OVERVIEW

We were the fifth largest commercial bank in the PRC based on total assets as of December 31, 2004. As of December 31, 2004, we had a network of 92 branches, 2,413 sub-branches, 87 outlets, 1,486 self-service centers and 4,545 ATMs in 137 cities in the PRC. Through this network and other distribution channels, we provide a broad range of financial products and services to our corporate and retail customers. For the year ended December 31, 2004, our operating profit before tax was RMB7,750 million. As of December 31, 2004, our total assets were RMB1,145,455 million, and our shareholders' equity was RMB53,553 million.

Our three principal lines of business are corporate banking, retail banking and treasury operations. Our corporate banking business provides a broad range of products and services to our corporate customers, such as loans, deposits, bill discounting, settlement, trade finance, fund custody and guarantees. Our retail banking business provides a broad range of retail banking products and services to our retail customers, such as deposits, mortgage loans, car loans, debit cards, credit cards, wealth management and foreign exchange trading services. Our treasury operations include, among others, inter-bank money market transactions, foreign exchange trading and government and finance bond trading and investment.

We are incorporated, and substantially all of our operations are located, in the PRC. In addition to our PRC operations, we currently have branch offices in Hong Kong, New York, Tokyo and Singapore, and representative offices in London and Frankfurt. In addition to our branches and representative offices, we also have 33 subsidiaries in the PRC and 16 subsidiaries in Hong Kong.

OUR STRENGTHS

Our principal strengths include:

- **Asset quality and capital adequacy.** As of December 31, 2004, our non-performing loan ratio calculated according to relevant PRC regulations and our capital adequacy ratio calculated in accordance with the formula promulgated by the PBOC and the CBRC and based on PRC GAAP, were 2.91% and 9.72%, respectively. Our non-performing loan ratio is significantly lower than the average non-performing loan ratio of the PRC joint stock commercial banks, which was 4.9% as of December 31, 2004, and that of the Big Four, which was 15.6% as of December 31, 2004. We believe our capital adequacy ratio is one of the highest among PRC commercial banks. Our asset quality and high capital adequacy provide us with a solid foundation for business expansion and continuous development. In particular, our high capital adequacy ratio enhances our ability to serve our customers.

- **Continuously improving corporate governance and organizational structure.** We believe we have a sound corporate governance structure and have adopted a system of checks and balances in the areas of decision-making, operations and supervision. Since becoming the first joint stock commercial bank in the PRC in 1987, we have gained extensive experience in improving our corporate governance. In addition, the introduction of three new significant shareholders, including HSBC, in 2004 further strengthened our corporate governance. For example, following HSBC's investment, we appointed five independent non-executive Directors to our Board, and established an audit committee that consists of five non-executive Directors, three of which are independent non-executive Directors and one of which was nominated by HSBC. In addition, one Director nominated by HSBC serves as a member of the personnel and compensation committee.

  In 2002, we redesigned our organizational structure in accordance with the customer-centric model commonly used by international banks. See the section headed "Our Reorganization and Restructuring". We are currently in the process of implementing the new organizational structure throughout our organization. We believe that our redesigned organizational structure will strengthen our marketing capabilities, enhance our operational efficiency and improve our risk management.

- **Strategic cooperation with HSBC.** As part of the strategic cooperation with HSBC, HSBC has been providing us with management training and advice and guidance in relation to international banking practices in several areas, including corporate governance, internal controls, risk management, financial reporting, asset and liability management and human resources management. In addition, we have established an independent business unit to develop, with the assistance of HSBC, a credit card business in the PRC, including the issuance of credit cards using both HSBC's branding and our branding. We believe that our strategic cooperation with HSBC provides us with a competitive advantage in the PRC banking market as such cooperation allows us to benefit from HSBC's expertise and knowledge in international banking practices and, as a result, to further improve our business operations and corporate governance.

- **Extensive and strategically located distribution network.** We have one of the most extensive distribution networks among all PRC commercial banks. As of December 31, 2004, our distribution network included, among others, 92 branches, 2,413 sub-branches, 87 outlets, 1,486 self-service centers and 4,545 ATMs across 137 cities in the PRC.

  Since our re-establishment in 1987, we have been focusing on the Yangtze River Delta, the Bohai Rim Economic Zone and the Pearl River Delta, which are among the most economically developed areas of the PRC, with a combined weighted average GDP per capita of approximately RMB16,556 in 2003 compared to average per capital GDP of RMB9,101 for the PRC as a whole for that year. As of December 31, 2004, over 50% of our branches, sub-branches and outlets were located in the Yangtze River Delta, the Bohai Rim Economic Zone and the Pearl River Delta, and approximately 63.4% of our total loans excluding interest receivable and 54.2% of our total revenues in the year ended December 31, 2004 were attributable to such areas.

  In addition to our extensive distribution network in the PRC, we have branches in a number of the world's leading financial centers, namely Hong Kong, New York, Tokyo and Singapore. In particular, our Hong Kong branch, which was established more than 70 years ago and is the largest of our overseas branches, has 38 sub-branches and 1,217 employees. Approximately 5.1% of our loans excluding interest receivables and 5.3% of our revenues in the year ended December 31, 2004 were attributable to our Hong Kong branch.

  Furthermore, we have been actively developing a technology-based distribution network, such as ATMs, Internet banking, telephone banking and self-service centers. In particular, the number of our ATMs increased 58.5% to 4,545 as of December 31, 2004 from 2,867 as of December 31, 2002.

- **Well-known brand names and broad customer base.** Initially established in 1908, we are one of the oldest commercial banks in the PRC. Through product and service innovation efforts, we have strengthened our brand recognition by developing a number of well-known brand name products and services, such as the Pacific Card, a leading bank card brand in the PRC, "*Waihuibao*" (外匯寶), a leading brand for personal foreign exchange trading service, and "*Quanguotong*" (全國通), a nationwide remittance, cash deposit and withdrawal service. We are the first PRC commercial bank to introduce certificates of deposits and distribute and act as custodian for open-ended equity investment funds, and are a leader in the fund custody business.

  Furthermore, we have established an extensive customer base in the PRC. In particular, a majority of our over 500,000 corporate and institutional customers are from the Yangtze River Delta, the Bohai Rim Economic Zone and the Pearl River Delta, which are among the most economically developed areas of the PRC. Moreover, we had approximately 500,000 customers that had deposits with us in excess of RMB100,000 as of December 31, 2004.

- **Increasing focus on prudent risk management and effective internal controls.** In 1999, we were chosen as the sole beneficiary of a World Bank project intended to strengthen the management of lending risks at our Company. The improvements we made to our credit risk management system as a result of this World Bank project served as a foundation for our current risk management system and a platform for our ongoing efforts to improve the quality of and refine the practices of our risk management. See "– Risk Management and Internal Controls". Based on this, we are in the process of further implementing our data centralization, accounting system centralization, organizational restructuring and comprehensive risk management system. In addition, in 2001, we engaged an international accounting firm to prepare an audit report in accordance with IFRS and have done so for the past four years. Moreover, we believe we were the first PRC commercial bank to design and implement a relatively advanced asset and liability management system. In addition, our performance-based review system is based on risk-adjusted return on capital, or RAROC, and the performance by our branches and employees in risk management and compliance with internal controls, which we believe helps strengthen our overall internal controls and risk management.

- **Experienced and incentivized management team**. We place great emphasis on the quality of our senior management, and we continually seek to attract skilled and experienced professionals to enhance our products and services. Many of our senior executives have had extensive experience in the commercial banking industry, and many of our professional staff have been recruited from diverse backgrounds with commercial banking experience. Our senior management team has an average of 20 years of banking industry experience. In particular, our chairman, Mr. JIANG Chaoliang, has over 23 years of banking industry experience and used to be an assistant governor of the PBOC. Our President, Mr. ZHANG Jianguo, has over 23 years of banking industry experience and used to be the general manager of the international business department of Industrial and Commercial Bank of China. In addition, we conduct performance-based reviews of, and provide incentive schemes to, our senior management.

OUR STRATEGY

We endeavor to become a world-class commercial bank by leveraging our strengths and the growth of the PRC economy, continuing to improve our corporate governance, strengthening risk management and internal controls, implementing effective cost management, and pursuing steady growth to maximize value for our shareholders.

We plan to achieve our objective through the implementation of the following strategic initiatives:

- **Strengthen and expand our core corporate banking business.** Corporate banking will continue to be our core banking business. We intend to maintain and further expand our corporate banking business by:
  - maintaining and establishing long-term relationships with our existing and potential high quality customers;
  - maximizing risk-adjusted returns through risk pricing based on different risk profiles of our customers; and
  - developing new products, enhancing product features and optimizing the product mix with a focus on the introduction of products with high growth potential and added value, and cultivating brand name products.

- **Enhance our retail banking businesses.** We believe that the PRC retail banking sector continues to offer significant growth opportunities, including the potential for higher margins and profitability. By taking advantage of these opportunities, we increased our total individual loans (including credit card advances) from 8.5% of our loans outstanding as of December 31, 2002 to 13.4% as of December 31, 2004. We intend to further enhance our retail banking by:

— increasing the ratio of individual loans to our total loans by increasing our lending to individual customers;

— establishing more wealth management centers for our platinum and gold customers, developing new wealth management services and products, and expanding our professional wealth management team; and

— expanding our credit card business, especially through our cooperation with HSBC.

- **Strengthen businesses that generate non-interest income.** We intend to continue focusing on businesses that generate non-interest income by providing a wide range of financial products and services to our corporate and retail customers. As part of this plan, we intend to increase the volume and the proportion of our non-interest income. We plan to implement this strategy by:

— continuing to focus on our international settlement business, trade finance and foreign currency asset management;

— continuing to promote our bank card and personal foreign exchange trading businesses to increase their contribution to our profit; and

— building on our leading position in the equity investment fund custody business to further develop fund custody business, including corporate pension fund custody and social security fund custody.

- **Strengthen our distribution network.** We intend to pursue profitable growth by expanding our distribution network in the more economically developed regions of the PRC and optimizing our distribution network. We plan to implement this strategy by:

— further strengthening our distribution network in the more economically developed areas in the PRC, in particular, the Yangtze River Delta, the Bohai Rim Economic Zone and the Pearl River Delta, as well as in medium-to-large cities with high growth potential;

— leveraging our information technology to further develop and improve our electronic distribution channels, including, among others, Internet banking, self-service centers, and telephone banking centers to provide multiple access channels to our customers and increase the percentage of transactions conducted through our low-cost electronic channels; and

— leveraging our customer base and developing differentiated service and marketing platforms, such as personal wealth management workshops, outlets located in large shopping centers and personalized customer service counters.

- **Enhance our ability to provide, and marketing of, multiple products and services by leveraging our broad customer base.** We believe that our large customer base presents significant growth potential. We plan to enhance our marketing of, and ability to provide, multiple products and services by broadening the range of our products and services and increasing our marketing efforts. We intend to implement this strategy by:

— strengthening the marketing function of our front office and improving the performance-based reviews and incentives schemes for our relationship managers;

— enhancing our ability to provide tailored products and services through a combination of bundling, improving existing products as well as strengthening the market position of our better-known products, including credit cards; and

— upgrading and integrating our database of over 55 million customers and accounts and implementing our customer relationship management system to better understand and predict the behavioral patterns of our customers, which would enable us to offer more competitive and tailored products.

- **Leverage our cooperation with HSBC to enhance our management and competitiveness.** We are the first among the five largest commercial banks in the PRC in terms of total assets to have a major international commercial bank as a substantial shareholder and strategic partner. We intend to leverage our cooperation with HSBC by:
  - — having HSBC participate in our Board of Directors, including the audit committee and the personnel and compensation committee, to align our corporate governance, risk management and strategic management with those of world-class commercial banks;
  - — leveraging the technical support and assistance provided by HSBC, including having secondees from HSBC provide technical support and assistance to our Company in order to bring our operations and management in line with international banking practices; and
  - — improving the quality and experience of our management personnel through such measures as sending our management members to HSBC as secondees to gain practical experience in international banking business and learn from the operations and management of HSBC.
- **Continue to improve our risk management and internal controls.** We plan to utilize various risk monitoring and management tools to improve our risk management capabilities and the quality of our loan portfolio. We plan to implement this strategy by:
  - — improving our credit policies and credit approval procedures to improve the quality of our loan portfolio. In addition, we plan to adjust our industry segmentation, customer segmentation and business segmentation to take into account our continuously adjusted credit policies;
  - — implementing our risk management tools, including, among others, classified risk management, risk migration analysis and risk monitoring watch lists to conduct comprehensive risk monitoring and management of credit and non-credit assets. In addition, we use a real-time, centralized credit management information system, or CMIS, which allows us to standardize credit risk detection, quantification and management and to effectively monitor and control the quality of our loan portfolio. See "– Risk Management and Internal Controls";
  - — strengthening our internal controls and legal compliance. According to the business and regulatory requirements, we are in the process of reviewing and standardizing internal policies and procedures with a view to establishing a comprehensive internal control system. We are also adjusting all departments in our front, middle and back office functions that involve internal controls and legal compliance and allocating responsibilities to ensure that these departments can properly monitor our operating risks, and prevent incidents of non-compliance with applicable laws, regulations and rules; and
  - — accelerating the implementation of a core banking system, which has centralized and standardized accounting and settlement, teller administration, data administration, approval authorization limit administration and post-approval monitoring, to effectively control risks associated with our businesses.
- **Implement and optimize our cost control system.** We have developed and partially implemented a centralized internal financial management system, which will be part of our cost accounting system. In addition, we plan to enhance our cost management by:
  - — consolidating and streamlining our back office processing operations to increase operating efficiency;
  - — centralizing financial management and purchasing to implement effective budgeting;

— fully implementing our management accounting system to allocate our resources effectively based on returns over costs for each branch, business line, customer and product; and

— rationalizing our distribution network by making appropriate changes at our branches and sub-branches with low profit potential and high costs.

OUR PRINCIPAL BUSINESS ACTIVITIES

We have three principal lines of business, consisting of corporate banking, retail banking and treasury operations. The following table sets forth our total loans and amounts due from other banks and financial institutions before allowance for impairment attributable to each of our principal lines of business as of the dates indicated:

	As of December 31,					
	2002		2003		2004	
	Amount	% of total	Amount	% of total	Amount	% of total
	(in millions of RMB, except percentages)					
Corporate banking (1)	389,237	74.4%	488,572	75.2%	553,007	75.9%
Retail banking	36,298	6.9	60,187	9.3	85,777	11.8
Treasury operations (2)	97,994	18.7	100,903	15.5	89,927	12.3
Total	523,529	100.0%	649,662	100.0%	728,711	100.0%

(1) Includes discounted bills.
(2) Includes amounts due from other banks and financial institutions before allowance for impairment.

The following table sets forth our revenue attributable to each of our principal lines of business for the periods indicated:

	For the year ended December 31,					
	2002		2003		2004	
	Amount	% of total	Amount	% of total	Amount	% of total
	(in millions of RMB, except percentages)					
Corporate banking (1)	19,393	70.0%	22,143	68.1%	26,226	63.3%
Retail banking	1,265	4.6	2,492	7.7	4,187	10.1
Treasury operations	6,752	24.4	7,348	22.6	10,324	24.9
Others	286	1.0	523	1.6	701	1.7
Total	27,696	100.0%	32,506	100.0%	41,438	100.0%

(1) Includes discounted bills.

Corporate Banking

Overview

For each of the years ended December 31, 2002, 2003 and 2004, our corporate banking operations represented 70.0%, 68.1% and 63.3%, respectively, of our revenue. We offer a broad range of products and services to corporate enterprises, including, among others, state-owned enterprises, privately owned enterprises and foreign-invested enterprises. Our corporate banking products include, among others, corporate loans, corporate deposits, bill discounting, settlement, trade finance, fund custody and guarantees. As of December 31, 2004, we had over 500,000 corporate customers. As of December 31, 2002, 2003 and 2004, our loans attributable to corporate banking operations represented 74.4%, 75.2% and 75.9%, respectively, of our total loans and amounts due from other banks and financial institutions before allowance for impairment. We deliver our corporate banking products and services through a combination of our branch network, service centers and online banking.

Business Initiatives

We intend to further develop our corporate banking business and implement our overall strategy by adopting the following business initiatives:

- **Pursue profitable growth in our corporate banking business by focusing on the leading companies in the more economically developed areas in the PRC.** A substantial portion of our corporate customers are located in the Yangtze River Delta, the Bohai Rim Economic Zone and the Pearl River Delta, which are among the most economically developed areas of the PRC. We expect future growth in our corporate banking business to be primarily concentrated in these areas. We will target multinational companies, leading domestic companies, listed domestic companies, and companies in fast-growing industries. In addition, we intend to maximize risk-adjusted returns through risk pricing.
- **Continue to improve the quality of our corporate loan portfolio.** We seek to improve the quality of our corporate loan portfolio by improving our credit policies and credit approval procedures. In addition, we plan to adjust our industry segmentation, customer segmentation and geographic segmentation to take into account our continuously adjusted credit policies. From January 2000 to August 2001, as the sole beneficiary of a World Bank-sponsored project, we worked closely with an independent consultant to revamp our credit risk management system to make it in line with practices adopted by leading international banks. The successful pilot program enabled our Company to introduce the new system to the rest of our organization.
- **Enhance product offerings and customer services.** We intend to enhance our product offerings by optimizing our product mix and enhancing product features. In addition, we seek to create a performance-based corporate culture that values customer satisfaction. We intend to foster greater specialization of our relationship managers based on customer and product segmentation.

Corporate Banking Products

We offer a broad range of products and services to our corporate customers, including, among others, loans, deposits, bill discounting, settlement, fund custody, guarantees, factoring, forfaiting, customs direct and bank-to-business link.

Corporate Loans

Our corporate loans include short-term loans and medium- and long-term loans.

Short-term loans. Short-term loans have maturities of no more than one year. Our short-term loans include, among others, revolving loans and trade finance. We provide revolving loans to our larger corporate customers to meet their special working capital or cash flow needs. A corporate borrower may draw on the revolving loan in part or in full and repay the loan whenever there are surplus funds or at final maturity of the loan. Our trade finance primarily involves import financing and export financing. Our import financing products and services include, among others, letters of credit, inward documentary bills, inward collection financing and import outward remittance financing. Our export financing products and services include, among others, negotiation, outward documentary bills, outward collection financing, export invoice financing, forfaiting and packing loans.

Medium- and long-term loans. Medium-term loans have maturities of longer than one year but no more than five years, and long-term loans have maturities of more than five years. We provide medium-to-long term loans to our corporate customers for a wide range of business purposes, including, among others, infrastructure development and construction, technology innovation and working capital for our customers.

Consistent with our focus on credit quality and diversification, we lend to corporate borrowers in a wide range of industry sectors and across all geographic regions of the PRC. Our largest concentration of corporate loans as of December 31, 2004 was to companies in the manufacturing industry, which accounted for 35.4% of our total corporate loans excluding discounted bills as of the same date. See the section headed "Description of Our Assets and Liabilities – Assets – Loans and Advances to Customers – Loan Concentration by Industry".

Corporate Deposits

We offer two principal deposit products, interest-bearing demand deposits and time deposits, to our corporate customers in Renminbi and major foreign currencies. Demand deposits accrue interest that is paid out on a quarterly basis, and account holders may withdraw their funds at any time. Time deposits require that the customer maintain a deposit for a fixed term, during which interest accrues at a fixed rate. Account holders may withdraw funds prior to maturity with interest payments calculated based on the demand deposit interest rate. We offer time deposit products with maturities of up to one year. In addition, we offer negotiated time deposit products with maturities of longer than one year.

The interest rates we pay on the regular time deposits are set by the PBOC. However, we are allowed to provide negotiated time deposits to PRC insurance companies with deposits of RMB30 million or more and with a term longer than five years, the National Council for Social Security Fund with deposits of RMB500 million or more and with a term longer than five years and China Post with deposits of RMB30 million or more and with a term longer than three years. In addition, we can negotiate freely the interest rates on foreign currency deposits of US$3 million or more. See the section headed "Supervision and Regulation – Prudent Operating Requirements – Regulation of Interest Rates".

Bill Discounting

We offer bill discounting by providing our customers with cash for their bills of exchange issued or accepted by other commercial banks as well as corporations. This facility is provided by us to our customers as a source of short-term financing. The interest rate we charge for bill discounting varies according to the credit worthiness of the customers. We can have these instruments re-discounted with the PBOC or other financial institutions authorized to conduct bill discounting business, providing us with liquidity and income. As of December 31, 2004, we had RMB43,996 million in discounted bills, representing 6.9% of our loans.

Settlement

We provide domestic and international settlement services to our customers. Our domestic settlement products include, among others, drafts, promissory notes, checks, foreign exchange, consignment collection and acceptance. Our international settlement products include, among others, letters of credit, export collection, import collection, bills, inward and outward remittance. We charge a fee for the settlement services we provide.

Fund Custody

We provide custodian services principally to domestic equity investment funds, the social security fund, insurance assets and corporate pension funds. We are also a qualified custodian bank for qualified foreign institutional investors. As of December 31, 2004, we had RMB87,878 million in face value in funds under custody, which made us one of the largest custodian banks in the PRC. We receive a custodian fee for acting as custodian and for providing settlement and supervision services for the assets under our custody. We are one of the few banks in the PRC licensed to operate a fund custody business.

In early 2001, the PRC government established the National Council for Social Security Funds to manage the social security fund. In December 2002, we became one of the first two banks chosen to act as custodian banks for the National Council for Social Security Funds.

Guarantees

We act as surety for our corporate banking customers by providing bank guarantees primarily in the form of letters of guarantee and standby letters of credit. These guarantee contracts provide for specified payments to be made by us to reimburse the holder for a loss it incurs when a guaranteed party defaults under the terms of a debt instrument. Guarantees are usually provided to our corporate banking customers as part of an overall credit facility. We receive a fee for providing guarantees and receive interest income on amounts that we are required to pay on behalf of a customer in connection with a guarantee. Guarantees are treated as off-balance sheet liabilities. See note 32 to Appendix I – "Accountants' Report" for more information regarding our outstanding guarantees.

Factoring

We are one of the first two PRC commercial banks to launch a factoring business in the PRC. Factoring involves the purchase of commercial customers' account receivables on an on-going basis. We launched the international factoring business in 1996 and have achieved significant growth since then. In 2003, according to statistics of the Factors Chain International, or FCI, a global network of factoring companies, we held approximately a 16% market share in the FCI two-factor system business in the PRC. The FCI two-factor system refers to the system under which the factor in the seller's country cooperates with the factor in the buyer's country in providing factoring services.

Forfaiting

We launched our forfaiting business in December 2000. Forfaiting is the non-recourse purchase of an exporter's drafts and promissory notes. By purchasing the drafts and promissory notes, which are usually guaranteed by the importer's bank, we free the exporter from credit and from the risk of not receiving payment from the importer who purchased the goods on credit. We believe this business has significant fee-generating potential due to the continued growth of import and export activities in the PRC.

Other products and services

Customs Direct

Customs Direct is an online tariff payment system jointly developed by the Customs Bureau of China, China E-port Database Center and us. We are one of the first five commercial banks permitted to provide online tariff payment services through this online system.

Bank-to-Business Link

Bank-to-business link, or "*Yinqitong*" (銀企通), is an online banking service we provide to our large corporate clients and our group customers particularly. A special link is established between our internal banking system and the enterprise resource planning, or ERP, system of our corporate customers, through which we provide account balance information, payment and settlement services and cash management services to customers. In addition, this special link enables us to provide tailored services based on the specific needs of these customers.

Pricing

Renminbi Loans

Pricing of our corporate banking products is regulated by the PBOC and other relevant regulatory authorities. For Renminbi loans, since October 29, 2004, there are no upper limits for the interest rates we can charge. However, these interest rates cannot be lower than 90% of the PBOC benchmark rate. Prior to October 29, 2004, we could charge interest rates within 90% to 170% of the corresponding PBOC benchmark rates. See the section headed "Supervision and Regulation – Prudent Operating Requirements – Regulation of Interest Rate". Within the permitted spread over the PBOC benchmark rates, we price our corporate loans based on, among other factors, the financial condition of the borrower, including its profitability, liquidity, cash flow and net worth position, the collateral available, the intended use of the loan, market conditions and the term of the loan.

Foreign Currency Loans

The interest rate on foreign currency loans is not subject to PBOC regulations. The interest rates we charge on foreign currency loans are determined based on factors similar to the ones we consider for determining the interest rates we charge on Renminbi-denominated loans. Our foreign currency loans are primarily denominated in US dollars.

Discounted Bills

The interest rate we charge on bill discounting is required to be higher than the PBOC rediscount rate, but cannot exceed the interest rate for Renminbi loans of a comparable term.

Deposits

The interest rates we pay on the regular time deposits are set by the PBOC. However, we are allowed to provide negotiated time deposits to insurance companies, the National Social Security Fund and China Post under certain circumstances. In addition, we can freely negotiate the interest rates on foreign currency deposits other than those denominated in US dollars, Euros, Japanese Yen and HK dollars in an amount less than US$3 million. We can also freely negotiate the interest rates on inter-bank foreign currency deposits and foreign currency deposits by non-PRC residents.

See the section headed "Supervision and Regulation – Prudent Operating Requirements – Regulation of Interest Rates" for more details about the pricing of corporate loans and deposits.

Marketing

We manage our corporate customers based on customer segmentation. Our head office is primarily responsible for the sales to, and management of, key corporate customers that have operations spanning different regions of the PRC, have a history of collaboration with us and have made significant contributions to our profit. We use our resources throughout our organization to provide services to these key customers. Our branches are primarily responsible for the sales to, and management of, our corporate customers within the areas covered by the branches. In addition, we encourage cross-referral among our branches, in particular between our overseas and domestic branches.

We market our corporate banking products and manage our corporate customers primarily through our relationship managers. Furthermore, we have product managers to conduct market and product research, develop new products and provide technical support to relationship managers and customers. Product managers assist in the development planning and day-to-day execution of more tailored marketing activities based on product and customer characteristics. Relationship managers focus on developing and maintaining an ongoing relationship with our customers, while leveraging the expertise of product managers for targeted marketing.

We consider the ongoing training of our relationship managers and product managers an important part of our business initiative to enhance the productivity and professionalism of our marketing and innovation. Accordingly, we require our relationship managers and product managers to participate in various training programs on an ongoing basis. We offer training courses that are required for promotion or for relationship managers and product managers who want to enhance their technical and marketing skills.

Retail Banking

Overview

Our retail banking operations experienced significant growth in the past few years. Our retail banking operations accounted for approximately 4.6%, 7.7% and 10.1% of our revenue for the years ended December 31, 2002, 2003 and 2004, respectively. We offer a full range of retail banking products and services to individual customers, consisting of mortgage loans, car loans, personal loans, deposits, debit-credit cards, funds and insurance products distribution. To market and deliver these products, we have multiple distribution channels, including automatic service machines, Internet banking and phone banking. As of December 31, 2004, we had over 50 million individual deposit accounts. As of December 31, 2002, 2003 and 2004, our loans attributable to retail banking operations represented 6.9%, 9.3% and 11.8%, respectively, of our total loans and amounts due from other banks and financial institutions before allowance for impairment.

Business Initiatives

The expansion of our retail banking business is one of the key elements of our growth strategy. We intend to further increase the contribution of our retail banking business to our net profit by adopting the following business initiatives:

- **Focus on consumer lending and credit cards.** The PRC market for personal financial services, such as consumer lending and credit cards, is large and rapidly expanding, but still relatively under-penetrated. We believe that this market, although highly competitive, has significant growth potential in light of the high savings rates and the relatively high per capita income in the coastal region of the PRC. We intend to focus on consumer lending and credit cards to increase our interest and fee income. In particular, we intend to increase the percentage of our retail loan portfolio that is comprised of high-margin products while maintaining the overall quality of our retail loan portfolio. In addition, we believe that the credit card business provides a profitable source of fee income. In collaboration with HSBC, we have recently established an independent business unit within our Company focusing on the credit card business. Moreover, we plan to expand co-branded and affinity programs and enhance brand image through marketing campaigns.
- **Customer segmentation.** We intend to increase our focus on high income, well educated and highly creditworthy individuals by dividing our current customer base into different customer segments. In addition, we intend to implement differential pricing, service and retention strategies that are specially designed for each customer segment. We are in the process of reorganizing our internal operations to establish a customer-focused business structure, which we believe will enable us to proactively market products and services to targeted customer segments.
- **Expand and strengthen our wealth management operations.** We plan to continue to expand and strengthen our wealth management operations by focusing on the wealth management needs of our customers, particularly our platinum and gold customers. See the section headed "– Retail Banking Products – Wealth Management Services". We intend to offer a broad range of lending and investment services to this customer segment. In addition, we plan to hire and train top quality relationship managers focusing on wealth management.

- **Maximize cross-selling opportunities.** We believe that our large customer base presents significant growth potential. We plan to expand our business with our existing customers and increase our revenues by broadening the range of our products and services and increasing our cross-selling efforts. For example, as many of these high net-worth customers hold various management positions in enterprises that are our corporate clients, we plan to promote cross-selling to this customer segment through our corporate banking relationship managers. To support this effort, we are in the process of creating a centralized database to better understand and predict the behavioral patterns of our customers and create cross-selling opportunities for our retail banking operations. In addition, we plan to enhance our product offerings through a combination of bundling and improving existing products, offering new in-house products and cooperating with our affiliates and third parties to provide increasingly sophisticated products and services, especially products and services that generate non-interest income, such as fund and insurance product distribution.

Retail Banking Products

We offer a broad range of products and services to our retail banking customers, including, among others, loans, deposits, debit-credit card services, wealth management and funds distribution.

Retail Deposits

We offer two principal deposit products, interest-bearing demand deposits and time deposits, to our retail banking customers in Renminbi and other major foreign currencies. Demand deposits bear interest at a rate set by the PBOC and account holders may withdraw funds at any time. Time deposits require that the customer maintain a deposit for a fixed term, during which interest accrues at a fixed rate. Account holders may withdraw funds prior to maturity with interest payment calculated based on the demand deposit interest rate. Currently, we offer time deposit products with maturities of up to 5 years. As of December 31, 2004, we had RMB368,901 million of individual deposits, representing 36.0% of our total customer deposits excluding interest payables. See the section headed "Description of Our Assets and Liabilities – Liabilities and Sources of Funds" for a description of our deposit profile.

Retail Loans

Our retail loans include mortgage loans, car loans, working capital loans and other individual loans.

Mortgage Loans. We provide a wide range of mortgage loan products to finance the purchase of residential and non-residential properties. We generally lend up to 80% of the appraised value of the property based on our evaluation of a particular borrower's credit and risk profile. Mortgage loans are generally secured by the property being purchased and have a term of as long as 30 years. As of December 31, 2004, we had RMB63,978 million of mortgage loans outstanding, representing 74.6% of our total retail loans.

Car Loans. We provide car loans for the purchase of new automobiles. We generally lend up to 70% of the purchase price of the automobile with a term of as long as 5 years. As of December 31, 2004, we had RMB5,113 million of car loans outstanding, representing 6.0% of our total retail loans.

Working Capital and Other Individual Loans. In addition to mortgage and car loans, we also provide working capital loans to individuals for business development purposes and other individual loans for purposes including, among others, travel and education. These individual loans are generally secured by collateral and guarantees and have maturities ranging from one to five years at either a fixed or a floating interest rate. As of December 31, 2004, we had RMB16,686 million of working capital and other individual loans outstanding, representing 19.5% of our total retail loans.

Card Services

We have offered quasi-credit card, debit card and credit card services in Renminbi under the brand name Pacific Card since 1993, 1996 and 2003, respectively. Holders of quasi-credit cards are required to maintain a certain level of deposits in order to maintain access to their credit facilities. A debit card is directly linked to the cardholder's bank account. Unlike a credit card or quasi-credit card, a debit card automatically withdraws money from the cardholder's bank account at the time of the transaction. Holders of debit cards are required to maintain deposits in the relevant bank account and are not allowed to overdraft. A credit card is a card whose holder has been granted a revolving credit line. The card enables the holder to make purchases and/or cash advances up to a pre-arranged limit. In addition, in 2002, we introduced Pacific International Card, a debit card product in foreign currencies that targets cardholders with frequent international traveling needs. In September 2004, we introduced dual-currency credit cards.

Since its launch in 1993, the Pacific Card has gained wide acceptance among customers and merchants. In 2004, our Pacific Card was selected as one of the ten most trustworthy bank cards in the PRC by the World Finance Laboratory 2004 Annual Awards. As of December 31, 2004, we ranked sixth in terms of overall card issuances in the PRC, with a market share of 5.1%. Our cardholder base has grown at an average of 66.6% per annum since 1997, with about 38.9 million Pacific Cards issued as of the December 31, 2004. As of December 31, 2004, in terms of Renminbi transaction volume, our card services ranked third among PRC banks, with a market share of approximately 12%. As of the same date, our outstanding balance of credit card advances was RMB107 million. Pursuant to the Credit Cards Cooperation Agreement entered into between us and HSBC, we established an independent business unit within our bank focusing on the credit card business on October 25, 2004. See the section headed "Strategic Investor" for more details.

In April 1999, we introduced the Pacific Card "*Quanguotong*" (全國通, meaning "nationwide connection") service, which enables customers to deposit and withdraw money nationwide, which had been previously unavailable. Pacific Card customers can deposit and withdraw money and have their accounts updated on a real-time basis in 137 cities. Due to our wide distribution network, real-time funds transfer capability, reliability and our strong sales and marketing efforts, the *Quanguotong* brand has gained widespread recognition. In 2004, the *Quanguotong* transaction volume reached RMB1,612.6 billion.

Foreign Exchange Services

We are authorized to provide comprehensive foreign exchange services, and one of the PRC commercial banks designated by SAFE to manage the PRC's foreign currency reserves. We provide all of the foreign exchange services that PRC commercial banks are currently permitted to provide. In 1993, we introduced "*Waihuibao*" (外匯寶, meaning "individual foreign exchange trading service"), a product allowing our customers to trade between foreign currencies, which was among the first of its kind in the PRC. In addition to our "*Waihuibao*" individual foreign exchange trading service for our retail banking customers, we provide foreign exchange services between Renminbi and foreign currencies, and provide foreign currency deposits and certain derivative products, including, among others, forwards, swaps, options and futures. In addition, we provide international settlement service to our corporate banking customers.

The following table sets forth the transaction volumes of our "*Waihuibao*" foreign currency exchange service for the periods indicated:

	Year ended December 31,		
	2002	2003	2004
	(in billions of US$)		
"*Waihuibao*" individual foreign exchange trading service	21.0	51.9	74.9

Our *Waihuibao* customers can conduct inquiries and transactions across the PRC via fixed-line telephone, mobile phone, Internet, and other multi-media channels. We believe our real-time transaction capability and competitive pricing differentiate *Waihuibao* from other products in the market.

Our foreign exchange transactions are largely dependent on our nationwide branch network, the broad range of foreign exchange services we provide throughout the PRC and overseas, and the increasing globalization of our customers. As of December 31, 2004, 2,195 of our 2,505 branches and sub-branches provided foreign exchange services. In addition, we have established approximately 1,760 agency relationships with banks in approximately 100 countries.

Wealth Management Services

To better serve the wealth management needs of our retail banking customers, we currently classify our customers into three categories, namely, platinum customers, gold customers and general customers. Platinum customers are customers who generally maintain no less than RMB2 million or US$200,000 or other foreign currency equivalent in deposits in any quarter, or no less than RMB2 million in combined accounts. Gold customers are customers who generally maintain between RMB500,000 and RMB2 million or between US$50,000 and US$200,000 or other foreign currency equivalent in deposits in any quarter, or between RMB500,000 and RMB2 million in combined accounts. We currently do not impose any minimum deposit requirements for general customers. For our general customers, we offer various financial products and services within the province or municipality in which they use our banking services. In addition to the financial products and services available to our general customers, our platinum and gold customers enjoy various personalized wealth management services including, among others, priority banking, fee discounts for banking services, personal financial advisory services, priority check-in and other privileges, and have access to our VIP wealth management workshops. Furthermore, platinum and gold customers are entitled to our wealth management privileges throughout the PRC. We utilize our wealth management system to design tailored personal wealth management plans for our customers. Our customers with a "BoComm Wealth Management" card can enjoy discounts and other value-added services provided by over 500 partners including, among others, airports, hotels, restaurants, shopping centers and fitness clubs. As of December 31, 2004, we had a team of approximately 935 dedicated and experienced financial advisers focusing on the provision of wealth management services.

Other Products and Services

In addition to the above products and services, we provide other products and services to our retail banking customers, including, among others, funds and insurance products distribution, remittances, bill payment and safe deposit boxes. We act as a distributor of third party equity investment funds, and earn commissions for acting as a distributor. We were the first bank in the PRC to distribute an open-ended equity investment fund, the RMB5 billion Hua An open-ended equity investment fund, in 2001. As of December 31, 2004, we had distributed 62 open-ended equity investment funds with an aggregate value of over RMB20 billion.

In addition, we have been chosen as one of the commercial banks to establish fund management companies on a pilot basis under the Fund Management Companies Administrative Measures jointly promulgated by the CBRC and the CSRC on February 20, 2005. See the section headed "Supervision and Regulation – Prudent Operating Requirements – Other Requirements – Establishment of Fund Management Companies by Commercial Banks". We entered into a joint venture contract with China International Marine Containers (Group) Co., Ltd. and Schroder Investment Management Limited on May 27, 2005 to establish a joint venture fund management company in China, subject to approvals by relevant PRC regulatory authorities. We will have a majority interest in this joint venture fund management company.

Pricing

Retail Loans

Pricing of our Renminbi-denominated retail loans is regulated by the PBOC. We can freely negotiate the interest rates on foreign currency-denominated loans. The interest rate we charge on primary mortgage loans is fixed by the PBOC. The interest rate we charge on second-mortgage loans is the interest rate for corporate loans of a comparable term, which is generally higher than the interest rate of primary home loans. For car loans, pursuant to the regulatory requirements of the PBOC, we can charge interest rates no lower than 90% of the corresponding PBOC benchmark rates. See the section headed "Supervision and Regulation". As of August 2004, we adopted a stricter interest rate policy. Under this policy, we charge interest rates no lower than the corresponding PBOC benchmark rates.

Retail Deposits

Interest rates for retail deposit rates are generally set by the PBOC. We can, however, negotiate freely the interest rates on foreign currency deposits of US$3 million or more and all foreign currency inter-bank deposits and foreign currency deposits made by non-residents denominated in all foreign currencies and up to any amount. In addition, we can freely negotiate the interest rates on foreign currency deposits, except for US dollar, Euro, Japanese Yen and HK dollar deposits, of less than US$3 million. See the section headed "Supervision and Regulation – Prudent Operating Requirements – Regulation of Interest Rates" for more details.

Marketing

We conduct our marketing and other promotional activities primarily through our distribution network. We intend to attract and retain additional retail banking customers by improving our product portfolio and distribution network. In particular, we plan to increase the number of our 24-hour self-service centers to provide convenient access to our retail banking services during non-business hours and holidays. In addition, we have established a customer relationship analysis system. We believe this platform will allow us to monitor and analyze customer purchase behavior and customer profile, segment our customers and develop tailored products and services. Moreover, we believe this platform will enable us to formulate more effective marketing variables through customer data mining processes to allow effective and efficient marketing, product delivery and product cross-selling.

Treasury Operations

Overview

The principal objective of our treasury operations is to maximize the return on our excess funds, while at the same time maintaining adequate levels of liquidity and applying prudent investment criteria. To achieve this objective, we try to enhance our internal control and optimize our investment portfolio. In addition, our treasury operations provide support to our other businesses, such as foreign exchange and settlement services. Our treasury operations are primarily conducted through the treasury department and the international department. As of December 31, 2004, approximately 24.9% of our revenue was attributable to our treasury operations.

In recent years, our treasury operations, especially our Renminbi-denominated treasury operations, have been one of the leaders of the PRC inter-bank money markets. We have underwritten finance bond offerings by PRC policy banks in the PRC inter-bank bond market. For the year ended December 31, 2004, we ranked fourth in terms of transaction volume of placement, bond repurchases and bond trading, compared to our ranking of fifth in 2002 and 2003.

Our treasury operations primarily include the following business activities:

- liquidity management;
- inter-bank money market transactions;
- capital markets investment and trading;
- trading of debt securities on behalf of our customers; and
- foreign exchange trading.

Liquidity Management and Inter-Bank Money Markets

Our treasury operations seek to maximize the return on our funds not used for loan activities, provided that our liquidity requirements are met. We generally use money market transactions, including inter-bank placement and repurchase agreements, to manage our liquidity. In addition, our treasury department monitors our daily Renminbi cash flows and liquidity positions throughout our organization and invests excess liquid assets in the PRC inter-bank money markets in accordance with our internal investment guidelines. As of December 31, 2004, we had total inter-bank loans and placements before allowance for impairment losses of RMB89,927 million, representing approximately 12.3% of our total loans and amounts due from other banks and financial institutions before allowance for impairment losses, and had total inter-bank liabilities of RMB31,711 million, representing approximately 2.9% of our total liabilities.

The following table sets forth the balances of our inter-bank assets and liabilities as of the dates indicated:

	As of December 31,		
	2002	2003	2004
	(in millions of RMB)		
Due from other banks and financial institutions (1)	97,994	100,903	89,927
Due to other banks and financial institutions (2)	24,682	21,150	31,711

(1) Includes placements with other banks, securities purchased under resale agreements, loans purchased under resale agreements, loans and advances to other banks and loans to other financial institutions before allowance for impairment losses.

(2) Includes deposits and loans from other banks.

Investment Securities

We manage our foreign currency investment portfolio under internal investment guidelines established by our international business department, while our Renminbi investment portfolio are managed under internal investment guidelines established by our treasury department. We generally invest in short- (less than three years) to medium-term (between three and ten years) debt securities. Our Renminbi-denominated fixed income investments primarily include PRC government bonds, finance bonds issued by PRC policy banks and subordinated term bonds issued by PRC commercial banks. Our foreign currency fixed income investments primarily include foreign currency bonds issued by entities with a Standard & Poors credit rating of BBB- or above. We conduct periodic analysis of the market risk of our bond investment portfolio and make adjustments to our investment strategy in a timely manner according to the changing investment environment. The following table sets forth certain information regarding the composition of our investment portfolio before allowance for impairment losses as of the dates indicated:

	As of December 31,					
	2002		2003		2004	
	Carrying value	% of total	Carrying value	% of total	Carrying value	% of total
	(in millions of RMB, except percentages)					
Originated loans	94,057	80.6%	104,670	70.7%	159,826	64.0%
Available-for-sale	14,639	12.6	36,687	24.8	90,028	36.0
Held-to-maturity	7,942	6.8	6,721	4.5	0	0.0
Total	116,638	100.0%	148,078	100.0%	249,854	100.0%

Derivatives

We conduct derivative transactions, including primarily forwards, swaps, options and futures, for our own account, on behalf of our customers. In addition, certain structure notes we have purchased also have embedded derivative transactions. Only our overseas branches and the international business department at our head office are authorized to engage in derivative transactions for our own account, which are primarily for the purpose of risk hedging. Our international business department at our head office maintains a list of pre-determined counterparties with pre-determined credit limits based on the types of derivative transactions. Our derivative traders operate within pre-determined authorization levels on the selected international markets approved by our international business department at our head office. Our derivative transactions are conducted through a system that connects our front, middle and back offices and enables real-time monitoring. Our credit exposure resulting from the derivative transactions is an integral part of our overall credit risk management system, and is evaluated on a daily basis.

The following table sets forth the fair value of our derivative instruments as of the date indicated:

	As of December 31, 2004		
	Contract/ notional Amount	Fair values Assets	Liabilities
	(in millions of RMB)		
Foreign exchange derivatives	49,412	129	(189)
Interest rate derivatives	17,543	90	(388)
Total recognized derivative assets/(liabilities)		219	(577)

Foreign Exchange Operations

Our international business department engages in money market transactions, foreign exchange transactions and derivative transactions. The principal goals of these trading activities are to minimize the impact of currency exchange and interest rate fluctuations on our financial position as well as adjust our assets and liabilities structure. For each trade, traders are subject to authorization limits.

Distribution Network

We recognize the importance of utilizing a broad network of distribution channels to provide quality customer service, increase our sources of income and enhance our reputation and brand recognition. Our distribution network includes branches, outlets, automated service machines, 24-hour phone banking and an Internet banking platform. As part of our long-term strategy for developing and integrating both our traditional and technology-based channels, we aim to offer convenient access while enhancing our overall operating efficiency by:

- focusing on the development of our distribution network in the more affluent areas in the PRC; and
- leveraging our technology-based channels, such as phone banking and Internet banking to provide convenient access to our customers and to reach potential customers.

Branch Network

We deliver our banking products and services to our corporate and retail banking customers primarily through our branch network. As of December 31, 2004, we had 92 branches, 2,413 sub-branches and 87 outlets. Our branch network covers 137 cities in the PRC, most of which are located in the more densely populated and wealthier areas in the PRC. The 92 branches, which include 7 directly administered branches, 27 provincial level branches, and 58 branches under the management of the 27 provincial level branches, prepare their own independent financial statements. These 92 branches administer all of our sub-branches and outlets. While all of the 92 branches and 2,413 sub-branches can take loan applications, the loan approval decisions are made at the 92 branches, except in very limited circumstances. See the section headed "– Risk Management and Internal Controls".

As of December 31, 2003, the population of the Yangtze River Delta, the Bohai Rim Economic Zone and the Pearl River Delta accounted for approximately 10.7%, 17.5% and 6.2%, respectively, of the entire population of the PRC. As of December 31, 2003, the GDP of the Yangtze River Delta, the Bohai Rim Economic Zone and the Pearl River Delta accounted for approximately 24.0%, 27.0% and 11.6%, respectively, of the national GDP of the PRC.

The following table sets forth the distribution of our branch network as of the dates indicated:

	As of December 31,		
	2002	2003	2004
Yangtze River Delta			
Jiangsu	370	364	353
Zhejiang	145	148	150
Shanghai	102	105	107
Sub-total	617	617	610
Bohai Rim Economic Zone			
Liaoning	273	255	249
Shandong	216	214	212
Beijing	76	77	77
Hebei	71	72	72
Tianjin	66	64	62
Sub-total	702	682	672
Pearl River Delta	234	224	222
Other PRC Locations	1,121	1,090	1,088
Total	2,674	2,613	2,592

Technology-based Distribution Channels

We believe that technology-based distribution channels are an important part of our distribution network. These technology-based distribution channels include self-service centers, telephone banking and an Internet banking platform.

Automated Service Machines

Our automated service machines include ATMs, CDMs and CRSs. As of December 31, 2004, we had 4,545 ATMs, 943 CDMs and 1,150 CRSs. We have automated service machines located at a majority of our branches and outlets, as well as in numerous shopping centers, office buildings and residential areas. We are an active participant of the Golden Card project, which is an electronic currency project launched in 1993 to accelerate the development and reform of the PRC's finance and trade industries through the introduction and modernization of an electronic payment system. We are also an active participant of the China UnionPay project, which is part of the Golden Card project, and we are a shareholder of China UnionPay. Such projects are aimed at providing quality and convenient self-service banking as part of a nationwide spending and clearing network.

Telephone Banking

We provide our customers with telephone banking services, allowing them to conduct transactions by telephone using a nationwide unified access number. Currently, 83 of our 92 branches provide telephone banking services via an automatic voice response system and 46 branches provide telephone banking services through a combination of automatic voice response system and customer service representatives, with 25 of these 46 branches providing 24-hour customer service. Our telephone banking services include, among others, inter-account fund transfers, balance and transaction inquiries, credit card transaction inquiries and customer service inquiries. We are contemplating the consolidation of the 46 telephone banking centers with customer service representatives into one customer service center in Shanghai in order to standardize our services and reduce costs.

Internet Banking Services

We launched our Internet banking service in 2002, which allows our customers to conduct certain banking transactions over the Internet, including the transfer of funds, open-ended equity investment fund trading, credit card payment, foreign currency trading and various other payment and settlement functions. Since 2003, the number of transactions conducted through the Internet by our corporate and retail banking customers has grown significantly. For the year ended December 31, 2004, the total transactions conducted through our Internet banking service reached over 86 million.

Overseas Operations

Our overseas operations are conducted through our branches in Hong Kong, New York, Tokyo and Singapore, which were established in 1934, 1991, 1995 and 1996, respectively. These branches generally provide foreign currency lending and deposit-taking services, foreign exchange trading as well as international settlement services. In addition, our Hong Kong branch also provides certain non-banking financial services including, among others, securities and brokerage businesses through BCOM Securities Company Limited, insurance business through China Communications Insurance Company Limited and trust business through Bank of Communications Trustee Limited. Each of these overseas branches and subsidiaries is in compliance with the local regulatory requirements with respect to internal controls and risk management in all material respects. In addition to these overseas branches, we also have representative offices in London and Frankfurt, which were established in 1993 and 1994, respectively. Moreover, we have received approval from the CBRC, and are currently applying for approval from the Korea banking regulatory authority, with respect to the establishment of a branch in Seoul. As of December 31, 2004, assets of our overseas branches accounted for approximately 9.3% of our total assets. As of the same date, our total loans outstanding attributable to our overseas operations represented approximately 5.7% of our total loans outstanding excluding interest receivables.

Hong Kong Branch

Established more than 70 years ago, our Hong Kong branch is our largest overseas branch. As of December 31, 2004, our Hong Kong branch had 38 sub-branches and approximately 1,217 employees. In addition to foreign exchange deposit, foreign exchange loan and international settlement services, the Hong Kong branch also provides non-banking services through its subsidiaries. As of December 31, 2004, our gross loans excluding interest receivables attributable to our Hong Kong branch operations, in the amount of RMB32,647 million, represented approximately 5.1% of our total loans outstanding excluding interest receivables; our total deposits attributable to our Hong Kong operations, in the amount of RMB74,279 million, represented approximately 7.2% of our total deposits; and our total assets attributable to our Hong Kong branch operations, in the amount of RMB90,333 million, represented 7.9% of our total assets. In 2004, our Hong Kong branch generated RMB1,729 million in interest income and RMB294 million in fee and commission income.

Banking Services

The Hong Kong branch has placed an increasing emphasis on serving retail banking customers. As of December 31, 2004, total retail loans outstanding of our Hong Kong branch represented 37.5% of the total loans outstanding of our Hong Kong branch, among the highest within our organization. For corporate banking operations, our Hong Kong branch targets, among others, listed companies and large state-owned enterprises. As of December 31, 2004, 17 of our Hong Kong branch's top 20 customers in terms of amount of loans were listed companies and their affiliates. In addition, our Hong Kong branch also actively participates in the syndicated loan market. As of December 31, 2004, 29.5% of its total loans outstanding, or approximately RMB9,628 million, were attributable to syndicated lending, generating significant interest and fee income.

Recognizing the increasing pressure on net interest margins, we have re-oriented ourselves towards fee income generation. We provide a variety of fee-based products and services. In the year ended December 31, 2004, non-interest income as a percentage of total income for the Hong Kong branch was approximately 20.5%, the highest within our Company.

Securities and Brokerage Businesses

BCOM Securities Company Limited, or BCOM Securities, was established in June 1998 under the control of our Hong Kong branch to redirect commission income previously paid to third party brokers back to our organization. In 2004, trading volume reached HK$30,877 million. In addition to the purchase and sale of securities on behalf of our customers (including online trading), BCOM Securities provides other services, including subscription, underwriting and distribution of new listings on the Hong Kong Stock Exchange, fixed investment savings plans and margin lending. BCOM Securities has recently expanded into the financial advisory and corporate finance businesses, targeting customers including PRC-based small- to medium-sized enterprises that are potential listing candidates. These candidates are generally referred to BCOM Securities by our branch network in the PRC.

Insurance

China Communications Insurance Company Limited, or CCINS Insurance, was established under the control of our Hong Kong branch in November 2000. CCINS Insurance offers property and casualty insurance products. As of December 31, 2004, in addition to its in-house sales force, the distribution network of CCINS Insurance includes over 490 insurance sales agents and 106 insurance brokers. The following table sets forth the gross written premiums for CCINS Insurance for the periods indicated:

	Year ended December 31,		
	2002	2003	2004
	(in millions of HK dollars)		
Gross written premiums	34.3	45.2	53.0

Trust

Bank of Communications Trustee Limited, or BCOM Trustee, began its operation in 1981 under the control of our Hong Kong branch. Its scope of business includes pension plans, wealth management and custody services. BCOM Trustee is one of the 19 trustees of the licensed Mandatory Provident Fund, the corporate pension plan in Hong Kong. As of December 31, 2004, various pension funds under BCOM Trustee's custody amounted to HK$898 million, of which the Mandatory Provident Fund accounted for HK$487 million, representing an 148.5% increase from HK$196 million in 2002.

Other Overseas Branches

Our New York branch was established in November 1991 and is one of the only two PRC commercial bank branches in New York. As of December 31, 2004, our New York branch had approximately 44 employees and approximately RMB1,353 million in total loans outstanding excluding interest receivables.

Our Tokyo branch was established in December 1995 and is licensed to provide full banking services in Japan. As of December 31, 2004, our Tokyo branch had approximately 30 employees and approximately RMB933 million in total loans outstanding excluding interest receivables.

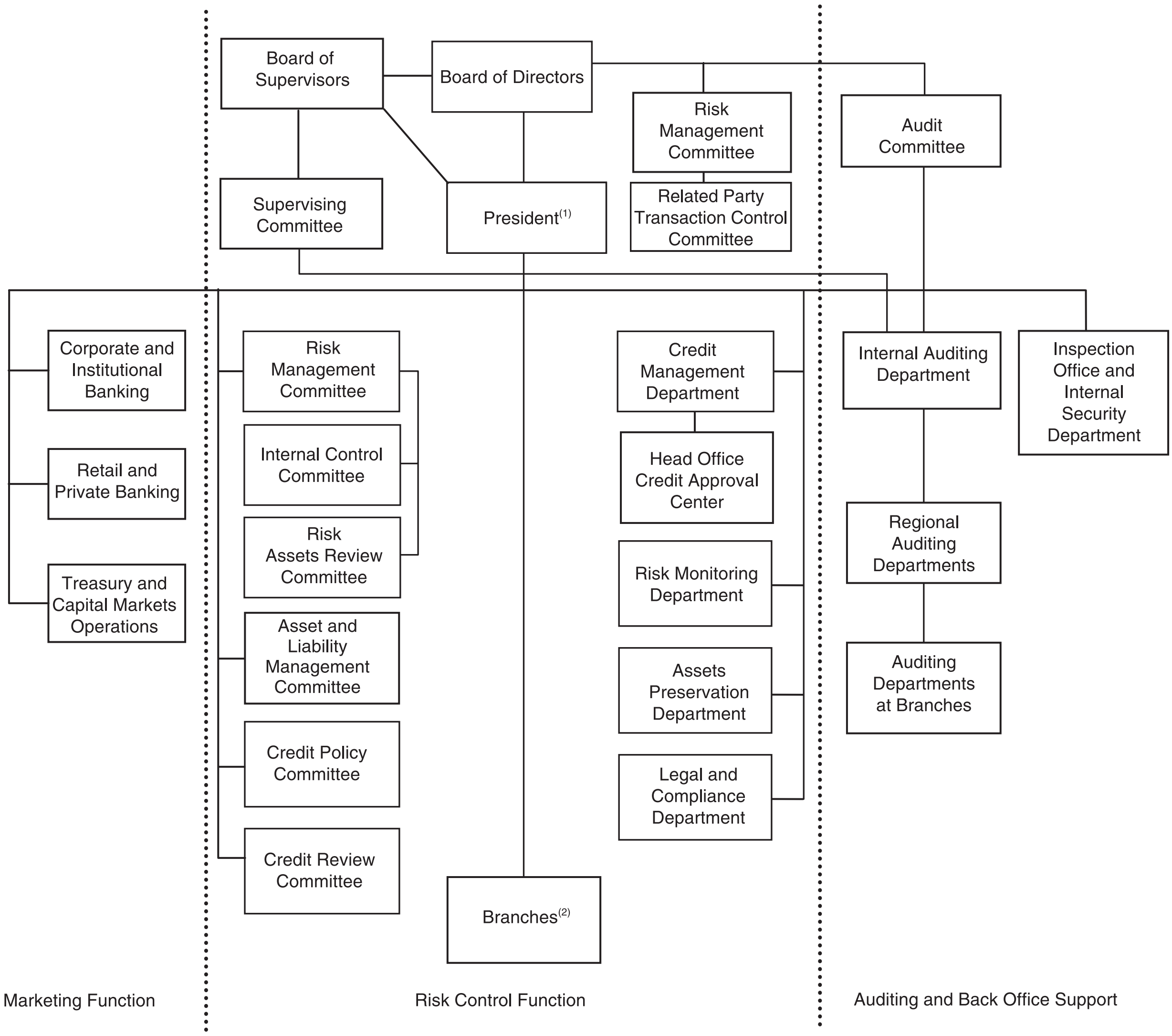
Our Singapore branch was established in September 1996. As of December 31, 2004, our Singapore branch had approximately 26 employees and approximately RMB1,519 million in total loans outstanding excluding interest receivables.

RISK MANAGEMENT AND INTERNAL CONTROLS

The principal types of risk inherent in our business include credit risk, market risk (including interest rate risk and exchange rate risk), liquidity risk and operational risk, and our goal is to continue to improve our risk management system with effective internal controls and to manage our risk exposure in compliance with the guidelines established by our Board.

Our Risk Management and Internal Control Structure

The chart below illustrates the organizational structure of our risk management and internal control system.



(1) With the authorization from our president, one of our executive vice presidents is responsible for risk management-related matters and supervises our credit management department, risk monitoring department, assets preservation department and legal and compliance department. The general manager of each of these departments is required to report directly to this executive vice president while the deputy general manager of the branch responsible for risk management at each of our 92 branches is required to report to the general manager of the respective branch and this executive vice president. In addition, our credit policy committee and credit review committee report directly to this executive vice president.

(2) Generally, one of the deputy general managers at each of our branches is responsible for risk management-related matters.

Some of the key benefits of our current risk management system include:

- *Adoption of international practices*. In 2001, as part of its efforts to help resolve the non-performing loan issue of the PRC banking industry, ASEM Fund provided special funds to the PBOC for the purposes of improving the credit management of PRC commercial banks. We were chosen as the sole beneficiary of the project, and the World Bank cooperated with us in designing this project. As part of this project, we engaged PricewaterhouseCoopers Zhong Tian CPAs Co., Ltd. as our independent consultant, whose findings revealed weaknesses of our then existing credit management system, including inconsistent credit approval criteria and lack of centralized credit risk management. In addition, PricewaterhouseCoopers Zhong Tian CPAs Co., Ltd. recommended us to revise our loan approval procedures by adopting international practices. Based on such recommendation, we revised our loan approval procedures, which served as a foundation for our current risk management system. This project has enabled us to study the latest credit risk control practices, including the practices followed by leading international banks, and to improve our credit risk management system. We have further improved our risk management systems to emphasize the important elements of these practices as they relate to our own operations.

- *Defined risk management responsibilities*. We have defined the risk management functions of our Board, Board of Supervisors, senior management and relevant departments. In addition, individuals from senior management to branch officers and individual employees are assigned different risk control responsibilities based on their respective positions and responsibilities. We have also linked individual performance evaluations and remuneration to our asset quality to encourage full compliance with our risk management guidelines and procedures.
- *Segregation of front office, middle office and back office functions*. Risk control functions in our middle office are independent of the business activities conducted in our front office and the monitoring and assessment of our risk management and internal controls conducted in our back office, such as auditing.
- *Comprehensive risk coverage*. Our risk management system is designed to cover risks of all of our business segments and all types of risks, such as credit risk, market risk, liquidity risk and operational risk.
- *Matrix risk reporting structure*. In our current risk management framework, deputy general managers of our branches are responsible for managing the risks and asset quality of their respective branches, and report directly to the relevant general managers of the respective branch and the executive vice president responsible for risk management of our Company.

Board of Directors and Board Committees

Our Board is ultimately responsible for managing the risks of our Company and reviewing and approving our risk management strategies and policies. Through its risk management committee and audit committee, it supervises our risk management and internal control system and evaluates our overall risks.

The risk management committee of our Board is primarily responsible for supervising the risk management of our Company, assessing our risks, and making recommendations to the Board regarding our risk management and internal control strategies and policies. Currently, the risk management committee consists of four members, Messrs. XIE Qingjian, LI Keping, GAO Shiqing and Ian Ramsay Wilson and, among them, Messrs. XIE Qingjian and Ian Ramsay Wilson are independent non-executive Directors. Mr. XIE Qingjian acts as chairman of the risk management committee.

We also have a related party transaction control committee which reports directly to the risk management committee. Our related party transaction control committee reviews and provides its opinion for our Board's consideration and approval on any related party transaction that exceeds 1% but is lower than 5% of our shareholders' equity for the previous quarter or any related party transaction where the outstanding amount exceeds 5% of our shareholders' equity for the previous quarter after the transaction is completed. Currently, our related party transaction control committee consists of three members, Messrs. XIE Qingjian, LI Keping and Ian Ramsay Wilson, and, among them, Messrs. XIE Qingjian and Ian Ramsay Wilson are independent non-executive Directors. Mr. XIE Qingjian currently acts as chairman of the related party transaction control committee.

Our audit committee oversees our internal auditing system and its implementation, reviews our financial information, and evaluates our compliance with, and adequacy of, our internal controls.

Currently, our audit committee consists of five members, Messrs. Herbert HUI Ho Ming, OR Ching Fai, LI Zexing, XIE Qingjian and CHEN Qingtai and, among them, Messrs Herbert HUI Ho Ming, XIE Qingjian and CHEN Qingtai are independent non-executive Directors. Mr. Herbert HUI Ho Ming currently acts as chairman of the audit committee.

See the section headed "Directors, Supervisors, Senior Management and Employees – Board Committees".

In addition, our Board monitors the status of our regulatory compliance, including, among others, capital adequacy ratios and other ratios under the relevant laws and regulations. Our Board holds meetings at least four times a year. In addition to the regular Board meetings, our Board holds meetings when they consider it necessary. Moreover, we maintain frequent written communications with our non-executive Directors and independent non-executive Directors to ensure that they are informed in a timely manner of any material developments in our day-to-day operations.

Board of Supervisors and Its Committee

Our Board of Supervisors and its supervising committee participate in and supervise our financial and audit-related matters. Our supervising committee consists of seven members, Mr. LIU Qiang, Ms. CHEN Zheng, Mr. NING Jinbiao, Mr. TENG Tieqi, Mr. JI Keliang, Ms. YIN Baoyu and Ms. CHEN Qing. The supervising committee is chaired by Mr. LIU Qiang. For a detailed description of the authority and responsibilities of our Board of Supervisors, see the section headed "Directors, Supervisors, Senior Management and Employees – General".

Senior Management and Their Special Committees

Our president is responsible for all aspects relating to our risk management and internal controls, including formulating and implementing our risk management strategies and policies. Our president appoints one of our executive vice presidents to assist him in risk management-related matters.

In addition, we have established four special management committees and are in the process of refining their functions and responsibilities. These committees are the risk management committee, the asset and liability management committee, the credit policy committee, and the credit review committee. They assist our senior management to design and refine our risk management strategies, credit policies and guidelines, and to implement risk management policies and guidelines throughout our functional departments. The majority of these committees are comprised of members of our senior management. We also have individuals with relevant experience serving on these committees. Among these four committees, our risk management committee and asset and liability committee report directly to our president while the other two report directly to the designated executive vice president.

Our risk management committee primarily formulates our risk management goals, policies and implementation procedures within the framework of the risk management strategies approved by our Board, assesses our bank-wide risk management condition, and reviews and decides on any material violations of our risk management policies. In addition, we have established an internal control committee and risk assets review committee that report directly to our risk management committee. Our internal control committee primarily assesses and supervises our internal control system and studies and approves policies and guidelines to improve our internal controls and minimize our operational risks. Our risk assets review committee reviews and provides opinions on asset preservation matters relating to our non-performing assets.

Our asset and liability management committee inspects our business operations, formulates our business objectives in respect of our risk management, inspects the implementation of our internal rules, and formulates relevant rules and policies in relation to the foregoing.

Our credit policy committee reviews, revises and approves our bank-wide credit policies.

Our credit review committee reviews and approves loan applications submitted by our credit management department.

Credit Management Department, Risk Monitoring Department and Assets Preservation Department

As part of our organizational restructuring, we established a head office credit approval center within our credit management department, a risk monitoring department, an assets preservation department, and a legal and compliance department to improve our risk management and internal control system. The credit approval center and the other three departments, together with our credit management department, internal auditing department, inspection office and security department, are responsible for our risk management and internal control procedures.

Our credit management department proposes credit management policies and guidelines, analyzes credit-related business activities, monitors the implementation of credit policies, and directly supervises our head office credit approval center. Our head office credit approval center reviews loan applications exceeding the credit limits of our branches, currently ranging from RMB30 million to RMB500 million, depending on the authority of each individual branch. It submits loan applications that have been approved by its reviewers to the credit review committee for final approval. We plan to establish independent regional credit approval centers, which will be responsible for reviewing and approving loan applications submitted by the branches in their respective regions.

Our risk monitoring department monitors and assesses the credit risk, market risk and operational risk relating to our business activities, and supervises and advises other departments in managing risks. In addition, it develops risk management tools and proposes risk management strategies and policies for review by our risk management committee.

Our assets preservation department is responsible for the preservation of our assets. This department provides centralized management of our non-performing loans and, with the guidance of the risk management committee, is responsible for the development and implementation of a uniform set of guidelines and procedures for managing our non-performing loans.

Legal and Compliance Department

At the end of 2004, our legal department was reorganized into the legal and compliance department, responsible for legal affairs and compliance, including our Company's compliance with applicable anti-money laundering rules and regulations. We are currently in the process of establishing implementing rules for our internal compliance. These implementing rules will provide that our legal and compliance department shall conduct ongoing compliance assessments in response to new regulatory requirements. In addition, the departments at our head office and our branches will be required to submit comprehensive compliance reports for review by the legal and compliance department at least once every year.

Internal Auditing Department

Under the direct supervision of our president, our internal auditing department is responsible for supervising and assessing our internal controls and auditing our business activities. In addition, the internal auditing department reports to the audit committee of our Board and the supervision committee of our Board of Supervisors. The internal auditing department determines the frequency and scope of the inspection and assessment of our operations and internal controls, and conducts independent inspections or assessments on any potential material risk or internal control issue in any of our business departments, especially the inspection and assessment of the following matters:

- compliance with all applicable laws and regulations;
- compliance with, and effectiveness of, our internal policies or guidelines;

- effectiveness of our risk management (including our credit management) and accounting systems;
- the security of our information technology system; and
- the soundness, applicability and effectiveness of our internal controls and procedures. Our audit department is also responsible for following up on any issues detected, overseeing remedial actions and enhancing risk prevention.

Our internal auditing department conducts comprehensive examinations once a year of our financial and operational performance, credit risk management, accounting matters, technology applications and internal controls, including those of our branches and sub-branches. In addition, it conducts special examinations in response to new matters. Examinations may be conducted both on-site and off-site.

We have established a three-tiered auditing system composed of the head office internal auditing department, regional auditing departments and auditing departments at our branches, with our head office internal auditing department managing this system independently of the other departments.

Inspection Office and Internal Security Department

Our inspection office is primarily responsible for supervising the compliance by our senior officers and our employees with applicable laws and rules, and taking disciplinary or preventive actions against our senior officers and our employees for breach of applicable internal rules. Our internal security department is responsible for implementing and enforcing our internal security rules and handling criminal cases or accidents. The inspection office and internal security department have established a set of disciplinary rules applicable to our senior management and employees for such breaches and violations. They have also established mechanisms for reporting, supervising and investigating any potential violations.

Credit Risk Management

Credit risk is the risk that a customer or counterparty will be unable or unwilling to meet a commitment that it has entered into with us.

Our primary goal in credit risk management is to maximize our risk-adjusted return on capital. To achieve this goal, we have developed and implemented comprehensive policies and procedures to identify, measure, monitor and control credit risk across our organization. Our credit risk management system is formulated to achieve this primary goal by enforcing prudent procedures for, and management of, credit approvals in a centralized manner and ensuring adequate independent oversight and control over credit risk.

Consistent with our overall risk management strategies, we have implemented the following principal initiatives to ensure effective credit risk management in our operations:

- maintaining the independence of the credit review process;
- maintaining a single consolidated credit line for each of our customers with respect to all of the products and services we provide to such customer;
- maintaining a single consolidated credit line for group customers;
- emphasizing the importance of cash flow while incorporating various other elements, including repayment, tax and commercial credit records, in our pre-approval analysis;
- avoiding over-reliance on collateral and guarantees in the credit extension process;
- continuing to implement risk revaluation and risk alert measures during and after loan approvals, as necessary;

- assigning clearly defined credit risk management responsibilities and accountability to each relevant operating unit and persons involved in the risk management process;
- diversifying our loan portfolio among different geographic regions, industries, products, customers, maturities and currencies;
- accurately measuring and disclosing credit risk exposure; and
- maintaining consistent credit policies.

Credit Policies and Guidelines

Under our current risk management system, the credit management department at our head office proposes credit policies and guidelines for our corporate customers. If these proposed policies and guidelines are material, they are required to be reviewed and approved by our credit policy committee. Otherwise, they are required to be reviewed and approved by our president or the relevant executive vice president. The personal finance department at our head office proposes credit policies and guidelines for our retail customers, which are subject to the review and approval by our president or the relevant executive vice president. After these policies and guidelines have been approved, our branches are required to implement them within their respective authority granted by our head office. These policies and guidelines are reviewed and revised as necessary to reflect policy guidelines, rules or regulations issued by the PBOC or CBRC, changes in the macroeconomic environment or trends in different industries, and other relevant factors. These credit policies and procedures generally set forth, among other things, the types of industries and businesses for which credit will be extended, procedures and guidelines for assessing the credit risk of individual clients, credit approval procedures and record maintenance requirements.

Loan Approval and Monitoring Procedures

General

Our loan approval procedures involve the evaluation and analysis of loan applications to ensure that we have a thorough understanding of the borrower, the purpose and structure of the loan and the borrower's sources of liquidity, financial condition, cash flow position and repayment ability. To avoid conflicts of interest, we endeavour to maintain separation of duties and responsibilities in our loan approval and monitoring process, which can be primarily divided into three functional steps: marketing and pre-approval investigation; approval of loan applications; and loan monitoring and management.

Corporate Lending

We employ a multi-level credit approval process that requires corporate loan approvals to be granted at successively higher levels of our organization, depending primarily on the principal amount of the proposed loan and the type of loan. Upon approval by the appropriate authority within our Company, the loan disbursement center disburses the loan to the customer upon satisfaction of various documentation and legal requirements.

Pre-approval Investigation

All applications for corporate loans, either in the form of new loans or renewals of existing loans, are subject to pre-approval credit investigations, which are primarily undertaken by our customer relationship managers. The purposes of pre-approval investigations is to understand the background of the corporate borrower, the purpose and structure of the loan, industry risks, operating and management risks of the corporate borrower, and financial condition of the corporate borrower, including its profitability, financial ratios, cash flows, liquidity and repayment ability, to determine an appropriate loan limit, understand the guarantor's (if any) overall credit risk and ability to repay the loan, and formulate an initial evaluation of the corporate client's credit rating. The results and analysis of the pre-approval investigations and proposed rating of the prospective customer, as discussed below, are reflected in credit evaluation reports prepared by our customer relationship managers. In addition, our overall credit risk, applicable legal or regulatory restraints and other factors are also considered before the decision to extend credit is made.

To further refine our assessment and monitoring of the credit risk associated with a loan, we have adopted an internal 10-class credit rating system to evaluate our domestic corporate clients and loans, which was a result of the World Bank project we have been implementing since 2001. The corresponding credit rating under the PBOC's five-category loan rating system for a credit rating from 1 through 5 under our internal 10-class credit rating system is "pass", for 6 through 7 is "special-mention", for 8 is "sub-standard", for 9 is "doubtful" and for 10 is "loss".

Under this 10-class credit rating system, we not only assess the credit risk of our loans but the credit risk of our corporate clients, which allows us to further refine our assessment of the credit risk associated with a loan. We take into account a number of quantitative and qualitative factors when we evaluate a corporate client's credit risk rating, including:

- the borrower's financial condition, including its cash flows, assets and liabilities, and ability to obtain other sources of funding;
- the borrower's non-financial condition, mainly including its management and operations and potential impact by external factors and unforeseen events; and
- the industry in which the borrower is engaged and the borrower's market position.

In addition, in order to streamline the process of determining the credit risk of our corporate clients or loans, our 10-class credit rating system takes into account certain quantitative criteria. For example:

- the highest credit rating for any loan with principal or interest payments overdue more than 30 days is 6;
- the highest credit rating for any secured loan with principal or interest payments overdue more than 90 days is 7;
- the highest credit rating for any unsecured loan with principal or interest payments overdue more than 90 days is 8;
- the highest credit rating for any corporate client without three-year financial statements is 7; and
- the highest credit rating for any corporate client with two or more late payments or nonpayments of interest within the last twelve months is 7.

Clients with a credit rating from 1 to 7 under our internal 10-class credit rating system and with no repayment overdue more than 90 days are classified as "regular clients" while clients with a credit rating from 8 to 10 or with at least one repayment overdue more than 90 days are classified as "high risk clients".

The following table sets forth our loans to our domestic corporate customers by our internal 10-class credit rating system as of December 31, 2004:

Credit Rating of Corporate Customers	As of December 31, 2004	
	Amount	% of total
	(in millions of RMB, except percentages)	
Class 1	65	0.0%
Class 2	5,494	1.0
Class 3	7,522	1.4
Class 4	57,086	10.8
Class 5	253,842	48.0
Class 6	118,337	22.4
Class 7	50,804	9.6
Class 8	11,193	2.1
Class 9	5,123	1.0
Class 10	121	0.0
Not classified(1)	19,339	3.7
Total loans to corporate banking customers	528,926	100%

(1) Includes foreign government on-lending loans and re-discounted bills.

When we evaluate the credit risk rating for a particular loan, we primarily take into account the credit risk rating assigned to that corporate client and other factors, such as:

- loan guarantees (if any);
- the intended purpose, use or structure of the loan;
- the country risk; and
- history of late repayments (if any).

To ensure consistent application of our 10-class credit rating system, we update application manuals and hold training sessions for employees from time to time. As required by the application manuals, the credit ratings of our corporate clients and their loans are assessed and reviewed at every step of the loan approval process, from the pre-approval investigation to loan approval and loan monitoring. In addition, ongoing assessments on the accuracy of the credit ratings are conducted by both our middle office and back offices, including our credit management department, risk monitoring department and internal auditing department.

Each loan application is reviewed based on the total existing outstanding exposure to the borrower. If a borrower has loans outstanding, any new application must be approved, depending on the borrower's total indebtedness and type of loans, by the appropriate authorizing officer or the credit review committee. In assessing the credit risk, we also consider our overall credit risk at the portfolio level. Our loan portfolio consists of loans broadly categorized as loans for specific countries or regions, industries, products, individual and group customers, related parties and specific projects. Our policy is to limit each loan category to no more than a certain percentage of our total outstanding credit balances or our capital base.

Loan Approval

Following a successful pre-approval investigation, corporate loan applications are further reviewed by different risk management departments and committees at our branches. Loan applications submitted by our customer relationship managers will be initially reviewed by the credit management department at our branch level, which will then submit the loan applications, together with its review report and analysis, to the credit review committee of that branch for approval except in very limited circumstances. For example, loan applications with 100% cash guarantees can be approved by the general manager of the respective branch. The credit review committees at our branches consist of either nine members or seven members. The deputy general managers of our branches that are responsible for risk management of their respective branch act as the chairman of the credit review committees. To ensure segregation of the front office and middle office functions at our branches, these deputy general managers are prohibited from being in charge of the front office functions of their respective branches, such as marketing. Each loan application must be approved by seven members out of a nine-member credit review committee or six members out of a seven-member committee with the chairman counted for one vote. The deputy general manager at a branch has only the right to veto the credit approval decision by the credit review committee at the branch level but not the right to approve what has been previously rejected by the credit review committee. The credit review committees at our branches generally hold their meetings once a week. Any loan application exceeding the credit limit of a branch is required to be submitted to our head office credit approval center.

Our head office credit approval center reviews the loan applications submitted from our branches. Based on its review, our head office credit approval center will either reject the applications or submit such applications to our head office credit review committee for review, and submits those loan applications that have not been rejected by its reviewers to our head office credit review committee for approval. Our head office credit review committee consists of nine members, including our executive vice president, representatives from the credit management department, corporate banking department, risk monitoring department, budget accounting department, international banking department, treasury department and legal and compliance department, as well as experts with relevant experience, with the executive vice president acting as the chairman. All loan applications submitted to our head office credit review committee must be approved by seven members. Each of our president and executive vice president responsible for risk management has the right to veto the credit extension decision by our credit review committee. However, our president or executive vice president has no authority to approve what has been previously rejected by our head office credit review committee.

Special Procedures for Certain Clients

High Risk Clients. Any loan application by, or any loan restructuring plan in connection with, a high risk client is required to be submitted to the assets preservation department and risk management committee for their review and approval. Each of our branches is assigned a credit limit for each type of restructuring plan, and any restructuring plan exceeding such limit is required to be submitted to our risk assets review committee at our head office for review.

The risk assets review committee at our head office consists of nine members, including one of the executive vice presidents that are in charge of asset preservation, as well as representatives from the assets preservation department, credit management department, corporate banking department, risk monitoring department, legal and compliance department, international banking department, budget and finance department and inspection office department, with the executive vice president acting as the chairman. Experts with relevant experience may serve as consultants to the risk assets review committee.

At our branches, all of the functions of the risk management committee, internal control committee and risk assets review committee are generally performed by the risk management committee. The risk management committees at our branches consist of either nine members or seven members, with the general manager of that branch or sub-branch acting as the chairman and the deputy general manager who is responsible for risk management acting as the vice chairman. The decisions by the risk management committee must be approved by six members out of a nine-member committee or five members out of a seven-member committee, with the chairman having the right to veto the decision of the risk management committee. However, none of the deputy general manager of that branch, the executive vice president in charge of risk management or our president has any authority to approve what has previously been rejected by the risk management committee. The risk management committees at our branches hold their meetings when necessary.

Group Customers. To better manage our overall credit risk exposure, we have begun to centrally manage the credit limit of group accounts either at the central level or at a designated branch, and to adopt a single credit limit for customers within the same group. Any additional credit exposure will require approval from the head office or the lead branch. This approach will enable us to centrally formulate a uniform lending strategy to such types of accounts.

Affiliated Entities. Recognizing the credit risk exposure associated with multiple credit extensions to affiliated entities, we have recently established new policies and procedures for approving credit extensions to affiliated entities. Affiliates that are either consolidated for financial statement purposes or under common control are considered closely related affiliates and treated as a single entity when their loan applications are reviewed. For closely related affiliates that have most of their operations in one location, the branch in that location is responsible for credit extentions, while closely related affiliates that have operations across regions will be handled centrally by the lead branch designated by our head office, as appropriate. Affiliates of other types will be required to be handled centrally through our head office or a branch that has a business relationship with the parent company of these affiliated entities. During the credit approval process, special attention will be paid to the relationship and the fund flows among the affiliates, the intended use of the funds, the ability to repay the loan and, if there is a guarantee arrangement, the qualification of the guarantor, the ability of the guarantor to repay the loan and the possibility of other third-party guarantees. We believe these additional cautionary measures enable us to better manage the credit risks associated with affiliated entities.

Loan Monitoring

We monitor our corporate loans both on an individual basis and on a portfolio basis at all levels within our organization. Our customer relationship managers are responsible for the preparation of loan monitoring reports, which are submitted to our credit management department for review and approval. In connection with their loan monitoring activities, the customer relationship managers and the credit management department are supervised by our risk monitoring department, which conducts periodic loan monitoring inspections. Our periodic loan monitoring inspections are designed to:

- acquire current information regarding each borrower's financial position;
- acquire current information regarding the performance and repayment status of each individual loan;
- detect early signs of delinquency to facilitate prompt remedial actions;
- acquire current information regarding the credit exposure of our overall loan portfolio; and
- enable our credit policy committee and risk management committee to monitor the overall quality of our loan portfolio, identify significant trends and assess the suitability of our credit risk strategies and policies.

The frequency of our loan monitoring varies with each individual corporate loan, depending on each customer's credit grade and the size and payment history of the loan. For example, for any corporate client with a credit rating from 1 to 5 under our internal 10-class credit rating system, the scheduled review is once every year, and for a client with a credit rating of 6 or 7, the scheduled review is once every six months. Finally, a scheduled review is carried out every three months for a corporate client with a credit grade of 8 or above. Depending on the nature of the credit product being monitored, we may rely on one or more of the following methods to monitor the credit risk of our loans and our customers, including:

- checking ongoing compliance with credit terms;
- keeping regular contacts with customers via site visits and meetings;

- promptly following up on documentation deficiencies; and
- performing periodic portfolio risk assessments based on borrowers' types, business sectors and internal credit ratings.

If these methods detect signs of delinquency, we will conduct a more detailed review of the credit quality and the repayment ability of the customer concerned and take appropriate remedial actions, such as requesting early repayment. In addition, we continuously monitor our lending activities to ensure that our credit policies are observed throughout the credit approval process.

Risk Alert and Monitoring System

General. We have initiated a risk alert and monitoring system for purposes of early detection and remediation of risks and to ensure we have adequate provisions and to minimize our losses. We employ various risk management tools, including risk watch lists.

Risk Watch List. For purposes of promptly detecting risks and enforcing risk monitoring and management of loans classified as "special-mention" and "pass" in a consistent, prudent and effective manner, our risk monitoring department initiated a "risk watch list" program. A client or a loan will be included in the "risk watch list" if there is a potential risk that the borrower or guarantor may not be able to perform their obligations and the loan may be classified as "substandard" in the future. We further classify the risks in the "risk watch list" into three levels: low-level risk, mid-level risk and high-level risk. "Low-level risk" means the loan is likely to be classified as "pass" after certain remedial actions are taken. These risks are primarily handled by customer relationship managers under the supervision of our risk monitoring department. "Mid-level risk" means the loan is likely to become "substandard", and such risks are primarily handled by customer relationship managers and our business departments (or branches) under the supervision and guidance of the specialists designated by our risk monitoring department. "High-level risk" means the loan is likely to become "substandard" within six months, and such risks are handled by our assets preservation department.

Retail Lending

The retail departments at our branches are primarily responsible for retail loan credit management at their respective branch, and the retail loan management centers established within the retail departments at our branches are primarily responsible for reviewing, approving and managing retail loans at their respective branch, and managing the retail loans within their jurisdiction.

Pre-Approval Investigation

After a retail client indicated his or her intent to apply for a consumer loan or working capital loan, our sales force at our branches and sub-branches conduct in-person interviews, collect loan application materials, ensure application materials are accurate and valid, and submit application materials in paper and electronically to the retail loan management center at our branches.

When reviewing the loan applications, our reviewers at retail loan management centers are required to ascertain the credit risk based on several factors, including, among other things:

- the completeness of the application materials and whether those materials have complied with applicable rules;
- the intended use of the loan;
- the repayment ability of the borrower;
- the loan to value ratio; and
- the guarantor's financial condition or the appraisal value of the collateral and the feasibility for registering the pledge or mortgage.

Loan Approval

We employ a multi-level credit approval process for our retail loans, requiring approvals granted at successively higher levels at our branches, depending primarily on the principal amount of the proposed loan and the type of loan. Upon approval from the appropriate authority, the retail loans will be disbursed by the retail loan management centers. In addition, retail loans secured by government bonds and certificate of deposits may be approved at our sub-branches.

Loan Monitoring

Our consumer loans are monitored primarily through the monthly repayment of the principal and interest, while our working capital loans to individuals are primarily monitored by conducting a review of the use of the loan within 15 days of the disbursement. When we detect that the retail customer may have problems in repaying the loan, we will conduct an investigation and take appropriate remedial actions.

Non-performing Loan Management and Recovery

We have also established procedures for non-performing loan management and recovery. For a detailed discussion, see the section headed “Description of Our Assets and Liabilities – Assets – Non-performing Loan Management and Recovery”.

Market Risk Management

Market risk is the risk of potential loss to future earnings, fair values or future cash flows that may result from changes in the value of a financial instrument as a result of changes in interest rates, foreign currency exchange rates and other market changes that affect market risk-sensitive instruments. The principal types of market risk are interest rate risk and exchange rate risk. Market risk is attributed to all market risk-sensitive financial instruments.

The CBRC promulgated the Guidelines on Market Risk Management of Commercial Banks on December 29, 2004. For a detailed discussion of these guidelines, see the section headed “Supervision and Regulation – Recent Development of PRC Banking Regulations – Guidelines on Market Risk Management of Commercial Banks”.

Our risk monitoring department approves and reviews market risk management policies and guidelines, which, among other things, limit the types of the transactions that may be conducted by our branches. Our branches are required to implement these policies and guidelines and conduct transactions within the authority granted by the head office. In addition, our branches are required to report these transactions to our risk monitoring department on a real-time basis for risk monitoring and controlling purposes.

Interest Rate Risk Management

Interest rate risk is the risk that our interest income or the value of our assets may suffer losses due to the volatility of interest rates. Our primary sources of interest rate risk are mismatches in the maturities or re-pricing periods of these assets and liabilities and fluctuations in interest rates. In addition, different pricing bases for different products may also lead to interest rate risk for our assets and liabilities within the same re-pricing period.

We have internally developed a Renminbi assets/liabilities gap management and analysis system to perform quantitative analyses and measurement of our interest rate risk exposures relating to our Renminbi assets and liabilities. This system is used by all of our branches. In addition, we utilize the data provided by this system to perform stress tests, which provide us with guidance in adjusting the maturities and durations of our Renminbi asset and liability portfolio to manage our interest rate risk exposure. We use gap analysis to measure our exposure to interest rate risk. Gap analysis measures the difference between the amount of interest-earning assets and interest-bearing liabilities that mature or must be re-priced within certain periods. Gap analysis provides us with a static view of the maturity and re-pricing characteristics of our balance sheet positions. We conduct our gap analysis by classifying all assets, liabilities and off-balance sheet items into time bands according to contracted maturities or anticipated re-pricing dates. The difference in the amount of assets, liabilities and off-balance sheet items maturing or being re-priced within each time band provides us with an indication of the extent to which we are exposed to the risk of potential changes in the margins on new or re-priced assets and liabilities. We conduct such gap analysis at least once a month.

We manage our assets and liabilities by controlling the interest rate gaps for successive time bands. These gaps are measured through simulated interest rate scenarios to ensure that the interest income variations are within the established range. In addition, we manage our Renminbi-denominated liabilities by adjusting their maturities and allocation.

We continue to develop risk management systems to assist us in identifying, measuring, monitoring and controlling interest rate risk. For example, we are currently in the process of designing an information system for the management of Renminbi-denominated asset transactions to help us manage our interest rate risks.

We primarily manage our foreign currency assets and liabilities through the following measures: centralizing the investment of the excess foreign-currency denominated funds and investing a significant portion of such funds in short term financing, including inter-bank market notes and short-term debt, managing the ratio of our floating rate foreign-currency denominated investments and entering into interest rate swaps.

Exchange Rate Risk Management

We provide foreign currency deposits, foreign currency loans and foreign currency trading services to our customers. Our trading activities in the foreign currency markets and other general banking activities expose us to exchange rate risk. We manage exchange rate risk primarily through hedging activities in the inter-bank markets. In particular, we mitigate exchange rate risk by establishing exposure limits and stop-loss limits.

We have established a risk management system under which a series of indicators, including foreign exchange exposure limits, stop-loss limits and other trading parameters, are clearly defined. We have also implemented the Reuters Kondor+ Risk Management System, which provides stress testing capabilities for analyzing through simulation potential impact from market price movements or other unusual movements.

Liquidity Risk Management

Liquidity risk arises in the funding of lending, trading and investment activities and in the management of trading positions. Liquidity risk includes both the risk of unexpected increases in the cost of funding our asset portfolio at appropriate maturities and the risk of being unable to liquidate a position in a timely manner and/or at a reasonable price. The goal of liquidity management is for us to be able to meet all of our repayment obligations and fund all of our investment operations on a timely basis and at a lower cost.

Our treasury department proposes risk management policies and guidelines relating to our liquidity risks for monitoring by our risk monitoring department, which, among other things, limit the types of the transactions that may be conducted by our branches. Our branches are required to implement these policies and guidelines and conduct transactions within the authority granted by the head office. In addition, our branches are required to report these transactions to our treasury department on a real time basis for risk monitoring and controlling purposes.

The primary goal of our asset and liability management strategy is to achieve an optimal return while maintaining adequate levels of liquidity and effective interest rate risk management. In particular, we have implemented various measures to:

- improve our management information system to provide timely information on the movement of our liquid assets on a daily, weekly and monthly basis;
- monitor liquidity ratios in compliance with regulatory and internal requirements, especially the required Renminbi reserve ratio and the loan-to-deposit ratio;
- prepare regular maturity gap analyses to enable management to review and monitor our liquidity position on a timely basis; and
- follow a diversified funding strategy.

We rely on a broad range of liquidity sources to meet our funding requirements. We fund our operations principally by accepting deposits from retail and corporate depositors. We use the majority of deposit funds to extend loans, make investments in debt securities or conduct inter-bank placements. Generally, deposits are of shorter average maturity than loans or investments. We maintain a portfolio of liquid and high credit-rated securities that are managed by the treasury department and the international department. We manage the liquidity of Renminbi-denominated assets primarily by maintaining approximately 4.5% of our deposits as excess reserves with the PBOC in addition to the 7.5% required reserve and holding certain funds for inter-bank money market transactions and debt securities repurchases. In addition, we monitor and manage our liquidity risk by setting ratio requirements, such as loan-to-deposit ratios and ratios for excess reserves, medium- and long-term loans and liquidity on a bank-wide basis and on a branch-by-branch basis. In complying with the ratio requirements set by the head office, our branches may, upon authorization from our head office, satisfy their liquidity needs either through the inter-bank market or over-the-counter transactions, depending on the type of transactions and the counterparties.

Operational Risk Management

Operational risk is the risk of loss resulting from inadequate or failed internal processes and systems, human errors or external events. We are exposed to many types of operational risks in the conduct of our business. We attempt to manage this risk by continuing to implement our internal control system and internal control assessment system.

As part of our ongoing efforts to strengthen our internal controls, we continue to formulate new policies and procedures to manage our operational risks more systematically. These policies and procedures are reviewed and adjusted periodically in light of changing circumstances and regulatory requirements.

Our management of operational risk begins with the managers of our business operation departments. These managers are responsible for supervising our operating personnel for compliance with the control standards established by the risk management committee as well as applicable laws and regulations. Their efforts to manage operational risks are overseen by the operational risk division of the risk monitoring department.

Other key functions of operational risk management are performed by our internal auditing department, legal and compliance department, inspection office and internal security department. For a detailed discussion of their functions, see "– Our Risk Management and Internal Control Structure".

Please see the sections headed "Risk Factors – Risks Relating to our Business – Any failure or ineffectiveness in implementing our centralized management may adversely affect our business operations, financial condition and reputation", "– Failure to successfully implement and continue to improve our credit risk management system may materially and adversely affect our business operation and prospects", "– We are in the process of further improving our internal control system, and we cannot assure you that we will be able to implement and maintain stringent internal controls at all times", "– Our business, reputation and prospects may be adversely affected if we are not able to timely detect and prevent fraud or other misconduct committed by our employees, customers or other third parties" and "Business – Special Events".

INFORMATION TECHNOLOGY

Our information technology systems are managed by our information technology management department at our head office, which is organized into six divisions, namely the overall management, applications management, information security, systems management, network management and operations management divisions. As of December 31, 2004, we employed 1,457 employees for information technology-related positions. Collectively, these divisions provide the information technology infrastructure and support that are crucial to the conduct of our banking activities. In order to facilitate the generation and implementation of efficient information technology solutions to meet our business needs, we formed a cross-divisional steering committee to enable greater coordination and communication between the information technology management department and our business units. This committee oversees all the major information technology development requirements of our operations and is responsible for the planning and design of our major information technology initiatives.

We believe that the development and use of information technology plays a critical role in the conduct of our businesses and operations and in managing our risks. Prior to 2002, our information technology infrastructure was organized on a regional basis and, in addition to integrated information technology systems, our branches employed their own stand-alone information technology systems. In addition, there was no data or systems integration across different business functions within a particular branch. As a result, business and customer data within a branch and across the branches cannot be accessed on a real-time basis. We began a major overhaul of these legacy information technology systems by embarking on an information technology re-engineering project in 2002 to replace the fragmented incompatible legacy systems with a single integrated system.

There are three components to our reengineering project that began in 2002, namely, the development of a core accounting system and frontline software applications and the construction of hardware infrastructure.

The core accounting system is an organization-wide integrated computing system with a centralized database. It will allow for centralized data management, implement systems compatibility across the entire organization and ensure uniformity of software applications. As part of our efforts in the development of our core accounting system, we are in the process of centralizing data from our domestic branches and sub-branches to a data storage center in Shanghai and data from our overseas branches to a data storage center in Hong Kong. We currently plan to complete this process by 2006. Such consolidated data will then be accessible through our core accounting system.

Based on the core accounting system, we will continue to refine and develop proprietary software applications to support our banking activities. These applications will include, among other things, software applications for customer relationship management, credit management, fund management and online banking websites. In combination with the core accounting system, these applications will also permit different types of analyses to be performed on the relevant data, including credit risk, customer behavior as well as profit and loss analysis. The results of such analyses will then be used in connection with our operations, product marketing, customer relationship management and cross-selling activities.

We also plan to deploy the necessary hardware infrastructure to support the core banking system and frontline applications. As part of such plan, we are building two emergency back-up centers that can provide us with timely data back-up when needed. We expect to have these two emergency back-up centers fully established by the end of 2006. Before the establishment of these two emergency back-up centers, we will continue to ensure the security of our hardware infrastructure through our existing real-time data back-up between the main servers separately located in the two towers of our headquarters as well as our existing data back-up mechanism between our headquarters, which are located in the Pudong area of Shanghai, and our Shanghai branch, which is located in the Puxi area of Shanghai, which save all the data of the other office for the preceding business day.

We currently expect the reengineering project to be completed by 2006. Upon the completion of this project, we hope to increase the effectiveness of our cross-selling activities as well as to improve the management of our credit risk and the asset quality. The centralized data management system will also complement our customer relationship management initiatives as all the relevant data on a particular customer will be centralized and accessible. Phase one of our data centralization project, including the system intended to enhance our ability to categorize group customers, identify the affiliate relationships among such group customers and monitor our exposure to all members of group customers, is expected to be completed by June 2005. This system will enable us to fulfill our disclosure obligations under the Hong Kong Listing Rules. This will greatly facilitate our customer relationship management activities, particularly in the areas of targeted marketing and customer retention.

A brief summary of the current status of our information technology systems is as follows:

- ***Computing platform***. As a result of the reengineering project, we currently have an organization-wide computing network based on IBM Z series mainframes and UNIX open-source systems supported by a technologically advanced hardware infrastructure. We also employ IBM mainframe computers for our core accounting processing. Our computing platform utilizes a three-tiered client/server open system architectural design. In addition, we are making significant efforts to increase the rate of personal computer penetration across the entire organization, partly to facilitate the increased use of e-mail communications within the organization.
- ***Software applications***. Consistent with the schedule of the reengineering process, the information technology management department is also working to improve our intranet functions and our proprietary software applications. Our proprietary software applications are user-friendly and come with built-in help support features. As a security measure, these software applications have dual-password protection for critical functions. In addition, we have developed software applications for our credit management system and international business.
- ***Network infrastructure and security***. We have established a three-tier network backbone infrastructure, with our head office at the center, connecting all of our branches, sub-branches and outlets by high-speed cables leased from two major telecommunications service providers. In the event of any network malfunction, the network will automatically create backups. We have also adopted a series of technical measures including, among others, firewall systems, network monitoring systems and hacker detection systems, in order to increase our network security. Our network infrastructure is capable of performing daily monitoring, maintenance and management functions. We carry out a system of two-tier management and three-tier monitoring throughout our entire network. Our information technology management department holds weekly meetings to discuss material issues regarding network functions and security issues. In addition, we strictly comply with the CBRC's requirements regarding network operations of financial institutions and undergo formal audits by our internal audit department and the CBRC's audit department, respectively, on a regular basis. We have also completed the construction of our enterprise control center, or ECC, in 2003. As the monitoring and management center of our entire applied computer system, the ECC controls, oversees and manages our various applied systems. The ECC is directly under the control of our information technology management department, and the ECC provides us with technical support in order to ensure the safety and quality of our operations.

Our commitment to the reengineering process reflects our belief in the importance of information technology to our operations. We expect to increasingly leverage information technology to drive our business in the future. Consistent with our information technology reengineering project, we will continue to upgrade and integrate our information technology systems to facilitate operational efficiency, risk management and business development.

COMPETITION

The competitive landscape of commercial banking in the PRC mainly is comprised of the Big Four, joint stock commercial banks and urban commercial banks as well as foreign-invested financial institutions. As of December 31, 2004, the aggregate banking assets of the Big Four and the joint stock commercial banks accounted for approximately 53.6% and 14.9%, respectively, of the total banking assets in the PRC. As of the same date, our banking assets accounted for approximately 3.6% of the total banking assets in the PRC and 24.4% of the aggregate banking assets collectively held by PRC joint stock commercial banks.

The Big Four generally have larger capital bases, wider distribution networks and more customers than joint stock commercial banks. As incumbents, the Big Four also control the substantial majority of the market. We face substantial competition in each of our product and services lines in both the retail and corporate segment from the Big Four as well as the other joint stock banks.

The PRC's banking system is undergoing a period of reform. The objectives of these banking reforms are to align the corporate governance, management and operations of the Big Four with international best practices and to improve the overall asset quality of the Big Four. As part of the banking reforms instituted by the PRC government, these banks ceased their policy-based lending activities in 1994. In addition, in January 2004, the PRC government injected approximately US$45 billion in foreign currency reserves into Bank of China and China Construction Bank, thereby enabling these two banks to write off a significant level of their impaired loans, which strengthened the competitiveness of the Big Four.

We also face competition from other joint stock commercial banks. Generally, these banks have less of a historical burden of non-performing loans and more flexibility in their operations.

As a result of PRC joining the WTO in December 2001, the PRC government is gradually phasing out restrictions on foreign participation in the PRC banking market. We expect the PRC government to continue reducing these restrictions. This will result in the further opening of the PRC banking market to foreign financial institutions and could erode any competitive advantages that we currently enjoy. In particular, in the accession agreement relating to its entry to the WTO, the PRC has undertaken to eliminate by 2006:

- geographic restrictions on business activities of foreign banks and other foreign financial institutions; and
- restrictions on the permitted scope of business for foreign banks and other foreign financial institutions.

The opening of the PRC banking market to foreign financial institution may adversely affect our business as well as our future profitability.

We believe that the competition in the commercial banking industry in the PRC will continue to be intensive in the future. We believe that our strengths and strategies will differentiate us from our competitors and will enable us to compete effectively with the state-owned banks, which are getting stronger as a result of banking reforms, as well as the other joint stock banks.

EMPLOYEES

We believe that our employees are the most important element of our Company and professional training is one of our key responsibilities. We have devoted significant attention and resources to recruit and train our employees in order to enhance their professional capabilities and instill the qualities that are essential to enabling us to realize our long-term goals.

We believe that a high degree of customer satisfaction can only be achieved with qualified employees. We provide on-the-job training as well as training in the classroom. Training programs are aimed at improving the operational and management skills of our employees at all levels and strengthening the risk controls of our Company. In 2004, we conducted 111 in-house training sessions and 15 overseas training programs, including in the United States, Canada and Hong Kong. In 2004, over 82.3% of our employees participated in various training programs. We provide benefits that include pension fund, housing and medical care. We believe we have created an attractive work environment for our employees. See the section headed "Directors, Supervisors, Senior Management and Employees – Employees".

INTELLECTUAL PROPERTY

We conduct business under the "交通銀行" and "太平洋卡" brand names and logos. We have registered, or are in the process of applying for registration of, these brand names and logos and other related logos in the PRC and Hong Kong. We are also the registered owner of the domain name "www.bankcomm.com". Details of the intellectual property rights of the Bank are set forth in the paragraph headed "Our intellectual property rights" under the section headed "Further Information About Our Business" in Appendix IX to this prospectus.

LEGAL AND REGULATORY PROCEEDINGS

We are involved in legal proceedings in the ordinary course of our business. As of December 31, 2004, we were involved in legal proceedings (including both court and arbitration proceedings) that involved claims against us in an aggregate amount of approximately RMB2,601 million, for which we made a provision in the amount of RMB989 million as of December 31, 2004. See Note 32 to the Accountants' Report which is set forth in Appendix I to this prospectus. As most of these legal proceedings have not reached conclusion, the exact amount of potential damages to our Company cannot be accurately predicted.

Jin Xin Incident

On June 24, 2003, our Shanghai branch agreed with Jin Xin Trust Investment Joint Stock Company Limited ("Jin Xin") to act as the capital clearance agent for the offering of the Capital Trust Fund for Strategic Acquisitions in the Dairy Industry (the "Dairy Fund"). Jin Xin is an investment trust company incorporated under PRC law, the establishment of which was approved by the relevant PRC government authorities. The Dairy Fund is an investment trust fund established for a term of one year to raise funds for investment in the PRC dairy industry. Our Shanghai branch, as the capital clearance agent, received a commission of 1% of the total proceeds raised by Jin Xin for the Dairy Fund, which commission amount was consistent with the then prevailing market practice. Our Shanghai branch circulated materials relating to the proposed offering of the Dairy Fund to certain of our customers. 191 of them subscribed for an interest in the Dairy Fund and made total investments of RMB87.2 million into this fund.

When the Dairy Fund matured in July 2004, Jin Xin was not able to repay the investment principal and the guaranteed investment returns to the investors. In August 2004, China Huarong Asset Management Co., Ltd. assumed the management of Jin Xin.

Our Shanghai branch is qualified to engage in capital clearance business for investment trust funds. However, despite our limited role as a capital clearance agent for the Dairy Fund, some of the investors in the Dairy Fund who made their investment through our capital clearance service staged protests against us on various occasions since July 2004, seeking compensation from our Company for their losses. We have been advised by our PRC legal counsel, King & Wood, PRC Lawyers, that our Shanghai branch is not liable for any contractual claims asserted by the investors for their losses in the Dairy Fund investments as there was no contractual relationship between these investors and our Shanghai branch. To the best of our knowledge, as at the date of this prospectus, no formal legal proceedings have been brought by these investors against our Company. We cannot assure you, however, that no legal proceedings will be brought against our Company, or that no civil or administrative liabilities will be imposed on us, as a result of this Jin Xin incident. We have been advised by our PRC legal counsel, King & Wood, PRC Lawyers, that it is possible that the relevant PRC judicial authorities may hear the lawsuits brought by these investors and may request our Company to compensate part of their losses. King & Wood, PRC Lawyers further advised us that in no event will our Company be required to compensate these investors more than their original investment, which was approximately RMB87.2 million.

PROPERTIES

We are headquartered at No. 188 Yin Cheng Zhong Road, Shanghai Municipality, PRC.

As of March 31, 2005, we held 1,677 properties and leased 2,359 properties in the PRC, Hong Kong and other overseas countries. We currently have a network of 92 branches, 2,413 sub-branches, 87 outlets, 1,486 self-service centers and 4,545 ATMs in the PRC.

Owned Properties and Properties to be Acquired

As of March 31, 2005, we held and occupied 1,633 properties with an aggregate gross floor area of approximately 2,407,744 square meters in the PRC, of which 1,147 are commercial properties, 385 are residential properties and 101 are ancillary properties.

Among the 1,633 properties, we obtained the right to use or occupy 98 properties through government allocation. We are prohibited from transferring, leasing and mortgaging these 98 properties or the land use rights relating thereto unless we have paid transfer premiums and other related fees for land use rights. We currently do not anticipate we will be able to obtain the land use rights for these 98 properties prior to the Listing Date due to several factors, including, among others, the following: (a) it requires a significant amount of time to effect the transfer of land use rights as a result of the relevant procedural requirements; (b) it requires a significant amount of time to negotiate with PRC governmental authorities on the transfer premiums and other related fees; and (c) confirmation and cooperation from the owners of adjacent properties are required, which are beyond our control. The transfer premiums and other related fees are currently estimated to be approximately RMB30 million, and we will endeavor to obtain the land use rights to these 98 properties by paying these fees within a year after our listing. As these properties account for only a small portion of the properties we use, we are of the view that failure to obtain land use rights for these properties will not have a material adverse impact on our business operations or financial condition.

We also leased to independent third parties fourteen properties in respect of which we do not hold the relevant building ownership certificates. The leases for these fourteen properties may be deemed invalid under PRC law and may not be enforceable. The lessees of these properties may make claims against us in the event that the relevant leases are deemed invalid.

In addition, 15 properties were under construction in the PRC with an aggregate gross floor area upon completion of approximately 127,966 square meters. As of the same date, we also held 44 properties in Hong Kong and overseas with an aggregate gross floor area of approximately 61,950 square meters. The properties held and occupied by us are primarily used as offices, branches and sub-branches and staff quarters.

In addition to the above properties, we have entered into contracts with various real estate developers in respect of acquiring 71 commercial properties with an aggregate gross floor area of approximately 61,706 square meters. As at March 31, 2005, these properties have not been assigned to us and thus the title of such properties is not vested in us. No commercial value has been attributed to these properties in our property valuation report.

Leased Properties

We lease and sub-lease from various independent third parties 2,334 properties in the PRC with an aggregate gross floor area of approximately 732,369 square meters and 25 properties in Hong Kong and overseas with an aggregate gross floor area of approximately 2,630 square meters.

As of March 31, 2005, the lease agreements for 1,904 of the 2,334 leased properties for which we are the lessee had not been registered with relevant governmental authorities as required under applicable PRC regulations. Relevant PRC regulations do not specify which party between the lessor and the lessee is responsible for such registration although in practice it is the lessors that usually handle registration. According to an interpretation issued by the Supreme People's Court on the PRC Contract Law, failure to register a lease agreement does not affect the validity of such lease agreement. Therefore, we have requested all lessors who have not registered the lease agreements to register them or provide an indemnity to us. Lessors of 919 properties have provided an indemnity to us, undertaking to compensate us for any losses arising out of such non-compliance. We do not foresee any difficulty in seeking alternative premises for these properties should this become necessary. In addition, our rights as a lessee have not been challenged by any other parties on the basis of non-registration of the lease agreement as of the date of this prospectus. In the event that we suffer any losses due to other parties' challenges, we will be able to seek indemnification for our losses from the lessors under the lease agreements even without the indemnity undertaking from the lessors. We believe, based on our PRC legal counsel's advice, that failure to register the lease agreements for the 1,904 leased properties will not have a material adverse impact on our business operations or financial condition.

Property Titles

For the 1,147 commercial properties held and occupied by us in the PRC, we have obtained the relevant title certificates for 913 of them, representing a total gross floor area of approximately 1,865,744 square meters. For the remaining 234 commercial properties with a total gross floor area of approximately 248,000 square meters, we have not obtained valid title certificates. These properties are currently occupied by us for our business operations, which can be, if necessary, replaced by other comparable alternative premises for the relevant uses without any material adverse effect to our business operations.

For the 486 residential and other ancillary properties held and occupied by us in the PRC, we have obtained relevant title certificates for 371 of them, representing a total gross floor area of approximately 195,941 square meters. For the remaining 115 residential and other ancillary properties representing a total gross floor area of approximately 98,058 square meters, we have not obtained valid title certificates. These premises are currently occupied by our employees as staff quarters or used for ancillary purposes such as storage and canteens, which are of no material significance to our business operations.

For the 2,334 leased properties in the PRC, the relevant lessors have not obtained the requisite title certificates or consent to sublet in respect of 1,047 properties representing an aggregate gross floor area of approximately 289,539 square meters. We are of the view that such leased properties occupied by us can, if necessary, be replaced by other comparable alternative premises for the relevant use without any material adverse effect to our operations.

We are in the process of applying for the relevant title certificates that we do not yet hold and have taken steps to rectify the title defects. We are of the view that we may be able to correct a large number of such title defects. For the remainder of the title defects, we are of the view that the lack of such title certificates and/or the existence of such title defects will not have a material adverse effect on our business, financial condition and results of operations as the relevant properties represent a de minimus portion of the total value of our properties. See the section headed “Risk Factors – Risks Relating to Our Business – We do not possess the relevant land use right certificates or building ownership certificates in respect of some of the properties held by us, and we may be required to seek alternative premises for some of our offices due to our landlords’ lack of relevant land use right certificates or building ownership certificates”.

Property Valuation

Sallmanns (Far East) Limited, an independent property valuer, has valued our owned property interests as at March 31, 2005 at RMB20,433,927,000. The text of the valuation letter, a summary of values and the valuation certificate issued by Sallmanns (Far East) Limited for this prospectus are set out in Appendix V.

No commercial value will be attributed to any leased properties, including those where the relevant lessors have not obtained requisite title certificates.

Waiver

Regarding the format and content of the valuation report, owing to the substantial number of properties we own (1,677 in total) and lease (2,359 in total), we have applied for and obtained a waiver from the Hong Kong Stock Exchange from strict compliance with Rule 5.01, Rule 5.06, Rule 19A.27(4) and Paragraph 3(a) of Practice Note 16 of the Hong Kong Listing Rules and an exemption from the SFC from strict compliance with Paragraph 34(2) of Part II of the Third Schedule to the Companies Ordinance on the grounds that it would be impracticable and unduly burdensome to include the full valuation report in this prospectus and that having regard to the financial services nature of the Company’s business, it would be of little relevance and assistance to potential investors to include excessive details on each property in this prospectus. The exemptions are granted on the conditions that (1) the full valuation report (which will be prepared in the Chinese language only) complying with all the requirements of Paragraph 34 of Part II of the Third Schedule to the Companies Ordinance will be made available for public inspection; and (2) a summary valuation report of all of our property interests prepared on the basis of the full valuation report is included in Appendix V to this prospectus. See the paragraph headed “Documents available for inspection” in Appendix X for the time and place that the full valuation report will be available for public inspection.

CONNECTED TRANSACTIONS

Certain transactions entered into by our Company which are expected to remain in effect following the Listing Date will, on and from the Listing Date, constitute connected transactions under Chapter 14A of the Hong Kong Listing Rules. Details of these transactions are set out below.

Exempt Continuing Connected Transactions

Bill Payment Collection Services

One of our promoters, Shandong Electric Power Corporation, is wholly owned by State Grid Corporation of China. Accordingly, the subsidiaries of State Grid Corporation of China are connected persons of our Company for the purposes of the Hong Kong Listing Rules.

The relevant branches of our Company have entered into certain electricity bill payment collection arrangements with more than 50 subsidiaries of State Grid Corporation of China. Under the terms of these bill payment collection arrangements, we make available our branch network to receive cash and electronic payments in respect of power and other utility charges on behalf of the relevant subsidiaries, and pay the relevant amounts to the relevant subsidiaries. These servicing arrangements are generally of unlimited duration (subject to termination by either party) and are expected to continue following the Listing Date.

The specific amounts charged for provision of the above bill payment collection services vary from subsidiary to subsidiary and are either charged on the basis of the total amount collected up to 0.4% thereof, or charged at a fixed fee of RMB1 per transaction. The aggregate bill payment collection fees paid to our Company under the above arrangements for the years ended December 31, 2002, 2003 and 2004 amounted to approximately RMB300,000, RMB750,000 and RMB600,000 and the aggregate bill payment collection fees payable to our Company for the year ending December 31, 2005 are expected to amount to approximately RMB1,000,000. Based on our Company's financial information for the period ended December 31, 2004, the aggregate amounts payable in consideration for the provision of bill payment collection services are expected to represent less than 0.1% of each of the percentage ratios (other than the profits ratio) of our Company calculated according to Rule 14.07 of the Hong Kong Listing Rules on an annual basis. The bill payment collection servicing arrangements are thus exempt from the reporting, announcement and independent shareholders' approval requirements under Rule 14A.33(3) of the Hong Kong Listing Rules.

We will comply with the reporting, announcement and/or independent shareholders' approval requirements in accordance with the Hong Kong Listing Rules if any of the percentage ratios exceeds 0.1%.

Commercial banking services and products provided in the ordinary and usual course of business

We provide commercial banking services and products to our customers in the ordinary and usual course of our business. Such services and products include the taking of deposits (including fixed and floating term deposits and deposits at call) and the provision of long term loans, short term loans, consumer loans and mortgages by our Company. Customers who place deposits with our Company include the Directors, chief executive officers, supervisors of our Company and its subsidiaries, each ex-Director of our Company and its subsidiaries who was a Director within the 12 months preceding the Listing Date, the promoters of our Company, such as China FAW Group Corporation, Shandong Electric Power Corporation, China Aviation Industrial Corporation I and China Great Wall Industries Group Company and their subsidiaries, HSBC and their respective associates, each of whom is a connected person of our Company under Chapter 14A of the Hong Kong Listing Rules. It is likely that these connected persons will continue to place deposits with our Company following the Listing Date which will constitute continuing connected transactions within the meaning of Chapter 14A of the Hong Kong Listing Rules.

The deposits placed by our connected persons who are not employees of the Hong Kong branch of our Company are at market rates and on normal commercial terms. The interest on deposits placed by connected persons who are employees of the Hong Kong branch of our Company are at staff rates but are also on normal commercial terms as such terms are no more favorable than the staff rates applicable to other employees of the Hong Kong branch of our Company. The PRC branches of our Company do not offer preferential rates to their employees.

The provision of commercial banking services and products by our Company to our connected persons (including the employees of the Hong Kong branch of our Company) in the ordinary and usual course of our business and on normal commercial terms that are comparable or no more favorable than those offered to independent third parties (which include other comparable employees of our Company who are not connected persons) will be exempt from complying with the reporting, disclosure and independent shareholders' approval requirements under Rule 14A.65(4) of the Hong Kong Listing Rules (namely financial assistance provided by a connected person in the form of deposits placed at our Company for the benefit of a listed issuer on normal commercial terms (or better to the listed issuer) where no security over the assets of the listed issuer is granted in respect of the financial assistance).

Loans and credit facilities granted to connected persons

In the ordinary course of our business, we extend loans and credit facilities (including provision of guarantees, security for third party loans, comfort letters and bill discounting facilities) to our customers in our ordinary and usual course of business on normal commercial terms with reference to prevailing market rates. Customers who utilise our Company's loans and credit facilities include the Directors, chief executive officers, supervisors of our Company and our subsidiaries, persons who have held the position of director of our Company or our subsidiaries in the 12 months preceding the Listing Date, the promoters of our Company, such as China FAW Group Corporation, Shandong Electric Power Corporation, China Aviation Industrial Corporation I and China Great Wall Industries Group Company and their subsidiaries, HSBC and other substantial shareholders of our Company, and their respective associates, each of whom is a connected person of our Company under Chapter 14A of the Hong Kong Listing Rules. It is expected that we will continue to provide loans and credit facilities to our connected persons after the Listing Date, which will constitute continuing connected transactions within the meaning of Chapter 14A of the Hong Kong Listing Rules.

The loans and credit facilities provided to our connected persons who are not employees of the Hong Kong branch of our Company are on normal commercial terms with reference to prevailing market rates. The loans and credit facilities provided to our connected persons who are employees of the Hong Kong branch of our Company or our subsidiaries are, depending on the circumstances, provided at staff rates or market rates but are also on normal commercial terms as such terms are no more favourable than the staff rates applicable to other employees of the Hong Kong branch of our Company. The PRC branches of our Company do not provide loans or credit facilities to employees at preferential rates.

The provision of loans and credit facilities by our Company to our connected persons (including the employees of the Hong Kong branch of our Company) in the ordinary and usual course of our business and on normal commercial terms that are comparable or no more favorable than those offered to independent third parties (which include other comparable employees of our Company who are not connected persons) will be exempt from complying with the reporting, disclosure and independent shareholders' approval requirements under Rule 14A.65(1) of the Hong Kong Listing Rules (namely financial assistance provided by a listed issuer in its ordinary and usual course of business for the benefit of a connected person on normal commercial terms).

Connected Transactions with HSBC

As HSBC is a substantial shareholder of our Company, transactions contemplated under the Investor Rights Agreement, the Credit Cards Cooperation Agreement, the Technical Support and Assistance Agreement and the Licence Agreement will constitute connected transactions or continuing connected transactions within the meaning of Chapter 14A of the Hong Kong Listing Rules if the transactions are to be carried out after Listing. The following sets forth details of the connected transactions and continuing connected transactions anticipated to be entered into between our Company and HSBC following the Listing Date, which are either exempt from the requirements relating to connected transactions or continuing connected transactions under the Hong Kong Listing Rules or for which an application has been made for a waiver from strict compliance with such requirements.

Exempt Connected Transaction with HSBC

Pursuant to the Credit Cards Cooperation Agreement, we and HSBC established a standalone business unit within our Company (the "Business Unit") to engage in the issuance in the PRC of credit cards and quasi-credit cards and the provision of Renminbi-denominated unsecured consumer finance products and services, and the marketing and distribution of such products and services ("Business") in the PRC, and HSBC will use its reasonable endeavours to transfer, subject to the consent of the customers thereof, its then-existing credit card business (excluding the HSBC Premier™ business) in the PRC to the Business Unit no later than 12 months from the date of the Credit Cards Cooperation Agreement. Since no consideration for the transfer is specified in the Credit Cards Cooperation Agreement, such transfer after the Listing Date is exempt from the reporting, announcement and independent shareholders' approval requirements under Rule 14A.31(2) of the Hong Kong Listing Rules.

Exempt Continuing Connected Transactions with HSBC

Provision of general technical support

Pursuant to the Technical Support and Assistance Agreement, HSBC agreed to provide to us general technical support and assistance in relation to our banking business, including in the areas of risk management, corporate governance, internal audit and control, financial accounting, reporting and control, balance sheet management and human resources management. The term of the Technical Support and Assistance Agreement is three years from the completion of HSBC's initial subscription of shares in our Company on August 18, 2004. The agreement may be renewed for subsequent periods of three years at the sole discretion of HSBC by serving notice to us no later than 30 days prior to the expiration of the term. HSBC will not charge us for the technical support and assistance provided. However, we will reimburse any out-of-pocket expenses incurred by HSBC in performing its obligations under the Technical Support and Assistance Agreement. As HSBC will only receive reimbursements of out-of-pocket expenses and will not receive any consideration for the provision of technical support and assistance, the Technical Support and Assistance Agreement is exempt from the reporting, announcement and independent shareholders' approval requirements under Rule 14A.33(3) of the Hong Kong Listing Rules.

Licensing of trademarks by HSBC

Pursuant to the Licence Agreement, HSBC granted to us a licence for the Business Unit to use certain trademarks owned by HSBC and a sub-licence for the Business Unit to use certain trademarks owned by the holding company of HSBC. Both the licence and the sub-licence are granted on a royalty-free, non-exclusive and non-transferable basis. These trademarks are to be used in connection with credit cards and quasi-credit cards, stationery (including business cards) and advertising (including print advertising such as leaflets, giveaways, posters and billboards, radio advertising, television advertising, internet advertising, direct mail and telemarketing). The initial term of the Licence Agreement is three years commencing on August 18, 2004, renewable for subsequent two-year terms by HSBC at its sole discretion by serving notice on us no later than three months prior to the expiration of the term. A nominal consideration of RMB1.00 is payable under the Licence Agreement and the Licence Agreement is, therefore, exempt from the reporting, announcement and independent shareholders' approval requirements under Rule 14A.33(3) of the Hong Kong Listing Rules.

Interbank loans and borrowings transactions with HSBC (including its subsidiaries and associates, together the "HSBC Group")

The relevant branches and subsidiaries of our Company have entered into various interbank loans and borrowings transactions with the HSBC Group, under which either the relevant branch of our Company or the HSBC Group acts as lender and for which security is not provided by the borrower. These transactions have been entered into in the ordinary course of business of our Company and on normal commercial terms. We expect to continue to enter into these transactions with the HSBC Group in the ordinary course of business following the Listing Date and will do so on normal commercial terms.

The interbank loans and borrowing transactions by the relevant branch of our Company or the HSBC Group to each other are conducted in accordance with common standards to manage our exposure and at standard rates prescribed by our Company in accordance with the relevant market conditions. These standards and rates are applied equally to all third party banking groups that enter into such transactions with our Company, including the HSBC Group. When entering into these transactions, our Company applies standard procedures for deal brokerage, capturing of data and screening of potential exposure to counterparties. Accordingly, these transactions have been entered into on normal commercial terms and will be exempt from complying with the reporting, announcement and independent shareholders' approval requirements under:

(i) Rule 14A.65(1) of the Hong Kong Listing Rules (namely financial assistance provided by a listed issuer in its ordinary and usual course of business for the benefit of a connected person on normal commercial terms); or

(ii) Rule 14A.65(4) of the Hong Kong Listing Rules (namely financial assistance provided by a connected person for the benefit of a listed issuer on normal commercial terms (or better to the listed issuer) where no security over the assets of the listed issuer is granted in respect of the financial assistance).

Correspondent banking services

The relevant branches of our Company have correspondent banking arrangements with various members of the HSBC Group in relation to the processing of letters of credit or collection arrangements issued by our Company or members of the HSBC Group at the request of their respective clients. Depending on their role in the particular transactions, we and HSBC may act as issuing bank, advising bank, negotiating bank, collecting bank or remitting bank in accordance with the Uniform Customs and Practice for Documentary Credits or the Uniform Rules for Collections. No fees and expenses are payable between us and the HSBC Group under these transactions. Accordingly, these correspondent banking services transactions will, after Listing, be exempt from the reporting, announcement and independent shareholders' approval requirements under Rule 14A.31(2) of the Hong Kong Listing Rules.

Settlement account

Bank of Communications Trustee Limited ("BOCOM Trustee"), our wholly owned subsidiary, has established a trading account with Wardley Futures Limited (now known as HSBC Broking Futures (Asia) Limited), a member of the HSBC Group, for BOCOM Trustee to purchase and sell futures and options on behalf of its customers. All fees and expenses payable to HSBC Broking Futures (Asia) Limited for the maintenance of this account are funded by the clients of BOCOM Trustee for whose benefit the services are provided. Accordingly, the maintenance of this trading account by BOCOM Trustee with HSBC Broking Futures (Asia) Limited will, after Listing, be exempt from the reporting, announcement and independent shareholders' approval requirements under Rule 14A.31(2) of the Hong Kong Listing Rules.

Deposits

Certain branches of our Company place with, and accept from, the HSBC Group various deposits (including without limitation ordinary deposits, structured deposits and certificates of deposit) in the ordinary course of business of the respective banking groups, on an unsecured basis and on normal commercial terms. Accordingly, these deposit transactions will, after Listing, be exempt from the reporting, announcement and independent shareholders' approval requirements under:

- Rule 14A.65(1) of the Hong Kong Listing Rules (namely financial assistance provided by a listed issuer in its ordinary and usual course of business for the benefit of a connected person on normal commercial terms); or
- Rule 14A.65(4) of the Hong Kong Listing Rules (namely financial assistance provided by a connected person in the form of deposits placed at our Company, for the benefit of a listed issuer on normal commercial terms (or better to the listed issuer) where no security over the assets of the listed issuer is granted in respect of the financial assistance).

Non-exempt connected transactions and continuing connected transactions with the HSBC Group in the normal course of banking business

We and our subsidiaries have regularly engaged in various kinds of transactions (both one-off transactions and continuing transactions) in the normal course of banking business with the HSBC Group, such as foreign 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), paying and reference agency services and agency services for syndicated loans. Each of these transactions will constitute a connected transaction under Rule 14A.13(1)(a) of the Hong Kong Listing Rules if entered into following the Listing Date.

We and our subsidiaries on the one hand and the HSBC Group on the other expect to continue to enter into normal banking transactions following the Listing Date. Each of these transactions between the two groups will constitute a connected transaction of our Company requiring compliance with the reporting, announcement and/or independent shareholders' approval requirements, depending on the amount involved on each occasion it arises, unless we have been otherwise exempt under Rule 14A.31 or Rule 14A.33 of the Hong Kong Listing Rules.

To regulate these on-going transactions, we have entered into the Interbank Transactions Master Agreement with HSBC on June 1, 2005, pursuant to which the HSBC Group and ourselves agree to conduct interbank transactions in accordance with applicable normal interbank practices and on normal commercial terms. The Interbank Transactions Master Agreement is valid for a period of three years and the parties to the agreement may agree to extend the agreement for further three-year terms if agreement is reached within two months before the expiry of the term of the agreement. Brief descriptions of the material transactions that are covered under the Interbank Transactions Master Agreement are set out below.

Sales and purchases of bonds

Various branches of our Company either purchase bonds from, or sell bonds to, the HSBC Group in the ordinary course of business of our Company and on normal commercial terms.

Sales and purchases of money market instruments

Various branches of our Company, in accordance with the normal practice of the relevant markets and in the ordinary course of business of our Company, purchase from and sell to the HSBC Group certain Exchange Fund Bills and other money market instruments.

Foreign currency transactions

The relevant branches of our Company regularly enter into foreign exchange sale and purchase transactions with the HSBC Group on the standard terms of the foreign exchange market, and the head office of the Company purchases foreign banknotes from, and sells foreign banknotes to, HSBC Bank USA under two Foreign Currency Banknotes Agreements that were entered into in the ordinary course of business of our Company and on normal commercial terms.

Swap and option transactions

The HSBC Group and the relevant branches of our Company enter into various swap and option transactions (including, without limitation, currency swaps both on agency and own account bases, interest rate swaps, currency options and swaptions) on normal commercial terms and in the ordinary course of business.

Credit card settlement services

We have established a credit card settlement arrangement with Hang Seng Bank Limited (“HSB”), a member of the HSBC Group, since 1992 pursuant to which HSB provides VISA card and MasterCard settlement services to us and we pay settlement charges to HSB in accordance with general market practice.

Factoring

Certain branches of our Company and the HSBC Group carry out their factoring transactions through the international factoring network, Factors Chain International. These transactions are entered into in the ordinary course of business of our Company and on normal commercial terms.

Third party loans guaranteed by the HSBC Group

Certain branches of our Company have loan commitments to third party borrowers secured by guarantees from the HSBC Group. These guarantees are entered into on normal commercial terms and in the ordinary course of business of our Company.

Application for Waivers

Upon completion of the Global Offering, we will continue the non-exempt connected transactions and continuing connected transactions with the HSBC Group in the normal course of our banking business (the “Non-exempt Connected Transactions”). In the opinion of the Directors, including our independent non-executive Directors, the Non-exempt Connected Transactions have been entered into in our ordinary course of business, on normal commercial terms, are fair and reasonable and in the interests of our shareholders as a whole.

It is expected that each of the Non-exempt Connected Transactions will constitute a connected transaction pursuant to Rule 14A.13(1)(a) or a continuing connected transaction pursuant to Rule 14A.14, and accordingly such transactions will be subject to the reporting and announcement requirements set out in Rules 14A.45 to 14A.47 of the Hong Kong Listing Rules and the independent shareholders' approval requirements set out in Rule 14A.48 of the Hong Kong Listing Rules, depending on the amount involved on each occasion the relevant connected transaction arises, unless exemptions provided for in the Hong Kong Listing Rules are available.

As we believe prior approval from independent shareholders of the Non-exempt Connected Transactions in full compliance with the Hong Kong Listing Rules would be unduly burdensome, impracticable and add administrative costs for us, we have applied to the Hong Kong Stock Exchange for, and the Hong Kong Stock Exchange has granted, a waiver under Rule 14A.42(3) of the Hong Kong Listing Rules from strict compliance with the announcement (but not reporting) and independent shareholders' approval requirements of the Hong Kong Listing Rules (to the extent applicable) in respect of the Non-exempt Connected Transactions. In addition, we have applied to the Hong Kong Stock Exchange for, and the Hong Kong Stock Exchange has granted, a waiver under Rule 14A.42(3) of the Hong Kong Listing Rules from strict compliance with the requirement to set a maximum aggregate annual value in respect of the Non-exempt Connected Transactions. We will, however, comply with the applicable provisions under Rules 14A.35(1), 14A.36(2), 14A.37, 14A.38, 14A.39, 14A.40, 14A.45 and 14A.46 of the Hong Kong Listing Rules.

We set out below a summary of the Non-exempt Connected Transactions as well as the waivers from strict compliance with the relevant requirements of the Hong Kong Listing Rules that we have applied for.

Parties	Nature of Transaction	Expiry date	Applicable Hong Kong Listing Rules	Waiver sought
(1) Our Company and our subsidiaries (2) HSBC Group	Regular banking transactions (both one-off transactions and continuing transactions) in the normal course of banking business, such as foreign 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), paying and reference agency services and agency services for syndicated loans	May 31, 2008	14A.13(1)(a), 14A.14, 14A.35(1), 14A.35(2), 14A.45, 14A.46, 14A.47, 14A.48	Waiver from requirements to set a maximum aggregate annual value, and announcement and independent shareholders' approval requirements

Confirmation of Joint Sponsors

The Joint Sponsors are of the view that the non-exempt connected transactions and continuing connected transactions with the HSBC Group in the normal course of banking business described above are to be entered into in the ordinary and usual course of our business, on normal commercial terms and on terms that are fair and reasonable as far as our shareholders as a whole are concerned.

SPECIAL EVENTS

Jinzhou Incident

According to the 2003 National Audit Office Audit Report which was released in June 2004, between 2000 and 2002, our branch in the city of Jinzhou, Liaoning Province and three local courts are alleged to have collaborated in falsifying legal documents and court judgments, which were submitted to our head office as the basis for writing off loans to 175 enterprises in the amount of approximately RMB221 million as non-performing loans. These enterprises had not been informed by the courts or our Jinzhou Branch of the legal proceedings for these write-offs and some of them are still paying off the loans. The loan payments (including interest payments) as well as proceeds recovered from foreclosure of the underlying collateral were diverted to separate accounts, which were not reflected in the financial statements of our Jinzhou branch. The National Audit Office referred this incident to the relevant judicial authorities for investigation. During such investigation, seven individuals (including three employees of our Jinzhou branch) have been investigated and one has been arrested. None of our Directors or senior management are implicated or involved in this incident. We believe, based on the advice of our PRC legal counsel, King & Wood, PRC Lawyers, that the likelihood of our Directors or senior management being held liable for the misconduct of our branch staff in this incident is remote.

The then general manager of our Jinzhou branch when this incident occurred has been released on bail pending a trial for alleged misuse of power, while two employees of the risk management department of our Jinzhou branch are being held in criminal detention.

In response to this incident, our head office has substantially reorganized the senior management team in our Jinzhou branch. Executives from our Shenyang branch are currently in charge of the day-to-day operations of our Jinzhou branch. We have also sent a special investigation team to conduct an examination of all write-offs of our Jinzhou branch.

Our head office has taken this Jinzhou incident seriously and adopted a number of initiatives aimed at preventing similar incidents from recurring. We have conducted an internal investigation on non-performing loan write-offs during the period from 2000 to 2003 and amended relevant rules and procedures to enhance our supervision and control over non-performing loan disposals. Moreover, we have developed and are in the process of finalizing an information system and detailed operating procedures for non-performing loan write-offs. We are also developing operating measures for the preservation and recovery of assets obtained by our Company from foreclosures. Furthermore, we have adopted procedures that require on-site inspections for loan write-offs of RMB30 million or more as well as special inspections of the loan write-off operations of our branches. See the section headed "Risk Factors – Risks Relating to Our Business – Our business, reputation and prospects may be adversely affected if we are not able to timely detect and prevent fraud or other misconduct committed by our employees, customers or other third parties".

Taiyuan Incident

From July 2003 to July 2004, a group of individuals allegedly used forged seals to fraudulently abscond with approximately RMB345 million out of deposit accounts opened by four companies with our branch located in the city of Taiyuan, Shanxi Province. Five employees of our Taiyuan branch are under custody of the relevant law enforcement authorities for allegedly having committed conspiracy with the alleged criminals and participating in such financial fraud. Four of them have been referred by the police to the prosecutors' office for prosecution and one of the them is still under custody and investigation by the police.

In response to this incident, we have set up a special working group to fully cooperate with the relevant law enforcement authorities in their investigation. We have also taken a series of measures to enhance our internal controls, including inspections of circumstances surrounding the opening and closing of bank accounts as well as capital transfers and withdrawals by our corporate customers in large amounts. As this incident is currently under investigation by the relevant law enforcement authorities, the impact on our Company cannot be accurately estimated. See the section headed "Risk Factors – Risks Relating to Our Business – Our business, reputation and prospects may be adversely affected if we are not able to timely detect and prevent fraud or other misconduct committed by our employees, customers or other third parties".

Other Incidents

We have also experienced other irregular incidents at some of our branches and sub-branches. For example, there have been incidents in which some employees violated the relevant accounting rules by establishing and concealing separate accounts to hold funds that were generated from unauthorized transactions or diverted from business operations and were not reflected in the financial statements of the relevant branch or sub-branch. In other cases, some employees violated our internal procedures on credit approval, foreclosure or other aspects of our business operations, resulting in losses to us. As a result of such incidents, our relevant branches or sub-branches have been fined or censured by various regulatory authorities from time to time. We have always punished the perpetrators firmly and initiated tailored corrective measures in response to these incidents. We believe that the losses resulting from these irregular incidents have not had, in the aggregate, any material adverse effect on our business, financial condition or results of operations. Nonetheless, we will continue to strengthen our centralized internal control and risk management system with the goal of successfully detecting and preventing such irregular incidents or employee misconduct from recurring in the future.

OTHER MATTERS

Other Investments

The PRC Commercial Banking Law, which became effective in July 1995, prohibits any investment by a PRC financial institution in a non-financial institution, and on November 25, 1998 the PBOC and a governmental task force issued a joint release requiring financial institutions to dispose of their investments in non-financial institutions. However, the PRC Commercial Banking Law, which was amended several times after 1998, does not stipulate any penalties for failing to comply with such disposal requirements. In addition, in a special notice issued by the PBOC in 1987, we were explicitly permitted to set up non-financial institution subsidiaries. As a result, the investments in non-financial institutions we made prior to the enactment of the 1995 PRC Commercial Banking Law did not violate any of the then applicable rules and regulations.

We had holdings or investments in approximately 300 non-financial institutions in 1998 before we started to dispose of our holdings or investments in such non-financial institutions. In March 2005, the CBRC granted us an approval to continue to hold our investments in China UnionPay Co., Ltd. (中國銀聯股份有限公司) and Xiamen Financial Security Escort Co., Ltd. (廈門金融保安守押股份有限公司), both of which are classified as non-financial institutions.

As of the date of this prospectus, we have holdings or investments in 175 non-financial institutions. We are disposing of such holdings or investments primarily through transfer or liquidation, both of which require a significant amount of time to complete. We currently plan to dispose of our holdings or investments in these non-financial institutions other than our investments in China UnionPay Co., Ltd. and Xiamen Financial Security Escort Co., Ltd., within five years after the Listing Date. For the eight non-financial institutions in which we hold, directly or indirectly, 50% or more equity interest, we plan to dispose of our holdings in a majority of such non-financial institutions by the end of 2005.

King & Wood, PRC Lawyers, our PRC legal counsel, is of the opinion that failure to timely dispose of these holdings and investments will not have a material adverse impact on our business operations or financial condition as (1) the relevant PRC laws and regulations do not stipulate penalties for failing to dispose of holdings or investments in non-financial institutions, (2) we have undertaken to dispose of our holdings or investments in non-financial institutions within five years after the Listing Date, (3) the CBRC, in its approval of our proposal for the disposal of our holdings or investments in non-financial institutions, did not penalize us in connection with our disposal arrangement or proposal, and (4) according to relevant PRC laws and regulations, we are only responsible for our capital contribution in these non-financial institutions.

Bancassurance Permit

As of March 31, 2005, 129 of our branches or sub-branches had not obtained permits for concurrent insurance agency business, and these branches and sub-branches have been required not to conduct any insurance agency business until their permit for concurrent insurance agency business has been obtained. We are in the process of applying for permits for these branches and sub-branches. As our insurance agency business has contributed an insignificant amount of revenue in the past, suspension of insurance agency business for these branches and sub-branches will not have a material impact on our operating income.

Under applicable PRC law, penalties, including a ban on certain activities, criminal liabilities or fines, may be imposed on any entity that conducts concurrent insurance agency business without having obtained the requisite permit. The business licenses of these 129 branches and sub-branches permit them to conduct concurrent insurance agency business, and most of these branches and sub-branches had legitimately conducted such business prior to the effective date of applicable rules. As of the date of this prospectus, we have been advised by King & Wood, PRC Lawyers, our PRC legal counsel, that the likelihood of any penalties being imposed on us for our past failures to obtain the permits is remote.

Unqualified Shareholders

In July 1994, the PBOC issued the Temporary Measures on Investments in Financial Institutions, which provide that only certain categories of investors, or qualified investors, may become shareholders of PRC financial institutions. Some of our then existing shareholders were deemed as "unqualified shareholders", and such shareholders held approximately 1.92% of our Shares as of the date of this prospectus. We have received the approval from, and have undertaken to, the CBRC that we will be completing the transfer of the Shares held by these shareholders to qualified investors by the end of 2005.

We have been working with our unqualified shareholders to transfer Shares held by them to qualified investors. As of May 8, 2005, we have received responses from 102 unqualified shareholders, among which, (1) 62 unqualified shareholders have completed the transfer of their holdings to qualified investors and (2) 40 unqualified shareholders have provided regulatory approvals for their investments or other documents proving that they are qualified investors. As of the date of this prospectus, we have not received any penalties in connection with the fact that some of our shareholders are unqualified shareholders. In addition, we have been advised by King & Wood, PRC Lawyers, our PRC legal counsel, that the likelihood of any penalties being imposed on us for failing to complete the transfer of the Shares held by unqualified shareholders to qualified investors by the end of 2005 is remote.