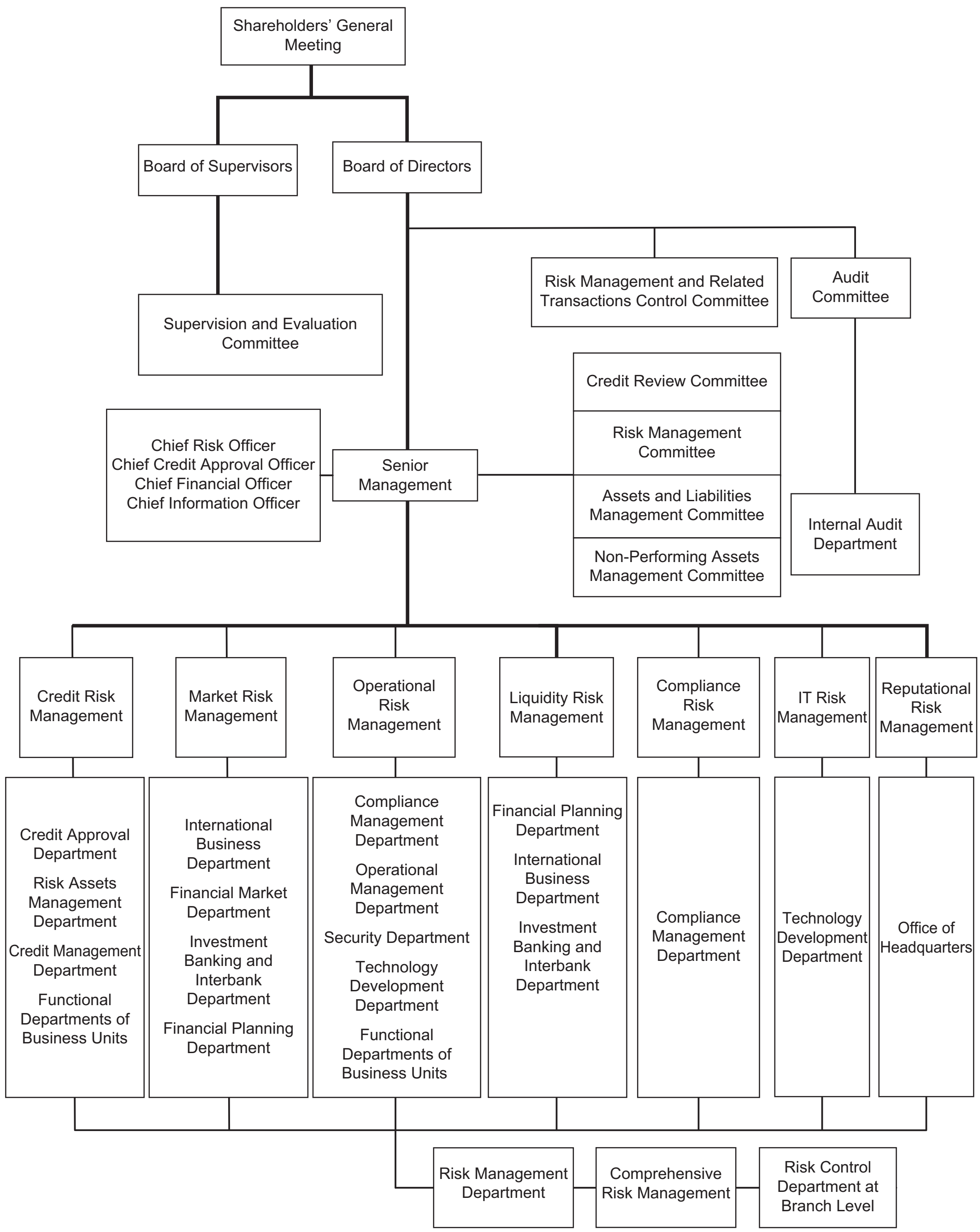
RISK MANAGEMENT FRAMEWORK

Our Bank monitors and controls its risk exposure through various reporting systems that cover the financial, management, compliance and legal aspects of our business operations. We have established a four-tier governance framework for risk management and internal control: the four levels being the Board, the Board of Supervisors, the senior management and the operations.

The following chart sets forth the risk management structure of our Bank:



Board and Special Committees

The Board is the highest decision-making and risk management body of our Bank. It is responsible for reviewing and approving our Bank's risk management and internal control systems and strategies, evaluating our Bank's risk management and internal control performance, and enhancing them based on the evaluation results. The Risk Management and Related Transactions Control Committee and the Audit Committee of the Board are responsible for assisting the Board in fulfilling its responsibilities in respect of risk management and internal control.

Risk Management and Related Transactions Control Committee

The Risk Management and Related Transactions Control Committee is mainly responsible for monitoring the control exercised by our senior management over credit risk, market risk and operational risk; conducting periodic evaluations of our Bank's risk profile and providing suggestions on how to optimise risk management; reviewing our Bank's policy on asset and liability management; and providing advice on the optimisation of risk management and internal control.

Audit Committee

The Audit Committee is mainly responsible for reviewing our internal control policies and their implementation. The Audit Committee supervises and evaluates the performance of the Internal Audit Department, and coordinates our internal and external audit work.

Board of Supervisors

The Board of Supervisors supervises the effectiveness of the compliance risk management conducted by the Board and the senior management. It is also responsible for overseeing and evaluating our Bank's compliance with legal requirements and the performance of duties by the Board and management. The Supervision and Evaluation Committee is established under the Board of Supervisors to supervise our Bank's risk management and internal control, and provide supervisory advice.

Senior Management

Our senior management is the highest executive level of risk management of our Bank. Risk management functions are mainly performed by four designated personnel and four special committees relating to risk management.

- *Chief Risk Officer*: mainly responsible for the overall implementation of our Bank's risk management strategies, coordinating the formulation of comprehensive risk management policies and the establishment of a risk management organisational structure (including coordinating the formulation of risk management rules and procedures, comprehensive risk monitoring, identification and reporting and the construction of an internal control system) so as to strengthen internal control and compliance management, and the promotion and development of our risk and compliance culture.
- *Chief Credit Approval Officer*: mainly responsible for the construction and management of our credit review and approval system; optimising the credit risk management system; promoting our credit business operations; as well as preventing and controlling the credit and operational risks in our credit business.

- *Chief Financial Officer*: mainly responsible for the construction and improvement of our overall financial policies; establishing a strict internal financial system and a cost and expenses management system; and overall planning, establishment and operation of our financial system and proposing forward-looking alerts and measures from a risk control perspective.
- *Chief Information Officer*: responsible for formulating the IT development plan; coordinating our IT management; coordinating the establishment of our IT management organisational structure and IT departments; coordinating and promoting the implementation of our IT management plan; coordinating the establishment of our IT risk management system; formulating and implementing our risk management strategies, ensuring the effectiveness of our IT risk management, and performing other duties relevant to IT risk management.
- *Risk Management Committee*: a special committee responsible for the overall control, management, evaluation and monitoring of bank-wide risks. Its main responsibilities range from the supervision and management of bank-wide operational risk, reviewing the organisational structure and planning in connection with the supervision and control of various risks and reporting the same to the Board for approval or record, supervising the operation of the risk management organisations for operational risks, developing of our organisational structure and rules on our bank-wide operational risk management, making decisions as well as conducting regular reviews of various risk limits, authorisation, risk management systems and policies that are within the committee's authority.
- *Credit Review Committee*: the highest decision-making organ of our Bank in connection with the review and approval of our credit business, which provides decisions on the relevant credit business and matters. Its main responsibilities include the review and approval of various on- and off-balance-sheet credit business in excess of approval authorities of relevant departments in each business line and the credit approval department in our headquarters, and providing decisions thereon.
- *Assets and Liabilities Management Committee*: mainly responsible for determining the total amount and composition of assets and liabilities, determining business strategies for bond investments and bills, proposing measures for improving asset and liability management, monitoring and managing various regulatory indicators and business operation indicators, focusing on the enhancement of the level of return on assets and the effectiveness of cost control policies, deciding on the plans for handling any materially unusual conditions relating to asset and liability management arising in operating activities, reviewing and determining the policies for liquidity management and interest rate management, determining the contingency plans for liquidity management, determining the performance appraisal plan for asset and liability management, and evaluating the implementation results of the policies for asset and liability management.
- *Non-performing Assets Management Committee*: responsible for reviewing and determining the preservation, recovery, restructuring and disposal of non-performing assets that are in excess of the approval authority granted to the risk assets management department.

Any resolution of the Risk Management Committee, Credit Review Committee, Assets and Liabilities Management Committee and the Non-performing Assets Management Committee may only be passed by the approval of two-thirds or more of the respective committee members present at the meeting.

OPERATION

Headquarters

Our Bank's risk management functions are performed by several departments in our headquarters:

- *Risk Management Department*: the core department of our Bank for risk management and responsible for overall risk management. Its main responsibilities include formulating and optimising our risk management rules and annual risk control policies; developing and maintaining the risk measurement instruments; managing credit risk portfolios; identifying, measuring, monitoring and reporting our major risks; submitting risk analysis reports to the Risk Management Committee; and managing the authorisation process.

- *Credit Management Department*: a functional department of our risk management mainly in charge of coordinating our Bank's credit business management, including formulating our credit business policies and planning, credit business management and maintaining the credit system.

- *Credit Approval Department*: one of our Bank's core departments for credit risk management and mainly responsible for the managing of our credit business; reviewing and approving credit business within its approval authority; and submitting its review comments to the Credit Review Committee of the headquarters for approval where the credit business is beyond its approval authority.

- *Compliance Management Department:* our Bank's core department for compliance risk and legal risk management and mainly responsible for monitoring, identifying, evaluating and reporting of any compliance risk and legal risk, and being responsible for the management of anti-money laundering and internal control of our Bank.

- *Financial Planning Department:* a business department for the management of our liquidity risk and bank account interest rate risk. In relation to liquidity risk, the department is mainly responsible for setting the liquidity management objectives and their implementation plans, coordinating management work and deploying funds, routine monitoring and management of liquidity risk, monitoring and managing the liquidity ratio indicators, and contingent liquidity management. In relation to capital management, the main duties of the department are to managing our interest rates, ensuring implementation of the national policy on benchmark interest rates for deposits and loans denominated in RMB and foreign currencies, and determining the interest rates for intra-bank capital transfers.

- *Risk Assets Management Department:* a business department for the management of our non-performing assets. Its duties are to formulate various rules for managing and disposing of our non-performing assets, provide guidance on and examine the management and disposal of non-performing assets by different branch institutions, convene meetings of the Non-performing Assets Management Committee at the headquarters level and supervise the implementation of resolutions of such meetings; and to review and approve matters concerning the management and disposal of non-performing assets of branches according to its approval authority.

- *Internal Audit Department:* the supervisory and appraisal department for our internal control management. There are six divisions under the Internal Audit Department, namely Harbin regional audit division, Shuangyashan regional audit division, Tianjin regional audit division, off-site audit centre, on-site audit centre and Village and Township Banks audit centre. These divisions are responsible for the internal audit and supervision of all businesses and entities within our Bank, and provide support and services for the internal audit and supervision of all

Village and Township Banks of which our Bank is the controlling shareholder. The Internal Audit Department is subject to the supervision and appraisal of the Audit Committee of the Board, and is independent from the entities and departments being audited. The audit budget and salary of the personnel of the Internal Audit Department are determined by the Board or the Audit Committee of the Board. The appointment, removal and performance appraisal of the key personnel are determined by the Board.

- *Technology Development Department:* a functional department for our IT risk management. It is responsible for the construction of our IT infrastructure and the management of IT risk.
- *Office of Our Headquarters:* mainly responsible for managing our reputational risk, identifying and handling in a timely manner any reputational risks that may arise from time to time.
- *Other Business Departments:* in addition to the above functional departments for risk management, all other business departments of our Bank also implement our risk management policies and procedures. Our business departments each perform their own risk management functions in their respective business areas in accordance with the risk features of their respective businesses.

Branches

Our Bank has established risk control departments in its branches to identify, monitor and report any risks faced by the branches, such as credit risk and operational risk.

MAJOR RISK MANAGEMENT

Our Bank aims to be a "domestically leading, internationally renowned microfinance bank" and has adopted a risk management model and process suitable for the development of our microcredit business in order to achieve the balanced development of scale, quality and efficiency. Our Bank allocates its capital in a rational manner and within an acceptable risk range with the aim of maximising our revenue and ensuring the achievement of our strategic objectives.

Our risk management objectives are to:

- improve the corporate governance and risk management mechanism to ensure that the Board, the senior management and the risk management personnel at all levels implement comprehensive risk management in accordance with the risk management strategies formulated by our Bank;
- establish a comprehensive, independent and vertical organisational structure for risk management and develop a risk management system with a clear division of duties and responsibilities;
- formulate comprehensive risk policies, rules and procedures to ensure that our risk management covers all our businesses, products and positions;
- develop and apply risk management tools and means to identify and measure risks so as to ensure that risk information is timely communicated at different levels;
- nurture our risk management culture via the management's supervision and management, regulation and managerial accountability, as well as staff training.

The major risks of our Bank include credit risk, market risk (including interest rate risk and exchange rate risk), liquidity risk, operational risk, IT risk, reputational risk and compliance risk.

Credit Risk Management

Credit risk refers to the risk of economic losses suffered by our Bank due to impact on the value of the financial products as a result of the failure by the debtor or the counterparty to fulfil its obligations under the contract or changes in its credit rating. Our credit risk is primarily associated with such businesses as loan portfolios, investment portfolios, collateral, commitments and other on- and off-balance sheet risk exposures.

In terms of the governance structure of our credit risk management, the Risk Management and Related Transactions Control Committee is established at the Board level, while the Risk Management Committee, the Credit Review Committee and the Non-performing Assets Management Committee are set up at the senior management level. The Risk Management Committee is responsible for supervising and managing bank-wide credit risk, as well as reviewing credit risk management policies and rules, credit risk limits and authorisations. The Credit Review Committee is the highest decision-making body for our credit business transactions. The Non-performing Assets Management Committee is responsible for reviewing and determining the rules in relation to the recovery of our non-performing assets and other related recovery policies. Our risk management department, credit management department, credit approval department, risk assets management department and other related business departments are responsible for the daily credit risk management within their respective authority and duties.

Our Bank adopts a unified risk appetite in credit risk management to control its risks within an acceptable range with an aim of achieving satisfactory risk returns and successfully identifying, measuring, monitoring and controlling credit risk.

Credit Risk Management and Control Measures

Our risk management department formulates the risk management policies for the year ahead at the end of each year in accordance with the regulatory requirements and priorities of various regulatory authorities as well as our own management requirements. In the middle of each year, the risk management department will adjust the credit risk policies according to the risk management conditions and relevant policies promulgated in the first half of the year. We also conduct centralised management over the overall credit approvals for single customers, group customers and customers in the banking industry and optimise the structure of credit assets based on the credit policies of various industries.

Our authorisation is granted primarily based on general authorisation policies and supplemented by authorisations granted via ad hoc powers of attorney. We formulate an authorisation matrix with customer ratings and risk mitigation as its two criteria, and differentiate authorisation limits according to regional risk index and the assessment results of the risk management capabilities of different branches. We have established a risk limit system comprising a portfolio risk limit and single customer risk limit to achieve the quantitative estimation of portfolio risk limit and single customer risk limit, so as to keep the concentration risk under control. Our Bank fully takes into account risk costs to ensure that relevant risks are adequately covered in determining loan pricing. Our Bank has established a credit risk reporting system between all departments and the risk management department, as well as between our headquarters and the branches.

Credit Risk Management Tools

Internal Rating Method for Credit Risk

In order to improve credit risk measurement and to meet the regulatory requirements of Basel III and from the CBRC, our Bank launched a programme to carry out comprehensive risk management and implement Basel Accords in 2011, and began to develop an internal rating system in 2012. The establishment of our internal rating system will take place in three steps: (1) the overall framework design of the internal rating system, (2) the development and application of the internal rating model for retail/non-retail risk exposures; and (3) the stage III examination of the internal rating system. Our Bank has completed the overall framework design of the internal rating system and is now gradually advancing the development and application of the internal rating model for retail/non-retail risk exposures.

Six Credit Risk Management Mechanisms

The risks associated with different credit business lines vary widely. In order to unify the credit risk management requirements of various business lines, our Bank has developed six credit risk management mechanisms, i.e., pre-approval investigation, credit review and approval, credit disbursement management, post-disbursement management, risk alert and non-performing assets management.

Pre-approval investigation: pre-approval investigation is conducted based on the type of the business and the relevant risk appetite and is carried out in a sufficient manner so as to effectively identify and assess risks, formulate reasonable credit disbursement plans, implement unified credit management and achieve balance between risks and profits.

Credit review and approval: our Bank separates the credit review and approval from the disbursement of loans to ensure their independence, conducts centralised management and control to ensure that the credit review and approval is carried out by designated personnel, and sets out an approval and decision-making mechanism to grant authorisation in a rational manner based on the risk of relevant credit business and the qualification of the loan approvers to ensure that the responsibilities correspond with the authorisation and the risks correspond with the profits.

Credit disbursement management: based on the principles of independence and standardisation for credit disbursement management, our Bank separates the review and disbursement of credit, adopts a two-person review panel mechanism and strictly controls credit lines to standardise the disbursement mechanism.

Post-disbursement management: our Bank formulates different post-disbursement management plans according to the relevant risk level and implements differentiated post-disbursement management measures to establish a dynamic management mechanism and to ultimately achieve effective tracking.

Risk alert: our Bank has established a unified, multi-tiered risk alert mechanism and a comprehensive, multi-tiered risk alert indicator system to clarify risk alert responsibilities, achieve proactive management, set up a timely reporting mechanism and set out a prompt response mechanism when risk alerts are trigged.

Non-performing assets management: our Bank clearly defines management responsibilities and mechanisms, standardises information management of non-performing loans to ultimately maintain the integrity of the non-performing assets classified as substandard, doubtful and loss under the five-category classification criteria through special collection, remedies and settlements by designated management personnel of non-performing assets based on a full understanding of the status of the non-performing assets.

Our Bank has adopted a differentiated credit risk management approach and processes for different business lines according to their specific features.

Credit Risk Management for our Microcredit Business

Credit Risk Management for Loans to Small Enterprise Customers

Our loans to Small Enterprise Customers include corporate loans to Small Enterprises and personal loans to Small Enterprise Owners. See "Business – Our Principal Business Activities – Microcredit Business". Loans to both Small Enterprises and Small Enterprise Owners are classified as our credit business for Small Enterprise Customers and are under centralised management by our small enterprise banking department, so as to control the credit risk of loans granted to Small Enterprise Customers. Our credit business for Small Enterprise Customers is jointly run by marketing managers, risk managers and product managers to achieve a balance of business development, product innovation and risk prevention. We adopt the pricing principle of revenue covering costs and risks in granting credits to Small Enterprise Customers. For example, we charge higher interest rates on unsecured loans with higher risk such as corporate loans to Small Enterprises. Our Bank has unified the performance measurement standards for our loans to Small Enterprise Customers business and has taken various measures in terms of application acceptance, credit review and approval, post-disbursement management and other aspects to implement credit risk management.

Rating and credit extension: the marketing manager accepts customers' applications and proceeds with the credit rating and credit extension after a preliminary review of customer information. For corporate customers, the principle is that credit rating will need to be conducted prior to credit extension. Our Bank has established a 10-grade credit rating model for Small Enterprises to carry out internal credit ratings. Our Bank develops loan application scorecards at the customer access stage, measures credit risk by using financial indicators, non-financial indicators and special adjustment indicators based on combined qualitative and quantitative analysis. We aim to link the credit rating of Small Enterprises with the credit pre-approval process to fully reflect the comprehensive strength of Small Enterprises. Our Bank classifies the Small Enterprises into AAA grade, AA+ grade, AA grade, AA- grade, A+ grade, A grade, A- grade, BBB grade, BB grade and B grade based primarily on their default risk and determines their credit lines mainly based on their credit rating results using a credit calculation formula.

Credit investigation and review: the marketing manager is in charge of business investigation, the risk manager is in charge of business review, and the product manager is in charge of the design of financing plans on a case-by-case basis. The marketing manager in charge of business investigation and the risk manager in charge of business review are independent from each other. For the mortgaged (pledged) loan business, valuation report of the collaterals shall be prepared by the valuation firms determined by our Bank.

Credit approval: three approval levels are adopted in our credit business for Small Enterprise Customers, namely the three-person approval panel of the small enterprises banking department of our headquarters, the three-person approval panel of our branches and the three-person approval panel of our sub-branches. Each approval panel reviews and approves loans within their respective authorisation and requires unanimous decision of all the relevant panel members. The personnel involved in the investigation and approval procedures are independent from each other, which means investigation personnel cannot not become members of the approval panels.

Credit disbursement management: The authority to approve the disbursement of loans is centrally exercised by the risk control department at the branch level.

Post-disbursement management: the marketing manager is responsible for post-disbursement management, and the risk manager participates in post-disbursement investigations into overdue loans in cooperation with the marketing manager. Our Bank conducts post-disbursement management at sub-branch, branch and headquarters levels and from six perspectives, namely, classification of management targets, joint cross-checking, real-time risk alert, post-disbursement management and supervision, progressive recoveries and disposal by multiple means.

Risk alert: our Bank has established a risk alert mechanism for credit services for Small Enterprise Customers to carry out risk alert management over its customers through identification of risk signals, dissemination of risk alerts and preparation of risk plans. At the same time, our Bank implements a credit business management system for Small Enterprise Customers to conduct real-time monitoring on credit business for Small Enterprise Customers, so as to obtain updated information on customer status on a timely basis. To facilitate risk alert management, our Bank has adopted behavioural scorecards on customers and provides a score for the behaviours of each customer in accordance with the analysis and quantification results of the account and behavioural data of each Small Enterprise Customer. Our Bank determines credit ratings on borrowers based on their scores so as to provide the customer managers with the means of measuring risk for the purpose of credit risk alerts.

Loan classification: On the basis of the five-category loan classification, our Bank further adopts the 12-grade risk classification standards for loans to Small Enterprises. The grading method is the same as that of general corporate loans.

Non-performing loan management: non-performing loans are recovered by the relevant personnel in charge of credit business for Small Enterprise Customers in collaboration with the risk assets management department.

Credit Risk Management for Loans to Farmers

Our Bank adopts the business-line based management model for loans to farmers and has improved our risk control capabilities by implementing vertical management of loans to farmers in our outlets and establishing approval and evaluation mechanisms that are independent from each other. Our Bank adopts a bank-wide unified basic risk management system for its loans to farmers and implements differentiated credit risk management policies. The risk management tools of our Bank include ratings of rural areas and customer ratings which are used to identify quality customers. Our Bank also adopts various guarantee portfolios and mitigates the risks associated with accidental death of our customers that are farmers and natural disasters through insurance and other means.

Main steps in the risk management for our rural financial services:

Market research and access: our Bank applies progressive approval processes for entering village (township) or lower markets. Before entering a village market, our Bank will conduct a comprehensive rating exercise for the targeted village market, specify access scope, implement differentiated management and, after entering into such a market, conduct a ratings exercise once a year on the loan disbursement area so as to control regional risks.

Loan application and acceptance: farmers shall fill out the applicant investigation forms and provide relevant information to apply for loans with our Bank. The customer managers accept farmers' loan applications mainly on site.

Loan investigation: each of our investigations of loans to farmers is implemented jointly by two customer managers. Our customer managers mainly investigate farmers' assets, liabilities and credit history to form the evidence of field investigation.

Loan review: our Bank has arranged designated personnel to take charge of the review of loans to farmers. Our Bank conducts a comprehensive review mainly on the legality, reasonableness and compliance of the contents of loan investigations and issues review opinions.

Loan approval: our Bank adopts the three-person approval panel in the rural banking department of our headquarters, branches and rural financial service centres in approving loans. Approval of a loan requires the unanimous consent of all the panel members.

Loan disbursement: our Bank appoints disbursement supervisors and disbursement auditors to review and approve the disbursement of loans.

Post-disbursement inspection: our Bank ensures the independence of post-disbursement inspection by customer managers cross-checking among themselves, after which they will produce a risk analysis report. The post-disbursement inspections for loans to farmers are categorised into two types, namely, regular post-disbursement inspection and *ad hoc* post-disbursement inspection.

Risk alert mechanism: our Bank sets up a risk alert mechanism for our customers that are farmers to comprehensively monitor the borrowers and the changes of relevant indicators of the places where the borrowers are located, as well as a reporting and handling mechanism to facilitate proactive management and prompt response to risks, and thus realising active and dynamic risk management.

Loan classification: The risks in loans to farmers are classified into various grades based on comprehensive evaluation on the conditions of farmers' production and operations, number of loan overdue days and collateral types, details of which are as follows:

Classes	Name of seven-grade classification	Code of seven-grade classification	Name of five-grade classification
1	Pass	A1	Pass
2	Special mention Class I	B1	Special mention
3	Special mention Class II	B2	
4	Substandard Class I	C1	Substandard
5	Substandard Class II	C2	
6	Doubtful	D	Doubtful
7	Loss	E	Loss

Credit Risk Management for Personal Consumption Loans

The credit risk management of our personal consumption loans is conducted mainly through the implementation of a two-person investigation system, a real estate assessment system, a loan approval system of a three-member approval panel and a personal loan approval centre, the centralised account management by our branches and the 7-grade risk classification standards. We seek to control our credit risk by taking a series of approaches and measures, including the creation of a designated position responsible for post-disbursement management.

For our credit card business, we seek to control credit risk by, among others, investigating applicants' qualifications and the genuineness of their application materials, establishing a scorecard system based on the regional characteristics and customer base and mix, developing risk alert and risk reporting mechanisms and adopting the 7-grade risk classification standards. We conduct real-time transaction monitoring by overseeing cardholder transactions, reviewing and dealing with risk-alert accounts on a real-time basis and contacting the cardholders to confirm their transactions. When any unusual circumstances occur to the credit cards of those cardholders who have other business relations with us, such circumstances shall be reported to the relevant business units to achieve the joint-alert of credit card risk.

Credit Risk Management for Other Corporate Loans

Our process for other corporate loans comprises of customer application, business acceptance, credit rating, credit investigation, credit review, credit approval, credit disbursement (handling) and post-disbursement management. Our Bank mainly relies on the credit risk management mechanism to manage and control risks in each step in the process of other corporate loans business, and adopts the "No credit approval before credit rating" principle to manage and control the credit risk in the whole process. According to our business characteristics, we have prepared separate lists for customers in the industries regulated by national policies and our prioritised customers, and established a 7-grade credit rating system. Our risk managers are required to participate in customer investigations conducted by our customer managers and express independent opinions on risk. Credit review committees at various levels are responsible for reviewing and approving credit services at their corresponding levels. The branches conduct centralised account management, and adopt risk alert mechanism and the 12-grade risk-based loan classification system, where their risk managers participate in post-disbursement management. We succeed in controlling our credit risk by taking a series of the above approaches and measures.

Credit Risk Management for Investment Banking and Interbank Business

Our investment banking and interbank department adopts a "headquarters-branches" management model. The investment banking and interbank business refers to interbank capital transfers, financial asset trading and management, corporate investment and financing consultancy, restructuring, merger and acquisition advisory and financing, structured financing advisory, asset management and wealth management products design that our Bank operates in cooperation with various financial institutions in accordance with relevant regulatory requirements. The credit risk management of investment banking and interbank business adopts differentiated business approval mechanisms and risk management models based on different business types, and our Bank enhances credit risk management through a clear approval process, strict internal control system and effective authorisation mechanisms and by introducing IT support systems and other measures. For details of the credit risk management for our investment in debt instruments issued by financial institutions, see "Business – Treasury Operations – Investments in Securities and Other Financial Assets".

Customer access: our Bank adopts a strict access management system for interbank customers, and develops differentiated rating models based on the different types of interbank customers. The current rating models include those for banks and financial companies, trust companies and financial leasing companies. Our Bank conducts credit rating exercises on interbank customers by taking the combination of qualitative and quantitative scoring methods in accordance with the relevant rating model, and reasonably determines the credit lines for each interbank customer. Our Bank has established a unified marketing platform for interbank business. Our Bank adopts the name-list based management system for interbank customers and updates such name list regularly to ensure a healthy development of the investment banking and interbank business.

Credit rating: In terms of credit extension to interbank customers, our Bank assesses operating conditions, financial condition, compliance with regulatory indicators, risk events, proposed cooperation and other conditions of credit receiving institutions based on the principles of "unified management, differentiated credit extension, reasonable determination and dynamic adjustment", and determines credit lines and business types in accordance with the actual needs and solvency of customers, credit policies, assets and liabilities structure and credit approval conditions of our Bank and credit extended by other financial institutions to the same customers. Our credit ratings for interbank customers are divided into seven grades based on the comprehensive results of qualitative and quantitative assessment, namely, AAA grade, AA grade, A grade, BBB grade, BB grade, B grade and C grade. Each grade corresponds to a different risk coefficient, and each credit line is determined by multiplying net assets with the risk coefficient.

Interbank credit extension management: Upon approval of an interbank credit limit, the investment banking and interbank department of the headquarters, as the management department of the utilisation of interbank credit lines, allocates credit lines based on credit approval requirements, business relationship with other banking institutions, regional and cooperative status, so as to prevent the risks of excessive extension of credit facilities. Status regarding the utilisation of interbank credit lines is regularly reported to the credit approval department, risk management department and other relevant departments of our headquarters.

Review and approval: Each branch reviews and approves the credit risk of investment banking projects for financing purpose in accordance with management requirements for traditional credit approval. The projects for which the approval is beyond the authority of the relevant branches are reported to the credit approval department of our headquarters for approval. The funds and interbank business risk control centre of our headquarters is responsible for issuing risk assessment opinions, and the investment banking and interbank department is responsible for designing and arranging the trading structure and counterparties of projects and reporting the same to the Investment Management Committee of our headquarters for approval.

Post-investment management for investment banking projects: the post-investment management for investment banking projects adheres to the principles of "layered management, clearly defined responsibilities; accountability imposed on individuals, effective appraisal, real-time monitoring and rapid processing". The investment banking and interbank department of our headquarters is responsible for formulating relevant rules for post-investment management for investment banking projects, and guiding, supervising and examining the post-investment management of projects of branches. Each branch is responsible for the specific implementation of post-investment management of various projects, including setting up management teams and appointing a person-in-charge, supervising funds accounts, managing borrowers and collaterals, reminding borrowers to duly repay principal and other earnings.

Credit Risk Management of Bonds and Bills Business

In our bond investments business, we keep credit risk under strict control mainly by setting clear investment thresholds for bond-related credit products, specifying issuer and bond ratings and setting an upper limit for our holdings in single bond issuance. In interbank discounting of bank accepted bills, we select acceptance banks according to strict standards, determine the access standards, and put these acceptance banks under our unified interbank customers credit management to ensure that business is conducted strictly within relevant credit lines, and we also grant authority to our outlets as appropriate for the purpose of credit risk control.

Credit Risk Management for Local Government Financing Vehicles

In view of the debt level of local government financing vehicles and their potential policy, administrative and financial risks, the Bank imposes strict control on our exposure to local government financing vehicles. As of 31 December 2010, 2011 and 2012 and 30 September 2013, our exposure to local government financing vehicles accounted for 2.6%, 1.8%, 1.6% and 2.1%, respectively, of our total assets. We have taken the following measures in relation to credit risk management for local government financing vehicles.

Risk Management for Loans: The Bank manages risks relating to loans to local government financing vehicles strictly in accordance with regulatory requirements and implementation measures regarding risk management of local government financing vehicles issued by the CBRC and its local bureaus. In particular, the Bank has tightened the authorisation for approval and the conditions for granting of loans. All new loans to local government financing vehicles shall be approved, granted and managed centrally by our headquarters. The Bank manages the balance of loans to local government financing vehicles by restricting the total amount of loans strictly. The Bank implements a controlling list of permitted counterparties for granting loans with an aim of strictly controlling the scope of customers of local government financing vehicles. Further, the Bank strictly controls the guarantee for loans to local government financing vehicles and requires the borrowers to provide qualified collateral guarantees. The Bank puts great emphasis on the post-management of loans to local government financing vehicles and strictly monitors the operation and financial condition of these vehicles to ensure loans to local government financing vehicles can be recovered as scheduled.

According to the requirements of the CBRC, banks in the PRC shall classify the loans to local government financing vehicles into four categories, namely, fully covered, basically covered, half covered and uncovered[1] based on the cash flow coverage ratio, which is calculated as cash flow divided by the principal amount of the loan and accrued interest. As of 30 September 2013, the cash flow coverage ratio of loans to local government financing vehicles was classified as "fully covered".

As of 30 September 2013, the balance of loans to local government financing vehicles amounted to RMB2,020 million of which RMB1,050 million, RMB790 million and RMB180 million were invested in land reserves, transportation and infrastructure and affordable housing projects, respectively. Among such loans, RMB1,050 million, RMB790 million and RMB180 million were secured by collateral, pledges and guarantees, respectively, accounting for 52.0%, 39.1% and 8.9%, respectively, of our total loans as of 30 September 2013. There were no unsecured loans. Under the five-category loan classification system, all of our loans to local government financing vehicles were classified as "pass" as of 30 September 2013.

Risk Management for Investment in Debentures: The Bank has imposed strict requirements on the rating of debentures issued by local government financing vehicles (the external ratings of all debentures issued by local government financing vehicles are AA or above) and the limit of individual investment. In addition, the Bank implements mark to market and limit management for debentures. As of 30 September 2013, our investment in debentures issued by local government financing vehicles amounted to RMB1,415 million, of which RMB200 million, RMB156.5 million and RMB432.8 million were secured by collateral, pledges and guarantees, respectively, accounting for 14.1%, 11.1% and 30.6%, respectively, of our total investment as of 30 September 2013. As of that date, RMB625.7 million of such investment was unsecured accounting for 44.2% of our total investment. As the interest and principal of these investments were fully recovered as scheduled, there was no loss from default.

1 "Fully covered" means that the cash flow of the borrower is sufficient to repay 100% or more of the principal amount of the loan and accrued interest. "Basically covered" means that the cash flow of the borrower is sufficient to repay 70% to 100% of the principal amount of the loan and accrued interest. "Half covered" means that the cash flow of the borrower is sufficient to repay 30% to 70% of the principal amount of the loan and accrued interest. "Uncovered" means that the cash flow of the borrower is sufficient to repay less than 30% of the principal amount of the loan and accrued interest.

Risk Management for Investment through Fund Trust Plans and Directional Asset Management Plans: The Bank manages the risk of investment through fund trust plans and directional asset management plans based on the measures on risk management for loans to local government financing vehicles. Through establishing a control list of permitted counterparties, standardised guarantees and enhanced management for loans, the Bank seeks to ensure the security of the investment. As of 30 September 2013, our investment in local government financing vehicles through fund trust plans and directional asset management plans was RMB2,088 million, of which RMB1,100 million and RMB988 million were secured by pledges and guarantees, respectively, accounting for 52.7% and 47.3%, respectively, of our total investment as of 30 September 2013. As the interest and principal amount of these investments were fully recovered as scheduled, there was no loss from default.

Market Risk Management

Market risk refers to the risk of loss in our on- and off-balance sheet businesses as a result of adverse changes in market prices (interest rates, exchange rates, stock prices and commodity prices). Market risk exists in our trading and non-trading businesses.

The market risks currently faced by our Bank are interest rate risk and exchange rate risk. Our objective of market risk management is to maximise risk-adjusted revenue while limiting the potential losses arising from market risk within a reasonably acceptable level based on our bank-wide risk appetite.

Our Bank carries out market risk management in accordance with the regulatory requirements under the framework of a standardised approach for market risk under Basel III. Our Risk Management Committee is responsible for bank-wide supervision and management of market risk. Our risk management department, financial planning department, financial market department and international business department are responsible for identifying, measuring, monitoring and reporting the market risk in our on- and off- balance sheet trading and non-trading businesses. Our risk management department is responsible for overall market risk management.

Bank Account Interest Rate Risk

This refers to the risk of decrease in net interest income or long-term market value of our assets and liabilities portfolio as a result of fluctuation in interest rates. Our bank account interest rate risk arises primarily from the differences in the maturity dates (for fixed rate) or re-pricing dates (for floating rate) of our assets, liabilities and off-balance sheet businesses. In addition, the value of assets and liabilities under our bank accounts is also subject to bank account interest rate risk arising due to adverse changes in interest rates. We use gap analysis, sensitivity analysis and other methods to measure bank account interest rate risk.

Transaction Account Interest Rate Risk

This refers to the risk of loss in the on- and off-balance sheet businesses under our transaction accounts as a result of adverse changes in interest rates. The interest rate risk associated with our transaction accounts exists mainly in our trading businesses. Our Bank has clear transaction account classification standards, revaluates the market value of assets under our transaction accounts on a daily basis, sets transaction caps, stop-loss limits and risk limits, and monitors and controls them by frequencies. Our Bank uses duration analysis, sensitivity analysis and other methods to measure transaction account interest rate risk. We use standardised methods to measure our interest rate risk capital in transaction accounts in strict compliance with regulatory requirements.

Exchange Rate Risk

This refers to the risk of loss in our on- and off-balance sheet businesses as a result of adverse changes in exchange rates. Our exchange rate risk exists mainly in our foreign currency-related trading and non-trading businesses. Our Bank sets transaction caps, stop-loss limits and exposure limits to manage the exchange rate risk in our foreign exchange business. For the Ruble market-making business and the Ruble cash exchange business, our Bank implements Ruble exposure management on each trading day. Our headquarters implements centralised management in respect of the bank-wide exchange rate risk so as to reduce the exchange rate risk and improve exchange rate risk management efficiency. We use standardised methods to measure our exchange rate risk capital in strict compliance with regulatory requirements.

Liquidity Risk Management

Liquidity risk refers to the risk of failure to obtain adequate funds to repay debts on a timely basis or at reasonable costs. The objective of our liquidity risk management is to comply with relevant supervisory and regulatory requirements, to ensure that we are able to perform all of our payment obligations under any circumstances, and to finance all our payment needs and business operations in a timely and cost-effective manner.

The Assets and Liabilities Management Committee is mainly responsible for formulating our goal and policy of liquidity management, and reviewing any major matters arising out of our liquidity management. The risk management department, financial planning department, international business department and investment banking and interbank department are responsible for our day-to-day liquidity risk management in accordance with their respective duties and responsibilities.

We have established a bank-wide liquidity risk management system. Our main liquidity risk management measures are as follows:

- formulate annual liquidity risk management policies, propose annual liquidity risk management indicators, management requirements and management strategies, and monitor a number of liquidity indicators for our liquidity management;
- closely track any changes in our funds and re-allocate our funds reasonably;
- develop financing channels and ensure smooth financing channels;
- the Assets and Liabilities Management Committee undertakes the management of asset and liability portfolios, and prepares the liquidity gap statements via the asset and liability management system;
- the financial planning department is responsible for our capital management, liquidity management and transfer pricing;
- regularly carry out liquidity risk stress tests and conduct quarterly analyses and appraisals for liquidity management and report the status of risk management; and
- formulate liquidity risk contingency plan to ensure that we can react to emergency in a standardised, systematic and an orderly manner.

Operational Risk Management

Operational risk refers to the risk of loss arising from flawed internal procedures, incompetent personnel or flawed IT systems, or external events. The operational risks faced by our Bank mainly include internal fraud, external fraud, internal rules and workplace safety, customers, products and business activities, damage to physical assets, IT system failure and other problems identified in the course of execution, delivery and process management.

In 2012, our Bank launched the operational risk management system project in accordance with Basel III, and established a full set of operational risk management systems, covering relevant corporate governance structures, policies and systems, management tools, measurement methods and IT system.

Our Bank has established a three-layer operational risk defence system with business departments, risk and compliance management departments, and Internal Audit Departments at each line of defence. We have also established an operational risk reporting system between our business departments and risk control departments, as well as between our headquarters and branches. Our Bank has also formulated operational risk management policies and procedures, and applied operational risk management tools such as Risk and Control Self Assessment (RCSA), Key Risk Indicators (KRI) and Loss Data Collection (LDC) to identify, assess, monitor and measure risks, so as to strengthen our operational risk management.

Our operational risk management measures include:

- enhancing the technology of our operational risk management system, and gradually realising the automatic control of operational risk through systematic centralisation, functional combination, automatic operation, process control, etc;
- conducting centralised risk management and control over high-risk business and important management areas so as to reduce business operational risk;
- commencing the establishment of a “process-based bank”, optimising and redesigning business and risk management process;
- using three main operational risk management tools to identify, monitor and collect the risk factors and risk signals identified in operational activities;
- establishing an early-stage risk analysis, monitor and alert system and focus on key steps and positions in risk management which are prone to incidents and risks so as to identify and eliminate potential risk and monitor and alert risk in key businesses and steps; and
- establishing a joint contingency management system, initiating the establishment of business continuity management system, organising and implementing drills aimed at maintaining business continuity so as to ensure the continuous and effective operation of our businesses.

IT Risk Management

IT risk refers to operational, legal, reputational and other risks caused by natural factors, human factors, technical loopholes and flawed management in the course of our usage of IT. Our IT risk management objectives are to identify, monitor, assess and control IT risks by establishing a complete, reasonable and effective risk management system and mechanism, so as to operate our business in a safe, continuous and stable manner, promote our business development and innovation, improve our IT operation and management, and enhance our core competitiveness and capability of sustainable development.

Our main IT risk management measures are to:

- formulate unified fundamental policies for our IT risk management, establish and improve our bank-wide IT risk management system;

- strengthen the IT risk management function of the IT Management Committee and our IT decision-making and risk control capabilities;
- establish an IT contingency management system and formulate relevant rules;
- improve our capabilities in the establishment and management of a disaster recovery system, and mitigate the negative impact of accidents on our critical information systems; and
- implement the ISO27001 International Standards to further improve the information security management and prevention strategies.

Reputational Risk Management

Reputational risk refers to the risk of negative comments about our Bank generated by relevant interested parties in respect of our Bank's operations, management and other activities or external events. Our reputational risk management objectives are to build an effective reputational risk management mechanism, so as to identify, monitor, control and eliminate reputational risk, to build and maintain a good corporate image and to promote our continuous and healthy development.

The Reputational Risk Contingency Steering Group of our Bank is responsible for the supervision, coordination and process control of emergency recovery measures in the event of significant reputational incidents. Each department and branch is responsible for routine work such as the identification, assessment, monitoring and prevention of reputational risk in accordance with their respective duties.

Our major reputational risk management measures are to:

- formulate unified basic policies and management system for reputational risk management to ensure the completeness and feasibility of the system;
- communicate with media to enhance our positive influence;
- focus on the trend of public opinions, implement the daily reporting of public opinions and strengthen our capabilities in alerting and responding to sensitive financial issues;
- establish a press spokesman system, with our headquarters coordinating our internal and external relationships;
- enhance customer services and complaints management, and improve service quality and levels; and
- enhance training of frontline staff.

Compliance Risk Management

Compliance risk refers to the risk of being subject to legal and regulatory sanctions, and the risk of major financial loss and reputational loss as a result of our failure to comply with relevant laws, rules and guidelines.

Our Bank has established a preventive system to manage compliance risk. Our business departments take initiatives to identify and manage compliance risk in accordance with compliance management procedures, and timely report such risk through reporting channels in accordance with relevant reporting requirements of compliance risk. The compliance risk management department performs independent compliance risk management responsibilities and provides compliance support and implements professional compliance management. The Internal Audit Department is responsible for inspecting, supervising and evaluating the compliance risk management system and the effectiveness of our compliance risk management.

Our compliance risk management framework is as follows:

- the Board assumes ultimate responsibility for the compliance of our business activities;
- the Board of Supervisors supervises the effectiveness of compliance risk management of the Board and senior management;
- the senior management assumes direct responsibility for the compliance risk management of our Bank, and regularly reports our compliance risk status to the Board;
- each business management department of our headquarters takes foremost responsibility for the compliance of the operation and management of respective departments and business lines;
- each branch is responsible for compliance of the operation of entities under its control;
- each business management department of our headquarters and the head of each of our branches and sub-branches assume the foremost responsibilities for the compliance of their respective operation and management activities; and
- each of our employees assumes the compliance responsibility corresponding to his/her position and duties, and shall consciously observe and strictly enforce relevant laws, rules and guidelines.

Anti-Money Laundering

Our Bank has established an Anti-money Laundering Steering Group headed by our president, which is responsible for coordinating the implementation of PRC Anti-Money Laundering Law and other anti-money laundering rules, regulations, guidelines and policies formulated by regulatory authorities such as the PBOC, and organising and leading all aspects of our anti-money laundering work. The compliance management department is responsible for the implementation of day-to-day anti-money laundering management and the specific arrangement and coordination of anti-money laundering work.

Our Bank performs customer identification and reports large amount and suspicious transactions on each business day to the Anti-Money Laundering Monitoring and Analysis Centre in accordance with PRC anti-money laundering laws. In the event that any transaction or customer is in connection with money laundering activities, terrorism activities or other criminal activities, we will also make a simultaneous report to both the local branch of the PBOC and local public security department, and cooperate with them in their anti-money laundering investigations.

Internal Audit

The Internal Audit Department is subject to the supervision and appraisal of the Audit Committee, which is primarily responsible for the establishment of internal audit systems, internal audit planning, internal audit, internal control, supervision and appraisal, preparation of audit reports, supervision over rectification of issues identified in the audit and coordination with external parties involved in the auditing process.

The Internal Audit Department has six divisions, namely, Harbin regional audit division, Shuangyashan regional audit division, Tianjin regional audit division, off-site audit centre, on-site audit centre and Village and Township Banks audit centre, which are responsible for the internal audit and supervision of all businesses and entities within our Bank and provide support and services for the internal audit and supervision of all Village and Township Banks of which our Bank is the controlling shareholder. The Internal Audit Department is independent from the entities and departments being audited. The audit budget and salary of the personnel of the Internal Audit Department are determined by the Board or the Audit Committee. The appointment, removal and performance appraisal of the person-in-charge of this department are determined by the Board.

The Internal Audit Department determines the audit plan of each of our branches and businesses on the basis of risk-oriented and cycle coverage principles. It audits, supervises and evaluates the bank-wide business operation and management, internal control and risk profile through regular audits, *ad hoc* audits, follow-up audits, current (post-resignation) economic responsibilities audits, and procures that the audited entities and departments effectively perform their duties.

INTERNAL CONTROLS

The Internal Control System of our Bank

From 2011 to 2013, we engaged Deloitte (Shanghai) to advise on the construction of our internal control system and to carry out the automation of our internal control function, in each case in accordance with the requirements on the establishment of corporate internal control under, among others, the PRC Commercial Banking Law, the Basic Rules on Enterprise Internal Control, the Internal Control Guidelines for Commercial Banks and the guidelines issued by the Basel Committee on Banking Supervision. We thereby formulated an internal control system covering the five aspects of internal environment, risk assessment, control activities, information and communication, and internal supervision.

Internal Control Management Structure

Our Bank has established a corporate governance organisational structure mainly consisting of shareholders' general meeting, the Board, the Board of Supervisors and the senior management. Our internal control management framework comprises the internal control decision-making level, execution level and supervision and evaluation level. The heads of each of our various branches/sub-branches and functional departments are in charge of our internal control management, while all of our employees also jointly participate in the process.

- *Decision-making level*: the Board is our decision-making body for internal control. Its responsibilities are to ensure the establishment and implementation of our internal control system; approve our overall operating strategies and key policies, regularly inspect and assess their implementation; ensure our prudent operation within the relevant legal and policy limits; explicitly set acceptable risk exposures; ensure that our senior management will take necessary measures to identify, measure, monitor and control risks; and ensure that our senior management will monitor and assess the adequacy and effectiveness of our internal control system.

  The Board has established four committees, including the Development Strategy Committee, Nomination and Remuneration Evaluation Committee, Risk Management and Related Transactions Control Committee, and Audit Committee, among which, the Risk Management and Related Transactions Control Committee is primarily responsible for regularly assessing our risk exposure and risk management strategies, and making proposals to improve our risk management and the internal control relating to risk management. Each of our committees shall report to the Board.

- *Execution level*: our management and the various bodies at different levels are responsible for the establishment and implementation of our internal control system. The senior management of our headquarters are in charge of coordinating the formulation of our internal control policies, monitoring and assessing the adequacy and efficiency of our internal control system; implementing the decisions of the Board; establishing the procedures and measures to identify, measure, monitor and control risks; and establishing and improving our internal organisational structure to ensure the effective performance of various internal control duties.

The establishment and implementation units in our internal control system are responsible for the formulation and coordination of the implementation of our internal control system, processes and methods and the timely rectification of any problems in our internal control system.

- *Supervision and evaluation level*: the Board of Supervisors, the Audit Committee and internal audit departments responsible for the supervision and evaluation of our internal control system and its implementation.

  The Board of Supervisors supervises the fulfilment of duties of our directors and senior management; conducts resignation audits of our senior management; supervises our financial activities, business decisions, risk management and internal control, and makes supervisory recommendations; studies the preparation of periodic reports of the Board and relevant significant adjustments thereto; and makes supervisory recommendations on appointment of external auditors.

  The responsibilities of the Audit Committee are to review our accounting policies, financial status and financial reporting procedures; audit our financial information and its disclosure; review our internal control system and its implementation; supervise and evaluate our Internal Audit Department; propose the appointment or replacement of external auditors; and coordinate the work of our internal and external auditors; and handle other matters authorised by the Board. The Audit Committee shall be chaired by an independent director.