

BANKING INDUSTRY IN THE PRC

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OVERVIEW

China has experienced significant economic growth over the past two decades largely as a result of the PRC Government's extensive economic reforms. In the beginning, these reforms were focused on transforming China from a centrally planned economy to a more market-based economy. More recently, particularly following China's accession to the WTO in 2001, the economic reforms have also focused on, among other things, enhancing the competitiveness of Chinese enterprises. As a result of these reforms, China's GDP grew at a CAGR of 14.9% between 2002 and 2006, according to the National Bureau of Statistics of China, and, as of December 31, 2006, China was the fourth largest economy in the world, with a GDP of RMB 20.9 trillion. During the same period, China's total import and export volume increased at a CAGR of 29.8%. The following table sets forth China's GDP and total import and export volume from 2002 to 2006.

	As of and for the year ended December 31,					Compound Annual Growth Rate (2002-2006)
	2002	2003	2004	2005	2006	
GDP (RMB billions) ⁽¹⁾	12,033.3	13,582.3	15,987.8	18,232.1	20,940.7	14.9%
GDP per capita (in RMB)	8,214.0	9,111.0	10,561.0	13,943.6	15,930.8	18.0
Total import and export (US\$ billions)	620.8	851.0	1,154.4	1,422.2	1,760.7	29.8

Source: PBOC, National Bureau of Statistics of China.

(1) National Bureau of Statistics of China (NBS) adjusted the GDP for 2004 and revised the annual historical GDP data of certain years from 1993 to 2003 based on China's economic census data published in 2004. GDP is calculated based on current price.

As an important component of the country's overall economic system, China's banking industry has experienced rapid growth which is in line with the economic development of China. Banks have historically been, and will continue to be, the principal provider of capital for enterprises and the primary choice for domestic savings. According to the information published by PBOC, bank loans accounted for 71.1% of total financing in 2006 with the remaining 28.9% raised through bond and equity issuances.

Total RMB-denominated loans and RMB-denominated deposits of China's banking industry have increased at a CAGR of 14.5% and 18.4%, respectively, from December 31, 2002 to December 31, 2006. The following table sets forth total RMB-denominated loans, total RMB-denominated deposits, and the respective CAGR of banking institutions in China as of the dates indicated.

	As of December 31,					Compound Annual Growth Rate (2002-2006)
	2002	2003	2004	2005	2006	
	(in billions of RMB)					
Total RMB-denominated loans ⁽¹⁾	13,129.4	15,899.6	17,819.8	19,469.0	22,528.5	14.5%
Total RMB-denominated deposits ⁽¹⁾	17,091.7	20,805.6	24,142.4	28,717.0	33,543.4	18.4

Source: PBOC.

(1) Consists, as applicable, of the deposits or loans of the PBOC, the Big Four commercial banks, the Other National Commercial Banks, city commercial banks, policy banks, rural commercial banks, foreign-invested banks, urban credit cooperatives, rural credit cooperatives, finance companies, trust and investment companies, financial leasing companies and the postal savings bureau.

BANKING INDUSTRY IN THE PRC

In line with the rising income levels in China in recent years, China's banking industry has experienced increasing demand for personal banking products and services, including both personal loan products such as residential mortgages and fee- and commission-based products and services such as credit cards. From December 31, 2002 to December 31, 2006, total personal loans and total residential mortgage loans in China increased at a CAGR of 22.5% and 24.6%, respectively, according to data released by the National Bureau of Statistics of China. Total bank cards outstanding increased from 380 million as of December 31, 2001 to 1,175 million as of December 31, 2006, according to China UnionPay.

The PRC's eastern coastal areas, which consist of the Bohai Rim Zone, the Yangtze River Delta and the Pearl River Delta, have historically been a focus of the PRC Government's economic development policies and account for a relatively higher percentage of the GDP of the PRC. According to the China Statistical Abstract 2006, the eastern coastal areas accounted for 55.0% of the total GDP of the PRC in 2005, with a combined GDP of RMB 10,811 billion. Residents in these areas tend to be more affluent than those in the rest of the country as evidenced by a higher GDP per capita of RMB 28,919 in 2005, compared to the national average of RMB 13,744. In addition, between 2001 and 2005, the eastern coastal areas experienced faster growth than other parts of the nation, with combined GDP growing at an annual average rate of 18.0%, compared to the national average of 13.6%.

With the faster growth in income levels and corporate activities in the eastern coastal areas, the banking industry in these areas is also more developed compared to other parts of the PRC. According to the Almanac of China's Finance and Banking 2006, total loans in these areas grew at an annual average rate of 18.8% between 2001 and 2005 compared with the national average of 14.7% during the same period. Deposits and loans of banking institutions in these areas accounted for 60.9% and 59.8%, respectively, of total deposits and loans in the PRC in 2005.

HISTORY AND DEVELOPMENT OF CHINA'S BANKING SECTOR

Between 1949 and the 1970s, China's banking industry functioned as part of the centrally planned economy and the PBOC was China's central bank as well as the primary commercial bank engaging in deposit-taking and lending activities. Since the late 1970s, as part of the economic reform, the banking industry underwent significant changes as some of the PBOC's commercial banking functions were separated from its central bank function. The Big Four commercial banks assumed the role of state-owned specialized banks, while the PBOC focused on acting as China's central bank and as the principal regulator and supervisor of China's banking system.

In the late 1980s, new commercial banks and non-bank financial institutions were established. Some of these commercial banks, known as the Other National Commercial Banks, were permitted to offer nationwide commercial banking services, while others were permitted to operate only in local markets.

Since the mid-1990s, the PRC Government has taken a series of measures to reform the commercial banking sector, including the establishment of three policy banks in 1994 to substantially undertake the policy lending functions of the Big Four commercial banks. In 1995, the PRC Commercial Banking Law and the PRC People's Bank of China Law were enacted to define more clearly the permitted scope of business of commercial banks and the functions and powers of the PBOC as the central bank and banking regulator of China. In 2003, the CBRC was established to become the primary banking industry regulator and assumed the majority of the regulatory functions of the PBOC.

BANKING INDUSTRY IN THE PRC

China's banking industry has been historically burdened with large portfolios of non-performing loans. Since the late 1990s, the PRC Government has taken numerous initiatives to improve the asset quality and strengthen the capital base of the Big Four commercial banks, including the following:

- In 1998, the MOF issued special government bonds and contributed RMB 270.0 billion to the Big Four as equity to improve their capital adequacy.
- In 1999, the PRC Government established four asset management companies to acquire and manage non-performing loans of the Big Four commercial banks.
- In 1999 and 2000, the Big Four commercial banks transferred a significant amount of non-performing loans to the asset management companies.
- In 2003, the PRC Government, through China SAFE Investments Limited, previously known as Central Huijin Investment Co., Ltd. ("Huijin"), contributed US\$22.5 billion as equity to each of Bank of China and China Construction Bank, and in 2005, Huijin contributed US\$15 billion as equity to Industrial and Commercial Bank of China.

Apart from the Big Four commercial banks, in 2004, MOF and Huijin also contributed in aggregate RMB 8 billion as equity to Bank of Communications. Bank of Communications afterwards also transferred approximately RMB 53 billion of non-performing loans to an asset management company. As a result of the aforementioned efforts, the asset quality of China's biggest commercial banks improved significantly.

Many Other National Commercial Banks have relied on their own resources to improve their asset quality and lowered their non-performing loan ratios. With the exception of Bank of Communications and China Everbright Bank, the other Other National Commercial Banks have not received government assistance and improved their asset quality by taking measures such as strengthening credit risk management and writing-off or transferring non-performing loans. Furthermore, in recent years, several PRC commercial banks have listed their shares in the domestic or overseas markets to strengthen capital base and have adopted international best management practices, which in turn helped improve their respective asset quality. See "— Industry Trends — Listing of China's Commercial Banks."

CURRENT COMPETITIVE LANDSCAPE

China's banking institutions are divided broadly into seven categories, namely, the Big Four commercial banks, the Other National Commercial Banks, city commercial banks, rural credit cooperatives, urban credit cooperatives, foreign-invested banks and other financial institutions. China Postal Savings Bank, whose predecessor is the postal savings bureau, was established on March 21, 2007. Due to its very recent establishment and lack of public data, information relating to this bank is not included in this prospectus. The following table sets forth, as of December 31, 2005, certain information relating to the assets, deposits and loans of each category.

	As of December 31, 2005						
	Number of Institutions	Total Assets		Total Loans ⁽³⁾		Total Deposits	
		Total Amount	Market Share	Total Amount	Market Share	Total Amount	Market Share
(in billions of RMB, except number of institutions and percentages)							
Big Four Commercial Banks	4	20,552.9	54.1%	10,812.5	51.7%	17,479.2	58.9%
Other National Commercial Banks . . .	13	5,881.9	15.5	3,559.0	17.0	5,036.5	17.0
City Commercial Banks	113	2,027.0	5.3	1,011.3	4.8	1,674.5	5.6
Rural Credit Cooperatives ⁽¹⁾	27,171	3,175.4	8.4	1,855.2	8.9	2,764.5	9.3
Urban Credit Cooperatives	599	205.0	0.5	111.6	0.5	181.3	0.6
Foreign-Invested Banks	254	635.3	1.7	318.4	1.5	98.0	0.3
Other ⁽²⁾	153	5,480.2	14.5	3,241.2	15.6	2,441.7	8.3
Total	<u>28,307</u>	<u>37,957.7</u>	<u>100.0%</u>	<u>20,909.1</u>	<u>100.0%</u>	<u>29,675.8</u>	<u>100.0%</u>

BANKING INDUSTRY IN THE PRC

Sources: PBOC, CBRC, annual reports and prospectuses of relevant banks. All data based on PRC GAAP except for Industrial and Commercial Bank of China, Bank of China and China Construction Bank, Bank of Communications, China Merchants Bank, China CITIC Bank, Shanghai Pudong Development Bank, China Minsheng Bank, Industrial Bank, Huaxia Bank and Shenzhen Development Bank, the financial data of which were prepared in accordance with IFRS.

- (1) Consists of rural cooperative banks, rural commercial banks and rural credit cooperatives.
- (2) Consists of policy banks, finance companies, trust and investment companies, financial leasing companies, auto financing companies and the postal savings bureau. Amounts of total assets, loans and deposits include only those of policy banks, finance companies and the postal savings bureau.
- (3) Amounts shown are before allowances for impairment losses.

The table below sets forth our market shares in Renminbi and foreign currency deposits-taking and lending markets for the year ended December 31, 2004, 2005 and 2006.

	As of December 31,		
	2004	2005	2006
Deposits in RMB	1.63%	1.61%	1.68%
Lending in RMB	1.58	1.74	1.94
Deposits in foreign currency	3.44	5.18	4.47
Lending in foreign currency	1.17	1.52	1.31

Sources: Calculated based on relevant data provided by the PBOC.

Big Four Commercial Banks

The Big Four commercial banks play a major role in China's banking market and, since their establishment, have been the principal source of financing in China, particularly for state-owned enterprises. Although historically being state-owned enterprises, certain members of the Big Four commercial banks have undergone restructuring and become joint stock commercial banks. China Construction Bank is currently listed on the Hong Kong Stock Exchange, and Bank of China and Industrial and Commercial Bank of China are listed on both the Hong Kong Stock Exchange and the Shanghai Stock Exchange. As of December 31, 2005, total assets and total loans of the Big Four commercial banks represented 54.1% and 51.7% of total assets and total loans of banking institutions in China, respectively.

The following table sets forth, at December 31, 2005, the number of branches, total assets, deposits and loans of each of the Big Four commercial banks.

	As of December 31, 2005						
	Approximate Number of Branches	Total Assets		Total Loans		Total Deposits	
		Amount	% of Total	Amount	% of Total	Amount	% of Total
(in billions of RMB, except percentages and number of branches)							
Industrial and Commercial Bank of China ⁽¹⁾⁽²⁾	18,764	6,456.1	31.4%	3,289.6	30.4%	5,736.9	32.8%
Agricultural Bank of China	28,234	4,771.0	23.2	2,829.3	26.2	4,036.9	23.1
Bank of China ⁽¹⁾⁽²⁾	11,018	4,740.0	23.1	2,235.3	20.7	3,699.5	21.2
China Construction Bank ⁽¹⁾	13,977	4,585.7	22.3	2,458.4	22.7	4,006.0	21.9
Total	71,993	20,552.9	100.0%	10,812.5	100.0%	17,479.2	100.0%

Sources: Banks' annual reports and prospectuses. Except for Agricultural Bank of China, all numbers are based on IFRS.

- (1) Listed on the Hong Kong Stock Exchange.
- (2) Listed on the Shanghai Stock Exchange.

BANKING INDUSTRY IN THE PRC

Other National Commercial Banks

As of the date of this prospectus, there were 13 Other National Commercial Banks in China. These Other National Commercial Banks are licensed to engage in commercial banking activities nationwide, and their equity ownership is distributed among the PRC Government, state-owned enterprises and other investors. Established mostly in the late 1980's and early 1990's, the Other National Commercial Banks have gradually increased their collective market share while the market share of the Big Four commercial banks has gradually decreased. Total assets of the Other National Commercial Banks represented 16.3% of total assets of banking institutions in China as of December 31, 2006, compared to 13.0% as of December 31, 2002.

The following table sets forth, as of December 31, 2005, the number of branches, total assets, deposits and loans of the Other National Commercial Banks.

	As of December 31, 2005						
	Number of Branches	Total Assets ⁽⁵⁾		Loans ⁽⁵⁾		Deposits ⁽⁵⁾	
		Amount	Ranking	Amount	Ranking	Amount	Ranking
(in billions of RMB, except number of branches)							
Bank of Communications ⁽¹⁾	2,607	1,423.4	1	771.4	1	1,220.8	1
China Merchants Bank ⁽¹⁾⁽²⁾	456	734.6	2	472.2	2	634.4	2
China CITIC Bank	416	594.6	3	370.3	5	530.6	3
Shanghai Pudong Development Bank ⁽²⁾	350	573.5	4	377.4	4	504.5	4
China Minsheng Bank ⁽²⁾	240	557.4	5	386.4	3	488.8	5
China Everbright Bank	382	530.1	6	303.8	6	450.0	6
Industrial Bank ⁽²⁾	328	474.8	7	242.6	7	355.2	7
Huaxia Bank ⁽²⁾	266	356.5	8	233.7	8	312.1	8
Guangdong Development Bank	500	355.8	9	207.5	9	302.8	9
Shenzhen Development Bank ⁽³⁾	238	222.4	10	156.1	10	200.8	10
Evergrowing Bank	76	37.0	11	24.6	11	24.3	11
China Zheshang Bank	6	21.8	12	13.0	12	12.2	12
China Bohai Bank ⁽⁴⁾	1	n.a.	13	n.a.	13	n.a.	13
Total	<u>5,866</u>	<u>5,881.9</u>		<u>3,559.0</u>		<u>5,036.5</u>	

Sources: Banks' annual reports and websites, Almanac of China's Finance and Banking 2006. Data related to our bank are derived from audited consolidated financial statements included in the Accountants' Report in Appendix I prepared in accordance with IFRS.

(1) Listed on the Hong Kong Stock Exchange.

(2) Listed on the Shanghai Stock Exchange.

(3) Listed on the Shenzhen Stock Exchange.

(4) China Bohai Bank started operation in February 2006.

(5) Except for Guangdong Development Bank, Evergrowing Bank and China Zheshang Bank, all numbers are based on IFRS.

City Commercial Banks

City commercial banks are permitted to engage in commercial banking activities, generally within specific geographic areas. As of December 31, 2005, total assets and total loans of city commercial banks represented 5.3% and 4.8% of total assets and total loans of banking institutions in China, respectively.

Rural and Urban Credit Cooperatives

Rural and urban credit cooperatives provide a limited range of banking products and services, including personal deposit-taking, lending and settlement services, to small enterprises and local residents in rural and urban areas, respectively. Due to the rapid growth of other banking institutions in the urban areas, in particular the establishment of city commercial banks, total assets of urban credit cooperatives as a percentage of the

BANKING INDUSTRY IN THE PRC

total assets of banking institutions in China have declined in recent years. As of December 31, 2005, total assets of rural credit cooperatives (including rural commercial banks and rural cooperative banks) and urban credit cooperatives represented 8.4% and 0.5%, respectively, of total assets of banking institutions in China.

Foreign-Invested Banks

Foreign-invested banks include foreign bank branches, wholly foreign-owned banks and joint venture banks. Similar to the other types of banking institutions in China, foreign-invested banks are subject to supervision and regulation by the CBRC. See “Regulation and Supervision — PRC Regulation and Supervision — Regulation of Foreign-invested Banks Operating in China.” Pursuant to its WTO accession commitments, China has progressively opened RMB-denominated banking activities to foreign-invested banks, and effective from December 11, 2006, all restrictions on the geographic presence, customer base and operational licenses of foreign-invested banks were lifted. See “— Industry Trends — Participation of Foreign Banks in China.” As of December 31, 2005, there were 254 foreign-invested banks in China, their total assets and total loans represented 1.7% and 1.5% of total assets and total loans of banking institutions in China.

Other Banking Institutions

Other banking institutions include policy banks (i.e., banks established by the PRC Government to focus on policy lending, such as the China Development Bank, the China Export and Import Bank and the Agriculture Development Bank of China), the postal savings bureau, trust and investment companies, finance companies, financial leasing companies and automobile finance companies. As of December 31, 2005, other financial institutions (which, for this purpose, includes only policy banks, finance companies and the postal savings bureau) represented 14.5% of total assets and 15.6% of total loans in China.

INDUSTRY TRENDS

Increasing Role of Other National Commercial Banks in China’s Banking Industry

While the Big Four commercial banks have dominated the banking industry in China, their market share has declined over the past few years. The collective market share of the Other National Commercial Banks, however, has increased from 13.0% in 2002 to 16.3% in 2006 in terms of total assets. The Other National Commercial Banks generally focus on more developed regions and have gained market share by providing innovative products and high-quality customer services. As compared with the Big Four commercial banks, we believe they are more adaptive to changing market conditions and more responsive to customer’s special needs, and as compared with most other regional banking institutions, they enjoy certain competitive advantages such as a national distribution network, larger capital base, access to more resources, more diverse product and service offerings and advanced information technology infrastructure.

The following table sets forth the respective market share based on total assets of each category of China’s banking institutions as of the dates indicated.

	As of December 31,				
	2002	2003	2004	2005	2006
Big Four Commercial Banks	58.7%	57.4%	54.0%	54.1%	51.3%
Other National Commercial Banks	13.0	14.3	14.9	15.5	16.3
City Commercial Banks	5.0	5.4	5.4	5.3	5.9
Foreign-Invested Banks	1.2	1.2	1.6	1.7	n.a.
Urban Credit Cooperatives	0.5	0.5	0.6	0.5	n.a.
Rural Credit Cooperatives	9.6	9.8	9.7	8.4	n.a.
Others	12.0	11.3	13.9	14.5	n.a.
Total	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

Source: CBRC, PBOC, annual reports and prospectuses of relevant banks.

BANKING INDUSTRY IN THE PRC

Other National Commercial Banks have relatively better asset quality compared to the Big Four commercial banks due to their relatively smaller exposure to policy lending and less legacy non-performing loans resulting from their shorter operating history. Compared to the city commercial banks and rural credit cooperatives, asset quality of Other National Commercial Banks is generally higher due to their lower geographic concentration. The non-performing loan ratios of the Other National Commercial Banks have historically been lower than other categories of banking institutions in the PRC. The following table sets forth the collective non-performing loan ratios of the Big Four commercial banks and the Other National Commercial Banks as of the dates indicated.

	As of December 31,		
	2004	2005	2006
Big Four Commercial Banks	15.57%	10.49%	9.22%
Other National Commercial Banks	4.94	4.22	2.81

Sources: CBRC.

Enhanced Regulation and Supervision

In recent years, the CBRC and other PRC regulatory authorities have promulgated numerous rules and regulations in an effort to enhance supervision and promote orderly market competition in the banking industry, including:

- *Enhancing corporate governance.* The CBRC has encouraged banks to establish a corporate governance structure that includes a board of directors with independent directors, audit, compensation and other board committees, and a board of supervisors. In addition, banks have been instructed to create an independent internal audit function that is supported by clearly defined policies and procedures;
- *Enhancing risk management.* The CBRC has promulgated a series of risk management guidelines and undertaken measures to more closely monitor and enforce the adoption and implementation of the five-category loan classification system by commercial banks, risk rating system, due diligence requirements during the credit extension process, as well as enhanced management of market and operational risks in addition to credit risks;
- *Enhancing supervision over capital adequacy.* In March 2004, the CBRC implemented a set of new and more stringent capital adequacy guidelines which were based on the 1988 Basel Capital Accord, or Basel I, and took into consideration Basel II. Under these guidelines, all banks in China are required to comply with the new capital adequacy requirements by January 1, 2007;
- *Establishing a general provision requirement for risk-bearing assets.* Starting from July 2005, commercial banks in China are required by the MOF to set aside a regulatory general reserve, generally not less than 1% of the year-end balance of their risk-bearing assets, to cover any possible unidentified impairment. A grace period of a maximum of five years is provided to meet this requirement;
- *Raising the statutory reserve requirement.* In July 2006, August 2006, November 2006, January 2007, February 2007 and April 2007, the PBOC increased the requirement for statutory deposit reserve six times by 0.5%, to 10.5% from 7.5%. The statutory deposit reserve requirement was increased by 1.0% in September 2003 and 0.5% in April 2004;
- *Promulgating the Internal Control Guidelines.* The CBRC has required commercial banks to adopt a three-tiered structure to conduct effective management and supervision, as well as to improve credit approval procedures; and
- *Enhancing supervision over information disclosure.* The CBRC has required commercial banks to enhance disclosure in their annual report.

BANKING INDUSTRY IN THE PRC

See “Regulation and Supervision — PRC Regulation and Supervision” for more information regarding PRC regulations affecting the banking institutions. PRC regulatory authorities are expected to continue to promulgate new rules and regulations in an effort to enhance risk management capabilities of China’s commercial banks and to ensure the healthy development of China’s banking industry.

Improvement of Asset Quality and Enhancement of Capital Base

China’s banking sector has been historically burdened with large portfolios of non-performing loans. Since the late 1990s, the PRC Government has taken various measures to improve the asset quality and strengthen the capital base of the Big Four commercial banks and Bank of Communications. See “— History and Development of China’s Banking Sector.” With the exception of Bank of Communications and China Everbright Bank, the other Other National Commercial Banks have not received government assistance and have relied on their own resources to manage their non-performing loan ratios. In an effort to improve and standardize non-performing loan disclosure by banks and allow regulators to better monitor bank asset quality in accordance with international practices, a five-category classification system was formally implemented in 2002. In addition, pursuant to PRC Government directives and regulatory requirements, the PRC commercial banks have adopted various measures designed to enhance their risk management capabilities and improve their asset quality.

The following table sets forth certain information regarding the non-performing loans of China’s banking industry, the Big Four commercial banks and Other National Commercial Banks as of the date indicated:

	As of December 31, 2006	
	Amount	% Total Loans
	(RMB in billions)	
Non-performing loans by category of the banking industry in China		
Substandard	267.5	1.51%
Doubtful	518.9	2.93
Loss	468.5	2.65
	1,254.9	7.09%
Non-performing loans by types of banks:		
Big Four Commercial Banks	1,053.5	9.22%
Other National Commercial Banks ⁽¹⁾	116.8	2.81

Source: CBRC.

(1) Includes Bank of Communications, China CITIC Bank, China Everbright Bank, Huaxia Bank, China Minsheng Bank, Guangdong Development Bank, Shenzhen Development Bank, China Merchants Bank, Industrial Bank, Shanghai Pudong Development Bank and Evergrowing Bank.

Listing of China’s Commercial Banks

To accelerate the development of China’s banking industry, China’s commercial banks are increasingly looking to list their shares on domestic and overseas markets to enhance capitalization, increase internationalization and improve management capabilities. In June 2005, Bank of Communications, the largest national commercial bank after the Big Four commercial banks, became the first Chinese bank to conduct an initial public offering on the Hong Kong Stock Exchange. China Construction Bank was the first Big Four commercial bank to list on the Hong Kong Stock Exchange in October 2005. Bank of China, China Merchants Bank and Industrial and Commercial Bank of China also completed their initial public offerings on the Hong Kong Stock Exchange in June 2006, September 2006 and October 2006, respectively. In addition, major international commercial banks and financial institutions made substantial investments in, and entered into certain commercial cooperation agreements with, Bank of Communications, China Construction Bank, Bank of China and Industrial and Commercial Bank of China prior to their respective initial public offerings.

BANKING INDUSTRY IN THE PRC

The following table sets forth certain profitability indicators for each of China's listed commercial banks calculated based on IFRS.

	Actual			Ranking		
	2003-2005 Net Income CAGR	2004 Pre Tax ROAA	2005 Pre Tax ROAA	2003-2005 Net Income CAGR	2004 Pre Tax ROAA	2005 Pre Tax ROAA
Industrial and Commercial Bank of China ⁽¹⁾⁽²⁾	29.7%	1.13%	1.09%	8	—	—
Bank of China ⁽¹⁾⁽²⁾	-3.9	0.90	1.19	10	—	—
China Construction Bank ⁽¹⁾	44.6	1.37	1.30	3	—	—
Bank of Communications ⁽¹⁾	45.3	0.75	1.00	2	5	2
China Merchants Bank ⁽¹⁾⁽²⁾	30.2	0.96	0.98	7	1	3
China Minsheng Bank ⁽²⁾	42.0	0.70	0.86	5	6	5
Huaxia Bank ⁽²⁾	43.6	0.60	0.66	4	7	7
Shanghai Pudong Development Bank ⁽²⁾	27.3	0.75	0.84	9	4	6
Shenzhen Development Bank ⁽³⁾	-16.9	0.30	0.27	11	8	8
Industrial Bank ⁽²⁾	35.5	0.91	0.93	6	2	4
China CITIC Bank⁽⁴⁾	47.3%	0.91%	1.00%	1	3	1
Average excluding China CITIC Bank	27.7%	0.84%	0.91%			

Source: Banks' annual reports and prospectuses. All numbers are calculated based on IFRS.

(1) Listed on the Hong Kong Stock Exchange.

(2) Listed on the Shanghai Stock Exchange.

(3) Listed on the Shenzhen Stock Exchange.

(4) 2004 and 2005 Pre-tax ROAA would be 0.98% and 1.09%, respectively, if excluding the management fee paid to CITIC Group.

Bank Lending Remains the Most Important Source of Financing

The Chinese economy has historically relied on bank loans as the primary source of financing. Despite the development of domestic capital markets since the late 1980s and the commercial paper market since 2005, commercial banks remain the principal provider of financing to businesses in China. The following table sets forth the relative proportion of bonds issued, equity raised and bank loans in China between 2002 and 2006:

	2002	2003	2004	2005	2006
Bonds	1.6%	1.2%	1.5%	10.0%	10.7%
Equity	4.7	4.6	7.2	9.2	18.2
Bank Loans	93.7	94.2	91.3	80.8	71.1
Total	100.0%	100.0%	100.0%	100.0%	100.0%

Source: China Statistical Abstract 2006, SDC, www.chinabond.com.cn., PBOC.

BANKING INDUSTRY IN THE PRC

Increasing Demand for Foreign Exchange Products and Services

According to the National Bureau of Statistics of China, from 2002 to 2006, the foreign trade volume of China almost tripled, with a total volume of approximately US\$1,760.7 billion as of the end of 2006, representing a CAGR of 29.8%. The following table sets forth the imports and exports growth of China from 2002 to 2006:

Year	Export	Import	Total	Year on	Year on
				Growth	Growth
				Export	Import
(in billions of US\$, except percentages)					
2002	325.6	295.2	620.8	22.3%	21.2%
2003	438.2	412.8	851.0	34.6	39.8
2004	593.6	560.8	1,154.4	35.5	35.9
2005	761.9	660.3	1,422.2	28.4	17.7
2006	969.1	791.6	1,760.7	27.2	19.9

Source: PBOC.

From 2002 to 2006, actual foreign direct investment into China has grown at CAGR of 7.1% to US\$69.4 billion in 2006. The table below sets forth actual foreign direct investment between 2002 and 2006:

	For the year ended December 31,					Compound Annual Growth Rate (2002-2006)
	2002	2003	2004	2005	2006	
	(in billions of US\$, except percentages)					
Foreign direct investment	52.7	53.5	60.6	60.3	69.4	7.1%

Source: PBOC Quarterly Reports.

The growing foreign trade in China, the steady inflow of foreign investment into China and the PRC Government's policy to encourage Chinese companies to conduct business overseas are expected to create greater future demand for foreign exchange products and services, such as foreign exchange loans, international trade settlement and trade finance.

Currently the Big Four commercial banks and three of the Other National Commercial Banks, including our bank, are licensed to conduct foreign exchange forward sale and purchase business. According to the PBOC, the reform of the RMB exchange rate regime in July 2005 has created greater demand for exchange rate risk hedging services. As China continues to deregulate the derivatives market and further reform the exchange rate regime, we expect the demand for foreign exchange derivative products in China will continue to grow.

Interest Rate Deregulation

Historically, interest rates on deposits and loans were set by and subject to restrictions established by the PBOC. In recent years, as part of the overall reform of the banking system, the PBOC has implemented a series of initiatives designed to gradually liberalize interest rates and move towards a more market-based interest rate regime. See "Regulation and Supervision — PRC Regulation and Supervision — Pricing of Products and Services — Interest Rates for Loans and Deposits." We expect the on-going interest rate liberalization to facilitate the ability of banks to develop and market innovative products and services and adopt risk-based pricing.

Further Expansion of Fee-based Business

Historically, banks in China were restricted in their ability to charge fees for services. Since 2001, the PRC Government has promulgated regulations permitting banks to charge for fee- and commission-based products and services. Currently, certain services are still subject to government guidance prices, including

BANKING INDUSTRY IN THE PRC

basic RMB settlement services specified by the CBRC and the NDRC. Fees for other products and services are determined by banks based on market conditions. See “Regulation and Supervision — PRC Regulation and Supervision — Pricing of Products and Services.” The ratio of non-interest income to total income of the PRC banks was less than 10% in 2005, substantially lower than the ratio in more mature markets. This ratio is expected to increase as domestic banks continue to expand products and services offerings in response to demands for increasingly sophisticated financial products and services by corporate and retail customers.

Increasing Demand for Personal Banking Products and Services

We believe that rising income levels in China will continue to foster demand for personal banking products, including both personal loan products and fee- and commission-based products and services. The following table sets forth key personal income data for China and their respective CAGRs for the periods indicated.

	For the year ended December 31,					Compound Annual Growth Rate (2002- 2006)
	2002	2003	2004	2005	2006	
	(in RMB, except percentages)					
GDP per capita	8,214.0	9,111.0	10,561.0	13,943.6	15,930.8	18.0%
Annual disposable income of urban households per capita	7,703.0	8,472.7	9,421.6	10,493.0	11,759.0	11.2
Annual net income of rural households per capita	2,713.0	2,929.5	3,234.2	3,255.0	3,587.0	7.2

Sources: National Bureau of Statistics of China, PBOC.

Personal Loans

Personal loans totaled RMB 2.4 trillion as of December 31, 2006, representing 10.7% of total loans in China and 14.6% of China’s GDP, according to the National Bureau of Statistics of China. From December 31, 2002 to December 31, 2006, total personal loans in China increased at a CAGR of 22.5%. Comparing to the market share of personal loans in Japan and United States, we believe that the personal loans business in China will continue to demonstrate high growth potential.

	For the year ended December 31, 2006	
	Personal Loans as a Percentage of	
	Total Domestic Loans	Total GDP
China	10.7%	14.6%
Japan	28.3	22.5
United States	53.7	29.3

Sources: CEIC, Federal Deposit Insurance Corporation and National Bureau of Statistics of China.

Residential mortgage loans generally account for the majority of personal loans. The growth of residential mortgage loans has been fostered by increasing private home ownership in China as a result of the PRC Government’s housing reform programs that began in the 1980s. Total residential mortgage loans have grown from RMB 825.8 billion as of December 31, 2002 to approximately RMB 2.0 trillion as of December 31, 2006, according to the National Bureau of Statistics of China. The PRC Government introduced in April 2006 and implemented in June 2006 several monetary policies and other regulatory measures to control the over heating of real estate and certain other industries. Such measures include increasing the minimum down payment requirement from 20% to 30% of the total purchase price of the mortgaged residential property. See

“Regulation and Supervision — PRC Regulation and Supervision — Regulation of Principle Commercial Banking Activities — Lending.”

Bank Cards

The bank card business has been growing rapidly in China. Total bank cards outstanding increased from 380 million as of December 31, 2001 to 1,175 million as of December 31, 2006, according to China UnionPay. The growth has also been accompanied by an expansion of the electronic banking terminal network.

Debit cards have been the primary type of bank card in the PRC. According to China UnionPay, as of December 31, 2006, there were approximately 1,119 million debit cards issued in China, representing a 21.6% growth from December 31, 2005. In addition, to compete for retail customers, China’s commercial banks are continually improving the convenience and scope of services provided through debit cards. For example, some banks enable their customers to conduct various online transactions with their debit cards in addition to enabling them to conduct ordinary transactions such as withdrawals and deposits at automated service machines and payment for store purchases.

Credit card usage in China is very low as compared to the developed economies. According to China UnionPay, as of December 31, 2006, there were a total of approximately 56 million credit cards issued in China, of which a substantial majority were either quasi-credit cards (which require cash deposit balance as a condition for an interest-bearing credit line) or RMB-only credit cards that can only be used in China. According to China UnionPay, as of December 31, 2005, the total number of dual-currency credit cards issued by VISA International Service Association, or VISA International and MasterCard International Inc., or MasterCard International in China that can be used overseas was only approximately 10 million. In addition to the short history of credit card business in China, the low penetration rate of credit cards in China is also due to numerous other factors, including strict regulation on licensing, relatively few points-of-sale, the short period of the use of a nationwide consumer credit information system and the traditional cash-oriented consumption culture. However, as merchants increasingly accept credit cards and consumers in China become more accustomed to using credit cards, demand for credit cards is expected to grow rapidly. The increasing number of licenses granted to banks to engage in the credit card business and the development of China UnionPay are expected to contribute to the growth of China’s credit card industry. In addition, the increases in per capita disposable income and average household income are expected to drive the demand for credit cards.

Wealth Management Services

The number of relatively affluent individuals in China is expected to grow as a result of China’s rapidly growing economy. According to Asia-Pacific Wealth Report 2006 published by Capgemini and Merrill Lynch, China had approximately 320,000 high net worth individuals in 2005, which are defined as individuals holding US\$1 million or more financial assets. These high net worth individuals possessed US\$1,590 billion financial assets in aggregate in 2005. According to a report published by Boston Consulting Group in December 2005, the number of high net worth individuals in China was estimated to grow at an annual rate of approximately 13% in the next several years. We believe these relatively affluent individuals should increasingly require comprehensive and personalized wealth management advice in addition to traditional banking products and services. To meet such demand, many commercial banks in China have in recent years launched wealth management services, which generally entail the provision of one-on-one wealth management advisory services and other value added services. As such services are usually provided only to customers with relatively large aggregate asset balances, they have become an important marketing platform for commercial banks to attract relatively affluent customers and to cross sell other financial products and services.

Rapid Growth of Inter-bank Market

Since its establishment in the mid-1990s, the inter-bank market in China has grown significantly. The PRC inter-bank market currently consists of a number of segments, including inter-bank borrowings, discounted bills, bonds, foreign exchange, futures and gold. In addition, in recent years, there have been significant developments in new financial tools and derivative products in the PRC inter-bank market, which

include, among others, non-recourse repurchase of bonds, bond forwards, interest rate swaps, foreign exchange forwards, foreign exchange swaps and commercial paper. According to the PBOC, the total amount of inter-bank borrowings increased from RMB 197.8 billion in 1998 to RMB 1.3 trillion in 2005, representing a CAGR of 30.9%. The total amount of bonds repurchased on a non-recourse basis increased from RMB 1.4 trillion in 1998 to RMB 18.2 trillion in 2005, representing a CAGR of 44.3%. The total amount of foreign exchange traded in the inter-bank market of China increased from US\$40.8 billion in 1994 to US\$209.0 billion in 2004, representing a CAGR of 17.7%.

Development of a National Credit Information System

In past years, the PRC Government has begun to develop a nationwide credit information system in order to enable PRC commercial banks to make better-informed credit decisions. In 1997, the PBOC began to develop a bank loan registration system to collect credit information on corporate borrowers. As of November 30, 2005, the system had collected data on approximately 4.5 million corporate loan borrowers, and the outstanding RMB-denominated loans recorded in the system amounted to RMB 17.4 trillion, representing approximately 90.0% of the total outstanding loans of financial institutions in China. By the end of 2005, the PBOC had upgraded this system into a consolidated nationwide corporate credit database, and introduced it in selected regions on a trial basis. It is expected that, starting from the second half of 2006, all PRC commercial banks and certain qualified rural credit cooperatives will implement this system. In addition, in September 2003, the PBOC established the Credit Information System Bureau, or CISB, to focus on developing nationwide credit information systems. The CISB started to develop a personal credit information system to collect information on personal credit data in 2004. As of December 31, 2005, the outstanding personal loans recorded in this system amounted to RMB 2.2 trillion, representing 97.5% of the total outstanding personal loans in China. After implementing this system on a trial basis in selected PRC commercial banks and rural credit cooperatives, the CISB officially launched the system on a nationwide basis in January 2006.

Participation of Foreign Banks in China

Historically, operations of foreign banks in China were subject to significant restrictions. Upon China's accession to the WTO in December 2001, all geographic and customer restrictions on foreign currency-denominated business conducted by foreign-invested banks were gradually lifted. Pursuant to China's WTO commitments, foreign-invested banks were gradually allowed to participate in RMB banking activities in more cities before December 2006, and effective from December 2006, all restrictions on geographic presence, customer base and operational licenses were removed. See "Regulation and Supervision — PRC Regulation and Supervision — Regulations of Foreign-invested Banks Operating in China."

Furthermore, we expect more commercial banks from Hong Kong and Macau to enter into the banking market in China. China and Hong Kong signed the Closer Economic Partnership Arrangement, or Hong Kong CEPA, in June 2003. Hong Kong CEPA has further eased restrictions on the activities of Hong Kong banks in China, permitting them to enter the mainland financial sector and conduct Renminbi banking activities earlier than other non-PRC banks under China's WTO commitments. For example, under such CEPA, commercial banks incorporated in Hong Kong with US\$6 billion or more in total assets are qualified to apply for the establishment of branches in the PRC. In October 2003, China and Macau signed a Macau CEPA with similar arrangements. By comparison, under the PBOC and CBRC regulations, commercial banks incorporated in other jurisdictions must have US\$20 billion or more in total assets to be qualified to apply for the establishment of branches in China.

Recently, a series of initiatives designed to further open China's banking industry to foreign participation have been implemented by the PRC Government. The key features of these initiatives include:

- allowing foreign banks to establish banking financial institutions as independent legal entities in China;
- allowing foreign participation in the automobile finance sector;
- lowering capital requirements for the establishment of branches in China by foreign banks;

BANKING INDUSTRY IN THE PRC

- streamlining the procedures for foreign financial institutions to enter the Chinese market;
- increasing the maximum percentage of ownership interests in domestic financial institutions that may be held by foreign investors; and
- encouraging qualified overseas strategic investors to participate in the restructuring and reform of China's banking industry.

As a result, there has been an increase in investments by foreign investors in Chinese commercial banks which have helped strengthen the capital base of Chinese commercial banks in the past few years. In addition, foreign investors are generally also expected to provide assistance in corporate governance, risk management and various business areas thereby enhancing the overall competitiveness of the Chinese commercial banks. In return, foreign investors generally expect to develop and expand cooperation with these banks in areas of anticipated potential growth, such as credit card, wealth management and treasury services. As more banks in China take initiatives to improve their competitiveness in the face of increasing competition from their domestic and foreign peers and as more foreign investors take the opportunity to participate in the rapidly growing banking sector, we expect foreign investments in banks in China to continue to grow.

Rapid Growth of Direct Corporate Financing

In May 2005, the PBOC promulgated regulations allowing qualified companies to issue domestic commercial paper in the inter-bank market. Following such regulatory change, the domestic commercial paper market has grown significantly. According to China Government Securities Depository Trust & Clearing Co. Ltd., from May 2005 to December 2005, approximately 60 corporations in China issued commercial paper, with a total transaction volume of RMB 149.1 billion, of which RMB 91.2 billion, or 61.2%, was sold in the fourth quarter of 2005. As compared with bank loans, commercial paper currently represents a cheaper source of financing. Direct financing channels (such as the issuance of commercial paper) are expected to become an increasingly important source of short-term financing for companies, thereby reducing their dependence on commercial banks for short-term loans. Commercial banks in China are permitted to earn fee-based income from underwriting commercial paper.