OVERVIEW

The primary risks we face in relation to our operations are credit risk, operational risk, market risk and liquidity risk. We are also exposed to other risks, such as reputational risk and legal and compliance risk.

Since our inception, we have been committed to enhancing our risk management capability, implementing comprehensive risk management strategies and maintaining a "prudent, rational and stable" risk appetite, and have established a clear, rational and comprehensive risk management framework. Our risk management objectives are as follows:

- enhancing our risk management organizational structure;
- improving our risk management system and procedures;
- implementing advanced risk measurement and management tools; and
- fostering a corporate culture of sound risk management.

To achieve these objectives, we have undertaken a number of initiatives in recent years, including:

- *Strengthening our research on macroeconomic policies and analyzing macroeconomic trends.* By strengthening our research and analysis capabilities, we studied macroeconomic trends and policy changes, assessed their impact on our operations, and adjusted our business strategies accordingly. We formulate risk management policies every year to guide our business development based on the macroeconomic trends, our business requirements and our risk appetite.
- *Refining risk management system.* We consistently believe in the equal importance of risk management and business development. Accordingly, we strongly promote the implementation of comprehensive risk management strategies to manage our exposure to credit, operational, market, liquidity, legal and compliance, reputational and other risks. We expanded the functions and scope of risk management and enhanced our risk management organization structure, improved our risk management tools, and strengthened our core competency in risk management. We have maintained strict supervision and control over the identification, measurement, monitoring and management of credit risk, promoted multi-level management and centralized reporting for operational risk, and implemented centralized management for market risk.
- *Enhancing the management of risk appetite.* We consistently adhere to a "prudent, rational and stable" risk appetite and impose risk limits for our operations. Based on our strategic development goals and market environment, we seek to achieve a balance between risks and returns, formulate a bank-wide risk appetite, set annual risk policies and risk limits, and consistently implement our risk management policies and measures, so as to achieve sustainable development.
- *Improving risk management mechanisms.* We have established a series of effective risk management mechanisms that cover, among others, risk monitoring, risk alert, risk management, risk assessment and risk accountability. In addition, we have set up risk management teams for our corporate banking, small business banking, retail banking and financial market departments to control their respective risks, and have assigned risk management officers to supervise our treasury operations.

- *Improving credit structure and loan portfolios.* We strictly adhere to our credit policies and procedures in our lending business. We have enhanced our loan portfolio to prioritize lending to major customers in key industries, proactively balance our fund allocation among large corporate customers, SME customers and retail customers, and reduce our loan concentration.

- *Strengthening post-disbursement management and credit limit management.* In 2010, our "post-disbursement management year," we enhanced our post-disbursement management mechanism and formulated differentiated guidelines for the post-disbursement management of our corporate banking, SME banking and retail banking businesses. We also strengthened the credit risk limit management and established a corresponding risk alert mechanism for lending to certain types of customers, such as loans to local government financing vehicles and real estate companies.

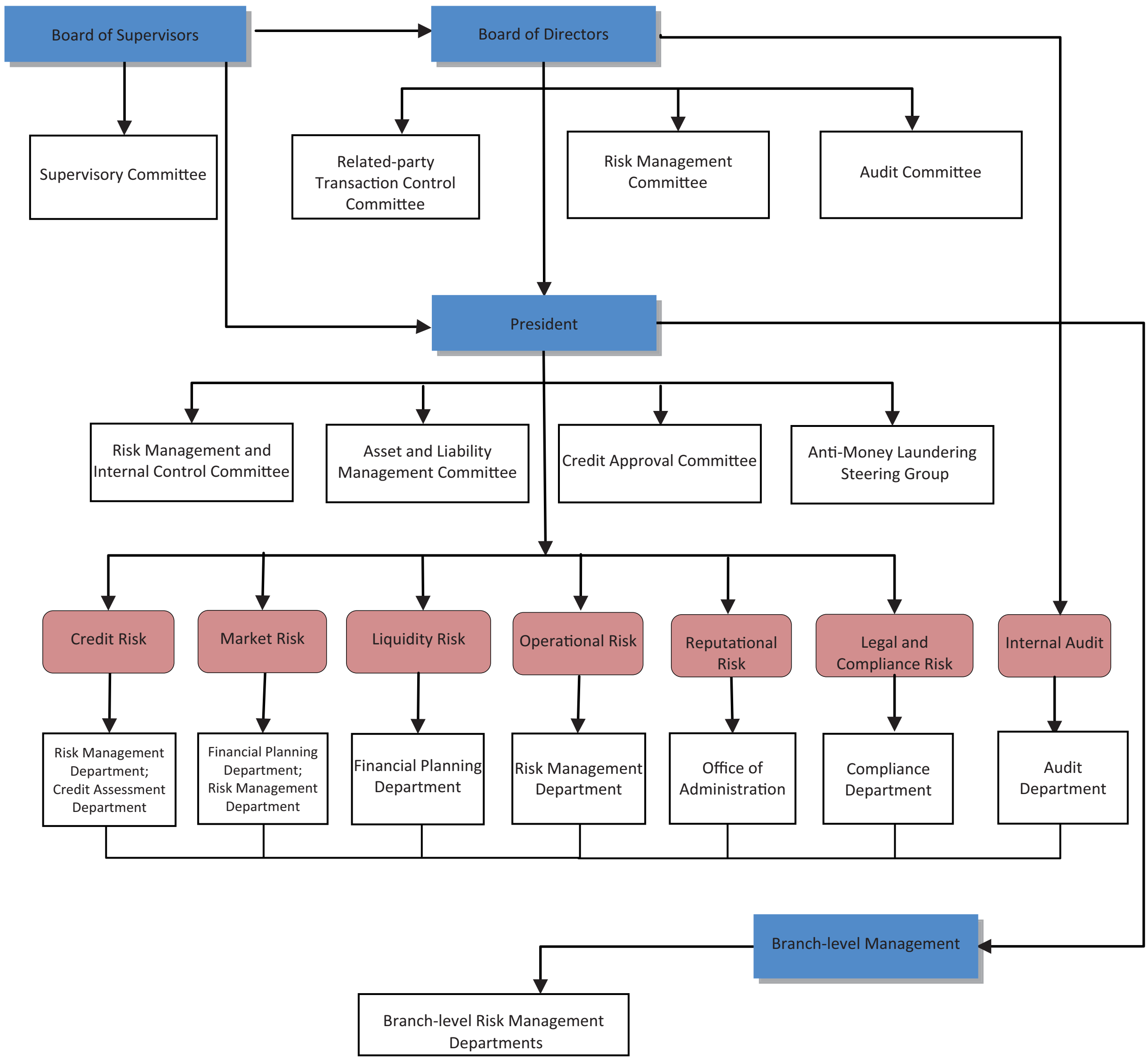
- *Regularly screening our credit risk.* Besides our daily post-disbursement management, we reviewed our credit asset quality from various perspectives through semi-annual "top-down" and "bottom-up" investigations, and took preventive measures based on such screening.

- *Periodically analyzing and assessing our overall risk exposure and internal control.* To further improve our risk management and facilitate our sustainable development, we have been, on a semi-annual basis, conducting comprehensive analyses on our primary risks, assessing the effectiveness of our risk management at our business departments and branches, and prudently evaluating the effectiveness and validity of our risk management efforts. We also regularly analyze and evaluate the adequacy and effectiveness of our internal control.

- *Enhancing implementation of advanced risk management tools.* In 2008, we began to work with Standard & Poor's Ratings Services to develop a new internal rating system for our non-retail customers based on the internal ratings-based approach set forth in the Basel II, which was launched in 2012. In 2012, we began to develop a retail credit risk internal rating system. We are among the first city commercial banks in China to have implemented the Basel II and Basel III internal ratings-based approach. We have also adopted various advanced market risk management tools, such as valuation management, scenario analysis and value-at-risk value analysis.

RISK MANAGEMENT STRUCTURE

The following diagram depicts the principal organizational structure of our risk management:



Board of Directors and Special Committees

Our board of directors is responsible for determining our overall risk appetite and reviewing and approving our risk management objectives and strategies. The risk management committee, the related-party transaction control committee and the audit committee are the three major committees for our board-level risk management.

The risk management committee is primarily responsible for reviewing our risk management policies based on our overall strategy, monitoring and evaluating the implementation and effectiveness of our risk management policies and giving recommendations to our board of directors accordingly. It also oversees the establishment of our risk management system, supervises and evaluates the organizational framework, operating procedures and effectiveness of our risk management, and gives advice for improvement. In addition, the committee reviews our risk reports, conducts regular assessments on our risk policies, risk management and risk tolerance, advises on how to improve our risk management and internal control, and supervises and evaluates our senior management's risk control activities with respect to credit risk, market risk, operational risk and other risks. Upon the authorization of our board of directors, the committee also reviews and approves major risk management issues and transactions that are beyond our president's authorization or are proposed by our president for the risk management committee's approval.

The related-party transaction control committee is primarily responsible for identifying related parties and connected persons, their relationships, and related-party and connected transactions, minimizing the risks of related-party and connected transactions, identifying and reporting material related-party and connected transactions to the board of directors for review and approval, formulating the related-party and connected transaction management system, and submitting at the end of each year a detailed report of the overall conditions, risk levels and compositions of related-party and connected transactions occurred within the year to the board of directors.

The audit committee is primarily responsible for inspecting our financial reports, annual reports and other financial information, reviewing major financial reporting opinions contained in our financial statements and reports and other documents relating to our operations, and reviewing significant issues raised by external auditors and the response of our senior management to those issues. The committee also examines information disclosed at shareholders' meetings and to the public, inspects our internal control and financial monitoring policies, audits our material related-party transactions, and monitors our compliance and the implementation of our risk management polices and internal audit policies.

Board of Supervisors and Special Committee

Our board of supervisors oversees the compliance of our directors and senior management's performance, conducts off-site audits of our executive directors and senior management, examines and supervises our financial activities, risk management and internal control, and investigates any abnormal operations. The board of supervisors has a supervisory committee, responsible for formulating specific plans for the exercise of authority by the board of supervisors.

Senior Management and Special Committees

Our senior management has the overall responsibility for managing the risks associated with our business.

Our president, with the assistance from other members of senior management, is responsible for our overall risk management at senior management level and reports directly to the board of directors.

We have established three special committees (namely, the asset and liability management committee, the risk management and internal control committee and the credit approval committee) and an anti-money laundering steering group under our senior management, which are collectively responsible for organizing, coordinating and reviewing our risk management work.

- *The asset and liability management committee* formulates material operational strategies, manages the size, composition and proportion of our assets and liabilities, and determines appropriate adjustment plans to address any problems in the management of our assets and liabilities based on our business development strategies. The committee also reviews the size and composition of our investments and transactions, our product pricing policies and plans, interest rate risk prevention plans, liquidity stress test results and risk reports, and major measures and policies for risk-weighted asset control and capital adequacy management. The members of the committee include our president as the chairman of the committee, our vice president in charge of financial planning, key officers of various business departments and special experts. The asset and liability management committee generally meets on a quarterly basis, and the chairman of the committee or the committee office may propose to hold interim meetings.

- *The risk management and internal control committee* manages the various risks and internal control in line with our risk management strategies and policies. The committee is responsible for reviewing our risk management and internal control plans, policies, systems and measures and any material risk management and internal control matters. It also reviews the bank-wide risk management and internal control reports and makes recommendations for improvement. The members of the committee include our president as the chairman of the committee, our vice president in charge of risk management and key officers of various business departments. The risk management and internal control committee generally meets on a quarterly basis, and the chairman or the authorized vice chairman of the committee may propose interim meetings when needed.
- *The credit approval committee* implements the credit policies and operation strategies of the board of directors and senior management, reviews and approves credit-related matters within its authority, oversees the implementation by relevant departments of credit-related decisions of the committee, and guides and examines the credit review process at our branches. The members of the committee include the vice president in charge of credit approval as the chairman of the committee, and other members nominated by the chairman of the committee and approved by the president. The committee generally meets on a weekly basis, and the chairman of the committee may call interim meetings when needed.
- *The anti–money laundering steering group* leads and coordinates our bank-wide anti-money laundering efforts. The group convenes regularly to review our anti-money laundering policies, systems and measures, discuss important anti-money laundering matters, supervise our anti-money laundering efforts on the identification and risk classification of customers and the reporting of large suspicious transactions. The group is led by one of our vice presidents and consists of key officers of relevant departments at our head office, including the compliance department, the corporate banking department and the retail banking department. The group holds interim meetings as needed.

Risk Management Departments at Head Office

Risk Management Department

Our risk management department is responsible for coordinating bank-wide risk management efforts on a day-to-day basis. The department formulates our overall risk management policies and systems, designs procedures for the formulation and inspection of our risk management system, conducts research on our risk appetite and proposes to the board of directors. It also studies and develops risk measuring tools and formulates customer credit rating guidelines and procedures in accordance with the Basel II and Basel III, organizes customer credit ratings and classification of risk assets, monitors and issues risk alerts with regard to our credit risk, market risk and operational risk and establishes and improves our internal risk reporting system. Moreover, the risk management department is responsible for formulating asset quality control plan and organizing the disposal of non-performing assets. The risk management department consists of seven teams, namely, the risk system management team, the corporate credit risk management team, the personal credit risk management team, the market and capital operation risk management team, the operational risk management team, the risk composition management team, the asset quality management team.

Credit Assessment Department

The credit assessment department formulates our credit policies, reviews and approves credit matters in excess of the authorized limits granted to our branches, enacts credit authorization and related delegation plans in accordance with our business development and risk management needs, and manages our bank-wide credit risk management system and credit collection work. The credit assessment department consists of five teams, namely, the policy and system management team, the industrial credit assessment team, the large customer and trade financing credit assessment team, the small business credit assessment team and the personal credit assessment team.

Financial Planning Department

The financial planning department implements the plans enacted by the asset and liability management committee, formulates our asset and liability management policies, establishes and maintains our asset and liability system, monitors our capital efficiency and optimizes our capital allocation. The financial planning department also monitors, analyzes and guides our treasury operation, manages the capital position of our head office and our liquidity risk. The financial planning department consists of six teams, namely, the asset and liability management team, the plan management team, the finance and cost management team, the capital and interest rate management team, the fixed asset management team and the statistics analysis team.

Compliance Department

The compliance department is responsible for managing our legal and compliance risk, monitoring related-party transactions and coordinating the establishment of our internal control system. Bases on our development strategy and external regulatory requirements, the compliance department formulates and enhances our framework for internal control and compliance risk management, improves internal control and compliance risk management systems to effectively identify legal and compliance risk and ensure our compliance with applicable laws and regulations. The compliance department consists of five teams, namely, the compliance affairs team, the compliance monitoring team, the anti-money laundering and connected transaction management team, the legal affairs team and the internal control management and assessment team.

Audit Department

The audit department formulates our audit policies and procedures, examines and assesses our operations, risk profile, internal control and corporate governance, conducts subsequent audits, supervises the implementation of remedial measures and facilitates our continuous implementation of national economic and financial laws, regulations and guidelines of relevant authorities. The audit department has six teams, namely, the audit and planning team, the asset and liability audit team, the financial audit team, the off-site and IT audit team, the economic liability and internal control audit team and the branch audit team.

Branch-level Risk Management

We have established risk management committees at our branches, which are responsible for establishing and improving risk management and internal control systems, reviewing material risk management and internal control issues, and providing proposals on improving risk and internal control management at our branches. Risk management committees at our branches normally consist of senior managers of our branches and key officers of relevant departments at our branches.

We have also established risk management departments at our branches, which are responsible for implementing the risk management policies formulated by our head office, conducting asset risk classification, risk monitoring and credit risk investigation, and supervising and assessing the risk management at our sub-branches. The risk management departments at our branches report to the branch management and their corresponding departments at our head office.

CREDIT RISK MANAGEMENT

Credit risk is the risk of financial loss when a borrower or counterparty fails to meet its obligations in accordance with agreed terms. We are exposed to credit risk primarily through our loan portfolio, inter-bank borrowings, investment portfolio and off-balance sheet credit exposures.

We have established a "three-line defense" system to monitor our risk management throughout each phase of our lending business. As the first line, our business units are responsible for screening and assessing customers and formulating plans for risk prevention, management and control. The risk management department, which is independent from our business departments, serves as the second line that sets forth risk management criteria for risk identification, monitoring, measurement, alert, reporting and management, and assesses the rationality of asset allocation in view of the risk management goal formulated by our board of directors. The third line is our supervisory departments, such as the audit department, which are responsible for monitoring the effectiveness and soundness of our risk management policies, systems and procedures. We have standardized our lending policies and procedures and customer credit rating system. We have also streamlined our risk management procedures for pre-loan review, credit approval and post-disbursement management. We regularly review and update our credit policies and procedures in line with the changing regulatory requirements and the evolving business environment.

Our credit policies and procedures vary according to loan products and the type and industry of customers. We implement credit limits to reduce credit concentration on certain types of customers, such as real estate developers and local government financing vehicles. We generally keep the amount of real estate loans at no more than 8% of our total loans, based on the condition of the real estate industry in Anhui and Jiangsu provinces and our forecast of the 2013 real estate market. In addition, we conduct at least one stress test on real estate loans every year, in compliance with the CBRC's requirement. Test results showed that, even under severe stress, the increase in our non-performing real estate loans had insignificant effect on our asset quality, deposit reserve, profit and capital adequacy ratio for the relevant periods.

With regard to our loans to local government financing vehicles, we have been focusing on improving the management of customer admission, credit assessment, project evaluation, fund supervision and post-disbursement management. We have increased the credit approval threshold for local government financing vehicles so that only the credit approval committee at our head office can approve such loans. We have implemented total and regional limits on loans to local government financing vehicles and constantly adjusted the size of such loans in accordance with the relevant regulatory policies. We have also formulated annual credit approval guidelines specifically for local government financing vehicles to clarify the customer management and exit standards and measures for local government financing vehicle customers, and explore other ways of cooperation with local government financing vehicles.

The CBRC requires all Chinese banks to classify their loans to local government financing vehicles in terms of cash flow coverage ratio, which is calculated as a borrower's cash flow divided by its loan principal and interest payable. The following table sets forth the cash flow coverage status of our loans to local government financing vehicles as of June 30, 2013:

Cash flow coverage status	As a percentage of total loans to local government financing vehicles as of June 30, 2013[5]
Fully covered[1]	99.7%
Basically covered[2]	0%
Half covered[3]	0.3%
Not covered[4]	0%

Notes:

(1) "Fully covered" means that a borrower has sufficient cash flow to repay 100% or more of its loan principal and interest payable.

(2) "Basically covered" means that a borrower has sufficient cash flow to repay 70% to 100% of its loan principal and interest payable.

(3) "Half covered" means that a borrower has sufficient cash flow to repay 30% to 70% of its loan principal and interest payable.

(4) "Not covered" means that a borrower has sufficient cash flow to repay less than 30% of its loan principal and interest payable.

(5) The percentages are shown as rounded figures.

As of June 30, 2013, among our loans to local government financing vehicles, 10.1% was granted to provincial-level vehicles, 44.9% to municipal-level vehicles and 45.0% to vehicles below the municipal level. These loans are distributed by industry among (i) infrastructure, (ii) industrial parks, (iii) land reserve centers, (iv) affordable housing projects and (v) other industries, which accounted for 43.0%, 22.5%, 16.8%, 10.5% and 7.2%, respectively, of our total loans to local government financing vehicles as of June 30, 2013.

To ensure the accuracy of risk assessment and the independence of credit approval, we follow the principle of independent, first-class and professional evaluation and proper balance of risk and efficiency. We have established a multi-level credit approval process based on the credit risk level of loan applications and the types of customers and businesses, including: at our head office, reviews by the credit approval committee, five-reviewer meetings, three-reviewer meetings, dual reviewer and a single reviewer; and at our branches, reviews by the branch-level credit approval committees, three-reviewer meetings, dual reviewer for small business banking and retail loan centers and a single reviewer for low-risk businesses.

Credit Risk Management For Corporate Loans

Customer Applications and Pre-loan Review

We formulate credit policies on an annual basis to manage fund allocation, optimize loan portfolio and reduce credit risk. Our credit policies consist of industry credit guidelines, credit assessment guidelines and customer intake guidelines. We adjust our credit policies based on China's industrial policies, the development of different industries, and the implementation of our industry-specific credit policies.

We commence the pre-loan review process upon receipt of a corporate loan application, typically at our branch or sub-branch. The applicant is generally required to file a credit application with necessary supporting documents, such as organizational documents and financial statements of the applicant, and documents relating to the guarantors, where applicable. We also proactively offer credit to potential clients with low credit risk, based on our analysis of their financial condition, industries and the primary areas of operation.

Pre-loan Due Diligence Review

Authorized officers at the relevant branch or sub-branch investigate the truthfulness, completeness and validity of the application materials. After the application passes the preliminary screening, the loan officers commence a pre-loan due diligence review focusing on a number of factors, including:

- the applicant's organizational structure and the credentials of its management team;
- the applicant's credit history, including its credit ratings, contingent liabilities and relationship with us;
- the applicant's business scope, core businesses and operation plans;
- the market and industry environment in which the applicant operates;
- the applicant's financial condition, including its profitability, accounts payable and accounts receivable, operating cash flow and indebtedness;
- the applicant's related parties and related party transactions;
- the purpose of the loan and the potential sources of repayment;
- the title and value of the collateral; and
- the creditworthiness of the guarantor.

The authorized officers are responsible for preparing a pre-loan evaluation report with detailed analysis of the above factors and a preliminary opinion on the application. The report, together with other application materials, will then be submitted to our credit assessment department for review and approval.

Customer Credit Rating

As a part of the pre-loan review process, authorized officers at the relevant branch or sub-branch are also required to initiate a credit rating on the loan applicant according to our credit rating policies and our 14-grade rating system. We rate a corporate customer based on a number of factors, such as its creditworthiness, qualification of senior management, competitiveness and growth prospects of main business and debt repayment ability.

Our internal rating system for non-retail customers uses both scoring cards and a default model to estimate the probability of default. The evaluation results of our clients have exhibited correlation with their probability of default. Based on the scores, we rate our corporate customers from AAA to D. We generally reject the loan applications of customers with credit ratings below BB. The following table illustrates our 14-grade rating system for our corporate customers:

Credit Rating	Creditworthiness	Qualification of Management	Competitiveness of Main Business	Growth Prospects of Main Business	Debt Repayment Ability	Value to Our Business
AAA	Excellent	Excellent	Extremely Strong	Good	Extremely Strong	Highly Valuable
AA+	Good	Good	Very Strong	Fair	Strong	Valuable
AA	Good	Good	Fairly Strong	Fair	Fairly Strong	Valuable
AA-	Good	Good	Some Competitiveness	Some Growth Prospects	Somewhat Assured	Valuable
A+	Fair	Fair	Competitive	Somewhat Uncertain	Assured	Some Value
A	Fair	Fair	Some Competitiveness	Uncertain	Somewhat Assured	Some Value
A-	Fair	Fair	Some Competitiveness	Clearly Uncertain	Somewhat Assured	Some Value
BBB	Average	Average	Average	Average	Average	Average
BB	Average	Average	Fairly Weak	Fairly Poor	Fairly Weak	Average
B	Average	Average	Fairly Weak	Poor	Weak	Not High
CCC	Problematic	Average	Fairly Weak		Weak	Fairly Low
CC	Fairly Poor	Fairly Poor	Weak		Weak	Low
C	Poor	Poor	Extremely Weak		Extremely Weak	Extremely Low
D	In Default at the Time of the Rating					

Our credit rating system utilizes different scoring methods according to the types of companies and the industries in which they operate. We currently have five basic credit rating models and two special rating models based on the types of corporate customers, including large- and medium-sized corporations, small enterprises, public institutions, guarantee companies and financial institutions. We have 22 different industry-specific models within the five basic models. For example, our basic credit rating model for large- and medium-sized corporate customers consists of 14 industry-specific models.

We generally re-rate each customer and guarantor on an annual basis. We may also re-rate a customer or guarantor when there is a material change in general macroeconomic conditions, industry environment, or such customer's or guarantor's business operations and debt repayment history that could negatively impact such customer's or guarantor's debt repayment ability or creditworthiness.

Collateral Appraisal

For secured loans, we generally require the value of collateral to be determined by third-party appraisers approved by us. Secured loans are generally subject to loan-to-value ratio limits based on the type of collateral. The maximum loan-to-value ratios of our principal types of collateral for corporate loans are as follows:

Types of Collateral	General Maximum Loan-to-Value Ratio
RMB deposit receipts, bank notes, PRC treasury bonds	90%
Debt securities issued by financial institutions	80%
Construction land use rights	70%
Commercial buildings and residential buildings	70%
Office buildings	60%
Commodity warehouse receipts	60%

We generally require regular re-appraisal of collaterals. In respect of guarantees provided by third-party guarantors, we evaluate the guarantor's financial condition, credit history and ability to meet its obligations according to the same procedures and criteria we use for evaluating the loan applicant.

Credit Review and Approval

Our credit assessment department commences its credit review upon receiving required documents, such as the loan application and the pre-loan evaluation report. The process begins with a compliance review of the application, followed by a detailed analysis of the major risks of the loan and remedial measures, in view of the regulatory requirements and our internal policies. In particular, our reviewers consider the following aspects of the application:

- whether the applicant meets our basic requirements;
- whether the loan amount is appropriate;
- the applicant's operating capabilities and debt repayment ability;
- the potential risks of the loan and the availability of remedial measures;
- the qualification and repayment ability of the guarantor; and
- the sufficiency and liquidity of the collateral.

After considering the above factors, the credit reviewers will report to the appropriate approving body for corporate loans with respect to the amount, tenor, interest rate, guarantee and repayment method of the loan.

Fund Disbursement and Post-disbursement Management

Fund Disbursement

Once a corporate loan application is approved, we will enter into a standard loan agreement and ancillary agreements with the borrower, which stipulate the key terms of the loan, including amount, duration, interest rate, use of funds and repayment method. Our relevant branch and sub-branch will review the loan agreement and other required disbursement documents to ensure that the documents have been validly authorized and properly completed before submitting the same to the disbursement department. The disbursement department authorizes the fund disbursement after confirming that all conditions for disbursement have been satisfied.

Post-disbursement Management

Our post-disbursement management primarily consists of fund disbursement monitoring, post-disbursement inspection, risk monitoring and alert, collateral management, loan risk classification, overdue loan management, non-performing loan management and post-disbursement management reporting.

Once we disburse funds to loan applicants, we closely monitor the use of the funds to ensure that the funds are being used according to the loan agreement.

We conduct regular and special reviews of the status of our borrowers. During regular onsite visits, we interview the senior management of the borrower, inspect inventories and operating facilities and review management accounts. The frequency of our subsequent post-disbursement inspections varies depending on the classification of loans. For loans classified as special mention or substandard, the frequency of our on-site inspection is no more than 60 days. We conduct special risk inspection and take risk mitigating measures upon discovery of significant risks in the borrower's industry, material adverse changes in the borrower's business, or other risk alerts during our on-site or off-site inspections. We also perform circumstantial investigations based on publicly available information and information from the PBOC's credit system.

To detect and mitigate credit risks at an early stage, we have formulated risk alert measures and established risk alert mechanisms for our corporate loans at both our head office and our branches. We classify credit risk alerts into three levels, namely, low risk (yellow warning), medium risk (orange warning) and high risk (red warning). Upon receipt of a risk alert, the risk management department at the relevant branch will determine the level of risk, report to the risk management department at our head office pursuant to its authorization and take appropriate mitigating measures. Our head office will issue a risk alert notice to the relevant branch and provides advice on mitigating measures when identifying problematic loans.

With respect to collateral management, we have standardized our collateral management process and system, enhanced the management of third-party appraisers and improved the documentation of collateral. Our relevant business department records the collateral in our centralized credit management system. Our risk management department will require the relevant business department to promptly dispose of the collateral or request additional collateral when it detects signs of damage or devaluation of the collateral.

Loan classification is an important part of our ongoing loan monitoring. Based on the five-category loan classification (normal, special mention, substandard, doubtful and loss) as required by the CBRC, we further classify our corporate loans into 12 categories, which include four categories of normal loans, three categories of special mention loans, two categories of substandard loans, two categories of doubtful loans and one category of loss loans. We consider the loans in the substandard, doubtful and loss categories as non-performing loans. The factors we consider when classifying our loans include the borrower's repayment ability, guarantees, collateral and the length of any prior payment default. We report our five-category loan classification data to the CBRC on a monthly basis.

We conduct on-site or off-site inspections of borrowers before maturities of the loans to evaluate their repayment ability and repayment intention and determine the possibility of their timely repayment. We remind borrowers of making timely payments through telephone interviews, on-site visits and written notices. We take appropriate risk prevention measures for those whose repayment ability and repayment intention is in question.

We proactively manage non-performing loans to reduce our credit risk and improve our collection abilities. We formulate strategies and disposal plans for each non-performing loan. We seek to collect our non-performing loans through multiple means, including cash collection, foreclosure on collateral, legal proceedings, loan restructuring and write-off of doubtful debt.

We have established a post-disbursement management reporting system, which requires each branch to report the results of its post-disbursement inspections to our head office on a quarterly basis.

Credit Risk Management for Retail loans

Loan Applications and Pre-loan Review

When we receive a retail loan application, our retail loan department of the relevant branch or sub-branch will initiate the credit extension process by interviewing applicants and conducting onsite investigation. An applicant must provide certain required documents to support his or her loan application, such as personal identification card, employment letter and proof of income. Based on the result of the pre-approval investigation, a loan officer will prepare a credit evaluation report and submit the application package to appropriate reviewers for review.

Credit Review and Approval

Retail loan reviewers review the completeness of the application package and the applicant's risk profile. The reviewers assess the credit risk associated with a retail loan based on a number of factors, including the applicant's income, creditworthiness, marital status, net worth and sources of funding for repayment, the value of collateral (if any) and the purposes of the loan. Based on the foregoing analysis, the reviewers determine the key terms of the loan such as amount and interest rate. Applications for large loans or loans involving high risks need to be reviewed and approved by the credit assessment department of our head office or other authorized reviewers at our head office. Once an application is approved, our relevant branch or sub-branch will enter into a standard retail loan agreement with the customer and coordinate with the customer to properly register any collateral for the loan.

We have developed a customer credit rating system, under which we classify our retail customers into eight credit levels based on multiple metrics, including customer background, repayment ability, income, creditworthiness and prior business relationships with us. The following table sets forth our eight-level credit rating system for retail loan applicants:

Credit Rating	Credit Score	Description
A1	90-100	Very good credit; very high income; very high value to our business
A2	80-89	Good credit; high income; high value to our business
A3	70-79	Relatively good credit; relatively high income; relatively high value to our business
B1	60-69	Medium credit, medium income; some value to our business
B2	50-59	Medium credit; medium income
C1	40-49	Relatively poor credit; relatively low income
C2	0-39	Poor credit; low income
D	N/A	Customers with history of default

To improve our measurement and management of personal credit assets, we began to develop our retail credit risk internal rating system in 2012 in accordance with the requirements of Basel II. We completed the development of credit scoring models and the classification of retail assets in 2012 for four categories of products, namely, residential mortgage loans, personal automobile loans, personal business loans and credit cards. We will continue to use the internal rating results of retail loan assets as an important basis for our business decisions throughout the retail loan management process, including customer approval, credit review and approval, post-disbursement management, risk management and capital allocation.

Loan Disbursement and Post-disbursement Management

The disbursement procedures for retail loans are similar to those for corporate loans. Our disbursement department, whose operations are entirely independent from the loan assessment process, reviews loan documents to ensure that all the conditions for disbursement have been satisfied. Our accounting department disburses the funds according to the loan agreement and opinions from our disbursement department. We strictly control the use of funds by closely monitoring the actual use of the funds, tracking and inspecting the funds on a regular basis and keeping close contact with the borrower.

We have established an asset quality and risk monitoring system for our retail loan portfolio. The method and frequency of our retail loan monitoring vary according to the nature of the loan and the associated risk exposure. In particular, we conduct regular and special reviews of the financial status of borrowers and guarantors and the value of collateral. We also monitor the source of funds for repayment and focus on material changes in the financial condition of borrowers.

For overdue retail loans, we investigate the reason for default by calling or meeting the borrower or carrying out on-site inspections. If we identify potential default risk, we promptly issue a risk alert and increase the frequency of our post-disbursement inspections. We may stop the disbursement of fund or ask for additional collateral if we think the risk of default is significant. In addition, we undertake a variety of actions to reduce our losses from loan default, such as sending default and collection notices or initiating legal proceedings when necessary.

Credit Risk Management for Credit Cards

We have established a basic risk management system to prevent, monitor and handle risks associated with credit cards. We have also formulated a series of rules and policies in connection with the sales and marketing of credit cards, the review and approval of credit card applications and the recovery of overdue repayments. To prevent fraudulent applications, we conduct personal interview of the applicant upon receipt of a credit card application. We assess applicants' income, employment and creditworthiness with advanced tools such as credit card application scoring model, strictly review applicants' credit profile and grant reasonable credit lines based on our review and analysis. We have established a 24-hour authorization mechanism to enhance the monitoring of credit card transactions. In addition, we have launched a credit card transaction monitoring system to identify suspicious transactions, promptly take effective preventive measures and enhance risk alert management. To enhance the management of overdue credit card repayments, we have established a three-tier coordinated management mechanism at our head office, branches and sub-branches to recover overdue repayments through phone calls, letters, on-site visits or legal proceedings, depending on the risk profile of the cardholders.

Credit Risk Management for Treasury Operations

Our treasury operations include investments in treasury bonds, bonds issued by financial institutions, corporate bonds and other types of securities. We conduct credit risk management of our treasury operations primarily through managing credit ratings and credit lines for counterparties, post-disbursement management and risk appraisal. We assign an aggregate credit limit for all the financial institutions and bond issuers. Our head office reviews our annual credit limits on financial institutions and bond issuers, determines the authorization limits of the relevant departments at our head office and branches, and adjust such authorization limits in response to changes in counterparty risk.

IT Systems for Credit Risk Management

We are committed to improving our risk management with advanced IT systems. We have upgraded and integrated our IT systems to enhance the collection and analysis of customer data, and have established an internal rating system for our corporate banking business and a risk limit management system to provide technical support for our credit risk management. Our corporate credit risk rating system utilizes risk measurement models to establish a risk data analysis platform, which measures the rating results of credit risk for our customers. It provides basis for making risk management-related decisions, and improves our operational efficiency for credit risk management. The risk limit management system measures, sets, monitors and issues alerts for the credit risk limits for our lending and treasury business based on a number of metrics, such as industries, regions, business lines, counterparties and products, controls the scale of our loan portfolio and treasury business and optimizes asset structure through credit limits. In addition, the periodical credit limit monitoring reports provide a basis for the formulation of our credit limit management strategies, our day-to-day monitoring of credit limits and our performance assessment.

To meet our evolving risk management requirements, we will continue to optimize and enhance our existing system functions and develop new systems.

OPERATIONAL RISK MANAGEMENT

Operational risk is the risk of loss resulting from inadequate or problematic internal control procedures, from employees or information technology systems, or from external events. Our primary departments that are exposed to operational risk include our risk management department, human resource department, technology and information department and accounting department. Our risk management department is primarily responsible for formulating policies and procedures for operational risk management, establishing approaches for identifying, assessing, monitoring, controlling and reporting operational risks. Our relevant departments, including all business departments, our human resources department and technology and information department, are directly responsible for managing their own operational risk. They identify and assess their own operational risk using our standardized operational risk assessment methods, and establish and implement effective procedures for monitoring, controlling and reporting operational risk on an on-going basis.

We have established and implemented a system to monitor and report key operational risk indicators, which require each branch to collect, sort out and report relevant operational risk. Our branches and business lines are also required to designate specialists to monitor and evaluate operational risks. In addition, we periodically publish cases and provide training regarding operational risk management, to implement our risk management policies and guidelines across our branches, and facilitate communication and share information among our head office, branches and sub-branches. We supervise and evaluate the adequacy and effectiveness of our operational risk management on a regular basis.

To manage risks related to technology and information systems, we have adopted a number of security measures to strengthen information security and ensure the proper functioning of our information systems. Such measures include firewalls, data encryption and intrusion detection. We maintain real-time data backup for major information systems and communication networks and built an off-site disaster recovery center in Hangzhou, Zhejiang Province in 2009 to minimize risks from system failures.

MARKET RISK MANAGEMENT

Market risk is the risk of loss in on- and off-balance sheet positions arising from movements in market prices. We are exposed to market risk primarily through our banking portfolio and trading portfolio. The primary market risks associated with our banking portfolio are interest rate risk and exchange rate risk. The primary market risk associated with our trading portfolio is the fluctuation of market values of our trading positions, which are affected by movements in observable market variables such as interest rates and exchange rates. Historically, our exposure to material market risks was limited due to the supervision and regulation of interest rates and exchange rates by the PBOC. We expect to be subject to increasing levels of market risk as the PBOC continues to liberalize regulations governing interest and exchange rates and the financial service sector becomes more market-oriented in the PRC.

Our primary departments for market risk management include our financial planning department, risk management department, finance market department and international business department. The principal objective of our market risk management is to keep potential market losses within acceptable levels and enhance earnings stability through independent identification, assessment and monitoring of the market risks inherent to our day-to-day businesses. Our market risk management consists of the identification, measuring, monitoring and control of market risk. In measuring and monitoring market risk, we primarily employ sensitivity analysis, foreign currency exposure analysis, gap analysis, duration analysis, stress test and value-at-risk analysis. We also strictly apply authorization limits, which are determined based on factors such as our overall ability to bear market risk, product type and our business strategy. We set different exposure limits and employ different quantitative measures to manage the different types of market risk in our trading book and banking book. We also continually enhance our treasury operations risk management system, adjust relevant risk parameters and refine our risk measurement model in accordance with regulatory requirements.

Market Risk Management for the Banking Book

Interest Rate Risk Management

Interest rate risk is the exposure of a bank's financial condition to adverse movements in interest rates. Our primary source of interest rate risk is the mismatch in repricing periods of our on- and off-balance sheet assets and liabilities. Maturity or repricing date mismatches may cause changes in net interest income due to fluctuations of the prevailing interest rates. We are exposed to interest rate risk through our day-to-day lending and deposit-taking activities and our treasury operations.

We manage the interest rate risk exposure of our RMB-denominated assets and liabilities on our balance sheet primarily through adjusting the interest rate and managing maturity profile. We perform duration analysis on debt instruments in our investment portfolio to assess the potential price volatility of a bond by measuring its sensitivity to interest rate fluctuations. We use interest rate sensitivity analysis, stress tests and scenario analysis to measure exposures to potential interest rate changes in our investment portfolio.

Exchange Rate Risk Management

Exchange rate risk primarily arises from mismatches in the currency denomination of our on- and off-balance sheet assets and liabilities and mismatches in the currency positions of our foreign currency transactions. We seek to manage the exchange rate risk resulting from mismatches in our assets and liabilities by matching the source and use of our funds. We seek to keep the adverse impact of exchange rate fluctuations within an acceptable range by managing risk exposure limits and the currency structure of our assets and liabilities. In addition, we try to reduce the number of transactions with high exchange rate risk, monitor significant indicators in a real-time manner, and inspect the position of major foreign currencies on a daily basis to manage the exchange rate risk resulting from mismatches in the currency position of our foreign currency transactions.

Market Risk Management for the Trading Book

Market risk in our trading book primarily comes from fluctuations in the value of our financial instruments on the trading book due to changes in exchange rates and interest rates. We employ a number of risk management techniques to monitor and control the market risks of our treasury operations. We monitor and manage open positions, stop-loss limits and value-at-risk of our trading book on a daily basis. To better prevent market risk of our trading book, we introduced a market risk management system (Opics Risk Plus) in November 2009 to enhance our market risk measurement methods. We analyze our potential market risk through various methods, including liquidity analysis, sensibility analysis, scenario analysis and value-at-risk analysis, to enhance our risk measurement and control capability and effectively mitigate the potential losses from interest rate and exchange rate fluctuation. We also conduct sensitivity tests on a quarterly basis and stress tests for our treasury operations on a semiannual basis. Our audit department conducts regular audits on the implementation of our internal procedures for managing our trading book in accordance with applicable regulations and our internal policies.

LIQUIDITY RISK MANAGEMENT

Liquidity risk refers to the risk of failing to liquidate a position in a timely manner to acquire sufficient funds or failing to acquire sufficient funds at a reasonable cost to fulfill payment obligations. Factors affecting our liquidity include the term structure of our assets and liabilities and changes to banking industry policies, such as changes in the requirements relating to loan-to-deposit ratio and statutory deposit reserve ratio. 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 cash flow positions. The objective of our liquidity risk management is to ensure the availability of adequate funding at all times to meet our payment obligations and fund our lending and investment operations on a timely basis.

The risk management committee of our board of directors and the asset and liability management committee and the risk management and internal control committee at our senior management level are collectively responsible for establishing policies and strategies relating to our overall management of liquidity risk. Our board of supervisors is responsible for overseeing the implementation of these policies by our financial planning department and relevant business departments.

When developing our liquidity risk management strategy, we consider a number of factors, including our financial position, business development plans, market conditions and the convertibility of currencies. We also seek to achieve an optimal return while balancing our liquidity and other needs. We have implemented various measures to control liquidity risk, such as:

- improving liquidity management measures and contingency plans;
- continuing to enhance our asset and liability management system and stress test system;
- monitoring liquidity ratios in compliance with regulatory and internal requirements; and
- preparing regular maturity gap analyses to enable management to review and monitor our liquidity position on a timely basis.

We conduct stress tests on a quarterly basis to analyze our liquidity risk, and have developed contingency plans to ensure the availability of adequate liquidity under a variety of market conditions. We have also established emergency groups at our head office, branches and sub-branches to handle liquidity-related emergencies. The group consists of our president as the head of the group, a vice president, and the supervisors of relevant departments of our head office, including the financial planning department, the office, the risk management department, the operations management department and the compliance department. The group organizes various departments to handle liquidity-related emergencies by implementing the following measures:

- establishing forecast and early warning mechanisms for liquidity-related emergencies and improving daily monitoring and analysis of liquidity risk limits;
- promptly determining the nature, potential risk and controllability of a liquidity emergency, implementing contingency plans on a timely basis, and taking immediate actions within its authority;
- reducing the impact of the events and restoring ordinary business operations in a timely manner, and monitoring relevant risk factors on an on-going basis to prevent future occurrence of similar events.

The New Capital Adequacy Regulations (Provisional), which were promulgated by the CBRC based on the Basel III, set out more stringent requirements on the capital adequacy ratio and liquidity of commercial banks. In response, we have established a dedicated steering group and organized relevant departments to establish a focus team to coordinate the implementation of the new regulatory standards. Moreover, we have developed plans to implement the new regulatory standards, analyzed the possible effects of the new standards on us, and formulated concrete measures to implement the new standards, which include continuously providing capital management-related training programs and strengthening the monitoring of the uses of capital.

REPUTATIONAL RISK MANAGEMENT

Reputational risk is the risk of negative publicity caused by our operations, management or other activities or external events. The offices of our head office and branches are responsible for managing our public relations and monitoring, reporting and handling incidents that may affect our reputation. We have formulated reputational risk management policies and guidelines to streamline the identification, reporting and management of significant reputational incidents. We have also established a reputational risk emergency control steering group at our head office to guide and coordinate various departments' to handle reputational risk-related emergencies, and to decide whether to launch reputational risk emergency plans based on the nature and severity of the incidents. The steering group comprises our president as the head of the group, president of the relevant outlet as the deputy head and supervisors of relevant departments of our head office, including the office of the board of directors and the board of supervisors, the office of our head office, the risk management department and the compliance department. In addition, we closely monitor and promptly deal with negative reputational incidents, and strengthen our efforts to communicate with news agencies and other media.

LEGAL AND COMPLIANCE RISK MANAGEMENT

Legal and compliance risk refers to the risk of potential legal sanctions, regulatory penalties, significant financial losses and reputational harm resulting from failure to comply with applicable laws and regulations. Our compliance department is in charge of managing our legal and compliance risks, and coordinating the establishment of our internal control system. To strengthen our legal and compliance management capabilities, we have established, and will continue to strengthen, our bank-wide compliance management framework. We periodically review applicable rules and regulations and compile separate catalogs of effective and repealed rules and regulations. We also conduct compliance review of our internal rules and legal documents on a regular basis, and provide legal advice with respect to the research and development of new financial products or businesses.

Anti-Money Laundering

We have formulated comprehensive anti-money laundering rules and procedures in accordance with the Anti-Money Laundering Law of the PRC and other applicable regulations promulgated by the PBOC. Our board of directors oversees our bank-wide implementation of anti-money laundering policies, supervises senior management with respect to the formulation and implementation of anti-money laundering rules and procedures, review reports from senior management on any major anti-money laundering matters and our overall money-laundering risk profile, and adjusts our anti-money laundering policies on a timely basis. Our anti-money laundering steering group at the senior management level leads and coordinates our bank-wide anti-money laundering efforts. See "—Risk Management Structure—Senior Management and Special Committees." Our compliance department is responsible for the day-to-day management of our anti-money laundering work. The head of our anti-money laundering team in our compliance department has extensive experience in the banking industry and in-depth knowledge in anti-money laundering laws and regulations. He has 13 years of experience working at banks in Anhui, including our bank and our predecessor, Hefei City Commercial Bank Corporation Limited, holding several positions in compliance, accounting, deposit taking and technology.

We regard anti-money laundering as an important aspect of legal and compliance risk management. We provide on-going training to our employees on the importance of preventing money-laundering activities. In addition to live and video training programs, we also invite anti-money laundering specialists from the PBOC and our key anti-money laundering personnel to give presentations on new laws and regulations and our bank's rules and procedures with respect to anti-money laundering. We also organize various branch-level anti-money laundering activities, such as quiz, speech contests and writing contests, to promote anti-money laundering at our branches.

In recent years, we have taken the following initiatives to improve our anti-money laundering management:

- developing and refining a "risk-cautious, customer-centered and procedure-streamlined" anti-money laundering risk control system and formulating internal control rules on anti-money laundering;
- improving anti-money laundering mechanism and defining duties, responsibilities and working procedures for anti-money laundering efforts;
- establishing a risk assessment indicator system to assess risks relating to money laundering products and customers, and strengthening risk control measures for businesses and customers with high risks;
- strengthening customer identification and the record-keeping of our customers' identities and transactions;
- enhancing the screening, identification and reporting of suspicious transactions;
- establishing and upgrading anti-money laundering information systems in line with the changing regulatory policies;
- collecting and processing anti-money laundering information to provide prompt risk alerts and updates;
- analyzing money laundering cases, summarizing money laundering risk characteristics and formulating guidelines for analyzing suspicious transactions;
- providing anti-money laundering training and related performance assessment, and enhancing employee admission procedures for anti-money laundering positions; and
- organizing reviews, examinations and internal assessment relating to anti-money laundering.

INTERNAL AUDIT

We believe internal audit is essential to our stable operations and sustainable development. We have established an independent vertical internal audit system. The internal audit committee of our board of directors inspects, oversees and evaluates our overall internal audit work. The senior manager designated by the board of directors guides our internal audit and directly reports to the board of directors. The audit department at our head office, together with audit teams established in accordance with our business development requirements, performs audits on our operations and management.

We have formulated a series of internal audit rules and policies, including the internal audit charters, specific guidelines and accountability measures for internal auditors. Such rules clearly set forth the principles, departments, personnel, duties, authorities, procedures and responsibilities for our internal audit.

We review, evaluate and improve our operation, risk management, internal control and corporate governance through systematic and standardized internal audit methods. Our internal audit complies with principles of independence, objectivity, prudence, efficiency, importance and relevance. The primary objectives of our internal audit are to ensure our compliance with applicable laws and regulations, keep risks within the levels set by our board of directors and improve our operations.

We conduct audits through on-site audits, off-site audits and audit investigations. Our audit procedures consist of audit planning, preparing, deposition, reporting and subsequent audit.

The audit department formulates mid- and long-term audit plans and annual audit plans, which are implemented upon the approval by the board of directors. Based on the approved audit plans, the audit department selects appropriate audit methods and forms, formulates appropriate audit plans and working procedures, utilizes advanced audit methods and instruments and clarifies the responsibilities of audit staff to ensure that our internal audit functions are carried out in a proper and orderly manner.

The audit department is required to truthfully identify problems discovered during the audit process, prepare objective audit reports with audit analysis, audit evaluation, proposals and other audit information, and submit these reports to the senior manager designated by the board of directors and the chairman of the board. Once approved, the audit reports will be submitted to the chairman of the supervisory committee, the president and the audit objects in accordance with audit procedures. The audit department reports to the audit committee on a regular basis. The designated senior manager in charge of internal audit regularly reports the status of audit to the board of directors. Audit reports are submitted to the senior management and the board of supervisors simultaneously. The audit department submits audit reports and other reports to regulatory authorities upon request.

The audit department conducts subsequent audits on completed audit projects to ensure that the audit objects have taken proper and effective corrective measures to solve the issues identified during audits in response to audit suggestions.