CHIEF EXECUTIVE'S REPORT

Last year we forged ahead with implementing the Group's 2006-2011 Strategic Plan approved by the Board a year ago. The results were gratifying and I am quite sure that 2006 will go down in the Group's history as a year of new records and significant achievements in our operation.

Our outstanding results were shaped by two main factors. First, the overall operating environment was favourable on account of the continuing growth of the Hong Kong economy, the pace of which was even more pronounced in the latter half of the year. Business sentiments remained basically upbeat among nearly all major sectors. In terms of overall performance, the financial sector stood out from the rest due to an exceptionally robust stock market and rising demand for credit and related services. Of equal, if not greater, importance, by capitalising on the strong foundations and impetus built up in recent years through systematic corporate reforms, last year we were in a better position than ever to move ahead full steam to grow our business on all fronts. As a result, considerable progress was made in executing our strategic initiatives as approved by the Board, particularly those aimed at generating higher organic growth and enhancing service capabilities.

I am proud of our success in bringing the Group's profit attributable to shareholders, dividend payout, operating income and pre-provision profit to new peaks since the Group's restructuring and merger in 2001 and public listing in Hong Kong in 2002. The growth rates of our pre-provision profit and net interest margin were amongst the highest in the market. Our improvement in both asset quality and cost-to-income ratio was also remarkable.

Performance Highlights

Our broad-based business growth and good financial performance amply reflected our firm commitment to the goals set down in our Strategic Plan and the positive results of our key strategic initiatives.

In 2006, the Group's profit attributable to shareholders reached HK$14,007 million, up 3.0% from a year ago. This represented the fourth consecutive year of growth since our IPO in 2002 and also the highest level for the Group so far. Earnings per share were HK$1.3248, also up 3.0%. Following a very strong growth of 17.5% last year, the Group's operating profit before loan impairment allowances surged by an even higher 18.9% to HK$14,751 million. The Group's asset quality improved further. Our classified loan ratio and impaired loan ratio dropped to 0.57% and 0.26% respectively, outperforming most of our peers. Our cost-to-income ratio of 30.78% was also better than the market average.

The Group's return on average total assets was 1.56%, versus 1.67% in 2005. Return on total shareholders funds stood at 17.02%, versus

18.27% in 2005. The decreases were due mainly to lower loan impairment write-back and revaluation gain on investment properties, if not for which we would have recorded increases instead.

Our capital adequacy ratio remained at the healthy level of 13.99% while liquidity ratio was 50.46%.

We adhered to the principle of prudent cost management, having regard to the need to drive income and profit growth as well as to invest in the future. Operating expenses last year amounted to HK$6,558 million, up 13.6%, due mainly to higher staff costs. Regardless of that, the Group's cost efficiency improved because the growth of operating income outpaced that of expenses by a wide margin. Cost-to-income ratio improved by 0.97 percentage point to 30.78%.

Significant Achievements

Last year we registered considerable growth by focusing on business segments with higher profit margin. Net operating income before loan impairment allowances grew strongly by 17.2% year-on-year to HK$21,309 million, of which net interest income was up 20.7% to HK$15,835 million. This substantial rise in net interest income owed primarily to the 9.8% increase in average interest-earning assets to HK$835,493 million and also to the widening of the net interest margin to 1.90%, versus 1.72% a year ago.

The Group's vigor in driving broad-based organic growth was demonstrated in the performance of its key business segments, including corporate banking, retail banking, treasury and China business.

Our large corporate lending, SME lending and trade financing increased by 6.1%, 10.5% and 4.9% respectively. Our wealth management client base expanded substantially by 45.9% while the amount of assets under management grew by 42.9%. Fees and commissions income soared by 24.4%, which was the direct result of both Hong Kong's stock market boom that boosted securities brokerage income and the rise in asset management income. The fee income from stock brokerage shot up by 93.7% to HK$1,383 million while that from asset management was up 56.2% to HK$317 million. We also recorded a hefty increase of over 60% in total investment and insurance fee income due mainly to higher investment and insurance fee income as well as BOC Life's insurance income. Our treasury registered a strong growth of 45.8% in operating income and a corresponding rise in operating profit. In the Mainland, our lending business continued to expand, with a healthy growth of 22.7% in total advances to customers.

In addition to driving business growth, we keep our eyes open to other expansion opportunities, with a view to enhancing our service capabilities. In mid-2006, we completed the acquisition from our parent BOC of a 51% controlling stake in BOC Life. The synergy arising from this acquisition was already evident in the closer cooperation between the Group and BOC Life. In 2006, operating profit of BOC Life was HK$174 million, up 33.8% from the year before.

Last year, we were also proactively preparing ourselves to meet emerging needs by establishing a new business platform. These new business needs include the introduction by China of the systems of Qualified Domestic Investment Institutions (QDII) and Qualified Foreign Investment Institutions (QFII), cash management, asset management, bank assurance and stock brokerage. Approval of the China Banking Regulatory Commission was obtained for the Group to operate as a QDII.

We continued to work closely with BOC for mutual benefits last year. For instance, together with our parent we launched a new service that enabled our wealth management customers to enjoy our banking services at BOC's branch network in the whole Asia Pacific region. In the area of corporate banking, active business referrals between BOCHK and BOC contributed to business growth for both. At the same time, we started launching some well-developed treasury products at BOC's regional branches and subsidiaries. This was a significant step that would eventually help us develop a strategic presence in the region. Through such close cooperation with our parent, we succeeded in expanding our customer base and strengthening our Mainland business.

VISA BOC Olympic Games Card five-ring-five-colour series is designed specially for sports enthusiasts and Beijing Olympic aficionados

We remained the local leader in personal RMB banking. With our superiority in this area we continued to contribute to the long-term development of RMB banking business in Hong Kong. We were once again authorised by the People's Bank of China (PBC) to be the local RMB clearing bank. More recently PBC announced the approval of yuan-denominated bonds to be issued in Hong Kong in the near future. We welcome this as the issuance of yuan bonds would be highly important for Hong Kong to reinforce its status as a regional financial centre. In March 2006, in cooperation with Hong Kong Interbank Clearing Limited we launched the RMB Settlement System that provides a safe and efficient electronic platform for RMB transactions in Hong Kong.

As recommended by the Board, the development of the Group's China business would take a two-pronged approach whereby our wholly-owned subsidiary Nanyang Commercial Bank (Nanyang) has applied for local incorporation in the Mainland and BOCHK would remain a foreign-funded bank in China. Chiyu, another of our subsidiary banks, would also remain a foreign-funded bank. This, we believe, would be the best approach for us to fully capitalise on the unique merits of the BOCHK Group to enter into the newly opened retail banking sector and better focus on the faster growing and more profitable corporate banking sector, thus enabling us to build a stronger presence in the Mainland market as a whole.

A new Relationship-Product-Channel (RPC) business model is introduced to enhance customer relationship management, centralise and professionalise product development, and optimise our channels and workflow to drive sales and marketing more effectively at our branches, electronic channels and call centres. After months of preparation, this model was fully formulated, approved by the Board and rolled out in March this year. This model will enable us to significantly improve the Group's overall operation and workflow, and achieve higher productivity, lower operational risk, better delegation of authority, and optimised staffing.

Our credit ratings continued to improve. In June 2006, Fitch Ratings upgraded BOCHK's individual rating to "B". In July, Moody's Investors Service upgraded our rating outlook from "stable" to "positive". As a further proof of our business and credit outlook, in mid-February 2007, Standard & Poor's Ratings Services raised our counterparty credit ratings to "A-/A-2" from "BBB+/A-2". It also upgraded our fundamental strength rating to "B" from "C+".

Business Review

In 2006 we succeeded in growing our business on all major fronts.

Loans and advances continued to grow with market demand. Following a relatively slow first half caused chiefly by our conscious effort to pursue higher net interest margin and ensure better asset and liability management, our lending business picked up its growth momentum again in the second half of the year after we had adjusted our growth strategy in accordance with market conditions. Total loans to customers increased to HK$347,090 million, up 3.9%. Loans for use outside Hong Kong, particularly in the Mainland, surged by 27.3% while loans for use in Hong Kong increased marginally. Trade finance increased by 4.9% as external trade continued to flourish.

The Group's retail banking business sustained its high growth momentum last year. Total operating income was up 14.3%, of which net interest income and other operating income were up 7.2% and 34.3% respectively. The substantial growth in other operating income owed mainly to higher income from fees and commissions which grew by 38.8% on the back of robust stock trading and IPO activities in Hong Kong. Residential mortgage lending dropped by nearly 5% in the first half due to fierce competition on mortgage rates but rebounded strongly in the second half after the launching of a range of new mortgage products. New mortgage loans shot up by over 90% and we regained our market lead toward the end of the third quarter in 2006.

Our investment and insurance business maintained its strong growth momentum last year. Stock brokerage volume recorded a hefty increase of 112% while the sales of open-end funds soared by 90%. Taking advantage of the IPO boom in Hong Kong, we aggressively expanded our IPO receiving bank services and IPO financing business by acting as the major receiving bank for the IPO of several leading companies. During the year, the Group's IPO financing provided to corporate and retail customers amounted to over HK$200 billion, representing an increase of over 10 folds versus 2005. We responded to market needs by launching eIPO financing services. That, coupled with our effective marketing and execution, resulted in record high numbers of IPO subscriptions received and processed.

As mentioned above, wealth management remained a major business focus. Through proactive sales and marketing as well as service enhancement and customisation, the number of wealth management customers and the amount of assets under management increased by 45.9% and 42.9% respectively.

The Group's card business continued to grow in terms of card issuance (+4.1%), card advances (+17.6%), cardholder spending (+13.7%) and merchant acquiring volume (+22.5%).

On the personal RMB banking front, the Group continued to be the local market leader with the largest deposit base and offering a wide range of related services. We also maintained our lead in RMB card issuance and merchant acquiring, which increased by 22.7% and 91.9% respectively last year. Cardholder spending was up 46.9%.

The Group's corporate banking business saw substantial growth last year, especially in the second half. Total operating income grew by 12.3%, of which net interest income was up 13.4% and other operating income 8.6%. The rise in net interest income was the result of our effort in widening the loan spread. We also consistently maintained our lead in loan syndication in the Hong Kong, Macau and Mainland market as a whole.

At the same time, we continued to drive the expansion of our SME business through service innovation and enhancement. The amount of SME loans increased by more than 10%. Again, through service enhancement and workflow improvement, we strengthened our trade finance segment and increased our bills volume by a solid 16.5%.

Our Mainland business picked up its growth momentum again in the second half of 2006 after a relatively slow first half. Total advances to customers rose by 22.7% to HK$18,600 million while deposits increased by 67.4% to HK$3,900 million. Our asset quality in the Mainland continued to improve. Classified loan ratio dropped to 0.23%. Meanwhile our business scope in China kept expanding. All our 14 branches and sub-branches are now licensed to conduct derivatives business and provide insurance agency service. Our wealth management products were also extended to the Mainland market.

The Group's treasury business continued to perform well last year under a refined structure and a more rational portfolio management strategy. Operating income rose by 45.8%. During the year, the Group actively managed its investment portfolio to maximise the return on residual funds, create a more balanced portfolio and reduce concentration risks. On the product side, market conditions last year facilitated the development and launching of structured deposit products which turned out to be very much in demand.

The performance of the Group's insurance segment was outstanding last year. Total operating income almost doubled to HK$6,894 million, of which net interest income and other operating income were up 48.7% and 98.8% respectively. Following the acquisition of a controlling stake in BOC Life, the Group started offering a more diversified range of insurance products to meet the needs of customers. In 2006, a series of new insurance products were introduced and customers' response was very encouraging. Premium from new business increased by 77%.

Our Telford Garden Branch was granted for the second year in a row the *Total Quality Service Regime – Top Performer 2006 – under the Category of Service and Entertainment* organised by the MTR Corp

Outlook

Looking ahead, we are basically optimistic about the growth potential of the local economy as investment and internal consumption continue to increase. This potential would be underpinned by the levelling off or possible reduction of US interest rates. For the banking sector, new business opportunities are on the horizon as China proceeds to expand the scope of RMB banking services in Hong Kong and fulfill her WTO obligations by further liberalising her financial services. That said, we are also mindful that competition is likely to intensify both domestically and offshore, and that the movement of interest rates must be watched closely and managed proactively. At the same time, though inflationary pressure is still not a major issue, rising costs should be a concern for banks, and there are signs that the international financial market is likely to become more volatile in the foreseeable future.

Our record-breaking financial performance and business growth last year speak forcefully for the solid foundations and capabilities we have built up in recent years as well as our effective execution of the Group's strategic initiatives. However, as a banking group with a vision, we are constantly seeking improvement. Going forward, we will follow closely and measure our progress against the goals and priorities laid down in the Group's 2006-2011 Strategic Plan so that we can excel in what we pursue, lead the market and enhance our capabilities.

In 2007 and beyond, we will drive organic growth by enhancing our business structure through diversification. In particular, we will focus on high-margin segments, notably wealth management and insurance. We have already attained certain synergy with BOC Life upon becoming its major shareholder. We will deepen that synergy through closer cooperation.

For the purpose of enhancing business capabilities, we will explore new opportunities locally and beyond. Our main focus will be on asset management, stock brokerage and insurance.

As mentioned above, the Group's China business strategy is two-pronged. Nanyang will actively develop full banking services in the Mainland with an emphasis on retail banking. BOCHK, on the other hand, will continue to operate as a foreign-funded bank in China and focus on corporate banking and foreign exchange businesses. This, we believe, is the best business model that will allow us to develop retail and wholesale banking simultaneously in the vast Mainland market. It will enable us to capitalise on Nanyang's unique brand awareness and expertise

Our sponsorship of *Growth Leadership Forum* was well-received by SME clients which could share their experience in business

in RMB retail banking, wealth management and SME banking services. It will also maintain BOCHK's superior market position in servicing large corporate clients and conducting foreign exchange business in China. To support this business model and to drive business growth in the Mainland, we will expand our branch network by focusing on major cities in the Pearl River Delta, Yangzi River Delta and the coastal region, including Dongguan, Suzhou and Hangzhou. We aim to more than double the number of outlets in China by 2009 with a corresponding increase in workforce. It follows that we will allocate adequate financial and other resources for the running of this expanded branch network, service enhancement, business development and brand building in the Mainland.

We will continue to work closely with our parent BOC for mutual gains, particularly in corporate business referral and the development of high-yield segments like wealth management and cross-border services.

Internally we will vigorously implement the RPC model to further enhance operational efficiency and drive long-term business growth. We will ensure high standards of corporate governance, risk management and internal control. Meanwhile we will continue to deepen the Group's new corporate culture and enforce human resources reforms so that we can build up and retain a stronger work team.

This year we enter the 90th year of Bank of China's operation in Hong Kong. For nearly a century, we have witnessed and contributed to the rise of Hong Kong as a leading economic player in the Asia Pacific region. Like Hong Kong, we have been through ups and downs but, again, like Hong Kong, we have always emerged stronger than before. It is with this resilience, I am convinced, that the Group will continue to grow with and play a positive part in the Hong Kong economy and society.

In concluding, I wish to express my heartfelt gratitude to both the Board and the staff for a great year once again. Together we will move on to better ourselves and create higher value for our shareholders and customers.

HE Guangbei
Vice Chairman and Chief Executive

Hong Kong, 22 March 2007