



Integrity, prudence and
always prepared
for the future



Our

PRINCIPLES

Report of the Board of Directors

The Board of Directors hereby presents its report and the audited consolidated financial statements of the Bank and its subsidiaries for the year ended 31 December 2006.

1 PRINCIPAL BUSINESS

The Bank is principally engaged in banking and related financial services. An analysis of the Bank's operating results by business segments for the year is set out in note 6 to the supplementary unaudited financial information.

2 RESULTS AND DISTRIBUTION

The operating results of the Bank for the year are set out in the consolidated profit and loss account on page 83.

The Board recommends a final dividend of RMB0.10 per share (2005: RMB0.08 per share), amounting to an aggregate of RMB4.580 billion as dividends for distribution (2005: RMB3.664 billion) for the financial year ended 31 December 2006. The distribution plan shall be subject to approval from shareholders at the 2006 Annual General Meeting.

3 RESERVES

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

4 CHARITABLE DONATIONS

Donation made by the Bank during the year for charitable purpose amounted to RMB84.4095 million (2005: RMB9.6323 million).

5 FIXED ASSETS

Details of movements in the fixed assets of the Bank are set out in note 20 to the consolidated financial statements.

6 SHARE CAPITAL

Details of the share capital of the Bank are set out in note 29 to the consolidated financial statements.

As at the latest practicable date prior to the issue of this annual report, the Bank has maintained the prescribed public float under the Listing Rules and as agreed with The Stock Exchange of Hong Kong Limited (the "Stock Exchange"), based on the information that is publicly available to the Bank and within the knowledge of the Directors of the Bank.

7 DISTRIBUTABLE PROFIT

As at 31 December 2006, pursuant to the relevant laws and regulations, the Bank's distributable profit amounted to approximately RMB12.635 billion (2005: RMB8.991 billion).

8 FINANCIAL SUMMARY

A summary of the results, assets and liabilities of the Bank for the last five financial years is set out on page 4.

9 DIRECTORS

Biographical details of the Directors, Supervisors and senior management are set out on pages 21 to 29 of this annual report. The Bank has received an annual confirmation of independence from each of Independent Non-executive Directors and considered them to be independent.

10 BOARD COMMITTEE

Please refer to the corporate governance report on pages 48 to 61 of this annual report.

11 DIRECTORS' AND SUPERVISORS' SERVICE CONTRACTS

None of the Directors and Supervisors of the Bank has entered into any service contract with the Bank which is not determinable by the Bank within one year without payment of compensation (other than statutory compensation).

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

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

13 INTERESTS OF DIRECTORS AND SUPERVISORS IN SIGNIFICANT CONTRACTS

No contract of significance in respect of the business of the Bank to which the Bank or any of its subsidiaries was a party and in which a Director or a Supervisor of the Bank had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

14 DIRECTORS' AND SUPERVISORS' INTERESTS IN COMPETING BUSINESS OF THE BANK

None of the Directors or Supervisors of the Bank is interested in any business that competes or is likely to compete, either directly or indirectly, with the Bank's business.

Report of the Board of Directors

15 DIRECTORS' AND SUPERVISORS' RIGHTS TO ACQUIRE SHARES

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

16 DIRECTORS' INTERESTS

As at 31 December 2006, none of the Bank's Directors, Supervisors, Chief Executive and their associates had or was deemed to have any interest or short position in the shares, underlying shares or debentures of the Bank or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (the "SFO")) which were required to be notified to the Bank and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they were deemed or taken to have under such provisions of the SFO), or which were required to be entered in the register pursuant to section 352 of the SFO, or which were required, pursuant to Model Code for Securities Transactions by Directors of Listed Issuers, to be notified to the Bank and the Stock Exchange.

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

As at 31 December 2006, the shareholders (other than the Bank's Directors, Supervisors or Chief Executive) who had interests or short positions in the shares and underlying shares of the Bank as recorded in the register, which is required to be kept pursuant to Section 336 of the SFO, are as follows:

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

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

Name of substantial shareholders	Capacity	Number of H shares	Nature of interest (Note 1)	Approximate percentage of issued H shares (%)	Approximate percentage of total issued shares (%)
National Council for Social Security Fund	Beneficial owner	5,555,555,556	Long positions	24.09	12.13
China SAFE Investments Limited	Beneficial owner	3,000,000,000	Long positions	13.01	6.55
The Hongkong and Shanghai Banking Corporation Limited	Beneficial owner	9,115,002,580	Long positions	39.52	19.90
HSBC Asia Holdings BV	Interest of controlled corporations <i>(Note 2)</i>	9,115,002,580	Long positions	39.52	19.90
HSBC Asia Holdings (UK)	Interest of controlled corporations <i>(Note 3)</i>	9,115,002,580	Long positions	39.52	19.90
HSBC Holdings BV	Interest of controlled corporations <i>(Note 4)</i>	9,115,002,580	Long positions	39.52	19.90
HSBC Finance (Netherlands)	Interest of controlled corporations <i>(Note 5)</i>	9,115,002,580	Long positions	39.52	19.90
HSBC Holdings plc.	Interest of controlled corporations <i>(Note 6)</i>	9,115,002,580	Long positions	39.52	19.90

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

Notes:

1. Long positions held other than through equity derivatives.
2. HSBC Asia Holdings BV holds 88.86% equity of the Hongkong and Shanghai Banking Corporation Limited. Pursuant to the SFO, HSBC Asia Holdings BV is considered to own the 9,115,002,580 H shares of the Bank which are held by Hongkong and Shanghai Banking Corporation Limited.
3. HSBC Asia Holdings BV is wholly-owned by HSBC Asia Holdings (UK). Pursuant to Note (2) and the SFO, HSBC Asia Holdings (UK) is considered to own the 9,115,002,580 H shares of the Bank which are held by the Hongkong and Shanghai Banking Corporation Limited.
4. HSBC Asia Holdings (UK) is wholly-owned by HSBC Holdings BV. Pursuant to Note (2), (3) and the SFO, HSBC Holdings BV is considered to own the 9,115,002,580 H shares of the Bank which are held by the Hongkong and Shanghai Banking Corporation Limited.
5. HSBC Holdings BV is wholly-owned by HSBC Finance (Netherlands), which also directly holds 8.53% equity of the Hongkong and Shanghai Banking Corporation Limited. Pursuant to Note (2) to (4) and the SFO, HSBC Finance (Netherlands) is considered to own the 9,115,002,580 H shares of the Bank which are held by the Hongkong and Shanghai Banking Corporation Limited.
6. HSBC Finance (Netherlands) is wholly-owned by HSBC Holdings plc, which also directly holds 2.61% equity of the Hongkong and Shanghai Banking Corporation Limited. Pursuant to Note (2) to (5) and the SFO, HSBC Holdings plc is considered to own the 9,115,002,580 H shares of the Bank which are held by the Hongkong and Shanghai Banking Corporation Limited.

18 TEN LARGEST SHAREHOLDERS AND THEIR SHAREHOLDINGS AS AT 31 DECEMBER 2006

Pursuant to the requirements of the China Banking Regulatory Commission (“CBRC”), the Bank’s ten largest shareholders and their shareholdings at the end of the reporting period are as follows:

Rank	Name of shareholders	Number of shares	Approximate percentage of shareholding
1	Ministry of Finance of the People’s Republic of China	9,974,982,648	21.78%
2	The Hongkong and Shanghai Banking Corporation Limited	9,115,002,580	19.90%
3	National Council for Social Security Fund	5,555,555,556	12.13%
4	China SAFE Investments Limited	3,000,000,000	6.55%
5	Capital Airports Holding (Group) Company	985,447,500	2.15%
6	Shanghai Tobacco (Group) Corp.	378,328,046	0.83%
7	Yunnan Hongta Group Co. Ltd.	345,215,314	0.75%
8	Shandong Electric Power Corporation	300,000,000	0.65%
9	Huaneng Capital Services Corporation Ltd.	231,525,876	0.51%
10	China National Cereals, Oils and Foodstuffs Corp.	178,106,024	0.39%

19 PURCHASE, SALE OR REDEMPTION OF SHARES OF THE BANK

During the reporting period, neither the Bank nor any of its subsidiaries purchased, sold or redeemed any shares of the Bank.

20 PRE-EMPTIVE RIGHTS AND SHARE OPTION ARRANGEMENTS

There are no provisions for pre-emption rights pursuant to the Bank's Articles of Association and the relevant laws and regulations of the People's Republic of China. Currently, the Bank does not have any arrangement with respect to share option.

21 SHARE APPRECIATION RIGHTS

As part of the incentive scheme, the Bank has granted to its members of senior management share appreciation rights ("**SARS**"). The issuance of SARS does not involve any issue of new shares. There is no dilution of existing shareholders' equity. Details of the SARS are set out on page 60.

22 MAJOR CUSTOMERS

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

23 CONTINUING CONNECTED TRANSACTIONS

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

To regulate these on-going transactions, the Bank has entered into an interbank transactions master agreement with HSBC on 1 June 2005, pursuant to which the HSBC Group and the Bank agreed to conduct inter-bank transactions in accordance with applicable normal interbank practices and on normal commercial terms. During the reporting period, the Bank and the HSBC were engaged in the following continuing connected transactions or the balances of transactions between the Bank and the HSBC were as follows:

- (1) For the year ended 31 December 2006, the aggregate balance of deposits placed in HSBC by the Bank's branches amounted to RMB1.434 billion, and the deposit interest income was approximately RMB34.38 million in 2006.

23 CONTINUING CONNECTED TRANSACTIONS *(Continued)*

- (2) For the year ended 31 December 2006, the aggregate balance of deposits and loans placed in the Bank by HSBC amounted to RMB489 million, and the interest expense was approximately RMB64.26 million in 2006.
- (3) For the year ended 31 December 2006, the aggregate balance of securities investments purchased by the Bank's branches from HSBC amounted to RMB1.395 billion, and the interest income from the securities investments was approximately RMB28.00 million in 2006.
- (4) For the year ended 31 December 2006, the major off balance sheet transactions namely guarantee, issuance of letter of credit and derivative transactions unsettled entered between the Bank's branches and HSBC amounted to RMB5.04 million, RMB218 million and RMB5.739 billion, respectively.

The Bank has made application to the Stock Exchange for, and the Stock Exchange has granted, a waiver from strict compliance with the announcement and independent shareholders' approval requirements of the Listing Rules in respect of the abovementioned continuing connected transactions.

After careful review of the abovementioned continuing connected transactions, each Independent Non-executive Directors of the Bank considers that the abovementioned continuing connected transactions which have been entered into by the Bank as:

- (1) having been entered into by the Bank in the ordinary and usual course of business;
- (2) having been entered into on normal commercial terms or on terms no less favorable to the Bank than terms available to or from independent third parties; and
- (3) having been entered into in accordance with the interbank transactions master agreement, which are considered as fair and reasonable and in the interests of the Bank's shareholders as a whole.

The auditors have also issued a letter to the Board confirming that the abovementioned continuing connected transactions:

- (1) have received the approval of the Board of Directors;
- (2) are in accordance with the pricing policies of the Bank; and
- (3) have been entered into in accordance with the interbank transactions master agreement.

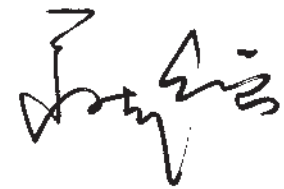
24 SIGNIFICANT EVENTS

As at 31 December 2006, the amount of unsettled litigation, to which the Bank was involved as a defendant or as a third party, amounted to RMB2.058 billion. Provision for liabilities arising from such litigation by the Bank was considered to be sufficient.

25 AUDITORS

The Bank's financial statements for 2006 were audited by PricewaterhouseCoopers and Deloitte Touche Tohmatsu. A resolution will be proposed at the forthcoming annual general meeting for the reappointment of PricewaterhouseCoopers and Deloitte Touche Tohmatsu as the Group's auditors for 2007.

By order of the Board
Chairman

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

Jiang Chaoliang

Shanghai, PRC, 8 March 2007