招商銀行
CHINA MERCHANTS BANK

# 招商銀行股份有限公司
# CHINA MERCHANTS BANK CO., LTD.

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

**(Stock code: 3968)**

## 2008 ANNUAL RESULTS ANNOUNCEMENT

The Board of Directors (the "Board") of China Merchants Bank Co., Ltd. (the "Company") is pleased to announce the audited results of the Company and its subsidiaries for the period ended 31 December 2008. This announcement, containing the full text of the 2008 Annual Report of the Company, complies with the relevant requirements of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited in relation to information to accompany preliminary announcements of annual results. Printed version of the Company's 2008 Annual Report will be delivered to the H-Share Holders of the Company and available for viewing on the websites of The Stock Exchange of Hong Kong Limited at www.hkex.com.hk and of the Company at www.cmbchina.com in late April 2009.

**Publication of Results Announcement**

Both the Chinese and English versions of this results announcement are available on the websites of the Company (www.cmbchina.com) and The Stock Exchange of Hong Kong Limited (www.hkex.com.hk). In the event of any discrepancies in interpretations between the English version and Chinese version, the Chinese version shall prevail.

The Company also prepared the financial statements in Chinese in accordance with the PRC Generally Accepted Accounting Principles, 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
**China Merchants Bank Co., Ltd.**
**Qin Xiao**
*Chairman*

24 April 2009

*As at the date of this announcement, the executive directors of the Company are Ma Weihua, Zhang Guanghua and Li Hao; the non-executive directors of the Company are Qin Xiao, Wei Jiafu, Fu Yuning, Li Yinquan, Hong Xiaoyuan, Ding An Hua Edward, Sun Yueying, Wang Daxiong and Fu Junyuan; and the independent non-executive directors of the Company are Wu Jiesi, Yan Lan, Yi Xiqun, Chow Kwong Fai, Edward, Liu Yongzhang and Liu Hongxia.*

**World famous pianist Lang Lang, the brand ambassador of CMB**

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# Important Notice



The Board of Directors, the Board of Supervisors, and directors, supervisors and senior management of the Company confirm that there are no false representations, misleading statements or material omissions contained herein, and individually and collectively accept full responsibility for the truthfulness, accuracy and completeness of the contents of this report.

The 37th meeting of the Seventh Session of the Board of Directors of China Merchants Bank Co., Ltd. (the "Company") was held at the training center of China Merchants Bank Co., Ltd., Shenzhen on 24 April 2009. The meeting was presided by Qin Xiao, Chairman of the board. 14 out of 18 eligible Directors attended the meeting. Wei Jiafu and Fu Yuning (both being directors) appointed Qin Xiao (director) as proxy, and Wang Daxiong and Fu Junyuan (both being directors) appointed Li Yinquan (director) as proxy to vote on their behalf respectively. Six supervisors of the Company were present at the meeting. The convening of the meeting complied with the relevant provisions of the Company Law and the Articles of Association of the Company.

KPMG Huazhen Certified Public Accountants and KPMG Certified Public Accountants have reviewed the 2008 financial report respectively in accordance with the PRC and international accounting standards, and issued standard auditing reports with unqualified opinions.

Unless otherwise stated, all monetary sums stated in this annual report are expressed in RMB.

Hereinafter the "Company", the "Bank" and "CMB" mentioned in this annual report are all referred to China Merchants Bank Co., Ltd.; and the "Group" is referred to China Merchants Bank Co., Ltd. and its subsidiaries.

Mr. Qin Xiao, Chairman of the Company, Mr. Ma Weihua, President, Mr. Li Hao, Executive Vice President and Chief Financial Officer, and Mr. Zhou Song, the person in charge of the Planning and Finance Department, hereby make representations in respect of the truthfulness and completeness of the financial statements in this annual report.

## 1.1 Company Profile

**1.1.1 Registered Corporate Name in Chinese:** 招商銀行股份有限公司 (Chinese abbreviation: 招商銀行)
**Registered Corporate Name in English:** China Merchants Bank Co., Ltd.

**1.1.2 Legal Representative:** Qin Xiao
**Authorized Representatives:** Ma Weihua, Li Hao
**Secretary of the Board of Directors:** Lan Qi
**Joint Company Secretaries:** Lan Qi, Seng Sze Ka Mee, Natalia (FCIS, FCS(PE), FHKIoD)
**Qualified Accountant:** Cheng Ting Nan (CPA, FCCA)
**Securities Representative:** Wu Jianbing

**1.1.3 Registered and Office Address:**
7088 Shennan Boulevard, Futian District, Shenzhen, Guangdong Province, China

**1.1.4 Mailing Address:**
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

**1.1.5 Principal Place of Business in Hong Kong:**
21st Floor, Bank of America Tower, 12 Harcourt Road, Hong Kong

**1.1.6 Share Listing:**

| | |
|---|---|
| A Share: | Shanghai Stock Exchange<br>Abbreviated Name of A Share: CMB<br>Stock Code: 600036 |
| H Share: | The Stock Exchange of Hong Kong Ltd.<br>("SEHK" or the "Hong Kong Stock Exchange")<br>Abbreviated Name of H Share: CM BANK<br>Stock Code: 3968 |
| Convertible Bonds: | Shanghai Stock Exchange<br>Abbreviation of Convertible Bonds: CMB Convertible Bonds<br>Code of Convertible Bonds: 110036 |

**1.1.7 Domestic Auditor:** KPMG Huazhen Certified Public Accountants
Office Address: 8th Floor, Tower 2, Oriental Plaza, 1 East Chang An Avenue, Beijing, PRC
**International Auditor:** KPMG Certified Public Accountants
Office Address: 8th Floor, Prince's Building, 10 Charter Road, Central, Hong Kong

**1.1.8 Legal Advisor as to the PRC Law:** Jun He Law Office
**Legal Advisor as to Hong Kong Law:** Herbert Smith

**1.1.9 Trustee for A Share with Trading Restrictions:** China Securities Depository & Clearing Corporation Ltd., Shanghai Branch

**1.1.10 Share Registrar and Transfer Office as to H Share:** Computershare Hong Kong Investor Services Ltd.
Rooms 1712-1716, 17/F, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong

**1.1.11 Websites and Newspapers Designated by the Company for Information Disclosure:**

Mainland China: "*China Securities Journal*", "*Securities Times*", "*Shanghai Securities News*", website of the Shanghai Stock Exchange (www.sse.com.cn), the Company's website (www.cmbchina.com);

Hong Kong: website of The Stock Exchange of Hong Kong Ltd. (www.hkex.com.hk), the Company's website (www.cmbchina.com);

Annual reports available at: the office of the Board of Directors

**1.1.12 Other Information about the Company:**

Initial registration date: 31 March 1987

Initial registration place: Administration for Industry and Commerce of Shenzhen, Shekou Branch

Registered No. of business licence for an enterprise as a legal person: 4403011228801

Taxation Registration No.: Guo Shui Shen Zi 44030010001686X<br>Shen Di Shui Deng Zi 44030410001686X

Organization Code: 10001686-X

## 1.2 Corporate Information

Founded in 1987 with its head office in Shenzhen, China, the Company mainly focuses on the China market. As at 31 December 2008, the Company had 44 branches, 623 sub-branches (including offices), 1 representative office (in Beijing), 1 credit card center, 1 credit center for small-sized enterprises, 1,567 self-service banking centers and over 1,400 off-bank self-service machines (ATM & CDM) in Mainland China, and a wholly owned subsidiary CMB Financial Leasing Company Limited. The efficiently operated 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 owns two subsidiaries, namely, Wing Lung Bank Limited ("WLB" or "Wing Lung Bank") and CMB International Capital Corporation Limited ("CMBICC"), and a branch in Hong Kong. It has a branch and a representative office in New York. The Company has established correspondent relationship with 1,756 overseas financial institutions in 93 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 was listed on Shanghai Stock Exchange in April 2002 and on SEHK in September 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 customers.The innovative products and services of the Company, such as "All-in-one Card," a multi-function debit card, "All-in-one Net," a comprehensive online banking service, dual currency credit card, the "Sunflower Wealth Management" services and private banking services, have become widely accepted in China.

Principal activities of the Company:

Taking deposits from the public; granting short, medium and long term loans; settlement; bills discounting; issuing financial bonds and acting as agent for issuance and encashment; underwriting and trading government bonds; inter-bank lending and borrowing; letter of credit and guarantees; collection and payment; bancassurance; safety-deposit box services; foreign currency deposits and loans, remittance; foreign exchange; international settlement; foreign currency placement; foreign currency 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 short-term commercial paper; derivative products trading; and other businesses approved by China Banking Regulatory Commission ("CBRC").

## 1.3 Important events for the year

### 1.3.1 Acquisition of Wing Lung Bank

On 30 May 2008, the Company entered into an agreement with the Wu family in respect of the acquisition of approximately 53.12% equity interest in WLB for a total consideration of HK$19,302 million. On 30 September 2008, the Company completed the acquisition of approximately 53.12% equity interest in WLB from the Wu family. On 6 October 2008, the Company dispatched the composite offer document to the remaining shareholders of Wing Lung Bank. On 15 January 2009, the Company completed the compulsory acquisition of WLB which then became a wholly-owned subsidiary of the Company. WLB withdraw the listing of its shares on the Hong Kong Stock Exchange effective from 16 January 2009.


The ceremony of the acquisition of controlling interest in WLB by CMB

The Company's acquisition of WLB is a significant strategic move, which is of profound strategic significance for the Company to expand its operations in Hong Kong, speed up the process of internationalization, promote the adjustment in the operation strategy and provide more comprehensive and better integrated financial services to customers both in Mainland China and Hong Kong.

### 1.3.2 Inauguration of New York Branch

On 8 October 2008, our New York Branch, which is located at 535 Madison Avenue, New York, officially commenced operation. It was the first time that a Chinese bank was approved by the Federal Reserve to establish a branch in the U.S. since the enactment of the Foreign Bank Supervision Enhancement Act of 1991 in the U.S.

The New York Branch of the Company was granted a whole-sale banking business license and was positioned as a bank focusing on international settlement and trade finance for the promotion of Sino-US economic and trade cooperation. At the meantime, it also carries out treasury activities and clearing businesses as an important supplement to its business scope. The New York Branch of the Company primarily targets Chinese enterprises which "go abroad" to foreign countries by offering handy follow-up services to them.

By closely following our corporate cultural principle of catering to the changing needs of our customers and capitalizing on the increasing Sino-US co-operation, our New York Branch will serve as a window and a platform, through which the Company's internationalized management strength and ability to provide globalized services will be further enhanced.

The senior management of CMB and all the staff in the New York Branch


**1.** We are recognized as "The Best Local Private Wealth Management Bank in China".

**2.** We are recognized as one of "China's Most Admired Enterprises".

## 1.4 Awards and honors received in 2008

In 2008, we have received many domestic and international awards and honors for our outstanding business performance, management capability and corporate culture. These include:

The Company ranked first in "The Best Banking Institution in China" and third in "The Best Banking Institution in Asia" in the selection of "Asia's Best Companies for 2008" organized by *Euromoney*.

The Company ranked second in"The Best Local Private Wealth Management Bank in China" and first in "The Best Local Private Wealth Management Bank Providing Corporate Advisory Services to Private Banks in China" in the selection of "World's Best Private Wealth Management Bank for 2008".

In the "Results Release on the 2008 Survey of Preferred Brand Names of Chinese Multimillionaires" held by Chinese Hurun Report, we were the winner among Chinese banks, being recognized as "The Most Preferred RMB Wealth Management Bank" and "The Most Preferred Credit Card Issuer" for wealthy people, respectively for four consecutive years.

The Company was the winner of "The Best Corporate Governance Award" and "The Best Bank Credit Card Award" in the selection activities organized by *Global Finance*.

The Company was awarded the honor of "China's Best Local Bank for 2008" by *Asia Money*.

For six consecutive years, we were voted as one of "China's Most Respected Enterprises" in an annual survey jointly conducted by Peking University Management Case Study Center and the *Economic Observer*.

**3. The Asian Banker Magazine**
The only banker in the Asia-Pacific region receiving "Best Retail Banker of the Year"
Awarded "The Best Retail Bank in China" the third time
Received "The Best Joint Stock Retail Bank in China" award for five consecutive years.

**4.** We received the "Outstanding Directors Award for 2008" in three categories regarding non Hang Seng Index Constituents honored by the Hong Kong Institute of Directors.

The Board of Directors of the Company was granted the "Outstanding Board of Directors Award for 2008".

Mr. Qin Xiao, Chairman of the Company, was the winner of the "Outstanding Non-Executive Directors Award for 2008".

Mr. Ma Weihua, President of the Company, won the "Outstanding Executive Directors Award for 2008".

**5.** We received six awards including "The Best Investor Relations Award" and "The Best Corporate Governance Award" granted by Investor Relations, a British Magazine.

The Company ranked the second place among the top ten in China in the selection of the "Asia's 200 Most Admired Companies" for 2008 organized by *The Wall Street Journal*.

The Company won three awards, namely, "The Best Management Company", "The Best Corporate Governance" and "The Best Investor Relationship" in the selection of "2008 Best Companies in Asia" organized by *Finance Asia*.

At the award presentation ceremony for the "Excellent Retail Financial Service Awards" for 2008 organized by *The Asian Banker* magazine, Mr. Ma Weihua, President of the Company, was the only banker in the Asia-Pacific region as well as the first president of a commercial bank in China to receive the title of the "Best Retail Banker of the Year". The Company received "The Best Retail Bank in China" award for the third time and received "The Best Joint Stock Retail Bank in China" award for five consecutive years and is one of the most awarded banks since the introduction of the latter award.

At the 2008 award presentation ceremony organized by The Hong Kong Institute of Directors, the Company won the "Outstanding Directors Award for 2008" in three categories regarding non Hang Seng Index Constituents. The Board of Directors of the Company was granted the "Outstanding Board of Directors Award for 2008", while Mr. Qin Xiao, Chairman of the Company, was the winner of the "Outstanding Non-Executive Directors Award for 2008," and Mr. Ma Weihua, President of the Company, won the "Outstanding Executive Directors Award for 2008".

In the award ceremony (China region) organized by *Investor Relations*, a British Magazine, we again received six awards including "The Best Investor Relations Award" and "The Best Corporate Governance Award".

## 2.1 Key financial data

### Operating Results

| | 2008 | 2007 | Changes |
|---|---|---|---|
| | (in millions of RMB) | | +/(-)% |
| Net operating income [1] | **55,655** | 41,086 | 35.46 |
| Profit before tax | **26,759** | 21,043 | 27.16 |
| Net profit attributable to the Bank's shareholders | **21,077** | 15,243 | 38.27 |

### Per Share

| | 2008 | 2007 | Changes |
|---|---|---|---|
| | (in RMB) | | +/(-)% |
| Basic earnings attributable to the Bank's shareholders | **1.43** | 1.04 | 37.50 |
| Diluted earnings attributable to the Bank's shareholders | **1.43** | 1.04 | 37.50 |
| Year-end net assets value attributable to the Bank's shareholders | **5.41** | 4.62 | 17.10 |

### Financial Position

| | As at 31 December 2008 | As at 31 December 2007 | Changes |
|---|---|---|---|
| | (in millions of RMB) | | +/(-)% |
| Total assets | **1,571,797** | 1,310,964 | 19.90 |
| of which: total loans and advances to customers | **874,362** | 673,167 | 29.89 |
| Total liabilities | **1,492,016** | 1,242,980 | 20.04 |
| of which: total deposits from customers | **1,250,648** | 943,534 | 32.55 |
| Total equity attributable to the Bank's shareholders | **79,515** | 67,984 | 16.96 |

Note: [1] Net operating income is the sum of total operating income and share of profits of associates or joint ventures.

## 2.2 Financial Ratios

| | **2008** | 2007 | Changes |
|---|---|---|---|
| | | (%) | +/(-) |
| **Profitability ratios** | | | |
| Return on average assets (after tax) attributable to the Bank's shareholders | **1.46** | 1.36 | 0.10 |
| Return on average equity (after tax) attributable to the Bank's shareholders | **28.58** | 24.76 | 3.82 |
| Net interest spread | **3.24** | 2.96 | 0.28 |
| Net interest margin | **3.42** | 3.11 | 0.31 |
| **As percentage of operating income** | | | |
| – Net interest income | **84.24** | 82.51 | 1.73 |
| – Net non-interest income | **15.76** | 17.49 | (1.73) |
| Cost-to-income ratio (excluding business tax) | **36.55** | 34.94 | 1.61 |

| | **As at 31 December 2008** | As at 31 December 2007 | Changes |
|---|---|---|---|
| | | (%) | +/(-) |
| **Capital adequacy ratios** | | | |
| Core capital adequacy ratio | **6.56** | 8.78[1] | (2.22) |
| Capital adequacy ratio | **11.34** | 10.40[1] | 0.94 |
| Total equity to total assets | **5.08** | 5.19 | (0.11) |
| **Asset quality ratios** | | | |
| Non-performing loan ratio | **1.11** | 1.54 | (0.43) |
| Allowances for impairment losses to non-performing loans | **223.29** | 180.39 | 42.90 |
| Allowances for impairment losses to total loans and advances to customers | **2.47** | 2.79 | (0.32) |

Note: (1) The core capital adequacy ratio and capital adequacy ratio as at 31 December 2007 were restated according to the Yinjianfu Document [2008] No. 123 issued by China Banking Regulatory Commission.

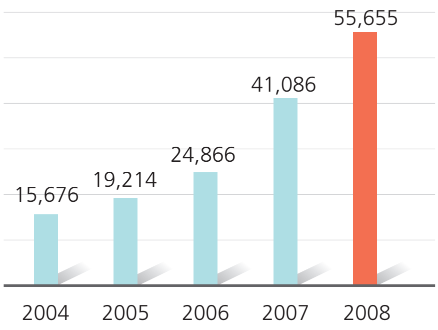
## 2.3 Five-year Financial Summary

| | **2008** | 2007 | 2006 | 2005 | 2004 |
|---|---|---|---|---|---|
| **Results for the year** | | | (in millions of RMB) | | |
| Net operating income | **55,655** | 41,086 | 24,866 | 19,214 | 15,676 |
| Operating expenses | **23,636** | 16,738 | 11,091 | 9,115 | 7,432 |
| Provision for impairment losses | **5,154** | 3,305 | 3,691 | 3,637 | 3,066 |
| Profit before tax | **26,759** | 21,043 | 10,084 | 6,462 | 5,178 |
| Net profit attributable to the Bank's shareholders | **21,077** | 15,243 | 6,794 | 3,749 | 3,276 |
| **Per share** | | | (RMB) | | |
| Dividend | **0.40** | 0.28 | 0.12 | 0.08 | 0.11 |
| Basic earnings | **1.43** | 1.04 | 0.53 | 0.34 | 0.29 |
| Diluted earnings | **1.43** | 1.04 | 0.53 | 0.33 | 0.29 |
| Year-end net assets value attributable to the Bank's shareholders | **5.41** | 4.62 | 3.75 | 2.51 | 3.21 |
| **Year end (31 December)** | | | (in millions of RMB) | | |
| Share capital | **14,707** | 14,705 | 14,703 | 10,374 | 6,848 |
| Total shareholders' equity | **79,781** | 67,984 | 55,160 | 25,998 | 21,958 |
| Total liabilities | **1,492,016** | 1,242,568 | 878,942 | 708,615 | 564,757 |
| Deposits from customers | **1,250,648** | 943,534 | 773,757 | 634,404 | 512,586 |
| Total assets | **1,571,797** | 1,310,964 | 934,102 | 734,613 | 586,715 |
| Loans and advances to customers[(1)] | **852,754** | 654,417 | 549,420 | 458,675 | 363,097 |
| **Key financial ratio** | | | (%) | | |
| Return on average assets (after tax) attributable to the Bank's shareholders | **1.46** | 1.36 | 0.81 | 0.57 | 0.61 |
| Return on average equity (after tax) attributable to the Bank's shareholders | **28.58** | 24.76 | 16.74 | 15.64 | 16.25 |
| Cost-to-income ratio | **36.55** | 34.94 | 38.28 | 41.10 | 41.18 |
| Non-performing loan ratio | **1.11** | 1.54 | 2.12 | 2.58 | 2.88 |
| Core capital adequacy ratio[(2)] | **6.56** | 8.78 | 9.58 | 5.57 | 5.41 |
| Capital adequacy ratio[(2)] | **11.34** | 10.40 | 11.39 | 9.01 | 9.47 |

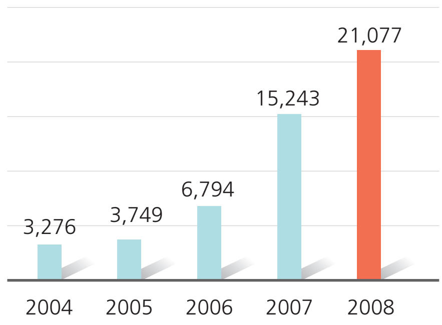
Notes: (1) Loans and advances to customers represent gross loans and advances to customers less allowances for loan impairment losses.

(2) The core capital adequacy ratio and capital adequacy ratio as at 31 December 2007 were restated according to the Yinjianfu Document [2008] No. 123 issued by China Banking Regulatory Commission.

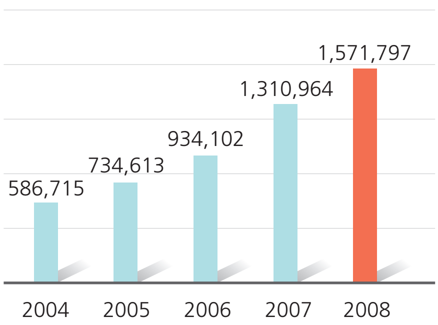
## Net operating income
in millions of RMB



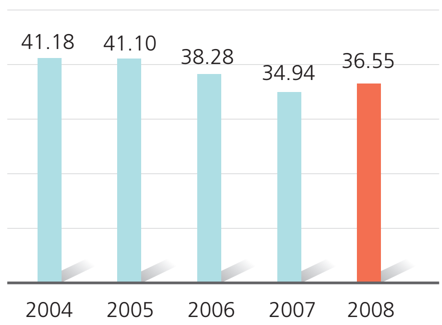

## Net profit attributable to the Bank's shareholders
in millions of RMB



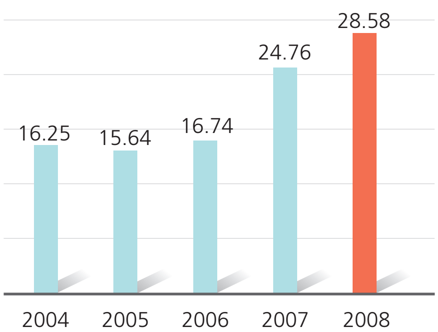

## Total assets
in millions of RMB



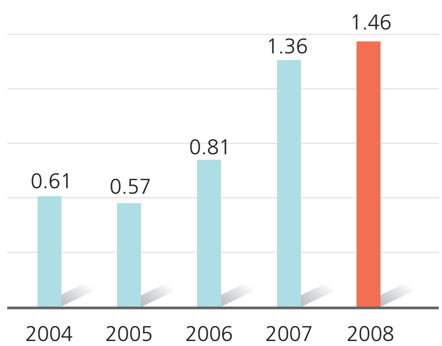

## Cost-to-income ratio
precentage




## Return on average equity (after tax) attributable to the Bank's shareholders
precentage




## Return on average assets (after tax) attributable to the Bank's shareholders
precentage



**Qin Xiao**
Chairman

Chairman's Statement

**CMB gets well prepared to move with the times. Confronting with the adjustment of macroeconomic policies and the new development trends of banking industry, we proactively adapt to the changes of the market and meet the requirements of our customers. Through improving the operation structure, enhancing the risk control level, ameliorating the reform of corporate governance, and fulfilling the social responsibility, CMB maintains a sound profitability, picturing a bright and pleasant spot in China's banking industry.**

和您一起

**Qin Xiao** Chairman

The year 2008 has been deeply engraved in our memory. We tasted the joy of overwhelming success of the Beijing Olympic Games and the Shenzhou VII manned space flight mission as well as the bitterness of the natural disasters that was unprecedented in a hundred years and the devastating financial tsunami in the same year. Against the background of global financial market turbulence and world-wide economic recession, China's economy also suffered a great shock – its monetary policy has undergone changes from "tightening up" to "striking a delicate growth-inflation balance" and then "appropriately loosening", as we have rarely seen. The operating environment for banks became more complicated and was full of uncertainties.

As an important part of China's finance industry, there was no way for the Bank to dodge the challenges arising from the stunning changes in the world and China's economies. However, we are gratified that we achieved encouraging operating results in the year as we adhered to the concept of scientific development for a "Balanced Development of Profits, Quality and Scale", persisted with the operating philosophy of "Change as Situation Does" and our service guideline of "We are here just for you". We focused on accelerating the adjustments to operating strategies, pressed on with internationalization of operation and management reform. We achieved a net profit attributable to shareholders of the Company of RMB21.077 billion, representing an increase of RMB5.834 billion or 38.27% over the previous year. The return on average assets (ROAA) attributable to shareholders of the Company was 1.46%, up 0.10 percentage point as compared with the last year. The return on average equity (ROAE) attributable to shareholders of the Company was 28.58%, up 3.82 percentage points as compared with the last year. The non-performing loan ratio was 1.11%, down 0.43 percentage points as compared with the last year while the non-performing loan coverage ratio was 223.29%, up 42.9 percentage points as compared with the last year, and the capital adequacy ratio was 11.34%, increasing by 0.94 percentage points as compared with the last year. Satisfactory results were also attained for the refinement of assets-liabilities structure, innovation of business model, enhancement of risk management and strengthening of internal control and IT project management.

The year of 2008 was a busy and challenging year for the Board of Directors of the Bank. During the year the Board held 19 meetings while its specialized committees convened 22 meetings, in which approximately 70 proposals had been considered and approved and various major decisions were made. These efforts back up the operations of the management and facilitated the healthy development of various businesses of the Bank. In particular, the Board made fruitful efforts in the internationalization of our operation, corporate governance and the fulfilment of social responsibilities.

As for internationalization of operation, the Bank made two landmark accomplishments during 2008, namely the establishment of the New York Branch and the acquisition of Wing Lung Bank. As part of our drive of overseas expansion, the establishment of New York Branch signified CMB's status as the first Chinese bank which was permitted to set up its branch in the U.S. since the adoption of the Foreign Bank Supervision Enhancement Act of 1991. This enabled us to offer more services to clients in the global arena by leveraging on the privileged international financial center of New York to keep ourselves abreast with the international financial markets and gain advanced management experience in international banking. The acquisition of Wing Lung Bank allowed us to speed up the realization of internationalization in a prudent approach. Many of our clients are already operating businesses abroad and some of them are setting up overseas presences in recent years. Therefore, internationalization is an inevitable process in the development path of CMB. Currently the integration of CMB with Wing Lung Bank is going smoothly and for the purpose of successful integration, we strive to "lay the foundation within one year, obtain apparent contributions within three years and accomplish success by the end of five years".

To further strengthen corporate governance, we adjusted and improved the organization structure, duties and composition of specialized committees under the Board of Directors and the Board of Supervisors in 2008, in order to maintain strict compliance with the requirements of the domestic and foreign regulatory authorities and to clearly divide their functions and duties. The Company revised the Implementation Measures of China Merchants Bank Co., Ltd. for the Specialized Committees under the Board of Directors and the Implementation Measures of China Merchants Bank Co., Ltd. for the Specialized Committees under the Board of Supervisors to ensure that all specialized committees carry out their duties in an independent, compliant and effective manner in accordance with laws on the one hand and that high efficiency and objective decision-making are achieved. During the year, specialized committees under the Board of Directors worked out a set of valuable proposals for the sustainable development of the Bank and the enhancement of corporate governance and they were presented for consideration and approval by the Board of Directors. The corporate governance of the Company earned high regard as we won all the awards for the three categories under "Director of the Year Award 2008" – Non-Hang Seng Index Constituent Issuers granted by The Hong Kong Institute of Directors and other six awards including the Best Corporate Governance and Best Investor Relations granted by the *Investor Relations*, a British magazine.

Mr. Qin Xiao, Chairman, giving a speech at the opening ceremony of our New York Branch.

As regards social responsibilities, apart from proactively supporting social and economic development by fully fulfilling our functions as a bank we also endeavor to fulfill our social responsibilities as a responsible corporate citizen by various means. This year we carried on our concept of "who benefited from the society must give back to the society" and did not hesitate to perform our social responsibilities. Following the outbreak of snowstorm disasters in Southern China and the earthquake in Wenchuan, we immediately made emergency donations totaling RMB14.70 million to the disaster stricken areas through the Red Cross Society of China. At the same time, we organised the donation of more than RMB18 million from employees of the bank and organized a drive of donation from our clients totaling RMB130 million. In addition, a series of favourable measures regarding remittance, transfer, credit granting and etc. were adopted in the disaster stricken areas to support the reconstruction works. During the period of the Olympic Games, along with rendering quality financial services, we lent our full support by sending a team of more than 140 volunteers to Beijing to provide hotline consultancy services to foreign guests. The initiative was highly praised and unanimously recognised by the Olympics Organizing Committee and the CBRC. Given the spreading global financial crisis, the domestic small and medium sized enterprises had their difficulties in obtaining finance. We moved to address the issue by emphasizing the development of banking services for small and medium sized businesses. To this end, we established the first credit centre for small sized enterprises in China so as to provide specialized financial services to help small sized enterprises get through the difficulties. A long term relief policy was put in place for the impoverished Wuding County and Yongren County in Yunnan Province. In 2008, we designated four poverty-alleviation cadres to local rural areas to carry out relief projects such as construction of Project Hope primary schools, grant of small amount revolving loans and set up "model villages" which succeeded in getting out of poverty to lead a well-off livelihood. Our genuine devotion has earned us widespread recognition. In 2008, we received the honors of being ranked first in "Top 10 Most Outstanding Listed Companies in Social Responsibilities in China", "Best Corporate Citizenship in China", "Most Caring Corporate in China", "Poverty Relief Charity Star in China", "Pioneer of the China Livelihood Movement", "Best Corporate in Innovation of Charity Model in China" and "Top 50 Charity Corporations in China". Furthermore, we have been awarded the honourable title of "China's Most Respected Enterprises" for 7 consecutive years.

2008 was a year marked with difficulties and volatilities. On 2 March 2009, China Merchants Bank became the first listed bank whose shares can be freely traded on both Shanghai Stock Exchange and Hong Kong Stock Exchange since the Share Reform. Standing on the turning point in history and facing with an anfractuous operating environment, the issue of how to realize a balanced and sustainable development and create better value and return for our investors is on top of our agenda in the years ahead.

In 2009, the global and domestic economies will still be affected by the financial crisis. In an effort to stimulate domestic demand and boost economic growth, the PRC government implemented a series of measures and announced a large scale economic stimulus plan, which presents valuable opportunities for the banking industry in China. On the other hand, the Chinese banking industry is also confronted with various unfavorable factors including low net interest margin, slow growth of non-interest income, and rising credit risks. In light of the challenges and opportunities in 2009, the Bank will follow the guiding principle of "steady pace, scientific development and expansion with effective risk control". Firstly, a proper growth rate for credit expansion will be maintained with reference to potential projects, risk control and adequacy of funds. Secondly, we will actively manage assets-liabilities structure so as to mitigate the adverse effects from the interest-rate cut cycle. Finally, effective measures will be taken to increase fee-based income, control expenditures, ensure that funds are properly allocated and reduce those controllable and unnecessary expenses.

We believe that by standing up to and addressing risks, seizing the opportunities, assessing the situation carefully and following a stable growth path, we can excel in 2009. We are to live up to the expectations of our investors and the society. We are also confident that China Merchants Bank will ride through the prevailing storm, emerge even stronger after and open a new chapter of glorious growth.

**Ma Weihua**
President

# President's Statement

The year 2008 was extraordinary for China Merchants Bank in the course of its development. During the year, against the background of the continuing deepening of the global financial crisis, the slowdown in domestic economic growth, and dramatic changes in market environments, the Bank actively fulfilled the requirements of the regulatory authorities and the Board, overcame various unfavorable factors, steadily advanced the adjustment of business strategies and the reform on management, thereby maintaining a positive development trend as a whole.

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**Ma Weihua** President

Giving a speech at the opening ceremony of our New York Branch.

和您一起

The year 2008 was extraordinary for China Merchants Bank in the course of its development. During the year, against the background of the continuing deepening of the global financial crisis, the slowdown in domestic economic growth, and dramatic changes in market environments, the Bank actively fulfilled the requirements of the regulatory authorities and the Board, overcame various unfavorable factors, steadily advanced the adjustment of business strategies and the reform on management, thereby maintaining a positive development trend as a whole.

As at the end of 2008, the total assets of the Group reached RMB1,571.797 billion, up by 19.90% from the beginning of the year, the total deposits amounted to RMB1,250.648 billion, increasing by 32.55%, the total loans and advances to customers amounted to RMB874.362 billion, increasing by 29.89%, and net profit attributable to shareholders of the Company amounted to RMB21.077 billion, increasing by 38.27%.

Our business development in 2008 displayed the following features. Firstly, our profitability improved steadily. Return on average assets (ROAA) attributable to shareholders of the Company reached 1.46% at the end of the year, an increase of 0.10 percentage point compared to the corresponding period of the previous year; return on average equity (ROAE) attributable to shareholders of the Company was 28.58%, an increase of 3.82 percentage points compared to the corresponding period of the previous year. Secondly, the assets quality continued to improve. The balance of the Company's non-performing loans amounted to RMB9.677 billion at the end of the year, a reduction of RMB717 million from the beginning of the year; the non-performing loan ratio was 1.11%, down 0.43 percentage point from the beginning of the year. Thirdly, our retail banking business achieved encouraging results in the adverse situation. Our total retail loans accounted for 26.61% of the gross loans and advances to customers, representing an increase of 0.61 percentage points from the beginning of the year; total savings deposit accounted for 41.97% of the total deposits from customers, representing an increase of 7.36 percentage points from the beginning of the year.

In 2008, the Bank firmly implemented management reforms, and established a perpendicular management structure featuring dual leadership of, dual assessment from and dual reporting to both the compliance officer of the head office and the compliance departments of the branches. Three "defense lines" were set up to ensure compliance management, thereby further enhancing the internal control and compliance management. During the year, the Company undertook an overall inspection on credit risk, and pressed forward the reform on loan approval system. A master plan for the implementation of the New Basel Capital Accord was submitted to the CBRC, which reflected further improvement in risk control. A new organ known as the Service Supervision and Management Center was set up in the head office and the branch level to further promote the concept of customer-oriented services. Moreover, in order to strengthen the professional management of the business lines, we introduced the "Six Sigma" tools to streamline the business procedures and steadily advanced a comprehensive procedure management.

In 2008, the Bank furthered the adjustment of operation strategies. Through continued innovation on retail financial products, promoting the integration of business procedures through "Network Winning" and adopting a new procedure for the retail loan business, the retail banking business realized a quicker pace of development. Marketing strategies for credit card business was adjusted to concentrate on tailor-made marketing activities towards customers of good development potential. With the basic objective to provide management service for customer's total assets, and offer excellent wealth management products, much effort has been given to substantially boost the wealth management business. The Bank also actively drove the development of fee-based businesses, particularly such new businesses as cash management, corporate annuity and business credit cards. Furthermore, according to CBRC's requirements of putting in place the "Six Systems", the Bank established the first domestic "quasi subsidiary bank and quasi legal person" in Suzhou which serves as a small-business credit center specifically engaged in credit business for small sized enterprises, thereby refining the business structure, customer base and income mix of the Bank.


Mr. Ma Weihua, President, giving a speech at the ceremony of the acquisition of controlling interest in WLB by CMB.

In 2008, the Bank advanced important steps towards globalized and comprehensive operations. Our New York Branch was opened for business in Wall Street, which was the first branch that a Chinese bank was approved to establish in the U.S. since the implementation of the US Foreign Bank Supervision Enhancement Act of 1991. We successfully took over Wing Lung Bank, a bank with 75 years' history which ranked fourth among Hong Kong's local banks. It was so far the biggest acquisition of controlling equity interests in a bank in Mainland China and was the biggest acquisition of the kind in recent years in Hong Kong. Other growth initiatives and major activities included the successful subscription for shares in Taizhou Commercial Bank, the successful issuance of the first tranche of asset-backed securities, the commencement of the business operation of CMB Financial Leasing Company Limited, the steady progress of the acquisition of equity interests in CIGNA & CMC Life Insurance Company Ltd. and in the Trust & Investment Corporation of the Tibet Autonomous Region, and the ongoing preparatory works for the futures settlement business. All these have consolidated the platform for comprehensive operation.

In 2008, the Bank successfully carried out the tasks of securing banking services for the Olympic Games and proactively fulfilled our corporate social responsibility, which enabled us to promote a popular brand image in various social communities. That was evidenced by the fact that we were elected and honored with the titles of "Top Ten Most Admired Companies in China", "The Best Banking Financial Company in China", "The Best Local Bank in China" and "The Best Local Cash Management Bank in China" by the authoritative media and institutions at home and abroad including *The Wall Street Journal* and *Euromoney*, and were granted six awards again by the British Magazine *Investor Relations*.

The above achievements were attributable to the joint efforts of all our staff and the unwavering support from our clients, investors and the general public. I hereby extend my sincere gratitude on behalf of the Bank to our friends and every people who have supported and shown concern for our developments.

Looking forward into 2009, we will abide by the guiding principles of "Recognising Risks, Capturing Opportunities, Improving Management and Developing Scientifically". We must fully acknowledge the opportunities and challenges brought about by the global financial crisis; insist on a prudent and proactive development strategy, strive to maintain a sustained and healthy development of all the businesses with full confidence and composure. By doing so, we will open a new chapter in the development of the magnificent undertaking by China Merchants Bank.

**Shi Jiliang**
Chairman of
the Board of Supervisors

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## We are here just for you

CMB is committed to providing quality and efficient financial services. We have the service philosophy of “We are here just for you”, which has impressed the domestic banking industry with new service model and reforms. At the early stage of its establishment, CMB was the first bank among the domestic competitors to introduce a new concept of service – standing up to serve you, serving you with smile and door-to-door service. Our outstanding services earned credits from all over the society. In recent years, in line with the changes in customers’ demand, CMB has put great effort in establishing a new model of customer service, with three main aspects of providing service, supporting service and supervising service. CMB consistently improves the level of service standardization, profession and segmentation, and keeps satisfying the customers, thus consolidating its image of providing quality service.

# Service

## 5.1 Analysis of general operating status

In 2008, confronted with the deterioration of the global financial crisis and the slowdown of China's economic growth as well as the drastic changes in market conditions, the Group earnestly implemented the guiding principle of coordinated development in terms of profitability, quality and scale. The Group overcame various adverse factors and steadily pressed forward the restructuring of operating strategies and managerial reform. The Group has maintained a sustainable momentum in respect of its overall operations. The particulars are as follows:

The profit of the Group has maintained relatively rapid growth. For the year 2008, the Group realized a net profit attributable to the shareholders of the Bank of RMB21.077 billion, representing an increase of RMB5.834 billion or 38.27% over the previous year; a net interest income of RMB46.885 billion, representing an increase of RMB12.983 billion or 38.30% over the previous year; a net non-interest income of RMB8.770 billion, representing an increase of RMB1.586 billion or 22.08% over the previous year. The rapid growth of net profit was mainly attributable to the following factors: firstly, there was an increase in the volume of interest-earning assets, a widening of interest spreads and a rapid growth of net interest income; secondly, net non-interest income continued to grow rapidly; thirdly, the decrease in the statutory tax rate has contributed to lower effective income tax rate.

The assets and liabilities have been expanding steadily and the balances of both deposits and loans growing rapidly. As at the end of 2008, the Group's total assets amounted to RMB1,571.797 billion, representing an increase of RMB260.833 billion or 19.90% as compared with the beginning of the year; loans and advances amounted to RMB874.362 billion, representing an increase of RMB201.195 billion or 29.89% as compared with the beginning of the year; deposits from customers amounted to RMB1,250.648 billion, representing an increase of RMB307.114 billion or 32.55% as compared with the beginning of the year. Excluding the effect of factors such as the merger with WLB, the Bank had total deposits of RMB833.548 billion as at the end of 2008, representing an increase of RMB160.381 billion or 23.82% as compared with the beginning of the year; and total deposits from customers amounted to RMB1,178.240 billion, representing an increase of RMB234.471 billion or 24.84% as compared with the beginning of the year.

The quality of assets remained at high level. As at the end of 2008, the Group had non-performing loans of RMB9.677 billion, a decrease of RMB717 million from the beginning of the year. The non-performing loan ratio was 1.11%, a decrease of 0.43 percentage points from the beginning of the year. The allowance coverage ratio was 223.29%, an increase of 42.9 percentage points from the beginning of the year.

## 5.2 Analysis of Income Statement

### 5.2.1 Financial results highlights

| | For the year ended 31 December | |
|---|---|---|
| | **2008** | 2007 |
| | (In millions of RMB) | |
| Net interest income | **46,885** | 33,902 |
| Net fee and commission income | **7,744** | 6,439 |
| Other net income | **917** | 707 |
| Insurance operating income | **98** | – |
| Operating expenses | **(23,636)** | (16,738) |
| Provision for insurance claims | **(106)** | – |
| Share of profits of an associate | **37** | 38 |
| Share of losses of a joint venture | **(26)** | – |
| Provision for impairment losses | **(5,154)** | (3,305) |
| Profit before tax | **26,759** | 21,043 |
| Income tax | **(5,813)** | (5,800) |
| Net profit | **20,946** | 15,243 |
| Net profit attributable to the Bank's shareholders | **21,077** | 15,243 |

In 2008, the Group achieved further improvement in its profitability. The profit before tax was RMB26.759 billion, an increase of 27.16% compared to the previous year; net profit attributable to the Bank's shareholders was RMB21.077 billion, an increase of 38.27% compared to the previous year.

In 2008, the Group's effective income tax rate was 21.72%, a decrease of 5.84 percentage points as compared to 2007. This was mainly due to the implementation of the new Enterprise Income Tax Law in 2008 which reduced the statutory tax rate.

The following table sets out the impact on the profit before tax of the Group for 2008 by changes in major income/loss items.

### Changes in profit before tax

(In millions of RMB)

| | |
|---|---|
| **Profit before tax for 2007** | **21,043** |
| Changes in 2008 | |
| Net interest income | 12,983 |
| Net fee and commission income | 1,305 |
| Other net income | 210 |
| Insurance operating income | 98 |
| Operating expenses | (6,898) |
| Share of profits in associates | (1) |
| Share of losses in joint ventures | (26) |
| Provision for impairment losses | (1,849) |
| Provision for insurance claims | (106) |
| **Profit before tax for 2008** | **26,759** |

## 5.2.2 Net operating income

In 2008, the net operating income of the Group was RMB55.655 billion, an increase of 35.46% from the previous year.It was primarily due to rapid growth in interest income from loans, interest income from debt investment, fees and commission income. Net interest income accounted for 84.24%, an increase of 1.73 percentage points from the previous year; fee and commission income accounted for 13.91%, a decrease of 1.76 percentage points from the previous year.

The following table sets out, for the period indicated, the income composition of the Group in the past 5 years.

| | For the year ended 31 December | | | | |
|---|---|---|---|---|---|
| | **2008** | 2007 | 2006 | 2005 | 2004 |
| Net interest income | **84.24%** | 82.51% | 86.50% | 86.61% | 91.17% |
| Net fee and commission income | **13.91%** | 15.67% | 10.11% | 8.16% | 5.67% |
| Other net income | **1.65%** | 1.72% | 3.39% | 5.23% | 3.16% |
| Insurance operating income | **0.18%** | – | – | – | – |
| Share of profits in associates and joint ventures | **0.02%** | 0.10% | – | – | – |
| Net operating income | **100.00%** | 100.00% | 100.00% | 100.00% | 100.00% |

### 5.2.3 Net interest income

In 2008, the net interest income of the Group was RMB46.885 billion, an increase of 38.30% from the previous year. It was primarily attributable to the increase of average balance of and average return on interest-earning assets.

The following tables set out, for the period indicated, the average balances of interest bearing assets and liabilities, interest income/interest expense and average yield/cost ratio of the Group and the Company. The average balances of interest-earning assets and interest-bearing liabilities are the average of daily balances.

**The Group**

| | For the year ended 31 December | | | | | |
|---|---|---|---|---|---|---|
| | 2008 | | | 2007 | | |
| | Average balance | Interest income | Average yield (%) | Average balance | Interest income | Average yield (%) |
| | (in millions of RMB, excluding percentages) | | | | | |
| **Interest-earning assets** | | | | | | |
| Loans | **829,814** | **56,097** | **6.76** | 672,739 | 39,028 | 5.80 |
| Debt investments | **225,792** | **8,820** | **3.91** | 198,086 | 6,613 | 3.34 |
| Balances with central bank | **169,684** | **2,827** | **1.67** | 109,563 | 1,742 | 1.59 |
| Placements with banks and other financial institutions | **147,367** | **4,891** | **3.32** | 109,224 | 4,202 | 3.85 |
| **Total interest-earning assets** | **1,372,657** | **72,635** | **5.29** | 1,089,612 | 51,585 | 4.73 |

| | 2008 | | | 2007 | | |
|---|---|---|---|---|---|---|
| | Average balance | Interest expense | Average cost (%) | Average balance | Interest expense | Average cost (%) |
| | (in millions of RMB, excluding percentages) | | | | | |
| **Interest-bearing liabilities** | | | | | | |
| Deposits from customers | **982,312** | **19,924** | **2.03** | 790,466 | 13,255 | 1.68 |
| Placements from banks and other financial institutions | **250,423** | **4,825** | **1.93** | 196,643 | 3,983 | 2.03 |
| Issued debts | **24,448** | **1,001** | **4.09** | 14,218 | 445 | 3.13 |
| **Total interest-bearing liabilities** | **1,257,183** | **25,750** | **2.05** | 1,001,327 | 17,683 | 1.77 |
| **Net interest income** | **–** | **46,885** | **–** | – | 33,902 | – |
| **Net interest spread**(1) | **–** | **–** | **3.24** | – | – | 2.96 |
| **Net interest margin**(2) | **–** | **–** | **3.42** | – | – | 3.11 |

**The Bank**

| | For the year ended 31 December | | | | | |
|---|---|---|---|---|---|---|
| | **2008** | | | 2007 | | |
| | **Average balance** | **Interest income** | **Average yield (%)** | Average balance | Interest income | Average yield (%) |
| | (in millions of RMB, excluding percentages) | | | | | |
| **Interest-earning assets** | | | | | | |
| Loans | **819,875** | **55,723** | **6.80** | 672,739 | 39,028 | 5.80 |
| Debt investments | **223,079** | **8,755** | **3.92** | 198,086 | 6,613 | 3.34 |
| Balances with central bank | **169,684** | **2,827** | **1.67** | 109,563 | 1,742 | 1.59 |
| Placements with banks and other financial institutions | **139,613** | **4,658** | **3.34** | 109,224 | 4,202 | 3.85 |
| **Total interest-earning assets** | **1,352,251** | **71,963** | **5.32** | 1,089,612 | 51,585 | 4.73 |

| | **2008** | | | 2007 | | |
|---|---|---|---|---|---|---|
| | **Average balance** | **Interest expense** | **Average cost (%)** | Average balance | Interest expense | Average cost (%) |
| | (in millions of RMB, excluding percentages) | | | | | |
| **Interest-bearing liabilities** | | | | | | |
| Deposits from customers | **964,285** | **19,556** | **2.03** | 790,466 | 13,260 | 1.68 |
| Placements from banks and other financial institutions | **250,370** | **4,845** | **1.94** | 196,643 | 3,983 | 2.03 |
| Issued debts | **23,829** | **992** | **4.16** | 14,218 | 445 | 3.13 |
| **Total interest-bearing liabilities** | **1,238,484** | **25,393** | **2.05** | 1,001,327 | 17,688 | 1.77 |
| **Net interest income** | **–** | **46,570** | **–** | – | 33,897 | – |
| **Net interest spread[(1)]** | **–** | **–** | **3.27** | – | – | 2.96 |
| **Net interest margin[(2)]** | **–** | **–** | **3.44** | – | – | 3.11 |

(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 period indicated, the allocation of changes in interest income and interest expenses due to changes in volume and interest rate. Changes in volume are measured by changes in average balances (daily average balance) while changes in interest rate are measured by changes in the average interest rates.

| | For the year ended 31 December | | |
|---|---|---|---|
| | 2008 compared with 2007 | | |
| | Increase/(decrease) due to | | Net increase/ (decrease) |
| | Volume | Interest rate | |
| | (In millions of RMB) | | |
| **Assets** | | | |
| Loans | **9,110** | **7,959** | **17,069** |
| Debt investments | **925** | **1,282** | **2,207** |
| Balances with central bank | **956** | **129** | **1,085** |
| Placements with banks and other financial institutions | **1,469** | **(780)** | **689** |
| Changes in interest income | **12,460** | **8,590** | **21,050** |
| **Liabilities** | | | |
| Deposits from customers | **3,223** | **3,446** | **6,669** |
| Placements from to banks and other financial institutions | **1,092** | **(250)** | **842** |
| Issued debts | **320** | **236** | **556** |
| Changes in interest expense | **4,635** | **3,432** | **8,067** |
| **Changes in net interest income** | **7,825** | **5,158** | **12,983** |

## 5.2.4 Interest income

In 2008, the interest income of the Group increased by 40.81% compared to the previous year, which was primarily attributable to the increase in average balance and average yield of loans and advances to customers, debt investments, and balances with central bank. Interest income from loans and advances still accounted for the majority of the interest income of the Group.

### *Interest income from loans and advances*

In 2008, the interest income from loans and advances of the Group increased by 43.74% compared to the previous year. The increase of interest income is primarily brought by the following factors: (1) loan business developed rapidly. As a result, the average balance of loans increased by 23.35%, and the impact of the increasing average balance of loans and advances accounted for 53.37% of the total increase in interest income; (2) the effect of the interest rate increase in 2007 was fully reflected in 2008, and for the purpose of mitigating the impact of interest rate cut in the second half of 2008, the Group also took effective measures to strengthen its pricing capability, thereby increasing the average yield of loans by 96 basis points compared to the previous year.

The following table sets forth, for the period indicated, the average balance, interest income, and average yield of respective types of loans and advances of the Company.

| | For the year ended 31 December | | | | | |
|---|---|---|---|---|---|---|
| | **2008** | | | 2007 | | |
| | **Average balance** | **Interest income** | **Average yield (%)** | Average balance | Interest income | Average yield (%) |
| | (in millions of RMB, excluding percentages) | | | | | |
| Corporate loans | **485,628** | **33,283** | **6.85** | 408,848 | 25,231 | 6.17 |
| Retail loans | **191,279** | **13,493** | **7.05** | 140,402 | 8,482 | 6.04 |
| Discounted bills | **142,968** | **8,947** | **6.26** | 123,489 | 5,315 | 4.30 |
| **Loans and advances** | **819,875** | **55,723** | **6.80** | 672,739 | 39,028 | 5.80 |

Note: The above average balances were averages of daily balances.

### *Interest income from debt investments*

In 2008, the interest income from debt investments of the Group increased by 33.37% compared to the previous year, which was primarily due to the fact that the Group ensured the quality of debts while increasing debt investment, and appropriately extending the duration of its debts. As a result, there was an increase in the yield of investments to 3.91% in 2008 from 3.34% in 2007, up by 57 basis points. The contribution from the yield accounted for 58.09% of the return on investments. In 2008, the average balance of debt investments amounted to RMB225.792 billion, an increase of 13.99% compared to the previous year. The volume factor accounted for 41.91% of the return on investments.

### *Interest income from placements with banks and other financial institutions*

In 2008, the interest income from placements with banks and other financial institutions of the Group increased by 16.40% compared to the previous year. It was primarily attributable to the increase in the average balance for placements with banks and other financial institutions to RMB147.367 billion, representing an increase of 34.92% compared to the previous year. However, due to the impact of lower interest rates in late 2008, the average yield of the placements with banks and other financial institutions decreased by 53 basis points compared to the previous year.

## 5.2.5 Interest Expense

In 2008, the interest expense of the Group increased by 45.62% compared to the previous year. It was primarily attributable to the increase in average balance of deposits from customers and issued debts, and increase in average cost.

### *Interest expense on deposits from customers*

Deposits from customers are the major funding source of the Group. In 2008, the Group's interest expense on deposits from customers increased by 50.31% compared to the previous year. The influence of increase in average balance and the change in average cost accounted for 48.33% and 51.67% respectively. As we entered into the cycle of interest rate cut in 2008, deposits from customers displayed a clear trend of transition from demand deposits towards time deposits, thus resulting in the average cost of deposits from customers increasing by 35 basis points compared to the previous year.

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

| | For the year ended 31 December | | | | | |
|---|---|---|---|---|---|---|
| | **2008** | | | 2007 | | |
| | **Average balance** | **Interest Expense** | **Average Cost (%)** | Average balance | Interest Expense | Average Cost (%) |
| | (in millions of RMB, excluding percentages) | | | | | |
| Deposits from corporate customers | | | | | | |
| Demand | **336,229** | **3,250** | **0.97** | 284,176 | 2,867 | 1.01 |
| Time | **285,325** | **9,489** | **3.33** | 220,448 | 5,963 | 2.70 |
| **Subtotal** | **621,554** | **12,739** | **2.05** | 504,624 | 8,830 | 1.75 |
| Deposits from retail customers | | | | | | |
| Demand | **185,885** | **1,213** | **0.65** | 158,777 | 1,266 | 0.80 |
| Time | **156,846** | **5,604** | **3.57** | 127,065 | 3,164 | 2.49 |
| **Subtotal** | **342,731** | **6,817** | **1.99** | 285,842 | 4,430 | 1.55 |
| **Total deposits from customers** | **964,285** | **19,556** | **2.03** | 790,466 | 13,260 | 1.68 |

Note: The above average balances were averages of daily balances.

### *Interest expense on placement from banks and other financial institutions*

In 2008, interest expense on placements from banks and other financial institutions increased by 21.14% compared to the previous year. It was primarily attributable to the increase in placements from banks and other financial institutions.

### *Interest expense on issued debts*

In 2008, the interest expenses on issued debts increased by 124.94% compared to the previous year, primarily due to the successful issuance of subordinated debts of RMB30 billion by the Group on 4 September 2008.

## 5.2.6 Net interest spread and net interest margin

In 2008, the net interest spread of the Group was 3.24%, up by 28 basis points compared to the previous year. It was primarily because the average interest margin of the interest-earning assets of the Group increased from 4.73% in 2007 to 5.29% in 2008, up by 56 basis points, and the average cost of the interest-bearing liabilities increased from 1.77% in 2007 to 2.05% in 2008, up by 28 basis points.

In 2008, the net interest margin of the Group was 3.42%, up by 31 basis points compared to the previous year. Such an increase was primarily due to the raise of interest rate in 2007 thus resulting in higher net interest margin in the first half of 2008. On the other hand, in the second half of 2008, the impact of interest rate cut was mitigated by extending the duration and reducing the proportion of loans that were linked to short-term benchmark interest rates. In 2008, net interest income of the Group increased by 38.30%, which was higher than the 25.98% increase of the average balance of total interest-earning assets.

## 5.2.7 Net fee and commission income

The net interest income of the Group experienced rapid growth in 2008. Meanwhile, due to the adverse impact of sluggish capital markets and the decline of imports and exports, the contribution of net fee and commission income to the total operating income of the Group decreased to 13.91% in 2008 from 15.67% in 2007, but recorded a growth rate of 20.27%. The following table sets forth the principal components of net fee and commission income of the Group.

| | For the year ended 31 December | |
|---|---|---|
| | **2008** | 2007 |
| | (in millions of RMB) | |
| **Fee and commission income** | **8,776** | 7,258 |
| Bank card fees | **2,673** | 1,896 |
| Settlement and clearance fees | **982** | 774 |
| Agency service fees | **1,628** | 2,978 |
| Commissions from credit commitment and loan business | **610** | 424 |
| Commissions from custody and other trustee businesses | **1,895** | 696 |
| Others | **988** | 490 |
| **Fee and commission expense** | **(1,032)** | (819) |
| **Net fee and commission income** | **7,744** | 6,439 |

In 2008, net fee and commission income of the Group increased by 20.27% compared to the previous year. Such an increase was primarily attributable to increases in bank card fees and commissions from custody and other trustee businesses.

In 2008, bank card fee income increased by 40.98% compared to the previous year. It was primarily due to increased issuance and transactions volume of bank cards, especially credit cards.

In 2008, income from settlement and clearance service increased by 26.87% compared to the previous year. Such increase was primarily attributable to the increase in remittance and settlement transaction volumes due to the gradual expansion of our business scale and customer base, and the increase of income from personal account management fees.

In 2008, the income from agency services decreased by 45.33% compared to the previous year. The decrease was primarily attributable to the decrease of income from agency sale of securities and funds of the Group as a result of the decline in the capital market.

In 2008, commissions from credit commitment and loan business of the Company increased by 43.87% over the previous year, which was primarily attributable to the expanding customer base and enlarged business volume.

In 2008, commissions from custody and other trustee business increased by 172.27% compared to the previous year, which was primarily attributable to significant increase in business of wealth management, asset custody, third party custody services.

In 2008, fee and commission expense increased by 26.01% compared to the previous year. The increase was primarily attributable to rapid growth of credit card issuance. On the other hand, there was an increase in expense on credit card service. Commissions on ATM cross-bank withdrawals also recorded an increase to some degree.

## 5.2.8 Other net income

In 2008, other net income of the Group increased by 29.70% compared to the previous year. It was primarily due to increased net income from foreign exchange transactions. Other net income accounted for 1.65% of the operating income.

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

| | For the year ended 31 December | |
|---|---|---|
| | **2008** | 2007 |
| | (in millions of RMB) | |
| Trading profit/(losses) arising from: | | |
| – Foreign exchange | **1,153** | 226 |
| – Securities, derivatives and other trading activities | **(96)** | 267 |
| Net gain on financial instruments designated at fair value through profit or loss | **2** | 29 |
| Net loss on disposal of available-for-sale financial assets | **(494)** | (4) |
| Distributions from investment in funds | **3** | 53 |
| Net gain on disposal of fixed assets | **25** | 19 |
| Rental income | **77** | 64 |
| Others | **247** | 53 |
| **Total other net income** | **917** | 707 |

## 5.2.9 Operating expenses

In 2008, operating expenses of the Group were RMB23.636 billion, representing an increase of 41.21% compared to the previous year, and the cost-to-income ratio was 36.55%, an increase of 1.61percentage points compared to the previous year.

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

| | For the year ended 31 December | |
|---|---|---|
| | **2008** | 2007 |
| | (in millions of RMB) | |
| Staff costs | **11,163** | 8,092 |
| Business tax and surcharges | **3,296** | 2,384 |
| Depreciation | **2,004** | 1,020 |
| Rental expenses | **1,453** | 1,078 |
| Other general and administrative expenses | **5,720** | 4,164 |
| **Total operating expenses** | **23,636** | 16,738 |

Staff costs constituted the majority of the operating expenses of the Group. In 2008, staff costs increased by 37.95% compared to the previous year, which was primarily due to increased headcounts along with our business expansion. In 2008, the Company recruited an addition of 7,945 employees, mainly for retail banking including credit card business. Depreciation of fixed assets increased by 96.47%, which was mainly because the Group shortened the depreciable life of fixed assets including electronic equipments and transportation vehicles in 2008. Rental expenses increased by 34.79%, which was primarily due to the addition of branches and offices of the Group. Other general and administrative expenses increased by 37.37% and business tax and surcharges increased by 38.26%, which were in line with the overall growth of business development and operation volume of the Group.

## 5.2.10 Provision for impairment losses

In 2008, provision for impairment losses was RMB5.154 billion, an increase of 55.95% compared to the previous year. The following table sets forth, for the periods indicated, the principal components of provision for impairment losses of the Group.

| | For the year ended 31 December | |
|---|---|---|
| | **2008** | 2007 |
| | (in millions of RMB) | |
| Impairment losses charged/(released) on: | | |
| – Loans and advances | **3,703** | 3,006 |
| – Placements with banks and other financial institutions | **–** | (1) |
| – Placements with banks | **(56)** | (4) |
| – Financial assets purchased under reverse repo agreements | **(218)** | 157 |
| – Investments | **861** | – |
| – Goodwill | **579** | – |
| – Other assets | **285** | 147 |
| **Total provision for impairment losses** | **5,154** | 3,305 |

Provision for impairment losses on loans and advances constituted the largest component of the provision for impairment losses. In 2008, provision for impairment losses on loans and advances was RMB3.703 billion, representing an increase of 23.19% compared to the previous year. It was primarily due to the increase in provision mix for impairment losses resulting from the growing volume of loans.

In 2008, the provision for impairment losses on placements with banks and financial assets purchased under reverse repo agreements was a release of RMB274 million, primarily due to a decrease in the historical loss ratio used in assessing the impairment of these assets.

In 2008, the provision for impairment losses on investments was RMB861 million, primarily due to a provision made for the impairment loss charged on its investments in the bonds issued by Lehman Brothers and American International Group (AIG).

In 2008, the provision for impairment losses on goodwill was RMB579 million, primarily due to the impairment loss on goodwill arisen from the merger and acquisition of Wing Lung Bank.

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 2008, the provision for impairment losses on other assets of the Group was RMB285 million.

# 5.3 Analysis of balance sheet

## 5.3.1 Assets

As at 31 December 2008, the total assets of the Group were RMB1,571.797 billion, representing an increase of 19.90% as compared to the end of 2007. The increase in total assets was primarily due to the increase in loans and advances to customers, investments, and cash and deposits with the central bank, which were the three major components of the Group's asset portfolio.

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

| | As at 31 December | | | |
|---|---|---|---|---|
| | **2008** | | 2007 | |
| | **Amount** | **Percentage of total (%)** | Amount | Percentage of total (%) |
| | (in millions of RMB, except percentages) | | | |
| Total loans and advances to customers | **874,362** | **55.63** | 673,167 | 51.35 |
| Allowance for impairment losses on loans and advances to customers | **(21,608)** | **(1.37)** | (18,750) | (1.43) |
| Net loans and advances to customers | **852,754** | **54.26** | 654,417 | 49.92 |
| Investments | **310,446** | **19.75** | 243,634 | 18.58 |
| Investment in associates and joint ventures | **402** | **0.03** | 225 | 0.02 |
| Balances with the central bank | **174,673** | **11.11** | 146,266 | 11.16 |
| Cash and balances with banks and other financial institutions | **37,016** | **2.35** | 20,276 | 1.55 |
| Placement with banks and other financial institutions | **156,378** | **9.95** | 225,669 | 17.21 |
| Fixed assets | **15,062** | **0.96** | 8,722 | 0.67 |
| Intangible assts | **2,381** | **0.15** | 518 | 0.04 |
| Deferred tax assets | **2,521** | **0.16** | 2,162 | 0.16 |
| Goodwill | **9,598** | **0.61** | – | – |
| Other assets | **10,566** | **0.67** | 9,075 | 0.69 |
| **Total assets** | **1,571,797** | **100.00** | 1,310,964 | 100.00 |

### 5.3.1.1 Loans and advances to customers

As at 31 December 2008, total loans and advances to customers of the Group amounted to RMB874.362 billion, representing an increase of 29.89% as compared to the end of previous year; the percentage of total loans and advances to customers to the total assets was 55.63%, representing an increase of 4.28 percentage points as compared to the end of the previous year.

#### Distribution of loans and advances to customers by product type

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

| | As at 31 December | | | |
|---|---|---|---|---|
| | **2008** | | 2007 | |
| | **Amount** | **Percentage of total (%)** | Amount | Percentage of total (%) |
| | (in millions of RMB, except percentages) | | | |
| Corporate loans | **545,961** | **62.44** | 445,865 | 66.23 |
| Discounted bills | **95,766** | **10.95** | 52,276 | 7.77 |
| Retail loans | **232,635** | **26.61** | 175,026 | 26.00 |
| **Total loans and advances to customers** | **874,362** | **100.00** | 673,167 | 100.00 |

In recent years, the Group continued to increase its efforts to expand the business of retail loans. The proportion of its retail loans increased in the loan portfolio. As at 31 December 2008, retail loans accounted for 26.61% of the total loan and advances to customers, representing an increase of 0.61 percentage points as compared to the end of previous year.

#### Corporate loans

As at 31 December 2008, the Group's total corporate loans amounted to RMB545.961 billion, representing an increase of RMB100.096 billion as compared to the beginning of the year. Such balance accounted for 62.44% of its total loans and advances to customers, representing a decrease of 3.79 percentage points as compared to the beginning of the year. In 2008, the Group consistently followed the nation's macroeconomic control policies, enhanced the management of credit approval policy and rationalized the size and speed of granting corporate loans, thereby optimizing the structure of corporate loans and matching risk and return synchronously.

#### Discounted bills

As at 31 December 2008, discounted bills amounted to RMB95.766 billion, representing an increase of 83.19% as compared to the end of previous year. Over the years, as the loss rate of discounted bills was relatively low and the capital consumption was relatively small, the Group kept striving to expand this business. According to the loan control policy and changes in market environment in the first three quarters of 2008, the Group improved the yield of discounted bills by appropriately speeding up turnover of bills and managed to control the loan size through sale of bills. In the fourth quarter, due to the changes in financial market, such as loosening control on loan scale and rapid declining of interest rates, the Group seized opportunities emerging in the market to promote its discounted bills business, and maintained positive growth.

Retail loans

As at 31 December 2008, retail loans amounted to RMB232.635 billion, representing an increase of 32.91% as compared to the end of the previous year. The increase was primarily due to continued growth of residential mortgage loans and rapid development of the credit card business. The following table sets forth, as at the dates indicated, the retail loans by product type.

| | As at 31 December | | | |
|---|---|---|---|---|
| | **2008** | | 2007 | |
| | **Amount** | **Percentage of total (%)** | Amount | Percentage of total (%) |
| | (in millions of RMB, except percentages) | | | |
| Residential mortgage loans | **158,512** | **68.14** | 131,138 | 74.93 |
| Credit card receivables | **32,019** | **13.76** | 21,324 | 12.18 |
| Others[1] | **42,104** | **18.10** | 22,564 | 12.89 |
| **Total retail loans** | **232,635** | **100.00** | 175,026 | 100.00 |

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

In 2008, due to continued weakness in the property market, the Group concentrated on the expansion of its residential mortgage loan business, thus the residential mortgage loans kept growing steadily. As at 31 December 2008, residential mortgage loans increased by 20.87% as compared to the end of previous year.

Affected by economic downturn and expected decrease of individual incomes, the growth of the Group's credit card business slowed down in 2008. Credit card receivables increased by 50.15% as compared to the end of previous year, representing a decrease of 60.02 percentage points as compared to the previous year in terms of growth speed.

### *5.3.1.2 Investments*

Analysis on investments in foreign currency debts

As at 31 December 2008, the Group had a balance of investments in foreign currency debts of US$4.236 billion, among which US$2.863 billion was held by the Company and US$1.373 billion was held by WL Group.

The investments in foreign currency debts held by the Bank can be categorized as follows: 53.3% of the foreign currency bonds are issued by the PRC government and Chinese companies; 1.8% by G7 governments and institutions; 39.8% by overseas banks and 5.1% by overseas companies. As at the end of 2008, an allowance of US$108 million has been made for the investments in foreign currency debts held by the Bank, with an evaluated unrealized loss of US$215 million, accounting for 7.5% of the total investments in foreign currency debts. As at the end of 2008, the Bank did not have any securities products in relation to subprime mortgage loans. The Bank used to hold the Fannie Mae and Freddie Mac debts and had sold out with slight profit. The bank also had a balance of Lehman Brothers bonds of US$70 million.

For details of investments by WL Group, please refer to the section headed "Business of Wing Lung Group".

### Investments

Investments of the Group comprise listed and non-listed securities denominated in Renminbi and in foreign currencies, including financial assets at fair value through profit or loss, available-for-sale investments, held-to-maturity securities and investment receivables.

The following table sets forth the components of the investment portfolio of the Company:

| **Investments** | **31 December 2008** | | 31 December 2007 | |
|---|---|---|---|---|
| | **Amount** | **Percentage of total (%)** | Amount | Percentage of total (%) |
| | (in millions of RMB, except percentages) | | | |
| Financial assets at fair value through profit or loss | **17,699** | **5.70** | 10,838 | 4.45 |
| Available-for-sale investments | **206,959** | **66.66** | 141,627 | 58.13 |
| Held-to-maturity securities | **70,373** | **22.67** | 74,632 | 30.63 |
| Receivables | **15,415** | **4.97** | 16,537 | 6.79 |
| **Total investments** | **310,446** | **100.00** | 243,634 | 100.00 |

### Financial assets at fair value through profit or loss

The following table sets forth the components of the portfolio of financial assets at fair value through profit or loss of the Company.

| **Financial assets at fair value through profit or loss** | **31 December 2008** | 31 December 2007 |
|---|---|---|
| | (in millions of RMB) | |
| PRC government bonds | **660** | 585 |
| PBOC bills | **2,873** | 986 |
| Debts issued by policy banks | **1,749** | 2,146 |
| Debts issued by commercial banks and other financial institutions | **3,372** | 690 |
| Others[1] | **9,045** | 6,431 |
| **Total financial assets at fair value through profit or loss** | **17,699** | 10,838 |

Note: (1) Consists of other bonds, equity investments, investments in funds and financial derivatives, etc.

### Available-for-sale investments

As at 31 December 2008, the available-for-sale investments of the Group increased by RMB65.332 billion or 46.13%, representing 66.66% of the investments of the Group, which was the largest investment category of the Group. The increase in this category was mainly for keeping the gear ratio at a healthy level.

In the first half of 2008, the cycle of interest rate raise was near the end, thus the value of debt investment was highlighted. In the second half of 2008, sharp changes took place in a variety of both domestic and foreign factors, the central bank shifted to a moderately loose monetary policy, resulted in substantial decline in the interest rates of debt market. The Group increased its debt investment. Amongst all:

(1) PBOC bills enjoy the sovereign bond status as well as sound liquidity and yield, thus the Company focused on the placement of such debt. However, with shifted monetary policy, the issuance of such debts decreased substantially. Meanwhile large amount of such debts had matured, therefore total amount of such debts held by the Group slightly decreased as compared to the end of last year.

(2) PRC government bonds and debts issued by policy banks are considered as mainstream debts, and the former is tax-free whereas the latter enjoys quasi-sovereign bond status. The reduction in amount of PBOC bills issuance led to increase in these investments by the Group. However, China Development Bank, a former policy bank, became a commercial bank in December 2008. As a result, the investment balance of debts issued by policy banks decreased at the end of 2008 as compared to the end of previous year.

(3) The credit control in the first half of 2008 and the low interest rate in the second half of 2008 continuously drove the credit market to undergo rapid development. In order to adapt to changes in market structure and to get higher investment returns, the Group significantly increased investments on debt instruments of non-financial enterprises. As a result, there were significant increases in short-term financial debts, mid-term bills and corporate bonds.

In addition, the investments on debts of financial institutions by the Group also increased significantly. This was mainly due to the structural change of China Development Bank into a commercial bank. In general, debts held by the Group had relatively high credit rating and a credit risk under control. Due to changes and adjustment of investment structure, the duration of available-for-sale portfolio had been extended, which could help reduce re-investment risk in a rate cut cycle.

The following table sets forth the components of the available-for-sale investment portfolio of the Company.

| **Available-for-sale investments** | **As at 31 December 2008** | As at 31 December 2007 |
|---|---|---|
| | (in millions of RMB) | |
| PRC government bonds | **9,734** | 6,858 |
| Debts issued by the PBOC | **52,661** | 53,537 |
| Debts issued by policy banks | **34,762** | 45,075 |
| Debts issued by commercial banks and other financial institutions | **58,264** | 10,583 |
| Other debts | **50,550** | 25,393 |
| Equity investments | **964** | 181 |
| Fund investments | **24** | – |
| **Total available-for-sale investments** | **206,959** | 141,627 |

### Held-to-maturity securities

As at 31 December 2008, the net amount of held-to-maturity securities of the Group decreased by RMB4.259 billion or 5.71% compared to the previous year end. Held-to-maturity securities are primarily long-term fixed rate debts and floating rate debts with higher coupon rates. The long-term fixed rate debts are held for the Group's strategic purpose on a long-term basis, while the floating rate debts are subject to adjustment according to the changes in the statutory benchmark rates, and thus subject to the pressure of price adjustment during interest rate cut cycle. However, as the Group's floating rate debts enjoy higher interest spread, and their yields are not less than the re-invested fixed rate bonds, so the floating rate debts are more defensive investments. As a result of the change in interest rate cycle and the management needs of the increasing market capitalization, the Group has gradually reduced the activities in held-to-maturity investments, and owing to the fact that many debts have reached their maturity, the portfolio of these securities was therefore reduced.

The following table sets forth the components of held-to-maturity securities of the Group.

| **Held-to-maturity securities** | **As at 31 December 2008** | As at 31 December 2007 |
|---|---|---|
| | (in millions of RMB) | |
| PRC government bonds | **15,548** | 16,444 |
| Debts issued by the PBOC | **13,588** | 10,810 |
| Debts issued by policy banks | **8,420** | 34,582 |
| Debts issued by commercial banks and other financial institutions | **31,113** | 5,013 |
| Other debts | **1,919** | 7,783 |
| Total amount of held-to-maturity securities | **70,588** | 74,632 |
| Less: allowance for impairment losses | **(215)** | – |
| **Net amount of held-to-maturity securities** | **70,373** | 74,632 |

### Investment receivables

Investment receivables are unlisted PRC evidence treasury bond and other bonds held by the Company, which do not have open market value in China or overseas. As at 31 December 2008, the Group's balance of investment receivables amounted to RMB15.415 billion, representing a decrease of RMB1.122 billion compared to the end of 2007.

### Carrying value and fair value

All financial assets classified as trading financial assets and designated at fair value through profit or loss and available-for-sale financial assets were stated at market value or at fair value. Due to the lack of a mature market for the investment receivables in the Group's investment portfolio and the absence of open market price in China and overseas, the Group has not made any estimation of their market value or fair value.

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

| | **As at 31 December 2008** | | As at 31 December 2007 | |
|---|---|---|---|---|
| | **Carrying value** | **Market/ fair value** | Carrying value | Market/ fair value |
| | (in millions of RMB) | | | |
| Held-to-maturity listed investment | **66,726** | **68,831** | 74,632 | 74,037 |

Investment concentration

The following table sets forth, as at 31 December 2008, our investment securities and other financial assets with carrying value exceeding 10% of our shareholders' equity.

| | **As at 31 December 2008** | | | |
|---|---|---|---|---|
| | **Carrying value** | **Percentage to total investment (%)** | **Percentage to total shareholders' equity (%)** | **Market/ fair value** |
| | (in millions of RMB, except percentages) | | | |
| The PBOC | **77,122** | **24.84** | **96.99** | **77,906** |
| The Ministry of Finance | **31,731** | **10.22** | **39.90** | **32,897** |
| China Development Bank | **68,510** | **22.07** | **86.16** | **68,831** |
| The Export-Import Bank of China | **18,726** | **6.03** | **23.55** | **18,794** |
| Agricultural Development Bank of China | **26,205** | **8.44** | **32.96** | **26,243** |
| **Total** | **222,294** | **71.60** | **279.56** | **224,671** |

### *5.3.1.3 Goodwill*

As at 30 September 2008, the Group completed the acquisition of a controlling interest in the equity of Wing Lung Bank. According to the provisions under "Business Enterprise Accounting Standards No.20- Merger of Enterprises" and "Interpretations No.2 on Business Enterprise Accounting Standards" promulgated by the Ministry of Finance of the People's Republic of China, the Group engaged a renowned independent asset appraiser to evaluate the identifiable net assets of Wing Lung Bank as at the acquisition date. Subsequent to the valuation, the Group recognised a combined goodwill of RMB10.177 billion as at the acquisition date based on the cost of the acquisition and the fair value of the identifiable net assets of Wing Lung Bank.

By the end of 2008, the Group conducted an impairment test on the goodwill arising from the acquisition of Wing Lung Bank, and made a provision for impairment losses of RMB579 million and the recognized carrying value of goodwill was RMB9.598 billion.

## 5.3.2 Liabilities

As at 31 December 2008, the total liabilities of the Group amounted to RMB1,492.016 billion, an increase of 20.04% compared to the previous year end. Total deposits from customers amounted to RMB1,250.648 billion, an increase of 32.55% compared to the previous year end, representing 83.82% of the total liabilities of the Group, and was the major source of funding of the Group. The increase in liabilities was primarily due to a rapid growth in deposits from customers.

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

| | As at 31 December | | | |
|---|---|---|---|---|
| | **2008** | | 2007 | |
| | **Amount** | **Percentage of the total (%)** | Amount | Percentage of the total (%) |
| | (In millions of RMB, excluding percentages) | | | |
| Deposits from customers | **1,250,648** | **83.82** | 943,534 | 75.91 |
| Deposits from banks and other financial institutions | **115,792** | **7.76** | 218,520 | 17.58 |
| Placements from banks and other financial institutions | **50,124** | **3.36** | 46,603 | 3.75 |
| Certificates of deposit issued | **1,840** | **0.12** | 1,095 | 0.09 |
| Convertible bonds issued | **2** | **0.00** | 13 | 0.00 |
| Subordinated debt issued | **33,440** | **2.24** | 3,500 | 0.28 |
| Other debts issued | **4,996** | **0.34** | 9,992 | 0.80 |
| Other liabilities | **35,174** | **2.36** | 19,723 | 1.59 |
| **Total liabilities** | **1,492,016** | **100.00** | 1,242,980 | 100.00 |

### *Deposits from customers*

The Group 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 of the Group by product type and customer type.

| | As at 31 December | | | |
|---|---|---|---|---|
| | **2008** | | 2007 | |
| | **Amount** | **Percentage of the total (%)** | Amount | Percentage of the total (%) |
| | (In millions of RMB, excluding percentages) | | | |
| **Deposits from corporate customers** | | | | |
| Demand | **373,222** | **29.84** | 350,951 | 37.19 |
| Time | **352,499** | **28.19** | 266,050 | 28.20 |
| Subtotal | **725,721** | **58.03** | 617,001 | 65.39 |
| **Deposits from retail customers** | | | | |
| Demand | **268,220** | **21.45** | 190,697 | 20.21 |
| Time | **256,707** | **20.52** | 135,836 | 14.40 |
| Subtotal | **524,927** | **41.97** | 326,533 | 34.61 |
| **Total deposits from customers** | **1,250,648** | **100.00** | 943,534 | 100.00 |

The Group has been consistently focusing on expanding deposit business. Deposits from customers of the Group maintained robust growth as a result of the rapid economic growth in the PRC and the increased disposable income of the public. As at 31 December 2008, deposits from customers of the Group amounted to RMB1,250.648 billion, representing an increase of 32.55% as compared to the end of last year.

Since 2008, China's stock market has slowed down and retail customer deposits have returned to commercial banks. As at the end of 2008, the percentage of retail deposits to total deposits from customers of the Group was 41.97%, representing an increase of 7.36 percentage points as compared to the end of 2007.

As interest rates enter into a the rate cut cycle, there is an obvious trend characterized by customers transferring their demand deposits to time deposits, resulting in a gradual increase in the percentage of time deposits to total deposits from customers. As at the end of 2008, the percentage of time deposits to total deposits from customers of the Group was 48.71%, representing an increase of 6.12 percentage points as compared to the end of 2007. Among the figures, the proportion of corporate time deposits accounted for 48.57% of the corporate deposits, representing an increase of 5.45 percentage points as compared to the end of 2007, and the proportion of retail time deposits accounted for 48.90% of the retail deposits, representing an increase of 7.30 percentage points as compared to the end of 2007.

### 5.3.3 Shareholders' equity

| | As at 31 December | |
|---|---|---|
| | **2008** | 2007 |
| | (In millions of RMB) | |
| Paid-up share capital | **14,707** | 14,705 |
| Capital reserve | **18,823** | 27,545 |
| Surplus reserve | **4,612** | 3,088 |
| Investment revaluation reserve | **2,854** | (471) |
| Regulatory general reserve | **10,793** | 9,500 |
| Foreign exchange translation reserve | **(34)** | – |
| Retained profits | **19,836** | 7,976 |
| Proposed profit appropriations | **7,924** | 5,641 |
| Total equity attributable to parent company | **79,515** | 67,984 |
| Minority interests | **266** | – |
| **Total shareholders' equity** | **79,781** | 67,984 |

### 5.3.4 Market share of major products or services

According to the statistics published by the PBOC, as at the end of 2008, the market share and ranking of the Bank among the 13 joint stock banks in Mainland China in terms of loans and deposits as at the end of the reporting period are as follows:

| **Items expressed in RMB** | **Market share** | **Ranking** |
|---|---|---|
| Total deposits | 13.0% | 2 |
| Total savings deposits | 22.8% | 2 |
| Total loans | 13.6% | 2 |
| Total personal consumption loans | 20.8% | 1 |

Note: The 13 joint stock banks include: Bank of Communications, China Merchants Bank, China Citic Bank, Shanghai Pudong Development Bank, China Minsheng Bank, China Everbright Bank, Industrial Bank, Huaxia Bank, Guangdong Development Bank, Shenzhen Development Bank, Evergrowing Bank, China Zheshang Bank, and Bohai Bank.

## 5.4 Loan quality analysis

In 2008, amid the volatile and challenging changes in the global economic and financial environment, the Group fully consolidated the credit risk management foundation and continued to optimize the credit asset quality through cautious actions, progressive reforms, prudent management and scientific development in adherence to the practical approach by "Streamlining System, Perfecting Rules, Optimizing Procedures, Building Teams, Improving Technologies". The overseas acquisition of Wing Lung Bank and business expansion of CMB's leasing subsidiaries enabled the diversified and healthy development of the Group's credit asset business. As at the end of 2008, the non-performing loan ratio was 1.11%, representing a decrease of 0.43 percentage points as compared to that at the beginning of the year; whereas the non-performing loan allowance coverage ratio was 223.29%, representing an increase of 42.9 percentage points as compared to that at the beginning of the year.

The following table sets forth, as at the dates indicated, the 5-tier loan classification of the Group.

| | **As at 31 December 2008** | | As at 31 December 2007 | |
|---|---|---|---|---|
| | **Amount** | **Percentage of total (%)** | Amount | Percentage of total (%) |
| | (in millions of RMB, excluding percentages) | | | |
| Normal | **850,356** | **97.25** | 648,431 | 96.33 |
| Special Mention | **14,329** | **1.64** | 14,342 | 2.13 |
| Substandard | **2,751** | **0.31** | 1,910 | 0.28 |
| Doubtful | **3,023** | **0.35** | 4,512 | 0.67 |
| Loss | **3,903** | **0.45** | 3,972 | 0.59 |
| Total loans and advances to customers | **874,362** | **100.00** | 673,167 | 100.00 |
| Total non-performing loans | **9,677** | **1.11** | 10,394 | 1.54 |

The key analysis on the loan quality of the Company is set out herein as follows:

## 5.4.1 Distribution and migration of loan portfolios by loan classification

Under the 5-tier loan classification, the non-performing loans of the Company are classified into substandard, doubtful and loss.

| | **As at 31 December 2008** | | As at 31 December 2007 | |
|---|---|---|---|---|
| | **Amount** | **Percentage of total (%)** | Amount | Percentage of total (%) |
| | (in millions of RMB, excluding percentages) | | | |
| Normal | **810,312** | **97.21** | 648,431 | 96.33 |
| Special Mention | **13,737** | **1.65** | 14,342 | 2.13 |
| Substandard | **2,626** | **0.32** | 1,910 | 0.28 |
| Doubtful | **2,970** | **0.36** | 4,512 | 0.67 |
| Loss | **3,903** | **0.46** | 3,972 | 0.59 |
| Total loans and advances to customers | **833,548** | **100.00** | 673,167 | 100.00 |
| Total non-performing loans | **9,499** | **1.14** | 10,394 | 1.54 |

In 2008, the Company fully pressed forward the development of the risk pre-warning system to strengthen the risk pre-warning over single borrower and loan portfolio; to monitor the overdue loans on a real-time basis; and prevent and resolve the systematic risks including industry risks, industry chain risks, geographical risks and corporate customers' risks by adhering to the principles of comprehensive risk pre-warning, timely reporting, prompt response and persistent monitoring, with a view to fully enhancing the asset quality.

In 2008, the Company recorded a decline in both the total amount of non-performing loans and non-performing loan ratio. The year-end non-performing loan balances were RMB9,499 million, decreased by RMB895 million, or 8.61%, as compared to that at the beginning of the year; whereas the non-performing loan ratio was 1.14%, a decrease of 0.40 percentage points as compared to that at the beginning of the year. Meanwhile, the special mention loan balances and percentage at the end of the year also fell as compared to those at the beginning of the year.

In 2008, the Company accelerated the recovery and reduction of non-performing loans and made significant progress through numerous measures such as liquidizing assets, demand of timely payment and disposals, reinforced accountability of the non-performing loans and increased write-offs for bad debts. During the year, an aggregate of RMB2,034 million in cash were collected for non-peforming loans at the beginning of the year, resulting in a decrease in the year-end doubtful and loss loan balances and percentage compared to that at the beginning of the year.

The following table sets forth the loan migration of the Company for the past three years. In 2008, the Company implemented comprehensive credit policy management and control to thoroughly investigate risk evaluation, actively implement risk pre-warning system and withdraw businesses of risky customers, which effectively curbed the downward migration of the loan categories. In 2008, the normal, special mention and substandard loan migration ratios of the Company decreased as compared to those in 2007.

| | **2008** | 2007 | 2006 |
|---|---|---|---|
| Normal loan migration ratio (%) | **2.52** | 4.06 | 1.98 |
| Special mention loan migration ratio (%) | **11.89** | 15.99 | 24.34 |
| Substandard loan migration ratio (%) | **29.09** | 30.85 | 62.67 |
| Doubtful loan migration ratio (%) | **14.49** | 12.82 | 25.35 |

Note: The migration ratios have been calculated according to the requirements of the CBRC. Normal loan migration ratio = the balance of normal loans at the beginning of the period that is converted to the loans of the last four categories at the end of the period/the portion of normal loans at the beginning of the period loans that remains at the end of the period x 100%; special mention loan migration ratio = the balance of special mention loans at the beginning of the period that is converted to non-performing loans at the end of the period/the portion of special mention loans that remains at the end of the period x 100%; substandard loan migration ratio = the balance of substandard loans at the beginning of the period that is converted to doubtful and loss loans at the end of the period/the portion of substandard loans that remains at the end of the period x 100%; doubtful loan migration ratio = the balance of doubtful loans at the beginning of the period that is converted to loss loans at the end of the period/the portion of doubtful loans at the beginning of the period that remains at the end of the period x 100%.

## 5.4.2 Loan structure and loan quality by product type

| | As at 31 December 2008 | | | | As at 31 December 2007 | | | |
|---|---|---|---|---|---|---|---|---|
| | Total loan balance | Percentage of the total (%) | Total non-performing loans | Non-performing loan ratio(1) (%) | Total loan balance | Percentage of the total (%) | Total non-performing loans | Non-performing loan ratio(1) (%) |
| | (in millions of RMB, excluding percentages) | | | | | | | |
| **Corporate loans** | 518,440 | 62.20 | 8,144 | 1.57 | 445,865 | 66.23 | 9,585 | 2.15 |
| Working capital loans | 379,793 | 45.56 | 6,820 | 1.80 | 339,991 | 50.51 | 8,198 | 2.41 |
| Fixed asset loans | 112,827 | 13.54 | 498 | 0.44 | 74,045 | 11.00 | 438 | 0.59 |
| Trade finance | 16,676 | 2.00 | 349 | 2.09 | 19,767 | 2.93 | 414 | 2.09 |
| Others(2) | 9,144 | 1.10 | 477 | 5.22 | 12,062 | 1.79 | 535 | 4.44 |
| **Discounted bills(3)** | 95,766 | 11.49 | – | – | 52,276 | 7.77 | – | – |
| **Retail loans** | 219,342 | 26.31 | 1,355 | 0.62 | 175,026 | 26.00 | 809 | 0.46 |
| Residential mortgage loans | 148,452 | 17.81 | 396 | 0.27 | 131,138 | 19.48 | 335 | 0.26 |
| Credit card receivables | 31,604 | 3.79 | 874 | 2.77 | 21,324 | 3.17 | 409 | 1.92 |
| Automobile loans | 2,212 | 0.26 | 26 | 1.18 | 1,940 | 0.29 | 40 | 2.06 |
| Others(4) | 37,074 | 4.45 | 59 | 0.16 | 20,624 | 3.06 | 25 | 0.12 |
| **Total loans and advances to customers** | 833,548 | 100.00 | 9,499 | 1.14 | 673,167 | 100.00 | 10,394 | 1.54 |

Notes: (1) Represents the percentage of non-performing loans in a certain category to the total loans of the said category.

(2) Consists primarily of corporate mortgage loans, including non-performing discounted bills.

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

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

In 2008, the Company adopted development strategies that combined business expansion and risk management. In addition to strengthening the marketing of product offers, the Company focused on the management of higher risk credit business types by adopting a number of refined management measures such as strengthening the control over loan use, avoiding the risks relating to the advances of various off-balance sheet credit businesses such as letters of credit and cash advance risk, adhering to approving residential mortgage loan based on stable source of income, and expanding the quality credit card loans based on customer group management.

As at 31 December 2008, the non-performing loans under corporate loans amounted to RMB8,144 million, representing a decrease of RMB1,441 million as compared to those at the beginning of the year. The non-performing loan ratio of corporate loans was 1.57%, representing a decline of 0.58 percentage points as compared to that at the beginning of the year. Among which, the non-performing amounts and ratios of working capital loans fell sharply, whilst those of the fixed assets loans were also in downward trend.

Affected by domestic stringent macroeconomic policies and declining prices in the capital market, in 2008, the non-performing loan ratio of retail loans increased from 0.46% as at the beginning of the year to 0.62 % as at the end of the year. Among them, the quality of residential mortgage loans was relatively stable. The non-performing loan ratio increased slightly by 0.01 percentage point from that at the beginning of the year to 0.27%. Due to the strict limits set out in the policy of writing-off doubtful debts, coupled with the impacts of the volatile economic environment, the non-performing loan ratio of credit card receivable balances rose by 0.85 percentage points to 2.77% as compared to that at the beginning of the year. In 2009, the Company will focus on two areas, namely business growth strategies and risk management procedures to strengthen the risk management of the credit card business. On the one hand, the Company will shift the focus of credit card business to the products where the risks are controllable. On the other hand, the Company will increase the ability to capitalize on the scoring card system for identifying customer and transaction risks, in addition to strengthening the overdue-loan collection management.

## 5.4.3 Loan structure and loan quality by industry

The following table sets forth the distribution of loans and non-performing loans by industry.

| | **As at 31 December 2008** | | | | As at 31 December 2007 | | | |
|---|---|---|---|---|---|---|---|---|
| | **Total loan balance** | **Percentage of the total (%)** | **Non-performing loan balance** | **Non-performing loan ratio (%)[1]** | Total loan balance | Percentage of the total (%) | Non-performing loan balance | Non-performing loan ratio (%)[1] |
| | (in millions of RMB, excluding percentages) | | | | | | | |
| **Corporate loans** | **518,440** | **62.20** | **8,144** | **1.57** | 445,865 | 66.23 | 9,585 | 2.15 |
| Manufacturing | **158,018** | **18.96** | **2,627** | **1.66** | 132,652 | 19.71 | 3,227 | 2.43 |
| Transportation, storage and postal services | **90,391** | **10.84** | **509** | **0.56** | 75,827 | 11.26 | 637 | 0.84 |
| Generation and supply of electric power, gas and water | **62,063** | **7.45** | **616** | **0.99** | 40,901 | 6.08 | 352 | 0.86 |
| Wholesale and retail | **56,897** | **6.83** | **1,855** | **3.26** | 58,441 | 8.68 | 1,832 | 3.13 |
| Property development | **47,233** | **5.67** | **1,193** | **2.53** | 43,181 | 6.41 | 1,634 | 3.78 |
| Leasing and commercial services | **27,982** | **3.36** | **445** | **1.59** | 29,789 | 4.43 | 724 | 2.43 |
| Construction | **22,774** | **2.73** | **44** | **0.19** | 17,145 | 2.55 | 90 | 0.52 |
| Mining | **14,127** | **1.69** | **–** | **–** | 10,310 | 1.53 | – | – |
| Water, environment and public utilities management | **9,163** | **1.10** | **10** | **0.11** | 6,262 | 0.93 | 7 | 0.11 |
| Financial services | **8,655** | **1.04** | **74** | **0.85** | 6,952 | 1.03 | 135 | 1.94 |
| Others[2] | **21,137** | **2.53** | **771** | **3.65** | 24,405 | 3.62 | 947 | 3.88 |
| **Discounted bills** | **95,766** | **11.49** | **–** | **–** | 52,276 | 7.77 | – | – |
| **Retail loans** | **219,342** | **26.31** | **1,355** | **0.62** | 175,026 | 26.00 | 809 | 0.46 |
| Residential mortgage loans | **148,452** | **17.81** | **396** | **0.27** | 131,138 | 19.48 | 335 | 0.26 |
| Credit card receivables | **31,604** | **3.79** | **874** | **2.77** | 21,324 | 3.17 | 409 | 1.92 |
| Others[3] | **39,286** | **4.71** | **85** | **0.22** | 22,564 | 3.35 | 65 | 0.29 |
| **Total loans to customers** | **833,548** | **100.00** | **9,499** | **1.14** | 673,167 | 100.00 | 10,394 | 1.54 |

Notes: (1) Represents the percentage of non-performing loans in a certain category to the total loans of the said category.

(2) Consists primarily of education, culture, sports, and social welfare, etc.

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

The Company strengthened the key industry researches, swiftly adjusted the credit policies, launched industry limit management and implemented pre-warning investigation retreat through closely monitoring the market changes, with a view to avoiding the industry risks associated with the economic downturn in a forward-looking manner. At the end of 2008, the Company rationalized the structure of the corporate loans sector. Apart from the slight increase in the non-performing loan ratio under the two sectors, generation and supply of electric power, gas and water, and wholesale and retail as compared to that at the beginning of the year, the non-performing loan ratios under other sectors showed a decrease in different magnitudes, thereby balancing and optimizing the credit distribution in industries.

In 2008, the Company timely adjusted the loan term structure in response to market demand, resulting in an increase in the percentage of medium to long-term loans during the reporting period. As at the end of 2008, the percentage of medium to long-term loans under the corporate loans within the Mainland China was 31.91%, an increase of 4.17 percentage points as compared to that at the beginning of the year, of which more than 70% were attributable to the three major sectors, namely transportation, storage and postal services; property development; and generation and supply of electric power, gas and water.

The Company closely monitored the market and policy trends relating to the real estate market. In adherence to the guiding policy of "Control over total loan volumes, structure optimization, market segmentation and differentiated treatments", the Company imposed strict control over loan disbursement to the real estate developers projects. The Company chose to support national and regional backbone real estate developers, while imposed strict limits toward small-and-medium sized real estate developers. The Company granted corporate loans mainly to common residential development projects while restricted those to commercial development projects. The Company mainly granted the residential mortgage loan to people buying a house for self-occupation while limited those for investment purposes. The Company strengthened its management over all critical processes such as conducting investigation prior to the granting of home mortgage loans, conducting investigation upon the granting of personal home loans, collateral registration and collection supervision. As at the end of 2008, the balance of the corporate loans granted under property development industry accounted for 5.67% of the total corporate loans, a decrease of 0.74 percentage points as compared to that at the beginning of the year. The non-performing loan ratio was 2.53%, a decrease of 1.25 percentage points as compared to that at the beginning of the year. In 2008, the Company maintained a moderate growth of 13.2% in its home mortgage loan business. The non-performing loan ratio was maintained at 0.27%, representing a slight increase of 0.01 percentage point as compared to that at the beginning of the year.

## 5.4.4 Percentage analysis by region

| | As at 31 December 2008 | | As at 31 December 2007 | |
|---|---|---|---|---|
| | Amount | Percentage of total (%) | Amount | Percentage of total (%) |
| | (in millions of RMB, excluding percentages) | | | |
| Eastern China | 356,013 | 42.71 | 275,956 | 40.99 |
| Southern China and Central China | 230,494 | 27.65 | 197,324 | 29.31 |
| Northern China | 147,035 | 17.64 | 121,474 | 18.05 |
| Western China | 93,323 | 11.20 | 71,898 | 10.68 |
| Others | 6,683 | 0.80 | 6,515 | 0.97 |
| **Total loans to customers** | 833,548 | 100.00 | 673,167 | 100.00 |

In 2008, the Company took into account the features of economic growth in these regions and strongly supported the pillar industries and quality customers with stronger competitive strengths in these regions in order to achieve a balanced and optimal regional credit structure.

## 5.4.5 Distribution of loans by the type of guarantees

| | As at 31 December 2008 | | As at 31 December 2007 | |
|---|---|---|---|---|
| | Amount | Percentage of the total (%) | Amount | Percentage of the total (%) |
| | (in millions of RMB, excluding percentages) | | | |
| Collateralized loans | 263,336 | 31.59 | 212,839 | 31.62 |
| Pledged loans | 51,843 | 6.22 | 58,023 | 8.62 |
| Guaranteed loans | 200,950 | 24.11 | 185,472 | 27.55 |
| Unsecured loans | 221,653 | 26.59 | 164,557 | 24.44 |
| Discounted bills | 95,766 | 11.49 | 52,276 | 7.77 |
| **Total loans and advances to customers** | 833,548 | 100.00 | 673,167 | 100.00 |

As at the end of 2008, loans (including collateralized loans and pledged loans) secured by assets accounted for 37.81% of the loan portfolios of the Company, representing a decrease of 2.43 percentage points as compared to those at the end of the previous year. The Company has been taking collaterals as an important means to mitigate credit risk. In 2008, the percentage of pledged loans fell by 2.4 percentage points primarily as a result of the lack of funds for enterprises due to the economic downturn, leading to the decrease in the percentage of loans pledge by deposits and margin. The percentage of unsecured loans increased by 2.15 percentage points as compared to that at the end of previous year primarily due to the increase in credit card loans and unsecured loans granted towards more promising industries and to quality customers.

### 5.4.6 Distribution of loans by customer type

In 2008, the percentage structure of the Company's loans by customer type remained stable in general, whilst the loans to domestic enterprises decreased by 4.28 percentage points as compared to those at the beginning of the year.

| | **As at 31 December 2008** | | As at 31 December 2007 | |
|---|---|---|---|---|
| | **Amount** | **Percentage of the total (%)** | Amount | Percentage of the total (%) |
| | (in millions of RMB, excluding percentages) | | | |
| State-owned enterprises | **197,905** | **23.74** | 179,192 | 26.62 |
| Joint-stock enterprises | **63,863** | **7.66** | 56,619 | 8.41 |
| Other limited liability enterprises | **100,421** | **12.05** | 77,186 | 11.47 |
| Other domestic enterprises | **60,083** | **7.21** | 56,831 | 8.44 |
| **Subtotal of domestic enterprises** | **422,272** | **50.66** | 369,828 | 54.94 |
| Foreign-funded enterprises | **89,485** | **10.74** | 69,522 | 10.33 |
| **Subtotal of enterprises operating in the Mainland** | **511,757** | **61.40** | 439,350 | 65.27 |
| Enterprises operating outside the Mainland | **6,683** | **0.80** | 6,515 | 0.96 |
| **Subtotal of corporate loans** | **518,440** | **62.20** | 445,865 | 66.23 |
| **Discounted bills** | **95,766** | **11.49** | 52,276 | 7.77 |
| **Retail loans** | **219,342** | **26.31** | 175,026 | 26.00 |
| **Total loans and advances to customers** | **833,548** | **100.00** | 673,167 | 100.00 |

In 2008, the SME corporate loans maintained solid growth momentum of "moderate growth in total amount, reasonable regional structure, balanced industry distribution, and continued quality optimization". As at the end of the reporting period, pursuant to the classification standards for SMEs (No.(2003)17) promulgated by the National Bureau of Statistics of China, the balance of the SME corporate loans grew by RMB30.24 billion from the beginning of the year to RMB220.54 billion, accounting 43.1% of the corporate loans within the Mainland China, a slight decrease of 0.2 percentage points as compared to that at the beginning of the year. The non-performing ratio of SME corporate loans was 2.68%, a decrease of 0.94 percentage points as compared to that at the beginning of the year.

The SME corporate loans within the Mainland China mainly concentrated in Eastern China, Southern China and Southern & Central China where economic activities were comparatively active and accounted for approximately 80% of the total economic activities. Among them, approximately 40% were collaterized loans; approximately 45% were guaranteed loans and over 60% were SME corporate loans granted to manufacturing, transportation, storage and postal services enterprises, and wholesale and retail sectors.

In 2008, amid the global financial crisis, deteriorating operating environment for SMEs, increasing risks of potential defaults, the Company took the lead to establish the first small enterprise credit center in China granted with the exclusive independent license and continued to pursue its growth strategies for SMEs. While observing the principles of "proactively exploring, boldly innovating, refined measures, controllable risks", the Company promulgated differentiated credit policies for SMEs. The Company selects quality customers from the industrial chain and the logistic chain. It has realized professional management through the organization of management structure, marketing by professional teams, construction of systems, innovation of products, and optimization of process, and has implemented risk control mechanism through various measures such as integrated scoring card system, pricing mechanism, management of authorization and risks pre-warning system, with a view to effectively controlling the quality of SME corporate loans.

## 5.4.7 Loans to the top ten customers

| Top ten borrowers | Industry | Sector nature | Loan balance as at 31 December 2008 | % of total net capital | % of total loans |
|---|---|---|---|---|---|
| | | | (in millions of RMB, excluding percentages) | | |
| A | Other financial business | State-owned enterprise | 4,900 | 5.31 | 0.59 |
| B | Communication and transportation | State-owned enterprise | 4,575 | 4.96 | 0.55 |
| C | Communication and transportation | State-owned enterprise | 3,500 | 3.80 | 0.42 |
| D | Communication and transportation | State-owned enterprise | 3,037 | 3.30 | 0.37 |
| E | Coal-fired power | State-owned enterprise | 2,621 | 2.84 | 0.31 |
| F | Generation and supply of electric power, gas and water | Foreign-invested enterprise | 2,500 | 2.71 | 0.30 |
| G | Wholesale and retail | Foreign-invested enterprise | 2,388 | 2.59 | 0.29 |
| H | Generation and supply of electric power, gas and water | State-owned enterprise | 2,250 | 2.44 | 0.27 |
| I | Communication and transportation | State-owned enterprise | 2,030 | 2.20 | 0.24 |
| J | Communication and transportation | State-owned enterprise | 1,839 | 1.99 | 0.22 |
| **Total loans** | | | **29,640** | **32.14** | **3.56** |

As at 31 December 2008, the closing loan balances of the Company's largest single borrower amounted to RMB4.9 billion, representing 5.31% of the Company's net capital. This was in line with the regulatory requirement stipulated by relevant regulatory authorities where the loan balances to a single borrower shall not exceed 10% of the bank's net capital.

## 5.4.8 Distribution of overdue loans

| | **As at 31 December 2008** | | As at 31 December 2007 | |
|---|---|---|---|---|
| | **Amount** | **Percentage of the total (%)** | Amount | Percentage of the total (%) |
| | (in millions of RMB, excluding percentages) | | | |
| Overdue within 3 months | **5,248** | **0.63** | 4,573 | 0.68 |
| Overdue more than 3 months but within 1 year | **1,573** | **0.19** | 1,435 | 0.21 |
| Overdue more than 1 year but within 3 years | **2,115** | **0.25** | 3,026 | 0.45 |
| Overdue more than 3 yeas | **4,491** | **0.54** | 4,637 | 0.69 |
| Total overdue loans | **13,427** | **1.61** | 13,671 | 2.03 |
| **Total loans to customers** | **833,548** | **100.00** | 673,167 | 100.00 |

As the Company's capability of identifying credit risks and managing credit risks enhanced gradually, the overdue loans of the Company saw reduction in 2008, with its percentage to the total loans decreasing from 2.03% at the beginning of the year to 1.61% as at the end of this year. The percentage of overdue loan balances in each level all decreased as compared to those at the beginning of the year.

## 5.4.9 Restructured loans

| | **As at 31 December 2008** | | As at 31 December 2007 | |
|---|---|---|---|---|
| | **Amount** | **Percentage of the total (%)** | Amount | Percentage of the total (%) |
| | (in millions of RMB, excluding percentages) | | | |
| Restructured loans | **1,350** | **0.16** | 1,790 | 0.27 |
| Of which: loans overdue more than 90 days | **1,007** | **0.12** | 1,332 | 0.20 |

Note: Substandard and doubtful loans after restructuring

The Company imposed strict and prudent control over restructuring of loans. As at the end of 2008, the Company's total restructured loans and percentage showed a decrease as compared to those at the beginning of the year.

## 5.4.10 Repossessed assets and its allowances

As at the end of 2008, the total repossessed assets of the Company amounted to RMB1,274 million, and after deduction of allowances for impairment losses of RMB1,190 million, the net repossessed assets amounted to RMB84 million.

### 5.4.11 Changes of allowances for impairment losses on loans and advances

The Company adopted two methods of assessing impairment losses on loans at the balance sheet date: individual assessment and portfolio assessment. Loans which were considered individually significant were assessed individually for impairment. If there was any objective evidence indicating that a loan was impaired, the impairment losses amount would be measured as the difference between the carrying amount of the loan and its discounted value of estimated future cash flows recoverable through profit or loss of the current period. Loans which were considered individually insignificant and had not yet been identified for loans subject to individual assessment for impairment were grouped in a pool of loans with similar credit risk characteristics for the purpose of impairment testing. Based on the result of testing, the Company would determine allowances for impairment losses on loans assessed on a portfolio basis.

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

| | **2008** | 2007 |
|---|---|---|
| | (in millions of RMB) | |
| **As at 1 January** | **18,750** | 16,282 |
| Charge for the year | **5,358** | 4,212 |
| Releases for the year | **(1,699)** | (1,206) |
| Unwinding of discount[1] | **(108)** | (118) |
| Recoveries of loans and advances previously written off | **64** | 48 |
| Write-offs | **(667)** | (528) |
| Transfers out | **(88)** | 238 |
| Foreign exchange rate movements | **(168)** | (178) |
| **As at 31 December** | **21,442** | 18,750 |

Note: (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.

In response to the financial crisis, the Company swiftly adopted prudent and cautious measures to make provision for the impairment losses arising from the credit assets. As at the end of 2008, allowances for impairment losses on loans amounted to RMB21,442 million, representing an increase of RMB2,692 million from the beginning of the year. The non-performing loan allowances coverage ratio (total allowances for impairment losses on loans to customers/total non-performing loans) was 225.73%, representing an increase of 45.34 percentage points as compared with that at the beginning of the year. The increase of allowances for impairment losses on loans was primarily due to the augment of loan scale. At the same time, the significant decrease in the non-performing loans resulted in a higher non-performing loan allowances coverage.

## 5.5 Analysis of capital adequacy ratio

The Group calculated and disclosed its capital adequacy ratio according to "Guideline of the Resolution on the Regulation Governing Capital Adequacy Ratio of Commercial Banks (CBRC Order (2007) No. 11)" issued by the CBRC in July 2007. As at 31 December 2008, the capital adequacy ratio of the Group was 11.34%, representing an increase of 0.94 percentage points as compared with that at the end of previous year, while the core capital adequacy ratio was 6.56%, representing a decrease of 2.22 percentage points as compared with that at the end of the previous year. The capital adequacy ratio of the Company was 10.49%, an increase of 0.20 percentage point as compared with that at the end of previous year; whereas the core capital adequacy ratio was 7.15%, a decrease of 1.56 percentage points as compared with that at the end of previous year.

The increase in the capital adequacy ratio was primarily attributable to the following: (i) the Group saw stronger internal capital generation ability in 2008 where the capital growth derived from the annual profit growth was able to offset the capital consumption as a result of increase in the weighted risk assets; (ii) in response to the capital consumption as a result of the acquisition of new equity interests, the Group activated supplementary capital plans and successfully issued subordinated debts in the sum of RMB30 billion to supplement capital in September 2008. The decrease in the core capital adequacy ratio was mainly due to the partial offset of surplus capital by the premium of the secondary acquisition of Wing Lung Bank, thereby reducing the core capital (where the issuance of the subordinated debts in the sum of RMB30 billion only supplemented the supplementary capital and did not affect the core capital).

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

| | **As at 31 December 2008** | As at 31 December 2007 (restated) |
|---|---|---|
| | (in millions of RMB) | |
| **Core capital** | | |
| Paid-up ordinary share capital | **14,707** | 14,705 |
| Reserves | **56,765** | 48,683 |
| Total core capital | **71,472** | 63,388 |
| **Supplementary capital** | | |
| General provisions for doubtful debts | **13,795** | 10,434 |
| Term subordinated debts | **30,074** | 1,400 |
| Convertible bonds | **2** | 13 |
| Other supplementary capital | **1,745** | 147 |
| **Total supplementary capital** | **45,616** | 11,994 |
| **Total capital base before deductions** | **117,088** | 75,382 |
| **Deductions:** | | |
| – Goodwill | **9,598** | – |
| – Investments in unconsolidated subsidiaries and other long-term investments | **1,044** | 342 |
| – Investments in commercial real estate | **2,407** | 394 |
| **Total capital base after deductions** | **104,039** | 74,646 |
| **Risk-weighted assets** | **917,201** | 718,082 |
| **Core capital adequacy ratio** | **6.56%** | 8.78% |
| **Capital adequacy ratio** | **11.34%** | 10.40% |

## 5.6 Segment operating results

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

The Group evaluated the results of business segments through the internal funds transfer pricing mechanism ("FTP"), and the business segments priced internal lendings and borrowings at the internal interest rate based on market interest rate, and the inter-segment interest incomes and expenses generated by the FTP system were offset when consolidating the operating results of the Group. Net interest income of the respective segments, including interest income from loans to other segments and interest expense for borrowings from other segments, reflected the profit or loss of funding allocation to the business segments through the FTP system. Cost allocation was based on the direct cost of related business segments and appropriation of management overheads.

### Business segments

The main businesses of the Group are corporate banking, retail banking and treasury business. For more information about the products and services of the respective main businesses, please refer to section headed "Business Operations". The following table sets forth the operating results of the business segments of the Group for the period indicated.

| | 2008 | | | | | 2007 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Corporate banking | Retail banking | Treasury business | Others and unallocated items | Total | Corporate banking | Retail banking | Treasury business | Others and unallocated items | Total |
| | | | | | (Unit: RMB million) | | | | | |
| External net interest income | 24,249 | 6,528 | 16,104 | 4 | 46,885 | 18,737 | 4,051 | 11,114 | – | 33,902 |
| Internal net interest (expense)/income | 752 | 5,862 | (6,616) | 2 | – | (390) | 4,294 | (3,904) | – | – |
| Net interest income | 25,001 | 12,390 | 9,488 | 6 | 46,885 | 18,347 | 8,345 | 7,210 | – | 33,902 |
| Net fee and commission income | 2,747 | 4,761 | (1) | 237 | 7,744 | 1,621 | 4,666 | – | 152 | 6,439 |
| Other net income/(expense) | 732 | 241 | (203) | 147 | 917 | 666 | 272 | (494) | 263 | 707 |
| Operating income from insurance | – | – | – | 98 | 98 | – | – | – | – | – |
| Total operating income | 28,480 | 17,392 | 9,284 | 488 | 55,644 | 20,634 | 13,283 | 6,716 | 415 | 41,048 |
| Operating expenses | (13,147) | (13,139) | (1,701) | (909) | (28,896) | (10,381) | (8,544) | (970) | (148) | (20,043) |
| Share of profits of associates and joint ventures | – | – | – | 11 | 11 | – | – | – | 38 | 38 |
| Profit before tax | 15,333 | 4,253 | 7,583 | (410) | 26,759 | 10,253 | 4,739 | 5,746 | 305 | 21,043 |

In 2008, the contributions made by each business segment to the profit before tax of the Company were: 57.30% from corporate banking, 15.89% from retail banking, and 28.34% from treasury business. That contribution from retail banking fell more quickly was primarily due to the slower growth of the net fee income related to retail banking business, resulting from the persistent downturn of the capital market in 2008.

## Geographical segments

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 the periods indicated.

| | Eastern China | | Southern and Central China | | Western China | | Northern China | | Overseas | | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount |
| | (Unit: RMB million) | | | | | | | | | | |
| **2008** | | | | | | | | | | | |
| Total operating income | **20,257** | **36** | **23,070** | **41** | **4,907** | **9** | **7,182** | **13** | **228** | **1** | **55,644** |
| Profit before tax | **9,524** | **35** | **11,987** | **45** | **2,547** | **10** | **3,503** | **13** | **(802)** | **(3)** | **26,759** |
| **As at 31 December 2008** | | | | | | | | | | | |
| Segment assets | **385,612** | **24** | **796,988** | **51** | **103,279** | **7** | **172,750** | **11** | **113,168** | **7** | **1,571,797** |
| Segment liabilities | **393,366** | **26** | **695,815** | **47** | **109,430** | **7** | **191,799** | **13** | **101,606** | **7** | **1,492,016** |
| 2007 | | | | | | | | | | | |
| Total operating income | 14,110 | 34 | 17,257 | 42 | 3,529 | 9 | 5,830 | 14 | 322 | 1 | 41,048 |
| Profit before tax | 6,260 | 30 | 10,527 | 50 | 1,379 | 6 | 2,707 | 13 | 170 | 1 | 21,043 |
| As at 31 December 2007 | | | | | | | | | | | |
| Segment assets | 326,857 | 25 | 717,794 | 55 | 90,644 | 7 | 156,281 | 12 | 19,388 | 1 | 1,310,964 |
| Segment liabilities | 334,084 | 27 | 612,890 | 49 | 93,978 | 7 | 182,800 | 15 | 19,228 | 2 | 1,242,980 |

# 5.7 Other information

## 5.7.1 Balance of off-balance sheet items that may have a material effect on the financial positions and operating results and the related important information

(1) Letters of irrevocable guarantee and letters of credit: the balance of the letters of irrevocable guarantee and the letters of credit issued by the Company amounted to RMB87,129 million as at the end of the reporting period. The Company's obligation to advance will arise only in the event of a default by an applicant under guarantees and letters of credit, and only then the Company's profit would be negatively affected.

(2) Bills of acceptance: As at the end of the reporting period, the Company's balance of the bills of acceptance was RMB197,582 million. The Company's obligation to advance will arise only in the event of a default by an applicant for the bill of acceptance, and only then the Company's profit would be negatively affected.

## 5.7.2 Outstanding overdue debts

As at the end of the reporting period, the Company did not have any outstanding overdue debts.

## 5.8 Business operations

### 5.8.1 Retail Banking Segment

The Company provides retail customers with diversified retail banking products and services, including retail loans, deposits, debit card, credit card, wealth management services, investment services, agency sale of insurance products and fund products, forex trading, and foreign exchange service, of which "All-in-one Card", "credit card", "Sunflower Wealth Management" and personal online banking have won wide spread recognition. The Company provides the above-mentioned services and products via varied channels, including branches and sub-branches, self-service centers, ATM, CDM, online banking and phone banking.

#### *Retail loans*


The Company provides retail customers with various loan products. In 2008, faced with distressed real estate market, intensified macroeconomic control on the property market and fierce competition in retail loans which comprised mainly of residential mortgage loans, the Company continued to deploy more resources into innovating and promoting new retail loan products, and further sharpened its competitive edge in retail banking. The Company reshuffled the personal loan processing work flows so that mid and back office operations were assigned to branches. The Company also introduced new series of retail loan products, including the innovative product known as "Easy Consumption", which utilizes the All-in-one Card as the platform to merge residential mortgage loans and consumer loans repayment, thereby further enhancing personal wealth management capability of customers taken on residential mortgage loans. The project of on-line residential mortgage loan application evaluation card was completed which raised the processing efficiency on application approval. A marketing campaign known as "Breakthrough 2008" ("突圍2008") was organized to boost the underwriting of personal loans and promote the steady development of personal operational loan business. Moreover, credit card business was vigorously promoted, thereby speeding up the growth of credit card loans business. As at 31 December 2008, the total retail loans amounted to RMB219.342 billion, increasing by 25.32% as compared to that at the beginning of the year, of which the total residential mortgage loans increased by 13.20% as compared to that at the beginning of the year, while the total credit card receivables increased by 48.21% as compared to that at the beginning of the year. Affected by the tightening of residential mortgage loan market in China, the total retail loans accounted for 26.31% of total loans, decreasing by a slight 0.31 percentage points from that of the end of the previous year.

#### *Retail customer deposits*

The retail deposit products of the Company mainly consist of demand deposits, time deposits and call deposits. Retail customer deposits provided substantial low-cost funding for the Company. As at 31 December 2008, total retail customer deposits amounted to RMB476,943 million, increasing by RMB150,410 million or 46.06% from the end of the previous year. Total retail customer deposits accounted for 40.48% of total deposits, increasing by 5.90 percentage points from the end of the previous year.

#### *Retail non-interest income business*

The Company keeps developing non-interest income business in recent years, which is now on a positive development track. In 2008, the non-interest income from retail banking was RMB5,827 million, increasing by RMB182 million or 3.23% as compared to that in the previous year. Amongst which, commission income from bank cards (including credit card) was RMB2,658 million, an increase of 40.19% as compared to that in the previous year; income from wealth management was RMB1,008 million, an increase of 208.47% as compared to that in the previous year; income from fund agency services was RMB674 million, a drop of 63.12% compared to that in the previous year as a result of the shrinking capital market; and income from agency sale of insurance was RMB354 million, an increase of 124.08% as compared to that in the previous year.

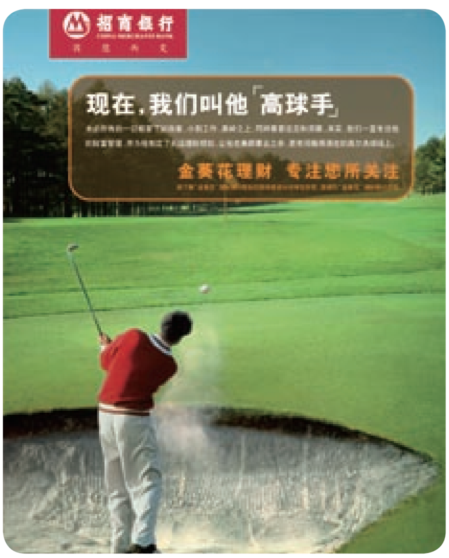
### *Bank cards business*

As at 31 December 2008, the Company had issued a cumulative total of 49.07 million All-in-one cards, including 5.56 million cards newly issued during the year. Total deposit balance of All-in-one cards was RMB375.4 billion, accounting for 78.71% of the total retail deposits, representing RMB7,649 average balance per card.

As at 31 December 2008, the Company had issued 27.26 million credit cards, including 6.58 million cards newly issued during the year. The total number of cards in circulation was 16.94 million, the cumulative number of card holders was 10.70 million, the cumulative transaction volume via credit cards for the year was RMB210.8 billion, the average transaction volume per month of each card in circulation was RMB1,123, and the revolving credit line balance was RMB11.8 billion. The percentage of interest-earning balances was 37.34%, which was substantially the same as that at the end of previous year. The percentage of the revolving accounts of credit cardholders was 23.36%. Interest income from credit cards amounted to RMB1,853 milion, an increase of 70.31% as compared to that in the previous year. Income from credit card non-interest business was RMB2,276 million, an increase of 50.23% as compared to that in the previous year. Amongst which, POS fee income was RMB946 million, an increase of 44.43% as compared to that in the previous year; annual fee income was RMB92 million, a decrease of 10.68% as compared to that in the previous year; cash advance service charge was RMB189 million, an increase of 35.00% as compared to that in the previous year; overdue charge was RMB319 million, an increase of 69.68% as compared to that in the previous year; fee income from installment loan was RMB342 million, an increase of 34.12% as compared to that in the previous year; and other fee income from value-added services was RMB388 million, an increase of 122.99% over the previous year.

### *Customers*

As at 31 December 2008, the total number of retail deposit accounts of the Company was 38.44 million, and the total deposit balance was RMB476.943 billion, of which, the total number of Sunflower customers (high end customers, with more than RMB500,000 financial assets in the Company) was 393,000. Their total deposit balance was RMB187.3 billion, accounting for 39.27% of the total retail deposits of the Company. The balance of Sunflower customers' total assets under management of the Company amounted to RMB659.3 billion, an increase of 188.3 billion or 39.98% over the previous year, accounting for 61.86% of the balance of customers' total assets under management of the Company, up by 6.76 percentage points from that of the previous year.




### *Marketing*

With the sustained efforts of the Company in brand building for its products and services, the brands such as All-in-one Card, All-in-one Net and credit cards have gained relatively high recognition. In 2008, while continuously building up the above brands, the Company continued to refine the Sunflower Exclusive value-added services, actively commenced the targeted marketing based on customer database, and progressively promoted the integration of sales and service processes. Major marketing campaigns such as "Sunflower Cup National Teenager Piano Competition" and "The Second Wealth Management Education Community Tour" were launched. Such efforts on brand building will further help developing customer base and enhancing customer loyalty.

At present, the Company offers retail banking products primarily via its branches and sub-branches. In the meantime, to meet the market changes, the Company establishes a multi-level marketing system in its branches. As at 31 December 2008, the Company had established 668 wealth management centers.

In 2008, the focus of our private banking business was on the preparation work for branches establishment, team building and customer management, the results of which were encouraging. The establishment of branches for pilot operations of private banking was in smooth progress as scheduled, with seven private banking centers being established in Shenzhen, Beijing, Shanghai, Tianjin and Harbin respectively. As at 31 December 2008, the Company had a total of 6,398 private banking customers, increasing by 35.98% as compared to year 2007. Total assets under management for private banking customers amounted to RMB129.9 billion, increasing by 33.51% as compared to year 2007. The Company actively conducts induction training for private banking customer service managers and organizes advanced courses on private banking business, with the aim to build up a team of professional investment consultants and a market analysis platform. All these help setting up a preliminary model for private banking business.


## 5.8.2 Corporate Banking

The Company provides corporate customers, financial institutions and government agencies with diversified quality banking products and services. As at 31 December 2008, the corporate loan balances of the Company were RMB518,440 million, accounting for 62.20% of the total customer loans; the balances of total discounted bills were RMB95,766 million, accounting for 11.49% of the total customer loans; total corporate customer deposit was RMB701,297 million, accounting for 59.52% of total customer deposits.

### *Corporate loans*

Corporate loan products of the Company include working capital loans, fixed asset loans and other loans such as trade finance and factoring. In 2008, the Company actively implemented a customer strategy that equally emphasized small, medium and large customers. The Company provided more support for quality industries such as railway, transportation, electricity, telecommunications, urban infrastructure, renewable energy, environmental protection and high-tech industries. The Company controlled the loan disbursement to industries under macroeconomic control such as those "High pollution, High energy consumption and Resources dependent" industries. These all resulted in further optimization in the industry structure of corporate loans.

The Company continued its efforts in serving SME customers. In spite of the challenges arising from the macroeconomic fluctuations to SMEs, the Company still recorded a decline in both the non-performing loans and non-performing loan ratio among SMEs. The Company considers that, SMEs will take an increasingly important role in the domestic economy based on the historical economic development and the economic structure of the PRC. In addition, the SMEs possess very tenacious vitality and it is certain that many quality enterprises will be able to grow stronger in overcoming the economic difficulties. The SMEs remain a key strategic customer base of the Company. In terms of marketing to SME customers, the Company will place more emphasis on marketing and product provision in a professional manner; establishing a comprehensive risk management system and enhancing the incentive system; and encouraging geographical differentiation of businesses.

In 2008, the Company's SME corporate loans grew steadily where SME customers within the Mainland China accounted for 80% of the total corporate customers within the Mainland China. Pursuant to the classification standards for SMEs (GuoTongZi (2003) No.17) promulgated by the National Bureau of Statistics of China, the balance of the Company's SME corporate loans within the Mainland China amounted to RMB220.54 billion, an increase of RMB30.24 billion over that at the beginning of the year, accounting for 43.1% of the total corporate loans within the Mainland China, a slight decrease of 0.2 percentage point as compared with that at the beginning of the year. The development of SME business gradually expanded the corporate customer base in the industry and substantially enhanced the profitability of corporate loans.


In terms of business growth of SMEs, the Company focused on, in particular, branch establishment, market planning, product innovation, risk management and brand building. Firstly, the Company established the small enterprise credit center in Suzhou as a separate legal entity, specializing in the provision of financing services to small and tiny customers all over the country. This is an important measure in implementing professionalized SME credit services. Secondly, the Company extended its growth strategies of SME business geographically to target at three major regions namely Yangtze River Delta, Pearl River Delta and Bohai Rim as its core regional markets, whilst gradually expanding to Central China and Western China. Thirdly, the Company pursued product innovation and launched the "Go Fortune Logistics Finance" financial products which integrate movable properties, delivery rights and warehouse receipt pledge and combined products with new commercial mode of operation, thereby providing flexible services targeting logistics and trading enterprises. Fourthly, the Company continued to build on the brand concept of "Go Fortune Growth Program" in the course of strengthening brand management to realize the philosophy of "helping SMEs achieve long-term goals" and promote its brand through various channels including TV media, print media, APEC, Expo Central China as well as large-scale conventions and customer appreciation meetings.

In terms of risk management, the Company strengthened the control over the credit risks associated with SMEs through improving the risk management tools and launching special risk inspection. At the same time, the Company actively adjusted the existing customer mix. Through capitalizing on customer ratings, imposing more stringent guarantee requirements, exercising prudent industry selection and adjusting size and structure, the bank-wide risk-prevention ability on the SMEs was strengthened steadily.

In 2008, the Company was accredited as National Advanced Unit of Financial Service for Small Enterprises by CBRC, being the only joint stock bank granted such recognition for two years in a row.

### *Discounted bills*

Taking into consideration the combined factors of total loan amount, liquidity, yield and risks, the Company effectively drove the development of discounted bills operations in 2008. As at 31 December 2008, the balance of discounted bills loans was RMB95,766 million. Meanwhile, due to improved product offer and marketing efforts, the Company's Bill-Express business maintained an upward momentum, with the annual cumulative transaction volume increasing from RMB30.9 billion in 2007 to RMB55.1 billion in 2008.

### *Corporate client deposits*

The Company has high regard to enhancing the returns of corporate client deposits and strives to increase the percentage of low cost demand deposits to total corporate client deposits. With the expansion of innovative services such as online banking and cash management, higher quality marketing efforts have been made, which effectively facilitated the cooperation between the Bank and corporate clients. As a result, large amount of low cost demand deposits were obtained.

As at 31 December 2008, total corporate client deposits amounted to RMB701,297 million, an increase of 13.62% as compared to those at the end of previous year. Specifically, demand deposits accounted for 52.41%, which remained 4.82 percentage points higher than time deposits under the backdrop of the shift to term deposits. The high proportion of demand deposits helped reducing interest expenses on deposits.

### *Non-interest income business*

Under the guiding principles of restructuring the operating structure, the Company stepped up its efforts to maximize the percentage of fee-based income to total income from corporate banking business, besides ensuring the growth of interest income. In 2008, the Company made great efforts to promote the development of the innovative businesses including cash management, sale of corporate wealth management products, agency underwriting of short-term commercial papers, asset custody, corporate annuity and financial advisory etc. Meanwhile, the Company continued to maintain the growth of income from traditional businesses including domestic and international settlement, acceptance, guarantee and commitments in order to ensure the diversification of non-interest income sources and the continuous growth of total income. The net non-interest income was RMB4,371 million in 2008, representing a significant increase of 91.12% as compared to that in the previous year.

While strengthening the product innovation, the Company further enhanced the product operations and compliance management, with a focus on brand building for Cash Management and Online Corporate Banking. The Company further consolidated and expanded its leading edges in the area of cash management where the marketing and customer application indicators for various core products achieved material breakthroughs.

With regard to Online Corporate Banking, the total number of online corporate banking customers reached 80,279, an increase of nearly 30,000 over the previous year, which exceeded the sum of the new customers for the preceding three years. Among them, as a result of the upgrade of classification standards for active accounts, the number of new active accounts was over 20,000, representing an increase of over 100% relative to the comparable index in the previous year. The number of debit transactions exceeded 20 million for the year and the debit transaction substitution ratio exceeded 40% for the first time to reach 42.5%, achieving a substantial increase of 11 percentage points over the previous year. Based on the same benchmark, this ratio outperforms its peers in China, indicating that customers' preference over the products has been further enhanced. The product application has penetrated into the core areas of the cash management of customers and become the major tool and approach adopted by the customers for their daily settlement and financial transactions.

As for cash management, the number of cash management customers reached 78,682, accounting for 26% of the total number of the corporate accounts. The average daily deposit balance of cash management customers amounted to RMB442.0 billion, accounting for 72% of the total average daily corporate deposits. The loan balance of cash management customers amounted to RMB313.8 billion, accounting for 61% of the total loan balance of corporate accounts. The average daily demand deposits of the core cash management customers accounted for 65% of their total deposits, a significant increase over the previous year. This percentage significantly outperforms the percentage of the corporate demand deposits to the total corporate deposits throughout the Company. The Company also launched an innovative cross-bank cash management platform (CBS). Leveraging on the unique and exclusive edge of CBS in China, the Company not only stabilized and consolidated the business cooperation with the existing customers, but also successfully attracted a number of sizable and well-known domestic conglomerates as its new customers, thus providing a platform for cross-selling its wholesale products. The cash management business is proven to have played an active role in facilitating the liabilities business growth, especially absorbing and stabilizing demand deposits, reducing the cost of corporate liabilities and promoting cross-selling opportunities.

In respect of corporate wealth management, the Company continued to launch more wealth management products in 2008. These product investments covered treasury bonds in the inter-bank bonds market, central bank notes and financial notes on the inter-bank bond market, online and offline IPO subscription on the capital market, entrusted loans and high quality credit assets transfers with varying maturities of any periods beyond 7 days. Through over two years of development, the wealth management business has become an important tool for the Company to conduct customer marketing, attract funds, diversify business lines and increase non-interest income. The sales volume of corporate wealth management for the year was RMB345.5 billion, an increase of RMB291.5 billion or 540% over the previous year.

As for international settlement, the Company completed a volume of US$121.8 billion in 2008, an increase of 23.91% as compared to that in the previous year, and the foreign exchange settlement was US$84.4 billion, an increase of 30.45% over the previous year. The accumulated amount of trade finance was US$12.0 billion, an increase of 28.73% as compared to that in the previous year; while the international factoring amount reached US$1,414 million, representing an increase of 135.87% over the previous year. The accumulated non-interest income of international business was US$236 million, an increase of 38.37% as compared to that in the previous year. Among all the peers in China, the Company was ranked the second and the third respectively in terms of international factoring and trade finance balance.

With regard to offshore business, the offshore assets of the Company reached US$2.2 billion in 2008, including US$1.0 billion of credit assets, representing an increase of 307% as compared to those in the previous year. The average daily offshore deposits amounted to US$2.25 billion, an increase of 17% over the previous year; while the offshore settlement amount reached US$40.8 billion, an increase of 42% as compared to that in the previous year. The fee income arising from offshore business was US$16.93 million, an increase of 57% over the previous year. The profit arising from offshore business was US$47.86 million in 2008, an increase of 22% as compared to that in the previous year. The Company was ranked the top on the Chinese offshore banking market in terms of the size of offshore credit assets and liabilities, the total settlement amount and the fee income.

As for third party custody business, the Company had 3.10 million customers of third party custody in 2008, including 230,000 new customers. The number of active institutional third party custody accounts was 11,954 and the number of new institutional customers reached 5,815. Funds under third-party custody amounted to RMB98,936 million, and custody fee income amounted to RMB167 million.

With regard to the assets custody business, the Company made a profit of RMB877 million from custody business in 2008, an increase of 88% over the previous year. The average daily custody asset balance was RMB183.1 billion, an increase of 104% as compared to that in the previous year. The average daily custody deposit was RMB26.4 billion, an increase of 36% over the previous year. There were 18 funds, 15 wealth management products for securities firms, 542 entrusted asset management offerings, 13 insurance asset management offerings, 18 QDII products in total and the number of clients contracted for corporate annuity funds custody were 1,171, while the corporate annuity funds contracted for management reached RMB15.1 billion.

As for the corporate annuity management business, the number of newly contracted corporate annuity customers' individual accounts was 407,000 in 2008. The assets contracted for custody increased by RMB4.1 billion and the assets contracted for entrusted management increase by RMB1.8 billion. The Company maintained a leading position among its peers in terms of business volume and growth.

With regard to the underwriting of the debt financing instruments of non-financial enterprises (hereinafter as "debt financing instruments"), the Company filed a total of 27 debt financing instrument deals to the Central Bank (Dealers Association) and successfully completed 31 issuances of debt financing instruments for 26 customers in 2008, involving a total financing amount of RMB39.04 billion, including the lead underwriting volume of RMB29.09 billion. The underwriting fee of debt financing instruments reached RMB133 million. The Company's share in the debt financing instrument market was 10.83% by number of issuance and 4.85% by lead underwriting volume. Among the 24 financial institutions qualified to underwrite debt financing instruments on the inter-bank market, the Company ranked fourth by number of issuance.

In respect of financial advisory business, the Company earned a special financial advisory fee of RMB149 million in 2008, representing 495.03% of the original annual plan. The number of active customers reached 537, equivalent to 166.77% of the original annual plan.

With regard to asset securitization, the Company successfully completed its first issuance of credit-asset-backed securities (ABS) on October 31, 2008. The size of the ABS assets pool was RMB4,092 million, including 50 loans extended to 33 borrowers, all of which were normal corporate credit facilities or guaranteed loans extended by the Company. The weighted average credit rating of the assets pool was AA-/A+, while the weighted average remaining term was 15 months. As at 31 December 2008, the total receivable loan service fee amounted to RMB6,479,600.

#### *Customer base*

Over the past 21 years of development, the Company has developed 315,800 corporate depositors and 11,900 corporate borrowers, including domestic leading enterprises and enterprise groups, government agencies, financial institutions, and Fortune Top 500 multinational enterprises. Meanwhile, the Company has managed to develop small and medium sized enterprises to form a balanced customer structure. In addition, the Company's products and services have been widely recognized by our clients. According to 2008 Clients Satisfaction Survey conducted by Ipsos, the level of satisfaction of customers to our business maintained a relatively high level. The level of satisfaction in respect of several indicators, such as products, customer services, channels and marketing was at the upper end among all the major players in domestic banking industry.

### 5.8.3 Treasury

#### *Operating environment*

In 2008, under the multiple impacts of deteriorating external environment, structural adjustment on domestic policies and the inherent cycle of economy, the internal conflicts of China's "export & investment-oriented growth model" were intensified and became apparent. The market forces of demand and supply experienced a reverse where demand was wanting. The macro economy stumbled rapidly and entered its doldrums after a series of sharp falls. As the leading economies successively fell into recession, the central government launched aggressive fiscal policies and moderately loosened monetary policies in a move to defend against the adverse impacts of the shrinking external demand on the economic growth and achieve the objective of maintaining growth. The government introduced large-scale fiscal stimulus programs and bold rate cuts, whilst relaxed the monetary and credit control, as well as guided and encouraged credit granting. Internationally, as a result of Lehman Brothers' bankruptcy, the US sub-prime crisis escalated into a global financial tsunami. With the panic spreading in the market, the credit market was at the edge of collapse, resulting in widening credit spread and acute liquidity shortage for a time. The major financial markets including equity, foreign exchange, interest rate and credit were highly volatile, while the prices of bulk commodities such as raw materials and oils plunged sharply. Driven by the global demand by risk aversion funds, the gold price and the US dollar broke their long history of inverse relationship and both recorded appreciation in the second half of the year. In terms of monetary policies, the major economies successively undertook various measures including rate cuts, capital injection and guarantee provision in an effort to rescue the financial system and prevent the financial crisis from spilling over to the real economies. Currently the policies mainly target at "quantitative easing".

### *Operating strategy*

As for the RMB business, facing the dramatic changes of the domestic policies and market environment, the Company adhered to prudent strategies on treasury operations. Firstly, the Company reinforced the liquidity management to maintain adequate liquidity reserve and a sound liquidity structure, thereby effectively addressed the pressure of tightened monetary policies in the first half of the year. Meanwhile, the Company maintained sound liquidity position amid the global financial tsunami for the second half of the year, thereby eliminated the impacts of the volatility of foreign currency liquidity on the RMB business. Secondly, the Company strengthened the credit risk management as the commodity market and the foreign exchange market were highly volatile as a result of the global financial tsunami where some Chinese enterprises incurred huge losses for their offshore investments, which had an adverse effect on the domestic credit market. The Company swiftly adopted measures to control the total investment amount of the credit related products, accelerate the adjustment and optimize the investment structure. The Company decisively cashed certain bonds with lower credit ratings and the bonds of the enterprises at risk. This effectively safeguarded the security of the investments. Thirdly, the Company capitalized on the shift of the interest rate cycle and adopted a strategy of accelerating the building of new positions and extending the duration at the right time, thus managing to increase the holdings of some mid- and long-term bonds with fixed rate and high-quality credit related products, so as to optimize the asset and liability structure and help maintain the stability of the net interest income. Fourthly, the Company pressed forward the development of secondary market trading and re-arranged its bond holdings and increased turnover rates. In addition, the Company moderately applied the financial leverage and actively conducted interest spread trades, thereby effectively lowering the cost of investment portfolios.

As for foreign currency business, the Company proactively adjusted the size of foreign currency investments according to market conditions. In doing so, the Company overcame the adverse effect of the plunging US interest rates. The Company obtained funding through redemption of bonds and actively executed dealing in derivatives such as swaps and options in order to raise the portfolio yield. By trading local and foreign currencies swaps, the Company also profited from arbitrage opportunities in the domestic swap markets arising from the anticipated RMB appreciation.

### *Operating results*

In 2008, the annual yield of the Company's foreign currency/RMB-denominated securities portfolio reached 3.92%, up 58 basis points as compared with the full year of 2007. The increase in investment yield was mainly contributed by the floating rate bonds, newly conducted investments, repricing of reinvestment of matured securities and a higher proportion of investment in credit related products. In 2008, the Company's annual yield on financial assets under reverse repo agreement and placements to banks and other financial institutions was 3.78%, down by 7 basis points as compared with the full year of 2007.

As of the end of 2008, the Company's proprietary investment portfolio reached RMB300,339 million, up by 23.28% from the end of the previous year. In addition, assets under management on behalf of customers denominated in RMB reached RMB60,718 million, down by 12.14% from the end of the previous year. In 2008, the Company's income from wealth management on behalf of customers reached RMB1,263 million, an increase of 273.06% over the previous year.

***Business development***

In 2008, as a result of the slumping global equity, real estate and commodity markets, deleveraging was increasingly a common phenomenon. Large volume of fund flew from the high-risk investments to low-risk and high-liquidity banking wealth management products, generating tremendous growth opportunities for the wealth management business of commercial banks. In 2008, the number of wealth management products launched by the Company reached 2,344, with a total issue value of RMB701.9 billion. It is worth noting that the number of the wealth management products launched by the Company ranked second among all commercial banks nationwide. In 2008, the Company actively positioned itself as a market maker. The Company's interbank bond transaction volume reached RMB6.53 trillion, ranking first among the domestic banks in the bond market for two years in a row since 2007. The total bilateral quotations amounted to RMB643.4 billion; and the valid amount was RMB59.9 billion through the bilateral quotations, with more than 30 types of bonds for daily quotations averagely. The Company's quotation amount and quotation transactions surged significantly as compared to those in the previous year, ranking second among all market makers. The transaction volume of foreign exchange settlement on the inter-bank quotation market amounted to US$270.7 billion, an increase of 99.8% over the previous year.

## 5.8.4 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 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 than 70% of the benchmark rate. Interest rates for foreign currency-denominated loans are generally not subject to PRC regulatory restrictions.

The Company prices its products based on various criteria, such as the borrower's financial condition, types and value of collateral, the intended use and term of the loan, cost of loan, credit risk and other risks, expected rates of return, the Company's market position and the prices of competitors. The Company has started using the FTP method to calculate the cost of funds in connection with loan granting. The Company is in the process of developing a loan pricing model that assists the Company to determine the minimum interest rates at which various loan products may be priced. The branches are allowed to set prices at their own discretion within the established ranges of these internal benchmark prices so as to allow them with greater flexibility to compete effectively.

***Deposits***

Under current PRC laws and regulations, interest rates for the Company's RMB-denominated demand deposits and general term deposits shall not be higher than the relevant PBOC benchmark rate. However, the Company is permitted to provide negotiated term deposits to insurance companies, the National Council for Social Security Fund and Postal Savings Bank of China. The PBOC has liberalized interest rates charged for inter-bank RMB-denominated loans and deposits between financial institutions. In addition, the Company is permitted to negotiate the interest rates on foreign currency deposits other than those denominated in U.S. dollars, Euros, Japanese Yen or 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.

*Pricing for non-interest based products and services*

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

## 5.8.5 Distribution channels

The Company provides products and services via various distribution channels. As at 31 December 2008, the Company had 44 branches, 623 sub-branches (including offices), 2 exclusive operation centers equivalent to the branch (a credit card center and a small enterprise credit center), 1 representative office, 1,567 self-service centers and over 1,400 off-bank self-service machines in 54 cities across Mainland China, and a branch in Hong Kong, and a branch in New York and a representative office in the United States. The efficiently operated 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 and medium cities in other regions.

The Company also made efforts to develop and improve e-banking channels such as online banking and telephone banking, which is highly recognized and has effectively relieved the pressure from the business outlets of the Company. In 2008, the integrated counter-replacement ratio in respect of retail e-banking channels was 77.45%; whereas the integrated counter-replacement ratio in respect of corporate e-banking channels was 42.51%. As at 31 December 2008, the total number of online banking transactions was 183.40 million, up by 52% as compared to that in the previous year, and the accumulated transaction amount was RMB3,332.0 billion, up by 66% as compared to that in the previous year. Of which, the accumulated online banking transaction amount was RMB102.60 million, up by 90% as compared to that in the previous year, and the accumulated transaction amount was RMB46.0 billion, up by 51% as compared to that in the previous year. The number of transactions done through U-BANK, our online corporate bank, was 20,458,300, up by 62% as compared to that in the previous year, and the accumulated transaction amount was RMB17.47 trillion, up by 18% as compared to that in the previous year. In respect of telephone banking, as at 31 December 2008, the Company sold various types of wealth management products, such as fund, through telephone banking for a total amount of RMB10,297 million. The total transaction amount with Quick & Easy Wealth Management was RMB50,840 million and the number of accounts reached 1,705,800, representing a significant increase as compared to that in the previous year.

## 5.8.6 Overseas businesses

*Hong Kong Branch*

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 were HK$26.3 billion at the end of 2008.

Corporate banking services provided by Hong Kong Branch include loans and deposits, remittance, international trade facilities and settlement, initiating or participating in syndicated loan, and participating in inter-bank transaction of funds and bonds. Retail banking includes providing cross-border electronic banking services for individual customers between Hong Kong and the Mainland China, and the featured product is the "Mainland-Hong Kong All-in-one Card". This card combines the advantages of Hong Kong debit card and Mainland debit card. The cardholder can withdraw cash from ATM and use the card via POS in both Hong Kong and the Mainland China, and enjoy real-time online remittance service between the two places. Hong Kong Branch will launch Hong Kong stock dealing services in early 2009 where the holders of "Mainland-Hong Kong All-in-one Card" may trade Hong Kong stocks easily and efficiently through online banking and automated phone banking to enjoy the convenient investment and finance services.

### *New York Branch*

The New York branch of the Company, based in 535 Madison Avenue of New York, was officially opened on 8 October 2008. It was the first time that a Chinese bank was approved by the US Board of Governors of the Federal Reserve System since the implementation of the "US Foreign Bank Supervision Enhancement Act" in 1991.

The branch is primarily positioned as a bank focusing on international settlement and trade finance for the promotion of Sino-US economic and trade cooperation. Treasury activities and clearing services are important supplementary operations. The branch provides tailor-made follow-up services to Chinese companies "going global" which are its key target customers.

Devoted to innovations and proactive in the provision of quality services to customers, the branch upholds the business concept of "we are here, just for you" and fully demonstrates its edge in Sino-US synergy. Meanwhile, it functions as a window and a platform in the further advancement of the Company's internationalized management level and globalised service capability.

## 5.8.7 Information Technology and Research & Development

The Company has placed persistent emphasis on investments in the building of information technology. After years of effort, the Company has constructed a comparatively complete IT support system in line with its own strategic features to serve as a powerful technological support and security for the speedy development of the Company's businesses.

The system supported the steady operation of business during the year, with zero abnormal shutdown or network communication disconnection. After the switching to the new core business system for the remaining 4 branches, the Company successfully achieved centralization of bankwide system operation and management.

Through continuous technological innovations, the Company presses forward the building of e-banking channels, vigorously exploring room for the development of banking services. Corporate online banking system, comprising of settlement, financing, investment, cash management and supply chain services, has ensured the Company's capability in providing all-round corporate services. Retail online banking system with well-balanced multi-point backup and the call center system took up a substantial part of the Company's business handling volume. These systems bolstered up business development through the setting up of large-scale e-banking channels which compensated for the inadequacy of physical network points. The Company fully embarked on the construction of new business systems so as to provide all-round support for integrated business operations as permitted by the current policies and regulations. With the full-fledged implementation of "The New Basel Capital Accord" ("Basel II"), risk models were measured and improved to lift the Company's entire risk management level. Customer management level was enhanced through the development of online retail and wholesale of CRM systems. Having gone through these implementations and developments, the Company has constructed a complete IT support system in order to achieve integration of business operations.

The Company highly stresses the input of resources into information technology. To provide a more comprehensive and effective IT support system for the development of the Company's business, the project on a disaster data-recovery center in Shanghai covering 10,000 square meter in size is in full-swing and the construction of a second software development center in Hangzhou is well underway.

## 5.8.8 Businesses of Wing Lung Group

### *Profile of Wing Lung Bank*

Wing Lung Bank ("WLB"), founded in 1933, is among the oldest local Chinese banks in Hong Kong. It has at all times followed its motto of "Progress with prudence, service with sincerity" in providing personalised and sincere service to customers. The principal operations of WLB and its subsidiaries (hereinafter referred as "WL Group") comprise deposit-taking, lending, credit cards, documentary bills, foreign exchange, futures and securities broking, wealth management service, insurance business, financial lease, property trustee and nominees service.

As at 31 December 2008, WLB had a registered capital of HK$1.5 billion, while its total assets amounted to HK$100.6 billion and net assets amounted to HK$10.4 billion.

### *WL Group's Operation Review for 2008 and Prospect for 2009*

The year 2008 was an unusual year. Hong Kong's economy saw an apparent slowdown in the 3rd quarter, and an even more severe downturn in terms of GDP. The deepening US sub-prime mortgage crisis not only shattered the nation's own banking system, but also unleashed a financial tsunami which swept the world and caused severe damage to the already weak economic conditions. The crisis was further deteriorated as several large financial institutions in US went bankrupt or on the verge of bankruptcy, as a result of which, panic selling was seen in stock markets all around the world and financial institutions had to make impairment or provision for their assets denominated in US dollars. Not only Hong Kong, as an international financial metropolitan in Asia, suffered from the crisis, other export-oriented emerging markets in this area have also been affected to a certain extent. Services and trading activities saw rapid decrease against the backdrop of the global economic slump and the shrinkage of credit market. Stock markets and real estate markets also tumbled. Banks in Hong Kong suffered greatly from credit crunch in both US and Europe.

Due to various factors mentioned above, WL Group recorded a consolidated after tax loss of HK$816 million for 2008, mainly attributable to the allowance of HK$819 million provided for the Collateralised Debt Obligations ("CDO") it held and an additional impairment loss of HK$316 million provided for Structured Investment Vehicles ("SIV"), both of which were fully provided for or written off. Meanwhile, it also set aside provisions for some of its bond and investment holdings, which have dropped in market value owing to the financial tsunami, as well as allowances for the Lehman minibond incident.

With respect to the performance of core businesses, during 2008, WL Group realized a net interest income of HK$1.28 billion, a decrease of 14.4% from the same period of last year, mainly due to the narrowing spread and the decline in the interest income from interest-free funds resulting from a lower market interest rate. It's net fees and commission income amounted to HK$343 million, reflecting a decrease of 31.3% from that of the same period last year, mainly due to the significant decline in commission income from securities brokerage and investment services. It's insurance operating income (before taking into account of investment losses) recorded HK$445 million, an increase of 2% from that of the same period last year; however, if taking into consideration of charge for insurance claims, a loss would be recorded as claims for employees' compensation insurance continued to rise in the first half of 2008, and pursuant to the prudent principle, WL Group had increased the claims reserve for this insurance class. It's operating expenses totaled HK$1.05 billion, an increase of 41.7% when compared to the same period last year, mainly due to staff and salary increase, as well as the provision for the Lehman minibond incident.

Despite the aforesaid allowances and provisions made, the capital adequacy ratio and core capital adequacy ratio of WL Group at 31 December 2008 were 13.8% and 12.0% respectively, and the average liquidity ratio for the year was 51.7%.

It is expected that the global economy in 2009 will be still severe and the operation of banks in Hong Kong will still face difficulty. There must be great changes and full of challenges in banking businesses after the financial tsunami. After merging with CMB, WLB has attained not only a strong support in strength, but also more room for future expansion. With complementary advantages and internal and external linkage between the two, fruitful achievement from a gradually created synergy is something expected to happen.

Detailed analyses of the operation in 2008 and business prospect in 2009 for WL Group are as follows:

### Deposits

As at 31 December 2008, the total deposits of WL Group, including structured deposits, surged by 17.0% to HK$83.2 billion as compared with that at the end of 2007, which was higher than the average increase rate of its peers.

Among the various kinds of deposits, the Hong Kong Dollar deposits increased by 37.1% to HK$54 billion as compared with that at the end of 2007, of which time deposit increased the most; and the US Dollar deposits after conversion decreased by 16.4% to HK$13.5 billion as compared with that at the end of 2007; and other deposits on foreign currencies after being translated into Hong Kong Dollar slightly increased by 0.8% as a result of depreciation in the exchange rate, among which Renminbi deposits after translation surged by 54.6% to HK$0.82 billion as compared with that at the end of 2007.

In 2009, with respect to the deposit business, WLB will focus on promoting and developing projects including foreign currency pleasure savings plan, salary pay-out account and Bebichhichi savings plan. At the same time, it plans to promote deposit service and other services to Sunflower customers of CMB through the internal and external linkage with CMB.

### Loans to customers

As at 31 December 2008, total loans to customers (including trade bills) of WL Group grew by 3.3% to HK$43.5 billion as compared with that at the end of 2007; and the non-performing loans ratio was only 0.47%, approximating that at the end of 2007, yet the overall loan quality of WL Group remained sound.

With respect to the residential mortgage loan, it decreased by 5.2% to HK$9.6 billion at the end of 2008 as compared with that at the end of 2007. The decrease was mainly due to the deterioration of economic environment and increase in mortgage rate which affected the price of property trading, and the rentals also decreased, with luxury properties in particular.

With respect to the corporate loans, it increased by 5.6% to HK$4.7 billion at the end of 2008 as compared with that at the end of 2007. In 2009, it is expected that WLB may provide one-stop banking service to its corporate clients through the internal and external linkage with CMB and high-end customers introduced by CMB so as to improve its profitability.

With respect to the syndicated loans, it increased by 7.5% to HK$11.2 billion at the end of 2008 as compared with that at the end of 2007.

Through high-end clients introduced by CMB, it is expected that WLB will improve its lending business in 2009. Meanwhile, WLB will boost the restructuring of its lending departments, establish Corporate Banking Department by merging with the original Syndicated Loans Department, so as to provide the major corporate clients with more integrated banking services. In addition, in view of its greater lending capacity, WLB will make efforts to expand its client base and actively seek business opportunities from the existing and potential clients in 2009.

### Investments

As at 31 December 2008, WL Group had a debt securities investment balance of HK$10.90 billion, representing a decrease of 20.1% as compared with that at the end of previous year, which was mainly due to the reduction in fair value of investment assets resulted from the financial tsunami. At the end of the year, WL Group had debt securities investments denominated in foreign currency (including Hong Kong dollar) of HK$10.64 billion, and these debt securities in foreign currency (including Hong Kong dollar) were made an impairment provision of HK$116 million. More than 72.5% of these debt securities in foreign currency (including Hong Kong dollar) have the credit ratings of A3 or above and their risks are very limited. In 2009, the investment strategy of WLB will be implemented prudently and based on risk review. It is expected that if the market or economy is not confronted with significant continuous downturn in 2009, it will be unnecessary to make impairment provision for these investments.

### Foreign exchange trading

The exchange rate of US dollar kept decreasing in the first quarter of 2008, and reached the bottom in the third quarter, however, the exchange rate of US dollar rebounded to its peak in the fourth quarter due to appreciation pressure against other major currencies from the de-leveraging processes of carry trade resulted from the financial tsunami.

In view of the reasons above, WL Group recorded an overall foreign exchange revenue of HK$99 million in 2008, representing a decrease of 15.7% over the corresponding period of the previous year; of which revenue from foreign exchange trading amounted to HK$91.4 million, an increase of 19.3% over the corresponding period of the previous year; revenue from foreign money exchange amounted to HK$26.9 million, a decrease of 16.2% over the corresponding period of the previous year; however, the foreign currency deposits and investments held by Wing Lung Insurance Company Limited ("Wing Lung Insurance"), a wholly-owned subsidiary of WLB, recorded an exchange loss due to the decrease in exchange rate.

In 2009, WLB will enhance the cooperation with CMB to seek more trading opportunities, and will also tighten relevant market risk management at the same time.

### Wealth Management

For year 2008, the wealth management business of WL Group realised a revenue of HK$49.6 million, representing a decrease of 61.4% as compared to the last year. That was primarily attributable to the setbacks in US economy and decline of HK stock index to around 11,000 points in 2008 amid a deprived global economic market as a result of sub-prime crisis and credit crunch. Since the bankruptcy of Lehman Brothers in September 2008, investors were pessimistic about the future of stock market, which resulted in a plunge in trading volumes and a substantial decline in trading of structured products. As a result, profit dropped significantly.

In 2009, WLB will keep up communications with CMB's high-end clients, and meanwhile, dedicate more efforts in stepping up sales training and product analyses so as to upgrade service quality and strengthen risk management. More new products will be rolled out with the aim of drawing more new customers and driving up sales of other products.

### Credit Card

As at 31 December 2008, WLB has issued a total of 250,000 credit cards, up 1.3% as compared with the end of 2007. The credit card receivables amounted to HK$470 million, down 28.7% as compared with the end of 2007. The merchant business turnover was HK$1.93 billion, up 11.8% as compared to the year 2007.

In light of the worsening economy and increase of risks brought about by the financial tsunami, it is advisable to take conservative and prudent strategies. In view of the greater synergy as a result of the merger of CMB and WLB, WLB has adopted the following operating strategies for its credit card business in 2009:

- attracting new customers through the high end Sunflower individual customers via CMB's referral;
- promoting the world's first diamond credit card "Infinite Visa" issued at the beginning of 2009 to high-end customers of WLB and CMB through all-sided introduction;
- launching brand-new business cards in 2009 to cater for the expansion of corporate banking businesses of both CMB and WLB;
- allowing card holders of WLB to enjoy CMB's favorable offers leveraging on CMB's good relationship with a large number of shopping malls and stores in the PRC, and similarly, WLB will offer the same favorable treatments in the Hong Kong stores to card holders of CMB, intending for mutual benefits;
- continuing to launch various card swiping incentive plans and offer more favorable treatments to the customers jointly with other stores, thus enhancing the appeal of products.

### Securities

In 2008, Wing Lung Securities Limited ("Wing Lung Securities"), a wholly-owned subsidiary of WLB, realised a commission income of HK$180 million, representing a significant decrease of 36.2%. The reduction was primarily due to the year-on-year decrease of approximately 18% in the total turnover on Hong Kong stock market in 2008, the weak performances of the Hong Kong stock market and the significant drop in the brokerage commission income from IPOs as a result of the delayed listing in Hong Kong of a number of state-owned enterprises of Mainland China.

In 2009, Wing Lung Securities will continue to expand its business and improve the service quality, minimise the loss of customers to its peers in a slow-moving market while enhancing all the service channels and service facilities.

### Insurance

In 2008, Wing Lung Insurance recorded a net earned premium income of HK$566 million, representing an increase of 1.6% as compared to the corresponding period of the previous year. The total claims of Wing Lung Insurance amounted to HK$524 million, representing an increase of 47.8% as compared to the year 2007. Due to the increasing claims, the underwriting profit decreased to HK$131 million in deficit from HK$30.7 million in the year 2007.

Due to the existing price cutting competition in the insurance market of Hong Kong, Wing Lung Insurance will pay more attention to the improvement of profitability rather than chasing market share in 2009. Wing Lung Insurance will conduct detailed analysis on the conditions of its existing customers and leave out those with insufficient premium rates and disappointing claim records. Instead, Wing Lung Insurance will endeavour to enter into insurance business with large infrastructure project contractors with satisfactory claim records. In addition, Wing Lung Insurance will make timely adjustments to the premium and terms of motor vehicle insurance based on market conditions. As for accident and medical insurance, Wing Lung Insurance will formulate and launch a number of special employment schemes or high value-added schemes for small and medium sized enterprises so as to increase its revenue. Furthermore, Wing Lung Insurance will work closely and interact proactively with CMB to capture and capitalise development opportunities in the future.

### Branches

WLB has 37 branches in Hong Kong, 3 sub-branches in the PRC and an overseas branch in each of Los Angeles and Cayman Islands.

In 2008, the Shenzhen Branch of WLB maintained its growth momentum in terms of business volume and profits. It will continue to expand its customer base.

Having commenced business in February 2008, the Shanghai Branch of WLB will focus on developing trade financing business.

As it was established in the west coast of the United States more than 20 years ago, the Los Angeles Branch of WLB has considerable experience in handling local businesses and maintains a certain customer base. We hope that it can collaborate with the New York Branch of CMB in the east coast to share business platform, thereby expanding our North American presence.

### Information Technology

In order to cope with the integration between and future development of WLB and CMB, the Information Technology Department of WLB will accelerate its efforts in upgrading the capacity and compatibility of various basic facilities, such as IBM computers, servers, network and disks. WLB will also conduct analysis in respect of the efficiency of the integration of various development programs, and propose short-term and long-term solutions.

### Human Resources

As at 31 December 2008, the total number of employees of WLB is 1,680 (December 2007: 1,660), of which 1,595 are in Hong Kong, 73 are in the PRC and 12 are overseas.

In order to cope with its business development, WLB constantly conducts or arranges lectures in relation to its businesses and new products or services. It also offers its front-line staff with practical courses such as wealth management, insurance, new deposit products and services as well as sales techniques, with the aim of enhancing the capabilities of its staff, increasing its competitiveness and expanding businesses.

### Internal Control and Risk Management of WLB

The board of directors and senior management of WLB are responsible for establishing, maintaining and operating an effective system of internal control. The internal control system of WLB comprises a well-established organisational structure and comprehensive policies and standards. The expectations of the board of directors regarding duty, responsibility and integrity are clearly spelt out in formal policy statements, which include Code of Conduct, Internal Control Policy Statement and Compliance Policy Statement, etc. The board of directors has clearly defined the lines of authority and responsibilities of each business and operational unit to ensure adequate checks and balances.

The internal control system of WLB covers every business and operational function. The system is designed to safeguard the assets of WLB against loss and misappropriation; to maintain proper accounting records for producing reliable financial information; to provide reasonable assurance against material fraud and errors. WLB has established policies and procedures to ensure compliance with applicable laws, regulations and industry standards. To cope with the increasingly stringent requirements from relevant regulatory authorities together with ever changing business environment, the board of directors has dedicated more resources and efforts to further strengthen the management structure and oversight of WLB. An Internal Control Committee has been established with the primary objective to assist the management to oversee the internal control system of WLB. Regular Internal Control Committee meetings are held and the Committee reports its work to the Management Committee on a semi-annual basis.

WLB has had in place various risk management policies and procedures. Specific committees and units, such as the Credit Committee, the Risk Management Committee and the Asset and Liability Management Committee, are responsible for identifying, assessing, monitoring and managing the risks that WLB faces. Risk management policies and major risk control limits are established and approved by the board of directors or Management Committee.

## *Progress of Integration with WLB*

The acquisition of WLB by the Company is an important strategic move, which is of profound significance in terms of the expansion of our Hong Kong businesses, the acceleration of our internationalization process, the further readjustment of our operational strategies, and the provision of more comprehensive and higher-quality financial services both domestic and abroad.

The successful completion of the transfer of shares is only the first step of the acquisition. The essentials as to whether the acquisition is successful are efficient integration and the creation of synergy. To this end, the Company appointed internationally-renowned consultancy firms as its consultants and established dedicated teams for the integration, formulating impeccable integration plans and effective program-management mechanisms.

### 1. The Strategy and Objectives of Integration

Thanks to geographical and cultural proximity, Hong Kong and the Mainland China have been enjoying an ever closer economic and trade relationship, and residents from the regions engage in exchanges more frequently. As such, there are great demands for cross-boarder financial services. Focusing on the demands of customers for such services, the Company will initiate the integration with the wholesale of cross-boarder services and the provision of asset management services to high-end customers as the breakthrough points. The Company will implement a three-step strategy in realising the integration with WLB in a gradual, orderly, proactive and steady manner. Based on the principle of "laying a foundation within one year, remarkable achievements within three years and complete success within five years", the Company will strive to forge a new brand image for WLB within five years. The Company aims to develop CMB together with WLB into an excellent commercial bank, which has not only competitive advantages in the provision of cross-border financial services, but also unique characteristics, international competitive edges and management standards and integrated operations, in the Mainland China, Hong Kong, Southeast Asia and the world at large.

### 2. Progress of integration and our result

Since the integration with WLB formally commenced on 27 September 2008, the team being responsible for integration project has made good cooperation and done plenty of meticulous work, bringing great contributions which demonstrated mainly in the following three aspects:

Firstly, the continuity and stability of the operation of WLB maintained well. On or around the formal completion of the acquisition of shares of WLB by CMB, the international financial market was terribly bleak and difficult. An emergency team was set up by both banks and jointly prepared a well-conceived crisis relief plan. Under all parties' great effort, the customer basis and the labour force of WLB were maintained stably. Thus, the operation and management of WLB got smooth transition, which provides favorable conditions for further integration and upgrading.

Secondly, the relief plan worked effectively. Based on the stable transition of the operation of WLB, CMB and WLB jointly put great effort and focused on the main business opportunity arising from demand from cross-border financial market. Sharing the customer resources and connecting the domestic and overseas business brought new breakthrough to us and obtained sound effect, which preliminary demonstrated the synergic effect of the merger and acquisition. For corporate finance service, both banks have commenced to provide comprehensive cross-border financial services, such as accepting guarantees from domestic enterprise as security for loans granted to overseas entity, transfer settlement and international settlement to corporate customers that have business in Mainland China and Hong Kong. For retail finance service, both banks have tried to introduce the quality retail banking service to Hong Kong. With great effort on marketing and promoting, many originally VIP customers of CMB became customers of WLB and made cross-sell. For credit cards, both banks have successfully completed in sharing merchant offer. For financial market trading business, both banks became counterparties of trade and have commenced cooperation in certain aspects. For middle and back operation and management, both banks rode on the advancement of integration and achieved effective cost-saving measures by taking advantage of central purchase.

Thirdly, the future development of WLB was made definite and a detailed implementation plan for integration was prepared. Based on the analysis and research of the actual operating management of both banks, the integration team has summarised the pros and cons over their operating management. Thus, the future development and strategic focus of WLB, and the direction of enhancing the operating management of both banks were made definite. Specific integration measures were proposed as well. Those measures cover all aspects, such as the business development, management improvements and integration of the organisation and the culture. Meanwhile, the integration team also established the measuring system for the synergic effect that those integration measures would contribute after being implemented and set definite objectives of integration.

3. Prospect of integration

Looking forward, following the further development of unifying the financial sector between the Mainland China, Hong Kong and Taiwan, the market of cross-border financial service will keep expanding. CMB will capitalise on such great opportunity and further enhance the integration, in order to enhance the operating management standard and the capability of providing customer service of both banks.

## 5.8.9 Business of CMB Financial Leasing

CMB Financial Leasing Co., Ltd. ("CMBFL") was one of the five bank-affiliated financial leasing firms which were authorized by the State Council for experimental operation. It was given the approval for establishment from the China Banking Regulatory Commission on 26 March 2008, and was incorporated in Shanghai on 23 April 2008 with a registered capital of RMB2 billion. It is wholly owned by the Company.

The principal businesses of CMBFL are driven by the nation's industrial policies. It provides financial services such as finance leasing, asset management, investment and finance advisory to customers in industries involving large equipments such as shipping and transportation, electrical power and telecommunication, and to SMEs.

Since its establishment, CMBFL has been active in business development and building a sound internal management system. As at 31 December 2008, CMBFL had a total asset value of RMB2,575 million and a net asset of RMB2,040 million. Realized net profit was RMB40.01 million. It had a workforce of 42 employees. Its business structure is getting rationalized and business models have become increasingly diversified. It has taken active initiatives in exploring professionalized commercial development models. Besides, an all-round risk management system was built and team building was strengthened. It has also developed its own "leasing business system" and had established an effective internal incentive system.

In 2009, in face of various unfavorable factors such as the macroeconomic downturn and reforms on the value-added tax, CMBFL will adhere to the business concept of "solid foundation, ability training, accurate positioning, brand innovation" in expanding its business, enhancing its management level, delivering innovative ideas and accelerating its business development.

## 5.8.10 Business of CMB International Capital

CMB International Capital Co., Ltd. ("CMBIC") is a wholly-owned subsidiary of the Company in Hong Kong. Currently, CMBIC's businesses mainly cover corporate finance advisory services, securities brokerage, and securities investment. As at the end of 2008, CMBIC had a registered capital of HK$250 million and a workforce of 31 employees.

As at 31 December 2008, CMBIC had a total asset value of HK$433 million, an increase of 15.47% as compared to the beginning of the year. Net asset was HK$340 million, a decrease of 2.29% as compared to the beginning of the year. Asset quality was good and cash-flow was abundant with a liquidity ratio of 3.89. Realized operating income amounted to HK$20.72 million in 2008, a decrease of 68.14% from HK$65.03 million in 2007. Excluding securities investment loss of HK$11.12 million, realized operating income amounted to HK$31.84 million. Realized net loss was HK$13.05 million versus a net profit of HK$33.15 million in 2007. The loss was mainly due to a certain degree of adverse impact on the business of CMBIC arising from the global financial crisis and the economic downturn in Hong Kong.

In 2009, CMBIC will undertake large-scale restructuring and implementation in areas such as personnel, IT transaction and research information platform and market development. Based on the analysis of market opportunities and its own resource conditions, with the aid of the Company's advantages in domestic networks and client resources as well as the support from the advanced information technological platform and research advisory business, CMBIC will prioritize the development of securities brokerage business alongside moderate development of investment banking business, in an effort to build a solid foundation for the sustainable and sound development of CMBIC.

### 5.8.11 Business of China Merchants Fund Management

China Merchants Fund Management Co., Ltd. ("CMFM") was the first fund management joint venture approved by the CSRC. CMFM was established on 27 December 2002 with a registered capital of RMB210 million. As at the end of the reporting period, the Company had 33.4% equity interest in CMFM. The businesses of CMFM include fund establishment, fund management business and other operations as approved by CSRC.

As at 31 December 2008, CMFM had a total asset value of RMB660 million and a net asset of RMB460 million. It had a workforce of 165 employees. Realized operating income was RMB643 million in 2008, an increase of 8% as compared to that at the end of 2007. Realized net profit was RMB241 million, an increase of 18.7% as compared to that in the previous year. CMFM had altogether 10 open-ended mutual funds with funds under management totaling RMB50,333 million. In terms of the size of fund under management, it ranked 18th, up by 6 ranks from the 24th in 2007.

In 2009, CMFM will continuously strengthen internal control and risk management. It will also stress on the enhancement of investment management and execution capability whilst pursue differentiated marketing strategies so as to build a more solid foundation for future development.

## 5.9 Risk management

### 5.9.1 Credit risk management

Credit risk refers to risk arising from failure of the borrower or the related party to fulfill its obligations under the negotiated terms and conditions. The Company endeavors to formulate an independent risk management system for credit risk management and implement bank-wide policies and procedures, including credit risk identification, measurement, monitoring and management, to control the credit risk of the Company and maintain balanced profitability.

Risk Control Committee of Head Office is the highest authority of the Company in credit risk management. Under the framework of the risk management strategies, policies and authorizations approved by the Board, the Committee is responsible for reviewing and deciding the most significant bank-wide risk management policies, and reviewing complicated credit items. The Company separately reviews credit risk in accordance with business risk status and credit approving system. These decision-making entities include: Head Office Risk Management Committee, Head Office Professional Loan Approval Committee and Branch Risk Management Committee. The Company has formulated a comprehensive credit approval and authorization system according to credit management level, the borrowers' credit ratings and credit guarantee conditions. The Company has also implemented practical authorization standards, authorization methods and authorization adjustment rules. The Company is strictly in compliance with the principle of separating the authorization of reviewing credit and granting loans. The procedure of "triple reviewing" is strictly applied before, during and after loan granting. The system of cross-checking among different positions and responsibilities are designed according to various risk control procedures of credit business. The Company has established a well-defined accountability system to ensure effective working of the procedure of risk control management.

In 2008, amid the global financial crisis and economic depression, the domestic and overseas markets face very difficult and challenging conditions. Guided by the principle of "progressing with reforms, implementing industry-focus, enhancing management and improving quality", the Company fully enhanced its credit risk management capability through the five approaches of "Streamlining system, Perfecting rules, Optimizing procedures, Building teams, Improving technologies". On the one hand, it closely followed the directions of the credit policies to impose strict control over credit approval requirements. On the other hand, it closely monitored the risks pre-warning system to dynamically monitor and control loan granting so as to avoid any non-performing loans. Meanwhile, it studied intensively the comprehensive credit risk management system, implemented the appointment system for credit approval officer, whilst explored the possibility of introducing risk managers and considered the reform of existing credit approval and authorization procedures. It also adopted the system of centralized examination and offering guarantees, improved management policies for collective and group accounts, and furthered the development and applications of quantitative techniques. The Company also adopted and moved to reach the targets specified by the Basel II Capital Accord, reinforced credit inspection, enhanced the non-performing loan accountability system and recovery of bad debts. As the development of the new generation of credit risk management information system has been kicked off, the Company saw continuing optimization of asset quality under such increasingly challenging operating environment through its proactive and comprehensive credit risk management. In 2008, the credit assets of the Company continued to maintain sound development that demonstrated features of "appropriate growth in scale, continuous improvement in quality, adequate allowances for impairment, remarkable achievements on bad loan collection, and gradual decrease of credit costs".

In 2009, the impact of the global financial crisis on the PRC economy may extend from the export sector to many export related sectors such as raw materials production, processing and transportation sectors and from coastal and developed regions to inland and remote regions geographically. Under the falling of effective demand and the increasing in hidden risks, the Company will face severe challenges in maintaining balanced development between business expansion and risk management. By adhering to the principles of "healthy growth, proactive response, solid foundation and quality enhancement" in managing the credit risks, and closely following the directions of the nation's macroeconomic measures, the Company will hold on to maintain healthy operations and actively cope with various challenges and difficulties, while increase the scientific development and flexibility of risk management, and effectively enhance risk-return profile in order to maintain the quality of the credit assets at a steady level.

### 5.9.2 Liquidity risk management

Liquidity risk refers to the risk that the Company is not able to satisfy its customers by providing them with deposits, new loans and liabilities due, or the risk that the Company is not able to raise sufficient funds readily at reasonable cost to perform its own obligations. The overall liquidity of the Company is managed by the Assets and Liabilities Management Committee, and the Planning and Finance Departments in the Head Office and branches are responsible for execution.

In 2008, the economy and financial market in China and elsewhere experienced volatile movements, the liquidity on a macro level showed a feature of tight at first but loosened afterwards. Facing such market liquidity volatilities, the Company continued to adhere to its sound liquidity management policies and adopted effective liquidity management strategies. The liquidity was maintained at a steady and healthy level during the year. Meanwhile, under such unfavorable circumstances posed by the intensifying global financial crisis, domestic economic slowdown and abrupt market changes, the Company further reinforced the stress testing on liquidity, and three liquidity stress scenarios ranging from low stress, medium stress and high stress were designed so as to measure and analyze the liquidity risks under extreme circumstances.

As shown by the liquidity gap statement, at the end of December 2008, the Company had a liquidity gap for immediate repayment of RMB719.9 billion, primarily caused by a higher level of demand deposits (including deposits held at call). Taking into account of the depositional characteristics of demand deposits, the liquidity risk of immediate repayment of the Company was relatively small. The results of stress test showed that the Company was capable of coping with liquidity risks under medium stress scenario.

## 5.9.3 Interest rate risk management

Interest rate risk refers to the risk of adverse impact of fluctuating interest rates on the financial position or market capitalization of banks. The interest rate risks faced by the Company include the risk arising from the difference in the basis of assets and liabilities, repricing risk, yield curve risk and option risk. In particular, basis risk is the primary risk faced by the Company, followed by the repricing risk. The yield curve risk and option risk are relatively insignificant. In adherence to our prudent approach in risk management, the Company's overall objective of interest rate risk management is to achieve steady growth of net interest income under acceptable range of interest rate risk exposure.

In 2008, the Company focused on strengthening the development of the interest rate risk management system and refined the coverage and precision of risk measurement. Apart from utilizing analysis tools such as gap analysis, sensitivity analysis, scenario simulation and stress test to measure the bank-wide interest rate risks, the Company also provided relevant suggestions on the interest rate management to the Assets and Liabilities Management Committee on a monthly basis based on the monthly macroeconomic conditions and changes in interest rate trends. Due to the limited risk hedging instruments available in China, the RMB interest rate risk management was primarily adjusted in the balance sheet. In terms of interest rate sensitivity, as the Company had a higher level of demand deposits and under the existing RMB interest rate risk management policies, the frequency and basis point for the change of demand deposit interest rate were lower than those of other deposit and lending interest rates. As such, the Company saw strong asset sensitivity. The liability features of higher percentage of demand deposits enabled the Company to enjoy comparative advantage of funding at low cost. However, such comparative advantage is insignificant under rate cut environment. In 2008, by adhering to the general principles of "maintaining a balanced risk and return profile", the Company dynamically managed and adjusted the prices for internal fund transfers, while guided the optimization and adjustment of the deposit and loan duration structure and the repricing structure. Through the moderate extension of the term of long-term debt investments and reduction of interest rate sensitivity of the Company's assets and liabilities, the benefits of above adjustment would gradually emerge in 2009.

## 5.9.4 Exchange rate risk management

Exchange rate risk refers to the negative impact on the assets and liabilities denominated in foreign currency that may arise as a result of changes in exchange rate. The exchange rate risk of the Company is mainly measured through foreign exchange exposure analysis, sensitivity analysis, stress tests and Value at Risk ("VAR"). The exchange rate risks are divided into structural risk and transaction risk. The Company uses different management strategies to control structural risks and transaction risks.

Structural foreign exchange risk is difficult to avoid in banking operations. It is the exposure risk arising from mismatches between strategic foreign currency assets and liabilities. The Company matches as far as possible the amounts and durations of borrowings and lending made in each type of currency. For amounts which cannot be fully matched, the risk will be reduced by hedging through the foreign exchange market.

Foreign exchange transaction risk comes mainly from the provision of foreign exchange trading services by the Company to its customers. Exposure risks exist when the Company fails to immediately hedge all of the foreign exchange positions and when the Company holds a foreign exchange position based on the expectation of future trend with a view to profit from exchanging rate differences. The Company contains its foreign exchange transaction risk through setting risk exposure and stop-loss limits.

In 2008, the Company actively applied the foreign exchange management tools and hedging tools to reduce the cost of acquisition of Wing Lung Bank based on its accurate forecast of US dollar/RMB exchange rate trend.

As at 31 December 2008, the Company had an exposure of foreign exchange of RMB12.0 billion.

### 5.9.5 Investment risk management

Since the outbreak of the sub-prime crisis, the Company has established a system to closely monitor and analyze the change and development of the crisis. It subsequently completed a number of special analyses on Fannie Mae and Freddie Mac, Lehman Brothers, overseas financial institutions and overseas corporate bonds. Its detailed analysis in terms of market changes, positions and risks provided support for the decision-making of the senior management. Upon the filing of bankruptcy protection by Lehman Brothers and the escalation of sub-prime crisis into the global financial tsunami, the Company swiftly established a special daily reporting system for overseas investment and a regular negotiation system for treasury transactions to provide the senior management with first-hand information of the entire overseas investment portfolio throughout the Company including Wing Lung Bank and Hong Kong Branch. At the same time, the Company set up an emergency decision-making system for processing overseas investments to quickly sell the bonds of the overseas financial institutions. Of which, the bonds of Fannie Mae & Freddie Mac in the sum of US$243 million as at July 2008 were sold out and a slight gain was recorded; whereas the closing balance of the debt investment in overseas financial institutions was reduced to US$930 million. Moreover, in response to the financial tsunami induced by the sub-prime crisis, the Company also designed stress tests for a number of extreme market scenarios, analyzed the potential floating gain or loss and principal loss arising from the bonds held by the Company and established an investment impairment assessment and provision system in addition to a number of additional effective measures. As such, the risk exposure of the Company's overseas investment was reduced rapidly.

### 5.9.6 Operational risk management

Operational risk refers to the risk of loss arising from inappropriate or unsound internal procedures, incompetent personnel or IT systems, or external events. The Company reduces and controls the operational risk by introducing the Basel II-compliant operational risk management processes, strengthening internal control, performing the operational risk screening, enhancing staff's risk prevention awareness and ability, and implementing a strict accountability system. Major measures taken in 2008 were as follows:

(1) As required by Basel II and the "Guidelines on the Operational Risk Management of Commercial Banks" issued by CBRC, the Company diagnosed its operating risk management structure, administrative policies, methods and procedures in place and identified the gap between the current practices of operational risk management and the regulatory requirements.

(2) Pursuant to the requirements of the section "Standardized Approaches "under the "Guidelines on the Measurement of Operational Risk Regulatory Capital of Commerical Banks" promulgated by CBRC, the Company wrapped up classifying product lines with operation risk and preliminarily estimated the provisions for operating risk regulatory capital of the Company in 2008.

(3) The Company initiated the development of a set of tools for operational risk management and applied on a pilot basis to our three business lines including credit, accounting and international operations. This mainly involved the business process streamlining, establishment of risk control self-evaluation system, development of key risk indicators system and formulation of risk management policies and procedures, covering such key aspects as the identification, evaluation, monitoring and control of operational risks with such tools that are also broadly used by leading international banks. Currently the bidding process for the project is completed, with a full scale rollout expected in 2009.

(4) According to the deployment of CBRC Shenzhen Bureau, the Company organized a bank-wide screening of operational risk with a focus on the compliance management, audit management, work shift and taking-leave management, employee behavior management, reconciliation management and treasury management. The screening not only facilitated the construction of our long-term law case and risk prevention mechanism, but also identified and revealed problems and vulnerabilities existing at both the system execution level and certain business areas and aspects, thereby addressing specific targets for further improvement.

(5) The Company further enhanced the security management and reinforced the internal risk detection of online banking system, which has passed the penetration tests of two national authoritative institutions. Computer anti-virus protection and information confidentiality have been strengthened to further improve our control and monitoring capabilities.

## 5.9.7 Administration of compliance risks

Compliance risk refers to the risks of being subject to legal sanctions, regulatory punishments, major financial losses, and reputation diminishing as a result of commercial banks' failure to observe the laws, rules and guidelines. Our goal for the administration of compliance risks is to achieve an effective identification and management of compliance risks by establishing a sound compliance risk management framework to ensure operations in a legal and compliant manner.

The Company has substantially established a complete compliance risk management framework and built up an organization structure that senior management and head of compliance issues were responsible for the bank-wide compliance issues, head of each operating unit was responsible for the unit-wide compliance management, head of each business line was responsible for the line-wide compliance management and Compliant Officers and Compliant Supervisors were responsible for assisting the head persons at their respective level with the organization of compliance management. Major measures taken in 2008 included:

(1) Complemented the compliance management organization setup and strengthened the compliance management system reforms. Based on the existing operation and management structure, the Company established a Compliance Management Committee at both the head office and branch level with well-defined duties and staffing requirements for each to highlight the positioning of compliance department as the supporting function of bank's business compliance. A perpendicular management mechanism featuring double leadership, bi-directional assessment and dual-line reporting by both the compliance officers and the compliance departments of the branches has been established.

(2) Preliminarily constructed three defense lines of compliance risks management. The operating units and the business lines constitute the first defense line for implementing self evaluation, control and prevention of compliance risks; the compliance departments and the risks management departments constitute the second defense line for implementing professional compliance management prior to and in the process of the occurrence of misconducts; and the internal audit departments constitute the third defense line for post control.

(3) Refined the compliance management approaches and improved compliance risk management expertise. The Company employed various documents ranging from compliance risk reminders, proposals, rectification notices and legal/compliance opinions to promptly identify, remind and correct the compliance risks, established a compliance risk identification and evaluation mechanism through screening the compliance risk points, formulated and executed the risk-oriented Compliance Risk Management Program to drive the orderly functioning of our compliance management and initiated the preparation of Compliance Handbook.

### 5.9.8 Anti-money laundering management

The Company takes anti-money laundering as its social responsibility and legal liability. Since 2003 when the PBOC launched the anti-laundering campaign, the Company has attached great importance to anti-money laundering oversight and made remarkable results through establishing a professional anti-money laundering team, developing sound anti-money laundering system and procedures and conducting anti-money laundering trainings on an ongoing basis to improve employees' anti-money laundering awareness and skills.

During the reporting period, the Company fully enforced PBOC's customer identification requirements as well as other anti-money laundering laws and regulations and performed the network check of customer identity and classification of customer risks as required, completed the development of name list database and filtering system and the upgrade of the anti-money laundering monitoring and reporting system, enhanced the anti-money laundering supervision and inspection and improved the quality of large-value and doubtful transaction reporting.

### 5.9.9 Implementation of Basel II framework

In February 2007, CBRC released the "Guidelines on the Implementation of Basel II Framework by China's Banking Sector", which decided that the first group of commercial banks would be regulated based on Basel II framework from 2010 or, with approval, no later than 2013. Driven by the underlying needs to pursue an international strategy and improve reputation as well as operation and management, the Company is aiming to become one of the first banks approved by CBRC to adopt Basel II. To this end, the Company set up the Basel II Implementation Office under the head office to lead various preparation works for the implementation of Basel II. Based on a detailed gap analysis, the Office developed an overall plan of Basel II implementation, which divided the task into 16 enforceable project groups to refine and optimize the existing risk management system. Currently 8 project groups have been kicked off and each is well underway.

## 5.10 Change of external environment and counter measures adopted

### 5.10.1 Problems and difficulties in our operations and the solutions thereof

During the reporting period, the Company faced the following problems and difficulties in its operations: continuing global financial crisis, domestic economic slowdown, sharp market downturn, depressed corporate operations, escalated credit risks, overall slowdown in banks' non-interest income growth and heightened cost control pressure against the recession.

Due to the aforesaid problems and difficulties arising from its operations, the Company focused on taking the following counter measures:

(1) Enhanced the asset and liability management and promoted smooth and balanced business growth. Under the fast-changing external economic and financial conditions in 2008, the Company responded actively to the government and regulatory policies by making corresponding and timely adjustments to its asset and liability management strategy to effectively drive the balanced growth of asset and liability businesses, and by offering subordinated notes in the sum of RMB30.0 billion to fund the acquisition of Wing Lung Bank. In face of the extended economic recession and potentially narrowed spread for commercial banks in 2009, the Company will continue to further the asset and liability management by adhering to and reinforcing the management pattern driven by the profit growth, based on the risk management as well as the management of balance sheet and income statement, and focused on the economic capital management while employing various management approaches including internal funds transfer pricing, asset and liability management system and internal credit risk ratings to drive the steady and smooth growth of various businesses, and meanwhile discover the profit zone and explore the profit pool, thereby seeking balanced development of "profitability, quality and scale".

(2) Closely monitored the market development and effectively implement risk management. Against the backdrop of the macroeconomic downturn and deteriorating operating environment, commercial banks faced increasingly heightened credit risks. In 2008, the Company further strengthened the credit risk management by strictly enforcing the credit management policies in light of the government industry policy, promptly adjusting credit policies and marketing guidelines based on the enhanced credit risk screening and risk pre-warning process and by employing risk stress test, off-site credit monitoring tools to effectively control the credit risks. In particular, overall non-performing loan ratio for manufacturing borrowers in Yangtze River Delta and Pearl River Delta where our network is mainly concentrated in continued to fall while the non-performing loan ratio for textile and chemical fiber sectors rose slightly. However, it had limited impact on our overall credit asset quality given the small share it accounted for. In anticipation of the sustained high pressures on the asset quality of commercial banks in 2009, the Company will continue to emphasize the industry focus, improve the allocation mechanism of credit resources with priority over areas of better overall quality and more balanced risk-return profile and adhere to the principle of "encouraging the credit granting to some industry sectors while discouraging that to others" to optimize the credit structure.

(3) Explored innovation to drive the steady growth of non-interest income. The Company launched a number of wealth management brands such as "Wealth Cube" and "Choice of Five-Star" and put great effort to diversify non-interest income sources through various channels including agency sale of insurance products, third-party custody services, credit card, assets custody, investment banking and cash management to drive the growth of fee-based business. In view of the potentially high pressures on the net non-interest income of commercial banks in 2009, the Company will further enforce the strategic optimization of revenue structure to ensure the smooth growth of net non-interest income. The Company will, on the one hand, secure the growth momentum of traditional revenue including settlement fees and credit card POS commissions, and on the other hand, expand the revenue sources of emerging businesses and leverage the wealth management to strengthen asset allocation and portfolio marketing, and enhance our competitive strengths in key products including wealth management products and assets custody.

(4) Followed the principle of "encouraging the credit granting to some industry sectors while discouraging that to others" and enhanced cost control. The Company, on the one hand, strictly controlled the cost and further tightened the expense budget management, while on the other hand, continued to unwaveringly pursue the retail strategy and maintain the efforts in network construction and remodification. On account of the discordance between weakening market and cost expansion, the Company will focus on the redesign of existing outlets in network construction while seeking a reduction of costs and expenses through further process reengineering and exploitation of e-banking channels.

## 5.10.2 Change and impact of operating environment, macroeconomic control policies and regulations

### *1. In relation to the operating environment*

In 2008, the once-in-a-century and increasingly escalated financial crisis around the world, which saw the failure of some major financial institutions and the turbulence of financial market, has already evolved into an economic crisis. In China, it led to a turnaround of macroeconomic conditions from overheating to a sudden slowdown, capital market plunge, deteriorating corporate performance and a series of interest rate slash by PBOC.

Facing various difficulties, the Company made great efforts in improving the asset and liability structure with a focus on the highly profitable and risk manageable assets, proactively responded to the government's macro control objectives by promptly increasing the credit origination, actively engaged in bills, investment, financing and other market-based businesses based on the safely secured liquidity; aggressively expand the intermediary business to develop new value drivers and meanwhile endeavored to control the funding cost of liabilities.

### 2. *In relation to the changes in statutory deposit reserve ratio*

In the first three quarters of 2008, the PBOC raised the statutory deposit reserve ratio 6 times in a row from 14.5% at the beginning of the year to 17.5% to address the oversupply of market liquidity. With the sharp economic slowdown in the fourth quarter, PBOC cut the statutory deposit reserve ratio 4 times in a row totaling 3.5 percentage points.

The turbulent fluctuation of statutory deposit reserve ratio posed grim challenges to bank's liquidity management, urging commercial banks to strengthen their liquidity management entailing both liquidity and profitability. In the first half of 2008, the Company undertook a number of measures to enforce PBOC's credit control requirements and ensure the balanced origination of loans, while in the second half of 2008, the Company proactively responded to the government's policy of expanding domestic demand and promptly increased the loan origination by means of window guidance and policy direction among others. Meanwhile, the Company also made proper changes in the mix of assets including investment, financing and bills to diversify the range of capital use and improve capital returns.

### 3. *In relation to the changes in deposit and loan interest rates*

In 2008, PBOC lowered the benchmark interest rates for RMB deposit and loan of financial institutions for 5 times. In particular, the one-year deposit and loan interest rates were lowered by 1.89 percentage points and 2.16 percentage points from the beginning of the year to 2.25% and 5.31% respectively.

In response to the continuous rate cut, the Company made early deployment and proper adjustment including strengthening the asset and liability management and optimizing the asset structure to effectively improve the asset returns on one hand. On the other hand, the Company led the entire bank to properly extend the duration of assets through the FTP policy, thus reducing the interest rate sensitivity of assets. Along with a number of property supporting policies introduced by the government in 2008 including 30% discount on mortgage rate, the Company made a timely change to its housing loan policy according to the PBOC and CBRC's relevant circulars and provided credit products with a minimum of 20% downpayment and interest rate discount up to 30% in a bid to support the first-time purchase demand for the ordinary residential housing and renovated ordinary residential housing. To this end, the Company formulated the "Guidelines on the Pricing of Personal Housing Loans", which is designed to define the principle of "matching risk and return", determine the housing loan pricing scheme featured, inter alia, customer rating, credit rating and overall contribution, and require branches to develop respective implementation plans suitable to the local conditions. From an overall perspective of deposit and loan interest rate, considering the much more moderate rate cut for deposit (especially demand deposit) than loan in the previously released asymmetric rate cut policy as well as the significantly lower market yield of bond and lending, the Company's net interest margin (NIM) is expected to narrow significantly in 2009. In 2009, the Company will carry on the interest rate risk tracking, analysis and research efforts to effectively prevent the interest rate risks.

### 4. *In relation to the capital market*

In 2008, domestic capital market remained depressed due to the global financial crisis. As a result, our liability structure changed in that part of the deposits from banks and other financial institutions transferred to proprietary deposits comprising a higher percentage of term deposits. The Company managed to control the funding cost of liabilities and enhanced the marketing efforts of low-cost demand deposits. As another result, the growth of fee-based business related to the capital market was under pressure. The Company strived to diversify the revenue resources of the fee-based business to drive the growth of fee-based business, enhance business resiliency, adjust the revenue structure and therefore improve our operating performance.

### 5. *In relation to the foreign exchange changes*

During 2008, the exchange rate of RMB continued to appreciate against the US dollar in the first half and remained stable since August supported by the changes in external economic conditions and in the anticipation of RMB appreciation. Throughout the year, RMB appreciated by an accumulated 6.97% against the US dollar and 17.38% in aggregate since the foreign exchange reform in the PRC.

The appreciation of RMB exposed the Company to higher exchange rate risks in a certain extent. The Company enhanced the exchange rate movement estimation, strengthened the monitoring and measurement of exchange rate risks and thus lowered the pledge ratio of foreign currency-denominated asset-backed loans and our exposure to the exchange rate fluctuation.

## 5.11 Outlook and measures

In 2009, the Company is both confronted with grim challenges imposed by the global financial crisis and domestic economic slowdown, and blessed with unprecedented development opportunities.

From the perspective of pressures from operating environment, business expansion will encounter increasing challenges amid the economic downturn, market depression and bearish sentiment; risk prevention will become more difficult as various risks interconnect and interact with each other, showing systematic, chain-reacting and features and trends; earnings growth will face greater pressure under the combined effect of a weaker effective credit demand, further interest rate cuts and a continuing sluggish capital market; and the increasingly diversified and inflexible appeals and constraints internally and externally also require a higher level of management expertise of the Company.

In spite of the pressure on our operation and management, there are also many new opportunities under the current situations, among them, the government's policy to drive and expand domestic demand, accelerating corporate transformation process, market reshuffling, sustained strong demand for resident financial management and wealth management, fast growth of direct financing instruments, accelerated advance of geographical industry transfer, increasing release of monetary market liquidity, emerging changes in the competition landscape of Chinese and foreign banks and much higher demand for cross-border corporate hedging and arbitrage. All of these will provide new opportunities for our business expansion. Meanwhile, the return of financial elites from overseas due to the financial crisis will also imply a unique chance for us to seek and recruit various professionals, especially high-level financial specialists.

Facing the opportunities and challenges under the new circumstances, the Company will continue to accelerate the operating strategy adjustment and management transformation. In light of the directive ideas of "recognizing risks, capturing opportunities, improving management and developing scientifically", the Company will adhere to a prudent and proactive growth strategy which requires it to hold on to the bottom line and pursue a prudent operation and sound development on the one hand, and give full play to the pioneering spirit to explore new opportunities on the other hand. The Company intends to implement the following operational measures in 2009: (1) further optimize the asset and liability structure and enhance cost control to drive balanced development of "profitability, quality and scale"; (2) focus on the total assets under management to speed up the development of wealth management business and fully leverage on our strengths in personal loan products and procedures, push forward the transformation of credit card business, thereby further consolidating our customer base and building up its competitive edges for retail banking; (3) effectively integrate various resources of wholesale banking to enhance the marketing efforts to government financing platforms, key customers and major projects, vigorously promote corporate liabilities marketing, strongly support the innovation and rollout of feature products and further fuel the development of SME business; (4) fully enhance the management of credit risks, market risks, treasury and trading risks, liquidity risks and operational risks and accelerate the implementation of Basel II; (5) further tighten the internal control and compliance management so as to guard against incidents of fraud and misconduct; (6) powerfully advance the comprehensive procedure management and step up the improvement of IT governance; (7) further optimize employee incentive scheme, human resources deployment with a view to improving employees' efficiency; (8) firmly progress the integration with Wing Lung Bank and steadily drive forward the course of internationalized and integrated operation; (9) enhance the building of brand culture and create a positive and motivating atmosphere.

## Changes as situation does

**Satisfying the demand of the market and customers, CMB has launched innovative products and images such as "All-in-one card", "All-in-one Net", "Sunflower Wealth Management", "Gold Corporate Finance", international standard dual currency credit card, and wealth management account, which are recognized as one of the most energetic banks. In various surveys organized by both international and domestic entities, CMB has consecutively been awarded China's Best Local Bank, China's Best Retail Bank, China's Best Management Bank, China's Most Respected Enterprises, China's Top Ten Best Listed Companies, and CCTV Annual Best Employer. CMB is recognized in China's banking industry as one of the banks with the most powerful brand and image.**

# Innovation

## 6.1 The change in shares of the Company during the reporting period

| | 31 December 2007 | | Changes in the reporting period | | 31 December 2008 | |
|---|---|---|---|---|---|---|
| | Quantity (share) | Percentage (%) | Shares subject to trading moratorium converted into shares not subject to trading Moratorium (share) | Conversion from convertible bonds (share) | Quantity (share) | Percentage (%) |
| **I. Shares which are subject to trading moratorium** | 7,331,629,579 | 49.86 | **-2,532,396,325** | **–** | **4,799,233,254** | **32.63** |
| 1. State-owned shares | 201,557,020 | 1.37 | **-201,557,020** | **–** | **–** | **–** |
| 2. Shares held by state-owned legal persons | 6,639,650,699 | 45.15 | **-1,840,417,445** | **–** | **4,799,233,254** | **32.63** |
| 3. Other domestic shareholdings | 484,741,256 | 3.30 | **-484,741,256** | **–** | **–** | **–** |
| Of which: shares held by domestic legal persons | 484,741,256 | 3.30 | **-484,741,256** | **–** | **–** | **–** |
| Shares held by domestic natural persons | – | – | **–** | **–** | **–** | **–** |
| 4. Overseas shareholdings | 5,680,604 | 0.04 | **-5,680,604** | **–** | **–** | **–** |
| Of which: shares held by overseas legal persons | 5,680,604 | 0.04 | **-5,680,604** | **–** | **–** | **–** |
| Shares held by overseas natural persons | – | – | **–** | **–** | **–** | **–** |
| **II. Shares which are not subject to trading moratorium** | 7,373,435,255 | 50.14 | **2,532,396,325** | **2,119,840** | **9,907,951,420** | **67.37** |
| 1. Common shares in RMB (A Shares) | 4,711,435,255 | 32.04 | **2,532,396,325** | **2,119,840** | **7,245,951,420** | **49.27** |
| 2. Foreign shares listed domestically | – | – | **–** | **–** | **–** | **–** |
| 3. Foreign shares listed overseas (H Shares) | 2,662,000,000 | 18.10 | **–** | **–** | **2,662,000,000** | **18.10** |
| 4. Others | – | – | **–** | **–** | **–** | **–** |
| **III. Total shares** | 14,705,064,834 | 100.00 | **0** | **2,119,840** | **14,707,184,674** | **100.00** |

As at the end of the reporting period, the Company had a total of 481,566 shareholders, including 45,109 holders of H Shares and 436,457 holders of A Shares (including 13 holders of A Shares whose shares were subject to trading moratorium and 436,444 holders of A Shares whose shares were not subject to trading moratorium). In addition, the Company had 579 holders of convertible bonds, all of which were holders of tradable convertible bonds.

Based on the public information available to the Company and its directors, as at 31 December 2008, the Company had met the public floating requirement of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Ltd. (the "Hong Kong Listing Rules").

## 6.2 Top ten shareholders

| Serial No. | Name of shareholder | Type of shareholder | Shares held at the end of the period (share) | Percentage of total share capital % | Type of shares | Changes in the reporting period (share) | Number of Shares subject to trading moratorium (share) | Shares pledged or frozen (share) |
|---|---|---|---|---|---|---|---|---|
| 1 | HKSCC Nominees Ltd. (1) | / | 2,615,633,514 | 17.78 | H shares | -14,022,475 | 0 | – |
| 2 | China Merchants Steam Navigation Company Ltd. (2) | State-owned legal persons | 1,818,720,804 | 12.37 | A Shares subject to trading moratorium, A Shares not subject to trading moratorium | 37,350,713 | 1,781,677,633 | 0 |
| 3 | China Ocean Shipping (Group) Company | State-owned legal persons | 947,548,668 | 6.44 | A Shares subject to trading moratorium | 0 | 947,548,668 | 0 |
| 4 | Guangzhou Maritime Transport (Group) Company Ltd. | State-owned legal persons | 565,359,590 | 3.84 | A Shares subject to trading moratorium | 0 | 565,359,590 | 0 |
| 5 | Shenzhen Yan Qing Investment and Development Company Ltd. | State-owned legal persons | 433,484,335 | 2.95 | A Shares subject to trading moratorium | 0 | 433,484,335 | 0 |
| 6 | Shenzhen Chu Yuan Investment and Development Company Ltd. | State-owned legal persons | 378,715,868 | 2.58 | A Shares subject to trading moratorium | 0 | 378,715,868 | 0 |
| 7 | China Communications Construction Company Ltd. | State-owned legal persons | 261,024,805 | 1.77 | A Shares subject to trading moratorium | 0 | 261,024,805 | 0 |
| 8 | Shanghai Automotive Industry Corporation | State-owned legal persons | 250,564,996 | 1.70 | A Shares not subject to trading moratorium | 0 | 0 | 0 |
| 9 | CNOOC Investment Co., Ltd. | State-owned legal persons | 205,305,070 | 1.40 | A Shares not subject to trading moratorium | 0 | 0 | 0 |
| 10 | Qinhuangdao Port Group Company Ltd. | State-owned legal persons | 175,950,157 | 1.20 | A Shares not subject to trading moratorium | 0 | 0 | 0 |
| 10 | China Shipping (Group) Company | State-owned legal persons | 175,950,157 | 1.20 | A Shares subject to trading moratorium | 0 | 175,950,157 | 0 |
| 10 | Shandong State-owned Assets Investment Holdings Company Ltd. | State-owned legal persons | 175,950,157 | 1.20 | A Shares not subject to trading moratorium | 0 | 0 | 0 |
| 10 | Guangdong Provincial Highways Administration Bureau | State-owned legal persons | 175,950,157 | 1.20 | A Shares not subject to trading moratorium | 0 | 0 | 0 |

Notes:

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

(2) Shares held by China Merchants Steam Navigation Company Ltd. include 1,781,677,633 A Shares subject to trading moratorium and 37,043,171 A Shares not subject to trading moratorium.

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

## 6.3 Top ten shareholders whose A shares are subject to trading moratorium

| Name of shareholder whose shares are subject to trading moratorium | Number of shares held which are subject to trading moratorium at the end of the period (share) | Percentage of total share capital (%) | Trading day | Number of new tradable shares (share) | Undertakings |
|---|---|---|---|---|---|
| China Merchants Steam Navigation Company Limited | 1,781,677,633 | 12.11 | / | / | When the share price of the Company reaches RMB8.48 or above (rights to be excluded 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 (Note 2) |
| Shenzhen Yan Qing Investment and Development Company Limited | 433,484,335 | 2.95 | | | |
| Shenzhen Chu Yuan Investment and Development Company Limited | 378,715,868 | 2.58 | | | |
| China Ocean Shipping (Group) Company | 947,548,668 | 6.44 | 27 February 2009 (Note 1) | / | After expiry of 36 months after acquisition of right of circulation |
| Guangzhou Maritime Transport (Group) Company Limited | 565,359,590 | 3.84 | | | |
| China Communications Construction Company Limited | 261,024,805 | 1.77 | | | |
| China Shipping (Group) Company | 175,950,157 | 1.20 | | | |
| CCCC Guangzhou Dredging Co., Ltd. | 154,771,402 | 1.05 | | | |
| Shanghai Shipping (Group) Company | 51,024,331 | 0.35 | | | |
| CCCC Fourth Harbour Engineering Co., Ltd. | 21,067,429 | 0.14 | | | |

Notes:

(1) The day on which shares subject to trading moratorium should be floated on 27 February 2009 originally. However, as the Company held an extraordinary general meeting on the same day, the actual date of floating was postponed to the next trading day, being 2 March 2009.

(2) The shares subject to trading moratorium were floated on 2 March 2009.

(3) Of the aforesaid top 10 shareholders whose A shares are subject to trading moratorium, 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 CM Group; Guangzhou Maritime Transport (Group) Company Limited and Shanghai Shipping (Group) Company are the wholly-owned subsidiaries of China Shipping (Group) Company. CCCC Guangzhou Dredging Co., Ltd. and CCCC Fourth Harbour Engineering Co., Ltd. are the wholly-owned subsidiaries of China Ocean Shipping (Group) Company.

## 6.4 Top ten shareholders whose shares are not subject to trading moratorium

| Name of shareholder | Type of shares | Number of shares held at the end of the period (share) | Percentage of total share capital % |
|---|---|---|---|
| HKSCC Nominees Ltd. (Note 1) | H Shares | 2,615,633,514 | 17.78 |
| Shanghai Automotive Industry Corporation | A Shares not subject to trading moratorium | 250,564,996 | 1.70 |
| CNOOC Investment Co., Ltd. | A Shares not subject to trading moratorium | 205,305,070 | 1.40 |
| Qinhuangdao Port Group Company Ltd. | A Shares not subject to trading moratorium | 175,950,157 | 1.20 |
| Shandong State-owned Assets Investment Holdings Company Ltd. | A Shares not subject to trading moratorium | 175,950,157 | 1.20 |
| Guangdong Provincial Highways Administration Bureau | A Shares not subject to trading moratorium | 175,950,157 | 1.20 |
| Huaneng Capital Services Corporation Ltd. | A Shares not subject to trading moratorium | 141,650,000 | 0.96 |
| China Merchants Industry Development (Shenzhen) Co., Ltd. | A Shares not subject to trading moratorium | 116,623,078 | 0.79 |
| Shangzheng 50 Tradable Open Index Stock Investment Fund | A Shares not subject to trading moratorium | 106,886,694 | 0.73 |
| Yifangda 50 Index Stock Investment Fund | A Shares not subject to trading moratorium | 104,099,946 | 0.71 |

Notes:

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

(2) Of the aforesaid top 10 shareholders whose shares are not subject to trading moratorium, the Company is not aware of any related relationship of them.

## 6.5 Substantial shareholders' and other persons' interests and short positions in shares and underlying shares under Hong Kong laws and regulations

As at 31 December 2008, the following persons (other than the directors, supervisors and chief executives of the Company (defined as to the Hong Kong Listing Rules)) had interests and short positions 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 | Type of shares | Long/short position | Capacity | No. of shares | Notes | Percentage of the relevant share held in issue (%) | Percentage of all issued share (%) |
|---|---|---|---|---|---|---|---|
| China Merchants Group Ltd. | A | Long | Interest of controlled corporations | 2,599,932,810 | 1 | 21.58 | 17.68 (*) |
| China Merchants Steam Navigation Co. Ltd. | A | Long | Beneficial owner | 1,785,120,730 (#) | 1 | 14.82 | 12.14 |
| China Merchants Finance Investment Holdings Co. Ltd. | A | Long | Interest of controlled corporations | 814,812,080 | 1 | 6.76 | 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 | | 6.76 | 5.54 |
| China Ocean Shipping (Group) Company | A | Long | Beneficial owner | 950,595,801 (#) | | 7.89 | 6.46 |
| China Shipping (Group) Company | A | Long | Beneficial owner | 176,515,978 (#) | | | |
| | | Long | Interest of controlled corporations | 618,366,092 (#) | | | |
| | | | | 794,882,070 | 2 | 6.60 | 5.40 |
| JPMorgan Chase & Co. | H | Long | Beneficial owner | 71,133,089 | | | |
| | | Long | Investment manager | 326,936,000 | | | |
| | | Long | Custodian corporation/ approved lending agent | 83,132,911 | | | |
| | | | | 481,202,000 | 3 | 18.08 | 3.27 |
| | | Short | Beneficial owner | 40,796,400 | 3 | 1.53 | 0.28 |
| Mirae Asset Global Investments (Hong Kong) Ltd. | H | Long | Investment manager | 188,783,000 | | 7.09 | 1.28 |

| Name of Substantial Shareholder | Type of shares | Long/short position | Capacity | No. of shares | Notes | Percentage of the relevant share held in issue (%) | Percentage of all issued share (%) |
|---|---|---|---|---|---|---|---|
| UBS AG | H | Long | Beneficial owner | 114,297,492 | | | |
| | | Long | Interest of controlled corporations | 73,097,693 | 4 | | |
| | | | | 187,395,185 | | 7.04 | 1.27 |
| | | Short | Beneficial owner | 53,064,550 | | | |
| | | Short | Person having a security interest in share | 11,936,808 | | | |
| | | Short | Interest of controlled corporations | 27,900,151 | 4 | | |
| | | | | 92,901,509 | | 3.49 | 0.63 |
| Barclays Global Investors UK Holdings Ltd. | H | Long | Interest of controlled corporations | 160,143,637 | 5 | 6.02 | 1.09 |
| | | Short | Interest of controlled corporations | 4,664,639 | 5 | 0.18 | 0.03 |
| Barclays PLC | H | Long | Interest of controlled corporations | 160,143,637 | 5 | 6.02 | 1.09 |
| | | Short | Interest of controlled corporations | 4,664,639 | 5 | 0.18 | 0.03 |

(#) The above numbers of shares were recorded in the disclosure forms completed by the relevant substantial shareholders before 31 December 2008. During the period from the date on which the respective substantial shareholders submitted the said forms up to 31 December 2008, 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.

(*) It was the number stated in the register of members. As at 31 December 2008, China Merchants Group Ltd. indirectly held an aggregate of 18.04% of the total issued shares of the Company, in which the A shares it held accounted for 17.90% of that of the Company and the H shares it held accounted for 0.14% of that of the Company.

Notes:

(1) China Merchants Group Ltd. held interests 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 Ltd..

(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 Ltd. respectively. China Merchants Finance Investment Holdings Co. Ltd. was owned as to 90% and 10% by China Merchants Group Ltd. 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) China Shipping (Group) Company held interests in a total of 794,882,070 A shares in the Company by virtue of its direct interests in 176,515,978 A shares in the Company and indirect interests in 618,366,092 A shares in the Company by virtue of its wholly-owned subsidiaries, which held direct interests in the Company as follows:

(2.1) Guangzhou Maritime Transport (Group) Company Ltd. held 567,177,677 A shares in the Company; and

(2.2) Shanghai Shipping (Group) Company held 51,188,415 A shares in the Company.

(3) JPMorgan Chase & Co. held interest in a total of 481,202,000 H shares (Long position) and 40,796,400 H shares (Short position) in 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 94,196,411 H shares (Long position) 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 53,785,404 H shares (Long position) and 19,168,300 H shares (Short position) 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 Ltd.. J.P. Morgan International Finance Ltd. 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 8,250,000 H shares (Long position) and 8,250,000 H shares (Short position) in the Company. J.P. Morgan Securities Ltd. was owned as to 98.95% by J.P. Morgan Chase International Holdings Ltd., which in turn was wholly-owned by J.P. Morgan Chase (UK) Holdings Ltd.. J.P. Morgan Chase (UK) Holdings Ltd. was wholly-owned by J.P. Morgan Capital Holdings Ltd., which in turn was wholly-owned by J.P. Morgan International Finance Ltd., referred to in (3.2) above.

(3.4) J.P. Morgan International Derivatives Ltd. held 4,375,500 H shares (Short position) in the Company. J.P. Morgan International Derivatives Ltd. was wholly-owned by J.P. Morgan International Finance Ltd., referred to in (3.2) above.

(3.5) JF Asset Management (Taiwan) Ltd. held 3,246,000 H shares (Long position) in the Company. JF Asset Management (Taiwan) Ltd. was wholly-owned by JF Funds Ltd.. JF Funds Ltd. was a wholly-owned subsidiary of JF Asset Management Ltd., which in turn was a wholly-owned subsidiary of JPMorgan Asset Management (Asia) Inc., which was a wholly-owned subsidiary of JPMorgan Asset Management Holdings Inc. JPMorgan Asset Management Holdings Inc. was wholly-owned by JPMorgan Chase & Co.

(3.6) JF Asset Management Ltd. and JF Asset Management (Singapore) Ltd. held 103,355,500 H shares (Long position) and 32,100,000 H shares (Long position) in the Company respectively. Both of them were wholly-owned subsidiaries of JPMorgan Asset Management (Asia) Inc., referred to in (3.5) above.

(3.7) J.P. Morgan Investment Management Inc. held 56,671,500 H shares (Long position) in the Company. J.P. Morgan Investment Management Inc. was a wholly-owned subsidiary of JPMorgan Asset Management Holdings Inc., referred to in (3.5) above.

(3.8) China International Fund Management Ltd held 13,228,500 H shares (Long position) in the Company. China International Fund Management Ltd was owned as to 49% by JPMorgan Asset Management (UK) Ltd. (a wholly-owned subsidiary of JPMorgan Asset Management Holdings (UK) Ltd.), which held 107,271,000 H shares (Long position) directly in the Company. JPMorgan Asset Management Holdings (UK) Ltd. was wholly-owned by JPMorgan Asset Management International Ltd., which was a wholly-owned subsidiary of JPMorgan Asset Management Holdings Inc., referred to in (3.5) above.

(3.9) Bear Stearns International Ltd. held 9,097,685 H shares (Long position) and 9,002,600 H shares (Short position) in the Company. Bear Stearns International Ltd. was a wholly-owned subsidiary of Bear Stearns Holdings Ltd., which in turn was a wholly-owned subsidiary of Bear Stearns UK Holdings Ltd.. Bear Stearns UK Holdings Ltd. was wholly-owned by The Bear Stearns Companies LLC, which in turn was wholly-owned by JPMorgan Chase & Co.

The entire interest of JPMorgan Chase & Co. in the Company included a lending pool of 83,132,911 H shares (Long position). Besides, 39,779,554 H shares (Long position) and 23,543,800 H shares (Short position) were held through derivatives as follows:

| | | |
|---|---|---|
| 4,375,500 H shares (Short position) | – | through cash settled derivatives (on exchange) |
| 39,779,554 H shares (Long position) and 19,168,300 H shares (Short position) | – | through physically settled derivatives (off exchange) |

(4) UBS AG held interests in a total of 73,097,693 H shares (Long position) and 27,900,151 H shares (Short position) in the Company by virtue of its 100% control over the following corporations, which held direct interests in the Company:

| | No. of shares | |
|---|---|---|
| **Name of controlled Corporation** | **Long position** | **Short position** |
| UBS Fund Management (Switzerland) AG | 1,304,853 | – |
| UBS Global Asset Management (Canada) Inc. | 1,094,500 | – |
| UBS Global Asset Management (Americas) Inc. | 5,117,500 | – |
| UBS Global Asset Management (Hong Kong) Ltd | 6,961,900 | – |
| UBS Global Asset Management (Singapore) Ltd | 15,434,100 | – |
| UBS Global Asset Management (UK) Ltd. | 11,618,939 | – |
| UBS Global Asset Management (Japan) Ltd | 3,648,500 | – |
| UBS Securities LLC | 27,900,151 | 27,900,151 |
| UBS Securities Australia Ltd | 3,250 | – |
| UBS Financial Services Inc. | 14,000 | – |

Among the entire interest of UBS AG in the Company, 33,383,552 H shares (Long position) and 47,394,550 H shares (Short position) were held through derivatives as follows:

| | | |
|---|---|---|
| 2,877,500 H shares (Long position) and 6,086,500 H shares (Short position) | – | through physically settled derivatives (on exchange) |
| 2,959,000 H shares (Long Position) and 14,508,000 H shares (Short position) | – | through cash settled derivatives (on exchange) |
| 26,512,052 H shares (Long position) and 26,800,050 H shares (Short position) | – | through physically settled derivatives (off exchange) |
| 1,035,000 H shares (Long position) | – | through cash settled derivatives (off exchange) |

(5) Barclays PLC held interests in a total of 160,143,637 H shares (Long position) and 4,664,639 H shares (Short position) in the Company by virtue of its control over the following corporations, which held direct interests in the Company:

(5.1) Barclays Global Investors, N.A. held 8,852,137 H Shares (Long position) and 4,664,639 H shares (Short position) in the Company. Barclays Global Investors, N.A. was a wholly-owned subsidiary of Barclays California Corporation, which in turn was a wholly-owned subsidiary of Barclays Global Investors Finance Ltd., which was wholly-owned by Barclays Global Investors UK Holdings Ltd.. Barclays Global Investors UK Holdings Ltd. was owned as to 92.3% by Barclays Bank PLC, which in turn was a wholly-owned subsidiary of Barclays PLC.

(5.2) Barclays Global Fund Advisors held 137,008,500 H shares (Long position) in the Company. Barclays Global Fund Advisors was a wholly-owned subsidiary of Barclays Global Investors, N.A., referred to in (5.1) above.

(5.3) Barclays Global Investors Ltd held 14,039,500 H shares (Long position) in the Company. Barclays Global Investors Ltd was wholly-owned by Barclays Global Investors UK Holdings Ltd., referred to in (5.1) above.

(5.4) Barclays Global Investors (Deutschland) AG held 243,500 H shares (Long position) in the Company. Barclays Global Investors (Deutschland) AG was a wholly-owned subsidiary of Barclays Global Investors Holdings Deutschland GmbH, which in turn was a wholly-owned subsidiary of Barclays Global Investors UK Holdings Ltd., referred to in (5.1) above.

Save as disclosed above, the Company is not aware of any other person (other than the directors, supervisors and chief executives (defined as to the Hong Kong Listing Rules) of the Company) having any interests or short positions in the shares and underlying shares of the Company as at 31 December 2008 as recorded in the register required to be kept by the Company pursuant to Section 336 of the SFO.

## 6.6 Undertakings associated with the share reform

The Company implemented a share reform (the "Conversion Scheme") on 27 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 from 27 February 2006; shareholders with put obligation undertook not to trade or transfer their shares within 36 months from 27 February 2006. 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 reached RMB8.48 or above (after excluding rights and dividend depending on circumstances) in the 12 months after expiry of the aforesaid 36-month lock-up period. The aforesaid shareholders have performed their undertakings (as mentioned above) in 2008.

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 Shareholders' General Meeting of the Company for approval and then implemented by the Board of Directors according to the relevant regulations of the State.

The H-Share Appreciation Rights Scheme for the Senior Management of the Company was approved by the shareholders of the Company at the 2007 First Extraordinary General Meeting held on 22 October 2007. Details of the Scheme were disclosed in the relevant announcements published on the websites of the Shanghai Stock Exchange, the Hong Kong Stock Exchange and the Company.

## 6.7 Trading dates of shares which are subject to trading moratorium

| Time frame | No. of new tradable shares after expiry of lock-up period (shares) | Balance of shares which are subject to trading moratorium (shares) | 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 | 2,532,396,325 | 4,799,233,254 | / | Original non-circulated shares held by original non-circulated shareholders without put obligation, and the lock-up period expired on 27 February 2008 and these shares are tradable. |

| Time frame | No. of new tradable shares after expiry of lock-up period (shares) | Balance of shares which are subject to trading moratorium (shares) | Balance of shares which are not subject to trading moratorium[1] | Remarks |
|---|---|---|---|---|
| After expiry of 36 months after acquisition of right of circulation | 2,205,355,418 | 2,593,877,836 | / | Original non-circulated shares held by original non-circulated shareholders with put obligation other than China Merchants Steam Navigation Company Ltd., Shenzhen Yan Qing Investment and Development Company Ltd. and Shenzhen Chu Yuan Investment and Development Company Ltd.. |
| When the share price of the Company first reaches or goes above RMB8.48 (rights to be excluded 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 | 2,593,877,836 | 0 | / | Original non-circulated shares held by China Merchants Steam Navigation Company, Shenzhen Yan Qing Investment and Development Company Ltd. and Shenzhen Chu Yuan Investment and Development Company Ltd.. |
| Total | 7,331,629,579 | / | / | / |

Notes:

(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.

(2) On 27 February 2008, the lock-up period of 2,532,396,325 shares which were subject to trading moratorium had expired and the shares became tradable. For details of the liquidity of the shares which were subject to trading moratorium, please refer to the Company's announcement dated 22 February 2008 published on the websites of Shanghai Stock Exchange, the Hong Kong Stock Exchange and the Company.

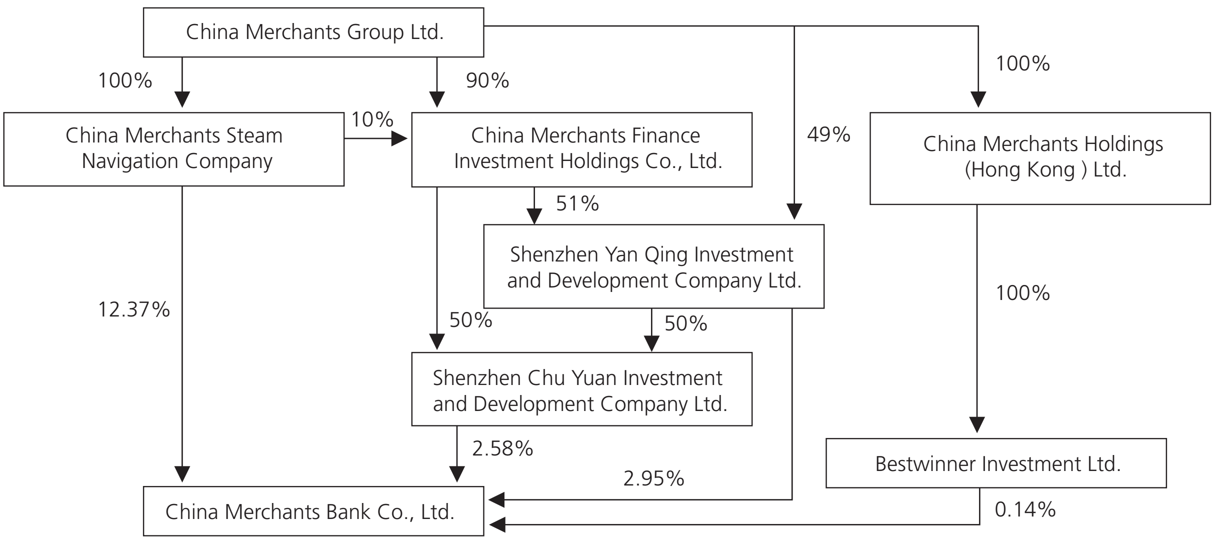
(3) On 2 March 2009, the lock-up period of 4,799,233,254 shares which were subject to trading moratorium had expired and the shares became tradable. For details of the liquidity of the shares which were subject to trading moratorium, please refer to the Company's announcement dated 23 February 2009 published on the websites of Shanghai Stock Exchange, the Hong Kong Stock Exchange and the Company.

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

(1) China Merchants Steam Navigation Company Ltd., being the largest shareholder of the Company, was founded on 11 October 1948 with a registered capital of RMB200 million. Its legal representative is Mr. Qin Xiao. It is a wholly owned subsidiary of China Merchants Group Ltd.. The said company is mainly engaged in passenger and cargo shipping businesses; dockyard, warehouse and vehicle transportation; sale, purchase and supply of various transportation equipments, spare parts and materials; ship and passenger/goods shipping agency, international maritime cargo; as well as finance, insurance and trust businesses related to transportation.

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

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




Note: As at 31 December 2008, China Merchants Group Ltd. was indirectly interested in an aggregate of 18.04% of the total shares of the Company, in which the A shares it held accounted for 17.90% of that of the Company and the H shares it held accounted for 0.14% of that of the Company.

## 6.9 Particulars of other shareholders holding over 5% of the shares of the Company

China Ocean Shipping (Group) Company. China Ocean Shipping (Group) Company was founded on 27 April 1961 with a registered capital of RMB1.9 billion. Its legal representative is Mr. Wei Jiafu. The company is a state-owned backbone enterprise under direct control of State-owned Assets Supervision and Administration Commission of the State Council and a multinational company with international shipping as its principal business. It is mainly engaged in international passenger and cargo shipping businesses; leasing, building, sale and purchase of vessels, containers and their maintenance and device fabrication; domestic coastal transportation of goods and shipping agency services; communication services; ship/cargo agency in major ports in China.

## 6.10 Particulars on share issuance and listing

***Particulars on share issuance by the Company for the past three years up to the end of the reporting period***

(1) A share issuance

Approved by China Securities Regulatory Commission ("CSRC") document Zheng Jian Fa Xing Zi【2002】No. 33, the Company initially publicly offered 1.5 billion common shares in RMB (A Shares) at an issue price of RMB7.30 per share on Shanghai Stock Exchange on 27 March 2002 by adopting a combination of offline placement to legal person investors and online placement to general public investors through accumulated bid-subscription process. On 9 April 2002, the A shares of the Company were listed and traded on Shanghai Stock Exchange.

(2) H share issuance

Upon approval by CSRC and the SEHK, the Company issued 2.2 billion overseas listed foreign currency denominated shares (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 for conversion into H shares. 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 and major underwriter 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 further reduced their shareholdings by transferring 22 million state-owned shares to the National Social Security Fund for conversion into H shares. Trading of the abovementioned 242,000,000 H shares commenced on SEHK on 5 October 2006. As a result of the exercise of the over-allotment option, the total number of H Shares issued by the Company amounted to 2,662,000,000.

(3) Shares held by staff

The Company did not issue internal staff shares during the reporting period.

## 6.11 Issuance and listing of convertible bonds

Upon approval of CSRC through its Zheng Jian Fa Xing Zi【2004】No. 155 document, the Company issued 65 million convertible bonds on 10 November 2004 with a face value of RMB100 each, totalling RMB6.5 billion. Upon approval of Shanghai Stock Exchange through its Shang Zheng Shang Zi【2004】No.165 document, the 65 million convertible bonds of the Company were listed and traded on 29 November 2004 under the name of "CMB Convertible Bonds" (bond code: 110036) on Shanghai Stock Exchange. The validity term for the listed convertible bonds of the Company was from 29 November 2004 to 10 November 2009.

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.

### Top ten holders of convertible bonds

| No. | Name of convertible bonds holder | Type of securities | Amount of convertible bonds held as at end of the reporting period (in RMB) | Percentage of total convertible bonds in issue % |
|---|---|---|---|---|
| 1 | Zhao Yanqing | Convertible bond | 69,000 | 0.0011 |
| 2 | Wan Xianghong | Convertible bond | 65,000 | 0.0010 |
| 3 | Zhang Jianfeng | Convertible bond | 49,000 | 0.0008 |
| 4 | Lu Junwen | Convertible bond | 40,000 | 0.0006 |
| 5 | Cui Qiang | Convertible bond | 37,000 | 0.0006 |
| 6 | Zhang Liang | Convertible bond | 35,000 | 0.0005 |
| 7 | He Guangping | Convertible bond | 32,000 | 0.0005 |
| 8 | Huang Xiaodu | Convertible bond | 30,000 | 0.0005 |
| 9 | Liang Tingjian | Convertible bond | 25,000 | 0.0004 |
| 10 | Ding Jin | Convertible bond | 19,000 | 0.0003 |

Note: The Company is not aware of any related relationship among the top ten convertible bonds holders.

***Price adjustment of convertible bonds***

On 20 June 2005, pursuant to the terms of issuance set out in the Prospectus of "CMB Convertible Bonds" and the relevant rules and regulations on the issuance of convertible bonds by CSRC, the Company implemented the Profit Appropriations Scheme for 2004 in which RMB1.1 (tax included) in cash was distributed for every 10 shares held. And the capital reserve was converted into share capital in the proportion of 5 shares for every 10 shares held. Accordingly, the conversion price of "CMB Convertible Bonds" was adjusted from RMB9.34 per share to RMB6.23 per share (details of which was set out in the Special Indicative Announcement Regarding the Adjustment to the Conversion Price of Convertible Bonds of China Merchants Bank Co., Ltd. published in *China Securities Journal*, *Shanghai Securities News* and *Securities Times* on 14 June 2005).

The Company implemented the Share Reform on 24 February 2006, pursuant to which capital reserve was converted into share capital in the proportion of 0.8589 bonus shares for every 10 shares held, and the conversion price of "CMB Convertible Bonds" was adjusted downward from RMB6.23 per share to RMB5.74 per share accordingly (details of which was set out in the Special Indicative Announcement Regarding the Adjustment to the Conversion Price of Convertible Bonds of China Merchants Bank Co., Ltd. published in *China Securities Journal*, *Shanghai Securities News* and *Securities Times* on 22 February 2006).

***Conversion of convertible bonds***

The "CMB Convertible Bonds" could be converted into shares starting 10 May 2005. As at 31 December 2008, "CMB Convertible bonds" (110036) amounted to RMB6,498,172,000 were converted into shares of "CMB" (600036). The number of convertible shares (including shares enlarged by capital reserve) were 1,043,682,393. The amount of convertible bonds was RMB13,996,000 at the beginning of the reporting period. The number of converted shares was 2,119,840 and the amount of which was RMB12,168,000 during the reporting period. The outstanding "CMB convertible bonds" amounted to RMB1,828,000, representing 0.03% of the total issued amount of the "CMB convertible bonds."

## 6.12 Issuance of subordinated debts

***Issuance of subordinated debts in 2004***

Pursuant to Yin Jian Fu【2004】No. 36 document, "Approval from the CBRC on the Issuance of Subordinated Debts by China Merchants Bank", 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 a fixed annual rate of 4.59 % for a term of 5 years and 1 month, with the interest 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 a fixed annual rate of 5.10 % for a term of 5 years and 1 month, with the interest payable once a year.

***Issuance of subordinated debts in 2008***

Pursuant to "The Approval from China Banking Regulatory Commission on the Issuance of Subordinated Debts by China Merchants Bank" (Yin Jian Fu【2008】No. 304) and "The Decision on the Administrative Approval from The People's Bank of China" (Yin Shi Chang Xu Zhun Yu Zi【2008】No. 25), the Company successfully issued subordinated debts in an aggregate principal amount of RMB30 billion to institutional investors in the domestic interbank debt markets on 4 September 2008.

There are three types of debts being offered: Type I are fixed rate debts for a term of 10 years and the issue size is RMB19 billion. The coupon rate for the first 5 years is 5.70% and the Company may elect to redeem the debts by the end of the first 5 years. Type II are fixed rate debts for a term of 15 years and the issue size is RMB7 billion. The coupon rate for the first 10 years is 5.90% and the Company may elect to redeem the debts by the end of the first 10 years. Type III are floating rate debts for a term of 10 years and the issue size is RMB4 billion. The coupon rate for the first 5 years is R+1.53% and the Company may elect to redeem the debts by the end of the first 5 years.

If the Company does not exercise the redemption right, then the annual coupon rate for Type II Debts for the last 5 interest-accuring years will be calculated at the initial coupon rate plus 3% from the eleventh interest-accuring year until maturity of the debts; while the annual coupon rate or basic interest spread for both Type I Debts and Type III Debts for the last 5 interest-accuring years will be calculated at the initial coupon rate or interest margin plus 3% from the sixth interest-accuring year to the maturity of the respective debts.

The benchmark interest rate R for Type III ten-year floating rate debts is the one-year RMB fixed deposit interest rate announced by The People's Bank of China (PBOC). The benchmark interest rate for the first interest-accruing period will be the one-year RMB fixed deposit interest rate announced by The People's Bank of China and effective from 21 December 2007. The benchmark interest rate for the floating rate debts for the first interest-accruing period is 4.14%.

## 7.1 Directors, supervisors and senior management

| Name | Gender | Date of birth (Y/M) | Title | Term of office | Shareholding at the beginning of the year | Shareholding at the end of the year | Aggregate remunerations before tax received from the Company during the reporting period (RMB ten thousand) | Remunerations paid by shareholders' companies or other related companies |
|---|---|---|---|---|---|---|---|---|
| Qin Xiao | Male | 1947.4 | Chairman & Non-Executive Director | 2007.6-2010.6 | 0 | 0 | 0 | Yes |
| Wei Jiafu | Male | 1949.12 | Vice Chairman & Non-Executive Director | 2007.6-2010.6 | 0 | 0 | 0 | Yes |
| Fu Yuning | Male | 1957.3 | Non-Executive Director | 2007.6-2010.6 | 0 | 0 | 0 | Yes |
| Li Yinquan | Male | 1955.4 | Non-Executive Director | 2007.6-2010.6 | 0 | 0 | 0 | Yes |
| Hong Xiaoyuan | Male | 1963.3 | Non-Executive Director | 2007.6-2010.6 | 0 | 0 | 0 | Yes |
| Ding An Hua, Edward | Male | 1964.4 | Non-Executive Director | 2007.6-2010.6 | 0 | 0 | 0 | Yes |
| Sun Yueying | Female | 1958.6 | Non-Executive Director | 2007.6-2010.6 | 0 | 0 | 0 | Yes |
| Wang Daxiong | Male | 1960.12 | Non-Executive Director | 2007.6-2010.6 | 0 | 0 | 0 | Yes |
| Fu Junyuan | Male | 1961.5 | Non-Executive Director | 2007.6-2010.6 | 0 | 0 | 0 | Yes |
| Ma Weihua | Male | 1948.6 | Executive Director, President and Chief Executive Officer | 2007.6-2010.6 | 0 | 0 | 789.28 | No |
| Zhang Guanghua | Male | 1957.3 | Executive Director and Executive Vice President | 2007.6-2010.6 | 0 | 0 | 396.55 | No |
| Li Hao | Male | 1959.3 | Executive Director, Executive Vice President and Chief Financial Officer | 2007.6-2010.6 | 0 | 0 | 394.79 | No |
| Wu Jiesi | Male | 1951.10 | Independent Non-Executive Director | 2007.6-2010.6 | 0 | 0 | 30.00 | No |
| Yi Xiqun | Male | 1947.8 | Independent Non-Executive Director | 2008.1-2010.6 | 0 | 0 | 30.00 | No |
| Yan Lan | Female | 1957.1 | Independent Non-Executive Director | 2007.6-2010.6 | 0 | 0 | 30.00 | No |
| Chow Kwong Fai, Edward | Male | 1952.8 | Independent Non-Executive Director | 2007.6-2010.6 | 0 | 0 | 30.00 | No |
| Liu Yongzhang | Male | 1956.12 | Independent Non-Executive Director | 2007.6-2010.6 | 0 | 0 | 30.00 | No |
| Liu Hongxia | Female | 1963.9 | Independent Non-Executive Director | 2007.6-2010.6 | 0 | 0 | 30.00 | No |
| Shi Jiliang | Male | 1945.2 | Chairman of Board of Supervisors and External Supervisor | 2007.6-2010.6 | 0 | 0 | 60.00 | No |
| Zhu Genlin | Male | 1955.9 | Shareholder Supervisor | 2007.6-2010.6 | 0 | 0 | 0 | Yes |
| Chen Haoming | Male | 1966.3 | Shareholder Supervisor | 2007.6-2010.6 | 0 | 0 | 0 | Yes |
| Li Jiangning | Male | 1959.4 | Shareholder Supervisor | 2007.6-2010.6 | 0 | 0 | 0 | Yes |
| Dong Xiande | Male | 1947.2 | Shareholder Supervisor | 2007.6-2010.6 | 0 | 0 | 0 | Yes |
| Shao Ruiqing | Male | 1957.9 | External Supervisor | 2007.6-2010.6 | 0 | 0 | 30.00 | No |
| Yang Zongjian | Male | 1957.4 | Employee Supervisor | 2007.6-2010.6 | 0 | 0 | 139.75 | No |
| Shi Shunhua | Male | 1962.12 | Employee Supervisor | 2007.6-2010.6 | 0 | 0 | 199.41 | No |
| Zhou Song | Male | 1972.4 | Employee Supervisor | 2008.8-2010.6 | 31,800 | 33,500 | 123.88 | No |
| Tang Zhihong | Male | 1960.3 | Executive Vice President | 2007.6-2010.6 | 0 | 0 | 396.43 | No |
| Yin Fenglan | Female | 1953.7 | Executive Vice President | 2007.6-2010.6 | 0 | 0 | 396.55 | No |
| Ding Wei | Male | 1957.5 | Executive Vice President | 2008.4-2010.6 | 0 | 0 | 380.36 | No |
| Zhu Qi | Male | 1960.7 | Executive Vice President | 2008.11-2010.6 | 0 | 0 | 0 | Yes |
| Tang Xiaoqing | Male | 1954.8 | Secretary of Party Discipline Committee | 2008.12 till now | 0 | 0 | 33.05 | No |
| Xu Lianfeng | Male | 1953.2 | Chief Technology Officer | 2001.11 till now | 0 | 0 | 237.70 | No |
| Fan Peng | Male | 1953.2 | Chief Audit Officer | 2007.6-2010.6 | 0 | 0 | 239.46 | No |
| Lan Qi | Male | 1956.6 | Secretary of Board of Directors | 2007.6-2010.6 | 0 | 0 | 237.70 | No |

Notes:

(1) The shares held by Mr. Zhou Song during the reporting period were A shares of the Company;

(2) Mr. Zhu Qi's remuneration was paid by the Company's subsidiary WLB.

## 7.2 Current positions held by the directors and supervisors in the Bank's shareholders' companies

| Name | Name of Company | Title | Term of office |
|---|---|---|---|
| Qin Xiao | China Merchants Group Ltd. | 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 Ltd. | President | From April 2000 up to now |
| Li Yinquan | China Merchants Group Ltd. | Vice President & Chief Financial Officer | From July 2002 up to now |
| Hong Xiaoyuan | China Merchants Finance Holdings Co., Ltd. | General Manager | From May 2007 up to now |
| Ding Anhua, Edward | China Merchants Group Ltd., Strategy and Research Department | General Manager | From July 2004 up to now |
| 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 Co., Ltd | Executive Director & Chief Financial Officer | From September 2006 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 Jiangning | Shandong State-owned Assets Investment Holdings Co., Ltd. | Vice President | From December 2005 up to now |
| Dong Xiande [note] | Qinhuangdao Port Group Co., Ltd. | – | – |

Note: Mr. Dong Xiande was previously a director & chief accountant of Qinhuangdao Port Group Company Ltd.. He retired in July 2007.

## 7.3 Major working experiences of directors, supervisors and senior management and details of their part-time jobs

### Directors

**Mr. Qin Xiao**, Chairman and non-executive director of the Company. He joined the Company in April 2001. Dr. Qin obtained a doctorate degree in economics from Cambridge University and is a senior economist. He is a member of the Eleventh Chinese People's Political Consultative Conference, the honorary president of the Hong Kong Chinese Enterprises Association, and an adjunct professor of the School of Economics & Management at Tsinghua University and the Graduate School of the People's Bank of China. He has been Chairman of the board of China Merchants Group Ltd. since January 2001, and was previously the general manager, vice chairman of the China International Trust and Investment Corporation, and the chairman of the board of China CITIC Industrial Bank. Dr. Qin was a deputy of the Ninth National People's Congress, an advisor on the Foreign Currency Policy of the State Administration of Foreign Exchange, a member of the International Advisory Committee of Toyota Corporation of Japan, and the chairman of the APEC Business Advisory Council in 2001.

**Mr. Wei Jiafu**, Vice Chairman and non-executive director of the Company. He joined the Company in April 2001. He obtained a doctorate degree from Tianjin University. He has been a member of the Chinese Communist Party Central Committee for Discipline Inspection since November 2002 and the president and CEO of China Ocean Shipping (Group) Company since November 1998. He is also the chairman of China Shipowners' Association, China Association of Trade in Services, Zhenghe Study Association, China Shipowner's Mutual Assurance Association and China Federation of Industrial Economics. He is also a member of the Council of Bo'ao Forum for Asia, the National MBA Education Supervisory Committee of China, and the Harvard Business School Asia-Pacific Advisory Board, and an advisor of the Panama Canal Authority.

Mr. Wei has been the chairman of the board of directors and executive director of China COSCO Holdings Company Ltd. (a company listed on Hong Kong Stock Exchange and Shanghai Stock Exchange) since February 2005, the chairman and director of COSCO International Holdings Ltd. since June 2000, and the chairman of the board and a director of COSCO (Hong Kong) Group Ltd. since June 2000.

**Mr. Fu Yuning**, 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. He has been a director and president of China Merchants Group Ltd. since April 2000. Mr. Fu has been the chairman of China Merchants Holdings (International) Co., Ltd. (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 Ltd. (a company listed on the Hong Kong Stock Exchange) since November 2004, an independent non-executive director of Sino Land Company Ltd. (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 China Nanshan Development (Group) Inc. since December 1998. He has also been the chairman of China Merchants Energy Shipping Co., Ltd. (a company listed on the Shanghai Stock Exchange) since December 2004, and the chairman of China International Marine Containers (Group) Co., Ltd. (a company listed on the Shenzhen Stock Exchange) since April 2007.

**Mr. Li Yinquan**, non-executive director of the Company. He joined the Company in April 2001. He obtained a master's degree in economics and finance in the Graduate School of the People's Bank of China and a master's degree in finance in FINAFRICA, Italy, and is a senior economist. He has been the vice president and chief financial officer of China Merchants Group Ltd. since March 2004. He has also been the director of China Merchants Holdings (International) Co., Ltd. (a company listed on the Hong Kong Stock Exchange) since June 2000, the director of China Merchants Energy Shipping Co., Ltd. (a company listed on the Shanghai Stock Exchange) since April 2007, and the chairman of China Merchants China Direct Investments Ltd. (a company listed on the Hong Kong Stock Exchange) since July 2008.

**Mr. Hong Xiaoyuan**, non-executive director of the Company. He joined the Company in June 2007. He obtained a master's degree in economics from Peking University and a master's degree in science from Australian National University. Since May 2007 till now, he has been the general manager of China Merchants Finance Holdings Company Ltd., and also the director of China Merchants Energy Transportation Co., Ltd. (a company listed on the Shanghai Stock Exchange), China Merchants China Direct Investment Ltd. (a company listed on the Hong Kong Stock Exchange), China Merchants Securities Co., Ltd., China Credit Trust Co., Ltd., and Morgan Stanley Huaxin Fund Management Company Ltd.. He is also the chairman of China Merchants Investment Management Ltd., China Merchants Finance Investment Holdings Co., Ltd., China Merchants Holdings (U.K.) Co., Ltd., China Merchants Insurance Co., Ltd., Houlder Insurance Brokers Far East Ltd., and Houlder Insurance Brokers Ltd.

**Mr. Ding An Hua, Edward**, non-executive director of the Company. He joined the Company in June 2007. He obtained a master's degree in business administration in the School of Business Administration of South China University of Technology and a master's degree in the School of Business of Macquarie University, Australia and held the certificate of Canadian investment manager. He has been the general manager of the Strategy Research Department of China Merchants Group Ltd since 2004. He is also a director of China Merchants Energy Transportation Co., Ltd. (a company listed on the Shanghai Stock Exchange) since December 2004, and also a director of China Merchants Securities Co., Ltd. since July 2007.

**Ms. Sun Yueying**, non-executive director of the Company. She joined the Company in April 2001. She obtained a master's degree and is a senior accountant. She has been the chief accountant of China Ocean Shipping (Group) Company since December 2000. She has also been a non-executive director of China COSCO Holdings Company Ltd., director of COSCO Corporation (Singapore) Ltd., a non-executive director of COSCO Pacific Ltd., the chairman of COSCO Finance Co., Ltd., a director of China Merchants Securities Co., Ltd. and a director of ICBC Credit Suisse Asset Management Co., Ltd.

**Mr. Wang Daxiong**, non-executive director of the Company. He joined the Company in March 1998. He is a university graduate and is a senior accountant. He has been the vice president and chief accountant of China Shipping (Group) Company since December 2004. He has also been a non-executive director of China Shipping Container Lines Company Ltd. (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 the 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.

**Mr. Fu Junyuan**, non-executive director of the Company. He joined the Company in March 2000. He obtained a doctorate degree in management and is a senior accountant. He has been the executive director and chief financial officer of China Communications Construction Ltd. (a company listed on the Hong Kong Stock Exchange) since September 2006. He has also been the director of Shanghai Zhenhua Port Machinery Company Ltd. (a company listed on the Shanghai Stock Exchange) since 2001, and the vice chairman of Jiang Tai Insurance Broker Co., Ltd. since 2006. He was the chief accountant of China Harbour Engineering (Group) Ltd. from October 1998 to August 2005, and the chief accountant of China Communications Construction (Group) Ltd from September 2005 to August 2006.

**Mr. Ma Weihua**, executive director, President and Chief Executive Officer of the Company. He joined the Company in January 1999. He obtained a doctorate degree in economics and is a senior economist. He is a member of the Eleventh Chinese People's Political Consultative Conference. He has been President and CEO of China Merchants Bank since January 1999. He has been the chairman of the boards of CMB International Capital Corporation Ltd., CIGNA & CMC Life Insurance Company Ltd., China Merchants Fund Management Co., Ltd. and Wing Lung Bank Ltd. since September 1999, September 2003, November 2007 and October 2008 respectively, and a director of China Merchants Group Ltd. since July 2002. He is also the vice chairman of China Chamber of International Commerce, the executive deputy chairman of China Enterprise Directors Association, 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 director of Shenzhen Soft Science Development Foundation and an adjunct professor at several higher educational institutions including Peking University and Tsinghua University, etc..

**Mr. Zhang Guanghua**, executive director and Executive Vice President of the Company. He joined the Company in April 2007. Mr. Zhang obtained a doctorate degree in economics and is a senior economist. He has been an executive vice president of the Company since April 2007. He is a member of the Standing Council of China Society for Finance and Banking, the deputy chairman of both Guangdong Society for Finance and Banking and Guangdong Commerce Association respectively, and a member of the Fifth Committee of China Council for the Promotion of International Trade. From September 2002 to April 2007, he served as the chief executive officer of Guangdong Development Bank. He has also been the vice chairman of the board of CMB International Capital Corporation Ltd. since July 2007, the chairman of the board of CMB Financial Leasing Co., Ltd. since March 2008, and the vice chairman of the board of Wing Lung Bank Ltd. since October 2008.

**Mr. Li Hao**, executive director, Executive Vice President, and Chief Financial Officer of the Company. He joined the Company in May 1997. Mr. Li obtained a master's degree in business administration and is a senior accountant. He has been an executive vice president of the Company since March 2002, and concurrently Chief Financial Officer since March 2007. He has been an executive assistant president of the Head Office and subsequently an executive vice president of the Company since 1997, and was previously the general manager of the Shanghai Branch from April 2000 to March 2002.

**Mr. Wu Jiesi**, independent non-executive director of the Company. He joined the Company in September 2005. He obtained a doctorate degree in economics, completed the postdoctoral research in theoretical economics in Nankai University, and is an adjunct professor in Nankai University. He currently is the chairman of the board of directors of Zhonghui Mining Industry Africa Ltd., the vice chairman and executive director of China Aoyuan Property Group Ltd. (a company listed on the Hong Kong Stock Exchange). He is also an independent non-executive director of Beijing Enterprises Holdings Ltd. (a company listed on the Hong Kong Stock Exchange) and China Insurance International Holdings Company Ltd. (a company listed on the Hong Kong Stock Exchange); a non-executive director of China Water Affairs Group Ltd. (a company listed on the Hong Kong Stock Exchange), Shenzhen Investment Holdings Ltd. (a company listed on the Hong Kong Stock Exchange) and Yinji Group Holdings Ltd.; a director of China Life Franklin Asset Management Company Ltd.; and a strategy consultant of Yingli Green Energy Holding Co., Ltd. (a company listed on the New York Stock Exchange). He was a director of Guangdong Investment Ltd. from 2000 to 2005, the chairman of Guangdong Investment Ltd. from 2000 to 2001, and the honorary president of Guangdong Investment Ltd. from 2001 to 2005; the chairman and director of Guangdong Yue Gang Investment Holdings Company Ltd. and Guangdong Holdings Ltd. from 2000 to 2005; the honorary president and director of Guangdong Tannery Ltd. from 2004 to 2005; the managing director and chief executive officer of Hopson Development Holdings Ltd. (a company listed on the Hong Kong Stock Exchange) from April 2005 to January 2008.

**Mr. Yi Xiqun**, independent non-executive director of the Company. He joined the Company in October 2007. He obtained a master's degree in economics management engineering from Tsinghua University. He has been the president of Beijing Holdings Ltd. and the chairman of the board of directors of Beijing Enterprises Holdings Ltd. since 2003, the president of Beijing Enterprises Group Company Ltd. (a company listed on the Hong Kong Stock Exchange) since December 2004, and has also been an independent director of SOHO China Ltd. since May 2007.

**Ms. Yan Lan**, independent non-executive director of the Company. She joined the Company in June 2007. She obtained a bachelor's degree in French Language and Literature from Beijing Foreign Studies University, a master's degree in international law from Peking University, a doctorate degree in international law from Graduate Institute of International Studies in Geneva and has been qualified as an avocat in France. She has served as the chief representative in the Beijing Office of Gide Loyrette et Nouel since 1998. She is now an arbitrator of China International Trade Arbitration Committee and one of the legal counsels of ICC CHINA. She also voluntarily serves as the chairman of the International Advisory Committee of Beijing Music Festival, the Chairman of China Heritage Protection Fund (NGO), the vice chairlady of the Women's Forum for the Economy and Society in Asia, and an advisor of France's foreign trade.

**Mr. Chow Kwong Fai, Edward**, 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. He is a senior member of the Institute of Chartered Accountants in England and Wales and the Hong Kong Institute of Certified Public Accountants and an expert advisor of the Accounting Standards Committee of the Ministry of Finance, Peoples Republic of China. 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 Ltd. (a company listed on the Hong Kong Stock Exchange) since June 2005, and an independent non-executive director of Melco China Resorts (Holdings) Ltd. (a company listed on Toronto Stock Exchange, Canada) since June 2008. He has also been a deputy chairman of Business and Professionals Federation of Hong Kong, and a core member of the OECD/World Bank Asian Corporate Governance Roundtable. He previously served as the deputy chairman of the Hong Kong Institute of Directors (2006 – 2008), the president of the Hong Kong Institute of Certified Public Accountants (2005) and the chairman of the Professional Accountants in Business Committee of the International Federation of Accountants (2006 – 2008). Mr. Chow was appointed as a Justice of the Peace (JP) by the Chief Executive of Hong Kong SAR on 1 July 2008.

**Mr. Liu Yongzhang**, independent non-executive director of the Company. He joined the Company in May 2006. He has obtained a master's degree in economics from Shanghai University of Finance and Economics. He is currently a professor of the International Business Administration Faculty, the deputy secretary of 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 Ltd. (a company listed on the Shanghai Stock Exchange) since June 2004.

**Ms. Liu Hongxia**, 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 and completed the postdoctoral research in the Corporate Governance Center of Nankai University. She is currently a professor in accounting at the Central University of Finance and Economics and a mentor to doctoral students. She has also been an accreditation expert of Beijing senior accountants and a director at the Beijing Institute of Accounting. She has served as an independent director of Henan Zhongfu Industrial Co., Ltd. (a company listed on the Shanghai Stock Exchange) since 2006.

## Supervisors

**Mr. Shi Jiliang**, Chairman of the Board of Supervisors and external supervisor of the Company. He is a university graduate and a senior economist. He was previously the vice governor of the People's Bank of China from 1997 to 2003, and the vice chairman of the China Banking Regulatory Commission from 2003 to 2005.

**Mr. Zhu Genlin**, shareholder representative supervisor of the Company. Mr. Zhu obtained a master's degree in economics. 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 (a company listed on the Shanghai Stock Exchange) since February 2002 and March 2001, respectively. He is currently the deputy chairman of Shanghai Cost Study Society and Shanghai Creative Industry Center, the chairman of Shanghai Automotive Asset Management Co., Ltd., the president of Shanghai Creative Industry Investment Corp., the chairman of Shanghai Pucheng Real Estate Development Co., Ltd., the vice chairman of board of supervisors to Shenyin & Wanguo Securities Co., Ltd., a director of SVA (Group) Co., Ltd. and a director of Changjiang Pension Insurance Co., Ltd.

**Mr. Chen Haoming**, shareholder representative supervisor of the Company. Mr. Chen obtained a master's degree in economics from the Central University of Finance and Economics and is a senior economist. He served as a general manager of CNOOC Investment Co., Ltd. from 2000 to 2005. Since August 2005, he has served as the vice president of Zhonghai Trust and Investment Co., Ltd. He is also the chairman of Zhonghai Investment Management Co., Ltd., the chairman of Shanghai Shenxin Real Estate Co., Ltd., the president of Zhonghai Fund Management Co., Ltd., the president of AEGON-CNOOC Life Insurance Co., Ltd. and a supervisor of Cinda Securities Co., Ltd.

**Mr. Dong Xiande**, shareholder representative supervisor of the Company. He graduated with an accounting and statistics degree from Shanghai Harbour School. He is a senior accountant. He is also the deputy chairman of Hebei Association of Communications Accountancy and a consultant for making accounting decisions of Hebei Communications Department. From June 1998 to August 2002, he was the chief accountant of Qinhuangdao Port Authority in June 1998, and a director and the chief accountant of Qinghuangdao Port Group Co., Ltd. from August 2002 to July 2007.

**Mr. Li Jiangning**, shareholder representative supervisor of the Company. He obtained a master's degree, and is a researcher. He is the vice president and chief legal advisor of Shandong Provincial State-owned Asset Investment Holding Co., Ltd., and is also a mentor to master students of economics at Shandong University of Finance, and an independent director of Luyin Investment Group Co., Ltd. He was the head of the General Office of the Committee for Economic Restructuring of Shandong from October 2000 to June 2004, the head of the Enterprise Distribution Department of State-owned Assets Supervision and Administration Commission of Shandong Provincial Government from June 2004 to November 2005.

**Mr. Shao Ruiqing**, external supervisor of the Company. Mr. Shao obtained a doctorate degree. He was the dean, a professor and a doctoral mentor at the School of Economic Administration at Shanghai Maritime University. He is currently a deputy dean and a professor at Shanghai Lixin University of Commerce and a doctoral mentor at Shanghai Maritime University. Mr. Shao is also the deputy head of China Association of Communications Accountancy, a director of China Institute of Accounting Instructors, the deputy head of Shanghai Association of Communications Accountancy, and the deputy head of Shanghai Association of Communications Accountancy. He is also an independent non-executive director of a number of listed companies such as Shenzhen Guangju Energy Co., Ltd. (a company listed on the Shenzhen Stock Exchange), Wuhan Jianmin Pharmaceutical Group Co., Ltd. (a company listed on the Shanghai Stock Exchange) and Shanghai Automotive Co., Ltd. (a company listed on the Shanghai Stock Exchange). Mr. Shao is a deputy to the thirteenth National People's Congress of Shanghai.

**Mr. Yang Zongjian**, employee supervisor of the Company. He is a postgraduate and a senior economist. He joined the Company in 1997. He successively served as the deputy general manager of the Development Department and Organization Management Department (in charge of daily management) of the head office of the Company, and the deputy general manager (at a general manager's level) of the Human Resources Department, the general manager of Kunming Branch of the Company. Since March 2007, he has served as the general manager of the Administration Department of the head office of the Company.

**Mr. Shi Shunhua**, employee supervisor of the Company. He obtained an MBA degree from China Europe International Business School and is an economist. He joined the Company in 1996. He successively served as the general manager of Xujiahui sub-branch of Shanghai Branch of the Company, the general manager of the Bund sub-branch of Shanghai Branch of the Company, and the assistant general manager of Shanghai Branch, and the deputy general manager of Shanghai Branch of the Company. Since November 2008, he has served as the general manager of Suzhou Branch of the Company.

**Mr. Zhou Song**, employee supervisor of the Company. Mr. Zhou is a postgraduate. He joined the Company in February 1997. He successively served as a manager of the Planning and Treasury Department, an assistant general manager and a deputy general manager of the Head Office of the Company, the general manager of the Planning and Finance Department, the deputy general manager of Wuhan Branch of the Company. Since August 2008, he has served as the head of the Planning and Financial Department of the Head Office of the Company.

## Senior Management

**Mr. Ma Weihua**, President and Chief Executive Officer of the Company. Please refer to Mr. Ma's biography under the paragraph headed "Directors" above.

**Mr. Zhang Guanghua**, Executive Vice President of the Company. Please refer to Mr. Zhang's biography under the paragraph headed "Directors" above.

**Mr. Li Hao**, Executive Vice President and Chief Financial Officer of the Company. Please refer to Mr. Li's biography under the paragraph headed "Directors" above.

**Mr. Tang Zhihong**, Executive Vice President of the Company. Mr. Tang graduated from Jilin University and is a senior economist. He joined the Company in May 1995. He successively served as the deputy general manager of the Shenyang Branch, the deputy general manager of the Shenzhen Branch, the general manager of the Lanzhou Branch, the general manager of the Shanghai Branch, head of the Shenzhen Administration Unit, and executive assistant president of the Head Office of the Company. He has been Executive Vice President of the Company since April 2006. Mr. Tang is concurrently a director of CIGNA & CMC Life Insurance Company Ltd. and China UnionPay Co., Ltd.

**Ms. Yin Fenglan**, Executive Vice President of the Company. Ms. Yin obtained a master's degree and is a senior economist. She joined the Company in May 1994. She successively served as the deputy general manager, the general manager of the Beijing branch, and an assistant president of the Head Office of the Company. She has been Executive Vice President of the Company since April 2006.

**Mr. Ding Wei**, Executive Vice President of the Company. Mr. Ding is a graduate and associate researcher. He joined the Company in December 1996. He successively served as the director of the General Office and the general manager of the Operation Department of Hangzhou Branch, the assistant general manager of Hangzhou Branch, the deputy general manager of Hangzhou Branch, the general manager of Nanchang sub-branch, the general manager of Nanchang Branch, and the general manager of the Human Resources Department of the Head Office of the Company. He has served as Executive Vice President of the Company since April 2008. He is concurrently a director of CMB International Capital Corporation Ltd..

**Mr. Zhu Qi**, Executive Vice President of the Company, executive director and Chief Executive Officer of Wing Lung Bank Ltd. Mr. Zhu holds a master's degree in economics. He joined the Industrial and Commercial Bank of China and worked at the head office in 1986 and successively served as the vice general manager and general manager of Industrial and Commercial Bank of China Ltd., Hong Kong Branch. He was also a director, managing director and the chief executive officer of Industrial and Commercial Bank of China (Asia) Ltd., and the chairman of Chinese Mercantile Bank. He joined the Company in August 2008 and has been Executive Vice President of the Company since November 2008.

**Mr. Tang Xiaoqing**, Secretary of the Party Discipline Committee of the Company. Mr. Tang obtained a doctorate degree in economics from Zhongnan Finance and Economics University. He is a senior economist. He worked in the China Banking Regulatory Commission from March 2003 to November 2008, and successively served as a deputy director of its Financial Services Regulatory Department, CPC (Communist Party of China), the secretary and director of CBRC Inner Mogolia Bureau, CPC, the secretary and director of CBRC Shanxi Bureau the director of the Banking Regulatory Department I of CBRC and the director of its Finance and Accounting Department. He joined the Company in December 2008, and served as a party committee member and Secretary of the Party Discipline Committee.

**Mr. Xu Lianfeng**, Chief Technology Officer of the Company. He is a graduate of Tsinghua University. He joined the Company in October 1991. He has served as Chief Technology Officer since November 2001, was the general manager of the Information Technology Department of the Company from December 2005 to September 2007.

**Mr. Fan Peng**, Chief Audit Officer of the Company. He graduated with a bachelor's degree in finance and is a registered accountant. From August 1983 to January 2007, he worked in the National Audit Office, and successively served as a deputy division chief of the Finance Audit Office of the National Audit Office, the deputy division chief of the Comprehensive Office, the deputy division chief of Commerce & Trade Audit Office (in charge of daily work), the deputy division chief of Economy & Trade Audit Office (in charge of daily work) and the division chief of Finance Audit Office. He joined the Company in February 2007 and has served as Chief Auditing Officer of the Company since February 2007.

**Mr. Lan Qi**, Secretary of Board of Directors and Head of the Office of Board of Directors, and one of the joint company secretaries of the Company. Mr. Lan obtained a master's degree in economics from the Graduate School of the People's Bank of China and is a senior economist. He joined the Company in April 1993, and successively served as the deputy general manager of the Development and Research Department of the Head Office, the deputy general manager of the Securities Department of the Head Office and deputy general manager of CMB Securities Company, the general manager of the Human Resources Department, Research and Development Department, Merchant Banking Department of the Head Office and the general manager of CMB International Capital Corporation Ltd. and the director of the General Affairs Department.

**Mrs. Seng Sze Ka Mee, Natalia**, 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 Ltd. from 1994 to 2002. Mrs. Seng is a chartered secretary, president, council member and a Fellow of the Hong Kong Institute of Chartered Secretaries and also a Fellow 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 present, apart from the Company, she has been providing professional secretarial services to many listed companies.

## 7.4 Evaluation and incentive system and annual remuneration for directors, supervisors and senior management

The Company offers remuneration to independent non-executive directors and external supervisors according to the "Resolution in respect of Adjustment to Remuneration of Independent Directors and External Supervisors", offers remuneration to executive directors and other senior executives according to the "Policies on Remunerations of Senior Management" of the Company; and offers remuneration to employee supervisors in accordance with the policies on remuneration of employees. Non-executive directors and supervisors acting as shareholders' representatives do not receive any remuneration from the Company.

The Board of Supervisors evaluates the performance of directors according to the "Policies on Evaluation of Performance of Directors by the Board of Supervisors (Provisional)" and through the review of the working report of the Directors. The Board of Directors evaluates the performance of the senior management through the "Policies on Remunerations of Senior Management".

For further details of remuneration for directors, supervisors and senior management, please refer to section 7.1 of this report.

## 7.5 H share appreciation rights incentive scheme during the reporting period

To further establish and enhance its incentive system for the combined interest of shareholders, the Company and the senior management people, the Company approved the H Share Appreciation Rights Incentive Scheme for senior management at the 1st Extraordinary General Meeting for 2007 held on 22 October 2007. On 30 October 2007, the Board of the Company made the first grant under the scheme.

On 7 November 2008, the Board of the Company made the second grant of the H Share appreciation rights. The target and proportion for the grants are as follows:

| No. | Name | Title | Number of share appreciation rights granted (in ten thousand) | Percentage of target shares in respect of granted appreciation rights to total shares | Percentage of granted appreciation rights to total appreciation rights for the period |
|---|---|---|---|---|---|
| 1 | Ma Weihua | President | 30 | 0.0020% | 22.73% |
| 2 | Zhang Guanghua | Executive Vice President | 15 | 0.0010% | 11.36% |
| 3 | Li Hao | Executive Vice President | 15 | 0.0010% | 11.36% |
| 4 | Tang Zhihong | Executive Vice President | 15 | 0.0010% | 11.36% |
| 5 | Yin Fenglan | Executive Vice President | 15 | 0.0010% | 11.36% |
| 6 | Ding Wei | Executive Vice President | 15 | 0.0010% | 11.36% |
| 7 | Xu Lianfeng | Chief Technology Officer | 9 | 0.0006% | 6.82% |
| 8 | Fan Peng | Chief Auditing Officer | 9 | 0.0006% | 6.82% |
| 9 | Lan Qi | Secretary of Board of Directors | 9 | 0.0006% | 6.82% |
| | **Total** | | 132 | 0.009% | 100.00% |

These H share appreciation rights are granted at the price of HK$12.76 and will remain valid for ten years effective from 7 November 2008, within which two years from 7 November 2008 is defined as a restricted exercising period, when no share appreciation rights can be exercised. The effective exercising period is 8 years after the expiry of the restricted exercising period. During the first 4 years of the effective exercising period, the annual effective exercisable rights is 25% of the total granted rights. The effective exercisable share appreciation rights granted are exercisable from the effective date till the end of the exercising period; the people receiving the incentive scheme may exercise his/her effective exercisable share appreciation rights once and for all or in several tranches. The share appreciation rights shall only be exercised within the exercising period. As at 31 December 2008, the closing price of the Company's H Shares was HK$14.36.

## 7.6 Appointment and resignation of executives during the reporting period

The General Meeting held on 22 October 2007 approved the resolution of appointing Mr. Yi Xiqun as an independent non-executive director of the Company. On 14 January 2008, CBRC approved that Mr. Yi Xiqun was qualified as an independent non-executive director.

The 18th Meeting of the Seventh Session of the Board of Directors of the Company held on 8 April 2008 approved the resolution of appointing Mr. Ding Wei as an executive vice president of the Company. The relevant announcement was published on the newspapers and websites designated by the Company for information disclosure on 9 April 2008. On 26 April 2008, the qualification of Mr. Ding Wei as an executive vice president of the Company was approved by the CBRC.

Mr. Yin Xuwen, the former employee supervisor of the Company, resigned as an employee supervisor due to work changes in August 2008. Mr. Zhou Song was elected as an employee supervisor of the Company at an employee representatives meeting of the Company. The relevant announcement was published on the newspapers and websites designated by the Company for information disclosure on 13 August 2008.

The 30th Meeting of the Seventh Session of the Board of Directors of the Company held on 7 November 2008 approved the resolution of appointing Mr. Zhu Qi as an executive vice president of the Company. The relevant announcement was published on the newspapers and websites designated by the Company for information disclosure on 8 November 2008. On 25 December 2008, the qualification of Mr. Zhu Qi as an executive vice president of the Company was approved by the CBRC.

Mr. Tang Xiaoqing was appointed as the Company's Party Committee member and Secretary of the Party Discipline Committee by the CBRC, effective from December 2008.

## 7.7 Information about employees

As at 31 December 2008, the Company had 36,916 employees, including 5,906 management people, 27,090 ordinary employees and 3,920 administration staff. Of these staff, 34,949 employees had college education or above, accounting for 94.67%. Currently, the Company has 102 retirees.

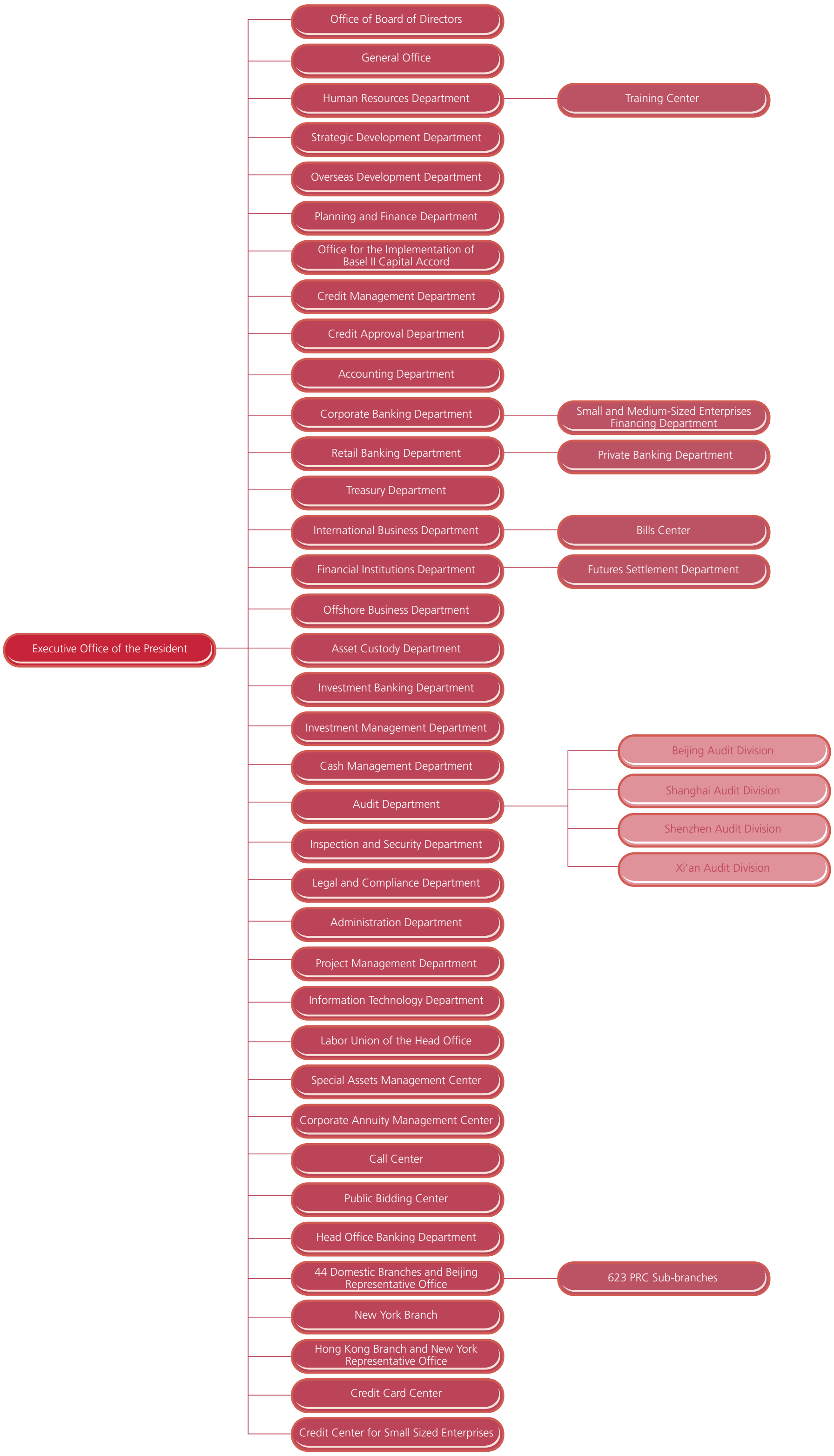
## 7.8 Branches and representative offices

The Company continued to expand its outlet network in 2008. 5 branches in Mainland China were approved to commence business during the year. Specifically, on 28 March 2008, the Company's Nantong Branch was given an approval by CBRC Jiangsu Bureau to commence business; on 17 June 2008, the Company's Credit Centre for Small Sized Enterprises was given an approval from the CBRC to commence business; on 18 June 2008, the Company's Weifang Branch was given an approval by CBRC Shandong Bureau to commence business; on 3 December 2008, the Company's Changchun Branch was given an approval by the CBRC Jilin Bureau to commence business; and on 29 December 2008, the Company's Nanning Branch was given an approval by the CBRC Guangxi Bureau to commence business. In addition, the Company's New York Branch commenced business on 8 October 2008 after long-time preparation.

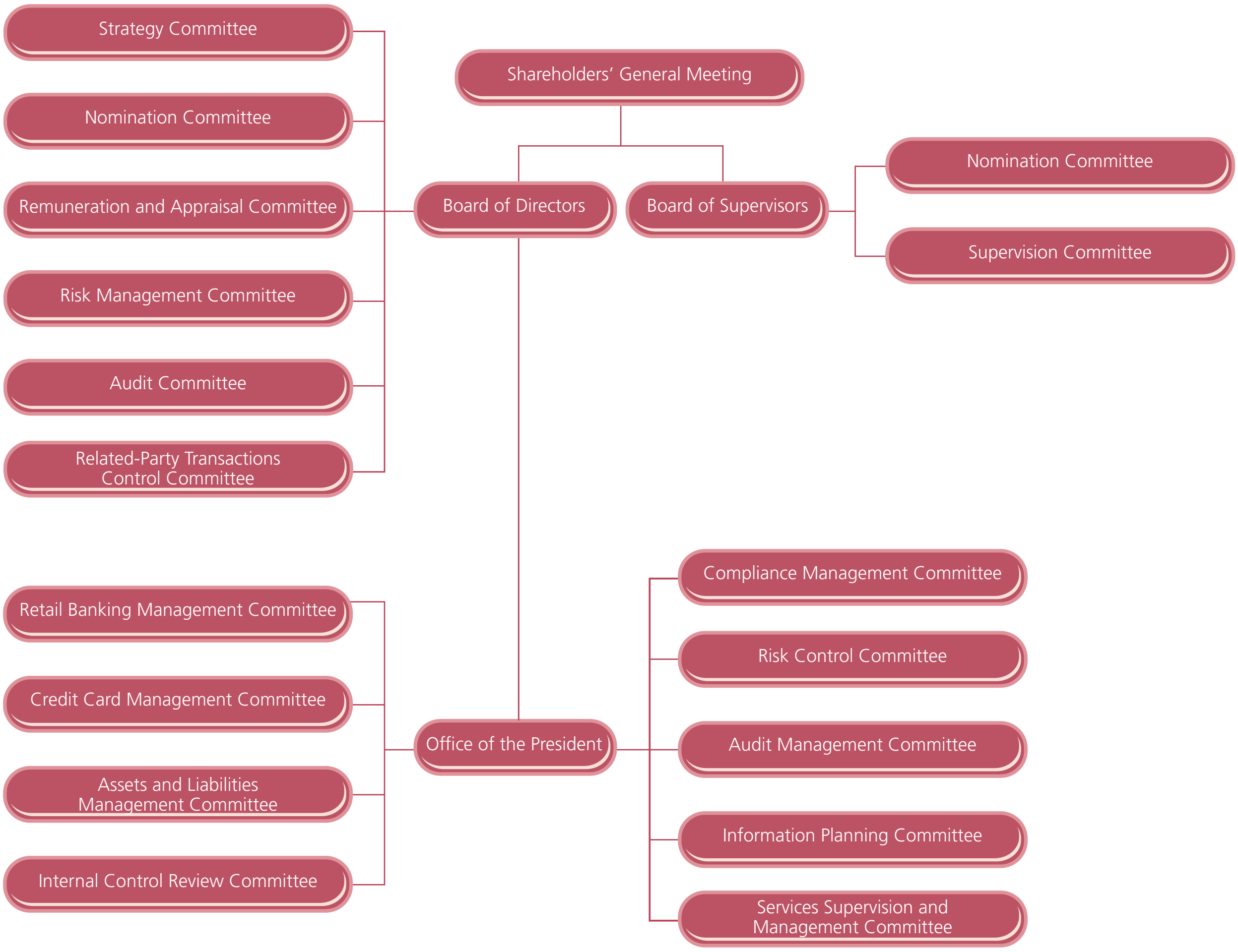
The following table sets out the branches and representative offices as at 31 December 2008:

| Name of branches | Business address | Postal code | No. of outlets | No. of staff | Size of asset (in millions of RMB) |
|---|---|---|---|---|---|
| Head Office | 7088 Shennan Boulevard, Shenzhen | 518040 | 1 | 1,885 | 560,080 |
| Shenzhen Branch | 2 Shennan Road Central, Shenzhen | 518001 | 66 | 2,869 | 106,715 |
| Shanghai Branch | 161 Lujiazui Road East, Pudong, Shanghai | 200120 | 51 | 2,539 | 86,234 |
| Wuhan Branch | 518 Jianshe Avenue, Hankou, Wuhan | 430022 | 27 | 1,282 | 30,531 |
| Beijing Branch | 156 Fuxingmen Nei Dajie, Beijing | 100031 | 43 | 2,379 | 91,850 |
| Shenyang Branch | 12 Shiyiwei Road, Heping District, Shenyang | 110003 | 20 | 1,113 | 27,397 |
| Guangzhou Branch | 138, Tiyu Road East, Tianhe District, Guangzhou | 510620 | 37 | 1,480 | 36,561 |
| Chengdu Branch | 248, Shuncheng Street, Qingyang District, Chengdu | 610016 | 24 | 873 | 19,643 |
| Lanzhou Branch | 9 Qingyang Road, Chengguan District, Lanzhou | 730030 | 16 | 581 | 13,808 |
| Xi'an Branch | 107 Heping Road, Xi'an | 710001 | 21 | 936 | 21,490 |
| Nanjing Branch | 1 Hanzhong Road, Nanjing | 210005 | 19 | 963 | 34,136 |
| Wuxi Branch | 128 Renmin Road Central, Wuxi | 214002 | 11 | 367 | 12,637 |
| Changzhou Branch | 125 Heping Road South, Changzhou | 213003 | 5 | 173 | 4,332 |
| Yangzhou Branch | 12 Wenchang Road West, Yangzhou | 225009 | 2 | 126 | 2,841 |
| Suzhou Branch | 128 Sanxiang Road, Suzhou | 215004 | 11 | 526 | 20,761 |
| Nantong Branch | Huachen Building, No.111 Gongnong Road, Nantong | 226001 | 1 | 44 | 1,675 |
| Chongqing Branch | 2 Linjiangzhi Road, Yuzhong District, Chongqing | 400010 | 24 | 895 | 22,545 |
| Dalian Branch | 17 Renmin Road, Zhongshan District, Dalian | 116001 | 16 | 619 | 12,744 |
| Hangzhou Branch | 23 Hangda Road, Hangzhou | 310007 | 21 | 1,045 | 37,024 |
| Ningbo Branch | 938 Baizhang Road East, Ningbo | 315041 | 10 | 516 | 24,158 |
| Wenzhou Branch | Jinglong Building, Chezhan Avenue, Wenzhou | 325000 | 9 | 342 | 11,749 |
| Shaoxing Branch | Jindun Building, 60 Shengli Road East, Shaoxing | 312000 | 6 | 238 | 9,414 |
| Jinhua Branch | 45 Shuangxi Road West, Jinhua | 321017 | 3 | 122 | 3,402 |
| Taizhou Branch | 535 Shifu Road, Taizhou | 318000 | 2 | 101 | 2,500 |
| Nanchang Branch | 162 Bayi Avenue, Nanchang | 330003 | 17 | 664 | 17,573 |
| Changsha Branch | 24 Cai'e Road Central, Furong District, Changsha | 410005 | 20 | 737 | 22,710 |
| Fuzhou Branch | 60 Guping Road, Fuzhou | 350003 | 13 | 573 | 12,189 |
| Quanzhou Branch | Huangxing Building, 301 Fengze Street, Fengze District, Quanzhou | 362000 | 6 | 213 | 4,017 |
| Qingdao Branch | 36 Hong Kong Road Central, Shinan District, Qingdao | 266071 | 15 | 758 | 26,579 |
| Tianjin Branch | 55 Youyi Road North, Hexi District, Tianjin | 300204 | 20 | 837 | 19,641 |
| Jinan Branch | 21 Chaoshan Street, Lixia District, Jinan | 250011 | 17 | 714 | 25,506 |
| Yantai Branch | 237 Nanda Street, Yantai | 264000 | 6 | 202 | 4,850 |
| Weifang Branch | 5151 Shengli Street East, Kuiwen District, Weifang | 261041 | 1 | 77 | 1,962 |
| Urumchi Branch | 80 Xinhua Road North, Urumchi | 830002 | 11 | 400 | 8,211 |
| Kunming Branch | 48 Dongfeng Road East, Kunming | 650051 | 17 | 659 | 17,582 |
| Hefei Branch | 436 Changjiang Road Central, Hefei | 230061 | 14 | 597 | 15,003 |
| Xiamen Branch | 862 Xiahe Road, Xiamen | 361004 | 11 | 396 | 10,362 |
| Harbin Branch | 3 Zhongyang Avenue, Daoli District, Harbin | 150001 | 11 | 461 | 9,997 |
| Zhengzhou Branch | 68 Jingsan Road, Zhengzhou | 450008 | 13 | 485 | 21,992 |
| Dongguan Branch | Yujing New Times Plaza, Dongcheng Avenue, Dongguan | 523129 | 12 | 479 | 12,361 |
| Foshan Branch | 1-3/F, Hongye Mansion, 23 Jihua 5th Road, Foshan | 528000 | 10 | 362 | 9,010 |
| Taiyuan Branch | 1 Xinjian Road South, Taiyuan | 030001 | 3 | 193 | 5,091 |
| Hohhot Branch | 56 Xinhua Street, Hohhot | 010010 | 3 | 174 | 4,946 |
| Changchun Branch | 1111 Ziyou Avenue, Zhaoyang District, Changchun | 130000 | 1 | 82 | 1,084 |
| Nanning Branch | 1-6/F, New City International Building, 92-1 Minzu Avenue, Nanning | 530022 | 1 | 79 | – |
| Hong Kong Branch | 12 Harcourt Road, Hong Kong | – | 1 | 80 | 22,870 |
| Beijing Representative Office | 35 Jinrong Avenue, Xicheng District, Beijing | 100005 | 1 | 8 | 1 |
| USA Representative Office | 509 Madison Aveune, Suite 306, New York, New York 10022, U.S.A | – | 1 | 1 | 1 |
| New York Branch | 535 Madison Aveune | – | 1 | 21 | 58 |
| Credit Card Centre | 316 Lao Shan Road, Pudong New District, Shanghai | 200120 | 1 | 5,625 | 31,112 |
| Credit Centre for Small Sized Enterprises | Zhiye Commerce Square Building, 158 Wangdun Road, Suzhou | 215028 | 1 | 25 | 437 |
| Total | – | – | 674 | 36,916 | 1,499,372 |

## 7.9 The Company's organizational chart



## 8.1 Corporate Governance Structure



## 8.2 Overview of Corporate Governance

In 2008, the Company had made great efforts to promote and enhance its corporate governance, particulars of which were set out as follows:

1. During the year, the Company organised and convened in aggregate 53 meetings of various nature, among which, there were 1 general meeting, 19 board meetings (3 physical meetings and 16 by way of written resolutions), 22 meetings of the Specialized Committees of the Board of Directors (1 of Strategy Committee, 5 of Risk Management Committee, 4 of Audit Committee, 9 of Related Party Transactions Control Committee, 1 of Remuneration and Appraisal Committee and 2 of Nomination Committee), 10 meetings of the Board of Supervisors (2 physical meetings, 5 by way of written resolutions, 1 in the form of special report and 2 in the form of research and investigations) and 1 meeting of the Specialized Committees of the Board of Supervisors (1 Supervision Committee meeting). During the aforesaid meetings, an aggregate of approximately 70 significant resolutions were reviewed and approved, including those on the Company's periodic reports, work reports of the Board of Directors and the Board of Supervisors, work report of the President, the financial budget and final reports, proposed profit appropriations plan, report on management of compliance risk, material related-party transactions and the written-off of large amount of bad debts.

2. Adjusted and enhanced the structure, duties and composition of the specialized committees under the Board of Directors and the Board of Supervisors. The original five specialized committees under the Board of Directors, being the Executive Committee, the Nomination Committee, the Remuneration and Appraisal Committee, the Risk Management Committee and the Audit and Related-Party Transactions Control Committee had been readjusted into six specialized committees, namely, the Strategy Committee, the Nomination Committee, the Remuneration and Appraisal Committee, the Risk Management Committee, the Audit Committee and the Related-Party Transactions Control Committee. The Audit Committee of the Board of Supervisors had been readjusted into the Supervision Committee. After the adjustments, the organization and structure of the specialized committees under the Board of Directors and the Board of Supervisors will better meet the requirements of the regulatory authorities both in the Mainland China and Hong Kong, and better highlight their respective duties.

3. Amended the "Implementation Rules of Specialized Committees under the Board of Directors and the Board of Supervisors of China Merchants Bank Co., Ltd.", and defined the duties and authorities, work flows and rules of procedures for all specialized committees, so as to ensure that these committees will exercise their respective powers and authorities in an independent, regulated and effective way, and in line with the law.

4. Formulated the "Administrative Measures on Holdings and Changes of China Merchants Bank's A Shares Held by its Directors, Supervisors and Senior Management" and the "Administrative Measures on Holdings and Changes of China Merchants Bank's H Shares Held by its Directors, Supervisors and Senior Management" respectively according to the Mainland China and Hong Kong regulatory requirements. The implementation of the aforesaid administrative measures will strengthen the governance on the holding of and dealings in the Company's A shares and H shares by directors, supervisors and senior management members.

5. Further strengthened the supervisory and appraising functions of the Board of Supervisors. In 2008, the Board of Supervisors issued the "Appraisal Report on Duty Performance of Directors in 2007" and the "Appraisal Report on Duty Performance and Cross-Evaluation of External Supervisors in 2007" and reported the same to the general meeting. In addition, the Board of Supervisors formulated the "Policies on Evaluation of Performance of Directors by the Board of Supervisors" (Trial Implementation). With these appraisal methods, which define the scope, criteria, ways, and work procedures of the Board of Supervisors' appraisal of duty performance of Directors, and which set out the results of such appraisal and the requirements for continuous supervision, the Board of Supervisors may perform its appraisal on duty performance of the Directors in a more standardized way, and effectively fulfill its role of urging the Directors to duly perform their duties.

6. To keep the Board of Supervisors informed of the Company's operations and risk control condition in a comprehensive and timely manner through various specific reports. During the year under review, several meetings were arranged for the Board of Supervisors to review various specific reports such as the Appraisal Report on the Company's Internal Control and Audit in 2007, the Report on the Audit of Related-Party Transactions in 2007, the Report on Credit Quality for 2007, the Report on Case Reflection and Rectification of Operational Risks in 2007 as well as reports on the status of credit assets under the current macroeconomic situation and reports on some hot issues.

Having conducted a careful self-inspection, the Company was not aware of any non-compliance of its corporate governance practice with the requirements set out in CSRC's regulatory documents governing the corporate governance of listed companies. There were no irregularities in the Company's corporate governance, nor was there any disclosure of information to its major shareholders or the beneficial controlling shareholders before such information being published.

The Company has fully complied with the provisions of the Code on Corporate Governance Practices set out in Appendix 14 of the Listing Rules of the SEHK, and has been dedicated to maintain a high standard of corporate governance.

## 8.3 Information about general meetings

During the reporting period, the Company convened its 2007 Annual General Meeting in Shenzhen on 27 June 2008. The notice and the convening, holding and voting procedures of the meeting all complied with the Company Law, the Articles of Association and the relevant requirements of the Listing Rules of the SEHK. At the meeting, the 2007 Work Report of the Board of Directors, the 2007 Work Report of the Board of Supervisors, the 2007 Audited Financial Report, the 2007 Report on Final Finance Account, the 2007 Proposed Profit Appropriation Plan, the Resolution Regarding the Appointment of Accounting Firm for the Years 2008 and 2009 and the Determination of their Remuneration, the Duty Performance and Cross-Evaluation Reports of Independent Non-Executive Directors, the Appraisal Report on Duty Performance of Directors in 2007, the Appraisal Report on Duty Performance and Cross-Evaluation of External Supervisors, the Related-Party Transactions Report for 2007, the Proposal on Acquisition of Part of the Equity Interest of CIGNA & CMC Life Insurance Company Ltd. and the Proposal on Acquisition of Wing Lung Bank Limited by China Merchants Bank Co., Ltd. were considered and approved as ordinary resolutions by way of poll, and the Proposal on Issuance of Subordinated Debts in the Domestic and/or Overseas Market by China Merchants Bank Co., Ltd. was considered and approved as a special resolution by way of poll.

Resolutions of the Company's 2007 Annual General Meeting were published on *China Securities Journal*, *Shanghai Securities News*, *Securities Times*, the websites of Shanghai Stock Exchange, Hong Kong Stock Exchange and the Company on 28 June 2008 respectively.

## 8.4 Board of Directors

The Board of Directors is the core of our corporate governance. The Company implements a system in which the President assumes full responsibility under the leadership of the Board of Directors, which in turn is an independent policy-making body of the Company, responsible for execution of the resolutions passed by the general meetings; devising the Company's major principles, policies and development plans; deciding on the Company's operating plans, investment proposals and the establishment of internal management organs; preparing annual financial budgets, final accounts and profit appropriation plans; and appointing members of the senior management. The Company's management team has discretionary powers in terms of operation, and the Board of Directors will not interfere with any specific matters in the Company's daily operation and management.

### 8.4.1 Composition of the Board of Directors

As at 31 December 2008, the Board of Directors of the Company had 18 members, including 9 non-executive directors, 3 executive directors, and 6 independent non-executive directors. All non-executive directors come from large state-owned enterprises where they hold key positions and are experienced in management. Most of them have work experience in the financial industry. All 3 executive directors have long been engaged in the management of banking operations and have extensive professional experience in this area. The 6 independent non-executive directors are renowned experts in finance, accounting and law who have extensive knowledge of the development of the domestic and overseas banking industry, with one from Hong Kong who is proficient in international accounting standards and Hong Kong capital market.

Such composition of the Board of Directors of the Company has brought about diversified management experience, and has maintained strong independent elements which enable each Director to make independent judgments effectively.

The list of directors is set out in Section VII of this report. To comply with the Listing Rules of the Hong Kong Stock Exchange, the independent non-executive directors have been clearly identified in all corporate communications of the Company which disclose their names.

### 8.4.2 Appointment, re-election and removal of directors

In accordance with the Articles of Association of the Company, the directors of the Company shall be elected or replaced by shareholders at general meetings, and the term of office for a director shall be three years. The qualifications as a director of the Company shall be verified by the CBRC of the State Council. The term of office for a director of the Company shall commence from the date of passing of the relevant resolution at a general meeting and expire on the date of expiry of the current session of the Board of Directors. A director is eligible for re-election upon the expiry of his term of office. The appointment of a director shall not be terminated without any justification at a general meeting before the expiry of his term of office. A director may be removed by an ordinary resolution at a general meeting before the expiry of his term of office in accordance with the relevant laws and administrative regulations (however, any claim which may be made in accordance with any contract will not be affected). The term of office for an independent director of the Company shall be the same as that for a director of the Company. The term of office for an independent director of the Company shall comply with the relevant laws and requirements of the governing authority.

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 experience of every candidate for director and recommends suitable candidates to the Board of Directors. Upon passing the candidate nomination proposal, the Board of Directors proposes election of related candidates at a general meeting and proposes the relevant resolution at a general meeting for consideration and approval. Except the independent non-executive directors, which will be treated individually due to the restriction of their terms of office, other new directors shall, upon expiry of the current Board of Directors (the term of office for each session is 3 years), be subject to re-election at the general meeting together with other members of the Board, and they will not be subject to individual re-election at the first general meeting after their appointment.

### 8.4.3 Responsibilities of directors

During the reporting period, each director of the Company is fully aware of his responsibilities as a director of the Company and has devoted sufficient time and attention to the business of the Company. Their attendance of meetings has been satisfactory, with the attendance rates of every director reaching 80% or above.

The Company also pay high attention to the continuous training of directors, so as 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 laws and the regulatory requirements of CBRC, CSRC, Shanghai Stock Exchange, Hong Kong Stock Exchange and the Articles of Association of the Company. The Company has renewed the "liability insurance for directors and senior management". During the reporting period, the Company also initiated the practice of annual appraisal of the performance of directors, which was performed by the Board of Supervisors, and the practice of making an annual report on their duty performance and cross-evaluation by independent non-executive directors and external supervisors respectively. The appraisal results shall be reported to the general meeting.

The independent non-executive directors of the Company have presented their professional advice on the resolutions reviewed by the Board of Directors, especially offered their respective independent written opinions on matters regarding the appointment of senior management personnel, the grant of H shares appreciation rights to senior management personnel, and major related party transactions. In addition, the independent non-executive directors of the Company played an active role in each specialized committee. The independent non-executive directors constitute the majority membership and act as convener in the Nomination Committee, the Remuneration and Appraisal Committee, the Audit Committee and the Related Party Transactions Control Committee of the Company. At least one independent non-executive director is an accounting professional in the Audit Committee and the Related-Party Transactions Control Committee. Such structure of the specialized committees serves to strengthen the responsibility consciousness of independent non-executive directors and makes full advantage of their professional dominance. They have provided a lot of valuable professional and independent advice regarding corporate governance and operation management of the Company, and played a positive role in facilitating the decision making of the Board of Directors.

## 8.4.4 Chairman of the Board and Chief Executive Officer ("CEO")

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

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

## 8.4.5 Attendance at Meetings of the Board of Directors

During the reporting period, the Board of Directors of the Company held a total of 19 meetings (3 physical meetings and 16 meetings by way of written resolutions), at which major issues involving the strategies, policies, finance and operations of the Company were reviewed and approved.

The following table sets out the records of attendance of the respective directors at physical board meetings held in the year ended 31 December 2008.

| Name of Director | Number of meetings attended/ Number of meetings held (Note) |
|---|---|
| **Non-Executive Directors** | |
| Qin Xiao | 19/19 |
| Wei Jiafu | 18/19 |
| Fu Yuning | 17/19 |
| Li Yinquan | 19/19 |
| Hong Xiaoyuan | 19/19 |
| Ding An hua Edward | 19/19 |
| Sun Yueying | 18/19 |
| Wang Daxiong | 18/19 |
| Fu Junyuan | 18/19 |
| **Executive Directors** | |
| Ma Weihua | 19/19 |
| Zhang Guanghua | 19/19 |
| Li Hao | 19/19 |
| **Independent Non-Executive Directors** | |
| Wu Jiesi | 18/19 |
| Chow Kwong Fai, Edward | 19/19 |
| Liu Yongzhang | 18/19 |
| Liu Hongxia | 18/19 |
| Yan Lan | 18/19 |
| Yi Xiqun | 19/19 |

Notes: During the year ended 31 December 2008, the Board of Directors held 3 physical meetings and 16 meetings were held by way of written resolutions.

## 8.4.6 Meetings of the Board and contents of resolutions

1. The 14th meeting of the Seventh Session of the Board was convened on 23 January 2008 by way of written resolutions. The "Resolution on Continuing Related Transactions in 2008" and the "Announcement regarding the Caps for Continuing Related Transactions for 2008" were considered and passed with 18 out of the 18 directors casting votes. The "Announcement regarding the Caps for Continuing Related Transactions for 2008" was published on *China Securities Journal*, *Shanghai Securities News* and *Securities Times* on 24 January 2008 and on the websites of the Shanghai Stock Exchange, the Hong Kong Stock Exchange and the Company.

2. The 15th meeting of the Seventh Session of the Board was convened on 4 February 2008 by way of written resolutions. The "Resolution on Adjustment to Members of Specialized Committees of the Seventh Session of the Board" was considered and passed with 18 out of the 18 directors casting votes. The resolution was published on *China Securities Journal*, *Shanghai Securities News* and *Securities Times* on 5 February 2008 and on the websites of the Shanghai Stock Exchange, the Hong Kong Stock Exchange and the Company.

3. The 16th meeting of the Seventh Session of the Board was convened on 10 March 2008 by way of written resolutions. The "Resolution on Material Related Party Transactions" and the "Resolution on Funding of Start-up Expenses and Working Capital for New York Branch" were considered and passed with 18 out of the 18 directors casting the vote.

4. The 17th meeting of the Seventh Session of the Board was held on 18 March 2008 in Shenzhen. 12 out of the 18 directors attended the meeting. Wei Jiafu and Fu Yuning (both being directors) appointed Qin Xiao as proxy, Sun Yueying (director) appointed Fu Junyuan (director) as proxy, Wu Jiesi and Liu Hongxia (both being independent non-executive directors) appointed Chow Kwong Fai, Edward (independent non-executive director) as proxy, Liu Yongzhang (independent non-executive director) appointed Yan Lan (independent non-executive director) as proxy, to vote. 7 supervisors of the Company were present. Resolutions regarding the Working Report of the Directors for 2007, the Working Report of the President for 2007, the 2007 Annual Report, the 2007 Financial Statements and 2008 Budget Report, 2007 Profit Appropriation Preliminary Plan were passed in the meeting. The resolutions were published on *China Securities Journal*, *Shanghai Securities News* and *Securities Times* on 19 March 2008 and on the websites of the Shanghai Stock Exchange, the Hong Kong Stock Exchange and the Company.

5. The 18th meeting of the Seventh Session of the Board was convened on 8 April 2008 by way of written resolutions. The "Resolution on Appointment of Ding Wei as Executive Vice President of China Merchants Bank" was considered and passed with 18 out of the 18 directors casting votes. The resolution was published on *China Securities Journal*, *Shanghai Securities News* and *Securities Times* on 9 April 2008 and on the websites of the Shanghai Stock Exchange, the Hong Kong Stock Exchange and the Company.

6. The 19th meeting of the Seventh Session of the Board was convened on 22 April 2008 by way of written resolutions. The "First Quarterly Report for 2008" of the Company was considered and passed with 18 out of the 18 directors casting votes. The "First Quarterly Report for 2008" was published on *China Securities Journal*, *Shanghai Securities News* and *Securities Times* on 23 April 2008 and on the websites of the Shanghai Stock Exchange, the Hong Kong Stock Exchange and the Company.

7. The 20th meeting of the Seventh Session of the Board was convened on 5 May 2008 by way of written resolutions. The "Resolution on Acquisition of 50% Equity Interest of CIGNA & CMC Life Insurance Company Ltd." and the "Resolution on Convening the 2007 Annual General Meeting" were considered and passed with 18 out of the 18 directors casting votes. The resolutions were published on *China Securities Journal*, *Shanghai Securities News* and *Securities Times* on 6 May 2008 and on the websites of the Shanghai Stock Exchange, the Hong Kong Stock Exchange and the Company.

8. The 21st meeting of the Seventh Session of the Board was held on 14 May 2008 in Shenzhen. 15 out of the 18 directors attended the meeting. Fu Yuning (director) appointed Qin Xiao as proxy, Fu Junyuan (director) appointed Li Yinquan as proxy, Yan Lan (independent non-executive director) appointed Liu Yongzhang as proxy, to vote. 5 supervisors of the Company were present. The "Resolution on the Acquisition of Wing Lung Bank Limited" and the "Resolution on the Issue of Subordinated Capital" were passed in the meeting. The issues related to the resolutions were published on *China Securities Journal*, *Shanghai Securities News* and *Securities Times* on 3 June 2008 and on the websites of the Shanghai Stock Exchange, the Hong Kong Stock Exchange and the Company.

9. The 22nd meeting of the Seventh Session of the Board was convened on 29 May 2008 by way of written resolutions. The relevant resolutions were considered and passed with 18 out of the 18 directors casting the vote.

10. The 23rd meeting of the Seventh Session of the Board was convened on 25 June 2008 by way of written resolutions. The relevant resolutions were considered and passed with 18 out of the 18 directors casting the vote.

11. The 24th meeting of the Seventh Session of the Board was convened on 18 July 2008 by way of written resolutions. The "Explanation of Rectification of Specific Matters relating to Corporate Governance of China Merchants Bank Co., Ltd." and the "Summary Report of China Merchants Bank Co., Ltd. on Internal Inspection into the Use of Funds by the Major Shareholders and their Related Parties" were considered and passed with 18 out of the 18 directors casting votes. The relevant announcement on resolutions was published on *China Securities Journal*, *Shanghai Securities News* and *Securities Times* on 21 July 2008 and on the websites of the Shanghai Stock Exchange, the Hong Kong Stock Exchange and the Company.

12. The 25th meeting of the Seventh Session of the Board was convened on 25 July 2008 by way of written resolutions. The "Resolution on Authorizations Given by the Legal Representative to the President of CMB" and the "Resolution on Material Related Party Transactions" were considered and passed with 18 out of the 18 directors casting the vote.

13. The 26th meeting of the Seventh Session of the Board was convened on 12 August 2008 by way of written resolutions. The "Implementation Rules for Specialized Committees under the Board of China Merchants Bank Co., Ltd." (revised in 2008), the "Resolution on Issuing 'Comfort Letter' to the Hong Kong Monetary Authority", the "Resolution on Application to the Federal Reserve Bank of the United States for Opening and Maintaining Accounts", the "Resolution on Application to the Federal Reserve Bank of the United States for Establishing Borrowing Qualifications" and the "Resolution on Material Related Party Transactions" were considered and passed with 18 out of the 18 directors casting votes. The relevant announcements on the resolutions were published on *China Securities Journal*, *Shanghai Securities News* and *Securities Times* on 13 August 2008 and on the websites of the Shanghai Stock Exchange, the Hong Kong Stock Exchange and the Company.

14. The 27th meeting of the Seventh Session of the Board was convened on 18 August 2008 in Harbin. 14 out of the 18 directors attended the meeting. Wei Jiafu, Sun Yueying (directors) and Wu Jiesi (independent non-executive director) attended the meeting by phone. Wang Daxiong (director) appointed Fu Junyuan (director) as proxy to vote. 8 supervisors of the Company were present. Resolutions regarding the full texts and summaries of the Working Report of the President for the Interim Period of 2008 and the 2008 Interim Report were passed in the meeting. The resolutions were published on *China Securities Journal*, *Shanghai Securities News* and *Securities Times* on 19 August 2008 and on the websites of the Shanghai Stock Exchange, the Hong Kong Stock Exchange and the Company.

15. The 28th meeting of the Seventh Session of the Board was convened on 26 September 2008 by way of written resolutions. The joint announcement on completion of acquisition of 53.12% equity interest of WLB, the joint announcement on despatch of the composite offer document and response document, the composite offer document and the form of acceptance and transfer were considered and passed at the meeting with 18 out of the 18 directors casting votes. The relevant resolutions were published on *China Securities Journal*, *Shanghai Securities News* and *Securities Times* dated 6 October 2008 and on the websites of the Shanghai Stock Exchange, the Hong Kong Stock Exchange and the Company.

16. The 29th meeting of the Seventh Session of the Board was convened on 29 October 2008 by way of written resolutions. The "Third Quarterly Report for 2008" of the Company and the "Internal Audit Procedures of China Merchants Bank Co., Ltd." were considered and passed at the meeting with 18 out of the 18 directors casting votes. The relevant materials were published on *China Securities Journal*, *Shanghai Securities News* and *Securities Times* dated 30 October 2008 and on the websites of the Shanghai Stock Exchange, the Hong Kong Stock Exchange and the Company.

17. The 30th meeting of the Seventh Session of the Board was convened on 7 November 2008 by way of written resolutions. The "Resolution on Phase II of the Grant of H Shares Appreciation Rights to the Senior Management of China Merchants Bank", the "Resolution on Appointment of Zhu Qi as Executive Vice President of China Merchants Bank" and the "Resolution on Material Related Party Transactions" were considered and passed at the meeting with 18 out of the 18 directors casting votes. The resolutions were published on *China Securities Journal*, *Shanghai Securities News* and *Securities Times* dated 8 November 2008 and on the websites of the Shanghai Stock Exchange, the Hong Kong Stock Exchange and the Company.

18. The 31st meeting of the Seventh Session of the Board was convened on 8 December 2008 by way of written resolutions. The "Administrative Measures for Holdings of and Changes in China Merchants Bank's A Shares by its Directors, Supervisors and Senior Management", the "Administrative Measures for Holdings of and Changes in China Merchants Bank's H Shares by its Directors, Supervisors and Senior Management", the "Resolution of Material Related Party Transactions" and the "Resolution on Approving the 'Confidentiality and Anti-Money Laundering Policies' of the New York Branch" were considered and passed at the meeting with 18 out of the 18 directors casting votes. The resolutions were published on *China Securities Journal*, *Shanghai Securities News* and *Securities Times* dated 9 December 2008 and on the websites of the Shanghai Stock Exchange, the Hong Kong Stock Exchange and the Company.

19. The 32nd meeting of the Seventh Session of the Board was convened on 24 December 2008 by way of written resolutions. The "Resolution on Write-off of Large Amount of Bad Debts and Loans for the Second Half of 2008" was considered and passed at the meeting with 18 out of the 18 directors casting votes.

Through the meetings mentioned above, the Board of the Company considered and passed approximately 70 proposals, including four quarterly reports, the work report of the Boards of Directors and Supervisors, the work report of the President, the Final Finance Report and the Financial Budget Report, the profit appropriation preliminary plan, the "Mid-Term Development Strategic Plan of China Merchants Bank (2008-2010)", the "Proposal on Acquisition of 50% Equity Interest of CIGNA & CMC Life Insurance Company Ltd.", the "Proposal on Acquisition of Shares of Wing Lung Bank Limited", the "Proposal on Acquisition of the Controlling Interest in the Trust and Investment Corporation of Tibet Autonomous Region", the "Proposal on Issuance of Subordinated Debts", the "Proposal on the Work Plan for the Implementation of the New Capital Accord", the "Administrative Measures for Related-Party Transactions of China Merchants Bank Co., Ltd." (2008 Revised Edition), the compliance risk management report, material related-party transactions and the written-off of large amount of bad debts, etc.

## 8.4.7 Implementation by the Board of Directors of resolutions passed at shareholders' general meetings

1. According to the "Resolution on Profit Appropriation for the Year 2007" considered and passed at the 2007 Annual General Meeting of the Company, the profit appropriation plan of the Company was as follows: 10% of the profit after tax in the audited financial statements (domestic edition), which amounted to RMB1.524 billion, was transferred to the statutory surplus reserve. Regulatory general reserve was RMB3.0 billion. The profit available for distribution to shareholders for the current year was RMB12.093 billion. Based on the total share capital of A shares and H shares, the Company proposed to declare a cash dividend (including tax) of RMB2.80 (denominated in RMB) for every 10 shares, payable in RMB for A share-shareholders and in HK Dollars for H share-shareholders. The actual profit appropriation amount in HK Dollars would be calculated based on the average rate of PBOC's RMB/HKD benchmark rates for the week before the date of the general meeting (inclusive). The retained profits would be carried forward to next year. The Board of Directors of the Company had already implemented the above-mentioned dividend distribution scheme.

2. Pursuant to the "Resolution on Acquisition of Certain Equity Interest in CIGNA & CMC Life Insurance Company Ltd." considered and passed at the 2007 Annual General Meeting of the Company, the Board of Directors of the Company has authorized the management team to effect the equity acquisition, which is pending approval from the relevant regulatory authorities.

3. Pursuant to the "Resolution on Acquisition of Wing Lung Bank Limited" considered and passed at the 2007 Annual General Meeting of the Company, the Board of the Company has authorized the management team to effect the equity acquisition.

4. Pursuant to the "Resolution on Issuance of Subordinated Debts in Domestic and/or Overseas Markets by China Merchants Bank Co., Ltd." considered and passed at the 2007 Annual General Meeting of the Company, the Board of the Company has authorized the management team to effect the issuance of subordinated debts.

## 8.4.8 Securities transactions of directors, supervisors and the relevant employees

The Company has adopted the Model Code set out in Appendix 10 to the Listing Rules of Hong Kong Stock Exchange as the code of conduct for directors and supervisors of the Company in respect of their dealings in the Company's securities. Having made specific enquiry of all the directors and supervisors, the Company confirmed that they had complied with the aforesaid Model Code throughout the year ended 31 December 2008.

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

## 8.4.9 Performance of duties by independent non-executive directors

The Board of Directors of the Company currently comprises 6 independent non-executive directors, the qualification, number and proportion of whom fully meet the relevant requirements of the CBRC, CSRC, the listing rules of the Shanghai Stock Exchange and Hong Kong Stock Exchange. Among all the members of the Nomination Committee, the Remuneration and Appraisal Committee, the Audit Committee and the Related-Party Transactions Control Committee under the Board of Directors of the Company, the majority are independent non-executive directors, who also act as chairmen. During the reporting period, the 6 independent non-executive directors maintained communication with the Company through on site visits and conferences, and attended meetings of the Board and the specialized committees, actively expressed their opinions and attended to the interests and requests of small and medium shareholders, and fully performed their functions as independent non-executive directors.

During the reporting period, the independent non-executive directors expressed independent opinions on material issues including related transactions of the Company, appointment of senior management staff and the proposal for the second grant of H share appreciation rights, and they made no dissent to the proposals of the Board of Directors nor any non-board proposals and matters during the year.

According to the "Rules Governing Independent Directors' Work on Annual Reports" of the Company and the CSRC Announcement (【2008】 No.48) dated 26 December 2008, the independent non-executive directors of the Company performed the following duties in preparing and reviewing the annual report for this year.

1. The independent non- executive directors received reports from the management and Chief Financial Officer on the operations, financial condition and operating results of the Company in 2008 and on significant matters such as investment and financing activities, and carried out on site inspection at the recently acquired Wing Lung Bank. The independent non-executive directors considered the reports prepared by the management of the Company were on an objective basis and had fully reflected the operating results of the Company in 2008 as well as the progress of significant matters, and they recognized and were satisfied with the measures taken by the management team and the results recorded in 2008.

2. Prior to the annual audit conducted by the accounting firm in charge of the annual audit, the independent non-executive directors discussed with the certified public accountants in respect of the composition of the auditing team, the auditing plan, risk judgement, tests and assessment on risks and embezzlement as well as the key aspects of audit for the year.

3. After receiving the initial audit opinions from the auditors, the independent non-executive directors discussed the major issues with the auditors and formed their written opinions.

## 8.4.10 Attendance of non-executive directors at board meetings

| Name of independent non-executive director | Times of attendance required for the year | Attendance in person (times) | Attendance by proxy (times) | Absence (times) | Remarks |
|---|---|---|---|---|---|
| Wu Jiesi | 19 | 18 | 1 | 0 | Appointed Chow Kwong Fai, Edward (an independent non-executive director) to exercise voting rights at 17th meeting of the Seventh Session of the Board of Directors. |
| Chow Kwong Fai, Edward | 19 | 19 | 0 | 0 | |
| Liu Yongzhang | 19 | 18 | 1 | 0 | Appointed Yan Lan (an independent non-executive director) to exercise voting rights at 17th meeting of the Seventh Session of the Board of Directors. |
| Liu Hongxia | 19 | 18 | 1 | 0 | Appointed Chow Kwong Fai, Edward (an independent non-executive director) to exercise voting rights at 17th meeting of the Seventh Session of the Board of Directors. |
| Yan Lan | 19 | 18 | 1 | 0 | Appointed Liu Yongzhang (an independent non-executive director) to exercise voting rights at 21st meeting of the Seventh Session of the Board of Directors. |
| Yi Xiqun | 19 | 19 | 0 | 0 | |

## 8.5 Specialized Committees of the Board of Directors

At the 15th Meeting of the Seventh Session of the Board of Directors of the Company held on 4 February 2008, the "Proposal for Changes in the Constitution of the Specialized Committees of the Seventh Session of the Board of Directors" was considered and passed. Pursuant to the resolutions passed at the 15th Meeting of the Seventh Session of the Board of Directors, the number of specialized committees of the Board of the Directors was increased from the original five (namely, the Executive Committee, the Audit and Related-Party Transactions Control Committee, the Risk Management Committee, the Remuneration and Appraisal Committee and the Nomination Committee) to six (namely, the Strategy Committee, the Nomination Committee, the Remuneration and Appraisal Committee, the Risk Management Committee, the Audit Committee and the Related-Party Transactions Control Committee), and the members and chairmen for each specialized committee were also approved.

The structure of the adjusted specialized committees is more compliant with the requirements of domestic and international regulatory authorities, and can better reflect their respective functions. The independent non-executive directors constitute the majority membership and act as chairmen in the Nomination Committee, the Remuneration and Appraisal Committee, the Audit Committee and the Related-Party Transactions Control Committee of the Company. At least one independent non-executive director in the Audit Committee and the Related-Party Transactions Control Committee has professional accounting expertise. All members of the Audit Committee are non-executive directors. The functions of the Strategy Committee are reinforced by defining its main duty as setting the operational targets and the long and medium term development strategies for the Company. The responsibilities of the Audit Committee become more specific. As the liaison between the Board of Directors and the internal and external auditors, the Audit Committee is responsible for reviewing the contents and process of both domestic and overseas financial reports, examining the internal control system as well as instructing and monitoring the internal audit affairs of the Company. The functions of the Risk Management Committee are further expanded to include monitoring and evaluation of the Company's exposures to credit risks, market risks, operational risks and compliance risks, conducting regular assessment of the risk management and risk tolerance of the Company and determining and adjusting the risk preference index of the Company accordingly.

At the 26th Meeting of the Seventh Session of the Board of Directors of the Company held on 12 August 2008, the revised "Implemention Rules for Specialized Committees of the Board of Directors of China Merchants Bank Co., Ltd." was considered and passed. In the revised version, the respective authorities and duties, work procedures and proceeding rules of each committee were specified, so that the committees can perform their duties, supervise the different matters of the Company in an independent, standard and effective manner, and report the same to the Board of Directors to guarantee its efficient operations and rational decisions.

In 2008, the specialized committees of the Board of Directors of the Company operated under the adjusted structure, responsibilities and composition, and held a total of 22 meetings, including 1 Strategy Committee meeting, 2 Nomination Committee meetings, 1 Remuneration and Appraisal Committee meeting, 5 Risk Management Committee meetings, 4 Audit Committee meetings and 9 Related Party Transactions Control Committee meetings. The specialized committees have completed a series of inspections and reviews on special topics and substantial issues, which have been proposed to the Board of Directors and the general meetings for approval, and thereby the corporate governance and operational efficiency of the Company are enhanced.

The composition and duties of the six committees and their work performed in 2008 are summarized as follows:

## 8.5.1 Strategy Committee

The Strategy Committee consists of equity holding directors and directors from senior management, including non-executive directors Fu Yuning (chairman), Wei Jiafu, Wang Daxiong and Fu Junyuan, and executive director Ma Weihua.

Main authorities and duties:

- to formulate operational goals and medium to long term development strategies of the company;
- to supervise and examine implementation of the Company's annual operating plans and investment proposals;
- to examine and supervise implementation of the Board's resolutions; and
- to put forward proposals and plans for important issues to be discussed and decided by the Board.

In 2008, the "Proposal on Medium Term Development Strategies for China Merchants Bank (2008-2010)" was considered and passed by the Strategy Committee.

During the reporting period, the Strategy Committee of the Company held no physical meeting but one meeting by way of written resolutions. The attendance record is as follows:

| Member | Number of meetings attended/ Number of meetings held |
|---|---|
| **Non-Executive Directors** | |
| Fu Yuning (Chairman) | 1/1 |
| Wei Jiafu | 1/1 |
| Wang Daxiong | 1/1 |
| Fu Junyuan | 1/1 |
| **Executive Director** | |
| Ma Weihua | 1/1 |

## 8.5.2 Nomination Committee

The Nomination Committee is composed of a majority of the independent non-executive directors with one serving as the chairman. The current members of the Nomination Committee includes Yan Lan (chairman), Liu Yongzhang, Liu Hongxia (all being independent non-executive directors), Fu Yuning (non-executive director) and Ma Weihua (executive director).

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;
- to make preliminary examination on the qualifications of the candidates for directors and senior management and put forward proposals; and
- to execute other duties as may be delegated by the Board of Directors.

In 2008, the Nomination Committee approved the qualifications of Ding Wei and Zhu Qi as executive vice presidents of the Company.

During the reporting period, the Nomination Committee held no physical meeting but two meetings were held by way of written resolutions. The attendance record is as follows:

| Member | Number of meetings attended/ Number of meetings held |
|---|---|
| **Independent Non-Executive Directors** | |
| Yan Lan (Chairman) | 2/2 |
| Liu Yongzhang | 2/2 |
| Liu Hongxia | 2/2 |
| **Non-Executive Director** | |
| Fu Yuning | 2/2 |
| **Executive Director** | |
| Ma Weihua | 2/2 |

## 8.5.3 Remuneration and Appraisal Committee

Current members of the Remuneration and Appraisal Committee, with independent non-executive directors forming the majority of the membership, including Wu Jiesi (chairman), Liu Yongzhang, Yi Xiqun (all being independent non-excutive directors), Li Yinquan and Fu Junyuan (both being non-executive directors).

Main authorities and duties:

- to study and propose standards for appraising directors and senior management, to conduct appraisals and provide advices based on the actual situation of the Company;
- to study and formulate the remuneration policies and plans for directors and senior management; and
- to execute other duties as may be delegated by the Board of Directors.

In 2008, the Remuneration and Appraisal Committee considered the second round of grant under H Shares Appreciation Rights Incentive Plan for the Senior Management of the Company which was subsequently submitted to the Board of Directors for implementation. The Remuneration and Appraisal Committee reviewed the remunerations of Senior Management in accordance with Measures on Remunerations of Senior Management of the Company and was of the view that such remunerations conformed to the Company's remuneration policies. The Committee also requested KPMG Huazhen Certified Public Accountants, to perform agreed-upon procedures for the execution of these polices. The remunerations of the independent non-executive directors and external supervisors paid by the Company also conformed to the Company's relevant policies on remuneration.

The Remuneration and Appraisal Committee reviewed the remunerations of the independent non-executive directors, external supervisors and senior management and the second round of grant under the H Shares Appreciation Rights Incentive Plan disclosed in the annual report for 2008 and was of the view that they were in line with the implementation of the Company's relevant polices on remuneration management system, remuneration packages and incentive plans.

During the reporting period, the Remuneration and Appraisal Committee held no physical meeting but one meeting was held by way of written resolutions. The attendance record is as follows:

| Member | Number of meetings attended/ Number of meetings held |
|---|---|
| **Independent Non-Executive Directors** | |
| Wu Jiesi (Chairman) | 1/1 |
| Liu Yongzhang | 1/1 |
| Yi Xiqun | 1/1 |
| **Non-Executive Directors** | |
| Li Yinquan | 1/1 |
| Fu Junyuan | 1/1 |

### 8.5.4 Risk Management Committee

The members of the Risk Management Committee are Yi Xiqun (independent non-executive director), Hong Xiaoyuan (chairman), Wang Daxiong, Sun Yueying (all being non-executive directors), and Li Hao (executive director).

Main authorities and duties:

- to monitor the risk management of the Company's exposures to credit risks, market risks and operational risks, etc. by the senior management;
- to conduct regular assessment of the risk position of the Company and to conduct evaluations of the procedures and performances of internal auditors;
- to put forward proposals on the improvement of the risk management and internal control of the Company; and
- to execute other duties as may be delegated by the Board of Directors.

In 2008, the Risk Management Committee considered and passed the proposals on the write-off of large amount of bad debts, and proposals on reduction and exemption of principal and interest of certain loans. The Risk Management Committee studied and reviewed the report on rethinking of the cases in 2007 and improvement of operational risk prevention measures, the report on implementation of New Basel II Capital Accord, the report on implementation of overall risk management, the report on provision models and provision policies, the report on management of market risks, the report on assets quality and credit risk management as well as the report on the performance of the Board of Directors in risk management as assessed by the National Audit Office. In addition, the working schedule for the Risk Management Committee in 2009 has been duly studied and organized.

During the reporting period, the Risk Management Committee held 3 physical meetings and 2 meetings were held by way of written resolutions. The attendance record of the meetings is as follows:

| Member | Number of meetings attended/ Number of meetings held |
|---|---|
| **Non-Executive Directors** | |
| Hong Xiaoyuan (chairman) | 5/5 |
| Wang Daxiong | 5/5 |
| Sun Yueying | 4/5 |
| **Executive Director** | |
| Li Hao | 5/5 |
| **Independent Non-Executive Director** | |
| Yi Xiqun | 5/5 |

### 8.5.5 Audit Committeee

The majority of the members of the Audit Committee was independent non-executive directors, with one of them serving as the chairman. The members include Liu Hongxia (chairman), Chow Kwong Fai, Edward,Yan Lan (all being independent non-executive directors), Sun Yueying and Ding An Hua, Edward (both being non-executive directors). It was found after investigation that no member of the Audit 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 the 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 execute other duties as may be delegated by the Board of Directors.

In 2008, the Audit Committee considered and approved the annual report for 2007 and the interim report for 2008, the auditors' review reports on the interim financial reports for 2007 and 2008 respectively, the proposal on re-appointment of external auditors and the Company's internal Audit Charter. In addition, the committee also studied and reviewed the management's report on the operations and the progress of significant matters of the Company for 2007, the auditors' report on auditing for 2007 and the internal audit department's report on auditing works.

According to "Work Procedures on Annual Report for Audit Committee of the Board of Directors" adopted by the Company and the Announcement 【2008】 No. 48 issued by CSRC on 26 December 2008, the Audit Committee of the Board of Directors of the Company performed the following duties in preparing and reviewing the report for this year:

1. Before the auditors commenced the annual audit, the 2008 audit plan was reviewed and the Company's financial statements for 2008 were considered. The Committee also issued a written consent agreeing to submit the financial statements to the auditors for annual audit.

2. In the course of conducting annual audit and after a preliminary audit opinion being issued by the external auditors, the Audit Committee reviewed the management's report on the operations and the progress of significant matters of the Company for 2008. The Audit Committee exchanged opinions on the significant matters and the audit progress with the external auditors conducting annual audit and reviewed the financial statements of the Company again. The Audit Committee then made written opinions for the above issues.

3. Before the annual meeting of Board of Directors commenced, the Audit Committee voted on and made a resolution on the Company's Annual Report for 2008 which was submitted to the Board of Directors for consideration and approval. Moreover, the Audit Committee reviewed and issued a conclusion report on the audit works performed by the external auditors in respect of the Company's financial statements for the year 2008 to the Board of Directors.

During the reporting period, the Audit Committee held 1 physical meeting and 3 meetings by way of written resolutions. The attendance record is as follows:

| Member | Number of meetings attended/ Number of meetings held |
|---|---|
| **Independent Non-Executive Directors** | |
| Liu Hongxia (Chairman) | 3/4 |
| Chow Kwong Fai, Edward | 4/4 |
| Yan Lan | 4/4 |
| **Non-Executive Directors** | |
| Sun Yueying | 3/4 |
| Ding An Hua Edward | 4/4 |

## 8.5.6 Related-Party Transactions Control Committee

The majority of members of the Related-Party Transactions Control Committee are independent non-executive directors, with one serving as the chairman. The members include Chow Kwong Fai, Edward (chairman), Wu Jiesi and Liu Hongxia (all being independent non-executive directors), Hong Xiaoyuan (non-executive director) and Zhang Guanghua (executive director).

Main authorities and duties:

- to identify related parties of the Company according to relevant laws and regulations;

- to inspect, supervise and review major related transactions and continuing related transactions, and to control the risks associated with related transactions;

- to review the administrative measures on related transactions of the Company, and to monitor the establishment and improvement of the related transactions management system of the Company;

- to review the announcements on related-party transactions of the Company.

In 2008, the Related-Party Transactions Control Committee considered and approved the resolutions on determining the caps of the continuing related transactions for 2008, administrative measures on related transactions, the report on related transactions for 2007, the audit report on related transactions for 2007, and the resolutions on determining the caps of the continuing related transactions for 2009-2011. In addition, the committee also completed reviews on 12 major related transactions, including 7 related transactions for credit granting, 4 major related transactions relating to the lead underwriting of finance notes, and 1 related transaction for acquistion.

During the reporting period, the Related-Party Transactions Control Committee did not hold any physical meeting, but held 9 meetings by way of written resolutions. The attendance record is as follows:

| Member | Number of meetings attended/ Number of meetings held |
|---|---|
| **Independent Non-Executive Directors** | |
| Chow Kwong Fai, Edward (Chairman) | 9/9 |
| Wu Jiesi | 8/8[Note] |
| Liu Hongxia | 9/9 |
| Yan Lan | 1/1[Note] |
| **Non-Executive Directors** | |
| Hong Xiaoyuan | 8/8[Note] |
| Ding An Hua, Edward | 1/1[Note] |
| Wang Daxiong | 1/1[Note] |
| **Executive Director** | |
| Zhang Guanghua | 8/8[Note] |

Note: In February 2008, the Company split the Audit and Related Party Transaction Control Committee into the Audit Committee and the Related-Party Transaction Control Committee and changed the composition of the Related-Party Transaction Control Committee, which resulted in the difference in number of meetings attended by certain members.

## 8.6 Board of Supervisors

The Board of Supervisors is established to monitor the Company's financial position, compliance with laws and regulations, the performance of duties by the Board of Directors and managements, thereby protecting the interests of depositors and shareholders.

### 8.6.1 Composition of the Board of Supervisors

The Company's Board of Supervisors comprises 9 members, including 2 external supervisors, 4 shareholder representative supervisors and 3 employee representative supervisors. The Nomination Committee and the Supervision Committee are established under the Board of Supervisors.

### 8.6.2 How the Board of Supervisors performs its supervisory duties

The duties of the Board of Supervisors are to inspect and supervise the operations and financial activities of the Company, the performance of directors and the senior management, and to evaluate the duty performance of directors for the year. These duties are performed by holding regular meetings, attending meetings of the Board of Directors as non-voting delegates, attending shareholders' general meetings, reviewing various documents submitted by the Company, reviewing the work reports and specific reports of the management, conducting investigations and surveys, etc.

### 8.6.3 Meetings held by the Board of Supervisors during the reporting period

From 17 March to 18 March 2008, the 5th Meeting of the Seventh Session of the Board of Supervisors of the Company was convened in Shenzhen. 9 out of the 9 eligible Supervisors were present at the meeting. At the meeting, the Work Report of the President for the year 2007, the text and the summary of the Annual Report for the year 2007, the Final Account Report for the year 2007 and the Financial Budget Report for the year 2008, the profit appropriation plan for the year 2007, the Conclusive Report on the Audit Result in Respect of the Company's Financial Statements for the year 2007, the resolution to appoint the statutory auditors and to fix their remuneration for the year 2008 and 2009, the Work Report of Board of Supervisors for the year 2007, the resolution on adjustment to Specialized Committees of the Seventh Session of the Board of Supervisors and the Appraisal Report on the Duty Performance of Directors in the year 2007 were considered and approved.

On 22 April 2008, the 6th Meeting of the Seventh Session of the Board of Supervisors was convened by way of written resolutions. 9 out of the 9 supervisors eligible for voting voted at the meeting. The First Quarterly Report of 2008 of the Company was approved at the meeting.

On 18 July 2008, the 7th Meeting of the Seventh Session of the Board of Supervisors was convened by way of written resolutions. 9 out of the 9 supervisors eligible for voting voted at the meeting. The Summary Report on Internal Inspection into the Use of Funds by the Major Shareholders and their Related Parties of the Company was considered and approved at the meeting.

From 17 August to 18 August 2008, the 8th Meeting of the Seventh Session of the Board of Supervisors of the Company was convened in Harbin. 8 out of the 9 eligible Supervisors were present at the meeting. The Work Report of the President for the first half of the year 2008, the text and the summary of the Interim Report for 2008, the resolution on Implementation Rules of the Specialized Committees of the Board of Supervisors of China Merchants Bank Co., Ltd. and the resolution on adjustment to the membership of the Specialized Committees of the Board of Supervisors was considered and approved at the meeting.

On 29 October 2008, the 9th Meeting of the Seventh Session of the Board of Supervisors was convened by way of written resolutions. 9 out of 9 supervisors eligible for voting voted at the meeting. The Third Quarterly Report of 2008 of the Company was considered and approved at the meeting.

On 7 November 2008, the 10th Meeting of the Seventh Session of the Board of Supervisors was convened by way of written resolutions. 8 out of the 9 supervisors eligible for voting voted at the meeting. An audit opinion was issued for the "Resolution on the Grant of H Share Appreciation Rights at Phase II to the Senior Management of China Merchants Bank".

On 26 December 2008, the 11th Meeting of the Seventh Session of the Board of Supervisors was convened by way of written resolutions. 9 out of the 9 supervisors eligible for voting voted at the meeting. "Policies on Evaluation of Performance of Directors by the Board of Supervisors of China Merchants Bank Co., Ltd. (Trial Implementation)" was considered and approved at the meeting.

In 2008, the Company convened one general meeting and 19 meetings of the Board of Directors. Supervisors attended the general meeting and were present at the meetings of the Board of Directors as non-voting delegates, and supervised the law and regulation compliance, voting procedures of and Directors' attendance at the general meeting and meetings of the Board of Directors.

### 8.6.4 Reviewing specific reports and conducting investigations and surveys by the Board of Supervisors

On 20 April 2008, the Board of Supervisors held a meeting in Shanghai to review four special reports, which were the "Assessment Report on the Audit of Internal Control for 2007", "Report on the Audit of the Related Party Transactions for 2007", "Report on the Quality of Credit Assets of the Company for 2007" and "Introspective Review of the Cases in 2007 and Improvement of Operational Risk Prevention Measures of the Company".

From 7 September to 12 September 2008, certain members of the Board of Supervisors visited Taiwan to conduct investigations and surveys on the corporate governance structure of commercial banks in Taiwan.

From 25 October to 26 October 2008, the Board of Supervisors conducted investigations and surveys on the situation of Changsha Branch's implementation of credit policy established by the head office and quality of credit assets, and reviewed the specific report of the Credit Management Department of the head office on the operating status of the Company's credit assets and relevant hot issues under the current macroeconomic situation.

### 8.6.5 Operation of the Specialized Committees of the Board of Supervisors

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

The members of the Nomination Committee are Shi Jiliang (chairman), Zhu Genlin and Yang Zongjian. The major duties of the Nomination Committee are as follow: 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 undertake preliminary examination on the qualifications of the candidates for supervisors nominated by shareholders and to provide relevant recommendations.

Members of the Supervision Committee are Shao Ruiqing (chairman), Chen Haoming and Zhou Song. The major duties of the Supervision Committee are to formulate specific schemes for conducting inspection of CMB's financial position, assess the duty performance of directors and senior management, and conduct supervision and investigation into the audit of resigning directors and senior management. During the reporting period, the Supervision Committee of the Board of Supervisors formulated the "Methods for Assessment on the duty performance of Directors of China Merchants Bank Co., Ltd. (Trial Implementation)".

## 8.7 Statement made by the Board about its responsibility on the financial statements

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 2008 to present a true view of the operating results of the Company. So far as the directors are aware, there are no material uncertainties relating to events or conditions that may have a significant negative effect on the Company's ability of sustainable operation.

## 8.8 Appointment of accounting firm

According to the resolutions passed at the 2007 Annual General Meeting, the Company appointed KPMG Huazhen Certified Public Accountants as the domestic auditor for the years 2008 and 2009 and KPMG Certified Public Accountants as the international auditor for the years 2008 and 2009.

The financial statements of the Group for the year 2008 prepared under PRC GAAP were audited by KPMG Huazhen Certified Public Accountants, and the financial statements for the year 2008 prepared under International Financial Reporting Standards were audited by KPMG Certified Public Accountants. The total audit fees amounted to approximately RMB9 million (including fees for the audits of the financial statements of overseas branches and subsidiaries). The statements made by KPMG Huazhen Certified Public Accountants and KPMG Certified Public Accountants about their reporting responsibilities on the financial statements are set out in the Auditors' Reports in Annual Reports of the Company's A Shares and H Shares, respectively. Apart from the audit services, the non-audit service fee for the year 2008 paid by the Group to KPMG Certified Public Accountants was RMB11 million, mainly covered services in respect of (i) interim financial statements; (ii) results announcement of H Shares; (iii) financial and tax due diligence; and (iv) consultation for the establishment of the New York Branch. KPMG Certified Public Accountants and KPMG Huazhen Certified Public Accountants have acted as the Company's auditors for more than 3 years.

## 8.9 Internal audit and internal control

### 8.9.1 Description of a complete, reasonable and effective internal control system

Under the requirements of the relevant laws, regulations and rules, and taking into account the asset structure, operation mode and business characteristics of the Company, the Company has established an organization structure that regards the general meeting, the Board of Directors, the Board of Supervisors and the senior management as the main management team, and an internal control system that involves all of its employees. The Board of Directors is responsible for formulating the basic regulations for internal control and supervising the implementation of such regulations; the Board of Directors discharges its responsibilities in relation to internal control management and the review of the effectiveness of internal control systems through the Risk Management Committee and the Audit Committee.

During the reporting period, the Company, following the principles of segregation of duties and mutual checks and balances, strengthened vertically the internal management, examination and supervision functions of business lines on the basis of horizontal integration of operating and management departments. In doing so, it further defined the boundaries of responsibility for the internal audit and compliance departments, clarified the division of business management, compliance examinations and internal audits, and enhanced the effectiveness of the internal control system. The Company established strict internal management control systems, approval procedures and approval authorities for each business functions, ensuring that different units and posts have clear cut rights and obligations and there are mutual constraints and mutual supervision among them. Based on the principles of ensuring completeness, appropriateness and legal compliance, the Company regularly identifies operating risks and evaluates internal control situations, so as to apply all those internal control systems in every business process including decision-making, execution, supervision and feedback and ensure the legal compliance of operation and management and the safety of assets. This lead to the preliminary internal control mechanisms that penetrate into all business processes and operational links and cover all institutions, departments and positions.

The Company has in place an effective risk control system, which ensures that the relevant risks in relation to operating activities and the realization of internal control targets are controlled within a reasonable range. During the reporting period, the Company continuously optimized business procedures and improved the standardized system of business operations while adhering to the principle of prioritizing systems and internal controls. The Company revised and perfected the indicator system and evaluation approach of internal controls, and organized branches to conduct internal control evaluations to reflect the current status of internal control management in the Company at various levels in a more complete and accurate manner; launching special audit activities concerning credit, accounting and finance, organizing and conducting thorough examinations of each business all over the Company including investigations into anti-money laundering and operational risk to improve the internal control systems of the Company. The Company will continue to improve its internal control in terms of completeness, reasonability and effectiveness with an improving legal system of the State and the strengthening of management and organic growth of the Company.

The Company standardized its accounting actions, thus ensuring the truthfulness and completeness of accounting information, the truthfulness and fairness in preparing the financial statements of the Company, and effective communications within the Company and between the Company and external parties.

As reviewed by the Board of the Company, no significant defects have been identified in the Company's internal control system in terms of completeness, reasonableness and effectiveness. KPMG Huazhen issued an audited opinion on "Self-assessment of internal control by the Board of Directors of China Merchants Bank Co., Ltd. 2008".

## 8.9.2 Internal audit

The internal auditing department of the Company is responsible for inspecting and assessing all the business and management activities of the Company independently and providing improvement suggestions to the senior management. The Company has set up a sound internal auditing system. It has established four auditing departments, which are directly under the administration of the head office, in Beijing, Shanghai, Shenzhen and Xi'an, and auditing divisions in each branch. The head office vertically manages all auditing departments and auditing divisions. The internal auditing department of the Company, which is independent of the operating and management units, reports the audit results directly to the Board of Directors, Board of Supervisors and the President. The Company has established internal auditing mechanisms that are based on the Internal Auditing Prospectus of China Merchants Bank Co., Ltd. and that are composed of general rules, operation rules and work standards. It has also established an inspection system that combines on-site auditing and off-site auditing.

In 2008, the risk assessment performed by the internal auditing department of the Company covered lending business, treasury business, international business, agency business, 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 the defects found in the inspection and evaluation process are corrected accordingly, etc.

The Company is highly concerned about the problems discovered during internal audit. It requires the corresponding line departments and the units being autdited to jointly make rectification. The rectification results would be checked business by the auditing department and be included in performance evaluation of the units being audited.

## 8.10 Misconduct reporting and monitoring

In 2008, the Company reported no cases of consummated theft and severe accidents with losses exceeding RMB1 million. During the reporting period, the Company carried out the following major preventive measures:

1. Bank-wide risk prohibition and monitoring. Firstly, we launched prohibition and monitoring operations of the "five-forbidden behaviours" and specific prohibition and monitoring of gambling. Secondly, we conducted bank-wide prohibition and monitoring of operating risks under the instruction of CBRC Shenzhen Bureau. The priorities of these operations are related to such 9 fields as compliance management, auditing, shift and vacation, account reconciliation and treasury management. The operations fostered the establishment of a mechanism for the prevention of cases and risks. Through such operations, we identified and exposed the problems and defects in certain systems and businesses, and proposed concrete objectives for improvement.

2. Improvement and refinement of the mechanism for the prevention of cases and severe accidents. Firstly, we procured the signing of Letter of Liability for Case Prevention Targets by employees at all levels, and determined concrete targets for case prevention and strengthened the liability of the management at all levels. Secondly, we optimized the assessment system for case prevention and intensified the level of punishment. Under the requirement of the CBRC in relation to case prevention, and taking into account the actual situations of the management and assessment of the Company, we revised the assessment standards in relation to the prevention of cases and accidents within the performance assessment mechanism of the departments of the head office and branches. We strengthened the management and supervision of the business line departments of the head office in the revised assessment standards.

3. Continuous education in respect of discipline, integrity and case prevention. In 2008, the head office and branches arranged education and training sessions in respect of integrity and case prevention. Firstly, we held lectures on integrity and arranged classes on ethics and integrity for new employees. Secondly, we engaged in case studies; we issued the Selected Cases of Incompliance by the Employees of the Bank as the textbook for case studies and ethics and integrity education for our employees. Thirdly, we used internal publications for the purpose of general education. By publishing Inspection Express, the head office reported cases in the industry and examined internal risk hazards identified in a timely fashion; it issued risk warnings inside the Bank and summarized experiences to prevent cases from happening.

4. Investigation of and punishment for misconduct. In 2008, the Company conducted serious investigations and meted out punishment to a total of 189 related people with regard to misconduct identified or reported by employees.

## 8.11 Communications with shareholders

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

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

## 8.12 Information disclosure and investor relations

The Company disclosed significant information in a responsive, accurate, truthful and complete manner pursuant to relevant provisions of laws and regulations on information disclosure, so that all the shareholders of the Company have equal chance of access to the relevant information. Apart from fulfilling legal obligation of information disclosure, the Company also takes the initiatives in information disclosure to improve its transparency.

In 2008, the Company published 4 regular reports, over 60 temporary announcements (including documents for general meetings) and 10 documents for corporate governance on Shanghai Stock Exchange. The Company also published 4 regular reports, over 60 announcements (including circulars to shareholders) and 10 documents for corporate governance.

The 2007 Annual Report of the Company has won "The Bronze Prize for the Overall Performance of the Best Annual Report" in the "The 2007 ARC International Annual Report Award", known as the "Academy Awards for Annual Reports". The Company also won the "Best Annual Report and Company Publication Award" from Investor Relations, a British Magazine in 2007.

The Company made continuing efforts to improve investor relations management and advanced capital marketing. In the reporting period, the Company received 146 visits from domestic and overseas investors, attended 31 investment promotion conferences sponsored by well-established investment banks worldwide, and staged road shows in Europe, U.S. 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 and in a timely manner. The Company received over 550 telephone enquiries throughout the year.

Upon the acquisition of Wing Lung Bank, the Company held a telephone conference for global investors and securities analysts in relation to the acquisition, whereby participants of capital market were aware of the strategic considerations made by the Company regarding the acquisition and questions raised by investors and analysts were answered. Timely and sufficient communications with investors generated positive results and enhanced the understanding of investors in respect of the acquisition by the Company.

During the first half of the year, the Company revised its website for investor relations and made available a new website for investor relations in both Chinese and English versions on June 30, 2008, thereby facilitating communications between investors and the Company.

Through extensive, careful and effective work, the investor relationship management of the Company has won widespread recognition. During the reporting period, the Company won a lot of honours. For example, the Company won six awards from IR Magazine, a British publication, in China, including Grand Prix for Best Overall Investor Relations. The Company won the "2008 Best Listed Company in Investor Relations" award in "2008 China Financial List" organized by Hexun.com. The Company won a number of prizes for investment relations management in "2008 China Investment Relations Management Annual Meeting" award jointly organized by "China Securities" and Nanjing University, including "2008 China Top 100 Listed A Share Companies in Investor Relations" and "Corporate Social Responsibility Contributions Award", and Mr. Lan Qi, Secretary of Board of Directors, was granted "The Best Secretary of Board of Directors" award.

## 8.13 Independent operation of the Company

The Company has no controlling shareholders and de facto controllers. As a commercial bank, the Company maintains full independence in terms of business, staff, assets, organization and finance under the regulation of PBOC and CBRC. The Company is an independent legal person responsible for its own profits and losses, running independent complete business and is capable of independent business operation.

## 8.14 Specific corporate governance matters

In accordance with the requirements set out in the Notice on Due Performance of Specific Matters relating to Corporate Governance of Listed Companies (Shen Zheng Ju Gong Si Zi 【2008】 No. 62) issued by the China Securities Regulatory Commission Shenzhen Bureau, a report titled "Explanation of Specific Matters relating to Corporate Governance of the Company" was considered and passed at the 24th meeting of the Seventh Session of the Board of Directors.

In accordance with the requirements set out in the Notice 【2008】 No. 27 issued by the China Securities Regulatory Commission and the Notice on Due Performance of Specific Matters relating to Corporate Governance of Listed Companies (Shen Zheng Ju Gong Si Zi 【2008】 No. 62) issued by the China Securities Regulatory Commission Shenzhen Bureau, the Company makes the following explanations in respect of the "Rectification Report on Specific Matters relating to Corporate Governance of China Merchants Bank Co., Ltd." disclosed on 31 October 2007 and the progress of the corporate governance matters:

I. The Company disclosed the "Rectification Report on Specific Matters in relation to the Corporate Governance of China Merchants Bank Co., Ltd." on 31 October 2007. At the time of disclosing the Rectification Report, the Company implemented the corrective measures and finished the task; it has no other matters that need to be explained in this regard.

II. During the half month period from 1 July to 15 July 2008, the Company made an internal inspection into the use of funds by the major shareholders and their related parties. The Summary Report of China Merchants Bank Co., Ltd. on Internal Inspection into the Use of Funds by the Major Shareholders and their Related Parties was considered and passed at the 24th meeting of the Seventh Session of the Board of Directors of the Company. It was found that neither the major shareholders of the Company nor their related parties had used any funds of the Company (the "Listed Company") for non-operating purposes and none of them had used the funds of the Listed Company through any unfair related party transactions.

III. During the reporting period, by taking advantage of the opportunity of the launch of special corporate governance project by the CSRC, the Company continuously improved and enhanced its corporate governance and ensured the Company's compliant operations and continued healthy growth. Since 2008, the corporate governance of the Company was improved mainly by taking the following measures:

(I) Further revising and improving relevant systems governing corporate governance

1. The new Articles of Association of the Company became effective. In May 2008, the CBRC approved the Articles of Association of the Company which was considered and passed at the Company's first extraordinary general meeting in 2007, thereby the new Articles of Association of the Company officially took effect. The new Articles of Association of the Company include amendments to the provisions regarding the registered capital, the total share capital, the

shareholding structure of the Company, and amendments to the provisions regarding the qualification and terms for the independent non-executive directors and external supervisors, time of notice of the board meetings, the names and duties of certain committees under the Board of Directors and the Board of Supervisors. In addition, Rules of Procedures for Annual General Meeting, Rules of Procedures for the Board of Directors and Rules of Procedures for the Board of the Supervisors were also revised accordingly.

2. To further regulate supervision of related transactions. In order to control the non-credit related transactions which are strictly regulated by Hong Kong Stock Exchange, establish a comprehensive management system governing related transactions, further regulate the conduct of related transactions, effectively control the risks of related transactions and meet relevant overseas regulatory requirements, the Company further improved and regulated the management system governing related transactions. The newly revised Regulations on Related Party Transactions was considered and passed at the 17th meeting of the seventh board meeting of the Company and was subsequently implemented across the Company.

   The new version of regulations on related transactions stipulates the inclusion of the non-credit related transactions into the regulations, the definition of the departments relevant to the management of related transactions and the division of their responsibilities, the regulation governing the classified management of related transactions, the standardization of the procedure for the approval of related transactions by the Board as well as the reporting and disclosure thereof, and the prescription of the management procedure and supervisory priorities under different circumstances, all of which help contribute to regularize the management with clearer guidelines.

3. In accordance with the Notice Regarding the Improvement of the 2007 Annual Report and Relevant Work of Listed Companies promulgated by the CSRC, the Company formulated its rules governing independent non-executive directors' work on annual reports and set out the annual report workflow of the audit committee.

(II) Adjust the composition of the board committees to bring their professional functions into full play.

The Company refined the structure and relevant duties of the special committees under the Board in February 2008. Under the new structure of the special committees, the Executive Committee of the Board of Directors was changed into the Strategy Committee, and the Audit and Related Party transaction Control Committee was divided into the Audit Committee and the Related Party Transaction Control Committee. The structure of the special committees under the board after adjustments better meets the requirements of regulatory authorities in Mainland China and Hong Kong and better highlights their respective duties.

(III) Improving on working method and reinforcing appraisal and incentive mechanism to enhance the directors' awareness and capability.

1. To increase directors' meeting attendance by improving working style and ways of holding meeting. Firstly, a plan of physical board meetings has been prepared at the beginning of the year so as to let the directors know the general schedule for holding physical board meetings throughout the year and include such board meetings into directors' annual working schedule. Secondly, communication with directors in relation to the timing and venue of any of such board meetings shall be made as soon as practicable prior to the date of holding to facilitate each director's working schedule. Thirdly, board meetings are allowed to be held in various forms such as physical meetings, video and telephone meetings. This is aimed at complying with the requirements in relation to the attendance by directors and saving travel time and expenses.

2. To further seek ways for the improvement of appraisal system on directors' performance. The Board of Supervisors of the Company is the pioneer among small and medium-sized Chinese commercial banks to have conducted appraisal on directors' performance since 2007. Attendance rates of various board meetings, performance of duties in good faith, independent opinions given by independent non-executive directors on significant issues are regarded as important appraisal indications. Beneficial researches have been conducted on the appraisal standards of directors' performance and means of supervision adopted by the Board of Supervisors. The appraisal results have been submitted to the annual general meeting of the Company.

3. To actively organize the directors to participate in training programs and to edit and reproduce various regulations effective at home and abroad for the directors to learn, so as to enhance the directors' awareness and capability of performing duties.

(IV) Engaging in timely, accurate, truthful and complete disclosure of significant information to ensure the equal opportunities of all shareholders to obtain information and being more proactive in information disclosure to enhance the transparency of the Company.

(V) Strengthening the management of investor relations and establishing various platforms to ensure smooth communications with its investors at large. The Company revised its website for investor relations and formally launched a new website for investor relations in both Chinese and English versions. The Company has established a database in respect of Chinese and overseas analysts, institutional investors and investor relations, and formulated the workflow of investor relations activities.

The Board of Directors of the Company is of the view that the refinement and perfection of corporate governance shall be an on-going process. The Company will always be committed to achieving its great target of "creating a blue-chip for the market, and building a century-lasting bank", with the aim of delivering long-term, continuous and stable returns to the investors.

## Coordinated Development in terms of Efficiency, Quality and Scale

As early as 2002, CMB has set up the guiding principle of "coordinated development in terms of efficiency, quality and scale". Taking efficiency as the objective, quality as the premise, and scale as the method, the Company is committed to coordinated development. During the seven years' period from the beginning of 2002 to the end of 2008, the total assets of CMB increased by more than 4 times, return on average assets increased by approximately 1.2 percentage points, non-performing loan ratio decreased by approximately 9 percentage points, and the allowance coverage ratio increased by approximately 160 percentage points. The Company is progressing steadily on the path of coordinated development in terms of efficiency, quality and scale.

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## 9.1 Principal business activities

The Company is engaged in banking and related financial services.

## 9.2 Financial highlights

Details are set out in Section 2 – Financial Highlights of this annual report.

## 9.3 Reserve

The details of the changes of reserve of the Company are set out in "Statement of Changes in Equity" of the Company.

### Distributable Reserve

The details of the distributable reserve of the Company are set out in Note 38 to the financial statements.

## 9.4 Profit appropriation

### Proposal of the profit appropriation for the year 2008

10% of the profit after tax of RMB20.412 billion as stated in the audited financial statements (prepared in accordance with the PRC accounting principles), amounting to RMB2.041 billion, was appropriated to statutory surplus reserve. Regulatory general reserve was RMB1.400 billion. Profits distributable to shareholders for the current year was RMB24.874 billion. Based on the total share capital of A shares and H shares, the Company proposed to declare a bonus issue of 3 bonus shares for every 10 shares and cash dividend (including tax) of RMB1.00 (denominated in RMB) for every 10 shares, payable in RMB for A share-shareholders and in HKD for H share-shareholders. The actual profit distribution amount in HKD will be calculated based on the average of PBOC's RMB/HKD benchmark rates for the week before the date of the general meeting (inclusive). The profits which have not been appropriated will be carried forward to the next year.

As the "CMB Convertible Bonds" (110036) issued by the Company have not been fully converted into share capital of A shares and capital reserve of the Company, it is impossible to determine the total share capital at the share registration date and the total amount of dividends cannot be determined at the moment. In this regard, the Company proposed to declare the above bonus issue and dividends based on the total share capital at the closing of the registration date of A shares dividend.

In accordance with the Enterprise Income Tax Law of the PRC and its implementation regulations which are applicable for the period commencing from 1 January 2008, the Company shall be obligated to withhold and pay enterprise income tax on behalf of non-resident enterprise shareholders with a tax rate of 10% when the company distributes dividends to non-resident enterprise shareholders whose names appear on the register of members for H share of the Company. As such, any H shares of the Company registered other than in the name(s) of individual(s), including HKSCC Nominees Limited, other nominees, trustees, or other organizations or groups, shall be deemed to be shares held by non-resident enterprise shareholder(s) and enterprise income tax shall be withheld from any dividends payable thereon.

The record date for the determination of entitlements to proposed dividends and the period for the closure of register of members will be set out in the notice convening the above annual general meeting of the Company. The Company shall comply with the relevant rules and regulations to withhold and pay enterprise income tax on behalf of the relevant shareholders who are listed in the register of members of H share of the Company as of the record date.

## Dividend payout for the previous 3 years:

(Unit: RMB million)

| Year | Total cash dividends (Tax included) | Net profit for the year | Payout ratio (%) |
|---|---|---|---|
| 2005 | 3,193 | 3,787 | 84.31 |
| 2006 | 1,764 | 6,794 | 25.96 |
| 2007 | 4,117 | 15,243 | 27.01 |

Note: The net profit for the year represents the net profit attributable to the shareholders of ordinary shares of the Company as shown in the adjusted consolidated financial statements.

## Details of the implementation of the profit appropriation plan of 2007

Details are set out in the section "Implementation by the Board of Directors of resolutions passed at general meeting of the shareholders" in Section 8 of this report.

## 9.5 Donations

The total amount of the charitable donations and other donations contributed by the Company and its employees for the year ended 31 December 2008 was RMB41,590,000.

## 9.6 Fixed assets

Changes in fixed assets as at 31 December 2008 of the Company are set out in note 21 to the financial statements in this annual report.

## 9.7 Companies in which the Company holds controlling interests and other investee companies

### Shareholdings in non-listed financial companies

| Name of companies | Initial investment (RMB) | Shareholding percentage (%) | Shareholdings at end of period (shares) | Carrying value at end of period (RMB) | Profits/ (losses) for the reporting period (RMB) | Changes in owners' equity for the reporting period (RMB) | Origination of shares |
|---|---|---|---|---|---|---|---|
| CMB International Capital Corporation Limited ("CMBICC") | 250,520,000 | 100.00 | 250,000,000 | 250,520,000 | (13,455,000) | (9,455,872) | Ownership upon establishment by promotion |
| CMB Financial Leasing Co., Ltd. | 2,000,000,000 | 100.00 | N/A | 2,000,000,000 | 40,014,048 | 2,040,014,048 | Ownership upon establishment by promotion |
| China Merchants Fund Management Co., Ltd. | 190,914,400 | 33.40 | 70,000,000 | 261,498,400 | 36,584,000 | 43,469,931 | Equity investment |

| Name of companies | Initial investment (RMB) | Shareholding percentage (%) | Shareholdings at end of period (shares) | Carrying value at end of period (RMB) | Profits/ (losses) for the reporting period (RMB) | Changes in owners' equity for the reporting period (RMB) | Origination of shares |
|---|---|---|---|---|---|---|---|
| Taizhou City Commercial Bank Co., Ltd. | 306,671,377 | 10.00 | 90,000,000 | 306,671,377 | – | – | Equity investment |
| China UnionPay Co., Ltd. | 155,000,000 | 3.80 | 110,000,000 | 155,000,000 | 1,600,000 | – | Equity investment |
| EPS Company (Hong Kong) Limited | HK$8,400,000 | 2.10 | 2 | HK$8,400,000 | – | – | Equity investment |
| Yantai City Commercial Bank Corporation Limited | 189,620,000 | 4.99 | 99,800,000 | 189,620,000 | – | – | Equity investment |
| Bank Consortium Holdings Ltd. | HK$66,745,633 | 13.04 | 20,000,000 | HK$59,995,092 | HK$5,782,188 | HK$(114,667) | Equity investment |
| Joint Electronic Teller Services Limited | HK$7,992,679 | 2.82 | 20,000 | HK$8,315,888 | HK$1,128,128 | – | Equity investment |
| Hong Kong Life Insurance Ltd. | HK$44,774,577 | 16.31 | 70,000,000 | HK$56,993,318 | HK$(79,091,138) | HK$(5,004,636) | Equity investment |
| BC Reinsurance Limited | HK$36,402,820 | 20.54 | 21,000,000 | HK$24,133,769 | HK$(12,772,324) | – | Equity investment |
| Professional Liability Underwriting Services Limited | HK$4,124,929 | 26.41 | 810,000 | HK$4,516,816 | HK$2,455,299 | HK$(174,569) | Equity investment |
| Equity Underwriters Limited | HK$2,093,060 | 39.13 | 1,580,000 | HK$1,350,092 | HK$(573,243) | – | Equity investment |
| Hong Kong Precious Metals Exchange Ltd. | HK$136,000 | 0.35 | 136,000 | HK$136,000 | – | – | Equity investment |
| AR Consultant Service Ltd. | HK$4,023,349 | 8.70 | 100,000 | HK$6,341,999 | – | HK$1,232,073 | Equity investment |
| Luen Fung Hang Life Limited | MOP6,000,000 | 6.00 | 60,000 | MOP6,000,000 | – | – | Equity investment |
| China Insurance Brokers Co., Ltd. | HK$570,000 | 3.00 | N/A | HK$570,000 | – | – | Equity investment |

## Shareholdings in other listed companies

| Stock code | Abbreviation | Initial investment (RMB) | Shareholding percentage (%) | Shareholdings at end of period (shares) | Carrying value at end of period (RMB) | Profits/ (losses) for the reporting period (RMB) | Changes in owners' equity for the reporting period (RMB) | Origination of shares |
|---|---|---|---|---|---|---|---|---|
| 0096.HK | Wing Lung Bank Limited | 31,391,150,440 | 97.82 | 227,130,807 | 29,623,000,000 | (1,129,431,000) | (668,073,000) | Equity investment |

Note: Profits/(losses) for the reporting period indicated the net impact on the consolidated net profits of the Group for the reporting period

## Securities investments

| Stock code | Abbreviation | Currency | Initial investment (RMB) | Percentage of total investment at end of period (%) | Shareholdings at end of period (shares) | Carrying value at end of period (RMB) | Profits/ (losses) for the reporting period (RMB) |
|---|---|---|---|---|---|---|---|
| 00388.HK | Hong Kong Exchanges and Clearing Ltd. | HK$ | 1,110,688 | 39.15 | 1,983,500 | 145,985,600 | 247,198,764 |
| 03988.HK | Bank of China Ltd. | HK$ | 35,864,798 | 6.82 | 12,000,000 | 25,440,000 | (10,424,798) |
| 00005.HK | HSBC Holdings plc | HK$ | 25,227,237 | 4.39 | 222,264 | 16,380,857 | (12,803,929) |
| 00939.HK | China Construction Bank Corporation | HK$ | 7,138,971 | 3.42 | 3,000,000 | 12,750,000 | 609,513 |
| 02778.HK | Champion Real Estate Investment Trust | HK$ | 31,754,586 | 3.41 | 6,164,000 | 12,697,840 | (19,056,746) |

| Stock code | Abbreviation | Currency | Initial investment (RMB) | Percentage of total investment at end of period (%) | Shareholdings at end of period (shares) | Carrying value at end of period (RMB) | Profits/ (losses) for the reporting period (RMB) |
|---|---|---|---|---|---|---|---|
| 03328.HK | Bank of Communications Co., Ltd. | HK$ | 6,630,805 | 3.09 | 2,060,000 | 11,515,400 | (10,851,720) |
| 00066.HK | MTR Corporation Ltd. | HK$ | 8,454,134 | 2.98 | 619,835 | 11,107,443 | (6,610,661) |
| 00002.HK | CLP Holdings Ltd. | HK$ | 5,791,272 | 2.64 | 188,000 | 9,851,200 | (46,046) |
| 00011.HK | Hang Seng Bank Ltd. | HK$ | 114,987 | 2.37 | 86,667 | 8,814,034 | – |
| 02628.HK | China Life Insurance Co. Ltd. | HK$ | 9,248,000 | 2.21 | 350,000 | 8,242,500 | (3,416,757) |
| Other securities investments at end of period | | HK$ | 104,827,461 | 29.52 | 6,819,691 | 110,072,228 | (54,654,097) |
| **Total** | | **HK$** | **236,162,939** | **100.00** | **33,493,957** | **372,857,102** | **129,943,523** |

Notes: 1. The above table ranked the securities according to their carrying values at end of period to show the top 10 holdings;

2. Other securities investments refer to those other than the top 10 holdings.

## 9.8 Shareholdings and trading in equity interest of other listed companies

During the reporting period, save as the acquisition of the equity interest in WLB as disclosed herein, the Company had not held or traded the equity interest of other listed companies.

## 9.9 Purchase, sale or repurchase of listed securities of the Company

Prior to the completion of the acquisition of WLB, WLB and its subsidiaries held 184,500 H shares of the Company. For the year ended 31 December 2008, WLB and its subsidiaries sold all those 184,500 H shares on the Hong Kong Stock Exchange at a total consideration of HK$2,386,353.04, at prices ranging from HK$11.66 to HK$13.40 per share. Save as disclosed above, neither the Company, nor any of its subsidiaries had purchased, sold or repurchased any of the Company's listed securities during the reporting period.

## 9.10 Pre-emptive rights

There are no provisions for pre-emptive rights for the subscription of shares by the Company's shareholders under the Articles of Association of the Company and the shareholders of the Company have not been granted any pre-emptive right to subscribe shares.

## 9.11 Retirement and welfare

Details about retirement welfares provided by the Company to its employees are set out in note 31(a) to the financial statements in this annual report.

## 9.12 Principal customers

As at the end of the reporting period, the operating income 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 of the Company did not have any material interests in the aforesaid 5 customers.

## 9.13 Use of fund raised and major investment not financed by raised fund

### Use of fund raised from H Shares

The Company issued 2,200,000,000 H Shares at face value per share of RMB1 at the price of HK$8.55 per share on 22 September 2006 which were listed and tradable on the Hong Kong Stock Exchange, and through the exercise of the over-allotment option, issued 220,000,000 H Shares of RMB1 per share at the price of HK$8.55 per share on 27 September 2006 which were listed and tradable on the Hong Kong Stock Exchange, raising net proceeds of RMB20.505 billion. All the proceeds had been received, as of 5 October 2006. According to the commitments stated in the Prospectus, the funds raised were used completely as additional capital to enhance capital adequacy ratio and the capacity of risk resistance.

### Use of funds raised from the issue of RMB30 billion subordinated debts

According to the approval documents "Approval of Issuing Subordinated Debts by China Merchants Bank" (Yin Jian Fu【2008】No. 304) issued by CBRC and "Determination on Administration Approval by the People's Bank of China" (Yin Shi Chang Xu Zhun Yu Zi【2008】No. 25), the Company successfully issued subordinated debts in the amount of RMB30 billion to institutional investors in the PRC interbank bond market on 4 September 2008.

The funds raised from the issue of subordinated debts were mainly used as additional capital to consolidate the capital base, to strengthen the supplementary capital and to enhance capital adequacy of the Company, in accordance with the applicable laws and approvals granted by the regulatory authorities.

### Major investments not financed by raised fund

As at the end of 2008, the total amount of fund invested in Shanghai Lujiazui Project was RMB652,000,000, of which RMB164,000,000 was invested during the reporting period.

## 9.14 Interests and short positions of directors and supervisors

As at 31 December 2008, the interests and short positions of the Directors and Supervisors of the Company in the shares, underlying shares and debentures of the Company and its associated corporations (within the meaning of Part XV of the SFO), which have been notified to the Company and the Hong Kong Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO, including interests and short positions which the Directors and Supervisors of the Company are taken or deemed to have under such provisions of the SFO, or which are required to be and are recorded in the register required to be kept pursuant to Section 352 of the SFO or as otherwise required to be notified to the Company and the Hong Kong Stock Exchange pursuant to the Model Code set out in Appendix 10 to the Hong Kong Listing Rules, were as follows:

| Name | Position | Class of shares | Long/short position | Capacity | No. of shares | Percentage of the relevant share held in issue (%) | Percentage of all issuedshare (%) |
|---|---|---|---|---|---|---|---|
| Zhou Song | Supervisor | A | Long position | Beneficial owner | 33,500 | 0.00028 | 0.00023 |

Save as disclosed above, as at 31 December 2008, none of the Directors or Supervisors held or was deemed to hold any interests or short positions in the shares and underlying shares or debentures of the Company or any of its associated corporations, which were required to be recorded in the register required to be kept under Section 352 of the SFO, or otherwise required to be notified by the Directors or Supervisors to the Company and the Hong Kong Stock Exchange pursuant to the Model Code nor have they been granted the right to acquire any interests in shares or debentures of the Company or any of its associated corporations.

## 9.15 Directors' interests in competing businesses

None of the directors has interests in any business that competes or is likely to compete, either directly or indirectly, with the business of the Company.

## 9.16 Financial, business and kinship relations among directors, supervisors and senior management

Save as disclosed herein, directors, supervisors and senior management of the Company do not have any relations between each other with respect to financial, business, kinship or other material or connected relations.

## 9.17 Contractual rights and service contracts of directors and supervisors

No contract of significance in relation to the business of the Company, to which the Company or any of its subsidiaries was a party and in which a director or supervisor of the Company had a material interest, subsisted during the reporting period. None of the directors and supervisors of the Company has entered into any service contract with the Company or its subsidiaries which is not determinable by the Company within one year without payment of compensation (excluding statutory compensation).

## 9.18 Disciplinary actions imposed on the Company, directors, supervisors and senior management

During the reporting period, none of the Company, directors, supervisors or senior management was subject to investigation by relevant authorities nor subject to mandatory measures imposed by judicial organs or discipline inspection authorites. None of them was referred or handed over to judicial authorities or being prosecuted for criminal liability, under investigation or administrative sanction by the CSRC, prohibitted from entering any securities markets nor determined as unqualified. None of them has been penalized by other administratiive authorities nor publicly censured by any stock exchange.

## 9.19 Confirmation of the independence of independent non-executive directors

None of the six independent non-executive directors of the Company were involved in any matters set out in Rule 3.13 of the Hong Kong Listing Rules which would lead to concern over his/her independence. In addition, the Company has received annual confirmation in writing from each of the independent non-executive directors with regard to his/her independence according to the requirements of the Hong Kong Listing Rules and therefore considers each of them to be independent.

## 9.20 Undertakings made by the Company

The Company has no undertakings which need to be notified during the reporting period.

## 9.21 Significant connected transactions

### 9.21.1 Overview of connected transactions

All the connected transactions of the Company have been conducted on normal commercial terms which are fair and reasonable and in the interests of the Company and its shareholders as a whole. Pursuant to Chapter 14A of the Rules Governing the Listing of Securities on the Hong Kong Stock Exchange (the " Hong Kong Listing Rules"), the non-exempt continuing connected transactions of the Company in the reporting period were those conducted between the Company and CIGNA & CMC Life Insurance Company Limited ("CIGNA & CMC Life Insurance"), China Merchants Fund Management Company Limited ("CMFM") and China Merchants Securities Company Limited ("CM Securities"), respectively.

### 9.21.2 Non-exempt continuing connected transactions

In 2008, with the approval of the Board of Directors, the Company announced the continuing connected transactions entered into between the Company and CIGNA & CMC Life Insurance, CMFM and CM Securities respectively and approved the cap for each of the three transactions to be RMB620,000,000 for the year of 2008. Further details were disclosed in the Announcement on Continuing Connected Transactions issued by the Company on 23 January 2008.

### *GIGNA & CMC Life Insurance*

The insurance marketing agency services between the Company and CIGNA & CMC Life Insurance constituted continuing connected transactions of the Company under the Hong Kong Listing Rules.

China Merchants Steam Navigation Company Limited, a wholly owned subsidiary of CM Group, is one of the promoters and a substantial shareholder of the Company. CM Group currently holds approximately 18.04% of indirect equity interest in the Company (including those interest deemed to be held through connected companies). CM Group is an indirect controlling shareholder of Shenzhen Dingzun Investment Advisory Company, Ltd. ("Dingzun"), which in turn holds 50% equity interest in CIGNA & CMC Life Insurance. Pursuant to the Hong Kong Listing Rules, CIGNA & CMC Life Insurance is an associate of the connected person of the Company and therefore a connected person of the Company.

Pursuant to the Share Transfer Agreement entered into between Dingzun and the Company on 5 May 2008, the Company would acquire from Dingzun its 50% equity interests in CIGNA & CMC Life Insurance for a consideration of RMB141,865,000 (please refer to the Company's announcement dated 5 May 2008 and the Company's circular dated 13 May 2008). The principal business of CIGNA & CMG Life Insurance includes the life insurance, accidents and health insurance products. The completion of the acquisition was subject to the approvals from the independent shareholders of the Company and the regulatory authorities. After the completion of the acquisition, CIGNA & CMC Life Insurance would become a non-wholly subsidiary of the Company. The future financial statements of CIGNA & CMC Life Insurance would be consolidated into the Company's financial statements. The independent shareholders have granted their approvals for the acquisition. However, as at the date of this report, the regulatory authorities have not yet granted their approvals. Prior to the completion of the acquisition by the Company, the agency services conducted by the Company relating to the sale of insurance products of CIGNA & CMC Life Insurance constitute continuing connected transactions of the Company under the Hong Kong Listing Rules.

As at 23 January 2008, the Company entered into the service co-operation agreement with CIGNA & CMC Life Insurance for a term commencing on 1 January 2008 and expiring on 31 December 2008. The agreement was entered into on normal commercial terms. The service fees payable by CIGNA & CMC Life Insurance to the Company pursuant to the service co-operation agreement should be determined in accordance with the following pricing policies:

(1) to follow the fees as prescribed by the State government; or

(2) where there are no prescribed fees but there are applicable State guided fee rates, to follow the State guided fee rates; or

(3) where there are no prescribed fees or State guided fee rates, to follow the fees to be agreed between the parties based on arm's length negotiations.

The annual cap of the continuing connected transactions between the Company and CIGNA & CMC Life Insurance for 2008 was set at RMB620,000,000 which was less than 2.5% of the relevant percentage ratio calculated in accordance with Rule 14.07 of the Hong Kong Listing Rules. Therefore, those transactions would accordingly be subject only to the reporting and announcement requirements pursuant to Rules 14A.45 to 14A.47 of the Hong Kong Listing Rules, and exempt from the independent shareholders' approval requirement.

As at 31 December 2008, the aggregate value of related transactions between the Company and CIGNA & CMC Life Insurance amounted to RMB77,230,000.

### *CMFM*

The fund distribution agency services between the Company and CMFM constituted continuing connected transactions of the Company under the Hong Kong Listing Rules.

Pursuant to the share transfer agreement signed in June 2006, the Company acquired 33.4% of the equity interest in CMFM. After the acquisition, each of CM Securities and ING Asset Management B.V. held 33.3% of the equity interest in CMFM (please refer to the Company's announcement dated 6 July 2007). The Company's acquisition of the 33.4% equity interest in CMFM completed on 28 August 2007. Pursuant to the Hong Kong Listing Rules, CMFM is an associate of the connected person of the Company and therefore a connected person of the Company.

The Company entered into a service co-operation agreement with CMFM on 23 January 2008 for a term commencing on 1 January 2008 and expiring on 31 December 2008. The agreement was entered into on normal commercial terms. The agency service fees payable to the Company by CMFM pursuant to the service cooperation agreement would be on an arm's length basis and calculated on normal commercial terms, having regard to the fees and charges specified in the funds offering documents and/or the offering prospectus.

The annual cap of the continuing connected transactions between the Company and CMFM for 2008 was set at RMB620,000,000 which was less than 2.5% of the relevant percentage ratio calculated in accordance with Rule 14.07 of the Hong Kong Listing Rules. Therefore, those transactions would accordingly be subject only to the reporting and announcement requirements pursuant to Rules 14A.45 to 14A.47 of the Hong Kong Listing Rules, and exempt from the independent shareholders' approval requirement.

As at 31 December 2008, the aggregate value of related transactions between the Company and CMFM amounted to RMB63,260,000.

### *CM Securities*

The provison of third-party custodian account, the wealth management agency services and collective investment products between the Company and CM Securities constituted continuing connected transactions of the Company under the Hong Kong Listing Rules.

China Merchants Steam Navigation Company Limited, a wholly owned subsidiary of CM Group, is one of the promoters and a substantial shareholder of the Company. CM Group currently holds approximately 18.04% of indirect equity interest in the Company (including those interest deemed to be held through connected companies). As CM Group also holds a 51.65% equity interest in CM Securities, pursuant to the Hong Kong Listing Rules, CM Securities is an associate of the connected person of the Company and therefore a connected person of the Company.

The Company entered into a service co-operation agreement with CM Securities on 23 January 2008 for a term commencing on 1 January 2008 and expiring on 31 December 2008. The agreement was entered into on normal commercial terms. The service fees payable by CM Securities to the Company pursuant to the service co-operation agreement should be should be determined in accordance with the following pricing policies:

(1) to follow the fees as prescribed by the State government; or

(2) where there are no prescribed fees but there are applicable State guided fee rates, to follow the State guided fee rates; or

(3) where there are no prescribed fees or State guided fee rates, to follow the fees to be agreed between the parties based on arm's length negotiations.

The annual cap of the continuing connected transactions between the Company and CM Securities for 2008 was set at RMB620,000,000 which was less than 2.5% of the relevant percentage ratio calculated in accordance with Rule 14.07 of the Hong Kong Listing Rules. Therefore, those transactions would accordingly be subject only to the reporting and announcement requirements pursuant to Rules 14A.45 to 14A.47 of the Hong Kong Listing Rules, and exempt from the independent shareholders' approval requirement.

As at 31 December 2008, the aggregate value of related transactions between the Company and CM Securities amounted to RMB217,450,000.

The independent non-executive directors of the Company had reviewed the above-mentioned non-exempt continuing connected transactions between the Company and each of CIGNA & CMC Life Insurance, CMFM and CM Securities, respectively, and confirmed that:

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

(2) the terms of the related transactions were fair and reasonable and in the interests of the Company and its shareholders as a whole;

(3) the transactions were entered into on normal commercial terms and conditions which were no more favourable than those to or from independent third parties; and

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

The auditors of the Company have reviewed the above related transactions and submitted to the Board of Directors of the Company a letter setting out the following:

(1) the transactions were approved by the Board of Directors of the Company;

(2) the transactions were conducted in accordance with commercial principles and were in compliance with the pricing policies as stated in the relevant agreements;

(3) the transactions were conducted in accordance with terms of relevant agreements concluded by the Company; and

(4) the transactions did not exceed the aforesaid 2008 annual caps as approved by the Hong Kong Stock Exchange.

## 9.22 Material litigation and arbitration

As at 31 December 2008, the number of pending litigation and arbitration cases in which the Company was involved totaled 1,680, involving a total principal amount of RMB1,555,637,300. In particular, there were a total of 56 pending litigation and arbitration cases against the Company as at 31 December 2008, involving a total principal amount of RMB358,333,100 and total interests of RMB22,334,400. There are three pending cases with a principal amount exceeding RMB100,000,000, involving an aggregate principal amount of RMB418,076,400.

## 9.23 Material contracts

None of the material contracts of the Company is involved in holding in custody or hire or lease any assets of other companies and vice versa which are outside the Company's normal scope of business. All guarantee contracts have been entered into in the course of the Company's regular guarantee businesses within the normal scope of operation. The Company is not aware of any significant guarantee nor illegal guarantee for its subsidiaries.

## 9.24 Significant event in respect of fund entrusting

During the reporting period, there was no event in respect of fund entrusting beyond of our normal business.

## 9.25 Major activities in asset acquisition, disposal and reorganization

### 9.25.1 Acquisition of Wing Lung Bank Limited ("WLB")

***Brief description and progress of the acquisition of WLB***

On 30 May 2008, the Company entered into an agreement with the Wu family in respect of the acquisition of approximately 53.12% interest in WLB for a total consideration of HK$19.302 billion.

On 30 September 2008, the Company completed the acquisition of approximately 53.12% equity interest in WLB from the Wu family. Upon completion of the above acquisition, the Company and parties acting in concert with it held an aggregate of 123,336,170 shares in WLB.

On 6 October 2008, the Company despatched to the shareholders of WLB a Composite Offer Document pursuant to the Hong Kong Takeovers Code in order to make a general offer. On 27 October 2008, the closing date of the General Offer, the Company received acceptances in respect of 227,130,807 valid shares in WLB, representing 97.82% of the shares in WLB.

On 27 October 2008, as the shares acquired by the Company under the General Offer exceeded 90%, the Company made a compulsory offer for the remaining shares in accordance with the requirements under Section 168 of, and the Ninth Schedule to, the Hong Kong Companies Ordinance and the relevant requirements of the Hong Kong Takeovers Code. On 15 January 2009, the Company completed the compulsory acquisition of WLB which then became a wholly-owned subsidiary of the Company. WLB withdrew the listing of its shares on the Hong Kong Stock Exchange effective from 16 January 2009.

*Strategic significance of the acquisition of WLB*

Acquisition of WLB is of critical and strategic significance to the Company given that: (i) the acquisition allows the Company to enter into a highly developed and mature market which carries a significant strategic meaning; (ii) the Company could quickly establish its foothold in Hong Kong market with the extensive distribution network of WLB; (iii) WLB enjoys relatively high reputation in Hong Kong with satisfactory results of operation and relatively good asset quality which will give the Company advantages in future competition and development in Hong Kong's banking industry; and (iv) WLB offers its customers a wide range of comprehensive products which generate diversified income. The Company has established a strong integrated team and conducted detailed studies with the middle to senior level executives of WLB on how to utilize the increasingly close economic and financial ties between the Mainland China and Hong Kong to optimize the complementary competencies of CMB and WLB and create distinct synergies following the acquisition of WLB. After detailed study, the Company formulated an overall integration plan for WLB and confirmed the main approach and framework of the integration. In addition, potential synergies in respect of strategy, sale, operation and management of both parties were initially identified and proposals were made for the realization of such synergies. In the future, the Company will give due consideration to external factors and the respective operation and management features of both banks, so as to further refine the initiatives to enhance the competitiveness of WLB. The integration project will be implemented in several steps and the synergies between CMB and WLB will be gradually realized.

## 9.25.2 Acquisition of CIGNA & CMC Life Insurance

In order to further optimize revenue structure, broaden operation channels and enhance comprehensive competitive edges, the Company and Shenzhen Dingzun Investment Advisory Company, Ltd. ("Dingzun") entered into a Share Transfer Agreement on 5 May 2008, pursuant to which the Company agreed to acquire from Dingzun its 50% equity interests in CMC Life Insurance for a consideration of RMB141,865,000.

China Merchants Steam Navigation Company Limited, a wholly owned subsidiary of CM Group, is one of the promoters and a substantial shareholder of the Company. CM Group is an indirect controlling shareholder of Dingzun which in turn holds 50% equity interest in CMC Life Insurance. Dingzun is therefore a connected person of the Company under the Hong Kong Listing Rules. The transaction contemplated by the Share Transfer Agreement constituted a discloseable and connected transaction of the Company, which was subject to Independent Shareholders' approval pursuant to Rule 14A.18 of the Hong Kong Listing Rules.

The resolution regarding the acquisition was passed at the 2007 Annual General Meeting held by the Company on 27 June 2008, and is still subject to the approvals from relevant regulatory authorities.

Further details of the above acquisition were set out in the announcements published by the Company on the websites of Shanghai Stock Exchange, Hong Kong Stock Exchange, and the Company on 6 May 2008.

### 9.25.3 Acquisition of Taizhou Commercial Bank

Pursuant to "The Approval from China Banking Regulatory Commission on the Transfer of Shares in Taizhou City Commercial Bank" (Yin Jian Fu 【2008】 No. 315), China Banking Regulatory Commission approved the transfer of 30,000,000 shares in Taizhou City Commercial Bank Corporation Limited ("Taizhou Commercial Bank") to the Company. Upon completion of the transfer, the Company will hold a 10% equity interest in the share capital of Taizhou Commercial Bank.

Pursuant to the approval from CBRC Zhejiang Bureau (Zhe Yin Jian Fu 【2008】 No. 717), the registered capital of Taizhou Commercial Bank was changed from RMB300,000,000 to RMB900,000,000. Accordingly, the number of shares held by the Company was increased from 30,000,000 shares to 90,000,000 shares and the percentage of shareholding remained at 10%.

## 9.26 Implementation of the Share Appreciation Rights Incentive Scheme during the reporting period

For details about the implementation of the Company's Share Appreciation Rights Incentive Scheme in 2008, please refer to the section "Directors, supervisors, senior management, employees and branch operational structure".

## 9.27 Explanatory notes and independent opinions of the independent non-executive directors towards the Company's guarantees

**China Merchants Bank Co., Ltd.**
**Explanatory notes and independent opinions of the**
**independent non-executive directors towards the Company's guarantees**

In accordance with Zheng Jian Fa【2003】No. 56 of the China Securities Regulatory Commission and the relevant provisions of the Shanghai Stock Exchange, the independent non-executive directors of China Merchants Bank Co., Ltd. carried out a due review of the Company's guarantees for 2008 on an open, fair and objective basis, and their opinions are as follows:

After review, it was ascertained that the guarantee business of China Merchants Bank Co., Ltd. was approved by the People's Bank of China and the China Banking Regulatory Commission, and it is carried out in the ordinary course of business of banks as a conventional business. As at the end of December 2008, the balance of the Company's guarantee business (including irrecoverable letters of guarantees and shipping guarantees) was RMB69.050 billion, up 24.92% from the beginning of the year.

The Company emphasizes risk management of the guarantee business. It formulates specific management measures and operation workflow according to the risk characteristics of this business. In addition, the Company enhances risk monitoring and safeguards of this business through management means such as on-site and offsite checks. During the reporting period, the operations of the Company's guarantee business was normal and there was no default guarantees.

China Merchants Bank Co., Ltd.
Independent Non-executive Directors
Wu Jiesi Chow Kwong Fai, Edward
Liu Hongxia Liu Yongzhang Yan Lan Yi Xiqun

## 9.28 Liabilities, changes in funding and credit facilities and cash arrangement of the Company for the repayment of convertible bonds in the coming years

As at the end of the reporting period, the Company had only RMB2 million of convertible bonds remained outstanding, and the Company is capable of repaying the principal and interests of the convertible bonds.

## 9.29 Use of funds by related parties

During the reporting period, neither the major shareholders of the Company nor their related parties had used any funds of the Company for non-operating purposes and none of them had used the funds of the Company through any unfair related party transactions.

## 9.30 Compliance statement for corporate governance

The Company has fully complied with the provisions of the Code On Corporate Governance Practices set out in Appendix 14 of the Hong Kong Listing Rules and has dedicated to maintaining its high standard of corporate governance.

## 9.31 Changes in accounting policies and accounting estimates

### 1. Recognition and de-recognition of financial assets

In order to standardize the accounting policies of all financial assets for investment purposes, effective from 1 January 2008, tradable financial assets designated at fair value through profit or loss, held-to-maturity debt securities, available-for-sale investments and investment receivables are recognized using trade date accounting. In previous years, purchase or sale of financial assets was recognized using settlement date accounting except for derivatives which were recognized using trade date accounting.

The change of accounting principle has minor effect on the Financial Statement and the relevant retroactive adjustment had been undertaken.

### 2. Changes in depreciable periods and net residual values

According to Articles 59 and 60 of the Implementation Regulations of the Enterprise Income Tax Law of the PRC which came into effect on 1 January 2008 and to better align with the observed economic behaviour, the depreciation treatment of computer equipment and motor vehicles included in the fixed assets has been changed from 5 years to 3 years and the net residual values of such items of fixed assets had been reduced accordingly. These changes in accounting estimates are recognised prospectively. Depreciation charges for 2008 increased by RMB524 million as a result of the changes in projected lives and net residual values.

## 9.32 Compliance with Banking (Disclosure) Rules

The Company has prepared the financial statements in respect of H shares for the year 2008 in strict compliance with the Banking (Disclosure) Rules issued by Hong Kong Monetary Authority.

## 9.33 Review on annual results

KPMG Huazhen and KPMG Certified Public Accountants, our external auditors, have audited the financial statements of the Company prepared in accordance with the PRC Generally Accepted Accounting Principles and the International Accounting Standards respectively, and each has issued an unqualified audit report respectively. The Audit Committee of the Company has reviewed the results and financial report of the Company for the year ended 31 December 2008.

## 9.34 Annual general meeting and closure of register of members

The dates of the Company's 2008 Annual General Meeting, closure of register of members and other relevant matters will be separately announced by the Company.

## 9.35 Publication of annual report

The Company prepared the annual report in both English and Chinese versions in accordance with the International Accounting Standards and the Hong Kong Listing Rules. These reports are available on the website of Hong Kong Stock Exchange and the website of the Company. In the event of any discrepancies in interpretation between the English version and Chinese version, the Chinese version shall prevail.

The Company also prepared the annual report in Chinese in accordance with the PRC Generally Accepted Accounting Principles and the preparation rules for annual reports, which is available on the website of Shanghai Stock Exchange and the website of the Company.

By Order of the Board

**Qin Xiao**
*Chairman of Board of Directors*

24 April 2009

The Board of Supervisors has 9 members, including 2 external supervisors, 4 shareholder representative supervisors and 3 employee representative supervisors. During the reporting period, the Board of Supervisors has fulfilled supervisory duties pursuant to the Company Law and Articles of Association of the Company.

## Independent opinions on relevant matters from the Board of Supervisors:

### Lawful operation

During the reporting period, the business activities of the Company complied with the Company Law, Commercial Banking Law and Articles of Association, and that the decision making procedures were lawful and valid. None of the director or senior executive was found to have violated the relevant laws, regulations or the Articles of Association or had done anything detrimental to the interests of the Company or shareholders.

### Authenticity of financial statements

KPMG Huazhen and KPMG audited the financial reports for 2008 in accordance with the PRC accounting standards and the international accounting standards respectively and have each produced a 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.

### Use of capital raised

The application of fund from the capital raised into specific projects was consistent with the committed uses as stated in the relevant prospectus.

### Purchase and sale of assets

In respect of the material acquisition during the reporting period, the Board of Supervisors was not aware of any insider dealing or act which was detrimental to the interests of shareholders of the Company.

### Related party transactions

The Board of Supervisors was not aware of any related party transactions carried out during the reporting period which ran against the spirit of fairness or was detrimental to the interests of the Company or its shareholders.

### Implementation of resolutions passed at the general meetings

The Board of Supervisors lodged no objections to the reports and proposals submitted by the Board of Directors to the general meetings for 2008, and concluded that the board had duly implemented relevant resolutions passed by the General Meetings.

### Internal control

The Board of Supervisors concurred with the Board of Directors' statement regarding the completeness, reasonableness, effectiveness and implementation of the internal control system of the Company.

By Order of the Board of Supervisors

**Shi Jiliang**
Chairman of the Board of Supervisors

24 April 2009

# XI Social Responsibilities of the Company

In 2008, the Company was dedicated to fulfiling its social responsibilities as a corporate citizen and contributed to the social and economic development in various ways in addition to the full performance of its banking functions.

## (I) Riding through serious natural disasters with the affected population

After an earthquake struck Wenchuan, Sichuan, the Company actively responded to the Party Central Committee and the State Council's call for special assistance, implemented CBRC's relevant instructions and immediately activated emergency plans. The Company managed to provide relief assistance, make donations and offer related financial services. As of 31 December 2008, the cash donations of the Company reached RMB164,000,000.

At the beginning of 2008, when parts of the southern China were hit by heavy snowstorms, the Company made an initial donation of RMB6,000,000 through the head office of Red Cross Society of China, and the employees of the Company donated an aggregate amount of RMB2,845,000 through the Sunflower Children Growth Fund which was jointly established by CMB and the China Children and Teenagers' Fund.

## (II) Ten years of persistence in designated poverty alleviation

In 2008, the Company provided designated poverty relief to Wuding County and Yongren County of Yunnan Province for the tenth year. During the year, the Company deployed four poverty-alleviation cadres off the job to station at the two counties to provide designated relief. Donation made by the Company's employees to the two counties during the year included RMB4,374,000 in cash donation, 27,371 clothes, 12,274 books (valued at approximately RMB334,000) and 71 computers. The Company also establish a new small loan program totaled RMB2,000,000.

## (III) Developing 'Green Credit' and implementing various energy-saving and emission-reduction measures

In 2008, the Company issued the "Guiding Opinions on Green Finance Marketing of CMB" which set out the guidelines of "professional marketing, credit support, diversified cooperation and efficiency first". At the same time, the Company established a "Green Finance working group" which was responsible for formulating operation standards for green finance across the Bank, setting up operation system for green finance and developing relevant products. As at the end of 2008, the Company's balance of loan for supporting renewable energy, clean energy and environment protection projects was RMB24.928 billion and the balance of loans for corporations labeled as "two highs" was RMB97.193 billion.


Mr. Ma Weihua, President, visited Wuding County and Yongren County in Yunnan Province.


Ms. Yin Fenglan, Executive Vice President, represented CMB to donate RMB8 million for Sichuan earthquake.


CMB's charity night of "Giving love to confront the snowstorm"

## (IV) Leveraging on its own strengths and going through difficult times with small and medium sized enterprises

In 2008, the Company adhered to the strategy of developing the customer base of small and medium sized enterprises. On 18 June 2008, the Company established the country's first credit center for small sized enterprises in Suzhou and became the first enterprise to launch professionalized operations of small and medium sized enterprises through an independent legal entity subordinate to the Company. As at the end of 2008, the balance of loans to small and medium sized enterprises was RMB220.54 billion representing an increase of RMB30.24 billion as compared to the beginning of the year.

## (V) Providing quality service to Olympic Games and continuously raising customer service standards

In 2008, the Company strived to enhance the financial services for the Olympics through the optimization of foreign exchange service, the strengthening of the supporting services for the Olympics and the management of ATM machines, the improvement of efficiency and quality in dealing with customer complaints and the implementation of various contingency measures, by which the Company put emphasis to ensure the efficient and smooth provision of financial services in the five Olympic cities, namely, Beijing, Qingdao, Shanghai, Tianjin and Shenyang. At the same time, as the biggest volunteer unit directly recruited by the Beijing Organizing Committee for the Games of the XXIX Olympiad ("BOCOG") for the "Audience Call Center", the Company deployed a total of 142 volunteers to Beijing to provide answering services for Olympic audience all over the world and was highly praised and recognized by both BOCOG and the CBRC.

## (VI) Participating actively in various welfare activities and supporting education, culture and sports events

In 2008, the Company handed out scholarship in the sum of RMB1,473,000 to the eleven higher education institutions in which it has set up a scholarship program, and provided subsidies to impoverished university students for them to finish their education by making continuous donation to the New Great Wall Fund.

In 2008, the Company entered into a contract with Shenzhen Municipal Party Committee and Municipal Government and became the first partner to the 2011 Summer Universiade in Shenzhen (the 26th World Summer University Games of Shengzhen), giving full support to the international sports events held in Shenzhen. During the year, the Company successively sponsored the "National Grand Theater Opening Performance", "Commemoration of the 30th Anniversary of the Establishment of Diplomatic Relations between China and the United States – Philadelphia Orchestra China Tour" and "Lang Lang Earthquake Relief Charity Performance in Qingdao". In addition, the Company is also a sponsor of the Chinese national sailing team, national rowing team, and TV Speed Chess Match, making full efforts to support the development of Chinese cultural and sports industries.

The Lecture of the ninth anniversary of CMB's poverty alleviation campaign

The sign of Greenway for Olympic Games

The launching ceremony of CMB's small enterprises credit center

## Contents

KPMG

# Independent auditor's report to the shareholders of China Merchants Bank Co., Ltd

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

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 163 to 295 which comprise the consolidated balance sheet and balance sheet as at 31 December 2008, and the consolidated income statement, consolidated statement of changes in equity, bank 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 the 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 consolidated financial statements give a true and fair view of the financial position of the Bank and of the Group as at 31 December 2008, and of the Group's profit and cash flows for the year then ended in accordance with International Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

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

24 April 2009

# CONSOLIDATED INCOME STATEMENT

for the year ended 31 December 2008
(Expressed in millions of Renminbi unless otherwise stated)



| | Note | 2008 | 2007 |
|---|---|---|---|
| Interest income | 3 | 72,635 | 51,585 |
| Interest expense | 4 | (25,750) | (17,683) |
| **Net interest income** | | 46,885 | 33,902 |
| Fee and commission income | 5 | 8,776 | 7,258 |
| Fee and commission expense | | (1,032) | (819) |
| **Net fee and commission income** | | 7,744 | 6,439 |
| **Other net income** | 6 | 917 | 707 |
| Insurance operating income | | 98 | – |
| **Operating income** | | 55,644 | 41,048 |
| Operating expenses | 7 | (23,636) | (16,738) |
| Charge for insurance claims | | (106) | – |
| **Operating profit before impairment losses** | | 31,902 | 24,310 |
| Impairment losses | 11 | (5,154) | (3,305) |
| Share of profits of associates | | 37 | 38 |
| Share of losses of jointly controlled entities | | (26) | – |
| **Profit before tax** | | 26,759 | 21,043 |
| Income tax | 12 | (5,813) | (5,800) |
| **Profit for the year** | | 20,946 | 15,243 |
| **Attributable to:** | | | |
| Equity shareholders of the Bank | | 21,077 | 15,243 |
| Minority interests | | (131) | – |
| **Profit for the year** | | 20,946 | 15,243 |
| **Dividends** | | | |
| Declared and paid | 38(a) | 4,117 | 1,764 |
| Proposed in respect of current year | 38(b) | 5,883 | 4,117 |
| | | 10,000 | 5,881 |
| | | RMB | RMB |
| **Earnings per share** | | | |
| Basic | 13(a) | 1.43 | 1.04 |
| Diluted | 13(b) | 1.43 | 1.04 |

The notes on pages 172 to 295 form part of these financial statements.

at 31 December 2008
(Expressed in millions of Renminbi unless otherwise stated)



| | Note | **2008** | 2007 (restated) |
|---|---|---|---|
| **Assets** | | | |
| Cash and balances with banks and other financial institutions | 14 | **37,016** | 20,276 |
| Balances with central bank | 15 | **174,673** | 146,266 |
| Placements with banks and other financial institutions | 16 | **156,378** | 225,669 |
| Loans and advances to customers | 17 | **852,754** | 654,417 |
| Investments | 18 | **310,446** | 243,634 |
| Interest in associates | 19 | **266** | 225 |
| Interest in jointly controlled entities | 20 | **136** | – |
| Fixed assets | 21 | **15,062** | 8,722 |
| Intangible assets | 22 | **2,381** | 518 |
| Deferred tax assets | 23 | **2,521** | 2,162 |
| Goodwill | 24 | **9,598** | – |
| Other assets | 25 | **10,566** | 9,075 |
| **Total assets** | | **1,571,797** | 1,310,964 |
| **Liabilities** | | | |
| Deposits from banks and other financial institutions | 26 | **115,792** | 218,520 |
| Placements from banks and other financial institutions | 27 | **50,124** | 46,603 |
| Deposits from customers | 28 | **1,250,648** | 943,534 |
| Trading liabilities | 18(e) | **524** | – |
| Derivative financial instruments | 44(h) | **2,266** | 2,945 |
| Financial liabilities designated at fair value through profit or loss | 18(f) | **1,828** | – |
| Certificates of deposit issued | 29(a) | **1,840** | 1,095 |
| Convertible bonds issued | 29(b) | **2** | 13 |
| Other debts issued | 29(c) | **4,996** | 9,992 |
| Current taxation | | **2,956** | 2,588 |
| Deferred tax liabilities | 23 | **848** | – |
| Other liabilities | 30 | **26,752** | 14,190 |
| Subordinated notes issued | 29(d) | **33,440** | 3,500 |
| **Total liabilities** | | **1,492,016** | 1,242,980 |

The notes on pages 172 to 295 form part of these financial statements.

at 31 December 2008
(Expressed in millions of Renminbi unless otherwise stated)

| | Note | 2008 | 2007 (restated) |
|---|---|---|---|
| **Equity** | | | |
| Share capital | 32 | **14,707** | 14,705 |
| Capital reserve | 33 | **18,823** | 27,545 |
| Surplus reserve | 34 | **4,612** | 3,088 |
| Investment revaluation reserve | 35 | **2,854** | (471) |
| Regulatory general reserve | 36 | **10,793** | 9,500 |
| Exchange reserve | 37 | **(34)** | – |
| Retained profits | | **19,836** | 7,976 |
| Proposed profit appropriations | 38(b) | **7,924** | 5,641 |
| **Total equity attributable to shareholders of the Bank** | | **79,515** | 67,984 |
| Minority interests | | **266** | – |
| **Total equity** | | **79,781** | 67,984 |
| **Total equity and liabilities** | | **1,571,797** | 1,310,964 |

Approved and authorised for issue by the board of directors on 24 April 2009.

| | | |
|---|---|---|
| **Qin Xiao** | **Ma Wei Hua** | **Company Chop** |
| *Director* | *Director* | |

The notes on pages 172 to 295 form part of these financial statements.

# BALANCE SHEET

at 31 December 2008
(Expressed in millions of Renminbi unless otherwise stated)



| | Note | **2008** | 2007 (restated) |
|---|---|---|---|
| **Assets** | | | |
| Cash and balances with banks and other financial institutions | 14 | **34,027** | 20,268 |
| Balances with central bank | 15 | **174,640** | 146,266 |
| Placements with banks and other financial institutions | 16 | **123,492** | 225,669 |
| Loans and advances to customers | 17 | **812,106** | 654,417 |
| Investments | 18 | **300,339** | 243,626 |
| Investments in subsidiaries | 1(c) | **31,874** | 251 |
| Interest in an associate | 19 | **191** | 191 |
| Fixed assets | 21 | **10,010** | 8,675 |
| Intangible assets | 22 | **1,017** | 518 |
| Deferred tax assets | 23 | **2,443** | 2,162 |
| Other assets | 25 | **9,233** | 9,033 |
| **Total assets** | | **1,499,372** | 1,311,076 |
| **Liabilities** | | | |
| Deposits from banks and other financial institutions | 26 | **115,742** | 218,520 |
| Placements from banks and other financial institutions | 27 | **49,278** | 46,603 |
| Deposits from customers | 28 | **1,178,240** | 943,769 |
| Derivative financial instruments | 44(h) | **2,092** | 2,945 |
| Certificates of deposit issued | 29(a) | **941** | 1,095 |
| Convertible bonds issued | 29(b) | **2** | 13 |
| Other debts issued | 29(c) | **4,996** | 9,992 |
| Current taxation | | **2,941** | 2,588 |
| Other liabilities | 30 | **24,263** | 14,174 |
| Subordinated notes issued | 29(d) | **33,440** | 3,500 |
| **Total liabilities** | | **1,411,935** | 1,243,199 |
| **Equity** | | | |
| Share capital | 32 | **14,707** | 14,705 |
| Capital reserve | 33 | **27,556** | 27,545 |
| Surplus reserve | 34 | **4,612** | 3,088 |
| Investment revaluation reserve | 35 | **2,833** | (471) |
| Regulatory general reserve | 36 | **10,900** | 9,500 |
| Exchange reserve | 37 | **(15)** | – |
| Retained profits | | **18,920** | 7,869 |
| Proposed profit appropriations | 38(b) | **7,924** | 5,641 |
| **Total equity** | | **87,437** | 67,877 |
| **Total equity and liabilities** | | **1,499,372** | 1,311,076 |

Approved and authorised for issue by the board of directors on 24 April 2009.

**Qin Xiao**
*Director*

**Ma Wei Hua**
*Director*

**Company Chop**

The notes on pages 172 to 295 form part of these financial statements.

for the year ended 31 December 2008
(Expressed in millions of Renminbi unless otherwise stated)



| | | 2008 | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Attributable to shareholders of the Bank | | | | | | | | | | |
| | Note | Share capital | Capital reserve | Surplus reserve | Investment revaluation reserve | Regulatory general reserve | Exchange reserve | Retained profits | Proposed profit appropriations | Subtotal | Minority interests | Total |
| At 1 January 2008 | | 14,705 | 27,545 | 3,088 | (471) | 9,500 | – | 7,976 | 5,641 | 67,984 | – | 67,984 |
| Net profit for the year | | – | – | – | – | – | – | 21,077 | – | 21,077 | (131) | 20,946 |
| Acquisition of subsidiary | | – | – | – | – | – | – | – | – | – | 6,047 | 6,047 |
| Appropriations to statutory surplus reserve for the year 2007 | | – | – | 1,524 | – | – | – | – | (1,524) | – | – | – |
| Proposed dividends for the year 2008 | 38(b) | – | – | – | – | – | – | (5,883) | 5,883 | – | – | – |
| Dividends paid for the year 2007 | 38(a) | – | – | – | – | – | – | – | (4,117) | (4,117) | – | (4,117) |
| Transfer of retained profits to regulatory general reserve | | – | – | – | – | 1,293 | – | (1,293) | – | – | – | – |
| Conversion of convertible bonds | 32, 33 | 2 | 11 | – | – | – | – | – | – | 13 | – | 13 |
| Share of investment revaluation reserve of associates | | – | – | – | (1) | – | – | – | – | (1) | – | 1 |
| Share of investment revaluation reserve of jointly controlled entities | | – | – | – | (4) | – | – | – | – | (4) | (1) | 5 |
| Available-for-sale financial assets: | | | | | | | | | | | | |
| – Transfer to income statement on impairment, net of deferred tax | 35 | – | – | – | 478 | – | – | – | – | 478 | 1 | 479 |
| – Realised on disposal, net of deferred tax | 35 | – | – | – | 133 | – | – | – | – | 133 | 28 | 161 |
| – Changes in fair value, net of deferred tax | 35 | – | – | – | 2,719 | – | – | – | – | 2,719 | (48) | 2,671 |
| Exchange differences | 37 | – | – | – | – | – | (34) | – | – | (34) | – | (34) |
| Proposed appropriations to statutory surplus reserve for the year 2008 | 38(b) | – | – | – | – | – | – | (2,041) | 2,041 | – | – | – |
| Acquisition of minority interests | | – | (8,733) | – | – | – | – | – | – | (8,733) | (5,630) | (14,363) |
| At 31 December 2008 | | 14,707 | 18,823 | 4,612 | 2,854 | 10,793 | (34) | 19,836 | 7,924 | 79,515 | 266 | 79,781 |

| | | 2007 | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Note | Share capital | Capital reserve | Surplus reserve | Investment revaluation reserve | Regulatory general reserve | Retained profits | Proposed profit appropriations | Total |
| At 1 January 2007 | | 14,703 | 27,536 | 2,377 | 195 | 6,500 | 1,374 | 2,475 | 55,160 |
| Net profit for the year | | – | – | – | – | – | 15,243 | – | 15,243 |
| Appropriations to statutory surplus reserve for the year 2006 | | – | – | 711 | – | – | – | (711) | – |
| Proposed dividends for the year 2007 | 38(b) | – | – | – | – | – | (4,117) | 4,117 | – |
| Dividends paid for the year 2006 | 38(a) | – | – | – | – | – | – | (1,764) | (1,764) |
| Transfer of retained profits to regulatory general reserve | | – | – | – | – | 3,000 | (3,000) | – | – |
| Conversion of convertible bonds | 32, 33 | 2 | 9 | – | – | – | – | – | 11 |
| Available-for-sale financial assets: | | | | | | | | | |
| – Realised on disposal, net of deferred tax | 35 | – | – | – | 99 | – | – | – | 99 |
| – Changes in fair value, net of deferred tax | 35 | – | – | – | (765) | – | – | – | (765) |
| Proposed appropriations to statutory surplus reserve for the year 2007 | 38(b) | – | – | – | – | – | (1,524) | 1,524 | – |
| At 31 December 2007 | | 14,705 | 27,545 | 3,088 | (471) | 9,500 | 7,976 | 5,641 | 67,984 |

The notes on pages 172 to 295 form part of these financial statements.

# STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December 2008
(Expressed in millions of Renminbi unless otherwise stated)



| | | 2008 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Note | Share capital | Capital reserve | Surplus reserve | revaluation reserve | Investment general reserve | Regulatory Exchange reserve | Retained profits | Proposed profit appropriations | Total |
| At 1 January 2008 | | 14,705 | 27,545 | 3,088 | (471) | 9,500 | – | 7,869 | 5,641 | 67,877 |
| Net profit for the year | | – | – | – | – | – | – | 20,375 | – | 20,375 |
| Appropriations to statutory surplus reserve for the year 2007 | | – | – | 1,524 | – | – | – | – | (1,524) | – |
| Proposed dividends for the year 2008 | 38(b) | – | – | – | – | – | – | (5,883) | 5,883 | – |
| Dividends paid for the year 2007 | 38(a) | – | – | – | – | – | – | – | (4,117) | (4,117) |
| Transfer of retained profits to regulatory general reserve | | – | – | – | – | 1,400 | – | (1,400) | – | – |
| Conversion of convertible bonds | 32, 33 | 2 | 11 | – | – | – | – | – | – | 13 |
| Available-for-sale financial assets: | | | | | | | | | | |
| – Transfer to income statement on impairment, net of deferred tax | 35 | – | – | – | 451 | – | – | – | – | 451 |
| – Realised on disposal, net of deferred tax | 35 | – | – | – | 52 | – | – | – | – | 52 |
| – Changes in fair value, net of deferred tax | 35 | – | – | – | 2,801 | – | – | – | – | 2,801 |
| Exchange differences | 37 | – | – | – | – | – | (15) | – | – | (15) |
| Proposed appropriations to statutory surplus reserve for the year 2008 | 38(b) | – | – | – | – | – | – | (2,041) | 2,041 | – |
| At 31 December 2008 | | 14,707 | 27,556 | 4,612 | 2,833 | 10,900 | (15) | 18,920 | 7,924 | 87,437 |

The notes on pages 172 to 295 form part of these financial statements.

for the year ended 31 December 2008
(Expressed in millions of Renminbi unless otherwise stated)



| | | 2007 | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Note | Share capital | Capital reserve | Surplus reserve | Investment revaluation reserve | Regulatory general reserve | Retained profits | Proposed profit appropriations | Total |
| At 1 January 2007 | | 14,703 | 27,536 | 2,377 | 195 | 6,500 | 1,316 | 2,475 | 55,102 |
| Net profit for the year | | – | – | – | – | – | 15,194 | – | 15,194 |
| Appropriations to statutory surplus reserve for the year 2006 | | – | – | 711 | – | – | – | (711) | – |
| Proposed dividends for the year 2007 | 38(b) | – | – | – | – | – | (4,117) | 4,117 | – |
| Dividends paid for the year 2006 | 38(a) | – | – | – | – | – | – | (1,764) | (1,764) |
| Transfer of retained profits to regulatory general reserve | | – | – | – | – | 3,000 | (3,000) | – | – |
| Conversion of convertible bonds | 32, 33 | 2 | 9 | – | – | – | – | – | 11 |
| Available-for-sale financial assets: | | | | | | | | | |
| – Realised on disposal, net of deferred tax | 35 | – | – | – | 99 | – | – | – | 99 |
| – Changes in fair value, net of deferred tax | 35 | – | – | – | (765) | – | – | – | (765) |
| Proposed appropriations to statutory surplus reserve for the year 2007 | 38(b) | – | – | – | – | – | (1,524) | 1,524 | – |
| At 31 December 2007 | | 14,705 | 27,545 | 3,088 | (471) | 9,500 | 7,869 | 5,641 | 67,877 |

The notes on pages 172 to 295 form part of these financial statements.

# CONSOLIDATED CASH FLOW STATEMENT

for the year ended 31 December 2008
(Expressed in millions of Renminbi unless otherwise stated)



| | Note | 2008 | 2007 (restated) |
|---|---|---|---|
| **Operating activities** | | | |
| Profit before tax | | **26,759** | 21,043 |
| Adjustments for: | | | |
| – Impairment losses charged on loans and advances | | **3,703** | 3,006 |
| – Impairment losses (released)/charged on balances and placements with banks and other financial institutions | | **(274)** | 152 |
| – Impairment loss charged on investments | | **861** | – |
| – Impairment losses charged on other assets | | **864** | 147 |
| – Unwind of interest income on impaired loans | | **(108)** | (118) |
| – Depreciation | | **2,004** | 1,020 |
| – Amortization of intangible assets | | **58** | 29 |
| – Amortisation of discount and premium of debt investments | | **(1,657)** | (1,630) |
| – Amortisation of discount and premium of issued debts | | **7** | 6 |
| – Share of associates | | **(37)** | (38) |
| – Share of jointly controlled entities | | **26** | – |
| – Write-off of loans and advances, net of recoveries | | **(613)** | (480) |
| – Net loss/(gain) on debt investments | | **92** | (43) |
| – Net gain on disposal of fixed assets | | **(25)** | (19) |
| – Interest income on debt investments | | **(7,163)** | (4,983) |
| – Interest expense on issued debts | | **994** | 439 |
| **Changes in operating assets and liabilities:** | | | |
| Increase in balances with central bank | | **(18,639)** | (50,978) |
| Decreases/(increase) in balances and placements with banks and other financial institutions with original maturity over 3 months | | **68,529** | (96,535) |
| (Increase)/decrease in discounted bills | | **(43,490)** | 51,560 |
| Increase in loans and advances to customers | | **(119,002)** | (159,025) |
| Decreases/(increase) in other assets | | **1,642** | (3,805) |
| Increase in deposits from customers | | **238,635** | 169,777 |
| (Decreases)/increase in deposits and placements from banks and other financial institutions | | **(100,691)** | 188,520 |
| Increase in other liabilities | | **6,894** | 5,562 |
| **Net cash inflow from operating activities** | | **59,369** | 123,607 |
| **Income tax paid** | | **(6,700)** | (5,625) |

The notes on pages 172 to 295 form part of these financial statements.

for the year ended 31 December 2008
(Expressed in millions of Renminbi unless otherwise stated)

| | Note | **2008** | 2007 (restated) |
|---|---|---|---|
| **Investing activities** | | | |
| Payment for purchase of debt investments | | **(2,248,112)** | (965,816) |
| Proceeds from redemption or disposal of debt investments | | **2,195,748** | 899,946 |
| Interest received from debt investments | | **6,340** | 3,869 |
| Acquisition of a new subsidiary | 39(c) | **13,178** | – |
| Acquisition of minority interests | | **(15,021)** | – |
| Payment for acquisition of interest in an associate | | **–** | (191) |
| Payment for purchase of fixed assets | | **(4,073)** | (2,975) |
| Proceeds from sale of fixed assets | | **1,033** | 267 |
| Payment for other investments | | **(356)** | – |
| **Net cash outflow from investing activities** | | **(51,263)** | (64,900) |
| **Net cash inflow before financing activities** | | **1,406** | 53,082 |
| **Financing activities** | | | |
| Proceeds from issuance of subordinated notes | | **30,000** | – |
| Proceeds from issuance of certificates of deposit | | **971** | 1,119 |
| Repayment of certificates of deposit issued | | **(1,462)** | (1,142) |
| Repayment of other debts | | **(5,000)** | – |
| Dividends paid | | **(4,206)** | (1,712) |
| Interest paid on issued debts | | **(1,017)** | (431) |
| Cost of issuance of subordinated notes | | **(63)** | – |
| **Net cash inflow/(outflow) from financing activities** | | **19,223** | (2,166) |
| **Net increase in cash and cash equivalents** | | **20,629** | 50,916 |
| **Cash and cash equivalents at 1 January** | | **167,031** | 118,246 |
| **Effect of foreign exchange rate changes** | | **(989)** | (2,131) |
| **Cash and cash equivalents at 31 December** | 39(a) | **186,671** | 167,031 |
| **Cash flows from operating activities include:** | | | |
| Interest received | | **64,421** | 43,881 |
| Interest paid | | **37,493** | 16,274 |

The notes on pages 172 to 295 form part of these financial statements.

(Expressed in millions of Renminbi unless otherwise stated)

# 1 ORGANISATION, PRINCIPAL ACTIVITIES AND DETAILS OF SUBSIDIARIES

## (a) Organisation

China Merchants Bank Company Limited (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 (the "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 2008, 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, Foshan, Changchun, Hohhot, Yangzhou, Nantong, Jinhua, Taizhou, Weifang, Nanning and New York (United States of America). In addition, the Bank has two representative offices in Beijing and United States of America.

## (b) Principal activities

The principal activities of the Bank and its subsidiaries ("the Group") are the provision of corporate and personal baking services, conducting treasury business, the provision of asset management and trustee services and other financial services.

## (c) Investments in subsidiaries

| | Bank | |
|---|---|---|
| | **2008** | 2007 |
| Unlisted shares, at cost | **33,642** | 251 |
| Less: Impairment loss | **(1,768)** | – |
| | **31,874** | 251 |

# 1 ORGANISATION, PRINCIPAL ACTIVITIES AND DETAILS OF SUBSIDIARIES *(continued)*

## (c) Investments in subsidiaries *(continued)*

The following list contains only particulars of subsidiaries which principally affected the results, assets or liabilities of the Group. Unless otherwise stated, the class of all shares held is ordinary. All of these companies are subsidiaries as defined under note 2(d) and have been included in the scope of the consolidated financial statements of the Group.

| Name of company | Place of incorporation and operation | Particulars of the issued and paid up capital *(in millions)* | % of ownership held by the Bank | Principal activities |
|---|---|---|---|---|
| CMB International Capital Corporation Limited (note (i)) | Hong Kong | HK$250 (2007: HK$250) | 100% | Investment advisory services |
| CMB Finance Lease Company Limited (note (ii)) | Shanghai | RMB2,000 | 100% | Finance lease |
| Wing Lung Bank Limited (note (iii)) | Hong Kong | HK$1,161 | 97.82% | Banking |

(i) CMB International Capital Corporation Limited ("CMBICC"), formerly known as Jiangnan Finance Company Limited is the Bank's wholly-owned subsidiary approved by the People's Bank of China ("PBOC") through its Yin Fu [1998] No. 405, and was renamed as CMBICC on 22 February 2002 upon approval of PBOC through its Yin Fu [2002] No. 30.

(ii) CMB Financial Leasing Company Limited ("CMBFLC") is a wholly-owned subsidiary of the Bank approved by the China Banking Regulatory Commission ("CBRC") through its Yin Jian Fu [2008] No. 110 and commenced its operation in April 2008.

(iii) The Bank entered into the Sale and Purchase Agreements with Wu Jieh Yee Company Limited, Wu Yee Sun Company Limited and Yee Hong Company Limited on 30 May 2008. CMB conditionally agreed to acquire approximately 53.12% of the entire issued share capital of Wing Lung Bank Limited ("WLB") for an aggregate cash consideration of HK$19.30 billion. The acquisition was completed on 30 September 2008.

Following the completion of the above acquisition, the Bank made an unconditionally mandatory general offer to acquire all the issued WLB shares not already owned or agreed to acquire by the Bank pursuant to Rule 26.1 of the Hong Kong Takeovers Code. The Bank acquired 44.70% of the issued share capital of WLB under the general offer. On 27 October 2008, the Bank held 97.82% of the entire issued share capital of WLB. As a result of the completion of the Compulsory Acquisition on 15 January 2009, WLB has become a direct wholly-owned subsidiary of the Bank.

Trading of the WLB Shares has been suspended from 28 October 2008. Listing of the WLB Shares on the Stock Exchange has been withdrawn with effect from 16 January 2009.

(Expressed in millions of Renminbi unless otherwise stated)

# 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.

## (b) Changes in accounting policies and accounting estimations

### *(i) Recognition and derecognition of financial assets*

In prior years, purchase or sale of financial assets is recognised using settlement date accounting except for derivatives which are recognised using trade date accounting.

With effect from 1 January 2008, the Group has changed its policy to recognise trading assets, financial assets designated at fair value through profit or loss, held-to-maturity securities, available-for-sale investments, investment receivables using trade date accounting. The purpose of the change is to unify the Group's policy on the recognition and derecognition of investment financial assets. The change in accounting policy has been applied retrospectively with comparatives restated.

The change in accounting policy has minimal impact on income statement and statement of changes in equity. The affected assets and liabilities items in the balance sheet as at 31 December 2007:

| | Group | | | Bank | | |
|---|---|---|---|---|---|---|
| | **2007 (as previously reported)** | **Restatement** | **2007 (as restated)** | **2007 (as previously reported)** | **Restatement** | **2007 (as restated)** |
| Investments | 244,123 | (489) | 243,634 | 244,115 | (489) | 243,626 |
| Other assets | 8,174 | 901 | 9,075 | 8,132 | 901 | 9,033 |
| Other liabilities | (13,778) | (412) | (14,190) | (13,762) | (412) | (14,174) |
| | | – | | | – | |

### *(ii) Changes in depreciation treatment*

The Group has modified the depreciation treatment of certain fixed-assets categories in order to better align this treatment with the observed economic behaviour of assets in these categories. As a result, the projected lives of motor vehicles and computer equipment have been reduced from 5 years to 3 years. In addition, estimates regarding the residual values of computer and other equipment have also been reduced. These changes in accounting estimates have been applied prospectively. Beginning in 2008 financial year, these modifications have changed depreciation in the aforementioned fixed-assets categories, and the after-tax effects in 2008 are as follows:

| | **2008** | Later years |
|---|---|---|
| Depreciation increase/(decrease) | **524** | (386) |

# 2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

## (b) Changes in accounting policies and accounting estimations *(continued)*

### *(iii) New interpretations and amendments to IFRSs*

The IASB has issued the following new Interpretations and an amendment to IFRSs that are first effective for the current accounting period of the Group:

- IFRIC 11, IFRS 2, Group and treasury share transactions
- IFRIC 12, Service concession arrangements
- IFRIC 14, IAS 19, The limit on a defined benefit asset, minimum funding requirements and their interaction
- Amendment to IAS 39, *Financial instruments: Recognition and measurement*, and IFRS 7, *Financial instruments: Disclosures – Reclassification of financial assets*

These IFRS developments have had no material impact on the Group's financial statements as either they were consistent with accounting policies already adopted by the Group or they were not relevant to the Group's operations.

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period (see note 48).

## (c) 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 which form the basis of making the 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 45.

## 2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

### (d) Basis of consolidation

The financial statements include the financial statements of the Bank and its subsidiaries. Subsidiaries are 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 the subsidiaries are included from the date that control commences until the date that control ceases.

The results of the subsidiaries are included in the consolidated result 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.

Minority interests represent the portion of the net assets of subsidiaries attributable to equity interests that are not owned by the Bank, whether directly or indirectly through subsidiaries, and in respect of which the Group has not agreed any additional terms with the holders of those interests which would result in the Group as a whole having a contractual obligation in respect of those interest that meets the definition of a financial liability. Minority interests are presented in the consolidated balance sheet and consolidated statement of changes in equity within equity, separately from equity attributable to the shareholders of the Bank. Minority interests in the results of the Group are presented on the face of the consolidated income statement as an allocation of the net profit or loss for the year between minority interests and the shareholders of the Bank.

Where losses applicable to the minority exceed the minority's interest in the equity of a subsidiary, the excess, and any further losses applicable to the minority, are charged against the Group's interest except to the extent that the minority has a binding obligation (such as the articles of association or agreement stipulate) to, and is able to, make additional investment to cover the losses. If the subsidiary subsequently reports profits, the Group's interest is allocated all such profits until the minority's share of losses previously absorbed by the Group has been recovered.

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

### (e) Associates

Associates are entities in which the Group or the Bank has significant influence, but not control, or joint control, over its management, including participation in the financial and operating policy decisions.

Investment in associates is accounted for in the consolidated financial statements under the equity method and is initially recorded at cost and adjusted thereafter for the post acquisition change in the Group's share of the associates' net assets. The consolidated income statement includes the Group's share of the post-acquisition, post-tax results of the associates for the year, including any impairment loss on goodwill relating to the investment in the associates recognised for the year (see notes 2(g) and (n)).

When the Group's share of losses exceeds its interest in the associates, the Group's interest is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associates. For these purposes, the Group's interest in the associates is the carrying amount of the investment under equity method together with the Group's long-term interests that in substance form part of the Group's net investment in the associates.

# 2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

## (e) Associates *(continued)*

Unrealised profits and losses resulting from transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates, except where unrealised losses provide evidence of an impairment of the asset transferred, in which case they are recognised immediately in profit or loss.

In the Bank's balance sheet, its interest in associates is stated at cost less impairment losses, if any. The results of associates are accounted for by the Bank on the basis of dividends received and receivable.

## (f) Jointly controlled entities

Jointly controlled entities are entities which operate under a contractual arrangement whereby the Group and other parties undertake an economic activity which is subject to joint control and none of the participating parties has unilateral control over the economic activity.

The consolidated income statement includes the Group's share of the results of jointly controlled entities for the year and the consolidated balance sheet includes the Group's share of the net assets of the jointly controlled entities.

In the Bank's balance sheet, the interests in jointly controlled entities are stated at cost less provision for impairment losses. The results of jointly controlled entities are accounted for by the Bank on the basis of dividends received and receivable.

## (g) Goodwill

Goodwill represents the excess of the cost of a business combination or an investment in an associate over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is allocated to cash-generating units and is tested annually for impairment (see note 2(n)). In respect of associate, the carrying amount of goodwill is included in the carrying amount of the interest in the associate.

Any excess of the Group's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over the cost of a business combination or an investment in an associate is recognised immediately in consolidated income statement.

On disposal of cash generating unit, or an associate during the year, any attributable amount of purchased goodwill is included in the calculation of the profit or loss on disposal.

## (h) Intangible assets (other than goodwill)

Intangible assets are stated at cost less accumulated amortisation and impairment losses (see note 2(n)). Amortisation of intangible assets with finite useful lives is charged to the consolidated income statement on a straight-line basis over the assets' estimated useful lives (2-50 years).

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

Intangible assets are not amortised while their useful lives are assessed to be indefinite. The Group does not have intangible assets with useful lives assessed to be indefinite.

## 2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

### (i) Financial instruments

#### *(i) Initial recognition*

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. Purchase or sale of financial assets is 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.

The Group classifies its financial instruments into different categories at inception, depending on the purpose for which the assets were acquired or the liabilities were incurred. The categories are:

– 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. They are not allowed to reclassify into or out of this category which it is held or issued.

  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;

# 2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

## (i) Financial instruments *(continued)*

### *(i) Initial recognition (continued)*

– 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

– 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)*

## (i) 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 PBOC. Other financial institutions represent finance companies, investment trust companies and leasing companies which are registered with and under the supervision of the CBRC and insurance companies, securities firms, and investment fund companies, etc. which are registered with and under the supervision of other regulatory authorities. Placements with banks and other financial institutions are accounted for as loans and 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.

### *(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 2(i)(i) above.

# 2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

## (i) Financial instruments *(continued)*

### *(vii) Securitisations*

The Group securitises various corporate loans, which generally results in the sale of these assets to special purpose entity, which, in turn issue securities to investors. Interests in the securitised financial assets may be retained in the form of credit enhancement or subordinated tranches, or other residual interests ("retained interests"). Retained interests are carried at fair value on inception date on the Group's balance sheet. Gains or losses on securitisation depend in part on the carrying amount of the transferred financial assets, allocated between the financial assets derecognised and the retained interests based on their relative fair values at the date of the transfer. Gains or losses on securitisation are recorded in "Other net income".

In applying its policies on securitised financial assets, the Group has considered both the degree of transfer of risks and rewards on assets transferred and the degree of control exercised by the Group over the financial assets:

– when the Group transfers substantially all the risks and rewards of ownership of the financial asset, the Group shall derecognise the financial assets;

– when the Group retains substantially all the risks and rewards of ownership of the financial assets, the Group shall continue to recognise the financial assets; and

– when the Group neither transfers nor retains substantially all the risk and rewards of ownership of the financial asset, the Group would determine whether it has retained control of the financial assets. If the Group has not retained control, it shall derecognise the financial asset and recognise separately as assets or liabilities any rights and obligation created or retained in the transfer. If the Group has retained control, it shall continue to recognise the financial asset to the extent of its continuing involvement in the financial assets.

## (j) 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 on a straight-line basis:

| | |
|---|---|
| Land and buildings | 20 years |
| Investment properties | 20 years |
| Computer equipment | 3 years |
| Motor vehicles and others | 3 – 5 years |
| Leasehold improvements (leasing property) | the shorter of the unexpired term of lease and the estimated useful lives, being no more than 5 years |
| Leasehold improvements (self-owned property) | the longer of the useful lives of the properties and the estimated useful lives, being no less than 5 years |

# 2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

## (j) Fixed assets and depreciation *(continued)*

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.

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.

## (k) Repossessed assets

In the recovery of impaired loans and advances, the Group may take possession of assets held as collateral through court proceedings or voluntary delivery of possession by the borrowers. When it is intended to achieve an orderly realisation of the impaired assets and the Group is no longer seeking repayment from the borrower, repossessed assets are reported in "other 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.

## (l) Finance and operating lease

### *(i) Classification*

A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred. An operating lease is a lease other than a finance lease.

### *(ii) Finance leases*

Where the Group is a lessor under finance leases, an amount representing the net investment in the lease is included in the balance sheet as "Loans and advances to customers". Unrecognised finance income under finance leases are amortised using an effective interest rate method over the lease term. Finance income implicit in the lease payment is recognised as "Interest income" over the period of the leases in proportion to the funds invested. Hire purchase contracts having the characteristics of finance leases are accounted for in the same manner as finance leases. Impairment losses are accounted for in accordance with the accounting policy as set out in Note 2(n).

# 2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

## (l) Finance and operating lease *(continued)*

### *(iii) Operating lease*

– ***Operating lease charges***

Rental payments under operating leases are recognised as costs or expenses on a straight-line basis over the lease term. Contingent lease expense is charged to profit and loss when actually happened.

– ***Assets leased out under operating leases***

Fixed assets other than investment properties leased out under operating leases are depreciated in accordance with the Group's depreciation policies described in Note 2(j) and if impaired, impairment losses are provided for in accordance with the accounting policy described in Note 2(n). Income derived from operating leases is recognised in the income statement using the straight-line method over the lease term. If initial direct costs incurred in respect of the assets leased out are material, the costs are initially capitalised and subsequently amortised in profit or loss over the lease term on the same basis as the lease income. Otherwise, the costs are charged to profit or loss immediately. Contingent lease income is charged to profit and loss when actually happened.

## (m) 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.

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.

## (n) 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. Objective evidences include:

– significant financial difficulty of the issuer or borrower;

– a breach of contract, such as a default or delinquency in interest or principal payments;

– it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;

## 2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

### (n) Impairment *(continued)*

#### *(i) Financial assets (continued)*

– significant changes in the technological, market, economic or legal environment that have an adverse effect on the borrower;

– disappearance of an active market for financial assets because of financial difficulties; and

– a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost.

Impairment losses are written off against the corresponding assets directly, except for impairment losses recognised in respect of loans and receivables and held-to-maturity investments, which are measured at amortised cost, whose recovery is considered doubtful but not remote. In this case, the impairment losses are recorded using an allowance account. When the Group is satisfied that recovery is remote, the amount considered irrecoverable is written off against loans and receivables or held-to-maturity investments directly and any amounts held in the allowance account relating to that borrower/investment are reversed. Subsequent recoveries of amounts previously charged to the allowance account are reversed against the allowance account. Other changes in the allowance account and subsequent recoveries of amounts previously written off directly are recognised in consolidated income statement.

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)*

### (n) 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.

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.

## 2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

### (n) Impairment *(continued)*

#### *(i) Financial assets (continued)*

***Impairment losses on loans and advances*** *(continued)*

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.

Loans and receivables with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Group has made concessions that it would not otherwise consider. Renegotiated loans and receivables are subject to ongoing monitoring to determine whether they remained as impaired or overdue.

In the recovery of impaired loans, the Group may take repossession of the collateral assets through court proceedings or voluntary delivery of repossession 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". The Group does not hold the repossessed assets for own use.

***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.

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.

## 2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

### (n) Impairment *(continued)*

#### *(ii) Other assets*

Internal and external sources of information are reviewed at balance sheet date to identify indications that other assets may be impaired or, except in the case of goodwill, an impairment loss previously recognised no longer exists or may have decreased.

If any such indication exists, the assets' recoverable amount is estimated. In addition, for goodwill, intangible assets that are not yet available for use and intangible assets that have indefinite useful lives, the recoverable amount is estimated at balance sheet date whether or not there is any indication of impairment.

– ***Calculation of recoverable amount***

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 value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

– ***Recognition of impairment losses***

An impairment loss is recognised in the consolidated income statement whenever the carrying amount of an asset, or the cash-generating unit to which it belongs exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit (or group of units) and then, to reduce the carrying amount of the other assets in the unit (or group of units) on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

– ***Reversals of impairment losses***

In respect of assets other than goodwill, an impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount. An impairment loss in respect of goodwill is not reversed.

A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to the consolidated income statement in the year in which the reversals are recognised.

# 2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

## (o) 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.

## (p) 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(p)(ii) and when (a) it becomes probable that the holder of the guarantee will call upon the Group under the guarantee, and (b) 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.

### *(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.

# 2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

## (q) 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.

Interest income and expenses on all financial assets and liabilities that are classified as trading or designated at fair value through profit and loss are considered to be incidental and are therefore presented together with all other changes in fair value arising from the portfolio. Net income from financial instruments designated at fair value through profit or loss and net trading income comprises all gains and losses from changes in fair value (net of accrued coupon) of such financial assets and financial liabilities, together with interest income and expense, foreign exchange differences and dividend income attributable to those financial instruments.

### *(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.

### *(iv) Premium income*

Premium income represents gross insurance premium written less reinsurance ceded, as adjusted for unearned premium. Gross premiums written are recognised at date of risk inception.

## (r) Taxation

Current income tax and movements in deferred tax balances are recognised in the 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, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

## 2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

### (r) Taxation *(continued)*

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. Deferred tax assets also arise from unused tax losses and unused tax credits. 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. Deferred tax assets and liabilities are not discounted.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced by the extent that it is no longer probable that the related tax benefit will be realised.

Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities if the Group or the Bank has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:

– in the case of current tax assets and liabilities, the Group or the Bank intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or

– in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:

  – the same taxable entity; or

  – different taxable entities, which, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered, intend to realise the current tax assets and settle the current tax liabilities on a net basis or realise and settle simultaneously.

### (s) 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, including available-for-sale equity instrument, 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.

The assets and liabilities of operations outside Mainland China are translated into RMB at the spot exchange rates ruling at the balance sheet date. The equity items, excluding "Retained profits", are translated to Renminbi at the spot exchange rates or the rates that approximate the spot exchange rates on the transaction dates. The income and expenses of foreign operation are translated to Renminbi at the spot exchange rates or the rates that approximate the spot exchange rates on the transaction dates. Foreign exchange differences arising from translation are recognised as "exchange reserve" in equity.

# 2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

## (t) 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.

## (u) 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.

Annual contributions to the retirement benefit schemes with defined benefit arrangements are determined based on periodic valuations of the assets and liabilities of such schemes by qualified actuaries using the projected unit credit method. Under this method, the cost of providing retirement benefits is charged to the income statement so as to spread the regular cost over the service lives of employees in accordance with the advice of qualified actuaries. The defined benefit obligation is measured as the present value of the estimated future cash outflows using interest rates of government securities which have terms to maturity approximating the terms of the related liabilities.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions in excess of the 10% of the greater of these schemes' assets and the defined benefit obligations are recognised in the income statement over the average expected future working lifetime of the members of the schemes.

### *(iii) Share-based payment*

The Group offers equity incentives to its employee, namely H-share Appreciation Rights Scheme for the Senior Management (the "Scheme"). The scheme is accounted for as cash settled plan. The fair value of the equity incentives is measured at grant date using Black-Scholes model, taking into account the terms and condition upon which the equity incentives were granted. Where the employees have to meet vesting conditions before becoming unconditionally entitled to the equity incentives, the total estimated fair value of the equity incentives is spread over the vesting period, taking into account the probability that the equity incentives will vest.

During the vesting period, the equity incentives that is expected to vest is reviewed. Any adjustment to the cumulative fair value recognised in prior years is charged or credited to the income statement for the year of the review. On vesting date, the amount recognised as an expense is adjusted to reflect the actual amount of equity incentives that vest.

(Expressed in millions of Renminbi unless otherwise stated)

## 2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

### (v) 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.

### (w) 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.

### (x) 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.

### (y) 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

| | **2008** | 2007 |
|---|---|---|
| Loans and advances (note) | | |
| – corporate loans | **33,556** | 25,231 |
| – retail loans | **13,594** | 8,482 |
| – discounted bills | **8,947** | 5,315 |
| Balances with central bank | **2,827** | 1,742 |
| Balances and placements with | | |
| – banks | **4,237** | 3,652 |
| – other financial institutions (note) | **654** | 550 |
| Debt investments | | |
| – listed | **8,136** | 6,259 |
| – unlisted | **684** | 354 |
| Interest income on financial assets that are not at fair value through profit or loss | **72,635** | 51,585 |

Note: Included in the above is interest income of RMB108 million accrued on impaired loans for the year ended 31 December 2008 (2007: RMB118 million) and RMB35 million accrued on impaired debt investments for the year ended 31 December 2008 (2007: Nil).

(Expressed in millions of Renminbi unless otherwise stated)

## 4 INTEREST EXPENSE

| | **2008** | 2007 |
|---|---|---|
| Deposits from customers | **19,924** | 13,255 |
| Deposits and placements from | | |
| – banks | **1,444** | 950 |
| – other financial institutions | **3,381** | 3,033 |
| Issued debts | **1,001** | 445 |
| Interest expense on financial liabilities that are not at fair value through profit or loss | **25,750** | 17,683 |

## 5 FEE AND COMMISSION INCOME

| | **2008** | 2007 |
|---|---|---|
| Bank cards fees | **2,673** | 1,896 |
| Remittance and settlement fees | **982** | 774 |
| Agency services fees | **1,628** | 2,978 |
| Commissions from credit commitment and loan business | **610** | 424 |
| Trust services fees | **1,895** | 696 |
| Others | **988** | 490 |
| | **8,776** | 7,258 |

Note: Included above is fee and commission income earned by the Group arising from financial assets and liabilities not carried at fair value through profit or loss (other than amount included in determining the effective interest rate) of RMB2,352 million (2007: RMB1,794 million).

(Expressed in millions of Renminbi unless otherwise stated)

## 6 OTHER NET INCOME

| | 2008 | 2007 |
|---|---|---|
| Trading profits/(losses) arising from | | |
| – foreign exchange | **1,153** | 226 |
| – securities, derivatives and other trading activities | **(96)** | 267 |
| Net gain on financial instruments designated at fair value through profit or loss | **2** | 29 |
| Net loss on disposal of available-for-sale financial assets | **(494)** | (4) |
| Distributions from investment in funds | **3** | 53 |
| Net gain on disposal of fixed assets | **25** | 19 |
| Rental income | **77** | 64 |
| Others | **247** | 53 |
| | **917** | 707 |

## 7 OPERATING EXPENSES

| | 2008 | 2007 |
|---|---|---|
| Staff costs | | |
| – salaries, bonuses and staff welfare (note (i)) | **8,929** | 6,563 |
| – retirement benefit costs | **1,031** | 720 |
| – housing allowances | **625** | 402 |
| – others | **578** | 407 |
| | **11,163** | 8,092 |
| Business tax and surcharges | **3,296** | 2,384 |
| Depreciation | **2,004** | 1,020 |
| Rental expenses | **1,453** | 1,078 |
| Other general and administrative expenses | **5,720** | 4,164 |
| | **23,636** | 16,738 |

Notes:

(i) Performance bonus is included in the above salaries and bonuses, the details of which are disclosed in note 31(c).

(ii) Auditors' remuneration amounted to RMB9 million for 2008 (2007: RMB6 million) and non-audit service fee paid to auditors was RMB11 million for 2008 (2007: RMB3 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:

| | 2008 | | | | | |
|---|---|---|---|---|---|---|
| | Directors' fees RMB'000 | Salaries, allowances and benefits in kind RMB'000 | Discretionary bonuses RMB'000 | Share-based payments (note (i)) RMB'000 | Retirement scheme contributions RMB'000 | Total RMB'000 |
| ***Executive directors*** | | | | | | |
| Ma Wei Hua | – | 4,200 | 3,109 | 682 | 584 | 8,575 |
| Zhang Guang Hua | – | 2,100 | 1,554 | 341 | 311 | 4,306 |
| Li Hao | – | 2,100 | 1,554 | 341 | 294 | 4,289 |
| ***Non-executive directors*** | | | | | | |
| Qin Xiao | – | – | – | – | – | – |
| Wei Jia Fu | – | – | – | – | – | – |
| Fu Yu Ning | – | – | – | – | – | – |
| Li Yin Quan | – | – | – | – | – | – |
| Hong Xiao Yuan | – | – | – | – | – | – |
| Edward Ding An Hua | – | – | – | – | – | – |
| Sun Yue Ying | – | – | – | – | – | – |
| Wang Da Xiong | – | – | – | – | – | – |
| Fu Jun Yuan | – | – | – | – | – | – |
| ***Independent non-executive directors and supervisors*** | | | | | | |
| Wu Jie Si | 300 | – | – | – | – | 300 |
| Yi Xi Qun | 300 | – | – | – | – | 300 |
| Yan Lan | 300 | – | – | – | – | 300 |
| Edward Chow Kwong Fai | 300 | – | – | – | – | 300 |
| Liu Yong Zhang | 300 | – | – | – | – | 300 |
| Liu Hong Xia | 300 | – | – | – | – | 300 |
| Shi Ji Liang | 600 | – | – | – | – | 600 |
| Zhu Gen Lin | – | – | – | – | – | – |
| Chen Hao Ming | – | – | – | – | – | – |
| Shao Rui Qing | 300 | – | – | – | – | 300 |
| Dong Xian De | – | – | – | – | – | – |
| Li Jiang Ning | – | – | – | – | – | – |
| Yin Xu Wen | – | 183 | 74 | – | 37 | 294 |
| Yang Zong Jian | – | 852 | 370 | – | 175 | 1,397 |
| Shi Shun Hua | – | 979 | 751 | – | 264 | 1,994 |
| Zhou Song | – | 742 | 350 | – | 147 | 1,239 |
| | 2,700 | 11,156 | 7,762 | 1,364 | 1,812 | 24,794 |

(Expressed in millions of Renminbi unless otherwise stated)

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

| | 2007 | | | | | |
|---|---|---|---|---|---|---|
| | 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 | 4,500 | 193 | 931 | 9,824 |
| Zhang Guang Hua | – | 1,552 | 1,663 | 96 | 352 | 3,663 |
| Li Hao | – | 2,100 | 2,540 | 96 | 467 | 5,203 |
| Chen Wei | – | 527 | 777 | – | 74 | 1,378 |
| ***Non-executive directors*** | | | | | | |
| Qin Xiao | – | – | – | – | – | – |
| Wei Jia Fu | – | – | – | – | – | – |
| Fu Yu Ning | – | – | – | – | – | – |
| Li Yin Quan | – | – | – | – | – | – |
| Hong Xiao Yuan | – | – | – | – | – | – |
| Edward Ding An Hua | – | – | – | – | – | – |
| Sun Yue Ying | – | – | – | – | – | – |
| Wang Da Xiong | – | – | – | – | – | – |
| Fu Jun Yuan | – | – | – | – | – | – |
| Huang Da Zhan | – | – | – | – | – | – |
| Tan Yue Heng | – | – | – | – | – | – |
| ***Independent non-executive directors and supervisors*** | | | | | | |
| Wu Jie Si | 300 | – | – | – | – | 300 |
| Song Lin | 150 | – | – | – | – | 150 |
| Yan Lan | 150 | – | – | – | – | 150 |
| Edward Chow Kwong Fai | 300 | – | – | – | – | 300 |
| Liu Yong Zhang | 300 | – | – | – | – | 300 |
| Liu Hong Xia | 300 | – | – | – | – | 300 |
| Lin Chu Xue | 150 | – | – | – | – | 150 |
| Austin Hu Chang Tau | 150 | – | – | – | – | 150 |
| Shi Ji Liang | 600 | – | – | – | – | 600 |
| Zhu Gen Lin | – | – | – | – | – | – |
| Chen Hao Ming | – | – | – | – | – | – |
| Shao Rui Qing | 300 | – | – | – | – | 300 |
| Dong Xian De | – | – | – | – | – | – |
| Li Jiang Ning | – | – | – | – | – | – |
| Yin Xu Wen | – | 892 | 592 | – | 186 | 1,670 |
| Yang Zong Jian | – | 864 | 592 | – | 191 | 1,647 |
| Shi Shun Hua | – | 997 | 322 | – | 162 | 1,481 |
| Li Yi | – | – | – | – | – | – |
| Lu Yu Huan | – | – | – | – | – | – |
| Lin Rong Guang | – | 928 | 560 | – | 271 | 1,759 |
| Xiang You Zhi | – | 126 | – | – | 22 | 148 |
| Zhou Wen Qiong | – | 421 | 161 | – | 119 | 701 |
| | 2,700 | 12,607 | 11,707 | 385 | 2,775 | 30,174 |

Notes:

(i) These represent the estimated fair value of the share option granted to Senior Management under the H-Share Appreciation Rights Scheme calculated based on Black-Scholes model. The fair value of the share option is estimated in accordance with the accounting policy set out in note 2(u)(iii). The share option under this Scheme had an weighted average exercise price of HK$25.72. As at 31 December 2008, the closing price of the H-Share of the Bank was HK$13.9. As the share options may expire without being exercised, the amounts disclosed are not representative of actual cashflow received/receivable by Senior Management. Details of this Scheme are set out in note 31(d).

(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 | **2008** | 2007 |
|---|---|---|
| Nil – 500,000 | **21** | 27 |
| 500,001 – 1,000,000 | **1** | 2 |
| 1,000,001 – 1,500,000 | **2** | 2 |
| 1,500,001 – 2,000,000 | **1** | 3 |
| 3,500,001 – 4,000,000 | **–** | 1 |
| 4,000,001 – 4,500,000 | **2** | – |
| 5,000,001 – 5,500,000 | **–** | 1 |
| 8,500,001 – 9,000,000 | **1** | – |
| 9,500,001 – 10,000,000 | **–** | 1 |
| | **28** | 37 |

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 2008, 3 (2007: 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:

| | **2008 RMB'000** | 2007 RMB'000 |
|---|---|---|
| Salaries and other emoluments | **12,600** | 12,180 |
| Discretionary bonuses | **9,325** | 13,920 |
| Share-based payments | **1,985** | 558 |
| Contributions to defined contribution retirement schemes | **1,810** | 2,741 |
| | **25,720** | 29,399 |

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

| RMB | **2008** | 2007 |
|---|---|---|
| 3,500,001 – 4,000,000 | **–** | 1 |
| 4,000,001 – 4,500,000 | **4** | – |
| 5,000,001 – 5,500,000 | **–** | 3 |
| 8,500,001 – 9,000,000 | **1** | – |
| 9,500,001 – 10,000,000 | **–** | 1 |

(Expressed in millions of Renminbi unless otherwise stated)

## 10 LOANS TO DIRECTORS, SUPERVISORS AND OFFICERS

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

| | 2008 | 2007 |
|---|---|---|
| Aggregate amount of relevant loans made by the Group outstanding at year end | **19** | 7 |
| Maximum aggregate amount of relevant loans made by the Group outstanding during the year | **27** | 16 |

## 11 IMPAIRMENT LOSSES

| | 2008 | 2007 |
|---|---|---|
| Impairment losses charged/(released) on: | | |
| – loans and advances (Note 17(c)) | **3,703** | 3,006 |
| – deposits and placements with banks and other financial institutions | **(274)** | 152 |
| – investments | | |
| – available-for-sale investments | **600** | – |
| – held-to-maturity investments | **199** | – |
| – receivables | **62** | – |
| – goodwill | **579** | – |
| – other assets | **285** | 147 |
| | **5,154** | 3,305 |

## 12 INCOME TAX

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

| | 2008 | 2007 |
|---|---|---|
| Current tax | | |
| – Mainland China | **7,014** | 5,561 |
| – Hong Kong | **9** | 4 |
| – Overseas | **3** | – |
| Subtotal | **7,026** | 5,565 |
| Deferred tax | **(1,213)** | 235 |
| Total | **5,813** | 5,800 |

(Expressed in millions of Renminbi unless otherwise stated)

## 12 INCOME TAX *(continued)*

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

| | **2008** | 2007 |
|---|---|---|
| Profit before tax | **26,759** | 21,043 |
| Notional tax on profit before tax, calculated at the statutory tax rate of 25% (2007: 33%) | **6,690** | 6,944 |
| Add/(less) the tax effect of the following items: | | |
| – Non-deductible expenses | **451** | 559 |
| – Non-taxable income | **(217)** | (158) |
| – Different income tax rates in other areas | **(401)** | (1,691) |
| – Effect of change in tax rate on opening deferred tax balances | **(244)** | 480 |
| – Others | **(466)** | (334) |
| Actual income tax expense | **5,813** | 5,800 |

Notes:

(i) The income tax rates applicable to the Bank's operations in Shenzhen Special Economic Zone is 18% (2007: 15%) during the year.

(ii) The provision for Hong Kong profit tax for 2008 is calculated at 16.5% (2007: 17.5%) of the estimated assessable profits from Hong Kong operations for the year.

(iii) Taxation for other overseas operations is charged at the appropriate current rates of taxation ruling in the relevant countries.

## 13 EARNINGS PER SHARE

Movements of the share capital are included in Note 32 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:

| | **2008** | 2007 |
|---|---|---|
| Net profit | **21,077** | 15,243 |
| Weighted average number of shares in issue (in million) | **14,707** | 14,704 |
| Basic earnings per share (in RMB) | **1.43** | 1.04 |

(Expressed in millions of Renminbi unless otherwise stated)

## 13 EARNINGS PER SHARE *(continued)*

### (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:

| | **2008** | 2007 |
|---|---|---|
| Net profit | **21,077** | 15,243 |
| Interest expense on convertible bonds issued | **–** | 1 |
| Diluted net profit | **21,077** | 15,244 |
| Weighted average number of shares in issue (in million) | **14,707** | 14,704 |
| Effect of deemed conversion of convertible bonds (in million) | **–** | 4 |
| Weighted average number of shares in issue after dilution (in million) | **14,707** | 14,708 |
| Diluted earnings per share (in RMB) | **1.43** | 1.04 |

## 14 CASH AND BALANCES WITH BANKS AND OTHER FINANCIAL INSTITUTIONS

### (a) Analysed by nature

| | **Group** | | **Bank** | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Cash | **6,928** | 6,381 | **6,479** | 6,373 |
| Balances with banks | **30,063** | 13,922 | **27,523** | 13,922 |
| Balances with other financial institutions | **58** | 6 | **58** | 6 |
| | **37,049** | 20,309 | **34,060** | 20,301 |
| Less: Impairment allowances | | | | |
| – banks | **(29)** | (29) | **(29)** | (29) |
| – other financial institutions | **(4)** | (4) | **(4)** | (4) |
| | **(33)** | (33) | **(33)** | (33) |
| | **37,016** | 20,276 | **34,027** | 20,268 |

(Expressed in millions of Renminbi unless otherwise stated)

## 14 CASH AND BALANCES WITH BANKS AND OTHER FINANCIAL INSTITUTIONS *(continued)*

### (b) Balances with banks and other financial institutions (analysed by geographical location)

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Balances with | | | | |
| – banks in the Mainland | **17,972** | 8,870 | **17,386** | 8,870 |
| – other financial institutions in the Mainland | **54** | 1 | **54** | 1 |
| | **18,026** | 8,871 | **17,440** | 8,871 |
| Balances with | | | | |
| – banks outside the Mainland | **12,062** | 5,024 | **10,108** | 5,024 |
| | **30,088** | 13,895 | **27,548** | 13,895 |

### (c) Movements of allowances for impairment losses (note)

| | Group and Bank | |
|---|---|---|
| | **2008** | 2007 |
| As at 1 January | **33** | 34 |
| Reversal for the year | **–** | (1) |
| As at 31 December | **33** | 33 |

Note: The impairment loss for balances with banks and other financial institutions is individually assessed.

(Expressed in millions of Renminbi unless otherwise stated)

## 14 CASH AND BALANCES WITH BANKS AND OTHER FINANCIAL INSTITUTIONS *(continued)*

### (d) Impaired balances with banks and other financial institutions and allowances

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Gross impaired balances with banks and other financial institutions | **33** | 33 | **33** | 33 |
| Individually assessed impairment allowances | **(33)** | (33) | **(33)** | (33) |
| Net balances | **–** | – | **–** | – |
| Gross impaired balances with banks and other financial institutions as a percentage of total balances with banks and other financial institutions | **0.11%** | 0.24% | **0.12%** | 0.24% |

## 15 BALANCES WITH CENTRAL BANK

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Statutory deposit reserve funds | **126,992** | 108,342 | **126,976** | 108,342 |
| Surplus deposit reserve funds | **46,751** | 36,521 | **46,734** | 36,521 |
| Fiscal deposits | **930** | 1,403 | **930** | 1,403 |
| | **174,673** | 146,266 | **174,640** | 146,266 |

The statutory deposit reserve funds are not available for the Group's daily operations. The statutory deposit reserve funds are calculated at 13.5% and 5% for eligible RMB deposits and foreign currency deposits respectively as at 31 December 2008 (2007: 14.5% and 5% 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.

(Expressed in millions of Renminbi unless otherwise stated)

# 16 PLACEMENTS WITH BANKS AND OTHER FINANCIAL INSTITUTIONS

## (a) Analysed by nature

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Money market placements | | | | |
| – banks | **80,836** | 42,697 | **47,950** | 42,697 |
| – other financial institutions | **1,000** | 300 | **1,000** | 300 |
| | **81,836** | 42,997 | **48,950** | 42,997 |
| Balances under resale agreements (note) | | | | |
| – banks | **61,652** | 164,356 | **61,652** | 164,356 |
| – other financial institutions | **12,890** | 18,595 | **12,890** | 18,595 |
| | **74,542** | 182,951 | **74,542** | 182,951 |
| | **156,378** | 225,948 | **123,492** | 225,948 |
| Less: Impairment allowances | | | | |
| – banks | **–** | (274) | **–** | (274) |
| – other financial institutions | **–** | (5) | **–** | (5) |
| | **–** | (279) | **–** | (279) |
| | **156,378** | 225,669 | **123,492** | 225,669 |

Note: 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.

## (b) Analysed by remaining maturity

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Maturing | | | | |
| – within one month | **92,605** | 136,582 | **63,329** | 136,582 |
| – between one month and one year | **63,395** | 89,025 | **60,138** | 89,025 |
| – after one year | **378** | 62 | **25** | 62 |
| | **156,378** | 225,669 | **123,492** | 225,669 |

(Expressed in millions of Renminbi unless otherwise stated)

## 16 PLACEMENTS WITH BANKS AND OTHER FINANCIAL INSTITUTIONS

*(continued)*

### (c) Analysed by geographical location

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Placements with | | | | |
| – banks in the Mainland | **76,353** | 187,071 | **75,991** | 187,071 |
| – other financial institutions in the Mainland | **13,890** | 18,890 | **13,890** | 18,890 |
| | **90,243** | 205,961 | **89,881** | 205,961 |
| Placements with | | | | |
| – banks outside the Mainland | **66,135** | 19,708 | **33,611** | 19,708 |
| | **156,378** | 225,669 | **123,492** | 225,669 |

### (d) Movements of allowances for impairment losses

| | Group and Bank | | | | | |
|---|---|---|---|---|---|---|
| | **2008** | | | 2007 | | |
| | **Collectively assessed** | **Individually assessed** | **Total** | Collectively assessed | Individually assessed | Total |
| As at 1 January | **274** | **5** | **279** | 121 | 5 | 126 |
| Charge for the year | **–** | **–** | **–** | 157 | – | 157 |
| Reversal for the year | **(274)** | **–** | **(274)** | (4) | – | (4) |
| Write-offs | **–** | **(5)** | **(5)** | – | – | – |
| As at 31 December | **–** | **–** | **–** | 274 | 5 | 279 |

### (e) Impaired placements with banks and other financial institutions and allowances

| | Group and Bank | |
|---|---|---|
| | **2008** | 2007 |
| Gross impaired placements with banks and other financial institutions | **–** | 5 |
| Individually assessed impairment allowances | **–** | (5) |
| Net balances | **–** | – |
| Gross impaired placements with banks and other financial institutions as a percentage of total placements with banks and other financial institutions | **–** | – |

(Expressed in millions of Renminbi unless otherwise stated)

# 17 LOANS AND ADVANCES TO CUSTOMERS

## (a) Loans and advances to customers

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Corporate loans | **545,961** | 445,865 | **518,440** | 445,865 |
| Discounted bills | **95,766** | 52,276 | **95,766** | 52,276 |
| Retail loans | **232,635** | 175,026 | **219,342** | 175,026 |
| Gross loans and advances to customers | **874,362** | 673,167 | **833,548** | 673,167 |
| Less: impairment allowances | | | | |
| – individually-assessed | **(6,727)** | (7,685) | **(6,692)** | (7,685) |
| – collectively-assessed | **(14,881)** | (11,065) | **(14,750)** | (11,065) |
| | **(21,608)** | (18,750) | **(21,442)** | (18,750) |
| Net loans and advances to customers | **852,754** | 654,417 | **812,106** | 654,417 |

## (b) Analysis of loans and advances to customers

### *(i) Analysed by legal form of borrowers:*

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| *Domestic enterprises:* | | | | |
| State-owned enterprises | **198,739** | 179,192 | **197,905** | 179,192 |
| Joint-stock enterprises | **64,244** | 56,619 | **63,863** | 56,619 |
| Other limited liability enterprises | **101,029** | 77,186 | **100,421** | 77,186 |
| Others | **60,283** | 56,831 | **60,083** | 56,831 |
| | **424,295** | 369,828 | **422,272** | 369,828 |
| Foreign-invested enterprises | **90,235** | 69,522 | **89,485** | 69,522 |
| Enterprises operating in the Mainland | **514,530** | 439,350 | **511,757** | 439,350 |
| Enterprises operating outside the Mainland | **31,431** | 6,515 | **6,683** | 6,515 |
| Corporate loans | **545,961** | 445,865 | **518,440** | 445,865 |
| Discounted bills | **95,766** | 52,276 | **95,766** | 52,276 |
| Retail loans | **232,635** | 175,026 | **219,342** | 175,026 |
| Gross loans and advances to customers | **874,362** | 673,167 | **833,548** | 673,167 |

(Expressed in millions of Renminbi unless otherwise stated)

## 17 LOANS AND ADVANCES TO CUSTOMERS *(continued)*

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

#### *(ii) Analysed by industry sector:*

***Operation in Mainland China***

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Manufacturing and processing | **159,565** | 132,463 | **157,867** | 132,463 |
| Transportation, storage and postal services | **89,408** | 74,511 | **88,898** | 74,511 |
| Production and supply of electric power, gas and water | **62,364** | 40,856 | **62,020** | 40,856 |
| Wholesale and retail | **56,311** | 57,684 | **56,301** | 57,684 |
| Property development | **44,581** | 40,057 | **44,411** | 40,057 |
| Leasing and commercial services | **27,982** | 29,185 | **27,982** | 29,185 |
| Construction | **22,969** | 17,145 | **22,774** | 17,145 |
| Mining | **14,127** | 10,310 | **14,127** | 10,310 |
| Water, environment and public utilities management | **9,163** | 6,262 | **9,163** | 6,262 |
| Financial services | **7,405** | 6,556 | **7,180** | 6,556 |
| Others | **21,084** | 24,321 | **21,034** | 24,321 |
| Corporate loans | **514,959** | 439,350 | **511,757** | 439,350 |
| Discounted bills | **95,766** | 52,276 | **95,766** | 52,276 |
| Credit cards | **31,604** | 21,324 | **31,604** | 21,324 |
| Mortgages | **148,548** | 131,138 | **148,452** | 131,138 |
| Others | **39,493** | 22,564 | **39,286** | 22,564 |
| Retail loans | **219,645** | 175,026 | **219,342** | 175,026 |
| Gross loans and advances to customers | **830,370** | 666,652 | **826,865** | 666,652 |

(Expressed in millions of Renminbi unless otherwise stated)

## 17 LOANS AND ADVANCES TO CUSTOMERS *(continued)*

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

#### *(ii) Analysed by industry sector:* *(continued)*

***Operation outside Mainland China***

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Property development | **19,646** | 3,124 | **2,822** | 3,124 |
| Financial concerns | **2,429** | 396 | **1,475** | 396 |
| Wholesale and retail trade | **1,837** | 757 | **596** | 757 |
| Manufacturing | **1,273** | 189 | **151** | 189 |
| Transport and transport equipment | **3,002** | 1,316 | **1,493** | 1,316 |
| Recreational activities | **97** | – | **79** | – |
| Information technology | **3** | – | **–** | – |
| Others | **2,715** | 733 | **67** | 733 |
| Corporate loans | **31,002** | 6,515 | **6,683** | 6,515 |
| Credit cards | **415** | – | **–** | – |
| Mortgages | **9,964** | – | **–** | – |
| Others | **2,611** | – | **–** | – |
| Retail loans | **12,990** | – | **–** | |
| Gross loans and advances to customers | **43,992** | 6,515 | **6,683** | 6,515 |

Note:

(i) Analyses by borrowers' geographical areas

Loans and advances to customers by geographical area are classified according to the location of the counterparties after taking into account the transfer of risk. In general, risk transfer applies when a loan and advance is guaranteed by a party located in an area that is different from that of the counterparty. At 31 December 2008, over 90% of the Group's loans and advances to customers was classified under People's Republic of China (unchanged from the positions at 31 December 2007).

(Expressed in millions of Renminbi unless otherwise stated)

## 17 LOANS AND ADVANCES TO CUSTOMERS *(continued)*

### (c) Movements of allowances for impairment losses

| | Group | | | |
|---|---|---|---|---|
| | 2008 | | | |
| | 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 |
| At 1 January | **10,434** | **631** | **7,685** | **18,750** |
| Charge for the year (note 11) | **3,363** | **597** | **1,454** | **5,414** |
| Addition through acquisition of subsidiary | **98** | **3** | **31** | **132** |
| Releases for the year (note 11) | **(10)** | **(1)** | **(1,700)** | **(1,711)** |
| Unwinding of discount | **–** | **–** | **(108)** | **(108)** |
| Recoveries of loans and advances previously written off | **–** | **–** | **65** | **65** |
| Write-offs | **–** | **(56)** | **(622)** | **(678)** |
| Transfers out | **–** | **(88)** | **–** | **(88)** |
| Exchange difference | **(90)** | **–** | **(78)** | **(168)** |
| At 31 December | **13,795** | **1,086** | **6,727** | **21,608** |

| | Group | | | |
|---|---|---|---|---|
| | 2007 | | | |
| | 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 |
| At 1 January | 8,005 | 404 | 7,873 | 16,282 |
| Charge for the year (note 11) | 2,551 | 229 | 1,432 | 4,212 |
| Releases for the year (note 11) | – | – | (1,206) | (1,206) |
| Unwinding of discount | – | – | (118) | (118) |
| Recoveries of loans and advances previously written off | – | – | 48 | 48 |
| Write-offs | – | (2) | (526) | (528) |
| Transfers in | – | – | 238 | 238 |
| Exchange difference | (122) | – | (56) | (178) |
| At 31 December | 10,434 | 631 | 7,685 | 18,750 |

(Expressed in millions of Renminbi unless otherwise stated)

# 17 LOANS AND ADVANCES TO CUSTOMERS *(continued)*

## (c) Movements of allowances for impairment losses *(continued)*

| | Bank 2008 | | | |
|---|---|---|---|---|
| | 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 |
| At 1 January | **10,434** | **631** | **7,685** | **18,750** |
| Charge for the year (note 11) | **3,323** | **593** | **1,442** | **5,358** |
| Releases for the year (note 11) | **–** | **–** | **(1,699)** | **(1,699)** |
| Unwinding of discount | **–** | **–** | **(108)** | **(108)** |
| Recoveries of loans and advances previously written off | **–** | **–** | **64** | **64** |
| Write-offs | **–** | **(53)** | **(614)** | **(667)** |
| Transfers out | **–** | **(88)** | **–** | **(88)** |
| Exchange difference | **(90)** | **–** | **(78)** | **(168)** |
| At 31 December | **13,667** | **1,083** | **6,692** | **21,442** |

| | Bank 2007 | | | |
|---|---|---|---|---|
| | 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 |
| At 1 January | 8,005 | 404 | 7,873 | 16,282 |
| Charge for the year (note 11) | 2,551 | 229 | 1,432 | 4,212 |
| Releases for the year (note 11) | – | – | (1,206) | (1,206) |
| Unwinding of discount | – | – | (118) | (118) |
| Recoveries of loans and advances previously written off | – | – | 48 | 48 |
| Write-offs | – | (2) | (526) | (528) |
| Transfers in | – | – | 238 | 238 |
| Exchange difference | (122) | – | (56) | (178) |
| At 31 December | 10,434 | 631 | 7,685 | 18,750 |

(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

| | Group 2008 | | | | | |
|---|---|---|---|---|---|---|
| | Loans and advances for which impairment losses are collectively assessed (note (i)) | Impaired loans and advances: for which impairment losses are collectively assessed (note (ii)) | Impaired loans and advances: for which impairment losses are individually assessed (note (ii)) | Total | Gross impaired loans and advances as a % of gross loans and advances | Fair value of collaterals held against individually assessed impaired loans and advances (note (iii)) |
| Gross loans and advances to | | | | | | |
| – financial institutions | 24,963 | – | 7 | 24,970 | 0.03 | – |
| – non-financial institution customers | 839,827 | 1,382 | 8,183 | 849,392 | 1.13 | 1,140 |
| | 864,790 | 1,382 | 8,190 | 874,362 | 1.09 | 1,140 |
| Less: | | | | | | |
| Allowances for impairment losses on loans and advances to | | | | | | |
| – financial institutions | (130) | – | (4) | (134) | | |
| – non-financial institution customers | (13,665) | (1,086) | (6,723) | (21,474) | | |
| | (13,795) | (1,086) | (6,727) | (21,608) | | |
| Net loans and advances to | | | | | | |
| – financial institutions | 24,833 | – | 3 | 24,836 | | |
| – non-financial institution customers | 826,162 | 296 | 1,460 | 827,918 | | |
| | 850,995 | 296 | 1,463 | 852,754 | | |

(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 *(continued)*

Group

2007

| | Loans and advances for which impairment losses are collectively assessed (note (i)) | Impaired loans and advances: for which impairment losses are collectively assessed (note (ii)) | Impaired loans and advances: for which impairment losses are individually assessed (note (ii)) | Total | Gross impaired loans and advances as a % of gross loans and advances | Fair value of collaterals held against individually assessed impaired loans and advances (note (iii)) |
|---|---|---|---|---|---|---|
| Gross loans and advances to | | | | | | |
| – financial institutions | 3,660 | – | 7 | 3,667 | 0.19 | – |
| – non-financial institution customers | 659,113 | 809 | 9,578 | 669,500 | 1.55 | 1,119 |
| | 662,773 | 809 | 9,585 | 673,167 | 1.54 | 1,119 |
| Less: | | | | | | |
| Allowances for impairment losses on loans and advances to | | | | | | |
| – financial institutions | (16) | – | (3) | (19) | | |
| – non-financial institution customers | (10,418) | (631) | (7,682) | (18,731) | | |
| | (10,434) | (631) | (7,685) | (18,750) | | |
| Net loans and advances to | | | | | | |
| – financial institutions | 3,644 | – | 4 | 3,648 | | |
| – non-financial institution customers | 648,695 | 178 | 1,896 | 650,769 | | |
| | 652,339 | 178 | 1,900 | 654,417 | | |

(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 *(continued)*

| | Bank | | | | | |
|---|---|---|---|---|---|---|
| | 2008 | | | | | |
| | Loans and advances for which impairment losses are collectively assessed (note (i)) | Impaired loans and advances for which impairment losses are collectively assessed (note (ii)) | Impaired loans and advances for which impairment losses are individually assessed (note (ii)) | Total | Gross impaired loans and advances as a % of gross loans and advances | Fair value of collaterals held against individually assessed impaired loans and advances (note (iii)) |
| Gross loans and advances to | | | | | | |
| – financial institutions | 23,785 | – | 7 | 23,792 | 0.03 | – |
| – non-financial institution customers | 800,264 | 1,355 | 8,137 | 809,756 | 1.17 | 1,130 |
| | 824,049 | 1,355 | 8,144 | 833,548 | 1.14 | 1,130 |
| Less: | | | | | | |
| Allowances for impairment losses on loans and advances to | | | | | | |
| – financial institutions | (128) | – | (4) | (132) | | |
| – non-financial institution customers | (13,539) | (1,083) | (6,688) | (21,310) | | |
| | (13,667) | (1,083) | (6,692) | (21,442) | | |
| Net loans and advances to | | | | | | |
| – financial institutions | 23,657 | – | 3 | 23,660 | | |
| – non-financial institution customers | 786,725 | 272 | 1,449 | 788,446 | | |
| | 810,382 | 272 | 1,452 | 812,106 | | |

(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 *(continued)*

Group

2007

| | Loans and advances for which impairment losses are collectively assessed (note (i)) | Impaired loans and advances: for which impairment losses are collectively assessed (note (ii)) | Impaired loans and advances: for which impairment losses are individually assessed (note (ii)) | Total | Gross impaired loans and advances as a % of gross loans and advances | Fair value of collaterals held against individually assessed impaired loans and advances (note (iii)) |
|---|---|---|---|---|---|---|
| Gross loans and advances to | | | | | | |
| – financial institutions | 3,660 | – | 7 | 3,667 | 0.19 | – |
| – non-financial institution customers | 659,113 | 809 | 9,578 | 669,500 | 1.55 | 1,119 |
| | 662,773 | 809 | 9,585 | 673,167 | 1.54 | 1,119 |
| Less: | | | | | | |
| Allowances for impairment losses on loans and advances to | | | | | | |
| – financial institutions | (16) | – | (3) | (19) | | |
| – non-financial institution customers | (10,418) | (631) | (7,682) | (18,731) | | |
| | (10,434) | (631) | (7,685) | (18,750) | | |
| Net loans and advances to | | | | | | |
| – financial institutions | 3,644 | – | 4 | 3,648 | | |
| – non-financial institution customers | 648,695 | 178 | 1,896 | 650,769 | | |
| | 652,339 | 178 | 1,900 | 654,417 | | |

Notes:

(i) These loans and advances include those for which no objective evidence of impairment has been identified on individual basis.

(ii) Impaired loans and advances include loans for which objective evidence of impairment has been identified:

– collectively; that is portfolios of homogeneous loans; or

– individually.

(iii) The fair value of collaterals was estimated by management based on the latest available external valuations adjusted by taking into account the current realisation experience as well as market situation.

(Expressed in millions of Renminbi unless otherwise stated)

# 17 LOANS AND ADVANCES TO CUSTOMERS *(continued)*

## (e) Finance leases and hire purchase contracts

Loans and advances to customers include investment in finance lease receivables and hire purchase contracts, analysed as follows:

| | Group | | | |
|---|---|---|---|---|
| | **2008** | | 2007 | |
| | **Present value of the minimum lease payments** | **Total minimum lease payments** | Present value of the minimum lease payments | Total minimum lease payments |
| Within 1 year | **840** | **985** | – | – |
| After 1 year but within 5 years | **2,044** | **2,237** | – | – |
| After 5 years | **60** | **63** | – | – |
| | **2,944** | **3,285** | – | – |
| Impairment allowances: | | | | |
| – individually assessed | **(22)** | **(22)** | – | – |
| – collectively assessed | **(54)** | **(54)** | – | – |
| Unearned future income on finance lease | **–** | **(341)** | – | – |
| Net investment in finance leases and hire purchase contracts | **2,868** | **2,868** | – | – |

# 18 INVESTMENTS

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 (restated) | **2008** | 2007 (restated) |
| Financial assets at fair value through profit or loss (Note 18(a)) | **17,699** | 10,838 | **13,116** | 10,830 |
| Available-for-sale investments (Note 18(b)) | **206,959** | 141,627 | **205,591** | 141,627 |
| Held-to-maturity securities (Note 18(c)) | **70,373** | 74,632 | **66,217** | 74,632 |
| Receivables (Note 18(d)) | **15,415** | 16,537 | **15,415** | 16,537 |
| | **310,446** | 243,634 | **300,339** | 243,626 |

(Expressed in millions of Renminbi unless otherwise stated)

# 18 INVESTMENTS *(continued)*

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

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| ***(i) Trading assets*** | | | | |
| *Listed* | | | | |
| In the Mainland | | | | |
| – PRC government bonds | **352** | 340 | **352** | 340 |
| – bonds issued by the PBOC | **2,873** | 986 | **2,873** | 986 |
| – bonds issued by policy banks | **1,585** | 2,146 | **1,585** | 2,146 |
| – bonds issued by commercial banks and other financial institutions | **2,266** | – | **2,266** | – |
| – other debt securities | **2,825** | 2,932 | **2,825** | 2,932 |
| Outside the Mainland | | | | |
| – PRC government bonds | **47** | – | **–** | – |
| – bonds issued by commercial banks and other financial institutions | **593** | 590 | **593** | 590 |
| – other debt securities | **439** | 198 | **–** | 198 |
| – equity investments | **96** | 8 | **–** | – |
| – investments in funds | **1** | – | **–** | – |
| | **11,077** | 7,200 | **10,494** | 7,192 |
| *Unlisted* | | | | |
| In the Mainland | | | | |
| – bonds issued by policy banks | **98** | – | **–** | – |
| – bonds issued by commercial banks and other financial institutions | **130** | – | **–** | – |
| Outside the Mainland | | | | |
| – bonds issued by commercial banks and other financial institutions | **65** | 100 | **–** | 100 |
| – other debts securities | **1,597** | – | **–** | – |
| | **12,967** | 7,300 | **10,494** | 7,292 |
| Derivative financial instruments (Note 44(h)) | **2,287** | 3,293 | **2,252** | 3,293 |
| | **15,254** | 10,593 | **12,746** | 10,585 |

(Expressed in millions of Renminbi unless otherwise stated)

# 18 INVESTMENTS *(continued)*

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

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| ***(ii) Financial assets designated at fair value through profit or loss*** | | | | |
| *Listed* | | | | |
| In the Mainland | | | | |
| – PRC government bonds | **261** | 245 | **261** | 245 |
| Outside the Mainland | | | | |
| – bonds issued by policy banks | **66** | – | **–** | – |
| – bonds issued by commercial banks and other financial institutions | **118** | – | **–** | – |
| – other debt securities | **1,189** | – | **–** | – |
| | **1,634** | 245 | **261** | 245 |
| *Unlisted* | | | | |
| Outside the Mainland | | | | |
| – bonds issued by commercial banks and other financial institutions | **200** | – | **–** | – |
| – other debt securities | **611** | – | **109** | – |
| | **811** | – | **109** | – |
| | **17,699** | 10,838 | **13,116** | 10,830 |

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| ***Financial assets at fair value through profit or loss (excluding derivative financial instruments)*** | | | | |
| Issued by: | | | | |
| Sovereigns | **5,564** | 1,571 | **3,486** | 1,571 |
| Banks and other financial institutions | **5,166** | 2,836 | **4,444** | 2,836 |
| Public sector entities | **297** | 198 | **–** | 198 |
| Corporates | **4,385** | 2,940 | **2,934** | 2,932 |
| | **15,412** | 7,545 | **10,864** | 7,537 |

(Expressed in millions of Renminbi unless otherwise stated)

## 18 INVESTMENTS *(continued)*

### (b) Available-for-sale investments

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 (restated) | **2008** | 2007 (restated) |
| *Listed* | | | | |
| In the Mainland | | | | |
| – PRC government bonds | **9,734** | 6,858 | **9,734** | 6,858 |
| – bonds issued by the PBOC | **52,661** | 53,537 | **52,661** | 53,537 |
| – bonds issued by policy banks | **34,762** | 45,075 | **34,762** | 45,075 |
| – bonds issued by commercial banks and other financial institutions | **46,514** | 2,601 | **46,514** | 2,601 |
| – other debt securities | **49,062** | 22,508 | **49,049** | 22,508 |
| Outside the Mainland | | | | |
| – bonds issued by commercial banks and other financial institutions | **4,468** | 6,643 | **4,307** | 6,643 |
| – other debt securities | **844** | 2,682 | **776** | 2,682 |
| – equity investments | **337** | – | **117** | – |
| – investments in funds | **11** | – | **–** | – |
| | **198,393** | 139,904 | **197,920** | 139,904 |
| *Unlisted* | | | | |
| In the Mainland | | | | |
| – bonds issued by commercial banks and other financial institutions | **6,976** | 401 | **6,976** | 401 |
| – equity investments | **609** | 38 | **395** | 38 |
| Outside the Mainland | | | | |
| – bonds issued by commercial banks and other financial institutions | **306** | 938 | **29** | 938 |
| – other debt securities | **644** | 203 | **264** | 203 |
| – equity investments | **18** | 143 | **7** | 143 |
| – investments in funds | **13** | – | **–** | – |
| | **8,566** | 1,723 | **7,671** | 1,723 |
| | **206,959** | 141,627 | **205,591** | 141,627 |

(Expressed in millions of Renminbi unless otherwise stated)

## 18 INVESTMENTS *(continued)*

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

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 (restated) | **2008** | 2007 (restated) |
| Issued by: | | | | |
| Sovereigns | **63,007** | 60,674 | **62,660** | 60,674 |
| Banks and other financial institutions | **93,578** | 55,594 | **92,895** | 55,594 |
| Public sector entities | **–** | 1,970 | **–** | 1,970 |
| Corporates | **50,374** | 23,389 | **50,036** | 23,389 |
| | **206,959** | 141,627 | **205,591** | 141,627 |

### (c) Held-to-maturity securities

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| *Listed* | | | | |
| In the Mainland | | | | |
| – PRC government bonds | **15,548** | 16,444 | **15,548** | 16,444 |
| – bonds issued by the PBOC | **13,588** | 10,810 | **13,588** | 10,810 |
| – bonds issued by policy banks | **8,420** | 34,582 | **8,420** | 34,582 |
| – bonds issued by commercial banks and other financial institutions | **26,238** | 1,908 | **26,238** | 1,908 |
| – other debt securities | **1,374** | 2,134 | **1,374** | 2,134 |
| Outside the Mainland | | | | |
| – bonds issued by commercial banks and other financial institutions | **1,379** | 3,105 | **898** | 3,105 |
| – other debt securities | **361** | 5,649 | **265** | 5,649 |
| | **66,908** | 74,632 | **66,331** | 74,632 |

(Expressed in millions of Renminbi unless otherwise stated)

# 18 INVESTMENTS *(continued)*

## (c) Held-to-maturity securities *(continued)*

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| *Unlisted* | | | | |
| Outside the Mainland | | | | |
| – bonds issued by commercial banks and other financial institutions | **3,496** | – | **–** | – |
| – other debt securities | **184** | – | **–** | – |
| | **3,680** | – | **–** | – |
| | **70,588** | 74,632 | **66,331** | 74,632 |
| Less: Impairment allowances | **(215)** | – | **(114)** | – |
| | **70,373** | 74,632 | **66,217** | 74,632 |
| Issued by: | | | | |
| Sovereigns | **29,280** | 31,923 | **29,258** | 31,923 |
| Banks and other financial institutions | **39,336** | 39,594 | **35,462** | 39,594 |
| Public sector entities | **24** | 849 | **–** | 849 |
| Corporates | **1,733** | 2,266 | **1,497** | 2,266 |
| | **70,373** | 74,632 | **66,217** | 74,632 |
| *Listed fair value* | **68,831** | 74,037 | **68,291** | 74,037 |

### *Movements of allowances for impairment losses*

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| As at 1 January | **–** | – | **–** | – |
| Addition through acquisition of subsidiaries | **84** | – | **–** | – |
| Charge for the year | **199** | – | **114** | – |
| Write-offs | **(68)** | – | **–** | – |
| As at 31 December | **215** | – | **114** | – |

(Expressed in millions of Renminbi unless otherwise stated)

## 18 INVESTMENTS *(continued)*

### (d) Receivables

| | Group and Bank | |
|---|---|---|
| | **2008** | 2007 |
| *Unlisted* | | |
| In the Mainland | | |
| – PRC government bonds | **5,789** | 7,962 |
| – bonds issued by the PBOC | **8,000** | 8,000 |
| – bonds issued by commercial banks and other financial institutions | **578** | 50 |
| Outside the Mainland | | |
| – bonds issued by commercial banks and other financial institutions | **877** | 232 |
| – other debt securities | **233** | 293 |
| | **15,477** | 16,537 |
| Less: Impairment allowances | **(62)** | – |
| | **15,415** | 16,537 |
| Issued by: | | |
| Sovereigns | **13,789** | 15,962 |
| Banks and other financial institutions | **1,393** | 282 |
| Corporates | **233** | 293 |
| | **15,415** | 16,537 |

***Movements of allowances for impairment losses***

| | Group and Bank | |
|---|---|---|
| | **2008** | 2007 |
| As at 1 January | **–** | – |
| Charge for the year | **62** | – |
| As at 31 December | **62** | – |

Receivables are unlisted bearer's national bonds issued by the PRC government and other debt investments which are not quoted in an active market in the PRC or overseas. Accordingly, the Group is unable to disclose their market values.

(Expressed in millions of Renminbi unless otherwise stated)

## 18 INVESTMENTS *(continued)*

### (e) Trading liabilities

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Short positions in exchange fund bill and notes at fair value: | | | | |
| – Listed | **1** | – | **–** | – |
| – Unlisted | **523** | – | **–** | – |
| | **524** | – | **–** | – |

### (f) Financial liabilities designated at fair value through profit or loss

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| *Unlisted* | | | | |
| Outside the Mainland | | | | |
| – certificates of deposit issued | **1,208** | – | **–** | – |
| – structured deposit | **620** | – | **–** | – |
| | **1,828** | – | **–** | – |

### (g) *(i)* *CIGNA & CMC Life Insurance Company Limited*

On 5 May 2008, the Bank entered into an agreement with Shenzhen Municipal Dingzun Investment Advisory Company ("Dingzun") to acquire 50% equity interest in CIGNA & CMC Life Insurance Company Limited ("CIGNA & CMC Life Insurance") for a total consideration of RMB141.9 million. The completion of the acquisition is subject to obtaining approvals from relevant regulatory authorities including the China Securities Regulatory Commission (the "CSRC"), the China Banking Regulatory Commission (the "CBRC") and the China Insurance Regulatory Commission ("CIRC"). As of 31 December 2008, the proposed acquisition has not yet been approved by the relevant regulatory authorities.

#### *(ii)* *Trust & Investment Corporation of Tibet Autonomous Region*

On 18 September 2008, the Bank entered into the framework agreement with the Tibet Autonomous Region Finance Bureau to acquire 60.5% equity interest in Trust & Investment Corporation of Tibet Autonomous Region ("Tibet Trust"). As of 31 December 2008, the completion of the acquisition is subject to obtaining approvals from relevant regulatory authorities including the CSRC and CBRC.

## 19 INTEREST IN ASSOCIATES

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Unlisted shares, at cost | **–** | – | **191** | 191 |
| Share of net assets | **152** | 111 | **–** | – |
| Goodwill | **114** | 114 | **–** | – |
| | **266** | 225 | **191** | 191 |

The following list contains only the particulars of associates as of 31 December 2008, which are unlisted corporate entities and principally affected the results or assets of the Group:

| Name of associate | Form of business structure | Place of incorporation and operation | Particulars of issued and paid up capital (in thousands) | Proportion of ownership interest: Group's effective interest | Held by the Bank | Held by the subsidiary | Principal activity |
|---|---|---|---|---|---|---|---|
| China Merchants Fund Management Company Limited | Incorporated | Shenzhen | RMB210,000 | 33.40% | 33.40% | – | Asset management |
| Professional Liability Underwriting Services Limited | Incorporated | Hong Kong | HK$3,000 | 26.41% | – | 27.00% | Insurance underwriting |
| Equity Underwriters Limited | Incorporated | Hong Kong | HK$3,950 | 39.13% | – | 40.00% | Insurance underwriting |

### Summary financial information on associates (China Merchants Fund Management Company Limited)

| | Assets | Liabilities | Equity | Revenues | Profit/(loss) |
|---|---|---|---|---|---|
| **2008** | | | | | |
| 100 per cent | **660** | **197** | **463** | **643** | **241** |
| Group's effective interest | **220** | **66** | **147** | **205** | **37** |
| 2007 | | | | | |
| 100 per cent | 525 | 192 | 333 | 595 | 203 |
| Group's effective interest | 175 | 64 | 111 | 93 | 38 |

## 19 INTEREST IN ASSOCIATES *(continued)*

### Summary financial information on associates (Others)

| | Assets | Liabilities | Equity | Revenues | Profit/(loss) |
|---|---|---|---|---|---|
| **2008** | | | | | |
| 100 per cent | **141** | **123** | **18** | **7** | **–** |
| Group's effective interest | **44** | **39** | **5** | **2** | **–** |

## 20 INTEREST IN JOINTLY CONTROLLED ENTITIES

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Share of net assets | **82** | – | **–** | – |
| Loan to jointly controlled entities | **54** | – | **–** | – |
| | **136** | – | **–** | – |

Details of the group's interest in the jointly controlled entities are as follows:

| Name of associate | Form of business structure | Place of incorporation and operation | Particulars of issued and paid up capital (in thousands) | Proportion of ownership interest: Group's effective interest | Held by the Bank | Held by the subsidiary | Principal activity |
|---|---|---|---|---|---|---|---|
| Bank Consortium Holding Limited | Incorporated | Hong Kong | HK$150,000 | 13.04% | – | 14.29% | Provision of trustee, administration and custodian services for retirement schemes |
| Joint Electronic Teller Services Limited (note) | Incorporated | Hong Kong | HK$10,024 | 2.82% | – | 20.00% | Provision of ATM network services |
| Hong Kong Life Insurance Limited | Incorporated | Hong Kong | HK$420,000 | 16.31% | – | 16.67% | Life insurance business |
| BC Reinsurance Limited | Incorporated | Hong Kong | HK$100,000 | 20.54% | – | 21.00% | Reinsurance business |
| i-Tech Solutions Limited | Incorporated | Hong Kong | HK$6,000 | 48.91% | – | 50.00% | Electronic document processing |

(Expressed in millions of Renminbi unless otherwise stated)

## 20 INTEREST IN JOINTLY CONTROLLED ENTITIES *(continued)*

### Summary financial information on jointly controlled entity:

| | Assets | Liabilities | Equity | Revenues | Profit/(loss) |
|---|---|---|---|---|---|
| **2008** | | | | | |
| 100 per cent | 3,638 | 2,945 | 693 | 66 | (132) |
| Group's effective interest | 561 | 479 | 82 | 8 | (26) |

Note: The Bank's subsidiary, Wing Lung Bank is one of the five founders of the entity and jointly control the entity. Wing Lung Bank holds 20% of the entity's common share and is entitled to 2.88% of the paid dividends.

## 21 FIXED ASSETS

**2008**

| | Group | | | | | | |
|---|---|---|---|---|---|---|---|
| | Land and buildings | Investment properties (note 21(b)) | Construction in progress (note 21(c)) | Computer equipment | Leasehold improvements | Motor vehicles and other equipment | Total |
| **Cost:** | | | | | | | |
| At 1 January 2008 | 5,065 | 531 | 1,411 | 3,828 | 1,801 | 1,202 | 13,838 |
| Additions through acquisition of subsidiaries | 2,839 | 2,095 | – | 52 | 62 | 21 | 5,069 |
| Additions | 93 | – | 1,442 | 1,502 | 652 | 384 | 4,073 |
| Transfers | 209 | (32) | (548) | – | 17 | 5 | (349) |
| Disposals/write-offs | (202) | – | – | (544) | (238) | (78) | (1,062) |
| At 31 December 2008 | 8,004 | 2,594 | 2,305 | 4,838 | 2,294 | 1,534 | 21,569 |
| **Accumulated depreciation:** | | | | | | | |
| At 1 January 2008 | 1,385 | 137 | – | 1,927 | 935 | 732 | 5,116 |
| Depreciation | 283 | 56 | – | 1,220 | 238 | 207 | 2,004 |
| Transfers | 5 | (5) | – | – | – | – | – |
| Written back on disposals/write-offs | (108) | – | – | (215) | (226) | (64) | (613) |
| At 31 December 2008 | 1,565 | 188 | – | 2,932 | 947 | 875 | 6,507 |
| **Net book value:** | | | | | | | |
| At 31 December 2008 | 6,439 | 2,406 | 2,305 | 1,906 | 1,347 | 659 | 15,062 |
| At 1 January 2008 | 3,680 | 394 | 1,411 | 1,901 | 866 | 470 | 8,722 |

(Expressed in millions of Renminbi unless otherwise stated)

## 21 FIXED ASSETS *(continued)*

2007

| | Group | | | | | | |
|---|---|---|---|---|---|---|---|
| | Land and buildings | Investment properties (note 21(b)) | Construction in progress (note 21(c)) | Computer equipment | Leasehold improvements | Motor vehicles and other equipment | Total |
| **Cost:** | | | | | | | |
| At 1 January 2007 | 4,558 | 584 | 766 | 3,014 | 1,411 | 1,013 | 11,346 |
| Additions | 48 | – | 1,154 | 1,162 | 366 | 245 | 2,975 |
| Transfers | 543 | (53) | (508) | – | 25 | 2 | 9 |
| Disposals/write-offs | (84) | – | (1) | (348) | (1) | (58) | (492) |
| At 31 December 2007 | 5,065 | 531 | 1,411 | 3,828 | 1,801 | 1,202 | 13,838 |
| **Accumulated depreciation:** | | | | | | | |
| At 1 January 2007 | 1,153 | 146 | – | 1,633 | 761 | 647 | 4,340 |
| Depreciation | 229 | 28 | – | 461 | 174 | 128 | 1,020 |
| Transfers | 37 | (37) | – | – | – | – | – |
| Written back on disposals/write-offs | (34) | – | – | (167) | – | (43) | (244) |
| At 31 December 2007 | 1,385 | 137 | – | 1,927 | 935 | 732 | 5,116 |
| **Net book value:** | | | | | | | |
| At 31 December 2007 | 3,680 | 394 | 1,411 | 1,901 | 866 | 470 | 8,722 |
| At 1 January 2007 | 3,405 | 438 | 766 | 1,381 | 650 | 366 | 7,006 |

(Expressed in millions of Renminbi unless otherwise stated)

## 21 FIXED ASSETS *(continued)*

**2008**

| | Bank | | | | | | |
|---|---|---|---|---|---|---|---|
| | Land and buildings | Investment properties (note 21(b)) | Construction in progress (note 21(c)) | Computer equipment | Leasehold improvements | Motor vehicles and other equipment | Total |
| **Cost:** | | | | | | | |
| At 1 January 2008 | 5,050 | 499 | 1,411 | 3,825 | 1,798 | 1,201 | 13,784 |
| Additions | 93 | – | 1,442 | 1,495 | 645 | 380 | 4,055 |
| Transfers | 207 | (30) | (548) | – | 17 | 5 | (349) |
| Disposals/write-offs | (200) | – | – | (544) | (235) | (78) | (1,057) |
| At 31 December 2008 | 5,150 | 469 | 2,305 | 4,776 | 2,225 | 1,508 | 16,433 |
| **Accumulated depreciation:** | | | | | | | |
| At 1 January 2008 | 1,384 | 136 | – | 1,926 | 932 | 731 | 5,109 |
| Depreciation | 246 | 28 | – | 1,213 | 232 | 205 | 1,924 |
| Transfers | 5 | (5) | – | – | – | – | – |
| Written back on disposals/write-offs | (108) | – | – | (215) | (223) | (64) | (610) |
| At 31 December 2008 | 1,527 | 159 | – | 2,924 | 941 | 872 | 6,423 |
| **Net book value:** | | | | | | | |
| At 31 December 2008 | 3,623 | 310 | 2,305 | 1,852 | 1,284 | 636 | 10,010 |
| At 1 January 2008 | 3,666 | 363 | 1,411 | 1,899 | 866 | 470 | 8,675 |

(Expressed in millions of Renminbi unless otherwise stated)

## 21 FIXED ASSETS *(continued)*

2007

| | Bank | | | | | | |
|---|---|---|---|---|---|---|---|
| | Land and buildings | Investment properties (note 21(b)) | Construction in progress (note 21(c)) | Computer equipment | Leasehold improvements | Motor vehicles and other equipment | Total |
| **Cost:** | | | | | | | |
| At 1 January 2007 | 4,542 | 552 | 766 | 3,013 | 1,410 | 1,013 | 11,296 |
| Additions | 48 | – | 1,154 | 1,160 | 364 | 244 | 2,970 |
| Transfers | 543 | (53) | (508) | – | 25 | 2 | 9 |
| Disposals/write-offs | (83) | – | (1) | (348) | (1) | (58) | (491) |
| At 31 December 2007 | 5,050 | 499 | 1,411 | 3,825 | 1,798 | 1,201 | 13,784 |
| **Accumulated depreciation:** | | | | | | | |
| At 1 January 2007 | 1,153 | 146 | – | 1,633 | 761 | 647 | 4,340 |
| Depreciation | 228 | 27 | – | 460 | 171 | 127 | 1,013 |
| Transfers | 37 | (37) | – | – | – | – | – |
| Written back on disposals/write-offs | (34) | – | – | (167) | – | (43) | (244) |
| At 31 December 2007 | 1,384 | 136 | – | 1,926 | 932 | 731 | 5,109 |
| **Net book value:** | | | | | | | |
| At 31 December 2007 | 3,666 | 363 | 1,411 | 1,899 | 866 | 470 | 8,675 |
| At 1 January 2007 | 3,389 | 406 | 766 | 1,380 | 649 | 366 | 6,956 |

(Expressed in millions of Renminbi unless otherwise stated)

# 21 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:

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Held in Mainland China | | | | |
| – long leases (over 50 years) | **508** | 552 | **506** | 507 |
| – medium-term leases (10 – 50 years) | **3,427** | 3,472 | **3,396** | 3,472 |
| | **3,935** | 4,024 | **3,902** | 3,979 |
| Held in Hong Kong | | | | |
| – long leases (over 50 years) | **4,222** | – | **–** | – |
| – medium-term leases (10 – 50 years) | **658** | 50 | **31** | 50 |
| | **4,880** | 50 | **31** | 50 |
| Held in Overseas | | | | |
| – freehold | **30** | – | **–** | – |
| | **8,845** | 4,074 | **3,933** | 4,029 |

**(b)** Investment properties of the Group mainly represent WLB's leasing properties and 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 2008, fair value of these properties was RMB2.86 billion (2007: RMB1.04 billion). The Group's total future minimum lease payments under non-cancellable operating leases are receivables as follows:

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| 1 year or less | **151** | 54 | **54** | 54 |
| 5 years or less but over 1 year | **158** | 82 | **50** | 82 |
| Over 5 years | **1** | 2 | **1** | 2 |
| | **310** | 138 | **105** | 138 |

**(c)** For the year ended 31 December 2008, the amortisation of the land use right of RMB16 million was capitalised as the cost of the properties built on the land (2007: 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 31 December 2008, the Board of Directors considered that there was no impairment loss on fixed assets (2007: nil).

**(e)** As at 31 December 2008, ownership documentation for the Group's properties with a net carrying value of RMB115 million (2007: RMB199 million) was being finalised.

(Expressed in millions of Renminbi unless otherwise stated)

## 22 INTANGIBLE ASSETS

**2008**

| | Group | | | | |
|---|---|---|---|---|---|
| | **Land use right** | **Software** | **Trademark** | **Core deposit** | **Total** |
| **Cost/Valuation:** | | | | | |
| At 1 January 2008 | **387** | **209** | **–** | **–** | **596** |
| Additions through acquisition of subsidiaries | **210** | **1** | **10** | **1,156** | **1,377** |
| Addition | **424** | **121** | **–** | **–** | **545** |
| Disposals | **–** | **(1)** | **–** | **–** | **(1)** |
| At 31 December 2008 | **1,021** | **330** | **10** | **1,156** | **2,517** |
| **Amortization:** | | | | | |
| At 1 January 2008 | **26** | **52** | **–** | **–** | **78** |
| Additions | **17** | **30** | **1** | **10** | **58** |
| At 31 December 2008 | **43** | **82** | **1** | **10** | **136** |
| **Net book value:** | | | | | |
| At 31 December 2008 | **978** | **248** | **9** | **1,146** | **2,381** |
| At 1 January 2008 | **361** | **157** | **–** | **–** | **518** |

2007

| | Group | | |
|---|---|---|---|
| | Land use right | Software | Total |
| **Cost/Valuation:** | | | |
| At 1 January 2007 | 387 | 122 | 509 |
| Additions | – | 166 | 166 |
| Disposals | – | (79) | (79) |
| At 31 December 2007 | 387 | 209 | 596 |
| **Amortization:** | | | |
| At 1 January 2007 | 17 | 32 | 49 |
| Additions | 9 | 20 | 29 |
| At 31 December 2007 | 26 | 52 | 78 |
| **Net book value:** | | | |
| At 31 December 2007 | 361 | 157 | 518 |
| At 1 January 2007 | 370 | 90 | 460 |

(Expressed in millions of Renminbi unless otherwise stated)

## 22 INTANGIBLE ASSETS *(continued)*

**2008**

| | | Bank | |
|---|---|---|---|
| | **Land use right** | **Software** | **Total** |
| **Cost/Valuation:** | | | |
| At 1 January 2008 | **387** | **209** | **596** |
| Additions | **424** | **121** | **545** |
| Disposals | **–** | **(1)** | **(1)** |
| At 31 December 2008 | **811** | **329** | **1,140** |
| **Amortization:** | | | |
| At 1 January 2008 | **26** | **52** | **78** |
| Additions | **16** | **29** | **45** |
| At 31 December 2008 | **42** | **81** | **123** |
| **Net book value:** | | | |
| At 31 December 2008 | **769** | **248** | **1,017** |
| At 1 January 2008 | **361** | **157** | **518** |

2007

| | | Bank | |
|---|---|---|---|
| | Land use right | Software | Total |
| **Cost/Valuation:** | | | |
| At 1 January 2007 | 387 | 122 | 509 |
| Additions | – | 166 | 166 |
| Disposals | – | (79) | (79) |
| At 31 December 2007 | 387 | 209 | 596 |
| **Amortization:** | | | |
| At 1 January 2007 | 17 | 32 | 49 |
| Additions | 9 | 20 | 29 |
| At 31 December 2007 | 26 | 52 | 78 |
| **Net book value:** | | | |
| At 31 December 2007 | 361 | 157 | 518 |
| At 1 January 2007 | 370 | 90 | 460 |

(Expressed in millions of Renminbi unless otherwise stated)

## 23 DEFERRED TAX

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Deferred tax assets | **2,521** | 2,162 | **2,443** | 2,162 |
| Deferred tax liabilities | **(848)** | – | **–** | – |
| Total | **1,673** | 2,162 | **2,443** | 2,162 |

### (a) Nature of deferred tax assets and liabilities

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

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Impairment losses on loans and advances to customers and other assets | **3,198** | 2,038 | **3,182** | 2,038 |
| Investment revaluation reserve | **(708)** | 103 | **(708)** | 103 |
| Deductible salary expenses | **–** | 144 | **–** | 144 |
| Others | **(817)** | (123) | **(31)** | (123) |
| | **1,673** | 2,162 | **2,443** | 2,162 |

(Expressed in millions of Renminbi unless otherwise stated)

# 23 DEFERRED TAX *(continued)*

## (b) Movements of deferred tax

| | Group | | | | |
|---|---|---|---|---|---|
| | Impairment losses on loans and advances to customers and other assets | Investment revaluation reserve | Deductible salary expenses | Others | Total |
| At 1 January 2008 | **2,038** | **103** | **144** | **(123)** | **2,162** |
| Addition through acquisition of subsidiaries | **16** | **8** | **–** | **(913)** | **(889)** |
| Recognised in the consolidated income statement | **1,144** | **–** | **(144)** | **213** | **1,213** |
| – due to timing differences | **883** | **–** | **(144)** | **230** | **969** |
| – due to income tax rate change | **261** | **–** | **–** | **(17)** | **244** |
| Recognised in reserves | **–** | **(819)** | **–** | **6** | **(813)** |
| – due to timing differences | **–** | **(830)** | **–** | **6** | **(824)** |
| – due to income tax rate change | **–** | **11** | **–** | **–** | **11** |
| At 31 December 2008 | **3,198** | **(708)** | **–** | **(817)** | **1,673** |
| At 1 January 2007 | 2,384 | (34) | – | (90) | 2,260 |
| Recognised in the consolidated income statement | (346) | – | 144 | (33) | (235) |
| – due to timing differences | 116 | – | 144 | (15) | 245 |
| – due to income tax rate change | (462) | – | – | (18) | (480) |
| Recognised in reserves | – | 137 | – | – | 137 |
| – due to timing differences | – | 144 | – | – | 144 |
| – due to income tax rate change | – | (7) | – | – | (7) |
| At 31 December 2007 | 2,038 | 103 | 144 | (123) | 2,162 |

(Expressed in millions of Renminbi unless otherwise stated)

# 23 DEFERRED TAX *(continued)*

## (b) Movements of deferred tax *(continued)*

| | Bank | | | | |
|---|---|---|---|---|---|
| | Impairment losses on loans and advances to customers and other assets | Investment revaluation reserve | Deductible salary expenses | Others | Total |
| At 1 January 2008 | **2,038** | **103** | **144** | **(123)** | **2,162** |
| Recognised in the consolidated income statement | **1,144** | **–** | **(144)** | **92** | **1,092** |
| – due to timing differences | **883** | **–** | **(144)** | **109** | **848** |
| – due to income tax rate change | **261** | **–** | **–** | **(17)** | **244** |
| Recognised in reserves | **–** | **(811)** | **–** | **–** | **(811)** |
| – due to timing differences | **–** | **(822)** | **–** | **–** | **(822)** |
| – due to income tax rate change | **–** | **11** | **–** | **–** | **11** |
| At 31 December 2008 | **3,182** | **(708)** | **–** | **(31)** | **2,443** |
| At 1 January 2007 | 2,384 | (34) | – | (90) | 2,260 |
| Recognised in the consolidated income statement | (346) | – | 144 | (33) | (235) |
| – due to timing differences | 116 | – | 144 | (15) | 245 |
| – due to income tax rate change | (462) | – | – | (18) | (480) |
| Recognised in reserves | – | 137 | – | – | 137 |
| – due to timing differences | – | 144 | – | – | 144 |
| – due to income tax rate change | – | (7) | – | – | (7) |
| At 31 December 2007 | 2,038 | 103 | 144 | (123) | 2,162 |

On 16 March 2007, the Fifth Plenary Session of the Tenth National People's Congress passed the Corporate Income Tax Law of the People's Republic of China ("New Tax Law") which will take effect on 1 January 2008. As a result of New Tax Law, the income tax rate applicable to the Bank's business in areas other than Shenzhen is 25%, the income tax rate for the Bank's business in Shenzhen will gradually increase from 18% to the standard rate of 25% (being 18% in 2008, 20% in 2009, 22% in 2010, 24% in 2011 and 25% in 2012).

# 24 GOODWILL

| | Group |
|---|---|
| | **2008** |
| At 1 January | **–** |
| Addition through acquisition of a subsidiary | **10,177** |
| Impairment | **(579)** |
| At 31 December | **9,598** |

(Expressed in millions of Renminbi unless otherwise stated)

## 24 GOODWILL *(continued)*

The goodwill arose from the acquisition of Wing Lung Bank Limited on 30 September 2008.

*Impairment test for cash-generating unit containing goodwill*

Goodwill is allocated to the Group's cash-generating unit ("CGU"), Wing Lung Bank Limited which was acquired on 30 September 2008.

The recoverable amount of the CGU is determined based on value-in-use calculations. These calculations use cash flow projections based on financial forecasts approved by management covering a 5-year period. Cash flows beyond the 5-year period are extrapolated using a steady growth rate. The growth rate does not exceed the long-term average growth rate for the business in which the CGU operates.

In assessing impairment of goodwill, the Bank assumed the terminal growth in line with long-term forecast gross domestic product for the main operating areas of Wing Lung Bank Limited. A discount rate of 11.0% was used.

## 25 OTHER ASSETS

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 (restated) | **2008** | 2007 (restated) |
| Interest receivable | | | | |
| – debt securities | **3,548** | 2,725 | **3,504** | 2,725 |
| – loans and advances to customers | **1,778** | 1,595 | **1,691** | 1,595 |
| – others | **359** | 561 | **316** | 561 |
| | **5,685** | 4,881 | **5,511** | 4,881 |
| Amounts pending for settlement | **319** | 153 | **223** | 153 |
| Repossessed assets (note) | **84** | 111 | **84** | 111 |
| Prepaid lease payments | **266** | 156 | **262** | 156 |
| Capital injection for establishment of a subsidiary | **–** | 2,000 | **–** | 2,000 |
| Receivables for debt securities disposed | **1,048** | 913 | **849** | 913 |
| Deposits | **122** | 85 | **122** | 85 |
| Prepayment for lease improvement and other miscellaneous items | **236** | 31 | **236** | 31 |
| Continuing involvement assets | **409** | – | **409** | – |
| Remainder of mandatory acquisition of Wing Lung Bank | **700** | – | **700** | – |
| Premium receivables | **155** | – | **–** | – |
| Recoverable from reinsurers | **138** | – | **–** | – |
| Retirement benefit scheme (note 31(a)(ii)) | **188** | – | **–** | – |
| Others | **1,216** | 745 | **837** | 703 |
| | **10,566** | 9,075 | **9,233** | 9,033 |

(Expressed in millions of Renminbi unless otherwise stated)

## 25 OTHER ASSETS *(continued)*

Note: During the year ended 31 December 2008, the Group has taken possession of collateral it holds as security with the nature and carrying amounts analysed as follows:

| | Group and Bank | |
|---|---|---|
| | **2008** | 2007 |
| **Nature** | | |
| Residential properties | **994** | 886 |
| Others | **280** | 361 |
| | **1,274** | 1,247 |
| Less: Impairment allowances | **(1,190)** | (1,136) |
| | **84** | 111 |

Repossessed assets obtained are intended for an orderly realisation of the impaired loans and advances and are not intended for the own use of the Group.

## 26 DEPOSITS FROM BANKS AND OTHER FINANCIAL INSTITUTIONS

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Deposits from banks | **25,150** | 6,951 | **25,024** | 6,951 |
| Deposits from other financial institutions | **90,642** | 211,569 | **90,718** | 211,569 |
| | **115,792** | 218,520 | **115,742** | 218,520 |

## 27 PLACEMENTS FROM BANKS AND OTHER FINANCIAL INSTITUTIONS

### (a) Analysed by nature

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Money market takings | | | | |
| – banks | **37,842** | 5,555 | **37,296** | 5,555 |
| Balances under repurchase agreements (note) | | | | |
| – banks | **4,840** | 21,922 | **4,840** | 21,922 |
| – other financial institutions | **946** | 19,126 | **646** | 19,126 |
| | **5,786** | 41,048 | **5,486** | 41,048 |
| Rediscounted bills | **6,496** | – | **6,496** | – |
| | **50,124** | 46,603 | **49,278** | 46,603 |

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

(Expressed in millions of Renminbi unless otherwise stated)

## 27 PLACEMENTS FROM BANKS AND OTHER FINANCIAL INSTITUTIONS

*(continued)*

### (b) Analysed by geographical location

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Money market takings | | | | |
| – banks in the Mainland | **36,394** | 5,555 | **36,410** | 5,555 |
| – banks outside the Mainland | **1,448** | – | **886** | – |
| | **37,842** | 5,555 | **37,296** | 5,555 |
| Balances under repurchase agreements | | | | |
| – banks in the Mainland | **4,840** | 21,922 | **4,840** | 21,922 |
| – other financial institutions in the Mainland | **946** | 14,728 | **646** | 14,728 |
| – other financial institutions outside the Mainland | **–** | 4,398 | **–** | 4,398 |
| | **5,786** | 41,048 | **5,486** | 41,048 |
| Rediscounted bills | | | | |
| – banks in the Mainland | **6,496** | – | **6,496** | – |
| | **50,124** | 46,603 | **49,278** | 46,603 |

## 28 DEPOSITS FROM CUSTOMERS

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Demand deposits | | | | |
| – corporate customers | **373,222** | 350,951 | **367,543** | 351,008 |
| – retail customers | **268,220** | 190,697 | **253,164** | 190,697 |
| | **641,442** | 541,648 | **620,707** | 541,705 |
| Time deposits | | | | |
| – corporate customers | **352,499** | 266,050 | **333,754** | 266,228 |
| – retail customers | **256,707** | 135,836 | **223,779** | 135,836 |
| | **609,206** | 401,886 | **557,533** | 402,064 |
| | **1,250,648** | 943,534 | **1,178,240** | 943,769 |

(Expressed in millions of Renminbi unless otherwise stated)

# 29 ISSUED DEBT SECURITIES

## (a) Certificates of deposit issued

At the balance sheet date, certificates of deposit issued by the Bank were as follows:

| Terms | Date of issue | Annual Interest Rate | Nominal value | Carrying amount | |
|---|---|---|---|---|---|
| | | (%) | | **2008** | 2007 |
| | | | (in US$ million) | | |
| 1 year | 25 October 2007 | LIBOR+0.15% | 150 | **–** | 1,095 |
| 1 year | 4 November 2008 | LIBOR+0.30% | 45 | **307** | – |
| | | | (in HK$ million) | | |
| 1 year | 10 January 2008 | 3.50% | 500 | **440** | – |
| 2 years | 16 April 2008 | HIBOR+0.40% | 220 | **194** | – |
| | | | | **941** | 1,095 |

At the balance sheet date, certificates of deposit issued by WLB were as follows:

| Terms | Date of issue | Annual Interest Rate | Nominal value | Carrying amount | |
|---|---|---|---|---|---|
| | | (%) | | **2008** | 2007 |
| | | | (in US$ million) | | |
| 1 year | 21 April 2008 | LIBOR+0.40% | 25 | **170** | – |
| Half a year | 4 September 2008 | LIBOR+0.30% | 30 | **205** | – |
| | | | (in US$ million) | | |
| 3 years | 27 March 2006 | HIBOR+0.12% | 115 | **101** | – |
| 3 years | 2 November 2006 | HIBOR+0.08% | 150 | **132** | – |
| 3 years | 8 March 2007 | HIBOR+0.08% | 120 | **106** | – |
| 2 years | 24 January 2008 | HIBOR+0.10% | 110 | **97** | – |
| 3 years | 24 January 2008 | HIBOR+0.18% | 100 | **88** | – |
| | | | | **899** | – |
| | | | | **1,840** | 1,095 |

Interest on all these certificates of deposit are payable quarterly.

(Expressed in millions of Renminbi unless otherwise stated)

# 29 ISSUED DEBT SECURITIES *(continued)*

## (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.

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% (including accrued interest) of the nominal value of the convertible bonds.

Details of the convertible bonds are as follows:

| | **Group and Bank** | |
|---|---|---|
| | **2008** | 2007 |
| 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 | **235** | 235 |
| Amounts converted to shares | **(5,750)** | (5,739) |
| Liability component as at 31 December | **2** | 13 |

(Expressed in millions of Renminbi unless otherwise stated)

## 29 ISSUED DEBT SECURITIES *(continued)*

### (c) Other debts issued

| Particulars | Terms | Date of issue | Annual fixed interest Rate | Nominal value | Group and Bank Carrying amount | |
|---|---|---|---|---|---|---|
| | | | (%) | (in million) | 2008 | 2007 |
| Fixed term notes | 36 months | From 13 October 2005 to 26 October 2005 | 2.13 | 5,000 | – | 4,998 |
| Fixed term notes | 60 months | From 13 October 2005 to 26 October 2005 | 2.56 | 5,000 | **4,996** | 4,994 |
| | | | | | **4,996** | 9,992 |

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 | Group and Bank Carrying amount | |
|---|---|---|---|---|---|---|
| | | | (%) | (in million) | 2008 | 2007 |
| Fixed rate notes (note (i)) | 61 months | from 31 March 2004 to 10 June 2004 | 4.59 to 5.10 | 3,500 | **3,500** | 3,500 |
| Fixed rate notes (note (ii)) | 120 months | 4 September 2008 | 5.70 (for the first 5 years); 8.70 (from 6 year onwards, if the notes are not called by the Bank) | 19,000 | **18,962** | – |
| Fixed rate notes (note (ii)) | 180 months | 4 September 2008 | 5.90 (for the first 10 years); 8.90 (from 11 year onwards, if the notes are not called by the Bank) | 7,000 | **6,986** | – |
| Floating rate notes (note (ii)) | 120 months | 4 September 2008 | R*+1.53% (for the first 5 years); R*+4.53% (from 6 years onwards, if the notes are not called by the Bank) | 4,000 | **3,992** | – |
| | | | | | **33,440** | 3,500 |

* R represents the 1-year fixed deposit rate ("Rate") promulgated by PBOC. The Rate on 4 September 2008 was 4.14%.

(Expressed in millions of Renminbi unless otherwise stated)

# 29 ISSUED DEBT SECURITIES *(continued)*

## (d) Subordinated notes issued *(continued)*

Note:

(i) 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.

(ii) The CBRC and PBOC approved the Bank's issuance of RMB30 billion subordinated notes on 12 August 2008 (Yin Jian Fu【2008】No.304 entitled "The Approval of the issuance of subordinated bonds by China Merchants Bank" and Yin Shi Chang Xu Zhun Yu Zi【2008】No.25 entitle "Decision on Administrative Approval from the People's Bank of China"). The amount has been included as supplementary capital in calculating the Bank's capital adequacy ratio.

# 30 OTHER LIABILITIES

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 (restated) | **2008** | 2007 (restated) |
| Interest payable | **8,139** | 4,428 | **7,985** | 4,428 |
| Clearing and settlement accounts | **2,654** | 869 | **2,642** | 869 |
| Salaries and welfare payable (Note 31) | **2,980** | 3,599 | **2,906** | 3,599 |
| Salary risk allowances (Note 31(e)) | **3,256** | – | **3,256** | – |
| Deferred interest income on discounted bills | **1,091** | 1,466 | **1,091** | 1,466 |
| Business tax and surcharges payable | **1,140** | 1,077 | **1,133** | 1,077 |
| Cheques and remittances returned | **213** | 273 | **178** | 273 |
| Payment and collection account | **492** | 557 | **489** | 557 |
| Insurance liabilities | **1,312** | – | **–** | – |
| Continuing involvement liability | **409** | – | **409** | – |
| Securitisation principal and interest | **549** | – | **549** | – |
| Debt securities acquisition payable | **1,026** | 412 | **841** | 412 |
| Others | **3,491** | 1,509 | **2,784** | 1,493 |
| | **26,752** | 14,190 | **24,263** | 14,174 |

# 31 STAFF WELFARE SCHEME

## (a) 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% (2007: 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.

For its employees outside Mainland China, the Group participates in defined contribution retirement schemes at funding rates determined in accordance with the local practise and regulations.

(Expressed in millions of Renminbi unless otherwise stated)

# 31 STAFF WELFARE SCHEME *(continued)*

## (a) Retirement benefits *(continued)*

### *(ii) Defined benefit schemes*

The Group operates a retirement benefit scheme and a pension scheme (collectively known as "Defined benefit scheme") for the staff of a subsidiary of the Bank. The contributions of the Defined benefit scheme are determined based on periodic valuations by qualified actuaries of the assets and liabilities of the Defined benefit scheme scheme. The Defined benefit scheme provides benefits based on members' final salary.

The latest actuarial valuation of the Defined befit scheme was performed in accordance with IAS 19 issued by the IASB as at 31 December 2008 by Watson Wyatt Hong Kong Limited, a professional actuarial firm, who has among their staff fellows of the Actuarial Society of Hong Kong. The present values of the defined benefit obligation and current service cost of the Defined benefit scheme are calculated based on the projected unit credit method.

The amounts recognised in the balance sheet as at 31 December 2008 are analysed as follows:

| | 2008 |
|---|---|
| Fair value of Defined benefit scheme assets | 406 |
| Present value of the funded defined benefit obligation | (411) |
| Unrecognised actuarial losses | 193 |
| Net asset recognised in the balance sheet | 188 |

A portion of the above asset is expected to be recovered after more than one year. However, it is not practicable to segregate this amount from the amounts payable in the next twelve months, as future contributions will also relate to future services rendered and future changes in actuarial assumptions and market conditions. No contribution to the Defined benefit scheme is expected to pay in 2009.

The amounts recognised in the income statement are as follows:

| | 2008<br>1 October to<br>31 December |
|---|---|
| Current service cost | (4) |
| Interest cost | (3) |
| Expected return on Defined benefit scheme assets | 9 |
| Net income for the year included in retirement benefit costs | 2 |

The actual loss on Defined benefit scheme assets for the year ended 31 December 2008 was RMB42 million.

(Expressed in millions of Renminbi unless otherwise stated)

# 31 STAFF WELFARE SCHEME *(continued)*

## (a) Retirement benefits *(continued)*

### *(ii)* *Defined benefit schemes* *(continued)*

The movements in the defined benefit obligation during the year are as follows:

| | 2008 |
|---|---|
| Present value of obligation at 1 October | 366 |
| Current service cost | 4 |
| Interest cost | 3 |
| Actual benefits paid | (3) |
| Actuarial losses | 41 |
| Actual obligation at 31 December | 411 |

The movements in the fair value of the Defined benefit scheme assets during the year are as follows:

| | 2008 |
|---|---|
| Fair value of Defined benefit scheme assets at 1 October | 452 |
| Expected return on Defined benefit scheme assets | 9 |
| Actual benefits paid | (3) |
| Actuarial losses | (52) |
| Fair value of Defined benefit scheme assets at 31 December | 406 |

The major categories of the Defined benefit scheme assets are as follows:

| | 2008 | |
|---|---|---|
| | | % |
| Equities | 166 | 40.9 |
| Bonds | 80 | 19.7 |
| Cash | 160 | 39.4 |
| Total | 406 | 100 |

The amount of the Defined benefit scheme assets consists of deposits with the Bank totalling RMB150 million in 2008.

(Expressed in millions of Renminbi unless otherwise stated)

# 31 STAFF WELFARE SCHEME *(continued)*

## (a) Retirement benefits *(continued)*

### *(ii) Defined benefit schemes* *(continued)*

The principal actuarial assumptions adopted in the valuation are as follows:

| | **2008** |
|---|---|
| | **%** |
| Discount rate | |
| – Retirement benefit scheme | **1.1** |
| – Pension scheme | **1.1** |
| Long-term average return on Defined benefit scheme assets | |
| – Retirement benefit scheme | **6.0** |
| – Pension scheme | **1.0** |
| Long-term average rate of salary increase for the defined benefit scheme of the Scheme | **5.0** |
| Pension increase rate for the defined benefit pension scheme | **2.5** |

There was no curtailment or settlement impact for the year ended 31 December 2008.

### *(iii) Supplementary retirement scheme*

Supplementary retirement scheme was an annuity contract purchased from independent life insurance company by the Bank to provide supplementary defined contribution retirement benefits to its full time employees. It was a voluntary payment and the Bank has no further obligations to make future contributions. In 2008, the Bank did not purchase any annuity contract (2007: RMB700 million).

The Group has no other material obligations for the payment of other post retirement benefits other than the contributions described above.

## (b) Staff quarters

The Bank purchased quarters by using the public welfare fund, and leases to the existing staff at market rates on short term basis. Rental income is recognised in the consolidated income statement as other net income.

## (c) Staff salary and incentive scheme

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.

(Expressed in millions of Renminbi unless otherwise stated)

## 31 STAFF WELFARE SCHEME *(continued)*

### (d) Cash settled share-based transactions

The Bank has H-share Appreciation Rights Scheme phase I and phase II for the Senior Management ("phase I") which was adopted on 30 October 2007 and 7 November 2008 respectively whereby the directors of the Bank are authorized, at their discretion, to invite the Senior Management of the Bank to take up options at nil consideration to subscribe for shares of the Group. The options vest after 2 years from the date of grant and are then exercisable within a period of 8 years. Each of the share appreciation right is linked to one H-share.

***(i) The terms and conditions of the grants that existed during the years are as follows, whereby all options are settled by delivery of cash:***

| | **Number of options** (in million) | **Vesting conditions** | **Contractual life of options** |
|---|---|---|---|
| Options granted on 30 October 2007 | 1.29 | 2 years from the date of grant | 10 years |
| Options granted on 7 November 2008 | 1.32 | 2 years from the date of grant | 10 years |

***(ii) The number and weighted average exercise prices of share options are as follows:***

| | **2008** | | 2007 | |
|---|---|---|---|---|
| | **Weighted average exercise price (HK$)** | **Number of options (in million)** | Weighted average exercise price (HK$) | Number of options (in million) |
| Outstanding as at the beginning of the year | **38.98** | **1.29** | – | – |
| Exercise during the year | **–** | **–** | – | – |
| Granted during the year | **12.76** | **1.32** | 39.3 | 1.29 |
| Outstanding at the end of the year | **25.72** | **2.61** | 39.3 | 1.29 |
| Exercisable at the end of the year | **–** | **–** | – | – |

The options outstanding at 31 December 2008 had an weighted average exercise price of HK$25.72 (2007: HK$39.3) and a weighted average remaining contractual life of 9.34 years (2007: 9.83 years).

Pursuant to the requirements set out in China Merchants Bank's H-share Appreciation Rights Incentive Scheme for the Senior Management (the "Scheme"). If any dividends were distributed, capital reserve was converted into shares, share split or dilution, an adjustment to the exercise price is applied. In view of a cash dividend of HK$0.32 per share made in respect of 2007, the exercise price granted to senior management under the Scheme in 2007's phase I is to reduce downward from HK$39.30 to HK$38.98.

(Expressed in millions of Renminbi unless otherwise stated)

# 31 STAFF WELFARE SCHEME *(continued)*

## (d) Cash settled share-based transactions *(continued)*

### *(iii) Fair value of share options and assumptions*

The fair value of services received in return for share options granted are measured by reference to the fair value of share options granted. The estimate of the fair value of the share option granted is measured based on the Black-Scholes model. The contractual life of the option is used as an input into this model.

| | **2008** | | 2007 |
|---|---|---|---|
| | **Phase I** | **Phase II** | Phase I |
| Fair value at measurement date (in RMB) | **7.44** | **9.76** | 12.84 |
| Share price (in HK$) | **13.90** | **13.90** | 31.85 |
| Exercise price (in HK$) | **38.98** | **12.76** | 39.30 |
| Expected volatility | **74%** | **74%** | 38% |
| Option life (year) | **8.83** | **9.83** | 9.83 |
| Expected dividends rate | **1%** | **1%** | 1.36% |
| Risk-free interest rate | **2.14%** | **2.14%** | 3.93% |

The expected volatility is based on the historic volatility (calculated based on the weighted average remaining life of the share options), adjusted for any expected changes to future volatility based on publicly available information. Expected dividends are based on historical dividends. Changes in the subjective input assumptions could materially affect the fair value estimate.

Share options were granted under a service condition. This condition has not been taken into account in the grant date fair value measurement of the services received. There were no market conditions associated with the share option grants.

## (e) Salary risk allowances

According to CBRC Yin Jian Ban Fa [2009] No.15, the Bank has established salary risk allowances. Salary risk allowances are specific funds withheld from the employees' (excluding senior management of the Bank) annual remunerations of which the payments are delayed for the purpose of risk management. The allocation of the funds is based on performance assessment and risk management results, taking into account the short term and long term benefit. In the event of a decline in the asset quality, a sharp deterioration of risk profiles and profitability, the occurrence of a serious legal case, or a significant regulatory violation identified by any regulatory authorities, the relevant employees will be restricted from the allocation of these allowances. As at 31 December 2008, these allowances amounted to RMB3.256 billion and were included in "Other liabilities".

(Expressed in millions of Renminbi unless otherwise stated)

## 32 SHARE CAPITAL

| | Registered and issued share capital | |
|---|---|---|
| | **No. of shares** (in million) | **Amount** |
| At 1 January 2008 | **14,705** | **14,705** |
| Conversion of convertible bonds | **2** | **2** |
| At 31 December 2008 | **14,707** | **14,707** |
| At 1 January 2007 | 14,703 | 14,703 |
| Conversion of convertible bonds | 2 | 2 |
| At 31 December 2007 | 14,705 | 14,705 |

By type of share:

| | No. of shares | |
|---|---|---|
| | **2008** | 2007 |
| Listed shares | | |
| – A-Shares – with trading moratorium | **4,799** | 7,331 |
| – A-Shares – without trading moratorium | **7,246** | 4,712 |
| – H-Shares | **2,662** | 2,662 |
| | **14,707** | 14,705 |

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.

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.

## 32 SHARE CAPITAL *(continued)*

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.

The Bank issued 2 million A-Shares upon conversion of the convertible bonds of RMB10 million during the year ended 31 December 2007, resulting in the increase in share capital and capital reserve of RMB2 million and RMB9 million respectively. The Bank's registered and issued capital increased from RMB14,703 million to RMB14,705 million.

The Bank issued 2 million shares upon conversion of the convertible bonds of RMB13 million during the six months period ended 30 June 2008, resulting in the increase in share capital and capital reserve of RMB2 million and RMB11 million respectively. As a result, the Bank's registered and issued capital increased from RMB14,705 million to RMB14,707 million.

All H-Shares are ordinary shares and rank pari passu with the A-Shares.

## 33 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.

## 34 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 (2006) and other relevant regulations issued by 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.

The purpose of statutory public welfare fund is to provide staff facilities and other staff benefits. It is not distributable other than in liquidation.

## 35 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.

## 36 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.

## 37 EXCHANGE RESERVE

The exchange reserve comprises all foreign exchange differences arising from the translation of the financial statements of operations outside Mainland China.

(Expressed in millions of Renminbi unless otherwise stated)

# 38 PROFIT APPROPRIATIONS

## (a) Dividends declared and paid

| | **2008** | 2007 |
|---|---|---|
| Dividends in respect of the previous year, approved, declared and paid during the year of RMB2.8 (2007: RMB1.2) per every 10 shares | **4,117** | 1,764 |

## (b) Proposed profit appropriations

| | **2008** | 2007 |
|---|---|---|
| Statutory surplus reserve | **2,041** | 1,524 |
| Dividends | | |
| – cash dividend: RMB1 (2007: RMB2.8) per every 10 shares | **1,471** | 4,117 |
| – stock dividend: 3 shares (2007: nil) per every 10 shares | **4,412** | – |
| Total | **7,924** | 5,641 |

Notes:

(i) 2008 profit appropriation is proposed in accordance with the resolution passed at the meeting of the board of directors held on 24 April 2009 and will be submitted to the 2009 annual general meeting for approval.

(ii) 2007 profit was appropriated in accordance with the resolution passed at the seventeenth meeting of the seventh board of directors held on 18 March 2008 and as approved in the annual general meeting held on 27 June 2008.

# 39 NOTES TO CONSOLIDATED CASH FLOW STATEMENTS

## (a) Analysis of the balances of cash and cash equivalents

| | **2008** | 2007 |
|---|---|---|
| Cash | **6,928** | 6,381 |
| With original maturity within 3 months: | | |
| – balance with banks and other financial institutions | **23,823** | 9,521 |
| – balances with central bank | **47,681** | 37,924 |
| – placements with banks and other financial institutions | **107,790** | 109,982 |
| – debt security investments | **449** | 3,223 |
| | **186,671** | 167,031 |

(Expressed in millions of Renminbi unless otherwise stated)

# 39 NOTES TO CONSOLIDATED CASH FLOW STATEMENTS *(continued)*

## (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 2008 and 2007 the details of which are included in Note 29(b), there were no other significant non-cash transactions.

## (c) Effect of acquisition

The acquisition had the following effect on the Group's assets and liabilities.

***Acquiree's net assets at the acquisition date***

| | Note | Recognised values | Fair value adjustments | Carrying amounts |
|---|---|---|---|---|
| Cash, balances and placements with banks and other financial institutions | | 32,443 | – | 32,443 |
| Loans and advances to customers | | 38,669 | – | 38,669 |
| Investments | | 11,351 | – | 11,351 |
| Others assets | | 10,586 | 3,704 | 6,882 |
| Deposits and placements from banks and other financial institutions | | (1,484) | – | (1,484) |
| Deposits from customers | | (68,479) | – | (68,479) |
| Other liabilities | | (10,188) | (611) | (9,577) |
| Net identifiable assets | | 12,898 | 3,093 | 9,805 |
| Proportion of ownership | | 53.12% | | |
| | | 6,851 | | |
| Goodwill on acquisition | 24 | 10,177 | | |
| Consideration paid, satisfied in cash | | 17,028 | | |
| Cash and cash equivalents acquired | | (30,206) | | |
| Net cash inflow | | (13,178) | | |

# 40 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. The Bank's capital attribution methodologies involve a number of assumptions and estimates that are revised periodically by management. Such methodologies have been revised by management in 2008 to reflect the latest development in the market. The 2007 comparative figures have not been restated as it is impracticable to apply the revised capital attribution methodology to last year result.

## (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 include insurance underwriting, insurance agency, securities and future brokerage services, 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)

# 40 SEGMENTAL REPORTING *(continued)*

## (a) Business segments *(continued)*

| | Group | | | | |
|---|---|---|---|---|---|
| | Year ended 31 December 2008 | | | | |
| | Corporate banking | Retail banking | Treasury business | Others and unallocated | Total |
| External net interest income | 24,249 | 6,528 | 16,104 | 4 | 46,885 |
| Internal net interest (expense)/income | 752 | 5,862 | (6,616) | 2 | – |
| **Net interest income** | 25,001 | 12,390 | 9,488 | 6 | 46,885 |
| Net fee and commission income | 2,747 | 4,761 | (1) | 237 | 7,744 |
| Other net income/(expense) | 732 | 241 | (203) | 147 | 917 |
| Insurance operating income | – | – | – | 98 | 98 |
| **Operating income** | 28,480 | 17,392 | 9,284 | 488 | 55,644 |
| **Operating expenses** | | | | | |
| – depreciation | (604) | (1,279) | (76) | (45) | (2,004) |
| – others | (9,696) | (10,801) | (1,064) | (71) | (21,632) |
| **Charge for insurance claims** | – | – | – | (106) | (106) |
| | (10,300) | (12,080) | (1,140) | (222) | (23,742) |
| **Operating profit before impairment losses** | 18,180 | 5,312 | 8,144 | 266 | 31,902 |
| Impairment losses | (2,847) | (1,059) | (561) | (687) | (5,154) |
| Share of profits of associates and jointly controlled entities | – | – | – | 11 | 11 |
| **Profit before tax** | 15,333 | 4,253 | 7,583 | (410) | 26,759 |
| Capital expenditure (note) | 1,420 | 3,017 | 177 | 9,602 | 14,216 |
| | 31 December 2008 | | | | |
| Segment assets | 633,629 | 235,919 | 674,442 | 27,807 | 1,571,797 |
| Segment liabilities | 726,410 | 526,021 | 209,509 | 30,076 | 1,492,016 |
| Interest in associates and jointly controlled entities | 53 | – | – | 349 | 402 |

(Expressed in millions of Renminbi unless otherwise stated)

# 40 SEGMENTAL REPORTING *(continued)*

## (a) Business segments *(continued)*

| | Group | | | | |
|---|---|---|---|---|---|
| | Year ended 31 December 2007 | | | | |
| | Corporate banking | Retail banking | Treasury business | Others and unallocated | Total |
| External net interest income | 18,737 | 4,051 | 11,114 | – | 33,902 |
| Internal net interest (expense)/income | (390) | 4,294 | (3,904) | – | – |
| **Net interest income** | 18,347 | 8,345 | 7,210 | – | 33,902 |
| Net fee and commission income | 1,621 | 4,666 | – | 152 | 6,439 |
| Other net income/(expense) | 666 | 272 | (494) | 263 | 707 |
| **Operating income** | 20,634 | 13,283 | 6,716 | 415 | 41,048 |
| **Operating expenses** | | | | | |
| – depreciation | (407) | (581) | (32) | – | (1,020) |
| – others | (7,320) | (7,612) | (786) | – | (15,718) |
| | (7,727) | (8,193) | (818) | – | (16,738) |
| **Operating profit before impairment losses** | 12,907 | 5,090 | 5,898 | 415 | 24,310 |
| Impairment losses | (2,654) | (351) | (152) | (148) | (3,305) |
| Share of profits of an associate | – | – | – | 38 | 38 |
| **Profit before tax** | 10,253 | 4,739 | 5,746 | 305 | 21,043 |
| Capital expenditure (note) | 1,187 | 1,693 | 95 | – | 2,975 |
| | 31 December 2007 (restated) | | | | |
| Segment assets | 485,525 | 177,425 | 636,242 | 11,772 | 1,310,964 |
| Segment liabilities | 617,143 | 326,391 | 282,684 | 16,762 | 1,242,980 |
| Interest in an associate | – | – | – | 225 | 225 |

Notes: Capital expenditure represents total amount incurred for acquiring assets that are expected to be used for some periods.

## 40 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. The Group also has branch operation in Hong Kong, New York and subsidiaries operating in Hong Kong and Shanghai.

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 following areas serviced by the subsidiary and 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 following areas serviced by the associate and branches of the Group: Guangdong Province, Hunan Province, Jiangxi Province, Hubei Province and Henan Province;

– "Western China" region refers to the following areas serviced by the 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, Jilin Province, Heilongjiang Province, Shanxi Province and Inner Mongolia Autonomous Region; and

– "Outside Mainland China" refers to operations of Hong Kong branch, New York branch and the overseas operations of subsidiaries.

(Expressed in millions of Renminbi unless otherwise stated)

## 40 SEGMENTAL REPORTING *(continued)*

### (b) Geographical segments *(continued)*

| | Group | | | | | |
|---|---|---|---|---|---|---|
| | Year ended 31 December 2008 | | | | | |
| | Eastern China | Southern and Central China | Western China | Northern China | Outside Mainland China | Total |
| Net interest income | 16,758 | 18,846 | 4,523 | 6,430 | 328 | 46,885 |
| Net fee and commission income | 2,865 | 3,943 | 306 | 508 | 122 | 7,744 |
| Other net income/(expense) | 634 | 281 | 78 | 244 | (320) | 917 |
| Insurance operating income | – | – | – | – | 98 | 98 |
| **Operating income** | 20,257 | 23,070 | 4,907 | 7,182 | 228 | 55,644 |
| **Operating expenses** | | | | | | |
| – depreciation | (666) | (764) | (201) | (292) | (81) | (2,004) |
| – others | (7,687) | (8,601) | (1,948) | (2,916) | (480) | (21,632) |
| **Charge for insurance claims** | – | – | – | – | (106) | (106) |
| | (8,353) | (9,365) | (2,149) | (3,208) | (667) | (23,742) |
| **Operating profit before impairment losses** | 11,904 | 13,705 | 2,758 | 3,974 | (439) | 31,902 |
| Impairment losses | (2,380) | (1,755) | (211) | (471) | (337) | (5,154) |
| Share of profits of associates and jointly controlled entities | – | 37 | – | – | (26) | 11 |
| Profit before tax | 9,524 | 11,987 | 2,547 | 3,503 | (802) | 26,759 |
| Capital expenditure (note) | 1,035 | 12,176 | 614 | 329 | 62 | 14,216 |
| | 31 December 2008 | | | | | |
| Segment assets | 385,612 | 796,988 | 103,279 | 172,750 | 113,168 | 1,571,797 |
| Of which: gross loans and advances to customers | 358,608 | 231,403 | 93,323 | 147,036 | 43,992 | 874,362 |
| Segment liabilities | 393,366 | 695,815 | 109,430 | 191,799 | 101,606 | 1,492,016 |
| Interest in associates and jointly controlled entities | – | 261 | – | – | 141 | 402 |

(Expressed in millions of Renminbi unless otherwise stated)

## 40 SEGMENTAL REPORTING *(continued)*

### (b) Geographical segments *(continued)*

| | Group | | | | | |
|---|---|---|---|---|---|---|
| | Year ended 31 December 2007 | | | | | |
| | Eastern China | Southern and Central China | Western China | Northern China | Outside Mainland China | Total |
| Net interest income | 11,768 | 13,578 | 3,248 | 5,247 | 61 | 33,902 |
| Net fee and commission income | 1,878 | 3,941 | 220 | 356 | 44 | 6,439 |
| Other net income/(expense) | 464 | (262) | 61 | 227 | 217 | 707 |
| **Operating income** | 14,110 | 17,257 | 3,529 | 5,830 | 322 | 41,048 |
| **Operating expenses** | | | | | | |
| – depreciation | (308) | (420) | (115) | (173) | (4) | (1,020) |
| – others | (5,824) | (5,870) | (1,555) | (2,401) | (68) | (15,718) |
| | (6,132) | (6,290) | (1,670) | (2,574) | (72) | (16,738) |
| **Operating profit before impairment Losses** | 7,978 | 10,967 | 1,859 | 3,256 | 250 | 24,310 |
| Impairment losses | (1,718) | (478) | (480) | (549) | (80) | (3,305) |
| Share of profits of an associate | – | 38 | – | – | – | 38 |
| **Profit before tax** | 6,260 | 10,527 | 1,379 | 2,707 | 170 | 21,043 |
| Capital expenditure (note) | 793 | 1,678 | 210 | 288 | 6 | 2,975 |
| | 31 December 2007 (restated) | | | | | |
| Segment assets | 326,857 | 717,794 | 90,644 | 156,281 | 19,388 | 1,310,964 |
| Of which: gross loans and advances to customers | 275,956 | 197,324 | 71,898 | 121,474 | 6,515 | 673,167 |
| Segment liabilities | 334,084 | 612,890 | 93,978 | 182,800 | 19,228 | 1,242,980 |
| Interest in an associate | – | 225 | – | – | – | 225 |

Note: 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)

# 41 ASSETS PLEDGED AS SECURITY

The following assets have been pledged as collateral for liabilities under repurchase arrangements:

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Secured liabilities | **12,282** | 41,048 | **11,982** | 41,048 |
| Assets pledged | | | | |
| – Available-for-sale financial assets | **–** | 20,232 | **–** | 20,232 |
| – Held-to-maturity securities | **4,840** | 19,095 | **4,840** | 19,095 |
| – Other assets | **7,439** | 1,636 | **7,142** | 1,636 |
| | **12,279** | 40,963 | **11,982** | 40,963 |

These transactions are conducted under terms that are usual and customary to standard lending and securities borrowing and lending activities.

# 42 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.

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| **Contractual amount** | | | | |
| Irrevocable guarantees | **69,408** | 55,263 | **69,048** | 55,263 |
| Irrevocable letters of credit | **17,721** | 23,937 | **17,615** | 23,937 |
| Bills of acceptances | **197,582** | 180,002 | **197,508** | 180,002 |
| Irrevocable loan commitments | | | | |
| – with an original maturity of under one year | **929** | 1,210 | **701** | 1,210 |
| – with an original maturity of one year or over | **13,139** | 8,620 | **9,448** | 8,620 |
| Credit card commitments | **92,877** | 50,881 | **86,084** | 50,881 |
| Shipping guarantees | **3** | 12 | **2** | 12 |
| | **391,659** | 319,925 | **380,406** | 319,925 |

(Expressed in millions of Renminbi unless otherwise stated)

# 42 CONTINGENT LIABILITIES AND COMMITMENTS *(continued)*

## (a) Credit commitments *(continued)*

Irrevocable 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.

Apart from the irrevocable loan commitments, the Group had loan commitments of RMB605,738 million at 31 December 2008 (2007: RMB454,490 million) which are unconditionally cancellable by the Group or automatically cancellable due to deterioration in the creditworthiness of the borrower as stipulated in respective loan agreements.

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.

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 (restated) (note) |
| **Credit risk weighted amounts of contingent liabilities and commitments** | | | | |
| Contingent liabilities and commitments | **142,914** | 119,761 | **141,368** | 119,761 |

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.

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.

Note: The credit risk weighted amounts of contingent liabilities and commitments of the Bank as at 31 December 2007 were restated according to the guidance set out in Yin Jian Fu 2008 No.123.

## (b) Capital commitments

Authorised capital commitments not provided for were as follows:

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| For purchase of fixed assets: | | | | |
| – Contracted for | **1,848** | 801 | **1,835** | 801 |

(Expressed in millions of Renminbi unless otherwise stated)

## 42 CONTINGENT LIABILITIES AND COMMITMENTS *(continued)*

### (c) Operating lease commitments

Total future minimum lease payments under non-cancellable operating leases of properties are payable as follows:

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Within 1 year | **1,145** | 816 | **1,116** | 816 |
| After 1 year but within 5 years | **3,417** | 2,241 | **3,371** | 2,241 |
| After 5 years | **1,100** | 649 | **1,093** | 649 |
| | **5,662** | 3,706 | **5,580** | 3,706 |

The Group and the Bank lease certain properties under operating leases. The leases typically run for an initial period of 1 to 5 years, and may include an option to renew the lease when all terms are renegotiated. None of the lease include contingent rental.

### (d) Outstanding litigations

At 31 December 2008, the Group was a defendant in certain pending litigations with gross claims of RMB381 million (2007: RMB246 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 Board of 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:

| | Group and Bank | |
|---|---|---|
| | **2008** | 2007 |
| Redemption obligations | **6,461** | 7,488 |

The Group expects that the amount of redemption before the maturity date of these government bonds through the Group will not be material.

(Expressed in millions of Renminbi unless otherwise stated)

## 43 TRANSACTIONS ON BEHALF OF CUSTOMERS

### (a) Entrusted lending business

The Group provides entrusted lending business services to corporations and individuals. All entrusted loans are made under the instruction or at the direction of these entities or individuals and are funded by entrusted funds from them.

For entrusted assets and liabilities business, the Group generally does not take on credit risk in relation to these transactions. The Group acts as an agent to hold and manage these assets and liabilities at the direction of the entrustor and receives fee income for the services provided.

Trust assets are not assets of the Group and are not recognised in the balance sheet. Surplus funding is accounted for as deposits from customers. Income received and receivable for providing these services is recognised in the income statement as fee income.

At the balance sheet date, the entrusted assets and liabilities were as follows:

| | Group and Bank | |
|---|---|---|
| | **2008** | 2007 |
| Entrusted loans | **75,214** | 67,824 |
| Entrusted funds | **75,224** | 67,824 |

### (b) Wealth management services

The Group's wealth management services to customers mainly represent sales of wealth management products to corporate and personal banking customers. The funds obtained from wealth management services are invested in investment products, including government bonds, PBOC bills, notes issued by policy banks, short-dated corporate notes, entrusted loans and IPO shares. The credit risk, liquidity risk and interest rate risk associated with these products are borne by the customers who invest in these products. The Group only earns commission which represents the charges on customers in relation to the provision of custody, sales and management services. The income is recognised in the income statement as commission income.

The wealth management products and funds obtained are not assets and liabilities of the Group and are not recognised in the balance sheet. The funds obtained from wealth management services that have not yet been invested are recorded under deposits from customers.

At the balance sheet date, funds received from customers under wealth management services were as follows:

| | Group and Bank | |
|---|---|---|
| | **2008** | 2007 |
| Funds received from customers under wealth management services | **60,718** | 69,111 |

# 44 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, coordinates and monitors the work of other risk management functions, including the Corporate Banking Department and the Legal and Compliance Department.

With respect to the credit risk management of corporate and institutional business, the Group enhanced post-lending monitoring, and refined the industry-specific guideline and credit policy baseline for credit approval. Fine-tuning credit acceptance and exit policies, and optimizing its economic capital management and credit risk limit management have also contributed to the improvement in asset quality. The Group manages credit risk throughout the entire credit process including pre-lending evaluations, credit approval and post-lending monitoring.

With respect to the personal credit business, the Group relies on credit assessment of applicants as the basis for loan approval. Customer relationship managers are required to assess the income level, credit history, and repayment ability of the applicant. The Group monitors borrowers' repayment ability, the status of collateral and any changes to collateral value. Once a loan becomes overdue, the Group starts the recovery process according to standard personal loan recovery procedures.

To mitigate risks, where appropriate, the Group requests customers to provide collateral and guarantees. It also sets guidelines as to the use and suitability of specific types of collateral. Collateral structures and legal covenants are regularly reviewed to ensure that they still serve their intended purposes and conform to market practices.

In respect of the loan portfolio, the Group adopts a risk based loan classification methodology. The loans and advances for which objective evidence of impairment exists based on a loss event or several events and which bear significant impairment losses are classified as impaired loans and advances. The allowances for impairment losses for the impaired loans and advances are assessed collectively or individually as appropriate.

The risks involved in credit-related commitments and contingencies are essentially the same as the credit risk involved in extending loan facilities to customers. These transactions are, therefore, subject to the same credit application, portfolio maintenance and collateral requirements as for customers applying for loans.

Concentration of credit risk: when certain number 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.

(Expressed in millions of Renminbi unless otherwise stated)

# 44 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 40(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.

### *The impact of market turmoil on credit risk*

The most significant factor affecting the Group's exposure to credit risk during 2008 was the continuing deterioration in credit conditions, as a result of the recent international financial crisis. Over 90% of the investments held by the Group were issued by the PRC Government, the PBOC, the PRC policy banks and large PRC-based corporations and commercial banks with high credit ratings. The remaining amount, just under 10%, was issued by large corporations and financial institutions domiciled outside PRC with investment grade credit ratings from the major agencies. Given that the impact of the financial crisis on China's economy was relatively minimal (when compared with the US and Europe), the credit quality of the Group remained stable.

### *(i) Maximum exposure*

The maximum exposure to credit risk at the balance sheet date without taking into consideration of any collateral held, irrevocable loan commitments or other credit enhancements is represented by the carrying amount of each financial assets in the balance sheet after deducting any impairment allowance. A summary of the maximum exposure is as follows:

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 (restated) | **2008** | 2007 (restated) |
| Cash and balances with banks and other financial institutions | **37,016** | 20,276 | **34,027** | 20,268 |
| Balances with central bank | **174,673** | 146,266 | **174,640** | 146,266 |
| Placements with banks and other financial institutions | **156,378** | 225,669 | **123,492** | 225,669 |
| Loans and advances to customers | **852,754** | 654,417 | **812,106** | 654,417 |
| Investments | **310,446** | 243,634 | **332,213** | 243,877 |
| Interest in associates and jointly controlled entities | **402** | 225 | **191** | 191 |
| Other assets | **10,482** | 8,964 | **9,149** | 8,922 |
| Financial guarantees and other credit related contingent liabilities | **284,714** | 259,214 | **284,173** | 259,214 |
| Loan commitments and other credit related commitments | **712,683** | 515,201 | **700,796** | 515,201 |
| | **2,539,548** | 2,073,866 | **2,470,787** | 2,074,025 |

(Expressed in millions of Renminbi unless otherwise stated)

# 44 RISK MANAGEMENT *(continued)*

## (a) Credit risk *(continued)*

***The impact of market turmoil on credit risk*** *(continued)*

***(ii) The credit quality of loans and advances to customers can be analysed as follows:***

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| **Impaired loans and advances to customers** | | | | |
| For which impairment losses are individually assessed | | | | |
| Gross amount | **8,190** | 9,585 | **8,144** | 9,585 |
| Less: impairment allowances | **(6,727)** | (7,685) | **(6,692)** | (7,685) |
| Carrying amount | **1,463** | 1,900 | **1,452** | 1,900 |
| For which impairment losses are collectively assessed | | | | |
| Gross amount | **1,382** | 809 | **1,355** | 809 |
| Less: impairment allowances | **(1,086)** | (631) | **(1,083)** | (631) |
| Carrying amount | **296** | 178 | **272** | 178 |
| **Overdue but not impaired** | | | | |
| Within which | | | | |
| – Less than 3 months | **5,743** | 3,928 | **4,628** | 3,928 |
| – 6 months or less but over 3 months | **253** | 316 | **248** | 316 |
| – 1 year or less but over 6 months | **1** | 32 | **–** | 32 |
| – Over 1 year | **1** | – | **–** | – |
| Gross amount | **5,998** | 4,276 | **4,876** | 4,276 |
| Less: impairment allowances – collectively assessed | **(411)** | (603) | **(406)** | (603) |
| Carrying amount | **5,587** | 3,673 | **4,470** | 3,673 |
| **Neither past due nor impaired** | | | | |
| Normal | **848,732** | 647,111 | **809,476** | 647,111 |
| Special mention | **9,964** | 11,386 | **9,697** | 11,386 |
| Substandard | **96** | – | **–** | – |
| Gross amount | **858,792** | 658,497 | **819,173** | 658,497 |
| Less: impairment allowances – collectively assessed | **(13,384)** | (9,831) | **(13,261)** | (9,831) |
| Carrying amount | **845,408** | 648,666 | **805,912** | 648,666 |
| Total carrying amount | **852,754** | 654,417 | **812,106** | 654,417 |

Loans and advances that would be past due or impaired had the terms not been renegotiated amounted to RMB1,426 million as at 31 December 2008 (2007: RMB1,790 million).

(Expressed in millions of Renminbi unless otherwise stated)

# 44 RISK MANAGEMENT *(continued)*

## (a) Credit risk *(continued)*

***The impact of market turmoil on credit risk** (continued)*

### *(iii) Credit quality of debt investments*

At the balance sheet date, the credit quality of debt investments analysed by designation of external credit assessment institution, Standard & Poors, is as follows:

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 (restated) | **2008** | 2007 (restated) |
| Individually assessed and impaired gross amount | **395** | – | **294** | – |
| Allowance for impairment carrying amount | **(277)** | – | **(176)** | – |
| Sub-total | **118** | – | **118** | – |
| Neither overdue nor impaired | | | | |
| AAA | **2,192** | 4,985 | **1,750** | 4,985 |
| AA- to AA+ | **7,047** | 5,716 | **3,909** | 5,716 |
| A- to A+ (note) | **226,907** | 188,098 | **223,476** | 188,098 |
| Lower than A– | **2,531** | 718 | **968** | 718 |
| | **238,677** | 199,517 | **230,103** | 199,517 |
| Unrated | **68,020** | 40,635 | **67,101** | 40,635 |
| Total | **306,815** | 240,152 | **297,322** | 240,152 |

Note: Included bonds issued by the PRC Government, PBOC and PRC Policy Banks held by the Group amounted to RMB153,784 million (2007: RMB186,985 million).

### *(iv) Collateral and other credit enhancements*

An estimate of the fair value of collateral and other credit enhancements held against financial assets that are overdue but not impaired is as follows:

| | Group | | Bank | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Estimate of the fair value of collateral and other credit enhancements held against – Loans and advances to customers | **9,285** | 4,367 | **6,923** | 4,367 |

## 44 RISK MANAGEMENT *(continued)*

### (b) Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices and market risk comprises currency risk, interest rate risk and other price risk. 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 and procedures, supervising the implementation of the policies and procedures and making decision on significant market risk management issues. The Planning and Finance Department is responsible for implementing the market risk management policies and procedures.

The use of derivatives for proprietary trading and their sale to customers as risk management products is an integral part of the Group's business activities. These instruments are also used to manage the Group's own exposures to market risk as part of its asset and liability management process. The principal derivative instruments used by the Group are interest and foreign exchange rate related contracts, which are primarily over-the-counter derivatives.

The historical simulation model for the Value-at-risk ("VaR") analysis is used by the Group to measure and monitor the market risk of its trading portfolio. Gap analysis and scenario analysis are used by the Group to measure and monitor the market risk of its non-trading business. Gap analysis is a technique to project future cash flows in order to quantify the differences, for a range of future dates, between assets and liabilities.

VaR is a technique that estimates the potential losses that could occur on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence. Effective from October 2007, the Group's ALCO calculates VaR using the historical movement in market rates and prices, at a 99% confidence level, the observation period is 250 trading days and the holding period is 10 days.

#### *The impact of market turmoil on market risk*

Credit spread volatility continued to increase during the first half of 2008 and, as the effect of the market turmoil on the wider economy became more apparent, there was a larger increase in the volatility of other risk types, such as interest rates. Because the investment portfolio of the Group mainly consists of debt securities issued by the PRC Government, PRC policy banks and large PRC-based corporations and commercial banks with high credit ratings, the increase in credit spreads has had a minimal impact on the Group.

### (c) Currency risk

The Group is exposed to currency risks primarily arising from the mismatch of its holdings of foreign currency denominated financial assets and liabilities.

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 also reviews and analyses its exposures to currency risks regularly. To mitigate currency risks, the Group adjust its foreign currency positions according to the movements in the foreign exchange rate.

(Expressed in millions of Renminbi unless otherwise stated)

# 44 RISK MANAGEMENT *(continued)*

## (c) Currency risk *(continued)*

In 2008, the Renminbi was volatile and appreciated rapidly against the USD dollar before gradually stablising. To manage the currency risk, the Group applied measures such as price leveraging, seeking to improve the structure of its assets and liabilities in foreign currencies, and closely monitoring its foreign exchange exposure and foreign exchange losses. The Group also closely monitored the foreign exchange fluctuations and forecasts, and took initiative to use foreign exchange management tools and hedging instruments to lower the acquisition cost of WLB.

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.

Assets and liabilities by original currency are shown as follows:

| | Group | | | | |
|---|---|---|---|---|---|
| | 2008 | | | | |
| | | Equivalent in RMB million | | | |
| | RMB | US dollar | HKD | Others | Total |
| **Assets** | | | | | |
| Cash and balances with central bank | 176,925 | 3,507 | 739 | 430 | 181,601 |
| Amounts due from banks and other financial institutions | 96,210 | 51,747 | 19,133 | 19,376 | 186,466 |
| Loans and advances to customers | 784,668 | 27,268 | 40,150 | 668 | 852,754 |
| Investments | 278,110 | 20,703 | 10,222 | 1,411 | 310,446 |
| Other assets | 32,663 | 903 | 6,773 | 191 | 40,530 |
| | 1,368,576 | 104,128 | 77,017 | 22,076 | 1,571,797 |
| **Liabilities** | | | | | |
| Amounts due to banks and other financial institutions | 160,656 | 4,146 | 971 | 143 | 165,916 |
| Deposits from customers | 1,084,100 | 83,391 | 60,034 | 23,123 | 1,250,648 |
| Trading liabilities | – | – | 524 | – | 524 |
| Financial liabilities designated as at fair value through profit or loss | – | – | 1,828 | – | 1,828 |
| Derivative financial instruments | 855 | 199 | 1,244 | (32) | 2,266 |
| Certificates of deposit issued | – | 682 | 1,158 | – | 1,840 |
| Convertible bonds issued | 2 | – | – | – | 2 |
| Other debts issued | 4,996 | – | – | – | 4,996 |
| Subordinated notes issued | 33,440 | – | – | – | 33,440 |
| Other liabilities | 25,890 | 1,525 | 2,993 | 148 | 30,556 |
| | 1,309,939 | 89,943 | 68,752 | 23,382 | 1,492,016 |
| Net on-balance sheet position | 58,637 | 14,185 | 8,265 | (1,306) | 79,781 |
| Off-balance sheet position: | | | | | |
| Credit commitments (note) | 237,523 | 42,919 | 12,497 | 4,897 | 297,836 |
| Derivatives: | | | | | |
| – forward purchase | 38,381 | 45,858 | 5,035 | 5,925 | 95,199 |
| – forward sales | (40,934) | (47,265) | (2,394) | (4,427) | (95,020) |
| – net option position | – | (22) | 2 | 20 | – |

(Expressed in millions of Renminbi unless otherwise stated)

# 44 RISK MANAGEMENT *(continued)*

## (c) Currency risk *(continued)*

Assets and liabilities by original currency are shown as follows *(continued)*:

| | Group | | | | |
|---|---|---|---|---|---|
| | 2007 (restated) | | | | |
| | | Equivalent in RMB million | | | |
| | RMB | US dollar | HKD | Others | Total |
| **Assets** | | | | | |
| Cash and balances with central bank | 148,890 | 2,860 | 656 | 241 | 152,647 |
| Amounts due from banks and other financial institutions | 207,333 | 21,012 | 6,619 | 4,600 | 239,564 |
| Loans and advances to customers | 609,162 | 38,600 | 5,919 | 736 | 654,417 |
| Investments | 208,878 | 30,426 | 3,905 | 425 | 243,634 |
| Other assets | 19,338 | 1,031 | 322 | 11 | 20,702 |
| | 1,193,601 | 93,929 | 17,421 | 6,013 | 1,310,964 |
| **Liabilities** | | | | | |
| Amounts due to banks and other financial institutions | 254,901 | 9,272 | 922 | 28 | 265,123 |
| Deposits from customers | 858,447 | 58,338 | 16,895 | 9,854 | 943,534 |
| Derivative financial instruments | 351 | 528 | 2,066 | – | 2,945 |
| Certificates of deposit issued | – | 1,095 | – | – | 1,095 |
| Convertible bonds issued | 13 | – | – | – | 13 |
| Other debts issued | 9,992 | – | – | – | 9,992 |
| Subordinated notes issued | 3,500 | – | – | – | 3,500 |
| Other liabilities | 15,607 | 981 | 145 | 45 | 16,778 |
| | 1,142,811 | 70,214 | 20,028 | 9,927 | 1,242,980 |
| Net on-balance sheet position | 50,790 | 23,715 | (2,607) | (3,914) | 67,984 |
| Off-balance sheet position: | | | | | |
| Credit commitments (note) | 185,796 | 39,543 | 3,262 | 4,514 | 233,115 |
| Derivatives: | | | | | |
| – forward purchase | 78,051 | 71,982 | 6,210 | 6,161 | 162,404 |
| – forward sales | (68,902) | (89,474) | (1,177) | (2,221) | (161,774) |
| – net option position | – | (61) | – | 61 | – |

(Expressed in millions of Renminbi unless otherwise stated)

# 44 RISK MANAGEMENT *(continued)*

## (c) Currency risk *(continued)*

Assets and liabilities by original currency are shown as follows:

| | Bank | | | | |
|---|---|---|---|---|---|
| | 2008 | | | | |
| | | Equivalent in RMB million | | | |
| | RMB | US dollar | HKD | Others | Total |
| **Assets** | | | | | |
| Cash and balances with central bank | 176,886 | 3,475 | 478 | 280 | 181,119 |
| Amounts due from banks and other financial institutions | 95,577 | 42,861 | 5,071 | 7,531 | 151,040 |
| Loans and advances to customers | 781,969 | 24,827 | 5,034 | 276 | 812,106 |
| Investments | 277,669 | 18,730 | 3,332 | 608 | 300,339 |
| Other assets | 23,192 | 785 | 30,668 | 123 | 54,768 |
| | 1,355,293 | 90,678 | 44,583 | 8,818 | 1,499,372 |
| **Liabilities** | | | | | |
| Amounts due to banks and other financial institutions | 160,363 | 3,648 | 922 | 87 | 165,020 |
| Deposits from customers | 1,083,181 | 71,519 | 13,311 | 10,229 | 1,178,240 |
| Derivative financial instruments | 855 | 119 | 1,153 | (35) | 2,092 |
| Certificates of deposit issued | – | 307 | 634 | – | 941 |
| Convertible bonds issued | 2 | – | – | – | 2 |
| Other debts issued | 4,996 | – | – | – | 4,996 |
| Subordinated notes issued | 33,440 | – | – | – | 33,440 |
| Other liabilities | 25,636 | 1,490 | 12 | 66 | 27,204 |
| | 1,308,473 | 77,083 | 16,032 | 10,347 | 1,411,935 |
| Net on-balance sheet position | 46,820 | 13,595 | 28,551 | (1,529) | 87,437 |
| Off-balance sheet position: | | | | | |
| Credit commitments (note) | 237,182 | 42,281 | 1,987 | 4,649 | 286,099 |
| Derivatives: | | | | | |
| – forward purchase | 38,381 | 43,936 | 3,389 | 4,550 | 90,256 |
| – forward sales | (40,934) | (45,874) | (324) | (2,963) | (90,095) |
| – net option position | – | (20) | – | 20 | – |

(Expressed in millions of Renminbi unless otherwise stated)

## 44 RISK MANAGEMENT *(continued)*

### (c) Currency risk *(continued)*

Assets and liabilities by original currency are shown as follows *(continued)*:

| | Bank | | | | |
|---|---|---|---|---|---|
| | 2007 (restated) | | | | |
| | | Equivalent in RMB million | | | |
| | RMB | US dollar | HKD | Others | Total |
| **Assets** | | | | | |
| Cash and balances with central bank | 148,890 | 2,860 | 648 | 241 | 152,639 |
| Amounts due from banks and other financial institutions | 207,333 | 21,012 | 6,619 | 4,600 | 239,564 |
| Loans and advances to customers | 609,162 | 38,600 | 5,919 | 736 | 654,417 |
| Investments | 208,878 | 30,426 | 3,897 | 425 | 243,626 |
| Other assets | 19,304 | 1,031 | 484 | 11 | 20,830 |
| | 1,193,567 | 93,929 | 17,567 | 6,013 | 1,311,076 |
| **Liabilities** | | | | | |
| Amounts due to banks and other financial institutions | 254,901 | 9,272 | 922 | 28 | 265,123 |
| Deposits from customers | 858,447 | 58,338 | 17,130 | 9,854 | 943,769 |
| Derivative financial instruments | 351 | 528 | 2,066 | – | 2,945 |
| Certificates of deposit issued | – | 1,095 | – | – | 1,095 |
| Convertible bonds issued | 13 | – | – | – | 13 |
| Other debts issued | 9,992 | – | – | – | 9,992 |
| Subordinated notes issued | 3,500 | – | – | – | 3,500 |
| Other liabilities | 15,607 | 981 | 129 | 45 | 16,762 |
| | 1,142,811 | 70,214 | 20,247 | 9,927 | 1,243,199 |
| Net on-balance sheet position | 50,756 | 23,715 | (2,680) | (3,914) | 67,877 |
| Off-balance sheet position: | | | | | |
| Credit commitments (note) | 185,796 | 39,543 | 3,262 | 4,514 | 233,115 |
| Derivatives: | | | | | |
| – forward purchase | 78,051 | 71,982 | 6,210 | 6,161 | 162,404 |
| – forward sales | (68,902) | (89,474) | (1,177) | (2,221) | (161,774) |
| – net option position | – | (61) | – | 61 | – |

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.

(Expressed in millions of Renminbi unless otherwise stated)

# 44 RISK MANAGEMENT *(continued)*

## (c) Currency risk *(continued)*

Under the existing managed floating exchange rate regime, the Group uses sensitivity analysis to measure the potential effect of changes in foreign currency exchange rates on the Group's net profit and loss. The following table sets forth, as at 31 December 2008 and 31 December 2007, the results of the Group's currency risk sensitivity analysis on the assets and liabilities at the same date.

| | **2008** | | 2007 | |
|---|---|---|---|---|
| | **Change in foreign currency exchange rate (in basis point)** | | Change in foreign currency exchange rate (in basis point) | |
| | **(100)** | **100** | (100) | 100 |
| (Decrease)/increase in annualised net profit | **(120)** | **120** | (87) | 87 |

This sensitivity analysis is based on a static foreign exchange exposure profile of assets and liabilities. In view of the nature of the RMB exchange rate regime, the analysis is based on the following assumptions: (i) the foreign exchange sensitivity is the gain and loss recognised as a result of a standard 100 basis point fluctuation in the foreign currency exchange rates against RMB, (ii) the exchange rates against RMB for all foreign currencies change in the same direction simultaneously, and (iii) the foreign exchange exposures calculated include both spot foreign exchange exposures, forward foreign exchange exposures and options. Actual changes in the Group's net foreign exchange gain and loss resulting from increases or decreases in foreign exchange rates may differ from the results of this sensitivity analysis.

## (d) Interest rate risk

The Group's interest rate exposures are primarily those arising from the basis risk of its lending and deposit taking activities governed by the benchmark interest rate set by the PBOC, and the repricing of assets and liabilities.

The ALCO regularly monitors such interest rate risk positions. The Group regularly performs gap analysis, sensitivity analysis, scenario analysis and stress tests on these interest rate positions to measure and manage the risk in order to limit the 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.

(Expressed in millions of Renminbi unless otherwise stated)

# 44 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.

| | Group | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2008 | | | | | | |
| | Effective interest rate | Total | 3 months or less (include overdue) | Over 3 months to 1 year | Over1 year to 5 years | Over 5 years | Non-interest bearing |
| **Assets** | | | | | | | |
| Cash and balances with central bank | 0.00% – 1.62% | 181,601 | 174,673 | – | – | – | 6,928 |
| Amounts due from banks and other financial institutions | 0.00% – 6.80% | 186,466 | 166,664 | 18,728 | 7 | – | 1,067 |
| Loans and advances to customers (note (i)) | 0.96% – 38.00% | 852,754 | 552,230 | 275,998 | 17,183 | 7,309 | 34 |
| Investments | 0.59% – 14.14% | 310,446 | 70,584 | 124,015 | 69,403 | 43,123 | 3,321 |
| Other assets | – | 40,530 | – | – | – | – | 40,530 |
| **Total assets** | | 1,571,797 | 964,151 | 418,741 | 86,593 | 50,432 | 51,880 |
| **Liabilities** | | | | | | | |
| Amounts due to banks and other financial institutions | 0.00% – 7.74% | 165,916 | 161,722 | 3,885 | 161 | – | 148 |
| Deposits from customers | 0.00%-10.25% | 1,250,648 | 948,795 | 238,155 | 49,719 | 5,334 | 8,645 |
| Financial liabilities at fair value through profit or loss | 0.00% – 4.88% | 4,618 | 1,408 | 761 | 183 | – | 2,266 |
| Certificates of deposit issued | 1.12% – 4.82% | 1,840 | 1,840 | – | – | – | – |
| Convertible bonds issued | 3.70% | 2 | – | 2 | – | – | – |
| Other debts issued | 2.13% – 2.56% | 4,996 | – | – | 4,996 | – | – |
| Subordinated notes issued | 4.10% – 5.90% | 33,440 | – | 7,492 | 18,962 | 6,986 | – |
| Other liabilities | – | 30,556 | – | – | – | – | 30,556 |
| **Total liabilities** | | 1,492,016 | 1,113,765 | 250,295 | 74,021 | 12,320 | 41,615 |
| Asset-liability gap | | 79,781 | (149,614) | 168,446 | 12,572 | 38,112 | 10,265 |

(Expressed in millions of Renminbi unless otherwise stated)

# 44 RISK MANAGEMENT *(continued)*

## (d) Interest rate risk *(continued)*

| | Group | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2007 (restated) | | | | | | |
| | Effective interest rate | Total | 3 months or less (include overdue) | Over 3 months to 1 year | Over1 year to 5 years | Over 5 years | Non-interest bearing |
| **Assets** | | | | | | | |
| Cash and balances with central bank | 0.00%-1.89% | 152,647 | 146,266 | – | – | – | 6,381 |
| Amounts due from banks and other financial institutions | 0.00%-9.74% | 239,564 | 201,927 | 37,592 | 45 | – | – |
| Loans and advances to customers (note (i)) | 1.29%-18.00% | 654,417 | 453,826 | 188,030 | 10,831 | 1,730 | – |
| Investments | 1.93%-12.93% | 243,634 | 60,690 | 107,362 | 55,472 | 16,628 | 3,482 |
| Other assets | – | 20,702 | – | – | – | – | 20,702 |
| **Total assets** | | 1,310,964 | 862,709 | 332,984 | 66,348 | 18,358 | 30,565 |
| **Liabilities** | | | | | | | |
| Amounts due to banks and other financial institutions | 0.00%-6.73% | 265,123 | 259,690 | 5,408 | – | 25 | – |
| Deposits from customers | 0.00%-6.43% | 943,534 | 764,522 | 158,093 | 19,952 | 967 | – |
| Derivative financial instruments | – | 2,945 | – | – | – | – | 2,945 |
| Certificates of deposit issued | 5.06% | 1,095 | 1,095 | – | – | – | – |
| Convertible bonds issued | 6.39% | 13 | – | – | 13 | – | – |
| Other debts issued | 2.34% | 9,992 | – | 4,998 | 4,994 | – | – |
| Subordinated notes issued | 4.74% | 3,500 | – | – | 3,500 | – | – |
| Other liabilities | – | 16,778 | – | – | – | – | 16,778 |
| **Total liabilities** | | 1,242,980 | 1,025,307 | 168,499 | 28,459 | 992 | 19,723 |
| Asset-liability gap | | 67,984 | (162,598) | 164,485 | 37,889 | 17,366 | 10,842 |

(Expressed in millions of Renminbi unless otherwise stated)

# 44 RISK MANAGEMENT *(continued)*

## (d) Interest rate risk *(continued)*

| | Bank | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2008 | | | | | | |
| | Effective interest rate | Total | 3 months or less (include overdue) | Over 3 months to 1 year | Over1 year to 5 years | Over 5 years | Non-interest bearing |
| **Assets** | | | | | | | |
| Cash and balances with central bank | 0.00% – 1.62% | 181,119 | 174,640 | – | – | – | 6,479 |
| Amounts due from banks and other financial institutions | 0.00% – 6.80% | 151,040 | 131,551 | 18,661 | 7 | – | 821 |
| Loans and advances to customers (note (i)) | 0.96% – 18.00% | 812,106 | 514,879 | 275,098 | 14,996 | 7,133 | – |
| Investments | 0.59% – 7.50% | 300,339 | 64,782 | 121,805 | 67,907 | 43,074 | 2,771 |
| Other assets | – | 54,768 | – | – | – | – | 54,768 |
| **Total assets** | | 1,499,372 | 885,852 | 415,564 | 82,910 | 50,207 | 64,839 |
| **Liabilities** | | | | | | | |
| Amounts due to banks and other financial institutions | 0.00% – 7.74% | 165,020 | 161,213 | 3,604 | 161 | – | 42 |
| Deposits from customers | 0.00% – 10.25% | 1,178,240 | 882,066 | 235,635 | 49,677 | 5,334 | 5,528 |
| Derivative financial instruments | – | 2,092 | – | – | – | – | 2,092 |
| Certificates of deposit issued | 2.48% – 3.08% | 941 | 941 | – | – | – | – |
| Convertible bonds issued | 3.70% | 2 | – | 2 | – | – | – |
| Other debts issued | 2.13% – 2.56% | 4,996 | – | – | 4,996 | – | – |
| Subordinated notes issued | 4.10% – 5.90% | 33,440 | – | 7,492 | 18,962 | 6,986 | – |
| Other liabilities | – | 27,204 | – | – | – | – | 27,204 |
| **Total liabilities** | | 1,411,935 | 1,044,220 | 246,733 | 73,796 | 12,320 | 34,866 |
| Asset-liability gap | | 87,437 | (158,368) | 168,831 | 9,114 | 37,887 | 29,973 |

(Expressed in millions of Renminbi unless otherwise stated)

# 44 RISK MANAGEMENT *(continued)*

## (d) Interest rate risk *(continued)*

| | Bank | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2007 (restated) | | | | | | |
| | Effective interest rate | Total | 3 months or less (include overdue) | Over 3 months to 1 year | Over1 year to 5 years | Over 5 years | Non-interest bearing |
| **Assets** | | | | | | | |
| Cash and balances with central bank | 0.00%-1.89% | 152,639 | 146,266 | – | – | – | 6,373 |
| Amounts due from banks and other financial institutions | 0.00%-9.74% | 239,564 | 201,927 | 37,592 | 45 | – | – |
| Loans and advances to customers (note (i)) | 1.29%-18.00% | 654,417 | 453,826 | 188,030 | 10,831 | 1,730 | – |
| Investments | 1.93%-12.93% | 243,626 | 60,690 | 107,362 | 55,472 | 16,628 | 3,474 |
| Other assets | – | 20,830 | – | – | – | – | 20,830 |
| **Total assets** | | 1,311,076 | 862,709 | 332,984 | 66,348 | 18,358 | 30,677 |
| **Liabilities** | | | | | | | |
| Amounts due to banks and other financial institutions | 0.00%-6.73% | 265,123 | 259,690 | 5,408 | – | 25 | – |
| Deposits from customers | 0.00%-6.43% | 943,769 | 764,579 | 158,271 | 19,952 | 967 | – |
| Derivative financial instruments | – | 2,945 | – | – | – | – | 2,945 |
| Certificates of deposit issued | 5.06% | 1,095 | 1,095 | – | – | – | – |
| Convertible bonds issued | 6.39% | 13 | – | – | 13 | – | – |
| Other debts issued | 2.34% | 9,992 | – | 4,998 | 4,994 | – | – |
| Subordinated notes issued | 4.74% | 3,500 | – | – | 3,500 | – | – |
| Other liabilities | – | 16,762 | – | – | – | – | 16,762 |
| **Total liabilities** | | 1,243,199 | 1,025,364 | 168,677 | 28,459 | 992 | 19,707 |
| Asset-liability gap | | 67,877 | (162,655) | 164,307 | 37,889 | 17,366 | 10,970 |

Note:

(i) For loans and advances to customers, the above "3 months or less" category includes overdue amounts (net of allowances for impairment losses). Overdue amounts represent loans of which the whole or part of the principals was overdue.

(Expressed in millions of Renminbi unless otherwise stated)

# 44 RISK MANAGEMENT *(continued)*

## (d) Interest rate risk *(continued)*

The Group uses sensitivity analysis to measure the potential effect of changes in interest rates on the Group's net interest income. The following table sets forth, as at 31 December 2008 and 31 December 2007, the results of the Group's interest rate sensitivity analysis on the assets and liabilities at the same date.

| | **2008** | | 2007 | |
|---|---|---|---|---|
| | **Change in interest rates (in basis point)** | | Change in interest rates (in basis point) | |
| | **100** | **(100)** | 100 | (100) |
| (Decrease)/increase in annualised net profit | **(967)** | **967** | (1,101) | 1,101 |

This sensitivity analysis is based on a static interest rate risk profile of assets and liabilities. The analysis measures only the impact of changes in the interest rates within a year, as reflected by the repricing of the Group's assets and liabilities within a year, on annualised interest income. The analysis is based on the following assumptions: (i) all assets and liabilities that reprice or are due within one year reprice or are due at the beginning of the respective periods, (ii) there is a parallel shift in the yield curve and in interest rates, and (iii) there are no other changes to the portfolio. Actual changes in the Group's net interest income resulting from increase or decrease in interest rates may differ from the results of this sensitivity analysis.

The interest rate environment in 2008 was unstable, switching from a steady increase to a sudden decrease later in the year. The group paid close attention to changes in the macroeconomic and financial environment, and adjusted the internal funds transfer pricing strategy and the guidance on the application of interest rates. To maintain the net interest margin at a reasonable level and keep a well-balanced development of its asset and liability business, the Group promptly adjusts the maturity structure of its lending and deposit-taking business and the duration of its debt security investments, as well as seeking to optimize the repricing gap between interest-bearing assets and liabilities.

## 44 RISK MANAGEMENT *(continued)*

### (e) Liquidity risk

Liquidity risk is the risk the Group cannot satisfy the customers by repaying deposits that fall due, granting new loans or providing financing, or that the Group cannot satisfy these requirements at a normal cost. 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 liquidity of the Group is centrally managed by the head office using the internal funds transfer pricing mechanism.

The Group adopts a centralised liquidity management approach. Through the internal funds transfer pricing mechanism, branches are guided to adjust the durations and product structures of their assets and liabilities. The Group closely monitors its daily position, monthly liquidity ratio and liquidity gap ratio, and performs stress testing to verify the bank's ability to meet liquidity needs under extreme circumstances. In addition, the Group has a liquidity risk warning system and a liquidity contingency plan in place to tackle any liquidity crises.

In 2008, adverse changes were observed in the macro liquidity environment. Through the internal funds transfer pricing mechanism, the head office encouraged branches to take deposits in the first-half of the year and control costs of deposits in the second-half of the year. The Group also paid close attention to the duration structure of its lending and deposit taking business. Such measures helped the Group to cope with the pressure from loosening liquidity trend as well as ensure liquidity safety and efficiency of the treasury operation.

The majority of the Group's assets come from customer deposits, mainly deposits from companies, retail customers and financial institutions. In addition, during the year, RMB30 billion was raised with the issue of subordinate debt to ensure stable funding. An analysis of the past three years' data shows that the Group's deposits from customers have been growing continuously, with a rising variety of deposit products with various maturities and have become a stable source of funds for the Group.

13.5% (2007: 14.5%) and 5% (2007: 5%) of eligible RMB deposits and foreign currency deposits respectively are deposits in PBOC as required.

#### *The impact of market turmoil on liquidity risk*

A significant aspect of the market turmoil continues to be its adverse effect on the liquidity and funding risk profile of the banking system in the US and Europe. The Group's interbank funding transactions were mainly with PRC banks, and China's money market was not significantly affected by the global financial crisis. As a result, the liquidity position of the Group remained stable.

(Expressed in millions of Renminbi unless otherwise stated)

# 44 RISK MANAGEMENT *(continued)*

## (e) Liquidity risk *(continued)*

Analysis of the Group's assets and liabilities by remaining maturity is as follows:

| | 2008 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 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 | Indefinite | Total |
| Cash and balances with central bank (note (i)) | 53,680 | – | – | – | – | – | 127,921 | 181,601 |
| Amounts due from banks and other financial institutions | 14,039 | 93,564 | 59,747 | 18,731 | 385 | – | – | 186,466 |
| Loans and advances to customers (note (ii)) | 3,508 | 45,899 | 117,208 | 374,444 | 167,610 | 141,556 | 2,529 | 852,754 |
| Investments (note (iii)) | – | 16,550 | 18,734 | 76,507 | 136,272 | 58,959 | 3,424 | 310,446 |
| – at fair value through profit or loss | – | 625 | 1,139 | 5,074 | 7,022 | 1,454 | 2,385 | 17,699 |
| – available-for-sale | – | 12,923 | 15,119 | 62,834 | 71,594 | 43,462 | 1,027 | 206,959 |
| – held-to-maturity | – | 3,002 | 1,860 | 6,685 | 45,463 | 13,357 | 6 | 70,373 |
| – receivables | – | – | 616 | 1,914 | 12,193 | 686 | 6 | 15,415 |
| Other assets | 4,935 | 1,248 | 1,353 | 2,310 | 862 | 1,032 | 28,790 | 40,530 |
| Total assets | 76,162 | 157,261 | 197,042 | 471,992 | 305,129 | 201,547 | 162,664 | 1,571,797 |
| Amounts due to banks and other financial institutions | 98,456 | 34,179 | 28,485 | 3,635 | 1,161 | – | – | 165,916 |
| Deposits from customers (note (iv)) | 694,315 | 113,071 | 144,483 | 238,655 | 58,570 | 1,554 | – | 1,250,648 |
| Financial liabilities at fair value through profit or loss | – | 317 | 471 | 1,069 | 495 | – | 2,266 | 4,618 |
| Certificates of deposit issued | – | 440 | 306 | 610 | 484 | – | – | 1,840 |
| Convertible bonds issued | – | – | – | 2 | – | – | – | 2 |
| Other debts issued | – | – | – | – | 4,996 | – | – | 4,996 |
| Subordinated notes issued | – | – | – | – | 3,500 | 29,940 | – | 33,440 |
| Other liabilities | 22,698 | 837 | 1,485 | 2,484 | 1,475 | 1,318 | 259 | 30,556 |
| Total liabilities | 815,469 | 148,844 | 175,230 | 246,455 | 70,681 | 32,812 | 2,525 | 1,492,016 |
| (Short)/long position | (739,307) | 8,417 | 21,812 | 225,537 | 234,448 | 168,735 | 160,139 | 79,781 |

(Expressed in millions of Renminbi unless otherwise stated)

## 44 RISK MANAGEMENT *(continued)*

### (e) Liquidity risk *(continued)*

Analysis of the Group's assets and liabilities by remaining maturity is as follows: *(continued)*

| | 2007 (restated) | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 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 | Indefinite | Total |
| Cash and balances with central bank (note (i)) | 42,902 | – | – | – | – | – | 109,745 | 152,647 |
| Amounts due from banks and other financial institutions | 8,994 | 138,018 | 54,889 | 37,593 | 70 | – | – | 239,564 |
| Loans and advances to customers (note (ii)) | 774 | 51,577 | 107,653 | 276,036 | 117,932 | 95,981 | 4,464 | 654,417 |
| Investments (note (iii)) | – | 8,780 | 20,907 | 65,852 | 112,925 | 31,688 | 3,482 | 243,634 |
| – at fair value through profit or loss | – | 324 | 738 | 2,992 | 2,260 | 1,223 | 3,301 | 10,838 |
| – available-for-sale | – | 8,383 | 19,240 | 48,478 | 50,873 | 14,472 | 181 | 141,627 |
| – held-to-maturity | – | – | 194 | 12,292 | 46,346 | 15,800 | – | 74,632 |
| – receivables | – | 73 | 735 | 2,090 | 13,446 | 193 | – | 16,537 |
| Other assets | 5,266 | 1,179 | 1,053 | 1,985 | 37 | 28 | 11,154 | 20,702 |
| Total assets | 57,936 | 199,554 | 184,502 | 381,466 | 230,964 | 127,697 | 128,845 | 1,310,964 |
| Amounts due to banks and other financial institutions | 207,845 | 43,545 | 4,280 | 9,428 | – | 25 | – | 265,123 |
| Deposits from customers (note (iv)) | 610,629 | 58,231 | 89,705 | 161,536 | 22,466 | 967 | – | 943,534 |
| Derivative financial instruments | – | – | – | – | – | – | 2,945 | 2,945 |
| Certificates of deposit issued | – | – | – | 1,095 | – | – | – | 1,095 |
| Convertible bonds issued | – | – | – | – | 13 | – | – | 13 |
| Other debts issued | – | – | – | 4,998 | 4,994 | – | – | 9,992 |
| Subordinated notes issued | – | – | – | – | 3,500 | – | – | 3,500 |
| Other liabilities | 14,075 | 535 | 789 | 1,057 | 301 | 21 | – | 16,778 |
| Total liabilities | 832,549 | 102,311 | 94,774 | 178,114 | 31,274 | 1,013 | 2,945 | 1,242,980 |
| (Short)/long position | (774,613) | 97,243 | 89,728 | 203,352 | 199,690 | 126,684 | 125,900 | 67,984 |

(Expressed in millions of Renminbi unless otherwise stated)

# 44 RISK MANAGEMENT *(continued)*

## (e) Liquidity risk *(continued)*

Analysis of the Bank's assets and liabilities by remaining maturity is as follows:

| | 2008 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 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 | Indefinite | Total |
| Cash and balances with central bank (note (i)) | 53,213 | – | – | – | – | – | 127,906 | 181,119 |
| Amounts due from banks and other financial institutions | 13,207 | 63,195 | 55,945 | 18,661 | 32 | – | – | 151,040 |
| Loans and advances to customers (note (ii)) | 2,503 | 45,086 | 115,386 | 369,528 | 148,548 | 128,667 | 2,388 | 812,106 |
| Investments (note (iii)) | – | 14,176 | 16,551 | 73,634 | 134,429 | 58,727 | 2,822 | 300,339 |
| – at fair value through profit or loss | – | – | 531 | 3,339 | 5,569 | 1,425 | 2,252 | 13,116 |
| – available-for-sale | – | 12,923 | 15,119 | 62,197 | 71,420 | 43,374 | 558 | 205,591 |
| – held-to-maturity | – | 1,253 | 285 | 6,184 | 45,247 | 13,242 | 6 | 66,217 |
| – receivables | – | – | 616 | 1,914 | 12,193 | 686 | 6 | 15,415 |
| Other assets | 4,775 | 934 | 1,220 | 2,007 | 581 | 4 | 45,247 | 54,768 |
| Total assets | 73,698 | 123,391 | 189,102 | 463,830 | 283,590 | 187,398 | 178,363 | 1,499,372 |
| Amounts due to banks and other financial institutions | 98,443 | 33,668 | 28,144 | 3,604 | 1,161 | – | – | 165,020 |
| Deposits from customers (note (iv)) | 672,968 | 80,682 | 128,373 | 236,135 | 58,528 | 1,554 | – | 1,178,240 |
| Derivative financial instruments | – | – | – | – | – | – | 2,092 | 2,092 |
| Certificates of deposit issued | – | 440 | – | 307 | 194 | – | – | 941 |
| Convertible bonds issued | – | – | – | 2 | – | – | – | 2 |
| Other debts issued | – | – | – | – | 4,996 | – | – | 4,996 |
| Subordinated notes issued | – | – | – | – | 3,500 | 29,940 | – | 33,440 |
| Other liabilities | 22,178 | 480 | 1,232 | 1,930 | 773 | 611 | – | 27,204 |
| Total liabilities | 793,589 | 115,270 | 157,749 | 241,978 | 69,152 | 32,105 | 2,092 | 1,411,935 |
| (Short)/long position | (719,891) | 8,121 | 31,353 | 221,852 | 214,438 | 155,293 | 176,271 | 87,437 |

(Expressed in millions of Renminbi unless otherwise stated)

# 44 RISK MANAGEMENT *(continued)*

## (e) Liquidity risk *(continued)*

Analysis of the Bank's assets and liabilities by remaining maturity is as follows: *(continued)*

| | 2007 (restated) | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 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 | Indefinite | Total |
| Cash and balances with central bank (note (i)) | 42,894 | – | – | – | – | – | 109,745 | 152,639 |
| Amounts due from banks and other financial institutions | 8,994 | 138,018 | 54,889 | 37,593 | 70 | – | – | 239,564 |
| Loans and advances to customers (note (ii)) | 774 | 51,577 | 107,653 | 276,036 | 117,932 | 95,981 | 4,464 | 654,417 |
| Investments (note (iii)) | – | 8,780 | 20,907 | 65,852 | 112,925 | 31,688 | 3,474 | 243,626 |
| – at fair value through profit or loss | – | 324 | 738 | 2,992 | 2,260 | 1,223 | 3,293 | 10,830 |
| – available-for-sale | – | 8,383 | 19,240 | 48,478 | 50,873 | 14,472 | 181 | 141,627 |
| – held-to-maturity | – | – | 194 | 12,292 | 46,346 | 15,800 | – | 74,632 |
| – receivables | – | 73 | 735 | 2,090 | 13,446 | 193 | – | 16,537 |
| Other assets | 5,224 | 1,179 | 1,053 | 1,985 | 37 | 28 | 11,324 | 20,830 |
| Total assets | 57,886 | 199,554 | 184,502 | 381,466 | 230,964 | 127,697 | 129,007 | 1,311,076 |
| Amounts due to banks and other financial institutions | 207,845 | 43,545 | 4,280 | 9,428 | – | 25 | – | 265,123 |
| Deposits from customers (note (iv)) | 610,686 | 58,231 | 89,705 | 161,714 | 22,466 | 967 | – | 943,769 |
| Derivative financial instruments | – | – | – | – | – | – | 2,945 | 2,945 |
| Certificates of deposit issued | – | – | – | 1,095 | – | – | – | 1,095 |
| Convertible bonds issued | – | – | – | – | 13 | – | – | 13 |
| Other debts issued | – | – | – | 4,998 | 4,994 | – | – | 9,992 |
| Subordinated notes issued | – | – | – | – | 3,500 | – | – | 3,500 |
| Other liabilities | 14,059 | 535 | 789 | 1,057 | 301 | 21 | – | 16,762 |
| Total liabilities | 832,590 | 102,311 | 94,774 | 178,292 | 31,274 | 1,013 | 2,945 | 1,243,199 |
| (Short)/long position | (774,704) | 97,243 | 89,728 | 203,174 | 199,690 | 126,684 | 126,062 | 67,877 |

(Expressed in millions of Renminbi unless otherwise stated)

# 44 RISK MANAGEMENT *(continued)*

## (e) Liquidity risk *(continued)*

Notes:

(i) For balances with central bank, indefinite amount represents statutory deposit reserve funds and fiscal balances maintained with the PBOC.

(ii) For loans and advances to customers, indefinite amounts represent loans of which the whole or part of the principals was overdue for more than 1 month. The indefinite 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 Bank's intention to hold them to maturity.

(iv) The deposits from customers that are repayable on demand included time deposits matured and awaiting for customers' instructions.

Analysis of the residual contractual maturities of non-derivative financial liabilities and gross loan commitments of the Group at the balance sheet date is as follows. Liabilities in trading portfolios are not included in this analysis as they are typically held for short periods of time. The amounts disclosed below are the contractual undiscounted cash flow:

| | 2008 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Carrying amount | Total | 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 | Indefinite |
| **Non-derivative financial liabilities** | | | | | | | | | |
| Amounts due to banks and other financial institutions | 165,916 | 166,898 | 98,726 | 34,337 | 28,713 | 3,810 | 1,307 | 5 | – |
| Deposits from customers | 1,250,648 | 1,278,777 | 697,005 | 114,695 | 147,791 | 248,238 | 68,853 | 2,195 | – |
| Financial liabilities at fair value through profit or loss | 2,352 | 2,390 | – | 320 | 483 | 1,092 | 495 | – | – |
| Certificates of deposit issued | 1,840 | 1,876 | – | 443 | 309 | 633 | 491 | – | – |
| Convertible bonds issued | 2 | 2 | – | – | – | 2 | – | – | – |
| Other debts issued | 4,996 | 5,229 | – | – | – | 128 | 5,101 | – | – |
| Subordinated notes issued | 33,440 | 44,972 | – | – | – | 1,821 | 11,692 | 31,459 | – |
| Other liabilities | 22,417 | 22,417 | 19,734 | 272 | 201 | 540 | 703 | 708 | 259 |
| | 1,481,611 | 1,552,561 | 815,465 | 150,067 | 177,497 | 256,264 | 88,642 | 34,367 | 259 |
| Gross loan commitments | | 106,945 | 106,945 | – | – | – | – | – | – |

(Expressed in millions of Renminbi unless otherwise stated)

# 44 RISK MANAGEMENT *(continued)*

## (e) Liquidity risk *(continued)*

Analysis of the residual contractual maturities of non-derivative financial liabilities and gross loan commitments of the Group at the balance sheet date is as follows. Liabilities in trading portfolios are not included in this analysis as they are typically held for short periods of time. The amounts disclosed below are the contractual undiscounted cash flow: *(continued)*

| | 2007 (restated) | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Carrying amount | Total | 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 |
| **Non-derivative financial liabilities** | | | | | | | | |
| Amounts due to banks and other financial institutions | 265,123 | 266,104 | 207,845 | 43,643 | 4,461 | 10,120 | – | 35 |
| Deposits from customers | 943,534 | 953,625 | 610,686 | 58,723 | 90,946 | 166,861 | 25,434 | 975 |
| Certificates of deposit issued | 1,095 | 1,136 | – | – | 14 | 1,122 | – | – |
| Convertible bonds issued | 13 | 15 | – | – | – | – | 15 | – |
| Other debts issued | 9,992 | 10,491 | – | – | – | 5,235 | 5,256 | – |
| Subordinated notes issued | 3,500 | 3,717 | – | – | – | – | 3,717 | – |
| Other liabilities | 5,298 | 5,298 | 5,298 | – | – | – | – | – |
| | 1,228,555 | 1,240,386 | 823,829 | 102,366 | 95,421 | 183,338 | 34,422 | 1,010 |
| Gross loan commitments | | 60,711 | 60,711 | – | – | – | – | – |

(Expressed in millions of Renminbi unless otherwise stated)

# 44 RISK MANAGEMENT *(continued)*

## (e) Liquidity risk *(continued)*

Analysis of the residual contractual maturities of non-derivative financial liabilities and gross loan commitments of the Bank at the balance sheet date is as follows. Liabilities in trading portfolios are not included in this analysis as they are typically held for short periods of time. The amounts disclosed below are the contractual undiscounted cash flow:

| | 2008 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Carrying amount | Total | 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 |
| **Non-derivative financial liabilities** | | | | | | | | |
| Amounts due to banks and other financial institutions | 165,020 | 165,998 | 98,713 | 33,775 | 28,371 | 3,827 | 1,307 | 5 |
| Deposits from customers | 1,178,240 | 1,206,145 | 675,656 | 82,208 | 131,596 | 245,682 | 68,808 | 2,195 |
| Certificates of deposit issued | 941 | 954 | – | 440 | – | 319 | 195 | – |
| Convertible bonds issued | 2 | 2 | – | – | – | 2 | – | – |
| Other debts issued | 4,996 | 5,229 | – | – | – | 128 | 5,101 | – |
| Subordinated notes issued | 33,440 | 44,972 | – | – | – | 1,821 | 11,692 | 31,459 |
| Other liabilities | 19,219 | 19,219 | 19,219 | – | – | – | – | – |
| | 1,401,858 | 1,442,519 | 793,588 | 116,423 | 159,967 | 251,779 | 87,103 | 33,659 |
| Gross loan commitments | | 96,233 | 96,233 | – | – | – | – | – |

| | 2007 (restated) | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Carrying amount | Total | 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 |
| **Non-derivative financial liabilities** | | | | | | | | |
| Amounts due to banks and other financial institutions | 265,123 | 266,104 | 207,845 | 43,643 | 4,461 | 10,120 | – | 35 |
| Deposits from customers | 943,769 | 953,625 | 610,686 | 58,723 | 90,946 | 166,861 | 25,434 | 975 |
| Certificates of deposit issued | 1,095 | 1,136 | – | – | 14 | 1,122 | – | – |
| Convertible bonds issued | 13 | 15 | – | – | – | – | 15 | – |
| Other debts issued | 9,992 | 10,491 | – | – | – | 5,235 | 5,256 | – |
| Subordinated notes issued | 3,500 | 3,717 | – | – | – | – | 3,717 | – |
| Other liabilities | 5,298 | 5,298 | 5,298 | – | – | – | – | – |
| | 1,228,790 | 1,240,386 | 823,829 | 102,366 | 95,421 | 183,338 | 34,422 | 1,010 |
| Gross loan commitments | | 60,711 | 60,711 | – | – | – | – | – |

## 44 RISK MANAGEMENT *(continued)*

### (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, asset recovery and legal affairs. This has allowed the Group to identify and address the operational risk inherent in key products, activities, processes and systems.

### (g) Capital management

The Group's capital management comprises the management of the capital adequacy ratio, capital financing, and economic capital, of which the prime focus is capital adequacy ratio management.

The Group calculates capital adequacy ratio in accordance with the guidelines issued by the CBRC. These guidelines may differ significantly from the relevant requirements in Hong Kong or other jurisdictions. The capital of the Group is analysed into core capital and supplementary capital. The core capital mainly includes paid-up share capital or ordinary shares, capital reserve, surplus reserve, retained earnings, and minority interest, after the deductions of dividends declared after the balance sheet date, as well as deductions of 100% of goodwill and 50% of unconsolidated equity investments. Supplementary capital includes general provisions, long-term subordinated debts, and reserves arising from changes in the fair value of available-for-sale debt securities.

The CBRC requires that the capital adequacy ratio and core capital adequacy ratio for commercial banks shall not fall below 8% and 4% respectively. For commercial banks, supplementary capital shall not exceed 100% of core capital while long-term subordinated liabilities included in the supplementary capital shall not exceed 50% of the core capital. When total positions of trading accounts exceed 10% of the on- and off-balance sheet total assets, or RMB8.5 billion, commercial banks must provide for market risk capital. At present, the Group is fully compliant with legal and regulatory requirements.

Capital adequacy ratio management is a core issue of capital management. The capital adequacy ratio reflects the Group's sound operations and risk management capability. The Group's capital adequacy ratio management objectives are to meet the legal and regulatory requirements and to prudently determine the capital adequacy ratio under realistic exposures with reference to the capital adequacy ratio levels of leading global banks and the Group's operating situations.

The Group predicts, plans, and manages the capital adequacy ratio by using scenario models and stress tests based on its strategic development plans, business expansion needs, and risk exposure trends.

### (h) 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. For accounting purpose, all derivatives are classified as held for trading.

Treasury business includes the formation and sale of financial derivatives to enable customers to transfer, change or mitigate existing or anticipated risks.

(Expressed in millions of Renminbi unless otherwise stated)

# 44 RISK MANAGEMENT *(continued)*

## (h) Use of derivatives *(continued)*

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.

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.

| | Group | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2008 | | | | | | |
| | 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 |
| **Derivatives held for trading** | | | | | | | |
| Interest rate derivatives | | | | | | | |
| Interest rate swaps | 1,860 | 34,691 | 7,303 | 136 | 43,990 | 197 | (388) |
| Currency derivatives | | | | | | | |
| Spot | 15,895 | – | – | – | 15,895 | 17 | (16) |
| Forwards | 20,024 | 32,217 | 1,344 | – | 53,585 | 1,400 | (1,165) |
| Foreign exchange swaps | 10,724 | 9,645 | 405 | – | 20,774 | 216 | (113) |
| Options | 9,654 | 56 | – | – | 9,710 | 295 | (318) |
| | 56,297 | 41,918 | 1,749 | – | 99,964 | 1,928 | (1,612) |
| Other derivatives | | | | | | | |
| Equity swaps | 1,617 | 1,189 | 112 | – | 2,918 | 59 | (59) |
| Equity options | 351 | 16 | – | – | 367 | 6 | (6) |
| Credit default swaps | – | – | 3,303 | – | 3,303 | 97 | (187) |
| | 1,968 | 1,205 | 3,415 | – | 6,588 | 162 | (252) |
| **Derivatives managed in conjunction with financial instruments designated at fair value through profit or loss** | | | | | | | |
| Interest rate derivatives | | | | | | | |
| Interest rate swaps | – | – | 136 | – | 136 | – | (14) |
| Total | | | | | | 2,287 | (2,266) |
| | | | | | | (Note 18(a)) | |

(Expressed in millions of Renminbi unless otherwise stated)

## 44 RISK MANAGEMENT *(continued)*

### (h) Use of derivatives *(continued)*

| | Group | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2007 | | | | | | |
| | 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 |
| **Derivatives held for trading** | | | | | | | |
| Interest rate derivatives | | | | | | | |
| Interest rate swaps | 811 | 25,115 | 7,088 | 497 | 33,511 | 16 | (31) |
| Currency derivatives | | | | | | | |
| Spot | 6,360 | – | – | – | 6,360 | 3 | – |
| Forwards | 32,864 | 70,355 | 3,387 | – | 106,606 | 2,543 | (2,374) |
| Foreign exchange swaps | 11,531 | 9,661 | – | – | 21,192 | 249 | (62) |
| Options | 41,790 | 4,093 | 37 | – | 45,920 | 374 | (371) |
| | 92,545 | 84,109 | 3,424 | – | 180,078 | 3,169 | (2,807) |
| Other derivatives | | | | | | | |
| Equity swaps | – | 9,306 | 1,705 | – | 11,011 | 104 | (104) |
| Credit default swaps | – | – | 480 | – | 480 | 4 | (3) |
| | – | 9,306 | 2,185 | – | 11,491 | 108 | (107) |
| Total | | | | | | 3,293 | (2,945) |
| | | | | | | (Note 18(a)) | |

(Expressed in millions of Renminbi unless otherwise stated)

# 44 RISK MANAGEMENT *(continued)*

## (h) Use of derivatives *(continued)*

| | Bank | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2008 | | | | | | |
| | 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 |
| **Derivatives held for trading** | | | | | | | |
| Interest rate derivatives | | | | | | | |
| Interest rate swaps | 1,190 | 33,338 | 5,707 | 136 | 40,371 | 178 | (229) |
| Currency derivatives | | | | | | | |
| Spot | 15,895 | – | – | – | 15,895 | 17 | (16) |
| Forwards | 19,939 | 32,214 | 1,344 | – | 53,497 | 1,397 | (1,164) |
| Foreign exchange swaps | 10,334 | 9,475 | 405 | – | 20,214 | 215 | (111) |
| Options | 9,308 | – | – | – | 9,308 | 289 | (312) |
| | 55,476 | 41,689 | 1,749 | – | 98,914 | 1,918 | (1,603) |
| Other derivatives | | | | | | | |
| Equity swaps | 1,617 | 1,189 | 112 | – | 2,918 | 59 | (59) |
| Credit default swaps | – | – | 3,303 | – | 3,303 | 97 | (187) |
| | 1,617 | 1,189 | 3,415 | – | 6,221 | 156 | (246) |
| **Derivatives managed in conjunction with financial instruments designated at fair value through profit or loss** | | | | | | | |
| Interest rate derivatives | | | | | | | |
| Interest rate swaps | – | – | 136 | – | 136 | – | (14) |
| Total | | | | | | 2,252 | (2,092) |
| | | | | | | (Note 18(a)) | |

(Expressed in millions of Renminbi unless otherwise stated)

# 44 RISK MANAGEMENT *(continued)*

## (h) Use of derivatives *(continued)*

| | Bank | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2007 | | | | | | |
| | 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 |
| **Derivatives held for trading** | | | | | | | |
| Interest rate derivatives | | | | | | | |
| Interest rate swaps | 811 | 25,115 | 7,088 | 497 | 33,511 | 16 | (31) |
| Currency derivatives | | | | | | | |
| Spot | 6,360 | – | – | – | 6,360 | 3 | – |
| Forwards | 32,864 | 70,355 | 3,387 | – | 106,606 | 2,543 | (2,374) |
| Foreign exchange swaps | 11,531 | 9,661 | – | – | 21,192 | 249 | (62) |
| Options | 41,790 | 4,093 | 37 | – | 45,920 | 374 | (371) |
| | 92,545 | 84,109 | 3,424 | – | 180,078 | 3,169 | (2,807) |
| Other derivatives | | | | | | | |
| Equity swaps | – | 9,306 | 1,705 | – | 11,011 | 104 | (104) |
| Credit default swaps | – | – | 480 | – | 480 | 4 | (3) |
| | – | 9,306 | 2,185 | – | 11,491 | 108 | (107) |
| Total | | | | | | 3,293 | (2,945) |
| | | | | | | (Note 18(a)) | |

The credit risk weighted amounts in respect of these derivatives are as follows. These amounts take into account the effects of bilateral netting arrangements.

### *Credit risk weighted amounts*

| | **2008** | 2007 |
|---|---|---|
| Interest rate derivatives | **62** | 18 |
| Currency derivatives | **585** | 428 |
| Other derivatives | **37** | 1 |
| | **684** | 447 |

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.

(Expressed in millions of Renminbi unless otherwise stated)

# 44 RISK MANAGEMENT *(continued)*

## (i) 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 securities investments are stated at amortised costs less impairment, and the fair values are disclosed in Note 18(c).

### *(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***

| | **2008** | 2007 |
|---|---|---|
| Convertible bonds issued | **2** | 13 |
| Subordinated notes issued | **33,440** | 3,500 |
| | **33,442** | 3,513 |

***Fair value***

| | **2008** | 2007 |
|---|---|---|
| Convertible bonds issued | **4** | 13 |
| Subordinated notes issued | **35,873** | 3,470 |
| | **35,877** | 3,483 |

## 45 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.

### (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. Objective evidence for impairment is described in accounting policy 2(n). 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 equity investments

For available-for-sale equity investments, 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, the Group considers historical data on market volatility and historical share price of the specific equity investment as well as other factors, such as 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.

### (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.

## 45 SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS *(continued)*

### (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.

### (f) Defined benefit scheme

Actuarial assumptions are made in valuing future pension obligations as set out in note 31(a). There is uncertainty that these assumptions will hold true in the future. They are reviewed periodically and are updated where necessary.

### (g) Ultimate liability arising from claims made under insurance contracts

The estimation of the ultimate liability arising from claims made under insurance contracts is one of the Group's critical accounting estimates. Estimates and judgements are continually evaluated and based on historical experience and other factors, including expectations of loss events that have been incurred but not reported ("IBNR") to the Group as of the balance sheet date. The estimation of IBNR claims is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified to the Group, where information about the claim events is available. IBNR claims may not be apparent to the insured until many years after the event that gives rise to the claim has happened.

Estimation of the ultimate cost of certain liability claims can be a complex process. There are several sources of uncertainty that need to be considered in the estimating of the liability that the Group will ultimately pay for such claims. In particular, the claims arising from the employees' compensation and other liability policies can be longer in tail and difficult to estimate. The Group has appointed an independent actuary to estimate the claim liabilities using established actuarial methodologies. The methodologies are statistical in nature and can be affected by various factors. The more significant factors that can affect the reliability of the liability estimation include jurisprudence that can broaden the intent and scope coverage of the protections offered in the insurance contracts issued by the Group, the extent to which actual claim results differ from historical experience and the time lag between the occurrence of the event and the report of such claim to the Group.

### (h) Provisions

Judgement has been exercised in determining the amount which may be payable to customers in respect of complaints or legal claims arising from the sale of investment products.

(Expressed in millions of Renminbi unless otherwise stated)

# 46 MATERIAL RELATED-PARTY TRANSACTIONS

## (a) Material connected person information

The Bank's largest shareholder and its parent company and the Bank's subsidiaries:

| Company name | Registered location | Issued and fully paid capital | Proportion of the Bank held by the Company | Proportion of the Company held by the Bank | Business | The relationship with the Bank | Legal form | Legal representative |
|---|---|---|---|---|---|---|---|---|
| China Merchants Group(CMG) | Beijing | RMB 5,400 million | 18.04% (note(i)) | – | Transportation, shipping agency, ware housing and storage, leasing, building and facility, repair and contracting, operating management service | Largest shareholder's parent company | Limited company | Qin Xiao |
| China Merchants Steam Navigation Company Limited (CMSNCL) | Beijing & Hongkong | RMB 200 million | 12.37% (note(ii)) | – | Transportation, building and repair, procurement, supply chain management and distribution, shipping agency services | Largest shareholder | Joint stock limited company | Qin Xiao |
| CMB International Capital Corporation Limited (CMBICCL) | Hongkong | HKD 250 million | – | 100% | Financial advisory | Subsidiary | Limited company | Ma Weihua |
| CMB Financial Leasing Corporation Limited (CMBFLCL) | Shanghai | RMB 2,000 million | – | 100% | Financial leasing and advisory | Subsidiary | Limited company | Zhang Guanghua |
| Winglung Bank Limited (WLB) | Hongkong | HKD 1,161 million | – | 97.82% | Banking | Subsidiary | Limited company | Ma Weihua |

(i) CMG hold 18.04% of the Bank (2007: 17.64%) through its subsidiaries.

(ii) As the largest shareholder, CMSNCL who is the subsidiary of CMG, hold 12.37% of the Bank (2007: 12.11%).

(Expressed in millions of Renminbi unless otherwise stated)

# 46 MATERIAL RELATED-PARTY TRANSACTIONS *(continued)*

## (a) Material connected person information *(continued)*

***The registered capital of each company***

| Connected person | 2008 | 2007 |
|---|---|---|
| CMG | **RMB5,400,000,000** | RMB5,400,000,000 |
| CMSNCL | **RMB200,000,000** | RMB200,000,000 |
| CMBICCL | **HKD250,000,000** | HKD250,000,000 |
| CMBFLCL | **RMB2,000,000,000** | – |
| WLB | **HKD1,160,950,575** | HKD1,160,950,575 |

***The change of proportion of the Bank held by the largest shareholder and the portion of the subsidiaries held by the Bank***

| | CMSNCL | | CMBICCL | | CMBFLCL | | WLB | |
|---|---|---|---|---|---|---|---|---|
| | RMB | % | HKD | % | RMB | % | HKD | % |
| At 1 January 2008 | 1,781,370,091 | 12.11 | 250,000,000 | 100.00 | – | – | – | – |
| Change | 37,350,713 | 0.26 | – | – | 2,000,000,000 | 100.00 | 1,135,641,852 | 97.82 |
| At 31 December 2008 | 1,818,720,804 | 12.37 | 250,000,000 | 100.00 | 2,000,000,000 | 100.00 | 1,135,641,852 | 97.82 |

## (b) 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, securities trading, agency services, trust services, 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:

| | 2008 | 2007 |
|---|---|---|
| Short-term loans | **4.86% to 7.47% p.a.** | 5.58% to 7.47% p.a. |
| Medium to long-term loans | **5.40% to 7.83% p.a.** | 6.30% to 7.83% p.a. |
| Saving deposits | **0.36% to 0.72% p.a.** | 0.72% p.a. |
| Time deposits | **1.17% to 5.85% p.a.** | 1.80% to 5.85% p.a. |

There were no individually assessed allowances for impairment losses made against loans and advances granted to related parties during the year.

(Expressed in millions of Renminbi unless otherwise stated)

# 46 MATERIAL RELATED-PARTY TRANSACTIONS *(continued)*

## (c) Shareholders and their related companies

As the Bank's largest shareholder CMSNCL and its related companies hold 17.89% (12.37% (2007: 12.11%) held directly by CMSNCL) of the Bank's shares as at 31 December 2008 (2007: 17.64%), 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:

| | **Group** | | **Bank** | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| On balance sheet: | | | | |
| – Loans and advances | **4,441** | 3,620 | **3,712** | 3,620 |
| – Investments | **2,168** | 406 | **2,167** | 406 |
| – Deposits from customers | **23,258** | 57,616 | **22,466** | 57,616 |
| Off-balance sheet: | | | | |
| – Irrevocable guarantee | **988** | 1,112 | **869** | 1,112 |
| – Irrevocable letters of credit | **169** | 80 | **169** | 80 |
| – Bills of acceptances | **269** | 296 | **269** | 296 |
| Average balance of loans and advances | **4,436** | 2,811 | **3,807** | 2,811 |
| Interest income | **281** | 156 | **275** | 156 |
| Interest expense | **618** | 728 | **618** | 728 |
| Fees and commission | **367** | 942 | **367** | 942 |

## (d) Companies controlled by directors other than those under Note 46(b) above

| | **Group and Bank** | |
|---|---|---|
| | **2008** | 2007 |
| On balance sheet: | | |
| – Loans and advances | **–** | 110 |
| – Investments | **370** | 1,343 |
| – Deposits from customers | **8,266** | 5,817 |
| Off-balance sheet: | | |
| – Bill of acceptances | **11** | – |
| Average balance of loans and advances | **276** | 461 |
| Interest income | **27** | 26 |
| Interest expense | **178** | 92 |
| Fees and commission | **–** | 8 |

(Expressed in millions of Renminbi unless otherwise stated)

## 46 MATERIAL RELATED-PARTY TRANSACTIONS *(continued)*

### (e) Subsidiaries

| | **2008** | 2007 |
|---|---|---|
| On balance sheet | | |
| – Deposits from customers | **314** | 45 |
| – Deposits with other banks | **61** | – |
| – Placement with other banks | **50** | – |
| Average balance of loans and advances | **–** | – |
| Interest income | **1** | – |
| Interest expense | **8** | – |

### (f) 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:

| | **2008**<br>**RMB'000** | 2007<br>RMB'000 |
|---|---|---|
| Salaries and other emoluments | **25,572** | 17,936 |
| Discretionary bonuses | **15,766** | 20,298 |
| Share-based payment | **2,944** | 828 |
| Contributions to defined contribution retirement schemes | **3,345** | 4,018 |
| | **47,627** | 43,080 |

## 47 COMPARATIVE FIGURES

Certain comparative figures have been adjusted or reclassified as a result of the change in accounting policies. Further details are disclosed in note 2(b).

(Expressed in millions of Renminbi unless otherwise stated)

## 48 POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE YEAR ENDED 31 DECEMBER 2008

Up to the date of issue of these financial statements, the IASB has issued a number of amendments, new standards and interpretations which are not yet effective for the year ended 31 December 2008 and which have not been adopted in these financial statements.

The Group is in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application.

So far it has concluded that the adoption of them is unlikely to result in a restatement of the Group's results of operations and financial position.

In addition, the following developments are expected to result in amended disclosures in the financial statements, including restatement of comparative amounts in the first period of adoption:

| | **Effective for accounting periods beginning on or after** |
|---|---|
| IFRS 8, Operating segments | 1 January 2009 |
| IAS 1 (revised 2007), Presentation of financial statements | 1 January 2009 |

## 49 EVENTS OCCURRED AFTER THE BALANCE SHEET DATE

Notices of Compulsory Acquisition were despatched to the holders of Outstanding WLB Shares who had not accepted the General Offer (the "Dissenting WLB Shareholders") on 13 November 2008. As at 14 January 2009, the Bank had received valid responses to the Compulsory Acquisition Notice in respect of 3,897,985 WLB Shares (representing approximately 1.68% of the entire issued share capital of WLB). As stated in the Compulsory Acquisition Notice, the Dissenting WLB Shareholders were entitled to apply to the High Court of Hong Kong for an order to the contrary within two months from the date of the Compulsory Acquisition Notice. Based on the searches made on 15 January 2009, no application was made to the High Court of Hong Kong by any Dissenting WLB Shareholders for an order to the contrary. As such, the Bank is entitled and bound to acquire the Outstanding WLB Shares.

The Compulsory Acquisition was completed on 15 January 2009 when all the Outstanding WLB Shares were transferred to the Bank. The amount representing the price payable by the Bank for the Outstanding WLB Shares shall be transferred to WLB by the Bank and kept in a separate account by WLB on trust for the Dissenting WLB Shareholders. The Dissenting WLB Shareholders are hereby requested to contact WLB forthwith with evidence of title to the WLB Shares to claim their respective entitlement under the trust.

As a result of the completion of the Compulsory Acquisition, WLB has become a direct wholly-owned subsidiary of the Bank.

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## (A) CAPITAL ADEQUACY RATIO

The capital adequacy ratio is prepared in accordance with the guideline "Regulation Governing Capital Adequacy of Commercial Banks" [Order (2007) No. 11] issued by the CBRC (the "CBRC guideline") in July 2007, which may differ significantly from the relevant requirements in Hong Kong or other countries.

The capital adequacy ratios and related components of the Group and Bank as at 31 December 2008 and 2007 calculated based on PRC GAAP, were as follows:

| | Group | | Bank | |
|---|---|---|---|---|
| | 31 December | | 31 December | |
| | **2008** | 2007 | **2008** | 2007 (restated) (note) |
| Core capital adequacy ratio | **6.56%** | 8.78% | **7.15%** | 8.71% |
| Capital adequacy ratio | **11.34%** | 10.40% | **10.49%** | 10.29% |
| **Components of capital base** | | | | |
| Core capital: | | | | |
| – Paid up ordinary share capital | **14,707** | 14,705 | **14,707** | 14,705 |
| – Reserves | **56,765** | 48,683 | **64,590** | 49,009 |
| Total core capital | **71,472** | 63,388 | **79,297** | 63,714 |
| Supplementary capital: | | | | |
| – General provisions for doubtful debts | **13,795** | 10,434 | **13,665** | 10,434 |
| – Term subordinated bonds | **30,074** | 1,400 | **30,700** | 1,400 |
| – Convertible bonds | **2** | 13 | **2** | 13 |
| – Other supplementary capital | **1,745** | 147 | **1,533** | 147 |
| Total supplementary capital | **45,616** | 11,994 | **45,900** | 11,994 |
| Total capital base before deductions | **117,088** | 75,382 | **125,197** | 75,708 |
| Deductions: | | | | |
| – Goodwill | **9,598** | – | **–** | – |
| – Investments in unconsolidated subsidiary and other long-term investments | **1,044** | 342 | **32,668** | 619 |
| – Investment in commercial real estate | **2,407** | 394 | **310** | 363 |
| Total capital base after deductions | **104,039** | 74,646 | **92,219** | 74,726 |
| Risk weighted assets | **917,201** | 718,082 | **878,810** | 726,029 |

Note: The capital adequacy ratios and related components as at 31 December 2007 were restated according to the guidance set out in Yin Jian Fu【2008】No.123.

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(Expressed in millions of Renminbi unless otherwise stated)



## (B) LIQUIDITY RATIOS

| | **2008** | 2007 (restated) |
|---|---|---|
| **Liquidity ratios** | | |
| RMB current assets to RMB current liabilities | **47.2%** | 41.8% |
| Foreign currency current assets to foreign currency current liabilities | **99.1%** | 95.0% |

The above liquidity ratios are calculated in accordance with the formula promulgated by the PBOC and the CBRC and based on PRC GAAP.

## (C) CURRENCY CONCENTRATIONS OTHER THAN RMB

| | **2008** | | | |
|---|---|---|---|---|
| | **US Dollars** | **HK Dollars (in millions of RMB)** | **Others** | **Total** |
| **Non-structural position** | | | | |
| Spot assets | **106,510** | **74,677** | **22,122** | **203,309** |
| Spot liabilities | **(94,871)** | **(71,502)** | **(23,431)** | **(189,804)** |
| Forward purchases | **45,858** | **5,035** | **5,925** | **56,818** |
| Forward sales | **(47,265)** | **(2,394)** | **(4,427)** | **(54,086)** |
| Net option position | **(22)** | **2** | **20** | **–** |
| Net long position | **10,210** | **5,818** | **209** | **16,237** |
| Net structural position | **269** | **31,693** | **–** | **31,962** |

| | 2007 | | | |
|---|---|---|---|---|
| | US Dollars | HK Dollars (in millions of RMB) | Others | Total |
| **Non-structural position** | | | | |
| Spot assets | 96,468 | 18,355 | 6,035 | 120,858 |
| Spot liabilities | (75,651) | (23,898) | (9,955) | (109,504) |
| Forward purchases | 71,982 | 6,210 | 6,161 | 84,353 |
| Forward sales | (89,474) | (1,177) | (2,221) | (92,872) |
| Net option position | (61) | – | 61 | – |
| Net long/(short) position | 3,264 | (510) | 81 | 2,835 |
| Net structural position | – | 51 | – | 51 |

(Expressed in millions of Renminbi unless otherwise stated)

## (C) 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 overseas branches; and

– Investments in subsidiaries.

## (D) 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.

| | **2008** | | | |
|---|---|---|---|---|
| | **Banks and other financial institutions** | **Public sector entities** | **Others** | **Total** |
| Asia Pacific excluding the PRC | **28,876** | **1,849** | **55,331** | **86,056** |
| – of which attributed to Hong Kong | **4,352** | **1,849** | **54,057** | **60,258** |
| Europe | **39,967** | **–** | **444** | **40,411** |
| North and South America | **11,930** | **348** | **3,881** | **16,159** |
| | **80,773** | **2,197** | **59,656** | **142,626** |

| | 2007 | | | |
|---|---|---|---|---|
| | Banks and other financial institutions | Public sector entities | Others | Total |
| Asia Pacific excluding the PRC | 10,093 | – | 6,123 | 16,216 |
| – of which attributed to Hong Kong | 3,526 | – | 5,990 | 9,516 |
| Europe | 21,069 | – | 439 | 21,508 |
| North and South America | 9,254 | 3,018 | 5,454 | 17,726 |
| | 40,416 | 3,018 | 12,016 | 55,450 |

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(Expressed in millions of Renminbi unless otherwise stated)



## (E) FURTHER ANALYSIS ON LOANS AND ADVANCES TO CUSTOMERS ANALYSED BY INDUSTRY SECTOR

### Operation in Mainland China

| | Group | | | |
|---|---|---|---|---|
| | **2008** | | 2007 | |
| | **Total** | **% of gross loans and advances covered by collateral or other security** | Total | % of gross loans and advances covered by collateral or other security |
| Manufacturing and processing | **159,565** | **23** | 132,463 | 25 |
| Transportation, storage and postal services | **89,408** | **24** | 74,511 | 19 |
| Production and supply of electric power, gas and water | **62,364** | **7** | 40,856 | 8 |
| Wholesale and retail | **56,311** | **42** | 57,684 | 47 |
| Property development | **44,581** | **65** | 40,057 | 57 |
| Leasing and commercial services | **27,982** | **28** | 29,185 | 25 |
| Construction | **22,969** | **24** | 17,145 | 17 |
| Mining | **14,127** | **4** | 10,310 | 4 |
| Water environment and public utilities management | **9,163** | **40** | 6,262 | 13 |
| Financial services | **7,405** | **2** | 6,556 | 2 |
| Others | **21,084** | **19** | 24,321 | 19 |
| Corporate loans | **514,959** | **26** | 439,350 | 27 |
| Discounted bills | **95,766** | **100** | 52,276 | 100 |
| Credit cards | **31,604** | **–** | 21,324 | – |
| Mortgages | **148,548** | **100** | 131,138 | 100 |
| Others | **39,493** | **100** | 22,564 | 93 |
| Retail loans | **219,645** | **86** | 175,026 | 87 |
| Gross loans and advances to customers | **830,370** | **50** | 666,652 | 48 |

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(Expressed in millions of Renminbi unless otherwise stated)



## (E) FURTHER ANALYSIS ON LOANS AND ADVANCES TO CUSTOMERS ANALYSED BY INDUSTRY SECTOR *(continued)*

### Operation in Mainland China *(continued)*

| | Bank | | | |
|---|---|---|---|---|
| | **2008** | | 2007 | |
| | **Total** | **% of gross loans and advances covered by collateral or other security** | Total | % of gross loans and advances covered by collateral or other security |
| Manufacturing and processing | **157,867** | **22** | 132,463 | 25 |
| Transportation, storage and postal services | **88,898** | **23** | 74,511 | 19 |
| Production and supply of electric power, gas and water | **62,020** | **7** | 40,856 | 8 |
| Wholesale and retail | **56,301** | **42** | 57,684 | 47 |
| Property development | **44,411** | **65** | 40,057 | 57 |
| Leasing and commercial services | **27,982** | **28** | 29,185 | 25 |
| Construction | **22,774** | **23** | 17,145 | 17 |
| Mining | **14,127** | **4** | 10,310 | 4 |
| Water environment and public utilities management | **9,163** | **40** | 6,262 | 13 |
| Financial services | **7,180** | **1** | 6,556 | 2 |
| Others | **21,034** | **19** | 24,321 | 19 |
| Corporate loans | **511,757** | **26** | 439,350 | 27 |
| Discounted bills | **95,766** | **100** | 52,276 | 100 |
| Credit cards | **31,604** | **–** | 21,324 | – |
| Mortgages | **148,452** | **100** | 131,138 | 100 |
| Others | **39,286** | **100** | 22,564 | 93 |
| Retail loans | **219,342** | **86** | 175,026 | 87 |
| Gross loans and advances to customers | **826,865** | **50** | 666,652 | 48 |

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(Expressed in millions of Renminbi unless otherwise stated)



## (E) FURTHER ANALYSIS ON LOANS AND ADVANCES TO CUSTOMERS ANALYSED BY INDUSTRY SECTOR *(continued)*

### Operation outside Mainland China

| | Group | | | |
|---|---|---|---|---|
| | **2008** | | 2007 | |
| | **Total** | **% of gross loans and advances covered by collateral or other security** | Total | % of gross loans and advances covered by collateral or other security |
| Property development | **19,646** | **67** | 3,124 | 21 |
| Financial concerns | **2,429** | **12** | 396 | – |
| Wholesale and retail trade | **1,837** | **78** | 757 | 81 |
| Manufacturing | **1,273** | **44** | 189 | 59 |
| Transport and transport equipment | **3,002** | **38** | 1,316 | 57 |
| Recreational activities | **97** | **15** | – | – |
| Information technology | **3** | **82** | – | – |
| Others | **2,715** | **45** | 733 | 10 |
| Corporate loans | **31,002** | **58** | 6,515 | 27 |
| Credit cards | **415** | **–** | – | – |
| Mortgages | **9,964** | **100** | – | – |
| Others | **2,611** | **97** | – | – |
| Retail loans | **12,990** | **96** | – | – |
| Gross loans and advances to customers | **43,992** | **69** | 6,515 | 27 |

| | Bank | | | |
|---|---|---|---|---|
| | **2008** | | 2007 | |
| | **Total** | **% of gross loans and advances covered by collateral or other security** | Total | % of gross loans and advances covered by collateral or other security |
| Property development | **2,822** | **18** | 3,124 | 21 |
| Financial concerns | **1,475** | **–** | 396 | – |
| Wholesale and retail trade | **596** | **90** | 757 | 81 |
| Manufacturing | **151** | **47** | 189 | 59 |
| Transport and transport equipment | **1,493** | **60** | 1,316 | 57 |
| Recreational activities | **79** | **–** | – | – |
| Others | **67** | **35** | 733 | 10 |
| Corporate loans | **6,683** | **30** | 6,515 | 27 |
| Gross loans and advances to customers | **6,683** | **30** | 6,515 | 27 |

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(Expressed in millions of Renminbi unless otherwise stated)



# (E) FURTHER ANALYSIS ON LOANS AND ADVANCES TO CUSTOMERS ANALYSED BY INDUSTRY SECTOR *(continued)*

## Operation outside Mainland China *(continued)*

Overdue loans, impaired loans and advances and the individual and collective assessment allowances, impairment losses charged to consolidated income statement and impaired loans and advances written off during the year made on the following industry sectors which constitute not less than 10% of total loans and advances to customers are:

| | Group | | | | | |
|---|---|---|---|---|---|---|
| | 2008 | | | | | |
| | **Overdue loans and advances** | **Impaired loans and advances** | **Individually assessed impairment allowance** | **Collectively assessed impairment allowance** | **Impairment losses charged to consolidated income statement during the year** | **Impaired loans and advances written off during the year** |
| Manufacturing and processing | **2,797** | **2,650** | **2,004** | **3,627** | **914** | **333** |
| Transportation, storage and postal Services | **636** | **509** | **484** | **1,852** | **23** | **51** |
| Mortgages | **4,214** | **411** | **–** | **1,624** | **119** | **5** |

| | Group | | | | | |
|---|---|---|---|---|---|---|
| | 2007 | | | | | |
| | Overdue loans and advances | Impaired loans and advances | Individually assessed impairment allowance | Collectively assessed impairment allowance | Impairment losses charged to consolidated income statement during the year | Impaired loans and advances written off during the year |
| Manufacturing and processing | 3,058 | 3,227 | 2,267 | 2,544 | 1,181 | 49 |
| Transportation, storage and postal Services | 783 | 637 | 557 | 1,436 | 389 | 10 |
| Mortgages | 2,788 | 335 | – | 1,502 | – | – |

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# (E) FURTHER ANALYSIS ON LOANS AND ADVANCES TO CUSTOMERS ANALYSED BY INDUSTRY SECTOR *(continued)*

## Operation outside Mainland China *(continued)*

Overdue loans, impaired loans and advances and the individual and collective assessment allowances, impairment losses charged to income statement and impaired loans and advances written off during the year made on the following industry sectors which constitute not less than 10% of total loans and advances to customers are: *(continued)*

| | Bank | | | | | |
|---|---|---|---|---|---|---|
| | 2008 | | | | | |
| | **Overdue loans and advances** | **Impaired loans and advances** | **Individually assessed impairment allowance** | **Collectively assessed impairment allowance** | **Impairment losses charged to income statement during the year** | **Impaired loans and advances written off during the year** |
| Manufacturing and processing | **2,741** | **2,627** | **1,984** | **3,600** | **890** | **328** |
| Transportation, storage and postal Services | **611** | **509** | **484** | **1,844** | **18** | **51** |
| Mortgages | **3,616** | **396** | **–** | **1,615** | **118** | **5** |

| | Bank | | | | | |
|---|---|---|---|---|---|---|
| | 2007 | | | | | |
| | Overdue loans and advances | Impaired loans and advances | Individually assessed impairment allowance | Collectively assessed impairment allowance | Impairment losses charged to consolidated income statement during the year | Impaired loans and advances written off during the year |
| Manufacturing and processing | 3,058 | 3,227 | 2,267 | 2,544 | 1,181 | 49 |
| Transportation, storage and postal Services | 783 | 637 | 557 | 1,436 | 389 | 10 |
| Mortgages | 2,788 | 335 | – | 1,502 | – | – |

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(Expressed in millions of Renminbi unless otherwise stated)



# (F) OVERDUE LOANS AND ADVANCES TO CUSTOMERS

## (i) By geographical segments

| | 2008 | 2007 |
|---|---|---|
| Eastern China | 2,317 | 1,414 |
| Southern and Central China | 3,469 | 4,831 |
| Western China | 1,444 | 1,762 |
| Northern China | 856 | 981 |
| Others | 133 | 110 |
| | 8,219 | 9,098 |

## (ii) By overdue period

| | 2008 | 2007 |
|---|---|---|
| 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 | 710 | 800 |
| – between 6 and 12 months | 882 | 635 |
| – over 12 months | 6,627 | 7,663 |
| Total | 8,219 | 9,098 |
| As a percentage of total gross loans and advances: | | |
| – between 3 and 6 months | 0.08% | 0.12% |
| – between 6 and 12 months | 0.10% | 0.09% |
| – over 12 months | 0.76% | 1.14% |
| Total | 0.94% | 1.35% |

## (iii) Collateral information

| | 2008 | 2007 |
|---|---|---|
| Secured portion of overdue loans and advances | 1,440 | 1,401 |
| Unsecured portion of overdue loans and advances | 6,779 | 7,697 |
| Value of collaterals held against overdue loans and advances | 1,188 | 1,151 |
| Provision of overdue loans and advances for which impairment losses are individually assessed | 5,905 | 6,835 |

(Expressed in millions of Renminbi unless otherwise stated)

## (G) OVERDUE LOANS AND ADVANCES TO FINANCIAL INSTITUTIONS

### (i) By geographical segments

| | **2008** | 2007 |
|---|---|---|
| Northern China | **7** | 1 |

### (ii) By overdue period

| | **2008** | 2007 |
|---|---|---|
| Gross loans and advances to financial institutions which have been overdue with respect to either principal or interest for period of | | |
| – between 3 and 6 months | **1** | 1 |
| – between 6 and 12 months | **3** | – |
| – over 12 months | **3** | – |
| Total | **7** | 1 |
| As a percentage of total gross loans and advances | | |
| – between 3 and 6 months | **–** | – |
| – between 6 and 12 months | **–** | – |
| – over 12 months | **–** | – |
| Total | **–** | – |

### (iii) Collateral information

| | **2008** | 2007 |
|---|---|---|
| Secured portion of overdue loans and advances | **–** | – |
| Unsecured portion of overdue loans and advances | **7** | 1 |
| Value of collaterals held against overdue loans and advances | **–** | – |
| Provision of overdue loans and advances for which impairment losses are individually assessed | **4** | – |

Note: The above analysis, (F) and (G), 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 were also considered as overdue.

The collaterals of the Group included cash deposit, shares, land use right, property, motor vehicles and equipment, etc. The fair value of collaterals was estimated by management based on the latest available external valuations adjusted by taking into account the current realisation experience as well as market situation. Where collateral values are greater than gross advances, only the amount of collateral up to the gross advance had been included in the "secured portion of overdue loans and advances" as set out in the above tables.

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## (H) RESCHEDULED LOANS AND ADVANCES TO CUSTOMERS

| | **2008** | **% of total loans and advances** | 2007 | % of total loans and Advances |
|---|---|---|---|---|
| Rescheduled loans and advances to customers | **1,426** | **0.16%** | 1,790 | 0.27% |
| Less: | | | | |
| – rescheduled loans and advances but overdue more than 90 days | **1,009** | **0.12%** | 1,332 | 0.20% |
| Rescheduled loans and advances overdue less than 90 days | **417** | **0.05%** | 458 | 0.07% |

There were no rescheduled loans and advances to financial institutions as at 31 December 2008 and 2007.

## (I) NON-BANK MAINLAND EXPOSURES

The Bank is a commercial bank incorporated in the Mainland with its banking business primarily conducted in the Mainland. As of 31 December 2008 and 31 December 2007, over 90% of the Bank's exposures arose from businesses with Mainland entities or individuals. Analyses of various types of exposure by counterparty have been disclosed in the notes to the financial report.

## (J) ADDITIONAL DISCLOSURE ON STRUCTURED INVESTMENTS

### Structured Investment Vehicles ("SIV")

The carrying value of the Group's SIV portfolio was sponsored by banks. The Group has been conservative in provisioning amidst deterioration in the asset-backed securities market. As at 31 December 2008, the total portfolio of SIV investments have been fully provided for or written off.

### Collateralised Debt Obligations ("CDO")

The credit market conditions were highly challenging in the second half of 2007 and have further deteriorated in 2008. This saw a tightening of the CDO market, particularly in the U.S. and the distressed conditions were reflected in the valuation of the Group's CDO investments. The Group continues to adopt a conservative approach towards accounting for its CDO investments that takes into account a range of factors affecting valuation including current market conditions, credit quality, maturity and other information. As at 31 December 2008, the portfolio of CDO of the Bank's subsidiary – WLB have been fully written down and the mark-to-market loss was recognised in the income statement.

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# (K) CORPORATE GOVERNANCE

## Board committees

The board of directors has established six committees including the Strategy Committee, Audit committee, Related-party transaction control committee, Risk Management Committee, Remuneration and Appraisal Committee and Nomination Committee.

### *(i) Strategy Committee*

Main authorities and duties of the Executive Committee are:

– to propose operation objective and long term development plan;

– to regularly review and monitor the execution status of annual operating plan and investment plan;

– to examine and monitor the status of carrying out the decision of board; and

– to propose the suggestion and scheme of significant issues which should be discussed and determined by board.

### *(ii) Audit Committee*

Main authorities and duties of the Audit Committee are:

– to propose the appointment or replacement of external auditors;

– to monitor the internal audit system of the Bank and its implementation;

– to coordinate communication between internal auditors and external auditors;

– to review the financial information of the Bank and its disclosure;

– to examine the internal control system of the Bank; and

– other matters that authorized by board.

### *(iii) Related-Party Transaction Control Committee*

Main authorities and duties of the Related-Party Transaction Control Committee are:

– to identify the related parties of the Bank according to the laws and regulations;

– to inspect, monitor and review material related parties transactions and continuing related parties transactions and control the risk arise;

– to review the rules governing related parties transaction and relevant system of controls; and

– to review the disclosure of related parties transaction of the Bank.

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# (K) CORPORATE GOVERNANCE *(continued)*

## Board committees *(continued)*

### *(iv) Risk Management Committee*

Main authorities and duties of the Risk Management Committee are:

– to monitor the risk control of the Bank's exposures to credit, market and operational, etc. by senior management;

– to conduct regular assessment of the risk position of the Bank and evaluate the working procedures and results of internal audit departments;

– to put forward proposals on the improvement of the risk management and internal control of the Bank; and

– Other matters that authorized by board.

### *(v) Remuneration and Appraisal Committee*

Main authorities and duties of the Remuneration and Appraisal Committee are:

– to study and propose standards for appraising directors and senior management, conduct appraisals and provide advices based on the actual situation of the Bank;

– to study and review the remuneration policy and plans for directors and senior management; and

– Other matters that authorized by board.

### *(vi) Nomination Committees*

Main authorities and duties of the Nomination Committee are:

– 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 Bank;

– 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;

– to make preliminary examination on the qualifications of the candidates for directors and senior management and put forward proposals; and

– Other matters that authorized by board.