

MANAGEMENT DISCUSSION AND ANALYSIS



(I) FINANCIAL HIGHLIGHTS

In 2006, in response to the market changes and macro-control policies, the Company adjusted its business focus to ensure steady business operations and balanced growth in profitability, quality and scale, resulting in remarkable operating results.

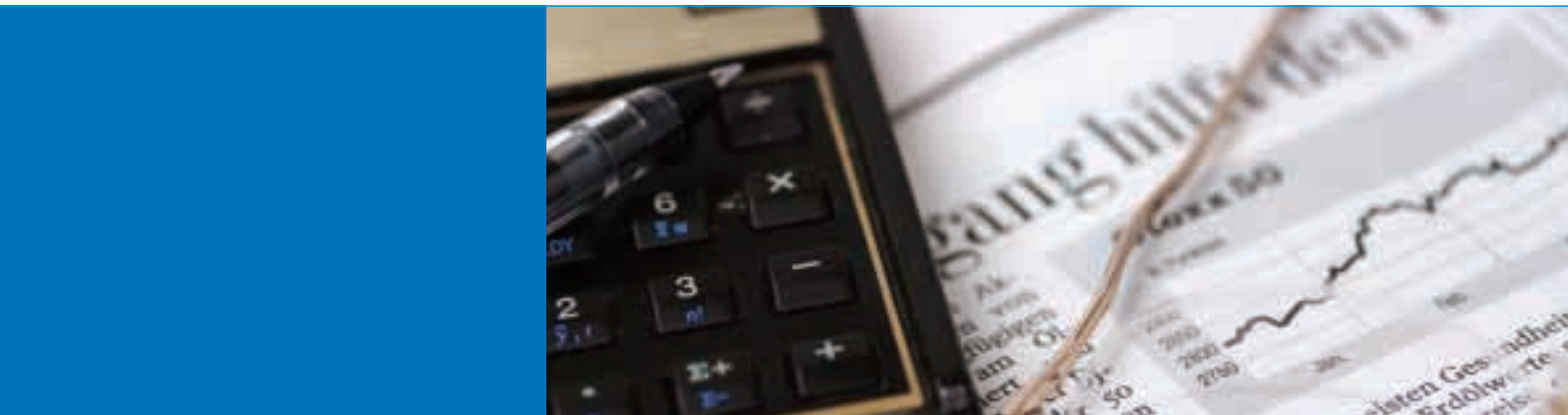
Analysis of Income Statement

Financial results highlights

| | For the year ended 31 December | |
|---|--------------------------------|----------------------|
| | 2006 | 2005 |
| | (in millions of RMB) | (in millions of RMB) |
| Net interest income | 21,509 | 16,642 |
| Net fee and commission income | 2,514 | 1,567 |
| Other net income | 843 | 1,005 |
| Operating expenses | 11,091 | 9,115 |
| Provision for impairment losses | 3,691 | 3,637 |
| Profit before tax | 10,084 | 6,462 |
| Income tax | 3,290 | 2,713 |
| Net profit attributable to equity holders of the Bank | 6,794 | 3,749 |

In 2006, the Company achieved a strong growth in operating results with its profit growth being nearly 3 times of the asset growth. The profit before tax was RMB10.084 billion, an increase of 56.05% compared to the previous year; net profit attributable to the Bank's equity holders was RMB6.794 billion, an increase of 81.22% compared to the previous year.

In 2006, the effective tax rate of the Company was 32.63%, a decrease of 9.35 percentage points compared to the year 2005. This is primarily due to the approval by MOF of the PRC and the State Administration of Taxation of the special deductible salary expenses on 9 April 2007. As such, the income tax payable by the Company was reduced by approximately RMB0.905 billion.



The net profit attributable to the Bank's equity holders for the year of 2006 was RMB6.794 billion which exceeded the amount as reported in the profit forecast announced (i.e. not less than RMB5.5 billion) before the listing of H-shares of the Company by 23.53%, primarily attributable to the above deduction of income tax.

The following table sets out the changes in the profit before tax of the Company for 2006 by major account caption.

Changes in profit before tax

| | (in millions of RMB) |
|-----------------------------------|----------------------|
| Profit before tax for 2005 | 6,462 |
| Changes in 2006 | |
| Net interest income | 4,867 |
| Net fee and commission income | 947 |
| Other net income | (162) |
| Operating expenses | (1,976) |
| Provision for impairment losses | (54) |
| Profit before tax for 2006 | 10,084 |

Operating income

In 2006, the operating income of the Company was RMB24.866 billion, an increase of 29.42% compared to the previous year. It was primarily due to rapid growth in interest income from loans and advances to customers and money market placements, and fee and commission income. Net interest income accounted for 86.50%, a decrease of 0.11 percentage point compared to the previous year; fee and commission income accounted for 10.11%, an increase of 1.95 percentage points compared to the previous year.

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The following table sets out the income composition of the Company in the past 5 years.

| | For the year ended 31 December | | | | |
|-------------------------------|--------------------------------|---------|---------|---------|---------|
| | 2006 | 2005 | 2004 | 2003 | 2002 |
| Net interest income | 86.50% | 86.61% | 91.17% | 90.60% | 92.34% |
| Net fee and commission income | 10.11% | 8.16% | 5.67% | 5.00% | 4.56% |
| Other net income | 3.39% | 5.23% | 3.16% | 4.40% | 3.10% |
| Operating income | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% |

Net interest income

In 2006, the net interest income of the Company was RMB21.509 billion, an increase of 29.25% compared to the previous year. It was primarily attributable to the increase of average balance of and average return on interest-earning assets.

The following table sets out, for the periods indicated, the average balances of assets and liabilities, interest income/interest expense and average yield/cost of the Company. The average balances of interest-earning assets and interest-bearing liabilities are the average of the daily balances. The average balances of non-interest-earning assets, non-interest-bearing liabilities and the allowances for impairment losses are the average of the balances at 1 January and 31 December for the year 2006 and 2005.

| | For the year ended 31 December | | | | | |
|---|---|-----------------|-------------------|-----------------|-----------------|-------------------|
| | 2006 | | 2005 | | | |
| | Average balance | Interest income | Average yield (%) | Average balance | Interest income | Average yield (%) |
| | (in millions of RMB, excluding percentages) | | | | | |
| Loans and advances to customers | 526,122 | 26,891 | 5.11 | 429,325 | 21,058 | 4.90 |
| Debt investments | 124,520 | 3,919 | 3.15 | 95,227 | 2,981 | 3.13 |
| Balances with central bank | 66,431 | 1,044 | 1.57 | 53,115 | 836 | 1.57 |
| Balances and placements with banks and other financial institutions | 74,103 | 2,136 | 2.88 | 40,444 | 1,002 | 2.48 |
| Total interest-earning assets | 791,176 | 33,990 | 4.30 | 618,111 | 25,877 | 4.19 |
| Allowances for impairment losses | (15,150) | – | – | (12,682) | – | – |
| Non-interest-earning assets and assets held for trading purpose | 29,610 | – | – | 29,970 | – | – |
| Total assets and total interest income | 805,636 | 33,990 | 4.22 | 635,399 | 25,877 | 4.07 |

| | For the year ended 31 December | | | | | |
|--|---|---------------------|---------------------|--------------------|---------------------|---------------------|
| | 2006 | | | 2005 | | |
| | Average balance | Interest expense | Average cost (%) | Average balance | Interest expense | Average cost (%) |
| | (in millions of RMB, excluding percentages) | | | | | |
| Deposits from customers | 694,702 | 10,449 | 1.50 | 550,719 | 7,558 | 1.37 |
| Amounts due to banks and other financial institutions | 65,205 | 1,551 | 2.38 | 46,303 | 1,076 | 2.32 |
| Issued debts | 15,528 | 481 | 3.10 | 11,881 | 601 | 5.06 |
| Total interest-bearing liabilities | 775,435 | 12,481 | 1.61 | 608,903 | 9,235 | 1.52 |
| Non-interest-bearing liabilities | 12,629 | – | – | 9,985 | – | – |
| Total liabilities and interest expense | 788,064 | 12,481 | 1.58 | 618,888 | 9,235 | 1.49 |
| Net interest income | – | 21,509 | – | – | 16,642 | – |
| Net interest spread⁽¹⁾ | – | – | 2.69% | – | – | 2.67% |
| Net interest margin⁽²⁾ | – | – | 2.72% | – | – | 2.69% |

⁽¹⁾ Net interest spread is the difference between the average yield of total interest-earning assets and the average cost of total interest-bearing liabilities.

⁽²⁾ Net interest margin is net interest income divided by the average balance of total interest-earning assets.

The following table sets out, for the periods indicated, the allocation of changes in interest income and interest expenses due to changes in volume and rate. Changes in volume are measured by changes in average balances (daily average balance) while changes in rate are measured by changes in the average rates.

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| | For the year ended 31 December | | |
|--|--------------------------------|-------|-----------------------------|
| | 2006 vs. 2005 | | |
| | Increase/(decrease) | | Net increase/ (decrease) |
| | due to | | |
| Volume | Rate | | |
| | (in millions of RMB) | | |
| Assets | | | |
| Loans and advances to customers | 4,748 | 1,085 | 5,833 |
| Debts Investments | 917 | 21 | 938 |
| Balances with central bank | 210 | (2) | 208 |
| Balances and placements with banks and other financial institutions | 834 | 300 | 1,134 |
| Changes in interest income | 6,709 | 1,404 | 8,113 |
| Liabilities | | | |
| Deposits from customers | 1,976 | 915 | 2,891 |
| Amounts due to banks and other financial institutions | 439 | 36 | 475 |
| Issued debts | 184 | (304) | (120) |
| Changes in interest expense | 2,599 | 647 | 3,246 |
| Changes in net interest income | | | 4,867 |

Interest income

In 2006, the interest income of the Company increased by 31.35% compared to the previous year, which was primarily attributable to increases in average balances and average yields of loans and advances to customers and balances and placements with banks and other financial institutions. Interest income from loans and advances to customers accounted for the majority of the interest income of the Company.

Interest income from loans and advances to customers

The following table sets out, for the periods indicated, the average balances, interest income and average yield of respective types of loans and advances to customers of the Company.

| | For the year ended 31 December | | | | | |
|--|---|--------------------|----------------------|--------------------|--------------------|----------------------|
| | 2006 | | | 2005 | | |
| | Average balance | Interest income | Average yield (%) | Average balance | Interest income | Average yield (%) |
| | (in millions of RMB, excluding percentages) | | | | | |
| Corporate loans | 336,814 | 18,853 | 5.60 | 277,083 | 14,655 | 5.29 |
| Retail loans | 84,320 | 4,967 | 5.89 | 63,089 | 3,454 | 5.47 |
| Discounted bills | 104,988 | 3,071 | 2.93 | 89,153 | 2,949 | 3.31 |
| Loans and advances to customers | 526,122 | 26,891 | 5.11 | 429,325 | 21,058 | 4.90 |

The above average balances were averages of daily balances.

In 2006, the interest income from loans and advances to customers of the Company increased by 27.70% compared to the previous year. The increase of interest income is primarily caused by the following factors: (1) Rapid economic growth in China, resulting in rapid development of corporate loans, mortgages and credit card business. The average balance of corporate loans increased by 21.56%, the average balance of retail loans increased by 33.65%, and the impact of the increasing average balance of loans and advances to customers accounted for 81.40% of the total increase in interest income. (2) The raise of interest rate twice for loans as announced by PBOC and the rise in US dollar interest rate, resulting in a rise in average yield of both loans and retail loans. Owing to the slump in the bills market in the first half of the year and a rebound in the second half of the year, the average yield of bills discounted was 2.93%, down by 38 BP compared with the previous year.

Interest income from debts investments

Interest income from investments was the second largest component of interest income of the Company, and the interest income from investments in 2006 increased by 31.47% compared to the previous year. It was primarily because the Company had anticipated increasing interest rates in RMB and foreign-currency markets and took a short term investment strategy to enjoy the benefits of several increases in USD interest rates and RMB interest rates, contributing to satisfactory yield of investment portfolios as a whole. In addition, the Company has stepped up investment in RMB denominated commercial paper in view of its investment value potential. The Company, as a tier-1 underwriter of commercial paper, benefited substantially from the price difference between primary and secondary markets, contributing to the overall satisfactory performance of the portfolios.

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Interest income from placements with banks and other financial institutions

In 2006, the interest income from placements with banks and other financial institutions increased by 113.17% compared to the previous year, and the contribution of interest income from placements with banks and other financial institutions to the total interest income increased from 3.87% in 2005 to 6.28% in 2006. With sufficient funds and increasing interest rate, the Company has entered into more money market placements transactions.

Interest expense

In 2006, the interest expense of the Company increased by 35.15% compared to the previous year. It was primarily attributable to the increase in average balance of deposits and average cost.

Interest expenses on deposits from customers

Deposits from customers are the major funding source of the Company. In 2006, the Company's interest expense on deposits from customers increased by 38.25% compared to the previous year. The influence of increase in average balance and the change in average cost accounted for 68.35% and 31.65% respectively. With the raise of interest rate of RMB deposits and the USD interest rate, the overall funding cost increased to some degree. Increase of funding cost slowed down in the second half of the year, which was primarily due to the slow-down of the growth in higher cost time deposits, especially time deposits from retail customers as a result of the booming stock markets and issuance of funds.

The following table sets forth, for the periods indicated, the average balance, interest expense and average cost for corporate and retail deposits of the Company.

| | For the year ended 31 December | | | | | |
|--|---|------------------|------------------|-----------------|------------------|------------------|
| | 2006 | | | 2005 | | |
| | Average balance | Interest expense | Average cost (%) | Average balance | Interest expense | Average cost (%) |
| | (in millions of RMB, excluding percentages) | | | | | |
| Deposits from corporate customers | | | | | | |
| Demand | 235,488 | 2,136 | 0.91 | 194,522 | 1,924 | 0.99 |
| Time | 176,897 | 4,158 | 2.35 | 138,578 | 2,912 | 2.10 |
| Subtotal | 412,385 | 6,294 | 1.53 | 333,100 | 4,836 | 1.45 |
| Deposits from retail customers | | | | | | |
| Demand | 128,226 | 951 | 0.74 | 104,593 | 713 | 0.68 |
| Time | 154,091 | 3,204 | 2.08 | 113,026 | 2,009 | 1.78 |
| Subtotal | 282,317 | 4,155 | 1.47 | 217,619 | 2,722 | 1.25 |
| Total deposits from customers | 694,702 | 10,449 | 1.50 | 550,719 | 7,558 | 1.37 |

The average balances of items in the table were averages of daily balances.

Interest expenses on amounts due to banks and other financial institutions

In 2006, interest expenses on amounts due to banks and other financial institutions increased by 44.14% compared to the previous year. It was primarily attributable to the increase in borrowings from banks and other financial institutions with greater transaction volume in the active stock markets in 2006.

Interest expenses on issued debts

In 2006, the interest expenses on issued debts decreased by 19.97% compared to the previous year, primarily due to significant amount of the convertible bonds issued by the Company on 10 November 2004 was converted into shares in 2006.

Net interest spread and net interest margin

In 2006, the net interest spread of the Company was 2.69%, up by 2BP compared to the previous year. It was primarily because the average interest margin of the interest-earning assets of the Company increased from 4.19% in 2005 to 4.30% in 2006, up by 11BP, and the average cost of the interest-bearing liabilities increased from 1.52% in 2005 to 1.61% in 2006, up by 9BP.

In 2006, the net interest margin of the Company was 2.72%, up by 3BP compared to the previous year. Such an increase was primarily due to the raise of interest rate twice for loans and advances by PBOC in 2006 and the raise of interest rate once for time deposits, while the activity in the capital market slowed down the increase of time deposit interest rate, resulting in higher net interest margin. The net interest income increased by 29.25%, which was slightly higher than the 28% increase of total interest-earning assets.

Net fee and commission income

In 2006, the contribution of net fees and commission income to the total operating income of the Company increased to 10.11% from 8.16% in 2005. The following table sets forth, for the periods indicated, the principal components of net fee and commission income of the Company.

| | For the year ended 31 December | |
|---|--------------------------------|----------------------|
| | 2006 | 2005 |
| | (in millions of RMB) | (in millions of RMB) |
| Fee and commission income | 2,988 | 1,856 |
| Bank card fees | 1,003 | 570 |
| Remittance and settlement fees | 607 | 429 |
| Agency services fees | 571 | 315 |
| Commissions from credit commitment and loan business | 267 | 186 |
| Trust service fees | 259 | 101 |
| Others | 281 | 255 |
| Fee and commission expense | (474) | (289) |
| Net fee and commission income | 2,514 | 1,567 |

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In 2006, net fee and commission income of the Company increased by 60.43%. Such an increase was primarily attributable to increases in all categories of fees and commissions, particularly the bank card fees, agency services fee and remittance and settlement fees.

In 2006, the bank card fee income increased by 75.96% compared to the previous year. It was primarily due to increased issuance and transactions volume of bank cards, especially credit cards; of which, POS

fee income was RMB548 million, representing an increase of 56% compared to the previous year; income from credit card cash advance and installment business was RMB0.32 billion, representing an increase of 188% compared to the previous year.

In 2006, the income from agency services increased by 81.27% compared to the previous year. The increase was primarily attributable to booming stock market in China during 2006, so that the Company stepped up marketing of its bancassurance and securities agency business.

In 2006, income from remittance and settlement service increased by 41.49% compared to the previous year. Such an increase was primarily driven by collection of personal account management fee and gradual expansion of the business scale and customer base, resulting in increased remittance and settlement transactions. In 2006, the personal account management fee of the Company was RMB0.12 billion, representing an increase of 300.7% compared to the previous year.

In 2006, commissions from credit commitment and loan business of the Company increased by 43.55% over the previous year, which was primarily attributable to the expanding customer base and enlarged business volume.

In 2006, income from trust service increased by 156.44% compared to the previous year, which was primarily attributable to significant increase in income from fund distribution business.

In 2006, fee and commission expenses increased by 64.01% compared to the previous year. The increase was primarily attributable to rapid growth of credit cards issuance. On the other hand, there was an increase in expenses on credit card service. Commissions on loan transfer business and ATM cross-bank withdrawals also recorded an increase.

Other net income

In 2006, other net income of the Company decreased by 16.12% compared to the previous year. It was primarily due to increased net loss arising from currency translation as well as decreased net income on financial instruments at fair value through profit or loss. Other net income accounted for 3.39% of the operating income.

The following table sets forth, for the periods indicated, the principal components of other net income of the Company.

| | For the year ended 31 December | |
|---|--------------------------------|----------------------|
| | 2006 | 2005 |
| | (in millions of RMB) | (in millions of RMB) |
| Net gain arising from foreign currency dealing | 607 | 509 |
| Net loss on foreign exchange | (313) | (38) |
| Net gain on financial instruments at fair value through profit or loss | 357 | 428 |
| Net (loss)/gain on disposal of available-for-sale financial assets | (22) | 5 |
| Distributions from investment in funds | 117 | 25 |
| Net gain on disposal of fixed assets | 1 | 4 |
| Rental income | 64 | 59 |
| Others | 32 | 13 |
| Total other net income | 843 | 1,005 |

In 2006, net gain arising from foreign currency dealing increased by 19.25% compared to the previous year, which was primarily because the Company acted as RMB market maker in 2006 and launched new products such as personal options, resulting in increased volume of dealing activities.

In 2006, net loss on foreign exchange increased by 723.68% compared to the previous year, which was primarily due to the RMB appreciation against the proceeds from H shares issuance.

In 2006, net gain on financial instruments at fair value through profit or loss, decreased by 16.59% compared to the previous year, which was primarily attributable to lower transactions volume.

In 2006, the distributions for investment in funds increased by 368% compared to the previous year. The distributions were derived from investment in the foreign currency markets for the purpose of liquidity management. The significant return was primarily attributable to the increase in USD interest rate.

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Operating expenses

In 2006, the operating expenses were RMB11.091 billion, representing an increase of 21.68% compared to the previous year. The increase in operating expenses was 7.74 percentage points lower than the increase in operating income, reflecting that there was an increase in the efficiency. In 2006, the cost-to-income ratio was 38.28%, decreased by 2.82 percentage points compared to the previous year, which was primarily attributable to robust growth of the operating income of the Company.

The following table sets forth, for the periods indicated, the principal components of the operating expenses of the Company.

| | For the year ended 31 December | |
|---|--------------------------------|------------------------------|
| | 2006 (in millions of RMB) | 2005 (in millions of RMB) |
| Staff costs | 5,053 | 4,241 |
| Business tax and surcharges | 1,573 | 1,219 |
| Depreciation and rental expenses | 1,741 | 1,547 |
| Other general and administrative expenses | 2,724 | 2,108 |
| Total operating expenses | 11,091 | 9,115 |

Staff costs constituted the majority of the operating expenses of the Company. In 2006, staff costs increased by 19.15% compared to the previous year, which was primarily due to increased headcounts and performance-based bonuses with the business expansion. In 2006, the Company recruited 2,549 employees, mainly for retail banking including credit card business. Depreciation and rental expenses increased by 12.54%, which were primarily due to increased capital expenditure on fixed assets including electronic equipments, in new branches and offices. Other general and administrative expenses increased by 29.22% and the business tax and surcharges increased by 29.04%, which were in line with the overall growth of business development and the operation of the Company.

Provision for impairment losses

In 2006, provision for impairment losses was RMB3.691 billion, an increase of 1.48% compared to the previous year. The following table sets forth, for the periods indicated, the principal components of provision for impairment losses of the Company.

| | For the year ended 31 December | |
|---|--------------------------------|------------------------------|
| | 2006 (in millions of RMB) | 2005 (in millions of RMB) |
| Impairment losses charged/(released) on: | | |
| – Loans and advances | 3,537 | 3,575 |
| – Deposits and placements with banks and other financial institutions | (91) | 62 |
| – Other assets | 245 | – |
| Total provision for impairment losses | 3,691 | 3,637 |

Provision for impairment losses on loans and advances constituted the largest component of the provision for impairment losses. In 2006, provision for impairment losses on loan was RMB3.537 billion, representing a decrease of 1.06% compared to the previous year. For the details of the provision for impairment losses on loan and advances, please refer to the section headed "Loan Quality Analysis" of this section.

In 2006, the provision for impairment losses on deposits and placements with banks and other financial institutions was a release of RMB91 million, primarily due to a decrease in the history loss used in assessing the impairment of these assets.

Provision for impairment losses on other assets consisted primarily of provision for impairment losses on repossessed assets, which represented the difference between the estimated realizable value and the carrying value of our repossessed assets. In 2006, the provision for impairment losses on other assets of the Company was RMB0.245 billion.

Analysis of balance sheet

Assets

As at 31 December 2006, the total assets of the Company were RMB934.102 billion, representing an increase of 27.16% compared to the previous year-end. The increase in total assets was primarily due to the increase in loans and advances to customers, investments, and placements with banks and financial institutions, which were the three major components of the Company's asset portfolio. The increase in these types of assets accounted for approximately 89.69% of the increase in total assets. The rapid increase in deposits from customers, placements from banks and other financial institutions, and proceeds from H Share IPO provided adequate funds for the asset growth of the Company.

In 2006, due to the continued strict control in loan growth, the increased efforts to diversify its assets, and the intensified investment in securities, the increase of investments for the year was higher than the increase of loans and advances to customers. To enhance the efficiency in fund use, the Company increased placements with other well-established banks and financial institutions.

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The following table sets forth, as at the dates indicated, the components of the total assets of the Company.

| | As at 31 December | | | |
|---|---|-------------------------|----------------|-------------------------|
| | 2006 | | 2005 | |
| | Amount | Percentage of total (%) | Amount | Percentage of total (%) |
| | (in millions of RMB, excluding percentages) | | | |
| Gross loans and advances to customers | 565,702 | 60.56 | 472,185 | 64.28 |
| Allowance for impairment losses on loans and advances | (16,282) | (1.74) | (13,510) | (1.84) |
| Net loans and advances to customers | 549,420 | 58.82 | 458,675 | 62.44 |
| Investments | 178,885 | 19.15 | 131,902 | 17.96 |
| Balances with the central bank | 82,372 | 8.82 | 62,102 | 8.45 |
| Cash and balances with banks and other financial institutions | 20,861 | 2.23 | 22,491 | 3.06 |
| Placement with banks and other financial institutions | 88,171 | 9.44 | 46,982 | 6.40 |
| Other assets | 14,393 | 1.54 | 12,461 | 1.69 |
| Total assets | 934,102 | 100.00 | 734,613 | 100.00 |

Loans and advances to Customers

As at 31 December 2006, total loans and advances to customers amounted to RMB565.702 billion, representing an increase of 19.81% compared to the previous year; the percentage of total loans and advances to customers to the total assets was 60.56%, representing a decrease of 3.72 percentage points compared to the previous year.

Distribution of loans by product type

The following table sets forth, as at the dates indicated, the loans and advances to customers by product type.

| | As at 31 December | | | |
|--|---|---|----------------|--|
| | 2006 | | 2005 | |
| | Amount | As a Percentage to total loans and advances to customer (%) | Amount | As a percentage to total loan and advances to customer (%) |
| | (in RMB million, excluding percentages) | | | |
| Corporate loans | 359,883 | 63.62 | 298,622 | 63.24 |
| Discounted bills | 103,836 | 18.35 | 99,527 | 21.08 |
| Retail loans | 101,983 | 18.03 | 74,036 | 15.68 |
| Total loans and advances to customers | 565,702 | 100.00 | 472,185 | 100.00 |

In recent years, the Company continued to increase our efforts to expand our business in retail loans, and the proportion of our retail loans in the loan portfolio. As at 31 December 2006, retail loans accounted for 18.03% of the total loan and advances to customers, representing an increase of 2.35 percentage points compared to the previous year. Meanwhile, the Company increased the yield on discounted bills by speeding up the turnover of bills. As at 31 December 2006, discounted bills accounted for 18.35% of the total loans and advances to customers, which was lower when compared to the previous year.

Corporate loans

As at 31 December 2006, corporate loans represented 63.62% of the total loans and advances to customers. The following table sets forth, as at the dates indicated, our corporate loans by product type.

| | As at 31 December | | | |
|------------------------------|---|-------------------------|----------------|-------------------------|
| | 2006 | | 2005 | |
| | Amount | Percentage of total (%) | Amount | Percentage of total (%) |
| | (in millions of RMB, excluding percentages) | | | |
| Working capital loans | 282,089 | 78.38 | 242,524 | 81.21 |
| Fixed asset loans | 60,427 | 16.79 | 38,762 | 12.98 |
| Trade finance | 12,204 | 3.39 | 13,804 | 4.62 |
| Others ⁽¹⁾ | 5,163 | 1.44 | 3,532 | 1.19 |
| Total corporate loans | 359,883 | 100.00 | 298,622 | 100.00 |

⁽¹⁾ Others consists primarily of factoring and corporate mortgage loans.

As at 31 December 2006, our corporate loans was amounted to RMB359.883 billion, an increase of 20.51% compared to the previous year. Amongst all, the working capital loans increased by 16.31%, whose growth rate was steady; fixed asset loans increased by a rapid rate of 55.89%, which was primarily attributable to the robust demand for fixed asset loans in quality industries such as communications, energy and transportation along with rapid economic growth in China, and the Company increased loans to the



said industries as a result; trade finance loans decreased by RMB1.6 billion, primarily due to reduced demand for the said products as a result of the interest rate rise in USD loan market.

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Discounted bills

As at 31 December 2006, our discounted bills were amounted to RMB103.836 billion, an increase of 4.33% compared to the previous year. Over the years, as the loss rate of discounted bills was relatively low, and the capital consumption was relatively small, the Company has continued to focus on the expansion of this business. However, owing to the increased fluctuations of market interest rates for the year, the Company appropriately adjusted its operational strategies, primarily by speeding up the turnover of bills to acquire earnings from the difference, so that the growth rate of the total discounted bills was lower accordingly.

Retail loans

As at 31 December 2006, our retail loans were amounted to RMB101.983 billion, increased by 37.75% compared to the end of the previous year. The increase was primarily due to continued growth of residential mortgage loans and rapid development of credit card business. The following table sets forth, as at the dates indicated, our retail loans by product type.

| | As at 31 December | | | |
|----------------------------|---|-------------------------|--------|-------------------------|
| | 2006 | | 2005 | |
| | Amount | Percentage of total (%) | Amount | Percentage of total (%) |
| | (in millions of RMB, excluding percentages) | | | |
| Residential mortgage loans | 81,383 | 79.80 | 64,609 | 87.27 |
| Automobile loans | 895 | 0.88 | 1,144 | 1.55 |
| Credit card balances | 10,146 | 9.95 | 4,550 | 6.14 |
| Others ⁽¹⁾ | 9,559 | 9.37 | 3,733 | 5.04 |
| Total retail loans | 101,983 | 100.00 | 74,036 | 100.00 |

⁽¹⁾ Consists primarily of retail loans secured by monetary assets, home improvement loans, education loans and general consumption loans.

As at 31 December 2006, our residential mortgage loans increased by 25.96% compared to the previous year, primarily due to the continued efforts made by the Company to expand the business of residential mortgage loans, and that the residential mortgage loans kept growing rapidly.

Our credit card balances increased by 122.99% compared to the previous year. The relatively rapid increase was primarily due to the rapid growth of the credit card business of the Company.

As the Company continued to be prudent with automobile loans, the personal automobile loans decreased by RMB0.249 billion compared to the previous year.

Investments

Investments of the Company included listed and unlisted securities dominated in RMB and foreign currencies. According to the requirements of IFRSs, the investments of the Company are classified into the following categories: financial assets at fair value through profit or loss, available-for-sale investments, held-to-maturity debt securities, and receivables.

The following table sets forth, as at the dates indicated, the components of the investment portfolio of the Company:

| | As at 31 December | | | |
|---|-------------------|-------------------------|---------|-------------------------|
| | 2006 | | 2005 | |
| | Amount | Percentage of total (%) | Amount | Percentage of total (%) |
| (in millions of RMB, excluding percentages) | | | | |
| Financial assets at fair value through profit or loss | 7,960 | 4.45 | 15,869 | 12.03 |
| Available-for-sale investments | 109,476 | 61.20 | 60,086 | 45.55 |
| Held-to-maturity debt securities | 54,065 | 30.22 | 48,711 | 36.93 |
| Receivables | 7,384 | 4.13 | 7,236 | 5.49 |
| Total investments | 178,885 | 100.00 | 131,902 | 100.00 |

Financial assets at fair value through profit or loss

The securities dealing activities of the Company was primarily in response to increased volumes of trading with our customers. As at 31 December 2006, the financial assets at fair value through profit or loss decreased by 50% compared to the previous year. The decrease was primarily due to the change in the investment preference of our customers, reduced demand for the bond investments as a result of the supplementary investment after maturity of PRC government bonds, listed bonds issued by policy banks and Central Bank bills.

MANAGEMENT DISCUSSION AND ANALYSIS

The following table sets forth, as at the dates indicated, the components of the financial asset portfolio of the Company.

| | As at 31 December | |
|--|----------------------|----------------------|
| | 2006 | 2005 |
| | (in millions of RMB) | (in millions of RMB) |
| Financial assets at fair value through profit or loss | | |
| PRC government bonds | 2,452 | 5,523 |
| PBOC bills | 1,993 | 5,081 |
| Bonds issued by policy banks | 1,952 | 4,003 |
| Others ⁽¹⁾ | 1,563 | 1,262 |
| Total financial assets at fair value through profit or loss | 7,960 | 15,869 |

⁽¹⁾ Consists of other bonds, equity investments and financial derivatives, etc.

Available-for-sale investments

As at 31 December 2006, the available-for-sale investments of the Company increased by 82.2%, represented 61.20% of the investments of the Company, which was the largest investment category of the Company. The increase was mainly due to the support of adequate liquidity from the increased deposits. Amongst all, (1) policy bank bonds have sovereign-equivalent credit ratings. With the significant increase in the issuing volumes, the Company increased the purchase of mid-to-short term policy bank bonds accordingly; (2) PBOC bills enjoyed the sovereign bond status. In recent years, PBOC issued bills to control the currency supply, in which such bonds have maturities meeting the Company's needs. The sound yield and liquidity of such bonds could consistent with investment strategy of the Company, thus leading to the significant increase in these investments. (3) The increase in other bond investments was in line with the Company's investment directions and diversification, so as to meet the needs of effective risk control, and also enhance the gain of such portfolio. In general, the bonds consisted of the available-for-sale investments portfolio was mainly in mid-to-short term with relatively short remaining maturity in average with sound liquidity, an appropriate degree of credit risk and market risk.



The following table sets forth, as at the dates indicated, the components of the available-for-sale investment portfolio of the Company.

| | As at 31 December | |
|---|----------------------|----------------------|
| | 2006 | 2005 |
| | (in millions of RMB) | (in millions of RMB) |
| Available-for-sale investments | | |
| PRC government bonds | 7,387 | 7,891 |
| PBOC bills | 43,699 | 27,502 |
| Policy bank bonds | 26,411 | 9,751 |
| Other bonds | 25,017 | 13,685 |
| Investment in funds | 6,914 | 1,211 |
| Equity investments | 48 | 46 |
| Total available-for-sale investments | 109,476 | 60,086 |

Held-to-maturity debt securities

As at 31 December 2006, the held-to-maturity debt securities of the Company increased by 10.99% compared to the previous year. The increase was primarily due to the support of a steady growth of core funding business of the Company. Amongst all, (1) the decreased in PRC government bonds due to more redemption of matured bonds during the year while the new issuances of government bonds with tenor that met the Company's needs decreased; (2) a larger growth of policy bank bonds, as there were more new issued policy bank bonds that met the maturity preferences of the Company.

MANAGEMENT DISCUSSION AND ANALYSIS

Such held-to-maturity portfolio has high credit rating, it consisted most of the floating-rate bonds held by the Company. The coupon rates of these bonds would be adjusted according to the statutory benchmark rates. With the gradual increase in the PBOC's benchmark interest rate, this portfolio would have good investment return, with average remaining maturity not more than 5 years and controllable risk in general.

The following table sets forth, as at the dates indicated, the components of held-to-maturity debt securities of the Company.

| | As at 31 December | |
|---|----------------------|----------------------|
| | 2006 | 2005 |
| | (in millions of RMB) | (in millions of RMB) |
| Held-to-maturity debt securities | | |
| PRC government bonds | 13,802 | 15,765 |
| PBOC bills | 2,270 | 1,137 |
| Policy bank bonds | 28,626 | 23,532 |
| Other bonds | 9,367 | 8,277 |
| Total held-to-maturity debt securities | 54,065 | 48,711 |

Receivables

Receivables are bearer's government bonds held by the Company. As at 31 December 2006, the receivables increased by RMB0.148 billion over the previous year. The fluctuation mainly resulted from issuing, and redemption on or before maturity of bearer's government bonds.

Carrying value and fair value

All financial assets classified as at fair value through profit or loss and the available-for-sale investments were stated at market value or at fair value. Due to the Company's intention and ability to hold these investments to maturity despite the lack of market value, the Company considers no provision for impairment losses is required as full recoverability is anticipated at maturity.

The following table sets forth, as at the dates indicated, the carrying value and the market/ fair value of the held-to-maturity debt securities in our investment portfolio:

| | As at 31 December | | | |
|----------------------------------|----------------------|--------------------|----------------|--------------------|
| | 2006 | | 2005 | |
| | Carrying value | Market/ fair value | Carrying value | Market/ fair value |
| | (in millions of RMB) | | | |
| Held-to-maturity debt securities | 54,065 | 54,335 | 48,711 | 48,997 |

Investment concentration

The following table sets forth, as at 31 December 2006, our investments which carrying value exceeded 10% of our shareholders' equity.

| | As at 31 December 2006 | | | |
|---------------------------------------|---|-------------------------------------|--|-------------------|
| | Carrying value | Percentage of total investments (%) | Percentage of total shareholder's equity (%) | Market/fair value |
| | (in millions of RMB, excluding percentages) | | | |
| The PBOC | 47,962 | 26.81 | 86.95 | 47,954 |
| The MOF | 29,119 | 16.28 | 52.79 | 29,265 |
| China Development Bank | 41,992 | 23.47 | 76.13 | 42,118 |
| The Export-Import Bank of China | 6,113 | 3.42 | 11.08 | 6,114 |
| Agriculture Development Bank of China | 8,954 | 5.01 | 16.23 | 8,954 |
| Total | 134,140 | 74.99 | – | 134,405 |

Liabilities

As at 31 December 2006, the total liabilities of the Company amounted to RMB878.942 billion, an increase of 24.04% compared to the previous year. Total deposits from customers was RMB773.757 billion, an increase of 21.97% compared to the previous year, representing 88.03% of the total liabilities of the Company, and was the major source of funding of the Company. The increase of liabilities was primarily due to a rapid growth of deposits from customers and inter-bank borrowings.



MANAGEMENT DISCUSSION AND ANALYSIS

The following table sets forth, as at the dates indicated, the components of the total liabilities of the Company.

| | As at 31 December | | | |
|--|---|-----------------------------|---------|-----------------------------|
| | 2006 | | 2005 | |
| | Amount | Percentage of the total (%) | Amount | Percentage of the total (%) |
| | (in millions of RMB, excluding percentages) | | | |
| Deposits from customers | 773,757 | 88.03 | 634,404 | 89.53 |
| Deposits from banks and other financial institutions | 68,854 | 7.83 | 39,673 | 5.60 |
| Placements from banks and other financial institutions | 7,749 | 0.89 | 3,574 | 0.50 |
| Certificates of deposit issued | 1,170 | 0.13 | 1,211 | 0.17 |
| Convertible bonds issued | 22 | 0.00 | 5,184 | 0.73 |
| Subordinated notes issued | 3,500 | 0.40 | 3,500 | 0.49 |
| Other debts issued | 9,987 | 1.14 | 9,982 | 1.41 |
| Other liabilities | 13,903 | 1.58 | 11,087 | 1.57 |
| Total liabilities | 878,942 | 100.00 | 708,615 | 100.00 |

Deposits from customers

The Company provides demand and time deposit products to corporate and retail customers. The following table sets forth, as at the dates indicated, the deposits from customers by product type and customer type.

| | As at 31 December | | | |
|--------------------------------------|---|-----------------------------|---------|-----------------------------|
| | 2006 | | 2005 | |
| | Amount | Percentage of the total (%) | Amount | Percentage of the total (%) |
| | (in millions of RMB, excluding percentages) | | | |
| Corporate deposits | | | | |
| Demand | 257,235 | 33.24 | 219,230 | 34.56 |
| Time | 204,563 | 26.44 | 159,245 | 25.10 |
| Subtotal | 461,798 | 59.68 | 378,475 | 59.66 |
| Retail deposits | | | | |
| Demand | 152,449 | 19.70 | 118,566 | 18.69 |
| Time | 159,510 | 20.62 | 137,363 | 21.65 |
| Subtotal | 311,959 | 40.32 | 255,929 | 40.34 |
| Total deposits from customers | 773,757 | 100.00 | 634,404 | 100.00 |

The Company continues to focus on developing deposit business. Deposits from customers of the Company maintained high growth as a result of rapid economic growth in the PRC, increased disposable income of the public and increased PBOC's deposit interest rate. As at 31 December 2006, deposits from customers of the Company amounted to RMB773.757 billion, an increase of 21.97% compared to the previous year.

Although booming of the stock markets in the second half of 2006 affected retail deposits of the banks in China, the percentage of retail deposits to total deposits from customers of the Company amounted to 40.32%, maintaining a relatively higher level among the banks in China, and basically of the same as in 2005, reflecting the Company's strategy and efforts to focus on retail business.

Owing to increased interest spread between time deposit and demand deposit after PBOC adjusted the deposit interest rate, time deposits of the Company grew faster than demand deposits, and time deposits accounted for a larger percentage of the total deposits. However, as the stock markets became more active in the second half of the year, the increase of time deposits, especially retail time deposits, slowed down to some extent. The proportion of corporate fixed-term deposits accounted for 47.05% of the deposits from customers, an increase of 0.30 percentage point compared to the previous year; amongst all, the proportion of corporate fixed-term deposits accounted for 44.30% of the corporate deposits, an increase of 2.22 percentage points compared to the previous year. The proportion of retail fixed-term deposits accounted for 51.13% of the retail deposits, a decrease of 2.54 percentage points compared to the previous year.

Shareholder's equity

| | As at 31 December | |
|-----------------------------------|----------------------|----------------------|
| | 2006 | 2005 |
| | (in millions of RMB) | (in millions of RMB) |
| Share capital | 14,703 | 10,374 |
| Capital reserve | 27,536 | 6,095 |
| Surplus reserve | 2,377 | 1,591 |
| Investment revaluation reserve | 195 | 404 |
| Regulatory general reserve | 6,500 | 3,000 |
| Retained profits | 1,374 | 2,918 |
| Proposed profit appropriations | 2,475 | 1,616 |
| Total shareholder's equity | 55,160 | 25,998 |

The significant increase of share capital and capital reserve of the Company was primarily due to the amount of RMB20.505 billion net proceeds received from the public offering of H Shares of the Company in 2006.

MANAGEMENT DISCUSSION AND ANALYSIS

Loan quality analysis

Asset quality analysis on loan classification

The Company evaluates and supervises the quality of loan portfolios through the loan classification system. The Company formulated and implemented five-tier loan classification system in accordance with the relevant guidelines of CBRC. Meanwhile, to strengthen internal risk management and monitoring, the Company further classified the normal and special-mention loans. For more information about classification standard, refer to “Risk Management – Credit Risk Management” in this annual report.

Distribution of loan portfolios by loan classification

The following table sets forth, as at the dates indicated, the loan portfolios categorised by loan classification. Under the 5-tier loan classification, the non-performing loans of the Company are classified into substandard, doubtful and loss, and the term “non-performing loans” used is of the same definition as the “impaired loans” used in the “2006 Financial Statements” of this annual report.

| | As at 31 Decemabr | | | |
|--|-------------------|-----------------------------|---------|-----------------------------|
| | 2006 | | 2005 | |
| | Amount | Percentage to the total (%) | Amount | Percentage to the total (%) |
| (in millions of RMB, excluding percentages) | | | | |
| Normal | 542,238 | 95.85 | 445,504 | 94.35 |
| Special mention | 11,458 | 2.03 | 14,514 | 3.07 |
| Substandard | 3,342 | 0.59 | 4,924 | 1.04 |
| Doubtful | 5,092 | 0.90 | 4,752 | 1.01 |
| Loss | 3,572 | 0.63 | 2,491 | 0.53 |
| Total loans and advances to customers | 565,702 | 100.00 | 472,185 | 100.00 |
| Total non-performing loans | 12,006 | 2.12 | 12,167 | 2.58 |

In 2006, the Company continued to benefit from “quality industries and quality customers”, and with the implementation of credit management framework and risk management culture, the Company was able to gradually improve credit management and loan portfolio quality. In 2006, the Company succeeded in reducing non-performing loans, and non-performing loan ratio. The year-end non-performing loan balance was RMB12.006 billion, decreased by 0.161 billion compared to the previous year. As at 2006 year end, non-performing loan ratio was 2.12%, decreased by 0.46 percentage point compared with the previous year.

In 2006, the Company took the following measures to effectively manage and monitor non-performing loans: (1) implementing target-based management on non-performing loan recovery by formulating Measures for Rewarding Recovery of Non-Performing Assets; (2) reporting, investigating and announcing new non-performing loans throughout the branches' Credit Management Department of the Company, thereby effectively preventing the occurrence and deterioration of non-performing loans; (3) establishing and improving bank-wide non-performing loan management framework and setting up Special Assets Management Centre at the Head Office, thereby effectively centralized recovery and management of bank-wide non-performing loans; (4) upgrading the credit information system, risk warning system and credit retreat mechanism; (5) improving the credit risk management procedure, formulating and amending credit examination and approval regulations such as *Regulations on Headquarters Risk Control Committee, Headquarters Credit Examination and Approval System, and Regulations on Due Diligence Investigation for Credit Loans of China Merchants Bank*, conducting industry-specific credit examination, implementing professional and vertical management on credit risks and improving the credit examination, approval and decision-making system, thereby controlling non-performing loans from the very beginning.

Distribution of loans and advances to customers and non-performing loans by product type

The following table sets forth, as at the dates indicated, our loans and advances to customers and non-performing loans by product type.

| | As at 31 December | | | | | |
|---|--------------------|----------------------------|--|--------------------|----------------------------|--|
| | 2006 | | | 2005 | | |
| | Total loan balance | Total non-performing loans | Non-performing loan ratio ⁽¹⁾ (%) | Total loan balance | Total non-performing loans | Non-performing loan ratio ⁽¹⁾ (%) |
| (in millions of RMB, excluding percentages) | | | | | | |
| Corporate loans | 359,883 | 11,452 | 3.18 | 298,622 | 11,707 | 3.92 |
| Working capital loans | 282,089 | 9,903 | 3.51 | 242,524 | 10,554 | 4.35 |
| Fixed asset loans | 60,427 | 796 | 1.32 | 38,762 | 611 | 1.58 |
| Trade finance | 12,204 | 240 | 1.97 | 13,804 | 101 | 0.73 |
| Others ⁽²⁾ | 5,163 | 513 | 9.94 | 3,532 | 441 | 12.49 |
| Discounted bills⁽³⁾ | 103,836 | 0 | 0.00 | 99,527 | 0 | 0.00 |
| Retail loans | 101,983 | 554 | 0.54 | 74,036 | 460 | 0.62 |
| Residential mortgage loans | 81,383 | 322 | 0.40 | 64,609 | 320 | 0.50 |
| Credit card balances | 10,146 | 155 | 1.53 | 4,550 | 78 | 1.71 |
| Automobile loans | 895 | 54 | 6.03 | 1,144 | 45 | 3.93 |
| Others ⁽⁴⁾ | 9,559 | 23 | 0.24 | 3,733 | 17 | 0.46 |
| Total | 565,702 | 12,006 | 2.12 | 472,185 | 12,167 | 2.58 |

(1) Percentage of non-performing loan to the total loan of the said category.

(2) Loans of this category were mainly factoring and corporate mortgage loans, including non-performing discounted commercial bills.

(3) Excluding non-performing discounted commercial bills described in Note (2). Once discounted commercial bills are classified as non-performing, the Company will classify them as non-performing corporate loans.

(4) Including retail loans secured by monetary assets, home improvement loans, education loans and general consumption loans.

MANAGEMENT DISCUSSION AND ANALYSIS

At 31 December 2006, non-performing corporate loans decreased by RMB0.255 billion, and non-performing loan ratio decreased by 0.74 percentage point. The improved quality of corporate loans was primarily attributable to the strengthened credit policies and industry research, implementation of industry-specific credit systems such as credit evaluation system and credit officer assignment system, thereby strictly implement more credit approval requirements and effectively mitigating credit risk.

At 31 December 2006, non-performing retail loan ratio decreased by 0.08 percentage point. Specifically, residential mortgage non-performing loan ratio decreased by 0.10 percentage point and credit card balances of non-performing loan ratio decreased by 0.18 percentage point. Non-performing automobile loan ratio increased by 2.10 percentage points over the beginning of the year, primarily because the balance of automobile loans decreased by RMB0.249 billion compared to the previous year.

Distribution of loans and non-performing loans by industry sectors

The following table sets forth, at the dates indicated, the distribution of loans and Non-performing loans by industry.

| | As at 31 December | | | | | |
|--------------------------------------|---|---------------------------------------|---|-----------------|---------------------------------------|---|
| | 2006 | | | 2005 | | |
| | Loan balance | Non- performing loan balance | Non- performing loan ratio ⁽¹⁾ (%) | Loan balance | Non- performing loan balance | Non- performing loan ratio ⁽¹⁾ (%) |
| | (in millions of RMB, excluding percentages) | | | | | |
| Corporate loans | 359,883 | 11,452 | 3.18 | 298,622 | 11,707 | 3.92 |
| Transportation and communications | 81,789 | 505 | 0.62 | 66,154 | 669 | 1.01 |
| Manufacturing | 82,527 | 3,168 | 3.84 | 75,735 | 3,351 | 4.42 |
| Energy and raw materials | 62,046 | 594 | 0.96 | 44,820 | 351 | 0.78 |
| Construction | 12,562 | 108 | 0.86 | 11,305 | 129 | 1.14 |
| Trade | 30,983 | 2,500 | 8.07 | 33,966 | 2,345 | 6.90 |
| Real estate | 26,775 | 2,373 | 8.86 | 20,089 | 2,830 | 14.09 |
| Investment management | 23,840 | 790 | 3.31 | 16,604 | 409 | 2.46 |
| Hospitality | 9,514 | 659 | 6.93 | 7,513 | 659 | 8.77 |
| Others ⁽²⁾ | 29,847 | 755 | 2.53 | 22,436 | 964 | 4.30 |
| Discounted bills | 103,836 | 0 | 0.00 | 99,527 | 0 | 0.00 |
| Retail loans | 101,983 | 554 | 0.54 | 74,036 | 460 | 0.62 |
| Total | 565,702 | 12,006 | 2.12 | 472,185 | 12,167 | 2.58 |

⁽¹⁾ Percentage of non-performing loans to the total loans of the said category.

⁽²⁾ Consists primarily of education, public utility, government agencies, finance, etc.

In 2006, both the non-performing loan balance and non-performing loan ratio of the Company decreased in real estate, manufacturing, transportation and communications, and construction. The improved loan quality was primarily attributable to the Company's growing credit risk management capacity and intensive integrated management on credit orientation.

The non-performing loan ratio for trade, investment management, energy and raw materials increased to some extent in 2006, which was primarily attributable to such factors as macro control in China, big fluctuations in the prices of energy and raw materials on the international markets, intensified trade barriers worldwide, deteriorating operating environment, increased industry risks, and poor operations and decreased solvency of some borrowers.

Distribution of loans by collateral

The following table sets forth, as at the dates indicated, the distribution of our loan portfolios by collateral.

| | As at 31 December | | | |
|--|--|-------------------------|----------------|-------------------------|
| | 2006 | | 2005 | |
| | Balance | Percentage of total (%) | Balance | Percentage of total (%) |
| | (in millions of RMB, excluding percentage) | | | |
| Loans secured by monetary assets ⁽¹⁾ | 145,870 | 25.79 | 135,449 | 28.69 |
| Loans secured by tangible assets, other than monetary assets | 132,943 | 23.50 | 99,435 | 21.06 |
| Guaranteed loans | 154,830 | 27.37 | 137,192 | 29.05 |
| Unsecured loans | 132,059 | 23.34 | 100,109 | 21.20 |
| Total loans and advances to customers | 565,702 | 100.00 | 472,185 | 100.00 |

⁽¹⁾ Primarily consists of loans guaranteed by pledged deposits, financial instruments (including discounted bills) and account receivables with collection right on future cash flow.



MANAGEMENT DISCUSSION AND ANALYSIS

In 2006, loans (including loans secured by monetary assets and secured by tangibles assets, other than monetary assets) collateralized by assets accounted for 49.29% of the loan portfolios of the Company, a decrease of 0.46 percentage points compared to the previous year. Amongst all, the percentage of loans secured by tangible assets, other than monetary assets increased by 2.44 percentage points, which was primarily because the Company had been taking collateral as an important means to mitigate credit risk; the percentage of loans secured by monetary assets decreased by 2.90 percentage points, which was primarily attributable to the decreased balance of discounted bills (which was classified as loans secured by monetary assets) in the loan and advances to customers, decreasing from 21.08% in 2005 to 18.35% in 2006. The percentage of unsecured loans increased by 2.14 percentage points compared to the previous year, due to the increased percentage of unsecured loans granted by the Company to quality customers in the quality industries.

Movements of allowances for impairment losses on loans and advances to customers

The following table sets forth, for the period indicated, the movements of allowances for impairment losses on loans and advances to customers of the Company.

| | As at 31 December | |
|---|----------------------|----------------------|
| | 2006 | 2005 |
| | (in millions of RMB) | (in millions of RMB) |
| At 1 January | 13,510 | 10,920 |
| Charge for the year | 4,152 | 4,031 |
| Releases for the year | (615) | (456) |
| Unwinding of discount ⁽¹⁾ | (222) | (244) |
| Recoveries of loans and advances previously written off | 58 | 84 |
| Write-offs | (328) | (745) |
| Transfers out ⁽²⁾ | (188) | (2) |
| Exchange differences | (85) | (78) |
| At 31 December | 16,282 | 13,510 |

⁽¹⁾ Represents the interest income accrued on impaired loans as a result of subsequent increases in their present values due to the passage of time.

⁽²⁾ Represents transfers out of loan loss allowances resulting from the transfer of loans and advances to customers to repossessed assets.

At the end of 2006, allowances for impairment losses on loans and advances to customers of the Company was RMB16.282 billion, and the allowances coverage (total allowances for impairment losses on loans and advances to customers/total non-performing loans) was 135.61%. Balance of loan loss allowances increased 2.772 billion compared to the previous year primarily due to: (1) total loans and advances to customers increased by 19.81%; (2) deterioration in certain loans and downgrading; (3) the estimated recoverable amount of certain non-performing loans decreased with the passage of time.

Analysis of capital adequacy ratio

The Company calculated capital adequacy ratio according to the guideline of *Regulation Governing Capital Adequacy of Commercial Banks* issued by CBRC in March 2004.

The Company adopts a prudent capital management policy and supports business development with adequate capital base. As at 31 December 2006, the capital adequacy ratio of the Company was 11.40%, up by 2.39 percentage points compared to the previous year. The increase was primarily due to the Company's issuance of H Shares in its IPO exercise during 2006, which brought RMB20.505 billion net proceeds. In addition, as at 31 December 2006, the convertible bonds of the Company were converted into shares and reported as core capital, totaling RMB6.478 billion, which also contributed to the increase of core capital adequacy ratio of the Company.

The following table sets forth, as at the dates indicated, the capital adequacy ratio and its related components.

| | As at 31 December | |
|--|----------------------|----------------|
| | 2006 | 2005 |
| | (in millions of RMB) | |
| Core capital | | |
| Paid-up ordinary share capital | 14,703 | 10,374 |
| Reserves | 38,422 | 13,466 |
| Total core capital | 53,125 | 23,840 |
| Supplementary capital | | |
| General provisions for doubtful debts | 8,005 | 6,135 |
| Term subordinated bonds | 2,100 | 2,800 |
| Convertible bonds | 22 | 5,864 |
| Investment revaluation reserve | 136 | – |
| Total supplementary capital | 10,263 | 14,799 |
| Eligible supplementary capital | 10,263 | 14,799 |
| Total capital base before deductions | 63,388 | 38,639 |
| Deductions: | | |
| – Investments in unconsolidated subsidiary and other long-term investments | 125 | 108 |
| – Investments in commercial real estate | 406 | 409 |
| Total capital base after deductions | 62,857 | 38,122 |
| Risk-weighted assets | 551,503 | 423,312 |
| Core capital adequacy ratio | 9.58% | 5.57% |
| Capital adequacy ratio | 11.40% | 9.01% |

Segment operating results

The following segment operating results are presented by business segment and geographical segment. Business segment information is more relevant to the business operations of the Company, and so the Company chooses business segment information as the primary reporting format of segment information.

MANAGEMENT DISCUSSION AND ANALYSIS

The Company evaluates the results of business segment through the internal funds transfer pricing mechanism (FTP), and the business segments effectuate capital loan at the internal interest rate based on market interest rate, and the inter-segment interest incomes and expenses confirmed by the FTP and pricing system are offset when consolidating the operating results of the Company. Net interest incomes of the respective segments, including interest income from loans to other segments and interest expense for borrowings from other segments, reflect the profit or loss of capital allocation to the business segment through the FTP. Cost distribution is based on the direct cost of related business segments and management fee distribution.

The main businesses of the Company include corporate banking, retail banking and treasury business. For more information about the products and services of the respective main businesses, refer to "Business Operations". The following table sets forth, at the periods indicated, the operating results of the business segments of the Company.

| | For the year ended 31 December | | | | | | | | | |
|---|--------------------------------|-------------------|----------------------|------------------------------|---------------|----------------------|-------------------|----------------------|------------------------------|---------------|
| | 2006 | | | | | 2005 | | | | |
| | Corporate Banking | Retail Banking | Treasury Business | Others and unallocated | Total | Corporate Banking | Retail Banking | Treasury Business | Others and unallocated | Total |
| | (in millions of RMB) | | | | | | | | | |
| External net interest income ⁽¹⁾ | 14,348 | 812 | 6,349 | - | 21,509 | 12,309 | 526 | 3,807 | - | 16,642 |
| Internal net interest (expense)/ income ⁽²⁾ | (814) | 4,086 | (3,272) | - | - | (74) | 3,488 | (3,414) | - | - |
| Net interest income | 13,534 | 4,898 | 3,077 | - | 21,509 | 12,235 | 4,014 | 393 | - | 16,642 |
| Net fee and commission income | 854 | 1,531 | 14 | 115 | 2,514 | 681 | 777 | 19 | 90 | 1,567 |
| Other net income/(expense) | 501 | 158 | 357 | (173) | 843 | 379 | 107 | 418 | 101 | 1,005 |
| Operating income/(expense) | 14,889 | 6,587 | 3,448 | (58) | 24,866 | 13,295 | 4,898 | 830 | 191 | 19,214 |
| Operating expenses | (5,882) | (4,507) | (697) | (5) | (11,091) | (4,944) | (3,637) | (530) | (4) | (9,115) |
| Provision for impairment losses | (3,241) | (533) | 83 | - | (3,691) | (3,176) | (399) | (62) | - | (3,637) |
| Total expenses | (9,123) | (5,040) | (614) | (5) | (14,782) | (8,120) | (4,036) | (592) | (4) | (12,752) |
| Profit/(loss) before tax | 5,766 | 1,547 | 2,834 | (63) | 10,084 | 5,175 | 862 | 238 | 187 | 6,462 |

⁽¹⁾ Represents net interest income earned from each segment's external customers or activities.

⁽²⁾ Represents net interest income/(expenses) attributable to each business segment's in transactions with other segments.

In 2006, the contributions made by each business segment to the profit before tax of the bank were: 57.18% in corporate banking, 15.34% in retail banking, and 28.10% in treasury business. Contribution from retail banking grew more quickly and its percentage increased. Contribution from treasury business grew considerably, primarily due to increased activities in the PRC's stock markets in 2006, resulting in an increase of inter-bank deposits of the Company.

The major outlets of the Company are located in relatively affluent regions and some large cities in other regions in China. The following table sets forth the segment results of the Company by geographical segments in 2006 and 2005.

| 2006 | Eastern China | | Southern China and Central China | | Western China | | Northern China | | Others | | Total | |
|---------------------------------------|----------------------|----|-------------------------------------|----|---------------|----|----------------|----|--------|---|---------|-----|
| | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % |
| | (in millions of RMB) | | | | | | | | | | | |
| Total operating income ⁽¹⁾ | 13,280 | 35 | 12,830 | 34 | 3,692 | 10 | 7,462 | 20 | 557 | 1 | 37,821 | 100 |
| Capital expenditure | 509 | 29 | 898 | 51 | 123 | 7 | 233 | 13 | 5 | - | 1,768 | 100 |
| Total assets | 234,884 | 25 | 481,722 | 52 | 68,741 | 7 | 122,700 | 13 | 26,055 | 3 | 934,102 | 100 |
| Gross loans and advances | | | | | | | | | | | | |
| to customers | 212,829 | 38 | 177,092 | 31 | 63,327 | 11 | 108,986 | 19 | 3,468 | 1 | 565,702 | 100 |
| Total deposits from customers | 249,848 | 32 | 246,712 | 32 | 84,898 | 11 | 167,831 | 22 | 24,468 | 3 | 773,757 | 100 |

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

⁽¹⁾ Represents the total operating income gross of interest expense, fee and commission expense.

⁽²⁾ The definition of geographical segment, please refer to Note 35 (b) to the financial statements.

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(II) BUSINESS OPERATIONS

Retail banking segment

The Company provides retail customers with diversified retail banking products and services, including retail loan, deposit, debit card, credit card, wealth management service, investment service, agency sale of insurance products and fund products, forex trading, and foreign exchange service, of which “All-in-one Card”, credit card, “Borrow & Repay Anytime”, “Sunflower” and personal internet banking have won wide spread recognition. The Company provides the above services and products via diversified channels, including branches and sub-branches, self-service centers, ATM, CDM, internet banking and telephone banking service system. As at 31 December 2006, the

retail loan balance of the Company was RMB101.983 billion, accounting for 18.03% of total loans and advances to customers; retail deposit balance was RMB311.959 billion, accounting for 40.32% of deposits from customers; operating income from retail banking accounted for 26.49% of the total operating income.

Retail loans

The Company provides retail customers with various loan products. In 2006, in view of the fierce competition in retail loans (mainly the residential mortgage loans) and intensified macro control on real estate, the Company made greater efforts to innovate and promote retail loan products, launching new products such as “Borrow & Repay Anytime”, thereby enhancing the development of credit card business, further sharpening the overall competitive edge of retail loans. As at 31 December 2006, the percentage of retail loan of total loans and advances to customers increased by 2.35 percentage points, total retail loans increased by 37.75% compared to the previous year, of which the total residential mortgage loan increased by 25.96% compared to the previous year while the total receivables of credit cards increased by 122.99% compared to the previous year.

Retail deposits

The retail deposit products of the Company mainly consist of demand deposits, time deposits and call deposits. Retail deposits are the most important source of low-cost funding of the Company. In 2006, in response to the attraction to the retail deposits from the active stock market, the Company stepped up the marketing activities such as Payroll services. In 2006, the percentage of retail deposits of total deposits from customers remained at a similar level as that of the previous year; among the retail deposits, the percentage of demand deposits increased by 2.54 percentage points to 48.87%.

Non-interest income retail business

The Company keeps developing non-interest income business in recent years, which is now on the right track of development. In 2006, the non-interest income from retail banking was RMB2.097 billion, up by 91.07% compared to the previous year. Amongst all, income from POS business was RMB548 million, an increase of 56.1% compared to the previous year; income from securities agency services was RMB0.227 billion, an increase of 383.7% compared to the previous year; and income from fund agency services was RMB0.21 billion, an increase of 442% compared to the previous year; income from agency sale of insurance was RMB0.06 billion, an increase of 115% compared to the previous year; income from credit card non-interest business was RMB0.74 billion, an increase of 80.7% compared to the previous year. Amongst all, POS service charge was RMB0.376 billion, an increase of 65% compared to the previous year; the annual fee was RMB60.15 million, up by 16.8%; and the installment service charge was RMB71.79 million, an increase of 560% compared to the previous year.

Bank card business

As at 31 December 2006, the Company had cumulatively issued 38.849 million All-in-one cards, including 2.09 million cards newly issued during the year. All-in-one Card deposit balance

was RMB240.68 billion, accounting for 77.15% of the total retail deposits, representing RMB6,195 average balance per card. As at 31 December 2006, the Company had issued 10.34 million credit cards, including 5.17 million cards issued during the year. The total number of cards in circulation was 7.12 million, the total number of card holders was 4.47 million, the cumulative transaction volume via credit cards was RMB66.4 billion, and the revolving credit card interest-earning balance was RMB3.6 billion.

Customers

As at 31 December 2006, the total number of retail deposit accounts of the Company was 23.79 million, and deposit balance was RMB311.959 billion. Among them, the total number of high-end customers (Sunflower customers, with more than RMB0.5 million deposit in the Company) was 0.142 million, and their deposit balance was RMB115.09 billion, accounting for 36.89% of the retail deposit balance of the Company.

Marketing

With the sustained efforts of the Company in brand building for its products and services, the brands such as All-in-one Card and credit



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cards have gained satisfactory recognition. In 2006, while continuously built up the above brands, the Company actively promoted the brands of "Sunflower" wealth management and "Lifetime Partner" financial planning. The Company believes that brand building will help develop customers base and enhance customer loyalty.

At present, the Company sells retail banking products primarily via its branches and sub-branches. In the meantime, to meet the market changes, the Company established a multi-level marketing system in branches. As at 31 December 2006, the Company had built up 129 financial management centers, 351 Sunflower VIP rooms and 360 VIP counters.

Corporate banking

The Company provides corporate customers, government agencies and financial institutions with diversified banking products and services. As at 31 December 2006, the corporate loan balance of the Company was RMB359.883 billion, accounting for 63.62% of the total customer loans; the total discounted bills was RMB103.836 billion, accounting for 18.35% of the total customer loans; total corporate deposit was RMB461.798 billion, accounting for 59.68% of total customer deposits; income from corporate banking business accounted for 59.88% of the total operating income of the Company.

Corporate loans

Corporate loan products of the Company include working capital loans, fixed asset loans and other loans. Other loans mainly include trade finance and factoring. In 2006, the Company actively implemented the strategy of industry focus and professionalized operations, and provided more support for quality industries such as transportation, energy and electricity, urban infrastructure and high-tech industries, while controlling loan growth to industries under macro control such as steel, cement and real estate, therefore further improving the industry structure of corporate loans.

In 2006, the Company focused on developing small and medium sized enterprises customers which is in line with the adjusted business strategies. To promote the development of small and medium sized enterprises loan business, the Company conducted pilot operations at branches in Hangzhou, Nanjing, Shenzhen, Suzhou, Ningbo, Foshan, Dongguan, Fuzhou and Xiamen, designed and launched "Go Fortune Growth Program" financial product portfolios for small and medium sized enterprises, provided such new products as floating charge, real estate collateral, trade finance and Online banking overdraft to meet the needs of small and medium sized enterprises at different stages of development, and simplified the business procedure to provide efficient and convenient credit services for small and medium sized enterprises.

The above-mentioned measures of the Company substantially increases the number of small and medium sized enterprise customers. The number of small and medium sized enterprise borrowers reached 5,720, 879 more than that of the previous year; small and medium sized enterprise customers accounted for 75.22%, up by 1.53 percentage points over the previous year; the general loan balance of small and medium sized enterprises reached RMB141 billion, up by 24.06% over the previous year.

Discounted bills

In view of the fairly low risk and high liquidity of discounted bills, the Company took it as one of the important means of assets and liabilities management. The Company launched Bill-Express business in April 2005, earlier than any of its counterparts in China. It combined traditional bills with e-banking technologies to provide customers with online application, custody, pledge, discounting and payment services, thereby building up the competitive edge of the Company on the bill markets. Since the launching of Bill Express, the annual cumulative transaction volume increased from RMB2.4 billion in 2005 to RMB21.3 billion in 2006. As at 31 December 2006, the discounted bills balance was RMB103.836 billion.

Corporate deposits

The Company made efforts to develop profitable corporate deposit products and maintain a high percentage of demand deposits in corporate deposits. In recent years, the Company made greater efforts to develop online corporate banking and cash management businesses, which became an effective channel for bank-enterprise cooperation and brought extensive demand deposits to the Company while providing customers with efficient e-banking services.

As at 31 December 2006, corporate deposit balance of the Company was RMB461.798 billion, an increase of 22.02% compared to the previous year. Specifically, demand deposits accounted for 55.70%, which was 11.40 percentage points higher than time deposits. The high proportion of demand deposits helped reducing interest expenses on deposits.

Non-interest-based Corporate banking business

An important policy of the Company in restructuring the corporate banking of the Company in recent years was to increase fee-based income. In 2006, while ensuring stable growth of income from traditional domestic and international settlements, acceptance and guarantee commitment, the Company stepped up its efforts to develop fee-based businesses such as cash management, treasury operation, asset custody, corporate annuity, financial consultation and investment banking, thereby increasing the percentage of fees and commissions income to the total income from corporate banking business. In 2006, net fee-based income of the Company was RMB1.355 billion, up by 27.83% compared to the previous year.

In respect of internet corporate banking and cash management, the Company leveraged advanced IT support to upgrade its products and technologies and diversify its products and services. The internet corporate banking of the Company provides online payment and settlement services, as well as Bank-Custom Express, Bill Express and Online Letter of Credit, to meet the needs of different enterprises for networking financial services. In 2006, the number of internet corporate banking customers reached 41,260, the annual cumulative number of transactions was 8.26 million, and the annual transaction amount was RMB4,800 billion. Besides the traditional account settlement services, the Company also provides an well-assorted range of cash management services including nominal fund management, corporate payment, corporate negotiated transfer, RMB cash pool, foreign currency cash pool, fund balance management and financial management platform. As at 31 December 2006, the number of customers using cash management service provided by the Company was 4,224, including 1,132 national corporate customers. The Company was awarded the honor of "China's Best Local Cash Management Bank" by *Asia Money* for two years consecutively in 2005 and 2006.

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In 2006, the Company completed USD91 billion international settlement, an increase of 23% compared to the previous year; the foreign exchange settlement was USD50.1 billion, an increase of 27% compared to the previous year. The cumulative non-interest income from international businesses was RMB0.9 billion.

As to the corporate wealth management, the Company launched 11 corporate wealth management products with various maturities, different investment targets and diversified operation ways. The accumulative product sales was RMB5.842 billion.

For the underwriting of short-term commercial paper, the Company has completed lead underwriting for 16 enterprises in 2006, with the lead underwriting volume of RMB16.0 billion, and the total finance amount up to RMB21.4 billion.

As to asset custody, the balance of net assets under custodian of the Company in 2006 was RMB40.9 billion, up by 19%. Particularly, securities companies integrated wealth management program under custodian was RMB11.8 billion; the corporate annuity under custodian was RMB2.38 billion, securities investment fund custodian volume was RMB21.0 billion; trust fund custodian volume was RMB3.73 billion. The Company became the third bank in China to provide QDII custodian service and the first primary custodian bank to undertake QDII products for foreign banks.

As to corporate annuity management, the number of corporate annuity contract customers was 108, 58 increase over the previous year; the total number of personal accounts of contract customers was 0.3 million, up by 200% over the previous year; and the corporate annuity management fund exceeded RMB2.5 billion. Both the business growth and size were in a leading position in the banking industry in China.

Customer base

Over the course of 20 years of development, the Company has developed 0.22 million corporate depositors and 8,000 corporate borrowers, including Chinese leading enterprises and enterprise groups, government agencies, financial institutions, and Fortune Top 500 multinational enterprises operating in China. In recent years, the Company stepped up marketing planning and focused development for target industries, forming a customer base with more rational and balanced industry pattern. Meanwhile, the Company made greater efforts to develop small and medium sized enterprises, forming a balanced customer structure. The corporate business products and services of the Company won widespread recognition among customers. According to customer satisfaction survey conducted by AC Nielson in 2006, customer satisfaction with the corporate business of the Company increased significantly as compared with last year, and customer satisfaction with the Company in provision of service, business and credit facility approval, financial products and service provision charges is in a leading position in China.

Treasury

Business strategy

In 2006, the Company made greater efforts to develop RMB and foreign currency treasury business and achieved satisfactory results while keeping various risks under proper control. The operating income of treasury business accounted for 13.87% of the total operating income of the Company.

In respect of the use of RMB funds, the Company stepped up fund operations in line with the high fund liquidity of the Company and the increased RMB interest rate. The Company enhanced fund utilization efficiency by expanding fund lending business such as taking and placing in the money markets, repurchase agreements and open market operations, and increasing investment in bonds such as bonds

issued by corporate and policy banks. The Company effectuated effective control of market risks and guaranteed return on investment by increasing investment in Central Bank bills and shortening their overall duration.

In respect of the use of foreign currency funds, in view of the uncertain market prospect of interest rate and the soaring swap rate, the Company responsively swapped floating interest rate for fixed interest rate to lock up future earnings, bought ECP with inverted yield curve, and made moderate investment in structured bonds while exercising proper risk control, thereby further enhancing return on foreign currency funds.

Operating results

In 2006, the RMB fund trading volume of the Company expanded rapidly, totaling RMB1,390 billion. Accordingly, the money market placement volume was RMB63.1 billion, repurchase volume was RMB838.7 billion, and secondary market spot trading volume was RMB482.6 billion.

In respect of bond underwriting, the Company has established extensive market partnerships and stepped up underwriting and distribution on the primary bond markets, thereby building up its good image on the markets. In 2006, the Company underwrote RMB133.6 billion bonds and distributed RMB13.0 billion bonds, and the underwriting commission reached RMB87.87 million, up by 16.9% over the previous year.

At the end of 2006, the Company duly launched products linking equity and commodity performance, QDII products, corporate liquid forex management program and personal daily forex management program, thereby maintaining a leading position in the market. In 2006, the Company launched 129 foreign currency corporate and personal integrated wealth management products, raising RMB43.7 billion proceeds; opened 44 settlement agency accounts, the

transaction volume reached RMB67.7 billion, the agency assets reached RMB36.1 billion, and transactions under various interest rate swap and forward interest rate contracts reached USD0.623 billion.

Business development

In respect of forex trading, the Company developed China's first self-service forex option product with 24-hour continuous quotation, and through professional design, made forex options available for trading by common investors in China. In respect of RMB wealth management, the Dealing Centre launched "GoFortune" corporate integrated financial management product series, "Daily Wealth" personal liquidity financial management product, liquidity financial management product linked to CMB money market fund index, single customer financial management business, as well as energy-related non-guaranteed financial product and high-grade wealth management trust product.

Product Pricing

Loans

The interest rates of RMB-denominated loans of the Company are regulated by the PBOC. The interest rate of RMB-denominated corporate loans and retail loans is not permitted to be lower than 90% of the relevant PBOC benchmark rate. The interest rate of residential mortgage loans is not allowed to be lower 85% of the benchmark rate. Interest rates for foreign currency-denominated loans are generally not subject to PRC regulatory restrictions.

We price our products based on various criteria, such as the borrower's financial condition, value of collateral, the intended use and term of the loan, cost of providing the loan, credit and other risks, expected rates of return, our market position and the prices of our competitors. We have started using the FTP method to calculate the cost of our funds in connection with the extension of loans. We are in

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the process of developing loan pricing models that assist us to determine the minimum interest rates at which our loan products may be priced. We permit our branches to set prices at their discretion within the established ranges of these internal benchmark prices and give them greater flexibility to compete effectively.

Deposits

Under current PRC laws and regulations, interest rates for our RMB-denominated demand and general time deposits cannot be higher than the relevant PBOC benchmark rate. The PBOC has liberalized interest rates charged for lendings and deposits between financial institutions. As such, we are permitted to provide negotiated time deposits to insurance companies, the National Council for Social Security Fund and China Post. In addition, we are permitted to negotiate the interest rates on foreign currency deposits other than those denominated in U.S. dollars, Euros, Japanese Yen and HK dollars in an amount less than US\$3 million. Interest rates on inter-bank foreign currency deposits and foreign currency deposits by non-PRC residents are generally not subject to PRC regulatory restrictions.

Non-interest-based Businesses

With respect to non-interest-based businesses, certain services are subject to government guideline prices, including basic Renminbi settlement business such as bank demand draft, bank acceptance, cashier order, cheque foreign exchange, agency receipt and the other services specified by the CBRC and the National Development and Reform Commission. The basis of charges of other products and services is based on market conditions.

Distribution channels

The Company provides products and services via different distribution channels. As at 31 December

2006, the Company had 36 branches, 464 sub-branches (including offices), 1 representative office, 1,050 self-service centres and 812 machines (ATM & CDM) across China. The efficient outlet network of the Company are primarily located in developed areas in China such as Yangtze River Delta, Pearl River Delta and Bohai Rim, and some large cities in other areas. Besides expanding physical distribution channels, the Company also made efforts to develop and improve e-banking channels such as internet banking and telephone banking. The highly acclaimed online retail banking of the Company has effectively relieved the pressure on the business outlets of the Company. The number of transactions on the professional version of internet banking was 20.07 million, up by 84% year on year, and the number of online payments was 24.60 million, up by 139% year on year.

Overseas businesses

The Company provides overseas banking business, including corporate and retail banking, via its Hong Kong Branch established in 2002. The total assets of Hong Kong Branch was HK\$26.1 billion at the end of 2006.

Corporate banking services provided by Hong Kong Branch includes loan and deposit, remittance, international trade facility and settlement, organizing or participating in syndicated loan, and participating in inter-bank transaction of funds and bonds. Retail banking includes providing services for individual customers remitting between Hong Kong and the Mainland, and the featured product is the Mainland-Hong Kong All-in-one Card. This card combines the strengths of Hong Kong debit card and Mainland debit card. The cardholder can withdraw cash from ATM and spend money via POS in both Hong Kong and the Mainland, and enjoy real-time online remittance service between the two places.

The Company has also established a wholly-owned subsidiary, CMB International Capital Corporation Limited in Hong Kong, which mainly provides

investment banking services such as advisory work on corporate finance, IPO underwriting, and securities brokerage, etc.

The Company has set up a representative office in New York, and the Company is currently applying for upgrading it into Branch.

Information technology

In 2006, the Company completed the construction of the Electronic Research & Development Center and put into use. The main equipment room was relocated; bank-wide system integration was successfully completed, which strengthening real-time monitoring of bank-wide information systems, and providing abundant basic data for business development and decision making; the increased effort in operations management contributes to stable operation of the business systems over the year. The Company launched the new core banking system in ten branches; meanwhile, the Company continued to develop application systems and launched a range of products, including financial management, facility, foreign exchange, retail loan, corporate fund management, small and medium enterprises, internet banking, payment and settlement, credit card, intermediate business and various e-channels. The reporting system, funds transfer pricing system (FTP) and customer relations management system (CRM) of the Bank have been put into operation, and the profit reporting system, residential mortgage evaluation card project and internal credit rating system are under upgrading.

Problems and difficulties in operations and their solutions

In 2006, the continued macro control, rapid development of direct financing, excessive liquidity, inflation, and pressure arising from RMB appreciation has accelerated the interest rate marketization. This requires higher capability of deposits and loans pricing and identifying risks. As China extensively opened up its financial markets, domestic and foreign banks



compete heatedly in products, businesses, human resources, customers, technologies, internal management and brand building.

The Company has done the following to meet the challenges in operations:

1. Under the pressure of macro control policies, the Company followed the guidelines of "Updating the mindset, deepening the reform, strengthening innovation and preventing risks", advanced the adjustment of operational strategies and management internationalization, stepped up loan limit control and restructuring in line with the macro control requirements, thereby accomplishing all the tasks set for the year.
2. The Company changed its perception of risk from the previous focus on risk control to the modern concept of risk management. The new initiatives undertaken by the Bank include the following: implement credit portfolio management by means of providing more detailed credit approval policies and procedures manual; develop tolerable risk management; improve market risk management framework; enhance the function of The Assets and Liabilities Management Committee ("ALCO") on the Bank's market risk management; increase effort during the onsite and offsite inspection of branches; improve recovery of non-performing assets by the implementation of effective recovery procedures; manage liquidity risk to ensure stable

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funding source by making use of the FTP and the analyses of market rates; and mitigate exchange rate risk by means of evaluation of exchange rate risk and formulation of related strategy for immediate actions.

3. Further optimisation of resource allocation by priority and strategic orientation. Stepped up outlet construction and improved outlet layout from the strategic perspective, increased investment in IT equipment upgrading and system network building, and stepped up human resources training and retention. In operations management, improved resource allocation can be achieved by budget management, income distribution, investment and fixed assets management.
4. Stepped up product innovation and marketing. Sped up innovating featured products in financial management, personal assets management, corporate cash management and trade finance. Stepped up brand building such as “Sunflower Wealth Management”, “Lifetime Partner” and “GoFortune” by combined marketing efforts on various businesses, the Company actively developed businesses for small and medium enterprises, and promoted the rapid development of retail banking, wholesale banking and inter-bank businesses.

(III) RISK MANAGEMENT

As a commercial bank, the Company mainly faces credit risk, liquidity risk, market risk and operational risk. The Company is well aware of such risks and is making continued efforts to enhance its risk management ability by building a bank-wide risk management system and prudent risk management culture, optimizing risk management framework, improving risk management policy and procedure, and using advanced risk measurement and management tools, thereby effectively controlling risks, effectuating

growth and increasing return after risk adjustment while maintaining good quality of assets. Throughout the year, the operation of the Company is not adversely affected by these risks.

Credit Risk management

Credit risk refers to risk arising from failure of the borrower or the counterparty of the Bank to fulfill its obligations under the negotiated terms and conditions. The credit risk faced by the Company mainly comes from loan portfolio, investment portfolio, guarantee, etc.

The Company has formulated and implemented bank-wide policy and procedure, including credit risk identification, measurement, monitoring and management, to control the credit risk of the Company. The credit risk management process of the Company consists of credit application and investigation, credit review and approval, loan disbursement, and post-disbursement inspection.

To effectively control the possible credit risk from credit business and product development, the Company formulates credit management manual, adjust credit direction policy, optimize credit structure and asset portfolio, optimize credit business operation standard and procedure, speed up improving credit information system, customer credit rating and performance evaluation system, etc.

Corporate loans

Loan application and investigation report. The Company usually starts the loan application procedure by interviewing the credit applicants. The account manager prepares the investigation report by analyzing the application documents submitted by the applicant, combined with the findings in onsite investigation and the score obtained from the customer credit rating system.

Credit review and approval. The credit application is reviewed and approved by the branch or the Head Office based on the approval limit. The Company establishes credit review teams specialised in different industries at the Head Office at the beginning of the year. Through industry-specific credit review, the Company can better evaluate the credit risks of different industries and enhance the credit review and approval efficiency.

Loan disbursement. Loan disbursement center is in charge of the loan disbursement of each branch. The loan disbursement center shall check relevant documents before releasing any loan to ensure that the loan is duly reviewed, approved and supported by appropriate loan documents.

Post-disbursement inspection

(1) **Loan classification.** The loan classification of the Company is mainly based on the solvency of borrowers as well as other factors such as borrowers' loan repayment records, repayment intention, collateral type and the length of overdue period. The sub-branches and branches of the Company collect, check and confirm the loan classification information and report to the Credit Management Department of the Head Office. The Credit Management Department of the Head Office may require the branches to adjust loan classification based on the information obtained from the loan monitoring system or other channels. The Company classifies loans into five tiers according to the requirements of CBRC and reports the classification data to CBRC on a monthly basis. To strengthen credit risk management, the Company begins from September 2005 to further classify normal loans into excellent and good loans and classify special mention loans into general mention and special mention loans.

(2) **Management and collection of non-performing loans.** The Credit Management Department of the Company is responsible for managing, coordinating, monitoring and analyzing non-performing loans. Special Assets Management Center of the Head Office is responsible for collection, restructuring, arbitration and lawsuit, auction, disposal, etc. of corporate non-performing loans.

The Company mainly takes the following measures for collection of non-performing loans: (1) sending a demand notice; (2) restructuring the non-performing loans; (3) exercising the right to dispose of collateral or to recover the loan from the guarantor; (4) recovering the loan by lodging legal proceedings or arbitration procedure. If recovery is confirmed as impossible, the Company will write off the loan in accordance with relevant regulations of the Ministry of Finance.

Retail loans

The Company provides retail loans strictly in accordance with relevant state regulations on retail loans. At the same time, the Company has formulated specific credit review and approval procedure and standard loan operation procedure based on the risk characteristics of different retail loan products. In respect of loan approval process, the Company has set a 3-level retail loan review and approval authority at the Head Office, branch and sub-branch according to different regions and different business products. In respect of pre-granting investigation, the Company focuses on analyzing and evaluating the financial position, past credit information and the market value of the collateral of the applicant. Prior to loan disbursement, the Company established retail loan review procedures, approval centers and retail loan release centers to ensure intensive, procedural and standard management of retail loan business. In respect of post-disbursement management, the

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Company manages overdue loans by reviewing regular reports generated by the credit management systems in real time analysing the length of overdue period, taking such measures as verbal dunning, written dunning, doorstep demand notices and legal proceedings to recover overdue loans. These measures constantly improve the quality of retail loans of the Company.

Liquidity risk management

Liquidity risk refers to the risk that funds will not be available to meet liabilities as they fall due by realising the assets at appropriate prices. The liquidity risk of the Company mainly comes from fund provision activities such as loans, transactions and investments, as well as management of liquid assets.

The ALCO of the Company is responsible for formulating liquidity risk management policies, and the Planning and Finance Department under the Committee is responsible for daily liquidity risk management, monitoring and analysing the daily, monthly and quarterly liquidity of the Company, and making decisions on liquidity risk management within the authorised range.

The Company implements centralised management on bank-wide liquidity via FTP. In respect of assets, the Company maintained adequate liquidity of its assets by maintaining an appropriate percentage of discounted bills in the total assets and allocating high-liquidity short-term assets such as money market placement, repurchase agreement and investment in Central Bank bills. In respect of liabilities, the Company secured funding sources via diversified channels including PBOC open market, inter-bank money market and inter-bank bill market. At the general meeting held in May 2006, the Company obtained authorization of shareholders to issue financial bonds in the coming three years by a certain percentage of the total liabilities of the Company, thereby meeting the daily liquidity requirements.

The Company sets various percentage requirements (including but not limited to loan-to-deposit ratio, provision ratio and guided target ratio for every branch) and transaction amount limits based on the overall position of assets and liabilities of the Company, in order to monitor and manage liquidity risk; and formulated liquidity warning mechanism and liquidity management system to daily monitor the position shortage of every branch to ensure adequate liquidity.

The Company measured and monitored liquidity net position and liquidity ratio through the assets and liabilities management information system, and conducted liquidity scenario analysis and liquidity stress test for the Company as a whole. The Company has established a liquidity risk reporting system to keep the senior management updated about the liquidity risk.

| | As at 31 December 2006 | | | | | | | | |
|---|------------------------|-------------------|---|--|---|------------------|---------------|--------------|----------------|
| | Repayable on demand | Within 1 month | After 1 month but within 3 months | After 3 months but within 1 year | After 1 year but within 5 years | After 5 years | Undated | Overdue | Total |
| (in millions of RMB) | | | | | | | | | |
| Assets | | | | | | | | | |
| Cash and balances with Central Bank | 29,324 | - | - | - | - | - | 57,670 | - | 86,994 |
| Amounts due from banks and other financial institutions | 13,282 | 58,826 | 15,104 | 15,568 | 1,591 | 39 | - | - | 104,410 |
| Loans and advances to customers | - | 49,314 | 93,463 | 228,092 | 66,783 | 108,718 | - | 3,050 | 549,420 |
| Investments | 6,914 | 10,843 | 12,698 | 59,374 | 69,726 | 19,079 | 251 | - | 178,885 |
| Other assets | 3,679 | 302 | 326 | 174 | 243 | 9 | 9,636 | 24 | 14,393 |
| Total assets | 53,199 | 119,285 | 121,591 | 303,208 | 138,343 | 127,845 | 67,557 | 3,074 | 934,102 |
| Liabilities | | | | | | | | | |
| Amounts due to banks and other financial institutions | 53,405 | 4,704 | 4,530 | 7,359 | 6,605 | - | - | - | 76,603 |
| Deposits from customers | 489,451 | 46,856 | 66,385 | 141,802 | 27,610 | 1,653 | - | - | 773,757 |
| Financial liabilities at fair value through profit or loss | - | - | - | - | - | - | 106 | - | 106 |
| Certificates of deposit issued | - | - | - | 1,170 | - | - | - | - | 1,170 |
| Convertible bonds issued | - | - | - | - | 22 | - | - | - | 22 |
| Other debts issued | - | - | - | - | 9,987 | - | - | - | 9,987 |
| Subordinated notes issued | - | - | - | - | 3,500 | - | - | - | 3,500 |
| Other liabilities | 10,242 | 532 | 1,841 | 881 | 228 | 73 | - | - | 13,797 |
| Total liabilities | 553,098 | 52,092 | 72,756 | 151,212 | 47,952 | 1,726 | 106 | - | 878,942 |
| Long/(short) position | (499,899) | 67,193 | 48,835 | 151,996 | 90,391 | 126,119 | 67,451 | 3,074 | 55,160 |
| Cumulative long/(short) position | (499,899) | (432,706) | (383,871) | (231,875) | (141,484) | (15,365) | 52,086 | 55,160 | - |

Long/(short) position of the Company in 2006 was RMB55.160 billion and short position for immediate repayment was RMB499.899 billion, which was primarily because there were huge RMB demand deposits, accounting for approximately 50% or above of customer deposits. The deposition ratio of RMB demand deposits remained above 70% in the recent two years, therefore the liquidity risk of immediate repayment was quite small.

MANAGEMENT DISCUSSION AND ANALYSIS



Market risk management

Market risk refers to the risk of unfavorable impact on the value of assets and liabilities or net income of the Company from market changes. The ALCO of the Company is responsible for bank-wide market risk management, including formulating market risk management strategies and policies, supervising implementation of market risk management policies, reviewing market risk analysis and report, and making decisions on relevant risk management policies. The Planning and Finance Department under the ALCO is responsible for formulating market risk management guidelines and granting authorization for fund dealings, setting market risk limits for investments and treasury dealing, and monitoring the execution.

The Company implemented centralized market risk management by formulating uniform market risk management policy and procedure, improving FTP mechanism, strengthening basic data management and using the assets and liabilities management information system.

Concerning the existing market risks in bank accounts and transaction accounts, the Company used different measurement methods, including but not limited to value at risk (VAR), gap analysis, sensitivity analysis and stress test, and has basically established a temporary system for regular reporting of market risks and important risk events, in order to keep the senior management updated and informed of the market risks.

Interest rate risk management

Interest rate risk refers to the risk of unfavorable impact on the financial positions of banks from fluctuating interest rates. The primary interest rate risks of the Company are mainly mismatching risk in repricing maturity and basis risk. Mismatch may put the net interest income or market price of the assets of the Company under the impact of interest rate fluctuations. The short-term target of interest rate risk management of the Company is to maintain stable growth of net interest income of the Company, and the long-term target is to gradually increase the market price of the assets of the Company. The Company is alert of the domestic and overseas interest rate environments and manages and analyses the interest rate risks of the Company accordingly. The Company monitors and manages the overall interest rate risk of the assets and liabilities portfolio of the Company by quantitative methods, including but not limited to VAR, gap analysis, duration analysis and scenario analysis, and uses the assets and liabilities management system to prepare regular and ad-hoc analysis and report.

| | As at 31 December 2006 | | | | | | |
|--|-------------------------|--------------------------------------|-------------------------|------------------------|---------------|----------------------|----------------|
| | Effective interest rate | 3 months or less (including overdue) | Over 3 months to 1 year | Over 1 year to 5 years | Over 5 years | Non-interest bearing | Total |
| (in millions of RMB) | | | | | | | |
| Assets | | | | | | | |
| Cash and balances with central bank | 0.00%-1.89% | 82,372 | - | - | - | 4,622 | 86,994 |
| Amounts due from banks and other financial institutions | 0.41%-6.22% | 97,752 | 5,583 | 1,075 | - | - | 104,410 |
| Loans and advances to customers | 0.00%-18.00% | 332,397 | 202,096 | 12,559 | 2,368 | - | 549,420 |
| Investments | 1.75%-9.05% | 45,668 | 86,730 | 35,008 | 11,228 | 251 | 178,885 |
| Other assets | - | - | - | - | - | 14,393 | 14,393 |
| Total assets | | 558,189 | 294,409 | 48,642 | 13,596 | 19,266 | 934,102 |
| Liabilities | | | | | | | |
| Amounts due to banks and other financial institutions | 0.00%-6.20% | 73,563 | 3,040 | - | - | - | 76,603 |
| Deposits from customers | 0.00%-7.00% | 616,189 | 131,932 | 25,199 | 437 | - | 773,757 |
| Financial liabilities at fair value through profit or loss | - | - | - | - | - | 106 | 106 |
| Certificates of deposit issued | 5.72% | 1,170 | - | - | - | - | 1,170 |
| Convertible bonds issued | 6.39% | - | - | 22 | - | - | 22 |
| Other debts issued | 2.34% | - | - | 9,987 | - | - | 9,987 |
| Subordinated notes issued | 4.74% | - | - | 3,500 | - | - | 3,500 |
| Other liabilities | - | - | - | - | - | 13,797 | 13,797 |
| Total liabilities | | 690,922 | 134,972 | 38,708 | 437 | 13,903 | 878,942 |
| Asset-liability Gap | | (132,733) | 159,437 | 9,934 | 13,159 | 5,363 | 55,160 |
| Cumulative asset-liability gap | | (132,733) | 26,704 | 36,638 | 49,797 | 55,160 | - |

As shown in the table of asset-liability gap, in 2006, the asset-liability gap of the Company was RMB132.733 billion in 3 months, which was due to the demand deposits (interest rate sensitive liabilities) of the Company accounted for over 50% of customer deposits. In view of the raise of interest rates in the past, the Central Bank has seldom changed the interest rate of demand deposits, the interest rate risk faced by asset-liability gap within 3 months is very small.

MANAGEMENT DISCUSSION AND ANALYSIS

Currency risk management

Exchange rate risks mainly come from currency mismatches of assets and liabilities in self-operating businesses and agency businesses and currency position mismatch resulting from foreign currency transactions. Exchange rate risks faced by the Company come from holding loans, deposits, securities and other financial derivatives not denominated in RMB.

To manage the exchange rate risks resulting from self-operating and agency businesses, the Company made efforts to match exposures in various currencies, conducted timely back-to-back cut-off to restrict the exchange rate risk exposure, and conducted hedging on the forex markets. Also, the Company reduced currency risks by setting exposure upper limit and stop-loss limit.

The Company paid special attention to the continuing and wide spread anticipation of appreciation of RMB against US dollar, and in June 2005, changed next-day trade to day trade for the settlement of exposure between RMB and major foreign currencies, and strictly controlled forex exposure.

Operational risk management

Operational risk refers to the risk of loss arising from inappropriate or unsounded internal procedure, personnel and system or external incidents. The Company reduces and controls the operational risk by strengthening internal control, enhancing the risk prevention awareness and ability of staff and implementing a strict accountability system. Major measures taken in 2006:

- (1) restructured the organization and management framework and risk management system, established compliance department at Head Office to specialize the compliance management;
- (2) stepped up inter-department independence and coordination to promote professional management;
- (3) handled specific cases and dealt with commercial bribery cases; implemented comprehensive self-inspection and review at all level of branches, further implemented the accountability system, and stepped up penalty on misconducts of staff;
- (4) implemented “bank-wide and comprehensive” internal control and enhance internal control level according to international banking industry standard and the requirements of regulatory authority and investors following the H share listing. The internal audit departments intensified inspections and reports on high-risk businesses and improper operations. The Head Office and branches of the Company held quarterly internal control evaluation meetings to evaluate and analyze internal and external improper operations, misconducts and illegal practices, and improve the risk prevention and internal control mechanisms;
- (5) regarding the information technology, the Company enhanced the set-up of production center of the information technology department and disaster recovery center, so as to improve the capability of the anti-disaster system; enhanced the security of the application system, strengthened the security management of the information system; formulated the system and regulations in respect of the use of key, maintainance of servers, computer-related emergency cases and security of audit data accordingly. The number of branches operating new integrated business systems increased from 9 to 18, systematically improving the accounting, saving and fee base business operation procedure and control procedure; developed a monitoring and analysis system of suspicious RMB transactions with reference to the monitoring requirements of anti-money laundering of the CBRC and the PBOC;

(6) Through providing training to department head, branch general managers and sub-branch managers on internal control and criminal case prevention, the Company has cultivated bank-wide awareness of laws, and the culture of compliance.

Misconduct reporting and monitoring

The Company has established a system to report cases, accidents and major events. Branches at various levels shall, as required by the Head Office, report their respective cases, accidents and major events to the Head Office within 24 hours, and submit relevant statistics to the Head Office on a regular basis. In addition, the Company reports misconducts and major accidents of staff to CBRC.

In 2006, the Company received reports of 2 staff criminal cases, involving a total of RMB0.79 million. 1 case was mis-appropriation of customer loan, involving RMB0.49 million; 1 case was commercial bribery, involving RMB0.3 million. The above 2 cases did not have major impacts on the business, financial position and operating result of the Company.

In 2006, 4 branches of the Company were fined a total of RMB2.95 million by PBOC for violating the regulations against money laundering. The fines were mainly due to omission or inadequate information in the reporting of suspicious transactions for submission to CBRC. Such fines did not have major impacts on the business and operating result of the Company.

Internal audit

The internal audit departments of the Company audit all the business and management activities of the Company, independently inspect and assess the risk management and internal control conditions of the Company, and provide improvement suggestions to the senior management. The internal audit department of the Company, which is independent of the operating units that being inspected and supervised, reports the audit results directly to the Board of Directors, Board of Supervisors and the president. The remuneration, performance evaluation and appointment of internal auditors of the Company are managed by the Head Office.

In 2006, the risk assessment performed by the internal audit departments of the Company covered lending business, treasury, accounting and financial reporting, retail banking, and information system of the Company. The details of risk assessment include: compliance with the laws, regulations and Company policies and procedures; validity of the risk management policies and procedures of the Company; coverage and validity of the internal control system of the Company; whether defects found in the inspection and evaluation process are corrected accordingly, etc.

In response to defects found by the internal audit department, the Company requires the corresponding superordinate departments and the units with defects to jointly make corrections. The correction results were included in the performance evaluation of the branches concerned in 2006.

MANAGEMENT DISCUSSION AND ANALYSIS

(IV) OUTLOOK

2007 is a year of continuing operational adjustment and management internationalization of the Company. In its operations management, the Company is both blessed with development opportunities brought by sustainable economic growth and improved financial ecosystem, and confronted with challenges posed by escalating inter-bank competition and greater financial risks.

From the business environment perspective, the sustaintive economic growth, the accelerated reform of the social security system, and the increasing income and changing consumption pattern of the public have created opportunities for the stable growth in business scale and profits of the Company and provided substantial support for our strategic transformation and restructuring. The accelerated marketization of interest rates and exchange rates provides further room for the financial innovation of the Company. The rapid development of the financial markets, especially the capital market, and the relaxed business environment provide favorable condition for the Company to explore new business frontiers, which will contribute to the rapid growth of net non-interest income.

In respect of industry developments, the extensive opening of the banking industry to the outside world will escalate inter-bank competition. Foreign banks expand partnership, increase equity investment, and

strive for high-end customers and retail banking markets in China; state-owned banks reform their shareholding structure and transform their operation mechanism, thereby reinforcing their strength in scale; small and medium sized joint-stock banks speed up operation transformation and use advanced technologies to develop new financial products; urban commercial banks invigorate themselves by speeding up ownership system restructuring and bank capital restructure, and some urban commercial banks are doing well in trans-regional operations. The escalating inter-bank competition lays pressure in our business development, profitability and human resources.

The development of the Company is also affected by uncertainties in the market. The structural contradictions still exist in economic development, and the escalating macro control is a challenge for the adjustment of business structure and customer structure and credit risk management of the Company. The changes in financing pattern arising from rapid development of the capital market and securities market and redundant capital liquidity pose challenges to the traditional income mode and profitability based on differential interest rates. Internationalized regulation presents higher requirements for the risk quantification and capital management of the Company. The accelerated marketization of interest rates and exchange rates has some impact and pressure for us on the market risk management and pricing of the Company.

In response to the opportunities and challenges ahead brought by social and economic development, the Company undertakes to develop itself into China's best commercial bank with international competitiveness by speeding up reform, taking effective measures to break through bottlenecks in risk management, internal distribution, IT support, human resources, etc., and speeding up shaking off the traditional operations management concept and modes and building up new core competitiveness. The Company will, 1. give full play to the core function of capital management in assets and liabilities management and improve capital allocation in order to provide substantial support for strategic adjustment of business operations; 2. step up reforming the retail banking management system, maintain and expand the high-end retail customer base, improve the personal asset business system, promote marketing of retail banking portfolios, and further develop credit card business; 3. steadily reform the corporate banking management system, actively and steadily develop business products oriented to small and medium enterprises, and create featured corporate banking business. 4. step up product integration and innovation and maintain the rapid development of Fee-base Business; 5. enhance risk management awareness and risk management level to improve the assets quality; 6. reinforce the base for system security, speed up promoting new systems, strengthen management of basic data, and enhance IP support capacity; 7. step up human resources training, and improve the staff incentive system; 8. strengthen evaluation of service quality and standardize the service management procedure to improve the service quality.