantai Branch
222 Nan Da Jie, Yantai
TEL: (0535)6677088
SWIFT: COMMCNSHYTI
P.C.: 264000
FAX: (0535) 6677086
- Weihai Branch
34 Hai Bin Bei Lu, Weihai
TEL: (0631) 5226210
SWIFT: COMMCNSHWHI
P.C.: 264200
FAX: (0631) 5230127

- Jining Branch
3 Dong Men Da Jie, Jining
TEL: (0537)2883600
SWIFT: COMMCNSHJNG
P.C.: 272119
FAX: (0537)2883628 2883659
- Taian Branch
55 Dong Yue Da Jie, Taian
TEL: (0538)8220402
SWIFT: COMMCNSHTAN
P.C.: 271000
FAX: (0538)8220402
- Zhengzhou Branch
11 Zheng Hua Lu, Zhengzhou
TEL: (0371)65723888
SWIFT: COMMCNSHZHE
P.C.: 450008
FAX : (0371)65751011
- Luoyang Branch
60 Kai Xuan Dong Lu, Luoyang
TEL: (0379)6321098
SWIFT: COMMCNSHLYA
P.C.: 471000
FAX : (0379)63938888
- Wuhan Branch
Rui Tong Square,
847 Jian She Avenue, Wuhan
TEL: (027)85487102 85487110
SWIFT: COMMCNSHWHN
P.C.: 430015
FAX: (027)85487112
- Huangshi Branch
380 Yi Yang Lu, Huangshi
TEL: (0714)6238934
SWIFT: COMMCNSHHSI
P.C.: 435000
FAX: (0714)6221614
- Yichang Branch
22 Sheng li Si Lu, Yichang
TEL: (0717)6484982
SWIFT:COMMCNSHYCG
P.C.: 443000
FAX: (0717)6484831
- Changsha Branch
37 Shao Shan Zhong Lu, Changsha
TEL: (0731)5555522
SWIFT: COMMCNSHCSA
P.C.: 410007
FAX: (0731)5603737
- Yueyang Branch
Yin Du Mansion, Nan Hu Da
Dao, Yueyang
TEL: (0730)8296178
P.C.: 41400
FAX: (0730)8296191
- Guangzhou Branch
123 Jie Fang Nan Lu, Guangzhou
TEL: (020)83271333
SWIFT: COMMCNSHGUA
P.C.: 510120
FAX: (020)83270386

List of Branches (Continued)

- Zhuhai Branch
Bocom Tower,
1227 Ji Da Jiu Zhou Da Dao Dong,
Zhuhai
TEL: (0756)3338822
SWIFT: COMMCNSHZHI
P.C.: 519015
FAX: (0756)3330881
- Shantou Branch
83 Jin Sha Lu, Shantou
TEL: (0754)8611888
SWIFT: COMMCNSHSTU
P.C.: 515041
FAX: (0754)8611962
- Dongguan Branch
190 Qi Feng Lu, Dongguan
TEL: (0769)22336998
SWIFT: COMMCNSHDGN
P.C.:523008
FAX: (0769)22336908
- Zhongshan Branch
30 Yue Lai Nan Lu,
Shi Qi, Zhongshan
TEL: (0760)8812999
SWIFT: COMMCNSHZSN
P.C.: 528400
FAX: (0760)8808917
- Foshan Branch
1-1 Ti Yu Lu,
Chan Cheng District, Foshan
TEL: (0757)83215360
SWIFT: COMMCNSHFSA
P.C.: 528000
FAX: (0757)83333125
- Jieyang Sub-branch
6 Bei Huan Cheng Lu,
Rong Cheng District, Jieyang
TEL: (0663)8611739
P.C.: 522000
FAX: (0663)8634640
- Nanning Branch
228 Ren Min Dong Lu, Nanning
TEL: (0771) 2835260
SWIFT: COMMCNSHNNG
P.C.: 530012
FAX: (0771) 2835475
- Liuzhou Branch
32 Yue Jin Lu, Liuzhou
TEL: (0772)2860711
SWIFT: COMMCNSHLIU
P.C.: 545001
FAX: (0772) 2866680
- Guilin Branch
8 Nan Huan Lu, Guilin
TEL: (0773)2829898
SWIFT: COMMCNSHGLN
P.C.: 541002
FAX: (0773) 2826506
- Wuzhou Branch
47 Da Zhong Lu, Wuzhou
TEL: (0774)2832582
SWIFT: COMMCNSHWUZ
P.C.:543000
FAX: (0774)2827711

- Beihai Branch
Bocom Tower, Yun Nan Lu, Beihai
TEL: (0779) 3088836
SWIFT: COMMCNSHBHI
P.C.: 536000
FAX: (0779) 3038440
- Hainan Branch
45, Guo Mao Lu,
Finance and Trade Zone, Haikou
TEL: (0898)68532666
SWIFT: COMMCNSHHNN
P.C.: 570125
FAX: (0898)68532333
- Chongqing Branch
158 Zhong Shan San Lu,
Yu Zhong District, Chongqing
TEL: (023)63639888
SWIFT: COMMCNSHCQG
P.C.: 400015
FAX: (023)63851916
- Chengdu Branch
211 Xi Yu Long Jie, Chengdu
TEL: (028)86525666
SWIFT: COMMCNSHCDU
P.C.: 610015
FAX : (028)86525555
- Zigong Branch
108 Wu Xing Jie,
Zi Liu Jing District, Zigong
TEL: (0813)2105667
P.C.: 643000
FAX : (0813)2105667
- Panzihua Branch
21 Xin Hua Jie, Panzihua
TEL: (0812)3334197
P.C.: 617000
FAX : (0812)3334197
- Guiyang Branch
4 Sheng Fu Lu, Guiyang
TEL: (0851)5861461
SWIFT: COMMCNSHGYG
P.C.: 550001
FAX: (0851)5861460
- Zunyi Branch
108 Zhong Hua Lu,
Hong Hua Gang District, Zunyi
TEL: (0852)8824421
P.C.: 563000
FAX: (0852)8825356
- Kunming Branch
67 Hu Guo Lu, Kunming
TEL: (0871)3197673
SWIFT: COMMCNSHKMG
P.C.: 650021
FAX : (0871)3107584
- Qujing Sub-branch
Qi Lin Nan Lu and
Wen Chang Street Crossing, Qujing
TEL: (0874)8988511
P.C.: 655000
FAX : (0874)8988555

List of Branches (Continued)

- Yuxi Branch
61 Yu Xing Lu,
Hong Ta District, Yuxi
TEL: (0877)2056555, 2052899
P.C.: 653100
FAX : (0877)2056555, 2053566
- Chuxiong Sub-branch
96 Bei Pu Lu, Chuxiong
TEL: (0878)3124223
P.C.: 675000
FAX : (0878)3127712
- Xian Branch
88 Xi Xin Jie, Xian
TEL: (029)87653017
SWIFT: COMMCNSHIAN
P.C.: 710004
FAX: (029)87653019
- Lanzhou Branch
252 Qing Yang Lu, Lanzhou
TEL: (0931)8820448
SWIFT: COMMCNSHLAN
P.C.: 730030
FAX: (0931)8810479
- Urumqi Branch
3 Dong Feng Lu, Urumqi
TEL: (0991)2833597
SWIFT: COMMCNSHWLM
P.C.: 830002
FAX : (0991)2840184
- Dalian Branch
6 Zhong Shan Plaza,
Zhong Shan District, Dalian
TEL: (0411)82639911
SWIFT: COMMCNSHDLN
P.C.: 116001
FAX: (0411)82656612
- Ningbo Branch
55 Zhong Shan Dong Lu, Ningbo
TEL: (0574)87361089
SWIFT: COMMCNSHNBO
P.C.: 315000
FAX: (0574)87262365
- Xiamen Branch
9 Hu Bin Zhong Lu, Xiamen
TEL: (0592)2295012
SWIFT: COMMCNSHIMN
P.C.: 361004
FAX: (0592)2295013
- Qingdao Branch
6 Zhong Shan Lu, Qingdao
TEL: (0532)2967888
SWIFT: COMMCNSHQDO
P.C.: 266001
FAX: (0532)2897062
- Shenzhen Branch
2066 Shen Nan Zhong Lu, Shenzhen
TEL: (0755)83680000
SWIFT: COMMCNSHSZN
P.C.: 518031
FAX: (0755)83680033

- Wuxi Branch
198 Ren Min Zhong Lu, Wuxi
TEL: (0510)2718733
SWIFT: COMMCNSHWXI
P.C.: 214001
FAX : (0510)2701640

- Suzhou Branch
77 Nan Yuan Bei Lu, Suzhou
TEL: (0512)65188666
SWIFT: COMMCNSHSUZ
P.C.: 215006
FAX : (0512)65186051

Overseas Offices



Seoul Branch

Address : 6th Samsung Fire & Marine Bldg.
87Euljiro 1-GA, Jung-Gil
Seoul, Korea
Tel : (82)-(2) 2022-6888
Telex : (82)-(2) 2022-6899
SWIFT
Address : COMMKRSE
Fax : (82)-(2) 2022-6899

London Representative Office

Address : 3rdFloor,
145 Leadenhall Street
London EC3V
4QT,U.K.
Tel : (0044)-207-9296050
Fax : (0044)-207-9296055

Frankfurt Representative Office

Address : Bockenheimer Landstr.,
4260323 Frankfurt am Main,
Germany
Tel : (0049)-(69) 172843
(0049)-(69) 172845
Fax : (0049)-(69) 172811



Hong Kong Branch

Address : 20 Pedder Street,
Central Hong Kong
Tel : (00852)-28419611
Telex : 73409 COMBK HX,
61466 COMBK HX,
SWIFT
Address : COMMHKHHXXX
Telegraph: 6527 COMMUBANK
Fax : (00852)-29738778

New York Branch

Address : One Exchange Plaza,
55 Broadway New York,
NY 10006-3008
U.S.A
Tel : (001)-(212)-376-8030
Telex : 49611348 COMBKNY
SWIFT
Address : COMMUS33XX
Fax : (001)-(212)-376-8089

Tokyo Branch

Address : 3-5-1, Toranomon
Minato-ku Tokyo 105,
Japan
Tel : (0081)-(3)-3432-1818
Telex : 25349
SWIFT
Address : COMMJPJTXXX
Fax : (0081)-(3)-3432-1824

Singapore Branch

Address : 50 Raffles Place #
26-04 Singapore
Land Tower
048623 Singapore
Tel : (0065)65320335
Telex : 20335 BOCOMS
SWIFT
Address : COMMSGSGXXX
Fax : (0065)65320339

Notice of Annual General Meeting

NOTICE IS HEREBY GIVEN that the Annual General Meeting of Bank of Communications Co., Limited (“the Bank”) will be held at 9:00 a.m. on Thursday, 22 June 2006 at 3/F., No.888 Zhongshan West Road, Shanghai Galaxy Hotel, Shanghai, the People’s Republic of China, for the purpose of considering and passing, if thought fit, the following resolutions:

As ordinary resolutions:

1. To consider and approve the report of the Bank’s Board of Directors (the “Board”) of the Bank for the year ended 31 December, 2005.
2. To consider and approve the report of the Bank’s Board of Supervisors for the year ended 31 December, 2005.
3. To consider and approve the auditors’ report and the audited financial statements of the Bank for the year ended 31 December, 2005.
4. To consider and approve the profit distribution plan and the recommendation for dividend for the year ended 31 December, 2005.
5. To re-appoint PricewaterhouseCoopers as international auditors and Deloitte Touche Tohmatsu CPA Ltd. as domestic auditors of the Bank for the term to be ended at the next annual general meeting, and to authorise the Board to determine their remuneration.
6. To consider and appoint Mr. Peng Chun as an Executive Director of the Bank with immediate effect until the expiry of the term of the current Board.

Mr. Peng Chun, aged 44, is a senior accountant with a master’s degree from the Financial Research Institute at the People’s Bank of China and currently the director and Vice President of the Bank. Mr. Peng joined the Bank in January 1994 and worked at the Urumqi branch of the Bank and served as Vice President and President of the Urumqi branch since April 1994; President of the Bank’s Nanning branch since November 1997; President of the Bank’s Guangzhou branch since June 1999 and assistant to President of the Bank since September 2001. He was a Director and assistant to President from June 2004 to September 2004; Vice President of the Bank from September 2004 to August 2005 and has served as a Director and Vice President of the Bank since August 2005.

7. To consider and appoint Mr. Peter Wong Tung Shun as a Non-executive Director of the Bank with immediate effect until the expiry of the term of the current Board.

Mr. Peter Wong Tung Shun, aged 54, held a master's degree in computer science and another master's degree in marketing and finance from the Indiana University of USA. He is currently the General Manager of HSBC Group and an Executive Director of Hongkong and Shanghai Banking Corporation Limited. Mr. Wong joined Citibank in April 1980 and served as Deputy Financial Controller, Director of Business Development, Assistant Managing Director and Director of Banking Business. He was appointed as the Director of Operating, Services, and Sales for North Asia of Citibank in 1996; Director of Personal Banking for Hong Kong and China, Chief Executive for Hong Kong and Director of Greater China of Standard Chartered Bank. He has been the General Manager of HSBC Group and an executive director of Hongkong and Shanghai Banking Corporation Limited since April 2005. In addition, Mr. Wong is also a director of Hang Seng Bank Limited and HSBC Insurance (Asia-Pacific) Holdings Limited.

8. To consider and appoint Mr. Qian Ping as a Non-executive Director of the Bank with immediate effect until the expiry of the term of the current Board.

Mr. Qian Ping, aged 41, is a senior accountant with a bachelor's degree from Shandong Industrial University. He is currently the Chief Accountant of Shandong Power (Group) Company and Deputy General Manager of Yinda International Trust and Investment Co., Ltd. and a Director of the Bank. Mr. Qian served as Deputy Director of Jinan Power Supply Bureau from July 1997 to January 2000 and Deputy Director, Director of Finance Department and Deputy Chief Accountant of Shandong Power (Group) Company (he has also been the Deputy General Manager of Yinda International Trust and Investment Co., Ltd. since January 2000). He has been the Chief Accountant of Shandong Power (Group) Company since February 2006.

9. To consider and appoint Ms. Laura M Cha as a Non-executive Director of the Bank with immediate effect until the expiry of the term of the current Board.

Ms. Laura M Cha, aged 56, holds a bachelor of arts degree from University of Wisconsin, United States and a doctorate degree in laws from of Santa Clara University, United States. Ms. Cha is a member of the Executive Council of the Hong Kong Special Administrative Region and the Vice Chairman of the International Advisory Committee of the China Securities Commission, a Non-executive Director of the Hongkong and Shanghai Banking Corporation Limited and a Non-executive Chairman of HSBC Investment (Asia) Holdings Limited. Ms. Cha was a lawyer at Pillsbury, Madison and Sutro in San Francisco from 1982 to 1984; lawyer at the Hong Kong office of Coudert Brothers LLP, United States. She worked at the Securities Futures Commission of Hong Kong from 1991 to 2001 and served as an Assistant Director of Corporate Finance,

Notice of Annual General Meeting (Continued)

Executive Director and Director of Corporate Finance and was the Vice-President since 1998. She served as the Vice President of the China Securities Regulatory Commission from March 2001 to September 2004.

By order of the Board

JIANG Chaoliang

Chairman

19 April 2006, Shanghai, China

As at the date of this announcement, the directors of the Company are Mr. Jiang Chaoliang, Mr. Zhang Jianguo, Mr. Li Jun, Mr. Peng Chun, Mr. Zhang Jixiang, Mr. Hu Huating*, Mr. Peter Wong Tung Shun*, Mr. William Fung Kwok Lun*, Mr. Li Keping*, Mr. Li Zexing*, Mr. Gao Shiqing*, Mr. Shen Weiming*, Mr. Li Guanglin*, Mr. Qian Ping*, Mr. Xie Qingjian#, Mr. Ian Ramsay Wilson#, Mr. Thomas Joseph Manning#, Mr. Herbert Hui Ho Ming#, and Mr. Chen Qingtai#.*

** Non-executive directors*

Independent non-executive directors

Notes:

1. According to the Bank's Articles of Association, resolutions shall be decided by a show of hands unless a poll is demanded before or after any vote on a show of hands. A poll may be demanded by (i) the Chairman of the meeting; or (ii) as least 2 shareholders entitled to vote, present in person or by proxy; or (iii) one or more shareholders present in person or by proxy representing more than 10% of all carrying voting rights at the meeting.
2. To determine the list of shareholders who have the right to attend the meeting and receive the final dividend for the year ended 31 December 2005, the register of members will be closed from Friday, 2 June 2006 to Thursday, 22 June 2006 (both days inclusive) during which period, no transfer of share will be effected. Holders of H Shares and Domestic Shares whose names appear on the register of members of the Bank on Thursday, 22 June 2006 are entitled to attend the meeting.

Holders of H Shares who wish to receive the final dividend and attend the meeting but have not registered the transfer documents are required to deposit the transfer document together with the relevant share certificates at the H share registrar of the Bank, Computershare Hong Kong Investor Services Limited at Rooms 1712-16, 17th Floor, Hopewell Centre, 183 Queen's Road East Wan Chai, Hong Kong at or before 4:00 p.m., Thursday, 1 June 2006.

Final dividend for the year ended 31 December 2005 is expected to be paid on or before Tuesday, 22 August 2006 to shareholders whose names appear on the register of members of the Bank on Thursday, 22 June 2006.

3. Shareholders entitled to attend and vote at the meeting may appoint one or more proxies to attend and vote in their stead. A proxy need not be a shareholder of the Bank.
4. The instrument appointing a proxy must be in writing under the hand of a shareholder or his attorney duly authorised in writing. If the shareholder is a corporate body, the proxy form must be either executed under its common seal or under the hand of its director(s) or duly authorised attorney(s). If this proxy form is signed by an attorney of the shareholder, the power of attorney authorising that attorney to sign or other authorisations document must be notarised.
5. To be valid, this proxy form together with the power of attorney or other authorisation document (if any) must be deposited at the Bank's Board of Directors' Office (in respect of domestic shareholders) not less than 24 hours before the time fixed for holding the meeting or any adjournment thereof (as the case may be). In order to be valid, the said documents together must be lodged at the Bank's H Share Registrar within the abovementioned period by holders of H Shares. Completion and return of this proxy form will not preclude a shareholder from attending and voting in person at the meeting if she/ he so wishes. The H Share Registrar of the Bank is Computershare Hong Kong Investor Services Limited, whose address is at 46th Floor, Hopewell Centre, 183 Queen's Road East, Wan Chai, Hong Kong.
6. Shareholders who intend to attend the meeting in person or by proxy should return the reply slip in person, by post or by fax to the principal place of business of the Bank in China (for holders of domestic shares) or Computershare Hong Kong Investor Services Limited (for holders of H shares) on or before Friday, 2 June 2006. The Company's principal place of business in China is 188, Yincheng Zhong Lu, Pudong New District, Shanghai, PRC (Tel: (86 21) 58781234, Fax: (86 21) 5879 8398, Post code: 200120). The contact person is Mr. Gao (Tel: (86 21) 58781234-3616) and Ms. Chai (Tel: (86 21) 58781234-3624). The address of Computershare Hong Kong Investor Services Limited is 46th Floor, Hopewell Centre, 183 Queen's Road East Wan Chai, Hong Kong (Tel: (852) 28628628, Fax: (852) 28650990 25296087).
7. The meeting is expected to last for half a day. Shareholders (in person or by proxy) attending the meeting are responsible for their own transportation and accommodation expenses. Shareholders or their proxies attending the meeting shall produce their identity documents.
8. Mr. Peng Chun has no relationship with any director, supervisor, senior management, substantial or controlling shareholder of the Bank. Mr. Wong Tung Shun is currently an Executive Director of Hongkong and Shanghai Banking Corporation Limited, a substantial shareholder of the Bank and the General Manager of HSBC Group. Ms. Laura M Cha is currently a Non-executive Director of the Hongkong and Shanghai Banking Corporation Limited and a Non-executive Chairman of HSBC Investment Asia Holdings Ltd. Mr. William Fung Kwok Lun, another Non-executive Director of the Bank, is a Non-executive Director of the Hongkong and Shanghai Banking Corporation Limited and a vice-chairman of HSBC Holding Plc., the parent of the Hongkong and Shanghai Banking Corporation Limited. Mr. Qian Ping is currently the Chief Accountant Assistant of Shangdong Electric Power Group Corporation, a shareholder of the Company.

Notice of Annual General Meeting (Continued)

9. None of Mr. Peng, Mr. Wong, Mr. Qian and Ms. Cha has entered into any service contract with the Bank and they will not receive any remuneration as directors of the Bank. In addition, they have no interest in the shares in the Bank (within the meaning as defined under Part XV of the Securities and Futures Ordinance). The Bank is not required to serve any notice or make any compensation if it terminates the services of Mr. Peng, Mr. Wong, Mr. Qian and Ms. Cha.

10. In respect of the appointment of Mr. Peng, Mr. Wong, Mr. Qian and Ms. Cha as the Bank's directors, there is no information that is required to be disclosed pursuant to Rules 13.51 (2)(h) to 13.51(2)(v) of the Listing Rules. Mr. Peng, Mr. Wong, Mr. Qian and Ms. Cha are not involved into any matters which is required to be disclosed under the above provisions of the Listing Rules, and save as disclosed above, there are no other matters that need to be brought to the attention of the Hong Kong Stock Exchange.