

Report of the Board of Directors

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

1 PRINCIPAL ACTIVITIES

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

2 RESULTS AND DISTRIBUTION

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

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

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

3 CLOSURE OF REGISTER OF MEMBERS

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

4 RESERVES

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

5 CHARITABLE DONATIONS

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

Report of the Board of Directors (Continued)

6 FIXED ASSETS

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

7 SHARE CAPITAL

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

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

8 DISTRIBUTABLE RESERVES

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

9 FINANCIAL SUMMARY

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

10 DIRECTORS

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

11 BOARD COMMITTEES

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

12 DIRECTORS' AND SUPERVISORS' SERVICE CONTRACTS

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

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

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

14 MATERIAL INTERESTS IN CONTRACTS OF THE DIRECTORS AND SUPERVISORS

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

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

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

16 DIRECTORS' AND SUPERVISORS' RIGHTS TO ACQUIRE SHARES

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

17 DIRECTORS' INTERESTS

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

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

Report of the Board of Directors (Continued)

17 DIRECTORS' INTERESTS (Continued)

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

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

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

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

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

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

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

Notes:

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

Report of the Board of Directors (Continued)

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

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

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

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

20 PURCHASE, SALE OR REDEMPTION OF SHARES OF THE BANK

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

21 PRE-EMPTIVE RIGHTS AND SHARE OPTIONS ARRANGEMENTS

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

22 SHARE APPRECIATION RIGHTS ("SARS")

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

23 MAJOR CUSTOMERS AND SUPPLIERS

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

24 CONTINUING CONNECTED TRANSACTIONS

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

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

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

Report of the Board of Directors (Continued)

24 CONTINUING CONNECTED TRANSACTIONS (Continued)

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

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

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

25 SIGNIFICANT EVENTS

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

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

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

27 TAX RELIEF MATERIALS

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

28 AUDITORS

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

29 ANNUAL GENERAL MEETING

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

30 PUBLICATION OF INFORMATION ON THE WEBSITE OF THE STOCK EXCHANGE

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

By order of Board of Directors

Chairman



Jiang Chaoliang

Shanghai, the PRC
28 March, 2006