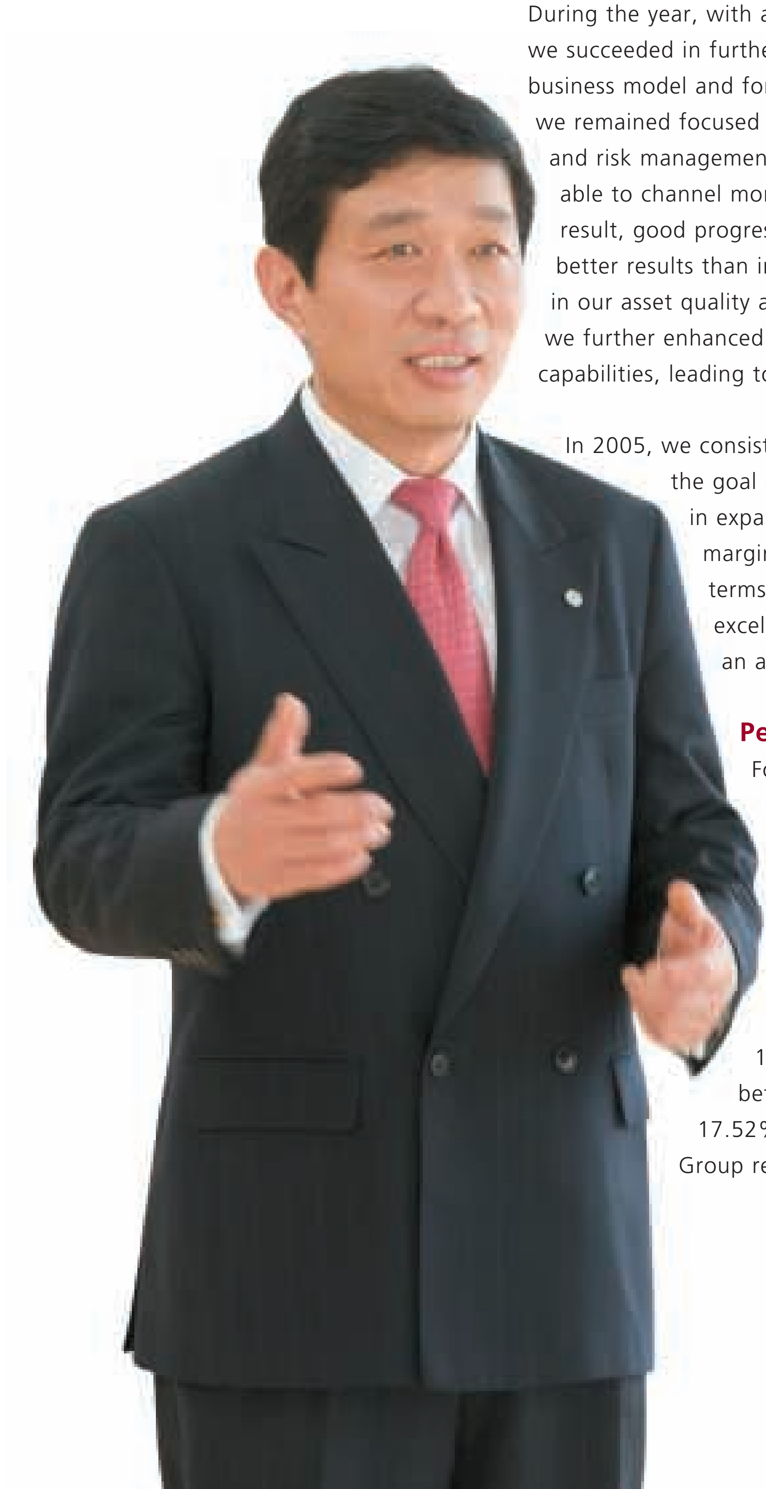
Chief Executive's Report

We are encouraged to witness that the growth momentum of the Hong Kong economy extended into 2005, marking two consecutive years of growth for the first time since 1997. After registering an increase of 8.6% in 2004, Hong Kong's GDP grew by 7.3% in 2005, supported by growth in all major sectors of the economy. Riding on this general economic upturn, we continued to drive business growth by leveraging our core strengths, capturing new business opportunities and overcoming key challenges like keen market competition, a consolidating property market, and higher interest rates.

During the year, with an enhanced management team and operational structure, we succeeded in further strengthening our business strategy. We refined our business model and forged ahead to foster a new corporate culture. All the while, we remained focused on our efforts to improve the Group's corporate governance and risk management. With sound corporate fundamentals, Management was able to channel more of its attention to business growth and development. As a result, good progress was made on all fronts and we delivered substantially better results than in 2004. At the same time, we saw significant improvement in our asset quality and maintained our cost efficiency at a high level. Internally, we further enhanced our human resources management and technological capabilities, leading to higher operational efficiency and productivity.



In 2005, we consistently created higher value for shareholders and achieved the goal of growing our operating income and profit. We succeeded in expanding our income portfolio and raising our net interest margin. Our Mainland business also delivered good results in terms of both income and profit. Meanwhile we continued to excel and maintain our market leadership in areas where we had an advantage.

Performance Highlights

For the year ended 31 December 2005, the Group's profit attributable to shareholders was HK$13,494 million, up 12.8% as compared to 2004, which represents the third consecutive year of double-digit growth since our IPO in 2002 and also a record high for us in absolute terms. Earnings per share for 2005 were HK$1.2763, up 12.8%. Return on average total assets increased to 1.66% whereas return on average shareholders' funds stood at 18.24%. More importantly, the Group's operating profit before impairment on advances was HK$12,166 million, up 17.52% year-on-year, which was a significant improvement for the Group relative to its past performance.

We are proud to have realised the goal of driving organic growth with greater force. Operating income increased by 12.86% to HK$17,896 million, which was attributable mainly to the growth of net interest income and non-interest income as the economic boom boosted the demand for credit and banking services.

Capitalising on the economic upturn, we grew our net interest income by 15% to HK$12,874 million, thus putting us among the best performing banks in Hong Kong. Higher net interest income was the result of the growth of average interest-earning assets and widening net interest margin. Average interest-earning assets grew by 4.3% to HK$752,257 million. Net interest margin rose to 1.71%, up 16 basis points from 1.55% in 2004.

At the same time, our non-interest income increased by 7.7% to HK$5,022 million. Total net fees and commission income experienced a drop of 5.2% on account of the impact of adopting Hong Kong's new accounting standards that came into effect in January 2005. If not for this, the said income would have decreased only very marginally by 0.7%. In fact, our net fees and commission income was up HK$59 million or 3.9% in the second half of 2005 with increases in stock-broking, payment services, loans and bills commissions.

Total net trading income increased substantially by 49.1% to HK$1,674 million after the adoption of the new accounting standards. This growth was led primarily by the rise in contribution from foreign exchange and foreign exchange-related products, which increased by 37.6% to HK$1,464 million.

Internally, we continued to exercise prudent cost management and maintained a low cost-to-income ratio during the year, notwithstanding the necessity to invest in technology and the human resources reform programmes introduced during the year. We have been refining our IT Strategy to make it more in line with the Group's new Strategic Plan. A number of new approaches have been introduced to better manage our IT resources. At the same time, we have continued to improve our remuneration system to ensure that our compensation levels are brought up to market standards. As a result of these initiatives, the Group's operating expenses increased by 4.1%. Cost-to-income ratio, however, remained at the industry-low level of 32.0% as compared to 34.7% a year ago, mainly due to the strong growth in operating income.

We consider it one of our key achievements that the Group's operating profit after impairment on advances was up a substantial 23.63% to HK$14,811 million after taking into account certain write-backs of loan impairment allowances. This was the result of our strong collection efforts on loans previously written off as well as releases on collective assessed allowance. Recoveries of loans previously written off totalled HK$1,639 million, up 20.9% from 2004.

To ensure the Group's healthy growth and development in the long term, we have been relentless in pursuing better asset quality. The Group's asset quality improved substantially during the year, as reflected in its low impaired loan ratio of 1.28%, as compared to 2.95% at end-2004. The reason for our success in this regard is that given the improved economic environment, stable property market and our effective collection and recovery efforts, the Group's impaired loans decreased substantially by HK$4,983 million, or 53.9%. In fact the Group's impaired loan ratio has been dropping from a very high 11.48% in 2001 to the current 1.28%, which clearly demonstrates our success in delivering our IPO promise of bringing this ratio to market level ahead of schedule.

The Group's consolidated capital adequacy ratio was 15.37% as at the end of 2005, down 0.77 percentage point, due to a 9.1% increase in total risk-weighted assets. Average liquidity ratio rose to 42.02% from 36.03%.

Review of Business Performance

In 2005, we forged ahead with business development initiatives in accordance with our long-term strategic plan and succeeded in achieving healthy growth in all our major business segments.

The growth in loans was one of the key factors accounting for the Group's solid overall business performance.

During the year, we continued to drive the growth of our lending business across all segments in both Hong Kong and the Mainland. The Group's total advances to customers grew by 6.6%.

BOCHK pioneered the launch of VISA BOC Olympic Games Card in the Hong Kong and Macau Regions. Officiating at the launch ceremony were Mr He Guangbei, Vice Chairman and Chief Executive of BOCHK (4th from left); Mr Chris Clark, Senior Vice President and General Manager, Greater China Region: Taiwan, Hong Kong/Macau and Philippines, VISA International (3rd from right); The Hon Timothy Fok, GBS, JP, Chairman of Sports Federation and Olympic Committee of Hong Kong, China, and Vice President of the Equestrian Committee (Hong Kong) of the Beijing Organising Committee for the Games of the XXIX Olympiad (3rd from left); Mr Eddie Laam Wah Ying, President, Macau Olympic Committee (2nd from left); Mr Zhang Hongyi, General Manager, Bank of China Macau Branch (2nd from right); Mr Xu Chen, Head of Olympic Office, Bank of China (1st from left) and Mr Dickson So, General Manager, BOC Credit Card (International) Limited (1st from right).

Benefiting from the improved business climate, loans for use in Hong Kong increased by a total of 3.4%, of which loans to the industrial, commercial and financial sectors grew by 4.1%. Loans to individuals – mainly residential mortgages – were up 2.6%. Thanks to our business in the Mainland, loans for use outside Hong Kong showed a more robust increase of over 30%. Spurred by the growth of Hong Kong's merchandise exports, our trade finance business increased by a healthy 21.1% in dollar terms.

Maintaining a strong growth momentum, our retail banking business reported good results in all key areas during the year. An increase in operating income by 24.7% boosted operating profit before impairment on advances to HK$5,559 million, or 34.7% higher than the previous year. Profit after the provisions was HK$6,515 million, up 56.8%.

Wealth management remained one of the top priorities in our development strategy. Notwithstanding higher interest rates and intense competition, the Group's wealth management customer base and assets under management grew by 64% and 50% respectively. The growth was attributable to our effort in product innovation and sales as well as a more customer-focused approach in our wealth management services. Our insurance business saw significant growth as a result of the successful launching of innovative product offerings.

For residential mortgage lending, we registered an increase of 3.7% and remained the market leader through effective marketing and the introduction of more flexible mortgage products. We also adjusted our pricing strategy, particularly in the second half of the year, with a view to raising profitability.

Our credit card business continued to grow satisfactorily. Card advances, card issuance, cardholder spending and merchant acquiring increased by 9.7%, 6.9%, 17.4% and 17.3% respectively. We also extended the reach of our card issuing and merchant acquiring business to Singapore and Thailand respectively during the year. As regards RMB personal banking, we consistently registered strong growth, of 74% and 265% respectively, in deposits and credit card spending. The Group started offering "RMB Merchant Link" banking services to corporate customers since December 2005 with new services tailored to corporate needs.

Our corporate banking business registered steady growth during the year. Operating profit before impairment on advances was HK$3,781 million, up 4.1%, whereas profit after impairment on advances was HK$5,470 million, up 4.5%.

With our expertise and experience in arranging syndicated loans, we were able to maintain our market leadership in Hong Kong and Macau. The Group was ranked number one in the top-tier arranger list.

As mentioned above, trade financing and bills volume recorded solid growth against the backdrop of flourishing export growth and as a result of our system upgrading. Another major product development was the integration of our cash management system with that of the BOC overseas branch system. This enables large corporate clients to access real-time information worldwide, thus making it vastly more convenient for them to centralise their cash management activities.

We introduced a new SME business model last year to better serve SME clients by expediting loan approval and enhancing credit risk management. As a result and through the successful launching of a series of products tailored to SME needs, we grew our SME loan portfolio by 9.1% in 2005. With these initiatives being embedded further in our operating system, we expect to see more positive results.

Our treasury business increased its operating income by 33.2% to HK$3,577 million. Operating profit before impairment on advances was HK$3,269 million, up 36.8%, whereas profit before taxation was HK$3,173 million, up 32.7%.

Having overcome the challenge of rising interest rates and flattening yield curves, treasury managed to achieve its goals in key areas. Specifically we succeeded in diversifying our investment portfolio to raise the return on residual funds. We also rolled out various sophisticated treasury products geared to customers' needs, thus deepening our market penetration and enriching clients' investment portfolio. By leveraging the Group's retail and corporate distribution channels, we grew the number of treasury clients by 46% by end-2005.

The growth momentum of our Mainland businesses remained robust in 2005. Total advances to customers increased significantly by 61.4% while operating profit before impairment on advances was more than doubled. To pave the way for greater expansion, we have been enhancing our sales capabilities and service offerings in the Mainland market. At the same time, our business collaboration with BOC continued to solidify with benefits accruing not only to the BOC group as a whole, but also to our mutual clients. In December 2005, we joined hands with BOC to launch the cross-border service for wealth management customers in the Asia Pacific region. This service enables the wealth management customers of both BOC and BOCHK to enjoy privileged and priority banking services whenever they are in Hong Kong, the Mainland and many other major cities in the region. This example illustrates clearly how cooperation between BOCHK and BOC can bring about mutual benefits to both parties.

Our People

People are our most valuable asset. That we have been able to grow our business on all fronts, consistently creating higher value for shareholders and customers, owes a great deal to our employees' dedication, innovation, self-motivation and relentless pursuit of excellence.

Mr Lam Yim Nam, Deputy Chief Executive (right), and Mr Lin Guangming, General Manager, Corporate Banking and Financial Institutions Department (left), officiated at the "Launch of Expanded RMB Services".

As a dynamic and forward looking financial services group, the Group considers the constant enhancement of its corporate culture and human resources management to be its long-term goals and responsibilities.

In 2005, we started a bank-wide staff communication and promotion programme for the purpose of strengthening the Group's corporate culture built on the Group's vision, mission and core values as formulated by the Board. The fruit of our effort so far in this respect is to a large degree demonstrated in the improvement of the Group's overall business performance in 2005.

We are also pleased to report that we have come a long way since the inception of the Group's bank-wide HR reform programme in 2004. Through the effective implementation of various reform measures, our remuneration levels and placement system are now more in line with the market.

The Group is also committed to ensuring a rewarding career and a better working environment for the staff. We are therefore determined to constantly review and adjust our remuneration to ensure that it is fair, competitive, performance-based and in line with market trends. More emphasis is being placed also in staff development with the aim of improving job satisfaction and enhancing career development. In April 2005, with the Board's endorsement, we raised the general pay level of our staff and gave special recognition to outstanding achievers. Towards the end of the year, we introduced a special salary adjustment to part of the staff in response to market situation.

Prospects and Implementation of Strategic Plan

The interplay of a number of key factors will shape the prospects of the banking sector in the coming years. At the macro level, we believe the global economy will continue to grow but perhaps at a more modest pace. The growth momentum of local banks looks sustainable in anticipation of the steady growth of the Mainland economy. However, demand for credit might soften in view of rising interest rates while trade finance would also be affected by the subdued growth of external trade. Private consumption, however, should remain upbeat because of the improvement in employment and rising household income. The property market is expected to experience a turnaround after a period of low supply and accumulated demand. On the other hand, banks should be mindful that the implementation of Basel II before the end of 2006 would render their capital adequacy ratio more susceptible to changes in the macroeconomic environment.

As a forward looking company, we are constantly reviewing and enhancing our business strategy and model to ensure our growth momentum in both the short and longer terms. From 2006 onwards, we will forge ahead with the Group's Strategic Plan 2006-2011 mapped out by the Board's Strategy Development Group in 2005. We will move forward with the objective to become a top-quality financial services group with its base firmly entrenched in Hong Kong. On this foundation we will solidify our presence in China and will look for opportunities to establish a strategic foothold in other Asian markets.

Our strategic focus will be on five key areas: (1) the strengthening of our leading position in Hong Kong; (2) the development of new capabilities in product manufacturing and distribution; (3) the building of a stronger presence in China; (4) the exploration of opportunities for regional expansion; and (5) the promotion of our corporate values and core competencies.

We will rely on organic growth to boost our existing business line but consider it equally important to build up our product manufacturing and distribution capabilities to support our growth in Hong Kong. Towards this end, we will consider opportunities to secure new expertise through acquisition of new talents or business operations that are complementary to our existing operation locally, in the Mainland and eventually in the region. We aim to achieve a broader service mix to include services like life insurance, asset management and securities operations. At the same time, we will also build up our treasury product manufacturing capabilities to broaden our corporate finance product range.

Internally, we will continue to promote our corporate culture and values across the Group so that they are properly integrated with our new strategy and business development plans. We will also further enhance our core competencies which are crucial for our transformation into a top-quality financial services group.

People development will be a crucial element in the successful implementation of our Strategic Plan. We will be significantly increasing our resources in staff recruitment and training, and will put in place development programmes that will facilitate career planning and broaden career advancement opportunities. As a service organisation, we will place more emphasis on improving our sales and service skills and will use automation extensively to improve work environment. Our goal will be to enrich the job satisfaction of our employees, which ultimately will enable us to attain our objective of becoming a top ranked financial services group.

Conclusion

In concluding, I am pleased that the corporate reforms, management restructuring and business development programme that we have been implementing progressively in the past two years have now given us a solid business foundation upon which our future strategy can be built on. We are now in an excellent position to become a leading financial services group in the region. With the continued guidance of the Board of Directors as well as the dedication and support of all our colleagues, I am certain that we can move on full steam to implement the Group's strategic plan for 2006-2011 successfully, grow our business on all fronts and create higher value for shareholders and customers.

HE Guangbei
Vice Chairman and
Chief Executive

Hong Kong, 23 March 2006