
SUPERVISION AND REGULATION

PRC BANKING SUPERVISION AND REGULATION

Overview

The PRC banking industry is highly regulated. The principal regulatory authorities in the PRC banking industry include the CBRC and the PBOC. The CBRC is responsible for supervising and regulating banking institutions and the PBOC, as the central bank of the PRC, is responsible for formulating and implementing monetary policies. We are also subject to regulation by the MOF. The principal laws relating to the PRC banking industry are the PRC Commercial Banking Law (中華人民共和國商業銀行法), the PRC People's Bank of China Law (中華人民共和國中國人民銀行法) and the PRC Banking Supervision and Regulatory Law (中華人民共和國銀行業監督管理法) and the rules and regulations promulgated thereunder.

History and Development of the Regulatory Framework

Established on December 1, 1948, the PBOC was initially the primary regulator of the financial industry in the PRC. In January 1986, the State Council promulgated the Interim Regulation of the PRC on the Supervision of Banks (中華人民共和國銀行管理暫行條例), which explicitly provided, for the first time, that the PBOC was the central bank of the PRC and the regulatory authority for the PRC financial industry.

The current regulatory framework of the PRC banking industry began to emerge in 1995 with the enactment of the PRC People's Bank of China Law (中華人民共和國中國人民銀行法) and the PRC Commercial Banking Law (中華人民共和國商業銀行法). The PRC People's Bank of China Law (中華人民共和國中國人民銀行法), which was enacted in March 1995, provided for the scope of responsibilities and the organizational structure of the PBOC and authorized the PBOC to administer Renminbi, implement monetary policies and regulate and supervise the PRC banking industry. The PRC Commercial Banking Law (中華人民共和國商業銀行法) was promulgated in May 1995 and laid down the fundamental principles of operations for PRC commercial banks.

Since then, the regulatory regime of the PRC banking industry has undergone further significant reform and development. The CBRC was established in April 2003 and took over from the PBOC its role as the primary regulator of the PRC banking industry. The CBRC was mandated to implement reforms, minimize overall risks, promote stable development and enhance the international competitiveness of the PRC banking industry. In December 2003, the PRC Commercial Banking Law (中華人民共和國商業銀行法) and the PRC People's Bank of China Law (中華人民共和國中國人民銀行法) were amended. The PRC Banking Supervision and Regulatory Law (中華人民共和國銀行業監督管理法) came into effect on February 1, 2004, and sets out the regulatory functions and responsibilities of the CBRC.

SUPERVISION AND REGULATION

Principal Regulators

CBRC

Functions and Powers

The CBRC is the principal regulatory authority responsible for the supervision and regulation of banking institutions operating in the PRC, including commercial banks, urban credit cooperatives, rural credit cooperatives, other deposit-taking financial institutions and policy banks, as well as certain non-banking financial institutions, such as financial asset management companies, trust and investment companies, financial companies, financial leasing companies and other financial institutions, whose establishments are subject to the CBRC's approval. The CBRC is also responsible for the supervision and regulation of the entities established by domestic financial institutions outside the PRC and the overseas operations of the above-mentioned banking and non-banking financial institutions. According to the PRC Banking Supervision and Regulatory Law (中華人民共和國銀行業監督管理法) and relevant regulations, the CBRC's primary regulatory responsibilities include:

- formulating and promulgating rules and regulations governing banking institutions and their activities;
- examining and approving the establishment, change and termination of banking institutions and their scope of business, as well as granting banking licenses to commercial banks and their branches;
- regulating the business activities of banking institutions, including their products and services;
- approving and overseeing qualification requirements for directors and senior management of banking institutions;
- setting prudential guidelines and standards for risk management, internal control, capital adequacy, asset quality, allowance for impairment losses, risk concentration, related party transactions and asset liquidity requirements for banking institutions;
- conducting on-site examinations and off-site surveillance of the business activities and risk levels of banking institutions;
- imposing corrective and punitive measures for violations of applicable banking regulations; and
- drafting and publishing statistics and financial reports of national banking institutions.

Examination and Supervision

The CBRC, through its head office in Beijing and branches throughout the PRC, monitors the operations of banks and their branches through on-site examinations and off-site surveillance. On-site examinations generally include inspections of a bank's business premises, interviews with employees, senior management and directors with respect to significant issues relating to the bank's operations and risk management, as well as a review of relevant documents and materials kept by the bank. Off-site surveillance generally involves the review of various business reports, financial statements and other reports regularly submitted by banks to the CBRC.

If a banking institution is not in compliance with an applicable banking regulation, the CBRC is authorized to impose corrective and punitive measures, including fines, suspension of certain business activities, stop on approving new operations, restrictions on dividends and other forms of distributions and asset transfers, compulsory transfer of equity interests by the controlling shareholder or restrictions on the rights of relevant shareholders, replacement of the directors and senior managerial personnel or restrictions on their rights and suspension of opening of new branches. In extreme cases or when a banking

SUPERVISION AND REGULATION

institution fails to take corrective actions within the period specified by the CBRC, the CBRC may order it to suspend operations and revoke its financial operating license. In the event of crisis or bankruptcy of a banking institution, the CBRC may assume management control over, or arrange for the restructuring of, such banking institution.

PBOC and Inter-departmental Coordination Joint Meeting for Financial Supervision

As the central bank of the PRC, the PBOC is responsible for formulating and implementing monetary policies and maintaining the stability of the PRC financial markets. According to the PRC People's Bank of China Law (中華人民共和國中國人民銀行法) and relevant regulations, the PBOC is empowered to:

- promulgate and implement orders and regulations in relation to its duties;
- formulate and implement monetary policy in accordance with the laws;
- issue Renminbi and administer its circulation;
- regulate the inter-bank money market and the inter-bank bond market;
- implement foreign exchange controls and regulate the inter-bank foreign exchange market;
- regulate the gold market;
- hold, administer and manage state reserves of foreign exchange and gold;
- manage the national treasury;
- safeguard the normal operation of payment and clearing systems;
- guide and orchestrate the financial industry in its anti-money laundering activities and take responsibility for monitoring capital in respect of anti-money laundering;
- take responsibility for financial industry statistics, surveys, analyses and forecasts;
- participate in international financial activities in its capacity as the central bank of the PRC; and
- undertake other duties as prescribed by the State Council.

On August 15, 2013, the State Council issued the Reply of the State Council on the Establishment of the Inter-departmental Coordination Joint Meeting System for Financial Supervision (國務院關於同意建立金融監管協調部際聯席會議制度的批復), which aims to build up such system. The PBOC shall take the lead at the joint meetings, with the CBRC, the CSRC, the CIRC and the SAFE being the major members. The NDRC and the MOF may be invited to attend the joint meetings, if necessary.

MOF

As a ministry under the State Council, the MOF is empowered to perform its duties in respect of state finance, taxation and state-owned assets management. The MOF mainly regulates the performance review and compensation systems for senior management of state-controlled banks as well as state-owned assets appraisal. Since the China Accounting Standards for Business Enterprises (企業會計準則), which were issued by the MOF, came into effect on January 1, 2007, the MOF is also responsible for monitoring their implementation in the banking industry. The MOF's primary responsibilities include:

- drafting regulations in respect of fiscal, finance and accounting management, enacting rules, organizing international negotiations regarding foreign-related finance and debt and agreeing on the form of relevant agreements and accords;
- managing state-owned financial assets, participating in drafting rules in relation to state-owned assets management and administering assets appraisal; and
- monitoring and inspecting the implementation of financial and tax rules and policies, reporting critical issues in fiscal income and expenses management and managing supervising commissioners' offices.

SUPERVISION AND REGULATION

Other Regulatory Authorities

In addition to the above regulators, commercial banks in the PRC are also subject to supervision and regulation by other regulatory authorities, including, but not limited to, the SAFE, the CSRC, the CIRC, the NAO, the SAT and the SAIC.

Licensing Requirements

Basic Requirements

The PRC Commercial Banking Law (中華人民共和國商業銀行法) and the Measures for Implementation of Administrative Licensing Matters Concerning Chinese-funded Commercial Banks (中資商業銀行行政許可事項實施辦法), effective from February 1, 2006 and amended on December 28, 2006 and October 15, 2013, set out the permitted scope of business, licensing standards and other requirements in respect of commercial banks. The establishment of a commercial bank requires the CBRC's approval and issuance of an operating license. The conditions include, but are not limited to, the following:

- the articles of association of the proposed commercial bank comply with the relevant requirements of the PRC Commercial Banking Law (中華人民共和國商業銀行法) and the PRC Company Law (中華人民共和國公司法);
- the minimum registered capital requirements under the PRC Commercial Banking Law (中華人民共和國商業銀行法) are RMB1,000 million for national commercial banks, RMB100 million for city commercial banks and RMB50 million for rural commercial banks;
- the directors and the senior management of the proposed commercial bank possess the requisite professional knowledge, working experience and qualifications;
- the organizational structure and management system of the proposed commercial bank are properly established;
- the business premises and security measures of the proposed commercial bank, as well as other business related facilities, comply with the relevant requirements; and
- the commercial bank to be established has set up a sound information technology structure which (i) matches, and is necessary to support, its business operations, (ii) is safe, (iii) complies with the relevant laws and regulations and (iv) possesses the technologies and measures to ensure its effectiveness and safety.

Significant Changes

The commercial banks are required to obtain the CBRC's approval to undertake significant changes, including, but not limited to, the following:

- change of name;
- change of registered capital;
- change of location of head office or branch;
- change of form of organization;
- change of business scope;
- any change of shareholders holding 5% or more of the bank's total capital or shares;
- amendment to the articles of association;
- merger or division; and
- dissolution and liquidation.

SUPERVISION AND REGULATION

Establishment of Branches

Domestic Branches

A commercial bank must apply to the CBRC or its local offices for approval and issuance of a business license and banking license to establish a domestic branch. To obtain such business license, the branch must have sufficient operating funds commensurate with its business scale and must meet other operating requirements.

Overseas Branches

The establishment of overseas branches by a PRC commercial bank is subject to the CBRC's approval and must also comply with all applicable regulations in the relevant foreign jurisdictions. The commercial bank making such application must comply with the following conditions:

- it has a clear strategy for overseas development;
- it has sound consolidated management capabilities;
- in principle, the balance of the equity investment should not exceed 50% of its net assets (on a consolidated basis);
- it has been profitable for the past three consecutive fiscal years;
- its total assets exceed RMB100 billion at the end of the year prior to the application;
- it owns a team of professional staff suitable for its overseas operational environment;
- it has established a good corporate governance system, as well as sound and effective internal control measures and its business line management and risk management capabilities are suitable for its overseas business development;
- its major indicators for prudent controls and management comply with regulatory requirements; and
- it satisfies other prudent conditions required by the CBRC.

Scope of Business

Under the PRC Commercial Banking Law (中華人民共和國商業銀行法), commercial banks in the PRC are permitted to engage in any or all of the following activities:

- taking deposits from the public;
- making short-term, medium-term and long-term loans;
- handling domestic and overseas payment settlements;
- bill acceptance and discounting;
- issuing financial bonds;
- acting as agents to issue, honor and underwrite government bonds;
- trading government bonds and financial institution bonds;
- engaging in inter-bank lending;
- engaging in foreign exchange trading as principals or as agents;
- engaging in bank card business;
- providing letters of credit and guarantee services;
- collecting and making payment as agents and acting as insurance agents;
- providing safe deposit box services; and
- other businesses approved by the banking regulatory authorities under the State Council.

SUPERVISION AND REGULATION

Commercial banks in the PRC are required to stipulate their scope of business in their articles of association and submit their articles of association to the CBRC for approval. Subject to approval by the PBOC and the SAFE, commercial banks can engage in settlement and sales of foreign exchange.

Regulation of Principal Commercial Banking Activities

Lending

To control risks relating to credit extension, PRC banking laws and regulations require that commercial banks should, among other things: (i) establish a strict and uniform credit risk management system; (ii) establish standard operating procedures for each step in the extension of credit, including conducting due diligence investigations before granting credit facilities, monitoring borrowers' repayment ability and preparing credit assessment reports on a regular basis; and (iii) make arrangements to appoint qualified risk management personnel.

The CBRC has also issued guidelines and measures to control risks in connection with related party loans. See “– PRC Banking Supervision and Regulation – Corporate Governance and Internal Control – Transactions with Related Parties.”

On July 23, 2009, the CBRC issued the Interim Measures for the Administration of Fixed Asset Loans (固定資產貸款管理暫行辦法) to ensure the flow of credit to critical projects that are vital to the national interest and people's livelihood, increase economy efficiency, prevent credit risk, optimize lending structure, improve the lending management quality of banking institutions, avoid systematic risk in the banking industry and enhance the risk management capabilities of banking institutions.

In addition, the CBRC has issued regulations concerning loans and credit granted to specific industries and customers to control the credit risk of PRC commercial banks. These regulations mainly include:

- the Guidelines on the Management of Risks of Credit Granted by Commercial Banks to Group borrowers (商業銀行集團客戶授信業務風險管理指引), which requires commercial banks to establish a risk management system for credit granted to group-borrowers and file the system with the CBRC. Where a single group-borrower of a commercial bank is deemed to be beyond its capacity for risks, the commercial bank shall adopt measures, including syndicated loans, joint loans and loan transfers, to diversify risks. According to the requirements for prudent supervision, the CBRC may lower the ratio of credit exposure to a single group-borrower;
- the Guidelines on the Management of Risks of Real Estate Credit Granted by Commercial Banks (商業銀行房地產貸款風險管理指引) requires commercial banks to establish real estate credit review and approval standards as well as a risk management and internal control system in connection with market risk, legal risk and operational risk to real estate credit. Commercial banks are not allowed to issue any type of loans to borrowers for real estate projects without the state-owned land use right certificate and other relevant permissions. The CBRC conducts periodic inspections of the implementation of the guidelines;
- the Automobile Loan Management Measures (汽車貸款管理辦法) requires commercial banks to establish credit rating and monitoring systems in connection with automobile loans. The measures also set out certain conditions for automobile loan applications. In addition, the amount of automobile loans shall not exceed 80% of the price of vehicles for self-use purpose, 70% of the price of vehicles for commercial purpose and 50% of the price of second-hand vehicles. Commercial banks shall also require borrowers to give security interests to the bank over their vehicles or other assets to obtain automobile loans;

SUPERVISION AND REGULATION

- the Interim Measures for the Administration of Working Capital Loans (流動資金貸款管理暫行辦法), which requires commercial banks to establish effective internal control and risk management systems to monitor the use of working capital loans and get full access to customer information. Commercial banks shall take reasonable and prudent measures to assess the actual demands of clients and ensure the amount of loans granted shall not exceed actual demands of clients. Commercial banks shall set out definitive and legitimate purposes for working capital loans. Such working capital loans shall not be used for fixed assets investment or equity investment or for fields or purposes prohibited by laws;
- the Guidelines on the Management of Risks of Merger and Acquisition Credit Granted by Commercial Banks (商業銀行併購貸款風險管理指引), which requires commercial banks to establish an operation flow and internal control system pursuant to the guidelines and launch their implementation following reporting to the CBRC. Commercial banks are allowed to operate a merger and acquisition credit business if they meet the following requirements: (i) a sound risk management system and an effective internal control system are established; (ii) allowance adequacy ratio for loan impairment is not less than 100%; (iii) capital adequacy ratio is not less than 10%; (iv) the balance of general reserve is not less than 1% of the balance of loans for the same period; and (v) a professional team for due diligence and risk evaluation is formed. The guidelines also set out certain requirements for risk evaluation and control in relation to merger and acquisition, including overall strategic risk, legal and compliance risk, consolidation risk, operational risk and financial risk;
- the Interim Measures for the Administration of Personal Loans (個人貸款管理暫行辦法), which requires commercial banks to establish an effective full process management mechanism and risk limit management system in connection with retail loans. The measures also set out certain conditions for retail loan applications. The use of retail loans should comply with the relevant laws and policies. Commercial banks must specify the purpose for retail loans;
- the Guidelines on Project Financing Business (項目融資業務指引), which requires banking institutions to establish a sound operation flow and risk management mechanism for project financing. Banking institutions shall fully identify and evaluate risks in association with the project construction period and operation period, including policy risk, financing risk, completion risk, product market risk, over-budget risk, raw material risk, operational risk, exchange rate risk, environmental risk and other related risks. Banking institutions shall also focus on borrowers' repayment capability to evaluate risks taking into consideration technical and financial feasibility as well as repayment sources. In addition, banking institutions shall require borrowers to set up a designated account to receive all revenues from projects, monitor the account and take actions in case of unusual movements;
- the Guiding Opinions of the PBOC, the CBRC, the CSRC and the CIRC on Further Supporting the Restructuring and Revitalization of Key Industries and Curbing Over-production in Certain Industries through Financial Services (中國人民銀行、銀監會、證監會、保監會關於進一步做好金融服務支持重點產業調整振興和抑制部分行業產能過剩的指導意見), which requires that the banking financial institutions to take initiatives to comply with the national industrial policies and financial control requirements and that credit granting shall reflect the principle of “differential treatments with encouragement and discouragement” in the spirit of the Notice of the State Council on Ratifying and Forwarding Several Opinions of the National Development and Reform Commission and Other Ministries on Curbing Over-production and Redundant Construction in Certain Industries and Guiding Sound Development of Industries (國務院批轉發展改革委等部門關於抑制部分行業產能過剩和重複建設引導產業健康發展若干意見的通知). For the enterprises and projects which meet the requirements of the plans for restructuring and revitalizing key industries, comply with market access conditions and conform to

SUPERVISION AND REGULATION

the principles of bank credit, the timely and efficient supply of credit funds shall be ensured. The banking financial institutions shall not provide any form of credit support for projects which do not conform to the plans for restructuring and revitalizing key industries or the requirements of the relevant industrial policies and which fail to go through examination or verification for approval under the prescribed procedures, especially those with obsolete production capacity that the state has expressly ordered to eliminate, those that are examined and approved in violation of laws and regulations and those that are constructed before approval or when awaiting approval, and shall take appropriate and effective measures to protect the safety of bank credit assets. For projects in industries with over-capacity, the banking financial institutions shall strictly examine them before approving any loans;

- the Notice of the PBOC and CBRC on Issues Concerning the Improvement of Differential Housing Credit Policies (中國人民銀行、中國銀行業監督管理委員會關於完善差別化住房信貸政策有關問題的通知), which requires all commercial banks to suspend granting housing loans for resident families to purchase the third set or more sets of housing; to suspend the granting of housing loans to non-residents who cannot provide proof of local taxation or social insurance contributions for more than one year. In terms of loans to buy commercial residential housing, the minimum down payment ratio is adjusted to 30%; in terms of loans to buy the second set of housing per family, the notice stipulates that the down payment shall not be less than 50% of the total price and the interest rate shall not be less than 110% of the benchmark interest rate. In addition, according to the Notice of the State Council on Firmly Curbing Excessive Rise of Housing Prices in Some Cities (關於堅決遏制部分城市房價過快上漲的通知) promulgated by the State Council, commercial banks are required to strengthen the pre-grant examination and post-disbursement management of loans to real estate development enterprises. For those real estate development enterprises which have idle lands and churning of lands, commercial banks shall not grant loans for new development projects;
- the Notice of the General Office of the CBRC on Issues concerning the Improvement of Housing Financial Services and the Reinforcement of Risk Management (中國銀監會辦公廳關於做好住房金融服務加強風險管理的通知) issued on March 2011, which requires that, for personal housing loans granted after the date of the issuance of the Notice of the General Office of the State Council on Issues concerning Further Enforcing the Regulation and Control of Real Estate Market (國務院辦公廳關於進一步做好房地產市場調控工作有關問題的通知), all financial institutions in the banking industry shall strictly implement the credit policy that the down payment ratio for the second set of housing of any family shall not be less than 60% and the interest rate shall not be less than 110% of the benchmark lending rate. On February 26, 2013, the State Council released the Circular on the Continuation of Property Market Control (國務院辦公廳關於繼續做好房地產市場調控工作的通知), requiring that banking and financial institutions strictly follow the policies regarding down payment and lending rates for first-time homebuyers and tighten the credit policies for second-time homebuyers. Relevant ministries should closely cooperate to verify the original value of taxable houses by tracking historical sales data and to impose a 20 percent tax on profit generated from certain residential property transactions; and
- the Notice on Implementing Several Matters relating to the Circular of the State Council on Relevant Issues Concerning Strengthening the Administration of Local Government Financing Vehicles (關於貫徹《國務院關於加強地方政府融資平台公司管理有關問題的通知》相關事項的通知), the Guiding Opinions of the CBRC on Strengthening the Risk Management of Loans to Financing Vehicles (中國銀監會關於加強融資平台貸款風險管理的指導意見), the Notice of Further Implementation of Risk Control and Management of Local Government Financing Vehicles in 2011 (關於切實做好2011年地方政府融資平台貸款風險監管工作的通知), the

SUPERVISION AND REGULATION

Guiding Opinions of the CBRC on Strengthening the Risk Control and Management of Loans to Local Financing Vehicles in 2012 (中國銀監會關於加強2012年地方政府融資平台貸款風險監管的指導意見), which require that banking financial institutions strictly implement the pre-loan investigation, examination at granting and post-disbursement inspection systems for loans to LGFVs, prudently grant loans to LGFVs and apply accurate classifications and implement dynamic adjustment in respect of such loans so as to reflect and assess accurately the risk profile of such loans. Banking financial institutions shall also give overall considerations to the debt burdens of local government and the potential risks and expected losses of loans to LGFVs. The allowance for impairment losses shall be provided reasonably and the risk weighting in calculating capital adequacy shall be determined by full coverage, basic coverage, semi-coverage and non-coverage of such loans. On April 9, 2013, the CBRC issued the Guiding Opinions of the CBRC on Strengthening the Risk Control and Management of Loans to Local Financing Vehicles in 2013 (中國銀監會關於加強2013年地方政府融資平台貸款風險監管的指導意見), which require each bank to restrict the total amounts of LGFVs and not to expand the scale of LGFVs. It also requires the proportion of LGFVs with cash flow coverage ratio lower than 100% and asset-liability ratio higher than 80% not to exceed that of the previous year.

- The CBRC issued the Guiding Opinions on Further Improving Financial Services for Micro-enterprises (關於進一步做好小微企業金融服務工作的指導意見) on August 29, 2013, which require financial institutions in the banking industry to actively adjust credit structure, separately list annual credit plans for micro-enterprises, distribute reasonable tasks to each branch, optimize performance assessment mechanism. Such tasks shall be promoted and implemented by chief responsible persons layer upon layer. At the same time, financial institutions in the banking industry shall fully support micro-enterprises by circulation and securitization of credit assets and invest revitalized capital mainly in micro-enterprises.

We have adopted certain rules and measures to comply with the above regulations. We also enhanced our risk management and internal control capabilities in respect of loans and credit granted to certain specific industries and customers.

Foreign Exchange Business

Commercial banks are required to obtain approvals from the PBOC and the SAFE to conduct foreign exchange businesses. Under the PRC's anti-money laundering laws and regulations, PRC financial institutions are required to report to the SAFE any large or suspicious foreign exchange transactions.

Securities and Asset Management Businesses

Commercial banks in the PRC are generally prohibited from trading and underwriting equity securities. Commercial banks in the PRC are permitted to:

- underwrite and deal in PRC government bonds, financial institution bonds and commercial bonds issued by qualified non-financial institutions;
- act as agents in transactions involving securities, including bonds issued by the PRC government, financial institutions and other corporate entities;
- provide institutional and individual investors with comprehensive asset management advisory services;
- act as financial advisors in connection with large infrastructure projects, mergers and acquisitions transactions and bankruptcy restructuring; and
- act as custodians for funds, including securities investment funds and enterprise annuity funds.

SUPERVISION AND REGULATION

According to the Measures for the Administration of Enterprise Annuity Fund (企業年金基金監督管理辦法) promulgated jointly by the Ministry of Human Resources and Social Security, the CBRC, the CSRC and the CIRC on February 23, 2004, amended on February 12, 2011 and effective on May 1, 2011, commercial banks are required to file with the CBRC to act as a custodian for enterprise annuity funds. Under the Administrative Measures on the Securities Investment Fund Custodianship Business (證券投資基金託管業務管理辦法) promulgated jointly by the CSRC and the CBRC on April 2, 2013, a commercial bank may obtain the qualifications to engage in the fund custodian business if approved by the CSRC and the CBRC. Such approval requires, among others, that the commercial bank holds net assets of not less than RMB2,000 million for each of the previous three fiscal years and its capital adequacy ratio and other risk control indexes fulfill the relevant regulatory requirements. Once engaged in the fund custody business, the fund custodian must ensure the separation of its custodian business from its other businesses, as well as the independence of its fund custody assets from the assets of other funds. The CSRC and the CBRC are jointly responsible for reviewing and approving the qualifications and the supervision and administration of fund custodian business activities undertaken by commercial banks. In addition, the candidates promoted as senior managers of the commercial banks' fund custody department must fulfill certain regulatory requirements.

Insurance

Commercial banks in the PRC are not permitted to underwrite insurance policies, but are permitted to act as agents to sell insurance products through their distribution networks. Commercial banks that conduct agency sales of insurance products are required to comply with applicable rules issued by the CIRC. Pursuant to the Interim Measures on the Administration of Ancillary Agency Insurance Business (保險兼業代理管理暫行辦法) promulgated by the CIRC on August 4, 2000, commercial banks are required to obtain licenses from the CIRC before conducting insurance agency business. Pursuant to the Notice Regarding Standardization of Insurance Agency Business Conducted by Banks (關於規範銀行代理保險業務的通知) issued jointly by the CIRC and the CBRC on June 15, 2006, such licenses are required for all tier-one branches of commercial banks conducting such business.

On February 18, 2009, the General Office of CBRC issued the Notice Regarding Further Standardization of Insurance Agency Business Conducted by Banks (中國銀監會辦公廳關於進一步規範銀行代理保險業務管理的通知), requiring commercial banks to (i) establish due diligence and post-performance evaluation systems and to carefully select the cooperating insurance companies and insurance products sold by agents; (ii) regulate their sales practices and prohibit misleading sales and inappropriate advertising; (iii) standardize the bank-insurance cooperation agreement and strengthen the regulation of selling expenses; (iv) establish a complaint handling system to properly handle complaints, so as to ensure the insurance agency businesses of commercial banks are standardized and to maintain orderly financial markets.

On January 13, 2010, the CIRC and the CBRC jointly promulgated the Notice on Strengthening Restructuring and Improving the Healthy Development of Banks' Life Insurance Agency Services (關於加強銀行代理壽險業務結構調整促進銀行代理壽險業務健康發展的通知), which enhanced supervision over life insurance agency licenses. The notice requires all commercial banks to obtain an insurance agency license issued by the CIRC before engaging in life insurance agency business through their outlets.

SUPERVISION AND REGULATION

On November 1, 2010, the CBRC issued the Notice on Further Strengthening the Sales Compliance and Risk Management of the Bancassurance Business of Commercial Banks (關於進一步加強商業銀行代理保險業務合規銷售與風險管理的通知), which emphasizes that commercial banks that operate the bancassurance business shall follow the principles of openness, equality and fairness and fully protect the interests of clients. The notice also requires that each outlet of the commercial banks shall establish thresholds on the selection and access of insurance companies and in principle, each outlet of a commercial bank may only cooperate with no more than three insurance companies. In addition, this notice has also clearly provided for the functions and obligations between commercial banks and insurance companies when conducting bancassurance business.

On March 7, 2011, the CIRC and the CBRC jointly issued the Guidelines on the Supervision and Regulation of Insurance Agency Business Conducted by Commercial Banks (商業銀行代理保險業務監管指引), which include comprehensive and systematic provision requirements regarding the bancassurance business. According to the guidelines, all commercial banks shall obtain a license issued by the CIRC before engaging in an insurance agency business through their outlets and prevent commercial bribery, misleading sales, unfair price competition and other illegal activities.

Personal Wealth Management Services

On September 24, 2005, the CBRC issued the Provisional Administrative Measures on the Personal Wealth Management Business of Commercial Banks (商業銀行個人理財業務管理暫行辦法). Under these measures, commercial banks are required to obtain CBRC approval to provide guaranteed investment return wealth management plans, new investment products with guaranteed investment return aimed at conducting personal wealth management business and other personal wealth management businesses which require CBRC approval, whereas in respect of certain remaining wealth management services, they are only required to submit a report to the CBRC. Commercial banks are also subject to certain restrictions on offering products under personal wealth management plans. In addition, under the Guidelines on Risk Management Regarding Personal Wealth Management Services of Commercial Banks (商業銀行個人理財業務風險管理指引) issued by the CBRC on September 24, 2005, commercial banks are required to establish an auditing and reporting system in respect of their wealth management services and to report any material risk management problems to the relevant authorities. Thereafter, the CBRC issued a series of regulations in an effort to further improve the reporting mechanism and risk control for personal wealth management services provided by commercial banks. Moreover, in August 2011, the CBRC issued the Administrative Measures on the Sales of Wealth Management Products of Commercial Banks (商業銀行理財產品銷售管理辦法) to further standardize and regulate the sales of wealth management products, which required prudent operation and timely disclosure of the wealth management business in order to fully protect the interests of consumers.

Further, with respect to domestic personal wealth management business, the PBOC, the CBRC and the SAFE jointly promulgated the Provisional Measures for Overseas Wealth Management by Commercial Banks (商業銀行開辦代客境外理財業務管理暫行辦法), which came into effect on April 17, 2006 and permitted duly licensed commercial banks to make overseas investments using funds from investors in pre-approved financial products on behalf of domestic institutions and individuals.

Investment Operations of Wealth Management

On March 25, 2013, the CBRC issued the Notice on Regulating Commercial Bank Wealth Management Business Investment Operation-related Issues (中國銀監會關於規範商業銀行理財業務投資運作有關問題的通知), which regulates the investment operations of commercial banks' wealth management businesses. The key measures of the notice include requiring commercial banks to match each financial product with its investment asset and the investment balance of funds from the wealth

SUPERVISION AND REGULATION

management accounts in non-standard debt instruments shall, at any time, be limited to the lower of 35% of the wealth management product's balance or 4% of the total assets presented in the commercial bank's previous year's audit report.

Electronic Banking

On January 26, 2006, the CBRC issued the Administrative Measures Regulating Electronic Banking Business (電子銀行業務管理辦法) and Security Evaluation Guidelines on Electronic Banking (電子銀行安全評估指引) in an effort to enhance risk management and security standards in this sector. All banking institutions applying to establish an electronic banking business are required to have sound risk management and internal control systems and should not have had any major incidents relating to their primary information management and operations processing systems in the year prior to the application for electronic banking business. In addition, all banking institutions conducting electronic banking business must adopt security measures to ensure information confidentiality and prevent the unauthorized use of electronic banking accounts.

Proprietary Investments

In general, commercial banks in the PRC are prohibited from making domestic investments other than in debt instruments issued by the PRC government and financial institutions, short-term commercial paper, medium-term notes and corporate bonds issued by qualified non-financial institutions, as well as certain derivative products. Unless approved by the PRC government, commercial banks in the PRC are prohibited from engaging in trust investment and securities businesses, investing in real property (other than for their own use), or investing in non-banking financial institutions and enterprises.

Derivatives

On January 5, 2011, the CBRC issued the Measures for Administration of Derivatives Transactions of Financial Institutions in the Banking Industry (銀行業金融機構衍生產品交易業務管理辦法), which set out, among other things, detailed regulations for market access and risk management for the derivatives business conducted by financial institutions. In accordance with the measures, commercial banks in the PRC seeking to conduct derivatives business must meet relevant eligibility requirements and obtain prior approval from the CBRC. Such measures also provide that commercial banks engaged in derivative product transactions relating to foreign exchange, stock and commodities, as well as in exchange-traded derivatives transactions, shall have the derivative product transaction qualification approved by the CBRC and shall abide by foreign exchange administrative rules and other relevant provisions.

Support for, and Encouragement of, Financial Innovation by PRC Commercial Banks

On December 5, 2006, the CBRC promulgated the Guidelines on Financial Innovation of Commercial Banks (商業銀行金融創新指引), the purpose of which is to encourage PRC commercial banks to engage prudently in financial innovation-related activities, including developing new businesses and products, improving existing businesses and products, expanding their scope of business, improving cost efficiency and profitability and reducing their reliance on the lending business for profits. To facilitate financial innovation by PRC commercial banks, the CBRC has indicated that it will streamline the examination and approval procedures for new products and increase the efficiency of the examination and approval process.

SUPERVISION AND REGULATION

Pricing of Products and Services

Interest Rates for Loans and Deposits

In the past, interest rates for RMB-denominated loans and deposits were set by the PBOC. In accordance with the PRC Commercial Banking Law, each commercial bank is required to determine its loan rate in accordance with the minimum limit of loan rate and its deposit rate in accordance with the maximum limit of deposit rate set by the PBOC. In recent years, the PBOC has gradually liberalized its regulation of interest rates, allowing banks more discretion to determine the interest rates for RMB-denominated loans and deposits. The following table sets forth, for the periods indicated, the permitted range of interest rates for RMB-denominated loans and deposits.

	<u>Loans Since July 20, 2013⁽¹⁾</u>	<u>Deposits Since June 8, 2012⁽²⁾</u>
Maximum interest rates.....	No cap (up to 230% of the PBOC benchmark interest rate for rural and urban credit cooperatives)	110% of the PBOC benchmark interest rate, except for negotiated deposits
Minimum interest rates	No minimum	No minimum

Notes:

- (1) From March 17, 2005 to August 18, 2006, interest rates for residential mortgage loans were regulated in the same way as most other types of loans. From August 19, 2006 to October 26, 2008, the minimum interest rates for personal commercial residential mortgage loans were 85% of the PBOC loan benchmark interest rate. Since October 27, 2008, the minimum interest rates for personal commercial residential mortgage loans have changed to 70% of the PBOC loan benchmark interest rate. Since April 17, 2010, the minimum interest rates for the mortgage loans of the second residential property purchased by a PRC family have been changed to 110% of the PBOC loan benchmark interest rate. Since July 20, 2013, the PBOC removed the lower limit for new loans provided by commercial banks, except for new residential mortgage loans, which remains at 70% of the PBOC benchmark lending rate.
- (2) Beginning on October 29, 2004, commercial banks in the PRC are permitted to set their own interest rates on RMB deposits so long as such interest rates are not higher than the relevant PBOC benchmark interest rates. However, these restrictions do not apply to interest rates on negotiated deposits, which are deposits by domestic insurance companies in amounts of RMB30 million or more or deposits by the provincial social security agencies in amounts of RMB500 million or more, both with a term longer than five years.

From August 19, 2006 to July 6, 2012, the PBOC adjusted the benchmark interest rate for RMB-denominated loans and the benchmark interest rate for RMB-denominated deposits on 19 and 18 separate occasions, respectively. Since then and as of the Latest Practicable Date, the PBOC has not adjusted the benchmark interest rate for RMB-denominated loans and the benchmark interest rate for RMB-denominated deposits.

SUPERVISION AND REGULATION

The following table sets forth the PBOC benchmark interest rates for RMB-denominated loans since August 19, 2006.

Date of adjustment	Six months or less	Six months to one year (inclusive of one year)	One to three years (inclusive of three years)	Three to five years (inclusive of five years)	More than five years	Residential Mortgage Loans		Housing Provident Fund Loans	
						Five years or less	More than five years	Five years or less	More than five years
(Interest rate per annum %)									
August 19, 2006	5.58	6.12	6.30	6.48	6.84	6.48	6.84	4.14	4.59
March 18, 2007	5.67	6.39	6.57	6.75	7.11	6.75	7.11	4.32	4.77
May 19, 2007	5.85	6.57	6.75	6.93	7.20	6.93	7.20	4.41	4.86
July 21, 2007	6.03	6.84	7.02	7.20	7.38	7.20	7.38	4.50	4.95
August 22, 2007	6.21	7.02	7.20	7.38	7.56	7.38	7.56	4.59	5.04
September 15, 2007	6.48	7.29	7.47	7.65	7.83	7.65	7.83	4.77	5.22
December 21, 2007	6.57	7.47	7.56	7.74	7.83	7.74	7.83	4.77	5.22
September 16, 2008	6.21	7.20	7.29	7.56	7.74	7.56	7.74	4.59	5.13
October 9, 2008	6.12	6.93	7.02	7.29	7.47	7.29	7.47	4.32	4.86
October 30, 2008	6.03	6.66	6.75	7.02	7.20	7.02	7.20	4.05	4.59
November 27, 2008	5.04	5.58	5.67	5.94	6.12	5.94	6.12	3.51	4.05
December 23, 2008	4.86	5.31	5.40	5.76	5.94	5.76	5.94	3.33	3.87
October 20, 2010	5.10	5.56	5.60	5.96	6.14	5.96	6.14	3.50	4.05
December 26, 2010	5.35	5.81	5.85	6.22	6.40	6.22	6.40	3.75	4.30
February 9, 2011	5.60	6.06	6.10	6.45	6.60	6.45	6.60	4.00	4.50
April 6, 2011	5.85	6.31	6.40	6.65	6.80	6.65	6.80	4.20	4.70
July 7, 2011	6.10	6.56	6.65	6.90	7.05	6.90	7.05	4.45	4.90
June 8, 2012	5.85	6.31	6.40	6.65	6.80	6.65	6.80	4.20	4.70
July 6, 2012	5.60	6.00	6.15	6.40	6.55	6.40	6.55	4.00	4.50

The following table sets forth the PBOC benchmark interest rates for RMB-denominated deposits since August 19, 2006.

Date of adjustment	Demand deposits	Time deposits					
		Three months	Six months	One year	Two years	Three years	Five years
(Interest rate per annum %)							
August 19, 2006	0.72	1.80	2.25	2.52	3.06	3.69	4.14
March 18, 2007	0.72	1.98	2.43	2.79	3.33	3.96	4.41
May 19, 2007	0.72	2.07	2.61	3.06	3.69	4.41	4.95
July 21, 2007	0.81	2.34	2.88	3.33	3.96	4.68	5.22
August 22, 2007	0.81	2.61	3.15	3.60	4.23	4.95	5.49
September 15, 2007	0.81	2.88	3.42	3.87	4.50	5.22	5.76
December 21, 2007	0.72	3.33	3.78	4.14	4.68	5.40	5.85
October 9, 2008	0.72	3.15	3.51	3.87	4.41	5.13	5.58
October 30, 2008	0.72	2.88	3.24	3.60	4.14	4.77	5.13
November 27, 2008	0.36	1.98	2.25	2.52	3.06	3.60	3.87
December 23, 2008	0.36	1.71	1.98	2.25	2.79	3.33	3.60
October 20, 2010	0.36	1.91	2.20	2.50	3.25	3.85	4.20
December 26, 2010	0.36	2.25	2.50	2.75	3.55	4.15	4.55
February 9, 2011	0.40	2.60	2.80	3.00	3.90	4.50	5.00
April 6, 2011	0.50	2.85	3.05	3.25	4.15	4.75	5.25
July 7, 2011	0.50	3.10	3.30	3.50	4.40	5.00	5.50
June 8, 2012	0.40	2.85	3.05	3.25	4.10	4.65	5.10
July 6, 2012	0.35	2.60	2.80	3.00	3.75	4.25	4.75

SUPERVISION AND REGULATION

The PBOC generally does not regulate interest rates for foreign currency-denominated loans or deposits, except for U.S. dollar-, Hong Kong dollar-, Japanese Yen- and Euro-denominated deposits of less than US\$3 million (or the equivalent) and with a term of one year or less. For these small sized short-term foreign currency deposits, the maximum interest rates may not exceed the PBOC benchmark interest rates.

Under the Notice of Further Promoting Interest Rate Liberalization Reform (中國人民銀行關於進一步推進利率市場化改革的通知) issued by the PBOC, commercial banks may determine the discount rates for their discounted bills beginning July 20, 2013.

Pricing for Fee- and Commission-based Products and Services

Under the Tentative Administrative Measures on Pricing of Commercial Banking Services (商業銀行服務價格管理暫行辦法) jointly promulgated by the CBRC and the NDRC on June 26, 2003 and effective on October 1, 2003, services which are subject to governmental pricing guidelines include basic RMB settlement services, such as bank drafts, bank acceptance drafts, promissory notes, checks, remittances and entrusted collection and other services specified by the CBRC and the NDRC. Fees for other products and services are determined based on market conditions. Commercial banks are also required to report to the CBRC at least 15 business days prior to the implementation of any new fee schedules and to post such fee schedules at their business premises at least ten business days prior to such implementation. On March 9, 2011, the CBRC, the PBOC and the NDRC jointly issued the Circular on the Exemption of Certain Service Charges of Banking Financial Institutions (關於銀行業金融機構免除部分服務收費的通知), which requires the banking financial institutions to waive several items of bank service fees from July 1, 2011.

On January 20, 2012, the CBRC issued the Circular on Supervision of the Non-Compliance Operation of the Banking and Financial Institutions (關於整治銀行業金融機構不規範經營的通知), which aims to address unreasonable conditions and fees related to loan issuance by financial institutions. On November 19, 2012, the PBOC issued the Notice on Effectively Implementing the Adjustment to the Criteria of Bank Card Transaction Charges (關於切實做好銀行卡刷卡手續費標準調整實施工作的通知) (Yinfa [2012] No. 263), which became effective on February 25, 2013 and aims to encourage the long-term growth of the bank card industry. The notice lowered the standard rate for bank card transaction charges, which effectively reduces the overall transaction costs for merchants in bank card transactions.

On February 25, 2013, the NDRC reduced certain credit card transaction fees that had been in place for the past nine years in order to alleviate fee burdens on certain transactions and expand convenience of and access to credit cards for the general public. Credit card charges on transactions such as meals, leisure activities, utilities, and general living and consumption were reduced. At the same time, credit card charges for real estate and automobile transactions were raised from 1% to 1.25%, with fee caps set at RMB80. On August 30, 2013, the CBRC published and implemented the Banking Consumer Protection Guidelines (銀行業消費者權益保護工作指引), which strengthens and improves consumer protection, proposes a system of requirements for consumer protection and provides for regulatory authorities to adopt consumer protection oversight responsibilities.

Required Deposit Reserve

Commercial banks are required to maintain a percentage of their total deposits as reserves with the PBOC to ensure they have sufficient liquidity to meet customer withdrawals. As of the Latest Practicable Date, we were required to maintain a deposit reserve of not less than 18.0% of our total RMB deposits according to the relevant requirements of the PBOC.

SUPERVISION AND REGULATION

The following table sets forth the historical data for the RMB required deposit reserve ratio applicable to us for recent years, which we have complied with. There has been no adjustment to the required deposit reserve ratio from May 19, 2012 up to the Latest Practicable Date.

Date of adjustment	RMB required deposit reserve ratio
	(%)
January 25, 2008	15.5
March 25, 2008	16.0
April 25, 2008	16.5
May 20, 2008	17.0
June 15, 2008	17.5
June 25, 2008	18.0
July 25, 2008	17.5
September 25, 2008	16.5
October 15, 2008	16.0
December 5, 2008	14.0
December 25, 2008	13.5
January 18, 2010	14.0
February 25, 2010	14.5
May 10, 2010	15.0
November 15, 2010	15.5
November 16, 2010	16.0
November 29, 2010	16.5
December 20, 2010	17.0
January 20, 2011	17.5
February 15, 2011	17.0
February 24, 2011	17.5
March 25, 2011	18.0
April 21, 2011	18.5
May 18, 2011	19.0
June 20, 2011	19.5
December 5, 2011	19.0
February 24, 2012	18.5
May 18, 2012	18.0

Supervision Over Capital Adequacy

Capital Adequacy Guidelines

Prior to March 1, 2004, commercial banks were required to maintain a minimum capital adequacy ratio of 8% and a minimum core capital adequacy ratio of 4%, calculated based on the following formula under PRC GAAP:

$$\text{Capital adequacy ratio} = \frac{\text{Capital} - \text{Capital deductions}}{\text{On- and off-balance sheet risk-weighted assets}} \times 100\%$$

$$\text{Core capital adequacy ratio} = \frac{\text{Core capital} - \text{Core capital deductions}}{\text{On- and off-balance sheet risk-weighted assets}} \times 100\%$$

SUPERVISION AND REGULATION

On February 23, 2004, the CBRC promulgated the Capital Adequacy Regulations (商業銀行資本充足率管理辦法), which became effective on March 1, 2004 and were amended on July 3, 2007. The Capital Adequacy Regulations have been superseded by the Rules Governing Capital Management of Commercial Banks (Provisional) (商業銀行資本管理辦法(試行)) which became effective on January 1, 2013. We were subject to the Capital Adequacy Regulations prior to January 1, 2013. While the Capital Adequacy Regulations did not change the pre-existing requirements of an 8% capital adequacy ratio and a 4% core capital adequacy ratio, they amended the risk weighting for various assets, adjusted the capital structure and included a capital charge for market risk in the calculation of capital adequacy ratios. In addition, the Capital Adequacy Regulations require commercial banks to make adequate allowance for various impairment losses, including those associated with loans, before calculating their capital adequacy ratios. These changes resulted in a more stringent capital adequacy requirement.

In accordance with the Capital Adequacy Regulations (商業銀行資本充足率管理辦法), the capital adequacy ratio and core capital adequacy ratio are calculated based on the following formulae under PRC GAAP:

$$\text{Capital adequacy ratio} = \frac{\text{Capital} - \text{Capital deductions}}{\text{Risk-weighted assets} + 12.5 \times \text{Capital charge for market risk}} \times 100\%$$

$$\text{Core capital adequacy ratio} = \frac{\text{Core capital} - \text{Core capital deductions}}{\text{Risk-weighted assets} + 12.5 \times \text{Capital charge for market risk}} \times 100\%$$

Components of Capital

Regulatory capital is composed of core capital and supplementary capital after subtracting relevant capital deductions. Supplementary capital may not exceed core capital. Core capital includes the following:

- Paid-in capital or common shares;
- Capital reserve;
- Surplus reserve;
- General reserve;
- Retained earnings; and
- Minority interests.

Supplementary capital includes the following:

- Up to 70% of the revaluation reserve;
- The general allowance for impairment losses under the CBRC's requirements. See “– PRC Banking Supervision and Regulation – Loan Classification, Allowance and Write-offs – Loan Classification” and “– PRC Banking Supervision and Regulation – Loan Classification, Allowance and Write-offs – Loan Allowance;”
- Preferred shares;
- Convertible bonds;
- Long-term subordinated debt, which may not exceed 25% of core capital for National Joint Stock Commercial Banks;
- Hybrid capital bonds; and

SUPERVISION AND REGULATION

- Changes in fair value (the positive change – but no more than 50% – to the fair value of available-for-sale bonds that have been calculated as part of the owners’ equity interests may be calculated into supplementary capital, and the negative change to the fair value shall be deducted in full from the supplementary capital. When a commercial bank calculates the capital adequacy ratio, it shall include the fair value of available-for-sale bonds in the capital reserve that is transferred from the core capital into the supplementary capital).

Capital deductions consist of the following:

- Goodwill;
- Equity investments in non-consolidated financial institutions; and
- Capital investments in real estate not used for the bank’s own operations and capital investments in enterprises.

Core capital deductions consist of the following:

- Goodwill;
- 50% of equity investments in non-consolidated financial institutions; and
- 50% of capital investments in real estate not used for the bank’s own operations and capital investments in enterprises.

Risk-weighted Assets

The Capital Adequacy Regulations (商業銀行資本充足率管理辦法) provide that, for on-balance sheet items, risk-weighted assets should be calculated by deducting any allowance for impairment losses and then multiplying the amount by their corresponding risk weighting (after taking into account risk-mitigating factors). For off-balance sheet items, including foreign exchange contracts, interest rate contracts and other derivative contracts, the nominal principal amount should be first converted to balance sheet credit equivalent amounts by multiplying such amount by a credit conversion factor. In addition, the risk weighting of assets secured by certain types of pledges or guarantees are allocated to the risk weighting applicable to the pledges or guarantors. Partially pledged or guaranteed loans receive such lower risk weighting only on the portion of the loan that is pledged or guaranteed. The following table sets forth risk weightings for different assets.

Risk Weighting	Assets
0%	<ul style="list-style-type: none"> • cash on hand • gold • claims on PRC incorporated commercial banks with an original maturity of four months or less • claims on the PRC central government or deposits at the PBOC • claims on the PBOC • claims on PRC policy banks • bonds issued by PRC financial asset management companies for the purpose of acquiring non-performing loans from state-owned banks • claims on non-PRC central governments or central banks in countries or regions where the sovereign or region is rated AA- or above⁽¹⁾ • claims on multilateral development banks

SUPERVISION AND REGULATION

Risk Weighting	Assets
20%	<ul style="list-style-type: none"> • claims on PRC incorporated commercial banks with an original maturity of more than four months • claims on non-PRC commercial banks and securities companies incorporated in other countries or regions where the sovereign or region is rated AA- or above⁽¹⁾
50%	<ul style="list-style-type: none"> • personal residential mortgages • claims on PRC public-sector entities invested by the PRC central government • claims on non-PRC public-sector entities invested by governments of countries or regions where the sovereign or region is rated AA- or above⁽¹⁾
100%	<ul style="list-style-type: none"> • all other assets

Note:

(1) These ratings refer to credit ratings of Standard & Poor's or the equivalent thereof.

Market Risk Capital

Market risk capital refers to the capital that a bank is required to maintain for the market risk relating to its assets. Market risk refers to the risk of losses in on- and off-balance sheet asset value arising from movements in market prices and includes risks relating to interest rate-influenced financial instruments and securities under trading books, commercial banking exchange rate risk and commodity risk. Domestic banks with total trading book positions greater than the lower of 10% of the bank's total on- and off-balance sheet assets and RMB8,500 million are required to make provisions for market risk capital.

The Latest Regulatory Standards of the CBRC on Capital Management of Commercial Banks

On June 7, 2012, the CBRC issued the Rules Governing Capital Management of Commercial Banks (Provisional) (商業銀行資本管理辦法(試行)), which came into effect on January 1, 2013. This regulation uses the new capital regulatory frameworks adopted by other countries as reference and follows the progression strategy set forth by Basel II and Basel III for the purpose of establishing a regulatory system for capital adequacy ratios. Specifically, this regulation establishes a unified and comprehensive regulatory system on capital adequacy ratio, provides a clear and strict definition of the term "capital," expands the scope of capital risk coverage, emphasizes on the scientific classification of commercial banks, capital adequacy level and differentiated regulatory measures, and sets out transitional periods for commercial banks to meet the new regulatory standards of capital adequacy ratio.

Pursuant to this regulation, commercial banks should use the following formula in calculating their capital adequacy ratios:

$$\text{Core tier-one capital adequacy ratio} = \frac{\text{Core tier-one capital} - \text{Corresponding capital deduction}}{\text{Risk-weighted assets}} \times 100\%$$

$$\text{Tier-one capital adequacy ratio} = \frac{\text{Tier-one capital} - \text{Corresponding capital deduction}}{\text{Risk-weighted assets}} \times 100\%$$

SUPERVISION AND REGULATION

$$\text{Capital adequacy ratio} = \frac{\text{Total capital} - \text{Corresponding capital deduction}}{\text{Risk-weighted assets}} \times 100\%$$

The following table sets forth the annual capital adequacy ratio requirements under the Notification on Matters Related to the Implementation of the Rules Governing Capital Management of Commercial Banks (Provisional) in Transitional Period (關於實施《商業銀行資本管理辦法(試行)》過渡期安排相關事項的通知) released by the CBRC during the transitional period.

Type of Bank	Core Indicators	As of December 31,					
		2013	2014	2015	2016	2017	2018
Systemically Important Banks	Core tier I capital adequacy ratio	6.5%	6.9%	7.3%	7.7%	8.1%	8.5%
	Tier I capital adequacy ratio	7.5%	7.9%	8.3%	8.7%	9.1%	9.5%
	Capital adequacy ratio	9.5%	9.9%	10.3%	10.7%	11.1%	11.5%
Other Banks	Core tier I capital adequacy ratio	5.5%	5.9%	6.3%	6.7%	7.1%	7.5%
	Tier I capital adequacy ratio	6.5%	6.9%	7.3%	7.7%	8.1%	8.5%
	Capital adequacy ratio	8.5%	8.9%	9.3%	9.7%	10.1%	10.5%

Regulatory Requirements on Capital Adequacy Ratio

The regulatory requirements on the capital adequacy ratio of commercial banks set forth the minimum requirements for capital, capital conservation buffer, countercyclical buffer, additional capital for domestic systemically important banks and the second pillar capital.

The commercial banks' capital adequacy ratio at each level should meet the following minimum requirements:

- (i) Core tier-one capital adequacy ratio not less than 5%.
- (ii) Tier-one capital adequacy ratio not less than 6%.
- (iii) Capital adequacy ratio not less than 8%.

Commercial banks should establish the capital conservation buffer above the minimum capital requirements. Capital conservation buffer is required to be 2.5% of the risk-weighted assets, which should be satisfied by core tier-one capital. Under certain circumstances, the PRC regulators may require commercial banks to establish a countercyclical buffer above both the minimum capital requirements and the minimum requirements for capital conservation buffer. Counter-cyclical buffer could be between zero and 2.5% of the risk-weighted assets, which should be satisfied by core tier-one capital.

Domestic systemically important banks are required to build up additional capital of 1% of their risk-weighted assets to be satisfied by core tier-one capital. If a domestic bank is recognized as a global systemically important bank, the applicable additional capital requirements should not be lower than those set forth by the Basel Committee. As of the Latest Practicable Date, the PRC regulators did not publish any criteria or list of "systemically important banks."

In addition, CBRC has the discretion to impose more prudent capital requirements within the framework of the second pillar capital to ensure the full coverage of risks, including:

- (i) specific capital requirements for certain asset portfolios based on risk assessment of the asset portfolio; and
- (ii) specific capital requirements for an individual bank based on the results of regulatory inspection conducted on that bank.

SUPERVISION AND REGULATION

Capital composition

Total capital of a commercial bank includes core tier-one capital, additional tier-one capital and tier-two capital.

Core tier-one capital includes:

- Paid-in capital or ordinary shares;
- Capital reserve;
- Surplus reserve;
- General reserve;
- Retained earnings; and
- Applicable portions of capital from minority shareholders.

Additional tier-one capital includes:

- Additional tier-one capital instruments and their premiums; and
- Applicable portions of capital from minority shareholders.

Tier-two capital includes:

- Tier-two capital instruments and their premiums;
- Over-provision for impaired loans; and
- Applicable portions of capital from minority shareholders.

In calculating the capital adequacy ratio, a commercial bank should deduct the following items in full from the core tier-one capital:

- Goodwill;
- Other intangible assets (other than land use rights);
- Net deferred-tax assets arising from operating losses;
- Inadequate provision for impaired loans;
- Profit from sales of asset securitization;
- Defined beneficial pension assets, net;
- Direct or indirect holding of its own shares;
- For the cash flow reserve arising from hedging with items not measured at fair value on the balance sheet, it should be deducted if it is positive or added if it is negative; and
- Unrealized profit or loss arising from changes in the fair value of the liabilities of the commercial bank due to the changes in its credit risks.

Capital instruments of all levels held under agreement between commercial banks or the capital investment of all levels considered as “watered capital” by the CBRC should be deducted from the corresponding levels of regulatory capital. Additional tier-one and tier-two capital instruments issued by commercial banks held directly or indirectly by themselves should be deducted from the corresponding regulatory capital.

SUPERVISION AND REGULATION

With respect to the small amount minority capital investments held by commercial banks in unconsolidated financial institutions, the amount of the investment that exceeds 10% of the commercial bank's net core tier-one capital should be deducted from the regulatory capital of all levels. With respect to the large amount minority capital investment by a commercial bank in unconsolidated financial institutions, the amount of the investment that exceeds 10% of its net core tier-one capital should be deducted from its core tier-one capital. Additional tier-one capital investment and tier-two capital investment should be deducted in full from the capital of the corresponding tier.

Except for the net deferred tax assets arising from the operating loss, other net deferred tax assets relying on their future operating profit which exceeds 10% of the commercial bank's net core tier-one capital should be deducted from its core tier-one capital.

The sum of (i) a large amount of minority capital investment by a commercial bank in financial institutions and (ii) the corresponding net deferred tax assets that have not been deducted from the core tier-one capital of the commercial bank should not exceed 15% of its net core tier-one capital.

Risk-weighted assets

The risk-weighted assets of commercial banks include credit risk-weighted assets, market risk-weighted assets and operating risk-weighted assets.

Commercial banks may adopt either the weight method or internal rating method to measure credit risk-weighted assets. Under the weight method, credit risk-weighted assets are the sum of credit risk-weighted assets on the bank's account balance sheet and credit risk-weighted assets off the bank's balance sheet. Specifically, the on-balance sheet credit risk-weighted assets should be calculated by multiplying the carrying value of the assets net of their corresponding provisions for impairment losses by the corresponding risk weightings of those assets. The off-balance sheet credit risk-weighted assets should be calculated by multiplying the nominal value of the off-balance sheet items by their corresponding credit conversion factors to arrive at an amount as the carrying amount of on-balance sheet assets, which will be used to calculate the credit risk-weighted assets following the abovementioned steps. Under the internal rating method, commercial banks should measure the risk-weighted assets exposed to non-default risks and default risks separately: (i) the calculation of the risk-weighted assets exposed to non-default non-retail risks is based on the probability of default, loss rate, exposure to default risk, relevance and effective period exposed by a single credit risk asset; (ii) the calculation of the risk-weighted assets exposed to non-default retail risks is based on the probability of default, default loss rate, exposure to default risk and exposure by a single pool of credit risk assets; and (iii) the calculation of the risk-weighted assets exposed to default risks is based on the default loss rate, expected loss rate and exposure to default risk.

Market risk-weighted assets of commercial banks shall be 12.5 times of the capital requirement for market risks, i.e. market risk-weighted assets = capital requirement for market risks × 12.5. The measurement of market risk capital should cover the interest rate risks and stock price risks in the commercial banks' trading books as well as all the exchange rate risks and commodity risks. Commercial banks may use either the standard method or the internal model method to measure capital requirement for market risks.

Operating risk-weighted assets shall be 12.5 times of the capital requirement for operating risks, i.e. operating risk-weighted assets = capital requirement for operating risks × 12.5. Commercial banks may use the index method, the standard method or the advanced measurement method to measure capital requirement for operating risks.

Timeline of compliance

The Rules Governing Capital Management of Commercial Banks (Provisional) (商業銀行資本管理辦法(試行)) provides that commercial banks should meet the regulatory requirements on capital adequacy ratio set forth in this regulation by the end of 2018, and well-positioned commercial banks are encouraged to meet the requirement ahead of schedule.

To ensure the implementation of the Rules Governing Capital Management of Commercial Banks (Provisional) (商業銀行資本管理辦法(試行)), the CBRC released the Notification on Matters Related to the Implementation of the Rules Governing Capital Management of Commercial Banks (Provisional) in Transitional Period (關於實施《商業銀行資本管理辦法(試行)》過渡期安排相關事項的通知) on November 30, 2012. The notification required commercial banks to meet the minimum capital and, in addition, the domestic systemically important banks to meet the additional capital requirement before January 1, 2013. During the transitional period, the reserve capital requirement (2.5%) shall be gradually introduced and commercial banks should meet the annual capital adequacy ratio requirement. In addition, the regulator will provide the timeline for compliance if it requires the commercial banks to establish a countercyclical buffer or sets out the requirements for the second pillar capital of certain banks. Commercial banks subject to these additional requirements should make efforts to meet such timeline.

Issuance of Subordinated Debt and Subordinated Bonds

Since June 17, 2004, PRC commercial banks have been permitted to issue bonds with the repayment of principal and interest subordinated to the banks' other liabilities but senior to the banks' equity capital, according to the Measures for Administration on Issuance of Subordinated Bonds of Commercial Banks (商業銀行次級債券發行管理辦法) jointly issued by the PBOC and the CBRC. The issuance of subordinated debt by PRC commercial banks is subject to the approval of the CBRC. PRC commercial banks may, upon approval by the CBRC, include such subordinated bonds in the banks' supplementary capital. Subordinated bonds can be issued either in a public offering in the inter-bank bond market or in a private placement. PRC commercial banks may not hold an aggregate amount of subordinated debt issued by other banks in excess of 20% of their core capital. The PBOC regulates the issuance and trading of subordinated bonds in the inter-bank bond market.

On December 12, 2005, the CBRC issued the Notice Regarding the Issuance of Hybrid Capital Bonds by Commercial Banks for the Replenishment of Supplementary Capital (關於商業銀行發行混合資本債券補充附屬資本有關問題的通知), permitting eligible commercial banks to issue hybrid capital bonds in the inter-bank market and include such bonds in their supplementary capital. The introduction of hybrid capital bonds in the PRC opened a new channel for commercial banks to replenish their supplementary capital and improve their capital adequacy ratio. On September 5, 2006, the PBOC issued the "PBOC Announcement (2006) No.11 – Notice Regarding the Issuance of Hybrid Capital Bonds by Commercial Banks", which set out the definition of hybrid capital bonds and the regulations on reporting and distribution.

On October 18, 2009, the CBRC issued the Notice on Improving the Mechanism for Capital Replenishment of Commercial Banks (關於完善商業銀行資本補充機制的通知), which requires major commercial banks (including China Development Bank, Large Commercial Banks and National Joint Stock Commercial Banks) and other banks to maintain a core capital adequacy ratio of no less than 7% and 5%, respectively, if they seek to issue long-term subordinated debt for the replenishment of supplementary capital. The major commercial banks and other banks should not issue long-term subordinated debt which constitutes more than 25% and 30% of their respective core capital, respectively. In the calculation of the capital adequacy ratio, after October 18, 2009, banks should deduct fully any long-term subordinated debt issued by other banks which they acquired after July 1, 2009.

The Rules Governing Capital Management of Commercial Banks (Provisional) (商業銀行資本管理辦法(試行)) issued by the CBRC on June 7, 2012 re-defines the term “capital.” The term “regulatory capital” was defined in the Capital Adequacy Regulations to include core capital and supplementary capital and the definition of such term has been adjusted by the Rules Governing Capital Management of Commercial Banks (Provisional) (商業銀行資本管理辦法(試行)) to include core tier-one capital, additional tier-one capital and tier-two capital. In addition, the new regulation specifies the requisite criteria of tier-two capital instrument which is different from the original definition and requirements of the subordinated debt and subordinated bond. Under this regulation, non-qualified tier-two capital instruments issued prior to September 12, 2010 can be included into regulatory capital before January 1, 2013, but should be reduced by 10% per annum starting from January 1, 2013 and may not be included into regulatory capital starting from January 1, 2022. For tier-two capital instruments issued by commercial banks during the period from September 12, 2010 to January 1, 2013, if they do not carry discounting or share conversion terms but meet other requisite criteria of relevant capital instruments, they can be included into regulatory capital prior to January 1, 2013, but should be reduced by 10% per annum starting from January 1, 2013 and may not be included into regulatory capital starting from January 1, 2022.

On November 29, 2012, the CBRC issued the Guidance on the Innovation of Capital Instruments by Commercial Banks (關於商業銀行資本工具創新的指導意見), accordingly to which additional tier-one and tier-two capital instruments issued by a commercial bank after January 1, 2013 must contain a provision that requires such instruments to either be written off or converted into common stock upon the occurrence of a triggering event. An additional tier-one instrument triggering event occurs when the core tier-one capital adequacy ratio of the commercial bank falls to 5.125% or below; and a tier-two instrument triggering event occurs upon the earlier of: (i) the CBRC decides that a write-off or an equity conversion is necessary, without which the commercial bank would become non-viable; or (ii) the relevant authority or authorities decide to make a public sector injection of capital, or equivalent support, without which the commercial bank would have become non-viable.

Pursuant to the Guidance on the Issuance of Corporate Bonds for Capital Supplement of Commercial Banks (關於商業銀行發行公司債券補充資本的指導意見) jointly issued by the CSRC and the CBRC on October 30, 2013 which came into effect on November 6, 2013, any listed bank or pre-IPO bank planning to issue corporate bonds with write-off terms for capital supplement shall design suitable terms in connection with such bonds, form a practicable plan for the issuance of such bonds and submit a confirmation to the CBRC regarding the capital nature of such bonds, all of which must be conducted in accordance with the relevant laws and regulations. In addition, the issuance of such bonds shall also be subject to a supervisory notice by the CBRC.

Issuance of micro-enterprise bonds

In October 2011, the CBRC issued the Supplementary Notice on Supporting Commercial Banks to Further Improve the Financing Services Offered to Micro-enterprises (中國銀監會關於支持商業銀行進一步改進小型微型企業金融服務的補充通知), allowing banks to issue bonds for the purpose of micro-enterprise lending as one of the supportive measures to help micro-enterprises obtain financing.

On March 21, 2013, the CBRC issued the Opinions on Enhancing Financial Services for Micro-enterprises (中國銀監會關於深化小微企業金融服務的意見), which requires commercial banks to further improve financial services for micro-enterprises. In particular, it encourages small and medium-sized banks to proactively adjust their credit portfolios and focus on supporting the development of micro-enterprises and regional economy. The General Office of the State Council of the PRC issued the Guidelines on Financial Support for the Adjustment, Transformation and Upgrading of Economic Structure (國務院辦公廳關於金融支持經濟結構調整和轉型升級的指導意見) on July 1, 2013 and the Opinions on Providing Financial Support to Micro-enterprises (國務院辦公廳關於金融支持小微企業發展的實施意見) on August 8, 2013, which encourage financial institutions to provide comprehensive financial services to support the development of micro-enterprises.

SUPERVISION AND REGULATION

Supervision on capital adequacy level by the CBRC

The CBRC supervises and examines the capital adequacy levels of commercial banks to ensure that their capital could fully cover a variety of potential risks through measures such as off-site supervision and on-site examinations. Further, a commercial bank should submit a report to the CBRC setting out its capital adequacy ratios before and after consolidation of its accounts. Capital adequacy ratios based on the consolidated statements should be reported every half year whereas capital adequacy ratios based on the unconsolidated statements should be reported every quarter.

Pursuant to the Rules Governing Capital Management of Commercial Banks (Provisional) (商業銀行資本管理辦法(試行)), the CBRC classifies commercial banks into four categories according to their capital adequacy status:

- (i) Category 1: capital adequacy ratio, tier-one capital adequacy ratio and core tier-one capital adequacy ratio all meet the relevant capital requirements of this regulation.
- (ii) Category 2: capital adequacy ratio, tier-one capital adequacy ratio and core tier-one capital adequacy ratio fail to meet the capital requirements of the second pillar but meet other levels of capital requirements.
- (iii) Category 3: capital adequacy ratio, tier-one capital adequacy ratio and core tier-one capital adequacy ratio meet the minimum capital requirements but have not yet met other levels of capital requirements.
- (iv) Category 4: any one of the capital adequacy ratio, tier-one capital adequacy ratio and core tier-one capital adequacy ratio fails to meet the relevant minimum capital requirements.

For category 1 commercial banks, the CBRC supports business development in a prudent manner and may take the following preventive measures to prevent rapid deterioration of the capital adequacy of such commercial banks:

- requiring the commercial bank to strengthen its analysis, forecasts and explanations regarding declines in its capital adequacy ratio;
- requiring the commercial bank to formulate a feasible plan on the management of its capital adequacy ratio; and
- requiring the commercial bank to improve its risk control abilities.

For category 2 commercial banks, in addition to the above measures, the CBRC may take the following regulatory measures:

- conducting a meeting with the board and senior management of the commercial bank to discuss prudential management;
- issuing a supervisory notice which shall cover, among others, existing problems with capital management of the commercial bank and suggested rectifications and timelines for compliance;
- requiring the commercial bank to implement a feasible capital replenishment plan and a compliance plan with target timelines;
- increasing the frequency of inspection on capital adequacy of the commercial bank; and
- requiring the commercial bank to adopt risk-mitigation measures for specific risks.

SUPERVISION AND REGULATION

For category 3 commercial banks, in addition to the above measures, the CBRC may take the following regulatory measures:

- restricting the distribution of dividends and other forms of distributions by the commercial bank;
- restricting any kind of incentive schemes offered to directors and senior management of the commercial bank;
- restricting the commercial bank to make equity investments or repurchase capital instruments;
- restricting significant capital expenditures of the commercial bank; and
- requiring the commercial bank to control the expansion of risk assets.

For category 4 commercial banks, in addition to the above measures, the CBRC may take the following regulatory measures:

- requiring the commercial bank to substantially reduce the amount of risk assets;
- ordering the commercial bank to suspend all businesses involving high risk assets;
- restricting or forbidding the establishment of new branches or the launching of new businesses;
- compulsorily discounting the tier-two capital instruments or converting the tier-two capital instruments into ordinary shares;
- ordering the commercial bank to change its directors and senior management or restrict their rights and authorities; and
- taking over the commercial bank or procuring restructuring of the commercial bank until it is being revoked.

In addition, the CBRC will consider other external factors and take other necessary measures to address the issues faced by category 4 commercial banks.

Basel Accords

The Basel Capital Accord, or Basel I, was introduced by the Basel Committee on Banking Supervision, or the Basel Committee, in 1988. Basel I is an international accord seeking to achieve unification of capital measurement and capital standards of commercial banks, which clearly sets 8% as the minimum requirement on capital adequacy ratio. Since 1998, the Basel Committee has issued certain proposals for the New Basel Capital Accord or Basel II, to replace Basel I. Basel II retains the key elements of Basel I, including the general requirement for banks to hold total capital equivalent to at least 8% of their risk-weighted assets, aiming at intrinsically and extrinsically consolidating the capital regulatory framework in all respects, including (i) establishment of the “three pillars” framework, the first pillar being “minimum capital standard,” the second pillar being “supervision and regulation by regulatory authorities” and the third pillar being “information disclosure;” and (ii) introducing material changes to the calculation of capital adequacy and adopting simple to complicated and diversified approaches.

The CBRC promulgated and amended the Capital Adequacy Regulations (商業銀行資本充足率管理辦法) on February 23, 2004 and July 3, 2007, respectively. The CBRC has advised that the Capital Adequacy Regulations are based on Basel I while taking into consideration certain aspects of Basel II. On February 28, 2007, the CBRC issued the Guidelines on Implementation of the New Capital Accord in PRC Banking Industry (中國銀行業實施新資本協議指導意見), which require large commercial banks that have set up active operational entities in other countries or regions (including Hong Kong and Macau) and have a significant international business to implement Basel II by the end of 2010 or upon the CBRC’s approval, and in any event no later than the end of 2013. To facilitate preparations for the implementation

SUPERVISION AND REGULATION

of Basel II, the CBRC adopted the first series of supervision guidelines in respect of implementation of Basel II in September 2008, including the Guidelines on Classification of Commercial Banking Book Credit Risk Exposure (商業銀行賬戶信用風險暴露分類指引), the Guidelines on Supervision of Commercial Bank Internal Rating Based System for Credit Risk (商業銀行信用風險內部評級體系監管指引), the Guidelines on Computation of Commercial Bank Specialized Loan Regulatory Capital (商業銀行專業貸款監管資本計量指引), the Guidelines on Computation of Commercial Bank Credit Risk Cushion Regulatory Capital (商業銀行信用風險緩釋監管資本計量指引) and the Guidelines on Computation of Commercial Bank Operational Risk Regulatory Capital (商業銀行操作風險監管資本計量指引). In March 2009, China officially joined the Basel Committee and participated in the establishment of international standards for banking supervision, which is conducive to the upgrading of supervision techniques and supervision levels in China's banking industry.

Since November 2009, the CBRC has issued the following five regulatory guidelines to implement Basel II: the Guidelines on Disclosure of Capital Adequacy Ratio (商業銀行資本充足率信息披露指引), the Guidelines on Verification of Advanced Approaches for Capital Measurement (商業銀行資本計量高級方法驗證指引), the Guidelines on Risk Management of Banking Book Interest Rates of Commercial Banks (商業銀行銀行賬戶利率風險管理指引), the Guidelines on Supervision and Review on Capital Adequacy Ratio (商業銀行資本充足率監督檢查指引) and the Guidelines on Measurement of Risk Exposure Relating to Assets Securitization (商業銀行資產證券化風險暴露監管資本計量指引). These five regulatory guidelines facilitate the implementation of Basel II, among which, the Guidelines on Risk Management of Banking Book Interest Rates of Commercial Banks (商業銀行銀行賬戶利率風險管理指引) also apply to those banks which are not yet implementing Basel II.

In December 2010, the Basel Committee formally released the latest version of capital accord (or Basel III), which reflects the new regulatory thoughts of organic integration between micro-prudential regulation and macro-prudential regulation. Thus, new international banking regulatory benchmarks are established according to the overall requirements of focus on both capital regulation and liquidity regulation, synchronous increase of capital amount and improvement of capital quality, parallel of capital adequacy and leverage and consideration of both long-term impact and short-term effects.

On April 27, 2011, the CBRC issued new guidelines setting more stringent capital adequacy, leverage, liquidity and loan loss provisioning requirements for Chinese banks in accordance with the reform of China's banking industry and regulatory practice and in light of the implications of Basel III.

- *Capital adequacy and leverage requirements.* The new guidelines reclassified the existing two-tier regulatory capital framework into three tiers, namely, the core tier-one ratio, tier-one ratio and capital adequacy ratio, which shall be no less than 5% (0.5% higher than the requirements of Basel III), 6% and 8% respectively. In addition, the guidelines introduced an additional 2.5% capital conservation buffer and the regulators may require a 0-2.5% countercyclical buffer under certain circumstances. The guidelines also require domestic systemically important banks – those which are considered fundamental to the well-being of the domestic banking industry as a whole – to maintain another 1% for additional capital. In summary, domestic systemically important banks are required to maintain the core tier-one capital adequacy ratio, tier-one capital adequacy ratio and capital adequacy ratio of no less than 8.5%, 9.5% and 11.5% respectively, and the non-systemically important banks of no less than 7.5%, 8.5% and 10.5% respectively. A leverage ratio – the ratio of tier-one capital to adjusted on-and-off-balance sheet exposure – has also been introduced and the minimum requirement is set at no less than 4%, 1% higher than the requirements of Basel III.

SUPERVISION AND REGULATION

- *Liquidity requirements.* Chinese banks are required to maintain a liquidity coverage ratio and a net stable funding ratio of no less than 100% by the end of 2013 and 2016, respectively.
- *Loan loss provisioning requirements.* The total allowance to total gross loans ratio is required to be no less than 2.5% while provision coverage ratio (namely the allowance for non-performing loans) is required to be no less than 150%. The guidelines require domestic systemically important banks to comply with the foregoing requirements by the end of 2013, and require non-systemically important banks to comply with the foregoing requirements either by the end of 2016 or by the end of 2018 subject to the banks' profitability and the allowance they need to charge to reach the new requirements.

We aim to comply with the requirements set forth as above within the applicable timeframe set out by the new guidelines and rules.

The methodologies of computation of our capital adequacy ratios may differ under Basel II and Basel III from our current practice, which may result in changes in our capital adequacy ratios. See "Risk Factors – Risks Relating to Our Business – We may face difficulties in meeting regulatory requirements relating to capital adequacy in the future."

Loan Classification, Allowance and Write-offs

Loan Classification

Commercial banks in the PRC are currently required to classify loans under a five-category loan classification system based on the estimated likelihood of repayment of principal and interest according to the Guidelines of Risk-based Classification of Loans (貸款風險分類指引). The five categories are "normal," "special mention," "substandard," "doubtful" and "loss" and a loan classified as substandard, doubtful or loss is considered to be non-performing. The primary factors for evaluating the likelihood of repayment include the borrower's cash flow, financial condition and credit history.

Loan Allowance

According to the Guidelines of Risk-based Classification of Loans (貸款風險分類指引), commercial banks are required to make full loan loss provisions on a timely basis and write off loan losses on the basis of classifications of loans and in accordance with the relevant regulations.

According to the Guidelines on Loan Loss Provisions (貸款損失準備計提指引), allowance for impairment losses consists of general allowance, specific allowance and special allowance. General allowance refers to the allowance for all unidentified but possible losses, which are made based on certain percentages of the balance of total outstanding loans; specific allowance refers to the allowance made for specific losses in connection with an individual loan based on its categorization under the guiding principles; and special allowance refers to the allowance made for the risks specifically related to certain countries, regions, industries, or types of loans.

Commercial banks are required to make provisions for impairment losses on a quarterly basis and to have a general allowance of not less than 1% of the total loans outstanding as of December 31 of each year. The guidelines further provide for the level of specific provisions as a percentage of the outstanding amount of loans for each loan category: 2% for special mention loans; 20%-30% for substandard loans; 40%-60% for doubtful loans; and 100% for loss loans. Commercial banks may make special provisions in accordance with special risk factors (including risks in association with certain industries and countries), probability of losses and historical experience.

SUPERVISION AND REGULATION

Pursuant to the Administrative Measures Regarding Loan Loss Provisions at Commercial Banks (商業銀行貸款損失準備管理辦法) issued by CBRC on July 27, 2011 and which took effect on January 1, 2012, CBRC will set the target loan provision ratio and provision coverage ratio for assessment of the adequacy of loan loss provisions at commercial banks. The benchmark loan provision ratio is 2.5% and the benchmark for provision coverage ratio is 150%. The higher of the two benchmarks will be the regulatory benchmark for loan provisions at commercial banks. Systemically important banks should pass the benchmark by the end of 2013, and non-systemically important banks should pass the benchmark by the end of 2016. Those who do not pass the benchmark before the end of 2016 should formulate a plan to do so and report to the banking supervisory authority and must pass by the end of 2018.

CBRC Supervision of Loan Classification and Loan Allowance

Commercial banks are required to formulate detailed internal procedures that clearly define the responsibilities of each relevant department with respect to loan classification, approval, review and related matters. In addition, since 2002, commercial banks have been required to submit quarterly and annual reports to the CBRC on the classification of their loan portfolios and their allowance for loan losses. Based on the review of these reports, the CBRC may require commercial banks to explain significant changes in loan classification and loan loss allowance levels and may carry out further inspections. Beginning in 2012, commercial banks should, on a monthly basis, provide information on their loan loss provisions to the banking regulatory authorities, including the balance of provisions at the beginning and the end of the period, the amount provided, reversed and written off, the loan provision ratio and the provisions coverage ratio at the beginning and the end of the period.

Loan Write-offs

Under the regulations issued by the CBRC and the MOF, commercial banks are required to establish a strict examination and approval process to write off loan losses. In order to be written off, a loan needs to meet the standards set by the MOF. Losses realized upon writing off loans are deductible for tax purposes but such deduction is subject to the review and approval of the tax authorities as to whether the loans written off were in compliance with the MOF's standards.

Bulk Transfer of Non-performing Assets

Pursuant to the Measures of the Management of Bulk Transfer of Financial Enterprises' Nonperforming Assets (金融企業不良資產批量轉讓管理辦法) jointly issued by the MOF and the CBRC on January 18, 2012, financial enterprises may transfer non-performing assets, including credit assets and non-credit assets generated from their business operations. Such transferrable assets include loans in the substandard, doubtful and loss categories recognized according to statutory processes and standards; written-off book assets; assets for the offsetting of debt and other non-performing assets.

Allowance and Statutory General Reserve for Impairment Losses

On March 30, 2012, the MOF promulgated the Administrative Measures for the Loan Provisioning of the Financial Enterprises (金融企業準備金計提管理辦法), which came into effect on July 1, 2012 and superseded the Administrative Measures for the Provisioning for Non-performing Assets of Financial Enterprises (金融企業呆賬準備提取管理辦法) promulgated on May 17, 2005. The new measures provide that the statutory general reserve to cover potential impairment losses shall not be less than 1.5% of the remaining amount of each financial institution's risk-bearing assets at the balance sheet date. For those who adopt the standard method to calculate the statutory general reserve, the standard risk coefficients of the credit assets in each classification are temporarily set to be 1.5% for normal loans, 3% for special mention loans, 30% for substandard loans, 60% for doubtful loans and 100% for loss loans. In addition, financial institutions that could not meet this requirement in 2012 were required to take necessary steps to ensure that they could meet such requirement by the end of 2017.

SUPERVISION AND REGULATION

Other Operational and Risk Management Ratios

The Core Indicators for the Risk Management of Commercial Banks (for Trial Implementation) (“Core Indicators (Provisional)”) (商業銀行風險監管核心指標(試行)) promulgated by the CBRC became effective on January 1, 2006.

The following table sets forth the required ratios as provided in the Core Indicators (Provisional) (商業銀行風險監管核心指標(試行)) and our Bank’s ratios for the three years ended December 31, 2010, 2011 and 2012 and the six months ended June 30, 2013, calculated under PRC GAAP.

Risk level	Primary indicators	Secondary Indicators	Requirement (%)	Ratios of our Bank (%)			
				As of December 31,			As of
				2010	2011	2012	June 30, 2013
Risk Level							
Liquidity risk	Liquidity ratio ⁽¹⁾	RMB	≥25	45.63	37.67	51.25	27.63
		foreign currency		95.81	70.94	45.88	43.94
	Core liabilities ratio ⁽²⁾		≥60	52.78	53.92	50.45	53.08
	Liquidity gap ratio ⁽³⁾		≥(10)	15.28	11.64	(2.57)	1.73
Credit risk	Non-performing asset ratio ⁽⁴⁾		≤4	0.39	0.31	0.36	0.38
		NPL ⁽⁵⁾ ratio	≤5	0.75	0.64	0.74	0.80
	Credit exposure to a single group-borrower ⁽⁶⁾		≤15	12.12	12.62	7.53	7.48
		Loan exposure to a single-borrower ⁽⁷⁾	≤10	4.12	5.58	4.40	4.16
	Overall credit exposure to related parties ⁽⁸⁾		≤50	0.44	0.61	0.34	3.06
Market risk	Cumulative foreign currency exposure ratio ⁽⁹⁾		≤20	2.53	10.78	10.61	0.94
Risk Cushion							
Profitability	Cost-to-income ratio ⁽¹⁰⁾		≤45	35.44	31.95	29.97	27.71
	Return on assets ⁽¹¹⁾		≥0.6	0.95	1.12	1.18	1.26
	Return on capital ⁽¹²⁾		≥11	20.99	20.44	22.54	24.59
Allowance adequacy	Allowance adequacy ratio for asset impairment ⁽¹³⁾		>100	376.75	487.42	537.99	542.86
		Allowance adequacy ratio for loan impairment ⁽¹⁴⁾	>100	401.17	518.89	595.98	586.18
Capital adequacy	Capital adequacy ratio		≥8	11.02 ⁽¹⁵⁾	10.57 ⁽¹⁵⁾	10.99 ⁽¹⁵⁾	10.55 ⁽¹⁶⁾
			≥8.5 ⁽¹⁷⁾	-	-	-	9.67 ⁽¹⁸⁾
		Core capital adequacy ratio ⁽¹⁹⁾	≥4	8.15	7.89	8.00	8.34 ⁽²⁰⁾
		Tier-one capital adequacy ratio ⁽²¹⁾	≥6.5 ⁽²²⁾	-	-	-	7.77
		Core tier-one capital adequacy ratio ⁽²³⁾	≥5.5 ⁽²⁴⁾	-	-	-	7.77

SUPERVISION AND REGULATION

Notes:

Calculated as follows:

- (1) Liquidity ratio = current assets/current liabilities x 100%. Current assets include cash, gold, surplus deposit reserve, net placement, and deposits with banks and financial institutions with maturities of one month or less, interest receivable and other receivables due within one month, qualified loans with maturities of one month or less, investment in debt securities with maturities of one month or less, debt securities that can be liquidated in the international secondary market at any time and other liquid assets with maturities of one month or less (excluding the non-performing portion of such assets). Current liabilities include demand deposits (excluding policy deposits), time deposits with remaining maturities of one month or less (excluding policy deposits), net placements and deposits from banks and financial institutions due within one month, issued debt securities with maturities of one month or less, interest payable and other payables due within one month, borrowings from the PBOC due within one month and other liabilities due within one month.
- (2) Core liabilities ratio = amount of core liabilities/amount of total liabilities x 100%. Core liabilities refer to the combined amount of time deposit with remaining maturities of three months or longer, issued debt securities and 50% of demand deposits. Total liabilities refer to total liabilities on the balance sheet prepared under PRC GAAP.
- (3) Liquidity gap ratio = liquidity gap/amount of on- or off-balance sheet assets with maturities of 90 days or less x 100%. Liquidity gap refers to the amount of on- or off-balance sheet assets with maturities of 90 days or less minus the amount of on- or off-balance sheet liabilities.
- (4) Non-performing asset ratio = amount of non-performing assets subject to credit risk/amount of assets subject to credit risk x 100%. Non-performing assets include non-performing loans and other assets categorized as non-performing. The categorization of non-loan assets is in accordance with relevant CBRC regulations.
- (5) NPL ratio = amount of non-performing loans/amount of total loans x 100%. Non-performing loans refer to loans in the substandard, doubtful and loss categories according to the PBOC and CBRC's five category loan classification system.
- (6) Credit exposure to a single group-borrower = total credit granted to the largest single group-borrower/net capital x 100%. Largest group-borrower refers to the single group-borrower granted the highest credit limit at the end of the period.
- (7) Loan exposure to a single-borrower = total loans to the largest single-borrower/net capital x 100%. Largest single-borrower refers to the borrower with the highest amount of loans outstanding at the end of the period.
- (8) Overall credit exposure to related parties = total granted credit limit to all related parties/net capital x 100%. Related parties refer to parties defined in the Related Party Transactions Measures. Total granted credit limit to all related parties refers to total credit limit granted to such parties minus cash deposit guarantees and collateral in the form of bank deposits and PRC government bonds.
- (9) Cumulative foreign currency exposure ratio = amount of cumulative foreign currency exposure/net capital x 100%. Cumulative foreign currency exposure refers to exchange rate sensitive foreign currency assets subtracted by exchange rate sensitive foreign currency liabilities.
- (10) Cost-to-income ratio = operating and management expenses/operating income x 100%, prepared under PRC GAAP.
- (11) Return on assets = net profit/average balance of total assets for the period x 100%.
- (12) Return on capital = net profit/average balance of shareholders' equity for the period x 100%.
- (13) Allowance adequacy ratio for asset impairment = actual amount of allowance for assets subject to credit risk/required amount of allowance for assets subject to credit risk x 100%.
- (14) Allowance adequacy ratio for loan impairment = actual amount of allowance for loans/required amount of allowance for loans x 100%. The required amount of allowance for loans is calculated based on the methodology under the PBOC guidelines as described under “– Loan Classification, Allowance and Write-offs – Loan Allowance.”
- (15) Capital adequacy ratio (as of December 31, 2010, 2011 and 2012) = (capital – capital deductions)/(risk-weighted assets + 12.5 x capital charge for market risk), calculated in accordance with the Capital Adequacy Regulations (資本充足率管理辦法).
- (16) Effective on January 1, 2013, the Rules Governing Capital Management of Commercial Banks (Provisional) (商業銀行資本管理辦法(試行)) required a new formula for calculating the capital adequacy ratio. The capital adequacy ratio as of June 30, 2013, calculated in accordance with the superseded Capital Adequacy Regulations (資本充足率管理辦法), was no longer a regulatory requirement and is presented here for illustrative purposes only.
- (17) According to the Notification on Matters Related to the Implementation of the Rules Governing Capital Management of Commercial Banks (Provisional) (關於實施《商業銀行資本管理辦法(試行)》過渡期安排相關事項的通知), the capital adequacy requirement is set at 8.5% as of December 31, 2013. The requirement increases by 0.4 percentage point each year until 2018. As of December 31, 2018, the capital adequacy ratio is required to be 10.5%.
- (18) Capital adequacy ratio (as of June 30, 2013) = (total capital – corresponding capital deduction)/(risk-weighted assets), calculated in accordance with the Rules Governing Capital Management of Commercial Banks (Provisional) (商業銀行資本管理辦法(試行)), which became effective on January 1, 2013.
- (19) Core capital adequacy ratio (as of December 31, 2010, 2011 and 2012) = (core capital – core capital deductions)/(risk-weighted assets + 12.5 x capital charge for market risk), calculated in accordance with the Capital Adequacy Regulations (資本充足率管理辦法).

SUPERVISION AND REGULATION

- (20) Effective on January 1, 2013, core capital adequacy ratio was no longer a regulatory requirement under the Rules Governing Capital Management of Commercial Banks (Provisional) (商業銀行資本管理辦法(試行)). The core capital adequacy ratio as of June 30, 2013, calculated in accordance with the superseded Capital Adequacy Regulations (資本充足率管理辦法), is presented here for illustrative purposes only.
- (21) Tier-one capital adequacy ratio = (tier-one capital – corresponding capital deduction)/(risk-weighted assets).
- (22) According to the Notification on Matters Related to the Implementation of the Rules Governing Capital Management of Commercial Banks (Provisional) in Transitional Period (關於實施《商業銀行資本管理辦法(試行)》過渡期安排相關事項的通知), the tier-one capital adequacy requirement is set at 6.5% as of December 31, 2013. The requirement increases by 0.4 percentage point each year until 2018. As of December 31, 2018, the tier-one capital adequacy ratio is required to be 8.5%.
- (23) Core tier-one capital adequacy ratio = (core tier-one capital – corresponding capital deduction)/(risk-weighted assets).
- (24) According to the Notification on Matters Related to the Implementation of the Rules Governing Capital Management of Commercial Banks (Provisional) in Transitional Period (關於實施《商業銀行資本管理辦法(試行)》過渡期安排相關事項的通知), the core tier-one capital adequacy requirement is set at 5.5% as of December 31, 2013. The requirement increases by 0.4 percentage point each year until 2018. As of December 31, 2018, the core tier-one capital adequacy ratio is required to be 7.5%.

Core liabilities ratio indicates a bank's liquidity position by measuring the amount of liabilities that is not expected to be settled in the near term, and represents the proportion of relatively stable funding sources for the bank. As of December 31, 2010, 2011, 2012 and June 30, 2013, our core liabilities ratio was 52.78%, 53.92%, 50.45% and 53.08%, respectively, which did not satisfy the core liabilities ratio requirement under the Core Indicators (Provisional) (商業銀行風險監管核心指標(試行)). Such non-compliance was mainly because our time deposits with remaining maturities of more than three months (inclusive) represented a relatively small portion of our funding resources, and inter-bank deposits represented a relatively large portion of our funding resources as of these dates. In order to comply with the core liabilities ratio requirement, we aim to further improve our customer base, obtain more stable funding sources, enhance our asset-liability management and closely monitor the key indicators relating to our core liabilities ratio. According to the Core Indicators (Provisional) (商業銀行風險監管核心指標(試行)), the CBRC may issue risk alerts to commercial banks based on the analysis of the data they have provided. However, we have been advised by our PRC legal advisor, King & Wood Mallesons, that the Core Indicators (Provisional) (商業銀行風險監管核心指標(試行)) do not stipulate any penalties for non-compliance. In accordance with the Core Indicators (Provisional) (商業銀行風險監管核心指標(試行)), the core liabilities ratio, together with other regulatory ratios, serve only as indicators of risk identification, monitoring and alertness of commercial banks, and do not form a direct basis for any regulatory penalties or other sanctions. Furthermore, failure to meet the core liabilities ratio does not necessarily result in any immediate, significant liquidity risk. As of the Latest Practicable Date, we have not been notified of any potential penalties or been subject to any actual penalties for non-compliance with the core liabilities ratio set out in the Core Indicators (Provisional) (商業銀行風險監管核心指標(試行)) and we do not expect any material adverse impact on us from such non-compliance. We have been advised by our PRC legal advisor, King & Wood Mallesons, that such non-compliance does not constitute a material impediment for our listing on the Hong Kong Stock Exchange. In addition, the Core Indicators (Provisional) (商業銀行風險監管核心指標(試行)) has also defined several other ratios, including liquidity ratio, core liabilities ratio, liquidity gap ratio and non-performing assets ratio, though no regulatory provisions have been adopted thereon. The CBRC may formulate regulatory provisions with respect to such ratios in the future.

In addition to the above, we did not, on certain occasions, meet certain requirements of the PRC banking regulators with respect to the required 75% loan-to-deposit ratio. On January 10, 2009, the CBRC issued the “Notice Regarding the Current Adjustment of Certain Credit Regulatory and Supervisory Policies to Promote Stable Development of the Economy” (中國銀監會關於當前調整部分信貸監管政策促進經濟穩健發展的通知), which permitted certain banks that meet capital adequacy requirements and have good coverage ratios to exceed the 75% loan-to-deposit ratio. As of December 31, 2009, our loan-to-deposit ratio was 78.15%. In the CBRC's annual inspection report for 2010, the CBRC also

SUPERVISION AND REGULATION

pointed out that, as of July 2010, our loan-to-deposit ratio was 77.35%. While we believe that we meet the eligibility requirements of the CBRC notice discussed above, we have adopted remedial actions to improve our loan-to-deposit ratio and have reported such actions to the CBRC. As of the Latest Practicable Date, we have not been notified by the CBRC that the above CBRC notice is not applicable to us, nor have we been notified of any potential penalties or become subject to any actual penalties for exceeding the 75% requirement. As of June 30, 2013, our loan-to-deposit ratio was 70.28%, which complied with the CBRC required 75% loan-to-deposit ratio. See “Business – Legal and Regulatory – Regulatory Reviews and Proceedings – Findings of Regulatory Examinations – CBRC” for more information about non-compliance with respect to regulatory ratios.

Corporate Governance and Internal Control

Corporate Governance

The PRC Company Law (中華人民共和國公司法), the PRC Commercial Banking Law (中華人民共和國商業銀行法), the Guidelines on the Corporate Governance of Commercial Banks (商業銀行公司治理指引) and other laws, regulations and regulatory documents provide for specific requirements relating to corporate governance. In particular, the Guidelines on the Corporate Governance of Commercial Banks, which was promulgated by the CBRC on July 19, 2013, requires commercial banks to set up a corporate governance structure under the principles of independent operation, effective balance, mutual cooperation and coordinated operation, and to establish a reasonable motivation incentive and control mechanism so as to decide, execute and supervise relevant corporate affairs scientifically and effectively. In addition, the guidelines provide that good corporate governance of a commercial bank shall include, but shall not be limited to, sound organizational structure, clearly defined responsibilities, scientific development strategies and value criterion, positive social responsibilities, effective risk management and internal control, a reasonable motivation incentive and restraint mechanism, as well as a complete information disclosure system.

The Guidelines on System of Independent Directors and External Supervisors of Joint Stock Commercial Banks (股份制商業銀行獨立董事和外部監事制度指引) requires that the board of directors of a commercial bank should have at least two independent directors and the board of supervisors should have at least two external supervisors, and the Guidelines on the Establishment of a System of Independent Directors by Listed Companies (關於在上市公司建立獨立董事制度的指導意見) require that at least one-third of the board members of a PRC listed company should be independent directors.

In addition, the CBRC has also strengthened shareholders’ long-term commitments and responsibilities in respect of capital injection, particularly with respect to controlling shareholders of joint stock commercial banks, by requiring them to commit to strictly control of connected transactions by banks and take steps to support their banks to meet the prudent regulatory standards, to abide by participation limitation and to take initiatives to prevent imprudent expansion and conflicts of interest. The CBRC also requires the boards of directors of banking financial institutions to implement their functions and duties in a practical manner and refine the collective decision-making mechanisms; requires the boards of supervisors of banking financial institutions to fully exercise their supervising functions and establish direct channels of communication with directors and senior management; requires the senior management of banking financial institutions to strengthen their control on management procedures, make clear the credit granting process and clarify the due diligence standards and liability prosecution standards at steps such as customer investigation, business acceptance, analysis and assessment, credit granting decision and implementation and credit granting management. Furthermore, according to the Measures for Evaluating the Performance of Directors of Commercial Banks (Provisional) (商業銀行董事履職評價辦法(試行)), commercial banks shall, as required by the relevant laws, rules and regulations, assess the performance of their directors. In addition, under the Supervisory Guidelines on Sound Compensation in

SUPERVISION AND REGULATION

Commercial Banks (商業銀行穩健薪酬監管指引), a commercial bank shall have a compensation system which is beneficial for realizing its strategic goals and enhancing its competitiveness, is suitable for fostering talents and controlling risk and shall serve as a major integral part of corporate governance for purposes of giving full play to the orienting role of compensation in commercial banks' corporate governance and in the management and control of risks, establishing a sound, scientific and effective corporate governance mechanism and promoting the sound operation and sustainable development of the banking sector.

Internal Control

Under the Internal Control Guidelines for Commercial Banks (商業銀行內部控制指引) issued by the CBRC in 2007, commercial banks are required to establish internal control to ensure effective risk management for their business activities. PRC commercial banks are also required to establish a risk management department that formulates and implements risk management policies and procedures. In addition, PRC banks are required to establish an internal audit department that can independently supervise and evaluate all aspects of their operations.

On June 27, 2006, the CBRC issued the Guidelines on Internal Audit for Banking Institutions (銀行業金融機構內部審計指引) which became effective on July 1, 2006. Pursuant to the guidelines, banks are required to establish an audit committee of the board with at least three members, a majority of whom must be non-executive directors. Banks are also required to have an internal audit department with employees who meet certain qualifications and in principle represent no less than 1% of the bank's total number of employees. As of the Latest Practicable Date, our total internal audit staff had not yet reached this 1% requirement. While our PRC legal advisor, King & Wood Mallesons, had advised us that such guidelines do not specify any penalties or disciplinary measures for non-compliance with this 1% requirement or any timeframe for compliance, we aim to improve our internal audit practices. Our Legal and Compliance Department, Audit Department, Supervision and Security Department are responsible for compliance management and internal control monitoring, internal audit and internal control assessment, case prevention and safety protection of our Bank.

On May 22, 2008, the Basic Rules on Enterprise Internal Control (企業內部控制基本規範) were issued jointly by the MOF, the CBRC, the NAO, the CSRC and the CIRC and became effective on July 1, 2009. The rules require enterprises to establish and implement internal control systems, utilize information technology to strengthen internal control and establish information systems addressing their operational and management needs, among other matters.

Information Disclosure Requirements

On July 3, 2007, the CBRC issued the Measures for the Information Disclosure of Commercial Banks (商業銀行信息披露辦法) which became effective on the same day. Under the measures, a PRC commercial bank is required to publish an audited annual report within four months after the end of each financial year, disclosing its financial position and operational results.

In accordance with the Guidelines on the Corporate Governance of Commercial Banks (商業銀行公司治理指引), the board of directors of a commercial bank shall be responsible for the information disclosure of such bank. The documents required for such disclosure include regular reports, temporary reports and other relevant materials. Commercial banks are required to disclose relevant information in their annual reports and/or on their websites to provide convenient access and to enable their shareholders and stakeholders to obtain the disclosed information on time. Listed commercial banks also need to satisfy other information disclosure requirements promulgated by the securities regulatory authorities.

SUPERVISION AND REGULATION

The Information Disclosure Rules on Companies Publicly Offering Securities No. 26 – Special Disclosure Rules on Commercial Banks (公開發行證券的公司信息披露編報規則第26號 – 商業銀行信息披露特別規定), which was issued by the CSRC on July 25, 2008 and became effective on September 1, 2008, set out guidelines on information disclosure, including financial and risk-related disclosure by commercial banks offering securities to the public. The rules also require commercial banks to publish announcements in relation to events which may have a material impact on their operational capability or profitability.

Apart from the disclosure requirements above, PRC listed commercial banks are also required to comply with the relevant disclosure requirements imposed by the CSRC through the Administrative Measures on Listed Companies Information Disclosure (上市公司信息披露管理辦法) and the relevant stock exchanges.

Transactions with Related Parties

Apart from the general rules regarding related party transactions issued by the CSRC and the relevant stock exchanges, the CBRC promulgated the Administrative Measures for Related Party Transactions between Commercial Banks and their Insiders or Shareholders (商業銀行與內部人和股東關聯交易管理辦法) (“Related Party Transaction Measures”) on April 2, 2004, which provided more stringent and detailed requirements on related party transactions of PRC commercial banks. The measures require PRC commercial banks to adhere to the principles of honesty and fairness in conducting related party transactions. PRC commercial banks are not allowed to grant unsecured loans to related parties or grant secured loans to related parties on terms more favorable than those offered to third-party borrowers.

The measures also set out detailed provisions on the definition of a related party, the form and content of a related party transaction and the procedures and principles that must be followed for related party transactions.

Pursuant to the measures, commercial banks must submit to the CBRC, on a quarterly basis, status reports regarding their related party transactions, as well as disclose matters relating to related parties and related party transactions in their financial statements. Furthermore, the board of directors is required to report related party transactions and the implementation of mechanisms for the monitoring and approval of such transactions annually at shareholder meetings. The CBRC has the power to require the rectification of transactions that violate the measures and to impose sanctions on the banks and/or the related parties.

Ownership and Shareholder Restrictions

Regulations on Equity Investment in Banks

Any natural or legal person intending to acquire 5% or more of the total equity interest of a commercial bank is required to obtain prior approval of the CBRC. If any existing shareholder of a commercial bank increases its shareholding to 5% or more without obtaining the CBRC’s prior approval, that shareholder will be subject to CBRC sanctions, which include, among others, rescission of the acquisition, disgorgement of profits (if any) for that shareholder and fines.

Under the Measures for the Administration of the Investment and Shareholding in Chinese-funded Financial Institutions by Foreign Financial Institutions (境外金融機構投資入股中資金融機構管理辦法), foreign financial institutions may make equity investments in PRC domestic commercial banks, subject to the CBRC’s approval. However, no single foreign financial institution may own 20% or more of the total equity interest of any domestic commercial bank. In addition, if aggregate foreign investment exceeds 25% of the total equity interest in a non-listed PRC domestic commercial bank, such bank will be regulated as a foreign invested bank. A listed PRC domestic commercial bank is regulated as a PRC domestic bank even if the aggregate foreign investment exceeds 25% of its total equity interest.

SUPERVISION AND REGULATION

Restrictions on Shareholders

The Guidelines on the Corporate Governance of Commercial Banks (商業銀行公司治理指引) imposes certain additional requirements on the shareholders of PRC commercial banks. For example:

- shareholders of commercial banks (particularly major shareholders) need to support reasonable capital plans formulated by the bank's board of directors so that the banks can continuously meet relevant regulatory requirements;
- when a commercial bank's capital adequacy ratio fails to meet regulatory requirements, the bank needs to formulate a capital injection plan to meet regulatory requirements within a required period and increase capital through measures such as supplementing core capital. Major shareholders of the bank shall not prevent other shareholders from injecting additional capital or object to the introduction of new qualified shareholders; and
- shareholders of a commercial bank (particularly major shareholders) who have any overdue loans from the bank are restricted from voting at the shareholders' meeting of the bank. Directors appointed by such shareholders are restricted from voting at the bank's board meetings.

In addition, the PRC Company Law (中華人民共和國公司法) and relevant CBRC rules and regulations impose certain restrictions on the ability of a commercial bank's shareholders to pledge their shares. For example, a PRC joint stock commercial bank may not accept its own shares as collateral. Moreover, there are legal limitations on the ability of shareholders in a PRC joint stock commercial bank to pledge to any other party their shares in the bank. According to the Guidelines on the Corporate Governance of Commercial Banks (商業銀行公司治理指引), if a shareholder of a PRC commercial bank pledges its shares in the bank as collateral for itself or for a third party, it must give prior notice to the board of directors of the bank and must strictly follow all relevant rules, regulations and regulatory requirements. Moreover, the shareholder may not create an additional pledge if the balance of the bank's loans to such shareholder exceeds the audited net value of such shareholder's equity in the bank for the immediately preceding year.

Risk Management

Since its establishment, the CBRC has published numerous risk management guidelines and rules to improve risk management of PRC commercial banks, including credit risk management, operational risk management, market risk management, compliance risk management and risk rating system, in addition to guidelines concerning loan and credit to certain specific industries and customers and the implementation of Basel II. See “– Regulation of Principal Commercial Banking Activities – Lending” and “– Supervision over Capital Adequacy – Basel Accords.” The CBRC also promulgated the Core Indicators (Provisional) (商業銀行風險監管核心指標(試行)) as a basis of supervising the risk management of PRC commercial banks. The CBRC established requirements for certain ratios relating to risk levels and risk provisions under the Core Indicators (Provisional) (商業銀行風險監管核心指標(試行)) and is expected to establish requirements for certain ratios relating to risk mitigation for the purpose of evaluating and monitoring the risks of PRC commercial banks. See “– PRC Banking Supervision and Regulation – Other Operational and Risk Management Ratios.” The CBRC periodically collects data through off-site surveillance to analyze such indicators and evaluate and issue early warnings of the risks on a regular basis.

Market Risk Management

On December 29, 2004, the CBRC promulgated the Guidelines on the Market Risk Management of Commercial Banks (商業銀行市場風險管理指引), which became effective on March 1, 2005, to strengthen the market risk management of PRC commercial banks. These guidelines mainly address (i) the responsibilities of the board of directors and the senior management in supervising market risk management, (ii) the policies and procedures for market risk management, (iii) the detection, quantification, monitoring and control of market risk and (iv) the responsibilities for internal control and external audits.

In addition, on June 7, 2012, the CBRC issued the Rules Governing Capital Management of Commercial Banks (Provisional) (商業銀行資本管理辦法(試行)) which became effective on January 1, 2013. The Measurement Rules on the Standardization for the Market Risk Capital Requirements (Appendix 10) (附件10,市場風險資本要求標準法計量規則) and the Regulatory Requirements on the Internal Models for the Market Risk (Appendix 11) (附件11,市場風險內部模型法監管要求) of this provisional regulation provided the basic standard that commercial banks should meet when using internal models to measure the market risk capital, as well as the examination and approval procedures and the regulatory requirements.

Operational Risk Management

On March 22, 2005, the CBRC issued the Circular on Strengthening Control of Operational Risk (關於加大防範操作風險工作力度的通知) to further strengthen PRC commercial banks' ability to identify, manage and control operational risks. Under this circular, commercial banks are required to establish internal policies and procedures specifically for the management and control of operational risks. A bank's internal audit department and business operations department are required to conduct independent and ad hoc reviews and examinations of the bank's business operations from time to time and ongoing reviews and examinations for business areas involving a greater degree of operational risks. Moreover, a commercial bank's head office is required to assess the implementation of, and compliance with, its internal policies and procedures on operational risks.

In addition, the circular sets out detailed requirements relating to, among other things, establishing a system under which branch officers responsible for business operations are required to rotate on a regular basis, establishing a system to encourage employees to fully comply with applicable laws and regulations and internal rules and policies, improving the regular checking of account balances between PRC commercial banks and their customers, improving the timely checking of the banks' internal accounting, segregating persons responsible for book-keeping from those responsible for account reconciliation and establishing a system to strictly control and manage the use and keeping of chops and specimen signatures, as well as evidential vouchers.

Furthermore, on May 14, 2007, the CBRC issued the Guidelines on Operational Risk Management of Commercial Banks (商業銀行操作風險管理指引) to enhance the risk management abilities of the PRC commercial banks. These guidelines mainly address the supervision and controls of the board of directors, responsibilities of senior management, proper organizational structure and policies and approaches and procedures for operational risk management. Those policies and procedures shall be submitted to the CBRC. If a commercial bank incurs a significant operational incident and fails to adopt effective corrective measures within a required period, the CBRC shall take relevant regulatory measures. On June 7, 2012, the CBRC issued the Rules Governing Capital Management of Commercial Banks (Provisional) (商業銀行資本管理辦法(試行)), which became effective on January 1, 2013 and amended or formulated several measures to calculate credit risk, market risk and operational risk. The Measurement Requirements on the Operational Risk Capital (Appendix 2) (附件2,操作風險資本計量要求) provided further guidance on the requirements for calculating operational risk-weighted assets.

Liquidity Risk Management

In order to strengthen liquidity risk management and maintain safe and stable operations of commercial banks, the CBRC issued the Guidelines on the Management of Liquidity Risk of Commercial Banks (商業銀行流動性風險管理指引) on September 28, 2009, which required commercial banks to establish a sound governance organization for the management of liquidity risk and specified, among other things, (i) the functions and responsibilities of the board of directors and its specialized committee, the board of supervisors (supervisors) and senior management of the commercial banks in the management of liquidity risk; (ii) the liquidity risk management policy and procedure; (iii) the internal control and management information system; and (iv) liquidity management methods and techniques.

In addition, the CBRC printed and distributed the Notice on Further Strengthening the Supervision of Liquidity Risk of Commercial Banks (關於進一步加強商業銀行流動性風險監管的通知) in February 2010, which introduced the new liquidity risk measuring indexes, such as liquidity coverage ratio and net stable funding ratio, and required commercial banks to strengthen the measurement and management of liquidity risk, optimize the asset-liability allocation, reduce the maturity mismatch and decrease the possibility and impact of a liquidity crisis. Moreover, in December 2010 the CBRC issued the Notice on Printing and Distributing Off-site Supervision Report of Year 2011 (關於印發 2011年非現場監管報表的通知), which improved the reporting system for off-site supervision of liquidity risk in accordance with the newest requirements.

On October 12, 2011, the CBRC published the Rules Governing Liquidity Risk Management of Commercial Banks (Consultation Draft) (商業銀行流動性風險管理辦法(徵求意見稿)), which further elaborated on the general principles of liquidity risk management and supervisory requirements for commercial banks. On October 11, 2013, the CBRC released a draft to solicit public opinions on regulations for liquidity risks faced by commercial banks, which will come into effect on January 1, 2014 (商業銀行流動性風險管理辦法(試行)(徵求意見稿)), requiring commercial banks to be allowed to maintain a liquidity coverage ratio (LCR) lower than 100 percent before 2018 under pressure conditions.

Compliance Risk Management

In order to strengthen the compliance risk management of commercial banks and maintain the safety and stability of the operations of PRC commercial banks, the CBRC promulgated the Guidelines on Compliance Risk Management of Commercial Banks (商業銀行合規風險管理指引) on October 20, 2006. These guidelines have clarified the responsibilities of the board of directors and the senior management of a PRC commercial bank with respect to compliance risk management, standardized the organizational structure for compliance risk management and set out the regulatory mechanisms for a bank's risk management.

Risk Management in Other Aspects

According to the Notice on Formal Operation of the Off-site Supervision Information System (中國銀行業監督管理委員會關於非現場監管資訊系統2007年正式運行的通知), issued by the CBRC on October 20, 2006, the Off-site Supervision Information System established by the CBRC formally entered operation since 2007. Under the Off-site Supervision Information System, banks shall submit to the CBRC statements regarding the basic business situation of the bank and major risks faced, as well as the unique risks and particulars of the bank's business. Depending on risk elements, supervisory requirements and other factors, such statements may be submitted on a monthly, quarterly, semi-annual or annual basis.

SUPERVISION AND REGULATION

In addition to the above, the CBRC promulgated several guidelines in other aspects of risk management such as the Guidelines on Reputation Risk Management of Commercial Banks (商業銀行聲譽風險管理指引), the Guidelines on the Management of Interest Rate Risk in the Banking Account of Commercial Banks (商業銀行銀行賬戶利率風險管理指引), the Guidelines on the Management of Outsourcing Risks of Banking Financial Institutions (銀行業金融機構外包風險管理指引), the Guidelines on the Management of Information Technology Risks of Commercial Banks (商業銀行信息科技風險管理指引) and the Guidelines on the Management of Country Risk by Banking Financial Institutions (銀行業金融機構國別風險管理指引), in order to strengthen the risk management of commercial banks in these fields.

Risk Rating System

PRC commercial banks are subject to evaluation by the CBRC based on a provisional risk rating system. Under this system, the capital adequacy, asset quality, management quality, profitability, liquidity and exposure to market risk of PRC commercial banks are evaluated and scored by the CBRC on a continuous basis. Each bank is classified into one of five risk-rating categories based on its scores. The CBRC's supervisory activities in respect of a bank, including the frequency and scope of its on-site examinations, depend on the bank's risk rating category. Such risk rating also forms the basis for the CBRC's evaluation of a bank's applications for new business licenses and its senior management qualification. These risk ratings are currently not publicly available.

Anti-money Laundering Regulation

The PRC Anti-money Laundering Law (中華人民共和國反洗錢法), which became effective on January 1, 2007, sets out the responsibilities of the relevant financial regulatory authorities regarding anti-money laundering, including participating in the formulation of the rules and regulations regarding anti-money laundering activities of the financial institutions they regulate and requiring financial institutions to establish sound internal control systems regarding anti-money laundering. To facilitate the implementation of the PRC Anti-money Laundering Law (中華人民共和國反洗錢法), the PBOC promulgated the Anti-money Laundering Regulations for Financial Institutions (金融機構反洗錢規定), which became effective on January 1, 2007. According to these regulations, PRC commercial banks are required to establish internal anti-money laundering procedures and either establish an independent anti-money laundering department or designate a relevant department to implement their anti-money laundering procedures. In accordance with the Administrative Measures for Financial Institutions' Reporting of Large Transactions and Suspicious Transactions (金融機構大額交易和可疑交易報告管理辦法) promulgated by the PBOC, which became effective on March 1, 2007, upon the detection of any suspicious transactions or transactions involving large amounts, PRC commercial banks are required to report the transactions to the PBOC or the SAFE, where applicable. Where necessary and pursuant to appropriate judicial proceedings, PRC commercial banks are required to cooperate with government authorities in preventing money laundering activities and freezing assets. PRC commercial banks are required to establish a customer identification system in accordance with the Measures on the Administration of Customer Identity Identification and Materials and Transaction Recording of Financial Institutions (金融機構客戶身份識別和客戶身份資料及交易記錄保存管理辦法) promulgated jointly by the PBOC, the CBRC, the CSRC and the CIRC, which became effective on August 1, 2007. PRC commercial banks are also required to record the identities of all customers and the information relating to each transaction and keep retail transaction documents and books. The PBOC supervises and conducts on-site examinations of PRC commercial banks' compliance with its anti-money laundering laws and regulations and may impose penalties for any violations thereof in accordance with the PRC Anti-money Laundering Law (中華人民共和國反洗錢法).

Other Requirements

Use of Funds

Under the PRC Commercial Banking Law (中華人民共和國商業銀行法), commercial banks are not permitted to engage in trust investment or securities business, invest in real property other than for their own use, or invest in non-banking financial institutions and enterprises, unless otherwise approved by the relevant government authorities. The use of funds by commercial banks is limited to the following:

- short-term, medium-term and long-term loans;
- discounts on negotiable instruments;
- inter-bank loans;
- trading of government bonds;
- trading of bonds from financial institutions;
- investment in banking institutions; and
- other uses as may be approved by the relevant government authorities.

Upon obtaining approvals from the relevant authorities, including the CBRC, commercial banks are permitted to invest in domestic insurance companies, fund management companies and financial leasing companies.

On February 20, 2005, the PBOC, the CBRC and the CSRC jointly promulgated and implemented the Pilot Administrative Measures on Establishment of Funds Management Companies by Commercial Banks (商業銀行設立基金管理公司試點管理辦法), pursuant to which state-owned commercial banks and joint stock commercial banks are allowed to set up or acquire fund management companies after obtaining approvals from the CBRC and the CSRC. In addition, commercial banks shall adopt effective measures to prevent risks associated with capital markets and the banking industry.

In accordance with the Administrative Measures on Financial Leasing Companies (金融租賃公司管理辦法), which were amended by the CBRC in 2007, commercial banks can invest in financial leasing companies where commercial banks are able to meet relevant requirements for capital adequacy, profitability, corporate governance and other matters.

On November 5, 2009, the CBRC enacted the Pilot Administrative Measures on Investment by Commercial Banks in Insurance Companies (商業銀行投資保險公司股權試點管理辦法). These pilot administrative measures require a pilot plan for investment by a commercial bank in a domestic insurance company to be filed with the relevant regulator for the approval of the State Council. Each commercial bank is allowed to invest in one domestic insurance company only. The pilot administrative measures also set out rules for the qualifications of a commercial bank intending to invest in a domestic insurance company and for the target insurance company itself.

SUPERVISION AND REGULATION

PRC SECURITIES LAW AND REGULATIONS

As our A Shares have been listed on the Shanghai Stock Exchange since August 2010, we are subject to the provisions of the PRC Securities Law (Revised) (中華人民共和國證券法(修訂)) and the listing rules of the Shanghai Stock Exchange, which regulate share listing and information disclosure of listed companies, including us, and seek to maintain the orderly operation of the stock market and protect the interests of investors. As a listed company with A Shares listed on the Shanghai Stock Exchange, we are subject to a number of obligations under the listing rules of the Shanghai Stock Exchange, including, but not limited to:

- publishing annual, interim and quarterly reports;
- disclosing all information that may have a material impact upon our share price;
- making announcements in relation to certain corporate matters; and
- appointing a secretary to the board of directors, who is responsible for, among other things, certain corporate governance matters and information disclosure matters.

Furthermore, as a commercial bank listed in the PRC, we are required to disclose in our annual report the financial information prepared according to PRC GAAP.

We are subject to a number of PRC laws governing the securities market. The CSRC is responsible for drafting the rules and regulations on the administration of securities markets, supervising listed companies and managing the public offering of securities by PRC companies and securities transactions, such as prohibiting listed companies from using inside information in any securities transaction. A company with shares dual-listed both in the PRC and abroad is concurrently subject to PRC laws and regulations as well as the regulations of other countries and regions in relation to securities market management and is simultaneously required to disclose important information to both investment communities.