



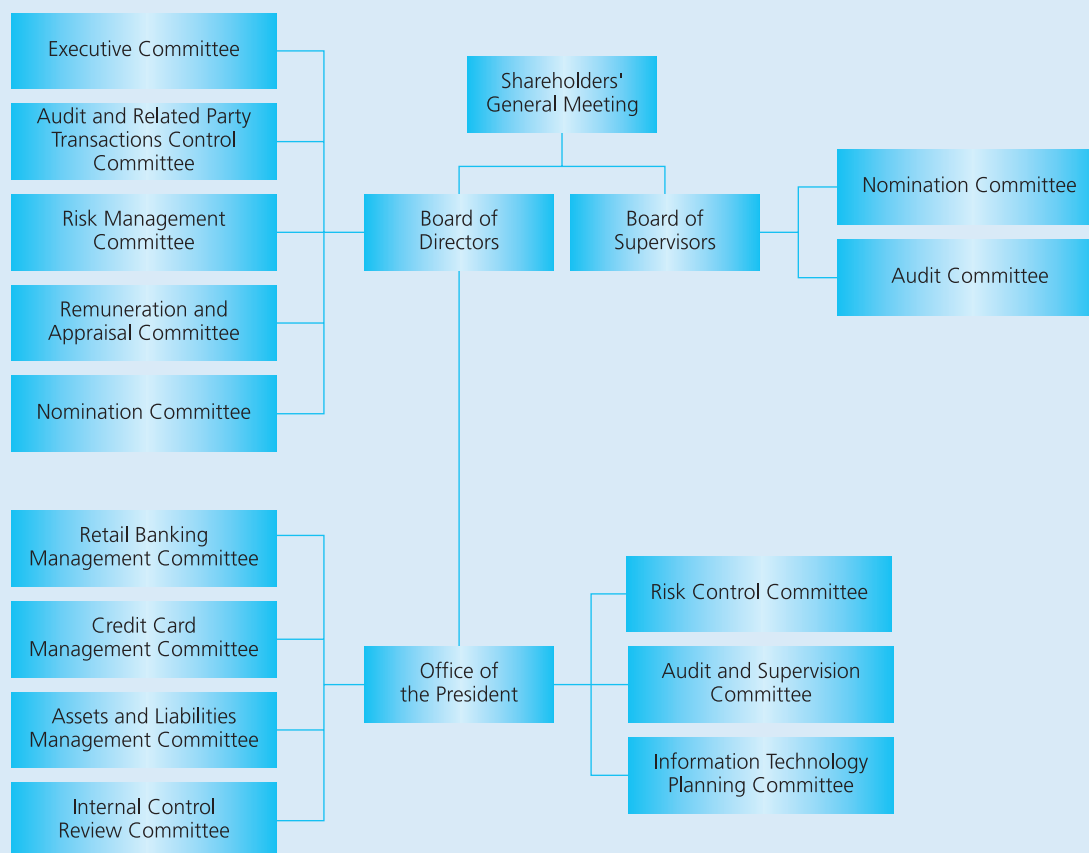


The Bank has taken the initiative to undertake a number of measures that combined market explorations and innovations in respect of products and services, which created dozens of “No. 1” records. The Bank has built up a number of well-known brand names such as “All-in-one Card”, “All-in-one Net”, “Sunflower”, “Go Fortune”, “China Merchants Bank Credit Card”, and “Wealth Management Account” etc. which have won a number of awards and have enabled the Bank to establish the social image of a technology-leading bank.

“All-in-one Card” is recognised as a breakthrough new product of personal savings for domestic market, with an average deposits per card maintaining at the leading place among domestic banks. “All-in-one Net”, the country’s first internet banking system, has again been in the leading place both in terms of its technical capacity and counter-replacement ratio. “Sunflower”, which is the first financial service of its kind offered to high-end clients in the domestic market, is ranked the top financial brand among affluent clients. “Wealth Management Account” is the country’s first integrated wealth management account comprising fund allocation, investment and smart wealth management services. It is recognised as a pioneering personal financial service product in the 3G era of the PRC. “China Merchants Bank Credit Card” is the first credit card in the domestic market for dual currencies dealing which meets the international standard. The issuing volume of the card has exceeded 10 million in four years’ time, with the profitability and asset quality reached the international advanced level. The card was chosen as a study case for MBA courses in Harvard University. “Go Fortune” is a corporate financial service brand name with the most comprehensive and unique features, and has strong competitive strengths in business areas like cash management, small and medium enterprise finance, off-shore financial services.

CORPORATE GOVERNANCE REPORT

Governance Structure of the Company



The business objective of the Company is to maximize the return to shareholders and protect the interests of the depositors and other creditors. The Company believes that good corporate governance is essential for maintaining and enhancing shareholders' value and investors' confidence.

Since the listing of its A Shares in Mainland China, the Company has, in accordance with PRC regulations and the practical situations of the Company, established a comprehensive corporate governance structure to enhance the checks and balance between the shareholders' general meeting, the Board of Directors and the Board of Supervisors, and has also made the effort to constantly enhance the corporate governance standard. The Board of Directors has established five specialised committees, i.e. the Executive Committee, the Audit and Related Party

Transactions Control Committee, the Risk Management Committee, the Remuneration and Appraisal Committee and the Nomination Committee; the Board of Supervisors has established two specialised committees, i.e. the Audit Committee and the Nomination Committee. The Board of Directors, the Board of Supervisors and their specialised committees perform their duties in accordance with the regulations and requirements of CBRC, CSRC and SEHK, the Articles of Association of the Company and the related Procedural Rules to effectively enhance the corporate governance and operational efficiency of the Company.

In 2006, after promulgation of the new *Company Law*, *Securities Law* and *Guidelines on Articles of Association of Listed Companies*, and in anticipation of the issuance of H Shares of the Company, the Company made significant amendments to its *Articles of Association* as per the domestic and overseas regulatory requirements after obtaining approval from CBRC. In addition, as per the regulatory requirements, the Company made proactive measures to improve the following areas of corporate governance: 1. further strengthened the management and approval of related party transactions by the Board of Directors; 2. enhanced the composition of members for the Audit and Related Party Transactions Control Committee under the Board of Directors; 3. commenced the performance evaluation of the directors by the Board of Supervisors at the end of 2006; 4. further strengthened the training of directors and supervisors; 5. purchased liability insurance for directors, supervisors and senior executives.

Save as disclosed below, the Company has met the code provisions as set out in the *Code on Corporate Governance Practices* contained in Appendix 14 of the Listing Rules of the SEHK and has strived to maintain high standard of corporate governance.

The key corporate governance principles and practices of the Company are summarised as follows:

A. THE BOARD OF DIRECTORS

The Company is led by an effective Board of Directors, which is responsible for leading and monitoring the Company. The Board of Directors primarily determines the Bank's strategic direction and approves its operating plans through a well-structured decision making mechanism. The directors make decisions objectively in the interests of the Company.

A.1 Membership of the Board of Directors

The determination of the size of the Board is based on the shareholding structure of the Company, relevant regulations and the business needs and practical situation of the Company. As at 31 December 2006, the Board had 17 directors, including 9 non-executive directors, 6 independent non-executive directors, and 2 executive directors, who have no relationship between each other. Non-executive directors nominated by the shareholders all come from large state-owned enterprises and are experienced in management of international enterprises. Most of them have work experience in the financial industry. The six independent non-executive directors are leaders of large enterprises or renowned professional scholars who have extensive knowledge of the development of China and international banking industry. Among our independent non-executive directors, two of them are accounting professional, three are experts in financial industry, and one from Hong Kong who is proficient in international accounting standard and Hong Kong capital market. The composition of the Board of Directors exhibits strong independent elements, which enable the Board to make independent judgements effectively.

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The list of directors is set out on page 118 of this Annual Report. To comply with the Listing Rules, the independent non-executive directors have been clearly identified in all corporate communications of the Company which disclose their names.

The qualifications of the six independent non-executive directors of the Company fully comply with Rule 3.13 of the *Listing Rules*. Also, the Company has received the written annual confirmation from each independent non-executive director of his/her independence pursuant to the *Listing Rules*. Accordingly, the Company considers all the independent non-executive directors to be independent.

A.2 Appointment, re-election and removal of directors

In accordance with the Articles of Association of the Company, directors shall be elected or replaced by shareholders in general meeting, and the term of the directors shall be three years. The term of a director is renewable by re-election after its expiry. Upon expiry of the 3-year term of office, an independent non-executive director may continue to serve as a director of the Company, but not as an independent non-executive director.

The procedures for appointment, re-election and removal of directors of the Company are set out in the Articles of Association of the Company. The Nomination Committee of the Company carefully considers the qualifications and experiences of every candidate for director and recommends suitable

candidates to the Board. Upon passing the candidate nomination proposal, the Board proposes election of related candidates at a general meeting. The term of a director shall start from the date upon which the resolution for the appointment is passed at the general meeting to the expiry of the current Board.

Save for the independent non-executive directors, other new directors shall, upon expiry of the current Board (the term of office of each Board is 3 years), be subject to re-election by shareholders together with other members of the Board, and they will not be subject to re-election at the first general meeting after their appointment.

A.3 Responsibilities of directors

All directors are fully aware of their responsibilities as directors of the Company and understand that they need to give sufficient time and attention to the affairs of the Company. The attendance of the respective directors in the Board meetings for the year ended 31 December 2006 has been satisfactory.

Non-executive directors provide the Board with extensive business and financial expertise, experience and independent judgement. The non-executive directors make various contributions to the effective direction of the Company by participating in Board meetings and offering independent opinions, taking the lead where potential conflicts of interests

arise, serving as members of various governance committees of the Board and scrutinising the performance of the Company, etc.

In addition, all newly appointed directors of the Company will receive training and induction on the first appointment to ensure that they have a proper understanding of the operations and businesses of the Company and that they are fully aware of their responsibilities and obligations under the *Hong Kong Listing Rules*, applicable laws and regulations, other regulatory rules, and the business and governance policies of the Company. Where necessary, the Company also arranges relevant briefings and professional developments for directors subsequently.

A.4 Chairman and Chief Executive Officer (“CEO”)

It is recommended in the *Hong Kong Listing Rules* that the roles of Chairman and CEO of a listed company should be separated and should not be performed by the same individual. The division of responsibilities between the chairman and CEO should be clearly defined.

The positions of the Chairman of the Board and President of the Company have been taken up by different persons and their duties have been clearly defined. Mr. Qin Xiao serves as the

Chairman of the Board and is responsible for leading the Board, chairing the meetings, ensuring that all directors receive appropriate briefing on issues arising at board meetings, managing the operations of the Board, and ensuring that all major and relevant issues are discussed by the Board in a constructive and timely manner. To enable the Board to discuss all important and relevant matters timely, the Chairman and senior management will work together to ensure that the directors duly receive appropriate, complete and reliable information in a timely manner for their consideration and review.

Mr. Ma Weihua serves as the President and CEO, who is responsible for the business operations of the Company and implementing the strategic and business plans of the Company.

A.5 Meetings of Board of Directors

During the year ended 31 December 2006, the Board held 15 meetings (6 physical meetings and 9 through written resolutions), at which the financial and operating performances of the Company and the general strategies and policies were approved.

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The following table sets out records of attendance of the respective directors at physical board meetings held in the year ended 31 December 2006.

Name of director	Times of attending physical Board meetings/number of physical meetings (Note 1)
Non-executive director	
Qin Xiao	6/6
Wei Jiafu	6/6
Fu Yuning	6/6
Li Yinquan	6/6
Huang Dazhan	6/6
Tan Yueheng	6/6
Sun Yueying	6/6
Wang Daxiong	6/6
Fu Junyuan	6/6
Executive director	
Ma Weihua	6/6
Chen Wei (resigned as director on 23 March 2007)	6/6
Independent non-executive director	
Wu Jiesi	6/6
Lin Chuxue	5/6
Hu Chang Tau, Austin	6/6
Chow Kwong Fai, Edward	4/4 (Note 2)
Liu Yongzhang	4/4 (Note 2)
Liu Hongxia	4/4 (Note 2)
Yang Jun (retired as director on 16 May 2006)	2/2 (Note 3)
Lu Renfa (retired as director on 16 May 2006)	2/2 (Note 3)
Ding Huiping (retired as director on 16 May 2006)	2/2 (Note 3)

Notes:

1. During the year ended 31 December 2006, the Board held 6 physical meetings and passed written resolutions on 9 occasions.
2. Chow Kwong Fai, Edward, Liu Yongzhang and Liu Hongxia were elected as independent non-executive directors of the Company on 16 May 2006. During the period from 1 January to 15 May 2006, the Board held two physical meetings. As Chow Kwong Fai, Edward, Liu Yongzhang and Liu Hongxia were not directors of the Company at the time when the two meetings were held, they were not counted in the quorum of these two meetings and should only be counted in the quorum of the four physical Board meetings which were held after they were appointed.
3. Yang Jun, Lu Renfa and Ding Huiping resigned as independent non-executive directors of the Company on 16 May 2006, and therefore were only be counted in the quorum of the two physical board meetings held during the period from 1 January to 15 May 2006.

At the board meetings held in 2006, the Board established the "Competitiveness Indicators System" to evaluate the competitiveness of the Company in terms of profitability, asset quality and development potentials, which will be used as a reference for the Board to evaluate the performance of the management; the Board formulated "Quantified Authorization Standards" for the management in order to bring the decision making of the management within the quantified framework authorized by the Board; the Board formulated *Policies on Remunerations of Senior Management*, specifying the performance evaluation indicators and rating method; formulated H Share appreciation rights plan for senior management of which the plan is being approved by the regulatory authority. The Board also formulated *Policies on Total Staff Salary and Other Labour Costs* to further strengthen cost control and management.

The Board will meet to consider and approve any material related party transaction (involving conflict of interest for substantial shareholder or director). Any director or his/her associates having a material interest in the said transaction must abstain from voting and not be counted in the quorum of the meeting.

The schedule of regular meetings of the Board of the Company and the draft agendas of the meetings are normally made available to the directors in advance. All directors are given an opportunity to include in the agenda any

relevant matters for discussion. Directors are given appropriate time to discuss relevant matters at the meetings. Where necessary, the Board and each director can have separate and independent access to the company secretary and senior management for advice and services, and are also entitled to have access to board papers and related materials to ensure the compliance of the procedural rules of the Board and all applicable rules and regulations, and to enable the Board to make informed decisions. Senior management may also attend meetings of the Board if necessary and provide opinions on the business development, financial and accounting affairs, statutory compliance, corporate governance and other important matters of the Company. Directors may make reasonable request to the secretary of the Board to seek independent professional advice in appropriate circumstances, with such expense to be borne by the Company.

Prior to the listing of our H Shares, notice of a board meeting was sent 10 days in advance. After the listing of H Shares of the Company, the notice of a regular board meeting is served to all the directors at least 14 days before the meeting, with the agenda and relevant board papers served to all the directors at least 3 days in advance in order to comply with the code provisions set out in *Code on Corporate Governance Practices contained in the Hong Kong Listing Rules*. Reasonable notice is generally given for other board meetings and board committee meetings.

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The draft minutes of a Board meeting is sent to the directors for comment within a reasonable time after the meeting and the finalised minutes is kept by the secretary of the Board. Copies of the minutes are sent to the directors for record. Minutes will be available for inspection at any reasonable time on reasonable notice by any director.

A.6 Delegation of the Board

The Company has a formal schedule setting out the matters specifically reserved to the Board for decision. The Board has given clear instructions to the management as to the matters that must be approved by the Board before decisions are made on behalf of the Company. The Board reserves the right to decide on all important matters of the Company, including all policy-related matters, overall strategies and budgets, internal control and risk management systems, material transactions (in particular those involving conflicts of interests), financial information, appointment of directors and other significant financial and operational matters. The senior management is responsible for the day-to-day management, administration and operation of the Company, and regularly reports to the Board about the operations and business development of the Company and handles significant transactions with the prior approval of the Board.

The Company has established the quantified authorisation standards for the Board's delegation of authority to the management in areas such as:

specified the non-performing loan ratio that the Board can accept, business authorization granted by the Head Office to the branch offices, write-off of bad debts and limit of repayment of debts in kind, definition of common and material related party transactions, loan-deposit ratio, and market risk control index. The authorisation standards as a whole comply with the policies and regulations of the regulatory authority, and are established board on the actual conditions of the Company, and are systematic and comprehensive.

A.7 Securities transactions of directors, supervisors and relevant employees

In accordance with the *Hong Kong Listing Rules*, the directors and supervisors must observe the *Model Code* set out in Appendix 10 to the *Listing Rules* in respect of their dealings in the securities of their listed companies. The board of directors of a listed company shall also establish written guidelines which are no less exacting than the *Model Code* for relevant employees in respect of their dealings in the securities of the listed company.

The Company has adopted the aforesaid *Model Code* as the code of conduct for directors and supervisors of the Company in respect of their dealings in the Company's securities. Upon making specific enquiry of all the directors and supervisors, the Company confirmed that they have complied with the aforesaid *Model Code* in respect of the year ended 31 December 2006.

The Company has also established written guidelines for relevant employees' securities transactions, which are no less exacting than the *Model Code*. The Company is not aware of any non-compliance of the said guidelines by employees.

B. BOARD COMMITTEES

As described above, the Board has established five committees, which are the Executive Committee, the Audit and Related Party Transactions Control Committee, the Risk Management Committee, the Remuneration and Appraisal Committee and the Nomination Committee, which supervise different matters of the Company. All these specialised committees have their own specific terms of reference.

In 2006, the Company optimized the membership constitution of the specialised committees under the Board. The Executive Committee consists of non-executive directors and executive directors; the members of the Audit and Related Party Transactions Control Committee are all non-executive directors pursuant to the requirements of SEHK and the majority of whom are independent non-executive directors, with one of them acting as chairman; the Nomination Committee and the Remuneration Committee also consists of independent non-executive directors in the majority, with one independent non-executive director acting as chairman. The committees under the Board have intensive research on specific issues, have studied and discussed a range of important topics including competitiveness index system, quantitative authorisation granted by the Board to the

management, system of reporting important events to the Board, regulations on senior management's remunerations, regulations on related party transactions (revised) and asset quality report etc., and have submitted the same to the Board and the shareholders' general meeting for consideration and approval.

The composition, main authority and duties of the aforesaid five committees and their work performed in 2006 are summarised as follows:

B.1 Executive Committee

Current members of the Executive Committee are non-executive directors: Fu Yuning (chairman), Wei Jiafu, Wang Daxiong and Fu Junyuan, and executive director: Ma Weihua.

Main authorities and duties:

- to examine and supervise implementation of board resolutions;
- to regularly review the work report of the president's team in relation to the operation and management of the Company;
- to examine the material matters of the Company, including changes in senior management, changes in organisations above the branch level, and significant investments etc.;
- to determine the basis for distribution of president incentive fund;
- to put forward proposals and plans for important issues to be discussed and decided by the Board; and

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- to analyse the medium to long-term development strategies and material investment decisions of the Company and provide recommendations.

In 2006, the Executive Committee of the Board did not hold any meeting.

B.2 Audit and Related Party Transactions Control Committee

Current members of the Audit and Related Party Transactions Control Committee include: Wang Daxiong and Fu Junyuan, who are non-executive directors, Liu Hongxia (chairman), Chow Kwong Fai, Edward and Lin Chuxue, who are independent non-executive directors. Upon investigation, no member of the Audit and Related Party Transactions Control Committee has ever served as a partner of the current auditors of the Company.

Main authorities and duties:

- to propose the appointment or replacement of external auditors;
- to monitor the internal audit system of the Company and its implementation;
- to coordinate communication between internal auditors and external auditors;

- to review the financial information of the Company and its disclosure;
- to examine the internal control system of the Company; and
- to examine the material connected transactions of the Company.

Summary of work performed in 2006:

To further regulate the management of connected transactions of the Company, in 2006, the Audit and Related Party Transactions Control Committee defined the connected parties of the Company and identified the preliminary connected legal persons in accordance with the identification standards set out in *The Administrative Measures for the Connected Transactions between Commercial Banks and their Insiders and Shareholders* issued by Chinese regulatory authority and *Regulations of China Merchants Bank Co., Ltd. on Connected Transactions*. During the year 2006, the Committee reviewed seven material connected transactions in the credit businesses of the Company, and submitted the examination results to the Board for approval.

In addition, the Committee also reviewed the 2006 quarterly results, the related financial information and the disclosure thereof.

The following table sets out the attendance records of the physical meeting (Note 1) held by the Audit and Related Party Transactions Control Committee in 2006:

Member	Attendance
Non-executive director	
Wang Daxiong	0/1
Fu Junyuan	1/1
Independent non-executive director	
Liu Hongxia (chairman) (appointed as director on 16 May 2006)	0/0 (Note 2)
Chow Kwong Fai, Edward (appointed as director on 16 May 2006)	0/0 (Note 2)
Lin Chuxue	1/1
Lu Renfa (retired as director on 16 May 2006)	0/1
Ding Huiping (retired as director on 16 May 2006)	1/1

Notes:

1. Besides the physical meeting, the Audit and Related Party Transactions Control Committee passed written resolutions on 3 occasions in 2006.
2. The said physical meeting was held before 16 May 2006.

B.3 Risk Management Committee

The existing members of the Risk Management Committee are non-executive directors: Sun Yueying (chairman), Huang Dazhan and Wang Daxiong, and independent non-executive director: Austin Hu Chang Tau.

Main authorities and duties:

- to monitor the risk management of the Company's exposures to credit risks, market risks and operational risks, etc. by senior management;
- to conduct regular assessment of the risk position of the Company; and
- to put forward proposals on the improvement of the risk management and internal control of the Company.

Summary of work performed in 2006

In 2006, the Risk Management Committee received the *Credit Quality Report 2005 of China Merchants Bank* and proposed to study and establish a scientific, complete and reliable risk control system which covers the aspects of risk management concepts, culture, organisation structure, management system and operation procedures; studied and formulated the *Proposal on Quantitative Authorisation Granted by the Board of Directors to Senior Management*, which had been approved by the Board; the disposal plan for two major NPL, which had been approved by the Board.

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The following table sets out the attendance records of the physical meeting (Note) held by the Risk Management Committee in 2006:

Member	Attendance
Non-executive director	
Sun Yueying (Chairman)	1/1
Huang Dazhan	1/1
Wang Daxiong	0/1
Executive director	
Chen Wei (resigned as director on 23 March 2007)	1/1
Independent non-executive director	
Austin Hu Chang Tau	1/1

Note: The Risk Management Committee also passed written resolutions on one other occasion in 2006.

B.4 Remuneration and Appraisal Committee

Current members of the Remuneration and Appraisal Committee include: Li Yinquan and Fu Junyuan, who are non-executive directors; Austin Hu Chang Tau (chairman), Wu Jiesi and Liu Yongzhang, who are independent non-executive directors, with the independent non-executive directors forming the majority of the membership.

Main authorities and duties:

- to study and propose standards for appraising directors and senior management, conduct appraisals and provide advices based on the actual situation of the Company; and
- to study and formulate the remuneration policy and plans for directors and senior management.

Summary of work performed in 2006:

In 2006, the Remuneration and Appraisal Committee made efforts to help the Board further improve the incentive mechanism of the Company, and studied and formulated a series of important incentive measures and submitted them to the Board for approval, including passing the *Regulations of China Merchants Bank on Total Staff Salary and Other Labour Costs (for trial purposes)*, *Regulations of China Merchants Bank on Remuneration of Senior Management (for trial purposes)*, *Matters Concerning Awards of the Operation Team of China Merchants Bank in 2005*, *Proposal to Enhance Remuneration Standard for Independent Non-executive Directors and External Supervisors of China Merchants Bank*, *Matters Concerning Appointment of Brokers for Liability Insurance of Directors, Supervisors and Senior Management of China Merchants Bank*, etc.

The following table sets out the attendance records of the physical meeting held by the Remuneration and Appraisal Committee in 2006

Member	Attendance
Non-executive director	
Li Yinquan	1/1
Fu Junyuan	1/1
Independent non-executive director	
Austin Hu Chang Tau (chairman)	0/1
Wu Jiesi	1/1
Liu Yongzhang	1/1

B.5 Nomination Committee

Current members of the Nomination Committee include: Fu Yuning, who is a non-executive director, Ma Weihua, who is an executive director, Lin Chuxue (chairman), Liu Yongzhang and Liu Hongxia, who are independent non-executive directors, with the independent non-executive directors forming the majority of the membership.

Main authorities and duties:

- to put forward proposals to the Board on the size and composition of the Board according to the business operations, asset scale and shareholding structure of the Company;
- to study the standards and procedures for the election of directors and senior management, and propose the same to the Board;
- to conduct extensive searches for qualified candidates as directors and senior management; and
- to make preliminary examination on the qualifications of the candidates for directors and senior management and put forward proposals.

Summary of work performed in 2006:

In 2006, 3 of the 6 independent non-executive directors of the 6th Board of the Company completed their terms of office. The Nomination Committee made preliminary examination on the qualifications of the 3 candidates as independent non-executive directors in accordance with the *Guide to Independent Non-executive Directors and External Supervisors System of Shareholding Commercial Banks* issued by the PBOC and the *Articles of Association* of the Company, determined the list of candidates for election and submitted the same to the Board and finally obtained the shareholders' approval in a general meeting, and thereby completing the replacement of independent non-executive directors.

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The following table sets out the attendance records of the physical meeting held by the Nomination Committee in 2006

Member	Attendance
Non-executive director	
Fu Yuning	1/1
Executive director	
Ma Weihua	1/1
Independent non-executive director	
Lin Chuxue (chairman)	1/1
Liu Yongzhang (appointed as director on 16 May 2006)	0/0 (Note)
Liu Hongxia (appointed as director on 16 May 2006)	0/0 (Note)
Yang Jun (retired as director on 16 May 2006)	1/1 (Note)
Ding Huiping (retired as director on 16 May 2006)	1/1 (Note)

Note: The said physical meeting was held before 16 May 2006.

The Company undertakes to provide adequate resources to all board committees to enable them to discharge their duties. The members of the committees may, upon reasonable request, separately and independently seek the advice and services of the senior management. Where necessary, the members of the committees may seek professional advice at the expenses of the Company.

The draft minutes of the meetings of the committees will be sent within a reasonable time after the meetings to all the members of the committees for comment. The minutes shall be kept by the secretary of the Board and copies shall be sent to the members for records.

In accordance with Appendix 14 to the Hong Kong Listing Rules, the Company has made available the terms of reference of the Audit and Related Party Transactions Control Committee, the Remuneration and Appraisal Committee and the Nomination Committee on its website www.cmbchina.com. In addition to the requirement, the Company has also made available the terms of reference of the Executive Committee and the Risk Management Committee on the above website.

C. BOARD OF SUPERVISORS

C.1 Duties and operations of the Board of Supervisors

The Board of Supervisors has currently 9 members, including 2 external supervisors, 4 supervisors being representatives of the shareholders and 3 supervisors being representatives of the employees. The major duties of the Board of Supervisors are: to supervise and examine the financial operations of the Company; to oversee the conduct of directors and senior management in carrying out their duties and to make proposal to remove those who have breached the applicable laws, administrative rules or the Articles of Association of the Company; to demand the directors or senior management to rectify their conduct when such conduct is prejudicial to the interests of the Company; to review the regular reports from the Board and provide written opinions; to propose to convene extraordinary general meetings; to convene and chair the shareholders' general meetings if the Board fails to perform its duty in convening and chairing such meetings pursuant to the Articles of Association of the Company; to submit proposals at shareholders' general meetings; to make inquiries to the directors, president, vice presidents and other senior management on behalf of the Company and to lodge legal proceedings against directors, president, vice presidents and other senior management in accordance with PRC *Company Law*; to investigate any

irregularities in the operations of the Company; to conduct a review on resigning directors and senior management.

The Board of Supervisors formulates procedural rules for Board of Supervisors meetings to ensure the work efficiency and well-structured decision making of the Board of Supervisors. The Board of Supervisors inspects and supervises the business operations and financial activities of the Company by holding regular meetings, reviewing various documents submitted by the Company, reviewing the work reports and specific reports of the management, conducting investigations and surveys, etc.

The Board of Supervisors held a total of 6 meetings in the reported period. For more information, please refer to "Report from the Board of Supervisors" in this Annual Report.

In the reported period, the Board of Supervisors enhanced discussion and communication with the regulatory divisions, focusing on reviewing the situation of the Branches' implementation of credit policy and credit system of the Head Office, quality of credit assets and execution of credit management procedures. The Board of Supervisors has presented a series of comments and recommendations to the management of the Head Office in respect of the observations noted in the above investigation.

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In the reported period, the Company held 4 shareholders' general meetings and 15 Board meetings. The supervisors attended the shareholders' general meetings and were present at the meetings of the Board in order to supervise the compliance of laws and regulations and voting procedures of the shareholders' general meetings and board meetings, as well as the work performance of the directors.

C.2 Committees under the Board of Supervisors

The Nomination Committee and the Audit Committee are established under the Board of Supervisors, each consisting of 3 supervisors. The Nomination Committee and the Audit Committee are headed by external supervisors.

The members of the Nomination Committee are: Shi Jiliang (chairman), Lin Rongguang and Li Yi. The major duties of the Nomination Committee are: to make proposals to the Board of Supervisors on the size and composition of the Board of Supervisors; to study the standards and procedures for the election of supervisors and propose the same to the Board of Supervisors; to conduct extensive searches for qualified candidates for supervisors; to make preliminary examination on the qualifications of the candidates for supervisors nominated by shareholders and to provide relevant recommendations. In the reported period, the Nomination Committee has made preliminary examination on the qualifications of the candidates as supervisors, and submitted the examination results to the Board of Supervisors for consideration.

Members of the Audit Committee are: Shao Ruiqing (chairman), Xiang Youzhi and Chen Haoming. The major duties of the Audit Committee are: to formulate schemes for conducting inspection and supervision of the financial activities of the Company; to formulate plans for conducting reviews on resigning directors and senior management; to formulate plans for conducting audit on the business policies, risk management and internal control of the Company. In the reported period, the Audit Committee discussed with KPMG, our external auditors on the audit work for the year 2005, and analysed the interim financial position of the Company in 2006.

D. FINANCIAL REPORTING

The senior management of the Company provides the Board with adequate explanation and sufficient information to enable the Board to make informed assessment on the financial and other information submitted to it for approval.

The directors of the Company acknowledged their responsibility for preparing the financial statements for the year ended 31 December 2006 to present a balanced, clear and fair view of the performance, results and prospect of the Company. The said responsibility extends to interim and quarterly reports, other stock price sensitive announcements, other financial disclosures required under the *Listing Rules*, reports to the regulatory authorities as well as information required to be disclosed pursuant to relevant laws and regulations.

In addition, the Board is not aware of any material uncertainties relating to events or conditions that may cast significant doubt upon the Company's ability to continue as a going concern.

The financial statements of the Company prepared for the year 2006 under *International Financial Reporting Standard* were audited by KPMG, Certified Public Accountants, and the financial statements prepared for the year 2006 under PRC GAAP were audited by KPMG Huazhen, Certified Public Accountants. The total audit expenses amounted to RMB5.08 million. The statement made by KPMG, Certified Public Accountants about its reporting responsibility on the financial statements is set out in the Auditor's Report on page 130 of the Annual Report.

The Bank also incurred HK\$22.5 million for the services provided by KPMG in respect of the global initial public offering and listing of the Bank's shares on Hong Kong Stock Exchange and the amount had been charged to the capital reserve account.

Apart from the above services, the non-audit service fee for the year 2006 paid by the Company to KPMG, Certified Public Accountants was RMB0.65 million, mainly covered due diligence review on investment projects and review works performed for regulatory reporting purposes.

KPMG, Certified Public Accountants and KPMG Huazhen, Certified Public Accountants have acted as the Company's auditors for more than 3 years.

E. INTERNAL CONTROL

The Board has reviewed the effectiveness of the internal control system of the Company for the year ended 31 December 2006. Such review covered the financial, operational and compliance controls and risk management functions. The internal control system of the Company is designed to facilitate effective and efficient operations of the Company, ensure reliability of the financial reporting, ensure compliance of laws and regulations, identify and manage potential risks, and safeguard assets of the Group.

The Audit and Supervision Department (which reports directly to the President's office and the Audit and Supervision Management Committee) of the Company is responsible for the internal audit of the Company and directly manages the four audit divisions in Beijing, Shanghai, Shenzhen and Xi'an. The Audit and Supervision Department is independent of the other departments that it audits, in order to ensure the independence and integrity of the audit process. The Audit and Supervision Department of the Company also regularly reports to the Board of Directors and the Board of Supervisors of the Company. The Company has adopted guidelines that set forth the procedures and scope of internal audit. In recent years, the Audit and Supervision Department has conducted annual bank-wide comprehensive audit on the credit, treasury, accounting, finance and retail banking business, and the integrity of the computer systems of the Company. The annual audit of the Company covers branches and sub-branches and particularly focus on the following aspects:

- Compliance with all applicable laws, regulations and internal polices and guidelines of the Company;

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- Effectiveness of the risk management policies and procedures of the Company;
- Scope and effectiveness of the internal control system of the Company; and
- Supervision and post-audit monitoring of the progress of the issues identified during the audit process.

The Company stresses the importance to rectify any deficiencies found during its internal audit. The department with the deficiencies and the department in the branch or head office that directly manages such department are responsible for implementing the rectifications. In evaluating the performance of the branches and sub-branches, the Company will consider the results of internal audit and the measures made on rectifying the deficiencies (if any).

The Company is fully aware of the importance of independent internal audit to successful business operations and effective internal control of the Company.

F. COMMUNICATIONS WITH SHAREHOLDERS

The Board maintains regular dialogues with shareholders, especially through annual general meetings or other general meetings where shareholders are encouraged to participate.

Furthermore, to safeguard the rights and interests of the shareholders, separate resolutions are proposed at shareholders' general meeting on each substantial issue. At the annual general meeting to be held in 2007, separate resolutions will be proposed for the election or re-election of directors.

The rights of shareholders and the procedures for demanding a poll on resolutions at shareholders' general meeting are set out in the notice of the forthcoming annual general meeting as contained in the Annual Report and in the Company's Articles of Association. The chairman of the shareholders' general meeting will, at the commencement of the meeting, explain the procedures for demanding a poll. The poll results will be published in Hong Kong newspapers on the business day following the shareholders' general meeting and posted on the websites of the Company and the Hong Kong Stock Exchange. Scrutineer would be appointed to ensure all votes cast on resolutions at the shareholders' general meeting are properly counted and recorded.

The management of the Company communicates regularly with institutional investors and analysts to keep them abreast of the latest developments of the Company. Inquiries from the investors will be dealt with in a timely manner. For any inquiries, investors may write directly to the Company at its principal place of business in Hong Kong or Shenzhen.

The Company has also maintained a website (www.cmbchina.com), which provides information about the business developments and operations, financial information, corporate governance practices and other information of the Company.