Local and foreign currency investments

Local and foreign currency denominated investments of the Bank mainly include investments denominated both in local currency and foreign currencies.

Foreign currency-denominated investments The foreign currency-denominated investments of the Bank primarily include investments in government bonds, institution bonds, corporate bonds, bank bonds, emerging market bonds, mortgage-backed securities (MBS), asset-backed securities (ABS), collateralized debt obligation (CDO) and lending at money market. The Bank normally invests in foreign currency-denominated bonds with high credit ratings, among which 74.9% are above Aaa grade. The Bank also conducts forward, option, swap and other derivative transactions to hedge the risk or to achieve the objectives of investments. In 2006, the Bank invested proceeds from the IPO in assets that have both high liquidity and high return, such as MBS, corporate bonds with high ratings and long-term investment portfolios which are flexible and conducive to the enhancement of overall investment returns. In addition, the Bank disposed of some bonds with low returns. It decreased the proportion of held-to-maturity investments, and thus enhanced liquidity and improved the valuation of the account. The duration of foreign currency-denominated bond investments decreased sharply in the second half of 2006 to 2.039 at the end of the year.

Local currency-denominated investments The local currency-denominated investments of the Bank primarily include investments in Chinese treasury bonds, financial bonds issued by Chinese policy banks, bills issued by PBOC and bonds issued by Chinese commercial banks. In 2006, the yield curve of the domestic bond market presented distinctly flattening trend. At the end of 2006, the total volume of the local currency-denominated investment portfolio exceeded RMB400 billion. Modified duration decreased to 2.16 and interest rate risk was effectively reduced. Following a comprehensive consideration of risk and return, the Bank held more bills of PBOC and policy related financial bonds, attaining greater stability and increasing income.

Proprietary transactions

Proprietary transactions of the Bank include foreign currency-denominated proprietary transactions and local currency-denominated proprietary transactions.

Foreign currency-denominated proprietary transactions The Bank efficiently performed the role of market-maker in inter-bank foreign exchange markets with the largest transaction volumes, and actively provided liquidity for the market. During 2006, the number of transactions in the inter-bank foreign exchange market reached 17,210, representing a significant increase of 70 times compared to the prior year. The Bank actively participated in domestic and overseas bullion transactions. While keeping its profit margin, it continued to maintain the leading position in the domestic market and expanded its influence in the international market.

Confronted with an unfavorable market environment, the Bank actively explored the volatility of various currencies and made a flexible use of different trading platforms and instruments so as to maintain the leading position in the market. The Bank also actively participated in bullion and other precious metal transactions in the international market. With the trade volume of bullion reaching 600 tons, the Bank further expanded its influence in the international market. As to the quotation of derivatives, the Bank kept its traditional advantages in the quotation of interest rate swap denominated in US dollar.

Development Trends of the Financial Market Business

Trading Volume	**2006**	2005
Trading Volume of settlement & purchase of CNY (USD billion)	347	308
Bullion Trading Volume of Shanghai Gold Exchange (Ton)	240	160
Trading Volume of FX Option (USD billion)	44	35.2

Renminbi-denominated proprietary transactions Local currency-denominated proprietary transaction of the Bank increased greatly as a result of its accurate research and judgment made on the market, active market participation and timely operation. In 2006, the volume of proprietary bond trading transactions reached RMB730.2 billion, representing a year-on-year increase of 38%. The number of bond trading transactions was 8,965, representing a year-on-year increase of 26%, securing the Bank's place as the first in the market. Renminbi-denominated interest rate swaps are one of the new businesses developed by PBOC in 2006. In 2006, the market share of the Bank in the Renminbi-denominated swap market was ranked second in the market. In 2006, the Bank maintained its leading position in domestic bullion transactions. In 2006, its market share in the Shanghai Gold Exchange, the only gold exchange in Chinese Mainland, increased from 33.86% in 2005 to 36.79% in 2006 with the volume of transactions being the largest at Shanghai Gold Exchange.

Treasury operations on behalf of customers and bond market operations

Treasury operations on behalf of customers includes corporate and private business.

Corporate business on behalf of customers mainly includes foreign exchange fund management (mainly to preserve values of the debt), "Four-Season Forwarding", "Credit Garden" and structured wealth management products denominated in Renminbi. The development model and product design of treasury operations on behalf of customers has entered into a new phase in 2006. All businesses reported sound growth. The volume of debt value-preservation transactions made on behalf of customers reached USD3 billion, representing the largest market share in the market. In addition to active marketing, the Bank strengthened innovation and strived to create new profit-growing areas in agency businesses. The "Credit Garden" developed rapidly, with transactions volumes reaching USD30 million.

Foreign exchange wealth management in private business on behalf of customers mainly includes "Huijubao", "Liangdebao", "Qiquanbao", "Personal Foreign Exchange Option", "Spring - Summer - Autumn - Winter", etc. It is a traditional business of the Bank and developed steadily in 2006. Amongst the products, the wealth management product "Game" had an interest-bearing fund of RMB5.4 billion.

The Bank provided itself and corporate customers with financing services by issuing

local and foreign currency-denominated bonds and arranging syndicated loans in international and domestic markets. In 2006, the Bank played an active role in issuing and underwriting bills in the domestic inter-bank bond market. In 2006, the Bank issued 22 short-term bonds with a transaction volume of RMB16.6 billion, and participated in the underwriting of 197 short-term bonds with a total underwriting volume of RMB51.04 billion.

Distribution and custody of fund

In 2006, on the basis of maintaining custodian customers, the Bank further expanded the scale of its custodian assets. It has made a breakthrough in the custody of annuity plans, financial institutions' asset securitization funds, which further strengthened and improved its market position and the image of its assets custody business. At the end of 2006, total net custodian assets of the Bank exceeded RMB300 billion, reaching RMB342.8 billion and doubling the amount at the end of 2005.

Business innovation

The development of new products and quotation ability is a major competitive advantage of the Bank. Resulting from the continuation of active international and domestic market activities, the performance of the Bank's settlement and purchase of foreign exchange, and local and foreign currency-denominated wealth management were excellent. In 2006, by fully utilizing its traditional advantages in foreign exchange, the Bank applied its experience in the foreign exchange business to its Renminbi-denominated business. The Bank designed standard business models for entrusted wealth management and created the product line concepts of "BOC Value-added Wealth Management". It developed a series of new products, including asset-backed wealth management plan, trust management, bill management, and mini-bonds. While facing fierce market competition, the Bank successfully designed and launched a foreign exchange wealth management product "Credit Garden" and a Renminbi-denominated wealth management product "Game", and took the lead in launching a structured wealth management product connected with stock called "Red chip leverage", and wealth management product linked to crude oil called "Tong Tong Jin" in the domestic market, which provided relatively high investment returns for investors. During 2006, Hexun.com, a domestic professional finance website, awarded the Bank the "Best RMB Wealth Management Investment Product (RMB)" in recognition of its strength in Renminbi-denominated wealth management products. The personal wealth management product "Huijubao" has been awarded the "Best Domestic Wealth Management Brand" by Hexun.com for two consecutive years. In the year, the Bank was selected as one of the 16 quotation banks of SHIBOR, and successfully

conducted its first one-year placement transaction.

Outlook

In 2007, the macro-economic environment and regulatory policies are expected to provide ample room for development, while posing new challenges to the Bank's financial market business. The Bank expects to face more intense market competition in the financial market business in light of the advantages in technology, experience and marketing measures foreign banks will bring into the market. The Bank will further expand its financial market business, take business opportunities in the Renminbi-denominated derivative market, strengthen local and foreign currency-denominated asset portfolio management, take full advantage of its cooperation with strategic investors, follow the development trends of international banks and its comparative competitive advantages, so as to maintain the Bank's leading position in competition with other banks.

Operations of BOCHK

The Group conducts commercial banking business in Hong Kong through its subsidiary BOCHK. As a licensed bank in Hong Kong and with 65.87% of its shares owned by the Group, BOCHK is the Bank's most significant overseas business entity in terms of assets and profit contributions. As at 31 December 2006, BOCHK Group's total assets reached RMB926.082 billion. At the end of 2006, BOCHK Group contributed a net profit of RMB9.448 billion to the Bank. BOCHK Holdings, which was the controlling shareholder of BOCHK, was listed on the Hong Kong Stock Exchange main board in July 2002.

BOCHK is one of the three note-issuing banks in Hong Kong. Through its extensive service network, BOCHK offers comprehensive financial products and services to its retail and corporate customers. As of the end of 2006, BOCHK had an aggregate of 302 branches, of which 287 branches are located in Hong Kong, 14 in Chinese Mainland and 1 overseas, together with 445 ATMs in Hong Kong. In the first half of 2006, BOCHK Holdings further extended its business lines and diversified its income resources by acquiring 51% stake in BOCG Life.

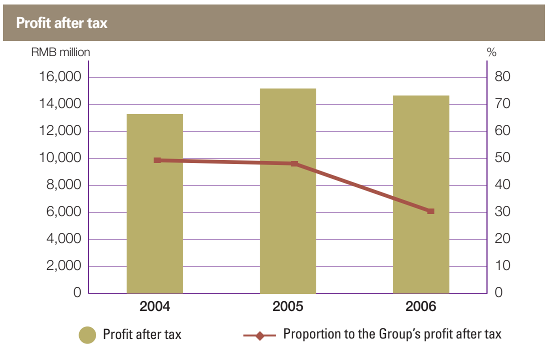
In 2006, BOCHK mapped out its strategic focus for the next five years: strengthening its position as one of the leading banks in Hong Kong; enhancing its capabilities in product manufacturing and distributing; building a

stronger presence in Chinese Mainland; exploring opportunities for regional expansion; and promoting corporate value and core advantage.

Business Performance

In 2006, benefiting from the vibrant economic growth and the active financial markets in Hong Kong, BOCHK delivered the highest operating profit before loan impairment allowances and profit attributable to shareholders since its restructuring in 2001, before taking into account the impact of foreign exchange retranslation. Net interest income and net interest margins increased substantially. Both the net interest income and the net interest yield experienced strong growth, with outstanding performance in both the investment and insurance businesses.

Proportion of BOCHK Group's profit after tax to that of the Group



In 2006, BOCHK actively developed its deposit taking business while controlling funding costs. To meet the various demands of its customers, BOCHK carried out specific product promotion, resulting in an increase in taking of low-interest and interest-free deposits as well as a more optimized deposit structure. With an emphasis on risk management and efficiency enhancement, BOCHK set up operational models for SME development. It streamlined business flows and improved customer service efficiency, and launched a series of competitive and diversified products in the year which doubled the loan balance for SMEs. BOCHK remained the leader in the syndication loan markets of Chinese Mainland, Hong Kong and Macau, with a market share of 9.3%.

BOCHK was appointed by the PBOC in 2003 as the clearing bank for Renminbi-denominated businesses in Hong Kong and was reappointed in January 2007. BOCHK has remained the leader in Renminbi-denominated businesses in Hong Kong since the Renminbi-related services were initially launched in February 2004. BOCHK has continued to achieve satisfactory results in this area. In 2006, Renminbi-denominated deposits in Hong Kong has increased by 1.8 %, and Renminbi-denominated credit card issuance has increased by 22.7%. A personal Renminbi-denominated cheque service was launched in March 2006 to provide more convenience to customers.

Business Cooperation and Complementary Operations between BOC and BOCHK

As one of the leading banks in Hong Kong, BOCHK will continue to consolidate its strength in the market in Hong Kong and leverage its strong base and platform to grow its businesses both in Chinese Mainland and other regions. BOC and BOCHK together will seek to increase their combined market share in the banking market in Chinese Mainland. The Bank believes the business strategies of BOCHK are complimentary and consistent with those of the Bank.

BOCHK's extensive network and branches in Hong Kong provide efficient services for customers from Chinese Mainland. The Bank's network of over 11,000 branches throughout Chinese Mainland offers convenient services for the Hong Kong customers of BOCHK. The cooperation and complement between BOCHK and the Bank in the areas of corporate banking, personal banking and financial market business have enhanced their combined market position in Chinese Mainland.

BOCHK has a network of 14 branches and sub-branches operating in Chinese Mainland, mainly spread along the Yangtse River Delta and Pearl River Delta regions, as well as several major cities along the coastline. Leveraging the competitive advantage, these domestic branches are able to offer cross-border banking services to customers both from Hong Kong and Chinese Mainland.

BOCHK announced in early 2007 the adoption of a dualistic approach to its China business model. Nanyang, a wholly-owned subsidiary of BOCHK, is applying to the regulatory authorities of Chinese Mainland for registration as a locally-incorporated bank and will move on full steam to develop full-scale banking services in Chinese Mainland with emphasis on retail banking services. BOCHK will continue to operate its branches in Chinese Mainland as foreign bank focusing on corporate banking and foreign exchange business. Chiyu Banking Corporation Limited, another subsidiary of BOCHK, will also maintain its status as a foreign subsidiary and continue its existing operations in China.

Outlook

In 2007, in terms of strategic business development, BOCHK will continue to increase its market share in traditional segments such as corporate banking and retail banking. It will also further strengthen and expand its business platform, enhance product innovation and manufacturing capabilities and take advantage of the synergies created through collaboration with the Bank which generate sustainable long-term returns on equity and maximize value for shareholders.

(For further details of BOCHK's business results and related information, please refer to its annual report for the same period.)

Investment Banking Business

BOC International Holdings Limited (BOCI), which specializes in investment banking, is a wholly owned subsidiary of the Bank. BOCI was founded in Hong Kong on 10 July 1998. It is a PRC-based world-class investment bank with a global presence in major financial centers, including New York, London, Hong Kong and Singapore. It has a well-established sales and distribution network in major cities along the coastal regions and inland regions of China, covering Beijing, Shanghai, Guangzhou and Chongqing. With a team of financial experts, a broad institutional and retail sales network and global infrastructure, BOCI is well-positioned to offer its clients a wide range of investment banking products and services, including corporate financing, mergers and acquisitions, financial advisory, sales and trading of equity and fixed income products, derivative and structured products, asset management and private equity investments.

BOCI adopted its strategy of taking root in China, making the world its stage and offering the best cross-border services in 2006. It emphasized strongly on corporate governance and focused on its sustainable traditional businesses while promoting business innovation. It is committed to shaping a global investment banking culture of "Customer-Oriented, Integrity, Teamwork, Initiative, and Innovation" in an effort to achieve continuous enhancements in its core competences.

The profit after tax of BOCI was HKD1.13 billion in 2006, representing a year-on-year growth of 280%.

Underwriting and financial advisory BOCI arranged 7 initial public offerings (IPO) in 2006 including the H share IPO of the Bank, which came out among the top in the league table and gained a market share of 12.2% in terms of deal value.

Domestic businesses BOCI leveraged its expertise in China to provide extensive investment banking services to its Chinese clients. In particular, BOCI completed a number of private placements as well as merger and acquisition projects for financial institutions and leading corporations in China in 2006.

Securities brokerage BOCI achieved substantial growth in its securities brokerage businesses, both for the primary and secondary markets in 2006. In particular, its market share in the Hong Kong retail stock brokerage market increased 20% compared to last year.

Asset management BOCI, operating via its subsidiary BOCI-Prudential, provides comprehensive asset management services and a wide range of investment products including the Hong Kong Mandatory Provident Fund (MPF), pension fund schemes, retail unit trusts, and other institutional mandates. As of December 2006, BOCI-Prudential managed over HKD28.73 billion of assets (including MPF), representing a year-on-year growth of 12.7% and maintained a market share of approximately 8% in terms of the assets under management.

Equity research BOCI has a team of investment research analysts covering the global capital markets. Their research capabilities as well as the depth and quality of their product offerings are well recognized and highly praised by clients worldwide.

Direct investment In 2006, BOCI became the equity participant of Bohai Industrial Investment Fund Management Co., Ltd., undertaking the management and operation of Bohai Industrial Investment Fund, with a total size of RMB20 billion. The establishment of BIIF was a breakthrough in the financial system reform in China, as well as a cornerstone of BOCI's private equity business. This also marked BOCI's leading position in China's RMB industrial investment fund sector.

Outlook

In 2007, BOCI will continue to leverage on the global operating platform of the Bank to strengthen its leading position in China as well as to grow further in the global capital markets. It is committed to creating value for its clients by providing high quality, comprehensive, professional, standardized and personalized financial products and services.

Insurance Business

The insurance business is conducted through the Bank's wholly-owned subsidiary, BOCG Insurance. The business scope of BOCG Insurance includes: property insurance, liability insurance, credit/bond insurance, short term health insurance, accident insurance and reinsurance of the above-mentioned classes of insurance. BOCG Insurance develops its business through 6 branches, 3 wholly-owned subsidiaries (Bank of China Insurance Company Limited, Eastern Pearl Insurance Advisers Limited and Ford Ease Investment Limited) and 3 associated companies (BOC Group Life Assurance Company Limited, Luen Fung Hang Insurance Company Limited and DongFeng Peugeot Citroen Auto Finance Company Limited).

Business Operation

Since its establishment in Hong Kong more than a decade ago, BOCG Insurance has been making a stable progress. It is now in possession of an extensive business network and offers diversified insurance products. At the end of 2006, the assets of BOCG Insurance totalled HKD4.845 billion. In 2006, the actual gross premium income of BOCG Insurance totaled HKD1.21 billion with profit before tax amounting to HKD0.76 billion, representing a growth of 91.66% over the previous year.

Analysis of gross premium income

Unit: HKD million

	2006	2005	2004
Gross premium income	**1,213**	1,266	1,398

In 2006, in the area of product innovation, BOCG Insurance actively responded to the HKSAR Government's "User Pays" principle in health-related service reform and introduced a series of brand new medical insurance products to address market competition and client demand. At the same time, it also actively cooperated with banks in the development of joint products such as a safety insurance scheme for students.

In 2006, BOCG Insurance sold 51% of its shares in BOCG Life to BOCHK Holdings. By leveraging the extensive network of BOCHK in Hong Kong, the Group can provide more effective customer support to its "BOC wealth management" services.

Business in Chinese Mainland

In line with the business strategy of BOCG Insurance and to achieve one of its goals of expanding its business in Chinese Mainland, BOCG Insurance has set up a wholly-owned subsidiary company, Bank of China Insurance Company Limited, in China. At present the latter has already established 4 branches. In 2006, Bank of China Insurance Company Limited adopted an operating philosophy aiming to be a first class insurance company in China by building up a strong insurance brand name with advanced skills and quality service. The aggregated actual gross premium income for the year was RMB125.81 million, representing a growth of 95.86% and an increase of RMB61.57 million over the past year.

In 2007, it is expected that there will be a continuous increase in the number of competitors in the insurance market in Chinese Mainland and the challenges will become more intense. Bank of China Insurance Company Limited will take positive steps to make good use of every opportunity that arises. It will endeavour to enhance its risk management ability, business support capabilities and efficiency to establish a highly effective service system so as to cope with the demand from business development and competition, and to maintain a leading role in the insurance market in China.

Outlook

In light of a highly competitive insurance market, BOCG Insurance will strive to explore new development channels while at the same time reinforce its traditional business. It aims to elevate the quality of its service and professional skills, and further extend its business operations to the overseas market. It will also make use of the Bank of China Insurance Company Limited to gain access to major cities in Chinese Mainland covering the Bank's existing network.

BOCG Investment

The Bank is engaged in direct investment and investment management business, through its wholly-owned subsidiary, BOCG Investment, which was incorporated in Hong Kong in 1984. As the only professional investment management company within the Group, BOCG Investment primarily aims to implementing the overall development strategy of the Group. Its major business includes corporate equity investments, distressed asset investments, fixed assets investments, management and lease and property management services.

Business Operation

At the end of 2006, BOCG Investment had total assets of HKD44.189 billion with an after tax profit of HKD1.947 billion, representing an increase of 88.70% compared to the prior year.

In 2006, BOCG Investment vigorously expanded its business and succeeded in establishing alliances in different areas with major investment banks, professional funds, asset management companies, the government authorities in Chinese Mainland and other strategic partners. Meanwhile, BOCG Investment did not hesitate to make every effort to achieve innovations and explore different business models to support its business development.

During 2006, BOCG Investment took part in organizing the first contractual-type Renminbi-denominated industrial fund in China, namely "Bohai Industrial Investment Fund". It has not only opened up opportunities for the Group to establish close strategic relationship with growing enterprises of high potential, but also consolidated and strengthened the core competitiveness of the Group.

In 2006, BOCG Investment successfully completed the acquisition of SALE through its wholly-owned subsidiary, Sky Splendor, which was incorporated in the Cayman Islands. The acquisition provides a platform for the Bank to enter into the aircraft leasing industry. With this platform, the Bank not only provides operating leases for aircraft, asset management and structured financing services to airline companies, but also achieves synergies by securing more business in lending, intermediate services, investment banking and insurance in the aviation industry. Consequently, the Bank's presence could be further elevated by differentiating itself from its competitors with its international, global and diversified business characteristics.

Outlook

In 2007, BOCG Investment will strive to become a growth company which has an appropriate asset size, a reasonable investment portfolio, high liquidity, strong profit making ability and stable investment returns. As a result, BOCG Investment will be one of the key sources for profit and contribute to the overseas diversified business developments of the Group.

Management Discussion and Analysis — Risk Management

Overview

In 2006, the Bank achieved steady progress in the development of its risk management system, and further improved its risk management ability and infrastructure with a view to promoting independence, centralization and professionalism in its risk management.

We seek to maintain a "moderate" risk appetite and a balance between risk and return in a "rational, stable and prudent" manner. Our primary risk management objectives are to maximize value for our shareholders while maintaining risk within acceptable parameters and satisfying the requirements of the regulatory authorities, our depositors and other stakeholders for the Bank's prudent and stable development.

The guiding principles in developing our risk management framework include:

- *Compliance with legal and regulatory requirements:* rigorously following the laws and regulations, stipulations and guidelines of regulatory authorities. Compliance and stable operations are preconditions of the effective implementation of risk management.

- *Achieving an appropriate equilibrium between risk and return:* through active control to achieve balance between profit and loss, each category of business should make profits which at least match the risk it bears.

- *Relative independence:* being relatively independent of business development, risk management objectively identifies, measures and controls risks existing in business development, with independent risk management institutions and personnel.

- *Strict accountability:* clarifying duties, rights and responsibilities through rigorous internal control mechanisms.

- *Alignment:* ensuring the objective of risk management is consistent with that of business development and preserving a unified risk management and control strategy.

- *Sufficient disclosure:* providing risk information to the supervisory authorities or disclosing the information to the public in accordance with regulatory requirements.

Through further improvement of our risk management system, we seek to achieve the following objectives: (1) extending our risk management framework to all of our business departments, branches and subsidiaries; (2) ensuring that risks inherent in our various lines of business are effectively managed; (3) establishing an all-encompassing risk management culture; (4) developing comprehensive and integrated risk management procedures, policies and processes; and (5) utilizing appropriate risk management tools to identify, monitor and quantify our risks.

Risk Management Framework

The Bank's risk management framework is mainly composed of the Board of Directors and the Risk Policy Committee under the Board; the Internal Control Committee, the Anti-Money Laundering Committee, the Asset-Liability Management Committee and the Asset Disposal Committee which report to the senior management; and the Risk Management Department, the Credit Administration Department, the Asset-Liability Management Department and the Legal and Compliance Department. The Bank manages the risks in branches through a vertical management model, the risks in business departments through the risk window management model, and monitors and controls the risk management in subsidiaries through appointing members of their boards of directors or risk management committees.

Credit Risk

Overview

Credit risk is the risk that a customer or counterparty may be unable or unwilling to meet a repayment obligation that it has entered into with us. The credit risks are mainly from loans, trade finance and treasury operations.

In 2006, as part of our ongoing efforts to improve the centralized credit approval system, the pilot running of the centralized credit approval system operated smoothly. Most of the chief credit officers of tier one branches have been put in place and the first batch of the authorized credit application approvers has been appointed and authorized by the head office. To further enhance the efficiency and acceleration of credit approval of our important and high quality customers, we have initiated a hierarchy management, with assigned and designated officials to serve our important and high quality customers, and we have drafted and implemented "Lending Guidelines". To support our business development, we have developed "The Guideline of SMEs Credit Policy" and "The Rules of SMEs Credit Management", and have initiated the pilot run of these measures in several branches.

In 2006, the Bank further enhanced the credit management of group customers. We amended and issued "The Rules of Credit Management of BOC Group Customers". By strengthening the identification process of the groups and their members, updating these information in IT system on a timely basis, specifying classification criteria for group customers, we enhanced the ability to identify group customers. We also enhanced the analysis of high-risk group customers which demonstrate the characteristics of large-scale loans, frequent capital transactions, family management, defective corporate governance, and lack of transparency and analyzed how to improve monitoring the risks of such customers.

In 2006, the Bank further improved the credit rating of corporate customers through our ten-category customer credit rating system, which forms overall assessments on the credit status of customers based on analysis of various criteria including the customer's solvency, profitability, operating and management indicators, credit record, market outlook, development potential and quality of financial information etc. Any assignment of a "A" or "B" credit rating under our ten-category customer rating system is required to be reviewed and approved either by our tier one branches or our head office. At the end of 2006, the outstanding loans extended to borrowers with a credit rating of "A" accounted for approximately 45.2% of the total loans outstanding of the rated corporate customers of our domestic operations, an increase of 3.3 percentage points compared with the prior year-end. The Bank has developed a new quantitative approach to its corporate borrower rating model, which focuses on the probability of default by a borrower, and have completed the back testing of the model to improve its performance.

For better understanding and assessment of the credit risks the Bank is taking, set forth below are the details of distribution, quality and allowance for impairment losses, respectively, of the loan portfolio.

Loan Distribution

Loan concentration by geographical region

As at 31 December 2006, our domestic operations accounted for 81.76% of the total loan portfolio of the Group, and overseas operations accounted for 18.24%. Domestic loans were mainly concentrated in Eastern China, and Central and Southern China, respectively, accounting for 41.21% and 24.41% of the total domestic loan portfolio. In 2006, loans in Eastern China and Central and Southern China achieved a relatively high growth rate, increasing by RMB99.675 billion and RMB40.416 billion respectively, compared to last year.

Group

Unit: RMB million, except percentages

	As at 31 December							
	2006		2005		2004		2003	
	Amount	**% of total**	Amount	% of total	Amount	% of total	Amount	% of total
Domestic institutions	**1,988,334**	**81.76%**	1,800,142	80.53%	1,735,528	80.81%	1,750,071	80.99%
Overseas institutions	**443,685**	**18.24%**	435,123	19.47%	412,160	19.19%	410,829	19.01%
Total	**2,432,019**	**100.00%**	2,235,265	100.00%	2,147,688	100.00%	2,160,900	100.00%

Note: In 2006, the Bank transferred impaired loans of RMB2.066 billion from overseas institutions. The transferred impaired loans, together with the allowance for loan impairment losses of RMB1.849 billion are adjusted in the Management Discussion and Analysis section for the comparison purposes. Such adjustments are included in the following disclosed information.

Domestic

Unit: RMB million, except percentages

	As at 31 December							
	2006		2005		2004		2003	
	Amount	**% of total**	Amount	% of total	Amount	% of total	Amount	% of total
Northern China	**348,596**	**17.53%**	322,451	17.91%	314,843	18.14%	355,279	20.30%
Northeastern China	**136,119**	**6.85%**	131,649	7.32%	128,600	7.41%	139,263	7.96%
Eastern China	**819,434**	**41.21%**	719,759	39.98%	679,773	39.17%	621,900	35.54%
Central & Southern China	**485,285**	**24.41%**	444,869	24.71%	433,860	25.00%	453,863	25.93%
Western China	**198,900**	**10.00%**	181,414	10.08%	178,452	10.28%	179,766	10.27%
Total	**1,988,334**	**100.00%**	1,800,142	100.00%	1,735,528	100.00%	1,750,071	100.00%

Note: To improve the recovery and disposal of the NPLs, we centralized credit management of the NPLs of RMB12.643 billion to our head office from 7 of our domestic branches, namely Heilongjiang, Jilin, Liaoning, Hubei, Shaanxi, Shanxi, and Xinjiang in 2006. For the convenience of comparison, such NPLs and related allowance are adjusted in the "Management Discussion and Analysis" section. Such adjustment is included in the following disclosed information.

Loan concentration by industry and product

In 2006, China continued with its macro-economic control policy. The Bank tightened the credit criteria of overheated industries, examined the credit status in high-risk industries, and emphasized the monitoring of existing credits. Our credit business in those industries, which were significantly affected by macro-economic control, such as real estate, developed steadily. The industry mix of the loan portfolio was enhanced with overall asset quality improved.

Group

Unit: RMB million, except percentages

	As at 31 December							
	2006		2005		2004		2003	
	Amount	**% of total**	Amount	% of total	Amount	% of total	Amount	% of total
Corporate loans								
Manufacturing	**603,078**	**32.61%**	531,410	31.04%	523,732	31.67%	559,348	31.47%
Commerce and Services	**301,254**	**16.29%**	301,863	17.63%	348,432	21.07%	430,993	24.25%
Real Estate	**217,960**	**11.79%**	190,297	11.11%	187,110	11.32%	216,734	12.19%
Energy, mining and agriculture	**260,706**	**14.10%**	230,854	13.48%	203,544	12.31%	188,821	10.62%
Transportation	**211,786**	**11.45%**	193,428	11.30%	185,449	11.21%	177,664	10.00%
Public utilities	**106,141**	**5.74%**	91,924	5.37%	87,731	5.31%	75,465	4.24%
Construction	**38,897**	**2.10%**	36,050	2.11%	36,059	2.18%	44,548	2.51%
Financial services	**72,909**	**3.94%**	96,245	5.62%	46,518	2.81%	48,261	2.71%
Others	**36,544**	**1.98%**	40,191	2.34%	35,072	2.12%	35,673	2.01%
Sub-total	**1,849,275**	**100.00%**	1,712,262	100.00%	1,653,647	100.00%	1,777,507	100.00%
Personal loans								
Mortgage loans	**456,930**	**78.41%**	413,007	78.97%	360,595	72.99%	275,303	71.81%
Credit cards	**8,458**	**1.45%**	6,785	1.30%	5,973	1.21%	4,944	1.29%
Others	**117,356**	**20.14%**	103,211	19.73%	127,473	25.80%	103,146	26.90%
Sub-total	**582,744**	**100.00%**	523,003	100.00%	494,041	100.00%	383,393	100.00%
Total	**2,432,019**	**100.00%**	2,235,265	100.00%	2,147,688	100.00%	2,160,900	100.00%

Domestic

Unit: RMB million, except percentages

	As at 31 December							
	2006		2005		2004		2003	
	Amount	**% of total**	Amount	% of total	Amount	% of total	Amount	% of total
Corporate loans								
Manufacturing	**556,032**	**35.99%**	491,117	34.58%	497,543	35.94%	528,728	35.34%
Commerce and Services	**255,787**	**16.56%**	255,460	17.99%	284,772	20.57%	366,279	24.48%
Real Estate	**113,589**	**7.35%**	96,390	6.79%	100,932	7.29%	127,368	8.51%
Energy, mining and agriculture	**240,314**	**15.56%**	210,281	14.81%	186,942	13.51%	169,948	11.36%
Transportation	**182,398**	**11.81%**	165,396	11.64%	158,762	11.47%	152,575	10.20%
Public utilities	**105,933**	**6.86%**	91,924	6.47%	87,731	6.34%	75,465	5.04%
Construction	**34,676**	**2.25%**	30,089	2.12%	27,938	2.02%	34,539	2.31%
Financial services	**53,333**	**3.45%**	77,237	5.44%	32,079	2.32%	36,873	2.47%
Others	**2,692**	**0.17%**	2,290	0.16%	7,484	0.54%	4,277	0.29%
Sub-total	**1,544,754**	**100.00%**	1,420,184	100.00%	1,384,183	100.00%	1,496,052	100.00%
Personal loans								
Mortgage loans	**337,834**	**76.16%**	286,829	75.49%	240,640	68.49%	159,314	62.71%
Credit cards	**2,876**	**0.65%**	1,929	0.51%	1,441	0.41%	931	0.37%
Others	**102,870**	**23.19%**	91,200	24.00%	109,264	31.10%	93,774	36.92%
Sub-total	**443,580**	**100.00%**	379,958	100.00%	351,345	100.00%	254,019	100.00%
Total	**1,988,334**	**100.00%**	1,800,142	100.00%	1,735,528	100.00%	1,750,071	100.00%

Loan concentration by currency

Group

Unit: RMB million, except percentages

	As at 31 December							
	2006		2005		2004		2003	
	Amount	**% of total**	Amount	% of total	Amount	% of total	Amount	% of total
RMB	**1,692,980**	**69.61%**	1,477,859	66.12%	1,378,760	64.20%	1,321,097	61.14%
Foreign currencies	**739,039**	**30.39%**	757,406	33.88%	768,928	35.80%	839,803	38.86%
Total	**2,432,019**	**100.00%**	2,235,265	100.00%	2,147,688	100.00%	2,160,900	100.00%

Domestic

Unit: RMB million, except percentages

	As at 31 December							
	2006		2005		2004		2003	
	Amount	**% of total**	Amount	% of total	Amount	% of total	Amount	% of total
RMB	**1,688,414**	**84.92%**	1,475,821	81.98%	1,378,343	79.42%	1,320,843	75.47%
Foreign currencies	**299,920**	**15.08%**	324,321	18.02%	357,185	20.58%	429,228	24.53%
Total	**1,988,334**	**100.00%**	1,800,142	100.00%	1,735,528	100.00%	1,750,071	100.00%

Loan concentration by type of guarantee

Group

Unit: RMB million, except percentages

	As at 31 December							
	2006		2005		2004		2003	
	Amount	**% of total**	Amount	% of total	Amount	% of total	Amount	% of total
Unsecured	**536,293**	**22.05%**	475,983	21.29%	449,026	20.91%	370,566	17.15%
Guaranteed	**731,759**	**30.09%**	684,824	30.64%	650,905	30.31%	805,770	37.29%
Collateralized and pledged	**1,163,967**	**47.86%**	1,074,458	48.07%	1,047,757	48.78%	984,564	45.56%
Total	**2,432,019**	**100.00%**	2,235,265	100.00%	2,147,688	100.00%	2,160,900	100.00%

Domestic

Unit: RMB million, except percentages

	As at 31 December							
	2006		2005		2004		2003	
	Amount	**% of total**	Amount	% of total	Amount	% of total	Amount	% of total
Unsecured	**433,087**	**21.78%**	369,163	20.51%	365,100	21.04%	291,437	16.65%
Guaranteed	**632,985**	**31.84%**	600,323	33.35%	582,577	33.57%	737,487	42.14%
Collateralized and pledged	**922,262**	**46.38%**	830,656	46.14%	787,851	45.39%	721,147	41.21%
Total	**1,988,334**	**100.00%**	1,800,142	100.00%	1,735,528	100.00%	1,750,071	100.00%

Loan concentration by maturity

Group

Unit: RMB million, except percentages

	As at 31 December			
	2006		2005	
	Amount	**% of total**	Amount	% of total
Overdue	**87,331**	**3.59%**	77,845	3.48%
Due less than 1 year (1 year included)	**1,081,992**	**44.49%**	1,177,420	52.68%
Due between 1 and 5 years (5 years included)	**642,817**	**26.43%**	518,316	23.19%
Due more than 5 years	**619,879**	**25.49%**	461,684	20.65%
Total	**2,432,019**	**100.00%**	2,235,265	100.00%

Note: For the purposes of this table, loans to customers are considered overdue only if the principal payment is overdue. In addition, for loans to customers that are repayable by installments, only the portion of the loan that is overdue is reported as overdue. Any part of the loan that is not due is reported according to residual maturity.

Domestic

Unit: RMB million, except percentages

	As at 31 December			
	2006		2005	
	Amount	**% of total**	Amount	% of total
Overdue	**82,548**	**4.15%**	72,837	4.04%
Due less than 1 year (1 year included)	**953,495**	**47.96%**	1,062,790	59.04%
Due between 1 and 5 years (5 years included)	**464,060**	**23.34%**	340,366	18.91%
Due more than 5 years	**488,231**	**24.55%**	324,149	18.01%
Total	**1,988,334**	**100.00%**	1,800,142	100.00%

Note: For the purposes of this table, loans to customers are considered overdue only if the principal payment is overdue. In addition, for loans to customers that are repayable by installments, only the portion of the loan that is overdue is reported as overdue. Any part of the loan that is not due is reported according to residual maturity.

Loan concentration by borrower

The Bank focused on the risk control of borrower concentration. We are currently in compliance with regulatory requirements on borrower concentration.

		As at 31 December		
Main regulatory ratios	Criteria	**2006**	2005	2004
Proportion of outstanding loans of the largest single borrower (%)	⩽ 10	2.2	4.7	3.4
Top ten customer ratio (%)	⩽ 50	15.7	25.6	25.4

Note: Proportion of outstanding loans of the largest single borrower = Total outstanding loans to the largest single borrower/net regulatory capital

Top ten customer ratio = Total outstanding loans to the top ten customers/net regulatory capital

The following table sets forth our largest ten single borrowers as of the date indicated:

Unit: RMB million, except percentages

	Industry	As at 31 December 2006 Outstanding Principal amount	% of total loans
Customer A	**Commerce and services**	**10,366**	**0.43%**
Customer B	**Energy, mining and agriculture**	**9,604**	**0.39%**
Customer C	**Transportation**	**8,306**	**0.34%**
Customer D	**Commerce and services**	**7,909**	**0.33%**
Customer E	**Energy, mining and agriculture**	**7,850**	**0.32%**
Customer F	**Transportation**	**6,814**	**0.28%**
Customer G	**Transportation**	**6,548**	**0.27%**
Customer H	**Commerce and services**	**6,127**	**0.25%**
Customer I	**Energy, mining and agriculture**	**5,315**	**0.22%**
Customer J	**Transportation**	**5,080**	**0.21%**
Total		**73,919**	**3.04%**

Loan Quality

Five-category loan classification

The Bank generally measures and manages the quality of our credit assets based on the Guiding Principles on the Classification of Loan Risk Management issued by the CBRC, which requires Chinese commercial banks to classify their loans into the following five asset quality categories: "pass", "special-mention", "substandard", "doubtful" and "loss", among which loans classified in the "substandard", "doubtful" and "loss" categories are regarded as non-performing loans. For our overseas operations, where local regulations and requirements are more prudent than the Guiding Principles on the Classification of Loan Risk Management, we classify our credit assets according to local regulations and requirements.

In 2006, the Bank amended the "Management Rules of Loan Classification" and continued centralizing the responsibility for reviewing and approving corporate loan classification to our head office and domestic tier one branches. When the loans are classified, we take into account various factors that will affect the quality of the loans and focus on the criterion of "the probability of asset recovery and the extent of loss". To obtain a loan's final risk classification, we must perform a standard process of initially classifying, checking, reviewing by our internal rating specialists, and approving by our authorized loan classification approvers. The loan classification of a corporate customer may be revised when there are significant changes to the customer or its loan risk status.

At the end of 2006, the Group reported NPLs of RMB98.22 billion, and NPL ratio of 4.04%, representing a decrease of RMB5.006 billion and 0.58 percentage point compared with the prior year-end respectively. Domestic NPLs and NPL ratio was RMB95.822 billion, and 4.82%, respectively representing a decrease of RMB2.387 billion and 0.64 percentage point compared with the prior year-end.

In 2006, we developed "Management Rules of Domestic Special-Mention Loans" to enhance the risk categorizing management and monitoring of special-mention loans, and achieved encouraging progress. As to the low-risk special-mention loans, we adopt practical measures to eliminate the risk. As to the high-risk special-mention loans, we improve the credit terms, reduce credit limits and undertake early recovery actions. As to those high-risk special-mention loans which meet the criteria of NPLs, we downgraded them to NPLs on a timely basis. At the end of 2006, the amount of outstanding special-mention loans was RMB198.145 billion, a decrease of RMB85.903 billion compared to those as of the end of last year, and this accounted for 8.15% of the total loan portfolio and a decrease of 4.56 percentage points from the end of last year.

Group

Unit: RMB million, except percentages

	As at 31 December							
	2006		2005		2004		2003	
	Amount	**% of total**	Amount	% of total	Amount	% of total	Amount	% of total
Pass	**2,135,654**	**87.81%**	1,847,991	82.67%	1,612,936	75.10%	1,494,275	69.15%
Special-mention	**198,145**	**8.15%**	284,048	12.71%	424,606	19.77%	314,968	14.58%
Substandard	**39,390**	**1.62%**	45,573	2.04%	61,515	2.87%	63,314	2.93%
Doubtful	**44,100**	**1.81%**	44,550	1.99%	32,931	1.53%	116,032	5.37%
Loss	**14,730**	**0.61%**	13,103	0.59%	15,700	0.73%	172,311	7.97%
Total	**2,432,019**	**100.00%**	2,235,265	100.00%	2,147,688	100.00%	2,160,900	100.00%
NPLs	**98,220**	**4.04%**	103,226	4.62%	110,146	5.13%	351,657	16.27%

Domestic

Unit: RMB million, except percentages

	As at 31 December							
	2006		2005		2004		2003	
	Amount	**% of total**	Amount	% of total	Amount	% of total	Amount	% of total
Pass	**1,703,908**	**85.69%**	1,430,429	79.46%	1,228,414	70.78%	1,145,990	65.48%
Special-mention	**188,604**	**9.49%**	271,504	15.08%	408,571	23.54%	284,400	16.25%
Substandard	**38,517**	**1.94%**	44,056	2.45%	57,882	3.33%	56,386	3.22%
Doubtful	**43,119**	**2.17%**	42,852	2.38%	29,787	1.72%	110,159	6.30%
Loss	**14,186**	**0.71%**	11,301	0.63%	10,874	0.63%	153,136	8.75%
Total	**1,988,334**	**100.00%**	1,800,142	100.00%	1,735,528	100.00%	1,750,071	100.00%
NPLs	**95,822**	**4.82%**	98,209	5.46%	98,543	5.68%	319,681	18.27%

In 2006, we recovered and disposed of non-performing loans through undertaking various recovery actions, including demand for payment, legal proceedings, arbitration and restructuring etc.

Overdue loans

Group

Unit: RMB million, except percentages

	As at 31 December							
	2006		2005		2004		2003	
	Amount	**% of total**	Amount	% of total	Amount	% of total	Amount	% of total
Not overdue	**2,313,465**	**95.13%**	2,108,794	94.34%	2,025,487	94.31%	1,854,365	85.81%
Overdue								
1–90 days	**44,336**	**1.82%**	50,450	2.26%	65,540	3.05%	24,086	1.12%
91–180 days	**8,957**	**0.37%**	14,012	0.63%	15,842	0.74%	10,448	0.48%
More than 180 days	**65,261**	**2.68%**	62,009	2.77%	40,819	1.90%	272,001	12.59%
Total overdue loans	**118,554**	**4.87%**	126,471	5.66%	122,201	5.69%	306,535	14.19%
Total loans	**2,432,019**	**100.00%**	2,235,265	100.00%	2,147,688	100.00%	2,160,900	100.00%
Overdue by more than 90 days	**74,218**	**3.05%**	76,021	3.40%	56,661	2.64%	282,449	13.07%

Note: For the purposes of this table, loans to customers are considered overdue if either the principal or interest payment is overdue. For loans to customers that are repayable by installments, if any portion of the loan is overdue, the whole amount of that loan is classified as overdue.

Domestic

Unit: RMB million, except percentages

	As at 31 December							
	2006		2005		2004		2003	
	Amount	**% of total**	Amount	% of total	Amount	% of total	Amount	% of total
Not overdue	**1,876,397**	**94.37%**	1,682,110	93.44%	1,626,070	93.69%	1,468,309	83.90%
Overdue								
1–90 days	**39,307**	**1.98%**	47,587	2.64%	61,930	3.57%	19,167	1.10%
91–180 days	**8,625**	**0.43%**	13,643	0.76%	15,261	0.88%	9,164	0.52%
More than 180 days	**64,005**	**3.22%**	56,802	3.16%	32,267	1.86%	253,431	14.48%
Total overdue loans	**111,937**	**5.63%**	118,032	6.56%	109,458	6.31%	281,762	16.10%
Total loans	**1,988,334**	**100.00%**	1,800,142	100.00%	1,735,528	100.00%	1,750,071	100.00%
Overdue by more than 90 days	**72,630**	**3.65%**	70,445	3.92%	47,528	2.74%	262,595	15.00%

Note: For the purposes of this table, loans to customers are considered overdue if either the principal or interest payment is overdue. For loans to customers that are repayable by installments, if any portion of the loan is overdue, the whole amount of that loan is classified as overdue.

Identified impaired loans

Under IAS 39, if there is objective evidence of a measurable decrease in estimated future cash flows from the loans and advances, those loans are assessed for impairment. When these loans are identified as impaired, we make allowance for impairment losses.

Movement of identified impaired loans

At the end of 2006, the Group reported identified impaired loans totalled RMB103.232 billion, a decrease of RMB6.298 billion compared with last year-end. The Group's impaired loan ratio was 4.24%, representing a reduction of 0.66 percentage point year-on-year. Domestic operations reported identified impaired loans which totalled RMB98.649 billion, a decrease of RMB3.71 compared to last year-end. The domestic impaired loan ratio was 4.96%, representing a reduction of 0.73 percentage point year-on-year. Overseas operations reported identified impaired loans totalled RMB4.583 billion, a decrease of RMB2.588 billion compared to last year-end. The overseas impaired loan ratio was 1.03%, representing a reduction of 0.61 percentage point year-on-year.

Movement of identified impaired loans

Group

Unit: RMB million

	2006	2005	2004	2003
Balance at the beginning of the year	**109,530**	118,383	358,218	436,163
Increase during the year	**41,928**	41,190	76,583	45,762
Reduction during the year	**(48,226)**	(50,043)	(316,418)	(123,707)
Balance at the end of the year	**103,232**	109,530	118,383	358,218

Domestic

Unit: RMB million

	2006	2005	2004	2003
Balance at the beginning of the year	**102,359**	104,553	324,252	364,279
Increase during the year	**40,924**	39,721	74,077	37,632
Reduction during the year	**(44,634)**	(41,915)	(293,776)	(77,659)
Balance at the end of the year	**98,649**	102,359	104,553	324,252

Identified impaired loans by geographical region

Group

Unit: RMB million, except percentages

	As at 31 December											
	2006			2005			2004			2003		
	Amount	**% of total**	**Impaired loan ratio**	Amount	% of total	Impaired loan ratio	Amount	% of total	Impaired loan ratio	Amount	% of total	Impaired loan ratio
Domestic operations	**98,649**	**95.56%**	**4.96%**	102,359	93.46%	5.69%	104,553	88.32%	6.02%	324,252	90.52%	18.53%
Overseas operations	**4,583**	**4.44%**	**1.03%**	7,171	6.54%	1.64%	13,830	11.68%	3.36%	33,966	9.48%	8.27%
Total	**103,232**	**100.00%**	**4.24%**	109,530	100.00%	4.90%	118,383	100.00%	5.51%	358,218	100.00%	16.58%

Notes: Loans and advances to customers are considered impaired, and we recognize losses on the loans and advances, if there is objective evidence of a measurable decrease in estimated future cash flows from the loans and advances. Impaired loan ratio = amount of identified impaired loans/total balance of that category of loan.

Domestic

Unit: RMB million, except percentages

	As at 31 December											
	2006			2005			2004			2003		
	Amount	**% of total**	**Impaired loan ratio**	Amount	% of total	Impaired loan ratio	Amount	% of total	Impaired loan ratio	Amount	% of total	Impaired loan ratio
Northern China	**18,718**	**18.97%**	**5.37%**	17,699	17.29%	5.49%	22,600	21.62%	7.18%	67,140	20.71%	18.90%
Northeastern China	**12,673**	**12.85%**	**9.31%**	12,582	12.29%	9.56%	13,396	12.81%	10.42%	36,645	11.30%	26.31%
Eastern China	**24,269**	**24.60%**	**2.96%**	27,811	27.17%	3.86%	28,595	27.34%	4.21%	91,087	28.09%	14.64%
Central and Southern China	**28,008**	**28.39%**	**5.77%**	30,611	29.91%	6.88%	26,611	25.46%	6.13%	98,759	30.46%	21.76%
Western China	**14,981**	**15.19%**	**7.53%**	13,656	13.34%	7.53%	13,351	12.77%	7.48%	30,621	9.44%	17.03%
Total	**98,649**	**100.00%**	**4.96%**	102,359	100.00%	5.69%	104,553	100.00%	6.02%	324,252	100.00%	18.53%

Domestic identified impaired loans by industry and product

Domestic identified corporate impaired loans by industry

Unit: RMB million, except percentages

	As at 31 December											
	2006			2005			2004			2003		
	Amount	**% of total**	**Impaired loan ratio**	Amount	% of total	Impaired loan ratio	Amount	% of total	Impaired loan ratio	Amount	% of total	Impaired loan ratio
Manufacturing	**34,123**	**38.33%**	**6.14%**	33,188	35.73%	6.76%	32,444	33.54%	6.52%	127,175	40.27%	24.05%
Commerce and Services	**22,579**	**25.36%**	**8.83%**	25,443	27.39%	9.96%	26,344	27.22%	9.25%	122,784	38.88%	33.52%
Real Estate	**10,710**	**12.03%**	**9.43%**	12,763	13.74%	13.24%	13,453	13.90%	13.33%	22,060	6.98%	17.32%
Energy, mining and agriculture	**6,153**	**6.91%**	**2.56%**	6,665	7.18%	3.17%	6,588	6.81%	3.52%	19,619	6.21%	11.54%
Transportation	**8,258**	**9.28%**	**4.53%**	7,759	8.35%	4.69%	9,729	10.05%	6.13%	7,349	2.33%	4.82%
Public utilities	**4,523**	**5.08%**	**4.27%**	4,627	4.98%	5.03%	5,564	5.75%	6.34%	6,019	1.91%	7.98%
Construction	**2,322**	**2.61%**	**6.70%**	2,226	2.40%	7.40%	2,569	2.65%	9.20%	5,190	1.64%	15.03%
Financial services	**187**	**0.21%**	**0.35%**	215	0.23%	0.28%	72	0.07%	0.22%	3,618	1.10%	9.81%
Others	**171**	**0.19%**	**6.35%**	—	—	—	6	0.01%	0.08%	2,015	0.68%	47.11%
Total corporate impaired loans	**89,026**	**100.00%**	**5.76%**	92,886	100.00%	6.54%	96,769	100.00%	6.99%	315,829	100.00%	21.11%

Domestic identified personal impaired loans by product

Unit: RMB million, except percentages

	As at 31 December											
	2006			2005			2004			2003		
	Amount	% of total	Impaired loan ratio	Amount	% of total	Impaired loan ratio	Amount	% of total	Impaired loan ratio	Amount	% of total	Impaired loan ratio
Mortgage loans	4,100	42.61%	1.21%	3,837	40.50%	1.34%	3,608	46.35%	1.50%	3,003	35.65%	1.88%
Credit cards	219	2.28%	7.63%	228	2.41%	11.82%	218	2.80%	15.13%	262	3.11%	28.14%
Others	5,304	55.11%	5.16%	5,408	57.09%	5.93%	3,958	50.85%	3.62%	5,158	61.24%	5.50%
Total personal impaired loans	9,623	100.00%	2.17%	9,473	100.00%	2.49%	7,784	100.00%	2.22%	8,423	100.00%	3.32%

Identified impaired loans by customer type

Group

Unit: RMB million, except percentages

	As at 31 December											
	2006			2005			2004			2003		
	Amount	% of total	Impaired loan ratio	Amount	% of total	Impaired loan ratio	Amount	% of total	Impaired loan ratio	Amount	% of total	Impaired loan ratio
Corporate loans and advances	92,237	89.35%	4.99%	98,888	90.28%	5.78%	108,230	91.42%	6.54%	345,778	96.53%	19.45%
Personal loans and advances	10,995	10.65%	1.89%	10,642	9.72%	2.03%	10,153	8.58%	2.06%	12,440	3.47%	3.24%
Total	103,232	100.00%	4.24%	109,530	100.00%	4.90%	118,383	100.00%	5.51%	358,218	100.00%	16.58%

Domestic

Unit: RMB million, except percentages

	As at 31 December											
	2006			2005			2004			2003		
	Amount	% of total	Impaired loan ratio	Amount	% of total	Impaired loan ratio	Amount	% of total	Impaired loan ratio	Amount	% of total	Impaired loan ratio
Corporate loans and advances	89,026	90.25%	5.76%	92,886	90.74%	6.54%	96,769	92.56%	6.99%	315,829	97.40%	21.11%
Personal loans and advances	9,623	9.75%	2.17%	9,473	9.26%	2.49%	7,784	7.44%	2.22%	8,423	2.60%	3.32%
Total	98,649	100.00%	4.96%	102,359	100.00%	5.69%	104,553	100.00%	6.02%	324,252	100.00%	18.53%

Identified impaired loans by currency

Group

Unit: RMB million, except percentages

	As at 31 December											
	2006			2005			2004			2003		
	Amount	% of total	Impaired loan ratio	Amount	% of total	Impaired loan ratio	Amount	% of total	Impaired loan ratio	Amount	% of total	Impaired loan ratio
RMB	86,816	84.10%	5.13%	87,980	80.33%	5.96%	84,469	71.36%	6.13%	204,846	57.18%	15.51%
Foreign currency	16,416	15.90%	2.22%	21,550	19.67%	2.84%	33,914	28.64%	4.41%	153,372	42.82%	18.26%
Total	103,232	100.00%	4.24%	109,530	100.00%	4.90%	118,383	100.00%	5.51%	358,218	100.00%	16.58%

Domestic

Unit: RMB million, except percentages

	As at 31 December											
	2006			2005			2004			2003		
	Amount	**% of total**	**Impaired loan ratio**	Amount	% of total	Impaired loan ratio	Amount	% of total	Impaired loan ratio	Amount	% of total	Impaired loan ratio
RMB	**86,816**	**88.01%**	**5.14%**	87,980	85.96%	5.96%	84,469	80.79%	6.13%	204,846	63.17%	15.51%
Foreign currency	**11,833**	**11.99%**	**3.95%**	14,379	14.04%	4.43%	20,084	19.21%	5.62%	119,406	36.83%	27.82%
Total	**98,649**	**100.00%**	**4.96%**	102,359	100.00%	5.69%	104,553	100.00%	6.02%	324,252	100.00%	18.53%

Identified impaired loans by impairment loss assessment methodology

Group

Unit: RMB million, except percentages

	As at 31 December							
	2006		2005		2004		2003	
	Amount	**% of total**	Amount	% of total	Amount	% of total	Amount	% of total
Individually assessed	**81,730**	**79.17%**	83,242	76.00%	89,768	75.83%	260,241	72.65%
Collectively assessed	**21,502**	**20.83%**	26,288	24.00%	28,615	24.17%	97,977	27.35%
Total	**103,232**	**100.00%**	109,530	100.00%	118,383	100.00%	358,218	100.00%

Domestic

Unit: RMB million, except percentages

	As at 31 December							
	2006		2005		2004		2003	
	Amount	**% of total**	Amount	% of total	Amount	% of total	Amount	% of total
Individually assessed	**78,409**	**79.48%**	78,309	76.50%	81,747	78.19%	241,200	74.39%
Collectively assessed	**20,240**	**20.52%**	24,050	23.50%	22,806	21.81%	83,052	25.61%
Total	**98,649**	**100.00%**	102,359	100.00%	104,553	100.00%	324,252	100.00%

Allowance for Impairment Losses on Loans

The Bank makes adequate allowance for impairment losses on loans promptly in accordance with prudent and established principles. Allowance for impairment losses on loans consists of two components: individually assessed allowance and collectively assessed allowance. For a further discussion of the accounting policy of allowance for impairment losses on loans, please refer to Note II.12 to the Financial Statements.

Movements of allowance for impairment losses on loans

At the end of 2006, the Group's allowance for impairment losses was RMB94.293 billion, representing an increase of RMB11.14 billion from last year-end, with the coverage ratio of allowance for impairment losses to identified impaired loans increasing by 15.42 percentage points to 91.34% from last year-end. The impairment losses for the year were RMB12.342 billion, representing an increase of RMB0.856 billion from last year. The credit cost ratio was

0.53%, representing an increase of 0.01 percentage point from last year. Domestic allowance for impairment losses reached RMB90.16 billion, representing an increase of RMB11.967 billion from last year-end, with the coverage ratio of allowance for impairment losses to identified impaired loan increasing by 15 percentage points to 91.39% from last year-end. The domestic impairment losses on loans in 2006 were RMB15.545 billion, representing an increase of RMB0.199 billion from last year, with the domestic credit cost ratio of 0.82%, representing a decrease of 0.05 percentage point from last year.

Group

Unit: RMB million, except percentages

	2006	2005	2004	2003
Balance at beginning of year	**83,153**	74,769	239,039	318,443
Impairment losses for the year	**12,342**	11,486	23,812	18,100
Loans and advances written off or transferred	**(3,711)**	(4,852)	(189,945)	(63,905)
Amounts recovered on loans and advances written off in previous years	**3,589**	2,954	2,507	731
Unwinding of discount on allowance	**(628)**	(529)	(644)	(1,354)
Exchange differences	**(452)**	(675)	—	—
Transfer to capital reserve	**—**	—	—	(32,976)
Balance at the end of the year	**94,293**	83,153	74,769	239,039

Domestic

Unit: RMB million, except percentages

	2006	2005	2004	2003
Balance at beginning of year	**78,193**	67,158	223,758	276,212
Impairment losses for the year	**15,545**	15,346	26,926	19,333
Loans and advances written off or transferred	**(2,829)**	(3,527)	(183,405)	(37,573)
Amounts recovered on loans and advances written off in previous years	**83**	120	523	116
Unwinding of discount on allowance	**(539)**	(396)	(644)	(1,354)
Exchange differences	**(293)**	(508)	—	—
Transfer to capital reserve	**—**	—	—	(32,976)
Balance at the end of the year	**90,160**	78,193	67,158	223,758

Allowance for impairment losses by region

Group

Unit: RMB million, except percentages

	As at 31 December											
	2006			2005			2004			2003		
	Amount	% of total	Impaired loan coverage ratio	Amount	% of total	Impaired loan coverage ratio	Amount	% of total	Impaired loan coverage ratio	Amount	% of total	Impaired loan coverage ratio
Domestic operations	**90,160**	**95.62%**	**91.39%**	78,193	94.04%	76.39%	67,158	89.82%	64.23%	223,758	93.61%	69.01%
Overseas operations	**4,133**	**4.38%**	**90.18%**	4,960	5.96%	69.16%	7,611	10.18%	55.03%	15,281	6.39%	44.99%
Total	**94,293**	**100.00%**	**91.34%**	83,153	100.00%	75.92%	74,769	100.00%	63.16%	239,039	100.00%	66.73%

Allowance for impairment losses on domestic identified impaired loans by geographical region

Unit: RMB million, except percentages

	As at 31 December											
	2006			2005			2004			2003		
	Amount	% of total	Impaired loan coverage ratio	Amount	% of total	Impaired loan coverage ratio	Amount	% of total	Impaired loan coverage ratio	Amount	% of total	Impaired loan coverage ratio
Northern China	**13,337**	**20.88%**	**71.26%**	10,624	19.64%	60.03%	9,697	22.87%	42.91%	40,399	19.71%	60.17%
Northeastern China	**7,903**	**12.37%**	**62.36%**	7,020	12.98%	55.79%	5,903	13.92%	44.07%	23,789	11.60%	64.92%
Eastern China	**13,530**	**21.18%**	**55.75%**	12,482	23.07%	44.88%	10,803	25.48%	37.78%	57,269	27.94%	62.87%
Central and Southern China	**19,495**	**30.52%**	**69.61%**	16,929	31.29%	55.30%	10,675	25.18%	40.11%	64,730	31.57%	65.54%
Western China	**9,614**	**15.05%**	**64.17%**	7,044	13.02%	51.58%	5,322	12.55%	39.86%	18,816	9.18%	61.44%
Total	**63,879**	**100.00%**	**64.75%**	54,099	100.00%	52.85%	42,400	100.00%	40.55%	205,003	100.00%	63.22%

Allowance for impairment losses on domestic identified corporate impaired loans by industry

Unit: RMB million, except percentages

	As at 31 December											
	2006			2005			2004			2003		
	Amount	% of total	Impaired loan coverage ratio	Amount	% of total	Impaired loan coverage ratio	Amount	% of total	Impaired loan coverage ratio	Amount	% of total	Impaired loan coverage ratio
Manufacturing	**22,018**	**38.67%**	**64.53%**	17,341	35.71%	52.25%	14,130	36.39%	43.55%	79,614	39.81%	62.60%
Commerce and Services	**14,759**	**25.93%**	**65.37%**	13,630	28.07%	53.57%	10,791	27.79%	40.96%	82,282	41.15%	67.01%
Real Estate	**5,937**	**10.43%**	**55.43%**	5,647	11.63%	44.24%	3,310	8.52%	24.60%	12,474	6.24%	56.54%
Energy, mining and agriculture	**4,092**	**7.19%**	**66.50%**	3,473	7.15%	52.11%	2,726	7.02%	41.38%	10,480	5.24%	53.42%
Transportation	**6,100**	**10.72%**	**73.87%**	5,500	11.32%	70.89%	5,572	14.35%	57.27%	3,444	1.72%	46.86%
Public utilities	**2,419**	**4.25%**	**53.48%**	1,877	3.87%	40.57%	1,635	4.21%	29.39%	3,860	1.93%	64.13%
Construction	**1,430**	**2.51%**	**61.58%**	1,003	2.06%	45.06%	647	1.67%	25.18%	3,545	1.77%	68.30%
Financial services	**100**	**0.18%**	**53.48%**	93	0.19%	43.26%	15	0.04%	20.83%	2,741	1.37%	75.76%
Others	**70**	**0.12%**	**40.94%**	—	—	—	3	0.01%	50.00%	1,539	0.77%	76.38%
Total	**56,925**	**100.00%**	**63.94%**	48,564	100.00%	52.28%	38,829	100.00%	40.13%	199,979	100.00%	63.32%

Allowance for impairment losses on domestic loans by customer type

Unit: RMB million, except percentages

	As at 31 December											
	2006			2005			2004			2003		
	Amount	% of total	Impaired loan coverage ratio	Amount	% of total	Impaired loan coverage ratio	Amount	% of total	Impaired loan coverage ratio	Amount	% of total	Impaired loan coverage ratio
Allowance for corporate loans	**71,234**	**79.01%**	**80.01%**	60,267	77.07%	64.88%	49,135	73.16%	50.78%	209,572	93.66%	66.36%
Allowance for personal loans	**18,926**	**20.99%**	**196.68%**	17,926	22.93%	189.23%	18,023	26.84%	231.54%	14,186	6.34%	168.42%
Total	**90,160**	**100.00%**	**91.39%**	78,193	100.00%	76.39%	67,158	100.00%	64.23%	223,758	100.00%	69.01%

Allowance for impairment losses on loans by assessment methodology

Group

Unit: RMB million, except percentages

	As at 31 December							
	2006		2005		2004		2003	
	Amount	% of total	Amount	% of total	Amount	% of total	Amount	% of total
Allowance for individually assessed identified impaired loans	**53,846**	**57.10%**	45,738	55.00%	35,699	47.75%	153,810	64.34%
Allowance for collectively assessed identified impaired loans	**12,735**	**13.51%**	12,009	14.44%	12,614	16.87%	63,748	26.67%
Allowance for non-impaired loans	**27,712**	**29.39%**	25,406	30.56%	26,456	35.38%	21,481	8.99%
Total	**94,293**	**100.00%**	83,153	100.00%	74,769	100.00%	239,039	100.00%

Domestic

Unit: RMB million, except percentages

	As at 31 December							
	2006		2005		2004		2003	
	Amount	% of total	Amount	% of total	Amount	% of total	Amount	% of total
Allowance for individually assessed identified impaired loans	**51,269**	**56.86%**	42,720	54.64%	31,539	46.96%	142,924	63.88%
Allowance for collectively assessed identified impaired loans	**12,610**	**13.99%**	11,379	14.55%	10,861	16.17%	62,079	27.74%
Allowance for non-impaired loans	**26,281**	**29.15%**	24,094	30.81%	24,758	36.87%	18,755	8.38%
Total	**90,160**	**100.00%**	78,193	100.00%	67,158	100.00%	223,758	100.00%

Market Risk

Overview

Market risk is the risk of loss in on and off-balance sheet positions arising from movements in market prices (interest rates, exchange rates, equity prices and commodity prices). Market risk exists in both trading and non-trading businesses of the Bank. The principal types of market risk for the Bank are interest rate risk and exchange rate risk. We expect to be subject to increasing levels of market risk as the PRC Government continues to deregulate restrictions governing interest and exchange rates.

We are exposed to market risk primarily through the assets and liabilities on our balance sheet, as well as our off-balance-sheet businesses. In accordance with regulatory requirements, we categorize our assets and liabilities as under either trading book or banking book. Our trading book primarily consists of positions in the freely-tradable financial instruments and commodities for trading purposes or in order to mitigate risks of other financial instruments in the trading book. Our banking book consists of positions in financial instruments not included in the trading book (and includes financial instruments in the investment book purchased with the Bank's surplus liquility for investment purposes).

In 2006, we integrated our market risk management function and set up an independent market risk management team within the Risk Management Department to specifically undertake the market risk management function of the Group.

In 2006, we formulated the Market Risk Management Policy for the Bank of China and specified the organizational structure, procedures, risk measurement, limit setting and reporting of market risk management. With reference to the relevant regulatory requirements as well as the market risk management practices of international commercial banks, we set up our market risk limit structure and improved our market risk indicator system considering our current business practice, our IT systems and our customer management model. Additionally, we set up our market risk limits for 2006. We have also established daily and monthly market risk reporting mechanism to integrate market risk information with the aim of conducting effective monitoring and analysis of market risk limit utilization and providing relevant information to the senior management.

Market Risk Management of the Trading Book

The Bank manages the market risk of the trading book primarily through setting up the overall VAR (see below for definition) and stop-loss limits on the trading book and allocating and establishing position limits and stop-loss limits for each trading desk and trader. Traders can only trade financial instruments which meet certain pre-determined criteria (e.g. the liquidity of the financial instruments). The Bank monitors the VAR, position and stop-loss limits of the traders on a daily basis.

Value-at-risk (VAR) is the possible loss in normal market conditions, given a specified time horizon and specified confidence level. The Bank is using a one day time horizon and 95%

confidence level to calculate the VAR for the domestic trading book. Based on such calculation, within the one day time horizon, the probability of loss on the trading book exceeding the VAR is limited to 5% or below.

The chart below shows the VAR of the Bank's domestic foreign currency-denominated trading book (excluding the investment book or banking book) at the end of 2006 and 2005:

Unit: USD million

	As at 31 December							
	2006				2005			
	Period end	**Average**	**High**	**Low**	Period end	Average	High	Low
Interest rate risk	**1.79**	**2.71**	**16.25**	**0.54**	4.77	3.27	11.94	0.20
Foreign exchange risk	**0.81**	**2.99**	**14.12**	**0.39**	12.84	2.70	18.69	0.34
Volatility risk	**0.13**	**0.79**	**6.19**	**0.07**	0.36	0.80	2.54	0.04
Total market risk	**2.07**	**5.64**	**19.15**	**0.86**	15.06	5.10	18.86	0.69

We also use information technology systems, such as Kondor+, Bloomberg PTS, DerivaTech, Summit, and RiskMetrics, to measure, analyze, monitor and manage the market risks of our treasury operations. Our Kondor+ system currently covers our major overseas branches and most of our treasury products. In addition, we use the Bloomberg PTS system to monitor the positions and mark-to-market of fixed income products and derivatives, the DerivaTech and Summit systems to price, value and monitor our risk exposure in derivative products, and the RiskMetrics system to generate VAR reports and stress testing reports. These systems help us monitoring the market risk exposure in our treasury operations.

The Bank has established a global middle office network to monitor and control the market risk in the investment book and the trading book (treasury business). The head office is responsible for directly monitoring the treasury business of our domestic branches. The Bank is also continuously improving the capability of the back office, especially the independent evaluation of the mark-to-market values of financial instruments.

Market Risk Management for the Banking Book

The primary market risk for our banking book is interest rate risk. Interest rate risk arises mainly from mismatches in the maturities or repricing periods of the assets and liabilities of our banking book. We manage the interest rate risk of the banking book primarily through gap analysis. Gap analysis measures the difference between the amount of interest-earning assets and interest-bearing liabilities that mature or must be repriced within certain periods. We also use the data generated by gap analysis to perform sensitivity analysis and stress testing, which provide us with relevant information in adjusting the maturities of the interest-earning assets and interest-bearing liabilities. Meanwhile, we closely follow the local and foreign currency interest rate trends and promptly adjust the interest rates of local and foreign currency deposits and loans in order to avoid interest rate risk.

In 2006, the benchmark rates on RMB-denominated deposits were raised in August and those on RMB-denominated loans were

increased both in April and August. The rising RMB interest rates, as a whole, were beneficial to the Bank's financial results of 2006, although the cumulative RMB interest rate sensitivity gap of the Bank within one year remained negative in 2006. The main reason was that the yield of loans was increased due to the RMB interest rate increase in April while the cost of deposits remained unchanged. In addition, the interest rate on demand deposits, which accounted for around 40% of the total deposits, was not affected by the RMB deposit rate increase in August. The U.S. Federal Reserve raised the federal funds target rate four times in January, March, May and June 2006. The rising USD interest rates were favorable to the financial results of the Bank although the cumulative USD interest rate sensitivity gap of the Bank within one year was essentially negative in 2006. The main reason was that the interest rates on small balance USD-denominated deposits were unchanged in domestic operations. Domestic deposits of small balance denominated in USD accounted for over 80% of the total domestic USD-denominated deposits.

At the end of 2006 and 2005, the Group's and the Bank's interest rate sensitivity gaps were as follows (For details on interest rate sensitivity gaps, please refer to Notes III.6 to the Financial Statements).

Group

Unit: RMB million

	Up to 1 month	1 to 3 months (incl.)	3 to 12 months (incl.)	1 to 5 years (incl.)	Over 5 years	Non interest-bearing
31 December 2006	(1,127,311)	220,794	591,503	347,020	341,294	39,656
31 December 2005	(894,734)	33,843	464,652	402,985	241,871	6,902

Note: interest rate sensitivity gap = interest rate sensitive assets – interest rate sensitive liabilities

Bank

Unit: RMB million

	Up to 1 month	1 to 3 months (incl.)	3 to 12 months (incl.)	1 to 5 years (incl.)	Over 5 years	Non interest-bearing
31 December 2006	(928,376)	155,514	547,218	267,636	246,984	66,418
31 December 2005	(828,023)	40,274	423,374	323,711	195,677	48,800

By the end of 2006, the gap of the Group for a time period of up to 1 month was negative and the gaps for the remaining time periods were positive. The gap up to 1 month was negative because the substantial amount of the demand deposits was placed in the time bucket of up to 1 month. The gap within all the other time periods was positive because the interest-earning assets were more than interest-bearing liabilities in those time periods.

Assuming the yield curves of all the currencies shift up 100 basis points in parallel at the beginning of 2007, the net interest income of the Group will decrease by RMB6.818 billion. Assuming the yield curves of all the currencies shift down 100 basis points at the beginning of 2007, the net interest income of the Group will increase by RMB6.818 billion. This analysis is based on the Group's gap position at the end of 2006 and does not take into consideration any changes in the asset-liability position during 2007 and the impact on customer behavior due to interest rate changes.

The RMB interest rate liberalization has developed steadily in 2006. Some commercial banks launched RMB-denominated fixed-rate residential mortgage loans. The RMB interest rate derivative markets including swap markets became active gradually. In particular, the formal implementation of SHIBOR on 4 January 2007 provided a foundation to establish China's money market benchmark rate system, which will further accelerate RMB interest rate liberalization in the near future. Under such circumstances, the Bank has begun to improve the interest rate pricing system and enhance pricing capability by developing and promoting the loan rate pricing model progressively. In addition, the Bank closely followed the potential risk arising from new businesses and products and started to consider the possibility of hedging interest rate risk by RMB interest rate derivative transactions.

Market Risk Management of the Investment Book

Pursuant to the regulatory requirements, our banking book also includes the investment book under which we purchase financial instruments with our excess funding for investment purposes. Apart from applying gap analysis to the interest rate risk underlying the investment book, the senior management of the Bank also reviews and approves the investment guidelines of the investment book annually based on the market risk management policy and the market risk limit approved by the Board (the Risk Policy Committee). The investment guidelines cover the relevant market risk limit, the size of the investment portfolios, authorized investment products, the duration of the portfolio, the concentration limit by issuer and the minimum rating requirement, etc. Business departments must strictly comply with these investment guidelines, and will be monitored and examined by the independent market risk management function. The Bank has been improving its risk management ability continuously. The Bank manage the market risk of the investment book mainly through the monitoring of VAR and the present value of a basis point and through the stress testing of the current investment portfolio.

Exchange Rate Risk

The Bank's management of exchange rate risk covers both non-trading books and trading books. Non-trading exchange rate risk mainly arises from foreign currency capital contribution, investment in overseas subsidiaries, and foreign currency profit and loss. The Bank seeks to reduce the foreign exchange exposure by matching the sources and utilization of our funds on a currency-by-currency basis. In addition, we also manage and control exchange risk through settlement or hedging transactions. Trading exchange rate risk mainly arises from the foreign exchange transactions the Bank is engaged for its own account or on behalf of customers. The Bank controls the foreign currency position within the required limits according to its risk tolerance and operating capability.

For details of the foreign currency position of the Bank, please refer to the section under "Financial Review".

Liquidity Risk

Summary

Liquidity risk relates to the risk associated with the failure to obtain funds at a reasonable cost when required to meet a repayment obligation and fund its asset portfolio. The objective of our liquidity risk management is to ensure that all

our branches/outlets maintain appropriate liquidity to meet the need of normal operations, and are able to raise enough funds at reasonable cost within a certain period to ensure payments can be made in the case of emergency or for business development opportunity.

By adhering to the tier-one legal person management principle, the head office is solely responsible for the management of liquidity risk throughout the Bank. Liquidity management policy and measures are applied across the Bank from using a top down approach with the effect that the higher tier management units are responsible for overseeing the lower tier management units. The liquidity management policies and the risk measurement benchmark are largely implemented centrally. We take full account of our market financing capability and other factors when developing the relevant proposals on a prudent basis.

The Bank has adopted both asset liquidity management and liability liquidity management. Our asset liquidity management strategies are intended to encourage diversification, the realizability of assets, and to hold an appropriate level of highly liquid assets in the portfolio. The strategies on liability management are intended to increase the proportion of core deposits and to maintain the stability of liabilities and financing ability.

Our liquidity management process considers operations under normal circumstances, as well as contingency measures under abnormal circumstances. In a normal business environment, the Bank regularly updates its management policies and guidelines and its liquidity benchmark management, its cash positions, the funds transfer between the head office and branches, the liquid asset portfolio and delegated authorities of financing activities so as to control the liquidity level across the Bank within an appropriate range. In addition, we established a funding forecast system to keep track of the movements in position. We also formulated a contingency plan as well as developed liquidity stress testing in order to promptly identify and mitigate any liquidity risks.

In 2006, the Bank's liquidity was, in general, sufficient with occasional liquidity pressures. Market conditions posed challenges to our liquidity position. Firstly, since the second half of 2006, a significant slow-down in the growth of new RMB-denominated deposits due to the continuing recovery of the stock market and fund market resulted in a decrease in stable sources of funds, while loan growth maintained at a fast pace, which resulted in liquidity pressure. Secondly, the Bank experienced significant fund inflows and outflows due to the increase in numbers of new share issuances. Third, on a number of occasions the central bank implemented restrictive monetary policies in order to control the fast growth in lending. The central bank increased the benchmark interest rate twice, raised the mandatory deposit reserve ratio three times, and issued notes to target investors four times. The number of restrictive monetary policy launched on the market and the frequency with which they have occurred during the year were historical high.

In these circumstances, we constantly improved our liquidity management ability, proactively managed the Bank's liability structure and shortened the duration of our bonds investment portfolio. We managed to maintain the proper liquidity level to meet normal business needs.

Regulatory Ratios on Liquidity

At the end of 2006, the Bank's liquidity position met all the regulatory requirements as shown in the table below: ("liquidity ratio" is the indicator of the Group; "loan to deposit ratio" and the "excess reserve ratio" are the indicators of the Bank's domestic operations in the Chinese Mainland).

Main regulatory ratios		Regulatory standard	2006	As at 31 December 2005	2004
Liquidity ratio (%)	RMB	≥25	**37.7**	48.9	35.3
	Foreign currency	≥25	**64.1**	87.4	78.6
Loan to deposit ratio (%)	RMB	≤75	**57.6**	51.7	59.6
	Foreign currency	≤85	**70.1**	70.4	67.9
Excess reserve ratio (%)	RMB		**2.8**	3.0	3.7
	Foreign currency		**25.8**	16.9	13.4

Note: Liquidity ratio = current assets/current liabilities; Liquidity ratio is calculated in accordance with the relevant provisions of the PBOC and the CBRC, and the financial data are based on the PRC Accounting Standard for Business Enterprises and the Accounting Systems for Financial Institutions.

Loan to deposit ratio = outstanding loans/outstanding deposits.

Excess reserve ratio for RMB=(reserve in excess of the mandatory requirements+cash)/(balance of deposits+remittance payables).

Excess reserve ratio for foreign currency=(reserve in excess of the mandatory requirements+cash+due from banks and due from overseas branches and subsidiaries)/outstanding deposits.

Liquidity Gap Analysis

We assess liquidity risk through liquidity gap analysis. We periodically monitor and calculate the liquidity gap (i.e. the difference between assets and liabilities which mature within a specified period), and perform sensitivity analysis and stress testing using gap data. At the end of 2006 and 2005, the liquidity gap position was as follows (For details on the liquidity position, please refer to Note III.7 to the Financial Statements):

Group

Unit: RMB million

	Overdue	On demand	Up to 1 month	1–3 months (incl.)	3–12 months (incl.)	1–5 years (incl.)	Over 5 years	Total
31 December 2006	48,754	(1,889,251)	4,183	55,597	41,576	1,070,214	1,081,883	412,956
31 December 2005	40,452	(1,637,566)	(12,384)	(75,143)	167,958	968,682	803,520	255,519

Bank

Unit: RMB million

	Overdue	On demand	Up to 1 month	1–3 months (incl.)	3–12 months (incl.)	1–5 years (incl.)	Over 5 years	Total
31 December 2006	46,738	(1,617,769)	243,207	41,472	(46,568)	804,957	883,357	355,394
31 December 2005	38,962	(1,389,992)	125,040	2,396	113,866	667,488	646,053	203,813

Note : Liquidity gap=assets matured in a specified period - liability matured in the same period

By the end of 2006, the Group's gap of the on demand bucket was negative and the gap positions for the remaining periods were positive. Since the demand deposits were 40% of the total amount of deposits, the percentage of current liability to total liability was high and hence the gap of the on demand bucket was negative. The above-mentioned negative gap did not lead to significant liquidity requirement because our demand deposits were very stable. The balance of assets in the remaining periods all exceeded the balance of liabilities with positive gap position.

Internal Control and Operational Risk

Three Lines of Defense

In order to enhance the internal control function and risk management in all respects, the Bank reengineered its internal control processes and established three lines of defense of internal control.

Branches, business departments and staff at various levels of the Bank take responsibility for internal control when promoting business development. The first line of defense is the individual who implements the policies and procedures. The objectives of internal control are achieved through self-assessment, self-checking, self-inspection, self-improvement and self-training.

The Legal and Compliance department and the business departments are responsible for making overall plans for establishing internal control policies, directing, examining, monitoring and assessing the work of the first line of defense, and playing the role of the second line of defense. The second line of defense aims at accomplishing the standardization and regulation of internal control management, and establishing an internal control system integrating the elements of training, early warning, prevention, rewards and punishment.

The Internal Audit department is responsible for reviewing and assessing the adequacy and effectiveness of the Bank's operating activities, risk management, internal control and corporate governance with a systematic and standard methodology, and playing the role of the third line of defense. The third line of defense aims at assisting the Board and management to perform their duties, providing assurance as to the adherence to national economic and financial laws, policies and regulatory rules and regulations, and improving operating efficiency and the effectiveness of risk control, so as to increase the Bank's value.

Operational Risk

Operational risk (OR) refers to the risk of losses caused by inadequate or improper internal processes, systems, issues in human resources or external events. In 2006, the Bank primarily commenced the following initiatives in connection with OR management:

In order to improve the work of Operational Risk Management (the "ORM"), the Bank cooperated with RBS Group in the ORM project, and formulated after conducting the relevant research, the fundamental ORM rules based on the circumstances of the Bank.

The Bank formulated the operational risk and control assessment (the "RACA") working process and conducted its pilot testing, and plans to roll out such processes in domestic branches in 2007. These processes can help the business lines being kept informed of the risk profile and risk exposure by regularly identifying and assessing the risks and controls of the key business processes.

Meanwhile, the Bank started to study the management process of the key risk indicators in relation to operational risk, and commenced the drafting of certain such indicators. It has also initiated the monitoring of, and providing guidances to the branches on ORM work.

The Bank tested the fulfillments of CBRC's Notice of Strengthening the Prevention Measures Against Operational Risk, conducted OR inspection on certain of the Bank's businesses, and took corrective actions timely to rectify the problems identified in accordance with the assessment and test results.

Internal Audit

As the third line of defense of the internal control of the Bank, internal audit forms the independent and objective confirmation and consultation process of the Bank under the leadership of the Board of Directors and the Audit Committee. Based on the principle of improving the operations of the Bank and creating values, the risk-oriented internal audit aims to assist the Board, the Audit Committee and senior management in the performance of their duties, and employs systematic and standardized approaches to provide audit services including audit confirmation, internal control evaluation, consultation and anti-fraud inspections to accomplish its goals.

In 2006, the Bank adopted a vertically integrated management model in internal audit, whereby the head office Internal Audit department oversees the internal audit departments of the branches subject to internal audit in respect of human resources, finance and functions. The audit work of the Bank was reported to the Board or the Audit Committee authorized by the Board, and to the management in respect of administration issues.

Independence, Professionalism and Authority of the Audit System

In 2006, the Audit Committee of the Board engaged independent external institutions to complete an overall evaluation on the audit work of the Bank. By consolidating the evaluation results and supervisory requirements, and by referring to the international standards and best practices of internal audit, the Bank established a special work team under the leadership of the Board, the Audit Committee and senior management, which studied and prepared a comprehensive plan on the improvement of the internal audit functions of the Bank including all aspects such as organizational structure, management systems, policies and procedures, and practices and technologies, and steadily implemented the plan according to the planned schedule upon the approval of the Board. The Bank completed the separation of inspection and audit functions in the course of the year and established an independent audit department, which clarified its functions, reporting lines and organizational structure. The department updated the audit policies and set up a vertically integrated audit management model. Meanwhile, in order to meet the requirements of new audit functions in terms of staff expertise, the Bank engaged internal audit professionals of globally-known accounting firms to provide special and centralized training for more than 600 auditors of the Bank. Through the above measures, the Bank further strengthened the management of internal audit in terms of its independence, professionalism and authority.

Enhanced Depth and Breadth of Internal Audit Inspection

Focusing on the target of continuously improving the effectiveness of internal control, the Bank has continued to further enhance the depth of internal audit inspections focusing on high-risk areas and the improvement of weak internal controls in 2006. The Bank has completed 5 internal audit projects at the head office, 23 projects in tier one branches or branches directly controlled by the head office (coverage of 72%) and 12 projects at overseas institutions or affiliated companies (coverage of 42%). Meanwhile, the Bank devoted most audit resources to the internal control inspection of grassroot operations, and has completed regular internal audit at 254 tier two branches (coverage of 88%), 2,171 sub-branches in urban regions (coverage of 57%) and 3,228 sub-branches in counties (coverage of 50%), 775 special audit projects, 1,132 audit projects of former employees and senior management, and 83 investigations of individual cases.

Anti-money Laundering

In 2001, the Bank established the Anti-Money Laundering Committee, which serves as the highest decision making body on anti-money laundering issues of the Group. According to the provisions set forth in the Articles for the Anti-Money Laundering Committee of the Bank, the main functions of the committee are as follows:

- To formulate the anti-money laundering policy through discussion in response to changes in the domestic and overseas legal and policy environment as well as development of trends in anti-money laundering;

- To plan for anti-money laundering work, recommend resolutions to major and unexpected events, and supervise the implementation of such plans.

Domestic and overseas branches of the Bank have also established anti-money laundering teams in charge of their respective work of anti-money laundering under the leadership and supervision of the Anti-Money Laundering Committee.

To standardize the Group's work on anti-money laundering and to combat the financing of terrorism, the Bank, based on the laws and regulations on anti-money laundering in the PRC has formulated the Policy of the Bank of China Limited on Anti-Money Laundering and Combating the Financing of Terrorism, which adequately embodies the basic international requirements of anti-money laundering and combating financing of terrorism for financial institutions. At the same time, the Bank endeavored to increase the quality of data acquisition through advanced technology, and the upgrade and reconstruction of relevant IT systems were carried out systematically to further strengthen the Bank's anti-money laundering technology.

In full consideration of the relevant laws and regulations of the country or region where the Bank's overseas branches are located, the Bank has implemented risk evaluation of anti-money laundering in overseas institutions during the year to obtain comprehensive knowledge of their progress in implementing anti-money laundering measures. Based on the evaluation results, the Bank has monitored and guided these branches.

In respect of anti-money laundering, a relatively comprehensive system has been established. A comprehensive anti-money laundering organizational structure has also been put in place. The scale of the anti-money laundering system basically meets the requirements of the regulatory authority and our Bank on risk control. The Bank has in all respects strictly performed its obligations on anti-money laundering.

Management Discussion and Analysis — Capital Management and Fund Transfer Pricing

The Group's capital management framework mainly comprises three parts: capital adequacy ratio (CAR) management, capital funding management and economic capital allocation. The primary objective of the Group's capital management is to keep the CAR at an appropriate level, through necessary means of capital funding management and economic capital allocation.

Objective of Capital Management

The objective of the Group's capital management is to ensure that the Group maintains sufficient capital at an appropriate level, meeting the requirements of all applicable regulatory standards and guidelines, credit rating agencies, risk compensation, and returns to stockholders. In addition, through effective allocation of capital, and capital investment instruments, the Group strives to continuously enhance its financial effectiveness, improve capital value, and ultimately maximize stockholders' value while controlling risk.

CAR Management

CAR is the most important measure of a Bank's stabilization and capacity to withstand risks. In order to fully safeguard against risk, the Group establishes various target CAR levels. Firstly, at no time should the minimum level of the Group's CAR level be less than the regulatory required 8% level. Secondly, the Group stipulates and maintains an operational target range of CAR levels. Based on the risks faced by the Group, the Group sets prudent level of CAR as its operational target for routine management, taking into consideration CAR levels of international peers and the Group's operating situations.

The Group uses stress testing to forecast, design and manage CAR level. The scenarios involved in the stress testings take into account business development, fluctuations in major risk exposures, changes in exchange rates for foreign currency capital contributions, and other significant factors.

The Group calculates and discloses CAR level in line with *Regulation Governing Capital Adequacy of Commercial Banks*, promulgated by CBRC on 23 February 2004 (CBRC Order Issuance [2004] No.2). The Group calculates market risk capital in accordance with the Notice of CBRC General Office on *Release of Calculation Tables and Notes for Market Risk Capital Requirements for Commercial Banks* (Yinjianfa [2004] No.374) from 2005. In 2006, the Group's CAR level increased significantly, largely as a result of the increase in the Group's core capital due to the Bank's IPOs on the Hong Kong and Shanghai stock exchanges. The other reason is that the Group's foreign exchange exposure has reduced substantially, and hence corresponding market risk capital requirement decreased. At the end of

2006, the Group's CAR level was 13.59%, up 3.17 percentage points from the prior year-end; core CAR level was 11.44%, up 3.36 percentage points.

Unit: RMB million, except percentages

	As at 31 December		
	2006	2005	2004
Core capital:			
Share capital	**253,623**	209,427	186,390
Capital reserve	**126,916**	25,795	21,276
Minority interests	**29,560**	28,778	27,387
Total core capital	**410,099**	264,000	235,053
Supplementary capital:			
General reserve	**28,315**	25,677	24,881
Long-term subordinated debt issued	**60,000**	60,000	26,070
Others	**(2,439)**	(1,380)	(2,315)
Gross value of supplementary capital	**85,876**	84,297	48,636
Total capital before deductions	**495,975**	348,297	283,689
Deductions:			
Goodwill	**(1,875)**	—	—
Investments in the non-consolidated financial institutions	**(4,371)**	(2,877)	(1,399)
Investments properties	**(5,141)**	(5,697)	(5,228)
Investments in non-financial institutions	**(13,226)**	(13,486)	(6,585)
Total capital based after deductions	**471,362**	326,237	270,477
Core capital based after deductions	**396,855**	252,970	228,447
Risk-weighted assets:			
On-balance-sheet risk-weighted assets	**2,758,602**	2,456,160	2,400,695
Off-balance-sheet risk-weighted assets	**421,560**	337,029	292,808
Total risk-weighted assets	**3,180,162**	2,793,189	2,693,503
Risk-weighted assets and market risk adjustment:	**3,469,017**	3,131,002	2,693,503
Capital adequacy ratio	**13.59%**	10.42%	10.04%
Core capital adequacy ratio	**11.44%**	8.08%	8.48%

Capital Funding Management

The primary objective of capital funding management is to keep the Group's CAR level within the target range through timely and proper capital funding management, with a view to allowing the Group to operate on a prudent basis. The objective should be fulfilled through effective planning and management of accounting capital, regulatory capital and economic capital so as to fulfil requirements of dividend payments, stabilization of share price, management of CAR level, and economic capital allocation.

The capital funding strategy stresses that capital funding should be in compliance with international practice and regulatory requirements and with a view to broadening capital replenishment channels, and enhancing financial structure's flexibility. In terms of its implementation, the Group puts emphasis on optimizing the capital structure to control cost of capital funding. Effort is also put into currency-optimization with the aim of minimizing exchange rate risk, and reducing the impact of RMB's appreciation on the CAR level. It is also important to enhance the maturity gap matching of the Group's assets and liabilities, reducing liquidity risk and interest rate risk of the Group.

Economic Capital Allocation

The Group developed its economic capital allocation process on a trial basis for several domestic branches in 2004. The Group formally started to implement the process for all domestic provincial branches in 2005. The economic capital allocation process calculates each branch's relevant economic capital requirements according to its risk-taking activities, and measures risk-adjusted return on capital (RAROC) and economic value added (EVA) to assess each branch's performance. The formule of RAROC and EVA are as follows:

RAROC = Risk-adjusted Profits/
Economic Capital Charge x 100%

EVA = Risk-adjusted Profit
– Cost of Economic Capital

Cost of Economic Capital = Economic Capital
Charge x Hurdle Rate

In 2006, the Group designed and launched BOCECA System, enabling the monitoring, analyzing and assessing the economic capital performance for the different level of domestic operations. The risk type covered by economic capital will be expanded from merely credit risk into market risk and operational risk.

The primary objective of economic capital allocation is to match returns with risks undertaken. It is inappropriate to place emphasis either on increasing income or on controlling risk separately. Through calculation and monitoring of economic capital performance, management at different levels raised awareness of cost of risk and cost of capital, significantly enhanced the matching of risks and rewards. Economic capital allocation has not only enhanced the coverage ratio of capital on risk exposures, but also enhanced the returns on risk and capital.

Capital Management in the Future

The Bank streamlines the process of capital management timely and continuously so as to enhance its leading role in Banking management.

In order to strengthen our capital base and provide this as support for the sustainable growth of our business, we will continue with effective capital adequacy ratio management, capital funding management and economic capital allocation.

Fund Transfer Pricing

Fund transfer refers to all forms of internal fund allocation among entities (including the Head Office, domestic and overseas branches and subsidiaries) within the Bank. In 2005, the Bank adopted the concept and principle for management by Fund Transfer Pricing (FTP) and started to explore the use of FTP as a means to optimize resources allocation, reduce operating cost and increase returns. In 2006, the Bank formulated *The Guidance to BOC FTP*, which clarified the objectives, pricing mechanism and transfer basis of FTP as well as the direction for the Bank's internal fund management. The major objectives for the Bank's FTP policies are as follows:

(1) To centralize the management functions of liquidity risks and market risks embedded in the Banking book to the Head Office Treasury so as to build a Bank-wide "centralized funding pool". By incorporating interest rate risk factor into the FTP price, it removes interest rate risks in the Banking book from business units (such as branches and departments) so that these business units could make sure that their profits are not affected by the uncertainties caused by fluctuations in interest rates and thus could concentrate on their own operations. Through centralizing the management of these risks at the Head Office Treasury, the Head Office Treasury will use hedging instruments to control the risks effectively, reducing the fluctuations of the Bank's profits caused by the uncertainties in movements in market interest rates.

(2) To provide a benchmark for performance evaluation by branch, department, product and customer, and to provide a common ground for product profitability assessment so that objectivity could be ensured in the process of profitability comparison.

(3) To communicate to the branches' and business departments' management in the right way and provide correct guidance for the operations of business units so that the Bank could maintain continual growth.

In 2006, the Bank adopted the multiple terms matching method for the FTP of the business segments. In the meantime, currency and terms matching fund support was provided to overseas branches' operation in respect of their syndicated loan business. As a result, the new FTP method helps to strengthen the Bank's asset and liability management as well as fund management.

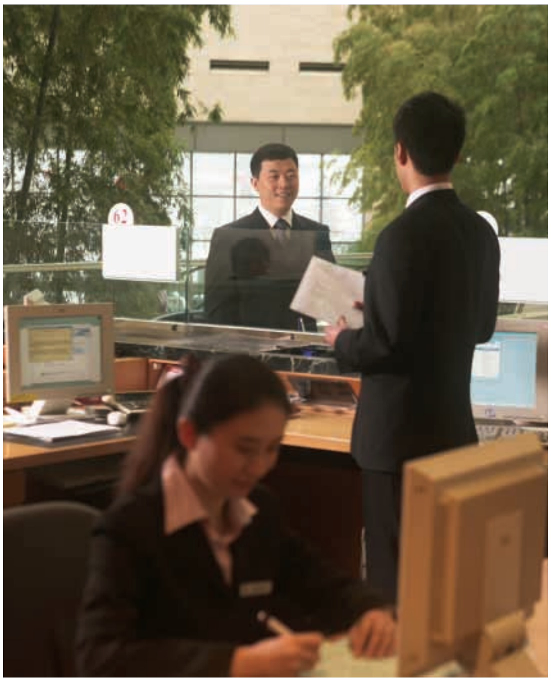
Management Discussion and Analysis — Organizational Information, Human Resources Management and Development

Organizational Management

Organizational Information

At the end of 2006, the Bank had 11,241 domestic and overseas branches and outlets, a reduction of 405 from the beginning of 2006. There were 37 tier one branches, 283 tier two branches and 10,277 outlets in domestic operation, and 643 branches, subsidiaries and representative offices in overseas operation.

The following table presents the geographic breakdown of the domestic outlets by the end of 2006.



	As at 31 December 2006	
	Branches and outlets	**% of total**
Northern China	1,625	15.3%
Northeastern China	931	8.8%
Eastern China	3,539	33.4%
Central and Southern China	2,856	26.9%
Western China	1,647	15.6%
Total	10,598	100.0%

Process Reengineering and Organizational Restructuring

In 2006, the Bank actively pushed forward process reengineering and organizational restructuring. The Bank's corporate and personal loans were all centralized to the Head Office and tier-one branches for approval. Perceptible progress has been made in the centralization of the functions of post monitoring, clearing, finance management, cash delivery, bill exchange, bill processing and account reconciliation between companies and the Bank. The internal control system was reformed and improved with the establishment of the three lines of defense, which included function management, internal control and compliance and internal audit to ensure the adequacy and effectiveness of internal control. The internal audit system started to exercise vertical line management. CROs and CFOs were dispatched to tier-one branches. The business line management was further strengthened.

The Bank clarified the overall goal of business structure and process reengineering. The General Framework of Business Architecture and Process Integration was formulated. It stressed an intensive and centralized reform direction, with the synchronized implementation of IT blueprint and business process integration. The Bank planned to realize its goals of a customer-centered business and management process, a bank-wide general ledger, logically centralized business processing, strengthened line management and enhanced product innovation within two or three years.

The Bank pushed forward institutions integration. In 2006, the Bank further adjusted its branch network. Some small branches and outlets with poor development potential were closed. New branches and outlets were established in key cities and areas, to optimize and rationalize the Bank's entire branch network distribution.

Human Resources Management and Development

The Bank recognizes that the key to a company's success is talented staff and regards its employees as the fundamental driving force behind a company's growth and development. Therefore, the Bank sticks to the principle of "People First" to create every opportunity possible for the staff to tap their talent, so that everyone can do their best in a harmonious environment. Bank of China strives to be the best choice for employees to realize their dream and actualize their value. Human resource strategy as an important part of the Bank's overall development strategies plays an important role in the Bank's development.

The Staff Profile

At the end of 2006, the Bank had 232,632[1] employees (including 40,620 dispatch contractors working in domestic institutions), of which 20,204 were local staff of overseas branches and subsidiaries. By the end of 2006, there were 7,278 retirees whose expenses should be borne by the Bank.

1 The number is calculated according to the Chinese Accounting Standards.

The profile of domestic staff in terms of age, education and professions

Category	Detailed distribution	Number of employees	% of total
Age	Below 30	28,928	16.84%
	Between 31 and 40	95,831	55.78%
	Between 41 and 50	40,617	23.64%
	Between 51 and 60	6,317	3.68%
	Above 60	115	0.06%
Educational Background	Holders of Master degree and above	2,883	1.68%
	Bachelor degree holders	64,231	37.39%
	Associate degree or professional training certificate holders	71,639	41.70%
	Others	33,055	19.23%
Professions	Corporate finance	18,151	10.56%
	Personal finance (tellers excluded)	16,088	9.36%
	Financial market	1,338	0.78%
	Operation services	25,256	14.71%
	Financial management and accounting	12,099	7.04%
	Risk management, internal audit and legal and compliance	10,086	5.87%
	Management *(Note 1)*	4,331	2.52%
	Others *(Note 2)*	84,459	49.16%

Notes:

1 This category includes deputy general managers of tier-two branches, the deputy general managers of functional departments in tier-one branches and team heads (included) in Head Office and the above managerial personnel.

2 This category includes front line staff, administrative staff and other supporting staff.

Deepening Human Resources Management Reform and Improving Incentive and Accountability Mechanism

In 2006, the Bank further improved the market-based human resources management mechanism, which is in line with a modern commercial bank's operation.

Pursuant to its development needs and business strategy, the Bank has taken steps to establish a position-based, performance-oriented human resources mechanism. For domestic institutions, the Bank established a new position classification system and staff recruitment policies, adopted the practice of competition-based appointments, strengthened staff allocation and structural adjustment, streamlined the new employees recruitment standards, centralized staff recruitment, and fostered the specialized human resources practitioners' development.

The Bank continued to improve its performance management by establishing and implementing a staff performance management system focused on "Balanced Score Card" and "Performance Process Management". Performance evaluation, which had relied solely on post-appraisal and results grading, was virtually changed to an all-round, full process based performance management system. A sound performance management culture is being built up, which contributes to represent the Bank's core value of "Performance Led, Effective Incentive, Value Creation and Sustainable Development".

Steadily pushing forward the remuneration management reform. The enterprise annuity plan was widely deployed, which further improved the staff welfare scheme.

Strengthening Employee Training

In 2006, sticking to the theme of "fully implementing the scientific approach of development and persistently building a labor force characterized by honesty, creditworthiness, professionalism, innovation and collaboration", the Bank developed a set of training plans for all levels of employees, such as middle and senior managerial personnel, core talents and front line staff, to strengthen the development of three types of employees, namely managerial personnel, professionals and operational staff.

The Bank attached great importance to the development of middle and senior managerial personnel by developing leadership models, establishing rudimentary, intermediate and advanced leadership courses, actively cooperating with our strategic investors and introducing RBS Group senior management programs, cooperating with Harvard Business School to develop the leadership programs for our senior management, and organizing core EMBA courses to upgrade the training for all levels of managerial personnel.

The Bank also placed emphasis on the training of front line staff by way of, in light of its business strategy, organizing various technical and professional training programs to strengthen the development of core talents and front line staff. The Bank prioritized the nurturing of risk management professionals, personal wealth management managers and corporate customer managers. The Bank also organized group-wide training and tests for front line employees, such as fully-skilled tellers, customer service managers, wealth managers and outlet managers, and the test pass rate

reached 97.9%. To support the building of compliance and internal control mechanisms, the Bank established compliance testing questions pool and organized the second round of legal and compliance testing on all employees, in which over 200, 000 employees took part, and the pass rate was 99.25%.

In China Financial Education Development Fund's appraisal of research results of the year 2006, the Bank won three awards for its achievements in training and development: "Bank of China's e-training system" was awarded the first prize in the distance education category; "Bank of China's series training materials for front line staff" was awarded the second prize for the publication category; and "commercial bank's marketing training materials" received the excellent publication prize.

Strengthening Our Corporate Culture

The Bank realizes that a strong and healthy corporate culture is essential for corporate survival and development. In 2006, the Bank devoted itself to further building its corporate culture. On the basis of the cultural essence emanated from the Bank's century-old history, the Bank further developed the underlying connotations and concept of its corporate culture in an innovative manner. The Bank further refined its corporate culture of "the pursuit of excellence" and distilled its distinctive century-old core values into "honesty and integrity, drive for performance, accountability, creativity and harmoniousness".

In 2007, the Bank will gradually intensify the promotion of its corporate culture of "the pursuit of excellence" and entrench its core values of "honesty and integrity, drive for performance, accountability, creativity and harmoniousness". We will integrate these core values into the Bank's business process and management structure and the building of its IT Blueprint. Guided by the core values, the Bank will continuously inspire the creativeness and enthusiasm of its employees, enhance internal cohesiveness and the sense of recognition, and establish a reliable credit standing as well as an excellent image for its brand name.

Management Discussion and Analysis — Cooperation with Strategic Investors

In 2006, the Bank deepened cooperation with its strategic investors — RBS Group, AFH, UBS and ADB, who have played an important role both in expanding the Bank's business and improving its corporate governance.

Overview

In 2006, the Bank and RBS Group held 4 joint steering committee meetings. RBS Group has totally seconded 47 experts in 7 successive groups to the Bank. RBS Group has provided trainings for about 500 BOC staff coming from the Head Office as well as domestic and overseas branches, covering such major fields as credit risk, operational risk, market risk, financial management, project finance, wealth management and credit card. The Bank has also established joint steering committee with UBS who seconded totally 3 experts to the Bank.

Corporate Banking Business

The Bank actively promoted its cooperation with RBS Group and achieved notable progress in the fields of aircraft financing, shipping financing, syndicated loans, supply chain financing, customer referral and business training. In 2006, the Bank successfully worked together with RBS Group in several large-scale projects both in domestic and overseas markets, improving its capability to provide high-end financial products and services to preferred corporate clients. The cooperative project of Shipping Debt Deal of Shanghai Time Shipping Co., Ltd. was granted the honour of *Shipping Debt Deal of the Year — Asia* in 2006 by Jane's in Britain. The Bank held seminars on supply chain financing with RBS Group to discuss feasible business solutions. Customer referral arrangements were made between the Bank and RBS Group, including its US subsidiary Citizens Bank. The Bank learned from Asia Financial (Holdings) the experience of small business financing. It was in the process of forming its own service model for small business. Meanwhile, the Bank worked together with strategic investors in optimisation of corporate banking organizational structure, business process reengineering and training in high-end and sophisticated financing products. Management capability was further enhanced. The cooperation with UBS included successful referral and investment in a number of IPOs UBS led and assistance in the acquisition of SALE.

Personal Banking Business

The Bank's cooperation with RBS Group proceeded in setting up a card Business Unit (the "BU"). The BU's Management Committee has been established, and started to direct the BU's founding and development. Senior Managers of the Bank Card Center have been appointed. The Bank is considering expanding the cooperation scope with RBS Group to the credit card business, the quasi credit card business and the acquiring services. Both sides have made a 2007–2011 Credit Card Finance Plan, and have jointly developed Internal Scoring Card System, and established the mechanism of risk budgeting and the monitoring of risk profile. In addition, according

to the related regulations, the cooperation between the Bank and RBS Group will be the related party transactions of listing programs by Shanghai Stock Exchange, which shall go public in accordance with related regulations. Progress in bank card cooperation has been made in such aspects as HR, IT, finance management, marketing and data analysis.

The Bank has deepened its strategic cooperation with RBS Group in private banking business, for which a letter of intent was signed, a bilateral project working group was set up to speed up the preparation for the private banking business in Beijing and Shanghai in areas of human resource development, product and services, brand promotion, IT, risk management and outlet construction.

Financial Market Business

The Bank arranged coordination meetings, lectures, trainings and seminars many times with its strategic investor RBS Group, and actively cooperated with each other in business and achieved good results. In 2006, the volume of foreign exchange transaction of the two parties doubled and volume of bond transaction increased by more than 25%. At the same time, the two parties built Electronic Brokerage System (EBS), providing a reliable foundation for future cooperation. In addition, the Bank has also held a number of seminars and workshop with UBS in financial market and treasury.

Risk Management

RBS Group has seconded 4 experts on risk management for long-term work in the Bank. In operational risk management, RBS Group provided technical support and core staff training in fields such as operational risks classification guideline, work process of risk and control assessment and key risk indicator (RACA&KRI). RBS Group helped the Bank formulate and promote the work process of operational risks and RACA&KRI and its pilot implementation program. RBS Group also provided the framework of anti-money laundering training and stipulations. The Bank seconded 2 key staff to RBS Group for a 3-month on-site training on operational risks and anti-fraud management. In credit risk management, RBS Group secondees assisted the Bank to design training courses on corporate credit analysis, loan structure and retail credit scorecard. RBS Group has also introduced to the Bank on its risk management experience by arranging seminars and on-site visits to RBS Group. In market risk management, RBS Group experts helped us in the design of market risk management framework. RBS Group provided technical support on developing the Bank's market risk limit structure and market risk management policy and on investment portfolio risk management review. A project was launched to evaluate the effectiveness of the market risk control environment within the dealing room. UBS sent 3 experts and provided a 3-month technical support in the fields of establishing market risk management policies, identifying risk factors in transactions and reporting value at risk. In addition, ADB also provided professional consultancy and advice on anti-money laundering, operational risk management and internal control.

Treasury and Capital Management

The Bank has reviewed and learned from the practices adopted by RBS Group in the fields of internal funds transfer, treasury, planning, budgeting and product pricing. Accordingly, the Bank developed *The Guidance to BOC FTP Objectives System* and its implementation plan. UBS has introduced to the Bank on its practices and experience on treasury management, interest rate risk management, liquidity management, fund raising management, group treasury and funding management etc.

Human Resources and Process Integration

The Bank carried out cooperation with RBS Group in the fields of leadership modeling, leadership development, human resources shared service, human capital management and business architecture. RBS Group experts provided consultancy and advices to the Bank on developing leadership models. The Bank sent 8 senior managers to take the leadership program co-developed by RBS Group and Harvard University. With the assistance of RBS Group, the Bank reached an agreement with Harvard Business School to co-develop training programs. With the support of RBS Group, the Bank carried out a full-scope review on the management structure and mechanisms of RBS Group and on which the Bank will draw reference for process integration and organization restructuring.

Information Technology

RBS Group consecutively assigned 3 teams of personnel (totaling 18 person-time) to provide assistance for the Bank on its Core Banking System (CBS) project, including sending an evaluation team of experts to offer on-site assistance on CBS package selection, introducing on CBS and related application systems, and sharing experience on IT system development. In 2006, the Bank also assigned 2 senior managers from IT Department and Information Center to RBS Group IT departments for a 3-month training program.

Management Discussion and Analysis — Corporate Honors and Responsibilities

Recognition in the Market

In 2006, the Bank received wide recognition on its performance from well-known media both at home and abroad. The awards covered many areas including banking business and management systems.

Emerging Markets
Banking Achievement of the Year

The Banker
Ranked 17th among the "Top 1,000 World Banks"

Global Finance
Best Foreign Exchange Bank-China

Best Trade Finance Bank-China

The Asset
2006 Triple A Best Cash Management Bank in China, Best Trade Finance Bank in China

Asia Risk
House of the Year China

Fortune
Ranked 255 in Fortune's "Global 500"

China's Most Admired Company (Chinese Version)

Asia Money
Best Local Cash Management Bank in China voted by large corporations in China

Asian Legal Business
Banking & Financial Services In-House Team of the Year (the only awarded domestic financial institution)

Universum
Ideal Employer for Chinese College Students (awarded for the second time)

21st Century Business Herald
Best International Business in Asian Banks

Investors Relations
Best IR for a Corporate Transaction

Best IR for an IPO in the Hong Kong Market

14th China International Financial (Banking) Technology & Equipment Exhibition

Financial Business Innovation (Cybertariff)

Charity and Community Initiatives

Aiming at building a harmonious society, the Bank is committed to its social responsibilities and reciprocates to the society in various ways. Over the years, the Bank has made its own contributions in poverty alleviation, disaster relief, aiding the disabled and vulnerable groups and sponsorship of cultural and sports activities.

Poverty reduction and disaster relief In 2006, the Bank sent its poverty alleviation work team to Xian Yang in Shanxi Province for the consecutive fourth year. The team spared no efforts to help the people in poverty-stricken areas and completed infrastructure programs including drinking water projects. They also built and reconstructed a number of middle and primary schools and provided assistance to 100 children lacking education opportunity and 30 college students in financial difficulty. With all these measures, the living conditions of the local people and backwardness in education were greatly improved. Their efforts won high appraisal from local people.

Donation for disaster-stricken regions In 2006, the Bank provided over a million of RMB funds to typhoon-affected Zhejiang and Guangdong Provinces and earthquake-affected Kashe area in Xinjiang Uigur Autonomous Region as well as other regions heavily struck by natural disasters. Donations showing care and help from the Bank staff were made to help people in these regions to return to normal state of work and carry out reconstruction after the disasters.

Sponsorship of China Children and Teenagers Fund Among the first to join the "collection box of affection" program launched by the China Children and Teenagers Fund, as of the end of 2006, the Bank has established over 1,700 collection boxes and collected over 1 million RMB funds for the China Children and Teenagers Fund. The Bank was thus conferred the honorary title of "The Best Unit of Children Affection" by the Fund.

Culture and Education

Launch of college education loans In 2006, the Bank continued to extend the education loan to all 115 colleges and universities affiliated to the Ministry of Education, and provided financial support to students suffering financial difficulty to help them finish their college education. Since the launch of the college education loans, the Bank has made 17.9 billion RMB loans accumulatively and the balance for education loans has exceeded 6.95 billion RMB by the end of 2006.

The Bank established the Tan Kah Kee Science Award Foundation jointly with the Chinese Academy of Sciences, awarding top Chinese scientists for their outstanding scientific achievements. The Foundation set up awards in five areas: science (including mathematics, physics, mechanics and astronomy), chemistry, life science (including biology, medicine and agriculture), geoscience and technology science, which are awarded every two years. In 2006, the Foundation awarded the winners for the first time, obtaining very positive feedbacks and promoting the scientific and technological development in China.

Provide Financial Services for Sports Events

In February 2006, as the 2008 Beijing Olympics official banking partner, the Bank established on-site financial service work team during the Torino Winter Olympics at the request of BOCOG and General Administration of Sport of China, and provided comprehensive financial services to the Chinese delegation and BOCOG.

In December 2006, the Bank sent its work team to Doha in Qatar to provide on-site financial services to the Chinese delegation during the 15th Asian Games.

In 2006, the Bank organized a number of Olympic theme activities, such as "Long-distance Walk with Beijing Citizens to Welcome Olympics" in Beijing, "True Understanding, Sincere Care-Bank of China Welcomes the

Paralytics and with You" in Tianjin, and "Bank of China Olympic Festival" in Hangzhou. These activities have led local people to a better understanding of and the participation in Olympics.

In 2006, the Bank sponsored various sports activities. It sponsored after its name the FIG 2006 World Cup Gymnastics in Shanghai. In August 2006, the Bank sponsored "Goodluck Beijing" ISF XI Women's Fast Pitch World

Championship in Beijing as well as the "Goodluck Beijing" 2006 Qingdao International Regatta, and provided on-site financial services for the two events.