OVERVIEW

Prior to 1994, we were a state-owned specialized bank and our risk management capabilities were limited. With the promulgation of the PRC Commercial Banking Law in 1995, we began to operate on a more commercial basis and started to more proactively manage our risks. We have accelerated the development of our risk management capabilities since the late 1990s.

We have undertaken the following initiatives to enhance our risk management capabilities based on applicable PRC regulatory requirements and the specific needs of our bank:

(1) establishing a bank-wide risk management framework and related systems to improve our risk assessment, monitoring and management capabilities and develop a risk management culture within our bank:

- in 1999, we established our asset and liability management committee;
- in 2001, we established a risk management committee and a credit policy committee at our head office and introduced a bank-wide risk management reporting structure, providing monthly asset quality analyses and reports;
- in 2001, we began to establish a tiered liquidity reserve and to centrally manage liquidity risk;
- in 2002, we engaged Ernst & Young to perform independent audits on our Shanghai and Zhejiang branches, making us the first Big Four commercial bank to have an internationally recognized accounting firm audit its domestic branches;
- in 2003, we refined our corporate customer credit rating system into a 12-grade system;
- in 2004, we began to establish a comprehensive risk management framework and re-organized the structure of our risk management committee with reference to the Enterprise Risk Management Framework of the Committee of Sponsoring Organizations of the Treadway Commission, or the COSO ERM Framework, and established four risk management sub-committees focusing on credit risk, liquidity risk, market risk and operational risk;
- in 2004, in collaboration with PricewaterhouseCoopers, we launched a project to incorporate the Internal Ratings-Based (IRB) approach recommended by the New Basel Capital Accord in our risk management systems, which is designed to enable a financial institution to use internal assessment of key drivers to determine risk weightings of its assets;
- in 2005, we adopted an internal 12-grade corporate loan classification system, which supplements our existing five-category loan classification methodology;
- in 2005, we started to classify our non-credit assets into five categories based on the relevant obligors' ability to repay and perform their other obligations;
- in 2005, we introduced economic capital management tools, including the economic value-added (EVA) methodology, to manage our risks through the quantification and allocation of our economic capital and the evaluation of the EVA of each business activity;

- in January 2006, we began to implement a comprehensive risk provisioning system to better assess allowances for our impairment losses; and
- in July 2006, we established the position of chief risk officer, or CRO, in an effort to further strengthen our risk management;

(2) enhancing our corporate governance and strengthening the independence of our internal audit functions:

- in 2004, we established a centrally managed and independent internal audit function which, since our incorporation as a joint-stock limited company, reports directly to our board of directors; and
- in 2005, we established a risk management committee (with a related-party transactions control sub-committee under it) and an audit committee under our board of directors;

(3) developing enhanced risk management information systems:

- in 2003, our CM2002 system became fully operational, enabling us to better manage credit risks associated with our corporate banking business;
- in 2004, we introduced our CIIS system which provides access to the data of customers on our internal watchlist, assisting us in avoiding potential credit risks; and
- in May 2006, our PCM2003 system became fully operational, which significantly enhanced our ability to monitor and manage credit risks associated with our personal banking business; and

(4) increasing our employees' accountability for their own performance and compliance with our policies and procedures:

- in 2002, to ensure our employees' and managers' compliance with our policies and procedures, we amended the code of conduct for our employees to strengthen our system of accountability; and
- in consultation with an internationally recognized consultant, we implemented a performance-based compensation system for employees in selected branches in 2003, and began to implement this system in stages throughout our bank in 2004.

The risk management initiatives described above have enabled us to achieve a significant degree of separation between our loan origination and credit approval and post disbursement monitoring functions, and significantly enhanced our risk management capabilities. We believe that the implementation of these initiatives has contributed to the improvement of our asset quality in recent years. Moreover, the establishment of our market, liquidity and operational risk management frameworks has improved our overall risk control environment. For a more detailed analysis of the changes in our asset quality, see "Assets and Liabilities—Assets—Asset Quality of Our Loan Portfolio—Changes in the Asset Quality of Our Domestic Loan Portfolio by Pre-existing Loans and New Loans." Some of the risk management initiatives described above were implemented recently and their effectiveness has not been fully tested. For a description of certain risks relating to our risk management policies and procedures, see "Risk Factors—Risks Relating to Our Business—We cannot assure you that our risk management and internal control policies and procedures can adequately control or protect us against all credit and other risks."

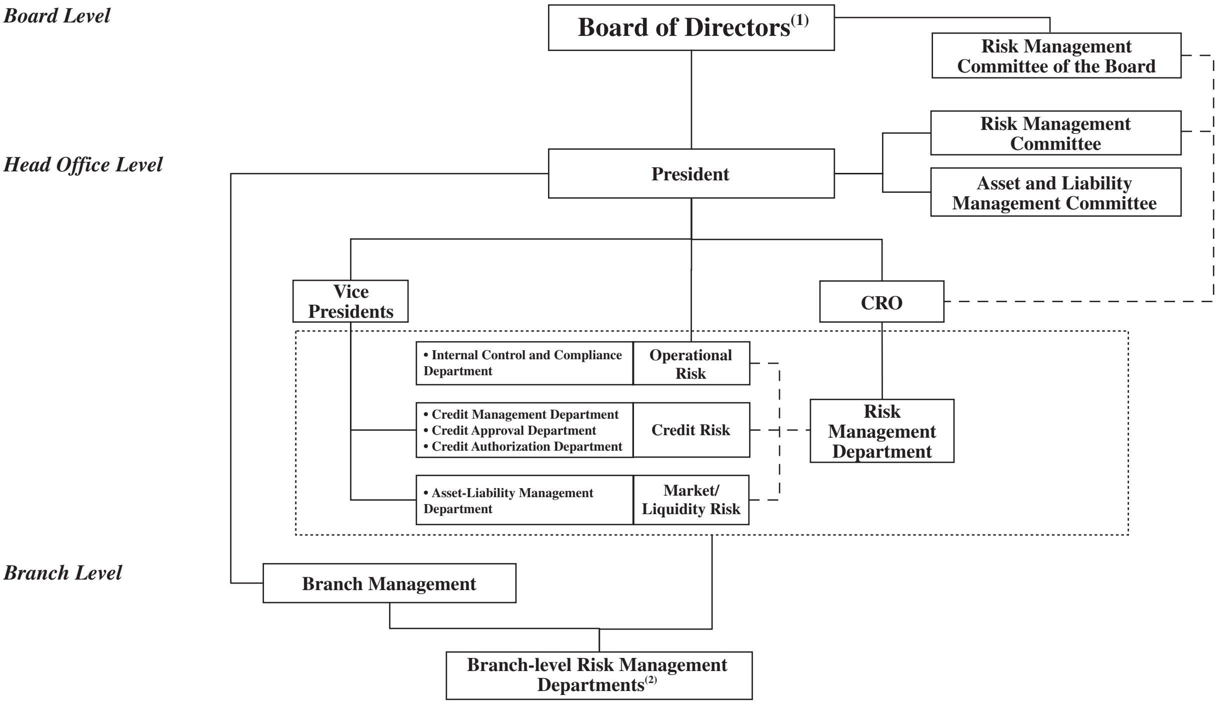
We will continue to enhance our risk management system with a view to aligning our policies and procedure with international best practices. We currently intend to implement the following initiatives in the next 12 to 18 months:

- we aim to meet the Foundation IRB Approach recommended by the New Basel Capital Accord guidelines for credit risk management by the end of 2007;
- we are in the process of strengthening our liquidity risk and market risk management through further centralizing our fund management, treasury operations and data collection;
- utilizing our NOVA system's centralized database, we are in the process of establishing a bank-wide information system that is designed to enable us to monitor our interest rate risk exposure on a real-time basis; and
- we seek to further enhance our internal control system based on five key components identified within the COSO Internal Control Integrated Framework: (i) control environment, (ii) risk assessment, (iii) control activities, (iv) information and communication, and (v) monitoring and rectification.

In addition, we will continue to enhance our risk management capabilities, establish a comprehensive and independent risk management framework, promote accountability and streamline our internal reporting process.

RISK MANAGEMENT STRUCTURE

The chart below illustrates the risk management structure of our bank:



(1) Our internal audit department reports directly to our board of directors. See "—Internal Audit."
(2) The risk management departments of our branches report to both corresponding risk management departments at our head office and the management of the relevant branches.

Board of Directors and Board Committees

Our board of directors has ultimate responsibility for our risk management and oversees our risk management functions through its risk management and audit committees. Our board of directors has final authority over our risk management strategies and policies.

Our risk management committee of the board is primarily responsible for:

- reviewing and finalizing the proposals for the risk management strategies and policies and internal control processes in line with our overall business strategies, presenting these proposals to our board of directors for approval, and monitoring and evaluating the implementation and effectiveness of these strategies, policies, procedures and processes;
- monitoring and evaluating the structure, working procedures and effectiveness of our internal risk management organizations, and making proposals to our board of directors regarding the related improvements;
- monitoring and evaluating the performance of our senior management in the control of our credit, market, operational and other risks;
- advising our board of directors on matters relating to our risk management and internal control;
- assessing our overall risk exposures on a regular basis and making related proposals to our board of directors; and
- pursuant to the authorization of our board of directors, reviewing and approving any significant risk management issue or transaction which is beyond the authorization limit of our president and submitted to this committee for its review and approval by our president.

This committee currently consists of nine directors and is chaired by Mr. LEUNG Kam Chung, Antony, one of our independent non-executive directors.

We have also established a related-party transactions control sub-committee under our risk management committee of the board in accordance with relevant PRC regulations. This committee is primarily responsible for identifying our related parties, preliminary review of our related-party transactions, and approving related-party transactions within its scope of authority granted by our board. This committee currently consists of three directors and is also chaired by Mr. LEUNG Kam Chung, Antony.

Our audit committee of the board is primarily responsible for supervising our internal controls, monitoring our financial information disclosure and supervising our internal audit operations and external audits. This committee currently consists of five directors and is also chaired by Mr. LEUNG Kam Chung, Antony.

President

Our president oversees our risk management and, on risk management-related matters, reports directly to our board and its risk management committee. He chairs both the risk management committee and the asset and liability management committee at our head office level. These two committees formulate and make recommendations regarding our risk management strategies and policies through our president to our board's risk management committee. In addition, our president has the power to veto any individual transaction or credit line approved by the credit approval committee at our head office. However, he cannot approve any proposal or recommendation that has been rejected by this committee.

Our current president, Mr. YANG Kaisheng, has extensive risk management experience with over 21 years of experience in the banking industry and five years of experience acting as the president of China Huarong Asset Management Corporation. See "Directors, Supervisors and Senior Management—Directors, Supervisors and Senior Management—Directors."

Risk Management Committee at the Head Office Level

This committee formulates and makes recommendations through our president to our board's risk management committee regarding our strategies and policies in credit risk, market risk and operational risk management. It consists of our president, vice presidents, our CRO and the heads of various business and risk management departments. This committee meets at least once every quarter. We have established a credit risk management sub-committee, a market risk management sub-committee and an operational risk management sub-committee under this committee. These sub-committees assist the risk management committee in their respective areas of focus and formulate rules and procedures for the implementation of our risk management strategies and policies.

Asset and Liability Management Committee

This committee formulates, and makes recommendations through our president to our board of directors on, strategies and policies for the management of our assets, liabilities and capital, plans regarding the total amounts and structure of our assets and liabilities, and our liquidity risk management strategies and policies. It consists of our president, vice presidents and the heads of various business and risk management departments. Our asset and liability management committee meets at least once every quarter.

Chief Risk Officer

We established the CRO position in July 2006 in an effort to further strengthen our risk management. Our CRO assists our president in overseeing our risk management and making related decisions. Our CRO is responsible for (i) analyzing and evaluating our risk management strategies and policies; (ii) making recommendations to our president and the risk management committee of our board on risk management-related matters; (iii) supervising the implementation of our risk management initiatives as well as the changes in risk management organizational structure; and (iv) promoting a risk culture throughout our bank. Our CRO acts as deputy chairman of our risk management committee at the head office level. Together with our vice president in charge of our credit risk management, our CRO reviews and approves the credit line, individual loan or other credit-related transactions recommended for approval by the credit approval committee at our head office. Our current CRO is Mr. WEI Guoxiong.

Internal Audit Department

Our internal audit department examines and independently evaluates the effectiveness of our risk management, internal controls, and corporate governance. Our internal audit department reports directly to our board of directors on a quarterly basis and is independent from management at our head office and branch levels. The appointment of the head of our internal audit department must be approved by either our board of directors or the audit committee as authorized by the board of directors. Our ten regional internal audit offices report directly to our head office's internal audit department.

Risk Management Department

Our risk management department at the head office is primarily responsible for coordinating our efforts in establishing our comprehensive risk management framework, preparing consolidated reports on our credit risk, market risk and operational risk, developing methodologies and approaches for the quantification of credit risk, developing and implementing our IRB project and monitoring and managing our non-performing loans. In addition, our risk management department at the head office provides administrative support to our risk management committee at the head office level. Our risk management department at the head office reports directly to our CRO.

Risk Management Coordination Between Our Head Office and Branches

Our tier-1 branches are subject to general supervision by our head office and are in turn responsible for supervising our tier-2 and lower tier branches within their designated jurisdictions. Such supervision is conducted in ordinary course by periodic on-site and off-site inspections in accordance with the internal procedures set by our head office.

We maintain a dual-reporting line structure at our branch level for risk management purposes. Under this structure, the risk management departments of our branches report to both the corresponding risk management departments at our head office and the management of the relevant branches. We believe that this approach has enhanced the independence and effectiveness of our risk management functions.

Credit Risk Management

Our head office determines the authorization limits of each of our tier-1 branches to grant customer credit ratings, credit line and individual loan approvals on an annual basis based on our overall credit strategies and policies as well as particular characteristics of the branch, including its asset quality, profitability, customer base, track record in risk management and location. The credit authorization limits of our tier-1 branches also vary depending on the loan type, relevant customer credit ratings, the relevant loan term, the collateral or guarantee, and the industry of the customer. For example, in 2005, the credit authorization limits of our tier-1 branches for infrastructure project loans ranged from RMB100 million to RMB1.0 billion.

Our branches are only permitted to grant customer credit ratings and credit line approvals within their specific authorization limits. Credit applications received by a branch which exceeds its authorization limits must be submitted to a higher tier branch with the requisite authorization or, as required, our head office for approval. Most of the credit lines granted to our corporate banking customers are approved either by our head office or a tier-1 branch. A tier-1 branch may delegate a limited portion of its credit authorization limit to the tier-2 and lower tier branches within its jurisdiction based on their asset quality, branch size and management capabilities.

In addition, we have also established a credit approval committee at the head office level to be responsible for reviewing large credit lines and individual loans, which currently include (i) any principal amount exceeding RMB1.0 billion for non-infrastructure project loans, (ii) any principal amount exceeding RMB1.5 billion for infrastructure project loans, (iii) any credit line exceeding RMB5.0 billion in aggregate for a single company, and (iv) any credit line exceeding RMB10.0 billion in aggregate for a group of affiliated companies. The credit approval committee at our head office consists of our vice president in charge of credit risk management, our vice presidents in charge of other related businesses, our CRO and the heads of relevant departments. The chairperson or vice chairperson convenes the meetings of the committee based on the circumstances relating to the matters required to be reviewed by the committee. Our branches also have their credit approval related committees with their respective authorization limits.

The credit management departments of our head office and branches are responsible for post-disbursement monitoring of our loans. Post-disbursement monitoring and non-performing loan management are generally conducted by the branches that were involved in granting the relevant loans and the credit management department of our head office supervises our branch post-disbursement loan management.

Market and Liquidity Risk Management

Our market and liquidity risk management operations are conducted primarily at the head office level by our asset and liability management department, with support from other relevant departments. Our asset and liability management department (i) monitors and assesses our overall liquidity position and market risk exposure and (ii) develops and implements measures based on approved strategies and policies. To manage our overall asset and liability structure in line with our market and liquidity risk management plans, our head office sets loan plans and guidelines, which our branches are required to observe. In addition, we pool the funds of our tier-2 and lower tier branches at our tier-1 branch level and allocate the pooled funds by using our internal fund transfer pricing mechanism on a bank-wide basis.

Operational Risk Management

Our internal control and compliance department at the head office is responsible for (i) the oversight of our compliance with applicable laws and regulations as well as our internal rules and procedures and (ii) the monitoring, assessment, analysis and reporting of our operational risk. This department is also responsible for developing and managing our internal control framework and conducting internal compliance audit. Each of our business departments at the head office and branch level is responsible for ensuring the suitability and effectiveness of the relevant operational risk management systems and procedures and is required to identify, monitor and control operational risks in their respective business areas. These business departments are required to report their operational risks and related compliance issues to the relevant internal control and compliance departments at the branch level and head office on a regular basis. The internal control and compliance departments and the business departments at our branches also report periodically to the corresponding departments at our head office. Our internal control and compliance department at the head office reports to the operational risk management sub-committee.

CREDIT RISK MANAGEMENT

Overview

Credit risk is the risk of loss arising from a borrower's or counterparty's inability to meet its obligations. Credit risk can also arise from operational failures that result in an unauthorized or inappropriate advance, commitment or investment of funds. We are exposed to credit risk primarily through our loans, guarantees and other payment commitments.

The principal features of our credit risk management function are: (i) standardized credit management procedures on a bank-wide basis; (ii) risk management rules and procedures that focus on risk control throughout our entire credit business process, including customer investigation and credit rating, loan evaluation, loan review and approval and post-disbursement loan monitoring; (iii) a stringent qualification system for our loan approval officers; and (iv) utilization of a series of information management systems designed to enable us to monitor risks on a real-time basis. To enhance our credit risk management practices, we conduct continuing training programs for our credit officers at different levels.

Credit Risk Management Departments

The credit risk management departments at our head office are as follows:

- our credit management department, which is responsible for overseeing the management of credit risk throughout our bank, monitoring our credit business and performing industry- and region-based credit analysis;

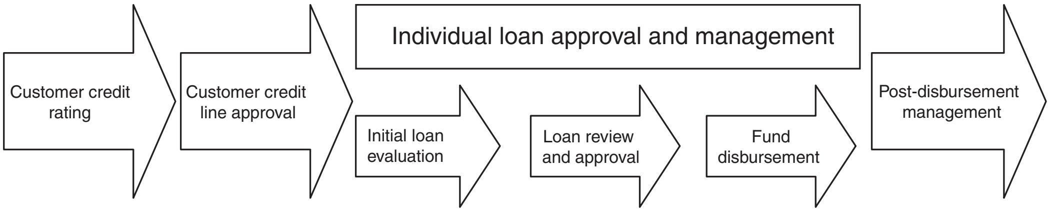
- our credit authorization department, which is responsible for assigning customer credit ratings, customer credit line approval, project evaluation and the appraisal of collateral; and

- our credit approval department, which is responsible for the review and approval of loans, guarantees and other credit applications.

Our branches have corresponding departments that perform similar functions at their levels, subject to standardized credit extension procedures and their authorization limits, including: (i) the credit rating it can assign to a customer; (ii) the maximum total credit line to any single borrower; and (iii) maximum loan amount of a single loan for each type of loans.

Credit Risk Management for Corporate Loans

The following chart illustrates the credit risk management process for our corporate banking business:



A customer must have a credit line with us to be eligible for an individual loan application. Each new corporate loan customer must first be assigned with a credit rating before being considered for a total credit line. Our corporate relationship managers conduct an initial investigation and evaluation of each new customer, which is primarily focused on the customer's financial condition and credit history. As part of their investigation, our corporate relationship managers rely on our CIIS system to screen out applicants with bad credit history. For new customers, the credit rating and credit line applications are processed at the same time as the individual loan applications, and the initial investigations conducted by our customer relationship managers form the basis for our evaluation of these applications.

Customer Credit Rating

We assign credit ratings to our customers based on detailed quantitative and qualitative indicators, which include a broad range of factors, such as the customer's ability and willingness to repay, the industry sector of the customer and geographic region where the customer operates. We maintain 12-grade internal ratings for our corporate customers ranging from AAA to B. Each new customer will be assigned a credit rating, and we re-assess the credit rating of each of our corporate customers each year based on an annual review. Customers must have a credit rating of AA- or above to be eligible for unsecured loans. Loans to customers with credit ratings below AA- are required to be secured by collateral or third-party guarantees. Our entire credit rating process is supported by proprietary information systems that we have developed in-house. We plan to further enhance our credit rating systems in the phase two deployment of our IRB project.

Customer Credit Line Approval

The total credit line that we grant to a customer is determined by taking into account its credit rating and conducting a comprehensive analysis and evaluation of the customer's credit history and financing needs. Our tier-1 and tier-2 branches may approve credit line applications within their specific authorization limits. When a credit line application report is received from our loan origination personnel, a primary reviewer is appointed to assess the application in accordance with our internal policies and procedures. If the credit line is within the authorization limits of the originating branch, the primary reviewer then presents his findings and recommendations to the credit approval committee of that branch for further review. Credit line applications that exceed the authorization limits of the originating branch must be submitted to a higher tier branch with requisite authorizations or, as required, to our head office. In addition, the preliminary decision by relevant committee at our head office or branches must be further approved by an authorized loan approval officer who is typically a senior manager at our head office or branches.

Individual Loan Approval and Management

Initial Loan Evaluation

When a customer applies for a new loan, our initial evaluation generally consists of (i) assessing recent developments relating to the customer's financial condition and credit history, (ii) reviewing the planned use of proceeds, (iii) evaluating the collateral or reviewing the financial conditions of the guarantor, if any, and (iv) assessing the overall credit risk and potential financial returns associated with that loan.

Loan Review and Approval

Individual Loan Approval

When a corporate relationship manager recommends a loan for approval, he will submit the loan application package, which includes his evaluation report, to a primary reviewer in the relevant credit approval department for review. If the loan will be collateralized or used to fund a project, our credit authorization department will conduct a separate evaluation of the underlying collateral or project. Based on his examination of the loan application package, the primary reviewer will prepare a report that includes his findings and recommendation to that branch's credit approval committee, or the relevant committee at a higher branch or our head office, as the case may be, for its review. Similar to the credit line approval process, the committee's recommendation decision must be further approved by an authorized loan approval officer, such as senior managers at our head office and senior branch officers. Certain small amount and low risk loans do not require the approval of any committee. However, in such instances, the primary reviewer will submit his report to an authorized loan approval officer with the requisite authority for review and approval.

Project Evaluation

In reviewing applications for medium- or long-term loans to fund major projects, such as acquisitions of fixed assets, expansion of production capacity, infrastructure development and property development, the relevant branch will form a team to evaluate the underlying project. The credit authorization departments at our head office or branches are responsible for conducting these project evaluations, depending on the loan size. In conducting these project evaluations, we assess the borrowers, the co-investors in the underlying projects and the underlying projects themselves, taking into account factors such as the anticipated cash flows of the projects, the perceived repayment ability of the borrowers and other credit risks related to the relevant loans. We may seek professional advice from external parties in the course of conducting such project evaluations.

Collateral Appraisal

In general, the value of collateral is determined by an independent appraiser prior to the origination of new loans and must be confirmed by our bank. The credit authorization department of the relevant branch or, as applicable, our head office is responsible for arranging the collateral appraisal process. We require three internal collateral evaluators to review and verify the collateral appraisals prepared by the independent appraiser. Loans that are secured by collateral are generally subject to the following loan-to-value ratio limits, depending on the type of collateral:

Type of Collateral	Maximum Loan-to-Value Ratio
Properties	
Real estate	70%
Land use rights	70%
Movable assets	60%
Monetary assets	
Cash deposits with us	90%
Government bonds	90% (based on the lower of book value or market value)
Bonds issued by financial institutions	80% (based on the lower of book value or market value)
Corporate bonds	50% (based on the lower of book value or market value)
Non-publicly traded equity securities	50% (based on net asset value)
Publicly traded stocks	60% (based on market value)

We require all the collateral to be re-appraised on a regular basis. In January 2006, we launched our collateral appraisal management information system, which allows us to maintain electronic records of titles, external appraisals, physical status and other factors that may affect the value of our collateral.

In respect of third-party guarantees, we evaluate the guarantor's financial condition, credit history and ability to meet its obligations according to the same procedures and criteria used for the primary obligor.

Fund Disbursement

When a loan application is conditionally approved, the relevant corporate relationship manager must ensure that all the conditions are satisfied before the loan is extended. Such conditions can include, as appropriate, obtaining a guarantee, securing funding of a portion of capital requirements for the project, obtaining government approval for the underlying project, or inclusion of additional provisions in the loan document, such as financial ratios requirements and restrictions on the borrower's ability to make dividend distributions. Upon satisfaction of all conditions, an authorized loan officer will execute credit documents with the borrower, and funds are disbursed. Our loan documents are generally based on standard forms and are reviewed by our legal personnel.

Post-disbursement Management

Post-disbursement Monitoring

The credit management departments at our head office and branches are responsible for post-disbursement monitoring of our loans. We conduct ongoing post-disbursement monitoring, including periodic customer assessments, in order to identify potential non-payment or other risks in a timely manner, implement preventive measures to reduce default risk and take remedial action to minimize potential losses. The frequency of our assessments varies for different customers depending on their credit ratings and other facts or circumstances that could potentially affect the customers' ability to repay our loans.

The credit management departments at our branches are responsible for supervising the credit business within their respective jurisdictions. Our post-disbursement monitoring personnel generally rely on documents obtained from our front office, customer files and internal database. Our post disbursement monitoring of lower tier branches focuses on compliance with our policies and procedures, credit risk assessment and the validity and enforceability of any collateral. Our post-disbursement monitoring personnel also conduct periodic analyses of customer credit risks and formulate specific risk prevention and control measures based on their findings.

Loan Classification

All PRC commercial banks are required to classify their outstanding loans based on a five-category loan classification system. See "Regulation and Supervision—PRC Regulation and Supervision—Loan Classification, Provisioning and Write-offs—Loan Classification." In October 2005, we adopted an internal 12-grade loan classification system, which refined the five-category loan classification, to classify our corporate loans. We continue to use the five-category loan classification system to classify our discounted bills and off-balance sheet commitments, such as guarantees, for internal purposes.

The following table illustrates our 12-grade loan classification system:

Normal				Special Mention			Substandard		Doubtful		Loss
Normal One	Normal Two	Normal Three	Normal Four	Special Mention One	Special Mention Two	Special Mention Three	Substandard One	Substandard Two	Doubtful One	Doubtful Two	Loss

This loan classification system takes into account both quantitative and qualitative factors, including the credit rating of the relevant borrower, the existence of a guarantee and the outstanding period of any overdue payments. The system utilizes a quantified scoring model and preliminary scores are automatically generated by our CM2002 system. Subject to specified authorization limits and internal approval, the relevant corporate relationship manager and our credit management department have the discretion to adjust the preliminary score based on their assessment of relevant facts and circumstances and to determine the classification of the relevant loan. We review our loan classification on a monthly basis.

Our internal 12-grade loan classification system is designed to enable us to better monitor changes in our asset quality, detect potential credit risks and more effectively conduct post-disbursement management of our loan portfolio. We believe that this system has strengthened our loan monitoring function and improved our overall credit management.

Management of Non-performing Loans

The risk management departments at our head office and branches are primarily responsible for managing our non-performing loans. When a loan becomes non-performing, the management of the loan is transferred to the relevant risk management department.

In order to strengthen and enhance the management of our non-performing loans, we have refined our internal organizational structure and tightened our procedures for non-performing loan management. We continue to develop practical and effective measures and methods for recovering or disposing of non-performing loans.

We manage our non-performing loans primarily based on the classification of such loans. For sub-standard loans, we focus on monitoring the current assets and cash flows of the borrower, paying particular attention to any major changes in its business. For doubtful loans, we closely monitor the businesses of the borrower and the related guarantor, increase our efforts to examine and preserve the assets of the borrower and actively engage in collecting and recovering these loans. For loss loans, we write off these loans in accordance with the relevant regulatory requirements, but continue to seek recovery of the relevant amounts.

To recover non-performing loans, we generally take, to the extent necessary, the following actions: (i) notification of collection; (ii) cash collection; (iii) restructuring of non-performing loans; (iv) disposal of collateral or collection on guarantees; (v) collection through legal or arbitration proceedings; and (vi) write-offs, once all other collection actions have failed.

To better manage our restructured loans, we implemented a set of guidelines in April 2006, which set forth the definitions pertinent to, provisions applicable to and allocation of responsibilities regarding the investigation, approval and post-restructuring management of the restructured loans. Under these guidelines, upon its restructuring, a restructured loan may not be initially classified to a category higher than substandard. A restructured loan may not be classified to a category higher than doubtful if, after its restructuring, the restructured loan remains overdue or the borrower remains incapable of repaying the loan. Within the six-month observation period immediately following its restructuring, a restructured loan may not be reclassified to a category higher than the one to which it was initially assigned.

Credit Risk Management for Personal Loans

In an effort to prevent potential credit risks and improve the efficiency of our personal loan approval, in 2005, we established personal loan approval centers at our tier-2 branches and higher levels to be responsible for reviewing and approving personal loans within their respective jurisdictions. Each step of our personal credit business process is operated through our PCM2003 information system.

Credit Origination and Evaluation

Once a personal loan application is received by the originating branch, two personal loan officers will conduct due diligence on the loan applicant, using our CIIS and other related information systems, such as the personal credit information system of the PBOC. Based on their due diligence, the personal loan officers assign a credit score to the loan applicant and make a recommendation to a reviewer. The reviewer examines the application and verifies the findings of the personal loan officers. If the reviewer confirms the personal loan officers' recommendation, the application materials are submitted to our personal loan approval center of the relevant branch.

Credit Approval

Upon receiving loan application materials, the relevant personal loan approval center assigns an officer to conduct further due diligence to verify the information contained in the loan application materials. If this officer recommends approval of the loan application, the application will be submitted to a loan approval officer in the personal loan approval center for final approval. If the amount of the loan exceeds the credit authorization limit of the originating branch, the application will be forwarded to the next higher tier branch with the requisite authority.

Loan Disbursement

After a loan application is approved, the designated personnel of the originating branch are responsible for further ensuring that the required guarantee, if any, is provided and that other pre-conditions required for loan disbursement are fulfilled, executing the loan agreement and other documentation and disbursing the funds.

Post-disbursement Management

Post-disbursement Monitoring

The credit management departments at our head office and branches are primarily responsible for managing our personal loans after the disbursement of the loan proceeds.

We conduct post-disbursement monitoring of our personal loans to have early warning of potential non-payment or other risks and enable us to implement preventive measures to reduce default risk and take remedial action to minimize potential losses.

Our post-disbursement inspection staff also utilize our personal credit management system, PCM2003, to conduct off-site inspections on the asset quality of our personal credit portfolio and monitor the asset quality of the branches and sub-branches within their jurisdictions. Our credit management departments review the inspection results on a regular basis.

Loan Classification

We use the five-category loan classification system to classify our personal loans. Our tier-1 and tier-2 branches are permitted to classify our personal loans subject to relevant authorization limits. Our PCM2003 system automatically classifies our personal loans based on quantative criteria, such as the duration for which the principal or interest is overdue. Subject to the approval of the relevant branch authority, our credit management departments may adjust the automatic loan classification based on an assessment of various qualitative factors, including the financial condition of the borrower, the status of related collateral and guarantee, in order to adequately reflect the relevant risks.

Collection of Non-performing Loans

Our non-performing personal loans are managed primarily by the risk management departments at our head office and branches. As part of our efforts to enhance the post-disbursement management of our personal loans, in 2001, we implemented standardized rules and procedures for the maintenance and use of our personal credit files and related records.

We have implemented standardized collection procedures bank-wide for our non-performing personal loans. When necessary, we initiate legal proceedings to recover non-performing loans and seek the enforcement of relevant guarantee or insurance obligations.

Credit Risk Management for Credit Cards

We have adopted an applicant scoring mechanism for evaluating and approving our credit card applications. With respect to our Renminbi-denominated credit cards and quasi-credit cards, our head office provides the scoring model and each tier-1 branch applies specific scoring standards to reflect the level of economic development, demographics and consumer spending in the region in which the branch operates. With respect to our dual-currency credit cards, our head office provides the scoring model and standards to be applied throughout our bank. In evaluating credit card applications, we rely on our internal CIIS management system as well as the credit data provided by the PBOC and those made available by China Unionpay.

Our head office oversees all credit card-related transactions on a bank-wide basis. We continuously monitor and analyze unusual credit card transactions to reduce the rate of fraud and intentional default.

Credit Risk Management for Treasury Operations

Our treasury operations are subject to credit risk as a result of our investment activities and inter-bank lending activities. Our Renminbi-denominated investment portfolio primarily consists of debt securities issued by the PRC government and other domestic issuers. The amount of the debt securities of any domestic or foreign entity (except the PRC government) that we purchase or our inter-bank lending to any domestic or foreign entity is limited to the total credit lines that we have approved for that entity. Our foreign currency-denominated investment portfolio primarily consists of investment-grade bonds.

Credit Management Information Systems

We utilize our credit management information systems to monitor and manage our credit business and risk management operations. These systems support each step of our credit risk management process. Our key credit systems include our credit management system (CM2002), client information integration solution system (CIIS) and personal credit management system (PCM2003). See "Business—Information Technology."

LIQUIDITY RISK MANAGEMENT

Liquidity risk is the risk of being unable to liquidate a position in a timely manner at a reasonable price to fund our obligations. We are exposed to liquidity risk primarily in the funding of our lending, trading and investment activities, as well as in the management of our liquidity positions. The primary objective of our liquidity risk management is to ensure that we are able to meet our payment obligations and fund our lending and investment operations on a timely basis.

Our asset and liability management department manages our day-to-day liquidity risk on a real-time basis under the supervision of our asset and liability management committee. It formulates our annual liquidity plan for approval by our asset and liability management committee, monitors its implementation and makes adjustments as required on a quarterly basis.

We fund our operations primarily through our customer deposits. In addition, we may borrow in the inter-bank money markets or open markets to meet our short-term liquidity needs. As a key element of our centralized liquidity management, we pool the funds of our tier-2 and lower tier branches at our tier-1 branch level. We allocate the pooled funds by utilizing an internal fund transfer pricing mechanism, which determines the appropriate internal benchmark prices on a bank-wide basis. We believe the consolidation and centralized pricing of our internal capital resources have enhanced our liquidity risk management.

We have taken a series of measures to actively manage our liquidity, including: (i) using a series of liquidity indicators to assess and monitor our liquidity position on a daily basis, and reporting the results of such assessment and monitoring to our asset and liability management committee on a quarterly basis; (ii) monitoring and adjusting the amount and structure of our cash, cash deposited with the PBOC and other banks and other interest-earning assets on an ongoing basis in an effort to ensure that our future liquidity needs will be met while seeking appropriate financial returns; (iii) monitoring liquidity ratios in compliance with regulatory and internal requirements and utilizing sensitivity analysis to evaluate our liquidity needs; and (iv) establishing an early-warning system for liquidity risks and formulating a liquidity emergency plan.

MARKET RISK MANAGEMENT

Market risk arises from movements in market variables such as interest rates, exchange rates, equity prices and commodity prices, and other market changes that affect market risk-sensitive instruments. We are exposed to market risk primarily through the assets and liabilities on our balance sheet, as well as our off-balance sheet commitments and guarantees. The principal types of market risk affecting our business are interest rate risk and exchange rate risk. We have imposed a set of exposure limits for our investment and trading activities to effectively control potential market losses within acceptable limits.

Historically, we were not exposed to significant market risk as Renminbi interest rates and exchange rates were set and controlled by the PRC government. See "Regulation and Supervision—PRC Regulation and Supervision—Pricing of Products and Services." As the government continues to implement market-based reforms on Renminbi interest rates and exchange rates and the financial services sector becomes more competitive, we are increasingly subject to market risk.

Our middle office function of monitoring our market risk exposure and control is independent from the front-office trading function for our treasury operations. Our asset and liability management department is primarily responsible for overseeing the management of our market risk under the supervision of the market risk management sub-committee at the head office level. Our financial markets department, which handles our front-office trading operations according to the guidelines and limits set by our asset and liability management department, has a division that focuses on day-to-day risk monitoring and management with respect to our trading operations. This division is separate from the trading divisions. In addition, we classify our assets in accordance with International Accounting Standards, set market risk limits for our trading book in accordance with approved policies and monitor the market value of our trading securities on a daily basis. We utilize different methods, including duration, convexity and basis point value analyses, to assess the risk associated with our trading book.

Interest Rate Risk Management

Interest rate risk represents exposure of a bank's financial condition to adverse movements in interest rates. Our primary source of interest rate risk is mismatches in the maturity or repricing periods of our interest rate-sensitive assets and liabilities. Maturity mismatches may cause net interest income to be affected by changes in the prevailing level of interest rates.

We have adopted a series of core indicators for interest rate risk management, standards for interest rate sensitivity gap analysis and guidelines for our interest rate risk management. The analysis of our interest rate risk includes an assessment of the incremental gaps between our interest-sensitive assets and liabilities and the results of sensitivity analysis to measure the potential exposures in our loan portfolio and total deposits as a result of an interest rate change.

We currently manage our interest rate risk primarily through managing the composition of assets and liabilities. We manage our interest rate risk exposure by adjusting the structure of our assets and liabilities based on our assessment of potential changes in interest rates utilizing gap analysis, which provides a static measure of the repricing characteristics of our assets and liabilities. As the PBOC continues to carry out reform initiatives to liberalize interest rates, we are enhancing our ability to analyze interest rate changes in financial markets and developing our interest rate risk management system.

Exchange Rate Risk Management

Exchange rate risk primarily results from mismatches in the currency denomination of our assets and liabilities and from foreign currency transactions.

We conduct sensitivity analysis to measure our exchange rate risk on a quarterly basis. We monitor our exposure to exchange rate risks on a daily basis. We prepare a report for our exchange rate risk exposure to the risk management committee at the head office level each quarter. We are also required to report our exchange rate risk exposures in both our trading book and banking book to the CBRC on a quarterly basis. We manage our exchange rate risk through derivative transactions and by establishing exposure and stop-loss limits.

In addition, through our foreign exchange transaction-related information technology systems, we are able to obtain foreign exchange pricing information on a real-time basis and monitor our exposure to foreign exchange risk.

OPERATIONAL RISK MANAGEMENT

Operational risk is the risk of loss resulting from inadequate or failed internal control procedures, from human- or system-related factors, or from external events. The operational risks that we are primarily subject to include, among others, internal fraud, external fraud, business disruption or system failure, unreliability of operational processes, risks of human errors and other failures related to transaction execution and data input in our business.

Our operational risk management sub-committee is primarily responsible for overseeing our overall operational risk management. Each of our business departments at the head office and branch level is responsible for managing the operational risks in their respective business areas. Our internal control and compliance departments at the head office and branches are primarily responsible for monitoring our operational risks and our compliance with applicable laws and regulations as well as internal rules and procedures.

Based on the principles of the COSO Internal Control Integrated Framework, we have developed a set of internal control guidelines and are in the process of enhancing our internal control system. We believe our efforts in developing our internal control system have enhanced our operational risk management.

In 2002, we began to implement a system under which all tier-1 branches evaluate the internal controls, including the operational risk management, of lower tier branches within their jurisdictions. By 2005, we had expanded this system so that our head office evaluates all of our tier-1 branches, including the adequacy and effectiveness of the internal controls and operational risk management at all departmental levels within these branches. We will continue to develop and enhance our internal control systems and management processes for each of our business lines through developing and implementing measures in line with our internal control guidelines and international best practices.

Other initiatives we have adopted to manage operational risk include the following:

- The internal control and compliance department at our head office has developed a comprehensive set of operational risk management manuals which identify key risk areas for our different business lines, required risk control procedures and related documentation requirements.
- We have implemented a series of measures to further centralize the management of our operational risks. For example, we have established the monitoring centers at our tier-2 branches to centralize the ongoing monitoring of our front-office operations. In addition,

we have reduced the number of reporting levels within our finance and accounting structure, and our head office is responsible for setting and reviewing our recruitment practice standards and for approving important personnel decisions.

- We have also established independent checks within our organizational structure by increasingly separating the front-, middle- and back-office functions of our business departments, particularly positions that involve potential conflicts of interest. We require periodic rotation of personnel holding senior positions, such as our branch managers.
- We have established a remote backup facility for our operational data, significantly reducing the operational risks associated with failures of our information technology systems.
- We have adopted a series of operational risk indicators and utilized our information systems, including databases and data monitoring and reporting functions within our accounting and business technology systems, to support our operational risk monitoring and management activities.

Reporting and Monitoring of Non-compliance

We have established internal reporting procedures for employee misconduct to ensure that all incidents of employee misconduct are reported to our head office in a timely manner. In addition, we are required to report to the CBRC significant cases of employee misconduct.

We believe that the number of incidents of reportable employee misconduct at our bank has been relatively low in recent years primarily due to our efforts to enhance our internal controls, promote employees' accountability, and implement routine and ad hoc inspections bank-wide. In 2003, 2004, 2005 and the first six months of 2006, there were 61, 66, 50 and 12 reported incidents, involving the total amounts of RMB70 million, RMB54 million, RMB56 million and RMB13 million, respectively.

Anti-money Laundering

We established an anti-money laundering working committee in 2002. This committee is responsible for formulating our anti-money laundering policies and procedures, monitoring the compliance with anti-money laundering laws and regulations, and cooperating with overseas organizations on anti-money laundering. Two of our vice presidents serve as chairperson and vice chairperson and other members include the heads of relevant departments. We have established an administrative office under the anti-money laundering working committee. The administrative offices of the anti-money laundering working committees at our head office and branches are primarily responsible for carrying out anti-money laundering management functions within our bank.

Based on the PBOC's anti-money laundering rules and requirements, we have implemented a series of internal rules and procedures relating to "know your customer," record keeping, suspicious transaction and large transaction reporting.

In 2005, we further upgraded our anti-money laundering information management system that is designed to enhance our ability to detect and monitor money laundering activities and report large or suspicious transactions to the regulators.

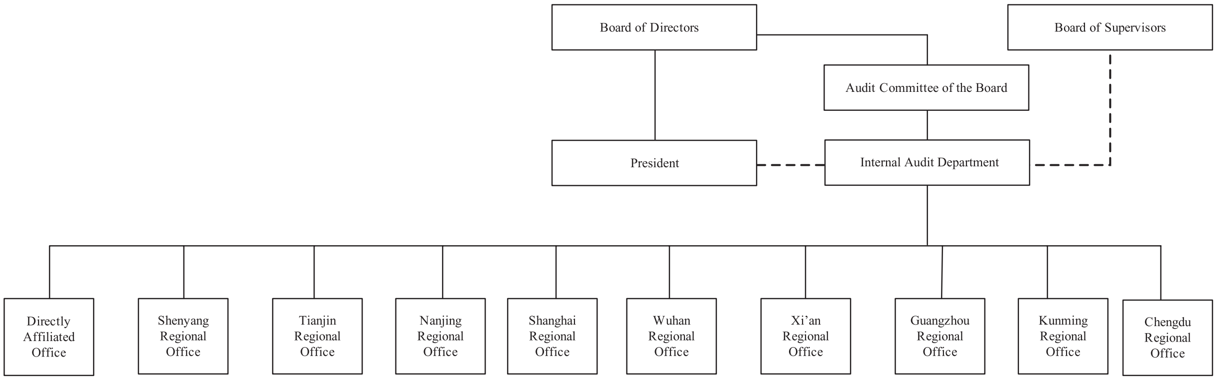
We regularly provide training to our employees to enhance their understanding of our anti-money laundering procedures and other requirements.

In addition, we have also adopted and implemented internal anti-money laundering guidelines and reporting procedures for our overseas operations in accordance with the anti-money laundering laws and regulations of the relevant jurisdictions.

INTERNAL AUDIT

We have established an independent internal audit system which comprises our internal audit department at the head office level and the ten regional internal audit offices throughout China. Our internal audit department reports directly to our board of directors.

The following chart illustrates the internal audit management and reporting structure:



In carrying out the internal audit of our bank, our internal audit department mainly focuses on the inspection and evaluation of:

- our compliance with laws and regulations, governmental policies and regulatory requirements as well as our internal rules and procedures;
- the integrity and effectiveness of our internal control system;
- the effectiveness of our risk management procedures and risk assessment methodologies;
- the security of our information system and the adequacy and effectiveness of the control of our information technologies and their applications;
- our operational performance, including efficiency in using our various resources and the protection of these resources;
- auditing the performance of primary managerial personnel at our head office, tier-1 branches and overseas subsidiaries, branches or offices and other managerial personnel;
- the accuracy and reliability of our accounting records and financial statements; and
- other matters as requested by our board of directors.

In an effort to enhance our internal audit function, we have adopted a set of principles and practices, including:

- Independence of audit work. Our internal audit department is not involved in any of our business activities and does not participate in formulating or implementing any business decision. Each of our regional internal audit offices performs audits only on branches that are located outside of the region where the regional internal audit office is located.
- Risk-oriented audit. Our internal audit work plans are driven by risk exposure, targeting and seeking to address any potential deficiency in the overall risk management system. Our 2006 internal audit plan has been formulated with a specific focus on our credit business, information systems and risks associated with our new businesses.
- Allocation of audit resources to enhance their efficiency. Based on an assessment of asset quality, profitability, internal control and liquidity, branches with lower performance rankings are allocated more audit resources to help to improve their risk management and internal control capabilities.