Xie Duyang

Chairman of the Board of Supervisors

MANAGEMENT DISCUSSION AND ANALYSIS

Financial Overview

In 2006 China's economy maintained a steady and fast growth with GDP increasing by 10.7%. The PBOC introduced a series of macroeconomic adjustment and control measures, which included lifting interest rates, issuing designated PBOC bills, and raising the statutory deposit reserve rates. Faced with new market conditions and opportunities, while continuing to tighten risk controls amid active business expansion, the Group achieved steady growth in both assets and liabilities, continuous improvement in income structure and stable rise in profit before tax.

Income Statement Analysis

The Group recorded profit before tax of RMB65,717 million in 2006, representing an increase of RMB10,353 million, or 18.70% compared to 2005. The increase was mainly attributable to rises in net interest income and net fee and commission income, which together brought about a 17.78% year-on-year increase in operating income, outweighing the 14.75% increase in operating expenses. Following the expiry of the Group's tax exemption status on 30 June 2005 granted as part of its restructuring, and the resultant increase in income tax for 2006, net profit fell slightly by 1.65% to RMB46,319 million against 2005. However, if the impact of tax exemption was excluded, net profit for 2006 rose by RMB7,071 million, or 18.02% compared to 2005.

Net Interest Income

The Group's net interest income for 2006 grew by RMB23,817 million to RMB140,368 million, representing an increase of 20.43% over 2005.

The table below shows the Group's average balance of assets and liabilities, related interest income or expense, and average yield or cost during the respective period.

	Year ended 31 December 2006			Year ended 31 December 2005		
	Average balance	Interest income/ expense	Average yield/ cost (%)	Average balance	Interest income/ expense	Average yield/ cost (%)
	(In millions of RMB, except percentages)					
Assets						
Total loans and advances to customers	2,753,100	153,456	5.57	2,357,586	127,105	5.39
Investments in debt securities	1,714,993	50,139	2.92	1,263,384	36,379	2.88
Balances with central banks	428,701	7,276	1.70	408,599	6,675	1.63
Amounts due from banks and non-bank financial institutions	129,819	4,318	3.33	160,524	3,442	2.14
Total interest-earning assets	5,026,613	215,189	4.28	4,190,093	173,601	4.14
Total allowances for impairment losses	(71,551)			(60,531)		
Non-interest-earning assets	153,746			153,330		
Total assets	5,108,808	215,189		4,282,892	173,601	
Liabilities						
Deposits from customers	4,424,663	67,811	1.53	3,757,636	52,084	1.39
Amounts due to banks and non-bank financial institutions	220,636	4,877	2.21	164,590	2,920	1.77
Subordinated bonds issued	39,912	1,883	4.72	39,907	1,850	4.64
Other interest-bearing liabilities	6,050	250	4.13	6,828	196	2.87
Total interest-bearing liabilities	4,691,261	74,821	1.59	3,968,961	57,050	1.44
Non-interest-bearing liabilities	93,545			72,182		
Total liabilities	4,784,806	74,821		4,041,143	57,050	
Net interest income		140,368			116,551	
Net interest spread			2.69			2.70
Net interest margin			2.79			2.78

Yields on various interest-earning assets improved over the year, resulting in an increase of 14 basis points in the overall yield on interest-earning assets from the previous year, although this was partly offset by the reduced proportion of average balance of loans and advances to customers in total assets. Meanwhile, the costs of various interest-bearing liabilities increased, leading to a rise of 15 basis points in the overall cost of interest-bearing liabilities compared with 2005. Net interest spread fell by one basis point over the year as the average yield on interest-earning assets rose at a lower rate than that of the average cost of interest-bearing liabilities. To raise the asset yield, the Group made great efforts to control the proportion of non-interest-earning assets, and as a result, interest-earning assets grew faster with increased share in the total assets. The net interest income grew at a rate slightly higher than that of the average balance of interest-earning assets, causing the net interest margin to move up by one basis point over the previous year.

Buoyed by the hikes of benchmark lending rates by the PBOC and adjustments in its operating strategies, the Group achieved sustained growth in yields on loans and advances to customers as well as investment in debt securities during the second half of 2006. The yields on interest-earning assets for the year was 13 basis points higher than in the first half of 2006, while the cost of interest-bearing liabilities also showed a slight increase of 3 basis points, leading to increases in the net interest spread and net interest margin for the year by 10 basis points and 9 basis points respectively over the first half of 2006.

Interest Income

The Group's interest income in 2006 was RMB215,189 million, with an increase of RMB41,588 million, or 23.96% over 2005. This was primarily attributable to the rises of the balances of and yields on loans and advances to customers as well as investment in debt securities.

Interest Income from Loans and Advances to Customers

The table below shows the Group's average balance, the interest income and average yield of each component of loans and advances to customers.

	Year ended 31 December 2006			Year ended 31 December 2005		
	Average balance	**Interest income**	**Average yield (%)**	Average balance	Interest income	Average yield (%)
	(In millions of RMB, except percentages)					
Corporate loans	**1,964,443**	**116,047**	**5.91**	1,723,111	96,679	5.61
Personal loans	**517,088**	**29,403**	**5.69**	429,193	23,781	5.54
Discounted bills	**227,537**	**5,456**	**2.40**	171,815	5,304	3.09
Operations outside Mainland China	**44,032**	**2,550**	**5.79**	33,467	1,341	4.01
Loans and advances to customers	**2,753,100**	**153,456**	**5.57**	2,357,586	127,105	5.39

Interest income from loans and advances to customers increased to RMB153,456 million by RMB26,351 million, or 20.73% over 2005, as a result of the rapid expansion of various lending businesses and an increase in the average yield on loans. Average yield on loans and advances to customers rose over 2005, largely due to the following factors: increases of 30 and 15 basis points were recorded for yields on corporate and personal loans respectively, as the PBOC raised the benchmark lending rates twice in 2006 and the Group enhanced its product pricing abilities; the decrease in average yield on discounted bills during the year was partly offset, as in the second half of 2006 the Group actively curtailed the bill discounting business with the average balance for the year dropping by RMB35,529 million compared to the first half of the year; lastly, there was an increase of 178 basis points in the average yield on operations outside Mainland China over 2005 because of USD interest rate hikes.

Interest Income from Investments in Debt Securities

Interest income from debt securities investments was RMB50,139 million, representing a year-on-year increase of RMB13,760 million, or 37.82%, as a result of the increase in the average balance of and the average yield on investment in debt securities. An increase of four basis points in the average yield was attributable to the increase of the average yield on foreign currency-denominated debt securities and their increased proportion within the total investments. The Group raised the investment portfolio yield by gradually scaling down foreign currency inter-bank lending balance and raising the balance of investments in debt securities. The investments mainly focused on the acquisition of asset-backed or mortgage-backed securities and corporate bonds, with a moderate increase in credit spread products such as callable bonds of institutions.

Interest Income from Balances with Central Banks

Interest income from balances with central banks amounted to RMB7,276 million, representing an increase of 9.00%. Because the PBOC lifted the statutory deposit reserve rate three times in 2006, both the average balance and the proportion of the statutory reserve funds increased. In addition, the Group reduced the average surplus deposit reserve rate by around one percentage point against the previous year while maintaining adequate liquidity, leading to the rise in the average yield on balances with central banks.

Interest Income from Amounts due from Banks and Non-bank Financial Institutions

Interest income from amounts due from banks and non-bank financial institutions rose to RMB4,318 million by RMB876 million, or 25.45% compared with 2005. This was chiefly due to the rise in the USD interest rates, which drove the average yield up by 119 basis points compared with 2005.

Interest Expense

Interest expense of RMB74,821 million was RMB17,771 million, or 31.15%, higher than in 2005, primarily due to an increase in the average balance of customers' deposits and a higher average interest rate for deposits.

Interest Expense on Deposits from Customers

Interest expense on deposits from customers was RMB67,811 million, with a rise of RMB15,727 million, or 30.20% against 2005, as a result of the increase in the average balance of deposits and higher average deposit rates. Influencing factors include the PBOC's decision to raise benchmark interest rates for deposits in August 2006, the rise of USD interest rates as well as the increase in the average balance of time deposits as part of the total deposits. Owing to the active domestic capital market, the customers are more willing to make demand deposits with us, as a result, the proportion of average balance of time deposits started to fall in the second half of 2006.

Interest Expense on Amounts due to Banks and Non-bank Financial Institutions

Interest expense on amounts due to banks and non-bank financial institutions reached RMB4,877 million, 67.02% higher than in 2005, primarily due to increases in the average balance and the average cost. The average cost rose by 44 basis points from the previous year, largely because the average cost of foreign currency-denominated amounts due to banks and non-bank financial institutions climbed in tandem with USD interest rates, as well as a bigger share of foreign currency assets in the average balance of the amounts due to banks and non-bank financial institutions.

Net Fee and Commission Income

	Year ended 31 December 2006	Year ended 31 December 2005
	(In millions of RMB)	
Fee and commission income	**14,627**	9,261
Agency fees from securities, foreign currency dealing and insurance services	**3,934**	1,927
Bank card fees	**3,836**	2,618
Remittances, settlement and account management fees	**2,768**	2,116
Consultancy and advisory fees	**1,466**	848
Commission on trust business	**1,229**	946
Guarantee fees	**636**	290
Payment and collection services fees	**335**	246
Others	**423**	270
Fee and commission expenses	**1,056**	806
Net fee and commission income	**13,571**	8,455

Net fee and commission income of RMB13,571 million was realised, 60.51% higher than in 2005, as the Bank took measures to improve its performance measurement and incentive methods, invested more resources in fee and commission based business, and exploited the competitive edge of its distribution network. The ratio of net fee and commission income to operating income reached 8.95%, an increase of 2.38 percentage points over 2005.

Agency fees for securities, foreign currency dealing and insurance services rose by RMB2,007 million, or 104.15%, largely benefiting from the considerable income growth of the securities agency business as well as purchases and sales of foreign exchange. Leveraging business opportunities from the revival of the domestic capital market, the Group stepped up marketing activities of its agency services for products such as funds, government bonds and insurance as well as underwriting commercial paper, and gained notable results. Specifically, we provided agency services for the initial issuance of funds totalling RMB64,600 million, nearly an eightfold increase over 2005; and underwrote commercial paper amounting to RMB65,775 million, maintaining our leading market position. Increased income from purchases and sales of foreign exchange was largely brought about by greater volume of purchases and sales of foreign exchange following the reform of the RMB exchange rate regime.

Bank card fees climbed by RMB1,218 million or 46.52%, primarily due to the substantial increases in the spending amount of bank cards and ATM transactions. In particular, the total spending amount of bank cards reached RMB243.7 billion, up 68.86% over 2005.

Other Operating Loss/Income

In 2006 the Group's other operating loss amounted to RMB4,401 million, comprising a net foreign exchange loss of RMB6,068 million, which was resulted from the appreciation of the RMB; and a net gain on disposal of property and equipment and other income of RMB1,667 million.

The specific composition of foreign exchange exposures as at 31 December 2006 and the respective profit and loss in 2006 are set out below:

	As at 31 December 2006 Composition of foreign exchange exposures[1]			Year ended 31 December 2006
	On balance sheet	Off balance sheet	Total	Foreign exchange gain/(loss)
	(In millions of RMB)			
Foreign exchange exposures related to the foreign currency assets arising from the USD22,500 million capital injection				
— Foreign currency assets arising from the USD22,500 million capital injection	175,615		175,615	(5,965)
— Respective foreign exchange hedging option contract		(175,615)	(175,615)	2,365
Subtotal	175,615	(175,615)	—	(3,600)
A swap of USD8,969 million	70,006	(70,006)	—	(1,987)
Exposures from foreign currency-denominated operating funds of USD5,205 million	40,625		40,625	(1,380)
Customer-driven foreign exchange transactions and other foreign exchange exposures	(14,425)	17,251	2,826	899
Net foreign exchange exposures[2]	271,821	(228,370)	43,451	
Net foreign exchange loss				(6,068)

1. The foreign exchange exposures are RMB equivalent foreign currency exposures. Positive figures represent long positions of foreign currency and negative figures represent short positions of foreign currency.
2. The net foreign exchange exposures represent the net long position disclosed in "Currency Concentrations" of the unaudited supplementary financial information.

— Foreign exchange exposures related to the foreign currency assets arising from the USD22,500 million capital injection

In 2006, a foreign exchange loss of RMB5,965 million was recorded on foreign currency assets arising from the capital injection of USD22,500 million as a result of the appreciation of the RMB; meanwhile, the net gain from the revaluation of the fair value of the foreign exchange option contract purchased to hedge currency risk of the above assets was RMB2,365 million. Thus the net foreign exchange loss from foreign exchange exposures related to the foreign currency assets arising from the capital injection of USD22,500 million was RMB3,600 million.

— A swap of USD8,969 million

The Group entered into a USD/RMB swap contract of USD8,969 million with the PBOC. Without affecting its foreign exchange exposures, the Group capitalised on the broad range of foreign currency investment, and gained extra interest income from the higher yields on assets denominated in US dollars over those on assets denominated in RMB. In 2006, the net realised and revaluation loss for the foreign exchange swap of USD8,969 million totalled RMB1,987 million. Meanwhile, the additional interest income from the assets denominated in US dollars arising from the swap transaction was shown in the interest income and net gain arising from investment securities in the consolidated income statement.

— Exposures from foreign currency-denominated operating funds of USD5,205 million

As at 31 December 2006, the Group's exposures from the accumulated purchase of foreign currency-denominated operating funds were USD5,205 million. In 2006 the net foreign exchange loss from the above funds was RMB1,380 million.

— Customer-driven foreign exchange transactions and other foreign exchange exposures

The net gain from customer-driven foreign exchange transactions and the net revaluation difference from other foreign exchange exposures totalled RMB899 million in 2006.

The above foreign exchange loss has been compensated by the additional interest income arising from the foreign currency assets which are mainly denominated in US dollars. The market yields on assets denominated in US dollars were higher than the market yields on assets denominated in RMB.

Operating Expenses

	Year ended 31 December 2006	Year ended 31 December 2005
	(In millions of RMB, except percentages)	
Staff costs	**32,285**	27,298
Property and equipment expenses	**11,133**	10,552
Business tax and surcharges	**8,977**	7,401
Other operating expenses	**14,267**	12,841
Total operating expenses	**66,662**	58,092
Cost-to-income ratio	**43.97%**	45.13%

In 2006 the Group continued to contain operating expenses and achieved a lower cost-to-income ratio of 43.97%.

The Group's operating expenses for 2006 was RMB66,662 million, with an increase of RMB8,570 million, or 14.75% over 2005, primarily due to higher salaries, bonuses and welfare payments which reflected improvements in operating results. Staff cost rose by 18.27%, reflecting the high growth of profit before tax. The Group also invested more in its network infrastructure and technology, and actively launched various marketing initiatives to further support the development of its strategic business.

Allowances for Impairment Losses

	Year ended 31 December 2006	Year ended 31 December 2005
	(In millions of RMB)	
Loans and advances to customers	**18,997**	13,706
Available-for-sale securities	**213**	948
Property and equipment	**42**	293
Others	**(38)**	311
Total allowances for impairment losses	**19,214**	15,258

In 2006 the Group's total allowances for impairment losses was RMB19,214 million, representing a year-on-year increase of RMB3,956 million, in which allowances for impairment losses on loans and advances to customers rose by RMB5,291 million; allowances for non-credit impairment losses fell to RMB217 million, RMB1,335 million lower than in 2005.

The main reasons for the rise in the allowances for impairment losses on loans and advances are that the Group extended more loans than in 2005 and increased provisioning accordingly. Meanwhile, changes in the structure of existing non-performing loans ("NPLs") also resulted in more provisioning for the impaired loans.

Income Tax

Income tax for 2006 totalled RMB19,398 million, an increase of RMB11,130 million compared with 2005, largely due to the improved profit before tax, and the income tax exemption of RMB7,848 million, which we enjoyed in the first half of 2005 in relation to our restructuring.

The effective tax rate for 2006 was 29.52%, lower than the statutory tax rate, primarily because the interest income derived from government bonds was not taxable.

Balance Sheet Analysis

Assets

The following table shows the composition of the Group's total assets as at the dates indicated.

	As at 31 December 2006		As at 31 December 2005	
	Amount	% of total	Amount	% of total
	(In millions of RMB, except percentages)			
Gross loans and advances to customers	2,873,609		2,458,398	
Allowances for impairment losses of loans	(77,633)		(63,085)	
Net loans and advances to customers	2,795,976	51.32	2,395,313	52.23
Investments	1,909,392	35.04	1,413,871	30.83
Cash and balances with central banks	539,673	9.91	480,136	10.47
Amounts due from banks and non-bank financial institutions	82,185	1.51	190,108	4.15
Other assets[1]	121,285	2.22	106,314	2.32
Total Assets	5,448,511	100.00	4,585,742	100.00

1. Consist of interest in an associated company, property and equipment, goodwill, deferred tax assets and other assets.

As at 31 December 2006, the Group's total assets amounted to RMB5,448,511 million, representing an increase of RMB862,769 million, or 18.81% as compared with the end of last year, primarily thanks to gains in net loans and advances to customers as well as investments. As a result of its surplus liquidity, the Group increased its investment in debt securities. The investments increased by RMB495,521 million, or 35.05%, higher than the increase rate of net loans and advances to customers. The proportion of investments in total assets also went up by 4.21 percentage points compared with the previous year.

During 2006 the PBOC raised the statutory deposit reserve rates three times. As a result, the Group's cash and balances with central banks increased by RMB59,537 million, or 12.40%. The decline of money market placements and debt securities held under repurchase agreements led to a sharp drop in the net amounts due from banks and non-bank financial institutions.

Loans and Advances to Customers

The following table shows the composition of loans and advances to customers by product type as at the dates indicated.

	As at 31 December 2006		As at 31 December 2005	
	Amount	**% of total**	Amount	% of total
	(In millions of RMB, except percentages)			
Corporate loans	**2,057,961**	**71.62**	1,775,791	72.23
Working capital loans	**991,927**	**34.52**	908,688	36.96
Fixed assets loans	**1,038,240**	**36.13**	842,415	34.27
Infrastructure loans	**711,456**	**24.76**	550,851	22.41
Real estate development loans	**232,649**	**8.10**	190,977	7.77
Technical improvement loans	**90,979**	**3.17**	98,153	3.99
Corporate mortgage loans	**3,156**	**0.10**	2,434	0.10
Other loans[1]	**27,794**	**0.97**	24,688	1.00
Personal loans	**585,085**	**20.36**	453,889	18.46
Residential mortgage loans	**428,039**	**14.90**	348,219	14.16
Personal consumption loans	**72,620**	**2.52**	60,150	2.45
Others loans[2]	**84,426**	**2.94**	45,520	1.85
Discounted bills	**159,368**	**5.55**	194,122	7.90
Operations outside Mainland China	**71,195**	**2.47**	34,596	1.41
Gross loans and advances to customers	**2,873,609**	**100.00**	2,458,398	100.00

1. Primarily consist of factoring, overdrafts, trade finance facilities and on-lending loans.

2. Primarily consist of individual commercial property mortgage loans, personal business loans, credit card overdrafts and education loans.

As at 31 December 2006, gross loans and advances to customers were RMB2,873,609 million, an increase of RMB415,211 million, or 16.89% compared with 2005. Such a sizable increase was chiefly attributable to the strong demand for loans and increased marketing efforts alongside effective risk control.

As at 31 December 2006, the corporate loan balance of RMB2,057,961 million showed an increase of RMB282,170 million, or 15.89% over 2005. As 2006 was the first year of China's Eleventh Five-Year Plan, the increase in new large scale projects drove strong demand for medium to long-term loans, which we were well placed to meet with our advantages in the established businesses. The increase of infrastructure loans accounted for 56.92% of the increase of corporate loans, an increase of RMB160,605 million, or 29.16% against 2005. Real estate development loans also rose by RMB41,672 million, or 21.82% over the previous year. New lending in this area was mainly extended to housing projects and customers with internal credit ratings of A or above.

Personal loans, one of the Group's strategic development priorities, grew by RMB131,196 million, or 28.90% as compared with the end of 2005. With our increasing brand advantage and competitiveness, residential mortgage loans rose by RMB79,820 million, or 22.92% as compared with the end of 2005. The gains in personal credit lines offset the fall in personal automobile loans, and generated an increase of RMB12,470 million in personal consumption loans. Other loans climbed by RMB38,906 million, or 85.47% over 2005, largely due to the rapid growth of individual commercial property mortgage loans and personal business loans.

As at 31 December 2006, the balance of discounted bills was RMB159,368 million, representing a drop of RMB34,754 million against the end of 2005, which was chiefly due to the initiatives taken by the Group in the second half of 2006 to control the bill discounting business, and in particular the growth of relatively low yield inter-bank discounting, so as to satisfy the credit needs of our strategic businesses and quality customers.

Operations outside Mainland China showed a year-on-year rise of 105.79%, mainly attributable to the substantial increase in the Group's total loans outside Mainland China following the acquisition of the Bank of America (Asia) Limited.

Investments

The following table shows the composition of the Group's investments as at the dates indicated:

	As at 31 December 2006		As at 31 December 2005	
	Amount	**% of total**	Amount	% of total
	(In millions of RMB, except percentages)			
Debt investments	**1,353,418**	**70.88**	958,470	67.79
Receivables	**546,357**	**28.62**	443,729	31.38
Equity investments	**9,617**	**0.50**	11,672	0.83
Total investments	**1,909,392**	**100.00**	1,413,871	100.00

As RMB-denominated deposits continued to grow in 2006, creating excess operating funds, the Group increased its investment in debt instruments. In particular, the amount of held-to-maturity debt securities increased by RMB394,735 million, or 61.30% over 2005. Receivables increased by RMB102,628 million, or 23.13%, mainly due to the subscription of designated PBOC bills totalling RMB103,000 million.

Liabilities

The following table shows the composition of the Group's total liabilities as at the dates indicated:

	As at 31 December 2006		As at 31 December 2005	
	Amount	**% of total**	Amount	% of total
	(In millions of RMB, except percentages)			
Deposits from customers	**4,721,256**	**92.24**	4,006,046	93.21
Amounts due to banks and non-bank financial institutions	**243,968**	**4.77**	164,524	3.83
Subordinated bonds issued	**39,917**	**0.78**	39,907	0.93
Other liabilities[1]	**113,166**	**2.21**	87,588	2.03
Total liabilities	**5,118,307**	**100.00**	4,298,065	100.00

1. Consist of amounts due to central banks, certificates of deposit issued, current tax liabilities, deferred tax liabilities, and other liabilities and provisions.

As at 31 December 2006, the Group's total liabilities amounted to RMB5,118,307 million, an increase of RMB820,242 million, or 19.08% against 2005. Deposits from customers remain the Group's primary source of funding, accounting for 92.24% of total liabilities. Owing to the boom of the stock market and the rapid growth of fund issuances volume, securities and funds houses substantially increased their deposits in the Group. This development resulted in amounts due to banks and non-bank financial institutions of RMB243,968 million as at 31 December 2006, RMB79,444 million, or 48.29%, higher than at the end of 2005.

Deposits from Customers

The following table sets forth the Group's deposits from customers by product type as at the dates indicated:

	As at 31 December 2006		As at 31 December 2005	
	Amount	**% of total**	Amount	% of total
	(In millions of RMB, except percentages)			
Corporate deposits	**2,466,284**	**52.23**	2,094,047	52.27
Demand deposits	**1,778,715**	**37.67**	1,474,483	36.81
Time deposits	**687,569**	**14.56**	619,564	15.46
Personal deposits	**2,207,442**	**46.76**	1,897,421	47.37
Demand deposits	**830,402**	**17.59**	708,608	17.69
Time deposits	**1,377,040**	**29.17**	1,188,813	29.68
Operations outside Mainland China	**47,530**	**1.01**	14,578	0.36
Total deposits from customers	**4,721,256**	**100.00**	4,006,046	100.00

As at 31 December 2006, the Group's deposits from customers amounted to RMB4,721,256 million, with an increase of 17.85% against the end of 2005, providing a stable funding source for its lending and investment businesses. Corporate and personal deposits rose by 17.78% and 16.34% respectively. The latter grew at a rate slower than the former, primarily because the active domestic capital market diluted domestic customers' savings. Domestic demand deposits moved up by RMB426,026 million, or 19.51% compared with the end of 2005, higher than the 14.17% growth rate of time deposits. The proportion of demand deposits within domestic customers' deposits moved up by 1.13 percentage points, turning around the condition that a growing part of the customers' deposits were time deposits.

Shareholders' Equity

	As at 31 December 2006	As at 31 December 2005
	(In millions of RMB)	
Share capital	**224,689**	224,689
Capital Reserve	**42,091**	42,091
General reserve	**10,343**	10,332
Retained earnings	**43,092**	4,783
Other reserves[1]	**9,989**	5,782
Total equity attributable to shareholders of the Bank	**330,204**	287,677

1. Consist of statutory surplus reserve, investment revaluation reserve, exchange reserve and minority interests.

As at 31 December 2006, shareholders' equity in the Group amounted to RMB330,204 million, with an increase of RMB42,527 million against the end of the previous year. In accordance with the PRC Company Law of 2005, since 1 January 2006, no further appropriation to the statutory public welfare fund is required, while the fund's pre-existing balance has been transferred to the statutory surplus reserve fund.

Capital Adequacy Ratio

The following table sets forth, as at the dates indicated, the information related to the Group's capital adequacy ratios.

	As at 31 December 2006	As at 31 December 2005
	(In millions of RMB, except percentage)	
Core capital adequacy ratio[1]	**9.92%**	11.08%
Capital adequacy ratio[2]	**12.11%**	13.59%
Components of capital base		
Core capital:		
Paid-up ordinary share capital	**224,689**	224,689
Share premium	**42,091**	42,091
Other reserves[3]	**42,658**	17,429
Minority Interests	**95**	98
Total core capital	**309,533**	284,307
Supplementary capital:		
General provision for doubtful debts	**28,736**	24,584
Term subordinated bonds	**40,000**	40,000
Total supplementary capital	**68,736**	64,584
Total capital base before deductions	**378,269**	348,891
Deductions:		
Goodwill	**(1,743)**	—
Unconsolidated equity investments	**(2,131)**	(787)
Total capital base after deductions	**374,395**	348,104
Total risk-weighted assets[4]	**3,091,089**	2,562,153

1. Core Capital adequacy ratio is calculated by dividing the net amount of core capital after deductions of 100% goodwill and 50% unconsolidated equity investments by risk-weighted assets.
2. Capital adequacy ratio is calculated by dividing the total capital base after deductions with risk-weighted assets.
3. Other reserves have been deducted by the dividend declared by the Bank after balance sheet date.
4. The balances of the total risk-weighted assets include 12.5 times of market risk capital charge.

In accordance with the Regulation Governing Capital Adequacy of Commercial Banks [Order (2004) No. 2] issued by the CBRC, on a consolidated basis, as at 31 December 2006 the Group's capital adequacy ratio was 12.11% and the core capital adequacy ratio was 9.92%, 1.48 and 1.16 percentage points lower than at the end of 2005. This was primarily driven by two factors: the expansion of the asset business, which led to an increase in risk-weighted assets; and the reduction in the capital base as a result of goodwill generated by the Bank's acquisition of the Bank of America (Asia) Limited completed on 29 December 2006 and increase in the carrying values of unconsolidated equity investments.

Loan Quality Analysis

Distribution of Loans by Grading

The following table sets forth, as at the dates indicated, the distribution of the Group's loans by the five-category loan classification under which NPLs include substandard, doubtful and loss loans.

	As at 31 December 2006		As at 31 December 2005	
	Amount	**% of total**	Amount	% of total
	(In millions of RMB, except percentages)			
Normal	**2,513,322**	**87.46**	2,072,969	84.32
Special mention	**265,888**	**9.25**	290,960	11.84
Substandard	**29,261**	**1.02**	42,456	1.73
Doubtful	**55,983**	**1.95**	45,457	1.84
Loss	**9,155**	**0.32**	6,556	0.27
Gross loans and advances to customers	**2,873,609**	**100.00**	2,458,398	100.00
Non-performing loans	**94,399**		94,469	
Non-performing loan ratio		**3.29**		3.84

In 2006 the Group proceeded with the reform of its risk management system, innovation of risk management tools, optimisation of the credit process and adjustment to the credit structure, and the quality of its credit assets continued to improve. Non-performing loans fell from RMB94,469 million at the end of 2005 to RMB94,399 million at the end of 2006, with the NPL ratio dropping from 3.84% to 3.29% during the year.

As the Group attaches great importance to the management of special mention loans, the customer groups identified as having potential risks have been monitored closely. Possible loan losses have been avoided or reduced through restructuring, scaling down of the relevant business, and loan recovery on a case by case basis. In 2006 the proportion of special mention loans in gross loans and advances was reduced from 11.84% at the end of 2005 to 9.25% at the end of 2006.

In 2006 the Group strengthened its efforts to dispose of the NPLs, especially substandard loans with relatively less expected loss. As a result, there is a significant decline in the proportion of substandard loans. Meanwhile, due to the downgrade of some substandard loans, the proportion of doubtful loans rose.

Distribution of Loans and NPLs by Product Type

The following table sets forth, as at the dates indicated, loans and NPLs by product type:

	As at 31 December 2006			As at 31 December 2005		
	Loans	NPLs	% of NPLs to loans	Loans	NPLs	% of NPLs to loans
	(In millions of RMB, except percentages)					
Corporate loans	**2,057,961**	**83,844**	**4.07**	1,775,791	85,654	4.82
Working capital loans	**991,927**	**60,044**	**6.05**	908,688	62,755	6.91
Fixed assets loans	**1,038,240**	**21,075**	**2.03**	842,415	20,560	2.44
Others[1]	**27,794**	**2,725**	**9.80**	24,688	2,339	9.47
Personal loans	**585,085**	**10,378**	**1.77**	453,889	8,668	1.91
Residential mortgage loans	**428,039**	**5,843**	**1.37**	348,219	4,605	1.32
Personal consumption loans	**72,620**	**2,424**	**3.34**	60,150	2,221	3.69
Others[2]	**84,426**	**2,111**	**2.50**	45,520	1,842	4.05
Discounted bills	**159,368**	**—**	**—**	194,122	—	—
Operations outside Mainland China	**71,195**	**177**	**0.25**	34,596	147	0.42
Total	**2,873,609**	**94,399**	**3.29**	2,458,398	94,469	3.84

1. Primarily consist of factoring, overdrafts, trade finance facilities and on-lending loans.
2. Primarily consist of individual commercial property mortgage loans, personal business loans, credit card overdrafts and education loans.

In terms of product structure, the quality of both corporate and personal loans improved, with their NPL ratios at the end of 2006 falling by 0.75 and 0.14 percentage points compared with the end of 2005 respectively.

Personal credit business developed rapidly, and with this expansion came greater credit risk exposure. Accordingly, the Bank has implemented strict lending criteria for personal loans, and rigorously screened credit applicants during the credit application process. Teams specialising in the assessment of personal loans have been put in place to control the quality of new loans. At the same time, the Bank has appointed special agencies to collect and dispose of NPLs promptly, and established a standardised collection process for personal loans.

Distribution of Corporate Loans and NPLs by Industry

	As at 31 December 2006				As at 31 December 2005			
	Loans	% of total	NPLs	% of NPLs to loans	Loans	% of total	NPLs	% of NPLs to loans
	(In millions of RMB, except percentages)							
Corporate loans	**2,057,961**	**71.62**	**83,844**	**4.07**	1,775,791	72.23	85,654	4.82
Manufacturing	**510,427**	**17.76**	**28,791**	**5.64**	433,104	17.61	25,967	6.00
Transportation, storage and postal services	**326,715**	**11.37**	**4,932**	**1.51**	278,532	11.33	5,512	1.98
Production and supply of electric power, gas and water	**318,493**	**11.08**	**4,348**	**1.37**	265,647	10.81	7,918	2.98
Property development	**302,290**	**10.52**	**18,290**	**6.05**	256,396	10.43	17,611	6.87
Construction	**96,580**	**3.36**	**3,755**	**3.89**	86,855	3.53	4,443	5.12
Water, environment and public utility	**92,173**	**3.21**	**1,400**	**1.52**	75,959	3.09	1,320	1.74
Education	**77,458**	**2.69**	**1,234**	**1.59**	63,395	2.58	644	1.02
Wholesale and retail	**73,526**	**2.56**	**8,170**	**11.11**	63,179	2.57	7,926	12.55
Leasing and commercial services	**63,659**	**2.22**	**3,119**	**4.90**	47,444	1.93	3,236	6.82
Telecommunications, computer services and software	**38,962**	**1.36**	**1,452**	**3.73**	60,304	2.45	1,494	2.48
Mining	**55,909**	**1.95**	**672**	**1.20**	49,332	2.01	717	1.45
Others[1]	**101,769**	**3.54**	**7,681**	**7.55**	95,644	3.89	8,866	9.27
Personal loans	**585,085**	**20.36**	**10,378**	**1.77**	453,889	18.46	8,668	1.91
Discounted bills	**159,368**	**5.55**	**—**	**—**	194,122	7.90	—	—
Operations outside Mainland China	**71,195**	**2.47**	**177**	**0.25**	34,596	1.41	147	0.42
Total	**2,873,609**	**100.00**	**94,399**	**3.29**	2,458,398	100.00	94,469	3.84

1. Primarily consist of healthcare, social security and social welfare; culture, sports and entertainment; government agencies and non-government organisations.

In 2006 the Group saw the NPL ratios all falling for industries that took up the largest proportions of the Group's lending business, i.e. manufacturing; transportation, storage and postal services; production and supply of electric power, gas and water; and property development. The NPL ratio for education, including school properties, local and corporate schools, worsened because of the deterioration of certain borrowers' financial position.

The Bank has put in place industry rating and internal rating systems, which can identify those industries with regulatory restrictions, excess capacity and stagnant development so that timely adjustments can be made to our credit approval criteria. Priority has been given to those customers with good development prospects and financial conditions, stable source of repayment and good credit records; whereas credit has not been granted to those enterprises that are not compatible with macroeconomic adjustment policies. The Bank also has specialised departments and expertise tracking the development of various industries and providing forward-looking guidance on the credit business development for these industries.

Strategic Transformation to Enhance Core Competitiveness

Wholesale Business	Wholesale & Retail Businesses
Traditional Business	Traditional & New Businesses
Interest Income	Interest Income & Non-interest Income
Domestic Market	Domestic & Overseas Markets

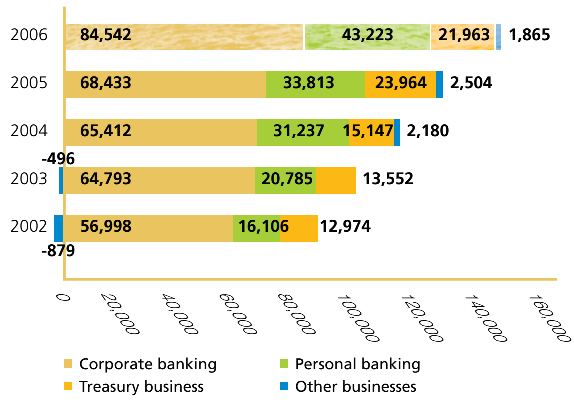
Business Operations

In 2006 we focused our efforts on business transformation and structural adjustment. We actively expanded our quality customer base and strived to strengthen our leading position in financial products and services for which we enjoy traditional advantages. We also vigorously developed our retail banking, international business, treasury operations, and wealth management in order to explore new business opportunities and gain new profit growth points. As a result, we achieved some initial success in business transformation, and the income from various businesses steadily increased.

According to the PBOC, as at 31 December 2006 our market share of total loans in the PRC was 12%, while our market share of total deposits was 13.4%. The Group's operating income increased by 17.78% to RMB151,593 million over 2005, in which corporate banking, personal banking, treasury operations, and other businesses including overseas business accounted for 55.77%, 28.51%, 14.49% and 1.23% respectively.

The chart below sets out the operating income over the last five years for each respective line of business:

Operating income
In millions of RMB



Note: Other businesses include equity investments, overseas operations, and head office income and expenses that can be neither attributed directly to a segment nor allocated on a reasonable basis.

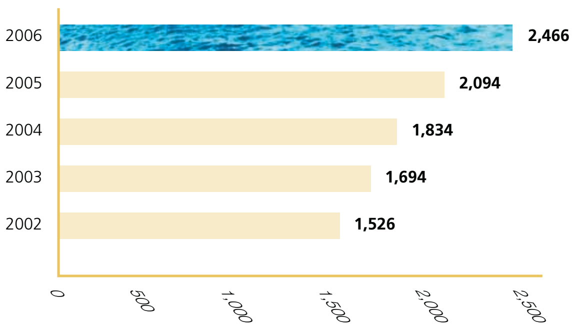
> Corporate banking remains the Group's major source of income and the foundation of our strategic development.

Corporate Banking

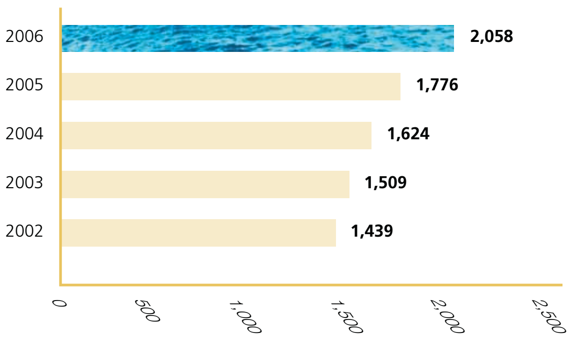
In 2006 the profit before tax for corporate banking reached RMB36,642 million, accounting for 55.76% of the profit before tax of the Group. As at 31 December 2006, corporate loans totalled RMB2,057,961 million, an increase of 15.89% compared to the end of 2005, while corporate deposits amounted to RMB2,466,284 million, a rise of 17.78% compared to the end of 2005.

The following charts set out the development of the Group's corporate banking business over the past five years:

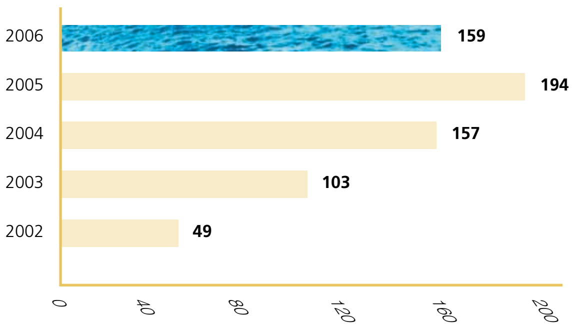
Corporate deposits
In billions of RMB



Corporate loans
In billions of RMB



Discounted bills
In billions of RMB



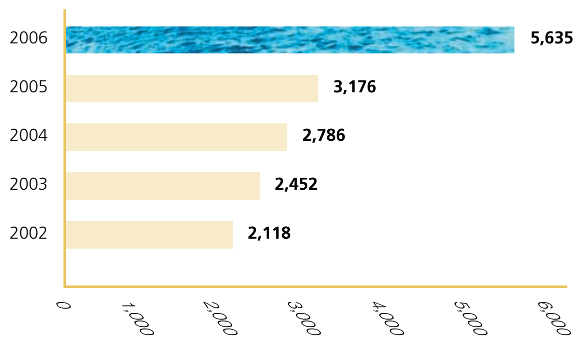
China's Eleventh Five-Year Plan began in 2006, resulting in robust demand for medium and long-term corporate loans. The Group strengthened its leading position in this area by intensifying marketing efforts and expanding quality customer base. In 2006 the amount of fixed asset loans increased by 23.25% over 2005 to RMB1,038,240 million, of which the increase in infrastructure loans accounted for 56.92% of the increase in corporate loans. As at the end of 2006, the balance of corporate loans granted to customers with internal credit ratings of A or above increased by 5.7 percentage points to 83.56% of our total corporate loan balance over 2005.

The small-sized enterprise business is regarded as one of our strategic priorities because of its great growth potential and expected contribution to the optimisation of our income structure. In 2006 we actively explored the effective operating model for small-sized enterprise business, implemented a standardised credit process, increased market penetration of our brands such as "Quick Finance" and "Road of Growth", and developed specialised customer service teams, resulting in the healthy development of this business. By the end of 2006, we had processed 4,796 "Quick Finance" and "Road of Growth" customer accounts. The accumulated balance of loans extended was RMB18,937 million, with the NPL ratio at only 0.07%. Our "Quick Finance" business was awarded as the "Best Financing Solution for Small and Medium-sized Enterprises" by the Association of Small and Medium Enterprises under the National Development and Reform Commission together with China Banking Association.

With the introduction and improvement of key fee and commission based services, we enhanced the market competitiveness of our agency, remittance, settlement and custodial services by optimising operating procedures, strengthening our internal performance evaluation system, and clarifying operational responsibilities. These initiatives drove up the proportion of net fee and commission income in our total corporate banking income. Net fee and commission income from corporate banking reached RMB5,635 million for 2006, 77.42% higher than in 2005.

The development of the Group's net corporate fee and commission income over the past five years are set out below:

Net corporate fee and commission income
In millions of RMB



- In 2006 income from funds settlement agency services for institutional customers and insurance agency services increased by 78.3% and 63.9% respectively. We maintained our leading position in payment processing of public finance and independent custodial services for securities settlement funds. We also successfully introduced funds settlement services for shares transfer of unlisted companies. We were the first pilot bank to provide standardised warehouse receipt lending services, and got a seat on the futures exchange for collateral transactions. Furthermore, we also became the only pilot bank to provide independent custodial services for B-share securities settlement funds.

- International settlements rose by USD49,397 million over 2005 to USD190,322 million in 2006; maintaining consecutive increases of over 30% for the last four years. Income from international settlement business of RMB2,019 million was realised, 51.7% higher than in 2005.

- As at the end of 2006, total net value of assets under custody reached RMB265,238 million, with an increase of 118.57% over 2005, of which, net asset value of securities investment funds under custody amounted to RMB192,352 million, a significant increase of 141.58% over 2005; assets of Qualified Foreign Institutional Investors ("QFIIs") under custody amounted to USD900 million, an increase of 63.63% over 2005; and securities assets such as insurance funds, social security funds and enterprise pension totalled RMB59,725 million, rising 204.42% over 2005. Accumulated income from the custodial business reached RMB209 million, a year-on-year increase of 69.92%.

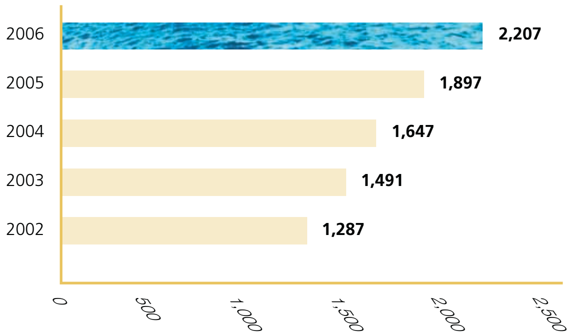
The development of the retail banking business is the most important part of the Group's business transformation.

Personal Banking

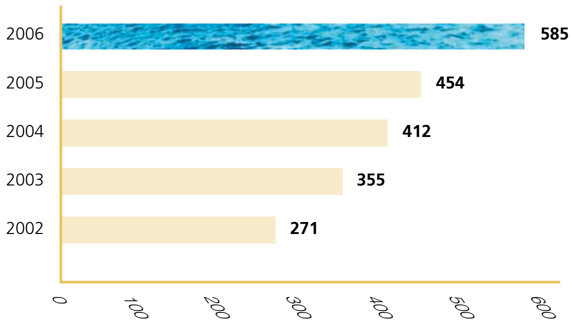
In 2006 residential mortgages, personal consumption loans and bank card business made great progress as a result of our product innovation and improvement in service quality. Profit before tax for personal banking was RMB10,655 million, accounting for 16.21% of the Group's profit before tax.

The development of the Group's personal banking business over the past five years are set out below:

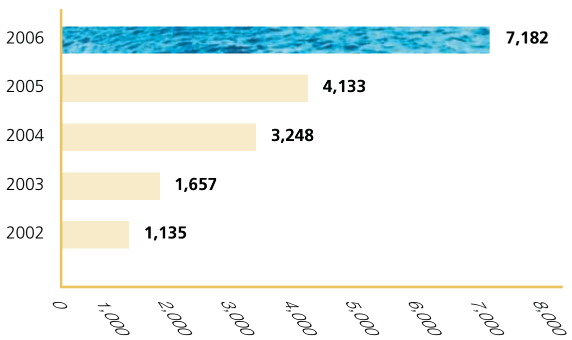
Personal deposits
In billions of RMB



Personal loans
In billions of RMB



Net personal fee and commission income
In millions of RMB



Personal deposits grew steadily

In 2006 we became the first PRC bank to enable our individual customers to deposit and withdraw time and demand RMB deposits across different branches all over the country. Our All in One Call Deposit Account provided our customers with a more flexible large deposit service at a higher return. As at 31 December 2006, the balance of the Group's personal deposits amounted to RMB2,207,442 million, an increase of 16.34% compared to the end of 2005, and accounted for 46.76% of total deposits from customers with a market share of 13.15%.

Personal loans increased significantly

The balance and increase of our personal loans reached record highs in 2006. As at 31 December 2006, total personal loans were RMB585,085 million, an increase of RMB131,196 million or 28.90% compared to the end of the previous year, and represented 20.36% of total customer loans and advances, an increase of 1.90 percentage points over 2005.

In 2006 we enhanced the innovation and integration of our personal lending products and services, introducing new products such as home equity loans and fixed rate loans as well as providing flexible repayment methods. We also worked with second-hand housing agencies and actively developed mortgage products for personal second-hand housing to satisfy the diversified needs of our customers. The residential mortgage business developed quickly with optimised business processes, improved service quality and coordinated marketing efforts, and we became the largest provider of residential mortgage loans. As at 31 December 2006, the balance of residential mortgage loans reached RMB428,039 million, an increase of RMB79,820 million or 22.92%. Personal consumption loans and other personal loans grew by 48.62% to RMB157,046 million in 2006. Personal consumption loans and personal business loans have become new growth engines fuelling our business development.

We retained our leading position in entrusted housing finance business. In 2006 we provided entrusted services of withdrawal of and repayment with provident housing funds, as well as electronic service channels, to enable Chinese citizens to deposit, withdraw and enquire about their provident housing funds more conveniently. As at 31 December 2006, provident housing fund deposits totalled RMB186,158 million, an increase of RMB43,597 million compared to 2005, with a market share of 59.58%; the balance of provident housing fund loans amounted to RMB186,834 million, an increase of RMB44,860 million over 2005, with a market share of 51.30%; an accumulated amount of RMB83,220 million was extended to 605,100 customers during the year.

Bank card business developed rapidly

The brand of Long Card was further enhanced with the continued development of new card products alongside improvements in our bank card services. At the end of 2006, the total number of Long credit cards and quasi-credit cards issued reached 10.06 million. The cumulative number of credit cards issued was 6.34 million, of which 3.22 million cards was issued in 2006. A total of RMB40,467 million was spent by cardholders during the year. The number of credit card issued and card spending amount during the year both posted more than 100% year-on-year growth. Following on from the release of the Renowned University Credit Card, we launched the Corporate Credit Card for the top 500 enterprises, and the City Credit Card for customers in major cities.

By the end of 2006, we had issued 186 million debit cards in total, which represented an increase of 20.47 million over 2005. Spending via debit cards in 2006 reached RMB212.50 billion, an increase of 69.2% over 2005. Fee and commission income from debit cards climbed to RMB2,880 million, representing a 17.6% rise compared to 2005. Our “Happy Investor” personal wealth management cards were promoted throughout the country in 2006, and services such as overseas and online transactions, and mobile phone short messaging services were also launched successfully. Our wealth management cards were awarded “Leading Comprehensive Debit Card Product in the World” by VISA International.

Enriched personal wealth management products

With the continuous growth of income, Chinese citizens have more diversified needs for personal wealth management. We exploited our brand advantage from "Profit from Interest" and "Profit from Exchange", and launched a number of innovative personal wealth management products to satisfy different needs of our customers. In 2006 we issued 19 batches of "Profit from Interest" RMB wealth management product; one phase of "CCB Fortune" wealth management product for high-net-worth customers; 17 batches of "Profit from Exchange" personal foreign exchange structured deposit product and two batches of "Profit from Exchange" QDII product; and developed asset allocation plans and tailor-made wealth management products for our VIP customers. All these products were well received by customers. The underlying assets of our wealth management products broadened from central bank bills to include commercial paper, trust plans, bank credit assets as well as overseas fixed income products.

We have always paid great attention to the selection of quality fund companies, and with the boom of China's capital market in 2006, we seized the opportunity to become actively involved in the provision of agency services for equity funds, and became the first commercial bank to provide agency service for Exchange Traded Fund ("ETF") transactions in the PRC. In 2006 we provided agency services to 33 initially offered funds with an amount of RMB64,600 million, representing an increase of RMB54,567 million, or 543.88% compared with the previous year. In 2006 ten open-end funds under our custody enjoyed yields exceeding 100%, accounting for 23% of the total open-end funds under our custody. The higher returns helped to establish a solid customer base for our future fund agency business.

In 2006 we intensified our product innovation efforts in gold products, and introduced the pending order and block trade discount functions for the Account Gold. We also launched "Longding Gold" zodiac animal commemorative coins for our personal physical gold business. As at the end of 2006, the amount of gold transacted through Account Gold reached 30.2 tons, 24.6 times higher than in 2005. The physical gold transacted reached 486.21 kg, an increase of 13.1 times over 2005.

Treasury Operations continue to expand and have become a major source of income for the Group.

Treasury Operations

At the end of 2006, our treasury assets amounted to RMB2,199,334 million, and the profit before tax from treasury operations in 2006 totalled RMB18,348 million, 27.92% of the Group's profit before tax.

During 2006 with significantly increased treasury funds, we actively adapted our bond investment strategies in line with market changes:

- We adopted an active but prudent foreign currency investment strategy. We significantly increased our asset-backed or mortgage-backed securities, and corporate bonds, and moderately increased spread products such as callable bonds to optimise the structure and enhance the performance of our foreign currency investment portfolio.

- On the RMB side, we strived to lower our surplus deposit reserve rate to increase the return of our funds. We maintained a relative stable duration of the RMB investment portfolio, adjusted the structure of our bond investments, and moderately increased corporate credit products so as to achieve a stable improvement in our return.

In 2006 the volume of repurchase transactions reached RMB2,258.5 billion while inter-bank lending transactions totalled RMB82.3 billion. The Bank underwrote RMB747.4 billion of government and quasi-government bonds, subordinated debts, central bank bills, commercial paper and corporate bonds, a 30.62% increase over the previous year. The total transaction volume in the secondary bond market amounted to RMB311.3 billion, an increase of 102.54% over the previous year.

We seized the opportunity of the reform of RMB exchange rate regime to launch foreign exchange trading and foreign exchange purchases and sales businesses for our customers. The Bank was among the first qualified market makers in 2006 to participate in foreign exchange purchases and sales in the RMB inter-bank market. The volume of foreign exchange trading, as well as purchases and sales of foreign exchange on behalf of customers reached USD123.3 billion, representing a 27.51% year-on-year increase.

In 2006 we continued to promote customer-driven business, and customer-driven derivative transactions showed significant growth, rising by 89.43% over the year to USD8,903 million. Of this, the volume of transactions for corporate and institutional customers and for personal customers amounted to USD5,282 million and USD3,621 million respectively, increases of 63.52% and 139.49% over the previous year.

The development of our overseas business and subsidiaries serves our comprehensive and international operating strategy.

Overseas Business and Subsidiaries

We have overseas branches in Hong Kong, Singapore, Frankfurt, Johannesburg, Tokyo and Seoul. There are also representative offices in London and New York. As at the end of 2006, the Group's total assets of overseas operations totalled RMB115,162 million, while the profit before tax for the year was RMB543 million.

In 2006 we expanded our overseas markets steadily by strengthening the coordination between our overseas and domestic branches, and continuously optimised our business structure with enhanced services. A solid foundation has been laid for the globalisation of our network for customer services,

marketing activities and business operations. As an important part of our overseas business development strategy, the Bank acquired a 100% equity interest in Bank of America (Asia) Limited in Hong Kong, a wholly owned subsidiary of BAC, and its subsidiaries. At present, we are integrating the branches and resources in Hong Kong to provide better financial services to our customers in Mainland China, Hong Kong and Macau.

At the end of 2006, the Bank had the following major subsidiaries:

China Construction Bank (Asia) Corporation Limited, formerly known as Bank of America (Asia) Limited, provides a wide range of personal and commercial banking services to customers, and is one of the 24 licensed banks registered in Hong Kong. As a typical small and medium-sized retail bank in the Hong Kong market, it has 14 branches in Hong Kong and 3 branches in Macau. As at the end of 2006, its total assets amounted to HKD36,895 million, and the profit before tax for the year was HKD734 million.

China Construction Bank (Asia) Limited, formerly known as Jian Sing Bank Limited, is a licensed commercial bank registered in Hong Kong, and a wholly owned subsidiary of the Bank. Its principal activities are deposit-taking, the provision of loans, fee and commission based services such as foreign exchange, letter of credit, guarantees and agency services, to local small and medium-sized enterprises. As at the end of 2006, its total assets amounted to HKD3,463 million, while profit before tax in 2006 was HKD262 million. The investment banking arm, CCB International (Holdings) Limited, is one of its subsidiaries.

Sino-German Bausparkasse Corporation Limited was jointly established by the Bank and Bausparkasse Schwaebisch Hall in February 2004 with RMB150 million of registered capital, of which 75.1% was contributed by the Bank. It is primarily engaged in the provision of services such as home savings deposit-taking, provision of home savings loans, inter-bank lending, investment in debt securities, and extension of personal mortgages.

We established CCB Principal Asset Management Co., Ltd. in September 2005 with Principal Financial Services, Inc and China Huadian Group Corporation. The Bank holds 65% and the other two parties hold 25% and 10% respectively of the RMB200 million registered capital. At the end of 2006, three funds were managed by CCB Principal Asset Management Co. Ltd., with the size and performance of the funds growing in a healthy manner.

Investment banking is an important part of our comprehensive operating strategy.

Investment Banking

As enterprises have more financing channels, the profit margin for traditional deposit and lending business will be narrowed to some extent. Market competition will become fiercer following the complete opening up of the China's financial sector. To fully capitalise on new growth opportunities such as capital market development and satisfy diversified customer needs for services such as wealth management, we have begun to actively develop our investment banking business as part of our pilot comprehensive operations.

As an important initiative of our business transformation, in September 2006 we re-established the investment banking department and developed investment banking services across the Bank. Major products and services include commercial paper, international bonds, trust beneficiary certificates, asset securitisation, project finance, enterprise's initial public offering and refinance, equity investment, financial advisory, and wealth management, with an aim of providing customers with a package of financial solutions.

In 2006 financial advisory fees from investment banking amounted to RMB880 million. Underwritten commercial paper totalled RMB65,775 million, allowing us to retain our prime market position. A wide range of wealth management products has been launched to satisfy customers' diversified and personal investment needs.

While strengthening and expanding our market share of existing products, we will focus our efforts on the innovation of investment banking products and businesses. In compliance with regulatory policies, we will actively commence operations such as trust, securities, asset management, asset securitisation and financial derivatives.

We attach great importance to the role of distribution channels in customer services and business development. The extensive and improved branch network is an important component of our competitiveness.

Distribution Channels

Distribution capability of electronic banking steadily strengthened

Since electronic banking is one of our most important distribution channels and strategic business sectors, we set ourselves the strategic objective to develop a world class electronic banking business. In 2006 we put more resources in electronic banking, consolidated the foundation of our business development, and strengthened the interaction between different distribution channels and marketing efforts. As a result, our electronic banking distribution capability was greatly enhanced, and both the influence and awareness of our brand increased. As at the end of 2006, we had 43.29 million electronic banking customers, an increase of 38% over the previous year. The number of transactions rose by 132% over the previous year to 810.80 million, and transaction volume was RMB30.7 trillion, representing a year-on-year increase of 227%.

In October 2006, we launched a new version of personal Internet banking to provide our customers with a faster, more convenient, and more secure online banking service. New Internet banking functions were introduced such as electronic reconciliation statements for enterprises, provident fund business, wealth management card business, individual to corporate remittances, and inter-bank transfers, all of which significantly pushed forward the development of our business. The Bank was awarded the "Best Internet Bank in 2006" by China Electronic Commerce Association.

Our VIP service system is a lease-line banking system based on the electronic settlement network, which can provide real-time account monitoring and a series of customer-based real-time transaction functions to major customers. In 2006 we introduced products such as the centralised management of bills, real-time transmission of account information, as well as centralised management of financial companies' funds, and have provided cash management services to numerous large corporate groups. New VIP service system products, including the monitoring system of special financial funds of the central government, the information system on futures margins and the fund settlement system for transfers of unlisted shares were also developed, which increased our market competitiveness. Our VIP service system won the first prize at the PBOC's Science and Technology Development Awards in 2006.

In order to establish a distributed centralised customer service structure to further strengthen our dominant position in intensive operations, we established a "95533" call centre in Chengdu in 2006, which successfully took over the manual customer services operation of 16 branches. The "95533" customer service was linked to 800 credit card customer service hotlines. "95533" was recognised as one of the "Top Ten Service Brands in China" and the "Best Customer Service in China", which are the highest awards in the domestic call centre service.

Our mobile phone banking services are at the forefront of providing superior business functions, customer experience and security in the PRC. In 2006 all of our 38 tier-one branches launched WAP mobile phone banking services, in which 37 tier-one branches worked together with mobile communication operators to provide short message services. Service functions relating to debit cards, provident funds and wealth management cards were introduced via mobile phone banking. We were also the first to launch domestic mobile stock trading services, which augmented our wealth management mobile phone banking functionality.

We further developed e-channel integration by linking channels such as the call centre, Internet banking and mobile phone banking together into one access point and combining service processes to achieve cross channel service connections.

Broad coverage of branch network

Our distribution network primarily consists of branches, sub-branches, sub-operating offices and deposit-taking offices. As at the end of 2006, the Bank had 13,629 domestic outlets.

In order to better provide differentiated services to our VIP customers, we set up a VIP customer service channel. As at the end of 2006, we were operating six wealth management centres, 702 banking centres, 3,177 wealth management offices and 10,660 wealth management windows, which represented an increase of three wealth management centres, 359 banking centres, 1,854 wealth management offices and 4,014 wealth management windows respectively over the previous year.

ATMs and self-service banking centres continuously increased

We continue to focus our efforts on developing a wider range of self-service banking products and raising our service levels. As at the end of 2006, we had 1,646 self-service banking centres, an increase of 765 over the previous year. The number of ATMs installed and in operation rose by 4,370, or 29% over the previous year, to a total of 19,490.

Information technology is an important measure to support the business development and management enhancement.

Information Technology

In 2006 we continued to invest more resources in our information technology (IT), and actively developed application systems to improve our overall IT management level, including architecture and security management , project management and operational management.

In 2006 based on the data consolidation for our core business processing systems during the previous year, we accelerated data centralisation of the business processing systems for credit, distribution channels, call centres, as well as the accounting system for expenses and fixed assets to further optimise business processes, support business development and enhance our risk prevention ability. The implementation of the new personal loan system together with the establishment of the personal loan

centre, strengthened our capacity of innovation in personal loan products, increasing our business management efficiency, and enhancing risk control. We have developed a new credit process management system that covers the entire corporate loan process and offers various credit functions, which has helped to standardise our corporate loan operating procedures.

In July 2006, we started strategic cooperation with BAC in six areas, encompassing resource management, infrastructure consolidation, business continuity planning, quality management of application development, IT project governance and operation process management, with an aim to reaching international standard in our IT management.

We are committed to attracting, retaining and motivating qualified managers and professionals. We are also proud of having a large team of professional, diligent and loyal staff.

Employees

At the end of 2006, we had 297,506 staff members of whom 96,117, or 32.3% completed undergraduate or higher courses.

The following table sets forth the total number of employees by function as at 31 December 2006.

	Number of employees	% of total
Corporate banking	32,582	10.95
Personal banking	131,673	44.26
Treasury operations	414	0.14
Finance and accounting	36,812	12.37
Management	14,457	4.86
Risk management, internal audit, legal and compliances	11,201	3.76
Information technology	10,568	3.55
Others[1]	59,799	20.11
Total	297,506	100.00

1. Primarily consist of supporting staff.

We attach great importance to personnel training and development, and develop our employees' knowledge and experience and push them through career paths via career potential development, job rotation, simulation exercises, quality evaluations, and degree and certification education. Training provided by our strategic investors' resources, BAC and Temasek, have accelerated the development of core personnel's professionalism in an international context. In 2006 we provided 7,071 training sessions with 402,200 enrolments.

We continue to deepen our human resources management reform, and improve the remuneration and performance policies with the concepts of performance-oriented compensation based on post, result and work ability, while building harmonious labour relationship. Incentives and disciplines have been strengthened by the implementation of an evaluation system based on key performance indicators for key positions. In order to facilitate the integration of both our employees' and shareholders' interests, we are actively seeking to implement a management share appreciation rights scheme, and employee stock ownership plans in accordance with the long-term incentive scheme approved by the general meeting of shareholders.

In 2006 we launched the CCB Outstanding Contribution Award, our highest honour, to recognise outstanding contributions made by our employees to the Bank's reform and development. This great company honour was awarded to twelve employees this year, with each of them receiving a financial award ranging from RMB100,000 to 300,000 in recognition of their outstanding performance.

Chairman Guo Shuqing and President Zhang Jianguo presented the Outstanding Contribution Award to the Bank's employees.

中国建设银行
China Construction Bank

An outstanding bank provides
premier services rendered by dedicated staff

Risk Management

In 2006 the Group focused on the reform of its risk management system, and improved risk management processes in order to maintain a prudent operating style. Aligning the business development with its risk appetite, it strives to enhance the risk-adjusted return within its risk tolerance level.

Reform of the Risk Management System

- ***Vertical risk management***

At the head office, the specialisation of our risk management was strengthened with the appointment of the chief risk officer and the establishment of a risk monitoring department. At the branch level, risk management personnel have been appointed under the principle of cross-regional exchanges. By the end of 2006, risk supervisors for all tier-one branches and risk heads for all tier-two branches had been installed (with tier-one branches' risk supervisors appointed by the head office, and tier-two branches' risk heads nominated by tier-one branches and approved by the head office). Dedicated or concurrent risk managers were also appointed for certain county-level branches. Risk management personnel are responsible for initiating the implementation of the overall risk management, and serve as lead credit approval officers for their respective units. Their first reporting line is to risk management officers at higher levels, with an additional reporting line to managers of their respective entities or business units. These systematic arrangements protect the independence of risk management, and help to achieve the vertical and centralised risk management and ensure the sustained improvement of the Bank's asset quality.

- ***Parallel operation structure***

A parallel operation structure, comprising relationship and risk managers, has been applied to credit extensions to large and medium-sized corporate customers. Risk managers participate in every aspect of the risk management process from credit analysis to post-disbursement management. Both relationship and risk managers participate in customer evaluation and project assessment during the pre-approval process, and provide risk evaluation opinions on the credit application materials. Before loans are extended, risk managers must examine whether all the conditions for credit extension have been met. After the disbursement of loans, risk managers continue to identify credit risks, and provide warnings of any new potential risks. This parallel operation is now smoothly promoted across the Bank.

Enhanced Risk Management Mechanism

- ***Authorisation system***

The Bank has continued to improve its authorisation system as demanded by the reform of its corporate governance and the risk management system. In 2006 policies relating to the granting of management powers to the President by the Board, and in turn to general managers at branches by the President, as well as plans for the delegation of authority for credit approvals in corporate and retail lending were rationalised to emphasize that the level of authority acquired is based on the results of evaluation of risk management capability.

- ***Internal control evaluation***

Under the specific requirements of the risk management committee and audit committee of the Board, the Group has conducted a systematic analysis and assessment of internal control capabilities (including control environment; risk identification and assessment; internal control activities; monitoring, evaluation and correction; as well as information and communication), and has implemented improvement initiatives in view of the problems identified. Please refer to the internal control part of the "Report of the Board of Directors" for details.

- ***Improvement on economic capital management***

The Group has made sustained efforts to optimise the methods of measuring and allocating economic capital, and to apply these methods to resource allocation, performance evaluation and risk monitoring, so as to enhance the guiding and binding effects of risk tools upon operating activities. In 2006 the following improvements were made: measuring the allocation of economic capital across the Bank by applying an asset volatility approach to corporate exposure, and linking economic capital to unexpected risks more closely; updating the economic capital allocation plan and incorporating it into the comprehensive budget of operations; strengthening the dynamic monitoring over the application of economic capital, and starting to develop the software for economic capital measurement.

- ***Evaluation of branch risk management***

Since 2006 the Bank has adopted a series of key performance indicators to regularly and comprehensively test and evaluate risk management at tier-one branch level. These tests highlight any deficiencies in branch risk management so that improvements in related areas are urged.

Credit Risk Management

The Group has further enhanced the credit risk management level by improving the credit risk management process and upgrading risk management technology.

Improved Framework of Rules in Credit Risk Management

In 2006 the Bank issued new credit management policies and credit approval standards for corporate and institutional businesses, amended the measures for estimation of impairment losses on credit assets and provisioning, and proposed a series of policies such as the manual for the management of the twelve-category risk classification of credit assets. Both project assessment and risk monitoring were revised to further improve the applicability and accuracy of the system and the policies.

Enhanced Credit Risk Management Process

The Group's credit risk management encompasses credit analysis, credit approval and post-disbursement management of the credit business. During credit origination and analysis, the internal rating system is used to perform customer credit risk ratings and to produce customer evaluation reports. A comprehensive evaluation is also conducted for the risk and return of the loan. During the credit approval process, any credit extension must be either reviewed and approved by two authorised managers, or countersigned, or approved at a credit approval meeting. During the post-disbursement management process, all extended loans are monitored on an ongoing basis. Any negative event, which could significantly affect the borrower's repayment ability, must be reported immediately, and effective measures are then taken to avoid and control related risks.

For the personal credit business, the Group has established personal loan centres in 100 major city branches and key tier-two branches. Functions such as investigation, approval, pledge registration, disbursement, collection and file management are assigned to personal loan centres, and batch processing is centralised at middle and back offices. These initiatives enhanced service quality and efficiency, reduced operational risks arising from dispersed operations, and helped to standardise credit access criteria across the Group. In line with the establishment of the personal loan centres, the Group has set up approval teams within these centres, or established personal credit business approval centres to raise the professionalism of personal credit approval. In addition, the special assets resolution department established and improved a standard operating process for the collection of personal loans, which further ensured the standardisation of personal loan collection.

Development of Risk Management Technology

In 2006 the Bank improved its Credit Management Information System ("CMIS") and the first phase of internal rating system in line with new business and management requirements. A Non-credit Asset Risk Management Information System ("NARMIS") was also developed and implemented across the Bank. All these systems provide quantitative analysis support to customer ratings, asset portfolio analysis, and risk limits monitoring as well as economic capital management.

A corporate lending process system and a new personal lending system were implemented in some branches to standardise the credit business process, reduce operational risks, and provide more comprehensive data for CMIS.

In line with the implementation of the New Basel Capital Accord, the Bank has pressed on with the development of an internal rating system, the first phase of which carries out corporate customer credit ratings and measures systemic risk by various criteria such as industry, geographical area and product. The second phase of the internal rating system is in development with the cooperation of BAC. This phase will primarily focus on the internal rating of retail exposures, and include enhancement for the grading of corporate exposures as well.

Liquidity Risk Management

The core strategy of the Group's liquidity management is to avoid risk and maximise value by improving established rules, rationalising operational systems, and adopting various measures to strengthen daily management. This strategy has resulted in the reduction in both the surplus reserve rate and the liquidity position, and led to improved efficiency of fund utilisation while ensuring sufficient liquidity.

The Bank has formulated a series of guidelines, such as a liquidity management contingency plan, to regulate and refine liquidity management, and enhanced the contingency mechanism for internal fund management.

The Group has successively optimised the RMB and foreign currency fund transfer system between head office and branches. As a result, the efficiency of fund transfer has greatly improved.

A designated liquifiable asset portfolio has been delimited from its existing treasury investment portfolio, and includes highly-liquid assets such as purchases under resale agreements, short-term PBOC bills and government bonds, and a multi-layered stock of liquid assets has been created.

With the recommencement of initial public offerings in the domestic stock market and the PBOC's frequent adjustments to monetary policies in 2006, the Bank reinforced its internal liquidity management and made overall fund arrangements in advance, which offset the impact of large cash inflows and outflows, and guaranteed normal payment and settlement at a relatively low reserve level.

The analysis of the remaining maturity of the Group's assets and liabilities as at the balance sheet date is set below:

	As at 31 December 2006						
	Overdue/ repayable on demand	Less than three months	Between three months and one year	Between one year and five years	More than five years	Undated	Total
	(In millions of RMB)						
Assets							
Cash and balances with central banks	**133,958**	**—**	**—**	**—**	**—**	**405,715**	**539,673**
Amounts due from banks and non-bank financial institutions	**12,921**	**64,047**	**4,879**	**338**	**—**	**—**	**82,185**
Loans and advances to customers	**59,289**	**350,341**	**839,969**	**837,069**	**709,308**	**—**	**2,795,976**
Investments							
— Receivables	**—**	**—**	**128,211**	**341,744**	**76,402**	**—**	**546,357**
— Held-to-maturity debt securities	**—**	**145,060**	**255,120**	**384,962**	**253,571**	**—**	**1,038,713**
— Available-for-sale investments	**—**	**58,853**	**112,038**	**50,633**	**87,565**	**9,617**	**318,706**
— Debt securities at fair value through profit or loss	**—**	**611**	**741**	**3,321**	**943**	**—**	**5,616**
Others	**2,324**	**17,125**	**19,125**	**3,224**	**683**	**78,804**	**121,285**
Total assets	**208,492**	**636,037**	**1,360,083**	**1,621,291**	**1,128,472**	**494,136**	**5,448,511**
Liabilities							
Amounts due to central banks	**21**	**1,235**	**—**	**—**	**—**	**—**	**1,256**
Amounts due to banks and non-bank financial institutions	**203,870**	**35,150**	**4,698**	**250**	**—**	**—**	**243,968**
Deposits from customers	**2,641,787**	**731,050**	**998,144**	**336,958**	**13,317**	**—**	**4,721,256**
Certificates of deposit issued	**—**	**—**	**1,806**	**5,151**	**—**	**—**	**6,957**
Others	**45,967**	**20,895**	**25,434**	**8,395**	**4,237**	**25**	**104,953**
Subordinated bonds issued	**—**	**—**	**—**	**—**	**39,917**	**—**	**39,917**
Total liabilities	**2,891,645**	**788,330**	**1,030,082**	**350,754**	**57,471**	**25**	**5,118,307**
Long/(short) positions in 2006	**(2,683,153)**	**(152,293)**	**330,001**	**1,270,537**	**1,071,001**	**494,111**	**330,204**
Long/(short) positions in 2005	**(2,118,250)**	**(28,807)**	**182,971**	**1,119,770**	**762,110**	**369,883**	**287,677**

As at the end of 2006, the Group's accumulated gap of various maturities amounted to RMB330,204 million, an increase of RMB42,527 million over 2005; both the short-term negative gap and the medium to long-term positive gaps widened. In 2006 the capital market became more active, and with expectations of interest rate hikes, there was a faster growth of customers' demand deposits, which led to the negative gap for overdue/repayable on demand totalled RMB2,683,153 million. However, our funding source remained stable for the Group had a relatively high proportion of core demand deposit.

Market Risk Management

The Group has gradually established and improved the market risk management mechanism, while continuing to enhance the measurement methods and techniques.

During 2006 the first phase of the asset and liability management information system was launched, which served as a technical base for the identification, measurement and monitoring of market risks across the Bank. The Bank also developed a market risk capital reporting system to measure market risk capital charge. Currently, the Bank has adopted market risk measurement techniques that are internationally accepted, to measure and monitor market risks in banking and trading books. The tools applied to the trading book mainly include value-at-risk ("VAR") analysis, sensitivity analysis and stress testing, while those applied to the banking book primarily include gap/position analysis, net interest income simulation, economic value analysis and stress testing.

Procedures for regular reporting on market risks, as well as ad hoc reporting on material issues have been preliminarily established. Daily reports are prepared on market risk in treasury activities; quarterly reviews and analysis are conducted on the implementation of market risk management policies and investment strategies; and market risk analysis reports containing relevant management proposals are regularly provided. Senior management are informed of any risks which could have a material impact on the Group in a timely manner.

Interest Rate Risk Management

The primary source of interest rate risk is the mismatches between the repricing dates of assets and liabilities. The Group regularly calculates the interest rate sensitivity gap, and assesses the impact of interest rate changes upon its net interest income and economic value under various scenarios of interest rate movements, and conducts stress testing on a regular basis.

The analysis of the expected repricing dates (or maturity dates whichever are earlier) of the Group's assets and liabilities as at the balance sheet date is set below:

	As at 31 December 2006					
	Total	Non-interest-bearing	Less than three months	Between three months and one year	Between one year and five years	More than five years
	(In millions of RMB)					
Assets						
Cash and balances with central banks	539,673	30,191	509,482	—	—	—
Amounts due from banks and non-bank financial institutions	82,185	—	77,067	4,879	239	—
Loans and advances to customers	2,795,976	—	1,200,801	1,532,253	38,106	24,816
Investments	1,909,392	9,617	269,623	618,099	597,663	414,390
Others	121,285	121,285	—	—	—	—
Total assets	5,448,511	161,093	2,056,973	2,155,231	636,008	439,206
Liabilities						
Amounts due to central banks	1,256	—	1,256	—	—	—
Amounts due to banks and non-bank financial institutions	243,968	—	239,020	4,698	250	—
Deposits from customers	4,721,256	36,346	3,348,482	989,439	335,151	11,838
Certificates of deposit issued	6,957	—	4,718	1,443	796	—
Others	104,953	104,953	—	—	—	—
Subordinated bonds issued	39,917	—	—	9,917	30,000	—
Total liabilities	5,118,307	141,299	3,593,476	1,005,497	366,197	11,838
Repricing gap in 2006	330,204	19,794	(1,536,503)	1,149,734	269,811	427,368
Accumulated repricing gap in 2006			(1,536,503)	(386,769)	(116,958)	310,410
Repricing gap in 2005	287,677	23,558	(1,142,437)	831,770	352,551	222,235
Accumulated repricing gap in 2005			(1,142,437)	(310,667)	41,884	264,119

As at 31 December 2006, the Group's accumulated negative interest rate sensitivity gap within one year widened by RMB76,102 million to RMB386,769 million over 2005, which was primarily due to the growth of the negative gap within three months exceeded that of the positive gap between three months and one year. The proportion of demand deposits in customers' deposits rose from 54.52% at the end of 2005 to 55.42% at the end of 2006, with an increase of RMB432,539 million in the ending balance, led to the widening of the negative gap within three months for the Group. The ratio of accumulative negative gap within one year to the interest-earning assets at the end of year is 7.31%, only 0.31 percentage points higher than that at the end of the previous year.

The Group performs VAR analysis on its foreign currency-denominated investment portfolio to measure and monitor the potential losses on positions due to shifts in factors such as interest rates and exchange rates. With a 99% confidence level and a one-day holding period, the Group used historical simulations to measure the following VARs of its domestic portfolio for foreign currency-denominated trading book in 2005 and 2006 respectively:

	2006				2005			
	Year end	**Daily average**	**Maximum value**	**Minimum value**	Year end	Daily average	Maximum value	Minimum value
	(In millions of RMB)							
Interest rate risk	**61.35**	**107.39**	**168.47**	**15.85**	144.23	70.56	213.26	4.74
Foreign exchange risk	**2.07**	**5.79**	**7.27**	**0.33**	14.62	9.11	0.17	0.88
Diversified portfolio risk	**(2.01)**	**(5.81)**	**(8.17)**	**(0.29)**	(11.00)	(5.15)	(0.33)	(0.20)
Total portfolio risk	**61.41**	**107.37**	**167.57**	**15.89**	147.85	74.52	213.10	5.42

Note: The VAR at the end of 2006 fell drastically, largely because a USD/HKD2,470 million forward contract entered into during 2005 expired before the end of 2006.

A regular interest rate risk reporting mechanism has been set up by the Group, so that a monitoring system is being implemented. The Group uses derivatives such as interest rate swaps and options to hedge interest rate risk associated with its foreign currency business. On the other hand, since interest rate hedging tools have not been adequately developed in the RMB market, the Group manages RMB interest rate risk largely by adjusting business volumes and maturity profiles.

Foreign Exchange Risk Management

The Group is exposed to foreign exchange risks primarily because it holds deposits, loans, marketable securities and other financial derivatives that are denominated in currencies other than RMB. The Group's foreign exchange risks comprise structural positions and trading positions, and different strategies are applied to manage each of these positions.

The Group mitigates structural exchange risks by matching assets and liabilities based on the currency involved. The amounts and periods of lending and borrowing are matched, as far as possible, on a currency-by-currency basis. Whenever possible, open positions are hedged with instruments such as spot and forward contracts as well as swaps and options.

Trading exchange risk is the Group's foreign exchange exposure from customer-driven and proprietary foreign exchange purchases and sales, foreign exchange trading and foreign exchange derivative business. The Group controls the trading exchange risk by setting a trading limit. The Group uses the asset and liability management information system to measure and monitor structural and trading exchange risks on a daily basis.

Operational Risk Management

Operational risk is the potential of loss resulting from inadequate or failed internal processes, people and systems, or from external events. The Group's operating units are responsible for assessing their operational risk and implementing related risk management policies and procedures. The risk management and risk monitoring departments regularly evaluate the compliance of various departments with the relevant policies and procedures.

The Group has undertaken the following key operational risk management initiatives:

— Established internal reporting procedures for any employee misconduct that adversely affects the Group's business. Under the internal reporting system, data relating to incidents of employee misconduct must be reported to the head office on a periodic basis, while serious cases must be reported within 24 hours after discovery;

— Strengthened operational checks and balances among departments and job positions, and introduced centralised job appointments as well as the rotations for key positions via systematic authorisation and operational arrangements;

— Implemented data backup from critical data processing systems to reduce operational risk due to IT system failure. The Group is now in the process of developing a computer disaster recovery centre for the automatic backup of operational data;

— Undertaken pilot projects for the self-assessment of operational risks. These trial projects were initiated in pilot branches to identify potential deficiency via self-assessment of operational risks. Risk managers have been appointed to control frequently occurring problems;

— Collected and accumulated operational risk loss data to determine the category of operational risks and the classification of loss data, which will act as a foundation for the development of quantitative measurement tools.

In 2006 the Group completed its operational risk management policy, which built the general framework, and set the roles, responsibilities, processes and principles of operational risk management. The document has been reviewed and approved by the Board's risk management committee.

Reporting and Monitoring of Non-compliance

By the end of 2006, 44 criminal offences committed by the Bank's employees, totalling RMB82.718 million, had been reported to the head office. Both the volume and the values involved in these offences were considerably lower than those of the previous year. Of these, 12 cases involved a sum of RMB1 million or more, totalling RMB72.758 million. Staff misconduct showed that internal controls were still not sufficient in some of the Group's branches. Nevertheless, these criminal offences have not, individually or in the aggregate, had any material adverse effects on the Group's business, financial conditions or operating results.

Internal Audit

The Group has continuously enhanced the internal audit system, which is vertically managed by the head office, with stronger audit teams, enhanced audit standards and new audit techniques, to fully support internal audit's role in the risk management, internal control and corporate governance.

During 2006 the Group's internal audit department adopted a risk-based audit approach for branches and business products, focusing on core areas and products, centralising useful resources, and strengthening quality management. A total of 15 system audit projects were conducted, including: audits on comprehensive business operations and investigations into the competitiveness of branches in certain central cities to make full use of audit evaluation and recommendations; verification of the five-category corporate loan classification and the new NPLs as well as a financial management audit to reinforce the audit efforts in key areas; specialised audits of credit cards, investment in debt securities, funds clearance, and electronic channels to pay more attention to new businesses. Other audits completed during the year included those relating to the economic accountability of the management during their tenure, the insurance agency business, corporate entrusted loans, interest rates related data and information quality, overseas entities, non-credit assets, the credit business. Auditing divisions from each branch also commenced more than 3,000 self-selected audits as required. With the continued enhancement of auditing depth and quality, our risk prevention ability and the standardisation of operating procedures across the Bank have been improved.