



中國銀行

BANK OF CHINA

中國銀行股份有限公司

BANK OF CHINA LIMITED

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

(Stock Code: 3988)

2006 Annual Results Announcement

The Board of Directors (the “Board”) of Bank of China Limited (the “Bank”) is pleased to announce the audited results of the Bank and its subsidiaries (the “Group”) for the year ended 31 December 2006.

1 CORPORATE INFORMATION

- 1.1 Place of Listing: A share: The Shanghai Stock Exchange
H share: The Stock Exchange of Hong Kong Limited
- 1.2 Stock Name and Stock Code: A share: Bank of China, 601988
H share: Bank of China, 3988
- 1.3 Registered Address: No. 1 Fuxingmen Nei DaJie, Beijing, China
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E-mail: bocir@bank-of-china.com
- 1.4 Secretary to the Board of Directors: YEUNG Jason Chi Wai
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2 SUMMARY OF BUSINESS DATA

(Note: The following is prepared in accordance with International Financial Reporting Standards)

Unit: RMB million

	Note	2006	2005	2004	2003 ^(note 1)
Results of operations					
Net interest income		121,371	101,008	88,435	76,597
Non-interest income		27,007	24,098	27,378	17,599
Operating income	2	148,378	125,106	115,813	94,196
Loan impairment losses		(12,342)	(11,486)	(23,812)	(18,100)
Operating expenses and others		(68,731)	(59,984)	(54,879)	(46,080)
Operating profit		67,305	53,636	37,122	30,016
Profit before income tax		67,937	53,811	37,263	29,947
Profit after tax		48,264	31,558	27,065	26,785
Profit attributable to the equity holders of the Bank		42,830	25,921	22,301	23,615
Total dividend		10,154	14,112	14,200	—
Balance sheet items					
Total assets		5,327,653	4,740,048	4,265,221	3,973,280
Loans and advances to customers, net		2,337,726	2,152,112	2,072,919	1,921,861
Investment securities	3	1,892,482	1,683,313	1,321,646	1,104,105
Total liabilities		4,914,697	4,484,529	4,037,314	3,751,434
Due to customers		4,091,118	3,699,464	3,338,448	3,033,364
Capital and reserves attributable to the equity holders of the Bank		382,917	226,419	200,755	196,820
Number of ordinary shares in issue					
Average (shares, million)	4	236,055	186,425	186,390	186,390
Year-end (shares, million)		253,839	209,427	186,390	186,390
Per share					
Earnings per share for profit attributable to the equity holders of the Bank (basic and diluted)		0.18	0.14	0.12	0.13
Dividend per share (before tax, RMB)	5	0.04	0.07	0.08	—
Net assets per share (RMB)	6	1.51	1.08	1.08	1.06
Key financial ratios					
Return on average total assets (%)	7	0.96	0.70	0.66	0.74
Return on average equity (%)	8	14.06	12.14	11.22	12.00
Net interest spread (%)	9	2.28	2.21	2.14	2.08
Net interest margin (%)	10	2.45	2.33	2.24	2.16
Loan-deposit ratio (%)	11	59.45	60.42	64.33	71.24
Non-interest income to operating income (%)	12	18.20	19.26	23.64	18.68
Cost to income (%)		46.32	47.95	47.39	48.92
Cost to income (%) (excluding business and other taxes, %)		41.97	43.41	43.08	44.70

	<i>Note</i>	2006	2005	2004	2003 ^(note 1)
Capital adequacy ratios					
Core capital adequacy ratio (%)		11.44	8.08	8.48	N/A
Capital adequacy ratio (%)		13.59	10.42	10.04	N/A
Asset quality					
Identified impaired loans		103,232	109,530	118,383	358,218
Identified impaired loans to gross loans (%)		4.24	4.90	5.51	16.58
Allowance for loan impairment losses		94,293	83,153	74,769	239,039
Allowance for loan impairment losses to identified impaired loans (%)		91.34	75.92	63.16	66.73
Allowance for loan impairment losses to gross loans (%)		3.88	3.72	3.48	11.06
Credit cost (%)	13	0.53	0.52	1.11	N/A
Human resources					
Number of employees of the Group (person)	14	232,632	229,742	238,672	241,401
Credit ratings					
Moody's		A2	A2	A2	A2
Standard & Poor's		BBB+	BBB+	BBB-	BB+
Fitch Ratings		A	A-	BBB+	BBB+
Exchange rate					
USD/RMB year-end middle rate		7.8087	8.0702	8.2765	8.2767
EUR/RMB year-end middle rate		10.2665	9.5797	11.2627	10.3383
HKD/RMB year-end middle rate		1.0047	1.0403	1.0637	1.0657
Share price (year-end closing price)					
Bank of China (601988.SH, RMB per ordinary share)		5.43	N/A	N/A	N/A
Bank of China (3988.HK, HKD per ordinary share)		4.27	N/A	N/A	N/A
BOC Hong Kong (Holdings) Limited (2388.HK, HKD per ordinary share)		21.15	14.95	14.85	14.60

On 26 August 2004, the Bank converted its form of ownership into a joint stock commercial bank and Bank of China Limited was formed and registered in Beijing. On 1 June and 5 July 2006, the Bank's shares were successfully listed on the Stock Exchange of Hong Kong and the Shanghai Stock Exchange, respectively, being the first bank in China dually listed in the international and domestic capital markets. The Bank remains a state-controlled joint stock commercial bank.

Note 1 The results of operations and related financial ratios for the year 2003 were adjusted to exclude the net gain on the disposal of BOCHK shares of RMB7.4 billion.

Note 2 Operating income comprises net interest income and non-interest income. Non-interest income includes net fee and commission income, net trading (losses)/gains, net (losses)/gains on investment securities and other operating income.

Note 3 Investment securities include available-for-sale securities, held-to-maturity securities, loans and receivables and trading assets and other financial instruments at fair value through profit or loss.

- Note 4* Average number of ordinary shares in issue represents the weighted average number of ordinary shares in issue during the period.
- Note 5* Dividend per share = total dividend ÷ number of ordinary shares in issue at the year-end
- Note 6* Net assets per share = capital and reserves attributable to the equity holders of the Bank at the year-end ÷ number of ordinary shares in issue at the year-end.
- Note 7* Return on average total assets = profit after tax ÷ average total assets. Average total assets = (total assets at the beginning of the year + total assets at the year-end) ÷ 2.
- Note 8* Return on average equity = profit attributable to the equity holders of the Bank ÷ average owner's equity. Average owner's equity (excluding minority interest) = (owner's equity, excluding minority interest, at the beginning of the year + owner's equity, excluding minority interest, at the year-end) ÷ 2. As the total owner's equity (excluding minority interest) was less than zero at 1 January 2003, the ratio for the year 2003 is computed using total equity (excluding minority interest) at 31 December 2003.
- Note 9* Net interest spread = average yield of interest-earning assets – average cost of interest-bearing liabilities. Average yield of interest-earning assets = interest income ÷ average balance of interest-earning assets. Average cost of interest-bearing liabilities = interest expense ÷ average balance of interest-bearing liabilities. Average balances are the daily average balances derived from the Bank's management accounts (unaudited).
- Note 10* Net interest margin = net interest income ÷ average balance of interest-earning assets. Average balances are daily average balances derived from the Bank's management accounts (unaudited).
- Note 11* Loan-deposit ratio = loan balance at year-end ÷ customer deposit balance at year-end.
- Note 12* Non-interest income to operating income = non-interest income ÷ operating income. In 2006, excluding the losses from revaluation of foreign currency positions of RMB9.82 billion (2005: RMB4.746 billion), the non-interest income accounted for 23.28% (2005: 22.21%) of the total operating income.
- Note 13* Credit cost = impairment losses on loans and advances ÷ average loans and advances to customers. Average loans and advances to customers = (loans and advances to customers at the beginning of the year + loans and advances to customers at the end of the year) ÷ 2.
- Note 14* Number of employees of the Group includes temporary and contract staff.

3 CHANGES IN SHARE CAPITAL AND SHAREHOLDINGS OF SUBSTANTIAL SHAREHOLDERS

3.1 Changes in Share Capital in the Report Period

(Unit: Share)

	1 January 2006		Increase/decrease in the report period				31 December 2006		
	Number	%	Issue of shares before IPO	Issue of H Shares	Issue of A Shares	Others	Sub-total	Number	%
I. Shares subject to selling restriction								173,487,740,209	68.34%
1. State-owned shares (promoters' shares)	174,128,718,217	83.15%				-2,803,313,477	-2,803,313,477	171,325,404,740	67.49%
2. Shares held by state-owned legal persons			8,514,415,652			-8,514,415,652	0		
3. Shares held by other domestic investors Incl.: Shares held by domestic legal persons Shares held by domestic natural persons				3,038,959,000		-876,623,531	2,162,335,469	2,162,335,469	0.85%
4. Shares held by foreign investors Incl.: Shares held by overseas legal persons Shares held by overseas natural persons	35,298,644,140	16.85%				-35,298,644,140	-35,298,644,140		
II. Shares not subject to selling restriction								80,351,421,800	31.66%
1. RMB-denominated ordinary shares					3,454,547,000	876,623,531	4,331,170,531	4,331,170,531	1.71%
2. Domestically listed foreign shares									
3. Overseas listed foreign shares			29,403,878,000			46,616,373,269	76,020,251,269	76,020,251,269	29.95%
4. Others									
III. Total	209,427,362,357	100.00%	8,514,415,652	29,403,878,000	6,493,506,000	0	44,411,799,652	253,839,162,009	100.00%

I. The Bank issued 8,514,415,652 ordinary shares to National Council for Social Security Fund (“NCSSF”) on 13 March 2006.

II. On 1 June 2006, the Bank completed a successful initial public offering of 25,568,590,000 H Shares and was listed on the Hong Kong Stock Exchange. On 9 June 2006, pursuant to the exercise of the over-allotment option, a further 3,835,288,000 H Shares were issued, thereby issuing in aggregate a total of 29,403,878,000 H shares. During the offering and listing of H Shares, 35,298,644,140 unlisted foreign shares held by overseas strategic investors of the Bank, 8,514,415,652 ordinary shares held by NCSSF, and 2,803,313,477 ordinary shares transferred by the promoter — Central SAFE Investments Limited (“Huijin”) to NCSSF according to state provisions were all converted into H Shares and became listed on the Hong Kong Stock Exchange.

III. In June 2006, 6,493,506,000 A Shares were offered to the public. On 29 June 2006, the A shares offered to the public by the Bank and 171,325,404,740 ordinary shares held by the promoter-Huijin were registered as A shares. On 5 July 2006, the Bank’s A Shares were listed on Shanghai Stock Exchange. Of the A Shares, 1,285,712,000 shares were placed to 14 strategic investors with a lock-up period of 18 months, 876,623,531 shares were placed with a lock-up period of three months and 876,623,469 shares with a lock-up period of six months to the offline investors, and

3,454,547,000 shares were not subject to selling restriction. The shares placed to offline investors have been unfrozen and allowed to be tradable on the stock exchange on 5 October 2006 and 5 January 2007 respectively.

IV. By the end of 31 December 2006, the Bank has issued 253,839,162,009 shares, including 177,818,910,740 A Shares and 76,020,251,269 H Shares.

V. “Selling restriction” in the above-mentioned table refers to A Shares issued by the Bank only.

VI. In the report period, the Bank has not issued bonus shares or transferred shares from the surplus reserve.

3.2 Shareholder Information in the Report Period

3.2.1 Number of Shareholders and Shareholdings Issuance and Listing of Shares

The Bank successfully floated H Shares on the Hong Kong Stock Exchange on 1 June 2006, including 25,568,590,000 issued in the IPO and 3,835,288,000 shares issued by exercise of over-allotment option on 9 June 2006. The number of H Shares issued, at an offer price of HKD2.95 per share, accounted for 11.89% of the Bank’s total equity after the offering. The Bank raised approximately HKD86.7 billion in the offering. Thereafter, the Bank successfully offered A Shares from 19 to 23 June 2006, at an issue price of RMB3.08 per share and was listed on Shanghai Stock Exchange on 5 July. 6,493,506,000 A Shares were issued in the IPO, accounting for approximately 2.56% of the fully diluted total equity. RMB20 billion was raised in the offering.

The IPOs of H-Share and A-Share account for 14.14% of the total enlarged share capital of the Bank. After the IPOs, the share capital of the Bank increased to RMB253,839,162,009 or 253,839,162,009 shares.

3.2.2 Shareholder Information at the End of the Report Period

As of 31 December 2006, the Bank had 846,127 shareholders, of which, there were 378,972 holders of H Shares, and 467,155 holders of A Shares.

3.2.3 Top ten shareholders as at 31 December 2006

No.	Shareholder’s name	Type of Shareholder	Type of shares	Number of shares held	Proportion in total share capital (%)	Shares pledged or frozen shares
1	Central SAFE Investments Limited	State-owned	A	171,325,404,740	67.49%	
2	HKSCC Nominees Limited	Foreign	H	30,262,318,674	11.92%	
3	RBS China Investments S.à.r.l.	Foreign	H	20,942,736,236	8.25%	
4	Asia Financial Holdings Pte. Ltd	Foreign	H	10,471,368,118	4.13%	
5	National Council for Social Security Fund, PRC	State-owned	H	8,377,341,329	3.30%	
6	UBS AG	Foreign	H	3,377,860,684	1.33%	
7	Asian Development Bank	Foreign	H	506,679,102	0.20%	
8	The Bank of Tokyo-Mitsubishi UFJ Ltd.	Foreign	H	473,052,000	0.19%	
9	Wingreat International Limited	Foreign	H	420,490,000	0.17%	
10	Best Sense Investments Limited	Foreign	H	236,526,000	0.09%	
10	Turbo Top Limited	Foreign	H	236,526,000	0.09%	

The number of shares held by H share shareholders is that recorded in the Register of Members as kept by the H Share Registrar of the Bank.

The Bank is not aware of whether the shares held by the aforesaid shareholders have been pledged or frozen, nor the existence of connected relations among the above-mentioned shareholders.

Top ten holders of A Shares not subject to selling restriction as at 31 December 2006

(Unit: Share)

No.	Shareholder's name	Number of shares not subject to trading moratorium	Class of shares
1	ICBC — Southern Securities Investment Fund for Stocks with Good Performance and Growth	210,000,000	A
2	Agricultural Bank of China — Jingshun Great Wall Domestic Demand Growth No. 2 Stock Securities Investment Fund	96,629,963	A
3	ICBC — Lion Value Growth Stock Securities Investment Fund	73,469,700	A
4	IFC — Standard Chartered — CITIGROUP GLOBAL MARKETS LIMITED	62,858,475	A
5	ICBC — SSE 50 Trading Open-end Index Securities Investment Fund	49,869,579	A
6	ICBC — E Fund Value Selective Stock Securities Investment Fund	42,000,000	A
7	China Pacific Life Insurance Co., Ltd — traditional-ordinary insurance products	35,179,154	A
8	Tiance Investment Management and Consulting (Shanghai) Co., Ltd	31,575,159	A
9	China Life Insurance Company Limited — traditional-ordinary insurance products-005L-CT001 SH	27,058,100	A
10	Xinghe Securities Investment Fund	25,843,028	A

Some of the above shareholders are managed by the same legal entity. Save for that, the Bank is not aware of any connected relations and concerted action among the above-mentioned shareholders.

3.3 Issue of Subordinated Bonds and Use of Proceeds

The purpose for the Bank's issue of the subordinated bonds was to effectively mitigate liquidity risk and optimize the maturity structure of assets and liabilities. The Bank plans to utilize the long-term funds raised by the issuance to grant long and medium-term loans, especially those for high-quality infrastructure construction projects.

In the report period, the Bank has not issued subordinated bonds.

3.4 The Controlling Shareholder of the Bank

Central SAFE Investments Limited

Central SAFE Investments Limited (Huijin) is a wholly state-owned company with limited liability. Established on 16 December 2003, the company has a registered capital of RMB372.465 billion and paid-in capital of RMB496.6125 billion. Its legal representative is Hu Xiaolian. On behalf of the state, Huijin performs the rights and obligations as an investor in the Bank, and implements the equity investment subject to the approval of the State Council and policies and arrangement relating to the state's reform of state-owned financial institutions. Huijin does not engage in other business activities.

4 DIRECTORS, SUPERVISORS, AND SENIOR MANAGEMENT

4.1 Directors, Supervisors and Senior Management

Name	Age	Gender	Position	Term of office	Total amount of pre-tax compensation received from the company in the report period (Thousand)	Whether also compensated by a controlling shareholder company or other associated companies
XIAO Gang	48	Male	Chairman	From August 2004 to August 2007	1,523.770	Yes
LI Lihui	54	Male	Vice Chairman and President	From August 2004 to August 2007	1,528.657	Yes
ZHANG Jinghua	50	Male	Non-Executive Director	From August 2004 to August 2007	—	Yes
YU Erniu	57	Male	Non-Executive Director	From August 2004 to August 2007	—	Yes
ZHU Yan	50	Female	Non-Executive Director	From August 2004 to August 2007	—	Yes
ZHANG Xinze	60	Male	Non-Executive Director	From August 2004 to August 2007	—	Yes
HONG Zhihua	54	Female	Non-Executive Director	From August 2004 to August 2007	—	Yes
HUANG Haibo	54	Female	Non-Executive Director	From August 2004 to August 2007	—	Yes
Sir Frederick Anderson GOODWIN	48	Male	Non-Executive Director	From January 2006 to January 2009	—	No
SEAH Lim Huat Peter	60	Male	Non-Executive Director	From June 2006 to June 2009	—	No
HUA Qingshan	53	Male	Executive Director and Executive Vice President	From August 2004 to August 2007	1,307.831	Yes
LI Zaohang	51	Male	Executive Director and Executive Vice President	From August 2004 to August 2007	1,307.235	Yes
Anthony Francis NEOH	60	Male	Independent Non-Executive Director	From August 2004 to August 2007	400	No
William Peter COOKE	75	Male	Independent Non-Executive Director	From December 2004 to December 2007	606.464	Yes
Patrick de SAINT-AIGNAN	58	Male	Independent Non-Executive Director	From January 2006 to January 2009	400	No
Alberto TOGNI	68	Male	Independent Non-Executive Director	From June 2006 to June 2009	145.833	No
LIU Ziqiang	58	Male	Chairman of Board of Supervisors	From August 2004 to August 2007	1,312.599	No
WANG Xueqiang	49	Male	Supervisor	From August 2004 to August 2007	878.334	No
LIU Wanming	48	Male	Supervisor	From August 2004 to August 2007	874.247	No
LI Chunyu	47	Male	Employee Supervisor	From December 2004 to December 2007	478.632	No
LIU Dun	43	Male	Employee Supervisor	From December 2004 to December 2007	422.972	No
ZHOU Zaiqun	54	Male	Executive Vice President	From August 2004 to August 2007	1,437.055	Yes
ZHANG Yanling	55	Female	Executive Vice President	From August 2004 to August 2007	1,313.222	Yes

Name	Age	Gender	Position	Term of office	Total amount of pre-tax compensation received from the company in the report period (Thousand)	Whether also compensated by a controlling shareholder company or other associated companies
ZHANG Lin	50	Female	Secretary of Party Discipline Committee	From August 2004 to August 2007	1,230.033	No
ZHU Min	54	Male	Executive Vice President	From August 2006 to August 2009	1,193.880	No
WANG Yongli	42	Male	Executive Vice President	From August 2006 to August 2009	1,187.267	No
YEUNG Jason Chi Wai	52	Male	Secretary to the Board of Directors	From November 2005 to November 2008	5,618.777	Yes
ZHU Xinqiang ¹	54	Male	Executive Assistant President	From November 2003 to August 2006	1,030.727	Yes
Lonnie DOUNN ²	54	Male	Chief Credit Officer	From March 2005 to September 2006	7,915.785	No

¹ Zhu Xinqiang resigned in August 2006 for personal reason.

² Lonnie Dounn resigned in September 2006 for personal reason.

Note:

- (1) In the report period, none of the directors, supervisors or senior management holds the Bank's shares.
- (2) Independent Non-Executive Directors' compensation is based on "the resolution of the fifth session of the first board of directors' meeting of the Bank". The supervisors' compensation is based on "the resolution of the second extraordinary meeting of shareholders of the Bank in 2005".

The annual compensation of Independent Non-Executive Directors and supervisors should be proposed by the Personnel and Remuneration Committee and submitted to the board of directors and shareholders' meeting for review and approval.

The compensation of the senior management is based on the Bank's *Management Measures on Remuneration of Senior Management*. The employee supervisors' compensation is based on staff salary control system.

- (3) Non-Executive Director holding a position in a shareholder of the Bank does not receive any compensation from the Bank. They are remunerated by the respective shareholder entity where they hold a position.

4.2 Compensations for Directors, Supervisors and Senior Management in 2006

Our Executive Directors and Supervisors, who are also our employees and our senior management personnel, receive compensation in the form of salaries, bonuses, benefits in kind, contributions to pension schemes, as well as other pension through our contribution to their social insurance and housing plans. Our Independent Non-Executive Directors receive directors' fees and allowance. Our Non-Executive Directors do not receive any salary or directors' fees from us.

The aggregate fees and compensation paid by us to all our Directors, Supervisors and senior management members in 2006 were RMB32.1133 million. A total of RMB2.6 million was contributed for the social insurance, supplementary insurance expenses and housing fund for Directors, Supervisors and senior management members.

RMB million

Total amount of Directors' fees and compensation	32.1133
Independent Non-Executive directors' fees and other income	1.5523

Compensation range	Number of persons
Above and including RMB7.00 million up to RMB7.99 million	1
Above and including RMB6.00 million up to RMB6.99 million	0
Above and including RMB5.00 million up to RMB5.99 million	1
Above and including RMB2.00 million up to RMB4.99 million	0
Above and including RMB1.00 million up to RMB1.99 million	11
RMB0.99 million and below	8

5 MANAGEMENT DISCUSSION AND ANALYSIS

5.1 Financial Review

Summary of financial position and results of operations of the Group for 2006

Profit after tax

For 2006, the Group earned a profit after tax of RMB48.3 billion, an increase of RMB16.7 billion (52.94%) compared to the prior year. Profit attributable to the equity holders of the Bank amounted to RMB42.8 billion, an increase of RMB16.9 billion (65.23%). These results exceeded the objectives in the budget approved by the Bank's shareholders and the profit forecast developed in connection with the Bank's initial public offering ("IPO") of its ordinary shares. The substantial improvement in profit after tax for the year was attributable to robust growth in operating income, improved operating efficiency, effective management of credit costs, and a decrease in the effective tax rate.

Earnings per share

In 2006, basic and diluted earnings per share was RMB0.18, an increase of RMB0.04 compared to the prior year. The capital raised in connection with the Bank's IPO in 2006, and the related listing of its ordinary shares on both the Hong Kong and Shanghai markets, further increased the Bank's capital base and ordinary shares outstanding. Benefiting from the Group's strong profits, both the basic and diluted earnings per share increased compared to the prior year.

ROA & ROE

During 2006, return on average total assets was 0.96%, the highest level in the past four years, and return on average shareholders' equity was 14.06%. These amounts reflected robust increases of 0.26 percentage points and 1.92 percentage points, respectively, as compared to 2005.

Revenue growth

The Group achieved operating income of RMB148.4 billion, an increase of RMB23.3 billion (18.60%) compared to the prior year. This increase was primarily due to the continued increase in the average balances of loans and investment securities, as well as an increase in average yields. At the same time, the Group intensified its focus on developing fee-based businesses, and there was continued improvement in net fee and commission income.

Non-interest income to operating income ratio

The Group recognized non-interest income of RMB27.0 billion in 2006, an increase of RMB2.9 billion (12.07%) compared to the prior year. The ratio of non-interest income to operating income was 18.20%, a decrease of 1.06 percentage points compared to the prior year. Excluding the effect of loss from revaluation of foreign currency positions, this ratio was 23.28%, an increase of 1.07 percentage points.

Cost to income ratio

The ratio of operating expenses and other items to operating income was 46.32%, a decrease of 1.63 percentage points compared to the prior year. Excluding business and other taxes, the ratio was 41.97%, a decrease of 1.44 percentage points compared to the prior year. This decrease was mainly due to the vigorous control of operating costs, as well as the robust growth in operating income.

Credit costs

The credit costs for 2006 were 0.53% of the average loans and advances, an increase of 0.01 percentage point compared to the prior year. While the Group has increased the size of its loan portfolio in recent years, credit costs have been maintained at a relatively low level. Improvement in asset quality, resulting from continuous improvements in the Group's credit risk management processes, and diligent efforts directed at disposing of non-performing assets contributed significantly to the Group's ability to control credit costs.

Identified impaired loans

At the end of 2006, identified impaired loans totaled RMB103.2 billion, a decrease of RMB6.3 billion compared to the end of 2005. The ratio of identified impaired loans to total loans and advances was 4.24%, a decrease of 0.66 percentage points compared to the end of 2005. The Group achieved its "dual decrease" objective of reducing both identified impaired loans and the ratio of identified impaired loans to total loans and advances.

Allowance for loan impairment losses

At the end of 2006, the allowance for loan impairment losses was RMB94.3 billion, an increase of RMB11.1 billion compared to the end of 2005. The ratio of the allowance for loan impairment losses to identified impaired loans was 91.34%, an increase of 15.42 percentage points compared to the prior year-end.

Capital adequacy ratio

At the end of 2006, the Group's capital adequacy ratio was 13.59% and its core capital adequacy ratio was 11.44%, representing increases of 3.17 percentage points and 3.36 percentage points, respectively, compared to those at the prior year-end. These ratios were the highest levels in recent years. This increase is primarily due to the significant core capital raised through the IPO and the decrease in the Group's net foreign currency exposure, which reduces the related market risk capital requirement.

Income Statement Analysis

Net interest income

In 2006, the Group's net interest income was RMB121.371 billion, an increase of RMB20.363 billion (20.16%) compared to the prior year.

Net interest income is affected by the average balances and average interest rates of interest-earning assets and interest-bearing liabilities. Domestically, interest rates related to interest-earning assets and interest-bearing liabilities are largely influenced by the benchmark interest rates and interest rate policy established by the People's Bank of China ("PBOC"). Significantly, the PBOC establishes floors benchmark interest rates for loans and ceilings benchmark interest rates for deposits denominated in RMB offered by domestic banks. Within the context of the framework established by the PBOC, the average interest rates of interest-earning assets and interest-bearing liabilities of the domestic operations are also influenced by other factors such as Chinese macro-economic changes, domestic competition, currency market liquidity and so on. Overseas rates are largely a function of foreign currency interest rate, local economic environment, financial market conditions and related fiscal policies.

The average balances and average interest rates³ of interest-earning assets and interest-bearing liabilities related to the Group's are shown in the following tables:

Items	2006		2005	
	Average balance	Average interest rate (%)	Average balance	Average interest rate (%)
<i>(Unit: RMB million, other than the percentage)</i>				
The Group				
Interest-earning assets				
Loans and advances to customers	2,353,694	5.48%	2,194,078	5.03%
Investment securities	1,895,643	3.54%	1,485,640	3.02%
Due from banks and other financial institutions ⁴	<u>710,323</u>	2.70%	<u>655,359</u>	1.94%
Total	<u>4,959,660</u>	4.34%	<u>4,335,077</u>	3.87%
Interest-bearing liabilities				
Deposits from customers	4,070,308	1.96%	3,560,014	1.57%
Due to banks and other financial institutions ⁵	373,811	2.51%	355,856	1.83%
Other borrowed funds	<u>109,910</u>	4.21%	<u>115,843</u>	3.90%
Total	<u>4,554,029</u>	2.06%	<u>4,031,713</u>	1.66%
Net interest spread		2.28%		2.21%

The impact of volume and interest rate⁶ changes on consolidated net interest income are summarized in the following table:

Items	2006	2005	Change	Net interest income analysis	
				Volume	Interest rate
<i>(Unit: RMB million)</i>					
The Group					
Interest-earning assets					
Loans and advances to customers	128,934	110,313	18,621	8,029	10,592
Investment securities	67,195	44,938	22,257	12,382	9,875
Due from banks and other financial institutions ²	19,205	12,697	6,508	1,066	5,442
Total	<u>215,334</u>	<u>167,948</u>	<u>47,386</u>	<u>21,477</u>	<u>25,909</u>
Interest-bearing liabilities					
Deposits from customers	79,939	55,914	24,025	8,012	16,013
Due to banks and other financial institutions ⁵	9,393	6,512	2,881	329	2,552
Other borrowed funds	4,631	4,514	117	(231)	348
Total	<u>93,963</u>	<u>66,940</u>	<u>27,023</u>	<u>8,110</u>	<u>18,913</u>
Net interest income	121,371	101,008	20,363	13,367	6,996

³ Average balances of interest-earning assets and interest-bearing liabilities are the average daily balance derived from the Group's management accounts which have not been audited.

⁴ Due from banks and other financial institutions include balances with central banks and placements with banks and other financial institutions.

⁵ Due to banks and other financial institutions include due to central banks and placements from banks and other financial institutions.

⁶ Impact of volume changes on interest income and expenses is calculated based on the changes in average balances of interest-earning assets and interest-bearing liabilities during the reporting period. Impact of interest rate changes on interest income and expenses is computed based on the changes in the average interest rates of interest-earning assets and interest-bearing liabilities during the reporting period. Changes caused by changes in both volume and rate have been allocated to rate.

Interest income

The Group's interest income was RMB215.334 billion, an increase of RMB47.386 billion (28.21%) compared to the prior year. This increase was primarily attributable to the growth in the average balance as well as the average yield of interest-earning assets. In this regard, the average balance of interest-earning assets increased by 14.41% and reached RMB4,959.660 billion. The consolidated yield on interest-earning assets increased 47 basis points during 2006 to 4.34%.

Loans and advances to customers

The Group's interest income earned on loans and advances to customers was RMB128.934 billion, an increase of RMB18.621 billion (16.88%) as compared to the prior year. This increase reflects the judicious increase in loan balances during the year and an increase in both domestic and foreign currency yields. After cautiously taking risk and reward in consideration, the Group's average balance of loans and advances to customers reached RMB2,353.694 billion, representing an increase of 7.27% compared to the prior year. Continued increases in foreign currency yields (in particular the USD), the PBOC's increases in the RMB loan benchmark rate in April and August of 2006 pushed, the combined yield on overseas and domestic loans to 5.48%, an increase of 45 basis points.

Investment securities

The Group's interest income earned on investment securities was RMB67.195 billion, an increase of RMB22.257 billion (49.53%) compared to the prior year. The growth was largely attributable to an intense focus on optimizing the mix of the Group's investment portfolio, including the IPO proceeds, in higher yielding securities. This deployment of excess liquidity resulted in an increase of 27.6% in the average balance of investment securities during the year to RMB1,895.643 billion. The Group has also continued to proactively manage the composition of its investment securities portfolio, taking into consideration continuing increases in the yields on securities denominated in foreign currencies, in particular the USD. The average yield of investment securities increased 52 basis points to 3.54% during the year.

The average yield of investment securities denominated in RMB was 2.35%, a decline of 6 basis points compared to the prior year. The decline was primarily attributable to the surplus liquidity in the RMB financial markets, pushing down the yields on RMB securities. The yield of one year PBOC bills decreased steadily from 2004, although the decline stabilized and began to rise from the third quarter of 2005. This effect was fully reflected in the Bank's earnings in 2006.

Due from banks and other financial institutions

The Group's interest income derived from due from banks and other financial institutions rose RMB6.508 billion (51.26%) to RMB19.205 billion. The increase was primarily due to the growth in customer deposits, a series of increases by the PBOC in deposit reserve requirements during the year from 7.5% to 9.0%, and continued increases in overseas interest rates particularly USD. The average yield on items due from banks and other financial institutions increased by 76 basis points during 2006 to 2.70%.

The Group continues its efforts to minimize the relative balance of this lower yielding asset class. At the end of 2006, the ratio of the average balance of items due from banks and other financial institutions to that of total interest-earning assets declined from 15.0% to 14.0%, or 1.0 percentage point compared to the prior year.

Interest expense

The Group's interest expense was RMB93.963 billion, an increase of RMB27.023 billion (40.37%) compared to the prior year. This increase was principally attributable to a 12.96% growth in the average balance of interest-bearing liabilities to RMB4,554.029 billion, as well as a 40 basis points increase in the average cost to 2.06%.

Deposits from customers

In 2006, the Group's interest expense for customer deposits was RMB79.939 billion, representing an increase of RMB24.025 billion (42.97%) compared to the prior year. The increase was primarily due to the Group's concerted efforts to expand its RMB customer deposit base, with the average balance of customer deposits increasing to RMB4,070.308 billion, an increase of 14.33% during the year and a rise of 39 basis points in the average cost on customer deposits to 1.96%. This increase in average cost

was mainly attributable to: the continued rise in foreign interest rates, particularly USD interest rates; the effect of the PBOC's five upward adjustments of the benchmark interest rate for smaller balance foreign currency deposit during 2005, which was fully reflected during 2006; the PBOC's increase of the benchmark interest rate for RMB deposits in August 2006; and a rise in the proportion of fixed deposits in overseas operations to total deposits.

Due to banks and other financial institutions

The Group's interest expense for items due to banks and other financial institutions was RMB9.393 billion, an increase of RMB2.881 billion (44.24%) compared to the prior year. The increase was primarily due to the interest rate increases related to major foreign currencies, particularly the USD, which resulted in a rise of 68 basis points on the average yield and to 2.51%.

The average interest rate of items due to banks and other financial institutions denominated in RMB was 2.14%, a decrease of 33 basis points. During the year, the Group intensified its efforts at proactive liability management to minimize the balance of this relatively high yielding class of interest-bearing liabilities.

Other borrowed funds

Other borrowed funds include special purpose borrowings and bonds issued. Special purpose borrowings are long-term borrowings in multiple currencies from foreign governments and/or banks in the form of export credit loans, foreign government loans and other subsidized loans. These special purpose loans are normally used to finance projects with special commercial purposes in PRC. The Group's interest expense for other borrowed funds was RMB4.631 billion, an increase of RMB0.117 billion (2.59%) compared to the prior year. The increase was mainly due to the rise in interest rates of major foreign currencies, in particular the USD. The average interest rate of other borrowed funds rose 31 basis points during the year to 4.21%.

Net interest margin

During 2006, the Group continued to improve the effectiveness of its asset and liability management, successfully reducing the proportions of relative low yielding assets to total assets and relative high cost liabilities to total liabilities. Due to continued increases in the interest rates of the major foreign currencies, in particular the USD, and the continued use of RMB/USD swap transactions, the Group's net interest margin rose by 12 basis points to 2.45%. RMB and foreign currency net interest margins of domestic operations, however, have experienced opposite trends.

Net interest margin (%)	2006	2005	2004	2003
Domestic operations: foreign currency business	3.21	2.43	1.71	1.54
Domestic operations: RMB business	2.24	2.38	2.72	2.64

Foreign currency net interest margin

The Group's foreign currency net interest margin rose 78 basis points to 3.21%. The Group entered into RMB/USD currency swap transactions attributable to its more active approach to its asset and liability management, the surplus liquidity in the market and the lack of RMB investment alternatives. These swap transactions resulted in the Group's earning additional USD interest income. The related swap costs were recognized under "Net trading (losses)/gain". And the change of net interest margin was also attributable to the continued increase in overseas interest rates, particularly USD.

RMB net interest margin

Although the PBOC's adjustments to the benchmark rates in RMB loans and deposits in 2006 had a positive impact on RMB net interest income, the RMB net interest margin narrowed compared to the prior year. The decline was primarily attributable to the changes in the domestic macro-economic environment and intensified competition in PRC capital markets led to a decline in the average yield

of RMB investment securities and discounted bills compared to the prior year, and at the same time, the proportion of the average balance of such items to interest-earning assets denominated in RMB increased, which led to the average interest rate of interest-earning assets denominated in RMB declined from last year's 4.11% to this year's 4.01%. As aforesaid, the Bank entered into RMB/USD swap transactions to improve the income, but these swap transactions will result in a decline in RMB interest income.

Non-interest income

Unit: RMB million

	2006	2005	2004	2003
Net fee and commission income	14,323	9,247	8,557	7,353
Net trading income	(1,544)	4,283	8,882	4,303
Net gains/losses on investment securities	1,132	(582)	337	1,094
Other operating income	13,096	11,150	9,602	12,249
Total	<u>27,007</u>	<u>24,098</u>	<u>27,378</u>	<u>24,999</u>

Notes: Net gains of RMB7.4 billion on the disposal of BOCHK shares were included in Other operating income in year 2003.

The Group reported non-interest income of RMB27.007 billion, an increase of RMB2.909 billion (12.07%) compared to the prior year. Non-interest income accounted for 18.20% of total operating income, down 1.06 percentage points. Excluding the impact of translation losses related to the Group's net foreign currency exposure, this ratio was 23.28%, an increase of 1.07 percentage points.

Net fee and commission income

Through its global network, the Group provides its customers with a variety of fee-based products, including agency services, settlement and clearing, credit commitment, bank cards, fiduciary and other custodian services. The Group improved its product mix, not only to generate consistent revenue growth, but also to deepen and strengthen its client relationships by providing more diversified financial services to address a more diverse set of customer needs.

The Group earned net fee and commission income of RMB14.323 billion in 2006, an increase of RMB5.076 billion (54.89%) compared to the prior year.

During 2006, the Group launched a three-year plan to further develop and enhance its fee based services, in order to leverage its competitive advantage and reinforce its leading position in the domestic market. The key elements of this plan include: enhancement of the management and organization structure and deployment of adequate resources to more effectively support the delivery of fee-based products and services, principally through objective-based performance evaluation and remuneration; a reinvigorated focus on new product development, with particular emphasis on the areas of international and trade finance, wealth management products, services for Qualified Domestic Institutional Investors, and bank cards; improvement of communications among various business and functional departments, including product management departments and the front line departments, domestic and overseas operations, commercial banking, investment banking and insurance operations, to promote efficient service and cross-selling; further strengthening of pricing strategy including revision and broadening of new fee based services.

Net trading (losses)/gains

Unit: RMB million

	2006	2005	2004	2003
Net (losses)/gains from foreign exchange and foreign exchange products	(2,290)	2,226	5,294	9,488
Net gains from interest rate instruments	492	1,753	2,294	(5,333)
Net gains from trading equity securities	324	130	(178)	3
Net (losses)/gains from precious metal transactions	(68)	150	1,271	(40)
Others	(2)	24	201	185
Total	<u>(1,544)</u>	<u>4,283</u>	<u>8,882</u>	<u>4,303</u>

The Group incurred a net trading loss of RMB1.544 billion in 2006. This loss arose principally from foreign exchange and foreign exchange products related to the continued appreciation of the RMB.

Net gains/losses from foreign exchange and foreign exchange products

The Group recognized net losses of RMB2.290 billion from foreign exchange and foreign exchange products during 2006. This loss reflects the net results of gains from foreign exchange transactions and losses from revaluation of foreign currency positions.

Gains from foreign exchange transactions

The volume of the Group's foreign exchange transactions grew steadily during the year, resulting in a gain of RMB7.530 billion. Domestically, the spread income derived from RMB/foreign exchange transactions amounted to RMB5.938 billion, an increase of RMB1.077 billion (22.16%) compared to the prior year. The increase was primarily attributable to the increase of the spread earned on RMB/foreign currency transactions compared to 2005.

Losses from revaluation of foreign currency positions

The Group reported a net loss of RMB9.82 billion which was attributable to its revaluation of its net foreign exchange positions in 2006. The composition of the Group's foreign exchange positions as of 31 December 2006 and the related revaluation gains and losses for the year are set out in the following table:

	Net foreign currency position as of 31 December 2006 ^①			Net gains/losses arising from the net foreign currency position reported in 2006 ^②		
	On Balance	Off Balance	Total	On Balance	Off Balance	Total
	Sheet	Sheet		Sheet	Sheet	
	Amount in USD Million			Amount in RMB Million		
1. Net foreign currency position relating to Huijin option						
(1) Foreign exchange option with Huijin	—	(18,000)			1,949	
(2) Foreign currency capital injected economically hedged by the Huijin option	18,000	—	—	(4,707)		(2,758)
2. Net foreign currency position relating to swap agreements						
(1) Spot transactions under foreign currency swap agreements	41,528	—	—	(6,730)	—	(4,508)
(2) Forward transactions under foreign currency swap agreements	—	(41,528)		—	2,222	
3. Structural position in foreign operations ^②	14,571		14,571			—
4. Other foreign currency position	11,588	4,109	15,697	(2,773)	219	(2,554)
	<u>85,687</u>	<u>(55,419)</u>	30,268	<u>(14,210)</u>	<u>4,390</u>	<u>(9,820)</u>
Less: Structural position in foreign operations ^②			<u>(14,571)</u>			
Net foreign currency position			<u>15,697</u>			

① Long and short positions of foreign currency are representing by positive and negative figures, respectively.

Gain and loss of revaluation and retranslation are representing by positive and negative figures, respectively.

② Translation losses related to the structural position of the Group's foreign operations are recognized as "Currency translation differences", a separate component of equity, which does not affect the consolidated profit and loss of the Group.

The following explains the key components presented in the above table:

1. Net foreign currency position relating to Huijin option

On 5 January 2005, the Bank entered into an option agreement with Huijin ("Huijin option"), to economically hedge a portion of its net foreign currency position arising from the foreign currency capital injection by Huijin. According to the terms of the agreement, the Bank acquired options to sell to Huijin USD, totaling USD18 billion, in tranches of no more than USD1.5 billion each at the beginning of each calendar month from 1 January to 31 December 2007 at a fixed exchange rate of USD1 to RMB8.2769. The related option premium of RMB4.469 billion is payable by the Bank to Huijin in 12 equal monthly installments beginning from 1 January 2007. The gain from the change in the fair value of the Huijin option for 2006 amounted to RMB1.949 billion, which partially offset the RMB4.707 billion foreign exchange revaluation loss of the related on-balance sheet foreign currency exposure.

2. Net foreign currency position relating to swap agreements

Considering the surplus liquidity in the RMB capital markets, the lack of investment alternatives, and the favorable interest yields of foreign currency denominated financial assets, the Bank entered into a series of USD/RMB swap transactions to increase its income through investment in additional USD denominated financial assets. Under these agreements, the Bank bought USD in spot transactions and invested the funds in financial assets denominated in foreign currency to benefit from the favorable interest differentials, and bought back the RMB in the future at agreed exchange rates to effectively mitigate the Group's foreign currency risks. The swap transactions had no impact on the Group's net foreign currency position. As of 31 December 2006, the outstanding notional amount of these transactions amounted to USD41.5 billion.

In 2006, the foreign exchange revaluation loss related to the USD currency positions through these spot transactions was RMB6.730 billion, partially offset by the revaluation gain of RMB2.222 billion on the forward sales of USD. This net loss of RMB4.508 billion was reported as a component of "Net trading (losses)/gains", contributing to the significant decrease in 2006. The beneficial effect of the favorable rate differential on USD financial assets, however, was reported as a component of "Net interest income".

3. Other foreign currency positions

As of 31 December 2006, other net foreign currency position of the Group amounted to USD15.7 billion which included a USD11.6 billion on-balance sheet position and a USD4.1 billion off-balance sheet position. The on-balance sheet position comprised primarily the unhedged portion of foreign currency capital contribution, foreign currency profits, foreign currency position retained for daily operation purposes.

During 2006, the foreign currency proceeds from the IPO and the foreign currency profits increased the Group's foreign currency position. However, the Bank sold approximately USD26.3 billion to the PBOC following the approval from the relevant authorities. As a result, the Group reduced its net foreign currency position from USD25.8 billion at 31 December 2005 to USD15.7 billion at 31 December 2006. In 2006, the net loss arising from this other net foreign currency position recognized was RMB2.554 billion, which was lower than that in 2005.

The Group will continue to actively manage its net foreign currency position in 2007 and the net foreign currency exposure will continue to decrease.

Cost/benefits discussion

The Bank recorded a foreign currency revaluation loss of RMB9.820 billion from its foreign currency position during 2006. However, it has benefited from the favorable interest differentials between foreign currency and RMB financial assets discussed above. By way of example, the average yield of our foreign currency denominated investment securities was 4.74%, which was higher than the average yield of 2.35% for RMB denominated investment securities, leading to a difference in yield of 2.39%. Management believes that the benefits from favorable interest differentials were greater than the foreign exchange revaluation loss aforesaid.

Net trading income from interest rate instruments

Net trading income from interest rate instruments was comprised primarily of realized and unrealized gains/losses related to the trading of debt securities and interest rate derivatives. In 2006, the Group reported a net gain of RMB0.492 billion from trading in interest rate instruments, a decrease of RMB1.261 billion or 71.93% compared to the prior year.

Net gains/losses from investment securities

Unit: RMB million

	2006	2005	2004	2003
De-recognition of available-for-sale securities (Write-back)/provision for impairment losses	1,178 <u>(46)</u>	(606) <u>24</u>	529 <u>(192)</u>	1,217 <u>(123)</u>
Total	<u>1,132</u>	<u>(582)</u>	<u>337</u>	<u>1,094</u>

The Group reported a net gain of RMB1.132 billion from investment securities in 2006, representing an increase of RMB1.714 billion. This was mainly attributable to the gain on disposal of RMB1.3 billion of equity securities originally acquired through domestic debt-for-equity swap arrangements with borrowers.

Other operating income

The Group's other operating income was RMB13.096 billion, an increase of RMB1.946 billion (17.45%) compared to the prior year. The increase was mainly attributable to the rapid development in our insurance business. In 2006, insurance premiums amounted to RMB7.708 billion, representing an increase of RMB2.471 billion (47.18%) compared to the prior year.

Impairment loss on loans and advances

In 2006, the Group's impaired loans and ratio of identified impaired loans to total loans both decreased, reflecting the improved credit quality of loans and advances. The Group continued to adopt a prudent loan provisioning policy. Impairment losses on loans and advances amounted to RMB12.342 billion in 2006, representing an increase of RMB0.856 billion compared to the prior year. In 2006, the credit cost was 0.53% of total loans, almost the same level as the prior year.

Operating expenses and others

The Group incurred operating expenses amounting to RMB68.731 billion, representing an increase of RMB8.747 billion (14.58%) compared to the prior year.

Staff costs amounted to RMB30.896 billion, representing an increase of RMB3.790 billion (13.98%) compared to the prior year. The increase in staff costs was mainly attributable to: an increase in domestic salary levels through the implementation of the new domestic Salary System in 2006, which assigned salary levels based on a consistent assessment of roles, responsibilities and market compensation levels, related increases for government mandated contributions, based on employee salary levels, to various employee welfare programs, labor union, and training initiatives which accounted for 14%, 2%, and 1.5% respectively of the staff salary costs have also increased.

General operating and administrative expenses mainly comprised postal fee, marketing fee, utility fee, printing expenses, maintenance fee, offices, regulatory expenses and other professional fees. In 2006, the general operating and administrative expenses was RMB14.603 billion, an increase of RMB1.352 billion (10.20%) compared to the prior year, consistent with the growth in the Group's business activities. These expenses also included regulatory fees of RMB0.992 billion paid to the China Banking Regulatory Commission (CBRC), which increased RMB0.066 billion compared to the prior year.

Insurance claims expense amounted to RMB7.484 billion, an increase of RMB3.331 billion (80.21%) compared to the prior year. As the life insurance business grew rapidly in 2006, the provision for insurance claims increased accordingly.

During 2006, the Group intensified its focus on cost control and management and the growth in operating income outpaced that of the general operating and administrative expenses. In 2006, the cost (excluding business and other taxes) to income ratio was 41.97%, representing a decrease of 1.44 percentage points compared to the prior year, indicating an improvement in the operating efficiency.

Income taxes

In 2006, the Group's income tax expense was RMB19.673 billion, representing a decrease of RMB2.580 billion (11.59%) compared to the prior year. The effective tax rate was 28.96%, representing a decrease of 12.39 percentage points compared to the prior year. The decrease in the effective tax rate was mainly due to the fact that pursuant to Cai Shui [2007] No. 40 "Notice to Bank of China Limited on the Deductible Criterion relating to Salary Expenses" issued by the Ministry of Finance and the State Administration of Taxation, the Group has obtained the approval for deduction of RMB15.669 billion of its domestic staff costs when determining the Group's 2006 taxable income, resulting in a decrease in tax expenses of RMB4.6 billion for 2006.

Balance Sheet Analysis

At the end of 2006, the Group's total assets were RMB5,327.653 billion, an increase of RMB587.605 billion (12.40%) compared to the prior year-end, and total liabilities were RMB4,914.697 billion, an increase of RMB430.168 billion (9.59%) compared to prior year-end.

Loans

Loan⁷ was a key component of the Group's assets. At the end of 2006, the Group had a total loan portfolio of RMB2,432.019 billion, an increase of RMB196.754 billion (8.80%) compared to the prior year-end.

The quality of the Group's loan portfolio continued to improve during the year, with loans classified as special mention decreasing significantly, resulting in an increase in the percentage of higher quality loans. The Group also continued to rebalance the mix of the loan portfolio to achieve higher yields by reducing the proportion of lower yielding trade bills in the loan portfolio.

⁷ Including loans and advances to customers.

Corporate loans and Personal loans

Unit: RMB million

Group	2006		2005		2004		2003	
	Balance	%	Balance	%	Balance	%	Balance	%
Corporate loans	1,849,275	76.04%	1,712,262	76.60%	1,653,647	77.00%	1,777,507	82.26%
Personal loans	582,744	23.96%	523,003	23.40%	494,041	23.00%	383,393	17.74%
Total	2,432,019	100.00%	2,235,265	100.00%	2,147,688	100.00%	2,160,900	100.00%

Investment Securities

The Group held investment securities totaling RMB1,892.482 billion at the end of 2006, an increase of RMB209.169 billion (12.43%) compared to the prior year-end. There was no significant impairment in the investment securities. The classification of the Group's investment securities portfolio at 31 December 2006 is as follows:

Unit: RMB million

Group	2006		2005		2004		2003	
	Balance	%	Balance	%	Balance	%	Balance	%
Trading assets and other financial instruments at fair value through profit or loss	115,828	6.12%	111,782	6.64%	92,124	6.97%	115,144	10.43%
Available-for-sale securities	815,178	43.07%	602,221	35.77%	357,587	27.06%	421,471	38.17%
Held-to-maturity securities, net	461,140	24.37%	607,459	36.09%	457,994	34.65%	215,175	19.49%
Securities classified as loans and receivables, net	500,336	26.44%	361,851	21.50%	413,941	31.32%	352,315	31.91%
Total	1,892,482	100.00%	1,683,313	100.00%	1,321,646	100.00%	1,104,105	100.00%

The percentage of securities classified as available-for-sale and as loans and receivables both increased during the year, while the percentage classified as held-to-maturity securities declined significantly. The percentage of the trading assets and other financial instruments at fair value through profit and loss maintained at similar level as prior year. The change in the classification mix of the investment securities portfolio principally related to the re-investment of funds received on the maturity of securities classified as held-to-maturity, into those classified as available-for-sale. Similarly, the Group increased its investment in securities with a shorter tenor, such as PBOC bills and commercial papers denominated in foreign currency. These changes provided the Group with more flexibility in managing its portfolio to achieve higher yields. As a result, the percentage of securities classified as loans and receivables increased.

Investment securities — Issuer Type

Unit: RMB million

Group	2006		2005		2004		2003	
	Balance	%	Balance	%	Balance	%	Balance	%
Government and government guaranteed	817,643	43.20%	794,413	47.19%	590,932	44.71%	430,903	39.01%
Financial institution	610,738	32.27%	475,878	28.27%	359,503	27.20%	318,744	28.85%
Public sector and quasi government	263,333	13.91%	263,007	15.62%	274,983	20.80%	275,178	24.91%
Corporate	187,856	9.93%	136,449	8.10%	84,253	6.37%	67,944	6.15%
Equity securities	13,064	0.69%	13,722	0.82%	12,167	0.92%	11,918	1.08%
Sub-total	1,892,634	100%	1,683,469	100%	1,321,838	100%	1,104,687	100%
Allowance for impairment losses	(152)		(156)		(192)		(582)	
Total	1,892,482		1,683,313		1,321,646		1,104,105	

Deposits from customers

The Group's deposits from customers totaled RMB4,091.118 billion at the end of 2006, an increase of RMB391.654 billion (10.59%) compared to the prior year-end. Of this increase, corporate and personal deposits increased by RMB180.025 billion and RMB194.171 billion, respectively.

Customer deposits by customer type

The following table sets forth the principal components of the Group's deposits from customers by customer type:

Unit: RMB million

Group	2006		2005		2004		2003	
	Balance	%	Balance	%	Balance	%	Balance	%
Corporate deposits								
Demand deposit	979,653	23.95%	836,763	22.62%	776,648	23.26%	679,524	22.40%
Time deposit	549,118	13.42%	511,983	13.84%	406,019	12.16%	332,606	10.96%
Sub-total	<u>1,528,771</u>	<u>37.37%</u>	<u>1,348,746</u>	<u>36.46%</u>	<u>1,182,667</u>	<u>35.42%</u>	<u>1,012,130</u>	<u>33.36%</u>
Personal deposits								
Demand deposit	770,583	18.83%	667,957	18.06%	697,028	20.88%	607,904	20.04%
Time deposit	1,645,914	40.23%	1,554,369	42.02%	1,351,692	40.49%	1,324,511	43.66%
Sub-total	<u>2,416,497</u>	<u>59.06%</u>	<u>2,222,326</u>	<u>60.07%</u>	<u>2,048,720</u>	<u>61.37%</u>	<u>1,932,415</u>	<u>63.71%</u>
Security and margin deposits	<u>145,850</u>	<u>3.57%</u>	<u>128,392</u>	<u>3.47%</u>	<u>107,061</u>	<u>3.21%</u>	<u>88,819</u>	<u>2.93%</u>
Total	<u>4,091,118</u>	<u>100.00%</u>	<u>3,699,464</u>	<u>100.00%</u>	<u>3,338,448</u>	<u>100.00%</u>	<u>3,033,364</u>	<u>100.00%</u>

During 2006, the Group continued to proactively manage its liability mix, while maintaining stable growth. In this regard, the proportion of generally low-interest bearing demand deposits, both corporate and personal, increased by 2.04 percentage points and 1.83 percentage points during the year.

Equity

The Bank substantially increased its capital base in recent years through, among other things, the capital contribution from Huijin at the end of 2003, the sale of equity to strategic investors during 2005, and the IPO in 2006. At the end of 2006, the Group's total shareholders' equity was RMB412.956 billion, representing an increase of RMB157.437 billion (61.61%) over the prior year-end. This increase was comprised of the following significant elements.

- (1) On 13 March 2006, the Bank issued about 8.514 billion ordinary shares of par value of RMB1.00 each to National Council for Social Security Fund at a premium. The share premium (net of share issuance costs) of RMB1.481 billion was recognized in the capital reserve;
- (2) On 1 June 2006 and 9 June 2006, the Bank issued about 29.404 billion H-shares of par value of RMB1.00 each through a global offering to Hong Kong and overseas investors at a premium. The share premium (net of share issuance costs) of RMB58.128 billion was recognized in the capital reserve;
- (3) On 29 June 2006, the Bank issued 6.494 billion A-shares of par value of RMB1.00 each through an initial public offering to the domestic investors at a premium. The share premium (net of share issuance costs) of RMB12.958 billion was recognized in the capital reserve;
- (4) In 2006, the Group's profit after tax amounted to RMB48.264 billion and profit attributable to equity holders of the Bank was RMB42.83 billion.

Please refer to the Consolidated Statement of Changes in Equity in the Financial Statements for additional details.

Segment reporting by geography

The Group conducts its business activities in the Chinese mainland, Hong Kong and Macau and other overseas locations. The geographical analysis of profit attributable to our business activities, along with information on the related assets and liabilities, in these three geographic areas are set forth in the following table:

Unit: RMB million

	Chinese mainland		Hong Kong & Macau		Other overseas regions		Eliminations		Group	
	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005
Total assets	4,220,395	3,736,930	1,084,078	969,872	214,766	186,995	(191,586)	(153,749)	5,327,653	4,740,048
Total liabilities	3,921,219	3,586,428	980,389	872,995	204,675	178,855	(191,586)	(153,749)	4,914,697	4,484,529
Net interest income	101,449	83,083	18,105	16,234	1,813	1,691	4	—	121,371	101,008
Non-interest income	7,061	8,313	19,564	14,356	931	1,429	(549)	—	27,007	24,098
Net fee and commission income	8,629	5,207	5,369	3,226	829	814	(504)	—	14,323	9,247
Operating expenses and others	(50,357)	(46,375)	(16,951)	(11,831)	(1,483)	(1,778)	60	—	(68,731)	(59,984)
Loan Impairment losses	(15,546)	(15,345)	2,983	3,276	221	583	—	—	(12,342)	(11,486)
Profit before tax	42,607	29,695	24,388	22,191	1,482	1,925	(540)	—	67,937	53,811
Income tax	(16,138)	(18,911)	(3,435)	(3,022)	(290)	(320)	190	—	(19,673)	(22,253)
Net profit	26,469	10,784	20,953	19,169	1,192	1,605	(350)	—	48,264	31,558

The Chinese mainland continues to be the Group's largest geographic business segment. At the end of year 2006, the total assets of this segment (before inter-company eliminations) were RMB4,220.395 billion, an increase of RMB483.465 billion (12.94%) compared to the prior year-end, accounting for 76.47% of the Group's total assets (before inter-company eliminations), an increase of 0.11 percentage points compared to the prior year. In 2006, this segment had net profit (before inter-company eliminations) of RMB26.469 billion, an increase of RMB15.685 billion (145.45%) compared to the prior year-end, accounting for 54.45% of the Group's total net profit (before inter-company eliminations). This segment has become increasingly important for the Group as a source of revenue and profit growth. The Group has an extensive domestic branch network, providing traditional retail and corporate banking services. The Group also provides both RMB and foreign currency banking services. With respect to the latter, the Group continues to maintain a distinct advantage over its competitors by virtue of its unique position in the foreign currency business.

The Hong Kong and Macau segment is also an important one for the Group. At the end of 2006, total assets of this segment (before inter-company eliminations) was RMB1084.078 billion, an increase of RMB114.206 billion (11.78%) compared to the prior year, accounting for 19.64% of the Group's total assets (before inter-company eliminations), a decrease of 0.18 percentage points compared to the prior year. In 2006, this segment had net profit (before inter-company eliminations) of RMB20.953 billion, an increase of RMB1.784 billion (9.31%) compared to the prior year, accounting for 43.10% of the Group's profit after tax (before inter-company eliminations). Apart from traditional commercial banking activities, the Group also has subsidiaries operating insurance and investment banking businesses in this geographic area. These include BOCI Holdings Limited, BOCG Insurance Co., Ltd. and BOC Group Investment Limited. The continued development of these businesses is essential to the successful implementation of the Group's plan to develop a universal banking platform.

The Group has also established a substantial overseas network, with operations in Europe, North America, South America, Africa, and other Asia-Pacific regions. At the end of year 2006, the total aggregate assets of these regions (before inter-company eliminations) was RMB214.766 billion, an increase of RMB27.771 billion (14.85%) compared to the prior year, accounting for 3.89% of the

Group's total assets (before inter-company eliminations). These overseas operations had a profit after tax (before inter-company eliminations) of RMB1.192 billion, accounting for 2.45% of the Group's total profit, after tax (before inter-company eliminations).

Other financial information

Reconciliation of differences between PRC GAAP and IFRS financial information

	Net assets as at		Net profit	
	31 December		for the year ended	
	2006	2005	2006	2005
PRC GAAP figures	388,254	233,842	41,892	27,492
Adjustments for accounting standard differences:				
— Reversal of asset revaluation surplus and corresponding depreciation (1)	(7,693)	(7,999)	306	427
— Fair value measurement on investment properties (2)	3,318	2,816	502	1,695
— Equity securities classified as available-for-sale financial assets and measured at fair value (3)	2,742	1,775	—	—
— Early retirement benefit obligation (4)	(5,316)	(5,097)	(219)	(2,627)
— Cost method applied on precious metals (5)	(791)	(637)	(154)	(329)
— RMB500 million start-up fund for annuity plan (6)	—	—	—	(500)
— Deferred tax impact (7)	1,866	992	184	290
— Minority interests effect and others	537	727	319	(527)
Sub-total	(5,337)	(7,423)	938	(1,571)
IFRS figures	382,917	226,419	42,830	25,921

(1) *Reversal of revaluation surplus and corresponding depreciation*

Under PRC GAAP, the Bank recorded an asset revaluation adjustment of RMB10,432 million as of 31 December 2003, related principally to property and equipment, in connection with the Joint Stock Reform Plan. The revalued property and equipment will be amortized over their remaining useful lives. According to IAS 16 *Property, Plant and Equipment*, once an entity has chosen the cost model as its accounting policy, it shall apply the policy to an entire class of property, and shall not be permitted to measure these fixed assets at fair value. Hence, the asset revaluation surplus and corresponding depreciation recognized under PRC GAAP should be reversed under IFRS.

(2) *Fair value measurement on investment properties*

Under PRC GAAP, investment properties as fixed assets are measured at cost after deducting accumulated depreciation and impairment losses. According to IAS 40 *Investment Property*, investment properties are measured at fair value at the balance sheet date by the Group.

(3) *Equity securities classified as available-for-sale financial assets and measured at fair value*

Under PRC GAAP, equity securities are accounted for at cost after deducting impairment losses. According to IAS 39 *Financial Instruments: Recognition and Measurement*, these securities have been classified as available-for-sale and are stated at fair value.

(4) *Early retirement benefit and obligation*

According to the MOF requirement, the early retirement benefit expenditures during the early retirement period (from early retirement date to legal retirement date) to those employees who accepted an early retirement arrangement is recognized on a cash basis by the Group. According to IAS 19 *Employee Benefits*, the early retirement benefit at the balance sheet date should be recorded based on the present value of the future payment obligation after adjusting for actuarial gain or loss and past servicing cost.

(5) *Cost method applied on precious metals*

According to the accounting practice of the PRC banking industry, all precious metals are initially recognized at cost and subsequently re-measured at fair value at the balance sheet date by the Group. According to IAS 2 *Inventories*, precious metals that are not related to the Group's precious metals trading activities are carried at cost.

(6) *RMB500 million start-up fund for annuity plan*

BOC established an annuity plan to provide supplementary retirement benefits to its domestic current employees. Huijin, as the parent company, committed a start-up fund of RMB500 million for the annuity plan in 2005. IFRS requires this amount to be recorded in operating expenses and capital reserve.

(7) *Deferred tax impact*

Under IFRS, deferred income tax is provided using the balance sheet liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Under PRC GAAP, deferred income tax is provided using the liability method, on timing differences between the Group's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

The difference between PRC GAAP and IFRS in 2006 mainly represents the deferred income tax credited or charged directly to equity under IFRS relating to the fair value re-measurement of available-for-sale investments charged or credited directly to equity.

5.2 Business Review

With an international network in 27 countries and regions, Bank of China's business scope operates encompasses three main business lines: commercial banking, investment banking and insurance. It has established correspondent banking relationships with 1,500 banks having a total of 47,000 branches worldwide. Through its global network, comprehensive range of services, the Bank has maintained a competitive advantage in the domestic banking market.

The following table sets forth our operating profit attributable to each of our principal lines of business for the periods indicated:

Unit: RMB million/except percentages

	2006		2005		2004		2003	
	Amount	Proportion	Amount	Proportion	Amount	Proportion	Amount	Proportion
Commercial banking	63,392	94.19%	49,735	92.73%	34,902	94.02%	31,022	82.92%
Investment banking	1,055	1.57%	274	0.51%	338	0.91%	337	0.90%
Insurance	581	0.86%	334	0.62%	266	0.72%	196	0.52%
Others	2,769	4.11%	3,293	6.14%	1,616	4.35%	5,861	15.66%
Elimination	-492	-0.73%	—	—	—	—	—	—
Total	67,305	100.0%	53,636	100.0%	37,122	100.0%	37,416	100.0%

5.2.1 Our commercial banking business comprises of three major lines of business: corporate banking business, personal banking business and treasury operations, which are the traditional business of the bank.

The following table sets forth the operating profit of major commercial banking business for the periods indicated:

Unit: RMB million/except percentages

	2006		2005		2004		2003	
	Amount	Proportion	Amount	Proportion	Amount	Proportion	Amount	Proportion
Corporate banking business	32,278	50.92%	27,033	54.36%	17,215	49.32%	17,103	55.13%
Personal banking business	17,396	27.44%	14,117	28.38%	6,990	20.03%	4,050	13.06%
Treasury operations	13,718	21.64%	8,585	17.26%	10,697	30.65%	9,869	31.81%
Total	63,392	100.0%	49,735	100.0%	34,902	100.0%	31,022	100.0%

5.2.1.1 Corporate banking business

At the end of 2006, the pre-tax profit (before inter-company eliminations) of corporate banking was RMB32.3 billion, an increase of 19.4% from the prior year-end. The average ROA reached 1.87%, one of the highest returns among domestic banks.

Unit: RMB million

	2006	2005	2004	2003
Net interest income	55,809	51,304	44,287	34,628
Non-interest income	10,915	9,564	7,188	5,973
Operating expenses and others	-22,904	-21,127	-18,071	-14,142
Impairment (losses)/write-back	-11,542	-12,708	-16,189	-9,356
Operating profit	32,278	27,033	17,215	17,103
Profit before tax	32,278	27,033	17,215	17,103
Segment assets	1,795,152	1,655,351	1,608,781	1,578,313

5.2.1.2 Personal banking business

As of the end of 2006, the pre-tax profits (before inter-company eliminations) of personal banking business was RMB17.4 billion, a year-on-year increase of 23.2% with the pre-tax average ROA of 2.7%.

Unit: RMB million

	2006	2005	2004	2003
Net interest income	36,414	32,302	30,148	26,469
Non interest income	8,897	6,176	5,088	4,507
Operating expenses and others	-27,121	-25,508	-20,592	-17,874
Impaired loans (losses)/write-back	-794	1,147	-7,654	-9,052
Operating profit	17,396	14,117	6,990	4,050
Profit before tax	17,396	14,117	6,990	4,050
Segment assets	687,553	599,263	556,066	453,665

5.2.1.3 Financial Markets Business

In the year of 2006, the overall pre-tax profit (before inter-company eliminations) of the treasury operation increased to RMB13.7 billion for the Group, an increase of 59.8% compared with the year of 2005, average pre-tax return on asset reached 0.5%.

Unit: RMB million

	2006	2005	2004	2003
Net interest income	29,860	18,053	13,585	15,324
Non-interest income	-7,324	-2,363	5,680	2,350
Operating expenses and others	-8,818	-7,105	-8,568	-7,805
Impaired loans (losses)/write-back	—	—	—	—
Operating profit	13,718	8,585	10,697	9,869
Profit before tax	13,718	8,585	10,697	9,869
Segment assets	2,725,362	2,397,839	2,019,737	1,860,575

5.2.1.4 Operations of BOCHK

The Group conducts commercial banking business in Hong Kong through its subsidiary Bank of China (Hong Kong) Limited (“BOCHK”). As a bank licensed in Hong Kong and with 65.87% of its shares owned by the Group, BOCHK is BOC Group’s most significant overseas operation entity in terms of assets and profit contributions. As of 31 December 2006, according to the statistics issued by Hong Kong Monetary Authority, BOCHK’s total asset reached RMB926.02 billion. In 2006, BOCHK achieved net profit of RMB9.448 billion (less minority interest). BOCHK (Holdings) Limited, which was directly controlled by BOCHK, was listed in the Hong Kong Exchange Stock main board since July 2002.

Capitalising on the vibrant economic growth and buoyant financial markets, in the year of 2006, BOCHK delivered the highest operating profit before loan impairment allowances and profit attributable to shareholders since its restructuring in 2001 disregard of the factor of foreign exchange rate. Net interest income and net interest margin increased substantially. Non-interest income registered steady growth, with outstanding performance in both the investment and insurance business.

Contribution of BOCHK to the Group's after tax profit

Unit: million HKD/except percentages

	31 Dec. 2006	31 Dec. 2005	Growth Volume/ Ratio
After tax profit	14,634	15,172	13,274
Proportion to the Group's after tax profit	30.32%	48.08%	49.04%

Note: net profit after minority interests

In 2006, BOCHK actively developed its deposit business while controlling funding cost. To meet the various demands of customers, BOCHK introduced product promotion to target segments, resulting in an increase in low-interest and interest-free deposits, as well as a more optimized deposit portfolio. With the emphasis on risk management and efficiency enhancement, BOCHK set up operation models for SMEs development, streamlined the business flow and improved customer service efficiency, and launched a series of competitive and diversified products in the year, which doubled SMEs loan balance. BOCHK remained as the leader in the loan syndication markets of mainland, Hong Kong and Macau, with a market share of 9.3%.

5.2.1.5 Risk Management

Risk management framework

The Risk Management framework of BOC is mainly composed of Board of Directors and the Risk Policy Committee under the Board, Internal Control Committee, Anti-Money-Laundering Committee, Asset-Liability Management Committee and Asset Disposal Committee under the senior management, Risk Management Department, Credit Administration Department, Asset & Liability Department and Law & Compliance Department. The Head Office manages the risks in branches through the vertical management model, the risk in business departments through windows management model, and monitors and controls the risks in subsidiaries by appointing certain members of the boards of directors or risk management committees of the subsidiaries.

Loan concentration by borrower

We emphasize on the risk control of borrower concentration. We are currently in compliance with regulatory requirements on borrower concentration.

Main regulatory ratios 31 Dec. 2004	Criteria	31 Dec. 2006	31 Dec. 2005
Proportion of outstanding loans of largest single borrowers (%)	≤ 10	2.2	4.7
Top ten customers ratio (%)	≤ 50	15.7	25.6

Note: Proportion of outstanding loans of largest single borrowers = Total outstanding loans to the largest single borrowers/net regulatory capital

Top ten customers ratio = Total outstanding loans to the top ten customers/net regulatory capital

Loan quality

As at the end of 2006, the outstanding special-mention loan was RMB198.15 billion, a drop of RMB85.90 billion compared with the last year end, and accounted for 8.15% of the total loan portfolio with a 4.56 percentage points down from the last year end.

Five-category loan classification of loans of the group

Unit: RMB million/except percentages

	31 Dec. 2006		31 Dec. 2005		31 Dec. 2004		31 Dec. 2003	
	Balance	Proportion	Balance	Proportion	Balance	Proportion	Balance	Proportion
Pass	<u>2,135,654</u>	<u>87.81%</u>	<u>1,847,991</u>	<u>82.67%</u>	<u>1,612,936</u>	<u>75.10%</u>	<u>1,494,275</u>	<u>69.15%</u>
Special-mention	<u>198,145</u>	<u>8.15%</u>	<u>284,048</u>	<u>12.71%</u>	<u>424,606</u>	<u>19.77%</u>	<u>314,968</u>	<u>14.58%</u>
Substandard	39,390	1.62%	45,573	2.04%	61,515	2.87%	63,314	2.93%
Doubtful	44,100	1.81%	44,550	1.99%	32,931	1.53%	116,032	5.37%
Loss	14,730	0.61%	13,103	0.59%	15,700	0.73%	172,311	7.97%
Total	2,432,019	100.00%	2,235,265	100.00%	2,147,688	100.00%	2,160,900	100.00%
NPL	98,220	4.04%	103,226	4.62%	110,146	5.13%	351,657	16.27%

Five-category loan classification of domestic loans

Unit: RMB million/except percentages

	31 Dec. 2006		31 Dec. 2005		31 Dec. 2004		31 Dec. 2003	
	Balance	Proportion	Balance	Proportion	Balance	Proportion	Balance	Proportion
Pass	<u>1,703,908</u>	<u>85.69%</u>	<u>1,430,429</u>	<u>79.46%</u>	<u>1,228,414</u>	<u>70.78%</u>	<u>1,145,990</u>	<u>65.48%</u>
Special-mention	<u>188,604</u>	<u>9.49%</u>	<u>271,504</u>	<u>15.08%</u>	<u>408,571</u>	<u>23.54%</u>	<u>284,400</u>	<u>16.25%</u>
Substandard	38,517	1.94%	44,056	2.45%	57,882	3.33%	56,386	3.22%
Doubtful	43,119	2.17%	42,852	2.38%	29,787	1.72%	110,159	6.30%
Loss	14,186	0.71%	11,301	0.63%	10,874	0.63%	153,136	8.75%
Total	1,988,334	100.00%	1,800,142	100.00%	1,735,528	100.00%	1,750,071	100.00%
NPL	95,822	4.82%	98,209	5.46%	98,543	5.68%	319,681	18.27%

Provision for Impairment Losses on Loans

The bank assesses impairment losses timely and sufficiently in accordance with prudent and actual principles. Provision for impairment losses on loans consists of two components, individually assessed provision and collectively assessed provision.

Market risks management

Market Risk Management of the Trading Book

The bank is using one day time horizon and 95% confidence to calculate the VaR for the domestic trading book. The chart below shows the VaR of the domestic foreign exchange (not including investment book or banking book) trading book as of 31 December 2006 and 2005:

Unit: RMB million

	As of 31 Dec. 2006				As of 31 Dec. 2005			
	Period end	Average	High	Low	Period end	Average	High	Low
Interest rate risk	1.79	2.71	16.25	0.54	4.77	3.27	11.94	0.20
Risk of foreign exchange rate	0.81	2.99	14.12	0.39	12.84	2.70	18.69	0.34
Fluctuation risk	0.13	0.79	6.19	0.07	0.36	0.80	2.54	0.04
Total volume of market risk	2.07	5.64	19.15	0.86	15.06	5.10	18.86	0.69

Market Risk Management of the Banking Book

Primary market risk for our banking book is interest rate risk. Interest rate risk arises mainly from mismatches between the maturities or re-pricing periods of the assets and liabilities of our banking book. We assess the interest rate risk of the banking book primarily through gap analysis. Gap analysis measures the difference between the amount of interest-bearing assets and interest-bearing liabilities that mature or must be re-priced within certain periods. We also use the data generated by the gap analysis to perform sensitivity analysis and stress testing, which provide us with guidance in adjusting the re-pricing period structure of the interest-bearing assets and interest-bearing liabilities. Meanwhile, we closely follow the local and foreign currency interest rate trend and adjust the interest rates of local and foreign currency deposits and loans in a timely manner to avoid the interest rate risk.

Market Risk Management of the Investment Book

Senior Management reviews and approves the investment guideline of the investment book annually based on the Market Risk Management Policy and the Market Risk Limit approved by the Board (RPC). The investment guideline covers the market risk limit, the size of the investment portfolios, authorized products, duration, issue concentration limit and the minimum rating requirement, etc. Business departments should strictly comply with the investment guideline, and will be monitored and examined by the independent risk management team. The bank has been improving its risk management ability continuously. We manage market risk of investment book mainly through monitoring VaR and PVBP and stress testing of investment portfolio currently.

Risk of Exchange Rate

The bank seeks to reduce the foreign exchange rate risk by matching the sources and utilization of our funds on a currency-by-currency basis. In addition, we also manage and control exchange risk through settlement or hedging transaction. Trading exchange rate risk mainly comes from the foreign exchange transaction the Bank is engaged in. The Bank tries to control the foreign exchange position within the limit required according to its risk tolerance and operating capability.

Liquidity Risk

In 2006, the bank's liquidity is sufficient in general with staggered deficient.

In this situation, we constantly improved our liquidity management ability, proactively managed our bank's liability structure, shortened the duration of bonds investment portfolio. We managed to maintain the proper liquidity level to meet the normal business needs.

Regulatory indicators on liquidity At the end of 2006, all indicators related to the Bank's liquidity conditions met regulatory requirements as table below: (liquidity ratio is the indicator of the group; loan/deposit ratio and the excess reserve ratio are the indicators of mainland China)

Main regulatory ratios		Regulatory standard	31 Dec. 2006	31 Dec. 2005	31 Dec. 2004
Liquidity ratio (%)	RMB	≥ 25	37.7	48.9	35.3
	Foreign Currency	≥ 25	64.1	87.4	78.6
Loan/deposit ratio (%)	RMB	≤ 75	57.6	51.7	59.6
	Foreign Currency	≤ 85	70.1	70.4	67.9
Excess reserve ratio (%)	RMB		2.8	3.0	3.7
	Foreign Currency		25.8	16.9	13.9

Note: Liquidity ratio = current assets/current liabilities; Liquidity ratio is calculated in accordance with the relevant provisions of the People's Bank of China and China Banking Regulatory Commission, and the financial data are based on the Accounting Standard for Business Enterprises and the Accounting Systems for Financial Institutions.

Loan-to-deposit ratio = outstanding loans/outstanding deposits

Excess reserve ratio for RMB = (reserve excess the legal standard + cash)/(balance of deposits + remittance payables)

Excess reserve ratio for foreign currency = (reserve excess the legal standard + cash + due from banks + due from overseas sub-branches and subsidiaries)/balance of deposits

Capital management The group calculates and discloses CAR level in line with *Regulation Governing Capital Adequacy of Commercial Banks*, promulgated by CBRC on 23rd Feb, 2004 (CBRC Order Issuance No. [2004]2). Since 2005, the group calculates market risk capital in accordance with the Notice of CBRC General Office on *Release of Calculation Tables and Notes for Market Risk Capital Requirements for Commercial Banks* (Yinjianfa No.[2004]374). In 2006, the group's CAR level has risen significantly. One major reason is the increase in the group's core capital due to BOC's IPOs on Hong Kong and Shanghai Markets. Another reason is that the group's foreign exchange exposure has shrunk substantially, and hence market risk capital requirement decreased. By the end of 2006, the group's CAR level is 13.59%, up 3.17 percentage points from the year end before last; core CAR level is 11.44%, up 3.36 percentage points.

Capital Management in the Future We'll streamline the process of capital management timely and continuously so as to enhance its positive role in banking management. In order to strengthen our capital base and provide which as support for sustainable growth of our business, we will stick with effective capital adequacy ratio management, capital funding management and economic capital allocation.

Funds Transfer Pricing Funds Transfer refers to all forms of internal fund trading among entities (including the Head Office, domestic and overseas branches and subsidiaries) within the Bank. In 2005, the Bank adopted the concept and principle for management by Funds Transfer Pricing (FTP) and started to explore the use of FTP as a means to optimize resources allocation, reduce operating cost and increase returns. In 2006, the Bank formulated The Guidance to BOC FTP, which clarified the objectives, pricing mechanism and transferring rules of FTP as well as the direction for the bank's internal fund management.

5.2.1.6 *Organizational Information, Human Resources Management and Development*

As of 31 December 2006, the Bank had 11,241 domestic and overseas branches and outlets, a reduction of 405 from the beginning of 2006. There were 37 tier one branches, 283 tier two branches and 10,277 outlets in domestic operation, and 643 branches, subsidiaries and representative offices in overseas operation.

At the end of December 2006, the Bank had 232,632⁹ employees (including 40,620 dispatch contractors working in domestic institutions), of which 20,204 were local staff of overseas branches and subsidiaries. In 2006, there were 7,278 retirees whose expense should be borne by the Bank.

⁹ The number is calculated according to the new 38 accounting standard issued by MOF.

5.3 Outlook

- 5.3.1 Corporate Banking Business** The financial industry is striding into a new era of competition wherein the participants are becoming more diversified and competition closing in all directions. In the year 2007, the Bank will continue to improve its service for customers. Some major measures include: improve service model for key customers; optimize business procedures of corporate banking; strengthen coordination and cross-selling among the Head Office and the branches, both domestic and in overseas markets, and across different business lines; encourage product innovation; improve service model for small business. These efforts will help the Bank lay down a sound foundation for future sustainable growth.
- 5.3.2 Personal Banking Business** In 2007, the Bank will base its personal banking business on the client-oriented tenet, striving to improve business operation, perfect service model, optimize business process, develop and cultivate stronger relationship with affluent customers, strengthen cross-selling and internal coordination, promote products innovation, strengthen marketing and increase the core competitiveness of services delivered by the outlet. The Bank will accelerate the innovation of personal finance for quicker development and expansion of the personal banking business and wealth management through deepening the cooperation with the overseas strategic investors on product, service and human resources. The human resource strategic plan for the personal banking business will be drawn up to accelerate the forming of specialized teams and lay a solid foundation for sustainable development.
- 5.3.3 Financial Market Business** In the year of 2007, the macro economic environment and regulatory policies are expected to provide ample room for development, while posing new challenges to the Bank's financial market businesses. It expects to face more market competition due to foreign banks' advantages in technology, experience and marketing measures. The bank shall further expand its financial market business, taking business opportunities in the RMB derivatives market, strengthen in local and foreign currencies investment asset portfolio management, sufficiently take advantage of the cooperation with strategic investors, follow the development trend of international banks and its comparative competition advantages, so as to maintain the leading position in competition with other banks.
- 5.3.4 BOCHK** In terms of strategic business development, BOCHK will continue to grow its market share in traditional segments like corporate banking and retail banking. It will also further strengthen and expand its business platform, enhance product innovation and manufacturing capabilities, and ride on the synergy effect through collaboration with BOC to create sustainable satisfactory returns on equity and to maximize value for shareholders.

6 SIGNIFICANT EVENTS

6.1 Material Litigation and Arbitration

During the report period and except as disclosed herein, there was no material litigation and arbitration that might have significant adverse impact on the operation of the Bank.

The Bank has been involved in certain litigation and arbitration cases in the ordinary of businesses. After consulting professional legal firms, the Management considers that these litigation and arbitration cases will not have significant adverse impacts on the operation of the Bank.

6.2 Purchase and Sale, Acquisition of Asset

On 15 December 2006, the Bank completed its first post IPO overseas acquisition with the purchase of Singapore Aircraft Leasing Enterprise (SALE) for USD965 million after several rounds of international competitive biddings.

The selling shareholders are Singapore Airlines Limited (56.67%¹⁰ held by Temasek Holdings (Private) Limited.) (35.5%), WestLB AG (35.5%), Apfarge Investment Pte. Ltd. (an investment vehicle of Singapore government's Special Investments Pte. Ltd.) (14.5%), and Seletar Investments Pte. Ltd. (a wholly-owned subsidiary of Temasek Holdings (Private) Limited) (14.5%).

On 31 December 2005, Temasek Holdings (Private) Limited indirectly held 5% shares of the Bank via its wholly owned subsidiary, AFH. Its shareholding proportion declined to 4.805% after the NCSSF completed its investment in the Bank on 13 March 2006. According to the register maintained by the Bank pursuant to Section 336 of the *Securities and Futures Ordinance of the laws of Hong Kong*, the shares held by Temasek in the Bank accounted for 4.65% of the bank's total issued share capital on 31 December 2006. According to the opinions of the bank's domestic and overseas legal advisors, the transaction did not constitute a connected transaction of the Bank.

¹⁰ As of 30 May 2006, the share volume held by Temasek Holdings (Private) Limited. in Singapore Airlines Limited derives from the 05/06 Annual report of Singapore Airlines Limited.

6.3 Related Party Transactions

Related parties are those parties that have the ability to control the other party or exercise significant influence over the other party in making financial or operating decisions. Parties are also considered to be related if they are subject to common control. Related parties may be individuals or other entities. The Group is subject to the control of the State Council of the PRC Government through Huijin.

6.3.1 Financial restructuring arrangements with the MOF

As at 31 December 2006, the Group had a liability of RMB8,680 million (2005: RMB17,362 million) to the MOF in respect of the excess of the appraised value of the net assets of the Bank as at 31 December 2003 over the amount of the share capital of the Bank as at the date of the government directed financial restructuring which involved the sales of non performing loans and policy related assets and various capital injections by the government through Huijin in the conversion of the Bank into a joint stock limited company during 2003 and 2004. This liability included in "other liabilities" is non-interest bearing and is to be paid in four annual installments before 31 December 2008.

6.3.2 Transactions with the MOF

The Group enters into banking transactions with the MOF and the PBOC in the normal course of business. These include purchase and redemption of investment securities issued by the MOF and the PBOC; maintenance of mandatory reserves; Foreign Exchange swap and spot transactions with PBOC; other deposits and amounts due to the PBOC; underwriting and distribution of Certificate Treasury Bonds issued by the MOF through the Group's branch network and earning commission income based on such bonds sold.

6.3.2.1 *Treasury bonds and PBOC bonds*

The Group purchases and redeems bonds issued by the MOF and the PBOC. The volume of such transactions and related interest rate range for the years ended 31 December 2006 and 2005 and the outstanding balances as of the respective year end dates are set out below:

	Year ended 31 December	
	2006	2005
Purchases during the year	574,169	642,574
Redemption/sales during the year	570,554	384,559
Interest rate range:	1.22%–9.00%	0.41%–9.00%
	2006	2005
Outstanding balance at 1 January	533,625	271,120
Outstanding balance at 31 December	539,828	533,625

6.3.2.2 *Transactions with the MOF in relation to the underwriting and distribution of Certificate Treasury Bonds*

The Group underwrites Certificate Treasury Bonds issued by the MOF and undertakes the role of a distributor of these bonds through its branch network and earns commission income based on the amount of such bonds sold.

	Year ended 31 December	
	2006	2005
Total distribution of Certificate Treasury Bonds in the year	25,350	26,000
Commission income earned in the year	269	252
	2006	2005
Outstanding balance at 1 January	10,185	8,717
Outstanding balance at 31 December	12,800	10,185

6.3.3 *Transactions with Huijin*

Huijin became the equity holder of the Bank from 30 December 2003. As of 31 December 2006, Huijin owned 67.49% equity interest in the Bank following the completion of the Bank's Global Offering and A share initial public offering.

In 2005, the Bank entered into a foreign currency option agreement with Huijin to reduce its foreign currency exposure and as at 31 December 2006 and 2005, the outstanding notional amount of the foreign currency option agreement was USD18 billion.

On 15 May 2006, a dividend of RMB1,375 million, relating to the year ended 31 December 2005 was paid to Huijin, in accordance with the approval by the equity holders at a post-adjudgment session of the Annual General Meeting on 30 April 2006.

In accordance with the resolution of the 7th Extraordinary Meeting of the Shareholder in 2005, Huijin agreed to the appropriation of RMB500 million of distributed dividends in 2004, as start-up funding for the Bank's new annuity plan. This payment has been recorded as a capital contribution in the Capital Reserve and as an operating expense in the income statement for the year ended 31 December 2005.

Deposit

	2006	2005
At 1 January	38,869	—
Deposits received during the year	288,128	42,972
Deposits repaid during the year	<u>(304,937)</u>	<u>(4,103)</u>
At 31 December	<u>22,060</u>	<u>38,869</u>

6.3.4 Transactions with other companies controlled by Huijin

Huijin also has controlling equity interests in certain other bank and non-bank entities in the PRC. The Group enters into banking transactions with these companies in the normal course of its business. These include trading assets, investment securities and money market transactions.

The volume of such transactions and related interest rate range for the years ended 31 December 2006 and 2005 and the outstanding balances with these companies as of 31 December 2006 and 2005 are as follows:

6.3.4.1 Trading assets and investment securities

	Year ended 31 December	
	2006	2005
Purchases during the year	1,207	1,499
Redemptions/sales during the year	1,804	1,218
Interest rate range	3.15%–6.54%	0.26%–5.90%
	2006	2005
Outstanding balance at 1 January	2,400	2,183
Outstanding balance at 31 December	1,762	2,400

6.3.4.2 Due from banks

	Year ended 31 December	
	2006	2005
Interest rate range:	0.00%–5.40%	0.00%–3.74%
	2006	2005
Outstanding balance at 1 January	88	94
Outstanding balance at 31 December	121	88

6.3.4.3 *Placements with banks and other financial institutions*

	Year ended 31 December	
	2006	2005
Interest rate range:	2.40%–6.05%	0.37%–5.50%
	2006	2005
Outstanding balance at 1 January	2,318	3,537
Outstanding balance at 31 December	1,662	2,318

6.3.4.4 *Due to banks and other financial institutions*

	Year ended 31 December	
	2006	2005
Interest rate range:	0.00%–3.00%	0.00%–2.50%
	2006	2005
Outstanding balance at 1 January	2,076	1,895
Outstanding balance at 31 December	1,971	2,076

6.3.4.5 *Transactions with other companies controlled by Huijin*

Placements from banks and other financial institutions

	Year ended 31 December	
	2006	2005
Interest rate range:	0.99%–4.25%	0.09%–4.50%
	2006	2005
Outstanding balance at 1 January	243	—
Outstanding balance at 31 December	106	243

6.3.5 *Transactions with other state controlled entities*

The Bank is subject to the control of the State Council of the PRC Government through Huijin, which also directly and indirectly controls a significant number of entities through its government authorities, agencies and affiliates. Accordingly, the Group has extensive transactions with other state controlled entities. The nature of these transactions for the year ended 31 December 2006 and 2005, conducted in the ordinary course of business, includes, but is not limited to, the following:

- Lending, provision of credit and guarantees and deposit taking;
- Inter-bank balance taking and placing;
- Sale, purchase, underwriting and redemption of bonds issued by other state-controlled entities;
- Rendering of foreign exchange, remittance, investment related services;
- Entrusted lending and provision of other custody services; and
- Purchasing of utilities, telecommunication and postal services.

6.3.5.1 *Due from banks*

	Year ended 31 December	
	2006	2005
Interest rate range	0.00%–11.00%	0.00%–4.67%
	2006	2005
Outstanding balance at 1 January	3,547	2,085
Outstanding balance at 31 December	3,499	3,547

No allowance for impairment losses on amounts due from banks has been recognized during the years ended 31 December 2006 and 2005.

6.3.5.2 *Transactions with other state controlled entities*

Placements with banks and other financial institutions

	Year ended 31 December	
	2006	2005
Interest rate range :	0.07%–7.40%	0.00%–6.09%
	2006	2005
Outstanding balance at 1 January	68,794	55,747
Outstanding balance at 31 December	42,963	68,794
Allowance for impairment losses	(499)	(546)

Impairment losses on placements with banks and other financial institutions recognized at 31 December 2006 and 2005 are immaterial.

6.3.5.3 *Loans and advances to customers*

As at 31 December 2006 and 2005, corporate loans accounted for 76% and 77% respectively of the total loans and advances to customers. The remaining balances comprise personal loans primarily to individuals which are not individually significant. The Group's 3,000 largest outstanding corporate loans to single customers as at 31 December 2006 and 2005 (those with balances exceeding RMB100 million) accounted for 57.3% and 58.6% respectively of the total outstanding corporate loans, amounting to RMB1,060,326 million and RMB1,003,638 million. Given that these large loans accounted for the majority of the Group's total corporate loan balances, the management is of the opinion that disclosure of related party transactions of these large borrowers as identified by management set forth below demonstrates the potential effect of the Group's lending to other state controlled entities.

	Year ended 31 December	
	2006	2005
Interest rate range:	0.20%–18.24%	0.72%–16.99%
Impairment losses on individually assessed loans and advances for the year	5,169	4,741
	2006	2005
Outstanding balance at 1 January ⁽¹⁾	471,500	547,416
Outstanding balance at 31 December	576,653	638,460
Allowance for impairment losses on individually assessed loans and advances at 31 December	(11,988)	(14,308)

⁽¹⁾ For the years ended 31 December 2006 and 2005, the population of accounts was based on balances as of 31 December in the respective year.

6.3.5.4 *Trading assets and investment securities*

	Year ended 31 December	
	2006	2005
Purchases during the year	276,278	192,532
Redemptions/sales during the year	245,303	95,920
Interest rate range:	0.48%–8.25%	0.39%–9.20%
	2006	2005
Outstanding balance at 1 January	319,039	222,084
Outstanding balance at 31 December	349,173	319,039
Allowance for impairment losses at 31 December	(152)	(156)

6.3.5.5 Due to banks and other financial institutions

	Year ended 31 December	
	2006	2005
Interest rate range:	0.00%–4.82%	0.00%–3.75%
	2006	2005
Outstanding balance at 1 January	87,033	54,802
Outstanding balance at 31 December	124,466	87,033

6.3.5.6 Placements from banks and other financial institutions

	Year ended 31 December	
	2006	2005
Interest rate range	0.01%–7.60%	0.00%–7.08%
	2006	2005
Outstanding balance at 1 January	152,409	84,813
Outstanding balance at 31 December	104,486	152,409

6.3.5.7 Due to customers

As at 31 December 2006 and 2005, approximately 59% and 60%, respectively of the balances due to customers are represented by balances due to personal customers which are not individually significant. Of the remaining 41% and 40%, of the balances due to customers as at 31 December 2006 and 2005, respectively, 47% and 50%, are represented by the Group's 4,000 largest corporate deposits amounting to RMB793,519 million and RMB728,475 million, respectively. Given that these deposits accounted for a significant portion of the Group's total corporate deposit balances, the management is of the opinion that disclosure of related party transactions of these large deposits as identified by the Group's management as set forth below demonstrate the potential effect of the Group's deposits from other state controlled entities.

	Year ended 31 December	
	2006	2005
Interest rate range:	0.00%–8.40%	0.00%–6.40%
	2006	2005
Outstanding balance at 1 January ⁽¹⁾	343,169	299,827
Outstanding balance at 31 December	464,088	463,980

⁽¹⁾ For the years ended 31 December 2006 and 2005, the population of accounts was based on balances as of 31 December in the respective year.

6.3.6 Transactions with associates and joint ventures

The Group enters into banking transactions with associates and joint ventures in the normal course of business at commercial terms. These include loans and advances, deposit taking and such other normal banking businesses. The outstanding balances with associates and joint ventures and related allowance

for impairment losses as of the respective year end dates, and the volume of transactions for the years ended 31 December 2006 and 2005 are stated below. The related interest income and expense amounts are not considered significant.

6.3.6.1 *Loans and advances*

	2006	2005
Outstanding balance as of 1 January	7,240	1,246
Granted during the year	381	8,128
Repaid during the year	(6,616)	(989)
Write-off and other changes during the year	(191)	(1,145)
	<u>814</u>	<u>7,240</u>
Outstanding balance as of 31 December		
Allowance for impairment losses	(18)	(119)

6.3.6.2 *Deposits*

	2006	2005
Outstanding balance as of 1 January	856	1,227
Received during the year	6,498	3,879
Repaid and other changes during the year	(4,065)	(4,250)
	<u>3,289</u>	<u>856</u>
Outstanding balance as of 31 December		

6.3.6.3 *Trading assets and investment securities*

	2006	2005
Purchases during the year	—	1,307
Redemptions/sales during the year	188	1,123
Interest rate range:	2.70–2.92%	1.61–2.92%
	2006	2005
Outstanding balance at 1 January	188	—
Outstanding balance at 31 December	—	188

6.3.7 *Interest rate*

Interest rate disclosed in 6.3.2 to 6.3.6 varies across product groups and transactions depending on maturity, credit risk of the counterparty and currency. In particular, given local market conditions, the spread of certain significant or long dated transactions can vary across the market.

6.3.8 *Transactions with 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 and Executive officers.

The Group enters into banking transactions with key management personnel in the normal course of business. During 2006 and 2005, there were no material transactions and balances with key management personnel on an individual basis.

The key management compensation for the year ended 31 December 2006 and 2005 is detailed as follows:

	2006	2005
Short-term employment benefits	32	30
Post-employment benefits	<u>1</u>	<u>1</u>
Total	<u>33</u>	<u>31</u>

Included in the above key management compensation are RMB3.90 million and RMB3.34 million paid by Huijin in 2006 and 2005, respectively.

6.4 Major Contracts and the Performance thereof

During the report period and except as disclosed, the Bank did not take custody of or sub-contract the operation or lease any material business assets from third parties or allowed its material business assets being subject to such arrangements. No material cash assets of the Bank were entrusted to others for management.

The guarantee business is one of our off-balance items in the ordinary course of our business. We carry out guarantee business in a prudent manner and adopt credit risk management approach.

During the report period, the Bank or to the Bank's best knowledge shareholders holding 5% or more shares in the Bank have not made undertakings that might have significant adverse impact on the operational results and financial position of the Bank.

6.5 Combination of Enterprise Income tax and Income tax on Foreign Invested Enterprises and Foreign Enterprises

On 16 March 2007, the National People's Congress enacted the new PRC Enterprise Income Tax Law. The enterprise income tax rate the Bank applied to will decline from 33% to 25% taking effect from 2008. The Bank will benefit from the reduction of tax rate prospectively from 2008. Meanwhile, the Bank will adjust the deferred income taxes according to the new tax rate.

7 OTHER INFORMATION

7.1 Purchase, Sale or Redemption of the Bank's Shares

The Bank issued 8,514,415,652 ordinary shares to NCSSF on 13 March 2006.

The Bank issued 25,568,590,000 H shares in the initial public offering and was listed on the Hong Kong Stock Exchange on 1 June 2006. 3,835,288,000 H shares were further issued pursuant to the exercise of over allotment option on 9 June 2006.

The Bank issued 6,493,506,000 A shares on 29 June 2006, and the Bank was listed on the Shanghai Stock Exchange on 5 July 2006.

As at 31 December 2006, 50 million shares of the Bank were held as treasury shares.

7.2 Compliance with the Code on Corporate Governance Practices

The Bank has adopted incremental measures to enable it to observe the Code on Corporate Governance Practices (“the Code”) as set out in Appendix 14 of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the “Hong Kong Listing Rules”). The Bank has complied with the Code provisions and has substantially complied with the recommended best practices set out in the Code.

7.3 Compliance with the Model Code for Securities Transactions by Directors

The Bank has adopted the Model Code for Securities Transactions by Directors of Listed Issuers as set out in Appendix 10 of the Hong Kong Listing Rules to govern securities transactions by Directors and Supervisors. The Bank has made specific enquiry of all Directors and Supervisors, and the Directors and Supervisors have confirmed that they have complied with the required standards set out in the said Model Code throughout the year.

7.4 Final Dividend

The Board has recommended a final dividend of RMB0.04 per share, amounting to approximately RMB10.154 billion, subject to the approval of shareholders at the forthcoming Annual General Meeting to be held on Thursday, 14 June 2007. If approved, detail arrangement of the final dividend distribution (including the closure of H Share Register of Members; the record date to determine H Share and A Share shareholders’ entitlement to the final dividend) for each of A Share and H Share will be announced after the Annual General Meeting separately.

The 2006 final dividend of the Bank will be denominated and declared in RMB. Dividend for A Share shareholders will be paid in RMB and dividend for H Share shareholders will be paid in Hong Kong dollars. RMB will be converted into Hong Kong dollars based on the average exchange rate prevailing one week before 14 June 2007 (inclusive), being the date of holding the Bank’s Annual General Meeting, as announced by the People’s Bank of China for such conversion.

7.5 Annual General Meeting and Closure of Register of H Share Shareholders

The Annual General Meeting of the Bank will be held at 3:00 p.m. on Thursday, 14 June 2007 at Central Garden Hotel, No. 18 Gaoliangqiaoxiejie, Xizhimenwai Ave., Hai Dian District, Beijing, China. The H share Register of Members of the Bank will be closed, for the purpose of determining H share shareholders’ entitlement to attend the Annual General Meeting, from Wednesday, 16 May 2007 to Thursday, 14 June 2007 (both days inclusive), during which period no transfer of shares will be registered. In order to attend the Annual General Meeting, H share shareholders should ensure that all transfer documents, accompanied by the relevant share certificates, are lodged with the Bank’s H Share Registrar, Computershare Hong Kong Investor Services Limited, at Rooms 1712–1716, 17th Floor, Hopewell Centre, 183 Queen’s Road East, Hong Kong, not later than 4:30 p.m. on Tuesday, 15 May 2007.

There is no book closure period for A share Register of Members. A notice of Annual General Meeting setting out the record date for the meeting and related issues will be published in due course.

7.6 Publication of Results Announcement and Annual Report

This results announcement is published on the websites of The Stock Exchange of Hong Kong Limited at www.hkex.com.hk and the Bank at www.boc.cn. The 2006 Annual Report (non printed version) prepared under the International Financial Reporting Standards (“IFRS”) is also available on the website of the Bank at www.boc.cn. The Annual Report (printed version) prepared under IFRS will be available at the Stock Exchange of Hong Kong Limited and the Bank’s websites in late April 2007 and

will be delivered to H share shareholders in late April 2007. The Annual Report prepared in accordance with PRC GAAP and the announcement will also be available at the same time on the websites of Shanghai Stock Exchange at www.sse.com.cn and the Bank at www.boc.cn.

7.7 Review of Annual Results

The Audit Committee has reviewed the 2006 Annual Report of the Bank. The Bank's external auditors, PricewaterhouseCoopers Zhong Tian Certified Public Accountants Limited has audited 2006 financial statements of the Bank prepared in accordance with PRC GAAP and PricewaterhouseCoopers Hong Kong has audited the financial statements of the Bank prepared in accordance with IFRS, and has issued unqualified audit reports. The Audit Committee has discussed matters such as accounting standards and practices adopted in the financial statements, internal control and the financial statements.

8 FINANCIAL STATEMENTS

8.1 The consolidated and company Balance Sheet, Consolidated Income Statement, Consolidated Statement of Changes in Equity and Consolidated Cash Flow Statement

8.1.1 Consolidated Balance Sheet

(Amount in millions of Renminbi, unless otherwise stated)

	As at 31 December	
	2006	2005
ASSETS		
Cash and due from banks	39,812	41,082
Balances with central banks	379,631	316,941
Placements with banks and other financial institutions	399,138	332,099
Government certificates of indebtedness for bank notes issued	36,626	35,586
Precious metals	42,083	26,974
Trading assets and other financial instruments at fair value through profit or loss	115,828	111,782
Derivative financial instruments	24,837	16,808
Loans and advances to customers, net	2,337,726	2,152,112
Investment securities		
— available-for-sale	815,178	602,221
— held-to-maturity	461,140	607,459
— loans and receivables	500,336	361,851
Investment in associates and joint ventures	5,931	5,061
Property and equipment	86,200	62,417
Investment property	8,221	8,511
Deferred income tax assets	21,396	20,504
Other assets	53,570	38,640
	<u>5,327,653</u>	<u>4,740,048</u>
Total assets	<u>5,327,653</u>	<u>4,740,048</u>

As at 31 December
2006 **2005**

LIABILITIES

Due to banks and other financial institutions	178,777	134,217
Due to central banks	42,374	30,055
Bank notes in circulation	36,823	35,731
Certificates of deposit and placements from banks and other financial institutions	146,908	212,626
Derivative financial instruments and liabilities at fair value through profit or loss	113,048	91,174
Due to customers	4,091,118	3,699,464
Bonds issued	60,173	60,179
Other borrowings	63,398	52,164
Current tax liabilities	18,149	23,459
Retirement benefit obligations	7,444	7,052
Deferred income tax liabilities	3,029	2,136
Other liabilities	<u>153,456</u>	<u>136,272</u>
Total liabilities	<u>4,914,697</u>	<u>4,484,529</u>

EQUITY

Capital and reserves attributable to equity holders of the Bank

Share capital	253,839	209,427
Capital reserve	66,617	(5,954)
Statutory reserves	10,380	5,987
General and regulatory reserves	13,934	5,109
Undistributed profits	38,425	10,188
Reserve for fair value changes of available-for-sale securities	2,009	1,899
Currency translation differences	(2,071)	(237)
Treasury shares	<u>(216)</u>	<u>—</u>
	382,917	226,419
Minority interest	<u>30,039</u>	<u>29,100</u>

Total equity	<u>412,956</u>	<u>255,519</u>
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Total equity and liabilities	<u><u>5,327,653</u></u>	<u><u>4,740,048</u></u>
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Balance Sheet

As at 31 December 2006

(Amount in millions of Renminbi, unless otherwise stated)

	As at 31 December	
	2006	2005
ASSETS		
Cash and due from banks	37,842	38,275
Balances with central banks	354,881	284,373
Placements with banks and other financial institutions	303,002	243,654
Government certificates of indebtedness for bank notes issued	1,713	1,641
Precious metals	40,542	25,238
Trading assets and other financial instruments at fair value through profit or loss	76,581	82,082
Derivative financial instruments	16,363	11,329
Loans and advances to customers, net	1,971,865	1,788,742
Investment securities		
— available-for-sale	706,739	542,142
— held-to-maturity	287,398	415,143
— loans and receivables	458,606	343,910
Investment in subsidiaries	45,451	45,080
Investment in associates and joint ventures	21	45
Property and equipment	49,473	48,061
Investment property	620	461
Deferred income tax assets	21,843	20,389
Other assets	30,272	25,837
Total assets	4,403,212	3,916,402
LIABILITIES		
Due to banks and other financial institutions	164,376	124,948
Due to central banks	42,349	30,030
Bank notes in circulation	1,909	1,786
Certificates of deposits and placements from banks and other financial institutions	146,596	215,923
Derivative financial instruments and liabilities at fair value through profit or loss	91,084	76,323
Due to customers	3,358,565	3,009,187
Bonds issued	60,173	60,179
Other borrowings	46,006	52,164
Current tax liabilities	16,757	22,440
Retirement benefit obligations	7,444	7,052
Deferred income tax liabilities	32	23
Other liabilities	112,527	112,534
Total liabilities	4,047,818	3,712,589

As at 31 December
2006 **2005**

EQUITY

Capital and reserves attributable to equity holders of the Bank

Share capital	253,839	209,427
Capital reserve	66,166	(6,054)
Statutory reserves	9,714	5,465
General and regulatory reserves	11,393	2,618
Undistributed profits/(accumulated losses)	14,385	(8,709)
Reserve for fair value changes of available-for-sale securities	(1,038)	280
Currency translation differences	935	786

Total equity	355,394	203,813
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Total equity and liabilities	4,403,212	3,916,402
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8.1.2 Consolidated Income Statement

(Amount in millions of Renminbi, unless otherwise stated)

	2006	2005
Interest income	215,334	167,948
Interest expense	<u>(93,963)</u>	<u>(66,940)</u>
Net interest income	<u>121,371</u>	<u>101,008</u>
Fee and commission income	17,139	12,698
Fee and commission expense	<u>(2,816)</u>	<u>(3,451)</u>
Net fee and commission income	<u>14,323</u>	<u>9,247</u>
Net trading (losses)/gains	(1,544)	4,283
Net gains/(losses) on investment securities	1,132	(582)
Other operating income	13,096	11,150
Operating expenses and others	(68,731)	(59,984)
Impairment losses on loans and advances	<u>(12,342)</u>	<u>(11,486)</u>
Operating profit	67,305	53,636
Share of results of associates and joint ventures	<u>632</u>	<u>175</u>
Profit before income tax	67,937	53,811
Income tax expense	<u>(19,673)</u>	<u>(22,253)</u>
Profit for the year	<u>48,264</u>	<u>31,558</u>
Attributable to:		
Equity holders of the Bank	42,830	25,921
Minority interest	<u>5,434</u>	<u>5,637</u>
	<u>48,264</u>	<u>31,558</u>
Earnings per share for profit attributable to the equity holders of the Bank during the year (Expressed in Renminbi per ordinary share) — Basic and diluted	<u>0.18</u>	<u>0.14</u>
Dividends		
Dividends declared and paid during the year	—	12,737
Dividends proposed after the balance sheet date	<u>10,154</u>	<u>1,375</u>
	<u>10,154</u>	<u>14,112</u>

8.1.3 Consolidated Statement of Changes in Equity
for the year ended 31 December 2006
(Amount in millions of Renminbi, unless otherwise stated)

	Attributable to equity holders of the Bank									
	Share capital	Capital reserve	Statutory reserves	General and regulatory reserves	Undistributed profits	Reserve for fair value changes of available-for-sale securities	Currency translation differences	Treasury shares	Minority interest	Total
At 1 January 2006	209,427	(5,954)	5,987	5,109	10,188	1,899	(237)	—	29,100	255,519
Issue of ordinary shares	44,412	72,567	—	—	—	—	—	—	—	116,979
Net profit	—	—	—	—	42,830	—	—	—	5,434	48,264
Appropriation to statutory reserves	—	—	4,393	—	(4,393)	—	—	—	—	—
Appropriation to general reserve and regulatory reserve	—	—	—	8,828	(8,828)	—	—	—	—	—
Net change in fair value of available-for-sale securities, net of tax	—	—	—	—	—	110	—	—	33	143
Exercise of subsidiary share options	—	—	—	—	—	—	—	—	33	33
Purchase of treasury shares	—	—	—	—	—	—	—	(216)	—	(216)
Dividends	—	—	—	—	(1,375)	—	—	—	(3,391)	(4,766)
Currency translation differences	—	—	—	—	—	—	(1,834)	—	(1,087)	(2,921)
Others	—	4	—	(3)	3	—	—	—	(83)	(79)
At 31 December 2006	<u>253,839</u>	<u>66,617</u>	<u>10,380</u>	<u>13,934</u>	<u>38,425</u>	<u>2,009</u>	<u>(2,071)</u>	<u>(216)</u>	<u>30,039</u>	<u>412,956</u>

8.1.4 Consolidated Cash Flow Statement

(Amount in millions of Renminbi, unless otherwise stated)

	2006	2005
Cash flows from operating activities		
Profit before income tax	67,937	53,811
Adjustments:		
Impairment losses on loans and advances	12,342	11,486
Reversal of impairment losses on other assets	(125)	(457)
Depreciation of property and equipment	5,209	5,186
Amortization of intangible assets and other assets	817	1,128
Net gains on disposal of property and equipment and other assets	(569)	(665)
Net gains on disposal of investments in subsidiaries, associates and joint ventures	(789)	(320)
Share of results of associates and joint ventures	(632)	(175)
Interest expense arising from bonds issued	2,840	2,611
Net changes in operating assets and liabilities:		
Net increase in balances with central banks	(69,063)	(41,130)
Net decrease in due from banks and placements with banks and other financial institutions	5,266	56,168
Net increase in loans and advances to customers	(197,956)	(90,679)
Net increase in investment securities	(151,786)	(375,150)
Net (increase)/decrease in other assets	(13,878)	1,139
Net increase in due to banks and other financial institutions	44,560	22,429
Net increase/(decrease) in due to central banks	12,319	(36,683)
Net (decrease)/increase in certificates of deposits and placements from banks and other financial institutions	(65,718)	71,539
Net increase in due to customers	391,654	361,016
Net increase/(decrease) in other liabilities	14,514	(10,274)
Net cash from operating activities	56,942	30,980
Income tax paid	(25,536)	(17,249)
Net cash inflow from operating activities	31,406	13,731
Cash flows from investing activities		
Acquisition of a subsidiary, net of cash acquired	(5,373)	—
Payment for increase of investments in subsidiaries, associates and joint ventures	(185)	(3,187)
Proceeds from disposal of investments in subsidiaries, associates and joint ventures	1,120	2,264
Proceeds from disposal of property and equipment, intangible assets and other assets	1,732	4,291
Dividends received	320	310
Purchase of property and equipment, intangible assets and other assets	(7,425)	(5,951)
Net cash outflow from investing activities	(9,811)	(2,273)
Net cash inflow before financing activities	21,595	11,458

	2006	2005
Cash flows from financing activities		
Proceeds from issuance of ordinary shares	117,423	27,001
Cash received from issuance of subordinated bonds	—	33,930
Proceeds from minority equity holders of a subsidiary upon exercise of subsidiary share options	33	17
Proceeds from minority equity holders of subsidiaries	55	—
Payment of interest on bonds issued	(2,774)	(1,485)
Dividend paid to equity holders of the Bank	(1,375)	(26,937)
Dividend paid to minority interest	(3,391)	(2,954)
Purchases of treasury shares	(216)	—
Payment of share issuance costs	(413)	—
	<u>109,342</u>	<u>29,572</u>
Net cash inflow from financing activities		
	<u>(8,105)</u>	<u>(10,060)</u>
Effect of exchange rate changes on cash and cash equivalents		
Net increase in cash and cash equivalents	122,832	30,970
Cash and cash equivalents as of 1 January	<u>397,112</u>	<u>366,142</u>
Cash and cash equivalents as of 31 December	<u><u>519,944</u></u>	<u><u>397,112</u></u>

8.2 Notes to the Financial Statements

8.2.1 Net interest income

(Amount in millions of Renminbi, unless otherwise stated)

	Year ended 31 December	
	2006	2005
Interest income		
Loans and advances to customers	128,934	110,313
Investment securities	67,195	44,938
Due from banks and other financial institutions	<u>19,205</u>	<u>12,697</u>
Sub-total	<u>215,334</u>	<u>167,948</u>
Interest expense		
Due to customers	(79,939)	(55,914)
Due to banks and other financial institutions	(9,393)	(6,512)
Other borrowed funds	<u>(4,631)</u>	<u>(4,514)</u>
Sub-total	<u>(93,963)</u>	<u>(66,940)</u>
Net interest income	<u><u>121,371</u></u>	<u><u>101,008</u></u>

Included in interest income is RMB628 million and RMB529 million related to the unwinding of the discount on the allowance for identified impaired loans for the years ended 31 December 2006 and 2005 respectively.

8.2.2 *Other operating income and expenses*

(Amount in millions of Renminbi, unless otherwise stated)

Other operating income

Year ended 31 December
2006 2005

Insurance premiums		
— Long term insurance contracts	6,349	3,807
— General insurance contracts	1,359	1,430
Gains on disposal of other subsidiaries and associates	789	320
Gains on disposal of property and equipment and other assets	717	870
Changes in fair value of investment properties	595	1,697
Dividend income	186	194
Others	3,101	2,832
	<u>13,096</u>	<u>11,150</u>
Total	<u>13,096</u>	<u>11,150</u>

Operating expenses and others

Year ended 31 December
2006 2005

Staff costs	30,896	27,106
General operating and administrative expenses ⁽¹⁾	14,603	13,251
Depreciation and amortization	6,026	6,314
Business and other taxes	6,462	5,680
Insurance benefits and claims		
— Long term insurance contracts	6,820	3,497
— General insurance contracts	664	656
Operating lease rentals	1,775	1,550
Impairment (write back)/losses on other assets	(171)	433
Losses on disposal of property and equipment	148	205
Provision for litigation losses	897	712
Other expenses	611	580
	<u>68,731</u>	<u>59,984</u>
Total	<u>68,731</u>	<u>59,984</u>

⁽¹⁾ Included in the general operating and administrative expenses are auditors' remuneration paid to PricewaterhouseCoopers of RMB183 million (2005: RMB154 million) for the year ended 31 December 2006.

8.2.3 Loans and advances to customers, net
(Amount in millions of Renminbi, unless otherwise stated)

Group

	As at 31 December	
	2006	2005
Corporate loans and advances	1,849,275	1,712,262
Personal loans and advances	<u>582,744</u>	<u>523,003</u>
	2,432,019	2,235,265
Allowance for impairment losses	<u>(94,293)</u>	<u>(83,153)</u>
Loans and advances to customers, net	<u><u>2,337,726</u></u>	<u><u>2,152,112</u></u>

Bank

	As at 31 December	
	2006	2005
Corporate loans and advances	1,616,052	1,483,933
Personal loans and advances	<u>448,775</u>	<u>384,390</u>
	2,064,827	1,868,323
Allowance for impairment losses	<u>(92,962)</u>	<u>(79,581)</u>
Loans and advances to customers, net	<u><u>1,971,865</u></u>	<u><u>1,788,742</u></u>

As at 31 December 2006, there were no bills pledged as collateral under repurchase agreements by the Group and Bank (2005: Group and Bank: RMB11,968 million).

8.2.4 Income tax expense
(Amount in millions of Renminbi, unless otherwise stated)

	Year ended 31 December	
	2006	2005
Current income tax		
Chinese Mainland income tax	16,477	18,536
Hong Kong profits tax	2,717	2,453
Overseas taxation	<u>570</u>	<u>302</u>
	19,764	21,291
Deferred income tax	<u>(91)</u>	<u>962</u>
	<u><u>19,673</u></u>	<u><u>22,253</u></u>

The provision for Chinese Mainland income tax is calculated based on the statutory rate of 33% of the assessable income of the Bank and each of the subsidiaries established in Chinese Mainland as determined in accordance with the relevant PRC income tax rules and regulations for the years ended 31 December 2006 and 2005. In addition, the Bank's Overseas Operations are subject to supplementary PRC tax at tax rate determined by the relevant PRC Authority.

The Group's operations in Hong Kong are subject to Hong Kong profits tax at the rate of 17.5% on the estimated assessable income for the years ended 31 December 2006 and 2005.

Taxation on overseas profits has been calculated on the estimated assessable profit at the rates of taxation prevailing in the countries or regions in which the Group operates.

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the basic domestic tax rate of the Bank as follows:

	Year ended 31 December	
	2006	2005
Profit before income tax	<u>67,937</u>	<u>53,811</u>
Tax calculated at 33%	22,419	17,758
Effect of different tax rates in Overseas Operations	(3,880)	(3,713)
Supplementary tax on overseas income paid in the PRC	2,510	1,388
Prior year tax expense adjustment ⁽¹⁾	(300)	2,376
Income not subject to tax ⁽²⁾	(2,402)	(1,862)
Expenses not deductible for tax purposes ⁽³⁾	781	5,264
Others ⁽⁴⁾	<u>545</u>	<u>1,042</u>
Income tax expense	<u><u>19,673</u></u>	<u><u>22,253</u></u>

- (1) The prior year tax expense adjustments for the year 2005 included RMB1,921 million related to the reversal in 2004 of certain provisions recorded in prior years. The relevant domestic tax authorities determined that these reversals constituted taxable income as they related to the implementation of the Joint Stock Reform Plan.
- (2) It mainly comprised the interest income from the PRC treasury bills.
- (3) In 2005, non tax-deductible expenses primarily included staff salary costs in excess of the deduction limit permitted under relevant PRC tax regulations. Following the completion of the listings of the Bank's ordinary shares in June 2006 on the Hong Kong Stock Exchange and Shanghai Stock Exchange, the Bank has successfully obtained approval from the Ministry of Finance ("MOF") and the State Administration of Taxation ("SAT") for deduction of its domestic staff salary costs amounting to RMB15.67 billion when determining the Bank's taxable income for the 2006 financial year.
- (4) Others primarily included non-performing loans sold in 2005 and 2006. The deferred income tax assets arising from the associated loan loss provisions were subsequently de-recognized.

8.2.5 *Earnings per share (Basic & diluted)*

(Amount in millions of Renminbi, unless otherwise stated)

Basic and diluted earnings per share for the years ended 31 December 2006 and 2005 have been computed by dividing the profit for each year by the weighted average number of ordinary shares in issue during the period.

The Group had no dilutive potential ordinary shares as at 31 December 2006 and 2005.

	Year ended 31 December	
	2006	2005
Profit attributable to equity holders of the Bank	42,830	25,921
Weighted average number of ordinary shares in issue (in millions)	236,055	186,425
Basic and diluted earnings per share (in RMB)	0.18	0.14

8.2.6 *Derivative financial instruments*

(Amount in millions of Renminbi, unless otherwise stated)

The Group enters into the following foreign currency exchange rate or interest rate related derivative financial instruments for trading, asset and liability management and on behalf of customers:

Currency forwards represent commitments to purchase and sell foreign currency on a future date. Foreign currency and interest rate futures are contractual obligations to receive or pay a net amount based on changes in currency rates or interest rates or buy or sell a foreign currency or interest rate financial instrument on a future date at an agreed price in the financial market under the administration of the stock exchanges. Forward rate agreements are individually negotiated interest rate futures that call for a cash settlement at a future date for the difference between a contracted rate of interest and the current market rate, based on a notional principal amount.

Currency and interest rate swaps are commitments to exchange one set of cash flows for another. Swaps result in an exchange of currencies or interest rates (for example, fixed rate for floating rate) or a combination of all these (i.e. cross-currency interest rate swaps). Except for certain currency swap contracts, no exchange of principal takes place.

Foreign currency and interest rate options are contractual agreements under which the seller (writer) grants the purchaser (holder) the right, but not the obligation, either to buy (a call option) or sell (a put option) at or by a set date or during a set period, a specific amount of a foreign currency or a financial instrument at a predetermined price. In consideration for the assumption of foreign exchange or interest rate risk, the seller receives a premium from the purchaser. Options may be either negotiated over-the-counter (“OTC”) between the Group and its counterparty or exchange-traded.

The contractual/notional amounts and fair values of derivative instruments held by the Group and the Bank are set out in the following table. The contractual/notional amounts of financial instruments provide a basis for comparison with fair value instruments recognized on the balance sheet but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, do not indicate the Group’s exposure to credit or market risks. The derivative instruments become favorable (assets) or unfavorable (liabilities) as a result of fluctuations in market interest rates or foreign exchange rates or equity/commodity prices relative to their terms. The aggregate fair values of derivative financial assets and liabilities can fluctuate significantly from time to time.

Group

	As at 31 December 2006			As at 31 December 2005		
	Contractual/ notional amount	Fair value		Contractual/ notional amount	Fair value	
		Assets	Liabilities		Assets	Liabilities
Exchange rate derivatives						
Currency forwards and swaps ⁽¹⁾	993,008	11,860	(4,974)	563,397	6,991	(4,813)
Currency options purchased ⁽²⁾	187,446	5,735	—	176,643	3,781	—
Currency options written	38,272	—	(419)	19,369	—	(374)
		<u>17,595</u>	<u>(5,393)</u>		<u>10,772</u>	<u>(5,187)</u>
Interest rate derivatives						
Interest rate swaps	369,093	4,236	(4,832)	361,332	3,132	(5,246)
Cross-currency interest rate swaps	34,793	1,532	(2,932)	39,427	1,735	(4,131)
Interest rate options purchased	41,151	592	—	11,584	148	—
Interest rate options written	48,939	—	(161)	98,994	—	(215)
Interest rate futures	14,675	40	(9)	14,939	28	(34)
		<u>6,400</u>	<u>(7,934)</u>		<u>5,043</u>	<u>(9,626)</u>
Equity derivatives	10,572	453	(390)	15,442	14	(7)
Precious metals derivatives	10,520	389	(606)	21,008	979	(932)
Total derivative financial instruments assets/ (liabilities)		<u>24,837</u>	<u>(14,323)</u>		<u>16,808</u>	<u>(15,752)</u>

	As at 31 December 2006			As at 31 December 2005		
	Contractual/ notional amount	Fair value		Contractual/ notional amount	Fair value	
		Assets	Liabilities		Assets	Liabilities
Exchange rate derivatives						
Currency forwards and swaps ⁽¹⁾	694,961	4,651	(2,097)	286,268	2,515	(2,391)
Currency options purchased ⁽²⁾	185,956	5,724	—	173,993	3,759	—
Currency options written	35,153	—	(403)	17,866	—	(346)
		<u>10,375</u>	<u>(2,500)</u>		<u>6,274</u>	<u>(2,737)</u>
Interest rate derivatives						
Interest rate swaps	331,111	3,712	(3,930)	328,245	3,050	(4,559)
Cross-currency interest rate swaps	32,313	1,520	(2,895)	37,786	1,785	(4,062)
Interest rate options purchased	40,293	586	—	11,377	148	—
Interest rate options written	48,125	—	(151)	96,950	—	(180)
Interest rate futures	5,180	1	(1)	9,701	1	(4)
		<u>5,819</u>	<u>(6,977)</u>		<u>4,984</u>	<u>(8,805)</u>
Precious metals derivatives	3,156	169	(166)	2,482	71	(64)
Total derivative financial instruments assets/ (liabilities)		<u>16,363</u>	<u>(9,643)</u>		<u>11,329</u>	<u>(11,606)</u>

- (1) Since 2005, the Bank has entered into foreign exchange swap transactions with the PBOC to manage its assets and liabilities. Under these agreements, the PBOC sold USD to the Bank in spot transactions for RMB and agreed to buy back the USD after one year or three years at agreed exchange and swap rates, which reflect the interest rate differentials between USD and RMB at the respective inception date of the transactions.
- (2) On 5 January 2005, the Bank entered into a foreign currency option agreement with Huijin whereby the Bank acquired options to sell to Huijin USD, totaling USD18 billion, of no more than USD1,500 million at the beginning of each calendar month during the year ending 31 December 2007 at a fixed exchange rate of USD1 to RMB8.2769. The related option premium of RMB4,469 million is payable by the Bank to Huijin in 12 equal monthly installments at the beginning of each calendar month during the year ending 31 December 2007. The fair value of the Huijing option, which has taken into consideration this option premium payable, as at 31 December 2006 amounted to RMB5,180 million (2005: RMB3,231 million).

The tables above provide a breakdown of the contractual or notional amounts and the fair values of the Group's and the Bank's derivative financial instruments outstanding at the year end. These instruments, comprising foreign exchange and interest rate derivatives are intended to enable the Group and the Bank and its customers to transfer, modify or reduce their foreign exchange and interest rate risks.

The Group and the Bank primarily undertake transactions in foreign exchange and interest rate contracts with other financial institutions. Management has established position limits of these contracts by counterparties. Actual credit exposures and limits are regularly monitored and controlled by management.

Credit risk weighted amounts

The credit risk weighted amounts are the amounts calculated with reference to the guidelines issued by the CBRC and are dependent on, among other factors, the credit worthiness of the counterparty and the maturity characteristics of each type of contract.

Group

As at 31 December
2006 **2005**

Derivatives

Exchange rate contracts	4,468	3,744
Interest rate contracts	3,379	3,543
Other derivative contracts	35	45
	<u>7,882</u>	<u>7,332</u>

Bank

As at 31 December
2006 **2005**

Derivatives

Exchange rate contracts	3,880	3,208
Interest rate contracts	3,228	3,469
	<u>7,108</u>	<u>6,677</u>

Replacement costs

Replacement costs are the costs of replacing all contracts which have a positive value when marked to market (should the counterparty default on its obligations) and is obtained by marking contracts to market. Replacement cost is a close approximation of the credit risk for these contracts as of the balance sheet date.

Group

As at 31 December
2006 **2005**

Derivatives

Exchange rate contracts	17,595	10,772
Interest rate contracts	6,400	5,043
Other derivative contracts	842	993
	<u>24,837</u>	<u>16,808</u>

Bank

As at 31 December
2006 **2005**

Derivatives

Exchange rate contracts	10,375	6,274
Interest rate contracts	5,819	4,984
Other derivative contracts	169	71
	<u>16,363</u>	<u>11,329</u>

The credit risk weighted amounts and replacement costs stated above have not taken the effects of netting arrangements into account.

8.3 Contingent liabilities and commitments

(Amount in millions of Renminbi, unless otherwise stated)

8.3.1 Legal proceedings

As at 31 December 2006, the Group was involved in certain lawsuits as defendants arising from its normal business operations. As at 31 December 2006 and 2005, provisions of RMB1,985 million and RMB1,516 million were made based on court judgments or the advice of counsel. After consulting legal professionals, management of the Group believes that the ultimate outcome of these lawsuits will not have a material impact on the financial position or operations of the Group.

8.3.2 Assets pledged

Assets pledged as collateral for repurchase and short positions with other banks and financial institutions are set forth in the tables below. As at 31 December 2006, the Group and the Bank had such Repo agreements and short positions amounting to RMB54,806 million (2005: RMB62,108 million) and RMB51,245 million (2005: RMB59,340 million) respectively. All such agreements mature within twelve months from inception.

Group

	As at 31 December	
	2006	2005
Precious metals	—	2,617
Bills	—	11,968
Debt securities	<u>55,212</u>	<u>49,658</u>
Total	<u>55,212</u>	<u>64,243</u>

Bank

	As at 31 December	
	2006	2005
Precious metals	—	2,617
Bills	—	11,968
Debt securities	<u>51,632</u>	<u>45,106</u>
Total	<u>51,632</u>	<u>59,691</u>

The Group has accepted cash collateral and security collateral that it is permitted to sell or re-pledge in connection with its Reverse repo agreements and securities lending transactions. The fair value of the collateral accepted by the Group and the Bank was RMB77,657 million (2005: RMB69,789 million) as of 31 December 2006. Both the Group and the Bank had an obligation to return collateral that it has sold with a fair value of RMB3,728 million (2005: RMB1,130 million) as of 31 December 2006.

8.3.3 Capital commitments

Group

As at 31 December

2006 2005

Contracted but not provided for	38,741	1,893
Authorized but not contracted for	<u>1,536</u>	<u>2,687</u>
	<u><u>40,277</u></u>	<u><u>4,580</u></u>

Bank

As at 31 December

2006 2005

Contracted but not provided for	3,210	1,731
Authorized but not contracted for	<u>1,531</u>	<u>2,671</u>
	<u><u>4,741</u></u>	<u><u>4,402</u></u>

8.3.4 Operating leases

According to the irrevocable operating lease contracts, the minimum rental payments that should be paid by the Group and the Bank in the future are summarized as follows:

Group

As at 31 December

2006 2005

Within one year	1,604	1,371
One to two years	1,281	1,085
Two to three years	969	807
Above three years	<u>2,832</u>	<u>2,546</u>
	<u><u>6,686</u></u>	<u><u>5,809</u></u>

Bank

As at 31 December

2006 2005

Within one year	1,286	1,157
One to two years	1,069	949
Two to three years	863	756
Above three years	<u>2,808</u>	<u>2,532</u>
	<u><u>6,026</u></u>	<u><u>5,394</u></u>

8.3.5 Certificate Treasury Bond redemption commitments

The Bank is entrusted by the MOF to underwrite certain Certificate Treasury Bonds. The investors of Certificate Treasury Bonds have a right to redeem the bonds at par any time prior to maturity and the Bank is committed to redeem those bonds. The redemption price is the principal value of the Certificate Treasury Bonds plus unpaid interest in accordance with the early redemption arrangement.

As at 31 December 2006, the principal value of the bonds amounts to RMB84,500 million (2005: RMB80,965 million). The original maturities of these bonds vary from 1 to 5 years. As the deposits base rate established by PBOC is currently lower than the yields on all issue of Certificate Treasury Bonds, management expects the amount of redemption before the maturity dates of those bonds through the Bank will not be material.

The MOF will not provide funding for the early redemption of these Certificate Treasury Bonds on a back-to-back basis but will pay interest and repay the principal at maturity.

8.3.6 Credit commitments

Group

	As at 31 December	
	2006	2005
Credit commitments		
with an original maturity of under one year	212,179	182,965
with an original maturity of one year or over	258,392	201,745
Acceptances	217,093	195,234
Letters of guarantee issued	290,205	212,987
Letters of credit issued	109,083	101,195
Others	870	1,636
	<u>1,087,822</u>	<u>895,762</u>

Bank

	As at 31 December	
	2006	2005
Credit commitments		
with an original maturity of under one year	98,392	72,359
with an original maturity of one year or over	211,520	169,322
Acceptances	212,163	191,034
Letters of guarantee issued	286,050	202,994
Letters of credit issued	93,613	86,824
Others	490	1,431
	<u>902,228</u>	<u>723,964</u>

8.3.7 Credit risk weighted amounts of off balance sheet exposures

Group

As at 31 December
2006 2005

Contingent liabilities and commitments	<u>413,678</u>	<u>329,697</u>
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The credit risk weighted amounts are the amounts calculated in accordance with the guidelines issued by the CBRC and are dependent on, among other factors, the creditworthiness of the counterparty and the maturity characteristics. The risk weights used range from 0% to 100% for contingent liabilities and commitments.

The credit risk weighted amounts stated above have not taken into account the effects of netting arrangements.

9. The Group adopted IAS 19 Amendment, IAS 21 Amendment, IAS 39 Amendment and IFRS 4 Amendment that were effective as at 1 January 2006. The application of above amendments did not result in substantial changes to the Group's accounting policies and did not materially impact the consolidated financial statements for the years ended 31 December 2005 and 2006.

The Group has chosen not to early adopt the following standards, amendments and interpretations to existing standards that were issued but not yet effective for accounting periods beginning on 1 January 2006: IFRS 7, IFRS 8, IFRIC 8, IFRIC 9, IFRIC 10, IFRIC 11. The application of these new standards, amendments and interpretations will not expected to have material impacts on the Group's consolidated financial position in the period of initial application.

Except for the adoption of the above amendments and interpretations which are effective on financial periods on or after 1 January 2006, the accounting policies and basis of presentation of the financial statements of the Group are consistent with those adopted in the 2005 annual financial statements.

By Order of the Board
Jason C.W. Yeung
Company Secretary

Beijing, PRC, 22 March 2007

As at the date of this announcement, the Directors of the Bank are: XIAO Gang, LI Lihui, ZHANG Jinghua, YU Erniu*, ZHU Yan*, ZHANG Xinze*, HONG Zhihua*, HUANG Haibo*, Sir Frederick Anderson GOODWIN*, SEAH Lim Huat Peter*, HUA Qingshan, LI Zaohang, Anthony Francis NEOH#, William Peter COOKE#, Patrick de SAINT-AIGNAN# and Alberto TOGN#.*

* Non-executive directors

Independent non-executive directors