

PRC BANKING SUPERVISION AND REGULATION

Overview

The banking industry in the PRC 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. The principal laws and regulations relating to the PRC banking industry are the PRC Commercial Banking Law, the PRC PBOC Law and the PRC Banking Supervision and Regulatory Law, and the rules and regulations established thereunder.

History and Development of the Regulatory Framework

Established on 1 December 1948, the PBOC was initially the primary regulator of the financial industry in the PRC. In January 1986, the State Council issued the Interim Regulations 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 when the PRC PBOC Law and the PRC Commercial Banking Law were issued. The PRC PBOC Law, which was issued in March 1995, provided for the scope of responsibilities and the organisational structure of the PBOC, and authorised the PBOC to administer the Renminbi, implement monetary policies and regulate and supervise the PRC financial industry. The PRC Commercial Banking Law was enacted in May 1995 and set out 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, minimise overall risks, promote stability and development and enhance the international competitiveness of the PRC banking industry. In December 2003, the PRC Commercial Banking Law and the PRC PBOC Law were amended and, on 1 February 2004, the PRC Banking Supervision and Regulatory Law came into effect. The PRC Banking Supervision and Regulatory Law sets out the regulatory functions and responsibilities of the CBRC.

Principal Regulators

CBRC

Functions and Powers

The CBRC is the principal regulatory authority in the PRC responsible for the supervision and regulation of banking institutions operating within the PRC, including commercial banks, urban credit cooperatives, rural credit cooperatives, other deposit-taking financial institutions and policy banks, as well as certain non-bank financial institutions, such as asset management companies, trust and investment companies, finance companies, financial leasing companies and other financial institutions which can only be set up with 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 such institutions. According to the PRC Banking Supervision and Regulatory Law and relevant regulations, the CBRC's primary regulatory responsibilities include:

- formulating and issuing rules and regulations governing banking institutions and their activities;

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- examining and approving the establishment, change and termination of banking institutions and their scope of business, as well as granting banking licences to commercial banks and their branches;
- regulating the business activities of banking institutions, including their products and services offered;
- 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 headquarters in Beijing and its bureaus throughout the PRC, monitors the operations of banks and their branches through on-site examinations and off-site surveillance. On-site examinations generally include inspecting a bank's business premises, interviewing its employees, senior management and directors for an explanation of significant issues relating to its operations and risk management, as well as reviewing relevant documents and materials kept by the bank. Off-site surveillance generally includes reviewing 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 authorised to impose corrective and punitive measures, including imposing fines, ordering the suspension of certain business activities, imposing restrictions on dividends and other forms of distributions and asset transfers, and suspending the opening of new branches. In extreme cases or when a commercial bank fails to take corrective action within the time period specified by the CBRC, the CBRC may order the banking institution to suspend operations and may revoke its operating-business licence. In the event of a crisis or failure within 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 PBOC Law and relevant regulations, the PBOC is empowered to:

- issue and implement orders and regulations in relation to its duties;
- formulate and implement monetary policy in accordance with 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;

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- 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 15 August 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

The MOF, a ministry under the State Council, is responsible for state finance, taxation, accounting and the management of state-owned financial assets. The MOF regulates the performance review and remuneration mechanism of senior management of state-owned banks, and overseas banks' compliance with the China Accounting Standards for Business Enterprises (企業會計準則—基本準則) and the Financial Rules for Financial Enterprise (金融企業財務規則), which both came into effect on 1 January 2007. The MOF's primary responsibilities include:

- issuing and implementing financial and taxation strategies, plans, policies and reform measures;
- drafting laws, rules and regulations concerning fiscal, financial and accounting management;
- organising international negotiations concerning foreign-related finance and debt agreements;
- managing state-owned financial assets, administering the appraisal of state-owned assets and participating in drafting rules governing state-owned financial assets management; and
- supervising the implementation of financial and tax rules and policies, reporting critical issues in the management of fiscal revenue and expenditure and managing the financial supervision commissioners' office.

Other Regulatory Authorities

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

Licensing Requirements

Basic Requirements

The PRC Commercial Banking Law and the Measures of the CBRC for the Implementation of Administrative Licensing Matters Concerning Chinese-funded Commercial Banks (中國銀行業監管管理委員會中資商業銀行行政許可事項實施辦法), effective from 1 February 2006 and amended on 28 December 2006, respectively, and the Measures for the 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 15 October 2013, set out the permitted scope of business, licensing standards and other requirements in respect of city commercial banks. The establishment of a city commercial bank requires the CBRC's approval and issuance of an operating license. In general, the CBRC will not approve an application to establish a city commercial bank unless certain conditions are satisfied, including, amongst others, that:

- the articles of association of the proposed commercial bank are in compliance with the relevant requirements of the PRC Company Law and the PRC Commercial Banking Law;
- in accordance with the minimum requirement of registered capital under the PRC Commercial Banking Law, which is RMB100 million for a city commercial bank which amount is required to be fully paid up;
- the directors and senior management of the proposed commercial bank possess the requisite qualifications and the proposed city commercial bank has qualified practitioners who are familiar with the banking business;
- the organisational structure and management system of the proposed commercial bank is sound and effective;
- the business premises, safety and security measures and other facilities of the proposed commercial bank is commensurate with its business operation; 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

City commercial banks are required to obtain the CBRC or its branches' approval to undertake significant changes, including:

- change of name;
- change of registered capital;
- change of location of headquarters;
- change of business scope;
- change of form of organisation;
- purchase of any equity interest in the city commercial bank that results in the purchaser becoming a holder of 5% or more of the city commercial bank's shares, and any change of shareholders holding 5% or more of the city commercial bank's total capital or shares;

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- investment in a city commercial bank by an enterprise located outside the province, autonomous region or directly administrated municipality where the city commercial bank is registered;
- amendment to the articles of association;
- merger or division; and
- dissolution and liquidation.

Establishment of Branches

Branches in the province (autonomous regions, directly administered municipalities) where their headquarters is located

To establish a local branch, a city commercial bank must apply to the relevant local offices of the CBRC in the province (autonomous regions, directly administered municipalities) where it is registered for approval and issuance of a finance license.

On 16 April 2009, the CBRC issued the Notice on Adjusting the Licensing Policies for the Establishment of Branch Outlets by Small- and Medium-Sized Commercial Banks (for Trial Implementation). According to this notice:

- the establishment of branches and sub-branches by city commercial banks is no longer subject to a working capital requirement. Instead, each city commercial bank may establish branches and sub-branches in accordance with its business development and capital management needs; and
- the number of branches and sub-branches of a city commercial bank within the province, (autonomous region or directly administered municipality) where its business is located is no longer subject to a cap.

Branches outside the province (autonomous regions, directly administered municipalities) where their headquarters is located

With regard to the establishment of branches by a city commercial bank in provinces (autonomous regions, directly administered municipalities) other than where its business is located, the approval from the CBRC is needed. The notice provides for a “Three-Step” principle: i.e., establishment within the province where the business is located before other provinces, establishment within the local economic region before other economic regions, and, finally, expansion throughout the entire country.

Scope of Business

Under the PRC Commercial Banking Law, commercial banks in the PRC are permitted to engage in the following activities:

- taking deposits from the public;
- extending short-term, medium-term and long-term loans;
- effecting domestic and overseas payment settlements;
- accepting and discounting instruments;
- issuing financial bonds;

- acting as the issuing agent, cashing agent and underwriter of government bonds;
- trading government bonds and financial institution bonds;
- engaging in interbank lending;
- trading foreign exchange as principal or agent;
- 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 service; and
- other businesses approved by the banking regulatory authorities under the State Council.

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 or its branches 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 the extension of credit, PRC banking regulations require that commercial banks should, among other things: (i) establish a strict and unified credit risk management system; (ii) establish standard operation procedures for each step in the extension of credit process, 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 control 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”.

The CBRC and other relevant authorities have issued a number of regulations and rules concerning loans and credit granted which are applicable to all industries. Set out below is a summary of some of these rules and regulations:

- under 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) issued by the CBRC on 6 December 2008, commercial banks are required to establish business processes and internal control systems and enforce them after reporting to the CBRC. A commercial bank cannot finance mergers and acquisitions unless it has, amongst others: (i) a sound risk management mechanism and an effective internal control mechanism; (ii) specific allowance adequacy ratio for loan impairment loss of no less than 100%; (iii) a capital adequacy ratio of no less than 10%; (iv) a general reserve balance of no less than 1% of the loan balance for the same period; and (v) a professional team responsible for due diligence and risk assessment of merger and acquisition loans. These guidelines also set out requirements in relation to assessment and control of risk associated with mergers and acquisitions, such as overall strategic risk, legal and compliance risk, consolidation, operational risk and financial risk;

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- on 23 July 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), which covered areas such as ensuring that loans flow to efficient real economy and major projects, preventing credit risk, optimising lending structure, improving lending management quality of banking institutions, avoiding systematic risk in the banking industry and promoting risk management capabilities of banking institutions; and
- the Interim Measures for the Administration of Working Capital Loans (流動資金貸款管理暫行辦法), implemented by the CBRC on 12 February 2010, requires commercial banks to establish effective internal control and risk management systems in order to monitor the use of working capital loans and to collect customer information. Commercial banks are required to take reasonable and prudent measures to compute the actual borrowing demand of clients for operating demands and to make sure amounts of loans do not exceed a client's actual capital demand for its business operations. Commercial banks are also required to set out written rules to ensure that working capital loans are used for legitimate purposes. In particular, these loans may not be used for investments into fixed assets and equity investments or for areas or purposes prohibited by applicable laws.

In addition, the CBRC and other relevant authorities have issued a number of regulations and rules concerning loans and credit granted to certain specific industries and customers in an effort to control the credit risk of PRC commercial banks and/or to realise the objectives of macroeconomic control. Set out below is a summary of some of the rules and regulations applicable to our Bank:

- the Guidelines on the Risk Management of Risks of Credits 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 require commercial banks to establish a risk management system to control the credit granted to group borrowers, which needs to be filed with the CBRC. If the credit balance to a single group borrower of a commercial bank exceeds 15% of its net capital, the commercial bank is required to adopt measures, including syndicated loans, joint loans and transfer of loans, to diversify risks. In line with its prudential supervision requirement, the CBRC may lower such credit balance ratio;
- the Interim Measures for the Administration of Personal Loans (個人貸款管理暫行辦法), which require commercial banks to establish an effective full process management mechanism and risk limit management system in connection with the provision of personal loans. These regulations also set out certain conditions in connection with the application for personal loans, such as the requirement that the use of personal loans should comply with relevant laws and policies and that commercial banks are required to specify the purpose for such personal loans;
- the Guidelines on Project Financing Business (項目融資業務指引), which require banking institutions to establish a sound operation flow and risk management mechanism. Banking institutions are required to fully identify and evaluate risks in association with the project construction 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 are also required to focus on borrowers' repayment capability so that they can evaluate risks associated with technical and financial feasibility as well as repayment sources. In addition, banking institutions are required to ensure that borrowers set up a designated account to receive all revenues from projects and to monitor the account and take actions in case of unusual movements;
- the Measures for the Administration of Peasant Household Loans (農戶貸款管理辦法), which clarifies the scope of peasant household loans and encourages banking institutions to develop

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- the business of peasant household loans, formulate relevant operational strategies and enhance risk management capabilities in relation to such loans;
- the Automobile Loan Measures (汽車貸款管理辦法), which require commercial banks to establish a credit rating system and monitoring system in connection with automobile loans. These regulations also set out certain conditions in relation to applications for such automobile loans. In addition, the regulations state that the amount of automobile loans shall not, in each case, 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 are also required to ensure that borrowers provide security over their vehicles or other types of security for automobile loans;
 - the Guidelines on the Management of Risks of Real Estate Loans Granted by Commercial banks (商業銀行房地產貸款風險管理指引), which require commercial banks to establish standards for the review and approval of real estate loans (including land reservation loans, estate development loans, residential housing loans, and commercial housing loans) and to develop systems of risk management and internal control for the analysis of market risk, legal risk, and operational risk in the real estate loan market. Commercial banks are not allowed to issue real estate development loans to borrowers without land use right certificates and relevant permissions. The CBRC conducts a periodic inspection of the implementation of the guidelines;
 - the Notice of the State Council on Firmly Curbing Excessive Rise of Housing Prices in Some Cities (國務院關於堅決遏制部分城市房價過快上漲的通知), which, among other things, requires commercial banks to strengthen the pre-lending examination and post-lending management of loans to real estate development enterprises, and prohibits commercial banks from granting new development loans to real estate developers which have land lying idle or which are involved in land speculation activities. The Notice of the General Office of the State Council on Further Working on the Market Regulation and Control of Real Estate Market (國務院辦公廳關於繼續做好房地產市場調控工作的通知) further prohibits commercial banks from making loans to land developers which are engaged in illegal activities such as land-hoarding and price speculation;
 - the Notice of the PBOC and the 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 implements the Notice of the State Council on Firmly Curbing Excessive Rise of Housing Prices in Some Cities in respect of housing loans. These regulations require all commercial banks not to grant housing loans to families who are purchasing a third or more residential property or to non-PRC residents who are unable to provide evidence of one or more years' payments of local tax or social security. With respect to a first-time purchase of any commercial residential property, the minimum down payment ratio is set at 30%, whilst the minimum down payment for a second-time home buyer is 50% whilst the regulations state that the interest rate shall be no less than 110% of the PBOC loan benchmark interest rate as set out in the Notice of the State Council on Firmly Curbing Excessive Rise of Housing Prices in Some Cities. In addition, 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), provides that the minimum down payment for a second-time home buyer will be raised to 60% for housing loans granted after 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);

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- 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臺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臺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年地方政府融資平臺貸款風險監管工作的通知), the 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年地方政府融資平臺貸款風險監管的指導意見), which require that banking financial institutions strictly implement pre-lending investigation, examination at lending and post-lending inspection systems for loans to Local Government Financing Vehicles (the “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 are also required to consider the debt burdens of local governments and the potential risks and expected losses of loans to LGFVs. The various regulations provide that the allowance for impairment losses is to be provided reasonably and the risk weighting in calculating capital adequacy is to be determined by full coverage, basic coverage, semi-coverage and non-coverage of such loans. In addition, 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年地方政府融資平臺貸款風險監管的指導意見), require each bank to impose aggregate loan limits on LGFVs and not to expand the scale of LGFVs, and also provides that, for the LGFVs with a cash flow coverage ratio lower than 100% or an asset-liability ratio higher than 80%, the proportion of their loans to total bank credit should not exceed that of the previous year;
- the Guiding Opinions on Further Supporting the Restructuring and Revitalisation of Key Industries and Curbing Over-capacity in Certain Industries through Financial Services (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 provide that banking financial institutions should, in compliance with the Notice of the State Council on Ratifying and Forwarding the Several Opinions of the National Development and Reform Commission and Other Ministries on Curbing Over-capacity and Redundant Construction in Certain Industries and Guiding the 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), actively cooperate with the national industrial policy and financial control requirements, and should extend credit in compliance with the principle of differential treatment. For enterprises and projects that revitalise key industries, meet market access requirements, and comply with the bank’s lending policy, the regulations provide that credit extension is to be made in a timely and efficient manner. For those that fail to satisfy these conditions, the regulations provide that credit is not to be extended. For projects in industries with over-capacity, the regulations provide that credit extension is to be strictly examined prior to approval; and
- the Guidelines of Green Credit (綠色信貸指引), which require banking financial institutions to support energy saving, emission reduction and environment protection by guarding against the environmental and social risks of their customers. Under the Guidelines, banking financial institutions are required to effectively identify, measure, monitor and control environmental and social risks in their credit business activities, and to establish relevant risk management systems. Banks are also required to explicitly support green credit, formulate targeted guidelines for credit extensions to restricted industries and those with substantial environmental and social risks, carry out differential and dynamic credit extension policies, and implement risk exposure management systems. Specifically, banking financial institutions are required to carry out more thorough due diligence investigations on environmental and

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social risk by taking into account the characteristics of their customers and are prohibited from granting credit to customers that fail to comply with relevant standards on environmental and social performance. Customers with substantial environmental and social risks are required to submit environmental and social risk reports and the banking financial institutions are required to include specific terms to address those risks in loan agreements. Also, banking financial institutions are required to implement tailor-made post-lending management measures for customers with potentially substantial environmental and social risks, adopt proper mitigating measures in a timely manner and report to regulatory authorities whenever an incident with substantial environmental and social risk occurs.

We have adopted certain rules and measures to comply with the above regulations. We have also further 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 the business of foreign exchange. Under the PRC's anti-money laundering laws and regulations, PRC financial institutions are required to report to the Anti-money Laundering Monitoring and Analysis Centre and SAFE on a timely basis any large or suspicious foreign exchange transactions which they encounter.

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 Chinese 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 Chinese 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 and bankruptcy reorganisations; and
- act as custodians for funds, including securities investment funds and corporate annuity funds.

Under the Administrative Measures on the Custodian Business for Securities Investment Fund (證券投資基金託管業務管理辦法) issued by the CSRC on 2 April 2013 and effective on the same day (which replaced the Administrative Measures on Qualifications for Securities Investment Fund (證券投資基金託管資格管理辦法), a commercial bank is permitted to apply for the right to engage in the custodian business for securities investment funds, if, amongst other requirements, such commercial bank had year-end net assets of not less than RMB2 billion for each of the previous three fiscal years and if its capital adequacy ratio fulfils the relevant regulatory requirements. The fund custodian must ensure the separation of its custodian business from its other businesses, as well as the segregation of its fund assets. The CSRC and the CBRC are jointly responsible for examining and approving the qualifications and supervising the activities of fund custodians. According to the Measures for the Administration of Enterprise Annuity Funds (企業年金基金管理辦法) issued jointly by the Ministry of Human Resources and Social Security, the CBRC and other authorities on 12 February 2011 and effective on 1 May 2011 (which replaced the Interim Measures for the Administration of Enterprise Annuity Funds (企業年金基金

管理試行辦法), commercial banks are required to report to the relevant regulatory bodies and establish a specialised funds custodian department.

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. In principle, each outlet of a commercial bank may cooperate with no more than three insurance companies to sell their insurance products. If the outlet cooperates with more than three insurance companies, the outlet must report to the local branch of the CBRC. Pursuant to the Supervisory Guidance on the Insurance Agency Business of Commercial Banks (商業銀行代理保險業務監管指引) jointly issued by the CIRC and the CBRC on 7 March 2011, if a commercial bank operates a bank assurance business, each of its business outlets is required to obtain the requisite license issued by the CIRC and authorisation from the tier one branch of the commercial bank before operating such business.

Wealth Management

In September 2005, the CBRC issued the Interim Measures on Administration of the Personal Wealth Management Services of Commercial Banks (商業銀行個人理財業務管理暫行辦法), which requires commercial banks to obtain the CBRC's approval in order to provide certain wealth management services such as return-guaranteed wealth management plans. For other personal wealth management services, commercial banks only need to file a report with the CBRC. Commercial banks are also subject to certain restrictions on personal wealth management products. In addition, under the Guidelines for the Risk Management of the 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 in September 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 issues to the relevant authorities. Since then, the CBRC has issued a series of regulations in an effort to further improve the reporting mechanism and risk control of personal wealth management services provided by commercial banks. To further standardise and regulate the sales of wealth management products, 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) in August 2011, which requires commercial banks to prudently operate and disclose in a timely manner their wealth management business to fully protect the interests of consumers.

In addition to domestic personal wealth management, the PBOC, the CBRC and the SAFE jointly issued the Interim Administrative Measures for Commercial Banks to Provide Overseas Financial Management Services (商業銀行開辦代客境外理財業務管理暫行辦法), effective on 17 April 2006, which 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.

On 25 March 2013, the CBRC issued the Notice on the Regulation of the Investment and Operation of Wealth Management Business by Commercial Banks (關於規範商業銀行理財業務投資運作有關問題的通知), to enhance the regulation of the wealth management business of commercial banks. This notice requires commercial banks to clearly link each wealth management product with its underlying investment asset. Moreover, the balance of wealth management funds invested by a commercial bank in non-standard debt-based assets cannot exceed the lower of (i) 35% of the balance of the commercial bank's wealth management products, and (ii) 4% of the commercial bank's total assets as disclosed in its annual audit report for the prior fiscal year.

Electronic Banking

In January 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 e-banking business are required to have sound internal control and risk management systems and are not permitted to have any major accidents relating to their primary information management and operations processing systems in the year immediately prior to the application to establish the e-banking business. In addition, all banking institutions conducting e-banking business must adopt security measures to ensure the confidentiality of information and to prevent the unauthorised use of e-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 Chinese government and financial institutions, short-term commercial paper, medium-term notes and corporate bonds issued by qualified non-financial institutions, and certain derivative products. Unless approved by the Chinese 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 non-banking financial institutions and enterprises.

Derivatives

The Provisional Administrative Measures on Derivative Business of Financial Institutions (金融機構衍生產品交易業務管理暫行辦法) issued by the CBRC on 4 February 2004 set out, among other things, detailed regulations on market access and risk management for the derivative business conducted by financial institutions. In accordance with these measures, commercial banks in the PRC seeking to conduct a derivative business must meet the relevant qualification requirements and obtain prior approval from the CBRC. In addition there have been a number of additional regulations aimed to further strengthen the risk management of derivative businesses conducted by commercial banks in the PRC: on 22 March 2005, the CBRC issued the Circular on Risk Alert Regarding Trading of Derivative Products by Domestic Banks (關於對中資銀行衍生產品交易業務進行風險提示的通知) (repealed on 3 July 2007); on 3 July 2007 and again on 5 January 2011 the CBRC amended the Provisional Administrative Measures on Derivative Business of Financial Institutions (金融機構衍生產品交易業務管理暫行辦法); and on 31 July 2009 the CBRC issued the Notice to Further Strengthen Risk Management of Derivative Product Transactions between Banking Institutions and Institutional Customers (關於進一步加強銀行業金融機構與機構客戶交易衍生產品風險管理的通知).

Financial Innovation

In December 2006, the CBRC issued 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 prudently engage in financial innovation-related activities, including developing new businesses and products and improving existing businesses and products, expanding their scope of business, improving cost efficiency and profitability, and reducing their reliance on lending business for profits. To facilitate financial innovation by PRC commercial banks, the CBRC has indicated that it will streamline and increase the efficiency of the examination and approval procedures for new products.

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Pricing of Products and Services

Interest Rates for Loans and Deposits

Interest rates for RMB-denominated loans and deposits were historically set by the PBOC. In accordance with the PRC Commercial Banking Law, each commercial bank is required to determine both its loan rate in accordance with a minimum loan rate limit and its deposit rate in accordance with a maximum deposit rate limit, in each case, as set by the PBOC. In recent years, the PBOC has gradually liberalised its regulation of interest rates, allowing banks more discretion to determine the interest rates for RMB-denominated loans and deposits. According to the current PBOC requirements, a commercial bank in China may set its interest rate for RMB-denominated deposit at no higher than 110% of the relevant PBOC benchmark rates, whilst the interest rate for RMB-denominated loans (except for commercial residential housing loans) can be determined by a commercial bank at its own discretion. The table below sets out, for the periods indicated, the permitted range of interest rates for RMB-denominated loans and deposits.

	Loans Since 20 July 2013 ⁽¹⁾	Deposits Since 8 June 2012 ⁽²⁾
Maximum interest rates	No Cap	Up to 110% of the PBOC benchmark rate, except for negotiated deposits
Minimum interest rates	No minimum	No minimum

Source: PBOC

Notes:

- (1) From 17 March 2005 to 18 August 2006, interest rates for personal residential mortgage loans were regulated in the same way as most other types of loans. Since 19 August 2006, the minimum interest rate for personal residential mortgage loans has been adjusted to 85% of the PBOC benchmark lending rate. Since 27 October 2008, the minimum interest rate for personal residential mortgage loans has been adjusted to 70% of the PBOC benchmark lending rate. Since 17 April 2010, the minimum interest rates for the loans to second-time home buyer have been adjusted to 110% of the PBOC benchmark lending rate. On 20 July 2013, the PBOC removed the minimum interest rate requirement for new loans provided by commercial banks, whereas the minimum interest rates for new personal residential mortgage loans remained at 70% of the PBOC benchmark lending rates.
- (2) Beginning on 29 October 2004, commercial banks in the PRC have been permitted to set their own interest rates on Renminbi-denominated deposits so long as such interest rates were not higher than the relevant PBOC benchmark rates. Since 8 June 2012, commercial banks in the PRC have been allowed to set their own interest rates on Renminbi-denominated deposits up to 110% of the relevant PBOC benchmark 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 social security funds in amounts of RMB50 million or more, in each case with a term longer than five years, or deposits by the Postal Savings Bank of China in amounts of RMB30 million or more with a term longer than three years.

In recent years (from 2008 to the Latest Practicable Date), the PBOC has adjusted the benchmark rate for RMB-denominated loans 12 times and the benchmark rate for RMB-denominated deposits 11 times.

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The table below sets out the PBOC benchmark rates for RMB loans since 2008.

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	Housing Fund Loan	
						Five years or less	More than five years
(Interest rate per annum %)							
16 September 2008	6.21	7.20	7.29	7.56	7.74	4.59	5.13
9 October 2008	6.12	6.93	7.02	7.29	7.47	4.32	4.86
30 October 2008	6.03	6.66	6.75	7.02	7.20	4.05	4.59
27 November 2008	5.04	5.58	5.67	5.94	6.12	3.51	4.05
23 December 2008	4.86	5.31	5.40	5.76	5.94	3.33	3.87
20 October 2010	5.10	5.56	5.60	5.96	6.14	3.50	4.05
26 December 2010	5.35	5.81	5.85	6.22	6.40	3.75	4.30
9 February 2011	5.60	6.06	6.10	6.45	6.60	4.00	4.50
6 April 2011	5.85	6.31	6.40	6.65	6.80	4.20	4.70
7 July 2011	6.10	6.56	6.65	6.90	7.05	4.45	4.90
8 June 2012	5.85	6.31	6.40	6.65	6.80	4.20	4.70
6 July 2012	5.60	6.00	6.15	6.40	6.55	4.00	4.50

Source: PBOC

The table below sets out the PBOC benchmark rates for Renminbi deposits since 2008.

Date of adjustment	Time deposits						
	Demand deposits	Three months	Six months	One year	Two years	Three years	Five years
(Interest rate per annum %)							
9 October 2008	0.72	3.15	3.51	3.87	4.41	5.13	5.58
30 October 2008	0.72	2.88	3.24	3.60	4.14	4.77	5.13
27 November 2008	0.36	1.98	2.25	2.52	3.06	3.60	3.87
23 December 2008	0.36	1.71	1.98	2.25	2.79	3.33	3.60
20 October 2010	0.36	1.91	2.20	2.50	3.25	3.85	4.20
26 December 2010	0.36	2.25	2.50	2.75	3.55	4.15	4.55
9 February 2011	0.40	2.60	2.80	3.00	3.90	4.50	5.00
6 April 2011	0.50	2.85	3.05	3.25	4.15	4.75	5.25
7 July 2011	0.50	3.10	3.30	3.50	4.40	5.00	5.50
8 June 2012	0.40	2.85	3.05	3.25	4.10	4.65	5.10
6 July 2012	0.35	2.60	2.80	3.00	3.75	4.25	4.75

Source: PBOC

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, the maximum interest rates on which may not exceed the PBOC benchmark rates for small amount of short-term foreign currency deposits.

Historically, commercial banks may determine the discount rate based on the rediscount rate set by the PBOC. On 27 November 2008, the PBOC set the rediscount rate to commercial banks at 2.97% per annum, which was lowered to 1.80% on 23 December 2008 and then raised to 2.25% on 26 December 2010. According to the Notice of the People's Bank of China on Further Promoting the Liberalisation of Interest Rate (中國人民銀行關於進一步推進利率市場化改革的通知) announced by the PBOC in July 2013, since 20 July 2013, commercial banks are permitted to determine the discount rate at their own discretion.

Pricing for Fee- and Commission-based Products and Services

Under the Interim Administrative Measures on Pricing of Commercial Banking Services (商業銀行服務價格管理暫行辦法) jointly issued by the CBRC and the NDRC on 26 June 2003 and effective on 1 October 2003¹, 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 fifteen (15) business days prior to the setting of any prices for bank services and to post such prices at their business premises at least ten (10) business days prior to such implementation. In addition, commercial banks are prohibited from charging service fees for the opening and cancellation of RMB savings accounts, as well as the deposit and withdrawal of large amounts of RMB that occur from the same bank of the same city. To improve the service standards of the banking industry and enhance the industry's social responsibilities under the principle of market orientation, the CBRC, the PBOC and the NDRC jointly issued the Notice on the Waiver of Some Service Charges of Banking Institutions (關於銀行業金融機構免除部分服務收費的通知) on 9 March 2011, which requires banking institutions to waive 34 charging items in relation to RMB personal accounts starting from 1 July 2011. In an effort to further regulate banking institutions' charging items, on 20 January 2012, the CBRC issued the Notice on Rectifying the Irregular Operations of Banking Financial Institutions (關於整治銀行業金融機構不規範經營的通知), which sets out certain prohibited operations in relation to charging items for banking institutions' credit business and enhanced the transparency of pricing.

Required Deposit Reserve and Surplus 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. Currently, city commercial banks are required to maintain a deposit reserve equal to 18% of their total outstanding Renminbi deposits according to the relevant requirements of the PBOC.

¹ The CBRC and the NDRC jointly issued the Administrative Measures on Pricing of Commercial Banking Services (商業銀行服務價格管理辦法) on 14 February 2014. However, such measures will become effective on 1 August 2014, upon which the Interim Administrative Measures on Pricing of Commercial Banking Services will be abolished.

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The following table sets forth the historical values of the RMB statutory reserve ratios applicable to our Bank since 2008. Throughout the Track Record Period, we have complied with the relevant requirements of the PBOC. There has been no further adjustment to the statutory reserve ratio from 18 May 2012 up to the Latest Practicable Date.

<u>Date of adjustment</u>	<u>Deposit reserve ratios (%)</u>
25 January 2008	15.0
25 March 2008	15.5
25 April 2008	16.0
20 May 2008	16.5
15 June 2008	17.0
25 June 2008	17.5
25 September 2008	16.5
15 October 2008	16.0
5 December 2008	14.0
25 December 2008	13.5
18 January 2010	14.0
25 February 2010	14.5
10 May 2010	15.0
16 November 2010	15.5
29 November 2010	16.0
20 December 2010	16.5
20 January 2011	17.0
24 February 2011	17.5
25 March 2011	18.0
21 April 2011	18.5
18 May 2011	19.0
20 June 2011	19.5
5 December 2011	19.0
24 February 2012	18.5
18 May 2012	18.0

Source: PBOC

Supervision Over Capital Adequacy

Latest CBRC Supervisory Standards Over Capital Adequacy

Prior to 1 March 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 formulae in accordance with the CBRC requirements:

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

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

On 23 February 2004, the CBRC issued the Capital Adequacy Measures which became effective on 1 March 2004 and was amended on 3 July 2007. The Capital Adequacy Measures have been superseded by the New Capital Adequacy Measures which became effective on 1 January 2013. We were subject to the Capital Adequacy Measures prior to 1 January 2013. While the Capital Adequacy Measures did not change the pre-existing requirements of an minimum 8% capital adequacy ratio and a minimum 4% core capital adequacy ratio, it amended the risk weighting for various assets and adjusted the components of

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capital. In addition, the Capital Adequacy Measures required 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 Measures, capital adequacy ratios were calculated based on the following formulae in accordance with the CBRC requirements:

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

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

On 7 June 2012, the CBRC announced the New Capital Adequacy Measures, setting up a new capital adequacy regulatory system by reference to Basel III to replace the Capital Adequacy Measures. The New Capital Adequacy Measures have been in effect since 1 January 2013. In particular, the New Capital Adequacy Measures establish a unified and comprehensive capital adequacy regulatory system, redefine the meaning of capital, enlarge the scope of risks to be covered by capital, stress on the scientific classification and differentiated supervision of the capital adequacy levels of commercial banks and give commercial banks a transitional period for meeting the new capital adequacy requirements.

Under the New Capital Adequacy Measures, capital adequacy ratios are calculated according to the following formulae in accordance with the CBRC requirements:

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

$$\text{Tier 1 capital adequacy ratio} = \frac{\text{Tier 1 capital} - \text{corresponding capital deductions}}{\text{Risk-weighted assets}} \times 100\%$$

$$\text{Core tier 1 capital adequacy ratio} = \frac{\text{Core tier 1 capital} - \text{corresponding capital deductions}}{\text{Risk-weighted assets}} \times 100\%$$

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In the preceding formula:

Capital	Includes both core capital and supplementary capital.
Core Capital	Includes paid-in capital or common shares, capital reserve, surplus reserve, general reserve, retained earnings and minority interests.
Supplementary Capital	<p>Includes up to 70% of the reserve for revaluation, general provisions, preference shares, qualifying convertible bonds, qualifying long-term subordinated debt, qualifying hybrid capital bonds and changes in fair value.</p> <p>(any positive change of no more than 50% to the fair value of available-for-sale bonds that have been included as part of the owners' equity interests may be calculated as supplementary capital; and any negative change to the fair value shall be deducted from supplementary capital in full. When a commercial bank calculates its capital adequacy ratio, it shall transfer the fair value of available-for-sale bonds that have been included in the capital reserves from the core capital into the supplementary capital).</p>
Capital deductions.	Include goodwill, capital investments in non-consolidated financial institutions, and equity investments in non-banking financial institutions and enterprises and capital investment in real estate not for self-use.
Core capital deductions	Include goodwill, 50% of capital investments in non-consolidated financial institutions, and 50% of equity investments in non-banking financial institutions and enterprises and capital investment in real estate not for self-use.
Risk-weighted assets	Refer to the assets calculated by multiplying the value of on- and off-balance-sheet assets by their corresponding risk weightings, after taking into account risk-mitigating factors.
Market risk capital	Refers to the capital reserve that a bank is required to maintain for the market risks relating to its assets. 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 over RMB8,500 million are required to make provisions for market risk capital.

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The following table sets forth risk weightings for different assets.

<u>Items</u>	<u>Risk weightings</u>
a. Cash	
i. Cash in vault	0%
ii. Gold	0%
iii. Deposits at the PBOC	0%
b. Claims on central government and central bank	
i. Claims on the PRC central government	0%
ii. Claims on the PBOC	0%
iii. Claims on the governments or central banks of other countries or jurisdictions where the credit ratings for such countries or jurisdictions are AA- (including AA-) or higher ⁽¹⁾	0%
iv. Claims on the governments or central banks of other countries or jurisdictions where the credit ratings for such countries or jurisdictions are between AA- and A- (including A-) ⁽¹⁾	20%
v. Claims on the governments or central banks of other countries or jurisdictions where the credit ratings for such countries or jurisdictions are between A- and BBB- (including BBB-) ⁽¹⁾	50%
vi. Claims on the governments or central banks of other countries or jurisdictions where the credit ratings for such countries or jurisdictions are between BBB- and B- (including B-) ⁽¹⁾	100%
vii. Claims on the governments or central banks of other countries or jurisdictions where the credit ratings for such countries or jurisdictions are below B- ⁽¹⁾	150%
viii. Claims on the governments or central banks of other countries or jurisdictions without ratings	100%
c. Claims on public-sector entities	20%
d. Claims on domestically incorporated financial institutions	
i. Claims on policy banks (not including subordinated bonds)	0%
ii. Claims on asset management companies invested by the PRC central government	
1. Claims on debts issued by asset management companies by way of private placements for purposes of acquiring non-performing loans of state-owned banks	0%
2. Other claims on asset management companies	100%
iii. Claims on domestically incorporated commercial banks (not including subordinated bonds)	
1. With an original maturity of three months or shorter	20%
2. With an original maturity over three months	25%
iv. Claims on subordinated bonds issued by domestically incorporated commercial banks (part not deducted)	100%
v. Claims on other domestically incorporated financial institutions	100%
e. Claims on financial institutions and public-sector entities incorporated in other countries or jurisdictions	
i. Claims on commercial banks or public-sector entities where the credit ratings for such countries or jurisdictions are AA- (including AA-) or higher ⁽¹⁾	25%
ii. Claims on commercial banks or public-sector entities where the credit ratings for such countries or jurisdictions are between AA- and A- (including A-) ⁽¹⁾	50%
iii. Claims on commercial banks or public-sector entities where the credit ratings for such countries or jurisdictions are between A- and B- (including B-) ⁽¹⁾	100%
iv. Claims on commercial banks or public-sector entities where the credit ratings for such countries or jurisdictions are below B- ⁽¹⁾	150%
v. Claims on commercial banks or public-sector entities without credit ratings for such countries or jurisdictions	100%
vi. Claims on multilateral development banks, the Bank of International Settlement and the International Monetary Fund	0%
vii. Claims on other financial institutions	100%
f. Claims on ordinary enterprises	100%
g. Claims on qualified small and micro enterprises	75%

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<u>Items</u>	<u>Risk weightings</u>
h. Claims on individuals	
i. Residential mortgage loans	50%
ii. The supplementary part of a supplementary financial facility secured by the re-evaluated net value of a mortgaged residence before the purchaser has paid up all the loans	150%
iii. Other claims on individuals	75%
i. The balance of rental assets	100%
j. Equity	
i. Equity investments in financial institutions (part not deducted)	250%
ii. Passive equity investments in business enterprises	400%
iii. Equity investment in business enterprises for policy reasons upon the extraordinary approval of the State Council	400%
iv. Other equity investments in business enterprises	1250%
k. Real estate not for own use	
i. Real estate not for own use, obtained by practicing mortgage rights within the lawful disposition period	100%
ii. Other real estate not for own use	1250%
l. Other assets	
i. Net deferred tax assets in reliance on the bank's future profit (part not deducted)	250%
ii. Other assets on balance sheet	100%

Note:

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

Regulatory Requirements in respect of Capital Adequacy Ratios

Regulatory requirements in respect of the capital adequacy ratios of commercial banks include the minimum capital requirement, capital conservation buffer requirement, countercyclical capital buffer requirement, additional capital requirement for systematically important banks and capital requirement under the second pillar.

The capital adequacy ratio of commercial banks at each tier must meet the following minimum requirements:

- capital adequacy ratio shall not be lower than 8%;
- tier 1 capital adequacy ratio shall not be lower than 6%; and
- core tier 1 capital adequacy ratio shall not be lower than 5%.

Commercial banks are required to calculate and set aside their capital conservation buffer after meeting the minimum capital requirements. The capital conservation buffer is required to be equal to 2.5% of risk-weighted assets and is to be fulfilled by core tier 1 capital. Under certain circumstances, commercial banks are required to calculate and set aside capital for meeting countercyclical capital buffer requirements in addition to meeting the minimum capital requirements and the capital conservation buffer requirements. The countercyclical capital buffer is required to be in the range of 0% to 2.5% of risk-weighted assets and to be fulfilled by core tier 1 capital.

In addition, the systematically important banks in the PRC are required to calculate and set aside additional capital in an amount equal to 1% of their risk-weighted assets, which is to be fulfilled by core Tier 1 capital. If a Chinese bank is recognised as a globally systematically important bank, the additional capital requirement applicable to it cannot be less strict than those requirements generally provided for by the Basel Committee on Banking Supervision. As of the Latest Practicable Date, the Chinese regulator had issued no standards for determining, and no list of, such systematically important banks.

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Furthermore, the CBRC has the right to impose more prudent capital requirements under the second pillar framework in order to ensure adequate risk coverage, including:

- specific capital requirements imposed in respect of some asset portfolios on the basis of risk judgments; and
- specific capital requirements imposed in respect of an individual bank according to the results of supervisory inspections.

Time Limit for Meeting the Requirements

The New Capital Adequacy Measures provide that commercial banks are required to meet the regulatory requirements on capital adequacy ratios as set forth in those measures before the end of 2018, and where conditions permit, commercial banks are encouraged to meet the requirements ahead of schedule.

To ensure the smooth implementation of the New Capital Adequacy Measures, on 30 November 2012 the CBRC issued the Notice on Relevant Matters in Relation to Transitional Period Arrangements for the Implementation of the Measures for Administration on Capital 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). This notice provides that commercial banks must meet the minimum capital requirements and also provides that the systematically important banks in the PRC are required to meet the additional capital requirements before 1 January 2013. During the transitional period, the capital reservation buffer requirement (2.5%) will be gradually introduced and commercial banks are required to meet the annual capital adequacy ratio requirement as follows:

Type of Bank	Item	As of 31 December					
		2013	2014	2015	2016	2017	2018
Systematically Important Banks	Core tier 1 capital adequacy ratio	6.5%	6.9%	7.3%	7.7%	8.1%	8.5%
	Tier 1 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 1 capital adequacy ratio	5.5%	5.9%	6.3%	6.7%	7.1%	7.5%
	Tier 1 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%

In addition, if the regulatory authorities require that commercial banks must set up countercyclical capital buff requirements or imposes on a single bank capital requirements under the second pillar, the regulatory authorities will prescribe a time limit for meeting the requirements. Commercial banks subject to such additional requirements are required to endeavour to meet the relevant deadlines.

Issuance of Subordinated Debt, Subordinated Bonds, Hybrid Capital Bonds and Innovative Capital Instruments

Since 17 June 2004, PRC commercial banks have been permitted to issue bonds which are subordinated to the banks' other liabilities but are 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. Upon approval by the CBRC, PRC commercial banks may include such subordinated bonds in their 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 bonds issued by other banks in excess of 20% of their core capital. The issuance of subordinated bonds by PRC commercial banks is subject to the approval of the CBRC. The PBOC regulates the issuance and trading of subordinated bonds in the inter-bank bond market.

On 12 December 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 has opened a new channel for commercial banks to replenish their supplementary capital and improve their capital adequacy ratio. On 5 September 2006, the PBOC issued the Notice of the PBOC 2006 No.11, which clarified the definition of hybrid capital bonds and specified the relevant issuance requirements.

On 18 October 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 required major commercial banks and other banks to maintain a core capital adequacy ratio of not less than 7% and 5%, respectively, if they sought to issue long-term subordinated debt for the replenishment of supplementary capital. It further required that the major commercial banks and other banks should not issue long-term subordinated debt which constituted more than 25% and 30% of their respective core capital. In the calculation of the capital adequacy ratio, after 18 October 2009, banks are required to fully deduct any long-term subordinated debt issued by other banks which they acquired after 1 July 2009.

On 7 June 2012, the CBRC issued the New Capital Adequacy Measures which redefined the capital of a commercial bank from core capital and supplementary capital under the Capital Adequacy Measures to core tier 1 capital, additional tier 1 capital and tier 2 capital. Also, the New Capital Adequacy Measures proposed the concept and criteria for inclusion of tier 2 capital instruments, which differ from that of subordinated debt, subordinated bonds and hybrid capital bonds. Pursuant to the New Capital Adequacy Measures, unqualified tier 2 capital instruments issued by a commercial bank before 12 September 2010 may be included in regulatory capital before 1 January 2013, but, from 1 January 2013, such instruments are to be decreased by 10% each year and, from 1 January 2022, such instruments are no longer allowed to be included in regulatory capital. For a tier 2 capital instrument issued by a commercial bank between 12 September 2010 and 1 January 2013, if the instrument has no write-down or share conversion clause but meets the other criteria for inclusion, it may be included in regulatory capital before 1 January 2013, but, from 1 January 2013, such instruments are to be decreased by 10% each year and, from 1 January 2022, such instruments are no longer allowed to be included in regulatory capital.

The Guiding Opinions on Capital Instrument Innovation of Commercial Banks (關於商業銀行資本工具創新的指導意見) issued by the CBRC on 29 November 2012 allow and encourage commercial banks to innovate capital instruments (including tier 2 capital instruments) which comply with the New Capital Adequacy Measures. Pursuant to the guiding opinions, Additional tier 1 capital and tier 2 capital instruments issued by a commercial bank after 1 January 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. A triggering event for additional tier 1 capital instruments occurs when the core tier 1 capital adequacy ratio of the commercial bank falls to 5.125% or below. A triggering event for tier 2 capital instruments occurs upon the earlier of: (i) a decision that a write-down or share conversion, without which the commercial bank would become non-viable, as determined by the CBRC; or (ii) the decision to make a public sector injection of capital, or equivalent support, without which the commercial bank would have become non-viable, as determined by relevant authorities.

CBRC's Supervision of Capital Adequacy

The CBRC is responsible for supervising the capital adequacy of banking institutions in the PRC. It reviews and evaluates banking institutions' capital adequacy through both on-site examination and off-site surveillance. Commercial banks are required to report to the CBRC their unconsolidated capital adequacy ratios on a quarterly basis and their consolidated capital adequacy ratios on a semi-annual basis. Under the New Capital Adequacy Measures, commercial banks are classified into four categories based on their capital adequacy ratios as follows:

- Grade I commercial banks: commercial banks which meet all the capital requirements for capital adequacy ratio, tier 1 capital adequacy ratio and core tier 1 capital adequacy ratio in these Measures;
- Grade II commercial banks: commercial banks which fail to meet the second pillar capital requirements but meet all other capital requirements for capital adequacy ratio, tier 1 capital adequacy ratio and core tier 1 capital adequacy ratio.;
- Grade III commercial banks: commercial banks which meet all the minimum capital requirements but fail to meet other capital requirements for capital adequacy ratio, tier 1 capital adequacy ratio and core tier 1 capital adequacy ratio; and
- Grade IV commercial banks: commercial banks which fail to meet the minimum capital requirement for any of capital adequacy ratio, tier 1 capital adequacy ratio and core tier 1 capital adequacy ratio.

In respect of a Grade I commercial bank, the CBRC will support the steady development of its businesses. To prevent any rapid decrease of its capital adequacy ratios, the CBRC may take the following precautionary regulatory measures:

- to require the commercial bank to improve the analysis and forecast of the reasons for the decrease of its capital adequacy ratios;
- to require the commercial bank to formulate a practicable capital adequacy ratio management plan; and
- to require the commercial bank to improve its risk control capability.

In respect of a Grade II commercial bank, in addition to the regulatory measures for Grade I commercial banks, the CBRC may take the following regulatory measures:

- to hold talks on prudent practice with the board of directors and the senior management of the commercial bank;
- to issue a regulatory opinion, which must include the problems identified with the capital management of the commercial bank, the proposed measures for rectification and the opinion on meeting the requirements within the prescribed time limit;
- to require the commercial bank to formulate a practicable capital supplement plan and the plan for meeting the requirements within the prescribed time limit;
- to increase the frequency of supervision and inspection of the capital adequacy of the commercial bank; and
- to require the commercial bank to take risk buffer measures for specific risk areas.

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In respect of a Grade III commercial bank, in addition to the regulatory measures for Grade I and Grade II commercial banks, the CBRC may take the following regulatory measures:

- to restrict the commercial bank from distributing dividends and other income;
- to restrict the commercial bank from granting any form of incentives to directors and senior managers;
- to restrict the commercial bank from making equity investments or repurchasing capital instruments;
- to restrict the commercial bank from incurring major capital expenditure; and
- to require the commercial bank to control the growth of risky assets.

In respect of a Grade IV commercial bank, in addition to the regulatory measures for Grade I, Grade II and Grade III commercial banks, the CBRC may take the following regulatory measures:

- to require the commercial bank to significantly downsize risky assets;
- to order the commercial bank to suspend all high-risk asset businesses;
- to restrict or prohibit the commercial bank from establishing new institutions or launching new businesses;
- to require the commercial bank to write down tier 2 capital instruments or convert them into ordinary shares;
- to order the commercial bank to change its directors or senior management or restrict their rights;
- to take over the commercial bank or procure the institutional reorganisation of, or even dissolve, the commercial bank; and
- to consider other external factors and take other necessary measures in order to solve the problems faced by Grade IV commercial banks.

Introduction of the New Leverage Requirements

In an effort to supplement the effect of risk-based capital adequacy requirements, on 1 June 2011, the CBRC issued the Administrative Measures on the Leverage Ratio of Commercial Banks (商業銀行杠杆率管理辦法), which came into effect on 1 January 2012 and which introduced new leverage requirements.

Pursuant to these measures, commercial banks are required to maintain a leverage ratio not lower than 4%, notwithstanding the consolidation of statements. The formula for calculating the leverage ratio is as follows:

$$\text{Leverage ratio} = \frac{\text{Tier 1 capital} - \text{tier 1 capital deductions}}{\text{Balance of adjusted on-balance sheet assets} + \text{balance of adjusted off-balance sheet assets} - \text{tier 1 capital deductions}} \times 100\%$$

Commercial banks are required to report to the CBRC their consolidated leverage ratios on a semi-annual basis and their unconsolidated leverage ratios on a quarterly basis. For a commercial bank which fails to meet the minimum leverage ratio, the CBRC may take regulatory measures including requiring the commercial bank to: (i) supplement its tier 1 capital within a specified period; (ii) control the growth of its on-and-off balance sheet assets; and (iii) reduce the size of its on-and off-balance sheet assets. If

the commercial bank fails to rectify its non-compliance within the specified period, or its behaviour has seriously endangered its sound and sustainable operation or damaged the legitimate interests of depositors or other clients, the CBRC may take relevant regulatory measures pursuant to the PRC Banking Supervision and Regulatory Law. In addition to the above-mentioned measures, the CBRC may also impose an administrative penalty upon the commercial bank.

The above measures also provide that systematically important banks are required to meet the regulatory requirements on leverage ratio before the end of 2013 whilst non-systematically important banks are required to meet such requirements before the end of 2016.

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 a capital measurement system for banks that provides for the implementation of a credit risk measurement framework with a minimum capital standard of 8%. Since 1998, the Basel Committee has issued certain proposals for Basel II, to replace Basel I. Basel II retained 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, but sought to improve the capital framework in various key respects, including: (i) establishment of the “three pillars” framework, namely the first pillar “minimum capital standard,” the second pillar “supervision and regulation by regulatory authorities” and the third pillar “information disclosure”; and (ii) introducing material changes to the calculation of capital adequacy. In response to the deficiencies in financial regulation revealed by the 2008 financial crisis, the Basel Committee on Banking Supervision started to advance the global financial regulatory reform in an effort to further strengthen the regulation, supervision and risk management of the banking industry. In such circumstances, Basel III was drafted and then endorsed by G20 Leaders at their November 2010 Seoul summit. On 16 December 2010, Basel III was officially issued by the Basel Committee on Banking Supervision. Basel III enhances micro-prudential regulation and supervision and adds a macro-prudential overlay. These two approaches to supervision are complementary as greater resilience at the individual bank level reduces the risk of system wide shocks. In summary, Basel III: (i) strengthens capital adequacy in capital resources, risk-weighted assets and capital ratios by requiring banks to hold more higher-quality capital against more conservatively calculated risk-weighted assets; (ii) introduces a new leverage ratio as a backstop to the risk-based requirement, which is aimed at promoting the build up of capital that can be drawn down in periods of stress; and (iii) introduces two new global liquidity standards, which aim to ensure that adequate funding is maintained in case of crisis.

The CBRC promulgated and amended the Capital Adequacy Measures on 23 February 2004 and 3 July 2007, respectively. The CBRC has advised that the Capital Adequacy Measures are based on Basel I, whilst also taking into consideration certain aspects of Basel II. On 28 February 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 required large commercial banks, which 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 with the CBRC’s approval, no later than the end of 2013. 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.

In line with the reform of Basel Accords and the implementation of Basel III, on 27 April 2011, the CBRC promulgated the Guiding Opinions on the Implementation of New Regulatory Standards in China’s Banking Industry (中國銀行業監督管理委員會關於中國銀行業實施新監管標準的指導意見), which set out the key targets and principles for the reform of China’s capital regulatory framework. On 1 June 2011, the CBRC

issued the Administrative Measures on the Leverage Ratio of Commercial banks. On 7 June 2012, the CBRC issued the New Capital Adequacy Measures was issued. The New Capital Adequacy Measures came into effect on 1 January 2013 and superseded the Capital Adequacy Measures and the various guidelines mentioned above. In an effort to enhance the effectiveness of capital supervision, improve the risk management capability of commercial banks and strengthen the constraint function of the market, on 19 July 2013, the PBOC issued the following four policy documents to complement the New Capital Adequacy Measures: the Measurement Rules for Risk Exposure Capital of Central Counterparties (中央交易對手風險暴露資本計量規則); the Supervisory Requirements Concerning Information Disclosure on the Capital Composition of Commercial Banks (關於商業銀行資本構成信息披露的監管要求); the Supplemental Supervisory Requirements Concerning the Implementation of Internal Ratings-based Approach by Commercial Banks (關於商業銀行實施內部評級法的補充監管要求); and the Questions and Answers Regarding the Capital Supervisory Policy (資本監管政策問答).

Loan Classification, Allowances and Write-offs

Loan Classification

Banks in the PRC are currently required to classify loans under a five-category loan classification system to estimate the likelihood of full repayment of principal and interest by debtors on time, in accordance with the Guidelines of Risk-based Classification of Loans (貸款風險分類指引). The five categories are “pass”, “special mention”, “substandard”, “doubtful” and “loss”. The primary factors for evaluating the likelihood of repayment include the borrower’s cash flow, financial conditions and other non-financial conditions affecting the ability of repayment.

Loan Loss Allowance

According to the Guidelines of Risk-based Classification of Loans, a loan classified as substandard, doubtful or loss is considered to be non-performing, and commercial banks are required to make allowance based on a reasonable estimate of the probable loss on a prudent and timely basis. According to the Guidelines on Loan Loss Allowance (貸款損失準備計提指引), the allowance for impairment losses consists of a general allowance, a specific allowance and a 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 categorisation under the Guidelines of Risk-based Classification of Loans; and special allowance refers to the allowance made for the risks specifically related to certain countries, regions, industries, or certain types of loans.

Under the Guidelines on Loan Loss Allowance, commercial banks are required to make a general loan loss allowance on a quarterly basis and to have a general allowance of not less than 1% of the total loans outstanding as of the end of any year. The guidelines provide additional guidance on the level of specific allowance as a percentage of the outstanding amount of loans for each loan category: 2% for special mention loans; 25% for substandard loans; 50% for doubtful loans and 100% for loss loans. Allowance for losses of substandard and doubtful loans may be set aside within a range of 20%. Commercial banks may make special allowance in accordance with special risk factors (including risks in association with certain industries and countries), probability of losses and historical experience.

In accordance with the Administrative Measures for Loan Loss Allowance of Commercial Banks (商業銀行貸款損失準備管理辦法), which became effective on 1 January 2012, the adequacy ratio of loan loss allowance of commercial banks is assessed based on its loan provision ratio and its provision coverage ratio, the benchmarks of which are 2.5% and 150%, respectively. The higher of the two ratios

will be taken to be the supervisory standard. The boards of directors of commercial banks are required to assume ultimate responsibility for the management of loan loss allowance. Systematically important banks are required to reach the standard before the end of 2013. Non-systematically important banks are required to reach such standard before the end of 2016 and those failing to reach the standard before the end of 2016 are required to formulate a plan on how to reach such standard, submit the same to the CBRC and reach such standard before the end of 2018 at the latest.

CBRC's Supervision of Loan Classification and Loan Loss 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, beginning in 2002, commercial banks have been required to report to the CBRC information regarding loan classification and loan loss allowance on a regular basis via quarterly report and annual report. Based on a review of these reports, the CBRC has the power to require commercial banks to explain significant changes in loan classification and loan loss allowance levels, or to carry out further inspections. Upon the effectiveness of the Administrative Measures for Loan Loss Allowance of Commercial banks on 1 January 2012, the CBRC has the power to issue a risk notice to a commercial bank and to require rectifications accordingly if the commercial bank fails to meet the relevant minimum loan loss allowance standards for a continuing period of three months; the CBRC has the power to take further regulatory actions pursuant to the PRC Banking Supervision and Regulatory Law if such non-compliance lasts for a continuing period of six months.

Loan Write-offs

Under the regulations issued by the CBRC and the MOF, commercial banks are required to establish a strict audit 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 realised when 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 written off in compliance with the MOF's standards.

Allowance and Statutory General Reserve for Impairment Losses

Pursuant to the Administrative Measures for the Provisioning for Non-performing Assets of Financial Institutions (金融企業呆賬準備提取管理辦法) and the subsequent Notice on Relevant Issues Concerning the Provisioning for Non-performing Assets (關於呆賬準備提取有關問題的通知), both issued by the MOF, financial institutions in the PRC are required to maintain adequate allowance for impairment losses. In addition, financial institutions are also required to set up a statutory general reserve to cover potential impairment losses that have yet to be identified. Financial institutions are required to assess the risk profile of their assets in determining the statutory general reserve level. In principle, such level should not be less than 1% of the aggregate amount of each financial institution's risk-bearing assets before allowance for impairment losses at the balance sheet date. Financial institutions are not allowed to make profit distributions to shareholders until adequate allowance for impairment losses and statutory general reserve have been made. On 30 March 2012, the MOF issued the Administrative Measures for the Provisioning for Reserves of Financial Institutions (金融企業準備金計提管理辦法). These measures became effective on 1 July 2012, and repealed the Administrative Measures for the Provisioning for Non-performing Assets of Financial Institutions. Under the Administrative Measures for the Provisioning for Reserves of Financial Institutions, the minimum general statutory reserve level was raised to 1.5% of the aggregate amount of risk-bearing assets at the balance sheet date. Financial Institutions may choose between an internal model approach and a standardised approach to determine the estimated value of potential risks for the provision of statutory general reserve.

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Other Operational and Risk Management Ratios

The Core Indicators (Provisional) issued by the CBRC became effective on 1 January 2006.

The table below sets out the required ratios as provided in the Core Indicators (Provisional) and our Bank's ratios as of 31 December 2010, 2011 and 2012 and 30 September 2013, calculated in accordance with PRC GAAP.

Risk level	Primary indicators	Secondary Indicators	Requirement (%)	Ratios of our Bank (%)			
				as of 31 December			as of
				2010	2011	2012	30 September 2013
Risk Level							
Liquidity risk	Liquidity ratio ⁽¹⁾	RMB	≥ 25	47.48%	42.62%	40.22%	40.68%
		Foreign Currency		177.20%	307.11%	145.93%	232.97%
	Core liabilities ratio ⁽²⁾		≥ 60	60.25%	60.02%	55.35%	61.40%
	Liquidity gap ratio ⁽³⁾		≥ -10	47.10%	20.37%	27.32%	2.72%
Credit risk	Non-performing asset ratio ⁽⁴⁾		≤ 4	0.34%	0.20%	0.21%	0.34%
		Non-performing loan ratio ⁽⁵⁾	≤ 5	0.79%	0.62%	0.64%	0.86%
	Credit exposure to a single group customer ⁽⁶⁾		≤ 15	11.75%	6.31%	4.86%	5.90%
		Loan exposure to a single customer ⁽⁷⁾	≤ 10	8.20%	4.67%	3.11%	4.64%
	Overall credit exposure to related parties ⁽⁸⁾		≤ 50	2.76%	1.53%	1.17%	1.40%
Market risk	Cumulative foreign currency exposure ratio ⁽⁹⁾		≤ 20	0.14%	0.17%	0.07%	0.25%
Risk Cushion							
Profitability . . .	Cost to income ratio ⁽¹⁰⁾		≤ 35	39.11%	33.80%	34.51%	34.23%
	Return on average total assets ⁽¹¹⁾		≥ 0.6	1.17%	1.12%	1.20%	1.19%
	Return on average equity ⁽¹²⁾		≥ 11	27.64%	22.57%	20.35%	17.67%
Allowance adequacy	Allowance adequacy ratio for asset impairment ⁽¹³⁾		> 100	99.35%	311.66%	449.30%	292.72%
		Allowance adequacy ratio for loan ⁽¹⁴⁾	> 100	99.33%	313.07%	450.75%	293.14%
Capital adequacy	Capital adequacy ratio ⁽¹⁵⁾		≥ 8	11.75%	12.61%	12.97%	13.04%
		Core capital adequacy ratio	≥ 4	9.04%	11.37%	11.94%	12.04%

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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 other 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 other financial institutions due within one month, issued debt securities with maturities of one month or less, interest payable and all kinds of 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 with maturities of 90 days or less.
- (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 categorised as non-performing. The categorisation of non-loan credit risk assets is in accordance with relevant CBRC regulations.
- (5) Non-performing loan 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 the CBRC's five category loan classification system.
- (6) Credit exposure to a single group borrower = Total credit granted to the largest 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 borrower/Net capital x 100%. Largest 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 Administrative Measures on Connected Transactions with Insiders and Shareholders of Commercial Banks (商業銀行與內部人和股東關聯交易管理辦法). 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 Chinese 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%.
- (11) Return on average total assets = Net profit for a period/average balance of total assets at the beginning and the end of the period x 100%.
- (12) Return on average equity = Net profit attributable to the equity shareholders of our Bank for a period/average balance of total equity attributable to equity holders of the parent company at the beginning and the end of 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%.
- (15) Capital adequacy ratio = (Capital – capital deductions)/(Risk-weighted assets + 12.5 x capital charge for market risk). Core capital adequacy ratio = (Core capital – core capital deductions)/(Risk-weighted assets + 12.5 x capital charge for market risk). Since 2013, we calculate and disclose the capital adequacy ratio according to the new regulations of capital adequacy ratio management. Capital adequacy ratio = (Total capital – corresponding capital deduction)/ risk-weighted assets; tier 1 capital adequacy ratio = (tier 1 capital – corresponding capital deduction)/ risk-weighted assets; core tier 1 capital adequacy ratio = (core tier 1 capital – corresponding capital deduction)/ risk-weighted assets. According to the new regulations of calculation, as of 30 September 2013, our bank's capital adequacy ratio, tier 1 capital adequacy ratio, and core tier 1 capital adequacy ratio were 13.24% , 11.65% and 11.65%, respectively.

According to the Core Indicators (Provisional), the CBRC may issue risk alerts to banks based on their analysis of data submitted by commercial banks. In addition, the Core Indicators (Provisional) defined certain other ratios without providing the regulatory requirement for those ratios, including ratios relating to interest rate risk sensitivity, operational risk and loan migration. The CBRC may provide the regulatory requirement for those ratios in the future.

Corporate Governance and Internal Controls

Corporate Governance

The PRC Company Law, the PRC Commercial Banking Law and other laws, regulations and regulatory documents provided for specific requirements for corporate governance. Among them, the Guidelines on Corporate Governance of Commercial Banks (商業銀行公司治理指引) require commercial banks to establish a sound corporate governance system and a clear organisational structure, with management and supervisory powers, functions and responsibilities being clearly divided among the board, the supervisory board and the senior management. The guidelines also require commercial banks to abide by the principles of ensuring independent operation of each governing body and maintaining effective checks and balances and mutual cooperation and coordination among them, establish reasonable incentive and restraint mechanisms in order to achieve efficiency in decision-making, execution and supervision.

As for the composition of the board of directors, according to Guidelines on the Duties of the Board of Directors of Joint Stock Commercial Banks (Provisional) (股份制商業銀行董事會盡職指引 (試行)) issued by the CBRC, a commercial bank with a registered capital exceeding RMB 1 billion is required to have at least three independent directors. As for the composition of supervisory board, according to the Guidelines on the Functioning of Supervisory Board of Commercial Banks (商業銀行監事會工作指引) issued by the CBRC, the proportion of employees representative supervisors or that of external supervisors cannot be less than one third of the supervisory board. In addition, the Guidelines on Independent Directors and External Supervisors of Joint Stock Commercial Banks (股份制商業銀行獨立董事及外部監事指引) recommend that the board of directors of a commercial bank should have at least two independent directors, senior management should constitute at least one quarter but not more than a third of the board of directors and the supervisory board should have at least two external supervisors.

Internal Controls

Under the Internal Control Guidelines for Commercial Banks (商業銀行內部控制指引) issued by the PBOC and the CBRC in 2002 and 2007 respectively, commercial banks are required to establish internal controls 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 27 June 2006, the CBRC issued the Guidelines on Internal Audit for Banking Financial Institutions (銀行業金融機構內部審計指引) which became effective on 1 July 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, which shall in principle represent 1% of the bank's total number of employees. The guidelines set forth the required scope of the Internal Audit Department. Banks are required to evaluate the risk of each business unit at least once per year and conduct internal audit of each business unit at least once every two years. The number of employees responsible for our internal auditing function is based on our risk management demand. As of 30 September 2013, we had 78 internal audit employees, representing 1.1% of our total number of employees.

On 22 May 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 1 July 2009. The rules require enterprises to establish and implement internal control systems, utilise information technology to strengthen internal control and establish information systems addressing their operational and management needs, among other matters.

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In accordance with the Guidelines on the Corporate Governance of Commercial Banks issued by the CBRC on 19 July 2013, commercial banks are required to establish an accountability system for a sound internal control environment. Under this system, the board of directors and senior management are required to maintain differentiated accountability for the effectiveness of internal control and are required to be liable for material losses caused by a breakdown in internal control. In addition, the supervisory board is required to perform its supervisory obligations by supervising directors and senior management, and refining the system and rules of internal control. Commercial banks are required to establish a relatively independent department for effectively supervising and evaluating internal control, which reports directly to the board of directors, supervisory board and senior management on the progress of developing the internal control system and its enforcement.

Information Disclosure Requirements

On 3 July 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 these measures, a PRC commercial bank is required to publish an audited annual report within four months of the end of each financial year disclosing its financial position and operational results.

Transactions with Related Parties

The CBRC issued the Administrative Measures on Connected Transactions with Insiders and Shareholders of Commercial Banks (商業銀行與內部人和股東關聯交易管理辦法) in April 2004, which provided more stringent and detailed requirements on the related party transactions of PRC commercial banks. These 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. Under PRC laws and regulations, related party transactions of commercial banks are required to be based on normal commercial principles and on terms no more favourable than similar transactions with non-related parties.

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

Pursuant to these measures, commercial banks must submit to the CBRC, on a quarterly basis, status reports regarding their related party transactions, and must 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 to monitor and approve such transactions annually at shareholder meetings. The CBRC has the power to request the rectification of transactions that violate these measures and to impose sanctions on the bank and/or the related parties.

We have established the Risk Management and Related Transactions Control Committee under our Board and have adopted approval procedures for related party transactions in accordance with the measures and other applicable laws and regulations. In addition, we have adopted a tiered system for the approval of related party transactions by setting out in our Administrative Measures on Connected Transactions the relevant approval requirements in accordance with the applicable laws and regulations.

Risk Management

Since its inception, the CBRC has published, in addition to guidelines concerning loan and credit to certain specific industries and customers and measures in respect of the implementation of Basel Accords, numerous risk management guidelines and rules in an effort to improve the risk management of PRC commercial banks, including credit risk management, operational risk management, market risk management, compliance risk management and a supervisory rating system. For the guidelines concerning loans and credit to certain specific industries and customers and measures in respect of the implementation of Basel Accords, see “ – PRC Banking Supervision and Regulation – Regulation of Principal Commercial Banking Activities – Lending” and “ – PRC Banking Supervision and Regulation – Supervision Over Capital Adequacy – Basel Accords”. The CBRC also issued the Core Indicators (Provisional) 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 in the Core Indicators (Provisional) 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 analyse such indicators and evaluate and issue early warnings of the risks on a timely basis.

Operational Risk Management

On 22 March 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, as well as on-going reviews and examinations for business areas involving a greater degree of operational risks. Moreover, a commercial bank’s headquarter 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 officers at primary level responsible for business operations are required to rotate on a regular basis; establishing a system to encourage employees to fully comply with applicable 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, specimen signatures and evidential vouchers.

Furthermore, on 14 May 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, among other things, the supervision and controls of the board of directors, responsibilities of senior management, proper organisational structure, and policies, approaches and procedures for operational risk management. Those policies and procedures are required to be submitted to the CBRC for filing. If a significant operational risk occurs and the commercial bank fails to adopt effective corrective measures within a specified period, the CBRC has the power to take relevant regulatory measures.

Market Risk Management

On 29 December 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 1 March 2005, to strengthen the market risk management of PRC commercial banks. These guidelines mainly address, among other things: (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 conducting external audits.

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 20 October 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, standardised the organisational structure for compliance risk management and set out the regulatory mechanisms for a bank's risk management.

Liquidity Risk Management

In order to strengthen the liquidity risk management and maintain the safe and stable operation of PRC commercial banks, the CBRC issued the Notice on Further Strengthening the Supervision of Liquidity Risk of Commercial Banks by the General Office of the CBRC (中國銀監會辦公廳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 indices, such as liquidity coverage ratio and new stable funding ratio, and required that PRC commercial banks should strengthen the measurement and management of liquidity risk, optimise the asset-liability allocation, reduce the maturity mismatch and decrease the possibility and impact of liquidity shortfalls.

In addition, the CBRC issued the Administrative Measures on the Liquidity Risk of Commercial Banks (Trial) (商業銀行流動性風險管理辦法 (試行)) on 17 January 2014, which became effective on 1 March 2014, which mainly address, among other things: (1) the liquidity risk management responsibilities of a commercial bank's board of directors, senior management, board of supervisors and specialised internal department in charge of liquidity risk management; (2) the strategy, policy and procedure of liquidity risk management; (3) the identification, measurement, supervision and control of liquidity risk; and (4) the calculation methods of liquidity coverage ratio, deposit ratio and liquidity ratio. It is also stated that the PRC commercial banks' liquidity coverage ratios must reach 100% by 2018.

Management of Other Risks

In addition to the above, the CBRC has issued guidelines in relation to several other risks, including the Guidelines on Reputational Risk Management of Commercial Banks (商業銀行聲譽風險管理指引), the Guidelines on Bank Account Interest Risk Management of Commercial Banks (商業銀行銀行賬戶利率風險管理指引), the Guidelines on Information Technology Risk Management of Commercial Banks (商業銀行信息科技風險管理指引), the Guidelines on Country Risk Management of Banking Financial Institutions (銀行業金融機構國別風險管理指引), all in an effort to strengthen commercial banks' risk management capacity in relevant fields.

Supervisory Rating System

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

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 city commercial bank is required to obtain prior approval by the local offices of the CBRC. All legal persons outside the province where a city commercial bank is registered intending to acquire equity interest of such bank are required to obtain prior approvals by the CBRC or its branches. If any existing shareholder of a commercial bank increases its shareholding in excess of the 5% threshold or any legal person from outside the bank's residence province becomes the bank's shareholder without obtaining the CBRC's prior approval, that shareholder will be subject to the sanctions of the CBRC or its branches, which include, among others, rescission of the acquisition and disgorgement of profits by that shareholder, if any, 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 that meets certain conditions can make investment or hold shares in PRC commercial banks, subject to the CBRC's approval. However, no single foreign financial institution may own 20% or more of the equity of such a bank. In addition, if foreign investment in the aggregate exceeds 25% of the total equity interest in a non-listed PRC commercial bank, such bank will be regulated as a foreign-invested bank. Listed PRC commercial banks are regulated as a PRC bank even if foreign investment in the aggregate exceeds 25% of its total equity interest.

Restrictions on Shareholders

The Guidelines on Corporate Governance of Commercial Banks impose certain additional requirements on shareholders of commercial banks. For example, shareholders, especially substantial shareholders, are required to support the capital planning formulated by the board of directors of the commercial bank so that the capital of the bank can meet the regulatory requirements on an on-going basis. If a commercial bank fails to meet the regulatory requirements, it is required to develop a capital replenishment plan to increase capital adequacy ratio to meet regulatory requirements within a specified period of time. If the requirements are not met within the timeframe, dividends are required to be decreased or even suspended from distribution, and capital is required to be replenished by means of increasing core capital. Under such circumstances, substantial shareholders cannot obstruct the capital injection moves by other shareholders or the participation of new qualified shareholders. If shareholders of a PRC commercial bank fail to repay outstanding loans when due, their voting rights will be restricted for the period during which the relevant loan is overdue.

In addition, the PRC Company Law 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 commercial bank may not accept its own shares as collateral. According to the Guidelines on Corporate Governance of Commercial Banks: (i) any shareholder of a commercial bank must give prior notice to the board of directors of the bank if it wishes to pledge its shares as collateral; and (ii) where the balance of loans extended by a commercial bank to its shareholder exceeds the audited net value of his or her equity stake for the preceding year, the shareholder cannot use his or her stake in the bank as pledge.

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 1 January 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 which 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, the PBOC issued the Anti-money Laundering Regulations for Financial Institutions (金融機構反洗錢規定) which became effective on 1 January 2007. In accordance with those regulations, commercial banks are required to establish an internal anti-money laundering procedure 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 the Financial Institutions' Report of Large-sum Transactions and Doubtful Transactions (金融機構大額交易和可疑交易報告管理辦法) issued by the PBOC which became effective on 1 March 2007, upon the detection of any suspicious transactions or transactions involving large amounts, PRC commercial banks are required to report the transactions to the Anti-money Laundering Information Centre. Where necessary and pursuant to appropriate judicial proceedings, PRC commercial banks are required to cooperate with government authorities in preventing money laundering activities and in freezing assets. The PBOC supervises and conducts on-site examinations of commercial banks' compliance with its anti-money laundering regulations and may impose penalties for any violations thereof in accordance with the PRC Anti-money Laundering Law. Commercial banks are required to establish a customer identification system in accordance with the Measures on the Administration of Client 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 1 August 2007. Commercial banks are also required to record the identities of all customers and the information relating to each transaction, and keep personal transaction records and documents.

Other Requirements

Use of Funds

Under the PRC Commercial Banking Law, commercial banks are not permitted to engage in trust investment or securities investment business, or 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;
- interbank loans;
- trading of government bonds;

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- trading of bonds from financial institutions;
- investment in banking institutions; and
- other uses as may be approved by the relevant government authorities.

Periodic Reporting Requirements

In accordance with the Notice of China Banking Regulatory Commission on the Official Operation of Off-site Regulatory Information System in 2007 (關於非現場監管信息系統2007年正式運行的通知) issued by the CBRC, banking institutions are required to regularly submit to the banking regulatory authorities relevant statements, including basic financial information, credit risk, liquidity risk, capital adequacy ratio and such other information as is required under such notice. In the statements required to be submitted by our Bank: the statistical statement of balance sheet items, the supervisory checklist of liquidity ratio and other similar information are required to be submitted monthly; the table of financial derivative business, the profit statement and other similar information, quarterly; the table of interest rate re-pricing risk, semi-annually; the statement of profit distribution and the table of credit quality migration and other similar information, annually.

Although the Bank will continue to submit such periodic reports to relevant regulatory bodies, given the fact that: (i) the financial information contained in such reports will not be shared with the public; and (ii) such financial information would be unaudited, the Bank does not plan to disclose the information contained in the reports by way of announcement after the Global Offering.

Regulatory and Shareholder's Approvals

We have obtained our shareholder's approval for the proposed listing. Please refer to Paragraph 1C "Resolution of Our Shareholders" of "Appendix VIII – Statutory and General Information".

We have also obtained all necessary PRC regulatory approvals for the proposed listing, including the CBRC approval on 30 December 2013 and the CSRC approval on 4 March 2014.