

The following is the text of a report, prepared for the purpose of incorporation in this prospectus, received from the Company's independent reporting accountants, KPMG, Certified Public Accountants, Hong Kong. As described in "Appendix XII — Documents Delivered to the Registrar of Companies and Available for Inspection", a copy of the Accountants' Report is available for inspection.



8th Floor
Prince's Building
10 Chater Road
Central
Hong Kong

September 8, 2006

The Directors
China Merchants Bank Co., Ltd.
China International Capital Corporation (Hong Kong) Limited
UBS AG

Dear Sirs

Introduction

We set out below our report on the financial information relating to China Merchants Bank Co., Ltd. (the "Bank") and its subsidiary (herein after collectively referred to as the "Group"), in Sections I to VII, including the consolidated balance sheets and balance sheets as at December 31, 2003, 2004 and 2005, and March 31, 2006, and the related consolidated income statements, consolidated statements of changes in equity and consolidated statements of cash flows of the Group for each of the years ended December 31, 2003, 2004 and 2005, and for the three months ended March 31, 2006 (the "Relevant Periods"), and the notes thereto (collectively the "Financial Information"), together with the unaudited financial information of the Group including the consolidated income statement, consolidated statement of changes in equity and consolidated statement of cash flows for the three months ended March 31, 2005 and the notes thereto (the "March 31, 2005 Corresponding Information"), for inclusion in the prospectus of the Bank dated September 8, 2006.

The Bank was established in the People's Republic of China (the "PRC" or the "Mainland" or China), excluding for the purpose of this report, the Hong Kong Special Administrative Region of the PRC, or Hong Kong, the Macau Special Administrative Region of the PRC, or Macau, and Taiwan, on March 31, 1987 as a commercial bank. It undertook a capital restructuring and became a joint stock commercial bank in April 1994. With the approval of the China Securities Regulatory Commission (the "CSRC"), the "A" shares of the Bank were listed on Shanghai Stock Exchange on April 9, 2002. The registered office of the Bank is located at China Merchants Bank Tower, Shenzhen, the PRC.

The Bank and its subsidiary have adopted December 31 as their financial year end date.

The Group prepared financial statements in accordance with the Accounting Standards for Business Enterprises issued by the Ministry of Finance of the PRC (the “MOF”), the Accounting Regulations for Financial Enterprises (2001), and other relevant regulations issued by the MOF (collectively “PRC GAAP”). The Group also prepared a set of its consolidated financial statements in accordance with International Financial Reporting Standards (“IFRSs”) and their interpretations promulgated by the International Accounting Standards Board (“IASB”) as required by the CSRC.

CMB International Capital Corporation Limited is a wholly-owned subsidiary of the Bank during the Relevant Periods.

We have acted as auditors of the Group for its consolidated financial statements prepared in accordance with IFRSs throughout the Relevant Periods.

KPMG Huazhen have acted as the statutory auditors of the Bank for its financial statements prepared in accordance with the PRC GAAP throughout the Relevant Periods.

No financial statements of the Bank and its subsidiary have been audited subsequent to March 31, 2006.

Basis of preparation

The Financial Information, together with the March 31, 2005 Corresponding Information, have been prepared by the Directors of the Bank in accordance with IFRSs and their interpretations promulgated by the IASB based on the audited financial statements, or where appropriate, unaudited financial statements of the Bank and its subsidiary. Adjustments have been made, for the purpose of this report, to restate the financial statements of the Bank and its subsidiary in accordance with the basis set out in Note 2(a) to conform with IFRSs and the disclosure requirements of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.

Responsibility

The Directors are responsible for preparing the Financial Information which gives a true and fair view. In preparing the Financial Information which gives a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently, that judgements and estimates are made which are prudent and reasonable and that the reasons for any significant departure from applicable accounting standards are stated.

It is our responsibility to form an independent opinion, based on our audit, on the Financial Information.

Basis of opinion

As a basis for forming an opinion on the Financial Information of the Bank and its subsidiary, for the purpose of this report, we have carried out appropriate audit procedures in respect of the audited financial statements of the Bank and its subsidiary for the years ended December 31, 2003, 2004 and 2005, and for the three months ended March 31, 2006 and have carried out such additional procedures as we considered necessary in accordance with the Auditing Guideline “Prospectuses and the Reporting Accountant” issued by the Hong Kong Institute of Certified Public Accountants (the “HKICPA”). The audited consolidated financial statements of the Group were audited by us in

accordance with International Standards on Auditing. We have not audited any financial statements of the Bank and its subsidiary in respect of any period subsequent to March 31, 2006.

An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Financial Information. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Financial Information, and of whether the accounting policies are appropriate to the circumstances of the Bank and its subsidiary, consistently applied and adequately disclosed.

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

Review work performed

For the purpose of this report, we have also reviewed the March 31, 2005 Corresponding Information, for which the Directors are responsible, in accordance with Statement of Auditing Standard 700 "Engagements to review interim financial reports" issued by the HKICPA.

A review consists principally of making enquiries of Directors and management, and applying analytical procedures to March 31, 2005 Corresponding Information and based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the March 31, 2005 Corresponding Information.

Opinion

In our opinion, for the purpose of this report, all adjustments considered necessary have been made and the Financial Information, on the basis set out in Note 2(a), gives a true and fair view of the state of affairs of the Group as at December 31, 2003, 2004 and 2005, and March 31, 2006, of its consolidated results and consolidated cash flows for each of the three years ended December 31, 2003, 2004 and 2005 and for the three months ended March 31, 2006 and the state of affairs of the Bank as at December 31, 2003, 2004 and 2005, and March 31, 2006, and have been properly prepared in accordance with IFRSs.

Review conclusion

On the basis of our review of the March 31, 2005 Corresponding Information which does not constitute an audit, for the purpose of this report, we are not aware of any material modifications that should be made to the unaudited financial information presented for the three months ended March 31, 2005.

I CONSOLIDATED INCOME STATEMENTS**(Expressed in millions of Renminbi unless otherwise stated)**

| | Note | Years ended December 31, | | | Three months ended March 31, | |
|---|-----------|--------------------------|---------------------|---------------------|------------------------------|---------------------|
| | | 2003 | 2004 | 2005 | 2005 (unaudited) | 2006 |
| Interest income | 3 | 15,058 | 21,080 | 25,877 | 5,621 | 7,241 |
| Interest expense | 4 | (4,939) | (6,788) | (9,235) | (1,901) | (2,815) |
| Net interest income | | <u>10,119</u> | <u>14,292</u> | <u>16,642</u> | <u>3,720</u> | <u>4,426</u> |
| Fee and commission income | 5 | 793 | 1,187 | 1,856 | 303 | 558 |
| Fee and commission expense | | (234) | (298) | (289) | (39) | (84) |
| Net fee and commission income | | <u>559</u> | <u>889</u> | <u>1,567</u> | <u>264</u> | <u>474</u> |
| Other net income | 6 | <u>491</u> | <u>495</u> | <u>1,005</u> | <u>249</u> | <u>162</u> |
| Operating income | | <u>11,169</u> | <u>15,676</u> | <u>19,214</u> | <u>4,233</u> | <u>5,062</u> |
| Operating expenses | 7 | (5,516) | (7,432) | (9,115) | (2,035) | (2,248) |
| Operating profit before provisions | | <u>5,653</u> | <u>8,244</u> | <u>10,099</u> | <u>2,198</u> | <u>2,814</u> |
| Provision for impairment losses | 11 | (2,236) | (3,066) | (3,637) | (627) | (587) |
| Profit before tax | | <u>3,417</u> | <u>5,178</u> | <u>6,462</u> | <u>1,571</u> | <u>2,227</u> |
| Income tax | 12 | (1,206) | (1,902) | (2,713) | (632) | (795) |
| Net profit attributable to equity holders of the Bank | | <u><u>2,211</u></u> | <u><u>3,276</u></u> | <u><u>3,749</u></u> | <u><u>939</u></u> | <u><u>1,432</u></u> |
| Dividends | | | | | | |
| Declared and paid | 34(a) | 685 | 525 | 753 | — | — |
| Proposed in respect of current year | 34(b) | 525 | 753 | 830 | — | — |
| Proposed in respect of the year 2005 on new shares converted from convertible bonds in 2006 | 34(b)(iv) | <u>—</u> | <u>—</u> | <u>—</u> | <u>—</u> | <u>153</u> |
| | | <u>RMB</u> | <u>RMB</u> | <u>RMB</u> | <u>RMB</u> | <u>RMB</u> |
| Earnings per share | | | | | | |
| Basic | 13(a) | 0.20 | 0.29 | 0.34 | 0.08 | 0.12 |
| Diluted | 13(b) | <u>0.20</u> | <u>0.29</u> | <u>0.33</u> | <u>0.08</u> | <u>0.12</u> |

II(a) CONSOLIDATED BALANCE SHEETS

(Expressed in millions of Renminbi unless otherwise stated)

| | | December 31, | | | March 31, |
|---|-------|--------------|---------|---------|-----------|
| | Note | 2003 | 2004 | 2005 | 2006 |
| Assets | | | | | |
| Cash and balances with banks and other financial institutions | | | | | |
| | 14 | 16,829 | 15,372 | 22,491 | 22,736 |
| Balances with central bank | | | | | |
| | 15 | 50,652 | 54,987 | 62,102 | 54,850 |
| Placements with banks and other financial institutions | | | | | |
| | 16 | 25,645 | 28,819 | 46,982 | 39,442 |
| Loans and advances to customers | | | | | |
| | 17 | 298,960 | 363,097 | 458,675 | 500,592 |
| Investments | | | | | |
| | 18 | 91,389 | 112,645 | 131,902 | 134,650 |
| Fixed assets | | | | | |
| | 19 | 5,247 | 6,366 | 6,777 | 6,719 |
| Deferred tax assets | | | | | |
| | 20(a) | 1,506 | 1,937 | 2,166 | 2,320 |
| Other assets | | | | | |
| | 21 | 3,789 | 3,492 | 3,518 | 5,371 |
| Total assets | | | | | |
| | | 494,017 | 586,715 | 734,613 | 766,680 |
| Liabilities | | | | | |
| Deposits from banks and other financial institutions | | | | | |
| | 22 | 28,499 | 25,053 | 39,673 | 36,259 |
| Amounts due to central bank | | | | | |
| | 23 | 5,989 | — | — | — |
| Placements from banks and other financial institutions | | | | | |
| | 24 | 28,559 | 7,943 | 3,574 | 1,621 |
| Deposits from customers | | | | | |
| | 25 | 406,886 | 512,586 | 634,404 | 667,271 |
| Financial liabilities at fair value through profit or loss | | | | | |
| | 18(e) | 75 | 75 | 86 | 116 |
| Certificates of deposit issued | | | | | |
| | 26(a) | — | 1,242 | 1,211 | 1,202 |
| Convertible bonds issued | | | | | |
| | 26(b) | — | 5,550 | 5,184 | 42 |
| Other debts issued | | | | | |
| | 26(c) | — | — | 9,982 | 9,983 |
| Current taxation | | | | | |
| | | 590 | 2,095 | 2,715 | 3,267 |
| Other liabilities | | | | | |
| | 27 | 5,065 | 6,713 | 8,286 | 10,798 |
| Subordinated notes issued | | | | | |
| | 26(d) | — | 3,500 | 3,500 | 3,500 |
| Total liabilities | | | | | |
| | | 475,663 | 564,757 | 708,615 | 734,059 |
| Shareholders' equity | | | | | |
| Share capital | | | | | |
| | 29 | 5,707 | 6,848 | 10,374 | 12,279 |
| Capital reserve | | | | | |
| | 30 | 9,269 | 9,046 | 6,095 | 9,433 |
| Surplus reserve | | | | | |
| | 31 | 516 | 962 | 1,591 | 1,591 |
| Investment revaluation reserve | | | | | |
| | 32 | — | (65) | 404 | 352 |
| Regulatory general reserve | | | | | |
| | 33 | — | — | 3,000 | 3,000 |
| Retained profits | | | | | |
| | | 1,891 | 3,785 | 2,918 | 4,197 |
| Proposed profit appropriations | | | | | |
| | 34(b) | 971 | 1,382 | 1,616 | 1,769 |
| Total shareholders' equity | | | | | |
| | | 18,354 | 21,958 | 25,998 | 32,621 |
| Total shareholders' equity and liabilities | | | | | |
| | | 494,017 | 586,715 | 734,613 | 766,680 |

II(b) BALANCE SHEETS OF THE BANK

(Expressed in millions of Renminbi unless otherwise stated)

| | | December 31, | | | March 31, |
|---|------|----------------|----------------|----------------|----------------|
| | Note | 2003 | 2004 | 2005 | 2006 |
| Assets | | | | | |
| Cash and balances with banks and other financial institutions | | 16,829 | 15,354 | 22,476 | 22,720 |
| Balances with central bank | | 50,652 | 54,987 | 62,102 | 54,850 |
| Placements with banks and other financial institutions | | 25,645 | 28,819 | 46,982 | 39,442 |
| Loans and advances to customers | | 298,960 | 363,097 | 458,675 | 500,592 |
| Investments | | 91,389 | 112,602 | 131,869 | 134,617 |
| Investment in subsidiary | 1(c) | 53 | 53 | 53 | 53 |
| Fixed assets | | 5,247 | 6,366 | 6,729 | 6,671 |
| Deferred tax assets | | 1,506 | 1,937 | 2,166 | 2,320 |
| Other assets | | 3,721 | 3,443 | 3,513 | 5,369 |
| Total assets | | <u>494,002</u> | <u>586,658</u> | <u>734,565</u> | <u>766,634</u> |
| Liabilities | | | | | |
| Deposits from banks and other financial institutions | | 28,499 | 25,053 | 39,673 | 36,259 |
| Amounts due to central bank | | 5,989 | — | — | — |
| Placements from banks and other financial institutions | | 28,559 | 7,943 | 3,574 | 1,621 |
| Deposits from customers | | 406,886 | 512,586 | 634,404 | 667,271 |
| Financial liabilities at fair value through profit or loss | | 75 | 75 | 86 | 116 |
| Certificates of deposit issued | | — | 1,242 | 1,211 | 1,202 |
| Convertible bonds issued | | — | 5,550 | 5,184 | 42 |
| Other debts issued | | — | — | 9,982 | 9,983 |
| Current taxation | | 590 | 2,095 | 2,715 | 3,267 |
| Other liabilities | | 5,050 | 6,700 | 8,285 | 10,797 |
| Subordinated notes issued | | — | 3,500 | 3,500 | 3,500 |
| Total liabilities | | <u>475,648</u> | <u>564,744</u> | <u>708,614</u> | <u>734,058</u> |
| Shareholders' equity | | | | | |
| Share capital | | 5,707 | 6,848 | 10,374 | 12,279 |
| Capital reserve | | 9,269 | 9,046 | 6,095 | 9,433 |
| Surplus reserve | | 516 | 962 | 1,591 | 1,591 |
| Investment revaluation reserve | | — | (65) | 404 | 352 |
| Regulatory general reserve | | — | — | 3,000 | 3,000 |
| Retained profits | | 1,891 | 3,741 | 2,871 | 4,152 |
| Proposed profit appropriations | | 971 | 1,382 | 1,616 | 1,769 |
| Total shareholders' equity | | <u>18,354</u> | <u>21,914</u> | <u>25,951</u> | <u>32,576</u> |
| Total shareholders' equity and liabilities | | <u>494,002</u> | <u>586,658</u> | <u>734,565</u> | <u>766,634</u> |

III CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Expressed in millions of Renminbi unless otherwise stated)

| | Note | For the year ended December 31, 2003 | | | | | | |
|--|------|--------------------------------------|-----------------|-----------------|--------------------------------|----------------------------|------------------|--------------------------------|
| | | Share capital | Capital reserve | Surplus reserve | Investment revaluation reserve | Regulatory general reserve | Retained profits | Proposed profit appropriations |
| At January 1, 2003 | | 5,707 | 9,269 | 210 | — | — | 651 | 991 |
| Net profit for the year | | — | — | — | — | — | 2,211 | — |
| Adjustments for | | | | | | | | |
| appropriations to statutory surplus reserve and statutory public welfare fund for the year 2001 | | — | — | (41) | — | — | — | 41 |
| Appropriations to statutory surplus reserve and statutory public welfare fund for the year 2002 | | — | — | 347 | — | — | — | (347) |
| Dividends paid for the year 2002 34(a) | | — | — | — | — | — | — | (685) |
| Proposed appropriations to statutory surplus reserve and statutory public welfare fund for the year 2003 34(b) | | — | — | — | — | — | (446) | 446 |
| Proposed dividends for the year 2003 34(b) | | — | — | — | — | — | (525) | 525 |
| At December 31, 2003 | | <u>5,707</u> | <u>9,269</u> | <u>516</u> | <u>—</u> | <u>—</u> | <u>1,891</u> | <u>971</u> |
| | | | | | | | | <u>18,354</u> |

III CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (CONTINUED)
(Expressed in millions of Renminbi unless otherwise stated)

| | Note | For the year ended December 31, 2004 | | | | | | |
|--|-----------|--------------------------------------|-----------------|-----------------|--------------------------------|----------------------------|------------------|--------------------------------|
| | | Share capital | Capital reserve | Surplus reserve | Investment revaluation reserve | Regulatory general reserve | Retained profits | Proposed profit appropriations |
| At January 1, 2004 | | 5,707 | 9,269 | 516 | — | — | 1,891 | 971 |
| Net profit for the year | | — | — | — | — | — | 3,276 | — |
| Appropriations to statutory surplus reserve and statutory public welfare fund for the year 2003 . . . | | — | — | 446 | — | — | — | (446) |
| Dividends paid for the year 2003 | 34(a) | — | — | — | — | — | — | (525) |
| Capital reserve transferred to share capital upon issue of shares | 29, 30 | 1,141 | (1,141) | — | — | — | — | — |
| Equity component of convertible bonds issued | 26(b), 30 | — | 918 | — | — | — | — | — |
| Changes in fair value of available-for-sale financial assets | 32 | — | — | — | (65) | — | — | — |
| Proposed appropriations to statutory surplus reserve and statutory public welfare fund for the year 2004 | 34(b) | — | — | — | — | — | (629) | 629 |
| Proposed dividends for the year 2004 | 34(b) | — | — | — | — | — | (753) | 753 |
| At December 31, 2004 | | <u>6,848</u> | <u>9,046</u> | <u>962</u> | <u>(65)</u> | <u>—</u> | <u>3,785</u> | <u>1,382</u> |
| | | | | | | | | <u>21,958</u> |

III CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (CONTINUED)
(Expressed in millions of Renminbi unless otherwise stated)

| | Note | For the year ended December 31, 2005 | | | | | | | Total |
|--|--------|--------------------------------------|-----------------|-----------------|--------------------------------|----------------------------|------------------|--------------------------------|---------------|
| | | Share capital | Capital reserve | Surplus reserve | Investment revaluation reserve | Regulatory general reserve | Retained profits | Proposed profit appropriations | |
| At January 1, 2005 | | 6,848 | 9,046 | 962 | (65) | — | 3,785 | 1,382 | 21,958 |
| Net profit for the year | | — | — | — | — | — | 3,749 | — | 3,749 |
| Appropriations to statutory surplus reserve and statutory public welfare fund for the year 2004 | | — | — | 629 | — | — | — | (629) | — |
| Dividends paid for the year 2004 | 34(a) | — | — | — | — | — | — | (753) | (753) |
| Transfer of retained profits to regulatory general reserve | | — | — | — | — | 3,000 | (3,000) | — | — |
| Capital reserve transferred to share capital upon issue of shares | 29, 30 | 3,424 | (3,424) | — | — | — | — | — | — |
| Conversion of convertible bonds | | 102 | 473 | — | — | — | — | — | 575 |
| Realised on disposal of available-for-sale financial assets | 32 | — | — | — | 110 | — | — | — | 110 |
| Changes in fair value of available-for-sale financial assets | 32 | — | — | — | 359 | — | — | — | 359 |
| Proposed appropriations to statutory surplus reserve and statutory public welfare fund for the year 2005 | 34(b) | — | — | — | — | — | (786) | 786 | — |
| Proposed dividends for the year 2005 | 34(b) | — | — | — | — | — | (830) | 830 | — |
| At December 31, 2005 | | <u>10,374</u> | <u>6,095</u> | <u>1,591</u> | <u>404</u> | <u>3,000</u> | <u>2,918</u> | <u>1,616</u> | <u>25,998</u> |

III CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (CONTINUED)

(Expressed in millions of Renminbi unless otherwise stated)

| For the three months ended March 31, 2005 | | | | | | | | |
|--|---------------|-----------------|-----------------|--------------------------------|----------------------------|------------------|--------------------------------|---------------|
| Note | Share capital | Capital Reserve | Surplus reserve | Investment revaluation reserve | Regulatory general reserve | Retained profits | Proposed profit appropriations | Total |
| At January 1, 2005 | 6,848 | 9,046 | 962 | (65) | — | 3,785 | 1,382 | 21,958 |
| Net profit for the period (unaudited) | — | — | — | — | — | 939 | — | 939 |
| Realised on disposal of available-for-sale financial assets (unaudited) | 32 | — | — | 83 | — | — | — | 83 |
| Changes in fair value of available-for-sale financial assets (unaudited) | 32 | — | — | 80 | — | — | — | 80 |
| At March 31, 2005 (unaudited) | <u>6,848</u> | <u>9,046</u> | <u>962</u> | <u>98</u> | <u>—</u> | <u>4,724</u> | <u>1,382</u> | <u>23,060</u> |
| For the three months ended March 31, 2006 | | | | | | | | |
| Note | Share capital | Capital reserve | Surplus reserve | Investment revaluation reserve | Regulatory general reserve | Retained profits | Proposed profit appropriations | Total |
| At January 1, 2006 | 10,374 | 6,095 | 1,591 | 404 | 3,000 | 2,918 | 1,616 | 25,998 |
| Net profit for the period | — | — | — | — | — | 1,432 | — | 1,432 |
| Capital reserve transferred to share capital upon issue of shares | 29, 30 | 971 | (971) | — | — | — | — | — |
| Conversion of convertible bonds | 934 | 4,309 | — | — | — | — | — | 5,243 |
| Realised on disposal of available-for-sale financial assets | 32 | — | — | 6 | — | — | — | 6 |
| Changes in fair value of available-for-sale financial assets | 32 | — | — | (58) | — | — | — | (58) |
| Proposed dividends for the year 2005 | 34(b)(iv) | — | — | — | — | (153) | 153 | — |
| At March 31, 2006 | <u>12,279</u> | <u>9,433</u> | <u>1,591</u> | <u>352</u> | <u>3,000</u> | <u>4,197</u> | <u>1,769</u> | <u>32,621</u> |

IV CONSOLIDATED CASH FLOW STATEMENTS

(Expressed in millions of Renminbi unless otherwise stated)

| | Note | Years ended December 31, | | | Three months ended March 31, | |
|---|------|--------------------------|-----------------|-----------------|------------------------------|-----------------|
| | | 2003 | 2004 | 2005 | 2005 (unaudited) | 2006 |
| Operating activities | | | | | | |
| Profit before tax | | 3,417 | 5,178 | 6,462 | 1,571 | 2,227 |
| Adjustments for: | | | | | | |
| — Impairment losses charged on loans and advances | | 2,139 | 2,764 | 3,575 | 608 | 708 |
| — Impairment losses charged/(released) on deposits and placements with banks and other financial institutions | | 76 | (15) | 62 | 19 | (121) |
| — Impairment losses charged on other assets | | 21 | 317 | — | — | — |
| — Unwind of interest income on impaired loans | | (95) | (108) | (244) | (57) | (57) |
| — Depreciation | | 670 | 731 | 854 | 170 | 220 |
| — Amortisation of discount and premium of debt investments | | 106 | 118 | 152 | 28 | 18 |
| — Amortisation of discount and premium of bonds issued | | — | 33 | 194 | 49 | 6 |
| — Write-off of loans and advances, net of recoveries | | (333) | (257) | (661) | 40 | 149 |
| — Net (gain)/loss on debt investments | | (50) | 121 | (276) | (82) | (20) |
| — Net gain on disposal of fixed assets | | (5) | (9) | (4) | — | — |
| — Interest income on debt investments | | (2,603) | (2,764) | (3,133) | (656) | (853) |
| — Interest expense on issued debts | | — | 145 | 407 | 89 | 120 |
| Changes in operating assets and liabilities: | | | | | | |
| Net decrease/(increase) in balances with and amounts due to central bank | | 4,807 | (5,989) | — | — | — |
| (Increase)/decrease in balances and placements with banks and other financial institutions with original maturity over 3 months | | (1,438) | 1,194 | (8,266) | 1,210 | 893 |
| (Increase)/decrease in discounted bills | | (17,189) | 1,338 | (38,641) | (15,924) | (21,865) |
| Increase in loans and advances to customers | | (83,358) | (67,874) | (59,605) | (18,092) | (20,852) |
| Decrease/(increase) in other assets | | 77 | 126 | 379 | (2,047) | (1,446) |
| Increase in deposits from customers | | 102,590 | 105,700 | 121,818 | 16,560 | 32,867 |
| Increase/(decrease) in deposits and placements from banks and other financial institutions | | 18,560 | (24,062) | 10,251 | 2,395 | (5,367) |
| Increase in other liabilities | | 1,012 | 1,635 | 1,408 | 796 | 2,526 |
| Net cash inflow/(outflow) from operating activities | | <u>28,404</u> | <u>18,322</u> | <u>34,732</u> | <u>(13,323)</u> | <u>(10,847)</u> |
| Income tax paid | | <u>(793)</u> | <u>(816)</u> | <u>(2,405)</u> | <u>(100)</u> | <u>(387)</u> |
| Investing activities | | | | | | |
| Payment for purchase of debt investments | | (119,247) | (90,267) | (132,115) | (30,585) | (36,315) |
| Proceeds from redemption or disposal of debt investments | | 117,293 | 70,886 | 113,998 | 27,060 | 30,388 |
| Interest received from debt investments | | 2,886 | 2,648 | 3,116 | 287 | 583 |
| Payment for purchase of equity investments | | (9) | (44) | — | — | — |
| Payment for purchase of fixed assets | | (745) | (2,002) | (1,256) | (152) | (177) |
| Proceeds from sale of fixed assets | | 75 | 161 | 43 | 19 | 15 |
| Net cash inflow/(outflow) from investing activities | | <u>253</u> | <u>(18,618)</u> | <u>(16,214)</u> | <u>(3,371)</u> | <u>(5,506)</u> |
| Net cash inflow/ (outflow) before financing | | <u>27,864</u> | <u>(1,112)</u> | <u>16,113</u> | <u>(16,794)</u> | <u>(16,740)</u> |

IV CONSOLIDATED CASH FLOW STATEMENTS (CONTINUED)

(Expressed in millions of Renminbi unless otherwise stated)

| | Note | Years ended December 31, | | | Three months ended March 31, | |
|---|-------|--------------------------|---------------|----------------|------------------------------|-----------------|
| | | 2003 | 2004 | 2005 | 2005 | 2006 |
| | | | | | (unaudited) | |
| Financing activities | | | | | | |
| Payment of issuing expenses on convertible bonds and other debts | | — | (65) | (19) | — | — |
| Proceeds from issue of certificates of deposit | | — | 1,242 | — | — | — |
| Proceeds from issue of convertible bonds | | — | 6,500 | — | — | — |
| Proceeds from issue of subordinated notes | | — | 3,500 | — | — | — |
| Proceeds from issue of other debts | | — | — | 10,000 | — | — |
| Dividends paid | | (686) | (523) | (742) | — | (3) |
| Interest paid on certificates of deposit, subordinated notes and convertible bonds issued | | — | (134) | (257) | (9) | (15) |
| Net cash (outflow)/inflow from financing activities | | (686) | 10,520 | 8,982 | (9) | (18) |
| Net increase/(decrease) in cash and cash equivalents | | 27,178 | 9,408 | 25,095 | (16,803) | (16,758) |
| Cash and cash equivalents at January 1 | | 59,365 | 86,549 | 95,952 | 95,952 | 120,609 |
| Effect of foreign exchange rate changes | | 6 | (5) | (438) | (14) | (129) |
| Cash and cash equivalents at December 31/ March 31 | 35(a) | 86,549 | 95,952 | 120,609 | 79,135 | 103,722 |
| Cash flows from operating activities include: | | | | | | |
| Interest received | | 11,563 | 17,742 | 22,507 | 5,020 | 6,314 |
| Interest paid | | 4,591 | 6,129 | 8,075 | 1,714 | 2,654 |

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****1 ORGANISATION, PRINCIPAL ACTIVITIES AND DETAILS OF PRINCIPAL SUBSIDIARY*****(a) Organisation***

The Bank is a commercial bank established by China Merchants Steam Navigation Company Limited in the Shenzhen China Merchants Shekou Industrial Zone on March 31, 1987, as approved by the People's Bank of China (the "PBOC"). In April 1994, the Bank undertook a capital restructuring and became a joint stock commercial bank.

With the approval of the CSRC of the PRC, the "A" shares of the Bank were listed on Shanghai Stock Exchange on April 9, 2002.

As at March 31, 2006, apart from the Head Office, the Bank had branches in Shenzhen, Shanghai, Beijing, Shenyang, Nanjing, Guangzhou, Wuhan, Lanzhou, Xi'an, Chengdu, Chongqing, Hangzhou, Fuzhou, Jinan, Tianjin, Dalian, Urumqi, Kunming, Hefei, Zhengzhou, Harbin, Nanchang, Changsha, Xiamen, Ningbo, Wenzhou, Wuxi, Suzhou, Hong Kong, Qingdao, Dongguan, Shaoxing, Yantai, Quanzhou, Changzhou and Foshan. In addition, the Bank has representative offices in Beijing and New York.

(b) Principal activities of the Bank

The Bank provides deposits taking, clearing and other related services. It also engages in the provision of credit and bills discounting, other treasury related activities; and acts as issuing agent and underwriter for government bonds.

(c) Details of the subsidiary consolidated

The particulars of the Bank's subsidiary as at March 31, 2006 are set out below.

| <u>Name of company</u> | <u>Place of incorporation and operation</u> | <u>Particulars of the issued and paid up capital</u> | <u>% of ownership held by the Bank</u> | <u>Principal activities</u> |
|---|---|--|--|------------------------------------|
| CMB International Capital Corporation Limited . . . | Hong Kong | HK\$50 million | 100% | Investment advisory services |

2 SIGNIFICANT ACCOUNTING POLICIES***(a) Statement of compliance and basis of preparation***

The Financial Information has been prepared in accordance with IFRSs and its interpretations promulgated by the IASB, and the disclosure requirements of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.

All IFRSs in issue which are effective for the accounting period beginning on January 1, 2006 and are relevant to the Group have been applied for the Relevant Periods presented, except for IFRS 7 Financial Instruments: Disclosures ("IFRS 7") and Amendment to International Accounting Standard 1 Presentation of Financial Statements: Capital Disclosures, both of which were issued in August 2005

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****2 SIGNIFICANT ACCOUNTING POLICIES (continued)*****(a) Statement of compliance and basis of preparation (continued)***

and are effective for the period beginning on January 1, 2007. IFRS 7 requires more detailed qualitative and quantitative disclosure primarily on fair value information and risk management. The Group has assessed the impact of IFRS 7 and concluded that IFRS 7 would only affect the level of details in the disclosure of the Financial Information, and would not have an impact on the Group's results or the state of affairs of the Group or the Bank.

The accounting policies set out below have been applied consistently by the Bank and its subsidiary to the Relevant Periods presented in the Financial Information.

(b) Basis of measurement

Unless stated otherwise, the Financial Information is presented in Renminbi ("RMB"), which is the Group's functional and presentation currency, rounded to the nearest million.

The Financial Information is prepared using the historical cost basis except that the financial assets and liabilities at fair value through profit or loss including derivatives and available-for-sale assets are stated at their fair value; and certain non-financial assets are stated at deemed cost.

The preparation of the Financial Information in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. The results of such estimates and assumptions form the basis of judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of IFRSs that have significant effect on the Financial Information and estimates with a significant risk of material adjustment in the subsequent period are discussed in Note 41.

(c) Basis of consolidation

The Financial Information includes the financial statements of the Bank and its subsidiary. Subsidiaries are those enterprises controlled by the Bank. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operational policies of an enterprise so as to obtain benefits from its activities. The results and affairs of subsidiaries are included from the date that control commences until the date that control ceases.

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****2 SIGNIFICANT ACCOUNTING POLICIES (continued)*****(c) Basis of consolidation (continued)***

The results of the subsidiary are included in the consolidated results of the Group. All significant inter company transactions and balances, and any unrealised gains or losses arising from inter company transactions, have been eliminated on consolidation.

(d) Financial instruments***(i) Recognition and measurement***

All financial assets and financial liabilities are recognised in the consolidated balance sheet when and only when, the Group becomes a party to the contractual provisions of the instrument. Financial assets are derecognised on the date when the contractual rights to the cash flows expire or substantially all the risks and rewards of ownership are transferred. A regular way purchase or sale of financial assets is recognised using settlement date accounting, except for derivatives which are recognised using trade date accounting.

Financial liabilities are derecognised on the date when the obligations specified in the contracts are discharged, cancelled or expire.

At initial recognition, all financial assets and liabilities are measured at fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include observable market data.

Financial assets and financial liabilities are categorised as follows:

- financial assets and financial liabilities at fair value through profit or loss include those financial assets and financial liabilities held principally for the purpose of short term profit taking and those financial assets and liabilities that are designated by the Group upon recognition as at fair value through profit or loss.

All derivatives not qualified for hedging purposes are included in this category and are carried as assets when their fair value is positive and as liabilities when their fair value is negative;

- held-to-maturity financial assets are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Group has the positive intent and ability to hold to maturity;
- loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than those that the Group intends to sell immediately or in the near term, and those that are designated as available-for-sale upon initial recognition; and

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****2 SIGNIFICANT ACCOUNTING POLICIES (continued)*****(d) Financial instruments (continued)******(i) Recognition and measurement (continued)***

- available-for-sale assets are non-derivative financial assets that are designated as available-for-sale or are not classified as financial assets at fair value through profit or loss, loans and receivables or held-to-maturity financial assets.

Subsequent to initial recognition, financial assets and financial liabilities are measured at fair value, without any deduction for transaction costs that may occur on sale or other disposal except for loans and receivables, held-to-maturity financial assets and financial liabilities not designated at fair value through profit or loss, which are measured at amortised cost using the effective interest rate method. Financial assets and financial liabilities that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are stated at cost.

Gains and losses from changes in the fair value of financial instruments at fair value through profit or loss are included in the consolidated income statement when they arise.

Gains and losses arising from a change in the fair value of available-for-sale assets are recognised directly in equity, except for impairment losses and foreign exchange gains and losses, until the financial asset is derecognised at which time the cumulative gains or losses previously recognised in equity will be recognised in the consolidated income statement.

For financial assets and liabilities carried at amortised cost, a gain or loss is recognised in the consolidated income statement when the financial asset or liability is derecognised, impaired and amortised.

(ii) Fair value measurement principles

The fair value of financial instruments is based on their quoted market price in an active market at the valuation date without any deduction for transaction costs. If a quoted market price is not available, the fair value of the instrument is estimated using pricing models referenced to the fair value of another instrument that is substantially the same (without deduction for transaction costs) or discounted cash flow techniques. Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate is a market rate at the valuation date for an instrument with similar terms and risk profile.

(iii) Hedge accounting

The Group does not have derivative financial instruments which meet the criteria for hedge accounting.

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****2 SIGNIFICANT ACCOUNTING POLICIES (continued)*****(d) Financial instruments (continued)******(iv) Specific instruments******Cash equivalents***

Cash equivalents comprise balances with banks and the central bank, and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition.

Placements with and takings from banks and other financial institutions

Banks represent other banks approved by the PBOC. Other financial institutions represent insurance companies, securities firms, and investment trusts etc. Placements with banks and other financial institutions are accounted for as loans or investment receivables.

Investments

Equity investments are accounted for as trading or available-for-sale financial assets. Debt investments are classified as financial assets at fair value through profit or loss, held-to-maturity financial assets, receivables and available-for-sale financial assets in accordance with the Group's holding intention at acquisition.

Loans and advances

Loans and advances directly granted by the Group to customers or participation in syndicated loans are accounted for as loans and receivables.

(v) Derivative financial instruments

The Group's derivative financial instruments include spot, forward and foreign currency swaps, interest rate swaps and option contracts undertaken in response to customers' needs or for the Group's own asset and liability management purposes. To hedge against risks arising from derivative transactions undertaken for customers, the Bank enters into similar derivative contracts with other banks.

Derivative financial instruments, including hedging instruments, are stated at fair value, with gains and losses arising recognised in the consolidated income statement.

(e) Fixed assets and depreciation

Fixed assets, including investment properties, are stated at cost or deemed cost less accumulated depreciation. These also include land held under operating leases and buildings thereon, where the fair value of the leasehold interest in the land and buildings cannot be measured separately at the inception of the lease and the building is not clearly held under an operating lease.

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****2 SIGNIFICANT ACCOUNTING POLICIES (continued)*****(e) Fixed assets and depreciation (continued)***

Depreciation is calculated to write off the cost of fixed assets over their following estimated useful lives, after taking into account an estimated residual value at 3% of the cost of each asset, on a straight-line basis:

| | |
|--|---|
| Land and buildings | 20 years |
| Investment properties | 20 years |
| Computer equipment | 5 years |
| Motor vehicles and other equipment | 5 years |
| Leasehold improvements | the shorter of the unexpired term of lease and the estimated useful lives, being no more than 5 years |

Construction in progress represents property under construction and is stated at cost less impairment losses. Cost comprises the direct and indirect cost of construction. Construction in progress is transferred to an appropriate class of property and equipment when the asset is ready for its intended use. No depreciation is provided for construction in progress.

The carrying amount of fixed assets is reviewed periodically in order to assess whether the recoverable amount has declined below the carrying amount. When such a decline has occurred, the carrying amount is reduced to the recoverable amount. The amount of impairment loss is recognised in the consolidated income statement. The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present values.

Subsequent expenditure relating to a fixed asset is capitalised only when it is probable that future economic benefits associated with the fixed assets will flow to the Group. All other expenditure is recognised in the consolidated income statement as an expense as incurred.

Profits or losses on disposal of fixed assets are determined as the difference between the net disposal proceeds and the carrying amount of the fixed assets and are accounted for in the consolidated income statement as they arise.

(f) Land use rights

Land use rights are stated at cost, and are amortised on a straight-line basis over the respective lease periods of 40 – 50 years.

(g) Repossessed assets

Repossessed assets are measured at the lower of the carrying value of the related loans and advances and fair value less costs to sell at the date of exchange. They are not depreciated or amortised.

Impairment losses on initial classification and on subsequent remeasurement are recognised in the consolidated income statement.

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****2 SIGNIFICANT ACCOUNTING POLICIES (continued)*****(h) Operating leases***

Leases of assets under which the lessor assumes substantially all the risks and benefits of ownership are classified as operating leases. Payments made under the leases are charged to the consolidated income statement in equal instalments over the accounting periods covered by the lease term.

(i) Repurchase and resale agreements

Securities sold under repurchase agreements are considered to be, in substance, secured loans borrowed. Therefore, the amounts received are included in “Amounts due to central bank” or “Placements from banks and other financial institutions”, depending on the identity of the counterparty. Conversely securities or loans purchased subject to commitment to resell are considered as loans granted, and the amounts paid are accounted for as “Balances with central bank” or “Placements with banks and other financial institutions”, depending on the identity of the counterparty.

The difference between the purchase and resale consideration or sale and repurchase consideration is amortised over the period of the transaction using the effective interest rate method and is included in interest income or expense, as appropriate.

(j) Impairment***(i) Financial assets***

Financial assets are assessed at each balance sheet date to determine whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset and that event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Losses expected as a result of future events, no matter how likely, are not recognised because the necessary loss event has not yet occurred.

Impairment losses on loans and advances

The Group uses two methods of assessing impairment losses on loans and advances: those assessed individually and those assessed on a collective basis.

- **Individually assessed**

Loans and advances which are considered individually significant are assessed individually for impairment. This includes all loans and advances in the corporate lending portfolios.

Impairment allowances are made on individually impaired loans when there is objective evidence of impairment as a result of one or more of the following loss events that will

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****2 SIGNIFICANT ACCOUNTING POLICIES (continued)****(j) Impairment (continued)****(i) Financial assets (continued)**

impact the estimated future cash flows of the loan. Individually impaired loans and advances are graded as substandard or below.

- adverse changes in the payment status of borrower;
- significant financial difficulty of the obligor;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- the Group granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the Group would not otherwise consider;
- it becoming probable that the borrower will enter bankruptcy or other financial reorganisation; and
- observable data indicating that there is a measurable decrease in the estimated future cash flows of the borrower's business operation.

Impairment allowances of an individually impaired loan is measured as the difference between the loan's carrying amount and the present value of estimated future cash flows discounted at the loan's original effective interest rate. The carrying amount of the loan is reduced through the use of the allowances for impairment losses.

The calculation of the present value of the estimated future cash flows of a collateralised loan or receivable reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

- Collectively assessed

Impairment allowances are calculated on a collective basis for the following:

- in respect of losses which have been incurred but have not yet been identified as loans subject to individual assessment for impairment; and
- for homogeneous groups of loans that are not considered individually significant, representing the retail lending portfolios.

Incurred but not yet identified impairment

If there is no objective evidence of impairment exists for an individually assessed loan on an individual basis, whether significant or not, the loans are grouped in a pool of loans on the basis of similar credit risk characteristics for the purpose of calculating a collective impairment allowance. This allowance covers loans that are impaired at the balance sheet date but which will not be individually identified as such until some time in

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****2 SIGNIFICANT ACCOUNTING POLICIES (continued)****(j) Impairment (continued)****(i) Financial assets (continued)**

the future. As soon as information is available that specifically identifies objective evidence of impairment on individual loans in the pool of loans, those loans are removed from the pool. Loans that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment for impairment. The collective assessment allowance is determined after taking into account:

- the structure and risk characteristics of the Group's loan portfolio (indicating the borrower's ability to repay all loans) and the expected loss of the individual components of the loan portfolio based primarily on the historical loss experience;
- the emergence period between a loss occurring and that loss being identified and evidenced by the establishment of an allowance against the loss on an individual loan; and
- management's judgement as to whether the current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience.

Homogeneous groups of loans

Portfolios of homogeneous loans are collectively assessed using roll rate or historical loss rate methodologies. Overdue period represents the major observable objective evidence for impairment.

Impairment losses are recognised in the consolidated income statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. The reversal shall not result in a carrying amount of the loan that exceeds the amortised cost at the date the impairment is reversed had the impairment not been recognised. The amount of the reversal is recognised in the consolidated income statement.

Where the loan has no reasonable prospect of recovery, the loan is written off. Amount recovered from a loan that has been written off will be recognised as income through the impairment loss account in the consolidated income statement.

In the recovery of impaired loans, the Group may take repossession of the collateral assets through court proceedings or voluntary delivery of possession by the borrowers. Upon the seizure of these assets, the carrying value of the related loan principal and interest receivable are initially transferred to "Repossessed assets", and the respective allowances for impairment losses are transferred to "impairment allowance for repossessed assets".

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****2 SIGNIFICANT ACCOUNTING POLICIES (continued)*****(j) Impairment (continued)******(i) Financial assets (continued)******Impairment losses on available-for-sale financial assets***

Where there is objective evidence that an available-for-sale financial asset is impaired, the cumulative loss that had been recognised directly in equity is removed from equity and is recognised in the consolidated income statement.

The amount of the cumulative loss that is recognised in the consolidated income statement is the difference between the acquisition cost (net of any principal repayment and amortisation) and current fair value, less any impairment loss on that asset previously recognised in consolidated income statement. For an available-for-sale asset that is not carried at fair value as its fair value cannot be reliably measured, such as an unquoted equity instrument, the amount of any impairment loss is measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increases can be objectively related to an event occurring after the impairment loss was recognised in the consolidated income statement, the impairment loss is reversed, with the amount of the reversal being recognised in the consolidated income statement. Impairment losses recognised in the consolidated income statement for an investment in an equity instrument classified as available-for-sale are not reversed through the consolidated income statement.

(ii) Impairment losses on other assets

The carrying amounts of the Group's other assets are reviewed periodically by the Directors to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. The recoverable amount is the estimated cash proceeds from the disposal of the assets or the present value of the future cash inflow. An impairment loss is recognised in the consolidated income statement when the net carrying amount of an asset exceeds its recoverable amount.

If there are evidences that the impairment losses previously recognised do not exist or have been reduced, reversals of the impairment losses are credited to the consolidated income statement in the period in which the reversals are recognised.

(k) Convertible bonds issued

At initial recognition the liability component of the convertible bonds issued is calculated as the present value of the future interest and principal payments, discounted at the market rate of interest applicable at the time of initial recognition to similar debt securities that do not have a conversion option. The liability component is subsequently carried at amortised cost until it is converted or redeemed. Any excess of proceeds over the amount initially recognised as the liability component is in substance an option and is recognised as the equity component in the capital reserve.

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****2 SIGNIFICANT ACCOUNTING POLICIES (continued)*****(k) Convertible bonds issued (continued)***

If the bond is converted into shares, the carrying value of the liability component and any interest payable at the time of conversion, are transferred to “share capital” based on the numbers of shares issued at par and the differences are recognised as share premium in capital reserve.

(l) Provisions and contingent liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Group has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditures expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

(m) Income recognition***(i) Interest income***

Interest income is recognised in the consolidated income statement on an accruals basis, taking into account the effective interest rate of the instrument or an applicable floating rate. Interest income includes the amortisation of any discount or premium or other differences between the initial carrying amount of any interest bearing instrument and its amount at maturity calculated on an effective interest rate basis.

When a financial asset or a group of financial assets are impaired, interest income is recognised on the impaired financial assets using the rate of interest used to discount future cash flows for the purpose of measuring the related impairment loss.

(ii) Fee and commission income

Fee and commission income is recognised in the consolidated income statement when the corresponding service is provided.

(iii) Dividend income

- Dividend income from listed investments is recognised when the underlying investment is declared ex-dividend.
- Where the investments are unlisted, interim dividend income is recognised when declared by the Board of Directors of the investees. Final dividend income is recognised only when the amount proposed by the Board of Directors is approved by shareholders at general meetings.

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****2 SIGNIFICANT ACCOUNTING POLICIES (continued)*****(n) Taxation******(i) Income tax***

Income tax in the consolidated income statement comprises current tax and movement in deferred tax. Income tax is recognised in the consolidated income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year calculated based on the PRC GAAP and adjusted for items based on the prevailing tax laws and interpretations, using PRC tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided, using the balance sheet liability method, for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date.

When it is probable that the future taxable profit will be available to utilise the above timing differences, a deferred tax asset will be recognised. Deferred tax assets are reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the related tax benefit to be utilised.

(ii) Other taxes

Other taxes, including business tax and surcharges and property tax, are calculated at respective tax rates enacted at the balance sheet date and are included in the operating expenses.

(o) Foreign currency translations

Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated into Renminbi at the foreign exchange rates ruling at that date. Non-monetary assets, liabilities and share capital which are measured at historical cost in a foreign currency are translated into Renminbi at the foreign exchange rates ruling at the date of the transaction, whilst those stated at fair value are translated into Renminbi at the foreign exchange rate ruling at the date of valuation. Income and expenses denominated in foreign currencies are translated at average exchange rates. When the gain or loss on a non-monetary item is recognised directly in equity, any exchange component of that gain or loss is recognised directly in equity, all other foreign exchange differences arising on settlement and translation of monetary and non-monetary assets and liabilities are recognised in the consolidated income statement.

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****2 SIGNIFICANT ACCOUNTING POLICIES (continued)*****(p) Offsetting***

Financial assets and liabilities are offset and the net amount is reported in the consolidated balance sheet when the Group has a legally enforceable right to set off the recognised amounts and the transactions are intended to be settled on a net basis.

(q) Employee benefits***(i) Salaries and staff welfare***

Salaries, bonus and other benefits are accrued in the period in which the associated services are rendered by employees.

(ii) Post employment benefits

The Group participates in a number of defined contribution retirement benefit schemes managed by different provincial governments or independent insurance companies. Obligation for contributions to these schemes are jointly borne by the Group and the staff, and contributions paid by the Group are recognised as an expense in the consolidated income statement as incurred.

(r) Related parties

For the purposes of the Financial Information, parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control or common significant influence. Related parties may be individuals (being members of key management personnel, significant shareholders and/or their close family members) or other entities and include entities which are under the significant influence of related parties of the Group where those parties are individuals, and post-employment benefit plans which are for the benefit of employees of the Group or of any entity that is a related party of the Group.

(s) Segmental reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment) which is subject to risks and rewards that are different from those of other segments.

(t) Fiduciary activities

The Group acts in a fiduciary capacity in entrusted loan and entrusted investment business. Assets held by the Group and the related undertakings to return such assets to customers are excluded from the balance sheets as the risks and rewards of the assets reside with the customers.

The Group enters into entrusted loan or investment agreements with a number of customers, whereby the customers provide funding (the “entrusted funds”) to the Group, and the Group grants loans to third parties (the “entrusted loans”) or makes investments (the “entrusted investments”) at the

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

2 SIGNIFICANT ACCOUNTING POLICIES (continued)*(t) Fiduciary activities (continued)*

instruction of the customers. As the Group does not assume the risks and rewards of the entrusted loans or the entrusted investments and the corresponding entrusted funds, entrusted loans and funds are recorded as off-balance sheet items at their principal or investment amounts and no impairment assessments are made for these entrusted loans or investments.

(u) Dividends or profit distributions

Dividends or profit distributions are recognised as a liability in the year in which they are approved and declared.

3 INTEREST INCOME

| | Years ended December 31, | | | Three months ended March 31, | |
|--|--------------------------|--------|--------|------------------------------|-------|
| | 2003 | 2004 | 2005 | 2005 (unaudited) | 2006 |
| Loans and advances (note) | 11,492 | 16,890 | 21,058 | 4,631 | 5,811 |
| Balances with central bank | 506 | 746 | 836 | 199 | 229 |
| Deposits and placements with | | | | | |
| — banks | 501 | 438 | 838 | 126 | 332 |
| — other financial institutions | 62 | 360 | 164 | 37 | 34 |
| Debt investments | 2,497 | 2,646 | 2,981 | 628 | 835 |
| Interest income on financial assets that are not at fair value through profit or loss | 15,058 | 21,080 | 25,877 | 5,621 | 7,241 |

Note: Included in the above is interest income of RMB68 million accrued on impaired loans for the three months ended March 31, 2006 (2005: RMB260 million; 2004: RMB108 million; 2003: RMB95 million; three months ended March 31, 2005 (unaudited): RMB57 million).

4 INTEREST EXPENSE

| | Years ended December 31, | | | Three months ended March 31, | |
|--|--------------------------|-------|-------|------------------------------|-------|
| | 2003 | 2004 | 2005 | 2005 (unaudited) | 2006 |
| Deposits from customers | 3,866 | 5,116 | 7,558 | 1,572 | 2,412 |
| Amounts due to central bank | 40 | 20 | — | — | — |
| Deposits and placements from | | | | | |
| — banks | 611 | 913 | 412 | 80 | 91 |
| — other financial institutions | 422 | 561 | 664 | 111 | 186 |
| Issued debts | — | 178 | 601 | 138 | 126 |
| | 4,939 | 6,788 | 9,235 | 1,901 | 2,815 |

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

5 FEE AND COMMISSION INCOME

| | Years ended December 31, | | | Three months ended March 31, | |
|--|-----------------------------|--------------|--------------|---------------------------------|------------|
| | 2003 | 2004 | 2005 | 2005 (unaudited) | 2006 |
| Bank card fees | 198 | 362 | 570 | 106 | 199 |
| Remittance and settlement fees | 237 | 301 | 429 | 83 | 130 |
| Agency services fees | 157 | 167 | 315 | 35 | 94 |
| Commissions from credit commitment and loan business | 93 | 140 | 186 | 37 | 61 |
| Trust services fees | 21 | 74 | 101 | 14 | 19 |
| Others | 87 | 143 | 255 | 28 | 55 |
| | <u>793</u> | <u>1,187</u> | <u>1,856</u> | <u>303</u> | <u>558</u> |

6 OTHER NET INCOME

| | Years ended December 31, | | | Three months ended March 31, | |
|--|-----------------------------|------------|--------------|---------------------------------|------------|
| | 2003 | 2004 | 2005 | 2005 (unaudited) | 2006 |
| Net gain arising from foreign currency dealing | 299 | 341 | 471 | 91 | 130 |
| Net gain/(loss) on financial instruments at fair value through profit or loss | 123 | (11) | 428 | 142 | 43 |
| Net gain/(loss) on disposal of available-for-sale financial assets | 19 | 33 | 5 | 1 | (23) |
| Net gain on disposal of fixed assets | 5 | 9 | 4 | — | — |
| Rental income | 45 | 55 | 59 | 13 | 12 |
| Others | — | 68 | 38 | 2 | — |
| | <u>491</u> | <u>495</u> | <u>1,005</u> | <u>249</u> | <u>162</u> |

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****7 OPERATING EXPENSES**

| | Years ended December 31, | | | Three months ended March 31, | |
|--|-----------------------------|--------------|--------------|---------------------------------|--------------|
| | 2003 | 2004 | 2005 | 2005 (unaudited) | 2006 |
| Staff costs | | | | | |
| — salaries, bonuses and staff welfare (note (i)) | 1,812 | 2,739 | 3,335 | 827 | 737 |
| — contributions to defined contribution retirement schemes | 181 | 335 | 428 | 99 | 117 |
| — housing allowances | 146 | 180 | 250 | 51 | 68 |
| — others | 123 | 163 | 228 | 34 | 98 |
| | <u>2,262</u> | <u>3,417</u> | <u>4,241</u> | <u>1,011</u> | <u>1,020</u> |
| Business tax and surcharges | 644 | 977 | 1,219 | 260 | 325 |
| Depreciation | 670 | 731 | 854 | 170 | 220 |
| Rental expenses | 493 | 575 | 693 | 155 | 192 |
| Other general and administrative expenses | 1,447 | 1,732 | 2,108 | 439 | 491 |
| | <u>5,516</u> | <u>7,432</u> | <u>9,115</u> | <u>2,035</u> | <u>2,248</u> |

Notes:

- (i) Included in the above salaries and bonuses is performance bonus, the details of which are disclosed in Note 28(d).
- (ii) Auditors' remuneration amounted to RMB 3 million for the three months ended March 31, 2006 (2005: RMB 5 million; 2004: RMB 4 million; 2003: RMB 4 million; three months ended March 31, 2005 (unaudited): Nil) and non-audit service fee paid to auditors was RMB 1 million for the three months ended March 31, 2006 (2005: RMB 1 million; 2004: RMB 2 million; 2003: Nil; three months ended March 31, 2005 (unaudited): Nil).

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

8 DIRECTORS' AND SUPERVISORS' EMOLUMENTS

The emoluments of the Directors' and Supervisors' during the Relevant Periods are as follows:

| | Years ended December 31, | | | Three months ended March 31, | |
|--|--------------------------|---------------|---------------|------------------------------|--------------|
| | 2003 | 2004 | 2005 | 2005 | 2006 |
| | RMB'000 | RMB'000 | RMB'000 | RMB'000 (unaudited) | RMB'000 |
| Fees | 436 | 640 | 640 | 160 | 160 |
| Salaries and other emoluments | 7,153 | 6,028 | 6,358 | 1,085 | 1,089 |
| Discretionary bonuses | 8,601 | 7,085 | 7,400 | — | — |
| Contributions to defined contribution retirement schemes | 167 | 117 | 516 | 129 | 129 |
| | <u>16,357</u> | <u>13,870</u> | <u>14,914</u> | <u>1,374</u> | <u>1,378</u> |

The number of the Directors and Supervisors whose emoluments are within the following bands is set out below:

| | Years ended December 31, | | |
|-----------------------------|--------------------------|----------|----------|
| | 2003 | 2004 | 2005 |
| RMB | | | |
| Nil - 500,000 | 33 | 30 | 24 |
| 500,001 - 1,000,000 | 2 | 1 | 1 |
| 1,000,001 - 1,500,000 | — | — | 1 |
| 3,000,001 - 3,500,000 | 1 | — | — |
| 3,500,001 - 4,000,000 | 1 | 1 | 1 |
| 6,500,001 - 7,000,000 | 1 | — | — |
| 7,500,001 - 8,000,000 | — | 1 | — |
| 8,000,001 - 8,500,000 | — | — | 1 |
| | <u>—</u> | <u>—</u> | <u>—</u> |

None of the Directors and Supervisors received any inducements, or compensation for loss of office, or waived any emoluments during the Relevant Periods.

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

9 INDIVIDUALS WITH HIGHEST EMOLUMENTS

Of the five individuals with the highest emoluments for the year ended December 31, 2005, 2 (2004: 2 ; 2003: 3) are Directors or Supervisors whose emoluments are included in Note 8 above. The aggregate of the emoluments in respect of the five individuals during the Relevant Periods is as follows:

| | Years ended December 31, | | | Three months ended March 31, | |
|--|--------------------------|---------------|---------------|------------------------------|--------------|
| | 2003 | 2004 | 2005 | 2005 | 2006 |
| | RMB'000 | RMB'000 | RMB'000 | RMB'000 (unaudited) | RMB'000 |
| Salaries and other emoluments | 7,833 | 8,556 | 8,794 | 1,500 | 1,500 |
| Discretionary bonuses | 11,291 | 11,138 | 11,960 | — | — |
| Contributions to defined contribution retirement schemes | 150 | 144 | 723 | 181 | 181 |
| | <u>19,274</u> | <u>19,838</u> | <u>21,477</u> | <u>1,681</u> | <u>1,681</u> |

The number of the five highest paid individuals whose emoluments fell within the following bands is set out below:

| | Years ended December 31, | | |
|-----------------------------|--------------------------|------|------|
| | 2003 | 2004 | 2005 |
| RMB | | | |
| 1,500,001 - 2,000,000 | 1 | — | — |
| 2,000,001 - 2,500,000 | — | 2 | 1 |
| 2,500,001 - 3,000,000 | — | — | 1 |
| 3,000,001 - 3,500,000 | 2 | — | — |
| 3,500,001 - 4,000,000 | 1 | 2 | 2 |
| 6,500,001 - 7,000,000 | 1 | — | — |
| 7,500,001 - 8,000,000 | — | 1 | — |
| 8,000,001 - 8,500,000 | — | — | 1 |

None of the Directors and Supervisors received any inducement, or compensation for loss of office, or waived any emoluments during the Relevant Periods.

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****10 LOANS TO DIRECTORS, SUPERVISORS AND OFFICERS**

Loans to Directors, Supervisors and Officers of the Bank disclosed pursuant to section 161B of the Hong Kong Companies Ordinance are as follows:

| | December 31, | | | March 31, |
|--|--------------|----------|----------|-----------|
| | 2003 | 2004 | 2005 | 2006 |
| Aggregate amount of relevant loans made by the Bank outstanding at year/period end | <u>4</u> | <u>3</u> | <u>2</u> | <u>2</u> |

| | Years ended December 31, | | | Three months ended March 31, 2006 |
|--|-----------------------------|----------|----------|--------------------------------------|
| | 2003 | 2004 | 2005 | |
| Maximum aggregate amount of relevant loans made by the Bank outstanding during the year/period | <u>5</u> | <u>5</u> | <u>4</u> | <u>3</u> |

11 PROVISION FOR IMPAIRMENT LOSSES

| | Years ended December 31, | | | Three months ended March 31, | |
|---|-----------------------------|--------------|--------------|---------------------------------|------------|
| | 2003 | 2004 | 2005 | 2005 | 2006 |
| | | | | (unaudited) | |
| Impairment losses charged/ (released) on: | | | | | |
| — loans and advances (Note 17(c)) | 2,139 | 2,764 | 3,575 | 608 | 708 |
| — deposits and placements with banks and other financial institutions | 76 | (15) | 62 | 19 | (121) |
| — other assets | 21 | 317 | — | — | — |
| | <u>2,236</u> | <u>3,066</u> | <u>3,637</u> | <u>627</u> | <u>587</u> |

12 INCOME TAX*(a) Income tax in the consolidated income statement represents:*

| | Years ended December 31, | | | Three months ended March 31, | |
|--------------------|-----------------------------|--------------|--------------|---------------------------------|------------|
| | 2003 | 2004 | 2005 | 2005 | 2006 |
| | | | | (unaudited) | |
| Current tax | 808 | 2,321 | 3,025 | 698 | 940 |
| Deferred tax | 398 | (419) | (312) | (66) | (145) |
| | <u>1,206</u> | <u>1,902</u> | <u>2,713</u> | <u>632</u> | <u>795</u> |

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

12 INCOME TAX (continued)

(b) A reconciliation of income tax expense in the consolidated income statement and that calculated at the applicable tax rate is as follows:

| | Years ended December 31, | | | Three months ended March 31, | |
|---|-----------------------------|-------|-------|---------------------------------|-------|
| | 2003 | 2004 | 2005 | 2005 (unaudited) | 2006 |
| Profit before tax | 3,417 | 5,178 | 6,462 | 1,571 | 2,227 |
| Notional tax on profit before tax, calculated at the statutory tax rate of 33% | 1,127 | 1,709 | 2,133 | 518 | 735 |
| Add/(less) the tax effect of the following items: | | | | | |
| Non-deductible expenses (note (i)) | 395 | 502 | 861 | 182 | 233 |
| Non-taxable income (note (ii)) | (284) | (287) | (237) | (51) | (99) |
| Different income tax rates in other areas (note (iii)) | (18) | (58) | (133) | (44) | (83) |
| Others | (14) | 36 | 89 | 27 | 9 |
| Income tax expense | 1,206 | 1,902 | 2,713 | 632 | 795 |

Notes:

- (i) Non-deductible expenses represent mainly staff costs in excess of the statutory deductible threshold, impairment losses on assets (such as loans and advances to customers, and repossessed assets) written off prior to 2001 in excess of the deductible amounts, and entertainment expenses, depreciation and amortisation charges which are not tax deductible.
- (ii) Non-taxable income primarily comprises interest income from the PRC government bonds.
- (iii) The income tax rates applicable to the Bank's operations in certain areas such as Shenzhen Special Economic Zone and Urumqi are 15% and 16.5% respectively.

13 EARNINGS PER SHARE

Movements of the share capital, including issuance of bonus shares and conversion of convertible bonds issued, are included in Notes 26(b) and 29 of the Financial Information.

(a) Basic earnings per share

The calculation of basic earnings per share is based on the net profit attributable to equity holders of the Bank and the weighted average number of shares in issue, calculated as follows:

| | Years ended December 31, | | | Three months ended March 31, | |
|---|--------------------------|--------|--------|---------------------------------|--------|
| | 2003 | 2004 | 2005 | 2005 (unaudited) | 2006 |
| Net profit | 2,211 | 3,276 | 3,749 | 939 | 1,432 |
| Weighted average number of shares in issue (in million) | 11,155 | 11,155 | 11,166 | 11,155 | 12,069 |
| Basic earnings per share (in RMB) | 0.20 | 0.29 | 0.34 | 0.08 | 0.12 |

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

13 EARNINGS PER SHARE (continued)**(b) Diluted earnings per share**

The calculation of diluted earnings per share is based on the diluted net profit and the weighted average number of shares in issue after adjusting for the effect of all dilutive potential shares, calculated as follows:

| | Years ended December 31, | | | Three months ended March 31, | |
|--|--------------------------|---------------|---------------|------------------------------|---------------|
| | 2003 | 2004 | 2005 | 2005 (unaudited) | 2006 |
| Net profit | 2,211 | 3,276 | 3,749 | 939 | 1,432 |
| Interest expense on convertible bonds issued | — | 47 | 282 | 75 | 9 |
| Diluted net profit | <u>2,211</u> | <u>3,323</u> | <u>4,031</u> | <u>1,014</u> | <u>1,441</u> |
| Weighted average number of shares in issue (in million) | 11,155 | 11,155 | 11,166 | 11,155 | 12,069 |
| Effect of deemed conversion of convertible bonds (in million) | — | 188 | 1,122 | 1,133 | 219 |
| Weighted average number of shares in issue after dilution (in million) | <u>11,155</u> | <u>11,343</u> | <u>12,288</u> | <u>12,288</u> | <u>12,288</u> |
| Diluted earnings per share (in RMB) | <u>0.20</u> | <u>0.29</u> | <u>0.33</u> | <u>0.08</u> | <u>0.12</u> |

14 CASH AND BALANCES WITH BANKS AND OTHER FINANCIAL INSTITUTIONS

| | December 31, | | | March 31, |
|--|---------------|---------------|---------------|---------------|
| | 2003 | 2004 | 2005 | 2006 |
| Cash | 2,922 | 3,942 | 3,915 | 3,712 |
| Balances with banks | 13,755 | 11,480 | 18,603 | 19,050 |
| Balances with other financial institutions | 270 | 70 | 71 | 73 |
| | <u>16,947</u> | <u>15,492</u> | <u>22,589</u> | <u>22,835</u> |
| Less: Impairment loss | | | | |
| — banks | (48) | (50) | (27) | (29) |
| — other financial institutions | (70) | (70) | (71) | (70) |
| | <u>(118)</u> | <u>(120)</u> | <u>(98)</u> | <u>(99)</u> |
| | <u>16,829</u> | <u>15,372</u> | <u>22,491</u> | <u>22,736</u> |

15 BALANCES WITH CENTRAL BANK

| | December 31, | | | March 31, |
|---------------------------------------|---------------|---------------|---------------|---------------|
| | 2003 | 2004 | 2005 | 2006 |
| Statutory deposit reserve funds | 23,646 | 32,058 | 39,909 | 41,432 |
| Surplus deposit reserve funds | 26,980 | 22,823 | 21,966 | 12,254 |
| Fiscal deposits | 26 | 106 | 227 | 1,164 |
| | <u>50,652</u> | <u>54,987</u> | <u>62,102</u> | <u>54,850</u> |

The statutory deposit reserve funds are not available for the Group's daily operations. The statutory deposit reserve funds are calculated at 7.5% and 3% for eligible Renminbi deposits and

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****15 BALANCES WITH CENTRAL BANK (continued)**

foreign currency deposits respectively as at March 31, 2006 (2005: 7.5% and 3% for eligible Renminbi deposits and foreign currency deposits; 2004: 7.5% and 2% for eligible Renminbi deposits and foreign currency deposits; 2003: 7% and 2% for eligible Renminbi deposits and foreign currency deposits). Eligible deposits include deposits from government authorities and other organisations, fiscal deposits (other than budgets), retail deposits, corporate deposits, net credit balances of entrusted business and other deposits.

16 PLACEMENTS WITH BANKS AND OTHER FINANCIAL INSTITUTIONS

| | December 31, | | | March 31, |
|----------------------------------|---------------|---------------|---------------|---------------|
| | 2003 | 2004 | 2005 | 2006 |
| Money market placements | | | | |
| — banks | 13,032 | 15,940 | 22,930 | 24,745 |
| — other financial institutions | 2,579 | 22 | 22 | 23 |
| | <u>15,611</u> | <u>15,962</u> | <u>22,952</u> | <u>24,768</u> |
| Balances under resale agreements | | | | |
| — banks | 7,074 | 7,423 | 14,153 | 5,089 |
| — other financial institutions | 3,145 | 5,604 | 10,126 | 9,712 |
| | <u>10,219</u> | <u>13,027</u> | <u>24,279</u> | <u>14,801</u> |
| | <u>25,830</u> | <u>28,989</u> | <u>47,231</u> | <u>39,569</u> |
| Less: Impairment loss | | | | |
| — banks | (31) | (38) | (49) | (37) |
| — other financial institutions | (154) | (132) | (200) | (90) |
| | <u>(185)</u> | <u>(170)</u> | <u>(249)</u> | <u>(127)</u> |
| | <u>25,645</u> | <u>28,819</u> | <u>46,982</u> | <u>39,442</u> |

Assets purchased under the above resale agreements are registered national bonds issued by the PRC government, bonds issued by policy banks and other debt securities of equivalent amounts.

17 LOANS AND ADVANCES TO CUSTOMERS**(a) Loans and advances to customers**

| | December 31, | | | March 31, |
|--|----------------|----------------|----------------|----------------|
| | 2003 | 2004 | 2005 | 2006 |
| Corporate loans | 210,674 | 258,370 | 298,622 | 315,473 |
| Discounted bills | 62,224 | 60,886 | 99,527 | 121,392 |
| Retail loans | 34,582 | 54,761 | 74,036 | 78,024 |
| Gross loans and advances to customers | 307,480 | 374,017 | 472,185 | 514,889 |
| Less: Allowances for impairment losses | (8,520) | (10,920) | (13,510) | (14,297) |
| Net loans and advances to customers | <u>298,960</u> | <u>363,097</u> | <u>458,675</u> | <u>500,592</u> |

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****17 LOANS AND ADVANCES TO CUSTOMERS (continued)****(b) Analysis of loans and advances to customers****(i) Analysed by legal form of borrowers:**

| | December 31, | | | March 31, |
|--|--------------|---------|---------|-----------|
| | 2003 | 2004 | 2005 | 2006 |
| <i>Domestic enterprises:</i> | | | | |
| State-owned enterprises | 84,996 | 98,632 | 111,779 | 121,261 |
| Joint-stock enterprises | 34,527 | 41,666 | 48,576 | 50,367 |
| Other limited liability enterprises | 38,611 | 47,370 | 47,619 | 54,563 |
| Others | 21,175 | 28,048 | 43,803 | 41,338 |
| | 179,309 | 215,716 | 251,777 | 267,529 |
| Foreign-invested enterprises | 27,264 | 37,244 | 43,418 | 44,295 |
| Enterprises operating in the Mainland | 206,573 | 252,960 | 295,195 | 311,824 |
| Enterprises operating outside the Mainland | 4,101 | 5,410 | 3,427 | 3,649 |
| | 210,674 | 258,370 | 298,622 | 315,473 |
| Discounted bills | 62,224 | 60,886 | 99,527 | 121,392 |
| Retail loans | 34,582 | 54,761 | 74,036 | 78,024 |
| Gross loans and advances to customers | 307,480 | 374,017 | 472,185 | 514,889 |

(ii) Analysed by borrowers' industry sector:

| | December 31, | | | March 31, |
|---|--------------|---------|---------|-----------|
| | 2003 | 2004 | 2005 | 2006 |
| Manufacturing | 47,210 | 61,621 | 75,735 | 73,799 |
| Transportation and telecommunications | 48,086 | 59,967 | 66,154 | 71,941 |
| Energy and resources | 28,365 | 39,292 | 44,820 | 50,415 |
| Trading | 30,332 | 32,081 | 33,966 | 31,922 |
| Property development and investment | 14,890 | 17,971 | 20,089 | 22,516 |
| Investment management | 9,865 | 15,024 | 16,604 | 16,841 |
| Hospitality | 9,366 | 9,648 | 7,513 | 7,988 |
| Infrastructure and construction | 7,407 | 8,703 | 11,305 | 11,702 |
| Others | 15,153 | 14,063 | 22,436 | 28,349 |
| Corporate loans | 210,674 | 258,370 | 298,622 | 315,473 |
| Discounted bills | 62,224 | 60,886 | 99,527 | 121,392 |
| Retail loans | 34,582 | 54,761 | 74,036 | 78,024 |
| Gross loans and advances to customers | 307,480 | 374,017 | 472,185 | 514,889 |

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

17 LOANS AND ADVANCES TO CUSTOMERS (continued)*(c) Movements of allowances for impairment losses*

| | Years ended December 31, | | | Three months ended March 31, |
|---|-----------------------------|---------------|---------------|---------------------------------|
| | 2003 | 2004 | 2005 | 2006 |
| At January 1 | 6,820 | 8,520 | 10,920 | 13,510 |
| Charge for the year/period | 2,539 | 3,098 | 4,031 | 1,076 |
| Releases for the year/period | (400) | (334) | (456) | (368) |
| Unwinding of discount | (95) | (108) | (244) | (57) |
| Recoveries of loans and advances previously written off | 135 | 46 | 84 | 149 |
| Write-offs | (468) | (303) | (745) | — |
| Transfers out | (13) | — | (2) | — |
| Exchange differences | 2 | 1 | (78) | (13) |
| At December 31/March 31 | <u>8,520</u> | <u>10,920</u> | <u>13,510</u> | <u>14,297</u> |

(d) Loans and advances to customers and allowances for impairment losses

| | December 31, 2003 | | | | |
|--|--|---|---|----------------|---|
| | (note (i)) Loans and advances for which impairment losses are collectively assessed | (note (ii)) Impaired loans and advances | | | Gross impaired loans and advances as a % of gross loans and advances |
| | | for which impairment losses are collectively assessed | for which impairment losses are individually assessed | Total | |
| Gross loans and advances to | | | | | |
| — financial institutions | 7,978 | — | — | 7,978 | 0.00 |
| — non-financial institution customers | 289,824 | 286 | 9,392 | 299,502 | 3.23 |
| | <u>297,802</u> | <u>286</u> | <u>9,392</u> | <u>307,480</u> | <u>3.15</u> |
| Less: | | | | | |
| Allowances for impairment losses on loans and advances to | | | | | |
| — financial institutions | (65) | — | — | (65) | |
| — non-financial institution customers | <u>(3,865)</u> | <u>(70)</u> | <u>(4,520)</u> | <u>(8,455)</u> | |
| | <u>(3,930)</u> | <u>(70)</u> | <u>(4,520)</u> | <u>(8,520)</u> | |
| Net loans and advances to | | | | | |
| — financial institutions | 7,913 | — | — | 7,913 | |
| — non-financial institution customers | <u>285,959</u> | <u>216</u> | <u>4,872</u> | <u>291,047</u> | |
| | <u>293,872</u> | <u>216</u> | <u>4,872</u> | <u>298,960</u> | |

Notes:

- (i) These loans and advances include those for which no objective evidence of impairment has been identified on individual basis (i.e. loans which are graded normal or special mention).
- (ii) Impaired loans and advances include loans for which objective evidence of impairment has been identified:
- individually (comprising corporate loans and advances which are graded substandard, doubtful and loss); or
 - collectively; that is portfolios of homogeneous loans (comprising retail loans which are graded substandard, doubtful and loss).

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

17 LOANS AND ADVANCES TO CUSTOMERS (continued)

(d) Loans and advances to customers and allowances for impairment losses (continued)

| December 31, 2004 | | | | | |
|--|--|---|---|-----------------|---|
| | (note (i)) Loans and advances for which impairment losses are collectively assessed | (note (ii)) Impaired loans and advances | | Total | Gross impaired loans and advances as a % of gross loans and advances |
| | | for which impairment losses are collectively assessed | for which impairment losses are individually assessed | | |
| Gross loans and advances to | | | | | |
| — financial institutions | 2,158 | — | — | 2,158 | 0.00 |
| — non-financial institution customers | 361,085 | 413 | 10,361 | 371,859 | 2.90 |
| | <u>363,243</u> | <u>413</u> | <u>10,361</u> | <u>374,017</u> | <u>2.88</u> |
| Less: | | | | | |
| Allowances for impairment losses on loans and advances to | | | | | |
| — financial institutions | (2) | — | — | (2) | |
| — non-financial institution customers | (5,178) | (160) | (5,580) | (10,918) | |
| | <u>(5,180)</u> | <u>(160)</u> | <u>(5,580)</u> | <u>(10,920)</u> | |
| Net loans and advances to | | | | | |
| — financial institutions | 2,156 | — | — | 2,156 | |
| — non-financial institution customers | 355,907 | 253 | 4,781 | 360,941 | |
| | <u>358,063</u> | <u>253</u> | <u>4,781</u> | <u>363,097</u> | |
| December 31, 2005 | | | | | |
| | (note (i)) Loans and advances for which impairment losses are collectively assessed | (note (ii)) Impaired loans and advances | | Total | Gross impaired loans and advances as a % of gross loans and advances |
| | | for which impairment losses are collectively assessed | for which impairment losses are individually assessed | | |
| Gross loans and advances to | | | | | |
| — financial institutions | 2,567 | — | — | 2,567 | 0.00 |
| — non-financial institution customers | 457,451 | 460 | 11,707 | 469,618 | 2.59 |
| | <u>460,018</u> | <u>460</u> | <u>11,707</u> | <u>472,185</u> | <u>2.58</u> |
| Less: | | | | | |
| Allowances for impairment losses on loans and advances to | | | | | |
| — financial institutions | (19) | — | — | (19) | |
| — non-financial institution customers | (6,116) | (315) | (7,060) | (13,491) | |
| | <u>(6,135)</u> | <u>(315)</u> | <u>(7,060)</u> | <u>(13,510)</u> | |
| Net loans and advances to | | | | | |
| — financial institutions | 2,548 | — | — | 2,548 | |
| — non-financial institution customers | 451,335 | 145 | 4,647 | 456,127 | |
| | <u>453,883</u> | <u>145</u> | <u>4,647</u> | <u>458,675</u> | |

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

17 LOANS AND ADVANCES TO CUSTOMERS (continued)*(d) Loans and advances to customers and allowances for impairment losses (continued)*

| | March 31, 2006 | | | | |
|--|---|---|---|----------|---|
| | (note(i)) Loans and advances for which impairment losses are collectively assessed | (note (ii)) Impaired loans and advances | | Total | Gross impaired loans and advances as a % of gross loans and advances |
| | | for which impairment losses are collectively assessed | for which impairment losses are individually assessed | | |
| Gross loans and advances to | | | | | |
| — financial institutions | 6,682 | — | — | 6,682 | 0.00 |
| — non-financial institution customers | 495,947 | 526 | 11,734 | 508,207 | 2.41 |
| | 502,629 | 526 | 11,734 | 514,889 | 2.38 |
| Less: | | | | | |
| Allowances for impairment losses on loans and advances to | | | | | |
| — financial institutions | (19) | — | — | (19) | |
| — non-financial institution customers | (6,811) | (344) | (7,123) | (14,278) | |
| | (6,830) | (344) | (7,123) | (14,297) | |
| Net loans and advances to | | | | | |
| — financial institutions | 6,663 | — | — | 6,663 | |
| — non-financial institution customers | 489,136 | 182 | 4,611 | 493,929 | |
| | 495,799 | 182 | 4,611 | 500,592 | |

18 INVESTMENTS

| | December 31, | | | March 31, |
|--|---------------|----------------|----------------|----------------|
| | 2003 | 2004 | 2005 | 2006 |
| Financial assets at fair value through profit or loss (Note 18(a)) | 5,061 | 5,607 | 15,869 | 10,622 |
| Available-for-sale investments (Note 18(b)) | 5,792 | 37,683 | 60,086 | 68,608 |
| Held-to-maturity debt securities (Note 18(c)) | 67,672 | 58,180 | 48,711 | 48,187 |
| Receivables (Note 18(d)) | 12,864 | 11,175 | 7,236 | 7,233 |
| | <u>91,389</u> | <u>112,645</u> | <u>131,902</u> | <u>134,650</u> |

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

18 INVESTMENTS (continued)

(a) Financial assets at fair value through profit or loss

| | December 31, | | | March 31, |
|---|--------------|--------------|---------------|---------------|
| | 2003 | 2004 | 2005 | 2006 |
| (i) Trading assets | | | | |
| <i>Listed/quoted</i> | | | | |
| In the Mainland | | | | |
| — PRC government bonds | — | — | 275 | 1 |
| — bonds issued by the PBOC | — | — | 5,081 | 1,788 |
| — bonds issued by PRC policy banks | — | — | 3,507 | 1,858 |
| — other debt securities | — | — | 1,003 | 1,140 |
| — equity investments | — | — | 30 | 24 |
| Outside the Mainland | | | | |
| — other debt securities | — | — | 141 | — |
| — equity investments | — | — | 2 | 9 |
| | — | — | 10,039 | 4,820 |
| Derivative financial instruments (Note 40(g)) | 78 | 66 | 86 | 78 |
| | <u>78</u> | <u>66</u> | <u>10,125</u> | <u>4,898</u> |
| (ii) Financial assets designated at fair value through profit or loss | | | | |
| <i>Listed/quoted</i> | | | | |
| In the Mainland | | | | |
| — PRC government bonds | 4,983 | 5,066 | 5,248 | 5,230 |
| — bonds issued by PRC policy banks | — | 475 | 496 | 494 |
| | <u>4,983</u> | <u>5,541</u> | <u>5,744</u> | <u>5,724</u> |
| | <u>5,061</u> | <u>5,607</u> | <u>15,869</u> | <u>10,622</u> |
| <i>Financial assets at fair value through profit or loss (excluding derivative financial instruments)</i> | | | | |
| Issued by: | | | | |
| Central governments | 4,983 | 5,066 | 5,523 | 5,231 |
| Central banks | — | — | 5,081 | 1,788 |
| Policy banks | — | 475 | 4,003 | 2,352 |
| Banks and other financial institutions | — | — | 141 | 69 |
| Corporate entities | — | — | 1,035 | 1,104 |
| | <u>4,983</u> | <u>5,541</u> | <u>15,783</u> | <u>10,544</u> |

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

18 INVESTMENTS (continued)

(b) Available-for-sale investments

| | December 31, | | | March 31, |
|--|--------------|---------------|---------------|---------------|
| | 2003 | 2004 | 2005 | 2006 |
| <i>Listed/quoted</i> | | | | |
| In the Mainland | | | | |
| — PRC government bonds | 957 | 12,940 | 7,891 | 9,162 |
| — bonds issued by the PBOC | 4,050 | 8,040 | 20,612 | 25,838 |
| — bonds issued by PRC policy banks | 290 | 8,582 | 9,751 | 8,889 |
| — other debt securities | — | — | 6,804 | 8,748 |
| Outside the Mainland | | | | |
| — PRC government bonds | 115 | 632 | — | — |
| — other debt securities | — | 6,057 | 4,901 | 5,052 |
| — other investments | — | 1,349 | 1,211 | 2,014 |
| | <u>5,412</u> | <u>37,600</u> | <u>51,170</u> | <u>59,703</u> |
| <i>Unlisted/unquoted</i> | | | | |
| In the Mainland | | | | |
| — bonds issued by the PBOC | — | — | 6,890 | 6,883 |
| — other debt securities | 1 | 1 | 1 | 1 |
| — equity investments | 38 | 73 | 38 | 38 |
| Outside the Mainland | | | | |
| — other debt securities | 332 | — | 1,979 | 1,975 |
| — equity investments | 9 | 9 | 8 | 8 |
| | <u>380</u> | <u>83</u> | <u>8,916</u> | <u>8,905</u> |
| | <u>5,792</u> | <u>37,683</u> | <u>60,086</u> | <u>68,608</u> |
| Issued by: | | | | |
| Central governments | 1,072 | 13,786 | 7,891 | 9,162 |
| Central banks | 4,050 | 8,040 | 27,502 | 32,721 |
| Policy banks | 290 | 8,582 | 9,751 | 8,889 |
| Banks and other financial institutions | 331 | 5,542 | 7,627 | 8,766 |
| Public sector entities | — | 512 | 611 | 610 |
| Corporate entities | 49 | 1,221 | 6,704 | 8,460 |
| | <u>5,792</u> | <u>37,683</u> | <u>60,086</u> | <u>68,608</u> |

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

18 INVESTMENTS (continued)

(c) Held-to-maturity debt securities

| | December 31, | | | March 31, |
|--|---------------|---------------|---------------|---------------|
| | 2003 | 2004 | 2005 | 2006 |
| <i>Listed/quoted</i> | | | | |
| In the Mainland | | | | |
| — PRC government bonds | 27,442 | 18,232 | 15,321 | 15,293 |
| — bonds issued by the PBOC | 3,160 | 12,579 | 1,137 | 319 |
| — bonds issued by PRC policy banks | 26,122 | 21,533 | 23,532 | 23,512 |
| — other debt securities | 400 | 640 | 1,934 | 2,951 |
| Outside the Mainland | | | | |
| — PRC government bonds | 683 | 171 | — | — |
| — bonds issued by PRC policy banks | 74 | — | — | — |
| — other debt securities | 9,791 | 5,025 | 6,787 | 6,112 |
| | <u>67,672</u> | <u>58,180</u> | <u>48,711</u> | <u>48,187</u> |
| Fair value | <u>68,475</u> | <u>57,737</u> | <u>48,997</u> | <u>48,490</u> |
| Issued by: | | | | |
| Central governments | 29,147 | 18,694 | 15,765 | 15,770 |
| Central banks | 3,160 | 12,579 | 1,137 | 319 |
| Policy banks | 26,196 | 21,533 | 23,532 | 23,512 |
| Banks and other financial institutions | 5,721 | 3,275 | 4,932 | 4,632 |
| Public sector entities | 1,541 | 1,538 | 1,821 | 1,771 |
| Corporate entities | 1,907 | 561 | 1,524 | 2,183 |
| | <u>67,672</u> | <u>58,180</u> | <u>48,711</u> | <u>48,187</u> |

(d) Receivables

| | December 31, | | | March 31, |
|--|---------------|---------------|--------------|--------------|
| | 2003 | 2004 | 2005 | 2006 |
| In the Mainland | | | | |
| — PRC government bonds | 7,105 | 7,099 | 5,388 | 5,092 |
| Outside the Mainland | | | | |
| — other debt securities | 5,759 | 4,076 | 1,848 | 2,141 |
| | <u>12,864</u> | <u>11,175</u> | <u>7,236</u> | <u>7,233</u> |
| Issued by: | | | | |
| Central governments | 7,699 | 7,418 | 5,596 | 5,247 |
| Banks and other financial institutions | 4,424 | 3,757 | 1,479 | 1,826 |
| Public sector entities | 256 | — | — | — |
| Corporate entities | 485 | — | 161 | 160 |
| | <u>12,864</u> | <u>11,175</u> | <u>7,236</u> | <u>7,233</u> |

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

18 INVESTMENTS (continued)**(d) Receivables (continued)**

Receivables are unlisted/unquoted bearer's national bonds issued by the PRC government and other debt investments which the Group has the intention and ability to hold to maturity. These receivables are not quoted in an active market in the PRC or overseas. Accordingly, the Group is unable to disclose their market values. The Group considers the recoverable amounts from these assets upon their maturities are the same as their carrying values and no provision for impairment losses is required.

(e) Financial liabilities at fair value through profit or loss

| | December 31, | | | March 31, |
|---|--------------|------|------|-----------|
| | 2003 | 2004 | 2005 | 2006 |
| Derivative financial instruments at fair value (Note 40(g)) | 75 | 75 | 86 | 116 |

19 FIXED ASSETS**2003**

| | Land and buildings | Investment properties (Note 19(b)) | Construction in progress (Note 19(c)) | Computer equipment | Leasehold improvements | Motor vehicles and other equipment | Total |
|--|-----------------------|--|---|-----------------------|---------------------------|---|-------|
| Cost: | | | | | | | |
| At January 1, 2003 | 3,901 | — | 201 | 1,540 | 1,011 | 890 | 7,543 |
| Additions | 31 | — | 157 | 360 | 100 | 97 | 745 |
| Transfers | (320) | 296 | (2) | — | — | 2 | (24) |
| Disposals/write-offs | (21) | — | (37) | (37) | (211) | (48) | (354) |
| At December 31, 2003 | 3,591 | 296 | 319 | 1,863 | 900 | 941 | 7,910 |
| Accumulated depreciation: | | | | | | | |
| At January 1, 2003 | 513 | — | — | 778 | 534 | 476 | 2,301 |
| Depreciation | 181 | 7 | — | 220 | 132 | 130 | 670 |
| Transfers | (24) | — | — | — | — | — | (24) |
| Written back on disposals/ write-offs | (1) | — | — | (29) | (208) | (46) | (284) |
| At December 31, 2003 | 669 | 7 | — | 969 | 458 | 560 | 2,663 |
| Net book value: | | | | | | | |
| At December 31, 2003 | 2,922 | 289 | 319 | 894 | 442 | 381 | 5,247 |

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

19 FIXED ASSETS (continued)

2004

| | <u>Land and buildings</u> | <u>Investment properties (Note 19(b))</u> | <u>Construction in progress (Note 19(c))</u> | <u>Computer equipment</u> | <u>Leasehold improvements</u> | <u>Motor vehicles and other equipment</u> | <u>Total</u> |
|--|-------------------------------|---|--|-------------------------------|-----------------------------------|---|--------------|
| Cost: | | | | | | | |
| At January 1, 2004 | 3,591 | 296 | 319 | 1,863 | 900 | 941 | 7,910 |
| Additions | 300 | — | 862 | 520 | 188 | 132 | 2,002 |
| Transfers | 308 | — | (308) | — | — | — | — |
| Disposals/write-offs | (39) | — | (63) | (72) | (136) | (234) | (544) |
| At December 31, 2004 | <u>4,160</u> | <u>296</u> | <u>810</u> | <u>2,311</u> | <u>952</u> | <u>839</u> | <u>9,368</u> |
| Accumulated depreciation: | | | | | | | |
| At January 1, 2004 | 669 | 7 | — | 969 | 458 | 560 | 2,663 |
| Depreciation | 177 | 15 | — | 282 | 136 | 121 | 731 |
| Written back on disposals/ write-offs | (11) | — | — | (60) | (134) | (187) | (392) |
| At December 31, 2004 | <u>835</u> | <u>22</u> | <u>—</u> | <u>1,191</u> | <u>460</u> | <u>494</u> | <u>3,002</u> |
| Net book value: | | | | | | | |
| At December 31, 2004 | <u>3,325</u> | <u>274</u> | <u>810</u> | <u>1,120</u> | <u>492</u> | <u>345</u> | <u>6,366</u> |

2005

| | <u>Land and buildings</u> | <u>Investment properties (Note 19(b))</u> | <u>Construction in progress (Note 19(c))</u> | <u>Computer equipment</u> | <u>Leasehold improvements</u> | <u>Motor vehicles and other equipment</u> | <u>Total</u> |
|--|-------------------------------|---|--|-------------------------------|-----------------------------------|---|---------------|
| Cost: | | | | | | | |
| At January 1, 2005 | 4,160 | 296 | 810 | 2,311 | 952 | 839 | 9,368 |
| Additions | 68 | — | 402 | 497 | 169 | 120 | 1,256 |
| Transfers | (100) | 262 | (90) | — | — | — | 72 |
| Disposals/write-offs | (42) | — | (1) | (135) | (1) | (49) | (228) |
| At December 31, 2005 | <u>4,086</u> | <u>558</u> | <u>1,121</u> | <u>2,673</u> | <u>1,120</u> | <u>910</u> | <u>10,468</u> |
| Accumulated depreciation: | | | | | | | |
| At January 1, 2005 | 835 | 22 | — | 1,191 | 460 | 494 | 3,002 |
| Depreciation | 184 | 34 | — | 367 | 150 | 119 | 854 |
| Transfers | (20) | 44 | — | — | — | — | 24 |
| Written back on disposals/ write-offs | (13) | — | — | (135) | — | (41) | (189) |
| At December 31, 2005 | <u>986</u> | <u>100</u> | <u>—</u> | <u>1,423</u> | <u>610</u> | <u>572</u> | <u>3,691</u> |
| Net book value: | | | | | | | |
| At December 31, 2005 | <u>3,100</u> | <u>458</u> | <u>1,121</u> | <u>1,250</u> | <u>510</u> | <u>338</u> | <u>6,777</u> |

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

19 FIXED ASSETS (continued)

2006

| | Land and buildings | Investment properties (Note 19(b)) | Construction in progress (Note 19(c)) | Computer equipment | Leasehold improvements | Motor vehicles and other equipment | Total |
|--|-----------------------|--|---|-----------------------|---------------------------|---|---------------|
| Cost: | | | | | | | |
| At January 1, 2006 | 4,086 | 558 | 1,121 | 2,673 | 1,120 | 910 | 10,468 |
| Additions | 1 | — | 82 | 42 | 42 | 10 | 177 |
| Transfers | (39) | 43 | (4) | — | — | — | — |
| Disposals/write-offs | (4) | — | (2) | (16) | — | (6) | (28) |
| At March 31, 2006 | <u>4,044</u> | <u>601</u> | <u>1,197</u> | <u>2,699</u> | <u>1,162</u> | <u>914</u> | <u>10,617</u> |
| Accumulated depreciation: | | | | | | | |
| At January 1, 2006 | 986 | 100 | — | 1,423 | 610 | 572 | 3,691 |
| Depreciation | 49 | 7 | — | 99 | 37 | 28 | 220 |
| Transfers | (20) | 20 | — | — | — | — | — |
| Written back on disposals/ write-offs | (2) | — | — | (9) | — | (2) | (13) |
| At March 31, 2006 | <u>1,013</u> | <u>127</u> | <u>—</u> | <u>1,513</u> | <u>647</u> | <u>598</u> | <u>3,898</u> |
| Net book value: | | | | | | | |
| At March 31, 2006 | <u>3,031</u> | <u>474</u> | <u>1,197</u> | <u>1,186</u> | <u>515</u> | <u>316</u> | <u>6,719</u> |

(a) Analysed by remaining terms of leases

The net book value of land and buildings, and investment properties at the balance sheet date is analysed by the remaining terms of the leases as follows:

| | December 31, | | | March 31, |
|--|--------------|--------------|--------------|--------------|
| | 2003 | 2004 | 2005 | 2006 |
| Held in the PRC | | | | |
| — long term leases (over 50 years) | 271 | 353 | 423 | 422 |
| — medium term leases (10 – 50 years) | 2,877 | 3,186 | 3,064 | 3,013 |
| | 3,148 | 3,539 | 3,487 | 3,435 |
| Held in Hong Kong | | | | |
| — medium term leases (10 – 50 years) | 63 | 60 | 71 | 70 |
| | <u>3,211</u> | <u>3,599</u> | <u>3,558</u> | <u>3,505</u> |

(b) Investment properties mainly represent the portion of the Bank's headquarters in Shenzhen that has been leased out under operating leases or is available for lease. The Directors considered that as at March 31, 2006, there was no material difference between the net book values and fair values of these properties where the fair values represent the net present value of the future lease payments at current interest rates. Leases of investment properties run for periods of less than 5 years. The Group's rental income to be received over the remaining terms of the non-cancellable operating leases was RMB74 million as at March 31, 2006 (December 31, 2005: RMB74 million; December 31, 2004: RMB72 million; December 31, 2003: RMB110 million).

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****19 FIXED ASSETS (continued)**

(c) As at March 31, 2006, December 31, 2005, December 31, 2004 and December 31, 2003, there was cost of land use right of RMB387 million included in the construction in progress. For the three months ended March 31, 2006, the amortisation of the land use right of RMB2.16 million was capitalised as the cost of the properties built on the land (December 31, 2005: RMB8.65 million; December 31, 2004: Nil; December 31, 2003: Nil). Upon completion of the construction, the property will be transferred to relevant asset categories based on the intention of usage.

(d) As at the relevant balance sheet date, the Directors considered that there was no impairment loss on fixed assets.

20 DEFERRED TAX**(a) Recognised deferred tax assets**

The components of deferred tax assets/(liabilities) are as follows:

| | December 31, | | | March 31, |
|---|--------------|--------------|--------------|--------------|
| | 2003 | 2004 | 2005 | 2006 |
| Impairment losses on loans and advances to customers and other assets | 1,346 | 1,884 | 2,292 | 2,429 |
| Write-off of overdue interest receivable | 171 | 86 | — | — |
| Investment revaluation reserve | — | 12 | (71) | (62) |
| Others | (11) | (45) | (55) | (47) |
| | <u>1,506</u> | <u>1,937</u> | <u>2,166</u> | <u>2,320</u> |

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

20 DEFERRED TAX (continued)*(b) Movements of deferred tax*

| | Impairment losses on loans and advances to customers and other assets | Write-off of overdue interest receivable | Investment revaluation reserve | Others | Total |
|---|---|---|--------------------------------------|-------------|--------------|
| At January 1, 2003 | 1,549 | 375 | — | (20) | 1,904 |
| Recognised in consolidated income statement | (152) | (204) | — | 9 | (347) |
| Write-offs | (51) | — | — | — | (51) |
| At December 31, 2003 | <u>1,346</u> | <u>171</u> | <u>—</u> | <u>(11)</u> | <u>1,506</u> |
| At January 1, 2004 | 1,346 | 171 | — | (11) | 1,506 |
| Recognised in consolidated income statement | 570 | (85) | — | (34) | 451 |
| Recognised in reserves | — | — | 12 | — | 12 |
| Write-offs | (32) | — | — | — | (32) |
| At December 31, 2004 | <u>1,884</u> | <u>86</u> | <u>12</u> | <u>(45)</u> | <u>1,937</u> |
| At January 1, 2005 | 1,884 | 86 | 12 | (45) | 1,937 |
| Recognised in consolidated income statement | 478 | (86) | — | (10) | 382 |
| Recognised in reserves | — | — | (83) | — | (83) |
| Write-offs | (70) | — | — | — | (70) |
| At December 31, 2005 | <u>2,292</u> | <u>—</u> | <u>(71)</u> | <u>(55)</u> | <u>2,166</u> |
| At January 1, 2006 | 2,292 | — | (71) | (55) | 2,166 |
| Recognised in consolidated income statement | 137 | — | — | 8 | 145 |
| Recognised in reserves | — | — | 9 | — | 9 |
| At March 31, 2006 | <u>2,429</u> | <u>—</u> | <u>(62)</u> | <u>(47)</u> | <u>2,320</u> |

21 OTHER ASSETS

| | December 31, | | | March 31, |
|-----------------------------------|--------------|--------------|--------------|--------------|
| | 2003 | 2004 | 2005 | 2006 |
| Interest receivable | | | | |
| — debt securities | 1,364 | 1,480 | 1,497 | 1,767 |
| — loans and advances to customers | 318 | 568 | 705 | 706 |
| — others | 42 | 63 | 62 | 109 |
| | <u>1,724</u> | <u>2,111</u> | <u>2,264</u> | <u>2,582</u> |
| Amounts pending for settlement | 139 | 187 | 185 | 1,404 |
| Reposessed assets | 1,250 | 678 | 579 | 570 |
| Prepaid lease payments | 38 | 70 | 89 | 117 |
| Prepaid land use rights | 186 | — | — | — |
| Others | 452 | 446 | 401 | 698 |
| | <u>3,789</u> | <u>3,492</u> | <u>3,518</u> | <u>5,371</u> |

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

22 DEPOSITS FROM BANKS AND OTHER FINANCIAL INSTITUTIONS

| | December 31, | | | March 31, |
|--|---------------|---------------|---------------|---------------|
| | 2003 | 2004 | 2005 | 2006 |
| Deposits from banks | 5,792 | 4,437 | 8,928 | 7,204 |
| Deposits from other financial institutions | 22,707 | 20,616 | 30,745 | 29,055 |
| | <u>28,499</u> | <u>25,053</u> | <u>39,673</u> | <u>36,259</u> |

23 AMOUNTS DUE TO CENTRAL BANK

These represented bills rediscounted to the PBOC.

24 PLACEMENTS FROM BANKS AND OTHER FINANCIAL INSTITUTIONS

| | December 31, | | | March 31, |
|--|---------------|--------------|--------------|--------------|
| | 2003 | 2004 | 2005 | 2006 |
| Money market takings | | | | |
| — banks | 782 | 1,506 | 424 | 287 |
| — other financial institutions | 13 | — | — | — |
| | <u>795</u> | <u>1,506</u> | <u>424</u> | <u>287</u> |
| Balances under repurchase agreements | | | | |
| — banks | 6,283 | — | 1,505 | 932 |
| — other financial institutions | 2,120 | 3,605 | 1,537 | 184 |
| | <u>8,403</u> | <u>3,605</u> | <u>3,042</u> | <u>1,116</u> |
| Rediscounted bills | 19,361 | 2,832 | 108 | 218 |
| | <u>28,559</u> | <u>7,943</u> | <u>3,574</u> | <u>1,621</u> |

Assets sold under the above repurchase agreements are registered national bonds issued by the PRC government, bonds issued by policy banks and other debt securities of equivalent amounts.

25 DEPOSITS FROM CUSTOMERS

| | December 31, | | | March 31, |
|---------------------------------|----------------|----------------|----------------|----------------|
| | 2003 | 2004 | 2005 | 2006 |
| Demand deposits | | | | |
| — corporate customers | 164,095 | 198,152 | 219,230 | 212,950 |
| — retail customers | 76,663 | 96,833 | 118,566 | 125,405 |
| | <u>240,758</u> | <u>294,985</u> | <u>337,796</u> | <u>338,355</u> |
| Time deposits | | | | |
| — corporate customers | 86,614 | 116,546 | 159,245 | 176,538 |
| — retail customers | 79,514 | 101,055 | 137,363 | 152,378 |
| | <u>166,128</u> | <u>217,601</u> | <u>296,608</u> | <u>328,916</u> |
| | <u>406,886</u> | <u>512,586</u> | <u>634,404</u> | <u>667,271</u> |

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****26 ISSUED DEBT SECURITIES*****(a) Certificates of deposit issued***

On June 21, 2004, the Bank issued 3-year certificates of deposit at a nominal value of US\$150 million with interest at LIBOR +0.35% per annum payable quarterly.

(b) Convertible bonds issued

On November 10, 2004, the Bank issued a 5-year convertible bond with a nominal value of RMB6.5 billion. The interest rates are 1.0% for the first year, 1.375% for the second year, 1.75% for the third year, 2.125% for the fourth year and 2.5% for the fifth year, payable on November 10 each year. The convertible bonds can be converted into the Bank's shares at the holder's option at RMB9.34 per share during the period from May 10, 2005 to November 10, 2009. Upon maturity, an additional 6% interest will be given to bond holders who have not converted the bonds into shares.

The conversion price of the bonds was revised from RMB9.34 per share to RMB6.23 per share with effect from June 17, 2005 following the issue of bonus shares by the Bank in 2005.

The conversion price of the bonds has been further revised from RMB6.23 per share to RMB5.74 per share with effect from February 24, 2006 following the issue of bonus shares by the Bank in 2006.

The Bank has an early redemption option which commences six months after the bonds' issue date and lapses on the maturity date. During that period, the Bank may redeem any outstanding convertible bonds at 103% of the nominal value of the convertible bonds plus the accrued interest if the closing price of the Bank's listed A shares is more than 125% of the then applicable conversion price for 20 consecutive business days.

During the final year before the maturity date of the convertible bonds, if the last traded price of the Bank's listed A shares falls below 75% of the conversion price for 20 consecutive trading days, the bond holders can exercise the put option to sell to the Bank all or a portion of the outstanding bonds at 108.5% of the nominal value of the convertible bonds plus accrued interest.

Details of the convertible bonds are as follows:

| | December 31, | | | March 31, |
|--|---------------------|-------------|-------------|------------------|
| | 2003 | 2004 | 2005 | 2006 |
| Initial recognition: | | | | |
| — Nominal value | — | 6,500 | 6,500 | 6,500 |
| — Issuance cost | — | (65) | (65) | (65) |
| — Equity component | — | (918) | (918) | (918) |
| Liability component at issue date | — | 5,517 | 5,517 | 5,517 |
| Accretion | — | 33 | 227 | 233 |
| Amounts converted to shares | — | — | (560) | (5,708) |
| Liability component as at December 31/March 31 | — | 5,550 | 5,184 | 42 |

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

26 ISSUED DEBT SECURITIES (continued)*(c) Other debts issued*

| <u>Particulars</u> | <u>Terms</u> | <u>Date of issue</u> | <u>Annual fixed interest rate</u> (%) | <u>Nominal value</u> (in million) |
|------------------------|--------------|--|--|--------------------------------------|
| Fixed term notes | 36 months | From October 13, 2005 to October 26, 2005 | 2.13 | 5,000 |
| Fixed term notes | 60 months | From October 13, 2005 to October 26, 2005 | 2.56 | 5,000 |

The China Banking Regulatory Commission (the “CBRC”) and the PBOC approved the Bank’s issuance of a total of RMB15 billion fixed term notes on September 29, 2005 (Yin Jian Fu [2005] No. 252) and October 9, 2005 (Yin Fu [2005] No. 75). The Bank issued a total of RMB10 billion fixed rate term notes during the period from October 13, 2005 to October 26, 2005. Interest on these notes is payable annually.

(d) Subordinated notes issued

| <u>Particulars</u> | <u>Terms</u> | <u>Date of issue</u> | <u>Annual fixed interest rate</u> (%) | <u>Nominal value</u> (in million) |
|------------------------|--------------|-------------------------------------|--|--------------------------------------|
| Fixed rate notes | 61 months | March 31, 2004 and June 10, 2004 | 4.59 to 5.1 | 3,500 |

The CBRC approved the Bank’s issuance of RMB3,500 million subordinated notes on March 30, 2004 (Yin Jian Fu [2004] No. 36), and the amount has been included as supplementary capital in calculating the Bank’s capital adequacy ratio. Interest on the subordinated notes is payable annually.

27 OTHER LIABILITIES

| | <u>December 31,</u> | | | <u>March 31,</u> |
|--|---------------------|--------------|--------------|------------------|
| | <u>2003</u> | <u>2004</u> | <u>2005</u> | <u>2006</u> |
| Interest payable | 1,520 | 2,012 | 2,705 | 2,850 |
| Clearing and settlement accounts | 657 | 910 | 812 | 2,824 |
| Salaries and welfare payable (Note 28) | 1,159 | 1,898 | 2,476 | 2,343 |
| Deferred interest income on discounted bills | 622 | 575 | 583 | 669 |
| Business tax and surcharges payable | 249 | 372 | 575 | 498 |
| Cheques and remittances returned | 145 | 50 | 106 | 23 |
| Others | 713 | 896 | 1,029 | 1,591 |
| | <u>5,065</u> | <u>6,713</u> | <u>8,286</u> | <u>10,798</u> |

28 STAFF WELFARE SCHEME*(a) Welfare payable*

This includes statutory welfare payable, which is accrued based on 14% of the total salaries.

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****28 STAFF WELFARE SCHEME (continued)*****(b) Retirement benefits******(i) Defined contribution schemes***

In accordance with the regulations in the PRC, the Group participates in statutory retirement schemes organised by the municipal and provincial governments for its employees. The Group's contributions to the schemes are determined by local governments and vary at a range of 8.0% to 35.0% (2005: 8.0% to 35.0%; 2004: 8.0% to 24.0%; 2003: 9.0% to 25.5%) of the staff salaries.

In addition to the above statutory retirement schemes, the Group has established a supplementary defined contribution plan for its employees. The Group's annual contributions to this plan is determined based on 8.33% of the staff salaries since January 1, 2004 (2003: 5%).

Upon retirement, an eligible member of the schemes is entitled to the retirement benefits, equal to a fixed proportion of the average salary specified by the municipal and provincial governments prevailing at his or her retirement date. The Group's total contributions during the Relevant Periods are disclosed in Note 7.

(ii) Supplementary retirement scheme

In 2005, the Group purchased two annuity contracts with total premiums of RMB500 million from two independent life insurance companies to provide supplementary defined contribution retirement benefits to its full-time employees on payroll as of December 31, 2005. New employees who join the Group after December 31, 2005 are not eligible for this benefit. This was a one-off voluntary payment and the Group has no further obligations to make future contributions.

The Group has no other material obligations for the payment of other post retirement benefits other than the contributions described above.

(c) Staff quarters

The Group purchases quarters by using the public welfare fund, and leases to the staff at market rates on short term basis. Rental income is recognised in the consolidated income statement as other net income.

(d) Staff incentive scheme

The Group has implemented a staff performance bonus scheme during the years ended December 31, 2003, 2004 and 2005. The performance bonus was accrued at a fixed percentage based on the growth in net profit for the year as approved by the Board of Directors. A new staff performance bonus scheme for years beginning 2006 was approved by the Board on June 30, 2006.

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

29 SHARE CAPITAL

| | Registered and issued share capital | |
|--|-------------------------------------|--------|
| | No. of shares (in million) | Amount |
| At January 1, 2003 and December 31, 2003 | 5,707 | 5,707 |
| At January 1, 2004 | 5,707 | 5,707 |
| Bonus shares issued | 1,141 | 1,141 |
| At December 31, 2004 | 6,848 | 6,848 |
| At January 1, 2005 | 6,848 | 6,848 |
| Bonus shares issued | 3,424 | 3,424 |
| Conversion of convertible bonds | 102 | 102 |
| At December 31, 2005 | 10,374 | 10,374 |
| At January 1, 2006 | 10,374 | 10,374 |
| Bonus shares issued | 971 | 971 |
| Conversion of convertible bonds | 934 | 934 |
| At March 31, 2006 | 12,279 | 12,279 |

By type of share:

| | No. of shares | | | |
|---|---------------|-------|--------|-----------|
| | December 31, | | | March 31, |
| | 2003 | 2004 | 2005 | 2006 |
| Unlisted legal person shares (note) | 4,207 | 5,048 | 7,572 | 7,573 |
| Listed shares | 1,500 | 1,800 | 2,802 | 4,706 |
| | 5,707 | 6,848 | 10,374 | 12,279 |

Note: Subsequent to the completion of the Bank's Share Reform Scheme, the unlisted legal person shares become listed shares subject to trading restriction with effect from February 27, 2006.

On May 10, 2004, bonus shares were issued at a ratio of 2 bonus shares for every 10 shares of the Bank by capitalisation of an amount of RMB1,141 million from the capital reserve. The registered and issued capital increased to RMB6,848 million accordingly.

On June 17, 2005, bonus shares were issued at a ratio of 5 bonus shares for every 10 shares of the Bank by capitalisation of an amount of RMB3,424 million from the capital reserve. In addition, the Bank issued 102 million shares upon conversion of the convertible bonds of RMB560 million during the year ended December 31, 2005, resulting in the increase in share capital and capital reserve of RMB102 million and RMB473 million respectively. As a result, the Bank's registered and issued capital increased from RMB6,848 million to RMB10,374 million.

On February 24, 2006, bonus shares were issued at a ratio of 0.8589 bonus shares for every 10 shares of the Bank by capitalisation of an amount of RMB971 million from the capital reserve. In addition, the Bank issued 934 million shares upon conversion of the convertible bonds of RMB5,148 million during the three months period ended March 31, 2006, resulting in the increase in share capital

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****29 SHARE CAPITAL (continued)**

and capital reserve of RMB934 million and RMB4,309 million respectively. As a result, the Bank's registered and issued capital increased from RMB10,374 million to RMB12,279 million.

30 CAPITAL RESERVE

The capital reserve primarily represents share premium and equity component of the convertible bonds issued by the Bank. The capital reserve can be used to issue shares with the shareholders' approval.

31 SURPLUS RESERVE

Surplus reserve includes statutory surplus reserve and statutory public welfare fund.

Statutory surplus reserve is calculated according to the requirements of the Accounting Standards for Business Enterprises, the Accounting Regulations for Financial Enterprises (2001) and other relevant regulations issued by the Ministry of Finance of the People's Republic of China (the "MOF") and is provided at a minimum of 10% of the audited profit after tax, until the reserve balance is equal to 50% of the Bank's registered share capital. Surplus reserve can be used to offset accumulated losses or capitalised as paid-up capital with the approval of shareholders.

Prior to January 1, 2006, statutory public welfare fund was calculated according to the requirements of the Accounting Standards for Business Enterprises, the Accounting Regulations for Financial Enterprises (2001) and other relevant regulations issued by the MOF and was provided at 5% to 10% of the audited profit after tax in accordance with the Company Law of the PRC. Effective from January 1, 2006, the Bank is no longer required to make further appropriation to the statutory public welfare fund following the issuance of revisions to the Company Law of the PRC on October 27, 2005.

The purpose of statutory public welfare fund is to provide staff facilities and other staff benefits. It is not distributable other than in liquidation.

32 INVESTMENT REVALUATION RESERVE

Investment revaluation reserve has been accounted for in accordance with the accounting policies adopted for the measurement of the available-for-sale financial assets at fair value, net of deferred tax.

33 REGULATORY GENERAL RESERVE

Pursuant to the "Administrative Measures on Provisioning for Doubtful Debts by Financial Institutions" (Cai Jin 2005 No. 49) issued by the MOF on May 17, 2005 and other related rules, the Group sets up a regulatory general reserve calculated as a percentage of the total risk assets at the balance sheet date, through a transfer directly from the retained profits, to cover its potential losses that are not yet incurred. The regulatory general reserve forms part of the equity of the Group.

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

34 PROFIT APPROPRIATIONS

(a) Dividends declared and paid

| | Years ended December 31, | | | Three months ended March 31, | |
|---|--------------------------|------------|------------|------------------------------|----------|
| | 2003 | 2004 | 2005 | 2005 (unaudited) | 2006 |
| Dividends in respect of the previous year, approved, declared and paid during the period of RMB0.8 (2005: RMB1.1; 2004: RMB0.92; 2003: RMB1.2; three months ended March 31, 2005 (unaudited): RMB1.1) per every 10 shares | <u>685</u> | <u>525</u> | <u>753</u> | <u>—</u> | <u>—</u> |

(b) Proposed profit appropriations

| | Amount appropriated in respect of the years ended December 31, | | | Amount appropriated in respect of the three months ended March 31, |
|---|--|--------------|--------------|--|
| | 2003 | 2004 | 2005 | 2006 |
| Statutory surplus reserve | 223 | 315 | 393 | — |
| Statutory public welfare fund | 223 | 314 | 393 | — |
| Dividends of RMB: Nil (2005: RMB0.8; 2004: RMB1.1; 2003: RMB0.92) per every 10 shares | <u>525</u> | <u>753</u> | <u>830</u> | <u>—</u> |
| Total | <u>971</u> | <u>1,382</u> | <u>1,616</u> | <u>—</u> |

Notes:

- (i) 2003 profit was appropriated in accordance with the resolution passed at the twenty-seventh meeting of the fifth Board of Directors held on February 16, 2004 and as approved in the annual general meeting held on March 19, 2004.
- (ii) 2004 profit was appropriated in accordance with the resolution passed at the eighth meeting of the sixth Board of Directors held on March 29, 2005 and as approved in the annual general meeting held on May 17, 2005.
- (iii) 2005 profit was appropriated in accordance with the resolution passed at the twenty-fourth meeting of the sixth Board of Directors held on April 10, 2006 and as approved in the annual general meeting held on May 16, 2006. The actual amount approved increased to RMB983 million from RMB830 million (see (iv) below).
- (iv) Additional dividends totalling RMB153 million in respect of the year ended December 31, 2005 were declared on new shares issued as a result of the conversion of convertible bonds exercised during the first three months of 2006. This amount together with the original dividend of RMB830 million proposed at December 31, 2005 were paid in June 2006.
- (v) In the light of the Global Offering, the Bank's Board of Directors approved on June 30, 2006, a special dividend distribution of RMB0.18 per share for the Bank's holders of A Shares from its distributable retained profits at December 31, 2005. The special dividend of RMB2,210 million was approved by the Bank's shareholders in an extraordinary general meeting on August 19, 2006.

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

35 NOTES TO CONSOLIDATED CASH FLOW STATEMENTS*(a) Analysis of the balances of cash and cash equivalents*

| | December 31, | | | March 31, |
|--|---------------|---------------|----------------|----------------|
| | 2003 | 2004 | 2005 | 2006 |
| Cash | 2,922 | 3,942 | 3,915 | 3,712 |
| With original maturity within 3 months: | | | | |
| — balances with banks and other financial institutions | 8,308 | 9,147 | 10,481 | 14,113 |
| — balances with central bank | 50,652 | 54,987 | 62,102 | 54,850 |
| — placements with banks and other financial institutions | 21,592 | 22,629 | 38,400 | 28,448 |
| — investment securities: | | | | |
| — at fair value through profit or loss | — | — | 270 | 100 |
| — available-for-sale | — | 2,323 | 5,233 | 2,344 |
| — held-to-maturity | 3,075 | 2,924 | 208 | — |
| — receivables | — | — | — | 155 |
| | <u>86,549</u> | <u>95,952</u> | <u>120,609</u> | <u>103,722</u> |

(b) Significant non-cash transactions

Apart from the non-cash transactions relating to the conversion of convertible bonds to share capital during the Relevant Periods of which the details are included in Note 26(b), there were no other significant non-cash transactions.

36 SEGMENTAL REPORTING

The Group's principal activities are commercial lending and deposits taking. The funding of existing retail and corporate loans are mainly from customer deposits.

Segment information is presented in respect of the Group's business and geographical segments. Business segment information is chosen as the primary reporting format as it is more relevant to the Group's operating activities.

For the purpose of segmental analysis, external net interest income/expense represents the net interest income earned or expenses incurred on banking businesses originated by these segments. Internal net interest income/expense represents the allocation of revenue to reflect the benefits of funding sources allocated to the business segments by way of internal funds transfer pricing mechanism. The internal funds transfer pricing mechanism has taken into account the structure and market returns of the assets and liabilities portfolio. Cost allocation is based on the direct cost incurred by the respective business segments and apportionment of management overheads. Inter-segment interest income and expenses recognised through the internal funds transfer pricing mechanism are eliminated in the consolidated results of the operations.

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****36 SEGMENTAL REPORTING (continued)****(a) Business segments**

The Group comprises the following main business segments:

- Corporate banking

The provision of financial services to corporations and institutions includes lending and deposit taking activities, project and structured finance products, syndicated loans, cash management, investment advice and other investment services.

- Retail banking

The provision of financial services to retail customers includes lending and deposit taking activities, credit card facilities and investment services.

- Treasury business

It covers interbank and capital market activities and proprietary trading.

- Others and unallocated

These represent equity investments, and assets, liabilities, income and expenses of the head office that are not directly attributable to a segment or cannot be allocated on a reasonable basis.

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

36 SEGMENTAL REPORTING (continued)

(a) Business segments (continued)

| | Year ended December 31, 2003 | | | | |
|---|------------------------------|----------------|-------------------|------------------------|-----------------|
| | Corporate banking | Retail banking | Treasury business | Others and unallocated | Total |
| External net interest income/(expense) | 7,412 | (207) | 2,914 | — | 10,119 |
| Internal net interest (expense)/income | (600) | 2,434 | (1,834) | — | — |
| Net interest income | 6,812 | 2,227 | 1,080 | — | 10,119 |
| Net fee and commission income/(expense) | 305 | 214 | (22) | 62 | 559 |
| Other net income | 226 | 75 | 140 | 50 | 491 |
| Operating income | 7,343 | 2,516 | 1,198 | 112 | 11,169 |
| Operating expenses | | | | | |
| — depreciation | (328) | (315) | (27) | — | (670) |
| — others | (2,585) | (1,931) | (327) | (3) | (4,846) |
| | (2,913) | (2,246) | (354) | (3) | (5,516) |
| Provision for impairment losses | (1,960) | (200) | (76) | — | (2,236) |
| Total expenses | (4,873) | (2,446) | (430) | (3) | (7,752) |
| Profit before tax | 2,470 | 70 | 768 | 109 | 3,417 |
| Capital expenditure | 365 | 350 | 30 | — | 745 |
| December 31, 2003 | | | | | |
| Segment assets | 268,805 | 36,442 | 184,725 | 4,045 | 494,017 |
| Segment liabilities | 250,709 | 156,177 | 63,122 | 5,655 | 475,663 |
| | Year ended December 31, 2004 | | | | |
| | Corporate banking | Retail banking | Treasury business | Others and unallocated | Total |
| External net interest income | 11,057 | 497 | 2,738 | — | 14,292 |
| Internal net interest (expense)/income | (801) | 2,956 | (2,155) | — | — |
| Net interest income | 10,256 | 3,453 | 583 | — | 14,292 |
| Net fee and commission income/(expense) | 421 | 421 | (25) | 72 | 889 |
| Other net income/(loss) | 280 | 84 | (1) | 132 | 495 |
| Operating income | 10,957 | 3,958 | 557 | 204 | 15,676 |
| Operating expenses | | | | | |
| — depreciation | (358) | (344) | (29) | — | (731) |
| — others | (3,712) | (2,578) | (408) | (3) | (6,701) |
| | (4,070) | (2,922) | (437) | (3) | (7,432) |
| Provision for impairment losses | (2,660) | (421) | 15 | — | (3,066) |
| Total expenses | (6,730) | (3,343) | (422) | (3) | (10,498) |
| Profit before tax | 4,227 | 615 | 135 | 201 | 5,178 |
| Capital expenditure | 981 | 941 | 80 | — | 2,002 |
| December 31, 2004 | | | | | |
| Segment assets | 313,186 | 56,700 | 212,078 | 4,751 | 586,715 |
| Segment liabilities | 314,698 | 197,888 | 43,363 | 8,808 | 564,757 |

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

36 SEGMENTAL REPORTING (continued)

(a) Business segments (continued)

| | Year ended December 31, 2005 | | | | |
|--|------------------------------|----------------|-------------------|------------------------|-----------------|
| | Corporate banking | Retail banking | Treasury business | Others and unallocated | Total |
| External net interest income | 12,309 | 526 | 3,807 | — | 16,642 |
| Internal net interest (expense)/income | (74) | 3,488 | (3,414) | — | — |
| Net interest income | 12,235 | 4,014 | 393 | — | 16,642 |
| Net fee and commission income | 681 | 777 | 19 | 90 | 1,567 |
| Other net income | 379 | 107 | 418 | 101 | 1,005 |
| Operating income | 13,295 | 4,898 | 830 | 191 | 19,214 |
| Operating expenses | | | | | |
| — depreciation | (470) | (350) | (34) | — | (854) |
| — others | (4,474) | (3,287) | (496) | (4) | (8,261) |
| | (4,944) | (3,637) | (530) | (4) | (9,115) |
| Provision for impairment losses | (3,176) | (399) | (62) | — | (3,637) |
| Total expenses | (8,120) | (4,036) | (592) | (4) | (12,752) |
| Profit before tax | 5,175 | 862 | 238 | 187 | 6,462 |
| Capital expenditure | 691 | 515 | 50 | — | 1,256 |

| | December 31, 2005 | | | | |
|--------------------------------------|-------------------|----------------|-------------------|------------------------|----------------|
| | Corporate banking | Retail banking | Treasury business | Others and unallocated | Total |
| Segment assets | 390,429 | 75,331 | 263,748 | 5,105 | 734,613 |
| Segment liabilities | 378,475 | 255,929 | 63,210 | 11,001 | 708,615 |

| | Three months ended March 31, 2005 (unaudited) | | | | |
|--|---|----------------|-------------------|------------------------|----------------|
| | Corporate banking | Retail banking | Treasury business | Others and unallocated | Total |
| External net interest income | 2,738 | 150 | 832 | — | 3,720 |
| Internal net interest (expense)/income | (94) | 951 | (857) | — | — |
| Net interest income/(expense) | 2,644 | 1,101 | (25) | — | 3,720 |
| Net fee and commission income | 123 | 117 | 5 | 19 | 264 |
| Other net income | 69 | 22 | 143 | 15 | 249 |
| Operating income | 2,836 | 1,240 | 123 | 34 | 4,233 |
| Operating expenses | | | | | |
| — depreciation | (94) | (69) | (7) | — | (170) |
| — others | (1,053) | (701) | (110) | (1) | (1,865) |
| | (1,147) | (770) | (117) | (1) | (2,035) |
| Provision for impairment losses | (545) | (63) | (19) | — | (627) |
| Total expenses | (1,692) | (833) | (136) | (1) | (2,662) |
| Profit/(loss) before tax | 1,144 | 407 | (13) | 33 | 1,571 |
| Capital expenditure | 84 | 62 | 6 | — | 152 |

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

36 SEGMENTAL REPORTING (continued)

(a) Business segments (continued)

| | Three months ended March 31, 2006 | | | | |
|---|-----------------------------------|----------------|-------------------|------------------------|----------------|
| | Corporate banking | Retail banking | Treasury business | Others and unallocated | Total |
| External net interest income | 2,991 | 96 | 1,339 | — | 4,426 |
| Internal net interest (expense)/income | (93) | 774 | (681) | — | — |
| Net interest income | 2,898 | 870 | 658 | — | 4,426 |
| Net fee and commission income/(expense) | 202 | 250 | (2) | 24 | 474 |
| Other net income | 105 | 31 | 14 | 12 | 162 |
| Operating income | 3,205 | 1,151 | 670 | 36 | 5,062 |
| Operating expenses | | | | | |
| — depreciation | (121) | (91) | (8) | — | (220) |
| — others | (1,145) | (761) | (121) | (1) | (2,028) |
| | (1,266) | (852) | (129) | (1) | (2,248) |
| Provision for impairment losses | (557) | (151) | 121 | — | (587) |
| Total expenses | (1,823) | (1,003) | (8) | (1) | (2,835) |
| Profit before tax | 1,382 | 148 | 662 | 35 | 2,227 |
| Capital expenditure | 98 | 74 | 5 | — | 177 |
| March 31, 2006 | | | | | |
| Segment assets | 428,164 | 79,533 | 251,862 | 7,121 | 766,680 |
| Segment liabilities | 389,488 | 277,783 | 52,723 | 14,065 | 734,059 |

(b) Geographical segments

The Group operates principally in the PRC with branches located in 31 provinces, autonomous regions and municipalities directly under the central government.

In presenting information on the basis of geographical segments, operating income is allocated based on the location of the branches that generated the revenue. Segment assets and capital expenditure are allocated based on the geographical location of the underlying assets.

Geographical segments, as defined for management reporting purposes, are as follows:

- “Eastern China” region refers to the areas serviced by the following branches of the Group: Shanghai Municipality, Jiangsu Province, Zhejiang Province, Shandong Province, Fujian Province, Anhui Province, City of Qingdao, City of Ningbo, City of Suzhou and City of Xiamen;
- “Southern and Central China” region refers to the areas serviced by the following branches of the Group: Guangdong Province, City of Shenzhen, Hunan Province, Jiangxi Province, Hubei Province, Henan Province, City of Dongguan and City of Foshan;
- “Western China” region refers to the areas serviced by the following branches of the Group: Sichuan Province, Chongqing Municipality, Yunnan Province, Shaanxi Province, Gansu Province, and Xinjiang Autonomous Region;

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

36 SEGMENTAL REPORTING (continued)

(b) Geographical segments (continued)

- “Northern China” region refers to the areas serviced by the following branches of the Group: Beijing Municipality, Tianjin Municipality, Liaoning Province, Heilongjiang Province and City of Dalian; and
- “Others” refer to operations of Hong Kong branch and the subsidiary.

| | Year ended December 31, 2003 | | | | | | | | | | | |
|-------------------------------------|------------------------------|----|-------------------------------|----|------------------|----|-------------------|----|--------|---|---------|-----|
| | Eastern China | | Southern and Central China | | Western China | | Northern China | | Others | | Total | |
| | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % |
| Total operating income | | | | | | | | | | | | |
| (note (i)) | 4,622 | 28 | 6,874 | 42 | 1,858 | 12 | 2,943 | 18 | 45 | — | 16,342 | 100 |
| Capital expenditure (note (ii)) . . | 230 | 31 | 290 | 39 | 96 | 13 | 128 | 17 | 1 | — | 745 | 100 |
| Total assets | 104,950 | 21 | 264,285 | 54 | 45,255 | 9 | 78,095 | 16 | 1,432 | — | 494,017 | 100 |
| Gross loans and advances to | | | | | | | | | | | | |
| customers | 101,614 | 33 | 97,435 | 32 | 40,963 | 13 | 66,755 | 22 | 713 | — | 307,480 | 100 |
| Total customer deposits | 123,181 | 30 | 120,278 | 30 | 57,182 | 14 | 105,219 | 26 | 1,026 | — | 406,886 | 100 |

Notes:

- (i) Total operating income represents the operating income gross of interest expense and fee and commission expense.
- (ii) Capital expenditure represents total amount incurred for acquiring assets that are expected to be used for some periods.

| | Year ended December 31, 2004 | | | | | | | | | | | |
|--|------------------------------|----|-------------------------------|----|------------------|----|-------------------|----|--------|---|---------|-----|
| | Eastern China | | Southern and Central China | | Western China | | Northern China | | Others | | Total | |
| | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % |
| Total operating income (note (i)) . . | 7,372 | 32 | 7,645 | 34 | 2,722 | 12 | 4,945 | 22 | 78 | — | 22,762 | 100 |
| Capital expenditure (note (ii)) | 482 | 24 | 876 | 44 | 216 | 11 | 427 | 21 | 1 | — | 2,002 | 100 |
| Total assets | 134,811 | 23 | 312,543 | 53 | 49,444 | 8 | 85,023 | 15 | 4,894 | 1 | 586,715 | 100 |
| Gross loans and advances to customers | 120,718 | 32 | 132,642 | 36 | 45,130 | 12 | 73,816 | 20 | 1,711 | — | 374,017 | 100 |
| Total customer deposits | 160,490 | 31 | 150,537 | 29 | 68,958 | 14 | 129,096 | 25 | 3,505 | 1 | 512,586 | 100 |

| | Year ended December 31, 2005 | | | | | | | | | | | |
|--|------------------------------|----|-------------------------------|----|------------------|----|-------------------|----|--------|---|---------|-----|
| | Eastern China | | Southern and Central China | | Western China | | Northern China | | Others | | Total | |
| | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % |
| Total operating income (note (i)) .. | 9,573 | 33 | 9,940 | 35 | 3,124 | 11 | 5,857 | 20 | 244 | 1 | 28,738 | 100 |
| Capital expenditure (note (ii)) | 459 | 37 | 431 | 34 | 217 | 17 | 149 | 12 | — | — | 1,256 | 100 |
| Total assets | 164,978 | 22 | 407,999 | 56 | 56,696 | 8 | 98,438 | 13 | 6,502 | 1 | 734,613 | 100 |
| Gross loans and advances to customers | 145,287 | 31 | 192,617 | 41 | 49,085 | 10 | 82,656 | 17 | 2,540 | 1 | 472,185 | 100 |
| Total customer deposits | 207,412 | 33 | 189,717 | 30 | 77,353 | 12 | 154,110 | 24 | 5,812 | 1 | 634,404 | 100 |

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

36 SEGMENTAL REPORTING (continued)*(b) Geographical segments (continued)*

| | Three months ended March 31, 2005 (unaudited) | | | | | | | | | | | |
|---|---|----|----------------------------|----|---------------|----|----------------|----|--------|---|--------|-----|
| | Eastern China | | Southern and Central China | | Western China | | Northern China | | Others | | Total | |
| | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % |
| Total operating income (note (i)) . . | 1,898 | 31 | 2,542 | 41 | 629 | 10 | 1,069 | 17 | 35 | 1 | 6,173 | 100 |
| Capital expenditure (note (ii)) | 53 | 35 | 61 | 40 | 18 | 12 | 20 | 13 | — | — | 152 | 100 |

| | Three months ended March 31, 2006 | | | | | | | | | | | |
|--|-----------------------------------|----|-------------------------------|----|------------------|----|-------------------|----|--------|---|---------|-----|
| | Eastern China | | Southern and Central China | | Western China | | Northern China | | Others | | Total | |
| | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % |
| Total operating income (note (i)) . . | 2,583 | 32 | 3,327 | 42 | 719 | 9 | 1,238 | 16 | 94 | 1 | 7,961 | 100 |
| Capital expenditure (note (ii)) | 65 | 37 | 66 | 37 | 18 | 10 | 28 | 16 | — | — | 177 | 100 |
| Total assets | 182,315 | 24 | 414,387 | 54 | 56,396 | 7 | 104,328 | 14 | 9,254 | 1 | 766,680 | 100 |
| Gross loans and advances to customers | 164,182 | 32 | 208,121 | 40 | 53,718 | 10 | 86,341 | 17 | 2,527 | 1 | 514,889 | 100 |
| Total customer deposits | 221,843 | 33 | 206,638 | 31 | 76,766 | 12 | 153,936 | 23 | 8,088 | 1 | 667,271 | 100 |

37 ASSETS PLEDGED AS SECURITY

The following assets have been pledged as collateral for liabilities under repurchase arrangements:

| | December 31, | | | March 31, |
|---|--------------|-------|-------|-----------|
| | 2003 | 2004 | 2005 | 2006 |
| Secured liabilities | 33,753 | 6,437 | 3,150 | 1,334 |
| Assets pledged | | | | |
| – Available-for-sale financial assets | — | 677 | — | — |
| – Held-to-maturity financial assets | 8,004 | 1,540 | 2,000 | 12 |
| – Other assets | 25,350 | 2,852 | 763 | 1,376 |
| | 33,354 | 5,069 | 2,763 | 1,388 |

38 CONTINGENT LIABILITIES AND COMMITMENTS*(a) Credit commitments*

At any given time the Group has outstanding commitments to extend credit. These commitments take the form of approved loans and credit card limits.

The Group provides financial guarantees and letters of credit to guarantee the performance of customers to third parties.

Acceptances comprise undertakings by the Group to pay bills of exchange drawn on customers. The Group expects most acceptances to be settled simultaneously with the reimbursement from the customers.

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

38 CONTINGENT LIABILITIES AND COMMITMENTS (continued)

(a) Credit commitments (continued)

The contractual amounts of commitments and contingent liabilities are set out in the following table by category. The amounts reflected in the table for commitments assume that amounts are fully advanced. The amount reflected in the table for guarantees and letters of credit represents the maximum potential loss that would be recognised at the balance sheet date if counterparties failed completely to perform as contracted.

| | December 31, | | | March 31, |
|---|---------------|----------------|----------------|----------------|
| | 2003 | 2004 | 2005 | 2006 |
| Contractual amount | | | | |
| Irrevocable guarantees | 9,932 | 24,274 | 34,691 | 34,241 |
| Irrevocable letters of credit | 14,833 | 21,058 | 22,436 | 25,424 |
| Bills of acceptances | 55,192 | 86,716 | 123,525 | 122,653 |
| Loan commitments | | | | |
| — with an original maturity of under one year | 181 | 287 | 878 | 923 |
| — with an original maturity of one year or over | 987 | 785 | 2,455 | 2,640 |
| Credit card commitments | 4,806 | 9,204 | 19,731 | 20,568 |
| Shipping guarantees | 12 | 16 | 22 | 30 |
| | <u>85,943</u> | <u>142,340</u> | <u>203,738</u> | <u>206,479</u> |

Loan commitments only include credit limits granted to offshore customers, and onshore and offshore syndicated loans. The Directors are of the opinion that the Group will not assume any risks on the unused credit limits for other loan customers as such limits are revocable and subject to the loan approval process. As a result, such balances are not included in the above contingent liabilities and commitments.

These commitments and contingent liabilities have off-balance sheet credit risk. Before the commitments are fulfilled or expire, management assesses and makes allowances for any probable losses accordingly. As the facilities may expire without being drawn upon, the total of the contractual amounts is not representative of expected future cash outflows.

| | December 31, | | | March 31, |
|---|---------------|---------------|---------------|---------------|
| | 2003 | 2004 | 2005 | 2006 |
| Credit risk weighted amounts of contingent liabilities and commitments | | | | |
| Contingent liabilities and commitments | <u>54,475</u> | <u>69,494</u> | <u>68,095</u> | <u>71,791</u> |

The credit risk weighted amount refers to the amount as computed in accordance with the rules set out by the CBRC and depends on the status of the counterparty and the maturity characteristics. The risk weights used range from 0% to 100% of contingent liabilities and commitments.

There are no relevant standards prescribed by IFRSs in calculating the above credit risk weighted amounts.

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

38 CONTINGENT LIABILITIES AND COMMITMENTS (continued)**(a) Credit commitments (continued)**

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

(b) Capital commitments

Authorised capital commitments not provided for were as follows:

| | December 31, | | | March 31, |
|-------------------------------|---------------|---------------|---------------|---------------|
| | 2003 | 2004 | 2005 | 2006 |
| For purchase of fixed assets: | | | | |
| — Contracted for | 298 | 170 | 335 | 324 |
| — Not contracted for | — | — | 132 | 8 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

(c) Operating lease commitments

Total future minimum lease payments under non-cancellable operating leases of properties are payable as follows:

| | December 31, | | | March 31, |
|---------------------------------------|--------------|--------------|--------------|--------------|
| | 2003 | 2004 | 2005 | 2006 |
| Within 1 year | 449 | 409 | 539 | 601 |
| After 1 year but within 5 years | 1,311 | 1,363 | 1,387 | 1,754 |
| After 5 years | 544 | 474 | 425 | 433 |
| | <u>2,304</u> | <u>2,246</u> | <u>2,351</u> | <u>2,788</u> |

(d) Outstanding litigations

At March 31, 2006, the Group was a defendant in certain pending litigations with gross claims of RMB256 million (2005: RMB250 million; 2004: RMB130 million; 2003: RMB30 million) arising from their banking activities. Many of these proceedings are in relation to steps taken by the Bank to collect delinquent loans and enforce rights in collateral securing such loans. The Directors consider that no material losses would be incurred by the Group as a result of these pending litigations and therefore no provision has been made in the Financial Information.

(e) Redemption obligations

As an underwriting agent of PRC government bonds, the Group has the responsibility to buy back those bonds sold by it should the holders decide to early redeem the bonds held. The redemption price for the bonds at any time before their maturity date is based on the coupon value plus any interest unpaid and accrued up to the redemption date. Accrued interest payables to the bond holders are calculated in accordance with relevant rules of the MOF and the PBOC. The redemption price may be different from the fair value of similar instruments traded at the redemption date.

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

38 CONTINGENT LIABILITIES AND COMMITMENTS (continued)*(e) Redemption obligations (continued)*

The redemption obligations below represent the nominal value of government bonds underwritten and sold by the Group, but not yet matured at the balance sheet date:

| | December 31, | | | March 31, |
|------------------------------|--------------|--------------|---------------|---------------|
| | 2003 | 2004 | 2005 | 2006 |
| Redemption obligations | <u>8,315</u> | <u>9,656</u> | <u>11,604</u> | <u>13,100</u> |

The Group expects the amount of redemption before the maturity date of these government bonds through the Group will not be material.

39 ENTRUSTED BUSINESS

| | December 31, | | | March 31, |
|-----------------------------|--------------|---------------|---------------|---------------|
| | 2003 | 2004 | 2005 | 2006 |
| Entrusted deposits | <u>9,983</u> | <u>16,191</u> | <u>28,489</u> | <u>32,241</u> |
| Entrusted loans | <u>9,117</u> | <u>16,191</u> | <u>28,489</u> | <u>32,241</u> |
| Entrusted investments | <u>866</u> | <u>—</u> | <u>—</u> | <u>—</u> |
| | <u>9,983</u> | <u>16,191</u> | <u>28,489</u> | <u>32,241</u> |

The Group undertakes entrusted loans and entrusted investments business.

Entrusted loans are funded by entrusted deposits and are granted to designated borrowers for specific purposes at terms specified by entrustors. The Group is responsible for managing entrusted loans. Entrusted investments are also funded by entrusted deposits, and investment decisions are made by the Group in accordance with the scope defined by entrustors.

The risks and gains or losses of entrusted business are borne by the entrustors and the Group only earns a commission. Therefore the Group does not recognise the entrusted businesses as its loans, investments and deposits. The above entrusted loans and investments are shown at their granted or invested amounts.

40 RISK MANAGEMENT*(a) Credit risk*

Credit risk represents the potential loss that may arise from the failure of a debtor to meet its obligation or commitment to the Group. Credit risk increases when all counterparties are concentrated in a single industry or a geographical region, as different counterparties in the same region or industry may be affected by the same economic development, which may eventually affect their repayment abilities.

The Group has designed its organisation framework, credit policies and processes with an objective to identify, evaluate and manage its credit risk effectively. The Risk Management and

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****40 RISK MANAGEMENT (continued)*****(a) Credit risk (continued)***

Internal Control Committee is set up and is appointed by the Board to be responsible for supervising and evaluating the set-up, organisational structure, work process and effectiveness of various risk management functions. To mitigate risk, the Group may obtain collateral and guarantees where appropriate.

With respect to daily operations, the Risk Management Department, as directed by the Risk Management and Internal Control Committee, monitors and coordinates the work of other risk management functions, including the Corporate Banking Department and the Legal Department.

In respect of the loan portfolio, the Group adopts a risk based loan classification methodology. Currently, the Group classifies loans into seven categories: excellent, good, general mention, special mention, substandard, doubtful and loss. Prior to September 2005, the Group classified all loans in accordance with the PBOC's 5-tier classification system. The last three categories are considered as impaired loans and advances for which objective evidence of impairment exists based on a loss event or several events and which bear significant impairment losses. The allowances for impairment losses for the impaired loans and advances are assessed collectively or individually as appropriate.

Concentration of credit risk: when certain numbers of customers are in the same business, located in the same geographical region or their industries share similar economic characteristics, their ability to meet their obligations may be affected by the same economic changes. The level of concentration of credit risk reflects the sensitivity of the Group's operating result to a specific industry or geographical region.

Analyses of loans and advances by industry, customer type, nature and geographical location are stated in Notes 17 and 36(b).

The Group's credit risk management policy for financial derivatives is the same as that for other transactions. In order to mitigate the credit risk arising from the financial derivatives, the Group has signed netting agreements with certain counterparties.

(b) Market risk

Market risk is the risk of loss arising from movements in observable market variables such as interest rates, exchange rates and equity markets. The Group is exposed to market risk primarily through its proprietary trading activities. The Group considers that any market risk arising from its proprietary trading book is not material.

The Asset and Liability Management Committee ("ALCO") of the Group is responsible for formulating market risk management policies, supervising implementation of the policies and performing independent assessments of the risk status. The Risk Management Department is responsible for managing the risks arising from the day to day operation of the Treasury division.

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****40 RISK MANAGEMENT (continued)****(c) Currency risk**

The Group's foreign exchange exposure mainly comprises foreign exchange dealing by Treasury and is mitigated primarily by matching spot and forward foreign exchange contracts with foreign currency borrowings.

The Group's functional currency is Renminbi. Foreign currency transactions are mainly in US dollar and HK dollar. The Group's assets and liabilities are mainly denominated in Renminbi, with the rest being mainly in US dollar and HK dollar. The exchange rates between Renminbi and US dollar and HK dollar are determined by the PBOC, and there have been small fluctuations during the Relevant Periods.

The Group monitors daily foreign currency transactions and positions closely. The following tables show the Group's assets and liabilities by major currencies as at each balance sheet date.

The PBOC, with the approval of State Council, has made the announcements regarding reforming the RMB exchange rate regime. Starting from July 21, 2005, China has reformed the exchange rate regime by moving into a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies. The Group has reviewed the exposures and has taken appropriate measures to mitigate currency risks.

Assets and liabilities by original currency are shown as follows:

| | Renminbi | December 31, 2003 | | |
|--|----------------|----------------------------|---------------|----------------|
| | | Equivalent in RMB' million | | |
| | | US dollar | Others | Total |
| Assets | | | | |
| Cash and balances with central bank | 51,375 | 1,321 | 878 | 53,574 |
| Amounts due from banks and other financial institutions | 27,289 | 6,234 | 6,029 | 39,552 |
| Loans and advances to customers | 277,246 | 18,368 | 3,346 | 298,960 |
| Investments | 74,496 | 13,134 | 3,759 | 91,389 |
| Other assets | 9,393 | 489 | 660 | 10,542 |
| | <u>439,799</u> | <u>39,546</u> | <u>14,672</u> | <u>494,017</u> |
| Liabilities | | | | |
| Amounts due to central bank | 5,989 | — | — | 5,989 |
| Amounts due to banks and other financial institutions | 52,128 | 2,625 | 2,305 | 57,058 |
| Deposits from customers | 360,272 | 34,816 | 11,798 | 406,886 |
| Financial liabilities at fair value through profit or loss | — | 70 | 5 | 75 |
| Other liabilities | 4,482 | 425 | 748 | 5,655 |
| | <u>422,871</u> | <u>37,936</u> | <u>14,856</u> | <u>475,663</u> |
| Net on-balance sheet position | <u>16,928</u> | <u>1,610</u> | <u>(184)</u> | <u>18,354</u> |
| Off-balance sheet position: | | | | |
| Credit commitments (note) | 44,293 | 1,465 | 1,817 | 47,575 |
| Derivatives | <u>3,304</u> | <u>2,181</u> | <u>1,330</u> | <u>6,815</u> |

Note: Credit commitments generally expire before they are drawn; therefore the above net position (net of pledged deposits) does not represent the cash flows need.

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****40 RISK MANAGEMENT (continued)****(c) Currency risk (continued)**

| | | December 31, 2004 | | |
|--|----------------|----------------------------|---------------|----------------|
| | | Equivalent in RMB' million | | |
| | Renminbi | US dollar | Others | Total |
| Assets | | | | |
| Cash and balances with central bank | 56,105 | 1,686 | 1,138 | 58,929 |
| Amounts due from banks and other financial institutions | 20,176 | 11,784 | 8,289 | 40,249 |
| Loans and advances to customers | 338,282 | 19,367 | 5,448 | 363,097 |
| Investments | 94,938 | 14,598 | 3,109 | 112,645 |
| Other assets | 10,836 | 325 | 634 | 11,795 |
| | <u>520,337</u> | <u>47,760</u> | <u>18,618</u> | <u>586,715</u> |
| Liabilities | | | | |
| Amounts due to banks and other financial institutions | 29,330 | 3,281 | 385 | 32,996 |
| Deposits from customers | 454,896 | 41,455 | 16,235 | 512,586 |
| Financial liabilities at fair value through profit or loss | — | 66 | 9 | 75 |
| Certificates of deposit issued | — | 1,242 | — | 1,242 |
| Convertible bonds issued | 5,550 | — | — | 5,550 |
| Subordinated notes issued | 3,500 | — | — | 3,500 |
| Other liabilities | 6,963 | (436) | 2,281 | 8,808 |
| | <u>500,239</u> | <u>45,608</u> | <u>18,910</u> | <u>564,757</u> |
| Net on-balance sheet position | <u>20,098</u> | <u>2,152</u> | <u>(292)</u> | <u>21,958</u> |
| Off-balance sheet position: | | | | |
| Credit commitments (note) | 73,556 | 18,723 | 3,414 | 95,693 |
| Derivatives | 3,127 | 2,504 | (1,076) | 4,555 |

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****40 RISK MANAGEMENT (continued)****(c) Currency risk (continued)**

| | | December 31, 2005 | | |
|--|----------------|----------------------------|---------------|----------------|
| | | Equivalent in RMB' million | | |
| | Renminbi | US dollar | Others | Total |
| Assets | | | | |
| Cash and balances with central bank | 63,561 | 1,567 | 889 | 66,017 |
| Amounts due from banks and other financial institutions | 43,196 | 8,777 | 13,585 | 65,558 |
| Loans and advances to customers | 430,037 | 24,733 | 3,905 | 458,675 |
| Investments | 110,449 | 18,057 | 3,396 | 131,902 |
| Other assets | 11,521 | 332 | 608 | 12,461 |
| | <u>658,764</u> | <u>53,466</u> | <u>22,383</u> | <u>734,613</u> |
| Liabilities | | | | |
| Amounts due to banks and other financial institutions | 38,286 | 4,463 | 498 | 43,247 |
| Deposits from customers | 570,620 | 44,559 | 19,225 | 634,404 |
| Financial liabilities at fair value through profit or loss | — | 42 | 44 | 86 |
| Certificates of deposit issued | — | 1,211 | — | 1,211 |
| Convertible bonds issued | 5,184 | — | — | 5,184 |
| Other debts issued | 9,982 | — | — | 9,982 |
| Subordinated notes issued | 3,500 | — | — | 3,500 |
| Other liabilities | 7,596 | 609 | 2,796 | 11,001 |
| | <u>635,168</u> | <u>50,884</u> | <u>22,563</u> | <u>708,615</u> |
| Net on-balance sheet position | <u>23,596</u> | <u>2,582</u> | <u>(180)</u> | <u>25,998</u> |
| Off-balance sheet position: | | | | |
| Credit commitments (note) | 111,357 | 26,156 | 4,727 | 142,240 |
| Derivatives | 3,735 | 3,920 | 86 | 7,741 |

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

40 RISK MANAGEMENT (continued)*(c) Currency risk (continued)*

| | Renminbi | March 31, 2006 | | |
|--|----------------|----------------------------|----------------|----------------|
| | | Equivalent in RMB' million | | |
| | | US dollar | Others | Total |
| Assets | | | | |
| Cash and balances with central bank | 56,046 | 1,695 | 821 | 58,562 |
| Amounts due from banks and other financial institutions | 30,409 | 14,068 | 13,989 | 58,466 |
| Loans and advances to customers | 473,184 | 23,480 | 3,928 | 500,592 |
| Investments | 112,747 | 18,540 | 3,363 | 134,650 |
| Other assets | 13,587 | 226 | 597 | 14,410 |
| | <u>685,973</u> | <u>58,009</u> | <u>22,698</u> | <u>766,680</u> |
| Liabilities | | | | |
| Amounts due to banks and other financial institutions | 33,442 | 3,857 | 581 | 37,880 |
| Deposits from customers | 599,047 | 46,767 | 21,457 | 667,271 |
| Financial liabilities at fair value through profit or loss | 18 | 58 | 40 | 116 |
| Certificates of deposit issued | — | 1,202 | — | 1,202 |
| Convertible bonds issued | 42 | — | — | 42 |
| Other debts issued | 9,983 | — | — | 9,983 |
| Subordinated notes issued | 3,500 | — | — | 3,500 |
| Other liabilities | 10,454 | 2,863 | 748 | 14,065 |
| | <u>656,486</u> | <u>54,747</u> | <u>22,826</u> | <u>734,059</u> |
| Net on-balance sheet position | <u>29,487</u> | <u>3,262</u> | <u>(128)</u> | <u>32,621</u> |
| Off-balance sheet position: | | | | |
| Credit commitments (note) | 118,038 | 25,232 | 7,065 | 150,335 |
| Derivatives | <u>6,927</u> | <u>2,333</u> | <u>(2,284)</u> | <u>6,976</u> |

(d) Interest rate risk

The Group's interest rate exposures primarily comprise those arising from mismatches in durations and structures of assets and liabilities in its banking operations and from positions undertaken for trading purposes.

Interest rate risk in banking operations is inherent in many business segments of the Group, and arises from factors such as differences in timing between contractual maturities or repricing of assets and liabilities. Similar risk in trading positions arises mainly from investment portfolio undertaken by treasury operation.

The ALCO regularly monitors such interest rate risk positions. The Group regularly performs interest rate sensitivity analysis on these interest rate positions for the purpose of measuring and managing the risk in order to limit potential adverse impacts of movements in interest rate on net interest income.

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

40 RISK MANAGEMENT (continued)

(d) Interest rate risk (continued)

As the reference interest rates for Renminbi loans and deposits are determined by the PBOC, the Group follows the interest rates set by the PBOC when carrying out lending and deposit taking activities. The Group's monetary assets and liabilities are mainly in Renminbi.

The following table indicates the effective interest rates for the Relevant Periods and the expected next repricing dates (or maturity dates whichever are earlier) for interest bearing assets and liabilities at the balance sheet date.

| | December 31, 2003 | | | | | | |
|--|------------------------------------|----------------|------------------------------------|-------------------------|------------------------|--------------|----------------------|
| | Effective interest rate (note (i)) | Total | 3 months or less (include overdue) | Over 3 months to 1 year | Over 1 year to 5 years | Over 5 years | Non-interest bearing |
| <i>Assets</i> | | | | | | | |
| Cash and balances with central bank | 1.88% | 53,574 | 50,652 | — | — | — | 2,922 |
| Amounts due from banks and other financial institutions | 2.33% | 39,552 | 38,288 | 1,264 | — | — | — |
| Loans and advances to customers (note (ii)) | 4.39% | 298,960 | 134,118 | 162,514 | 2,036 | 292 | — |
| Investments | 2.89% | 91,389 | 16,385 | 32,999 | 35,182 | 6,698 | 125 |
| Other assets | — | 10,542 | — | — | — | — | 10,542 |
| Total assets | | <u>494,017</u> | <u>239,443</u> | <u>196,777</u> | <u>37,218</u> | <u>6,990</u> | <u>13,589</u> |
| <i>Liabilities</i> | | | | | | | |
| Amounts due to central bank | 2.83% | 5,989 | 5,044 | 945 | — | — | — |
| Amounts due to banks and other financial institutions | 2.20% | 57,058 | 56,908 | 150 | — | — | — |
| Deposits from customers | 1.16% | 406,886 | 329,452 | 67,807 | 9,597 | 30 | — |
| Financial liabilities at fair value through profit or loss | — | 75 | — | — | — | — | 75 |
| Other liabilities | — | 5,655 | — | — | — | — | 5,655 |
| Total liabilities | | <u>475,663</u> | <u>391,404</u> | <u>68,902</u> | <u>9,597</u> | <u>30</u> | <u>5,730</u> |
| Asset-liability gap | | <u>18,354</u> | <u>(151,961)</u> | <u>127,875</u> | <u>27,621</u> | <u>6,960</u> | <u>7,859</u> |

Notes:

- (i) Effective interest rate represents the ratio of interest income/expense to average interest bearing assets/liabilities.
- (ii) For loans and advances to customers, the above "Less than three months" category includes overdue amounts (net of allowances for impairment losses) of RMB4,114 million as at March 31, 2006 (December 31, 2005, 2004 and 2003: RMB3,597 million, RMB4,104 million and RMB4,158 million). Overdue amounts represent loans, of which the whole or part of the principals was overdue.

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

40 RISK MANAGEMENT (continued)

(d) Interest rate risk (continued)

| | December 31, 2004 | | | | | | |
|--|------------------------------------|----------------|------------------------------------|-------------------------|------------------------|--------------|----------------------|
| | Effective interest rate (note (i)) | Total | 3 months or less (include overdue) | Over 3 months to 1 year | Over 1 year to 5 years | Over 5 years | Non-interest bearing |
| Assets | | | | | | | |
| Cash and balances with central bank | 1.82% | 58,929 | 54,987 | — | — | — | 3,942 |
| Amounts due from banks and other financial institutions | 2.60% | 40,249 | 37,975 | 2,109 | 165 | — | — |
| Loans and advances to customers (note (ii)) | 4.54% | 363,097 | 182,412 | 177,830 | 2,498 | 357 | — |
| Investments | 2.89% | 112,645 | 19,124 | 54,405 | 34,073 | 4,895 | 148 |
| Other assets | — | 11,795 | — | — | — | — | 11,795 |
| Total assets | | <u>586,715</u> | <u>294,498</u> | <u>234,344</u> | <u>36,736</u> | <u>5,252</u> | <u>15,885</u> |
| Liabilities | | | | | | | |
| Amounts due to banks and other financial institutions | 2.25% | 32,996 | 31,987 | 1,009 | — | — | — |
| Deposits from customers | 1.17% | 512,586 | 408,718 | 88,327 | 15,541 | — | — |
| Financial liabilities at fair value through profit or loss | — | 75 | — | — | — | — | 75 |
| Certificates of deposit issued | 2.12% | 1,242 | 1,242 | — | — | — | — |
| Convertible bonds issued | 6.39% | 5,550 | — | — | 5,550 | — | — |
| Subordinated notes issued | 4.74% | 3,500 | — | — | 3,500 | — | — |
| Other liabilities | — | 8,808 | — | — | — | — | 8,808 |
| Total liabilities | | <u>564,757</u> | <u>441,947</u> | <u>89,336</u> | <u>24,591</u> | <u>—</u> | <u>8,883</u> |
| Asset-liability gap | | <u>21,958</u> | <u>(147,449)</u> | <u>145,008</u> | <u>12,145</u> | <u>5,252</u> | <u>7,002</u> |

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

40 RISK MANAGEMENT (continued)

(d) Interest rate risk (continued)

| | December 31, 2005 | | | | | | |
|--|------------------------------------|----------------|------------------------------------|-------------------------|------------------------|--------------|----------------------|
| | Effective interest rate (note (i)) | Total | 3 months or less (include overdue) | Over 3 months to 1 year | Over 1 year to 5 years | Over 5 years | Non-interest bearing |
| Assets | | | | | | | |
| Cash and balances with central bank | 1.57% | 66,017 | 62,102 | — | — | — | 3,915 |
| Amounts due from banks and other financial institutions | 2.48% | 65,558 | 61,224 | 4,151 | 183 | — | — |
| Loans and advances to customers (note (ii)) | 4.90% | 458,675 | 264,129 | 190,853 | 3,273 | 420 | — |
| Investments | 3.13% | 131,902 | 32,784 | 57,795 | 35,628 | 5,531 | 164 |
| Other assets | — | 12,461 | — | — | — | — | 12,461 |
| Total assets | | <u>734,613</u> | <u>420,239</u> | <u>252,799</u> | <u>39,084</u> | <u>5,951</u> | <u>16,540</u> |
| Liabilities | | | | | | | |
| Amounts due to banks and other financial institutions | 2.32% | 43,247 | 42,612 | 336 | 299 | — | — |
| Deposits from customers | 1.37% | 634,404 | 498,954 | 116,056 | 19,361 | 33 | — |
| Financial liabilities at fair value through profit or loss | — | 86 | — | — | — | — | 86 |
| Certificates of deposit issued | 4.27% | 1,211 | 1,211 | — | — | — | — |
| Convertible bonds issued | 6.39% | 5,184 | — | — | 5,184 | — | — |
| Other debts issued | 2.34% | 9,982 | — | — | 9,982 | — | — |
| Subordinated notes issued | 4.74% | 3,500 | — | — | 3,500 | — | — |
| Other liabilities | — | 11,001 | — | — | — | — | 11,001 |
| Total liabilities | | <u>708,615</u> | <u>542,777</u> | <u>116,392</u> | <u>38,326</u> | <u>33</u> | <u>11,087</u> |
| Asset-liability gap | | <u>25,998</u> | <u>(122,538)</u> | <u>136,407</u> | <u>758</u> | <u>5,918</u> | <u>5,453</u> |

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

40 RISK MANAGEMENT (continued)

(d) Interest rate risk (continued)

| | March 31, 2006 | | | | | | |
|--|------------------------------------|----------------|------------------------------------|-------------------------|------------------------|--------------|----------------------|
| | Effective interest rate (note (i)) | Total | 3 months or less (include overdue) | Over 3 months to 1 year | Over 1 year to 5 years | Over 5 years | Non-interest bearing |
| <i>Assets</i> | | | | | | | |
| Cash and balances with central bank | 1.61% | 58,562 | 54,850 | — | — | — | 3,712 |
| Amounts due from banks and other financial institutions | 2.59% | 58,466 | 53,497 | 4,786 | 183 | — | — |
| Loans and advances to customers (note (ii)) | 4.77% | 500,592 | 256,191 | 240,735 | 3,394 | 272 | — |
| Investments | 2.99% | 134,650 | 39,283 | 48,840 | 39,335 | 7,035 | 157 |
| Other assets | — | 14,410 | — | — | — | — | 14,410 |
| Total assets | | <u>766,680</u> | <u>403,821</u> | <u>294,361</u> | <u>42,912</u> | <u>7,307</u> | <u>18,279</u> |
| <i>Liabilities</i> | | | | | | | |
| Amounts due to banks and other financial institutions | 2.42% | 37,880 | 37,537 | 183 | 160 | — | — |
| Deposits from customers | 1.53% | 667,271 | 503,849 | 141,681 | 21,711 | 30 | — |
| Financial liabilities at fair value through profit or loss | — | 116 | — | — | — | — | 116 |
| Certificates of deposit issued | 4.88% | 1,202 | 1,202 | — | — | — | — |
| Convertible bonds issued | 6.39% | 42 | — | — | 42 | — | — |
| Other debts issued | 2.34% | 9,983 | — | — | 9,983 | — | — |
| Subordinated notes issued | 4.74% | 3,500 | — | — | 3,500 | — | — |
| Other liabilities | — | 14,065 | — | — | — | — | 14,065 |
| Total liabilities | | <u>734,059</u> | <u>542,588</u> | <u>141,864</u> | <u>35,396</u> | <u>30</u> | <u>14,181</u> |
| Asset-liability gap | | 32,621 | (138,767) | 152,497 | 7,516 | 7,277 | 4,098 |

(e) Liquidity risk

Liquidity risk is the risk that funds will not be available to meet liabilities as they fall due, and it results from amount and maturity mismatches of assets and liabilities. The Group's liquidity is managed by the ALCO. The ALCO is responsible for managing liquidity on a prudent basis to meet regulatory requirement. The day to day monitoring of future cash flows and the maintenance of suitable levels of liquefiable assets by business units are the responsibility of the head office.

A substantial portion of the Group's assets is funded by customer deposits made up of corporate and retail savings accounts and term deposits as well as deposit of banks. These customer deposits, which have been growing in recent years, are widely diversified by type and maturity and represent a stable source of funds.

The Group's loans-to-deposits ratio is maintained within 75%. 7.5% of total Renminbi deposits (2005: 7.5%; 2004: 7.5%; 2003: 7%) and 3% of foreign currencies deposits (2005: 3%; 2004: 2%; 2003: 2%) are required to be deposited with the PBOC.

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

40 RISK MANAGEMENT (continued)

(e) Liquidity risk (continued)

Analysis of the Group's assets and liabilities by remaining maturity is as follows:

| | December 31, 2003 | | | | | | | | |
|--|------------------------|-------------------|--|---|--|------------------|---------|---------|---------|
| | Repayable on demand | Within 1 month | After 1 month but within 3 months | After 3 months but within 1 year | After 1 year but within 5 years | After 5 years | Undated | Overdue | Total |
| Cash and balances with central bank (note (i)) . . . | 29,902 | — | — | — | — | — | 23,672 | — | 53,574 |
| Amounts due from banks and other financial institutions | 10,969 | 21,431 | 1,942 | 4,967 | 233 | — | — | 10 | 39,552 |
| Loans and advances to customers (note (ii)) | — | 33,002 | 57,376 | 141,666 | 38,569 | 24,189 | — | 4,158 | 298,960 |
| Investments (note (iii)) | 230 | 3,280 | 3,403 | 12,347 | 40,220 | 31,784 | 125 | — | 91,389 |
| - at fair value through profit or loss | — | — | — | — | 4,983 | — | 78 | — | 5,061 |
| - available-for-sale | 230 | 249 | 1,256 | 3,593 | — | 417 | 47 | — | 5,792 |
| - held-to-maturity | — | 1,657 | 1,163 | 8,139 | 26,268 | 30,445 | — | — | 67,672 |
| - receivables | — | 1,374 | 984 | 615 | 8,969 | 922 | — | — | 12,864 |
| Other assets | 569 | 108 | 453 | 873 | 449 | 3 | 8,071 | 16 | 10,542 |
| Total assets | 41,670 | 57,821 | 63,174 | 159,853 | 79,471 | 55,976 | 31,868 | 4,184 | 494,017 |
| Amounts due to banks and other financial institutions | 27,390 | 22,076 | 7,002 | 590 | — | — | — | — | 57,058 |
| Amounts due to central bank | — | 2,760 | 2,284 | 945 | — | — | — | — | 5,989 |
| Deposits from customers . . | 257,790 | 21,761 | 34,845 | 72,651 | 19,230 | 609 | — | — | 406,886 |
| Financial liabilities at fair value through profit or loss | — | — | — | — | — | — | 75 | — | 75 |
| Other liabilities | 3,451 | 990 | 761 | 283 | 129 | 41 | — | — | 5,655 |
| Total liabilities | 288,631 | 47,587 | 44,892 | 74,469 | 19,359 | 650 | 75 | — | 475,663 |
| Long/(short) position | (246,961) | 10,234 | 18,282 | 85,384 | 60,112 | 55,326 | 31,793 | 4,184 | 18,354 |

Notes:

- (i) For balances with central bank, undated amount represents statutory deposit reserve funds and fiscal balances maintained with the PBOC.
- (ii) For loans and advances to customers, overdue amounts represent loans of which the whole or part of the principals was overdue. The overdue amounts are stated net of appropriate allowances for impairment losses.
- (iii) The remaining maturities of trading assets and assets designated at fair value through profit or loss included in investments do not represent the Group's intention to hold them to maturity.

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

40 RISK MANAGEMENT (continued)

(e) Liquidity risk (continued)

| | December 31, 2004 | | | | | | | | |
|--|------------------------|-------------------|--|---|--|------------------|---------|---------|---------|
| | Repayable on demand | Within 1 month | After 1 month but within 3 months | After 3 months but within 1 year | After 1 year but within 5 years | After 5 years | Undated | Overdue | Total |
| Cash and balances with central bank (note (i)) . . . | 26,765 | — | — | — | — | — | 32,164 | — | 58,929 |
| Amounts due from banks and other financial institutions | 9,147 | 22,633 | 5,525 | 2,109 | 666 | 156 | — | 13 | 40,249 |
| Loans and advances to customers (note (ii)) | — | 24,278 | 69,455 | 178,792 | 46,694 | 39,774 | — | 4,104 | 363,097 |
| Investments (note (iii)) | 1,267 | 2,056 | 5,479 | 33,433 | 38,804 | 31,458 | 148 | — | 112,645 |
| - at fair value through profit or loss | — | — | — | — | 5,301 | 240 | 66 | — | 5,607 |
| - available-for-sale | 1,267 | 218 | 2,032 | 16,121 | 15,234 | 2,729 | 82 | — | 37,683 |
| - held-to-maturity | — | 965 | 3,267 | 14,032 | 12,236 | 27,680 | — | — | 58,180 |
| - receivables | — | 873 | 180 | 3,280 | 6,033 | 809 | — | — | 11,175 |
| Other assets | 700 | 359 | 416 | 908 | 405 | 13 | 8,980 | 14 | 11,795 |
| Total assets | 37,879 | 49,326 | 80,875 | 215,242 | 86,569 | 71,401 | 41,292 | 4,131 | 586,715 |
| Amounts due to banks and other financial institutions | 16,601 | 2,218 | 5,837 | 2,040 | 6,300 | — | — | — | 32,996 |
| Deposits from customers . . | 348,794 | 21,790 | 32,827 | 90,655 | 17,951 | 569 | — | — | 512,586 |
| Financial liabilities at fair value through profit or loss | — | — | — | — | — | — | 75 | — | 75 |
| Certificates of deposit issued | — | — | — | — | 1,242 | — | — | — | 1,242 |
| Convertible bonds issued . . | — | — | — | — | 5,550 | — | — | — | 5,550 |
| Subordinated notes issued | — | — | — | — | 3,500 | — | — | — | 3,500 |
| Other liabilities | 2,486 | 216 | 1,323 | 4,305 | 255 | 223 | — | — | 8,808 |
| Total liabilities | 367,881 | 24,224 | 39,987 | 97,000 | 34,798 | 792 | 75 | — | 564,757 |
| Long/(short) position | (330,002) | 25,102 | 40,888 | 118,242 | 51,771 | 70,609 | 41,217 | 4,131 | 21,958 |

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

40 RISK MANAGEMENT (continued)

(e) Liquidity risk (continued)

| | December 31, 2005 | | | | | | | | |
|--|------------------------|-------------------|--|---|--|------------------|---------|---------|---------|
| | Repayable on demand | Within 1 month | After 1 month but within 3 months | After 3 months but within 1 year | After 1 year but within 5 years | After 5 years | Undated | Overdue | Total |
| Cash and balances with central bank (note (i)) . . . | 25,881 | — | — | — | — | — | 40,136 | — | 66,017 |
| Amounts due from banks and other financial institutions | 10,615 | 33,975 | 8,145 | 11,197 | 1,480 | 146 | — | — | 65,558 |
| Loans and advances to customers (note (ii)) | — | 37,891 | 84,094 | 204,031 | 67,524 | 61,538 | — | 3,597 | 458,675 |
| Investments (note (iii)) | 1,133 | 7,456 | 7,641 | 34,739 | 57,129 | 23,640 | 164 | — | 131,902 |
| - at fair value through profit or loss | — | 371 | 1,160 | 6,655 | 6,560 | 1,005 | 118 | — | 15,869 |
| - available-for-sale | 1,133 | 6,704 | 4,629 | 21,063 | 23,085 | 3,426 | 46 | — | 60,086 |
| - held-to-maturity | — | 173 | 1,111 | 6,098 | 22,615 | 18,714 | — | — | 48,711 |
| - receivables | — | 208 | 741 | 923 | 4,869 | 495 | — | — | 7,236 |
| Other assets | 660 | 222 | 626 | 956 | 452 | 2 | 9,523 | 20 | 12,461 |
| Total assets | 38,289 | 79,544 | 100,506 | 250,923 | 126,585 | 85,326 | 49,823 | 3,617 | 734,613 |
| Amounts due to banks and other financial institutions | 23,336 | 4,207 | 3,313 | 2,550 | 9,441 | 400 | — | — | 43,247 |
| Deposits from customers . . | 387,152 | 33,716 | 56,124 | 129,347 | 27,104 | 961 | — | — | 634,404 |
| Financial liabilities at fair value through profit or loss | — | — | — | — | — | — | 86 | — | 86 |
| Certificates of deposit issued | — | — | — | — | 1,211 | — | — | — | 1,211 |
| Convertible bonds issued . . | — | — | — | — | 5,184 | — | — | — | 5,184 |
| Other debts issued | — | — | — | — | 9,982 | — | — | — | 9,982 |
| Subordinated notes issued | — | — | — | — | 3,500 | — | — | — | 3,500 |
| Other liabilities | 8,706 | 224 | 1,069 | 705 | 268 | 29 | — | — | 11,001 |
| Total liabilities | 419,194 | 38,147 | 60,506 | 132,602 | 56,690 | 1,390 | 86 | — | 708,615 |
| Long/(short) position | (380,905) | 41,397 | 40,000 | 118,321 | 69,895 | 83,936 | 49,737 | 3,617 | 25,998 |

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

40 RISK MANAGEMENT (continued)

(e) Liquidity risk (continued)

| March 31, 2006 | | | | | | | | | |
|--|------------------------|-------------------|--|---|--|------------------|---------|---------|---------|
| | Repayable on demand | Within 1 month | After 1 month but within 3 months | After 3 months but within 1 year | After 1 year but within 5 years | After 5 years | Undated | Overdue | Total |
| Cash and balances with central bank (note (i)) | 15,966 | — | — | — | — | — | 42,596 | — | 58,562 |
| Amounts due from banks and other financial institutions | 13,410 | 25,317 | 8,845 | 9,411 | 1,238 | 245 | — | — | 58,466 |
| Loans and advances to customers (note (ii)) | — | 45,571 | 98,434 | 215,406 | 70,008 | 67,059 | — | 4,114 | 500,592 |
| Investments (note (iii)) | 2,014 | 1,412 | 8,341 | 38,929 | 64,038 | 19,759 | 157 | — | 134,650 |
| - at fair value through profit or loss | — | — | 951 | 4,350 | 4,783 | 427 | 111 | — | 10,622 |
| - available-for-sale | 2,014 | 934 | 5,608 | 27,317 | 27,731 | 4,958 | 46 | — | 68,608 |
| - held-to-maturity | — | 60 | 1,674 | 6,409 | 26,322 | 13,722 | — | — | 48,187 |
| - receivables | — | 418 | 108 | 853 | 5,202 | 652 | — | — | 7,233 |
| Other assets | 3,197 | 1,064 | 646 | 321 | 125 | 4 | 9,039 | 14 | 14,410 |
| Total assets | 34,587 | 73,364 | 116,266 | 264,067 | 135,409 | 87,067 | 51,792 | 4,128 | 766,680 |
| Amounts due to banks and other financial institutions | 20,226 | 2,019 | 2,494 | 4,371 | 8,370 | 400 | — | — | 37,880 |
| Deposits from customers | 380,728 | 45,587 | 66,370 | 142,912 | 30,691 | 983 | — | — | 667,271 |
| Financial liabilities at fair value through profit or loss | — | — | — | — | — | — | 116 | — | 116 |
| Certificates of deposit issued | — | — | — | — | 1,202 | — | — | — | 1,202 |
| Convertible bonds issued | — | — | — | — | 42 | — | — | — | 42 |
| Other debts issued | — | — | — | — | 9,983 | — | — | — | 9,983 |
| Subordinated notes issued | — | — | — | — | 3,500 | — | — | — | 3,500 |
| Other liabilities | 10,124 | 1,551 | 1,390 | 868 | 117 | 15 | — | — | 14,065 |
| Total liabilities | 411,078 | 49,157 | 70,254 | 148,151 | 53,905 | 1,398 | 116 | — | 734,059 |
| Long/(short) position | (376,491) | 24,207 | 46,012 | 115,916 | 81,504 | 85,669 | 51,676 | 4,128 | 32,621 |

(f) Operational risk

Operational risk includes the risk of direct or indirect loss due to an event or action causing failure of technology, processes, infrastructure and personnel, and other risks having an operational impact.

The Group manages this risk through a controls-based environment by establishing a framework of policies and procedures to identify, assess, control, manage and report risks. The framework covers all business functions ranging from finance, credit, accounting, settlement, savings, treasury, intermediary business, computer applications and management, special assets resolution and legal affairs. This has allowed the Group to identify and address the operational risk inherent in all key products, activities, processes and systems.

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****40 RISK MANAGEMENT (continued)****(g) Use of derivatives**

Derivatives are off-balance sheet financial instruments which include forward, swap and option transactions undertaken by the Group in the foreign exchange and interest rate markets.

The Group enters into financial derivative transactions for treasury business and its assets and liabilities management purpose.

Treasury business includes the formation and sale of financial derivatives to enable customers to transfer, change or mitigate existing or anticipated risks.

When there are mismatches in the interest rates of assets and liabilities, the Group will use interest rate swaps to swap fixed interest rates into floating interest rates.

For assets and liabilities denominated in foreign currencies, the Group will be exposed to risks due to the fluctuations of exchange rates. The Group will use currency swaps and forward contracts to mitigate these risks.

The following tables provide an analysis of the notional amounts of derivatives of the Group by maturity groupings based on the remaining periods to settlement and the corresponding fair values at the balance sheet date. The notional amounts of the derivatives indicate the transaction volume outstanding at the balance sheet date; they do not represent amounts at risk.

| | December 31, 2003 | | | | | | |
|---|---|--------------------------------------|-------------------------------------|----------------------|-------|--------------|--------------|
| | Notional amounts with remaining life of | | | | | Fair values | |
| | Less than 3 months | Between 3 months and 1 year | Between 1 year and 5 years | More than 5 years | Total | Assets | Liabilities |
| <i>Interest rate derivatives</i> | | | | | | | |
| Interest rate swaps | — | 192 | 136 | — | 328 | 2 | (11) |
| <i>Currency derivatives</i> | | | | | | | |
| Spot | 1,549 | — | — | — | 1,549 | 2 | (4) |
| Forwards | 451 | 326 | — | — | 777 | 29 | (25) |
| Foreign exchange swaps | 2,196 | 1,537 | — | — | 3,733 | 30 | (12) |
| Currency options written | 756 | — | — | — | 756 | 15 | (23) |
| | 4,952 | 1,863 | — | — | 6,815 | 76 | (64) |
| Total | | | | | | 78 | (75) |
| | | | | | | (Note 18(a)) | (Note 18(e)) |

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

40 RISK MANAGEMENT (continued)

(g) Use of derivatives (continued)

| | December 31, 2004 | | | | | Fair values | |
|------------------------------------|---|-----------------------------|----------------------------|-------------------|-------|--------------|--------------|
| | Notional amounts with remaining life of | | | | | Assets | Liabilities |
| | Less than 3 months | Between 3 months and 1 year | Between 1 year and 5 years | More than 5 years | Total | | |
| <i>Interest rate derivatives</i> | | | | | | | |
| Interest rate swaps | 584 | 3,462 | 3,346 | — | 7,392 | 42 | (51) |
| <i>Currency derivatives</i> | | | | | | | |
| Spot | 1,917 | — | — | — | 1,917 | 4 | (3) |
| Forwards | 253 | 136 | — | — | 389 | 9 | (9) |
| Foreign exchange swaps | 2,001 | — | — | — | 2,001 | 11 | (12) |
| Currency options written | 248 | — | — | — | 248 | — | — |
| | 4,419 | 136 | — | — | 4,555 | 24 | (24) |
| Total | | | | | | 66 | (75) |
| | | | | | | (Note 18(a)) | (Note 18(e)) |

| | December 31, 2005 | | | | | Fair values | |
|----------------------------------|---|-----------------------------|----------------------------|-------------------|--------|--------------|--------------|
| | Notional amounts with remaining life of | | | | | Assets | Liabilities |
| | Less than 3 months | Between 3 months and 1 year | Between 1 year and 5 years | More than 5 years | Total | | |
| <i>Interest rate derivatives</i> | | | | | | | |
| Interest rate swaps | 1,272 | 4,949 | 3,907 | 294 | 10,422 | 39 | (51) |
| <i>Currency derivatives</i> | | | | | | | |
| Spot | 2,826 | — | — | — | 2,826 | 1 | (1) |
| Forwards | 364 | 3,481 | — | — | 3,845 | 39 | (34) |
| Foreign exchange swaps | 182 | 726 | 162 | — | 1,070 | 7 | — |
| | 3,372 | 4,207 | 162 | — | 7,741 | 47 | (35) |
| Total | | | | | | 86 | (86) |
| | | | | | | (Note 18(a)) | (Note 18(e)) |

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

40 RISK MANAGEMENT (continued)

(g) Use of derivatives (continued)

| | March 31, 2006 | | | | | | |
|----------------------------------|---|-----------------------------|----------------------------|-------------------|--------|--------------|--------------|
| | Notional amounts with remaining life of | | | | | Fair values | |
| | Less than 3 months | Between 3 months and 1 year | Between 1 year and 5 years | More than 5 years | Total | Assets | Liabilities |
| <i>Interest rate derivatives</i> | | | | | | | |
| Interest rate swaps | 982 | 6,774 | 4,668 | 293 | 12,717 | 40 | (61) |
| <i>Currency derivatives</i> | | | | | | | |
| Spot | 861 | — | — | — | 861 | 1 | (1) |
| Forwards | 2,144 | 3,076 | — | — | 5,220 | 36 | (54) |
| Foreign exchange swaps | — | 735 | 160 | — | 895 | 1 | — |
| | 3,005 | 3,811 | 160 | — | 6,976 | 38 | (55) |
| Total | | | | | | 78 | (116) |
| | | | | | | (Note 18(a)) | (Note 18(e)) |

The replacement costs and credit risk weighted amounts in respect of these derivatives are as follows. These amounts take into account the effects of bilateral netting arrangements.

Replacement costs

| | December 31, | | | March 31, |
|-------------------------------------|--------------|------|------|-----------|
| | 2003 | 2004 | 2005 | 2006 |
| Interest rate derivatives | 2 | 42 | 39 | 40 |
| Currency derivatives | 76 | 24 | 47 | 38 |
| | 78 | 66 | 86 | 78 |

Replacement cost represents the cost of replacing all contracts which have a positive value when marked to market. Replacement cost is a close approximation of the credit risk for these derivative contracts as at the balance sheet date.

Credit risk weighted amounts

| | December 31, | | | March 31, |
|-------------------------------------|--------------|------|------|-----------|
| | 2003 | 2004 | 2005 | 2006 |
| Interest rate derivatives | 2 | 3 | 26 | 25 |
| Currency derivatives | 10 | 18 | 25 | 16 |
| | 12 | 21 | 51 | 41 |

The credit risk weighted amount refers to the amount as computed in accordance with the rules set out by the CBRC and depends on the status of the counterparty and the maturity characteristics.

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****40 RISK MANAGEMENT (continued)*****(h) Fair value information******(i) Financial assets***

The Group's financial assets mainly include cash, deposits and placements with the central banks, banks and other financial institutions, loans and advances to customers and investments.

Except for loans and advances and held-to-maturity investments, most of the financial assets mature within 1 year or are already stated at fair value, and therefore their carrying values approximate their fair values.

Loans and advances are stated at amortised costs less allowances for impairment loss (Note 17). The interest rate of loans and advances will be adjusted in accordance with the PBOC rates, and impairment allowance is made to reduce the carrying amount of impaired loans to estimated recoverable amount. Accordingly, the carrying values of loans and advances are close to the fair values.

Held-to-maturity debt securities investments are stated at amortised costs less impairment, and the fair values are disclosed in Note 18(c).

(ii) Financial liabilities

Financial liabilities mainly include customer deposits, placements from banks and other financial institutions, and debts issued by the Bank. The carrying values of financial liabilities approximate their fair values at the balance sheet date of the Relevant Periods presented, except the financial liabilities set out below:

Carrying value

| | December 31, | | | March 31, |
|---------------------------------|--------------|-------|-------|-----------|
| | 2003 | 2004 | 2005 | 2006 |
| Convertible bonds issued | — | 5,550 | 5,184 | 42 |
| Subordinated notes issued | — | 3,500 | 3,500 | 3,500 |
| | — | 9,050 | 8,684 | 3,542 |

Fair value

| | December 31, | | | March 31, |
|---------------------------------|--------------|-------|-------|-----------|
| | 2003 | 2004 | 2005 | 2006 |
| Convertible bonds issued | — | 5,846 | 5,595 | 45 |
| Subordinated notes issued | — | 3,350 | 3,657 | 3,652 |
| | — | 9,196 | 9,252 | 3,697 |

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****41 SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS**

In determining the carrying amounts of some assets and liabilities, the Group makes assumptions for the effects of uncertain future events on those assets and liabilities at the balance sheet date. These estimates involve assumptions about such items as cash flows and discount rates used. The Group's estimates and assumptions are based on historical experience and expectations of future events and are reviewed periodically. In addition to assumptions and estimations of future events, judgements are also made during the process of applying the Group's accounting policies.

(a) Impairment losses on loans and advances

Loan portfolios are assessed periodically to assess whether impairment losses exist and if they exist, the amounts of impairment losses. Objective evidence for impairment includes observable data indicating that there is a measurable decrease in the estimated future cash flows from an individual loan. It also includes observable data indicating adverse changes in the repayment status of borrowers in the loan portfolio or national or local or economic conditions that correlate with defaults on the loans in the portfolio. The impairment loss for a loan that is individually evaluated for impairment is the decrease in the estimated future cash flow of that loan. When loans and advances are collectively evaluated for impairment, the estimate is based on historical loss experience for assets with credit risk characteristics similar to the loans and advances. Historical loss experience is adjusted on the basis of the relevant observable data that reflect current economic conditions. Management review the methodology and assumptions used in estimating future cash flows regularly to reduce any difference between loss estimates and actual loss experience.

(b) Impairment of available-for-sale financial assets

For available-for-sale financial assets, a significant or prolonged decline in fair value below cost is considered to be objective evidence of impairment. Judgement is required when determining whether a decline in fair value has been significant or prolonged. In making this judgement, historical data on market volatility as well as in the share price of the specific equity investment are taken into account. The Group also takes into account other factors, such as industry and sector performance and financial information regarding the investee.

(c) Fair value of financial instruments

For a number of financial instruments, no quoted prices in an active market exists. The fair values for these financial instruments are established by using valuation techniques. These techniques include using recent arm's length market transactions, reference to the current fair value of similar instruments and discounted cash flow analysis and option pricing models. The Group has established a process to ensure that valuation techniques are constructed by qualified personnel and are validated and reviewed by personnel independent of the area that constructed the valuation techniques. Valuation techniques are certified before being implemented for valuation and are calibrated to ensure that outputs reflect actual market conditions. Valuation models established by the Group make the maximum use of market inputs and rely as little as possible on the Group's specific data. However, it should be noted that some inputs, such as credit and counterparty risk and risk correlations, require management estimates. Management estimates and assumptions are reviewed periodically and are adjusted if necessary.

V NOTES TO THE FINANCIAL INFORMATION**(Expressed in millions of Renminbi unless otherwise stated)****41 SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS (continued)****(d) Held-to-maturity investments**

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity investments if the Group has the intention and ability to hold them until maturity. In evaluating whether the requirements to classify a financial asset as held-to-maturity are met, management makes significant judgements. Failure in correctly assessing the Group's intention and ability to hold specific investments until maturity may result in reclassification of the whole portfolio as available-for-sale.

(e) Income taxes

Determining income tax provisions involves judgement on the future tax treatment of certain transactions. The Group carefully evaluates tax implications of transactions and tax provisions are set up accordingly. The tax treatment of such transactions is reconsidered periodically to take into account all changes in tax legislations. Deferred tax assets are recognised for tax losses not yet used and temporary deductible differences. As those deferred tax assets can only be recognised to the extent that it is probable that future taxable profit will be available against which the unused tax credits can be utilised, management's judgement is required to assess the probability of future taxable profits. Management's assessment is constantly reviewed and additional deferred tax assets are recognised if it becomes probable that future taxable profits will allow the deferred tax asset to be recovered.

42 MATERIAL RELATED-PARTY TRANSACTIONS**(a) Transaction terms and conditions**

During the Relevant Periods, the Group entered into transactions with related parties in the ordinary course of its banking business including lending, investment, deposit and off-balance sheet transactions. The Directors are of the opinion that the Group's material related-party transactions were all entered into on normal commercial terms. The banking transactions were priced at the relevant market rates prevailing at the time of each transaction. Interest rates on loans and deposits are required to be set in accordance with the following benchmark rates set by the PBOC:

| | From October 29, 2004 to March 31, 2006 | From January 1, 2003 to October 28, 2004 |
|---------------------------------|--|---|
| Short-term loans | 5.22% to 5.58% p.a. | 5.04% to 5.31% p.a. |
| Medium to long-term loans | 5.76% to 6.12% p.a. | 5.49% to 5.76% p.a. |
| Saving deposits | 0.72% p.a. | 0.72% p.a. |
| Time deposits | 1.71% to 3.60% p.a. | 1.71% to 2.79% p.a. |

There were no allowances for impairment losses made on an individual basis against loans and advances granted to related parties during the Relevant Periods.

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

42 MATERIAL RELATED-PARTY TRANSACTIONS (continued)

(b) Shareholders and their related companies

As the Bank's largest shareholder China Merchants Steam Navigation Company Limited ("CMSNCL") and its related companies hold 21.87% of the Bank's shares as at March 31, 2006 (2005: 24.15%; 2004: 24.32%; 2003: 22.74%), the Directors consider that CMSNCL is not a controlling shareholder of the Bank but can exercise significant influence over the financial and operating decisions of the Bank. The Group's transactions and balances with CMSNCL and its related companies are disclosed as follows:

| | December 31, | | | March 31, | |
|--|--------------------------|------------|------------|--------------------|--------------|
| | 2003 | 2004 | 2005 | 2006 | |
| On balance sheet: | | | | | |
| Loans and advances | 760 | 386 | 782 | 1,433 | |
| Deposits with banks and other financial institutions | 3 | — | — | — | |
| Placements with banks and other financial institutions | 600 | — | — | — | |
| Investments (note (i)) | 414 | — | — | 160 | |
| Deposits from customers | 736 | 443 | 667 | 2,388 | |
| Deposits from banks and other financial institutions | <u>2,951</u> | <u>855</u> | <u>—</u> | <u>—</u> | |
| Off balance sheet: | | | | | |
| Irrevocable guarantees | 98 | 21 | 70 | 338 | |
| Irrevocable letters of credit | 62 | 117 | 101 | 291 | |
| Bills of acceptances | <u>79</u> | <u>173</u> | <u>328</u> | <u>95</u> | |
| | | | | | |
| | Years ended December 31, | | | Three months ended | |
| | 2003 | 2004 | 2005 | 2005 | 2006 |
| | | | | (unaudited) | |
| Average balance of loans and advances | <u>792</u> | <u>553</u> | <u>905</u> | <u>626</u> | <u>1,220</u> |
| Interest income | 44 | 36 | 53 | 6 | 17 |
| Interest expense | 61 | 36 | 4 | 1 | 8 |
| Fee and commission income (note (ii)) | <u>17</u> | <u>31</u> | <u>41</u> | <u>6</u> | <u>18</u> |

Notes:

- (i) China Merchants Holdings Company Limited, a group company of CMSNCL, acts as the guarantor of the bond.
- (ii) Apart from the above transactions, the Bank also enters into transactions with CMSNCL and its related companies in the ordinary course of its banking activities such as remittance, securities trading, etc. The activities are priced at the relevant market rates at the time of the transactions.

V NOTES TO THE FINANCIAL INFORMATION

(Expressed in millions of Renminbi unless otherwise stated)

42 MATERIAL RELATED-PARTY TRANSACTIONS (continued)*(c) Companies controlled by directors other than those under Note 42(b) above*

| | December 31, | | | March 31, |
|--|--------------|------|------|-----------|
| | 2003 | 2004 | 2005 | 2006 |
| On balance sheet: | | | | |
| Loans and advances | 819 | 652 | 458 | 357 |
| Deposits from customers | 179 | 173 | 445 | 619 |
| Deposits from banks and other financial institutions | — | 375 | 337 | 782 |

| | Years ended December 31, | | | Three months ended March 31, | |
|---------------------------------------|--------------------------|------|------|------------------------------|------|
| | 2003 | 2004 | 2005 | 2005 | 2006 |
| | | | | (unaudited) | |
| Average balance of loans and advances | 735 | 596 | 765 | 652 | 424 |
| Interest income | 37 | 17 | 36 | 6 | 6 |
| Interest expense | 11 | 6 | 8 | 3 | 4 |

(d) Key management personnel

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Group, directly or indirectly, including Directors, Supervisors and Executive Officers.

Remuneration for key management personnel, including amounts paid to the Bank's Directors and Supervisors as disclosed in Note 8 and certain highest paid employees as disclosed in Note 9 during the Relevant Periods is as follows:

| | Years ended December 31, | | | Three months ended March 31, | |
|--|--------------------------|---------|---------|------------------------------|---------|
| | 2003 | 2004 | 2005 | 2005 | 2006 |
| | RMB'000 | RMB'000 | RMB'000 | RMB'000 (unaudited) | RMB'000 |
| Salaries and other emoluments | 7,833 | 8,556 | 8,794 | 1,500 | 1,500 |
| Discretionary bonuses | 11,291 | 11,138 | 11,960 | — | — |
| Contributions to defined contribution retirement schemes | 150 | 144 | 723 | 181 | 181 |
| | 19,274 | 19,838 | 21,477 | 1,681 | 1,681 |

V NOTES TO THE FINANCIAL INFORMATION
(Expressed in millions of Renminbi unless otherwise stated)

43 POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE ACCOUNTING PERIOD ENDED MARCH 31, 2006

Up to the date of issue of the Financial Information, the IASB has issued the following amendments, new standards and interpretations which are not yet effective for the accounting period ended March 31, 2006 and which have not been adopted in the Financial Information:

| | | Effective for accounting periods beginning on or after |
|--------------------------|--|--|
| IFRS 7 | Financial Instruments: Disclosures | January 1, 2007 |
| Amendment to IAS 1 | Presentation of Financial Statements: Capital Disclosures | January 1, 2007 |

The Group has assessed the impact of these amendments, new standards and new interpretations and concluded that they would only affect the level of details in the disclosure of the Financial Information, and would not have financial impact nor result in a change in the Group's accounting policies.

VI EVENTS OCCURRED AFTER THE BALANCE SHEET DATE

In June 2006, the Bank entered into an agreement with three independent third parties and China Merchants Securities Company, a related company of the Bank, to acquire 30% and 3.4% equity interest in China Merchants Fund Management Company ("CMFM") respectively for a total consideration of RMB197.7 million. The completion of the acquisition is subject to obtaining approvals from relevant regulatory authorities including the CSRC and the CBRC. As of 30 June 2006, the proposed acquisition has been approved by the CBRC but yet to be approved by the CSRC.

The following financial information of CMFM has been extracted from CMFM's statutory financial statements prepared in accordance with the requirements of the Accounting Standards for Business Enterprises and the Accounting Regulations for Financial Enterprises (2001) issued by the Ministry of Finance of the People's Republic of China and audited by Deloitte Touche Tohmatsu CPA Ltd. registered in the PRC in accordance with China's Independent Auditing Standards for Certified Public Accountants, who issued an unqualified audit opinion to the Board of Directors of CMFM thereon.

| | For the year ended December 31, | | |
|-------------------------------|---------------------------------|----------------|----------------|
| | 2003 | 2004 | 2005 |
| | (In RMB thousands) | | |
| Management fee income | 29,161 | 74,896 | 157,933 |
| (Loss)/profit after tax | (32,671) | (8,796) | 37,990 |
| | <u>29,161</u> | <u>74,896</u> | <u>157,933</u> |
| | <u>(32,671)</u> | <u>(8,796)</u> | <u>37,990</u> |
| | | | |
| | As at December 31, | | |
| | 2003 | 2004 | 2005 |
| | (In RMB thousands) | | |
| Net assets | 58,506 | 102,222 | 147,704 |
| | <u>58,506</u> | <u>102,222</u> | <u>147,704</u> |

We have not audited nor reviewed the abovementioned statutory financial statements of CMFM. Adjustments may arise if these financial statements had been prepared in accordance with IFRSs or if they had been audited in accordance with International Standards on Auditing.

Upon completion of the transaction, the Group's investment in CMFM will be recognised as an investment in associated company. The investment in associated company and any goodwill arising will be accounted for in the consolidated financial statements in accordance with IFRSs.

Apart from the above, the Group had no other material post balance sheet date events for disclosure.

VII SUBSEQUENT FINANCIAL STATEMENTS

No audited financial statements have been prepared by the Group in respect of any period subsequent to March 31, 2006.

Yours faithfully,

KPMG

Certified Public Accountants

Hong Kong, China