招商銀行
CHINA MERCHANTS BANK

CHINA MERCHANTS BANK CO., LTD.

(a joint stock company incorporated in the People's Republic of China with limited liability)

Stock Code：3968

Annual Report 2006

SERVICES • INITIATIVES • GROWTH

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招商銀行
CHINA MERCHANTS BANK

CORPORATE INFORMATION

1. Registered Corporate Name in Chinese:

招商銀行股份有限公司(Chinese abbreviation: 招商銀行, hereinafter the "Company", the "Bank" or the "Group")

Registered Corporate Name in English:

China Merchants Bank Co., Ltd.

2. Legal Representative:

Qin Xiao

Authorised Representatives:

Ma Weihua, Lan Qi

Secretary of Board of Directors:

Lan Qi

Joint Company Secretaries:

Lan Qi, Seng Sze Ka Mee, Natalia (FCIS, FCS, FHKIOD)

Qualified Accountant:

Cheng Ting Nan (CPA, FCCA)

Securities Representative:

Wu Jianbing

3. Registered Address:

No. 7088 Shennan Boulevard, Futian District, Shenzhen, Guangdong Province, China

4. Mailing Address:

No. 7088 Shennan Boulevard, Futian District,
Shenzhen, Guangdong Province, China
Postcode: 518040
Tel: 86755-83198888
Fax: 86755-83195109
Email: cmb@cmbchina.com
Website: www.cmbchina.com

5. Principal Place of Business in Hong Kong:

21st Floor, Bank of America Tower,
12 Harcourt Road, Hong Kong

6. Share Listing:

A Share	: Shanghai Stock Exchange
Abbreviated Name of A Share	: CMB
Stock Code	: 600036
H Share	: The Stock Exchange of Hong Kong Limited ("SEHK")
Abbreviated Name of H Share	: CMB
Stock Code	: 3968
Convertible Bonds	: Shanghai Stock Exchange
Abbreviation of Convertible Bonds	: CMB Convertible Bonds
Code of Convertible Bonds	: 110036

7. International Auditor:

KPMG Certified Public Accountants

Domestic Auditor:

KPMG Huazhen Certified Public Accountants

8. Legal Advisor as to Hong Kong Law:

Herbert Smith

Legal Advisor as to the PRC Law:

Jun He Law Offices

9. Compliance Advisors:

China International Capital (Hong Kong) Corporation Limited
UBS AG (acting via its operating arm UBS Investment Bank)

10. H Share Registrar and Transfer Office:

Computershare Hong Kong Investor Services Limited
Rooms 1712-1716, 17/F, Hopewell Centre,
183 Queen's Road East, Wanchai, Hong Kong

Founded in 1987 with its head office in Shenzhen, China, the Company mainly focuses on the China market. As at 31 December 2006, the Company had 36 branches, 464 sub-branches (including offices), 1 representative office, 1 credit center, 1,050 self-service centers and 812 independent machines (ATM & CDM) across China. The efficient outlets of the Company are primarily located in China's more economically developed regions such as Yangtze River Delta, Pearl River Delta and Bohai Rim, and some large cities in other regions. The Company has also set up a branch and a subsidiary in Hong Kong and a representative office in New York. The Company has established business relationship with over 1,150 overseas banks in 89 countries and regions.

The growth of the Company from a regional bank into a large national commercial bank of China is primarily attributable to its own resources and efforts. The Company prepared its financial statements under the Accounting Standards for Business Enterprises issued by the Ministry of Finance (the "MOF"), the Accounting Regulations for Financial Enterprises (2001), and other relevant regulations issued by the MOF (collectively "PRC GAAP") and International Financial Reporting Standards ("IFRSs") in connection with the listing on the Shanghai Stock Exchange in 2002, and has reported its annual audited financial results using both standards since its listing. The Company was listed on SEHK in September 2006. According to the statistics of the People's Bank of China ("PBOC"), the Company ranked No. 6 among commercial banks in China in terms of total assets as at 31 December 2006.

The Company provides customers with various corporate and retail banking products and services, and conducts treasury activities for proprietary purpose and on behalf of our customers. The innovative products and services of the Company, such as "All-in-one Card" multi-function debit card, "All-in-one Net" comprehensive online banking services, dual-currency credit card and the Sunflower wealth management services, become widely accepted in China.

In 2006, we have received many domestic and international honors for our business performance, management capability and corporate culture. For example:

In 2006, China's *The Banker*(銀行家)magazine in its "2005-2006 China Commercial Bank Competitiveness Research Report" ranked us first in core competitiveness among China's 13 largest national commercial banks in terms of total assets (Industrial and Commercial Bank of China was not included in the survey);

In 2006, *FinanceAsia* magazine named us the "Best Bank in China" in its 2006 Country Award for Achievement;

In 2006, *The Asian Banker* magazine named us the "Best Retail Bank China 2005";

For five consecutive years, we were voted as one of "China's Most Respected Enterprises" in an annual survey conducted by Peking University Management Case Center and the *Economic Observer*(經濟觀察報);

No.1 of "CCTV 2005 China's Most Valuable Listed Companies" in the annual election sponsored by CCTV;

"Best Retail Service Award" in "Asian Banks' Competitiveness Rankings 2006" sponsored by the *21st Century Business Review;*

Consecutively obtained the "Most Socially Committed Enterprise" in the "Survey on Corporate Social Responsibility in China" jointly sponsored by CCTV, Peking University and Corporate Social Responsibility Alliance.

Principal activities of the Company:

Taking deposits from the public; granting short, medium and long-term loans; settlement; bills discounted; issuing financial bonds and acting as agent for the issue and encashment; underwriting and trading government bonds; inter-bank lending and borrowing; letter of credit and guarantees; collection and payment; bancassurances; safety deposit box services; foreign currency deposits and loans, remittance; foreign exchange; international settlement; foreign currency placement; bills acceptance and discounting; trading and agency trading of foreign currency securities except stock; issuing and agency issuing of foreign currency securities except stock; proprietary FX trading and trading on behalf of customers; credit investigation, advisory and attestation services; offshore banking business; credit card business; securities investment fund custody and Qualified Foreign Institutional Investor (QFII) custodian services; corporate annuity fund custody and account management services; Social Security Fund custody; underwriting commercial paper; trading derivative products and other businesses approved by China Banking Regulatory Commission.

FINANCIAL HIGHLIGHTS

Results for the year	2006 (in millions of RMB)	2005 (in millions of RMB)	Change +/(-)%
Operating income	**24,866**	19,214	29.42
Profit before tax	**10,084**	6,462	56.05
Net profit attributable to the Bank's equity holders	**6,794**	3,749	81.22
Per share	**(in RMB)**	(in RMB)	+/(-)%
Dividend[1]	**0.12**	0.08	50.00
Basic earnings	**0.53**	0.34	55.88
Diluted earnings	**0.53**	0.33	60.61
Year-end net assets value	**3.75**	2.51	49.40
Year end (as at 31 December)	**(in millions of RMB)**	(in millions of RMB)	+/(-)%
Total shareholders' equity	**55,160**	25,998	112.17
Share capital	**14,703**	10,374	41.73
Total assets	**934,102**	734,613	27.16
Risk-weighted assets	**551,503**	423,312	30.28
Financial Ratios	**(%)**	(%)	+/(-)
Profitability ratios			
Return on average assets (after tax)	**0.81**	0.57	0.24
Return on average equity (after tax)	**16.74**	15.64	1.10
Net interest spread	**2.69**	2.67	0.02
Net interest margin	**2.72**	2.69	0.03
As a percentage of operating income			
– Net interest income	**86.50**	86.61	(0.11)
– Non-interest income	**13.50**	13.39	0.11
Cost-to-income ratio[2]	**38.28**	41.10	(2.82)
Capital adequacy ratio			
Core capital adequacy ratio	**9.58**	5.57	4.01
Capital adequacy ratio	**11.40**	9.01	2.39
Total equity to total assets	**5.91**	3.54	2.37
Asset quality ratios			
Non-performing loan ratio[3]	**2.12**	2.58	(0.46)
Allowances for loan impairment losses to non-performing loans	**135.61**	111.04	24.57
Allowances for loan impairment losses to total loans and advances to customers	**2.88**	2.86	0.02

(1) Dividend per share of RMB0.12 in 2006 will be submitted to the annual general meeting of shareholders. The RMB0.08 dividend per share in 2005 did not include special dividend (RMB1.8 for every 10 shares).
(2) Cost-to-income ratio is the operating expenses minus business tax and surcharge, and then divided by the operating income.
(3) Non-performing loan ratio is total non-performing loans divided by total loans and advances to customers.

FIVE-YEAR FINANCIAL SUMMARY

Results for the year	2006 (in millions of RMB)	2005 (in millions of RMB)	2004 (in millions of RMB)	2003 (in millions of RMB)	2002 [3] (in millions of RMB)
Operating income	**24,866**	19,214	15,676	11,169	8,154
Operating expenses	**11,091**	9,115	7,432	5,516	4,369
Provision for impairment losses	**3,691**	3,637	3,066	2,236	1,083
Profit before tax	**10,084**	6,462	5,178	3,417	2,703
Net profit attributable to the Bank's equity holders	**6,794**	3,749	3,276	2,211	1,847
Per share	**(RMB)**	(RMB)	(RMB)	(RMB)	(RMB)
Dividend	**0.12**	0.08	0.11	0.09	0.12
Basic earnings	**0.53**	0.34	0.29	0.20	0.35
Diluted earnings	**0.53**	0.33	0.29	0.20	0.35
Year-end net assets value	**3.75**	2.51	3.21	3.22	2.95
Year end (as at 31 December)	**(in millions of RMB)**	(in millions of RMB)	(in millions of RMB)	(in millions of RMB)	(in millions of RMB)
Share capital	**14,703**	10,374	6,848	5,707	5,707
Total shareholders' equity	**55,160**	25,998	21,958	18,354	16,829
Total liabilities	**878,942**	708,615	564,757	475,663	349,362
Deposits from customers	**773,757**	634,404	512,586	406,886	304,295
Total assets	**934,102**	734,613	586,715	494,017	366,191
Loans and advances to customers[1]	**549,420**	458,675	363,097	298,960	200,111
Key financial ratio	**(%)**	(%)	(%)	(%)	(%)
Return on average assets (after tax)	**0.81**	0.57	0.61	0.51	0.59
Return on average equity (after tax)	**16.74**	15.64	16.25	12.57	16.99
Cost-to-income ratio	**38.28**	41.10	41.18	43.62	46.97
Non-performing loan ratio	**2.12**	2.58	2.88	3.15	5.99
Core capital adequacy ratio[2]	**9.58**	5.57	5.41	6.17	8.42
Capital adequacy ratio[2]	**11.40**	9.01	9.47	9.49	12.57

(1) Loans and advances to customers represent gross loans and advances to customers less allowances for loan impairment losses.

(2) The capital adequacy ratios as at 31 December 2003 and 2002 were calculated based on the financial information prepared in accordance with the PRC GAAP and related guidelines of the PBOC. The capital adequacy ratios of the year 2004 and the years afterwards were calculated based on the related guidelines of China Banking Regulatory Commission ("CBRC").

(3) The applicable accounting policies on investments adopted in the preparation of the financial statements for the year 2002 differed from those prepared since 2003. The Company considers the changes in the accounting policies will not result in material impact on the above financial ratios.

CHAIRMAN'S STATEMENT

QIN XIAO
Chairman

In 2006, the State continued its efforts to implement macro-control policies to resolve conflicts arising from economic development. The national economy has maintained rapid and sustainable growth, which is a promising start for the 11th Five-year Plan. Under the favorable macro-economic environment, the banking industry has accelerated its pace of reform and development, evoked the trend of restructuring and system reform as well as domestic and overseas listings. On 11 December 2006, after the 5-year transition period, China's banking industry fulfilled its WTO commitment of fully opening up the financial market to foreign investors, which resulted in a new era for severe competition within the industry.

CHAIRMAN'S STATEMENT

In 2006, the State continued its efforts to implement macro-control policies to resolve conflicts arising from fast economic development. The national economy has maintained rapid and sustainable growth, which is a promising start for the 11th Five-year Plan. Under the favorable macro-economic environment, the banking industry has accelerated its pace of reform and development, evoked the trend of restructuring and reform, and also the domestic and overseas listings. On 11 December 2006, after the 5-year transition period, the State carried out its WTO commitment of fully opening up the financial market to foreign investors, which resulted in a new era for severe competition among the industry.

In the past year, the Bank consistently followed the philosophy of "balanced development in respect of profitability, quality and scale", with the support of regulatory authorities, shareholders and various sectors of the society. The bank actively promoted the adjustment of business strategies and further uplifted management standards, as well as achieved balanced growth and financial budget set out by the Board, recording another successful year.

It is worth mentioning that the H Shares of the Bank have been successfully listed, which is another milestone in the Bank's history. The Bank has issued 2,420,000,000 H Shares (including over-allotment option). The offering price was HK$8.55 per share, which was the upper end of the offer price range, having taken into account the interests of shareholders of both A shares and H shares. The total funds raised amounted to RMB20.505 billion. The successful listing of the H shares greatly enhanced the Bank's capital strength and competitiveness, and also ensured the continuous growth of the Bank.


As one of the milestones, the success of the H Shares listing marked a new development arena for the Bank. We are grateful to the investors for their recognition of our achievements. More importantly, we managed to maintain confidence of investors in the future prospects of the Bank. This is our responsibility and commitment. The goal of the Bank is "to become the best commercial bank in China with international competitiveness through provision of innovative financial products and quality customer services". To achieve this goal, we must be highly responsible, committed, diligent and innovative. We must reinforce and make good use of our competitive edges, and identify our weaknesses and shortcomings. Besides, we must continuously improve our ability to defend the systemetic risk, while facing the opportunities and challenges brought by the reform of the PRC banking industry. In addition, we must maintain our advantages in the new competitive environment, uplift the management standards of the Bank in all aspects as well as improve various operational benchmarks and key determinants.

Looking ahead, China's economy will continue its stable and healthy growth. While entering into the third decade, we are confident in facing all kinds of competition and challenges. I strongly believe that the Bank will distinguish itself among the competitors. Let us make concerted efforts to develop the Bank into the best commercial bank in China with international competitiveness, and to sustain its success with the aim of bringing better return to the shareholders and the society.

PRESIDENT'S STATEMENT

MA WEIHUA
President & CEO

2006 was a fruitful year for the operational management of the Bank. During the past year, the Bank faced severe challenges, such as the continuous implementation of the macro-control policies, the full-speed reform of opening-up of the banking industry, acceleration of the speed in the interest rate and exchange rate liberalisation, and the rapid development of direct financing. The Bank earnestly abided by the guidelines of "Updating the mindset, Deepening the reform, Strengthening innovation and Preventing risks" in accordance with the working policies set by the Board. The Bank has made its efforts in reaching the goal of "10 reforms", advanced towards the adjustment of business strategies and management internationalisation, as well as accomplished all working missions set out in the beginning of the year.

PRESIDENT'S STATEMENT

2006 was a fruitful year for the Bank in terms of operational management. During the past year, the Bank faced a range of challenges, such as the continuous implementation of the macro-control policies, the full reform and opening-up of the banking industry, accelerating the speed in the interest rate and exchange rate liberalisation, and the rapid development of direct financing. The Bank would earnestly abide by the guidelines of "Updating the mindset, Deepening the reform, Strengthening innovation and Preventing risks" in accordance with the strategies set by the Board. The Bank has made its efforts in reaching the goal of "10 reforms", advancing towards the adjustment of business strategies and management internationalisation, as well as accomplishing all targets set out in the beginning of the year.

By the end of 2006, the gross assets of the bank reached RMB934,102 million, up by 27.16% over that of the beginning of the year; total deposits of RMB773,757 million, with an increase of 21.97%; and total loans of RMB565,702 million, with an increase of 19.81%. We recorded a net profit of RMB6,794 million, with an increase of 81.22%. The non-performing loan ratio was 2.12%, dropping by 0.46 percentage point from the beginning of the year.

Our business development featured four significant characteristics in 2006. Firstly, we further enhanced our profitability. Our return on average assets (after-tax) reached 0.81% at the end of the year, 0.24 percentage point higher than that of the previous year, and our return on average equity (after-tax) was 16.74%, an increase of 1.10 percentage points compared to the previous year. Secondly, our capital strength had significantly been improved. The capital adequacy ratio was 11.40% at the end of the year, 2.39 percentage points higher than that at the beginning of the year, with the core capital adequacy ratio of 9.58%, 4.01 percentage points higher than that at the beginning of the year. Thirdly, our retail banking business grew rapidly. Our total retail loans accounted for 18.03% of total customer loans, representing a rise of 2.35 percentage points over that of last year. The net fee and commission income of retail banking was RMB1,531 million, up by 97.04%. Fourthly, the ratio of the net fee and commission income kept increasing. The net fee and commission income realised in the year was RMB2,514 million, up by 60.43%, accounted for 10.11% of the total business operating income, an increase of 1.95 percentage points over that of the previous year.

In 2006, we accelerated the reform of the credit risk management system; established the Credit Management Department, Credit Approval Department and Special Asset Management Centre in headquarter; strengthened the research of industry policies and reinforced the loan approval system; improved centralised credit approval for group companies; steadily promoted the system of client credit ratings; speeded up the development of the debt rating system; while continuously improved asset quality. We also continued to strengthen the internal control system, established the Legal and Compliance Department at our headquarter; accomplished the vertical reform of the internal audit system; organised and commenced three compliance monitoring; and increased the accountability for non-compliance

behaviour. Throughout the year, there were no incident of gross misconduct nor had we committed cases involving material liabilities.

In 2006, we made our concerted marketing efforts to build up the brand of “Lifetime Partner” for financial products and actively commenced the promotion of competitive products such as cash management and online banking, and brought about satisfactory marketing achievements. We newly issued 2.09 million All-in-one Card, realising a total issuance of 38.85 million with an average deposit in each card amounting to RMB6,195, which was RMB774 more than that of the previous year. Sunflower newly clients increased by 0.037 million and the assets increased by RMB56.9 billion. We newly issued 5.17 million credit cards, with an accumulative issuance of 10.34 million cards. Clients applied for Bank-Custom Express increased by 1,000 and the accumulated transaction volume exceeded RMB80 billion, accounting for the biggest market share in the field of mainland online-tax settlement (according to the statistics provided by China E-port Information Data Center). The percentages of the number of online corporate banking transactions and the total amount transacted online to the total banking transaction were 27% and 37% respectively.

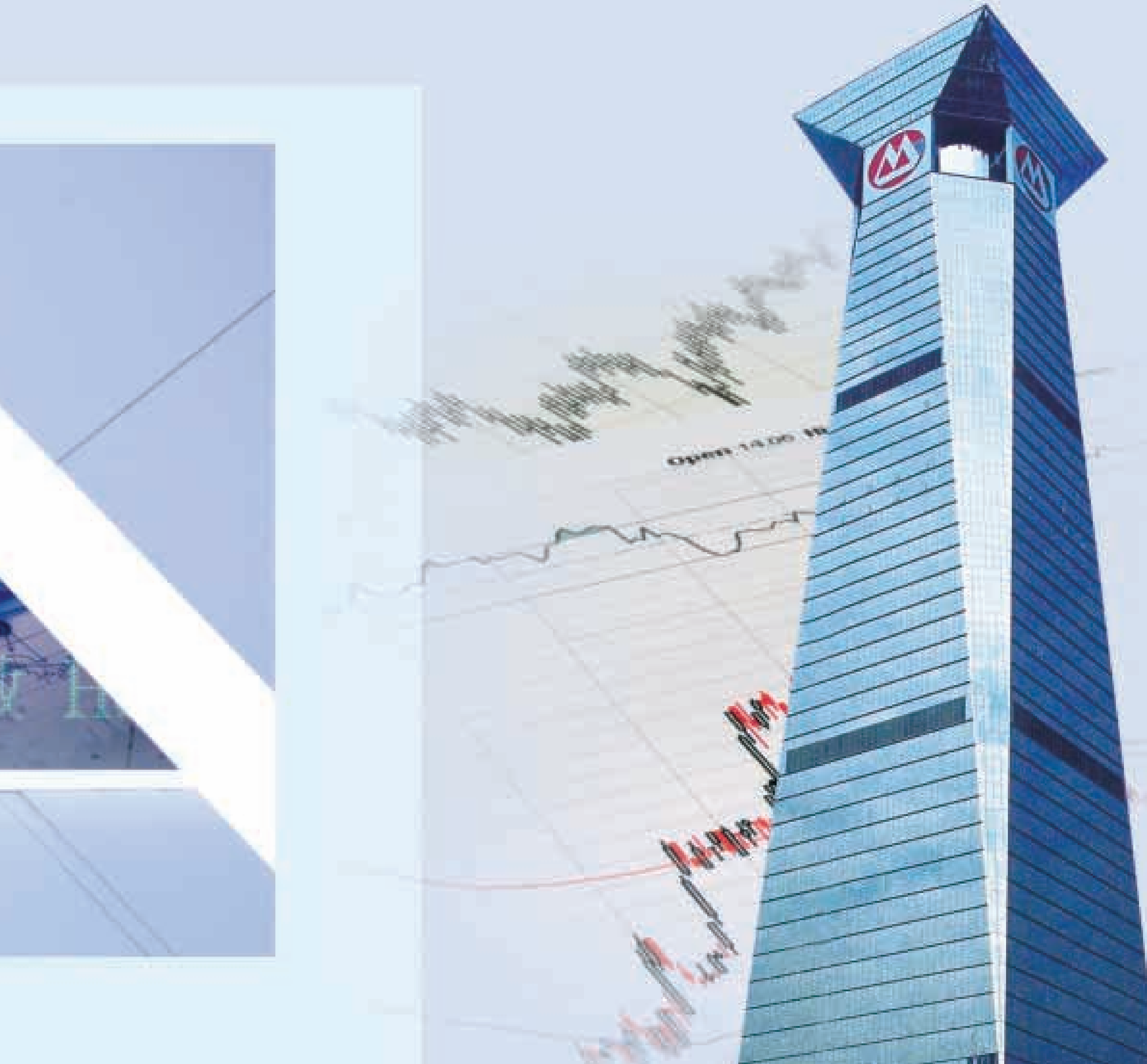
In 2006, we continued the expansion by applying the new core banking system across the Bank, and succeeded in applying new core banking systems in Credit Card Centre as well as 10 branches including Harbin and Nanjing branches. We improved and increased functions of new core banking system, improved the workflow of project management, and speeded up the construction of data system and management information system. We have succeeded in relocating and switching the whole server room, and concentrated the operation systems of all branches, thus improving system stability.

In 2006, we succeeded in listing our H Shares. The marketability, growth and stability of the Bank were highly recognised by international investors. In the evaluations held by the media and various organisations, we were awarded many honours including “The Best Retail Bank in China”, “The Best Bank in China” and “The Most Respected Enterprise of China”, etc.

The above achievements were attributable to the joint efforts of all our staff and the firm support from our clients, investors and supporters from the society. I hereby extend sincere gratitude on behalf of the Bank to our friends who have been supporting and caring for our developments all the times.

In 2007, the Bank is going to celebrate its 20th anniversary. We will abide by the guiding principles of “handling crisis proactively, preventing risks, breaking through obstacles and accelerating the 10 reforms”. We will understand in depth the rigorous challenges brought by social and economic developments; advance the reform at all levels of the Bank; accelerate the overturn of the conventional operating management concept and approach; and build up new competitive edges, so as to achieve satisfactory development in the first 20 years; and turn into a new page for the next 20 years.

SHI JILIANG
Chairman of the Board of Supervisors




DEDICATED
SERVICES

China Merchants Bank inherits the belief of "We are here, just for you" for its operation, and takes the lead in the country to improve customer services by various means. The Bank is committed to provide customers with efficient, convenient, caring and dedicated services, leading to a change in the service concept and manner of China's banking industry and a closer relationship between the Bank and its customers. China Merchants Bank is the first in the industry to develop E-banking services network, such as Online Banking, Phone Banking, Mobile Banking, and Self-service Banking, etc. in order to offer its clients with high quality financial services. 95555 phone banking, which is the best platform for transaction, inquiry, investment and wealth management, has been recognised as "China's Best Call Center". 800-820-5555, the customer hotline for credit card services, is also the first in China to be regarded as a "5-Star Customer Service Centre".

Acting upon the principle of market segmentation, China Merchants Bank, in addition to its ongoing efforts to provide quality services to the general public, it also develops 'one-to-one' tailor-made services to its affluent clients, continuously improving its professional and individualized financial services quality. According to a survey conducted by a recognised organization, China Merchants Bank is the most popular RMB wealth management bank among the affluent clients in the country. The Bank created another 'No.1' in the country by establishing a 'Customer Satisfaction Index System' in order to achieve a sustainable competitive advantage of management and service quality.

SIGNIFICANT EVENTS

Completion of Share Reform

Pursuant to "Certain Opinions from the State Council Regarding the Promotion of Further Reform and Stable Development of the Capital Market" (*Guo Fa* [2004] No. 3), the China Securities Regulatory Commission ("CSRC"), the State-owned Assets Supervision and Administration Commission of the State Council, the Ministry of Finance, the People's Bank of China and the Ministry of Commerce jointly promulgated the "Guidelines on Share Reform of Listed Companies", and CSRC promulgated the "Administration Procedures for the Implementation of State-owned Share Merger Reform for Listed Companies". Upon approval by the State-owned Assets Supervision and Administration Commission of the State Council and Shanghai Stock Exchange, the Company implemented Share Reform (the "Reform") on 24 February 2006. Based on its total share capital recorded on the equity registration date, the Bank issued to each shareholder 0.8589 new share for every 10 shares held by the shareholder out of our capital reserve fund. The holders of non-tradable shares paid newly acquired CMB shares to all holders of tradable shares registered with Shanghai Branch of China Securities Depository and Clearing Corporation Limited on the equity registration date specified in the Reform, and undertook that every 10 tradable shares were entitled to 1.6 shares paid by holders of non-tradable shares based on the shares held by such holders of tradable shares after implementation of the Reform and before payment of consideration. Every 10 shares held by holders of tradable shares were entitled to 2.59632 new shares. After the Reform, the original non-tradable shares were converted into shares subject to trading moratorium, totaling 7,573,629,579 shares; the original tradable shares were converted into shares not subject to any trading moratorium, totaling 4,705,433,834 shares; the total share capital increased by 971,229,827 shares as a result of the Reform.

Listing of H Shares

Upon approval by CSRC and the SEHK, the Company issued 2.2 billion H shares on 22 September 2006 at HK$8.55 per share. Our state-owned shareholders reduced their shareholdings by transferring 220 million state-owned shares to the National Social Security Fund. The total H shares issued by the Company amounted to 2.42 billion. Dealings in H shares on SEHK commenced on 22 September 2006 (stock code: 3968).

On 27 September 2006, in response to the request of the joint bookrunners to exercise the over-allotment option of the H Share Issue granted by us, the Company issued an additional 220 million H Shares at HK$8.55 per share. Due to the exercise of the over-allotment option, the state-owned shareholders of the Company reduced their shareholdings by transferring 22 million state-owned shares to the National Social Security Fund for conversion into H shares. Trading of the above 242,000,000 H shares commenced on SEHK on 5 October 2006. As a result of the exercise of the over-allotment, the total number of H Shares issued by the Company amounted to 2,662,000,000.

MANAGEMENT DISCUSSION AND ANALYSIS

(I) FINANCIAL HIGHLIGHTS

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

Analysis of Income Statement

Financial results highlights

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

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

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

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

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

Changes in profit before tax

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

Operating income

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

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

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

Net interest income

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

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

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

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

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

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

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

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

Interest income

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

Interest income from loans and advances to customers

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

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

The above average balances were averages of daily balances.

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

Interest income from debts investments

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

Interest income from placements with banks and other financial institutions

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

Interest expense

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

Interest expenses on deposits from customers

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

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

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

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

Interest expenses on amounts due to banks and other financial institutions

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

Interest expenses on issued debts

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

Net interest spread and net interest margin

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

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

Net fee and commission income

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

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

MANAGEMENT DISCUSSION AND ANALYSIS

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

In 2006, the bank card fee income increased by 75.96% compared to the previous year. It was primarily due to increased issuance and transactions volume of bank cards, especially credit cards; of which, POS fee income was RMB548 million, representing an increase of 56% compared to the previous year; income from credit card cash advance and installment business was RMB0.32 billion, representing an increase of 188% compared to the previous year.

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

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

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

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

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

Other net income

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

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

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

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

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

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

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

Operating expenses

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

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

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

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

Provision for impairment losses

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

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

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

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

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

Analysis of balance sheet

Assets

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

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

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

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

Loans and advances to Customers

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

Distribution of loans by product type

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

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

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

Corporate loans

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

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

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

As at 31 December 2006, our corporate loans was amounted to RMB359.883 billion, an increase of 20.51% compared to the previous year. Amongst all, the working capital loans increased by 16.31%, whose growth rate was steady; fixed asset loans increased by a rapid rate of 55.89%, which was primarily attributable to the robust demand for fixed asset loans in quality industries such as communications, energy and transportation along with rapid economic growth in China, and the Company increased loans to the said industries as a result; trade finance loans decreased by RMB1.6 billion, primarily due to reduced demand for the said products as a result of the interest rate rise in USD loan market.

Discounted bills

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

Retail loans

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

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

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

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

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

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

Investments

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

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

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

Financial assets at fair value through profit or loss

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

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

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

[1] Consists of other bonds, equity investments and financial derivatives, etc.

Available-for-sale investments

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

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

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

Held-to-maturity debt securities

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

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

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

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

Receivables

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

Carrying value and fair value

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

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

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

Investment concentration

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

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

Liabilities

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

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

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

Deposits from customers

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

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

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

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

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

Shareholder's equity

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

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

Loan quality analysis

Asset quality analysis on loan classification

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

Distribution of loan portfolios by loan classification

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

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

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

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

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

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

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

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

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

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

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

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

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

Distribution of loans and non-performing loans by industry sectors

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

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

(1) Percentage of non-performing loans to the total loans of the said category.
(2) Consists primarily of education, public utility, government agencies, finance, etc.

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

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

Distribution of loans by collateral

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

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

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

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

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

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

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

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

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

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

Analysis of capital adequacy ratio

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

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

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

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

Segment operating results

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

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

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

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

[1] Represents net interest income earned from each segment's external customers or activities.
[2] Represents net interest income/(expenses) attributable to each business segment's in transactions with other segments.

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

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

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

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

(1) Represents the total operating income gross of interest expense, fee and commission expense.
(2) The definition of geographical segment, please refer to Note 35 (b) to the financial statements.

(II) BUSINESS OPERATIONS

Retail banking segment

The Company provides retail customers with diversified retail banking products and services, including retail loan, deposit, debit card, credit card, wealth management service, investment service, agency sale of insurance products and fund products, forex trading, and foreign exchange service, of which "All-in-one Card", credit card, "Borrow & Repay Anytime", "Sunflower" and personal internet banking have won wide spread recognition. The Company provides the above services and products via diversified channels, including branches and sub-branches, self-service centers, ATM, CDM, internet banking and telephone banking service system. As at 31 December 2006, the retail loan balance of the Company was RMB101.983 billion, accounting for 18.03% of total loans and advances to customers; retail deposit balance was RMB311.959 billion, accounting for 40.32% of deposits from customers; operating income from retail banking accounted for 26.49% of the total operating income.

Retail loans

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

Retail deposits

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

Non-interest income retail business

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

Bank card business

As at 31 December 2006, the Company had cumulatively issued 38.849 million All-in-one cards, including 2.09 million cards newly issued during the year. All-in-one Card deposit balance was RMB240.68 billion, accounting for 77.15% of the total retail deposits, representing RMB6,195 average balance per card. As at 31 December 2006, the Company had issued 10.34 million credit cards, including 5.17 million cards issued during the year. The total number of cards in circulation was 7.12 million, the total number of card holders was 4.47 million, the cumulative transaction volume via credit cards was RMB66.4 billion, and the revolving credit card interest-earning balance was RMB3.6 billion.

Customers

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

Marketing

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

MANAGEMENT DISCUSSION AND ANALYSIS

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

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

Corporate banking

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

Corporate loans

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

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

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

Discounted bills

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

Corporate deposits

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

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

Non-interest-based Corporate banking business

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

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

MANAGEMENT DISCUSSION AND ANALYSIS

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

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

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

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

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

Customer base

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

Treasury

Business strategy

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

In respect of the use of RMB funds, the Company stepped up fund operations in line with the high fund liquidity of the Company and the increased RMB interest rate. The Company enhanced fund utilization efficiency by expanding fund lending business such as taking and placing in the money markets, repurchase agreements and open market operations, and increasing investment in bonds such as bonds issued by corporate and policy banks. The Company effectuated effective control of market risks and guaranteed return on investment by increasing investment in Central Bank bills and shortening their overall duration.

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

Operating results

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

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

At the end of 2006, the Company duly launched products linking equity and commodity performance, QDII products, corporate liquid forex management program and personal daily forex management program, thereby maintaining a leading position in the market. In 2006, the Company launched 129 foreign currency corporate and personal integrated wealth management products, raising RMB43.7 billion proceeds; opened 44 settlement agency accounts, the transaction volume reached RMB67.7 billion, the agency assets reached RMB36.1 billion, and transactions under various interest rate swap and forward interest rate contracts reached USD0.623 billion.

Business development

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

Product Pricing

Loans

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

We price our products based on various criteria, such as the borrower's financial condition, value of collateral, the intended use and term of the loan, cost of providing the loan, credit and other risks, expected rates of return, our market position and the prices of our competitors. We have started using the FTP method to calculate the cost of our funds in connection with the extension of loans. We are in the process of developing loan pricing models that assist us to determine the minimum interest rates at which our loan products may be priced. We permit our branches to set prices at their discretion within the established ranges of these internal benchmark prices and give them greater flexibility to compete effectively.

Deposits

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

Non-interest-based Businesses

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

Distribution channels

The Company provides products and services via different distribution channels. As at 31 December 2006, the Company had 36 branches, 464 sub-branches (including offices), 1 representative office, 1,050 self-service centres and 812 machines (ATM & CDM) across China. The efficient outlet network of the Company are primarily located in developed areas in China such as Yangtze River Delta, Pearl River Delta and Bohai Rim, and some large cities in other areas. Besides expanding physical distribution channels, the Company also made efforts to develop and improve e-banking channels such as internet banking and telephone banking. The highly acclaimed online retail banking of the Company has effectively relieved the pressure on the business outlets of the Company. The number of transactions on the professional version of internet banking was 20.07 million, up by 84% year on year, and the number of online payments was 24.60 million, up by 139% year on year.

Overseas businesses

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

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

The Company has also established a wholly-owned subsidiary, CMB International Capital Corporation Limited in Hong Kong, which mainly provides investment banking services such as advisory work on corporate finance, IPO underwriting, and securities brokerage, etc.

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

Information technology

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

Problems and difficulties in operations and their solutions

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

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

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

1. Under the pressure of macro control policies, the Company followed the guidelines of "Updating the mindset, deepening the reform, strengthening innovation and preventing risks", advanced the adjustment of operational strategies and management internationalization, stepped up loan limit control and restructuring in line with the macro control requirements, thereby accomplishing all the tasks set for the year.

2. The Company changed its perception of risk from the previous focus on risk control to the modern concept of risk management. The new initiatives undertaken by the Bank include the following: implement credit portfolio management by means of providing more detailed credit approval policies and procedures manual; develop tolerable risk management; improve market risk management framework; enhance the function of The Assets and Liabilities Management Committee ("ALCO") on the Bank's market risk management; increase effort during the onsite and offsite inspection of branches; improve recovery of non-performing assets by the implementation of effective recovery procedures; manage liquidity risk to ensure stable

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

3. Further optimisation of resource allocation by priority and strategic orientation. Stepped up outlet construction and improved outlet layout from the strategic perspective, increased investment in IT equipment upgrading and system network building, and stepped up human resources training and retention. In operations management, improved resource allocation can be achieved by budget management, income distribution, investment and fixed assets management.

4. Stepped up product innovation and marketing. Sped up innovating featured products in financial management, personal assets management, corporate cash management and trade finance. Stepped up brand building such as "Sunflower Wealth Management", "Lifetime Partner" and "GoFortune" by combined marketing efforts on various businesses, the Company actively developed businesses for small and medium enterprises, and promoted the rapid development of retail banking, wholesale banking and inter-bank businesses.

(III) RISK MANAGEMENT

As a commercial bank, the Company mainly faces credit risk, liquidity risk, market risk and operational risk. The Company is well aware of such risks and is making continued efforts to enhance its risk management ability by building a bank-wide risk management system and prudent risk management culture, optimizing risk management framework, improving risk management policy and procedure, and using advanced risk measurement and management tools, thereby effectively controlling risks, effectuating growth and increasing return after risk adjustment while maintaining good quality of assets. Throughout the year, the operation of the Company is not adversely affected by these risks.

Credit Risk management

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

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

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

Corporate loans

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

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

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

Post-disbursement inspection

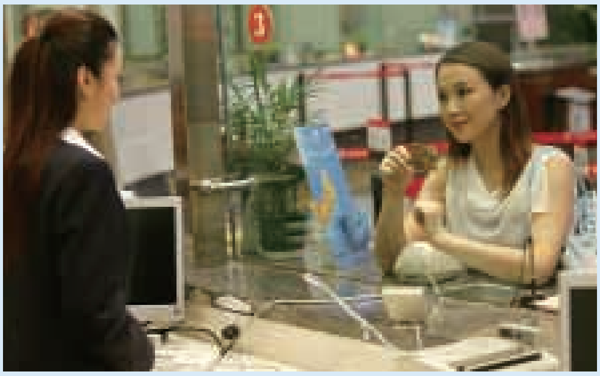
(1) **Loan classification**. The loan classification of the Company is mainly based on the solvency of borrowers as well as other factors such as borrowers' loan repayment records, repayment intention, collateral type and the length of overdue period. The sub-branches and branches of the Company collect,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

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

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

Retail loans

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



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

Liquidity risk management

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

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

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

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

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

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

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

Market risk management

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

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

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

Interest rate risk management

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

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

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

Currency risk management

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

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

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

Operational risk management

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

(1) restructured the organization and management framework and risk management system, established compliance department at Head Office to specialize the compliance management;

(2) stepped up inter-department independence and coordination to promote professional management;

(3) handled specific cases and dealt with commercial bribery cases; implemented comprehensive self-inspection and review at all level of branches, further implemented the accountability system, and stepped up penalty on misconducts of staff;

(4) implemented "bank-wide and comprehensive" internal control and enhance internal control level according to international banking industry standard and the requirements of regulatory authority and investors following the H share listing. The internal audit departments intensified inspections and reports on high-risk businesses and improper operations. The Head Office and branches of the Company held quarterly internal control evaluation meetings to evaluate and analyze internal and external improper operations, misconducts and illegal practices, and improve the risk prevention and internal control mechanisms;

(5) regarding the information technology, the Company enhanced the set-up of production center of the information technology department and disaster recovery center, so as to improve the capability of the anti-disaster system; enhanced the security of the application system, strengthened the security management of the information system; formulated the system and regulations in respect of the use of key, maintainance of servers, computer-related emergency cases and security of audit data accordingly. The number of branches operating new integrated business systems increased from 9 to 18, systematically improving the accounting, saving and fee base business operation procedure and control procedure; developed a monitoring and analysis system of suspicious RMB transactions with reference to the monitoring requirements of anti-money laundering of the CBRC and the PBOC;

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

Misconduct reporting and monitoring

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

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

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

Internal audit

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

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

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

(IV) OUTLOOK

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

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

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

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

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

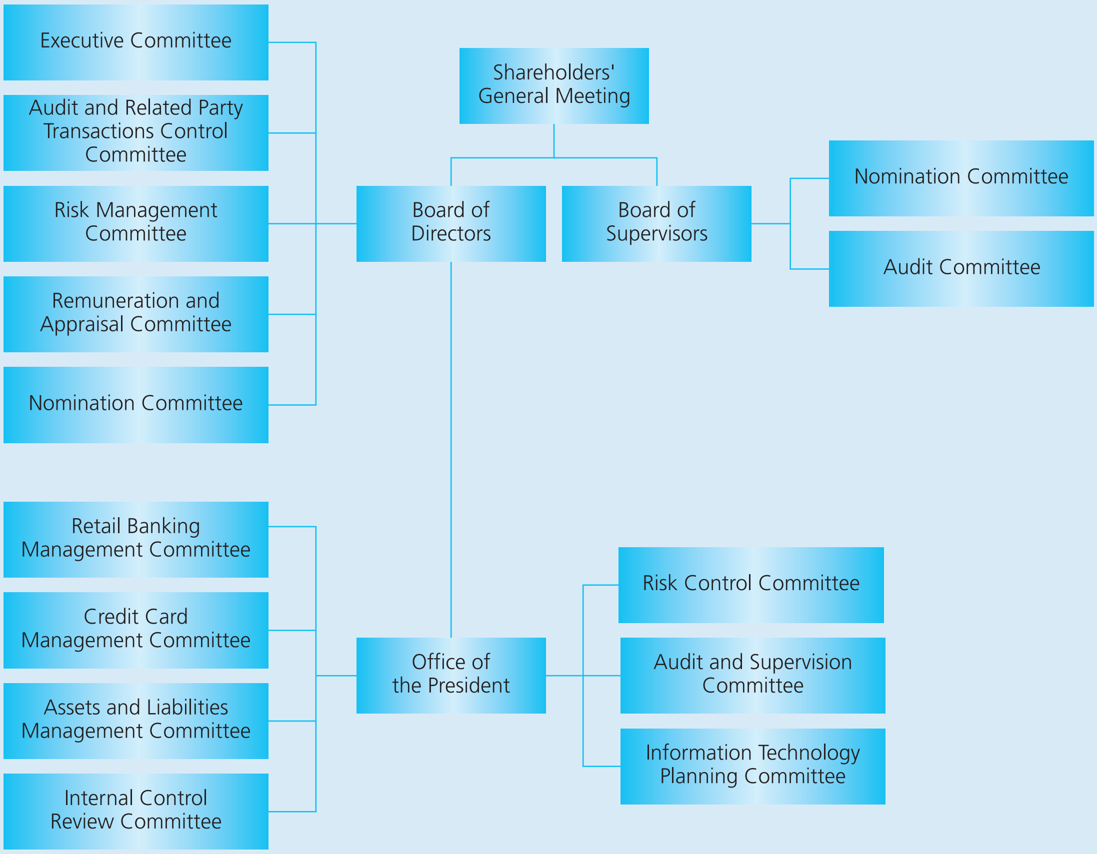
INNOVATION INITIATIVES

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

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

CORPORATE GOVERNANCE REPORT

Governance Structure of the Company



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

Since the listing of its A Shares in Mainland China, the Company has, in accordance with PRC regulations and the practical situations of the Company, established a comprehensive corporate governance structure to enhance the checks and balance between the shareholders' general meeting, the Board of Directors and the Board of Supervisors, and has also made the effort to constantly enhance the corporate governance standard. The Board of Directors has established five specialised committees, i.e. the Executive Committee, the Audit and Related Party Transactions Control Committee, the Risk Management Committee, the Remuneration and Appraisal Committee and the Nomination Committee; the Board of Supervisors has established two specialised committees, i.e. the Audit Committee and the Nomination Committee. The Board of Directors, the Board of Supervisors and their specialised committees perform their duties in accordance with the regulations and requirements of CBRC, CSRC and SEHK, the Articles of Association of the Company and the related Procedural Rules to effectively enhance the corporate governance and operational efficiency of the Company.

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

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

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

A. THE BOARD OF DIRECTORS

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

A.1 Membership of the Board of Directors

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

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

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

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

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

The procedures for appointment, re-election and removal of directors of the Company are set out in the Articles of Association of the Company. The Nomination Committee of the Company carefully considers the qualifications and experiences of every candidate for director and recommends suitable candidates to the Board. Upon passing the candidate nomination proposal, the Board proposes election of related candidates at a general meeting. The term of a director shall start from the date upon which the resolution for the appointment is passed at the general meeting to the expiry of the current Board.

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

A.3 Responsibilities of directors

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

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

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

A.4 Chairman and Chief Executive Officer ("CEO")

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

The positions of the Chairman of the Board and President of the Company have been taken up by different persons and their duties have been clearly defined. Mr. Qin Xiao serves as the Chairman of the Board and is responsible for leading the Board, chairing the meetings, ensuring that all directors receive appropriate briefing on issues arising at board meetings, managing the operations of the Board, and ensuring that all major and relevant issues are discussed by the Board in a constructive and timely manner. To enable the Board to discuss all important and relevant matters timely, the Chairman and senior management will work together to ensure that the directors duly receive appropriate, complete and reliable information in a timely manner for their consideration and review.

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

A.5 Meetings of Board of Directors

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

CORPORATE GOVERNANCE REPORT

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

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

Notes:

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

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

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

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

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

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

A.6 Delegation of the Board

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

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

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

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

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

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

B. BOARD COMMITTEES

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

In 2006, the Company optimized the membership constitution of the specialised committees under the Board. The Executive Committee consists of non-executive directors and executive directors; the members of the Audit and Related Party Transactions Control Committee are all non-executive directors pursuant to the requirements of SEHK and the majority of whom are independent non-executive directors, with one of them acting as chairman; the Nomination Committee and the Remuneration Committee also consists of independent non-executive directors in the majority, with one independent non-executive director acting as chairman. The committees under the Board have intensive research on specific issues, have studied and discussed a range of important topics including competitiveness index system, quantitative authorisation granted by the Board to the management, system of reporting important events to the Board, regulations on senior management's remunerations, regulations on related party transactions (revised) and asset quality report etc., and have submitted the same to the Board and the shareholders' general meeting for consideration and approval.

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

B.1 Executive Committee

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

Main authorities and duties:

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

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

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

B.2 Audit and Related Party Transactions Control Committee

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

Main authorities and duties:

- to propose the appointment or replacement of external auditors;
- to monitor the internal audit system of the Company and its implementation;
- to coordinate communication between internal auditors and external auditors;
- to review the financial information of the Company and its disclosure;
- to examine the internal control system of the Company; and
- to examine the material connected transactions of the Company.

Summary of work performed in 2006:

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

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

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

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

Notes:

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

B.3 Risk Management Committee

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

Main authorities and duties:

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

Summary of work performed in 2006

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

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

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

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

B.4 Remuneration and Appraisal Committee

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

Main authorities and duties:

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

Summary of work performed in 2006:

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

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

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

B.5 Nomination Committee

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

Main authorities and duties:

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

Summary of work performed in 2006:

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

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

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

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

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

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

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

C. BOARD OF SUPERVISORS

C.1 Duties and operations of the Board of Supervisors

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

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

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

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

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

C.2 Committees under the Board of Supervisors

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

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

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

D. FINANCIAL REPORTING

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

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

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

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

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

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

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

E. INTERNAL CONTROL

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

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

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

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

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

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

F. COMMUNICATIONS WITH SHAREHOLDERS

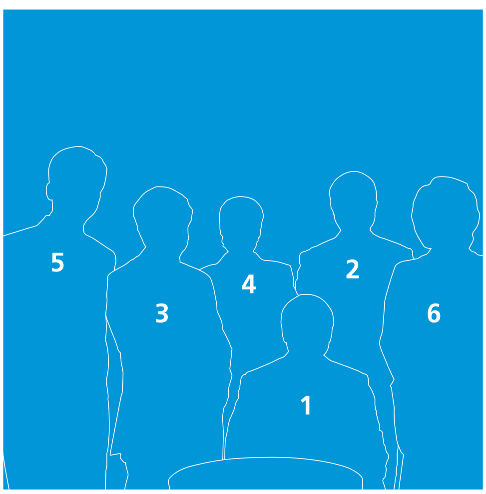
The Board maintains regular dialogues with shareholders, especially through annual general meetings or other general meetings where shareholders are encouraged to participate.

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

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

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

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



1. Ma Weihua, President and CEO
2. Li Hao, Executive Vice President
3. Tang Zhihong, Executive Vice President
4. Yin Fenglan, Executive Vice President
5. Ding Wei, Executive Vice President
6. Chen Wei, Executive Vice President (Resigned)

MAJOR WORKING EXPERIENCES OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

(1) Directors

Mr. Qin Xiao. He is the chairman and non-executive director of the Company. He joined the Company in April 2001. Mr. Qin obtained a doctorate degree in economics from Cambridge University in 2002 and is a senior economist. He is a member of the Tenth Chinese People's Political Consultative Conference, and is a part-time professor at the School of Economics & Management, Tsinghua University and the People's Bank of China Postgraduate Division. He has been chairman of the board of China Merchants Group Limited since January 2001, and was previously the vice chairman of the board of China International Trust and Investment Trust Corporation from 2000 to 2001, general manager of the China International Trust and Investment Corporation from 1995 to 2000, chairman of the board of China CITIC Industrial Bank (now China CITIC Bank) from 1998 to 2001, an advisor on the Foreign Currency Policy of the State Administration of Foreign Exchange from 1999 to 2001, chairman of the APEC Business Advisory Council for the 2001 term from 2000 to 2001, and a deputy of the Ninth National People's Congress.

Mr. Wei Jiafu. He is the vice chairman and non-executive director of the Company. He joined the Company in April 2001. He obtained a master's degree in transportation planning and management from Dalian Maritime University in 1999 and a doctorate degree from Tianjin University in 2001. He has been a member of the Chinese Communist Party Central Committee for Disciplinary Inspection since November 2002 and the president of China Ocean Shipping (Group) Company since November 1998. He is also the chairman of the China Group Companies Promotion Association, the China Shipowners' Association and the China Federation of Industrial Economics and a member of the Council of Bo'ao Forum for Asia. He has been a member of the Harvard Business School Asia-Pacific Advisory Board and an advisor of the Panama Canal Authority. He was the president of COSCO Holding (Singapore) Pte. Ltd. from 1993 to 1995, general manager of Chinese-Tanzania Joint Shipping Company from 1992 to 1993, Tianjin Ocean Shipping Company from 1995 to 1998 and COSCO Bulk Carrier Company Limited from 1997 to 1998. In 2003, he was awarded the "Famous Person in Shipping Award" from the Lloyd's Asia Shipping Magazine and the "Port Pilot Award" conferred by the Port Authority of Long Beach, the United States.

Mr. Wei has been the chairman of the board of directors and executive director of China COSCO Holdings Company Limited since February 2005, and was the chairman and executive director of COSCO Pacific Limited from June 2000 to June 2005. He has been the chairman and a non-executive director of COSCO Pacific Limited since June 2005, and the chairman and director of COSCO International Holdings Limited since June 2000. All these three companies are listed on the Hong Kong Stock Exchange. Mr. Wei has been the chairman and director of COSCO Corporation (Singapore) Limited (a company listed on the Singapore Stock Exchange) since March 2000, chairman and director of COSCO Container Lines Company Limited since July 2000, chairman of the board and director of COSCO (Hong Kong) Group Limited since June 2000 and the general manager of COSCO Bulk Carrier Company Limited since April 2000.

Mr. Fu Yuning. He is the non-executive director of the Company. He joined the

Company in March 1999. Mr. Fu obtained a doctorate degree from Brunel University, the United Kingdom in 1987. He has been a director and president of China Merchants Group Limited since April 2000. Mr. Fu has been the chairman and managing director of China Merchants Holdings (International) Co., Ltd. (a company listed on the Hong Kong Stock Exchange) and the chairman and executive director of China Merchants China Direct Investments Limited (a company listed on the Hong Kong Stock Exchange) since January 1999. He has also been an independent non-executive director of Integrated Distribution Services Group Limited (a company listed on the Hong Kong Stock Exchange) since November 2004, an independent non-executive director of Sino Land Company Limited (a company listed on the Hong Kong Stock Exchange) since June 2005 and a director of Hong Kong Port Development Council since January 2003. He has served as the chairman of Shenzhen Chiwan Petroleum Supply Base Co., Ltd. (a company listed on the Shenzhen Stock Exchange) since April 1998 and chairman of China Nanshan Development (Group) Inc. since December 1998. He previously served as chairman of the board of Shenzhen Chiwan Wharf Holdings Limited (a company listed on the Shenzhen Stock Exchange) from 1993 to 1998 and chairman of Union Bank of Hong Kong Limited (now known as Industrial and Commercial Bank of China (Asia) Limited) (a company listed on the Hong Kong Stock Exchange) from 1999 to 2000.

Mr. Li Yinquan. He is the non-executive director of the Company. He joined the Company in April 2001. He obtained a master's degree in economics and finance in Graduate School of the People's Bank of China in 1986 and a master's degree in finance in FINAFRICA, Italy in 1988, respectively, and is a senior economist. He has been the vice president and chief financial officer of China Merchants Group Limited since March 2004. He previously served as deputy division chief and division chief of the General Affairs Office of the Agricultural Bank of China from 1985 to 1992, an assistant general manager of the International Business Department and head of the Preparatory Group of the New York Branch from 1992 to 1995, deputy general manager of the Personnel and Education Department from 1995 to 1996, deputy general manager (acting general manager) of the Hong Kong Branch from 1997 to 1999, and general manager of the Planning and Finance Department of China Merchants Holdings (Hong Kong) Co., Ltd., deputy chief financial officer of China Merchants Group Limited and chief financial officer of China Merchants Group Limited from 2000 to 2002.

Mr. Huang Dazhan. He is the non-executive director of the Company. He joined the Company in February 2002. Mr. Huang obtained a doctorate degree in economics from University of Manchester, the United Kingdom in 1993. Mr. Huang has been the managing director of China Merchants Finance Holdings Company Limited since June 1999, a director of China Merchants Holdings (Hong Kong) Company Limited since April 2000, a financial advisor to China Merchants Group Limited since 1998, a director of China Merchants Securities Co., Limited since March 1999 and an executive director of China Merchants China Direct Investments Limited (a company listed on the Hong Kong Stock Exchange) and a director of China Credit Trust Co., Ltd. since March 1999 and since November 2005 respectively. Mr. Huang also has been the chairman of the board of China Merchants China Investment Management Limited, Houlder Insurance Brokers Far East Ltd, China Merchants Insurance Company Limited, China Merchants Holdings (UK) Co. Ltd., Houlder Insurance Brokers (China)

Limited, China Merchants Finance Investment Holdings Co., Ltd., China Merchants Houlder Insurance Brokers Far East (Shanghai) Co. Ltd., China Merchants Industry Development (Shenzhen) Ltd., and Shenzhen Yan Qing Investment Development Company Limited since February 1999, March 1999, February 1999, March 1999, June 2001, March 1999, November 2004, March 1999 and September 2001, respectively. He also has been an independent non-executive director of China Wireless Technologies Limited (a company listed on the Hong Kong Stock Exchange) since November 2004, and a supervisor of Industrial Bank Co., Ltd. since June 2004. He previously served as an executive director, a member of the executive committee and chairman of the audit committee of Union Bank of Hong Kong Limited (now known as Industrial and Commercial Bank of China (Asia) Limited) (a company listed on the Hong Kong Stock Exchange) from 1999 to 2000.

Mr. Tan Yueheng. He is a non-executive director of the Company. He joined the Company in June 2004. He obtained a master's degree in monetary banking from the postgraduate faculty of the People's Bank of China in 1986 and a doctorate degree in economics from the postgraduate college of China Social Science Institute in 1989 and is a senior economist and senior visiting scholar of University of Southern California, U.S. He has been the deputy general manager of China Merchants Finance Holdings Company Limited since July 2002 and the chief supervisor of China Merchants Securities Co., Ltd. since March 2003. He previously worked as an economist at the Research and Information Department of the Head Office of Agricultural Bank of China in June 1986, chief officer of the Department of Fiscal and Financial Affairs of the State Planning Commission from 1989 to 1992, deputy general manager and general manager of the International Department of China Southern Securities Company Limited from 1992 to 1995, chairman of the board and general manager of China Southern Securities Advisory Company from 1995 to 1997, deputy general manager of Jiangnan Finance Limited from 1997 to 2002, director and deputy general manager of CMB International Capital Corporation Limited from 1997 to 2002, general manager of Shenzhen New Jiangnan Investment Company Limited from 1997 to 2002 and director of Great Wall Securities Co., Ltd. from 1997 to 2002. (Mr. Tan Yueheng has resigned from the position of deputy general manager of China Merchants Finance Holdings Company Limited on 31 January 2007, and has served as the chairman of the board of BCOM Securities Company Limited since 8 February 2007.)

Ms. Sun Yueying. She is the non-executive director of the Company. She joined the Company in April 2001. She is a university graduate and is a senior accountant. She has been the chief accountant of China Ocean Shipping (Group) Company since December 2000. She previously served as deputy manager of the Finance Department of Tianji Ocean Shipping Company from 1982 to 1993, head of the General Affairs and Management Department of COSCO Japan Company Limited from 1993 to 1997, deputy general manager of the Accounting and Finance Department from December 1997 to November 1998, general manager of the Treasury Department of China Ocean Shipping (Group) Company from November 1998 to February 2000 and vice chief accountant of China Ocean Shipping (Group) Company from February 2000 to December 2000.

Mr. Wang Daxiong. He is the non-executive director of the Company. He joined the Company in March 1998. He is a university graduate and is a senior accountant. Mr. Wang has been the chief accountant and vice president of China Shipping (Group) Company since January 1998 and 2001, respectively. He has been the vice president and chief accountant of China Shipping (Group) Company from December 2004. He has also been a non-executive director of China Shipping Container Lines Company Limited (a company listed on the Hong Kong Stock Exchange) since February 2004, an executive director of China Shipping Development Co., Ltd. (a company listed on the Hong Kong Stock Exchange and Shanghai Stock Exchange) since August 1997 and chairman of the board of China Shipping (Hainan) Haisheng Shipping and Enterprise Co., Ltd. (a company listed on the Shanghai Stock Exchange) since July 2001. He previously served as a chief accountant and head of the Finance Department of Guangzhou Maritime Transport (Group) Co., Ltd. from 1996 to 1998.

Mr. Fu Junyuan. He is the non-executive director of the Company. He joined the Company in March 2000. He obtained a master's degree in business administration and is a senior accountant. He has been chief accountant of China Communications Construction (Group) Ltd. since September 2005. He previously served as deputy head and head of the Infrastructure Auditing Division of the Audit Bureau of the Ministry of Communications from 1989 to 1993, and head of the General Affairs Office of the Audit Bureau of the Ministry of Communications from 1994 to 1996.

Mr. Ma Weihua. He is the executive director, president and chief executive officer of the Company. He joined the Company in January 1999. He obtained a doctorate degree in economics in 1999 and is a senior economist. He is currently a deputy of the Tenth National People's Congress and a member of the Fourth Shenzhen Standing Committee of the Chinese People's Political Consultative Conference. He has been chairman of the board of CMB International Capital Corporation Limited and of CIGNA and CMC Life Insurance Company Ltd. since September 1999 and September 2003 respectively, a director of China Merchants Group Limited and an independent non-executive director of TOM Online Inc. (a company listed on the NASDAQ and the Hong Kong Growth Enterprise Market of the Hong Kong Stock Exchange) since July 2002 and October 2003 respectively. He is also vice chairman of the Affiliate of International Commerce Chamber in China, deputy chairman of China Enterprise Directors Association, chairman of the Association of Shenzhen Domestic Banks and the Shenzhen Association of Listed Companies, and a member of the Standing Council of China Society for Finance and Banking and of the Standing Council of the Eighth Council of Red Cross Society of China and a part time professor at over ten higher educational institutions including the Peking University, Tsinghua University, Nankai University, Jilin University and Southwest Finance University. He previously served as deputy office director of the People's Bank of China in 1990, deputy director of the Planning and Funding Department of the People's Bank of China from 1991 to 1992, president of the People's Bank of China, Hainan Branch and head of the State Administration of Foreign Exchange, Hainan Branch from 1992 to 1998. He was named as "China Economy Person of the Year" by CCTV in 2001 and one of the "Rising Stars of Banking" by the United Kingdom's The Banker magazine in 2005.

Ms. Chen Wei. She was an executive director, executive vice president and chief financial officer of the Company. She joined the Company in February 1993. Ms. Chen obtained a doctorate degree in management in 2006 and is a senior economist. She previously served as deputy head of the Funding and Planning Division from 1986 to 1991 and as head of the Financial Administration Department of the People's Bank of China, Shenzhen Special Economic Zone Branch from 1991 to 1993. (Ms. Chen resigned as executive director, executive vice president, chief financial officer and authorised representative of the Company on 23 March 2007.)

Mr. Wu Jiesi. He is the non-executive director of the Company. He joined the Company in September 2005. He obtained a doctorate degree in economics from Finance Research Institute of the People's Bank of China in 1996 and conducted post-doctorate research work in theoretical economics at the Economics Institute of Nankai University in 2001. He is a senior economist and a mentor of doctoral students. He has been the managing director and chief executive officer of Hopson Development Holdings Limited (a company listed on the Hong Kong Stock Exchange) since April 2005, an independent non-executive director of Beijing Enterprises Holdings Limited (a company listed on the Hong Kong Stock Exchange) since July 2004, an independent non-executive director of China Insurance International Holdings Company Limited (a company listed on the Hong Kong Stock Exchange) since May 2000, a non-executive director of China Water Affairs Group Limited (a company listed on the Hong Kong Stock Exchange) since February 2006 and a non-executive director of Shenzhen Investment Limited (a company listed on the Hong Kong Stock Exchange) since May 2006. He served in the Industrial and Commercial Bank of China from 1984 to 1995 in various senior positions, including the president of Industrial and Commercial Bank of China, Shenzhen Branch. As the Deputy Mayor between 1995 and 1998, he was responsible for finance, taxation, public revenue, securities, banking and education for the municipality. Mr. Wu was appointed as Assistant to the Governor of Guangdong Provincial People's Government from 1998 to February 2000. He was the chairman of Guangdong Yue Gang Investment Holdings Company Limited from 2000 to 2005, the chairman of Guangdong Holdings Limited from 2000 to 2005, the honorary president of Guangdong Investment Limited (a company listed on the Hong Kong Stock Exchange) from 14 March 2004 to 28 April 2005 and the honorary president of Guangdong Tannery Limited (a company listed on the Hong Kong Stock Exchange) from 2004 to 2005.

Mr. Lin Chuxue. He is an independent non-executive director of the Company. He joined the Company in June 2004. Mr. Lin obtained a bachelor's degree in electric engineering from Zhejiang University in 1982 and a master's degree in business administration from University of Stirling, the United Kingdom in 1992. He has been a professor level senior engineer. He has been the vice president of China Three Gorges Project Corporation since January 2002, chairman of Three Gorges Finance Co., Ltd. since May 2002 and director of China Yangtze Power Co., Ltd. since September 2005. He previously served as deputy head of the Mechanical & Electric Division of the Business Department of CITIC Company from 1986 to 1987, head of CITIC Company Bohai Aluminium Project Office from 1987 to 1989, division manager and assistant president of CITIC Development Co., Ltd. from 1989 to 1993, deputy director of the Securities Department of CITIC Company from 1994 to 1995, executive vice president of CITIC Securities Co., Ltd. from 1995 to 1997, director of CITIC Securities Co., Ltd. from 1995 to 2002, supervisor of Zhonghai Trust and Investment Company from 1998 to 2002, deputy director of the Finance Department of CITIC Company from 1997 to 2002, supervisor of the Management Information Center of CITIC Company and deputy managing head of eFinance Office of CITIC Company from 2000 to 2002, and the chairman of the supervisory board of China Yangtze Power Co., Ltd. from 2003 to 2005.

Mr. Austin Hu Chang Tau. He is an independent non-executive director of the Company. He joined us in June 2004. Mr. Hu obtained an MBA degree from The George Washington University, Washington D.C. in 1977. He is an Executive Education Fellow at Woodrow Wilson School of Public and International Affairs, Princeton University, U.S. and a senior consultant of the School of Public Policy and Management, Tsinghua University. He joined the World Bank in 1972 and had been responsible for conducting research in economics and for lending projects of the World Bank. He retired as deputy representative of the Representative Office of the World Bank in China in 2005. He is currently serving as senior consultant to the head of China Office of the World Bank.

Mr. Chow Kwong Fai, Edward. He is an independent non-executive director of the Company. He joined the Company in May 2006. Mr. Chow obtained a degree in business from Middlesex Polytechnic (subsequently renamed Middlesex University), the United Kingdom in 1975. He is a senior member of The Institute of Chartered Accountants in England and Wales and the Hong Kong Institute of Certified Public Accountants. He is a member of the Chinese People's Political Consultative Conference – Zhejiang Province and the Election Committee of Hong Kong SAR. Mr. Chow has been the chairman of China Infrastructure Group Holdings PLC since May 1996 and chairman of CIG Yangtze Ports PLC (a company listed on the Hong Kong Stock Exchange) since February 2003. He has also served as an independent non-executive director of COSCO Pacific Limited (a company listed on the Hong Kong Stock Exchange) since June 2005, a deputy chairman of both the Hong Kong Institute of Directors and the Business and Professionals Federation of Hong Kong since July 1997 and June 1998 respectively, deputy chairman of the Professional Accountants in Business Committee of the International Federation of Accountants since 2006 and a core member of the OECD/World Bank Asian Corporate Governance Roundtable since 1999. He previously served as the president of the Hong Kong Institute of Certified Public Accountants in 2005, chairman of its Corporate Governance Committee from 1995 to 2000 and from 2003 to 2004, and chairman of its Professional Accountants in Business Committee from 2001 to 2004. Mr. Chow previously worked for 11 years with Deloitte Haskins & Sells in the UK and Price Waterhouse (as they were then known) in Hong Kong.

Mr. Liu Yongzhang. He is an independent non-executive director of the Company. He joined the Company in May 2006. He obtained a master's degree in economics from Shanghai University of Finance and Economics in January 1997. He is currently an associate professor of the International Business Administration Faculty, a mentor to postgraduates, the deputy secretary to the party committee of the Shanghai University of Finance and Economics and has been an independent non-executive director of Shanghai Jin Jiang International Industrial Investment Company Limited (a company listed on the Shanghai Stock Exchange) since June 2004. He previously served as the deputy secretary and secretary to the league committee of the Shanghai University of Finance and Economics from 1984 to 1985, deputy division chief and division chief of the Student Management Division of the Shanghai University of Finance and Economics from 1985 to 1997, a member of the party committee and head of the party organisation committee from 1994 to 1997. From January 1995 to June 1995, he was a visiting scholar of the University of Illinois at Chicago, U.S., where he studied the subject of management.

Ms. Liu Hongxia. She is an independent non-executive director of the Company. She joined the Company in May 2006. She obtained a doctorate degree in management from the Central University of Finance and Economics in June 2004 and was a post doctoral fellow in Corporate Governance Center of the Nankai University from September 2004 to April 2007. She is currently a professor in accounting at the Central University of Finance and Economics and the mentor of doctoral students. Since November 2003, she has also been an accreditations expert of Beijing senior accountants. She has been a director at the Beijing Institute of Accounting since 2006. She has been an independent director of Henan Zhongfu Industrial Co., Ltd. (a company listed on the Shanghai Stock Exchange) since 2006. She was previously a lecturer at the Capital University of Economics and Business, the Shandong University of Finance, the Central College for Treasury Finance Administration and the Central University of Finance and Economics, School of Accounting, and practised as an auditor with Beijing Zhongzhou Accountancy Firm.

(2) Supervisors

Mr. Shi Jiliang. He is the chairman of Board of Supervisors and external supervisor of the Company. He is a university graduate and a senior economist, and member of the Tenth National Committee of the Chinese People's Political Consultative Conference. He was formerly vice president of the Heilongjiang branch of the Agricultural Bank of China from 1983 to 1988, vice president of the Tianjing branch of the Agricultural Bank of China from 1988 to 1991, president of the Tianjing branch of the People's Bank of China from 1991 to 1994, president of the Agricultural Bank of China from 1994 to 1997, vice president of the People's Bank of China from 1997 to 2003 and vice chairman of the China Banking Regulatory Commission from 2003 to 2005.

Mr. Zhu Genlin. He is a shareholder representative supervisor of the Company. Mr. Zhu graduated from Shanghai University of Finance in 1983 and obtained a master's degree in economics in 1995. He is a senior economist and associate researcher. He has been the chief financial officer of Shanghai Automotive Industry Corporation (Group) and the director of Shanghai Automotive Industry Corporation and a supervisor of Shanghai Automotive Co., Ltd. (a company listed on the Shanghai Stock Exchange) since February 2002, December 2004 and March 2001, respectively. He previously served as the manager of Planning Department and Fund Investment Management Department of Shanghai International Trust & Investment Co., Ltd. and concurrently general manager and legal representative of Shanghai Shangtou Investment Management Company from 1993 to 1998, general manager and chairman of Shanghai Automotive Group Finance Company, Ltd. from 1998 to 2005 and deputy chief accountant of Shanghai Automotive Industry Corporation (Group) from 2000 to 2002.

Mr. Chen Haoming. He is a shareholder representative supervisor of the Company. Mr. Chen obtained a master's degree in economics from the Central University of Finance and Economics in 2000 and is a senior economist. He has served as a deputy manager of Zhonghai Trust and Investment Co., Ltd. since August

2005. He previously served as the head of Assets Division of Finance Department of China National Offshore Oil Corp (CNOOC) from 1997 to 2000 and general manager of CNOOC Investment Co., Ltd. from 2000 to 2005.

Mr. Li Yi. He is a shareholder representative supervisor of the Company. Mr. Li is a university graduate and senior economist. He previously served as head of the Planning and Finance Division of Shandong Province Communications Department from 1994 to 1996, head of the Planning and Infrastructure Division from 1996 to 1998 and the general manager of Shandong Communications Development and Investment Company Limited from 1998 to 2005.

Ms. Lu Yuhuan. She is a shareholder representative supervisor of the Company. Ms. Lu is a university graduate and has been an accountant of the Guangdong Provincial Highways Administration Bureau since February 2002. Ms. Lu previously worked as an accountant at the Guangdong Road Affairs Administration Bureau from 1995 to 2000, and the Roads and Bridges Administration Center of Guangdong Provincial Highways Administration Bureau from January 2001 to February 2002.

Mr. Lin Rongguang. He is an employee representative supervisor of the Company. Mr. Lin is a university graduate and an economist. He has been the deputy general manager of the Shenzhen Branch since 2003. He previously served as the deputy branch manager of the Shenzhen Futian Branch from 1993 to 1995, branch manager of the Shenzhen Baoan Branch from 1995 to 1999, general manager of the Risk Management Department of the Shenzhen Branch from 2000 to 2002, and an assistant general manager of the Shenzhen Branch from 2002 to 2003.

Mr. Xiang Youzhi. He is an employee representative supervisor of the Company. Mr. Xiang obtained a doctorate degree in management from Xiamen University in 1998 and is a senior accountant. He has been the deputy general manager of our Planning and Finance Department since June 2006. He previously served as the deputy general manager of the Accounting Department at the head office from February 2006 to June 2006 and as an assistant general manager of the Accounting Department at the head office from 2003 to February 2006.

Ms. Zhou Wenqiong. She is an employee representative supervisor of the Company. Ms. Zhou is a university graduate and is an accountant. She has been the deputy general manager (executive) of the Auditing and Supervision Department of our Shanghai Branch since August 2006. She previously served as an assistant general manager of the Accounting Department of our Shanghai Branch from 2001 to 2002 and an assistant general manager (executive) and deputy general manager (executive) of our Auditing and Supervision Department of our Shanghai Branch from 2002 to 2006.

Mr. Shao Ruiqing. He is an external supervisor of the Company. Mr. Shao obtained a doctorate degree in Tongji University in May 2005 and is a professor and mentor to doctoral students. He is currently the deputy head of the Shanghai Lixin University of Commerce, deputy head of the China Association of Communications Accountancy, a director of the China Institute of Accounting Instructors, the deputy head of the Shanghai Association of Communications Accountancy, a director, and a member of the working committee on higher education of the Shanghai Institute of Accountancy. He has also served as an independent non-executive director of Zhonghai Shipping (Hainan)

DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND EMPLOYEES

Haisheng Shipping and Enterprise Co., Ltd. (a company listed on the Shanghai Stock Exchange) since February 2003, Nanjing Water Transport Industry Co., Ltd. (a company listed on the Shanghai Stock Exchange) since February 2002, Shenzhen Guangju Energy Co., Ltd. (a company listed on the Shenzhen Stock Exchange) since November 2004 and CHEC Dredging Co., Ltd. since June 2002. He was formerly the head of the finance and accounting department of the Shanghai Maritime University, and deputy dean of the school of management and dean of the School of Economic Administration of the Shanghai Maritime University since June 2002.

(3) Senior Management

Mr. Ma Weihua. He is the president and chief executive officer of the Company. Please refer to the biography under the paragraph "Directors".

Ms. Chen Wei. She was an executive vice president and chief executive officer of the Company (Ms. Chen resigned as executive director, executive vice president, chief financial officer and authorised representative of the Company on 23 March 2007). Please refer to the biography under the paragraph "Directors".

Mr. Li Hao. He is an executive vice president. He joined the Company in May 1997. Mr. Li obtained a master's degree in business administration in 2000 and is a senior accountant. He served as the deputy head and head of the Enterprise Finance Office of the Finance and Accounting Department of the Ministry of Communications from 1987 to 1994, an assistant director and deputy director of the Finance and Accounting Department of the Ministry of Communications from 1994 to 1997. He has been the executive vice president of the Company since 1997 and concurrently the general manager of the Shanghai Branch from April 2000 to March 2002. (Note: Mr. Li concurrently serves as chief financial officer of the Company since 23 March 2007.)

Mr. Tang Zhihong. He is an executive vice president of the Company. He joined the Company in May 1995. Mr. Tang graduated from Jilin University in 1982 and is a senior economist. He served as the vice president, president of Jinzhou Branch of the People's Bank of China from 1992 to 1995 and head of the State Administration of Foreign Exchange, Jinzhou Branch from 1994 to 1995. He also served as the deputy general manager of the Shenyang Branch from 1995 to 1998, and during the period from 1997 to 1998, he was seconded to the Shenzhen Branch as the deputy general manager. He was the general manager of the Lanzhou Branch from 1998 to 1999, the general manager of the Shanghai Branch from 1999 to 2000 and the general manager of the Shenzhen Branch from 2000 to 2004. He has been our executive vice president since 2004. Mr. Tang is concurrently a director of CIGNA and CMC Life Insurance Company Ltd. and China UnionPay Co., Ltd.

Ms. Yin Fenglan. She is an executive vice president of the Company. She joined the Company in May 1994. Ms. Yin obtained a master's degree in 1998 and is a senior economist. She previously worked at the Beijing City Branch of the People's Bank of China as the deputy head of the Currency Issuance Department from April 1986 to November 1986, deputy director and director of the General Office Department of the People's Bank of China Beijing City Branch from 1986 to 1993, and assistant manager and manager of the Planning Capital Department of the Beijing City Branch of the People's Bank of China from 1993 to 1994. She also worked as the deputy general manager, general manager of the Beijing Branch from 1994 to 2004 and has been the executive vice president of the Company from 2004 to 2006.

Mr. Ding Wei. He is an executive vice president of the Company. He joined the Company in December 1996. Mr. Ding is a university graduate and assistant analyst. He has been the deputy section chief of Education Section of Meteorological Bureau of Zhejiang Province from February 1982 to June 1986, division chief, vice director, director of education division of Industrial and Commercial Bank of China Hangzhou Financial Management Institute from June 1986 to February 1994, officer of training division of Industrial and Commercial Bank of China Hangzhou Financial Training Centre from February 1994 to December 1996, office supervisor of Hangzhou branch and general manager of sales department of the Company from December 1996 to August 1998, assistant general manager of Hangzhou branch from August 1998 to April 2000, deputy general manager of Hangzhou branch from April 2000 to December 2001, general manager of Nanchang sub-branch from December 2001 to October 2002, general manager of Nanchang branch from October 2002 to June 2003, general manager of human resources department of headquarter of the Company from June 2003 to March 2007. He serves as an executive vice president of the Company since May 2007.

Mr. Xu Lianfeng. He is a techonology director of the Company. He joined the Company in October 1991. He is a graduate of Tsinghua University in 1977 and an assistant professor. He previously served as vice-level cadre of computer department at the head office of Bank of China from February 1981 to October 1991, manager of computer department at London branch of Bank of China from 1983 to 1989, where he was responsible for the computer-related job at branch level, general manager of computer department at the head office of the Company from October 1991 to October 1999, president of Beijing Zhongrunfeng Information Technology Co., Ltd. from October 1999 to August 2001, technology director of preparation team of China Unionpay from September 2001 to November 2001. He joined the Company as technology director since November 2001 and concurrently serves as general manager of information technology department of the Company since December 2005.

Mr. Lan Qi. He is one of the joint company secretaries of the Company. Mr. Lan also serves as the secretary of our Board of Directors and as head of the Office of Board of Directors. He joined us in April 1993. Mr. Lan obtained a master's degree in economics from monetary banking specialty of the Graduate School of the People's Bank of China in 1987 and is a senior economist. He previously served as deputy head of the Financial Administration Division of the People's Bank of China Jiangxi Branch and vice president of the People's Bank of China Jiangxi Province Pingxiang City Branch from 1987 to 1993. Mr. Lan has been working in the Company since 1993. He previously served as deputy general manager of the Development and Research Department of our head office from April 1993 to August 1993, deputy general manager of the Securities Department of the head office and deputy general manager of CMB Securities Company from August 1993 to June 1995, general manager of the Research and Development Department, Human Resources Department, Merchant Banking Department of the head office and general manager of CMB International Capital Corporation Limited and office chief of the General Affairs Office from June 1995 to February 2004.

Mrs. Seng Sze Ka Mee Natalia, aged 50, one of the joint company secretaries of the Company since August 2006. Mrs. Seng is an executive director and head of Corporate Services of Tricor Group. Prior to joining Tricor, she was a director of Company Secretarial Services at Ernst & Young, Hong Kong and Tengis Limited from 1994 to early 2002. Mrs. Seng is a chartered secretary, president, council member and senior member of The Hong Kong Institute of Chartered Secretaries and a senior member of both The Institute of Chartered Secretaries and Administrators and The Hong Kong Institute of Directors. Mrs. Seng holds a master's degree in Business Administration (Executive) from City University of Hong Kong. Up till the present, apart from the Company, she has been providing professional secretarial services to many listed companies.

RESIGNED PERSONNEL AND REASONS FOR RESIGNATION DURING THE REPORTED PERIOD

Independent non-executive directors Yang Jun, Lu Renfa and Din Huiping of the Sixth Board of Directors of the Company fulfilled their current terms and no longer served as independent non-executive directors of the Company. Upon approval of general meeting for 2005 of the Company, Chow Kwong Fai, Edward, Liu Yongzhang and Liu Hongxia were elected as independent non-executive directors, who will serve the same terms as members of the Sixth Session of the Board of Directors.

External supervisors Wang Qiyan and Zhang Yuqing of the Sixth Board of Supervisors of the Company fulfilled their current terms and no longer served as external supervisors. Upon approval of general meeting for 2005 of the Company, Shi Jiliang and Shao Ruiqing were elected as external supervisors, who will serve the same terms as members of the Sixth Session of the Board of Supervisors.

The relevant announcement of the aforesaid change of independent directors and external supervisors was published on *China Securities*, *Securities Times* and *Shanghai Securities News* on 16 May 2006.

Shi Jiliang was elected as chairman of the Board of Supervisors at the eighth meeting of the Sixth Session of the Board of Supervisors. The relevant announcement was published on *China Securities*, *Securities Times* and *Shanghai Securities News* on 24 May 2006.

Executive Vice President Chen Wei was appointed as chief financial officer at the 24th meeting of the Sixth Session of the Board of Directors. Upon deliberation at the 24th meeting of the Sixth Session of the Board of Directors of the Company and approval of China Banking Regulatory Commission, Tang Zhihong and Yin Fenglan were elected as executive vice presidents, and the relevant announcement was published on *China Securities*, *Securities Times* and *Shanghai Securities* News on 12 April 2006.

INFORMATION ABOUT EMPLOYEE

As at 31 December 2006, the Company had 23,202 employees, including 3,086 executives, 17,223 ordinary employees and 2,893 administration staff. Of these staff, 20,398 employees had college education or above, accounting for 87.92%. The Company has now 68 retirees.

(I) INFORMATION ABOUT ANNUAL GENERAL MEETINGS

General meeting for 2005 of the Company was held in Shenzhen on 16 May 2006, and the resolutions were announced on *China Securities, Shanghai Securities News* and *Securities Times* on 17 May 2006, and the website of Shanghai Stock Exchange.

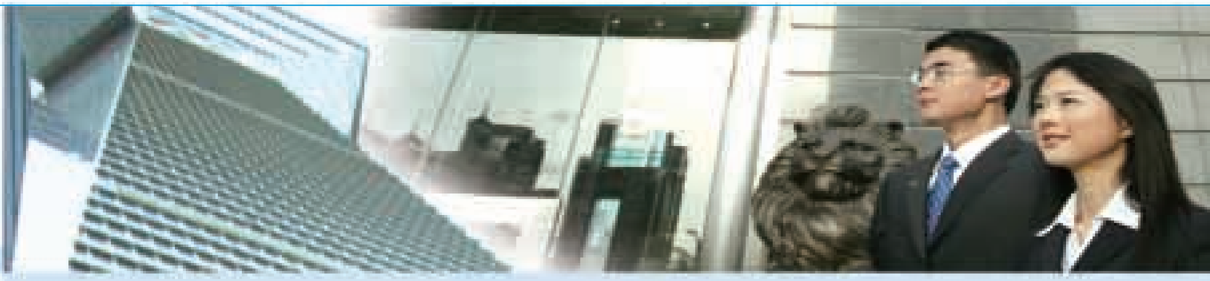
(II) INFORMATION ABOUT EXTRAORDINARY GENERAL MEETINGS

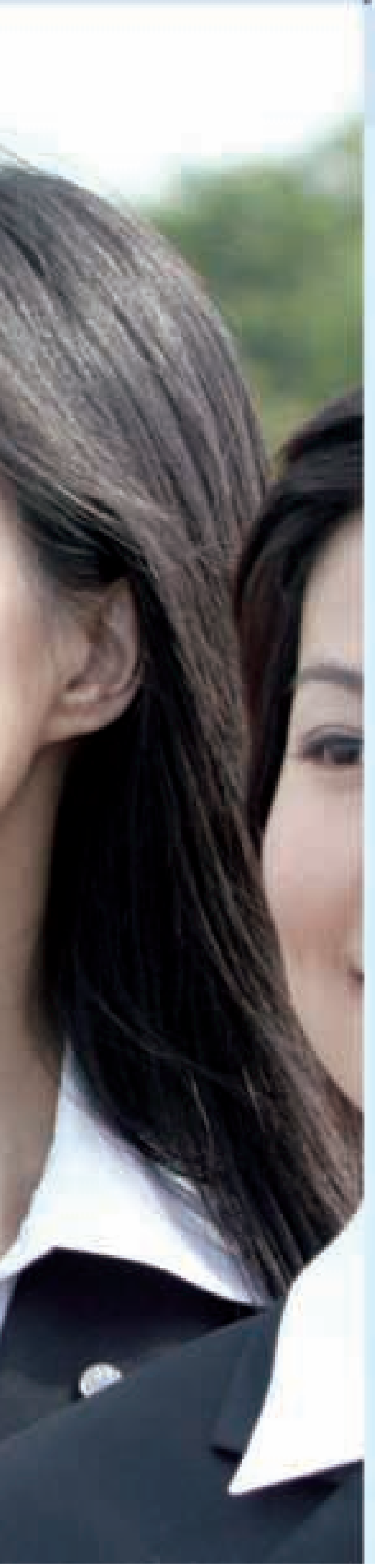
The first extraordinary general meeting of shareholders for 2006 of the Company was held in Shenzhen on 20 January 2006, and the resolutions were announced on *China Securities*, *Shanghai Securities News* and *Securities Times* on 23 January 2006, and the website of Shanghai Stock Exchange.

The second extraordinary general meeting of shareholders for 2006 of the Company was held in Shenzhen on 17 April 2006, and the resolutions were announced on *China Securities*, *Shanghai Securities News* and *Securities Times* on 18 April 2006, and the website of Shanghai Stock Exchange.

The third extraordinary general meeting of shareholders for 2006 of the Company was held in Shenzhen on 19 August 2006, and the resolutions were announced on *China Securities*, *Shanghai Securities News* and *Securities Times* on 22 August 2006, and the website of Shanghai Stock Exchange.

TEAM DEVELOPMENT





With reference to the advanced human resources management and incentive scheme in the PRC and overseas, China Merchants Bank developed a multi-level and multi-dimensional staff incentive scheme with a combination of material and non-material incentive; short-term and mid to long-term incentive; positive and negative incentive. The Bank emphasizes on career planning, welfare and training of staff, protects their interests, and offers development opportunities and competitive remuneration packages.

China Merchants Bank believes the satisfaction of customers is dependent upon staff performance. While the Bank is dedicated to attracting high-calibre talent, it actively promotes the people-oriented concept of "respect, care, share". The Bank emphasizes on the communication with staff through multi-channels, and listens to reasonable suggestions, with an aim to increase recognition and sense of belonging from the staff, and cultivate the people-oriented culture. In recent years, Chinese Merchants Bank has been awarded "*The Enterprise With Greatest Growth Value For Employees in China*", "*CCTV 2006 China's Best Employee*" and "*Top Ten Units For Corporate Culture Development in China*".

REPORT OF THE BOARD OF DIRECTORS

1. PRINCIPAL BUSINESS ACTIVITIES

The Company is engaged in banking and related financial services.

2. RESULTS AND PROFIT APPROPRIATIONS

Profit and profit appropriations

The profit appropriations scheme of the Company for the year 2005 was passed at the general meeting of shareholders held on 16 May 2006. In this case, with the total shares as the base for appropriations, RMB0.8 (tax included) was distributed for every 10 shares. The resolution announcement of the general meeting of shareholders was published on *China Securities Journal*, *Shanghai Securities News* and *Securities Times* on 17 May 2006. The equity registration date was 15 June 2006, the ex-dividend date was 16 June 2006 and cash dividend issue date was 21 June 2006. The profit appropriations scheme of the Company for the year 2005 was published on *China Securities Journal*, *Shanghai Securities News* and *Securities Times* on 12 June 2006. The said appropriations scheme was implemented during the reported period.

Proposal for Special Appropriations of Reserved Profit before Initial Public Offering of H Shares of the Company was passed at the third extraordinary general meeting of the year held on 19 August 2006. In this case, based on the total share capital, the cash dividend for every 10 shares was RMB1.80 (including tax). The resolutions of the general meeting were announced on *China Securities*, *Shanghai Securities News* and *Securities Times* on 22 August 2006. The equity registration date was 20 September 2006, the ex-dividend date was 21 September 2006 and cash dividend issue date was 27 September 2006. The profit appropriations scheme of the Company was announced on *China Securities Journal*, *Shanghai Securities News* and *Securities Times* on 12 June 2006. The said appropriations scheme was implemented during the reported period.

Profit appropriations plan for the year 2006

The audited profit after tax of the Company for year 2006 as stated in the financial statements (overseas edition) prepared in accordance with IFRSs was RMB6.794 billion, while the audited profit after tax stated in the financial statements (domestic edition) prepared in accordance with the PRC GAAP was RMB7.107 billion. 10% of the profit after tax in the financial statements prepared in accordance with the PRC GAAP, which amounted to RMB0.711 billion, was transferred to statutory surplus reserve. Regulatory general reserve was RMB3.5 billion. The profit distributable to shareholders for the current year was RMB3.489 billion. The profit distributable to shareholders for the current year in the financial statements prepared in accordance with the IFRSs was RMB3.138 billion. According to *Zheng Jian Kuai Ji Zi* [2001] No. 58 of the CSRC, the benchmark of dividend to be distributed should be the lower of the distributed profits audited by domestic and overseas auditors. That means the cash dividends should be distributed under the audited distributable profit shown in the financial statements prepared in accordance with the IFRSs.

Based on the total share capital of A shares and H shares, the Company proposed to declare a cash dividend (including tax) of RMB1.20 (dominated in RMB) for every 10 shares, payable in RMB for A share-shareholders and in HKD for H share-shareholders. The actual profit appropriations amount in HKD will be calculated based on the average benchmark rate for RMB to HKD announced by People's Bank of China on the previous week (including the day for the general meeting) before the date of general meeting.

Whereas the convertible bonds (CMB convertible bonds 110036) issued by the Company have not been fully converted into share capital or capital reserve of the Company and it is impossible to determine the total share capital as at the equity registration date, the total cash dividend cannot be determined. Therefore, the Company will implement the above profit appropriations on the basis of the total capital at the closing of the equity registration date of A share dividend payout.

The above profit appropriations plan will be submitted for approval at the annual general meeting to be held on 15 June 2007. If approved, the above dividend will be paid before 15 August 2007 to shareholders whose names appear on the Register of Members of the Company.

3. RESERVES

The details of the movements of reserves of the Company are set out in "Management Discussion and Analysis - Loan quality analysis - Changes in the allowance for impairment losses on loans and advance payments" of this annual report.

4. FINANCIAL HIGHLIGHTS

Highlights of operating results, assets and liabilities of the Company for the 5 years ended 31 December 2006 are set out in "Five-year Financial Summary" of this annual report.

5. DONATIONS

The total amount of the charitable donations and other donations contributed by the Company for the year ended 31 December 2006 was RMB9.7048 million.

6. SHARE CAPITAL STRUCTURE AND SHAREHOLDERS BASIS

Based on the publicly available information of the Company and within the knowledge of its directors, the Company had met the public float requirement of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") up to 31 December 2006 sets out in this report.

The change in shares of the Company during the reported period is as follows: (unit: share)

	As at 31 December 2005		Increase/decrease in the reported period							As at 31 December 2006	
	Quantity	Percentage (%)	Equity transfer or change in nature	Conversion from convertible bonds	Conversion from public reserves	Share splits	Reduction in state-owned shareholding for H Shares listing	Issue of H shares	Subtotal	Quantity	Percentage (%)
I. Shares which are subject to trading moratorium	**7,572,272,454**	**72.99**	**0**	**0**	**650,382,481**	**-649,025,356**	**-242,000,000**	**0**	**-240,642,875**	**7,331,629,579**	**49.86**
1. State-owned shares	388,649,475	3.75	-180,000,000		17,920,903	-17,883,508	-7,129,850	–	-187,092,455	201,557,020	1.37
2. Shares held by state-owned legal persons	6,285,670,371	60.59	587,618,627	–	590,346,792	-589,114,941	-234,870,150	–	353,980,328	6,639,650,699	45.16
3. Other domestic shareholdings	341,183,222	3.29	143,471,173	–	41,626,966	-41,540,105	–	–	143,558,034	484,741,256	3.29
Of which: shares held by domestic legal persons	341,183,222	3.29	143,471,173	–	41,626,966	-41,540,105	–	–	143,558,034	484,741,256	3.29
Shares held by domestic natural persons											
4. Overseas shareholdings	556,769,386	5.36	-551,089,800	–	487,820	-486,802	–	–	-551,088,782	5,680,604	0.04
Of which: shares held by overseas legal persons	556,769,386	5.36	-551,089,800	–	487,820	-486,802	–	–	-551,088,782	5,680,604	0.04
Shares held by overseas natural persons											
II. Shares which are not subject to trading moratorium	**2,802,071,360**	**27.01**	**0**	**937,685,633**	**320,847,346**	**649,025,356**	**242,000,000**	**2,420,000,000**	**4,569,558,335**	**7,371,629,695**	**50.14**
1. Common shares in RMB (A Shares)	2,802,071,360	27.01	–	937,685,633	320,847,346	649,025,356	–	–	1,907,558,335	4,709,629,695	32.03
2. Foreign shares listed domestically	2,802,071,360	27.01	–	937,685,633	320,847,346	649,025,356	–	–	1,907,558,335	4,709,629,695	32.03
3. Foreign shares listed overseas (H Shares)	–	–	–	–	–	–	242,000,000	2,420,000,000	2,662,000,000	2,662,000,000	18.11
4. Others	–	–	–	–	–	–	–	–	–	–	–
III. Total shares	**10,374,343,814**	**100.00**	**0**	**937,685,633**	**971,229,827**	**0**	**0**	**2,420,000,000**	**4,328,915,460**	**14,703,259,274**	**100.00**

Note: Change in equity nature of shares which were subject to trading moratorium was in compliance with Guo Zi Chan Quan [2006] Doc. 555 issued by State Asset Administration Commission of the State Council.

As at the end of the reported period, the Company had a total of 197,275 shareholders, including 70,247 holders of H Shares and 127,028 holders of A Shares (including 90 holders of A Shares whose shares were subject to trading moratorium). In addition, the Company had 1,064 holders of convertible bonds.

Top ten shareholders

As at 31 December 2006				
Serial No.	Name of Shareholder	Total no. of shares held	Percentage of total shares in issue (%)	Class of shares
1	HKSCC Nominees Limited(1)	2,615,034,000	17.79	H Shares
2	China Merchants Steam Navigation Company Limited(2)	1,779,162,511	12.10	A Shares subject to trading moratorium
3	China Ocean Shipping (Group) Company	947,548,668	6.44	A Shares subject to trading moratorium
4	Guangzhou Maritime Transport (Group) Company Limited(2)	565,359,590	3.85	A Shares subject to trading moratorium
5	Shenzhen Yan Qing Investment and Development Company Limited(2)	433,484,335	2.95	A Shares subject to trading moratorium
6	Shenzhen Chu Yuan Investment and Development Company Limited(2)	378,715,868	2.58	A Shares subject to trading moratorium
7	China Communications Construction Group (Limited)	261,024,805	1.78	A Shares subject to trading moratorium
8	Shanghai Automotive Industry Corporation	250,564,996	1.70	A Shares subject to trading moratorium
9	CNOOC Investment Co., Ltd.	205,305,070	1.40	A Shares subject to trading moratorium
10	China Shipping (Group) Company(2)	175,950,157	1.20	A Shares subject to trading moratorium
10	Shandong State-owned Assets Investment Holdings Company Limited	175,950,157	1.20	A Shares subject to trading moratorium
10	Guangdong Provincial Highways Administration Bureau	175,950,157	1.20	A Shares subject to trading moratorium
10	Qinhuangdao Port Group Company Limited	175,950,157	1.20	A Shares subject to trading moratorium

(1) Shares held by HKSCC Nominees Limited are the total shares in the accounts of holders of CMB H Shares trading on the transaction platform of HKSCC Nominees Limited.

(2) Of the aforesaid top 10 shareholders, China Merchants Steam Navigation Company Limited, Shenzhen Yan Qing Investment and Development Company Limited and Shenzhen Chu Yuan Investment and Development Company Limited are subsidiaries of China Merchants (Group) Co., Ltd.; Guangzhou Maritime Transport (Group) Company Limited is the wholly owned subsidiary of China Shipping (Group) Company. The Company is not aware of any co-relationship of other shareholders.

Top ten shareholders whose shares are subject to trading moratorium

Serial No.	Name of shareholder	No. of shares which are subject to trading moratorium as at 31 December 2006	Percentage of total shares in issue share held (%)	Trading date	No. of new tradable shares	Undertakings
1	China Merchants Steam Navigation Company Limited	1,779,162,511	12.10	/	/	When the share price of the Company reaches RMB8.48 or above (to be weighted depending on circumstances) in the 12 months after expiry of the 36-month period starting from acquisition of right of circulation/after expiry of 48 months after acquisition of right of circulation
2	China Ocean Shipping (Group) Company	947,548,668	6.44	27 February 2009	/	After expiry of 36 months after acquisition of right of circulation
3	Guangzhou Maritime Transport (Group) Company Limited	565,359,590	3.85			
4	Shenzhen Yan Qing Investment and Development Company Limited	433,484,335	2.95	/	/	When the share price of the Company reaches RMB8.48 or above (to be weighted depending on circumstances) in the 12 months after expiry of the 36-month period starting from acquisition of right of circulation/after expiry of 48 months after acquisition of right of circulation
5	Shenzhen Chu Yuan Investment and Development Company Limited	378,715,868	2.58			
6	China Communications Construction Group (Limited)	261,024,805	1.78	27 February 2009	/	After expiry of 36 months after acquisition of right of circulation
7	Shanghai Automotive Industry Corporation	250,564,996	1.70	27 February 2008	/	After expiry of 24 months after acquisition of right of circulation
8	CNOOC Investment Co., Ltd.	205,305,070	1.40			
9	Shandong State-owned Assets Investment Holdings Company Limited	175,950,157	1.20			
9	China Shipping (Group) Company	175,950,157	1.20	27 February 2009	/	After expiry of 36 months after acquisition of right of circulation
9	Qinhuangdao Port Group Company Limited	175,950,157	1.20	27 February 2008	/	After expiry of 24 months after acquisition of right of circulation
9	Guangdong Provincial Highways Administration Bureau	175,950,157	1.20			
10	Huaneng Capital Services Corporation Ltd.	173,881,403	1.18	27 February 2008	/	After expiry of 24 months after acquisition of right of circulation

Top ten shareholders whose shares are not subject to trading moratorium

Serial No.	Name of Shareholder	Class of shares	At the end of reported period (in RMB)	Percentage of total shares in issue (%)
1	HKSCC Nominees Limited[1]	H Shares	2,615,034,000	17.79
2	Jiashi Strategic Growth Hybrid Securities Investment Fund	A Shares not subject to trading moratorium	103,052,980	0.70
3	China Life Insurance Co., Ltd. – dividend – Personal dividend	A Shares not subject to trading moratorium	100,261,047	0.68
4	Southern Sustaining Growth Stock-type Securities Investment Fund[2]	A Shares not subject to trading moratorium	83,369,249	0.57
5	Southern High-Growth Stock-type Open-end Securities Investment Fund[2]	A Shares not subject to trading moratorium	74,000,000	0.50
6	Morgan Stanley International Limited	A Shares not subject to trading moratorium	60,564,083	0.41
7	The Hong Kong and Shanghai Banking Corporation Limited	A Shares not subject to trading moratorium	59,535,762	0.40
8	China Ping An Life Insurance Co. Ltd. – traditional – common insurance products	A Shares not subject to trading moratorium	55,338,811	0.38
9	UBS AG	A Shares not subject to trading moratorium	53,142,951	0.36
10	Jingshun Changcheng Internal Growth No.2 Stock Securities Investment Fund	A Shares not subject to trading moratorium	48,802,336	0.33

(1) Shares held by HKSCC Nominees Limited are the total shares in the accounts of holders of CMB H Shares trading on the transaction platform of HKSCC Nominees Limited.

(2) Of the aforesaid top ten shareholders whose shares are not subject to trading moratorium, Southern Sustaining Growth Stock-type Securities Investment Fund and Southern High-Growth Stock-type Open-ended Securities Investment Fund both belong to Southern Fund Management Co., Ltd. The Company is not aware of any co-relationship of other shareholders whose shares are not subject to trading moratorium.

Top ten convertible bonds holders

Serial No.	Name of convertible bonds holder	Type of securities	Amount of convertible bonds held as at the end of reported period (in RMB)	Percentage to total convertible bonds in issue (%)
1	Xingye Convertible Bond Hybrid Securities Investment Fund	Convertible bond	15,453,000	0.2377
2	Shenzhen Longgang Investment Management Co., Ltd.	Convertible bond	3,240,000	0.0498
3	Zhang Yulin	Convertible bond	385,000	0.0059
4	Zhang Zibin	Convertible bond	374,000	0.0058
5	Zhang Wen	Convertible bond	282,000	0.0043
6	Shenzhen Yuelongda Industrial Development Co., Ltd.	Convertible bond	124,000	0.0019
7	Li Guandong	Convertible bond	103,000	0.0016
8	Ding Cuiyu	Convertible bond	78,000	0.0012
9	Chu Qingnian	Convertible bond	78,000	0.0012
10	Zhao Yanqing	Convertible bond	69,000	0.0011
10	Fan Tian	Convertible bond	69,000	0.0011

The Company is not aware of any co-relationship of the top ten convertible bonds holders.

Substantial shareholders' and other persons' interests and short positions in shares and underlying shares

As at 31 December 2006, the following persons (other than the Directors and Supervisors of the Company) had interests in the shares of the Company as recorded in the register required to be kept by the Company pursuant to Section 336 of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) ("SFO"):

Name of Substantial Shareholder	Class of shares	Long/short position	Capacity	No. of shares held		Note	Percentage of relevant class of shares in issue (%)	Percentage of total shares in issue (%)
China Merchants Group Limited	A	Long	Interest of controlled corporations		2,599,932,810	1	21.59	17.68
China Merchants Steam Navigation Co. Ltd.	A	Long	Beneficial owner		1,785,120,730*	1	14.83	12.14
China Merchants Finance Investment Holdings Co. Ltd.	A	Long	Interest of controlled corporations		814,812,080	1	6.77	5.54
Shenzhen Yan Qing Investment Development Co. Ltd.	A	Long	Beneficial owner	434,878,336*		1		
		Long	Interest of controlled corporations	379,933,744*		1		
					814,812,080		6.77	5.54
China Ocean Shipping (Group) Company	A	Long	Beneficial owner		950,595,801*		7.89	6.47
China Shipping (Group) Company	A	Long	Beneficial owner	176,515,978*				
		Long	Interest of controlled corporations	618,366,092*		2		
					794,882,070		6.60	5.41
JPMorgan Chase & Co.	H	Long	Beneficial owner	53,555,900				
		Long	Investment manager	35,801,500				
		Long	Custodian	123,475,581				
					212,832,981	3	7.99	1.45

* The above numbers of shares were recorded in the disclosure forms completed by the relevant substantial shareholders before 31 December 2006. During the period from the date on which the respective substantial shareholders submitted the said forms up to 31 December 2006, there were some updates to the aforesaid numbers of shares, but the levels of the changes did not result in a disclosure obligation in accordance with the SFO.

REPORT OF THE BOARD OF DIRECTORS

Notes:

(1) China Merchants Group Limited held interest in a total of 2,599,932,810 A shares in the Company by virtue of its control over the following corporations, which held direct interests in the Company:

(1.1) China Merchants Steam Navigation Co. Ltd. held 1,785,120,730 A shares in the Company. China Merchants Steam Navigation Co. Ltd. was a wholly-owned subsidiary of China Merchants Group Limited.

(1.2) Shenzhen Yan Qing Investment Development Co. Ltd. held 434,878,336 A shares in the Company. Shenzhen Yan Qing Investment Development Co. Ltd. was owned as to 51% and 49% by China Merchants Finance Investment Holdings Co. Ltd. and China Merchants Group Limited respectively. China Merchants Finance Investment Holdings Co. Ltd. was owned as to 90% and 10% by China Merchants Group Limited and China Merchants Steam Navigation Co. Ltd., referred to in (1.1) above, respectively.

(1.3) Shenzhen Chu Yuan Investment Development Co. Ltd. held 379,933,744 A shares in the Company. Shenzhen Chu Yuan Investment Development Co. Ltd. was owned as to 50% by each of Shenzhen Yan Qing Investment Development Co. Ltd., referred to in (1.2) above, and China Merchants Finance Investment Holdings Co. Ltd., referred to in (1.2) above, respectively.

(2) The interest of China Shipping (Group) Company in 618,366,092 A shares of the Company was held through Guangzhou Maritime Transport (Group) Company Limited (held 567,177,677 A shares of the Company) and Shanghai Shipping (Group) Company (held 51,188,415 A shares of the Company), which were the wholly-owned subsidiaries of China Shipping (Group) Company.

(3) JPMorgan Chase & Co. held interest in a total of 212,832,981 H shares of the Company by virtue of its control over the following corporations, which held direct interests in the Company:

(3.1) JPMorgan Chase Bank, N.A. held 123,475,581 H shares in the Company. JPMorgan Chase Bank, N.A. was a wholly-owned subsidiary of JPMorgan Chase & Co.

(3.2) J.P. Morgan Whitefriars Inc. held 40,525,900 H shares in the Company. J.P. Morgan Whitefriars Inc. was a wholly-owned subsidiary of J.P. Morgan Overseas Capital Corporation, which in turn was a wholly-owned subsidiary of J.P. Morgan International Finance Limited. J.P. Morgan International Finance Limited was wholly-owned by Bank One International Holdings Corporation, which in turn was a wholly-owned subsidiary of J.P. Morgan International Inc. JPMorgan Chase Bank, N.A., referred to in (3.1) above, owned 100% interest in J.P. Morgan International Inc..

(3.3) J.P. Morgan Securities Ltd. held 13,030,000 H shares in the Company. J.P. Morgan Securities Ltd. was owned as to 98.95% by J.P. Morgan Chase International Holdings Limited, which in turn was a wholly-owned subsidiary of J.P. Morgan Chase (UK) Holdings Limited. J.P. Morgan Chase (UK) Holdings Limited was wholly-owned by J.P. Morgan Capital Holdings Limited, which in turn was wholly-owned by J.P. Morgan International Finance Limited, referred to in (3.2) above.

(3.4) JF International Management Inc. and JF Asset Management Limited held 247,000 and 35,554,500 H shares in the Company respectively. Both of them were wholly-owned subsidiaries of JPMorgan Asset Management (Asia) Inc., which in turn was a wholly-owned subsidiary of JPMorgan Asset Management Holdings Inc. JPMorgan Asset Management Holdings Inc. was a wholly-owned subsidiary of JPMorgan Chase & Co..

The entire interest of JPMorgan Chase & Co. in the Company included a lending pool of 123,475,581 H shares.

Save as disclosed above, the Company is not aware of any other person (other than the Directors and Supervisors of the Company) having any interests or short positions in the shares and underlying shares of the Company as at 31 December 2006 as recorded in the register required to be kept by the Company pursuant to Section 336 of the SFO.

Undertakings associated with the share reform of non-tradable shares

The Company implemented the share reform of Non-tradable Shares (a "Conversion Scheme") in February 2006. The Conversion Scheme stated the undertakings of the shareholders whose shares were subject to trading moratorium were as follows: shareholders without put obligation undertook not to trade or transfer their shares within 24 months after obtaining the right to trade their shares; shareholders with put obligation undertake not to trade or transfer their shares within 36 months after obtaining the right to trade their shares. In particular, China Merchants Steam Navigation Co., Ltd., Shenzhen Yan Qing Investment and Development Co., Ltd. and Shenzhen Chu Yuan Investment and Development Co., Ltd. undertook not to trade or transfer their shares before the share price of the Company first reaches RMB8.48 or above (to be weighted depending on circumstances) in the 12 months after expiry of the aforesaid 36-month lock-up period.

Shareholders with put obligation undertook that, after completion of the Conversion Scheme, they would advise the board of directors to formulate a long-term incentive plan including share option incentive plan, which should be implemented by the board of directors or first submitted to the general meeting of the Company for approval and then implemented by the board of directors according to the relevant regulations. The long-term incentive plan is currently under examination and pending approval by the relevant government authorities.

Trading date of shares which are subject to trading moratorium

Unit: share

Timeframe	No. of new tradable shares after expiry of lock-up period (in shares)	No. of balance of shares which are subject to trading moratorium (in shares)	No. of balance of shares which are not subject to trading moratorium[1]	Remarks
Within 24 months after acquisition of right of circulation	0	7,331,629,579	/	/
After expiry of 24 months after acquisition of right of circulation	2,534,911,447	4,796,718,132	/	Original non-circulated shares held by original non-circulated shareholders without put option.
After expiry of 36 months after acquisition of right of circulation	2,205,355,418	2,591,362,714	/	Original non-circulated shares held by original non-circulated shareholders with put option other than China Merchants Steam Navigation Company Limited, Shenzhen Yan Qing Investment and Development Company Limited and Shenzhen Chu Yuan Investment and Development Company Limited.
When the share price of the Company first reaches or above RMB8.48 (to be weighted depending on circumstances) in the 12 months after expiry of the 36-month period starting from acquisition of right of circulation/after expiry of 48 months after acquisition of right of circulation	2,591,362,714	0	/	Original non-circulated shares held by China Merchants Steam Navigation Company Limited, Shenzhen Yan Qing Investment and Development Company Limited and Shenzhen Chu Yuan Investment and Development Company Limited.
Total	7,331,629,579	/	/	/

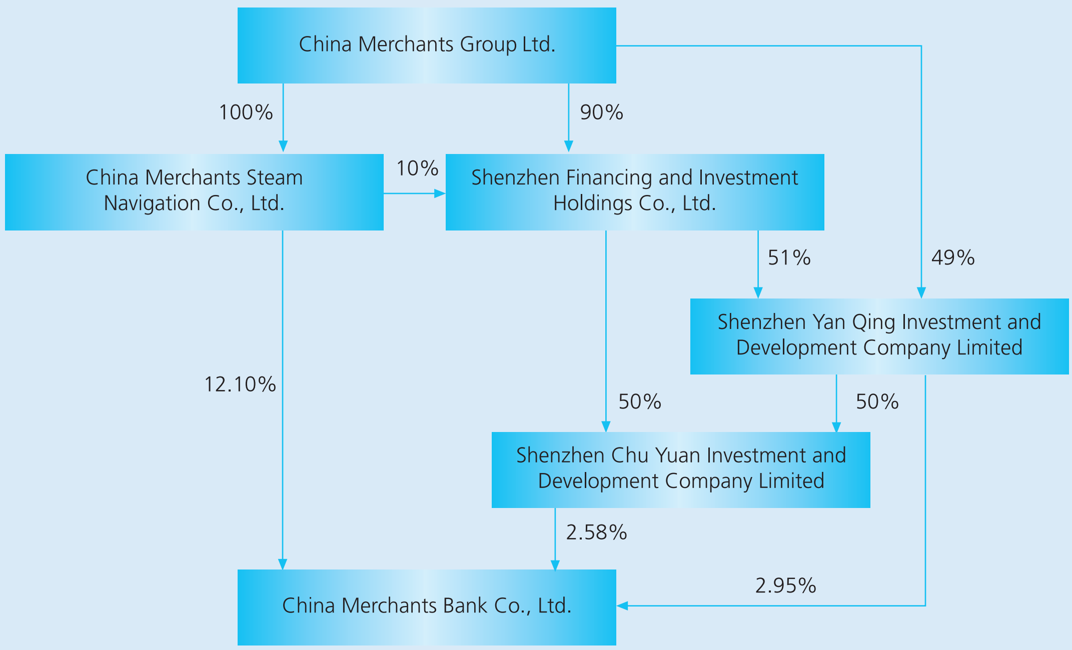
[1] The convertible bonds issued by the Company have not yet been fully converted, therefore it is impossible to estimate the balance of shares which are not subject to trading moratorium.

Information about the Company's largest shareholder and its parent company

(1) China Merchants Steam Navigation Company Limited was founded on 11 October 1948 and its legal representative is Mr. Qin Xiao. It is a wholly owned subsidiary of China Merchants Group Limited. The Company is mainly engaged in passenger and cargo shipping business; dockyard, warehouse and vehicle transportation; sale, purchase and supply of various transportation equipment, spare parts and materials; ship and passenger/goods shipping agency, international maritime cargo; as well as finance, insurance and trust business related to transportation.

(2) China Merchants Group Limited directly holds 100% equity interest in China Merchants Steam Navigation Company Limited and is the parent company of the Company's largest shareholder. Its legal representative is Mr. Qin Xiao. China Merchants Group Limited, formerly known as 招商局, is a state-owned backbone enterprise under direct control of State Asset Administration Commission of the State Council. It was incorporated in 1872 and was one of the enterprises which played significant roles in promoting the modernization of China's national industrial & commercial era at that time. Nowadays, it has developed into a conglomerate, specialising in transportation infrastructure, industry zone development, port, finance, property and logistics businesses, etc.

The Company has no controlling shareholder or actual controlling party. The equity relationship between the Company and its largest shareholder is illustrated as follows:



Note: In February 2006, China Merchants Shekou Industrial Zone Co., Ltd. transferred its 68,284,415 shares of the Company to Shenzhen Yan Qing Investment and Development Co., Ltd. Yiulian Dockyards Limited and Hoi Tung Marine Machinery Suppliers Limited transferred their 182,068,000 and 35,733,250 shares of the Company to Shenzhen Chu Yuan Investment and Development Co., Ltd. respectively.

Issuance of convertible bonds and their listing

Approved by CSRC document *Zheng Jian Fa Xing Zi* [2004] No. 155, the Company issued 65 million convertible bonds on 10 November 2004 at RMB100 each, totaling RMB6.5 billion. Upon approval by Shanghai Stock Exchange's document *Shang Zheng Shang Zi* [2004] No. 165, the 65 million convertible bonds were listed and traded on 29 November 2004 under the name of "CMB Convertible Bonds" (bond code 110036) on Shanghai Stock Exchange. The validity period for the convertible bonds that were listed was from 29 November 2004 to 10 November 2009. The prospectus and listing announcement of convertible bonds were published on *China Securities*, *Securities Times* and *Shanghai Securities News* on 29 October 2004 and 23 November 2004 respectively.

The unconverted convertible bonds of the Company were less than RMB30 million as at 25 September 2006, and pursuant to relevant regulations, trading of "CMB Convertible Bonds" was suspended since 29 September 2006. The announcement of suspension of trading of "CMB Convertible Bonds" was published on *China Securities*, *Securities Times* and *Shanghai Securities News* from 26 September 2006 to 28 September 2006.

Issuance of subordinated debts

In accordance with *Yin Jian Fu* [2004] No. 36 Document, "Approval of Issuing Subordinated Debts by China Merchants Bank" issued by CBRC, the Company issued RMB3.5 billion subordinated debts, of which, China Pacific Insurance (Group) Co., Ltd. subscribed RMB2.5 billion subordinated debts in March 2004 at the fixed annual rate of 4.59 % for a term of 5 years and 1 month, with the interest to be payable once a year. China Ping An Life Insurance Co., Ltd. and Tai Kang Life Insurance Co., Ltd. subscribed RMB0.7 billion and RMB0.3 billion subordinated debts in June 2004 respectively at the fixed annual rate of 5.10 % for a term of 5 years and 1 month, with the interest to be payable once a year.

7. INFORMATION DISCLOSURE AND INVESTOR RELATIONS

The Company disclosed significant information in a responsive, accurate, truthful and complete manner pursuant to relevant provisions on information disclosure, so that all the shareholders of the Company have equal chance of access to the relevant information. In the reported period, the Company published 60 announcements in total.

The Company made continuing efforts to improve the investor relations management and advance the capital marketing. In the reported period, the Company received 76 visits from domestic and overseas investors, attended 8 investment promotion conferences sponsored by well-established investment banks worldwide, and staged road shows in Europe, USA and Southeast Asia. Through the above promotional activities, the management made sincere communication with institutional investors. The Company consulted with small and medium shareholders by email, telephone, etc. on a daily basis, and answered their questions dutifully, patiently and responsively.

Through extensive careful and effective work, the investor relations management of the Company has won widespread recognition. In the reported period, the Company won such honors as third prize for "China 2005 Top 50 Listed A-Share Companies with Best Investor Relations", "Best Large Companies" award, "Best Communication" award, "Best Share Reform" award, "Best Executor of Investor Relations" award, etc. jointly organized by *Securities Market Weekly* and Nanjing University; "China 2006 Best Public Image on Securities Market" at the second annual meeting of the securities market sponsored by *Securities Daily*; fifth prize for "China 2005 Top 100 Listed Companies" at "China Top 100 Listed Companies Summit" jointly sponsored by China Enterprise Reform & Development Society and Warton Economic Institute; at the summit, chairman Qin Xiao won the award for "Outstanding Contributions of Distinguished Entrepreneurs of Chinese Listed Companies", president Ma Weihua won the honor of "Top 10 Leaders of Chinese Listed Companies", and secretary of the board of directors Lan Qi won the honor of "10 Best Secretaries of Boards of Directors of Chinese Listed Companies". In addition, Lan Qi secretary of the Board of Directors of the Company, also won second prize for "New Fortune 2006 Gold Medal Secretaries of Boards of Directors", the honor of "Secretaries of Boards of Directors Most Favored by Analysts", and the honor of "China 2006 Best Secretary of Boards of Directors of Chinese Listed Companies" elected by *Shanghai Securities News*.

8. FIXED ASSETS

Changes in fixed assets as at 31 December 2006 are set out in note 19 to the financial statements.

9. MAJOR HOLDING COMPANIES AND JOINT-STOCK COMPANIES

(In RMB'000)

Name of holding or joint-stock company	Investment period at the end of reported period	Shareholding percentage of the Company (%)	Investment at the end of reported period
CMB International Finance Co., Ltd.	None	100%	115,097
China UnionPay Co., Ltd.	None	4.8%	38,016
EPS (Hong Kong) Limited	None	0.7%	8,177

Notes:

(1) CMB International Finance Co., Ltd., formerly Jiangnan Finance Co., Ltd., is the Company's wholly owned subsidiary approved by PBOC through its *Yin Fu* [1998] No. 405 Document, and was renamed as CMB International Finance Co., Ltd. on 22 February 2002 upon approval of PBOC through its *Yin Fu* [2002] No. 30 Document. Since the year 2006, the Company consolidated the financial statements of CMB International Finance Co., Ltd with that of the Company.

(2) Upon approval of PBOC through its *Yin Fu* [2001] No. 234 Document concerning the Establishment of China UnionPay Co., Ltd., the Company contributed RMB80 million to establish China UnionPay Co., Ltd. The above contribution included the assessed net value RMB41.984 million of the bank card network service centers in various cities and RMB38.016 million as additional cash investment. China UnionPay Co., Ltd. was incorporated on 26 March 2002 and the Company recorded the RMB38.016 million contributed in 2002 as long-term equity investment.

(3) EPS (Hong Kong) Limited was incorporated in 1984 by several licensed banks in Hong Kong and provides e-pay services for customers in Hong Kong, Macao and Shenzhen.

10. PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES OF THE COMPANY

For the year ended 31 December 2006, neither the Company, nor any of its subsidiaries had purchased, sold or redeemed any of the Company's listed securities.

11. ARRANGEMENT OF PRE-EMPTIVE RIGHTS

The Articles of Association of the Company does not have any provision on pre-emptive rights, and the shareholders of the Company do not have any pre-emptive right. The Company does not have any share option plan at present.

12. RETIREMENT AND WELFARE

Details about retirement welfares provided by the Company to its employees are set out in note 27 to the financial statements in this annual report.

13. PRINCIPAL CUSTOMERS

As at 31 December 2006, the operating incomes of the top 5 customers of the Company did not exceed 30% of the total operating income of the Company. The directors and related persons or shareholders of the Company did not have any material interests in the aforesaid 5 customers.

14. USE OF FUND RAISED

The Company issued 2,200,000,000 H Shares at face value of RMB1 per share at the price of HK$8.55 per share on The Stock Exchange of Hong Kong Limited ("HKSE" or "SEHK") on 22 September 2006, and through the exercise of the over-allotment option, issued 220,000,000 H Shares at face value of RMB1 per share at the price of HK$8.55 per share on SEHK on 27 September, raising RMB20.505 billion net fund, which was all in place on 5 October 2006. According to the commitments stated in the Prospectus, the fund raised would be used as additional capital to enhance capital adequacy and risk resistance.

15. DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

Name	Gender	Birth (Y/M)	Title	Term of office
Qin Xiao	Male	1947.4	Chairman	2004.6 - 2007.6
Wei Jianfu	Male	1949.12	Vice chairman	2004.6 - 2007.6
Fu Yuning	Male	1957.3	Non-executive director	2004.6 - 2007.6
Li Yinquan	Male	1955.4	Non-executive director	2004.6 - 2007.6
Huang Dazhan	Male	1958.7	Non-executive director	2004.6 - 2007.6
Tan Yueheng	Male	1962.11	Non-executive director	2004.6 - 2007.6
Sun Yueying	Female	1958.6	Non-executive director	2004.6 - 2007.6
Wang Daxiong	Male	1960.12	Non-executive director	2004.6 - 2007.6
Fu Junyuan	Male	1961.5	Non-executive director	2004.6 - 2007.6
Ma Weihua	Male	1948.6	Director & president	2004.6 - 2007.6
Chen Wei	Female	1959.11	Director & executive vice president	2004.6 - 2007.6
Wu Jiesi	Male	1951.10	Independent non-executive director	2005.9 - 2007.6
Lin Chuxue	Male	1959.3	Independent non-executive director	2004.6 - 2007.6
Austin Hu Chang Tau	Male	1948.6	Independent non-executive director	2004.6 - 2007.6
Chow Kwong Fai, Edward	Male	1952.8	Independent non-executive director	2006.5 - 2007.6
Liu Hongxia	Female	1963.9	Independent non-executive director	2006.5 - 2007.6
Liu Yongzhang	Male	1956.12	Independent non-executive director	2006.5 - 2007.6
Shi Jiliang	Male	1945.2	Chairman of Board of Supervisors and external supervisor	2006.5 - 2007.6
Zhu Genlin	Male	1955.9	Supervisor	2004.6 - 2007.6
Chen Haoming	Male	1966.3	Supervisor	2004.6 - 2007.6
Li Yi	Male	1944.1	Supervisor	2004.6 - 2007.6
Lu Yuhuan	Female	1971.12	Supervisor	2005.5 - 2007.6
Shao Ruiqing	Male	1957.9	External supervisor	2006.5 - 2007.6
Lin Rongguang	Male	1961.11	Employee supervisor	2004.6 - 2007.6
Xiang Youzhi	Male	1964.2	Employee supervisor	2004.6 - 2007.6
Zhou Wenqiong	Female	1963.5	Employee supervisor	2004.6 - 2007.6
Li Hao	Male	1959.3	Executive vice president	2004.6 - 2007.6
Tang Zhihong	Male	1960.3	Executive vice president	2006.6 - 2007.6
Yin Fenglan	Female	1953.7	Executive vice president	2006.6 - 2007.6
Ding Wei	Male	1957.5	Executive vice president	2006.5 to now
Xu Lianfeng	Male	1953.2	Chief technology officer	2001.11 to now
Lan Qi	Male	1956.6	Secretary of Board of Directors	2004.6 - 2007.6

Note: Madame Chen Wei resigned the Executive director, Executive vice president, Chief financial officer and Authorised representative of the Company on 23 March 2007.

16. APPOINTMENT OF DIRECTORS AND SUPERVISORS IN SHAREHOLDERS' COMPANIES

Name	Name of Company	Title	Term of office
Qin Xiao	China Merchants Group Limited	Chairman	From January 2001 up to now
Wei Jiafu	China Ocean Shipping (Group) Company	President	From June 2000 up to now
Fu Yuning	China Merchants Group Limited	President	From April 2000 up to now
Li Yinquan	China Merchants Group Limited	Vice president & chief financial officer	From July 2002 up to now
Huang Dazhan	China Merchants Finance Holdings Co., Ltd.	General manager	From June 1999 up to now
Tan Yueheng	China Merchants Finance Holdings Co., Ltd.	Deputy general manager	From July 2002 up to January 2007
Sun Yueying	China Ocean Shipping (Group) Company	Chief accountant	From December 2000 up to now
Wang Daxiong	China Shipping (Group) Company	Vice president & chief accountant	From March 2001 up to now
Fu Junyuan	China Communications Construction Group (Limited)	Chief accountant	From October 1998 up to now
Zhu Genlin	Shanghai Automotive Industry Corporation (Group)	Chief financial officer	From February 2002 up to now
Chen Haoming	Zhonghai Trust & Investment Co., Ltd.	Deputy general manager	From November 2000 up to now
Li Yi	Shandong State-owned Assets Investment Holdings Company Limited	Former general manager of Shandong Communication Development and Investment Co.	From May 1998 to December 2005
Lu Yuhuan	Guangdong Provincial Highways Administration Bureau	Accountant	From February 2002 up to now

17. REMUNERATION OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

In 2006, the Board of Directors established the "Competitiveness indicators System" to evaluate the competitiveness of the Company in profitability, asset quality and development potentials, which will be used as a reference for the Board of Directors to evaluate the management; the Board of Directors formulated *Quantified Authorization Standards* for the management in order to bring the decision making of the management within the quantified framework authorized by the Board of Directors; the Board of Directors formulated *Regulations on Remunerations of Senior Executives*, specifying the evaluation indexes and method; formulated H Share appreciation rights plan for senior executives, which plan is pending examination and approval by the regulatory authorities; the Board of Directors also formulated *Regulations on Total Staff Salary and Other Labour Costs* to further strengthen cost control.

Details of the remuneration of the directors, supervisors and senior management are set out in notes 8 and 9 to the financial statements in this annual report.

18. LONG AND SHORT POSITIONS OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

As at 31 December 2006, none of the directors, supervisors and senior management of the Company held or was deemed to hold interest or short position in the shares, underlying shares or debentures of the Company or any of its associated corporation, (within the meaning of Part XV of the SFO), or as being recorded pursuant to section 352 of the SFO or as otherwise notified by the directors or supervisors to the Company and SEHK in accordance with *Model Code for Securities Transactions by Directors of Listed Issuers* as set out in the Listing Rules; neither were the directors, supervisors and senior management of the Company authorized to buy any share or debenture of the Company or any of its related companies.

19. EQUITY HELD BY DIRECTORS IN BUSINESSES COMPETING WITH THOSE OF THE COMPANY

No director of the Company held any equity in any business constituting or likely to constitute direct or indirect competition with that of the Company.

20. FINANCIAL, BUSINESS AND KINSHIP RELATIONS BETWEEN DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

Directors, supervisors and senior management of the Company did not have any relations between each other, including financial, business, kinship or other material or connected relations.

21. CONTRACTUAL RIGHTS AND SERVICE CONTRACTS OF DIRECTORS AND SUPERVISORS

The directors and supervisors of the Company did not have direct or indirect material interest in any contract of significance to the Group (excluding service contracts) to which the Company or any of its subsidiaries was a party during the year. The directors and supervisors of the Company did not enter into any service contract with the Company which is not determinable by the Company within one year without payment of compensation (excluding statutory compensations).

22. OVERVIEW OF CONNECTED TRANSACTIONS

In accordance with Chapter 14A of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited ("Listing Rules"), the transactions between the Company and China Merchants Group Limited ("CM Group"), China Ocean Shipping (Group) Company Limited ("COSCO"), and Shandong State-owned Asset Investment Holding Co., Limited ("Shandong Investment Group") and their members constitute the continuing connected transactions referred to in the Listing Rules. The following are the exempt and non-exempt continuing connected transactions of the Company determined in accordance with the Listing Rules.

Exempt continuing connected transactions

The continuing connected transactions between the Company and members of China Merchants Group Limited include providing China Merchants Group Limited with e-Tax - online tax payment service, providing custody service for China Merchants Group Limited, providing management service for corporate pension account of China Merchants Group Limited, providing settlement service for China Merchants Group Limited, providing e-Bond - online bond trading service for China Merchants Group Limited, property management service provided by China Merchants Group Limited and renting property from China Merchants Group Limited The above connected transactions were disclosed in the H Share Prospectus 2006 of the Company. The above connected transactions follow the normal commercial terms and conditions and are charged according to the normal commercial charging standards and government designated charging standards. As at the end of 2006, the total service charge for each category of transactions between the Company and China Merchants Group Limited amounted to less than 0.1% of the relevant percentage ratios set out in Chapter 14 of the Listing Rules. In accordance with rule 14A.33 (3) of the Listing Rules, the above transactions are exempt continuing connected transactions and are exempt from compliance with the reporting, announcement and approval by independent shareholders obligations under the Listing Rules.

The continuing connected transactions between the Company and COSCO members include settlement services and e-Bond services. As at the end of 2006, the total service charge for each category of transactions between the Company and China Merchants Group Limited amounted to less than 0.1% of the relevant percentage ratios set out in Chapter 14 of the Listing Rules. In accordance with rule 14A.33 (3) of the Listing Rules, the above transactions are exempt continuing connected transactions and are exempt from compliance with the reporting, announcement and approval by independent shareholders obligations under the Listing Rules.

The continuing connected transactions between the Company and members of Shandong Investment Group include settlement services and consigned loan arrangements. As at the end of 2006, the total service charge for each category of transactions between the Company and Shandong Investment Group amounted to less than 0.1% of the relevant percentage ratios set out in Chapter 14 of the Listing Rules. In accordance with rule 14A.33(3) of the Listing

Rules, the above transactions are exempt continuing connected transactions and are exempt from compliance with the reporting, announcement and approval by independent shareholders obligations under the Listing Rules.

Non-exempt continuing connected transactions

The non-exempt continuing connected transaction is Bank-Securities Express - securities agency service provided by the Company for China Merchants Securities Co., Ltd., a member of China Merchants Group Limited.

Bank-Securities Express is a service provided by the Company for retail customers through the e-Securities system, which service links customer deposit accounts to securities trading accounts. The Company and China Merchants Securities Co., Ltd., a member of China Merchants Group Limited, conclude a service cooperation agreement, which contains relevant terms and conditions governing provision of securities agency services by the Company to China Merchants Securities Co., Ltd. through the e-Securities system. The service cooperation agreement was concluded in accordance with normal commercial terms and conditions, and the agency service fees paid to the Company by China Merchants Securities Co., Ltd. in accordance with the service cooperation agreement was determined through arm's length negotiation with reference to the charging standards of the Company for securities agency services provided by the Company to independent third party securities companies.

At the time of H Share listing in 2006, the Company applied to SEHK for the annual cap of total agency service charge to be collected from China Merchants Securities Co., Ltd. in 2006, which cap was higher than 0.1% of the relevant percentage ratios under Chapter 14 of the Listing Rules but less than 2.5%. Therefore, securities service cooperation between the Company and members of China Merchants Group Limited did not require approval of independent shareholders but shall comply with provisions on reporting and announcement in rules 14A.45 – 14A.47 of the Listing Rules. The above continuing connected transactions were disclosed in the H Share Prospectus 2006 of the Company.

As at the end of 2006, the total agency service charge collected by the Company from China Merchants Securities was RMB173,031,100, which exceeded the aforesaid cap approved by SEHK. The relevant particulars were set out in *Announcement of Continuing Related party Transactions (e-Securities)* of the Company on 23 March 2007.

The independent non-executive directors of the Company have reviewed the relevant non-exempt continuing connected transactions - Bank-Securities Express, and confirmed that

(1) The transactions were conducted in the ordinary and usual course of business of the Company;

(2) The terms and conditions of transactions are fair and reasonable and in the interests of the Company as a whole;

(3) The transactions were conducted on normal commercial terms and conditions and on terms and conditions that are no less favorable than those for independent third parties;

(4) The transactions were conducted in accordance with the relevant agreements.

The auditors of the Company have reviewed the said transactions and submitted to the directors of the Company a letter setting out the following:

(1) The transactions were approved by the directors of the Company;

(2) The transactions were conducted in accordance with relevant agreements concluded by the Company.

(3) The transactions exceeded the aforesaid upper limit approved by SEHK.

Exemption as connected persons

In accordance with rules 1.01, 14A.11 and 19A.04 of the Listing Rules, after H Shares listing of the Company with SEHK, the promoters of the Company and their coordinators constitute connected persons of the Company. Accordingly, the continuing connected transactions between the Company and the said promoters and coordinators will be specified as continuing connected transactions and shall therefore comply with the provisions of rules 14A.45 and 14A.48 of the Listing Rules on reporting, announcement and approval of independent shareholders, unless otherwise waived.

Accordingly, the Company has applied to the SEHK for a waiver in accordance with rule 14A.42 of the Listing Rules, and Qinhuangdao Port Group, a promoter of the Company, and other promoters of the Company no longer holding any equity of the Company, including Shenzhen Hui He Investment and Development Co., Ltd. and CNOOC East of South China Sea Corp. and their coordinators shall be deemed as connected parties under the Listing Rules, and accordingly all the connected transactions between the Company and them are exempt from compliance with the provisions on connected transactions in Chapter 14A of the Listing Rules. The relevant details are set out in the section on connected transactions in the H Share Prospectus of the Company.

23. MATERIAL LITIGATION AND ARBITRATIONS

As at 31 December 2006, the number of pending litigation and arbitration cases involving the Company totaled at 856, involving a total principal sum of RMB1,295,215,700, US$6,000,100, HK$10 million and INR8,766,900; the interest totaled at RMB222,348,100 and US$10,900. In particular, the total number of pending litigation and arbitration cases against the Company totaled at 32, involving a total principal of RMB102,400,000, US$152,000, HK$10 million and INR8,766,900; the interest totaled at RMB4,154,400 and US$9,900.

24. MATERIAL CONTRACTS

The material contracts of the Company did not cover custody or contracting of other companies' assets or vice versa which are outside the ordinary course of business. The relevant guarantee contracts all fell within the guarantee businesses within the business scope of the Company, and the Company is not aware of any significant guarantee, no guarantee for its holding subsidiaries, and no illegal guarantee.

25. COMPLIANCE WITH GUIDELINE ON FINANCIAL DISCLOSURE BY LOCALLY INCORPORATED AUTHORISED INSTITUTIONS

The Company prepared the financial statements for the year 2006 in strict accordance with *Guideline on Financial Disclosure by Locally Incorporated Authorised Institutions* issued by Hong Kong Monetary Authority.

26. CLOSURE OF REGISTER OF MEMBERS

In order to determine the shareholders list of H shares who will be entitled to attend the annual general meeting of the Company and/or receive the final dividend for the year ended 31 December 2006, the Company will close its share register and suspend registration of transfer of shares from 16 May 2007 (Wednesday) to 15 June 2007 (Friday) (both days inclusive). To be qualified to attend the meeting and/or receive the final dividend, holders of H Shares of the Company whose transfer have not been registered should deposit the transfer documents accompanied by the relevant share certificates at the Company's H Share Registrar, Computershare Hong Kong Investor Services Limited at Rooms 1712-1716, 17/F, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong by no later than 4:30 p.m. on 15 May 2007 (Tuesday). Regarding the registration date and arrangement for the shareholders of A Shares who will be entitled to attend the annual general meeting of the Company and/or receive the final dividend for the year ended 31 December 2006, the Company will make further announcement in the PRC.

27. PUBLICATION OF ANNUAL REPORT

This annual report is printed in both English and Chinese versions. In the event of any discrepancies in interpretations between the English version and Chinese version, the Chinese version shall prevail. Both Chinese and English versions of the annual report are available on the website of the Company (www.cmbchina.com) and The Stock Exchange of Hong Kong Limited (www.hkex.com.hk).

The Company also prepared the annual report in Chinese in accordance with the PRC Generally Accepted Accounting Standards, which is available on the websites of the Company (www.cmbchina.com) and Shanghai Stock Exchange (www.sse.com.cn).

By Order of the Board

Qin Xiao
Chairman of Board of Directors
16 April 2007

REPORT OF THE BOARD OF SUPERVISORS

The Board of Supervisors has 9 members, including 2 external supervisors, 4 shareholder representative supervisors and 3 employee representative supervisors. The Board of Supervisors fulfills supervisory duties pursuant to *Company Law* and *Articles of Association* of the Company, and inspects and supervises the business operations and financial activities of the Company by holding regular meetings, reviewing various documents submitted by the Company, listening to the work reports and special reports of the management, making questionnaire surveys, etc.

In 2006, the Board of Supervisors held 6 meetings, which reviewed and approved four regular reports, financial budgets and final accounts, proposed profit appropriations plan, and 15 proposals including *Proposal Concerning Amendment of the Articles of Association of China Merchants Bank Co., Ltd., Proposal Concerning Change of Members of the Board of Supervisors*, etc.

In 2006, the former chairman of the Board of Supervisors Wang Qiyan and external supervisor Zhang Yuqing fulfilled their terms of office and upon discussion and approval of the general meeting, Shi Jiliang and Shao Ruiqing were elected as external supervisors of the sixth session of Board of Supervisors. The Board of Supervisors elected Shi Jiliang as its chairman who concurrently serves as chairman of Nomination Committee of Board of Supervisors, and elected Shao Ruiqing as chairman of Audit Committee of Board of Supervisors.

In 2006, the Board of Supervisors intensified investigation, focusing on implementation of credit policy and credit system given by the Head Office to branches, quality of credit assets and execution of credit management procedure. In respect of the problems identified during the investigation, the Board of Supervisors presented a series of proposals to the management of the Head Office.

In 2006, the Board of Supervisors studied ways to supervise the work performance of directors and senior management and made questionnaire survey on the work performance of directors at the end of the year.

In 2006, the Board of Supervisors stepped up communications and dialogues with the regulatory authorities to learn about the general opinion of the regulatory authorities about China Merchants Bank and their suggestions on the works of the Board of Supervisors of the Company.

The Nomination Committee of the Board of Supervisors made preliminary examination on the qualifications of the candidate supervisors; the Audit Committee consulted with KPMG on the audit work in 2005, and analyzed the interim financial position of the Company in 2006.

In 2006, the Company convened 4 general meetings and 15 meetings of the Board of Directors. Supervisors attended the general meetings and were present at the meetings of the Board of Directors as non-voting delegates, and supervised the law and regulation compliance and voting procedure of the general meetings and meetings of the Board of Directors, as well as the work performance of the directors.

The Board of Supervisors was of the view that the business activities of China Merchants Bank in 2006 complied with *Company Law*, *Commercial Banks Law* and *Articles of Association*, and the decision making procedure was lawful and valid. No director or senior executive was found to have violated the relevant laws, regulations or the *Articles of Association* or having done anything detrimental to the interests of the Company or shareholders; KPMG audited the financial reports of the year in accordance with the international audit standard and produced standard unqualified audit report, stating that the financial reports gave a true, objective and accurate view of the financial position and operating results of the Company; the projects actually funded with the capital raised were consistent with the undertakings in the Capital Raising Description; the connected transactions were fair and reasonable, not running against the spirit of fairness or detrimental to the interests of the Company or shareholders. The Board of Supervisors lodged no objections to the reports and proposals submitted by the Board of Directors to the general meetings for 2006, and concluded that the board had duly implemented relevant resolutions of the general meetings.

By Order of the Board of Supervisors

Shi Jiliang
Chairman of the Board of Supervisors
16 April, 2007

SOCIAL RESPONSIBILITIES OF THE COMPANY

In the spirit of "From the society, to the society", the Company commits itself to a range of community activities such as providing financial assistance to poor students, fighting against SARS, making donations, etc., and plays its due role as a "corporate citizen" in various aspects such as poverty relief, education and environmental protection.

ESTABLISHING CORPORATE SOCIAL RESPONSIBILITY ALLIANCE

On 15 October 2006, the Company, IBM, Vanke, Nokia, Ping An Insurance, Cisco, HP, TCL, Nanfang Daily, etc. jointly sponsored "Corporate Social Responsibility Alliance". The Alliance is China's first non-governmental organization advocating social responsibility and aims to mobilising various social resources to advance corporate social responsibility. In 2006, the Alliance launched the poverty-relieving "Nestar Project" at the pilot place of Bijie District, Guizhou Province. 27 college students volunteered to teach in the poverty-stricken areas of Bijie. The Alliance has also worked out a plan to train teachers in the poor areas, and the first 100 teachers from the poor Dingxi District of Gansu Province received training in Beijing on education theories.

PROVIDING ASSISTANCE TO WUDING AND YONG REN COUNTIES IN YUNNAN PROVINCE

Since September 1998, as arranged by the Aid-the-Poor Development Office of the State Council, the Company has been providing assistance to Wuding and Yongren Counties in Chuxiong Yi Autonomous Prefecture of Yunnan Province. By the end of 2006, the Company had donated more than RMB15 million to aid the poor and support education, including building 15 *Hope Project* primary schools, aiding 5,890 poor students, and donating 778 computers. In 2006, the Company donated over RMB2.8 million, including building 2 *Hope Project* primary school and aiding 462 students.

LAUNCHING "WINGS OF ANGEL" LEARNING-ASSISTING ACTIVITIES

In May 2006, in collaboration with Corporate Social Responsibility Alliance and Education Department of Yunnan Province, the Company launched "Wings of Angel" learning-assisting activities to help dropouts in the poor areas to return to schools. The Company donated RMB2 million, helping over 1,000 school dropouts in Yunnan, Guangxi and Xinjiang, etc. The Company also organized a nationwide "Wings of Angel" summer camp series for aided student representatives.

JOINING 100-ENTERPRISE IN CAMPUS WELFARE WALK

In April 2006, the Company sponsored "100-Enterprise in Campus Welfare Walk" series activities relating to employment of college students in China. The activities were the most extensive activities in recent years, aiming to provide onsite advice for job-hunting college students.

OTHER SOCIAL WELFARE ACTIVITIES

In 2006, the Company conducted other social welfare activities, e.g. providing scholarships for over 30 higher education institutions, participating in projects organized by China Foundation for Poverty Alleviation, sponsoring Asian premiere of the Lion King, CCTV Cup Go Tournament and 2006 F1 China Motorboat Championship, organizing "100-Year CMB Woods" tree-planting activities, issuing Sunflower financial index, etc.

BRANCHES AND REPRESENTATIVE OFFICES

Name of banches	Business address	Postcode	No. of outlets	No. of Staff	Amount of Asset (in million of RMB)
Head Office	7088 Shennan Boulevard, Shenzhen	518040	1	2108	327,833
Shenzhen Branch	2 Shennan Road Central, Shenzhen	518001	64	2244	75,087
Shanghai Branch	161 Lujiazui Road East, Pudong, Shanghai	200120	43	1637	67,723
Wuhan Branch	518 Jianshe Avenue, Hankou, Wuhan	430022	21	980	21,863
Beijing Branch	156 Fuxingmen Nei Dajie, Beijing	100031	34	1638	64,066
Shenyang Branch	12 Shiyiwei Road, Heping District, Shenyang	110003	17	941	21,914
Guangzhou Branch	138, Tiyu Road East, Tianhe District, Guangzhou	510620	30	1081	20,188
Chengdu Branch	9 Shuncheng Street, Qingyang District, Chengdu	610016	15	670	11,211
Lanzhou Branch	9 Qingyang Road, Chengguan District, Lanzhou	730000	14	462	10,367
Xi'an Branch	107 Heping Road, Xi'an	710001	16	659	13,731
Nanjing Branch	1 Hanzhong Road, Nanjing	210005	14	647	25,047
Wuxi Branch	128 Renmin Road Central, Wuxi	214002	8	224	8,359
Changzhou Branch	125 Heping Road South, Changzhou	213003	2	92	1,775
Suzhou Branch	128 Sanxiang Road, Suzhou	215004	9	292	10,737
Chongqing Branch	2 Linjiangzhi Road, Yuzhong District, Chongqing	400010	16	669	16,174
Dalian Branch	17 Renmin Road, Zhongshan District, Dalian	116001	13	503	11,441
Hangzhou Branch	310 Zhongshan Road North, Hangzhou	310001	17	685	22,575
Ningbo Branch	938 Baizhang Road East, Ningbo	315041	9	315	10,358
Wenzhou Branch	Jinglong Building, Chezhan Avenue, Wenzhou	325000	7	209	4,980
Shaoxing Branch	Jindun Building, 60 Shengli Road East, Shaoxing	312000	3	113	5,311
Nanchang Branch	162 Bayi Avenue, Nanchang	330003	11	537	9,998
Changsha Branch	24 Cai'e Road Middle, Furong District, Changsha	410005	14	529	9,321
Fuzhou Branch	60 Guping Road, Fuzhou	350003	11	398	8,785
Quanzhou Branch	Huangxing Building, 301 Fengze Street, Quanzhou	362000	3	87	1,223
Qingdao Branch	36 Hong Kong Road Middle, Shinan District, Qingdao	266071	11	502	18,503
Tianjin Branch	55 Youyi Road North, Hexi District, Tianjin	300204	17	566	15,436
Jinan Branch	21 Chaoshan Street, Lixia District, Jinan	250011	13	481	22,361
Yantai Branch-	CMB Building, 237 Nanda Street, Yantai	264000	4	111	2,703
Urumchi Branch	80 Xinhua Road North, Urumchi	830002	8	306	3,792
Kunming Branch	48 Dongfeng Road East, Kunming	650051	11	385	13,466

BRANCHES AND REPRESENTATIVE OFFICES

Name of branches	Business address	Postcode	No. of outlets	No. of staff	Amount of Asset (in million of RMB)
Hefei Branch	436 Changjiang Road Middle, Hefei	230061	10	445	8,934
Xiamen Branch	862 Xiahe Road, Xiamen	361004	6	276	5,377
Harbin Branch	3 Zhongyang Avenue, Daoli District, Harbin	150001	9	297	7,253
Zhengzhou Branch	68 Jingsan Road, Zhengzhou	450008	9	342	8,763
Dongguan Branch	Yujing New Times Plaza, Dongcheng Avenue, Dongguan	523129	7	250	4,167
Foshan Branch	1-3/F, Hongye Mansion, Jihua 5th Road, Foshan	528000	3	132	4,502
Taiyuan Branch	1 Xinjian Road South, Taiyuan	030001	1	95	2,590
Hong Kong Branch	12 Harcourt Road, Hong Kong		1	55	26,053
Beijing Representative Office(1)	35 Jinrong Avenue, Xicheng District, Beijing	100005	1	8	–
USA Representative Office	509 Madison Aveune, Suite 306, NewYork, NewYork 10022, U.S.A		1	2	1
Credit card centre	316 Lao Shan Road, Pudong New District, Shanghai	200120	1	1229	10,134
Total	—	—	505	23202	934,102

(1) As at 31 December 2006, the amount of asset of Beijing Representative Office was less than RMB1 million.

CONTENTS

KPMG

INDEPENDENT AUDITOR'S REPORT TO THE BOARD OF DIRECTORS OF CHINA MERCHANTS BANK CO., LTD.

We have audited the accompanying financial statements of China Merchants Bank Co., Ltd (the "Bank") and its subsidiaries (collectively the "Group") set out on pages 132 to 219, which comprise the consolidated balance sheet and balance sheet as at 31 December 2006, and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The directors are responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board and the disclosure requirements of the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these financial statements based on our audit. This report is made solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Bank's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

OPINION

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2006, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards and the disclosure requirements of the Hong Kong Companies Ordinance.

KPMG
Certified Public Accountants
8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong
16 April 2007

CONSOLIDATED INCOME STATEMENT

for the year ended 31 December 2006

(Expressed in millions of Renminbi unless otherwise stated)

	Note	2006	2005
Interest income	3	**33,990**	25,877
Interest expense	4	**(12,481)**	(9,235)
Net interest income		**21,509**	16,642
Fee and commission income	5	**2,988**	1,856
Fee and commission expense		**(474)**	(289)
Net fee and commission income		**2,514**	1,567
Other net income	6	**843**	1,005
Operating income		**24,866**	19,214
Operating expenses	7	**(11,091)**	(9,115)
Operating profit before provision		**13,775**	10,099
Provision for impairment losses	11	**(3,691)**	(3,637)
Profit before tax		**10,084**	6,462
Income tax	12	**(3,290)**	(2,713)
Net profit attributable to equity holders of the Bank		**6,794**	3,749
Dividends			
– Declared and paid	33(a)	**3,193**	753
– Proposed in respect of current year	33(b)	**1,764**	830
		4,957	1,583
		RMB	RMB
Earnings per share			
Basic	13(a)	**0.53**	0.34
Diluted	13(b)	**0.53**	0.33

The notes on pages 141 to 219 form part of these financial statements.

CONSOLIDATED BALANCE SHEET

at 31 December 2006

(Expressed in millions of Renminbi unless otherwise stated)

	Note	**2006**	2005
Assets			
Cash and balances with banks and other financial institutions	14	**20,861**	22,491
Balances with central bank	15	**82,372**	62,102
Placements with banks and other financial institutions	16	**88,171**	46,982
Loans and advances to customers	17	**549,420**	458,675
Investments	18	**178,885**	131,902
Fixed assets	19	**7,376**	6,777
Deferred tax assets	20(a)	**2,260**	2,166
Other assets	21	**4,757**	3,518
Total assets		**934,102**	734,613
Liabilities			
Deposits from banks and other financial institutions	22	**68,854**	39,673
Placements from banks and other financial institutions	23	**7,749**	3,574
Deposits from customers	24	**773,757**	634,404
Financial liabilities at fair value through profit or loss	18(e)	**106**	86
Certificates of deposit issued	25(a)	**1,170**	1,211
Convertible bonds issued	25(b)	**22**	5,184
Other debts issued	25(c)	**9,987**	9,982
Current taxation		**2,652**	2,715
Other liabilities	26	**11,145**	8,286
Subordinated notes issued	25(d)	**3,500**	3,500
Total liabilities		**878,942**	708,615

CONSOLIDATED BALANCE SHEET

at 31 December 2006

(Expressed in millions of Renminbi unless otherwise stated)

	Note	2006	2005
Shareholders' equity			
Share capital	28	**14,703**	10,374
Capital reserve	29	**27,536**	6,095
Surplus reserve	30	**2,377**	1,591
Investment revaluation reserve	31	**195**	404
Regulatory general reserve	32	**6,500**	3,000
Retained profits		**1,374**	2,918
Proposed profit appropriations	33(b)	**2,475**	1,616
Total shareholders' equity		**55,160**	25,998
Total shareholders' equity and liabilities		**934,102**	734,613

Approved and authorised for issue by the board of directors on 16 April 2007.

Qin Xiao, *Director*
Ma Wei Hua, *Director*

The notes on pages 141 to 219 form part of these financial statements.

BALANCE SHEET

at 31 December 2006

(Expressed in millions of Renminbi unless otherwise stated)

	Note	2006	2005
Assets			
Cash and balances with banks and other financial institutions		**20,831**	22,476
Balances with central bank		**82,372**	62,102
Placements with banks and other financial institutions		**88,171**	46,982
Loans and advances to customers		**549,420**	458,675
Investments		**178,885**	131,869
Investment in subsidiary	1(c)	**53**	53
Fixed assets		**7,326**	6,729
Deferred tax assets		**2,260**	2,166
Other assets		**4,711**	3,513
Total assets		**934,029**	734,565
Liabilities			
Deposits from banks and other financial institutions		**68,854**	39,673
Placements from banks and other financial institutions		**7,749**	3,574
Deposits from customers		**773,757**	634,404
Financial liabilities at fair value through profit or loss		**106**	86
Certificates of deposit issued		**1,170**	1,211
Convertible bonds issued		**22**	5,184
Other debts issued		**9,987**	9,982
Current taxation		**2,652**	2,715
Other liabilities		**11,134**	8,285
Subordinated notes issued		**3,500**	3,500
Total liabilities		**878,931**	708,614

BALANCE SHEET

at 31 December 2006

(Expressed in millions of Renminbi unless otherwise stated)

	Note	2006	2005
Shareholders' equity			
Share capital		**14,703**	10,374
Capital reserve		**27,536**	6,095
Surplus reserve		**2,377**	1,591
Investment revaluation reserve		**195**	404
Regulatory general reserve		**6,500**	3,000
Retained profits		**1,312**	2,871
Proposed profit appropriations		**2,475**	1,616
Total shareholders' equity		**55,098**	25,951
Total shareholders' equity and liabilities		**934,029**	734,565

Approved and authorised for issue by the board of directors on 16 April 2007.

Qin Xiao, *Director*
Ma Wei Hua, *Director*

The notes on pages 141 to 219 form part of these financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December 2006

(Expressed in millions of Renminbi unless otherwise stated)

	Note	2006							
		Share capital	Capital reserve	Surplus reserve	Investment revaluation reserve	Regulatory general reserve	Retained profits	Proposed profit appropriations	Total
At 1 January 2006		10,374	6,095	1,591	404	3,000	2,918	1,616	25,998
Net profit for the year		–	–	–	–	–	6,794	–	6,794
H-Shares issued	28	2,420	–	–	–	–	–	–	2,420
Share premium arising from H-Shares issued	29	–	18,085	–	–	–	–	–	18,085
Appropriations to statutory surplus reserve and statutory public welfare fund for the year 2005		–	–	786	–	–	–	(786)	–
Proposed dividends									
– for the year 2005	33(b)(ii)	–	–	–	–	–	(153)	153	–
– for the year 2006	33(b)	–	–	–	–	–	(1,764)	1,764	–
– special	33(b)(iii)	–	–	–	–	–	(2,210)	2,210	–
Dividends for the year 2005 and special dividend paid	33(a)	–	–	–	–	–	–	(3,193)	(3,193)
Transfer of retained profits to regulatory general reserve		–	–	–	–	3,500	(3,500)	–	–
Capital reserve transferred to share capital upon issue of A-Shares	28, 29	971	(971)	–	–	–	–	–	–
Conversion of convertible bonds	28, 29	938	4,327	–	–	–	–	–	5,265
Realised on disposal of available-for-sale financial assets	31	–	–	–	(42)	–	–	–	(42)
Changes in fair value of available-for-sale financial assets	31	–	–	–	(167)	–	–	–	(167)
Proposed appropriations to statutory surplus reserve for the year 2006	33(b)	–	–	–	–	–	(711)	711	–
At 31 December 2006		14,703	27,536	2,377	195	6,500	1,374	2,475	55,160

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December 2006

(Expressed in millions of Renminbi unless otherwise stated)

		2005							
	Note	Share capital	Capital reserve	Surplus reserve	Investment revaluation reserve	Regulatory general reserve	Retained profits	Proposed profit appropriations	Total
At 1 January 2005		6,848	9,046	962	(65)	–	3,785	1,382	21,958
Net profit for the year		–	–	–	–	–	3,749	–	3,749
Appropriations to statutory surplus reserve and statutory public welfare fund for the year 2004		–	–	629	–	–	–	(629)	–
Dividends paid for the year 2004	33(a)	–	–	–	–	–	–	(753)	(753)
Transfer of retained profits to regulatory general reserve		–	–	–	–	3,000	(3,000)	–	–
Capital reserve transferred to share capital upon issue of A-Shares	28, 29	3,424	(3,424)	–	–	–	–	–	–
Conversion of convertible bonds	28, 29	102	473	–	–	–	–	–	575
Realised on disposal of available-for-sale financial assets	31	–	–	–	110	–	–	–	110
Changes in fair value of available-for-sale financial assets	31	–	–	–	359	–	–	–	359
Proposed appropriations to statutory surplus reserve and statutory public welfare fund for the year 2005	33(b)	–	–	–	–	–	(786)	786	–
Proposed dividends for the year 2005	33(b)	–	–	–	–	–	(830)	830	–
At 31 December 2005		10,374	6,095	1,591	404	3,000	2,918	1,616	25,998

The notes on pages 141 to 219 form part of these financial statements.

CONSOLIDATED CASH FLOW STATEMENT

for the year ended 31 December 2006

(Expressed in millions of Renminbi unless otherwise stated)

	Note	2006	2005
Operating activities			
Profit before tax		**10,084**	6,462
Adjustments for:			
– Impairment losses charged on loans and advances		**3,537**	3,575
– Impairment losses (released)/charged on deposits and placements with banks and other financial institutions		**(91)**	62
– Impairment losses charged on other assets		**245**	–
– Unwind of interest income on impaired loans		**(222)**	(244)
– Depreciation		**910**	854
– Amortisation of discount and premium of debt investments		**(267)**	152
– Amortisation of discount and premium of bonds issued		**7**	194
– Write-off of loans and advances, net of recoveries		**(270)**	(661)
– Net gain on debt investments		**(335)**	(276)
– Net gain on disposal of fixed assets		**(1)**	(4)
– Interest income on debt investments		**(3,652)**	(3,133)
– Interest expense on issued debts		**474**	407
Changes in operating assets and liabilities:			
Increase in balances and placements with banks and other financial institutions with original maturity over 3 months		**(6,910)**	(8,266)
Increase in discounted bills		**(4,309)**	(38,641)
Increase in loans and advances to customers		**(89,208)**	(59,605)
Decrease in other assets		**7,362**	379
Increase in deposits from customers		**139,353**	121,818
Increase in deposits and placements from banks and other financial institutions		**33,356**	10,251
Increase in other liabilities		**2,812**	1,408
Net cash inflow from operating activities		**92,875**	34,732
Income tax paid		**(3,410)**	(2,405)

CONSOLIDATED CASH FLOW STATEMENT

for the year ended 31 December 2006

(Expressed in millions of Renminbi unless otherwise stated)

	Note	2006	2005
Investing activities			
Payment for purchase of debt investments		**(157,403)**	(132,115)
Proceeds from redemption or disposal of debt investments		**104,685**	113,998
Interest received from debt investments		**3,526**	3,116
Payment for purchase of fixed assets		**(1,768)**	(1,256)
Proceeds from sale of fixed assets		**260**	43
Net cash outflow from investing activities		**(50,700)**	(16,214)
Net cash inflow before financing activities		**38,765**	16,113
Financing activities			
Proceeds from H-Shares issuance		**21,049**	–
Cost of issuing shares, net of interest income		**(544)**	–
Payment of issuing expenses on other debts		**–**	(19)
Proceeds from issue of other debts		**–**	10,000
Dividends paid		**(3,160)**	(742)
Interest paid on issued debts		**(465)**	(257)
Net cash inflow from financing activities		**16,880**	8,982
Net increase in cash and cash equivalents		**55,645**	25,095
Cash and cash equivalents at 1 January		**120,609**	95,952
Effect of foreign exchange rate changes		**(644)**	(438)
Cash and cash equivalents at 31 December	34(a)	**175,610**	120,609
Cash flows from operating activities include:			
Interest received		**30,552**	22,507
Interest paid		**11,291**	8,075

The notes on pages 141 to 219 form part of these financial statements.

1 ORGANISATION, PRINCIPAL ACTIVITIES AND DETAILS OF PRINCIPAL SUBSIDIARY

(a) Organisation

The Bank is a commercial bank incorporated in Shenzhen, the People's Republic of China (the "PRC"). With the approval of the China Securities Regulatory Commission ("CSRC") of the PRC, the A-Shares of the Bank were listed on Shanghai Stock Exchange on 9 April 2002.

On 22 September 2006, the Bank's H-Shares were listed on the Main Board of the Stock Exchange of Hong Kong Limited.

As at 31 December 2006, apart from the Head Office, the Bank had branches in Shenzhen, Shanghai, Beijing, Shenyang, Nanjing, Guangzhou, Wuhan, Lanzhou, Xi'an, Chengdu, Chongqing, Hangzhou, Fuzhou, Jinan, Tianjin, Dalian, Urumqi, Kunming, Hefei, Zhengzhou, Harbin, Nanchang, Changsha, Xiamen, Ningbo, Wenzhou, Wuxi, Suzhou, Hong Kong, Qingdao, Dongguan, Shaoxing, Yantai, Quanzhou, Changzhou, Taiyuan and Foshan. In addition, the Bank has two representative offices in Beijing and New York.

(b) Principal activities of the Bank

The Bank provides deposits taking, clearing and other related services. It also engages in the provision of credit and bills discounting, other treasury related activities; and acts as issuing agent and underwriter for government bonds.

(c) Details of the subsidiary consolidated

The particulars of the Bank's subsidiary as at 31 December 2006 are set out below.

Name of company	Place of incorporation and operation	Particulars of the issued and paid up capital	% of ownership held by the Bank	Principal activities
CMB International Capital Corporation Limited	Hong Kong	HK$50 million	100%	Investment advisory services

2 SIGNIFICANT ACCOUNTING POLICIES

(a) Statement of compliance and basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs") and its interpretations promulgated by the International Accounting Standards Board ("IASB"), and the disclosure requirements of the Hong Kong Companies Ordinance. These financial statements also comply with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited. A summary of the significant accounting policies adopted by the Group is set out below.

All IFRSs in issue which are effective for the accounting period beginning on 1 January 2006 and which are relevant to the Group have been applied. IFRS 7 Financial Instruments: Disclosures ("IFRS 7") and Amendment to International Accounting Standard 1 Presentation of Financial Statements: Capital Disclosures, both of which were issued in August 2005 and which are effective for the period beginning on 1 January 2007 have not been adopted in these financial statements. IFRS 7 requires more detailed qualitative and quantitative disclosure primarily on fair value information and risk management. The Group has assessed the impact of IFRS 7 and concluded that IFRS 7 would only affect the level of details in the disclosure of the financial statements, and would not have an impact on the Group's results or the state of affairs of the Group or the Bank.

(b) Basis of measurement

Unless stated otherwise, the financial statements are presented in Renminbi ("RMB"), which is the Group's functional and presentation currency, rounded to the nearest million.

The financial statements are prepared using the historical cost basis except that financial assets and liabilities at fair value through profit or loss including derivatives, and available-for-sale assets are stated at their fair value; and certain non-financial assets are stated at deemed cost.

The preparation of the financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. The results of such estimates and assumptions form the basis of judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of IFRSs that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the subsequent period are discussed in Note 40.

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(c) Basis of consolidation

The financial statements include the financial statements of the Bank and its subsidiary. Subsidiaries are those enterprises controlled by the Bank. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operational policies of an enterprise so as to obtain benefits from its activities. The results and affairs of subsidiaries are included from the date that control commences until the date that control ceases.

The results of the subsidiary are included in the consolidated results of the Group. All significant inter company transactions and balances, and any unrealised gains or losses arising from inter company transactions, have been eliminated on consolidation.

In the Bank's balance sheet, an investment in a subsidiary is stated at cost less allowances for impairment losses.

In view of the immateriality of the subsidiary's assets and liabilities, all notes are prepared on consolidated balances only.

(d) Financial instruments

(i) Recognition and measurement

All financial assets and financial liabilities are recognised in the consolidated balance sheet when and only when, the Group becomes a party to the contractual provisions of the instrument. Financial assets are derecognised on the date when the contractual rights to the cash flows expire or substantially all the risks and rewards of ownership are transferred. A regular way purchase or sale of financial assets is recognised using settlement date accounting, except for derivatives which are recognised using trade date accounting.

Financial liabilities are derecognised on the date when the obligations specified in the contracts are discharged, cancelled or expire.

At initial recognition, all financial assets and liabilities are measured at fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include observable market data.

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(d) Financial instruments *(continued)*

(i) Recognition and measurement *(continued)*

Financial assets and financial liabilities are categorised as follows:

– financial assets and financial liabilities at fair value through profit or loss include those financial assets and financial liabilities held principally for the purpose of short term profit taking and those financial assets and liabilities that are designated by the Group upon recognition as at fair value through profit or loss.

All derivatives not qualified for hedging purposes are included in this category and are carried as assets when their fair value is positive and as liabilities when their fair value is negative;

– Financial instruments are designated at fair value through profit or loss upon initial recognition when:

  – the assets or liabilities are managed, evaluated and reported internally on a fair value basis;

  – the designation eliminates or significantly reduces an accounting mismatch which would otherwise arise;

  – the asset or liability contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract; or

  – the separation of the embedded derivative from the financial instrument is not prohibited;

– held-to-maturity financial assets are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Group has the positive intent and ability to hold to maturity;

– loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than those that the Group intends to sell immediately or in the near term, and those that are designated as available-for-sale upon initial recognition;

– available-for-sale assets are non-derivative financial assets that are designated as available-for-sale or are not classified as financial assets at fair value through profit or loss, loans and receivables or held-to-maturity financial assets; and

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(d) Financial instruments *(continued)*

(i) Recognition and measurement (continued)

– financial liabilities, other than that at fair value through profit or loss and designated at fair value through profit or loss, are measured at amortised cost using the effective interest method.

Subsequent to initial recognition, financial assets and financial liabilities are measured at fair value, without any deduction for transaction costs that may occur on sale or other disposal except for loans and receivables, held-to-maturity financial assets and financial liabilities not at fair value through profit or loss, which are measured at amortised cost using the effective interest method. Financial assets and financial liabilities that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are stated at cost.

Gains and losses from changes in the fair value of financial instruments at fair value through profit or loss are included in the consolidated income statement when they arise.

Gains and losses arising from a change in the fair value of available-for-sale assets are recognised directly in equity, except for impairment losses and foreign exchange gains and losses on monetary assets, until the financial asset is derecognised at which time the cumulative gains or losses previously recognised in equity will be recognised in the consolidated income statement.

For financial assets and liabilities carried at amortised cost, a gain or loss is recognised in the consolidated income statement when the financial asset or liability is derecognised, impaired and amortised.

(ii) Fair value measurement principles

The fair value of financial instruments is based on their quoted market price in an active market at the valuation date without any deduction for transaction costs. If a quoted market price is not available, the fair value of the instrument is estimated using pricing models referenced to the fair value of another instrument that is substantially the same (without deduction for transaction costs) or discounted cash flow techniques. Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate is a market rate at the valuation date for an instrument with similar terms and risk profile.

(iii) Hedge accounting

The Group does not have derivative financial instruments which meet the criteria for hedge accounting.

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(d) Financial instruments *(continued)*

(iv) Specific instruments

Cash equivalents

Cash equivalents comprise balances with banks and the central bank, and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition.

Placements with and takings from banks and other financial institutions

Banks represent other banks approved by the People's Bank of China (the "PBOC"). Other financial institutions represent insurance companies, securities firms, and investment trusts etc. Placements with banks and other financial institutions are accounted for as loans or investment receivables.

Investments

Equity investments are accounted for as trading or available-for-sale financial assets. Debt investments are classified as financial assets at fair value through profit or loss, held-to-maturity financial assets, loans and receivables, and available-for-sale financial assets in accordance with the Group's holding intention at acquisition.

Loans and advances

Loans and advances directly granted by the Group to customers or participation in syndicated loans are accounted for as loans and receivables.

(v) Derivative financial instruments

The Group's derivative financial instruments include spot, forward and foreign currency swaps, interest rate swaps and option contracts undertaken in response to customers' needs or for the Group's own asset and liability management purposes. To hedge against risks arising from derivative transactions undertaken for customers, the Bank enters into similar derivative contracts with other banks.

Derivative financial instruments are stated at fair value, with gains and losses arising recognised in the consolidated income statement.

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(d) Financial instruments *(continued)*

(vi) Embedded derivatives

An embedded derivative is a component of a hybrid (combined) instrument that includes both the derivative and a host contract with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. The embedded derivatives are separated from the host contract and accounted for as a derivative when (a) the economic characteristics and risks of the embedded derivative are not closely related to the host contract; and (b) the hybrid (combined) instrument is not measured at fair value with changes in fair value recognised in the consolidated income statement.

When the embedded derivative is separated, the host contract is accounted for in accordance with note 1(d)(i) above.

(e) Fixed assets and depreciation

Fixed assets, including investment properties, are stated at cost or deemed cost less accumulated depreciation. These also include land held under operating leases and buildings thereon, where the fair value of the leasehold interest in the land and buildings cannot be measured separately at the inception of the lease and the building is not clearly held under an operating lease.

Depreciation is calculated to write off the cost of fixed assets over their following estimated useful lives, after taking into account an estimated residual value at 3% of the cost of each asset, on a straight-line basis:

Land and buildings	20 years
Investment properties	20 years
Computer equipment	5 years
Motor vehicles and other equipment	5 years
Leasehold improvements	the shorter of the unexpired term of lease and the estimated useful lives, being no more than 5 years

Construction in progress represents property under construction and is stated at cost less impairment losses. Cost comprises the direct and indirect cost of construction. Construction in progress is transferred to an appropriate class of property and equipment when the asset is ready for its intended use. No depreciation is provided for construction in progress.

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(e) Fixed assets and depreciation *(continued)*

The carrying amount of fixed assets is reviewed periodically in order to assess whether the recoverable amount has declined below the carrying amount. When such a decline has occurred, the carrying amount is reduced to the recoverable amount. The amount of impairment loss is recognised in the consolidated income statement. The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present values.

Subsequent expenditure relating to a fixed asset is capitalised only when it is probable that future economic benefits associated with the fixed assets will flow to the Group. All other expenditure is recognised in the consolidated income statement as an expense as incurred.

Profits or losses on disposal of fixed assets are determined as the difference between the net disposal proceeds and the carrying amount of the fixed assets and are accounted for in the consolidated income statement as they arise.

(f) Land use rights

Land use rights are stated at cost, and are amortised on a straight-line basis over the respective lease periods of 40 – 50 years.

(g) Repossessed assets

Repossessed assets are measured at the lower of the carrying value of the related loans and advances and fair value less costs to sell at the date of exchange. They are not depreciated or amortised.

Impairment losses on initial classification and on subsequent remeasurement are recognised in the consolidated income statement.

(h) Operating leases

Leases of assets under which the lessor assumes substantially all the risks and benefits of ownership are classified as operating leases. Payments made under the leases are charged to the consolidated income statement in equal instalments over the accounting periods covered by the lease term.

(i) Repurchase and resale agreements

Securities sold under repurchase agreements are considered to be, in substance, secured loans borrowed. Therefore, the amounts received are included in "Amounts due to central bank" or "Placements from banks and other financial institutions", depending on the identity of the counterparty. Conversely securities or loans purchased subject to commitment to resell are considered as loans granted, and the amounts paid are accounted for as "Balances with central bank" or "Placements with banks and other financial institutions", depending on the identity of the counterparty.

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(i) Repurchase and resale agreements *(continued)*

The difference between the purchase and resale consideration or sale and repurchase consideration is amortised over the period of the transaction using the effective interest method and is included in interest income or expense, as appropriate.

(j) Impairment

(i) Financial assets

Financial assets are assessed at each balance sheet date to determine whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset and that event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Losses expected as a result of future events, no matter how likely, are not recognised because the necessary loss event has not yet occurred.

Impairment losses on loans and advances

The Group uses two methods of assessing impairment losses on loans and advances: those assessed individually and those assessed on a collective basis.

– *Individually assessed*

Loans and advances which are considered individually significant are assessed individually for impairment. This includes all loans and advances in the corporate lending portfolios.

Impairment allowances are made on individually impaired loans when there is objective evidence of impairment that will impact the estimated future cash flows of the loan. Individually impaired loans and advances are graded as substandard or below.

Impairment allowances of an individually impaired loan is measured as the difference between the loan's carrying amount and the present value of estimated future cash flows discounted at the loan's original effective interest rate. The carrying amount of the loan is reduced through the use of the allowances for impairment losses.

The calculation of the present value of the estimated future cash flows of a collateralised loan or receivable reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(j) Impairment *(continued)*

(i) Financial assets *(continued)*

Impairment losses on loans and advances *(continued)*

– *Collectively assessed*

Impairment allowances are calculated on a collective basis for the following:

– in respect of losses which have been incurred but have not yet been identified for loans subject to individual assessment for impairment; and

– for homogeneous groups of loans that are not considered individually significant, representing the retail lending portfolios.

Incurred but not yet identified impairment

If no objective evidence of impairment exists for an individually assessed loan on an individual basis, whether significant or not, the loans are grouped in a pool of loans with similar credit risk characteristics for the purpose of calculating a collective impairment allowance. This allowance covers loans that are impaired at the balance sheet date but will not be individually identified as such until some time in the future. As soon as information is available that specifically identifies objective evidence of impairment on individual loans in the pool of loans, those loans are removed from the pool. Loans that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment for impairment. The collective assessment allowance is determined after taking into account:

– the structure and risk characteristics of the Group's loan portfolio (indicating the borrower's ability to repay all loans) and the expected loss of the individual components of the loan portfolio based primarily on the historical loss experience;

– the emergence period between a loss occurring and that loss being identified and evidenced by the establishment of an allowance against the loss on an individual loan; and

– management's judgement as to whether the current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience.

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(j) Impairment *(continued)*

(i) Financial assets (continued)

Impairment losses on loans and advances *(continued)*

– *Collectively assessed (continued)*

Homogeneous groups of loans

Portfolios of homogeneous loans are collectively assessed using roll rate or historical loss rate methodologies. Overdue period represents the major observable objective evidence for impairment.

Impairment losses are recognised in the consolidated income statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. The reversal shall not result in a carrying amount of the loan that exceeds the amortised cost at the date the impairment is reversed had the impairment not been recognised. The amount of the reversal is recognised in the consolidated income statement.

Where the loan has no reasonable prospect of recovery, the loan is written off. Amount recovered from a loan that has been written off will be recognised as income through the impairment loss account in the consolidated income statement.

In the recovery of impaired loans, the Group may take repossession of the collateral assets through court proceedings or voluntary delivery of possession by the borrowers. Upon the seizure of these assets, the carrying value of the related loan principal and interest receivable are initially transferred to "Repossessed assets", and the respective allowances for impairment losses are transferred to "impairment allowance for repossessed assets".

Impairment losses on available-for-sale financial assets

When a decline in the fair value of an available-for-sale financial asset has been recognised in equity and there is objective evidence that an available-for-sale financial asset is impaired, the cumulative loss that had been recognised directly in equity is removed from equity and is recognised in the consolidated income statement even though the financial assets has not been derecognised.

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(j) Impairment *(continued)*

(i) Financial assets (continued)

Impairment losses on available-for-sale financial assets *(continued)*

The amount of the cumulative loss that is recognised in the consolidated income statement is the difference between the acquisition cost (net of any principal repayment and amortisation) and current fair value, less any impairment loss on that asset previously recognised in consolidated income statement. For an available-for-sale asset that is not carried at fair value as its fair value cannot be reliably measured, such as an unquoted equity instrument, the amount of any impairment loss is measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increases can be objectively related to an event occurring after the impairment loss was recognised in the consolidated income statement, the impairment loss is reversed, with the amount of the reversal being recognised in the consolidated income statement.

Impairment losses recognised in the consolidated income statement for an investment in an equity instrument classified as available-for-sale are not reversed through the consolidated income statement. Any subsequent increase in the fair value of these assets is recognised directly in equity.

(ii) Impairment losses on other assets

The carrying amounts of the Group's other assets are reviewed periodically by the Directors to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. The recoverable amount is the estimated cash proceeds from the disposal of the assets or the present value of the future cash inflow. An impairment loss is recognised in the consolidated income statement when the net carrying amount of an asset exceeds its recoverable amount.

If there are evidences that the impairment losses previously recognised do not exist or have been reduced, reversals of the impairment losses are credited to the consolidated income statement in the period in which the reversals are recognised.

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(k) Convertible bonds issued

At initial recognition the liability component of the convertible bonds issued is calculated as the present value of the future interest and principal payments, discounted at the market rate of interest applicable at the time of initial recognition to similar debt securities that do not have a conversion option. The liability component is subsequently carried at amortised cost until it is converted or redeemed. Any excess of proceeds over the amount initially recognised as the liability component is in substance an option and is recognised as the equity component in the capital reserve.

If the bond is converted into shares, the carrying value of the liability component and any interest payable at the time of conversion, are transferred to "share capital" based on the numbers of shares issued at par and the differences are recognised as share premium in capital reserve.

(l) Financial guarantee issued, provisions and contingent liabilities

(i) Financial guarantees issued

Financial guarantees are contracts that require the issuer (i.e. the guarantor) to make specified payments to reimburse the beneficiary of the guarantee (the holder) for a loss the holder incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

Where the Group issues a financial guarantee to customers, the fair value of the guarantee (being the guarantee fees received) is initially recognised as deferred income within other liabilities.

The deferred income is amortised in the income statement over the term of the guarantee as income from financial guarantees issued. In addition, provisions are recognised in accordance with note 2(l)(ii) if and when (i) it becomes probable that the holder of the guarantee will call upon the Group under the guarantee, and (ii) the amount of that claim on the Group is expected to exceed the amount currently carried in other liabilities in respect of that guarantee i.e. the amount initially recognised, less accumulated amortisation.

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(l) Financial guarantee issued, provisions and contingent liabilities *(continued)*

(ii) Other provisions and contingent liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Group has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditures expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

(m) Income recognition

(i) Interest income

Interest income is recognised in the consolidated income statement on an accruals basis, taking into account the effective interest rate of the instrument or an applicable floating rate. Interest income includes the amortisation of any discount or premium or other differences between the initial carrying amount of any interest bearing instrument and its amount at maturity calculated on an effective interest rate basis.

When a financial asset or a group of financial assets are impaired, interest income is recognised on the impaired financial assets using the rate of interest used to discount future cash flows for the purpose of measuring the related impairment loss.

(ii) Fee and commission income

Fee and commission income is recognised in the consolidated income statement when the corresponding service is provided.

(iii) Dividend income

– Dividend income from listed investments is recognised when the underlying investment is declared ex-dividend.

– Where the investments are unlisted, interim dividend income is recognised when declared by the Board of Directors of the investees. Final dividend income is recognised only when the amount proposed by the Board of Directors of the investees is approved by shareholders at general meetings.

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(n) Taxation

(i) Income tax

Income tax in the consolidated income statement comprises current tax and movement in deferred tax. Income tax is recognised in the consolidated income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year calculated based on the Accounting Standards for Business Enterprises issued by Ministry of Finance of the PRC (the "MOF"), the Accounting Regulations for Financial Enterprises (2001), and other relevant regulations issued by the MOF collectively and adjusted for items based on the prevailing tax laws and interpretations, using PRC tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided, using the balance sheet liability method, for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date.

When it is probable that the future taxable profit will be available to utilise the above timing differences, a deferred tax asset will be recognised. Deferred tax assets are reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the related tax benefit to be utilised.

(ii) Other taxes

Other taxes, including business tax and surcharges and property tax, are calculated at respective tax rates enacted at the balance sheet date and are included in the operating expenses.

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(o) Foreign currency translations

Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated into RMB at the foreign exchange rates ruling at that date. Non-monetary assets and liabilities, and share capital which are measured at historical cost in a foreign currency are translated into RMB at the foreign exchange rates ruling at the date of the transaction, whilst those stated at fair value are translated into RMB at the foreign exchange rate ruling at the date of valuation. Income and expenses denominated in foreign currencies are translated at the exchange rates ruling at the dates of the transactions. When the gain or loss on a non-monetary item is recognised directly in equity, any exchange component of that gain or loss is recognised directly in equity, all other foreign exchange differences arising on settlement and translation of monetary and non-monetary assets and liabilities are recognised in the consolidated income statement.

(p) Offsetting

Financial assets and liabilities are offset and the net amount is reported in the consolidated balance sheet when the Group has a legally enforceable right to set off the recognised amounts and the transactions are intended to be settled on a net basis.

(q) Employee benefits

(i) Salaries and staff welfare

Salaries, bonus and other benefits are accrued in the period in which the associated services are rendered by employees.

(ii) Post employment benefits

The Group participates in a number of defined contribution retirement benefit schemes managed by different provincial governments or independent insurance companies. Obligation for contributions to these schemes are jointly borne by the Group and the staff, and contributions paid by the Group are recognised as an expense in the consolidated income statement as incurred.

(r) Related parties

For the purposes of these financial statements, parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control or common significant influence. Related parties may be individuals (being members of key management personnel, significant shareholders and/or their close family members) or other entities and include entities which are under the significant influence of related parties of the Group where those parties are individuals, and post-employment benefit plans which are for the benefit of employees of the Group or of any entity that is a related party of the Group.

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(s) Segmental reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services ("business segment") or in providing products or services within a particular economic environment ("geographical segment"), which is subject to risks and rewards that are different from those of other segments.

(t) Fiduciary activities

The Group acts in a fiduciary capacity in entrusted loan and entrusted investment business. Assets held by the Group and the related undertakings to return such assets to customers are excluded from the balance sheets as the risks and rewards of the assets reside with the customers.

(u) Dividends or profit distributions

Dividends or profit distributions are recognised as a liability in the year in which they are approved and declared.

3 INTEREST INCOME

	2006	2005
Loans and advances (note)	**26,891**	21,058
Balances with central bank	**1,044**	836
Deposits and placements with		
– banks	**1,782**	838
– other financial institutions	**354**	164
Debt investments	**3,919**	2,981
Interest income on financial assets that are not at fair value through profit or loss	**33,990**	25,877

Note: Included in the above is interest income of RMB223 million accrued on impaired loans for the year ended 31 December 2006 (2005: RMB260 million).

(Expressed in millions of Renminbi unless otherwise stated)

4 INTEREST EXPENSE

	2006	2005
Deposits from customers	**10,449**	7,558
Deposits and placements from		
– banks	**424**	412
– other financial institutions	**1,127**	664
Issued debts	**481**	601
	12,481	9,235

5 FEE AND COMMISSION INCOME

	2006	2005
Bank card fees	**1,003**	570
Remittance and settlement fees	**607**	429
Agency services fees	**571**	315
Commissions from credit commitment and loan business	**267**	186
Trust services fees	**259**	101
Others	**281**	255
	2,988	1,856

6 OTHER NET INCOME

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

7 OPERATING EXPENSES

	2006	2005
Staff costs		
– salaries, bonuses and staff welfare (note (i))	**3,872**	3,335
– contributions to defined retirement contribution schemes	**500**	428
– housing allowances	**386**	250
– others	**295**	228
	5,053	4,241
Business tax and surcharges	**1,573**	1,219
Depreciation	**910**	854
Rental expenses	**831**	693
Other general and administrative expenses	**2,724**	2,108
	11,091	9,115

Notes:

(i) Included in the above salaries and bonuses is performance bonus, the details of which are disclosed in note 27(d).

(ii) Auditors' remuneration amounted to RMB5 million for 2006 (2005: RMB5 million) and non-audit service fee paid to auditors was RMB1 million for 2006 (2005: RMB1 million).

(Expressed in millions of Renminbi unless otherwise stated)

8 DIRECTORS' AND SUPERVISORS' EMOLUMENTS

The emoluments of the Directors' and Supervisors' during the year are as follows:

	2006					
	Directors' fees RMB'000	Salaries, allowances and benefits in kind RMB'000	Discretionary bonuses RMB'000	Share-based payments RMB'000	Retirement scheme contributions RMB'000	Total RMB'000
Executive directors						
Ma Wei Hua	–	4,200	3,506	–	927	8,633
Chen Wei	–	2,100	1,753	–	311	4,164
Non-executive directors						
Qin Xiao	–	–	–	–	–	–
Wei Jia Fu	–	–	–	–	–	–
Fu Yu Ning	–	–	–	–	–	–
Li Yin Quan	–	–	–	–	–	–
Huang Da Zhan	–	–	–	–	–	–
Tan Yue Heng	–	–	–	–	–	–
Sun Yue Ying	–	–	–	–	–	–
Wang Da Xiong	–	–	–	–	–	–
Fu Jun Yuan	–	–	–	–	–	–
Independent non-executive directors and supervisors						
Wu Jie Si	172	–	–	–	–	172
Lin Chu Xue	173	–	–	–	–	173
Austin Hu Chang Tau	173	–	–	–	–	173
Edward Chow Kwong Fai	138	–	–	–	–	138
Liu Yong Zhang	138	–	–	–	–	138
Liu Hong Xia	138	–	–	–	–	138
Shi Ji Liang	263	–	–	–	–	263
Zhu Gen Lin	–	–	–	–	–	–
Chen Hao Ming	–	–	–	–	–	–
Li Yi	–	–	–	–	–	–
Lu Yu Huan	–	–	–	–	–	–
Lin Rong Guang	–	896	382	–	256	1,534
Xiang You Zhi	–	558	240	–	94	892
Zhou Wen Qiong	–	319	140	–	82	541
Shao Rui Qing	138	–	–	–	–	138
Zhang Yu Qing	35	–	–	–	–	35
Yang Jun	35	–	–	–	–	35
Lu Ren Fa	35	–	–	–	–	35
Ding Hui Ping	35	–	–	–	–	35
Wang Qi Yan	35	–	–	–	–	35
	1,508	8,073	6,021	–	1,670	17,272

8 DIRECTORS' AND SUPERVISORS' EMOLUMENTS *(continued)*

The emoluments of the Directors' and Supervisors' during the year are as follows: *(continued)*

	2005					
	Directors' fees RMB'000	Salaries, allowances and benefits in kind RMB'000	Discretionary bonuses RMB'000	Share-based payments RMB'000	Retirement scheme contributions RMB'000	Total RMB'000
Executive directors						
Ma Wei Hua	–	3,187	4,820	–	260	8,267
Chen Wei	–	1,559	2,200	–	129	3,888
Non-executive directors						
Qin Xiao	–	–	–	–	–	–
Wei Jia Fu	–	–	–	–	–	–
Fu Yu Ning	–	–	–	–	–	–
Li Yin Quan	–	–	–	–	–	–
Huang Da Zhan	–	–	–	–	–	–
Tan Yue Heng	–	–	–	–	–	–
Sun Yue Ying	–	–	–	–	–	–
Wang Da Xiong	–	–	–	–	–	–
Fu Jun Yuan	–	–	–	–	–	–
Independent non-executive directors and supervisors						
Wu Jie Si	26	–	–	–	–	26
Lin Chu Xue	80	–	–	–	–	80
Austin Hu Chang Tau	–	–	–	–	–	–
Yang Jun	80	–	–	–	–	80
Lu Ren Fa	80	–	–	–	–	80
Ding Hui Ping	80	–	–	–	–	80
Wang Qi Yan	80	–	–	–	–	80
Zhu Gen Lin	–	–	–	–	–	–
Chen Hao Ming	–	–	–	–	–	–
Li Yi	–	–	–	–	–	–
Lu Yu Huan	–	–	–	–	–	–
Zhang Yu Qing	80	–	–	–	–	80
Lin Rong Guang	–	768	300	–	72	1,140
Xiang You Zhi	–	465	50	–	31	546
Zhou Wen Qiong	–	379	30	–	24	433
He Di	54	–	–	–	–	54
Hu Chang Tao	80	–	–	–	–	80
	640	6,358	7,400	–	516	14,914

(Expressed in millions of Renminbi unless otherwise stated)

8 DIRECTORS' AND SUPERVISORS' EMOLUMENTS *(continued)*

The number of the Directors and Supervisors whose emoluments are within the following bands is set out below.

RMB	**2006**	2005
Nil – 500,000	**26**	24
500,001 – 1,000,000	**2**	1
1,000,001 – 1,500,000	**–**	1
1,500,001 – 2,000,000	**1**	–
3,500,001 – 4,000,000	**–**	1
4,000,001 – 4,500,000	**1**	–
8,000,001 – 8,500,000	**–**	1
8,500,001 – 9,000,000	**1**	–
	31	28

None of the Directors and Supervisors received any inducements, or compensation for loss of office, or waived any emoluments during the year.

9 INDIVIDUALS WITH HIGHEST EMOLUMENTS

Of the five individuals with the highest emoluments for the year ended 31 December 2006, 2 (2005: 2) are Directors or Supervisors whose emoluments are included in Note 8 above. The aggregate of the emoluments in respect of the five individuals during the year is as follows:

	2006 **RMB'000**	2005 RMB'000
Salaries and other emoluments	**12,653**	8,794
Discretionary bonuses	**10,226**	11,960
Contributions to defined contribution retirement schemes	**2,430**	723
	25,309	21,477

9 INDIVIDUALS WITH HIGHEST EMOLUMENTS *(continued)*

The number of the five highest paid individuals whose emoluments fell within the following bands is set out below:

RMB	**2006**	2005
2,000,001 – 2,500,000	**–**	1
2,500,001 – 3,000,000	**–**	1
3,500,001 – 4,000,000	**1**	2
4,000,001 – 4,500,000	**3**	–
8,000,001 – 8,500,000	**–**	1
8,500,001 – 9,000,000	**1**	–

10 LOANS TO DIRECTORS, SUPERVISORS AND OFFICERS

Loans to Directors, Supervisors and Officers of the Bank disclosed pursuant to section 161B of the Hong Kong Companies Ordinance are as follows:

	2006	2005
Aggregate amount of relevant loans made by the Bank outstanding at year end	**7**	2

	2006	2005
Maximum aggregate amount of relevant loans made by the Bank outstanding during the year	**9**	4

11 PROVISION FOR IMPAIRMENT LOSSES

	2006	2005
Impairment losses charged/(released) on:		
– loans and advances (Note 17(c))	**3,537**	3,575
– deposits and placements with banks and other financial institutions	**(91)**	62
– other assets	**245**	–
	3,691	3,637

(Expressed in millions of Renminbi unless otherwise stated)

12 INCOME TAX

(a) Income tax in the consolidated income statement represents:

	2006	2005
Current tax	**3,347**	3,025
Deferred tax	**(57)**	(312)
	3,290	2,713

(b) A reconciliation of income tax expense in the consolidated income statement and that calculated at the applicable tax rate is as follows:

	2006	2005
Profit before tax	**10,084**	6,462
Notional tax on profit before tax, calculated at the statutory tax rate of 33%	**3,328**	2,133
Add/(less) the tax effect of the following items:		
– Non-deductible expenses	**198**	861
– Non-taxable income	**(209)**	(237)
– Different income tax rates in other areas	**(331)**	(133)
– Others	**304**	89
Income tax expense	**3,290**	2,713

Notes:

(i) Pursuant to the approval (Cai Shui 2007 No. 63) issued by the MOF and the State Administration of Taxation on 9 April 2007, the Bank's deductible salary expense for the year ended 31 December 2006 was approved to be RMB3.45 billion. The above tax concession is not applicable to the year ended 31 December 2005.

(ii) The income tax rates applicable to the Bank's operations in certain areas such as Shenzhen Special Economic Zone and Urumqi are 15% and 16.5% respectively during the year.

13 EARNINGS PER SHARE

Movements of the share capital are included in Note 28 of the financial statements.

(a) Basic earnings per share

The calculation of basic earnings per share is based on the net profit attributable to equity holders of the Bank and the weighted average number of shares in issue, calculated as follows:

	2006	2005
Net profit	**6,794**	3,749
Weighted average number of shares in issue (in million)	**12,833**	11,166
Basic earnings per share (in RMB)	**0.53**	0.34

(b) Diluted earnings per share

The calculation of diluted earnings per share is based on the diluted net profit and the weighted average number of shares in issue after adjusting for the effect of all dilutive potential shares, calculated as follows:

	2006	2005
Net profit	**6,794**	3,749
Interest expense on convertible bonds issued	**9**	282
Diluted net profit	**6,803**	4,031
Weighted average number of shares in issue (in million)	**12,833**	11,166
Effect of deemed conversion of convertible bonds (in million)	**60**	1,122
Weighted average number of shares in issue after dilution (in million)	**12,893**	12,288
Diluted earnings per share (in RMB)	**0.53**	0.33

(Expressed in millions of Renminbi unless otherwise stated)

14 CASH AND BALANCES WITH BANKS AND OTHER FINANCIAL INSTITUTIONS

	2006	2005
Cash	**4,622**	3,915
Balances with banks	**16,267**	18,603
Balances with other financial institutions	**6**	71
	20,895	22,589
Less: Impairment loss		
– banks	**(30)**	(27)
– other financial institutions	**(4)**	(71)
	(34)	(98)
	20,861	22,491

15 BALANCES WITH CENTRAL BANK

	2006	2005
Statutory deposit reserve funds	**57,364**	39,909
Surplus deposit reserve funds	**24,702**	21,966
Fiscal deposits	**306**	227
	82,372	62,102

The statutory deposit reserve funds are not available for the Group's daily operations. The statutory deposit reserve funds are calculated at 9% and 4% for eligible RMB deposits and foreign currency deposits respectively as at 31 December 2006 (2005: 7.5% and 3% for eligible RMB deposits and foreign currency deposits). Eligible deposits include deposits from government authorities and other organisations, fiscal deposits (other than budgets), retail deposits, corporate deposits, net credit balances of entrusted business and other deposits.

16 PLACEMENTS WITH BANKS AND OTHER FINANCIAL INSTITUTIONS

	2006	2005
Money market placements		
– banks	**38,843**	22,930
– other financial institutions	**10,390**	22
	49,233	22,952
Balances under resale agreements		
– banks	**17,770**	14,153
– other financial institutions	**21,294**	10,126
	39,064	24,279
	88,297	47,231
Less: Impairment loss		
– banks	**(57)**	(49)
– other financial institutions	**(69)**	(200)
	(126)	(249)
	88,171	46,982

Assets purchased under the above resale agreements are registered national bonds issued by the PRC government, bonds issued by the PBOC and policy banks and other debt securities of equivalent amounts.

(Expressed in millions of Renminbi unless otherwise stated)

17 LOANS AND ADVANCES TO CUSTOMERS

(a) Loans and advances to customers

	2006	2005
Corporate loans	**359,883**	298,622
Discounted bills	**103,836**	99,527
Retail loans	**101,983**	74,036
Gross loans and advances to customers	**565,702**	472,185
Less: Allowances for impairment losses	**(16,282)**	(13,510)
Net loans and advances to customers	**549,420**	458,675

(b) Analysis of loans and advances to customers

(i) Analysed by legal form of borrowers:

	2006	2005
Domestic enterprises:		
State-owned enterprises	**142,804**	111,779
Joint-stock enterprises	**42,642**	48,576
Other limited liability enterprises	**72,608**	47,619
Others	**44,783**	43,803
	302,837	251,777
Foreign-invested enterprises	**52,391**	43,418
Enterprises operating in the Mainland	**355,228**	295,195
Enterprises operating outside the Mainland	**4,655**	3,427
Corporate loans	**359,883**	298,622
Discounted bills	**103,836**	99,527
Retail loans	**101,983**	74,036
Gross loans and advances to customers	**565,702**	472,185

17 LOANS AND ADVANCES TO CUSTOMERS *(continued)*

(b) Analysis of loans and advances to customers *(continued)*

(ii) Analysed by borrowers' industry sector:

	2006	2005
Manufacturing	**82,527**	75,735
Transportation and telecommunications	**81,789**	66,154
Energy and resources	**62,046**	44,820
Trading	**30,983**	33,966
Property development and investment	**26,775**	20,089
Investment management	**23,840**	16,604
Hospitality	**9,514**	7,513
Infrastructure and construction	**12,562**	11,305
Others	**29,847**	22,436
Corporate loans	**359,883**	298,622
Discounted bills	**103,836**	99,527
Credit cards	**10,146**	4,550
Mortgages	**81,383**	64,609
Others	**10,454**	4,877
Retail loans	**101,983**	74,036
Gross loans and advances to customers	**565,702**	472,185

(c) Movements of allowances for impairment losses

	2006	2005
At 1 January	**13,510**	10,920
Charge for the year (Note 11)	**4,152**	4,031
Releases for the year (Note 11)	**(615)**	(456)
Unwinding of discount	**(222)**	(244)
Recoveries of loans and advances previously written off	**58**	84
Write-offs	**(328)**	(745)
Transfers out	**(188)**	(2)
Exchange differences	**(85)**	(78)
At 31 December	**16,282**	13,510

(Expressed in millions of Renminbi unless otherwise stated)

17 LOANS AND ADVANCES TO CUSTOMERS *(continued)*

(d) Loans and advances to customers and allowances for impairment losses

	2006				
	Loans and advances for which impairment losses are collectively assessed	Impaired loans and advances for which impairment losses are collectively assessed	Impaired loans and advances for which impairment losses are individually assessed	Total	Gross impaired loans and advances as a % of gross loans and advances
Gross loans and advances to					
– financial institutions	10,094	–	–	10,094	0.00
– non-financial institution customers	543,602	557	11,449	555,608	2.16
	553,696	557	11,449	565,702	2.12
Less:					
Allowances for impairment losses on loans and advances to					
– financial institutions	(41)	–	–	(41)	
– non-financial institution customers	(7,964)	(404)	(7,873)	(16,241)	
	(8,005)	(404)	(7,873)	(16,282)	
Net loans and advances to					
– financial institutions	10,053	–	–	10,053	
– non-financial institution customers	535,638	153	3,576	539,367	
	545,691	153	3,576	549,420	

17 LOANS AND ADVANCES TO CUSTOMERS *(continued)*

(d) Loans and advances to customers and allowances for impairment losses *(continued)*

	2005				
	Loans and advances	Impaired loans and advances			Gross impaired loans and advances as a % of gross loans and advances
	for which impairment losses are collectively assessed	for which impairment losses are collectively assessed	for which impairment losses are individually assessed	Total	
Gross loans and advances to					
– financial institutions	2,567	–	–	2,567	0.00
– non-financial institution customers	457,451	460	11,707	469,618	2.59
	460,018	460	11,707	472,185	2.58
Less:					
Allowances for impairment losses on loans and advances to					
– financial institutions	(19)	–	–	(19)	
– non-financial institution customers	(6,116)	(315)	(7,060)	(13,491)	
	(6,135)	(315)	(7,060)	(13,510)	
Net loans and advances to					
– financial institutions	2,548	–	–	2,548	
– non-financial institution customers	451,335	145	4,647	456,127	
	453,883	145	4,647	458,675	

(Expressed in millions of Renminbi unless otherwise stated)

18 INVESTMENTS

	2006	2005
Financial assets at fair value through profit or loss (Note 18(a))	**7,960**	15,869
Available-for-sale investments (Note 18(b))	**109,476**	60,086
Held-to-maturity debt securities (Note 18(c))	**54,065**	48,711
Receivables (Note 18(d))	**7,384**	7,236
	178,885	131,902

(a) Financial assets at fair value through profit or loss

	2006	2005
(i) Trading assets		
Listed/quoted		
In the Mainland		
– PRC government bonds	**11**	275
– bonds issued by the PBOC	**1,993**	5,081
– bonds issued by policy banks	**1,512**	3,507
– other debt securities	**1,360**	1,003
– equity investments	**–**	30
Outside the Mainland		
– other debt securities	**–**	141
– equity investments	**–**	2
	4,876	10,039
Derivative financial instruments (Note 39(g))	**203**	86
	5,079	10,125

18 INVESTMENTS *(continued)*

(a) Financial assets at fair value through profit or loss *(continued)*

		2006	2005
(ii)	**Financial assets designated at fair value through profit or loss**		
	Listed/quoted		
	In the Mainland		
	– PRC government bonds	**2,441**	5,248
	– bonds issued by policy banks	**440**	496
		2,881	5,744
		7,960	15,869
	Financial assets at fair value through profit or loss (excluding derivative financial instruments)		
	Issued by:		
	Central governments	**2,452**	5,523
	Central banks	**1,993**	5,081
	Policy banks	**1,952**	4,003
	Banks and other financial institutions	**–**	141
	Corporate entities	**1,360**	1,035
		7,757	15,783

(Expressed in millions of Renminbi unless otherwise stated)

18 INVESTMENTS *(continued)*

(b) Available-for-sale investments

	2006	2005
Listed/quoted		
In the Mainland		
– PRC government bonds	**7,387**	7,891
– bonds issued by the PBOC	**38,748**	20,612
– bonds issued by policy banks	**20,950**	9,751
– other debt securities	**13,822**	6,804
Outside the Mainland		
– other debt securities	**8,879**	4,901
– investments in funds	**6,914**	1,211
	96,700	51,170
Unlisted/unquoted		
In the Mainland		
– bonds issued by the PBOC	**4,951**	6,890
– bonds issued by policy banks	**5,461**	–
– other debt securities	**401**	1
– equity investments	**38**	38
Outside the Mainland		
– other debt securities	**1,915**	1,979
– equity investments	**10**	8
	12,776	8,916
	109,476	60,086

18 INVESTMENTS *(continued)*

(b) Available-for-sale investments *(continued)*

	2006	2005
Issued by:		
Central governments	**7,387**	7,891
Central banks	**43,699**	27,502
Policy banks	**26,411**	9,751
Banks and other financial institutions	**18,922**	7,627
Public sector entities	**1,085**	611
Corporate entities	**11,972**	6,704
	109,476	60,086

(c) Held-to-maturity debt securities

	2006	2005
Listed/quoted		
In the Mainland		
– PRC government bonds	**13,773**	15,321
– bonds issued by the PBOC	**2,270**	1,137
– bonds issued by policy banks	**28,626**	23,532
– other debt securities	**3,511**	1,934
Outside the Mainland		
– other debt securities	**5,885**	6,787
	54,065	48,711
Fair value	**54,335**	48,997
Issued by:		
Central governments	**13,802**	15,765
Central banks	**2,270**	1,137
Policy banks	**28,626**	23,532
Banks and other financial institutions	**5,136**	4,932
Public sector entities	**1,435**	1,821
Corporate entities	**2,796**	1,524
	54,065	48,711

(Expressed in millions of Renminbi unless otherwise stated)

18 INVESTMENTS *(continued)*

(d) Receivables

	2006	2005
In the Mainland		
– PRC government bonds	**5,506**	5,388
Outside the Mainland		
– other debt securities	**1,878**	1,848
	7,384	7,236
Issued by:		
Central governments	**5,710**	5,596
Banks and other financial institutions	**1,362**	1,479
Corporate entities	**312**	161
	7,384	7,236

Receivables are unlisted/unquoted bearer's national bonds issued by the PRC government and other debt investments which the Group has the intention and ability to hold to maturity. These receivables are not quoted in an active market in the PRC or overseas. Accordingly, the Group is unable to disclose their market values. The Group considers the recoverable amounts from these assets upon their maturities are the same as their carrying values and no provision for impairment losses is required.

(e) Financial liabilities at fair value through profit or loss

	2006	2005
Derivative financial instruments (Note 39(g))	**106**	86

18 INVESTMENTS *(continued)*

(f) In June 2006, the Bank entered into an agreement with three independent third parties and China Merchants Securities Company, a related company of the Bank, to acquire 30% and 3.4% equity interest in China Merchants Fund Management Company ("CMFM") respectively for a total consideration of RMB197.7 million. The completion of the acquisition is subject to obtaining approvals from relevant regulatory authorities including the CSRC and the China Banking Regulatory Commission (the "CBRC"). As of 31 December 2006, the proposed acquisition had been approved by the CBRC but yet to be approved by the CSRC.

Upon completion of the transaction, the Group's investment in CMFM will be recognised as an investment in an associated company. The investment in an associated company and any goodwill arising will be accounted for in the consolidated financial statements in accordance with IFRSs.

19 FIXED ASSETS

2006

	Land and buildings	Investment properties (Note 19(b))	Construction in progress (Note 19(c))	Computer equipment	Leasehold improvements	Motor vehicles and other equipment	Total
Cost:							
At 1 January 2006	4,086	558	1,121	2,673	1,120	910	10,468
Additions	83	–	610	694	218	163	1,768
Transfers	491	26	(590)	–	73	–	–
Disposals/write-offs	(102)	–	(5)	(353)	–	(60)	(520)
At 31 December 2006	4,558	584	1,136	3,014	1,411	1,013	11,716
Accumulated depreciation:							
At 1 January 2006	986	100	–	1,423	610	572	3,691
Depreciation	195	46	–	396	151	122	910
Written back on disposals/ write-offs	(28)	–	–	(186)	–	(47)	(261)
At 31 December 2006	1,153	146	–	1,633	761	647	4,340
Net book value:							
At 31 December 2006	3,405	438	1,136	1,381	650	366	7,376

for the year ended 31 December 2006
(Expressed in millions of Renminbi unless otherwise stated)

19 FIXED ASSETS *(continued)*

2005

	Land and buildings	Investment properties (Note 19(b))	Construction in progress (Note 19(c))	Computer equipment	Leasehold improvements	Motor vehicles and other equipment	Total
Cost:							
At 1 January 2005	4,160	296	810	2,311	952	839	9,368
Additions	68	–	402	497	169	120	1,256
Transfers	(100)	262	(90)	–	–	–	72
Disposals/write-offs	(42)	–	(1)	(135)	(1)	(49)	(228)
At 31 December 2005	4,086	558	1,121	2,673	1,120	910	10,468
Accumulated depreciation:							
At 1 January 2005	835	22	–	1,191	460	494	3,002
Depreciation	184	34	–	367	150	119	854
Transfers	(20)	44	–	–	–	–	24
Written back on disposals/ write-offs	(13)	–	–	(135)	–	(41)	(189)
At 31 December 2005	986	100	–	1,423	610	572	3,691
Net book value:							
At 31 December 2005	3,100	458	1,121	1,250	510	338	6,777

19 FIXED ASSETS *(continued)*

(a) Analysed by remaining terms of leases

The net book value of land and buildings, and investment properties at the balance sheet date is analysed by the remaining terms of the leases as follows:

	2006	2005
Held in the PRC		
– long term leases (over 50 years)	**467**	423
– medium term leases (10 – 50 years)	**3,309**	3,064
	3,776	3,487
Held in Hong Kong		
– medium term leases (10 – 50 years)	**67**	71
	3,843	3,558

(b) Investment properties mainly represent the portion of the Bank's headquarters in Shenzhen that has been leased out under operating leases or is available for lease. As at 31 December 2006, fair value of these properties was RMB0.75 billion (2005: RMB0.75 billion). Leases of investment properties run for periods of less than 5 years. The Group's rental income to be received over the remaining terms of the non-cancellable operating leases was RMB131 million as at 31 December 2006 (2005: RMB74 million).

(c) As at 31 December 2006 and 31 December 2005, there was cost of land use right of RMB387 million included in the construction in progress. For the year ended 31 December 2006, the amortisation of the land use right of RMB8.65 million was capitalised as the cost of the properties built on the land (2005: RMB8.65 million). Upon completion of the construction, the property will be transferred to relevant asset categories based on the intention of usage.

(d) As at the balance sheet date, the Directors considered that there was no impairment loss on fixed assets.

(e) As at 31 December 2006, ownership documentation for the Group's properties with a net carrying value of RMB539 million (2005: RMB1,218 million) was being finalised.

(Expressed in millions of Renminbi unless otherwise stated)

20 DEFERRED TAX

(a) Recognised deferred tax assets

The components of deferred tax assets/(liabilities) are as follows:

	2006	2005
Impairment losses on loans and advances to customers and other assets	**2,384**	2,292
Investment revaluation reserve	**(34)**	(71)
Others	**(90)**	(55)
	2,260	2,166

(b) Movements of deferred tax

	Impairment losses on loans and advances to customers and other assets	Write-off of overdue interest receivable	Investment revaluation reserve	Others	Total
At 1 January 2006	**2,292**	**–**	**(71)**	**(55)**	**2,166**
Credited/(charged) to consolidated income statement	**366**	**–**	**–**	**(35)**	**331**
Credited to reserves	**–**	**–**	**37**	**–**	**37**
Write-offs	**(274)**	**–**	**–**	**–**	**(274)**
At 31 December 2006	**2,384**	**–**	**(34)**	**(90)**	**2,260**
At 1 January 2005	1,884	86	12	(45)	1,937
Credited/(charged) to consolidated income statement	478	(86)	–	(10)	382
Charged to reserves	–	–	(83)	–	(83)
Write-offs	(70)	–	–	–	(70)
At 31 December 2005	2,292	–	(71)	(55)	2,166

21 OTHER ASSETS

	2006	2005
Interest receivable		
– debt securities	**1,623**	1,497
– loans and advances to customers	**952**	705
– others	**231**	62
	2,806	2,264
Amounts pending for settlement	**937**	185
Repossessed assets	**390**	579
Prepaid lease payments	**125**	89
Others	**499**	401
	4,757	3,518

22 DEPOSITS FROM BANKS AND OTHER FINANCIAL INSTITUTIONS

	2006	2005
Deposits from banks	**5,636**	8,928
Deposits from other financial institutions	**63,218**	30,745
	68,854	39,673

23 PLACEMENTS FROM BANKS AND OTHER FINANCIAL INSTITUTIONS

	2006	2005
Money market takings		
– banks	**1,512**	424
Balances under repurchase agreements		
– banks	**2,056**	1,505
– other financial institutions	**1,076**	1,537
	3,132	3,042
Rediscounted bills	**3,105**	108
	7,749	3,574

Assets sold under the above repurchase agreements are registered national bonds issued by the PRC government, bonds issued by policy banks and other debt securities of equivalent amounts.

(Expressed in millions of Renminbi unless otherwise stated)

24 DEPOSITS FROM CUSTOMERS

	2006	2005
Demand deposits		
– corporate customers	**257,235**	219,230
– retail customers	**152,449**	118,566
	409,684	337,796
Time deposits		
– corporate customers	**204,563**	159,245
– retail customers	**159,510**	137,363
	364,073	296,608
	773,757	634,404

25 ISSUED DEBT SECURITIES

(a) Certificates of deposit issued

On 21 June 2004, the Bank issued 3-year certificates of deposit at a nominal value of US$150 million with interest at LIBOR +0.35% per annum payable quarterly.

(b) Convertible bonds issued

On 10 November 2004, the Bank issued a 5-year convertible bond with a nominal value of RMB6,500 million. The interest rates are 1.0% for the first year, 1.375% for the second year, 1.75% for the third year, 2.125% for the forth year and 2.5% for the fifth year, payable on 10 November each year. The convertible bonds can be converted into the Bank's shares at the holder's option at RMB9.34 per share during the period from 10 May 2005 to 10 November 2009. Upon maturity, an additional 6% interest will be given to bond holders who have not converted the bonds into shares.

The conversion price of the bonds was revised from RMB9.34 per share to RMB6.23 per share with effect from 17 June 2005 following the issue of bonus shares by the Bank in 2005.

The conversion price of the bonds has been further revised from RMB6.23 per share to RMB5.74 per share with effect from 24 February 2006 following the issue of bonus shares by the Bank in 2006.

25 ISSUED DEBT SECURITIES *(continued)*

(b) Convertible bonds issued *(continued)*

On 25 September 2006, the convertible bonds of the Bank in circulation were less than RMB30 million. Pursuant to the relevant requirements, the convertible bonds were suspended for trading with effect from 29 September 2006. Holders of convertible bonds can convert the bonds into share anytime before the conversion period expires.

The Bank has an early redemption option which commences six months after the bonds' issue date and lapses on the maturity date. During that period, the Bank may redeem any outstanding convertible bonds at 103% of the nominal value of the convertible bonds plus the accrued interest if the closing price of the Bank's listed A-Shares is more than 125% of the then applicable conversion price for 20 consecutive business days.

During the final year before the maturity date of the convertible bonds, if the last traded price of the Bank's listed A-Shares falls below 75% of the conversion price for 20 consecutive trading days, the bond holders can exercise the put option to sell to the Bank all or a portion of the outstanding bonds at 108.5% of the nominal value of the convertible bonds plus accrued interest.

Details of the convertible bonds are as follows:

	2006	2005
Initial recognition:		
– Nominal value	**6,500**	6,500
– Issuance cost	**(65)**	(65)
– Equity component	**(918)**	(918)
Liability component at issue date	**5,517**	5,517
Accretion	**234**	227
Amounts converted to shares	**(5,729)**	(560)
Liability component as at 31 December	**22**	5,184

(Expressed in millions of Renminbi unless otherwise stated)

25 ISSUED DEBT SECURITIES *(continued)*

(c) Other debts issued

Particulars	Terms	Date of issue	Annual fixed interest rate (%)	Nominal value (in million)
Fixed term notes	36 months	From 13 October 2005 to 26 October 2005	2.13	5,000
Fixed term notes	60 months	From 13 October 2005 to 26 October 2005	2.56	5,000

The CBRC and the PBOC approved the Bank's issuance of a total of RMB15,000 million fixed term notes on 29 September 2005 (Yin Jian Fu【2005】No. 252) and 9 October 2005 (Yin Fu【2005】No. 75). The Bank issued a total of RMB10,000 million fixed rate term notes during the period from 13 October 2005 to 26 October 2005. Interest on these notes is payable annually.

(d) Subordinated notes issued

Particulars	Terms	Date of issue	Annual fixed interest rate (%)	Nominal value (in million)
Fixed rate notes	61 months	31 March 2004 and 10 June 2004	4.59 to 5.1	3,500

The CBRC approved the Bank's issuance of RMB3,500 million subordinated notes on 30 March 2004 (Yin Jian Fu【2004】No. 36), and the amount has been included as supplementary capital in calculating the Bank's capital adequacy ratio. Interest on the subordinated notes is payable annually.

26 OTHER LIABILITIES

	2006	2005
Interest payable	**3,450**	2,705
Clearing and settlement accounts	**1,873**	812
Salaries and welfare payable (Note 27)	**2,557**	2,476
Deferred interest income on discounted bills	**1,014**	583
Business tax and surcharges payable	**757**	575
Cheques and remittances returned	**123**	106
Others	**1,371**	1,029
	11,145	8,286

27 STAFF WELFARE SCHEME

(a) Welfare payable

This includes statutory welfare payable, which is accrued based on 14% (2005: 14%) of the total salaries.

(b) Retirement benefits

(i) Defined contribution schemes

In accordance with the regulations in the PRC, the Group participates in statutory retirement schemes organised by the municipal and provincial governments for its employees. The Group's contributions to the schemes are determined by local governments and vary at a range of 8% to 35% (2005: 8% to 35%) of the staff salaries.

In addition to the above statutory retirement schemes, the Group has established a supplementary defined contribution plan for its employees. The Group's annual contributions to this plan are determined based on 8.33% of the staff salaries since 1 January 2004. The Group's total contributions during the year are disclosed in Note 7.

(ii) Supplementary retirement scheme

In 2006, the Group purchased annuity contract with total premiums of RMB500 million (2005: RMB500 million) from independent life insurance companies to provide supplementary defined contribution retirement benefits to its full-time employees on payroll as of the year end date. New employees who join the Group after respective year ends are not eligible for this benefit. These were voluntary payments and the Group has no further obligations to make future contributions.

The Group has no other material obligations for the payment of other post retirement benefits other than the contributions described above.

(Expressed in millions of Renminbi unless otherwise stated)

27 STAFF WELFARE SCHEME *(continued)*

(c) Staff quarters

The Group purchases quarters by using the public welfare fund, and leases to the staff at market rates on short term basis. Rental income is recognised in the consolidated income statement as other net income.

(d) Staff incentive scheme

The Group has implemented a staff performance bonus scheme during the years ended 31 December 2006 and 2005. The performance bonus was accrued at a fixed percentage based on the growth in net profit for the year as approved by the Board of Directors.

The Board of Directors also approved a H-Share Appreciation Right Scheme for the Group's senior management during the year. This scheme was being reviewed and yet to be approved by the regulatory authorities at 31 December 2006. Accordingly, this scheme was not considered in these financial statements.

28 SHARE CAPITAL

	Registered and issued share capital	
	No. of shares (in million)	**Amount**
At 1 January 2006	**10,374**	**10,374**
Bonus shares issued	**971**	**971**
Conversion of convertible bonds	**938**	**938**
H-Shares issued	**2,420**	**2,420**
At 31 December 2006	**14,703**	**14,703**
At 1 January 2005	6,848	6,848
Bonus shares issued	3,424	3,424
Conversion of convertible bonds	102	102
At 31 December 2005	10,374	10,374

28 SHARE CAPITAL *(continued)*

By type of share:

	No. of shares (in million)	
	2006	2005
Unlisted legal person shares (note)	**–**	7,572
Listed shares		
– A-Shares – with trading moratorium	**7,331**	–
– A-Shares – without trading moratorium	**4,710**	2,802
– H-Shares	**2,662**	–
	14,703	2,802
	14,703	10,374

Note: Subsequent to the completion of the Bank's State Share Reform Plan, the unlisted legal person shares become listed shares subject to trading moratorium with effect from 27 February 2006.

On 17 June 2005, bonus shares were issued at a ratio of 5 bonus shares for every 10 A-Shares of the Bank by capitalisation of an amount of RMB3,424 million from the capital reserve. In addition, the Bank issued 102 million A-Shares upon conversion of the convertible bonds of RMB560 million during the year ended 31 December 2005, resulting in the increase in share capital and capital reserve of RMB102 million and RMB473 million respectively. As a result, the Bank's registered and issued capital increased from RMB6,848 million to RMB10,374 million.

On 24 February 2006, bonus shares were issued at a ratio of 0.8589 bonus shares for every 10 A-Shares of the Bank by capitalisation of an amount of RMB971 million from the capital reserve. In addition, the Bank issued 938 million A-Shares upon conversion of the convertible bonds of RMB5,169 million during the year ended 31 December 2006, resulting in the increase in share capital and capital reserve of RMB938 million and RMB4,327 million respectively.

On 22 September 2006, a total of 2,200 million H-Shares with a par value of RMB1 each were issued by the Bank at a subscription price of HK$8.55 per share as part of the Initial Public Offering.

On 27 September 2006, a total of 220 million H-Shares with a par value of RMB1 each were issued by the Bank at a subscription price of HK$8.55 per share as a result of the exercise of the over-allotment option.

(Expressed in millions of Renminbi unless otherwise stated)

28 SHARE CAPITAL *(continued)*

As a result of the Initial Public Offering and the exercise of the over-allotment option, a total of 242 million A-Shares, representing 10% of the number of H-Shares issued by the Bank were converted into H-Shares of equivalent value and transferred to Social Security Fund from state-owned shareholders of the Bank at no consideration. These H-Shares were eligible for trading since 5 October 2006.

As a result of the above events in 2006, the Bank's registered and issued capital increased from RMB10,374 million to RMB14,703 million.

All H-Shares are ordinary shares and rank pari passu with the A-Shares.

29 CAPITAL RESERVE

The capital reserve primarily represents share premium and equity component of the convertible bonds issued by the Bank. The capital reserve can be used to issue shares with the shareholders' approval.

The share premium arising from issuing H-Shares is as follows:

	2006
Gross proceeds upon issue of H-Shares	**21,049**
Shares at par value	**(2,420)**
Share premium before costs of issuing shares	**18,629**
Cost of issuing shares	**(544)**
Share premium recognised in capital reserve	**18,085**

30 SURPLUS RESERVE

Surplus reserve includes statutory surplus reserve and statutory public welfare fund.

Statutory surplus reserve is calculated according to the requirements of the Accounting Standards for Business Enterprises, the Accounting Regulations for Financial Enterprises (2001) and other relevant regulations issued by the Ministry of Finance of the People's Republic of China (the "MOF") and is provided at 10% of the audited profit after tax, until the reserve balance is equal to 50% of the Bank's registered share capital. Surplus reserve can be used to offset accumulated losses or capitalised as paid-up capital with the approval of shareholders.

30 SURPLUS RESERVE *(continued)*

Prior to 1 January 2006, statutory public welfare fund was calculated according to the requirements of the Accounting Standards for Business Enterprises, the Accounting Regulations for Financial Enterprises (2001) and other relevant regulations issued by the MOF and was provided at 5% to 10% of the audited profit after tax in accordance with the Company Law of the PRC. Effective from 1 January 2006, the Bank is no longer required to make further appropriation to the statutory public welfare fund following the issuance of revisions to the Company Law of the PRC on 27 October 2005.

The purpose of statutory public welfare fund is to provide staff facilities and other staff benefits. It is not distributable other than in liquidation.

31 INVESTMENT REVALUATION RESERVE

Investment revaluation reserve has been accounted for in accordance with the accounting policies adopted for the measurement of the available-for-sale financial assets at fair value, net of deferred tax.

32 REGULATORY GENERAL RESERVE

Pursuant to the "Administrative Measures on Provisioning for Doubtful Debts by Financial Institutions" (Cai Jin 2005 No. 49) issued by the MOF on 17 May 2005 and other related rules, the Group sets up a regulatory general reserve calculated as a percentage of the total risk assets at the balance sheet date, through a transfer directly from the retained profits, to cover its potential losses that are not yet incurred. The regulatory general reserve forms part of the equity of the Group.

33 PROFIT APPROPRIATIONS

(a) Dividends declared and paid

	2006	2005
Dividends in respect of the previous year, approved, declared and paid during the year of RMB0.8 (2005: RMB1.1) per every 10 shares	**983**	753
Special dividend of RMB1.8 (2005: Nil) per every 10 shares	**2,210**	–
	3,193	753

(Expressed in millions of Renminbi unless otherwise stated)

33 PROFIT APPROPRIATIONS *(continued)*

(b) Proposed profit appropriations

	2006	2005
Statutory surplus reserve	**711**	393
Statutory public welfare fund	**–**	393
Dividends of RMB1.2 (2005: RMB0.8) per every 10 shares	**1,764**	830
Total	**2,475**	1,616

Notes:

(i) 2005 profit was appropriated in accordance with the resolution passed at the twenty-fourth meeting of the sixth Board of Directors held on 10 April 2006 and as approved in the annual general meeting held on 16 May 2006. The actual amount approved increased to RMB983 million from RMB830 million (see (ii) below).

(ii) Additional dividends totalling RMB153 million in respect of the year ended 31 December 2005 were declared on new shares issued as a result of the conversion of convertible bonds exercised during the first three months of 2006. This amount together with the original dividend of RMB830 million proposed at 31 December 2005 were paid in June 2006.

(iii) In the light of the Global Offering, the Bank's Board of Directors approved on 30 June 2006, a special dividend distribution of RMB0.18 per share for the Bank's holders of A-Shares from its distributable retained profits at 31 December 2005. The special dividend of RMB2,210 million was approved by the Bank's shareholders in an extraordinary general meeting on 19 August 2006.

34 NOTES TO CONSOLIDATED CASH FLOW STATEMENTS

(a) Analysis of the balances of cash and cash equivalents

	2006	2005
Cash	**4,622**	3,915
With original maturity within 3 months:		
– balance with banks and other financial institutions	**9,701**	10,481
– balances with central bank	**82,372**	62,102
– placements with banks and other financial institutions	**71,031**	38,400
– investment securities:		
– at fair value through profit or loss	**247**	270
– available-for-sale	**7,637**	5,233
– held-to-maturity	**–**	208
	175,610	120,609

(b) Significant non-cash transactions

Apart from the non-cash transactions relating to the conversion of convertible bonds to share capital during the years ended 31 December 2006 and 2005 the details of which are included in Note 25(b), there were no other significant non-cash transactions.

35 SEGMENTAL REPORTING

The Group's principal activities are commercial lending and deposits taking. The funding of existing retail and corporate loans are mainly from customer deposits.

Segment information is presented in respect of the Group's business and geographical segments. Business segment information is chosen as the primary reporting format as it is more relevant to the Group's operating activities.

For the purposes of segmental analysis, external net interest income/expense represents the net interest income earned or expenses incurred on banking business originated by these segments. Internal net interest income/expense represents the allocation of revenue to reflect the benefits of funding sources allocated to the business segments by way of internal funds transfer pricing mechanism. The internal funds transfer pricing mechanism has taken into account the structure and market returns of the assets and liabilities portfolio. Cost allocation is based on the direct cost incurred by the respective business segments and apportionment of management overheads. Inter-segment interest income and expenses recognised through the internal funds transfer pricing mechanism are eliminated in the consolidated results of the operations.

(a) Business segments

The Group comprises the following main business segments:

– ***Corporate banking***

The provision of financial services to corporations and institutions includes lending and deposit taking activities, project and structured finance products, syndicated loans, cash management, investment advice and other investment services.

– ***Retail banking***

The provision of financial services to retail customers includes lending and deposit taking activities, credit card facilities and investment services.

– ***Treasury business***

It covers interbank and capital market activities and proprietary trading.

– ***Others and unallocated***

These represent equity investments, and assets, liabilities, income and expenses of the head office that are not directly attributable to a segment or cannot be allocated on a reasonable basis.

(Expressed in millions of Renminbi unless otherwise stated)

35 SEGMENTAL REPORTING *(continued)*

(a) Business segments *(continued)*

	Year ended 31 December 2006				
	Corporate banking	Retail banking	Treasury business	Others and unallocated	Total
External net interest income	14,348	812	6,349	–	21,509
Internal net interest (expense)/income	(814)	4,086	(3,272)	–	–
Net interest income	13,534	4,898	3,077	–	21,509
Net fee and commission income	854	1,531	14	115	2,514
Other net income/(expense)	501	158	357	(173)	843
Operating income/(expense)	14,889	6,587	3,448	(58)	24,866
Operating expenses					
– depreciation	(502)	(378)	(30)	–	(910)
– others	(5,380)	(4,129)	(667)	(5)	(10,181)
	(5,882)	(4,507)	(697)	(5)	(11,091)
Provision for impairment losses	(3,241)	(533)	83	–	(3,691)
Total expenses	(9,123)	(5,040)	(614)	(5)	(14,782)
Profit/(loss) before tax	5,766	1,547	2,834	(63)	10,084
Capital expenditure	975	735	58	–	1,768
	31 December 2006				
Segment assets	451,882	105,045	370,578	6,597	934,102
Segment liabilities	461,797	311,960	91,399	13,786	878,942

35 SEGMENTAL REPORTING *(continued)*

(a) Business segments *(continued)*

	Year ended 31 December 2005				
	Corporate banking	Retail banking	Treasury business	Others and unallocated	Total
External net interest income	12,309	526	3,807	–	16,642
Internal net interest (expense)/income	(74)	3,488	(3,414)	–	–
Net interest income	12,235	4,014	393	–	16,642
Net fee and commission income	681	777	19	90	1,567
Other net income	379	107	418	101	1,005
Operating income	13,295	4,898	830	191	19,214
Operating expenses					
– depreciation	(470)	(350)	(34)	–	(854)
– others	(4,474)	(3,287)	(496)	(4)	(8,261)
	(4,944)	(3,637)	(530)	(4)	(9,115)
Provision for impairment losses	(3,176)	(399)	(62)	–	(3,637)
Total expenses	(8,120)	(4,036)	(592)	(4)	(12,752)
Profit before tax	5,175	862	238	187	6,462
Capital expenditure	691	515	50	–	1,256
	31 December 2005				
Segment assets	390,429	75,331	263,748	5,105	734,613
Segment liabilities	378,475	255,929	63,210	11,001	708,615

35 SEGMENTAL REPORTING *(continued)*

(b) Geographical segments

The Group operates principally in the PRC with branches located in major provinces, autonomous regions and municipalities directly under the central government.

In presenting information on the basis of geographical segments, operating income is allocated based on the location of the branches that generated the revenue. Segment assets and capital expenditure are allocated based on the geographical location of the underlying assets.

Geographical segments, as defined for management reporting purposes, are as follows:

– "Eastern China" region refers to the areas serviced by the following branches of the Group: Shanghai Municipality, Jiangsu Province, Zhejiang Province, Shandong Province, Fujian Province and Anhui Province;

– "Southern and Central China" region refers to the Head Office and the areas serviced by the following branches of the Group: Guangdong Province, Hunan Province, Jiangxi Province, Hubei Province and Henan Province;

– "Western China" region refers to the areas serviced by the following branches of the Group: Sichuan Province, Chongqing Municipality, Yunnan Province, Shaanxi Province, Gansu Province and Xinjiang Autonomous Region;

– "Northern China" region refers to the areas serviced by the following branches of the Group: Beijing Municipality, Tianjin Municipality, Liaoning Province, Heilongjiang Province and Shanxi Province; and

– "Others" refer to operations of Hong Kong branch and the subsidiary.

35 SEGMENTAL REPORTING *(continued)*

(b) Geographical segments *(continued)*

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

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

Notes:

(i) Total operating income represents the operating income gross of interest expense and fee and commission expense.

(ii) Capital expenditure represents total amount incurred for acquiring assets that are expected to be used for some periods.

(Expressed in millions of Renminbi unless otherwise stated)

36 ASSETS PLEDGED AS SECURITY

The following assets have been pledged as collateral for liabilities under repurchase arrangements:

	2006	2005
Secured liabilities	**6,237**	3,150
Assets pledged		
– Available-for-sale financial assets	**1,372**	–
– Held-to-maturity debt securities	**1,545**	2,000
– Other assets	**3,386**	763
	6,303	2,763

37 CONTINGENT LIABILITIES AND COMMITMENTS

(a) Credit commitments

At any given time the Group has outstanding commitments to extend credit. These commitments take the form of approved loans and credit card limits.

The Group provides financial guarantees and letters of credit to guarantee the performance of customers to third parties.

Acceptances comprise undertakings by the Group to pay bills of exchange drawn on customers. The Group expects most acceptances to be settled simultaneously with the reimbursement from the customers.

The contractual amounts of commitments and contingent liabilities are set out in the following table by category. The amounts reflected in the table for commitments assume that amounts are fully advanced. The amount reflected in the table for guarantees and letters of credit represents the maximum potential loss that would be recognised at the balance sheet date if counterparties failed completely to perform as contracted.

37 CONTINGENT LIABILITIES AND COMMITMENTS *(continued)*

(a) Credit commitments *(continued)*

	2006	2005
Contractual amount		
Irrevocable guarantees	**37,063**	34,691
Irrevocable letters of credit	**28,323**	22,436
Bills of acceptances	**166,513**	123,525
Loan commitments		
– with an original maturity of under one year	**1,371**	878
– with an original maturity of one year or over	**5,172**	2,455
Credit card commitments	**31,694**	19,731
Shipping guarantees	**–**	22
	270,136	203,738

Loan commitments only include credit limits granted to offshore customers, and onshore and offshore syndicated loans. The Directors are of the opinion that the Group will not assume any risks on the unused credit limits for other loan customers as such limits are revocable and subject to the loan approval process. As a result, such balances are not included in the above contingent liabilities and commitments.

These commitments and contingent liabilities have off-balance sheet credit risk. Before the commitments are fulfilled or expire, management assesses and makes allowances for any probable losses accordingly. As the facilities may expire without being drawn upon, the total of the contractual amounts is not representative of expected future cash outflows.

	2006	2005
Credit risk weighted amounts of contingent liabilities and commitments		
Contingent liabilities and commitments	**86,444**	68,095

The credit risk weighted amount refers to the amount as computed in accordance with the rules set out by the CBRC and depends on the status of the counterparty and the maturity characteristics. The risk weights used range from 0% to 100% of contingent liabilities and commitments.

(Expressed in millions of Renminbi unless otherwise stated)

37 CONTINGENT LIABILITIES AND COMMITMENTS *(continued)*

(a) Credit commitments *(continued)*

There are no relevant standards prescribed by IFRSs in calculating the above credit risk weighted amounts.

The credit risk weighted amounts stated above have taken into account the effects of bilateral netting arrangements.

(b) Capital commitments

Authorised capital commitments not provided for were as follows:

	2006	2005
For purchase of fixed assets:		
– Contracted for	**126**	335
– Not contracted for	**–**	132

(c) Operating lease commitments

Total future minimum lease payments under non-cancellable operating leases of properties are payable as follows:

	2006	2005
Within 1 year	**739**	539
After 1 year but within 5 years	**1,852**	1,387
After 5 years	**696**	425
	3,287	2,351

The Group and the Bank lease a number of properties under operating leases. The leases typically run for an initial period of 1 to 20 years. Lease payments are usually increased every 1 to 10 years to reflect market rental. None of the lease include contingent rental.

37 CONTINGENT LIABILITIES AND COMMITMENTS *(continued)*

(d) Outstanding litigations

At 31 December 2006, the Group was a defendant in certain pending litigations with gross claims of RMB118 million (2005: RMB250 million) arising from its banking activities. Many of these proceedings are in relation to steps taken by the Bank to collect delinquent loans and enforce rights in collateral securing such loans. The Directors consider that no material losses would be incurred by the Group as a result of these pending litigations and therefore no provision has been made in the financial statements.

(e) Redemption obligations

As an underwriting agent of PRC government bonds, the Group has the responsibility to buy back those bonds sold by it should the holders decide to early redeem the bonds held. The redemption price for the bonds at any time before their maturity date is based on the coupon value plus any interest unpaid and accrued up to the redemption date. Accrued interest payables to the bond holders are calculated in accordance with relevant rules of the MOF and the PBOC. The redemption price may be different from the fair value of similar instruments traded at the redemption date.

The redemption obligations below represent the nominal value of government bonds underwritten and sold by the Group, but not yet matured at the balance sheet date:

	2006	2005
Redemption obligations	**11,621**	11,604

The Group expects that the amount of redemption before the maturity date of these government bonds through the Group will not be material.

38 ENTRUSTED BUSINESS

	2006	2005
Entrusted deposits	**49,801**	28,489
Entrusted loans	**45,627**	28,489
Entrusted investments	**4,174**	–

The Group undertakes entrusted loans and entrusted investments business.

38 ENTRUSTED BUSINESS *(continued)*

Entrusted loans are funded by entrusted deposits and are granted to designated borrowers for specific purposes at terms specified by entrustors. The Group is responsible for managing entrusted loans. Entrusted investments are also funded by entrusted deposits, and investment decisions are made by the Group in accordance with the scope defined by entrustors.

The risks and gains or losses of entrusted business are borne by the entrustors and the Group only earns a commission. Therefore the Group does not recognise the entrusted businesses as its loans, investments and deposits. The above entrusted loans and investments are shown at their granted or invested amounts.

39 RISK MANAGEMENT

(a) Credit risk

Credit risk represents the potential loss that may arise from the failure of a debtor to meet its obligation or commitment to the Group. Credit risk increases when all counterparties are concentrated in a single industry or a geographical region, as different counterparties in the same region or industry may be affected by the same economic development, which may eventually affect their repayment abilities.

The Group has designed its organisation framework, credit policies and processes with an objective to identify, evaluate and manage its credit risk effectively. The Risk Management and Internal Control Committee is set up and is appointed by the Board to be responsible for supervising and evaluating the set-up, organisational structure, work process and effectiveness of various risk management functions. To mitigate risk, the Group may obtain collateral and guarantees where appropriate.

With respect to daily operations, the Risk Management Department, as directed by the Risk Management and Internal Control Committee, monitors and coordinates the work of other risk management functions, including the Corporate Banking Department and the Legal and Compliance Department.

In respect of the loan portfolio, the Group adopts a risk based loan classification methodology. Currently, the Group classifies loans into seven categories: excellent, good, general mention, special mention, substandard, doubtful and loss. The last three categories are considered as impaired loans and advances for which objective evidence of impairment exists based on a loss event or several events and which bear significant impairment losses. The allowances for impairment losses for the impaired loans and advances are assessed collectively or individually as appropriate.

Concentration of credit risk: when certain numbers of customers are in the same business, located in the same geographical region or their industries share similar economic characteristics, their ability to meet their obligations may be affected by the same economic changes. The level of concentration of credit risk reflects the sensitivity of the Group’s operating result to a specific industry or geographical region.

39 RISK MANAGEMENT *(continued)*

(a) Credit risk *(continued)*

Analyses of loans and advances by industry, customer type, nature and geographical location are stated in Notes 17 and 35(b).

The Group's credit risk management policy for financial derivatives is the same as that for other transactions. In order to mitigate the credit risk arising from the financial derivatives, the Group has signed netting agreements with certain counterparties.

(b) Market risk

Market risk is the risk of loss arising from movements in observable market variables such as interest rates, exchange rates and equity markets. The Group is exposed to market risk primarily through its proprietary trading activities. The Group considers that any market risk arising from its proprietary trading book is not material.

The Asset and Liability Management Committee ("ALCO") of the Group is responsible for formulating market risk management policies, supervising implementation of the policies and performing independent assessments of the risk status. The Risk Management Department is responsible for managing the risks arising from the day to day operation of the Treasury division.

(c) Currency risk

The Group's foreign exchange exposure mainly comprises foreign exchange dealing by Treasury and is mitigated primarily by matching spot and forward foreign exchange contracts with foreign currency borrowings.

The Group's functional currency is RMB. Foreign currency transactions are mainly in US dollar and HK dollar. The Group's assets and liabilities are mainly denominated in RMB, with the rest being mainly in US dollar and HK dollar.

The Group monitors daily foreign currency transactions and positions closely. The following tables show the Group's assets and liabilities by major currencies as at each balance sheet date.

The PBOC, with the approval of State Council, has made the announcements regarding reforming the RMB exchange rate regime. Starting from 21 July 2005, China has reformed the exchange rate regime by moving into a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies. The Group has reviewed the exposures and has taken appropriate measures to mitigate currency risks.

(Expressed in millions of Renminbi unless otherwise stated)

39 RISK MANAGEMENT *(continued)*

(c) Currency risk *(continued)*

Assets and liabilities by original currency are shown as follows:

	2006			
		Equivalent in RMB' million		
	RMB	US dollar	Others	Total
Assets				
Cash and balances with central bank	83,768	2,317	909	86,994
Amounts due from banks and other financial institutions	51,126	33,252	20,032	104,410
Loans and advances to customers	525,464	18,899	5,057	549,420
Investments	141,264	34,272	3,349	178,885
Other assets	13,379	480	534	14,393
	815,001	89,220	29,881	934,102
Liabilities				
Amounts due to banks and other financial institutions	72,972	3,238	393	76,603
Deposits from customers	687,357	49,641	36,759	773,757
Financial liabilities at fair value through profit or loss	13	60	33	106
Certificates of deposit issued	–	1,170	–	1,170
Convertible bonds issued	22	–	–	22
Other debts issued	9,987	–	–	9,987
Subordinated notes issued	3,500	–	–	3,500
Other liabilities	11,094	1,905	798	13,797
	784,945	56,014	37,983	878,942
Net on-balance sheet position	30,056	33,206	(8,102)	55,160
Off-balance sheet position:				
Credit commitments (note)	131,590	27,083	4,020	162,693
Derivatives:				
– forward purchase	27,585	8,913	12,816	49,314
– forward sales	(7,626)	(40,801)	(1,285)	(49,712)
– net option position	–	115	(115)	–

39 RISK MANAGEMENT *(continued)*

(c) Currency risk *(continued)*

Assets and liabilities by original currency are shown as follows: *(continued)*

	2005			
		Equivalent in RMB' million		
	RMB	US dollar	Others	Total
Assets				
Cash and balances with central bank	63,561	1,567	889	66,017
Amounts due from banks and other financial institutions	43,196	8,777	13,585	65,558
Loans and advances to customers	430,037	24,733	3,905	458,675
Investments	110,449	18,057	3,396	131,902
Other assets	11,521	332	608	12,461
	658,764	53,466	22,383	734,613
Liabilities				
Amounts due to banks and other financial institutions	38,286	4,463	498	43,247
Deposits from customers	570,620	44,559	19,225	634,404
Financial liabilities at fair value through profit or loss	–	42	44	86
Certificates of deposit issued	–	1,211	–	1,211
Convertible bonds issued	5,184	–	–	5,184
Other debts issued	9,982	–	–	9,982
Subordinated notes issued	3,500	–	–	3,500
Other liabilities	7,596	609	2,796	11,001
	635,168	50,884	22,563	708,615
Net on-balance sheet position	23,596	2,582	(180)	25,998
Off-balance sheet position:				
Credit commitments (note)	111,357	26,156	4,727	142,240
Derivatives:				
– forward purchase	726	5,651	1,671	8,048
– forward sales	(1,915)	(2,439)	(3,387)	(7,741)

Note: Credit commitments generally expire before they are drawn; therefore the above net position (net of pledged deposits) does not represent the cash flows need.

39 RISK MANAGEMENT *(continued)*

(d) Interest rate risk

The Group's interest rate exposures comprise primarily those arising from mismatches in durations and structures of assets and liabilities in its banking operations and from positions undertaken for trading purposes.

Interest rate risk in banking operations is inherent in many business segments of the Group, and arises from factors such as differences in timing between contractual maturities or repricing of assets and liabilities. Similar risk in trading positions arises mainly from investment portfolio undertaken by treasury operation.

The ALCO regularly monitors such interest rate risk positions. The Group regularly performs interest rate sensitivity analysis on these interest rate positions for the purpose of measuring and managing the risk in order to limit potential adverse impacts of movements in interest rate on net interest income.

As the reference interest rates for RMB loans and deposits are determined by the PBOC, the Group follows the interest rates set by the PBOC when carrying out lending and deposit taking activities. The Group's monetary assets and liabilities are mainly in RMB.

39 RISK MANAGEMENT *(continued)*

(d) Interest rate risk *(continued)*

The following table indicates the effective interest rates and the expected next repricing dates (or maturity dates whichever are earlier) for interest bearing assets and liabilities at the balance sheet date.

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

(Expressed in millions of Renminbi unless otherwise stated)

39 RISK MANAGEMENT *(continued)*

(d) Interest rate risk *(continued)*

	2005						
	Effective interest rate (note (i))	Total	3 months or less (include overdue)	Over 3 months to 1 year	Over 1 year to 5 years	Over 5 years	Non-interest bearing
Assets							
Cash and balances with central bank	0.00%-1.89%	66,017	62,102	–	–	–	3,915
Amounts due from banks and other financial institutions	0.00%-5.49%	65,558	61,224	4,151	183	–	–
Loans and advances to customers (note (ii))	0.00%-18.00%	458,675	264,129	190,853	3,273	420	–
Investments	0.70%-11.83%	131,902	32,784	57,795	35,628	5,531	164
Other assets	–	12,461	–	–	–	–	12,461
Total assets		734,613	420,239	252,799	39,084	5,951	16,540
Liabilities							
Amounts due to banks and other financial institutions	0.00%-5.74%	43,247	42,612	336	299	–	–
Deposits from customers	0.00%-7.00%	634,404	498,954	116,056	19,361	33	–
Financial liabilities at fair value through profit or loss	–	86	–	–	–	–	86
Certificates of deposit issued	4.27%	1,211	1,211	–	–	–	–
Convertible bonds issued	6.39%	5,184	–	–	5,184	–	–
Other debts issued	2.34%	9,982	–	–	9,982	–	–
Subordinated notes issued	4.74%	3,500	–	–	3,500	–	–
Other liabilities	–	11,001	–	–	–	–	11,001
Total liabilities		708,615	542,777	116,392	38,326	33	11,087
Asset-liability gap		25,998	(122,538)	136,407	758	5,918	5,453

Notes:

(i) Effective interest rates are that carried by respective interest bearing assets/liabilities as at the year end.

(ii) For loans and advances to customers, the above "3 months or less" category includes overdue amounts (net of allowances for impairment losses) of RMB3,065 million as at 31 December 2006 (2005: RMB3,597 million). Overdue amounts represent loans of which the whole or part of the principals was overdue.

39 RISK MANAGEMENT *(continued)*

(e) Liquidity risk

Liquidity risk is the risk that funds will not be available to meet liabilities as they fall due, and it results from amount and maturity mismatches of assets and liabilities. The Group's liquidity is managed by the ALCO. The ALCO is responsible for managing liquidity on a prudent basis to meet regulatory requirement. The day to day monitoring of future cash flows and the maintenance of suitable levels of liquefiable assets by business units are the responsibility of the head office.

A substantial portion of the Group's assets is funded by customer deposits made up of corporate and retail savings accounts and term deposits as well as deposit of banks. These customer deposits, which have been growing in recent years, are widely diversified by type and maturity and represent a stable source of funds.

The Group's loans-to-deposits ratio is maintained within 75%. 9% of total RMB deposits (2005: 7.5%) and 4% of foreign currencies deposits (2005: 3%) are required to be deposited with the PBOC.

(Expressed in millions of Renminbi unless otherwise stated)

39 RISK MANAGEMENT *(continued)*

(e) Liquidity risk *(continued)*

Analysis of the Group's assets and liabilities by remaining maturity is as follows:

	2006								
	Repayable on demand	Within 1 month	After 1 month but within 3 months	After 3 months but within 1 year	After 1 year but within 5 years	After 5 years	Undated	Overdue	Total
Cash and balances with central bank (note (i))	29,324	–	–	–	–	–	57,670	–	86,994
Amounts due from banks and other financial institutions	13,282	58,826	15,104	15,568	1,591	39	–	–	104,410
Loans and advances to customers (note (ii))	–	49,314	93,463	228,092	66,783	108,718	–	3,050	549,420
Investments (note (iii))	6,914	10,843	12,698	59,374	69,726	19,079	251	–	178,885
– at fair value through profit or loss	–	306	741	2,939	3,176	595	203	–	7,960
– available-for-sale	6,914	10,255	10,134	48,928	26,761	6,436	48	–	109,476
– held-to-maturity	–	76	1,400	5,575	35,684	11,330	–	–	54,065
– receivables	–	206	423	1,932	4,105	718	–	–	7,384
Other assets	3,679	302	326	174	243	9	9,636	24	14,393
Total assets	53,199	119,285	121,591	303,208	138,343	127,845	67,557	3,074	934,102
Amounts due to banks and other financial institutions	53,405	4,704	4,530	7,359	6,605	–	–	–	76,603
Deposits from customers (note (iv))	489,451	46,856	66,385	141,802	27,610	1,653	–	–	773,757
Financial liabilities at fair value through profit or loss	–	–	–	–	–	–	106	–	106
Certificates of deposit issued	–	–	–	1,170	–	–	–	–	1,170
Convertible bonds issued	–	–	–	–	22	–	–	–	22
Other debts issued	–	–	–	–	9,987	–	–	–	9,987
Subordinated notes issued	–	–	–	–	3,500	–	–	–	3,500
Other liabilities	10,242	532	1,841	881	228	73	–	–	13,797
Total liabilities	553,098	52,092	72,756	151,212	47,952	1,726	106	–	878,942
Long/(short) position	(499,899)	67,193	48,835	151,996	90,391	126,119	67,451	3,074	55,160

39 RISK MANAGEMENT *(continued)*

(e) Liquidity risk *(continued)*

	2005								
	Repayable on demand	Within 1 month	After 1 month but within 3 months	After 3 months but within 1 year	After 1 year but within 5 years	After 5 years	Undated	Overdue	Total
Cash and balances with central bank (note (i))	25,881	–	–	–	–	–	40,136	–	66,017
Amounts due from banks and other financial institutions	10,615	33,975	8,145	11,197	1,480	146	–	–	65,558
Loans and advances to customers (note (ii))	–	37,891	84,094	204,031	67,524	61,538	–	3,597	458,675
Investments (note (iii))	1,133	7,456	7,641	34,739	57,129	23,640	164	–	131,902
– at fair value through profit or loss	–	371	1,160	6,655	6,560	1,005	118	–	15,869
– available-for-sale	1,133	6,704	4,629	21,063	23,085	3,426	46	–	60,086
– held-to-maturity	–	173	1,111	6,098	22,615	18,714	–	–	48,711
– receivables	–	208	741	923	4,869	495	–	–	7,236
Other assets	660	222	626	956	452	2	9,523	20	12,461
Total assets	38,289	79,544	100,506	250,923	126,585	85,326	49,823	3,617	734,613
Amounts due to banks and other financial institutions	23,336	4,207	3,313	2,550	9,441	400	–	–	43,247
Deposits from customers (note (iv))	387,152	33,716	56,124	129,347	27,104	961	–	–	634,404
Financial liabilities at fair value through profit or loss	–	–	–	–	–	–	86	–	86
Certificates of deposit issued	–	–	–	–	1,211	–	–	–	1,211
Convertible bonds issued	–	–	–	–	5,184	–	–	–	5,184
Other debts issued	–	–	–	–	9,982	–	–	–	9,982
Subordinated notes issued	–	–	–	–	3,500	–	–	–	3,500
Other liabilities	8,706	224	1,069	705	268	29	–	–	11,001
Total liabilities	419,194	38,147	60,506	132,602	56,690	1,390	86	–	708,615
Long/(short) position	(380,905)	41,397	40,000	118,321	69,895	83,936	49,737	3,617	25,998

39 RISK MANAGEMENT *(continued)*

(e) Liquidity risk *(continued)*

Notes:

(i) For balances with central bank, undated amount represents statutory deposit reserve funds and fiscal balances maintained with the PBOC.

(ii) For loans and advances to customers, overdue amounts represent loans of which the whole or part of the principals was overdue. The overdue amounts are stated net of appropriate allowances for impairment losses.

(iii) The remaining maturities of trading assets and assets designated at fair value through profit or loss included in investments do not represent the Group's intention to hold them to maturity.

(iv) Included in the deposits from customers that are repayable on demand were RMB79,767 million time deposits matured and awaiting for customers' instructions (2005: RMB49,356 million).

(f) Operational risk

Operational risk includes the risk of direct or indirect loss due to an event or action causing failure of technology, processes, infrastructure and personnel, and other risks having an operational impact.

The Group manages this risk through a controls-based environment by establishing a framework of policies and procedures to identify, assess, control, manage and report risks. The framework covers all business functions ranging from finance, credit, accounting, settlement, savings, treasury, intermediary business, computer applications and management, special assets resolution and legal affairs. This has allowed the Group to identify and address the operational risk inherent in key products, activities, processes and systems.

(g) Use of derivatives

Derivatives are off-balance sheet financial instruments which include forward, swap and option transactions undertaken by the Group in the foreign exchange and interest rate markets.

The Group enters into financial derivative transactions for treasury business and its assets and liabilities management purpose.

Treasury business includes the formation and sale of financial derivatives to enable customers to transfer, change or mitigate existing or anticipated risks.

When there are mismatches in the interest rates of assets and liabilities, the Group will use interest rate swaps to swap fixed interest rates into floating interest rates.

For assets and liabilities denominated in foreign currencies, the Group will be exposed to risks due to the fluctuations of exchange rates. The Group will use currency swaps and forward contracts to mitigate these risks.

39 RISK MANAGEMENT *(continued)*

(g) Use of derivatives *(continued)*

The following tables provide an analysis of the notional amounts of derivatives of the Group by maturity groupings based on the remaining periods to settlement and the corresponding fair values at the balance sheet date. The notional amounts of the derivatives indicate the transaction volume outstanding at the balance sheet date; they do not represent amounts at risk.

	2006						
	Notional amounts with remaining life of					Fair values	
	Less than 3 months	Between 3 months and 1 year	Between 1 year and 5 years	More than 5 years	Total	Assets	Liabilities
Interest rate derivatives							
Interest rate swaps	5,023	6,740	6,243	1,006	19,012	108	(53)
Currency derivatives							
Spot	15,717	–	–	–	15,717	10	(9)
Forwards	1,803	2,526	470	–	4,799	17	(13)
Foreign exchange swaps	11,976	17,063	156	–	29,195	41	(1)
Currency options	22,950	176	–	–	23,126	27	(30)
	52,446	19,765	626	–	72,837	95	(53)
Total						203	(106)
						(Note 18(a))	(Note 18(e))

(Expressed in millions of Renminbi unless otherwise stated)

39 RISK MANAGEMENT *(continued)*

(g) Use of derivatives *(continued)*

	2005						
	Notional amounts with remaining life of					Fair values	
	Less than 3 months	Between 3 months and 1 year	Between 1 year and 5 years	More than 5 years	Total	Assets	Liabilities
Interest rate derivatives							
Interest rate swaps	1,272	4,949	3,907	294	10,422	39	(51)
Currency derivatives							
Spot	2,826	–	–	–	2,826	1	(1)
Forwards	364	3,481	–	–	3,845	39	(34)
Foreign exchange swaps	182	726	162	–	1,070	7	–
	3,372	4,207	162	–	7,741	47	(35)
Total						86	(86)
						(Note 18(a))	(Note 18(e))

The replacement costs and credit risk weighted amounts in respect of these derivatives are as follows. These amounts take into account the effects of bilateral netting arrangements.

Replacement costs

	2006	2005
Interest rate derivatives	**108**	39
Currency derivatives	**95**	47
	203	86

Replacement cost represents the cost of replacing all contracts which have a positive value when marked to market. Replacement cost is a close approximation of the credit risk for these derivative contracts as at the balance sheet date.

39 RISK MANAGEMENT *(continued)*

(g) Use of derivatives *(continued)*

Credit risk weighted amounts

	2006	2005
Interest rate derivatives	**100**	26
Currency derivatives	**107**	25
	207	51

The credit risk weighted amount refers to the amount as computed in accordance with the rules set out by the CBRC and depends on the status of the counterparty and the maturity characteristics.

(h) Fair value information

(i) Financial assets

The Group's financial assets mainly include cash, deposits and placements with the central banks, banks and other financial institutions, loans and advances to customers and investments.

Except for loans and advances and held-to-maturity investments, most of the financial assets mature within 1 year or are already stated at fair value, and therefore their carrying values approximate their fair values.

Loans and advances are stated at amortised costs less allowances for impairment loss (Note 17). The interest rate of loans and advances will be adjusted in accordance with the PBOC rates, and impairment allowance is made to reduce the carrying amount of impaired loans to estimated recoverable amount. Accordingly, the carrying values of loans and advances are close to the fair values.

Held-to-maturity debt securities investments are stated at amortised costs less impairment, and the fair values are disclosed in Note 18(c).

(Expressed in millions of Renminbi unless otherwise stated)

39 RISK MANAGEMENT *(continued)*

(h) Fair value information *(continued)*

(ii) Financial liabilities

Financial liabilities mainly include customer deposits, deposits and placements from banks and other financial institutions, and debts issued by the Bank. The carrying values of financial liabilities approximate their fair values at the balance sheet date of the year presented, except the financial liabilities set out below:

Carrying value

	2006	2005
Convertible bonds issued	**22**	5,184
Subordinated notes issued	**3,500**	3,500
	3,522	8,684

Fair value

	2006	2005
Convertible bonds issued	**26**	5,595
Subordinated notes issued	**3,563**	3,657
	3,589	9,252

40 SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS

In determining the carrying amounts of some assets and liabilities, the Group makes assumptions for the effects of uncertain future events on those assets and liabilities at the balance sheet date. These estimates involve assumptions about such items as cash flows and discount rates used. The Group's estimates and assumptions are based on historical experience and expectations of future events and are reviewed periodically. In addition to assumptions and estimations of future events, judgements are also made during the process of applying the Group's accounting policies.

40 SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS *(continued)*

(a) Impairment losses on loans and advances

Loan portfolios are assessed periodically to assess whether impairment losses exist and if they exist, the amounts of impairment losses. Objective evidence for impairment includes observable data indicating that there is a measurable decrease in the estimated future cash flows from an individual loan. It also includes observable data indicating adverse changes in the repayment status of borrowers in the loan portfolio or national or local or economic conditions that correlate with defaults on the loans in the portfolio. The impairment loss for a loan that is individually evaluated for impairment is the decrease in the estimated future cash flow of that loan. When loans and advances are collectively evaluated for impairment, the estimate is based on historical loss experience for assets with credit risk characteristics similar to the loans and advances. Historical loss experience is adjusted on the basis of the relevant observable data that reflect current economic conditions. Management reviews the methodology and assumptions used in estimating future cash flows regularly to reduce any difference between loss estimates and actual loss experience.

(b) Impairment of available-for-sale financial assets

For available-for-sale financial assets, a significant or prolonged decline in fair value below cost is considered to be objective evidence of impairment. Judgement is required when determining whether a decline in fair value has been significant or prolonged. In making this judgement, historical data on market volatility as well as in the share price of the specific equity investment are taken into account. The Group also takes into account other factors, such as industry and sector performance and financial information regarding the investee.

(c) Fair value of financial instruments

For a number of financial instruments, no quoted prices in an active market exist. The fair values for these financial instruments are established by using valuation techniques. These techniques include using recent arm's length market transactions, reference to the current fair value of similar instruments and discounted cash flow analysis and option pricing models. The Group has established a process to ensure that valuation techniques are constructed by qualified personnel and are validated and reviewed by personnel independent of the area that constructed the valuation techniques. Valuation techniques are certified before being implemented for valuation and are calibrated to ensure that outputs reflect actual market conditions. Valuation models established by the Group make the maximum use of market inputs and rely as little as possible on the Group's specific data. However, it should be noted that some inputs, such as credit and counterparty risk and risk correlations, require management estimates. Management estimates and assumptions are reviewed periodically and are adjusted if necessary.

(Expressed in millions of Renminbi unless otherwise stated)

40 SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS *(continued)*

(d) Held-to-maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity investments if the Group has the intention and ability to hold them until maturity. In evaluating whether the requirements to classify a financial asset as held-to-maturity are met, management makes significant judgements. Failure in correctly assessing the Group's intention and ability to hold specific investments until maturity may result in reclassification of the whole portfolio as available-for-sale.

(e) Income taxes

Determining income tax provisions involves judgement on the future tax treatment of certain transactions. The Group carefully evaluates tax implications of transactions and tax provisions are set up accordingly. The tax treatment of such transactions is reconsidered periodically to take into account all changes in tax legislations. Deferred tax assets are recognised for tax losses not yet used and temporary deductible differences. As those deferred tax assets can only be recognised to the extent that it is probable that future taxable profit will be available against which the unused tax credits can be utilised, management's judgement is required to assess the probability of future taxable profits. Management's assessment is constantly reviewed and additional deferred tax assets are recognised if it becomes probable that future taxable profits will allow the deferred tax asset to be recovered.

41 MATERIAL RELATED-PARTY TRANSACTIONS

(a) Transaction terms and conditions

During the year, the Group entered into transactions with related parties in the ordinary course of its banking business including lending, investment, deposit and off-balance sheet transactions. The Directors are of the opinion that the Group's material related-party transactions were all entered into on normal commercial terms. The banking transactions were priced at the relevant market rates prevailing at the time of each transaction. Interest rates on loans and deposits are required to be set in accordance with the following benchmark rates set by the PBOC:

	From 19 August 2006 to 31 December 2006	**From 28 April 2006 to 19 August 2006**	**From 29 October 2004 to 28 April 2006**
Short-term loans	5.58% to 6.12% p.a.	5.40% to 5.85% p.a.	5.22% to 5.58% p.a.
Medium to long-term loans	6.30% to 6.84% p.a.	6.03% to 6.39% p.a.	5.76% to 6.12% p.a.
Saving deposits	0.72% p.a.	0.72% p.a.	0.72% p.a.
Time deposits	1.80% to 4.14% p.a.	1.71% to 3.60% p.a.	1.71% to 3.60% p.a.

There were no allowances for impairment losses on an individual basis against loans and advances granted to related parties during the year.

41 MATERIAL RELATED-PARTY TRANSACTIONS *(continued)*

(b) Shareholders and their related companies

As the Bank's largest shareholder China Merchants Steam Navigation Company Limited ("CMSNCL") and its related companies hold 17.63% of the Bank's shares as at 31 December 2006 (2005: 24.15%), the Directors consider that CMSNCL is not a controlling shareholder of the Bank but can exercise significant influence over the financial and operating decisions of the Bank. The Group's transactions and balances with CMSNCL and its related companies are disclosed as follows:

	2006	2005
On balance sheet:		
Loans and advances	**2,581**	782
Investments	**156**	–
Deposits from customers	**13,196**	667
Off-balance sheet:		
Irrevocable guarantee	**357**	70
Irrevocable letters of credit	**102**	101
Bills of acceptances	**370**	328
Average balance of loans and advances	**1,613**	905
Interest income	**105**	53
Interest expense	**123**	4
Fees and commission (Note)	**174**	41

Note: Apart from the above transactions, the Bank also enters into transactions with CMSNCL and its related companies in the ordinary course of its banking activities such as remittance, securities trading etc. The activities are priced at the relevant market rates at the time of the transactions.

(Expressed in millions of Renminbi unless otherwise stated)

41 MATERIAL RELATED-PARTY TRANSACTIONS *(continued)*

(c) Companies controlled by directors other than those under Note 41(b) above

	2006	2005
On balance sheet:		
Loans and advances	**637**	458
Deposits from customers	**1,030**	445
Deposits from banks and other financial institutions	**–**	337
Average balance of loans and advances	**728**	765
Interest income	**46**	36
Interest expense	**7**	8
Fees and commission	**17**	–

(d) Key management personnel

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Group, directly or indirectly, including Directors, Supervisors and Executive Officers.

Remuneration for key management personnel, including amounts paid to the Bank's Directors and Supervisors as disclosed in Note 8 and certain highest paid employees as disclosed in Note 9 during the year is as follows:

	2006	2005
	RMB'000	RMB'000
Salaries and other emoluments	**16,796**	8,794
Discretionary bonuses	**13,499**	11,960
Contributions to defined contribution retirement schemes	**3,177**	723
	33,472	21,477

42 POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE YEAR ENDED 31 DECEMBER 2006

Up to the date of issue of the financial statements, the IASB has issued the following amendments, new standards and interpretations which are not yet effective for the year ended 31 December 2006 and which have not been adopted in the financial statements:

		Effective for accounting periods beginning on or after
IFRS 7	Financial Instruments: Disclosures	1 January 2007
Amendment to IAS 1	Presentation of Financial Statements: Capital Disclosures	1 January 2007

The Group has assessed the impact of these amendments, new standards and new interpretations and concluded that they would only affect the level of details in the disclosure of the consolidated financial statements, and would not have an impact on the Group's results or the state of affairs of the Group or the Bank.

43 EVENTS OCCURRED AFTER THE BALANCE SHEET DATE

On 16 March 2007, the Tenth National People's Congress (NPC) plenary session passed a resolution of the draft corporate income tax law submitted by the Standing Committee of the Tenth NPC. According to the income tax law that was passed at the Tenth NPC plenary session, the Group's applicable income tax rate will be changed from 33% to 25% with effective from 1 January 2008. Given the resolution of the new tax law is a non-adjusting event after the balance sheet date, the Group did not apply the new income tax rate in preparing the financial statements for the year ended 31 December 2006. The Group is in the process of making an assessment of the impact of applying the new tax law on the Group's financial position.

Except for the above, the Group had no material post balance sheet date events for disclosure.

(Expressed in millions of Renminbi unless otherwise stated)

(A) SIGNIFICANT DIFFERENCES BETWEEN THE FINANCIAL STATEMENTS PREPARED UNDER INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRSs") AND THOSE PREPARED IN ACCORDANCE WITH THE RELEVANT ACCOUNTING RULES AND REGULATIONS IN THE PRC

As a bank incorporated in the People's Republic of China ("PRC") and listed in Shanghai Stock Exchange, China Merchants Bank ("the Bank") prepared its statutory financial statements for the year ended 31 December 2006 in accordance with the Accounting Standards for Business Enterprises issued by the Ministry of Finance (the "MOF"), the Accounting Regulations for Financial Enterprises (2001), and other relevant regulations issued by the MOF (collectively "PRC GAAP"').

The above financial statements are named as "PRC statutory financial statements" for the purposes of this reconciliation.

A reconciliation of differences between the financial statements prepared under IFRSs and those PRC statutory financial statements are set out below.

	2006	2005
Net profit attributable to equity holders of the Bank under IFRSs	**6,794**	3,749
Foreign exchange translation	**313**	38
Net profit shown in PRC statutory financial statements (Note)	**7,107**	3,787

Note: There is no difference in the shareholders' equity as shown in the financial statements prepared under IFRSs and the PRC statutory financial statements as at 31 December 2005 and 31 December 2006.

Effective from 1 January 2006, the Bank has adopted the new Provisional Regulations On the Recognition And Measurement Of Financial Instruments No. 14 which are substantially consistent with IAS 39 on "Financial Instruments: Recognition and Measurement". 2005 comparative figures have been retrospectively adjusted.

(B) LIQUIDITY RATIOS

	2006	2005
Liquidity ratios		
RMB current assets to RMB current liabilities	**51.1%**	52.2%
Foreign currency current assets to foreign currency current liabilities	**166.0%**	90.4%

The above liquidity ratios are calculated in accordance with the formula promulgated by the People's Bank of China ("the PBOC") and the China Banking Regulatory Commission ("the CBRC") and based on PRC GAAP.

(C) CAPITAL ADEQUACY RATIO

The capital adequacy ratio is prepared on a solo basis in accordance with the guideline "Regulation Governing Capital Adequacy of Commercial Banks"【Order (2004) No. 2】issued by the CBRC (the "CBRC guideline") in March 2004, which may have significant differences with the relevant requirements in Hong Kong or other countries.

The capital adequacy ratios and related components of the Bank as at 31 December 2006 and 2005 calculated based on PRC GAAP, were as follows:

	2006	2005
Core capital adequacy ratio	**9.58%**	5.57%
Capital adequacy ratio	**11.40%**	9.01%

for the year ended 31 December 2006

(Expressed in millions of Renminbi unless otherwise stated)

(C) CAPITAL ADEQUACY RATIO *(continued)*

The capital adequacy ratios and related components of the Bank as at 31 December 2006 and 2005 calculated based on PRC GAAP, were as follows: *(continued)*

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

(D) CURRENCY CONCENTRATIONS OTHER THAN RMB

	2006			
	US Dollars	**HK Dollars**	**Others**	**Total**
		(in millions of RMB)		
Non-structural position				
Spot assets	**92,152**	**22,979**	**7,281**	**122,412**
Spot liabilities	**(61,884)**	**(34,157)**	**(7,151)**	**(103,192)**
Forward purchases	**9,017**	**12,067**	**751**	**21,835**
Forward sales	**(40,845)**	**(615)**	**(676)**	**(42,136)**
Net option position	**115**	**–**	**(115)**	**–**
Net long/(short) position	**(1,445)**	**274**	**90**	**(1,081)**
Net structural position	**–**	**51**	**–**	**51**

	2005			
	US Dollars	HK Dollars	Others	Total
		(in millions of RMB)		
Non-structural position				
Spot assets	56,163	15,301	7,179	78,643
Spot liabilities	(56,243)	(15,547)	(7,179)	(78,969)
Forward purchases	5,684	407	1,270	7,361
Forward sales	(2,476)	(2,276)	(1,125)	(5,877)
Net long/(short) position	3,128	(2,115)	145	1,158
Net structural position	–	50	–	50

(Expressed in millions of Renminbi unless otherwise stated)

(D) CURRENCY CONCENTRATIONS OTHER THAN RMB *(continued)*

The net option position is calculated using the delta equivalent approach required by the Hong Kong Monetary Authority (the "HKMA"). The net structural position of the Group includes the structural positions of the Bank's branches substantially involved in foreign exchange. Structural assets and liabilities include:

– Investments in fixed assets and premises, net of depreciation charges;

– Capital and statutory reserves of Hong Kong branch; and

– Investment in a subsidiary in Hong Kong.

(E) CROSS-BORDER CLAIMS

The Group is principally engaged in business operations within the Mainland China, and regards all claims on third parties outside the Mainland China as cross-border claims.

Cross-border claims include loans and advances, balances and placements with banks and other financial institutions, holdings of trade bills and certificates of deposit and investment securities.

Cross-border claims have been disclosed by different country or geographical areas. A country or geographical areas is reported where it constitutes 10% or more of the aggregate amount of cross-border claims, after taking into account any risk transfers. Risk transfers are only made if the claims are guaranteed by a party in country which is different from that of the counterparty or if the claims are on an overseas branch of a bank whose head office is located in another country.

	2006			
	Banks and other financial institutions	Public sector entities	Others	Total
Asia Pacific excluding the PRC	20,813	1,684	5,701	28,198
– of which attributed to Hong Kong	4,999	1,684	4,643	11,326
Europe	32,536	1,180	635	34,351
North and South America	13,181	5,227	1,396	19,804
	66,530	8,091	7,732	82,353

(E) CROSS-BORDER CLAIMS *(continued)*

	2005			
	Banks and other financial institutions	Public sector entities	Others	Total
Asia Pacific excluding the PRC	6,858	247	4,067	11,172
– of which attributed to Hong Kong	208	247	3,900	4,355
Europe	15,513	475	10	15,998
North and South America	3,494	5,035	733	9,262
	25,865	5,757	4,810	36,432

(F) OVERDUE LOANS AND ADVANCES TO CUSTOMERS BY GEOGRAPHICAL SEGMENTS

	2006	2005
Eastern China	**1,105**	705
Southern and Central China	**5,961**	6,926
Western China	**2,245**	2,422
Northern China	**839**	682
Others	**105**	26
	10,255	10,761

Note: The above analysis includes loans and advances overdue for more than 90 days as required and defined by the HKMA.

Loans and advances with a specific repayment date are classified as overdue when the principal or interest is overdue.

For loans and advances repayable by regular instalments, if part of the instalments is overdue, the whole amount of these loans would be classified as overdue.

Loans and advances repayable on demand are classified as overdue when a demand for repayment has been served on the borrower but repayment has not been made in accordance with the instructions. If the loans and advances repayable on demand are outside the approved limit that was advised to the borrower, they are also considered as overdue.

(Expressed in millions of Renminbi unless otherwise stated)

(G) GROSS AMOUNT OF OVERDUE LOANS AND ADVANCES TO CUSTOMERS

	2006	2005
Gross loans and advances to customers which have been overdue with respect to either principal or interest for periods of:		
– between 3 and 6 months	**904**	1,360
– between 6 and 12 months	**847**	1,886
– over 12 months	**8,504**	7,515
Total	**10,255**	10,761
As a percentage of total gross loans and advances:		
– between 3 and 6 months	**0.16%**	0.29%
– between 6 and 12 months	**0.15%**	0.40%
– over 12 months	**1.50%**	1.59%
Total	**1.81%**	2.28%

Notes:

(i) The above analysis includes loans and advances overdue for more than 90 days as required and defined by the HKMA.

Loans and advances with a specific repayment date are classified as overdue when the principal or interest is overdue.

For loans and advances repayable by regular instalments, if part of the instalments is overdue, the whole amount of these loans would be classified as overdue.

Loans and advances repayable on demand are classified as overdue when a demand for repayment has been served on the borrower but repayment has not been made in accordance with the instructions. If the loans and advances repayable on demand are outside the approved limit that was advised to the borrower, they are also considered as overdue.

(ii) There were no overdue loans and advances to financial institutions as at 31 December 2006 and 2005.

(H) RESCHEDULED LOANS AND ADVANCES TO CUSTOMERS

	2006	**% of total loans and advances**	2005	% of total loans and advances
Rescheduled loans and advances to customers	**2,486**	**0.44%**	2,447	0.52%
Less:				
– rescheduled loans and advances but overdue more than 90 days	**1,581**	**0.28%**	1,822	0.39%
Rescheduled loans and advances overdue less than 90 days	**905**	**0.16%**	625	0.13%

There were no rescheduled loans and advances to financial institutions as at 31 December 2006 and 2005.

(I) CORPORATE GOVERNANCE

Board committees

The Board of Directors has established a number of committees including the Risk Management Committee, Audit and Related Party Transactions Control Committee and Senior Management and its Committees.

(i) Risk Management Committee

The Risk Management Committee supervises the senior management on risk management matters, assesses the risks and recommendations to the Board of Directors measures to improve the risk management and internal control systems.

(I) CORPORATE GOVERNANCE *(continued)*

Board committees *(continued)*

(ii) Audit and Related Party Transactions Control Committee

The Audit and Related Party Transactions Control Committee reviews the performance of the independent auditors and recommends each year to the Board of Directors whether to retain the independent auditors. The Committee also liaises between the internal audit function and independent auditors, oversees the internal auditing system, reviews the financial information, evaluates and monitors the compliance with, and adequacy of, the internal controls and reviews significant related party transactions and makes recommendations on whether to approve such transactions to the Board of Directors.

(iii) Senior Management and its Committees

The Senior Management comprises the President and Chief Executive Officer and four Vice Presidents. They meet regularly to review the management and performance of the Bank. There are four management committees that have senior management level responsibility in respect of risk management. These committees comprise Risk Control Committee (responsible for credit risk management), Assets and Liabilities Management Committee (responsible for managing liquidity risk and market risk and overall assets and liabilities), Audit and Supervision Management Committee (responsible for maintaining the independence, authority and effectiveness of internal auditing system) and Internal Control Review Committee (responsible for operational risk management).

NOTICE OF ANNUAL GENERAL MEETING

NOTICE IS HEREBY GIVEN that China Merchants Bank Co., Ltd. (the "Company") has decided to hold its annual general meeting of Shareholders for the year 2006 (the "Meeting") by way of physical meeting on 15 June 2007 (Friday). The details of the Meeting are as follows:

I. CONVENING OF THE MEETING

(1) Time of the Meeting

The Meeting will commence at 9:00 a.m. on 15 June 2007 (Friday). The Meeting is expected to be concluded within half a day.

(2) Venue of the Meeting

The Meeting will be held at the Conference Room, 5/F, China Merchants Bank Tower, 7088 Shennan Boulevard, Shenzhen, The People's Republic of China.

(3) Convenor

The Meeting will be convened by the Board of Directors of the Company.

(4) Way of conducting the Meeting

The Meeting will be conducted by way of voting at physical meeting.

(5) Attendees

1. All shareholders of the "China Merchants Bank" (600036) whose names appear on the register of members, kept by China Securities Depository and Clearing Corporation Limited, Shanghai Office, as at the close of A Share trading session of the Shanghai Stock Exchange as at 3:00 p.m. on 15 May 2007 (Tuesday) (hereinafter called "domestic shareholders");

2. all shareholders of H shares of "China Merchants Bank" (3698) whose names appear on the register of members of H Share, kept by Computershare Hong Kong Investor Services Limited, as at 15 June 2007 (Friday) (hereinafter called "shareholders of H Shares");

3. the proxies authorized by the above shareholders;

4. the directors, supervisors, senior management of the Company; and

5. the intermediate agents engaged by the Company and the guests invited by the Board of Directors.

II MATTERS TO BE CONSIDERED AND APPROVED AT THE MEETING

The following resolutions will be considered and approved in the Meeting:

As ordinary resolutions

1. Consider and approve the report of the Board of Directors for the year ended 31 December 2006;

2. Consider and approve the report of the Board of Supervisors for the year ended 31 December 2006;

3. Consider and approve the audited financial report for the year ended 31 December 2006;

4. Consider and approve the final financial report for the year ended 31 December 2006;

5. Consider and approve the proposed profit appropriations plan (including the distribution of final dividend) for the year ended 31 December 2006;

6. Consider and approve the resolution to appoint the accounting firm for the year 2007 and to fix their remuneration;

   Consider and approve the re-appointment of KPMG Huazhen and KPMG as the PRC auditors and international auditors for the year 2007 respectively; fees for the 2007 annual audit, 2007 interim review and other services as stated in the engagement letters (including but not limited to all outlay expenses such as travel allowance, accommodation fees, communication charges) would be totaled at RMB5.80 million.

7. Consider and approve the resolutions in relation to the Seventh session of the Board of Directors;[1]

   7.1 Consider and approve the re-appointment of Mr. Qin Xiao as non-executive director of the Company, with immediate effect, for a term of three years;

   7.2 Consider and approve the re-appointment of Mr. Fu Yuning as non-executive director of the Company, with immediate effect, for a term of three years;

   7.3 Consider and approve the re-appointment of Mr. Li Yinquan as non-executive director of the Company, with immediate effect, for a term of three years;

   7.4 Consider and approve the re-appointment of Mr. Huang Dazhan as non-executive director of the Company, with immediate effect, for a term of three years;

   7.5 Consider and approve the appointment of Mr. Ding An Hua, Edward as non-executive director of the Company, with immediate effect, for a term of three years;

1 For the information of the Directors nominated for re-election and election, please refer to the "Letter from the Board of Directors" to be dispatched to the shareholders of H Shares on 30 April 2007.

7.6 Consider and approve the re-appointment of Mr. Wei Jiafu as non-executive director of the Company, with immediate effect, for a term of three years;

7.7 Consider and approve the re-appointment of Ms. Sun Yueying as non-executive director of the Company, with immediate effect, for a term of three years;

7.8 Consider and approve the re-appointment of Mr. Wang Daxiong as non-executive director of the Company, with immediate effect, for a term of three years;

7.9 Consider and approve the re-appointment of Mr. Fu Junyuan as non-executive director of the Company, with immediate effect, for a term of three years;

7.10 Consider and approve the re-appointment of Mr. Ma Weihua as executive director of the Company, with immediate effect, for a term of three years;

7.11 Consider and approve the appointment of Mr. Zhang Guanghua as executive director of the Company, with immediate effect, for a term of three years;

7.12 Consider and approve the appointment of Mr. Li Hao as executive director of the Company, with immediate effect, for a term of three years;

7.13 Consider and approve the re-appointment of Mr. Wu Jiesi as independent non-executive director of the Company, with immediate effect, for a term of three years, except that such three-year term will be subject to adjustments pursuant to the requirements of the relevant applicable laws and regulations;

7.14 Consider and approve the appointment of Ms. Yan Lan as independent non-executive director of the Company, with immediate effect, for a term of three years;

7.15 Consider and approve the appointment of Mr. Song Lin as independent non-executive director of the Company, with immediate effect, for a term of three years;

7.16 Consider and approve the re-appointment of Mr. Chow Kwong Fai, Edward as independent non-executive director of the Company, with immediate effect, for a term of three years, except that such three-year term will be subject to adjustments pursuant to the requirements of the relevant applicable laws and regulations;

7.17 Consider and approve the re-appointment of Mr. Liu Yongzhang as independent non-executive director of the Company, with immediate effect, for a term of three years, except that such three-year term will be subject to adjustments pursuant to the requirements of the relevant applicable laws and regulations;

7.18 Consider and approve the re-appointment of Ms. Liu Hongxia as independent non-executive director of the Company, with immediate effect, for a term of three years, except that such three-year term will be subject to adjustments pursuant to the requirements of the relevant applicable laws and regulations;

8. Consider and approve the resolutions in relation to the shareholder representative supervisors and external supervisors of the Seventh session of the Board of Supervisors;[2]

8.1 Consider and approve the re-appointment of Mr. Zhu Genlin as shareholder representative supervisor of the Company, with immediate effect, for a term of three years;

8.2 Consider and approve the re-appointment of Mr. Chen Haoming as shareholder representative supervisor of the Company, with immediate effect, for a term of three years;

8.3 Consider and approve the appointment of Mr. Dong Xiande as shareholder representative supervisor of the Company, with immediate effect, for a term of three years;

8.4 Consider and approve the appointment of Mr. Li Jiangning as shareholder representative supervisor of the Company, with immediate effect, for a term of three years;

8.5 Consider and approve the re-appointment of Mr. Shi Jiliang as external supervisor of the Company, with immediate effect, for a term of three years, except that such three-year term will be subject to adjustments pursuant to the requirements of the relevant applicable laws and regulations;

8.6 Consider and approve the re-appointment of Mr. Shao Ruiqing as external supervisor of the Company, with immediate effect, for a term of three years, except that such three-year term will be subject to adjustments pursuant to the requirements of the relevant applicable laws and regulations;

9. Consider and approve the duty performance and cross-evaluation reports of independent non-executive directors;

10. Consider and approve the assessment report on the duty performance of Directors for the year 2006;

2 For the information of the shareholders representative supervisors and external supervisors, please refer to the "Letter from the Board of the Directors" to be despatched to the shareholders of H Shares on 30 April 2007.

11. Consider and approve the duty performance and cross-evaluation reports of external supervisors;

12. Consider and approve the related party transaction report for the year 2006.

Note: The details of the above items 4, 9, 10, 11 and 12 will be published on the website of the Shanghai Stock Exchange (www.sse.com.cn) 5 working days before convening the Meeting.

III. PROCEDURES TO DEMAND A POLL BY MEMBERS

According to the Articles of Association of the Company, the resolutions will be determined on a show of hands unless a poll is demanded before or after any vote on a show of hands. A poll may be demanded by (i) the chairman of the Meeting; or (ii) at least two shareholders entitled to vote, present in person or by proxy; or (iii) one or more shareholders present in person or by proxy representing more than 10% of all shares carrying the voting rights at the Meeting.

IV. REGISTRATION OF THE MEETING

(1) Registration of Domestic Shareholders

1. Registration

(1) Reply slip

Any domestic shareholders intending to attend the Meeting in person or by proxies shall return the reply slip together with the requisite documents to the Company by courier, mail or fax on or before 25 May 2007 (Friday).

(2) Registration of attendance

Any corporate domestic shareholders entitled to attend the Meeting shall produce for registration a copy of its business license with official seal, stock account card of entity shareholder, evidence of shareholding, a duly signed power of attorney and the ID card of the representative; an individual domestic shareholder shall produce for registration the stock account card, evidence of shareholding and his/her ID card.

2. Time of registration

The registration period for the domestic shareholders attending the Meeting shall be from 21 May 2007 to 25 May 2007.

3. Requirements for proxies on registration and documents to be provided when voting

(1) Any domestic shareholder entitled to attend and vote at the Meeting may appoint one or more persons as his/her proxy/proxies to attend and vote at the Meeting on his/her behalf. A proxy needs not be a member of the Company.

(2) A domestic shareholder shall appoint a proxy in writing. The domestic shareholder or his/her attorney duly appointed by a written authorisation shall sign the proxy form in writing. If the domestic shareholder is a legal person, the proxy form shall be signed by its legal representative with the official seal of the domestic shareholder. If the proxy form is signed by the attorney appointed by the domestic shareholder, the power of attorney authorising that attorney to sign or other authorisation document(s) shall be notarized.

(3) To be valid, the proxy form, together with the power of attorney or other authorisation document(s) (if any) must be delivered to the Company not less than 24 hours before the time designated for holding the Meeting or any adjournment thereof (as the case may be).

(2) Shareholders of H Shares

1. Closure of Register of Members of H Shares

In order to determine the shareholders list of H shares who will be entitled to attend the Meeting and receive the final dividend for the year ended 31 December 2006, the Company will close its share register and suspend registration of transfer of shares from 16 May 2007 (Wednesday) to 15 June 2007 (Friday) (both days inclusive).

In order to qualify to attend the Meeting and receive the final dividend, holders of H Shares of the Company whose transfer have not been registered should deposit the transfer documents accompanied by the relevant share certificates at the Company's H Share Registrar, Computershare Hong Kong Investor Services Limited at Rooms 1712-1716, 17/F, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong by no later than 4:30 p.m. on 15 May 2007 (Tuesday).

2. Registration of attendance

(1) Reply slip

Any corporate shareholder of H Shares intending to attend the Meeting in person or by his/her proxy/proxies shall return the reply slip together with the requisite documents to the Company by courier, mail or fax on or before 25 May 2007 (Friday).

(2) Registration of attendance

Any shareholder of H Shares entitled to attend the Meeting shall produce for registration his/her ID card. In case of corporate shareholder, its legal representative or the authorised representative appointed by resolutions of its board of directors or its governing body can attend the Meeting. Such authorised representative shall produce for registration a copy of the resolutions of the board of directors or the governing body appointing him/her.

3. Requirements for proxies on registration and documents to be provided when voting

(1) Any shareholder of H Shares entitled to attend and vote at the Meeting may appoint one or more persons as his/her proxy/proxies to attend and vote at the Meeting on his/her behalf. A proxy needs not be a member of the Company.

(2) A shareholder of H Shares shall appoint a proxy in writing. The shareholder of H Shares or his/her attorney duly appointed by a written authorisation shall sign the proxy form in writing. If the shareholder of H Shares is a legal person, the proxy form shall be signed by its legal representative with the common seal of the shareholder of H Shares. If the proxy form is signed by the attorney appointed by the shareholder of H Shares, the power of attorney authorising that attorney to sign or other authorisation document(s) shall be notarized.

(3) To be valid, the proxy form, together with the power of attorney or other authorisation document(s) (if any) must be delivered by the shareholder of H Shares to the H Share Registrar of the Company not less than 24 hours before the time designated for holding the Meeting or any adjournment thereof (as the case may be). Completing and return of the proxy form will not preclude the shareholder of H Shares from attending and voting at the Meeting. The H Share Registrar of the Company is Computershare Hong Kong Investor Services Limited at Rooms 46/F, Hopewell Centre, 183 Queen’s Road East, Wanchai, Hong Kong.

4. A “Letter from the Board of Directors” containing the information of the Directors and the Supervisors nominated for re-election and election will be dispatched to the shareholders of H Shares on 30 April 2007.

V. OTHER MATTERS

1. Contact details of the Company

Contact Address:	49/F, China Merchants Bank Tower, No. 7088 Shennan Boulevard, Shenzhen, The People's Republic of China
Postcode:	518040
Contact Person:	Chen Yuxiao, Lu Lan, Feng Guannan
Contact Telephone:	(86 755) 83195882, 83195829, 83195832
Contact Fax:	(86 755) 83195109

2. The Meeting is expected to be concluded within half a day. All shareholders and proxies of the shareholders are responsible for their own transportation fee, accommodation and other related expenses.

By order of the Board of Directors of

China Merchants Bank Co., Ltd.

Chairman
Qin Xiao

30 April 2007

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