OVERVIEW

As a commercial bank, we are subject to credit risk, liquidity risk, market risk and operational risk. We believe we were one of the first commercial banks in China to focus on establishing a comprehensive risk management system. Since our establishment, our goal has been to pursue growth while maintaining good asset quality by developing and improving our risk management capabilities. At June 30, 2006 and December 31, 2005, 2004 and 2003, our non-performing loan ratio was 2.30%, 2.58%, 2.88% and 3.15%, respectively. See "Assets and Liabilities — Assets — Asset Quality of Our Loan Portfolio."

In the middle to late 1990s, due to over-expansion in China's banking industry and the impact of the Asian financial crisis, the asset quality of China's banks deteriorated, thereby adversely affecting their financial condition and results of operations. The PRC government has since introduced numerous initiatives to improve the asset quality and strengthen the capital base of China's banks, including the establishment of asset management companies to assume a significant portion of the non-performing loans of certain state-owned banks and direct equity injection in certain state-owned banks. We resolved our non-performing loans largely through our own resources and efforts and have learned from our experience and the experience of China's banking industry in the 1990s. Since 1999, building an effective risk management system and establishing a prudent risk management culture throughout our organization have been our top priorities.

We plan to continue to enhance our risk management organizational structure, improve our risk management policies and procedures and implement advanced risk measurement and management tools in order to effectively manage risk and increase our return on a risk-adjusted basis.

We have undertaken, or have plans to undertake, the following initiatives in respect of our risk management objectives:

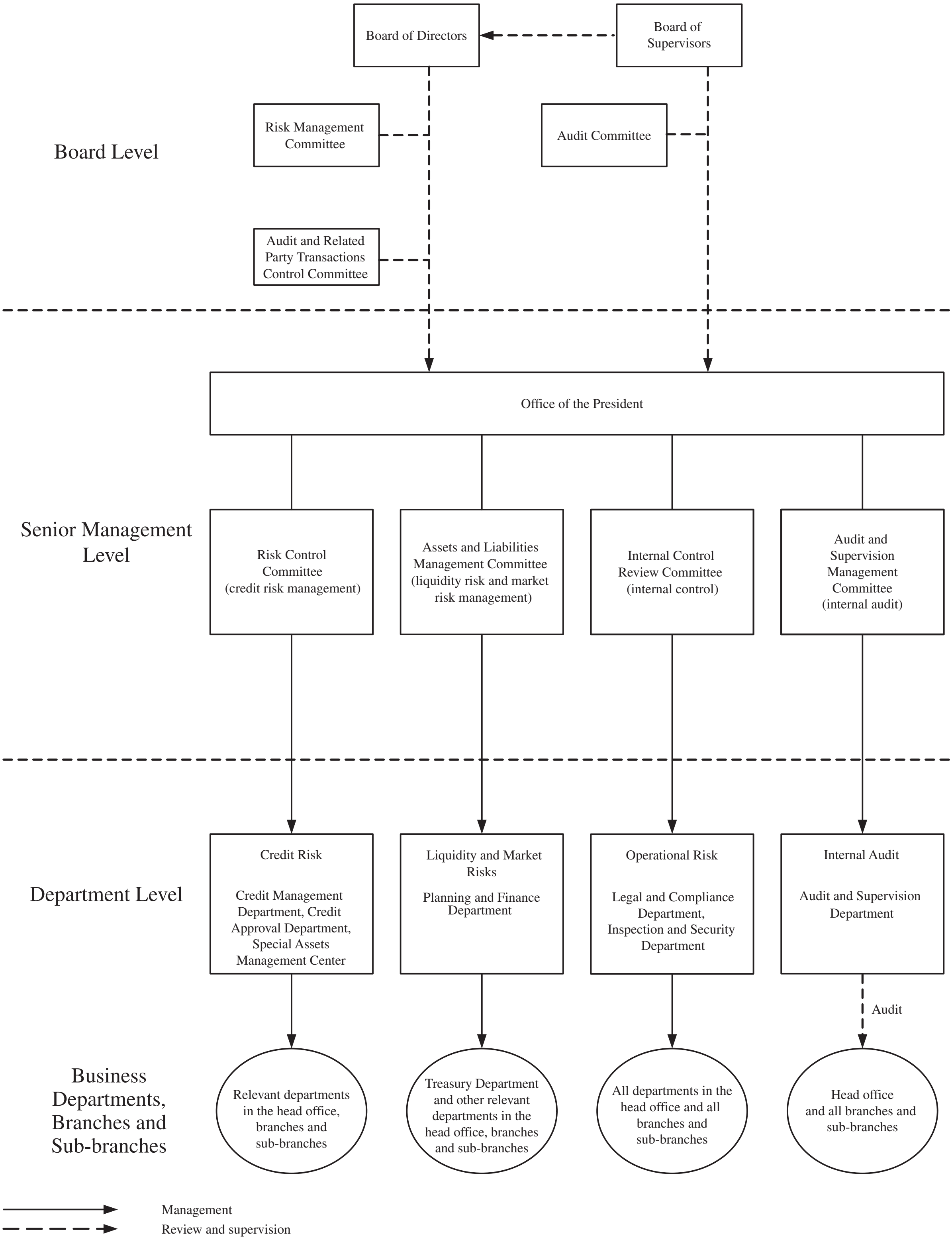
- **We have sought to establish a corporate culture of prudent risk management by:**
  - — emphasizing the principle of "balanced development in respect of profitability, quality and scale" throughout our organization with the goal that each employee conscientiously observes such principle in performing his or her job;
  - — strengthening a corporate culture of prudent risk management that was built upon the lessons learned from resolving non-performing loans from the 1990s and maintaining asset quality in a high-growth environment in recent years; and
  - — improving our risk management training (including engaging outside experts) in order to strengthen our employees' risk management awareness and capabilities.
- **We seek to continue to improve our risk management organizational structure by applying the principle of specialized, vertical and centralized management, including:**
  - — strengthening the Risk Control Committee's role in making bank-wide risk management policies and decisions;
  - — separating the loan origination and credit approval processes and segregating the front-office, middle-office and back-office functions to maintain internal checks and balances;

- — conducting industry-specific credit review to improve the specialization and efficiency of our credit approval process;
- — centralizing the management of internal audit to ensure independence in carrying out the audits; and
- — further centralizing risk management and establishing departments or committees specialized in managing specific types of risk.

- **We intend to continue to improve our risk management policies and procedures by:**
  - — establishing and adhering to strict credit approval limits at different levels of our organization, taking into account the risk management capabilities of our branches;
  - — improving our credit policy guidelines to include bank-wide standards for credit approval, taking into account factors relating to industries, customers, businesses and geographical regions;
  - — continuing to refine and improve our loan-classification system by introducing sub-categories under the five category system for our internal risk management purposes; and
  - — optimizing our mix of customers and assets in response to market conditions.
- **We have been increasingly employing advanced risk management tools, including:**
  - — starting to implement a bank-wide customer credit rating system to more accurately estimate the probability of default and develop a loan facility rating system to estimate loss on a given default;
  - — expanding our use of FTP in response to the gradual liberalization of China's interest rate regime, through which we seek to more accurately determine our cost of funds and to achieve optimal product pricing;
  - — using our ALM system to improve the management of our assets, liabilities and capital resources;
  - — using our treasury trading and risk management system to centrally manage the front-office, middle-office and back-office functions of our treasury business; and
  - — introducing SAP financial management system to improve our allocation of operating costs and establish a more rational profit allocation mechanism.
- **We have been improving our supervision and performance review mechanism by:**
  - — implementing an evaluation system that makes risk management a key performance measure for our branch outlets;
  - — making asset quality an important criterion in evaluating the performance of our senior management and employees; and
  - — strengthening the supervisory and monitoring capabilities of internal audit and focusing on auditing businesses we consider to be of high risk.

RISK MANAGEMENT STRUCTURE

The chart below illustrates the organizational structure of the principal elements of our risk management and internal control functions.



Board of Directors and its Committees

Our Board of Directors is primarily responsible for formulating our risk management strategies and policies and establishing our overall risk tolerance level. Our Board of Directors also monitors our compliance with applicable regulatory requirements, including capital adequacy ratios, non-performing loan ratios and provision requirements. Our Board of Directors meets at least four times a year and may meet more frequently as necessary. Our Office of the Board of Directors coordinates the communications between the Board of Directors and our bank and obtains additional information and reports from different departments at the request of the Board of Directors for its review. The Risk Management Committee and the Audit and Related Party Transactions Control Committee assist the Board of Directors in performing its risk management functions.

Risk Management Committee

The Risk Management Committee supervises our senior management on risk management matters, assesses our risks and recommends to the Board of Directors measures to improve our risk management and internal control systems. The Risk Management Committee consists of Ms. Sun Yueying (孫月英), Mr. Huang Dazhan (黄大展), Mr. Wang Daxiong (王大雄), Ms. Chen Wei (陳偉) and Mr. Austin Hu Chang Tau (胡長燾), with Ms. Sun as the Chairwoman.

Audit and Related Party Transactions Control Committee

The Audit and Related Party Transactions Control Committee reviews the performance of our independent auditors and recommends each year to the Board of Directors whether to retain our independent auditors. The Committee also liaises between our internal audit function and independent auditors, oversees our internal auditing system, reviews our financial information, evaluates and monitors our compliance with, and adequacy of, our internal controls and reviews significant related party transactions and makes recommendations on whether to approve such transactions to our Board of Directors. More than half of our Audit and Related Party Transactions Control Committee members must be independent non-executive directors, one of whom must be an accounting professional. The Audit and Related Party Transactions Control Committee consists of Mr. Wang Daxiong (王大雄), Mr. Fu Junyuan (傅俊元), Mr. Chow Kwong Fai, Edward (周光暉), Ms. Liu Hongxia (劉紅霞) and Mr. Lin Chuxue (林初學), with Ms. Liu as the Chairwoman. Our internal policies require interested committee members to refrain from reviewing, discussing or voting on related party transactions.

Board of Supervisors and its Committee

Our Board of Supervisors is primarily responsible for supervising and monitoring our Board of Directors and senior management and overseeing our financial and audit-related matters. It meets at least four times a year. The Audit Committee is responsible for assisting our Board of Supervisors in discharging its duties relating to financial and audit-related matters. The committee meets at least once a year with our independent auditors and may request reports from the Audit and Supervision Department to assess the quality of our financial auditing and internal control system. The Audit Committee consists of three members, Mr. Shao Ruiqing (邵瑞慶), Mr. Chen Haoming (陳浩鳴) and Mr. Xiang Youzhi (項有志), with Mr. Shao as the Chairman.

Senior Management and its Committees

Our president and chief executive officer, Mr. Ma Weihua, who reports directly to our Board of Directors, is responsible for the overall management of our operations and our assets and liabilities, including risk management. Mr. Ma is assisted by our executive vice presidents in performing his duties. Our executive vice president and chief financial officer, Ms. Chen Wei, is primarily in charge of credit risk management and assists our president and chief executive officer in liquidity risk and market risk management. Our executive vice president, Ms. Yin Fenglan, is primarily in charge of operational risk management and internal control. We also have four management committees (the Risk Control Committee, the Assets and Liabilities Management Committee, the Internal Control Review Committee and the Audit and Supervision Management Committee) that have senior management level responsibility in respect of credit risk management, liquidity and market risk management, operational risk management and internal audit, respectively. These committees consist of either our senior management or heads of our relevant departments in the head office.

Risk Control Committee

The Risk Control Committee is responsible for credit risk management. It assesses our credit risk exposure and establishes our credit risk strategies and policies within the framework of the risk management strategies and policies approved by our Board of Directors. It is our highest credit approval body, with the authority to make final credit approval decisions on certain complex or controversial loan applications. It also makes final decisions on certain foreclosure transactions. See "— Credit Risk Management — Credit Management for Corporate Loans — Credit Approval Procedures — Credit Approval Limits." The Risk Control Committee determines credit approval limits and directly supervises the credit approval process. The Risk Control Committee consists of the executive vice presidents, the assistant presidents, the general manager and the vice general manager of the Credit Approval Department and the respective general manager of each of our Credit Management Department, Planning and Finance Department, Corporate Banking Department, Financial Institution Department and Legal and Compliance Department. The executive vice president in charge of credit risk management, Ms. Chen Wei, serves as the chairwoman of the committee. Resolutions of our Risk Control Committee are adopted based on approval by at least a majority of its members. Our president does not directly participate in the credit approval process of the committee but can veto any credit application approved by the committee. Our president does not have the power to reverse a decision with respect to credit applications rejected by the committee.

Assets and Liabilities Management Committee

The Assets and Liabilities Management Committee is responsible for managing liquidity risk and market risk and our overall assets and liabilities. The committee establishes the risk management objectives in respect of our assets and liabilities, taking into consideration general macroeconomic conditions, the general environment of the financial services industry in China and our own operating conditions. The committee is also responsible for establishing and monitoring the implementation of the policies and procedures relating to liquidity risk and market risk. For more information, see "— Liquidity Risk Management" and "— Market Risk Management." The committee consists of the president, the executive vice presidents, the chief technology officer, and the respective general manager of each of our General Office, Strategy and Development Department, Planning and Finance Department, Credit Approval Department, Credit Management Department, Accounting Department, Financial Institution Department, Corporate Banking Department, Retail Banking Department, International Banking Department and Audit and Supervision Department. Our president and chief executive officer, Mr. Ma Weihua, serves as the chairman of the committee, and our executive vice president and chief financial officer, Ms. Chen Wei, serves as the vice chairwoman. The committee meets monthly to analyze the condition of our assets and liabilities and may meet more frequently as necessary to make important decisions relating to our assets and liabilities.

Audit and Supervision Management Committee

The Audit and Supervision Management Committee is responsible for internal audits. The committee is primarily responsible for maintaining the independence, authority and effectiveness of our internal auditing system. The committee establishes audit-related policies, reviews and approves internal audit rules (and monitors their implementation) and makes decisions on material issues relating to internal audits. It directly supervises the Audit and Supervision Department, which is responsible for conducting internal audits and related activities. The Audit and Supervision Management Committee consists of the president, the executive vice presidents, the chief technology officer, the general manager and the deputy general managers of Audit and Supervision Department, and the respective general manager of each of our General Office, Human Resource Department and Inspection and Security Department, with the president serving as the chairman. The committee meets annually and may meet on an ad hoc basis as necessary.

Internal Control Review Committee

The Internal Control Review Committee is responsible for operational risk management. The committee consists of the president, the executive vice president in charge of internal control, the chief technology officer and the general managers of the relevant head office departments. The committee organizes quarterly meetings to evaluate the effectiveness and adequacy of our internal controls, review any significant potential operational risks and management deficiencies, identify areas in need of improvement and recommend improvement measures.

Risk Management Departments

Under the supervision of our risk management committees, various risk management functions are implemented by certain departments.

Planning and Finance Department

The Planning and Finance Department is responsible for establishing our bank-wide assets and liabilities management system, including adopting and implementing relevant policies, rules and procedures. It establishes the acceptable range of various indicators relating to the management of liquidity risk and market risk, subject to approval by our Assets and Liabilities Management Committee. The department monitors our compliance with such indicators and formulates and implements strategies to reduce our exposure to liquidity risk and market risk. For more information, see "— Liquidity Risk Management" and "— Market Risk Management." It is also responsible for our capital and fund management, including monitoring capital adequacy ratio, establishing and improving our capital allocation mechanism and managing the use of our funds (other than our deposits and loans). The department also undertakes the middle-office function in monitoring and managing the risks associated with our treasury trading business. In addition, the department is responsible for information reporting and management, including operating and maintaining our data warehouse and management information reporting systems.

Credit Management Department

The Credit Management Department is responsible for formulating, monitoring and implementing our policies, rules and procedures relating to credit risk management, and for formulating credit policy guidelines and credit extension policies. It plans, develops, implements and manages our credit management information system and other quantitative credit risk management tools, such as our customer credit rating system and loan facility rating system. It also conducts post-disbursement inspections, performs statistical analysis, monitors the changes in our loan portfolio, issues credit risk alerts, and manages loan classification, loan provisioning and non-performing loans. In addition, the department performs daily management functions for the Audit and Related Party Transactions Control Committee of our Board of Directors in respect of related party transactions.

Credit Approval Department

The Credit Approval Department supervises and manages the credit approval process at the branch level and is responsible for reviewing and approving credit applications exceeding the credit approval limits granted to the branches. The Credit Approval Department assists the Credit Management Department in formulating our credit policy guidelines. It also collaborates with the Credit Management Department to establish credit review systems and procedures and conducts bank-wide training of our credit reviewers.

Special Assets Management Center

The Special Assets Management Center is responsible for managing and disposing of non-performing loans and other special assets, such as assets seized through foreclosure proceedings and loans that have been written off. The center establishes procedures for the collection or restructuring of, arbitration and litigation relating to, or auction, lease, transfer or other disposition of such special assets. It also conducts statistical analysis with respect to such assets.

Audit and Supervision Department

The Audit and Supervision Department is responsible for auditing our business and independently supervising and assessing our risk management and internal controls. The department is independent from the operating units that it audits and supervises. The department conducts regular independent inspections to identify internal control weaknesses and proposes improvement measures to our management. The department also reports periodically to the Board of Directors and the Board of Supervisors and supervises four audit and supervision offices in Beijing, Shanghai, Shenzhen and Xi'an.

Legal and Compliance Department

The Legal and Compliance Department is responsible for overseeing our compliance with applicable laws and regulations and review and enforce our internal rules for compliance, including those relating to anti-money-laundering laws. The department is also responsible for monitoring legal and regulatory developments applicable to us and informing management of pending changes. It provides legal consulting services in our head office and coordinates the preparation and review of all standard forms of legal documents (including loan contracts) used at our bank and handles legal issues arising from such legal documents. In addition, it is in charge of all the matters relating to arbitration and litigation (other than arbitration and litigation relating to the collection of non-performing loans in the head office) and patent-related matters.

Inspection and Security Department

The Inspection and Security Department is responsible for investigating alleged violations of laws and regulations and cooperates with government authorities in any government investigation. The department is also responsible for investigating breaches of our internal rules and imposing disciplinary measures on our officers and employees who breached such rules. The department is responsible for the security of our headquarters, branches and sub-branches and implementing measures to ensure the safety of our employees and assets. In addition, the Inspection and Security Department aims to prevent and detect fraud and corruption by adopting and enforcing internal rules, educating our employees and regularly inspecting our systems and processes designed to prevent and detect fraud and corruption.

Branch-level Risk Management

We have risk control committees, assets and liabilities committees and internal control review committees at all branches. In respect of branch-level risk management, our branch-level risk control committees manage credit risk and approve credit applications at the branch level within their authorization limits; our branch-level assets and liabilities committees monitor liquidity risk and market risk; and our branch-level internal control review committees review and supervise the operational risk. In general, each branch has risk management departments comparable to those at our head office. The branch-level risk management departments report to the branch management and to their corresponding departments at our head office.

CREDIT RISK MANAGEMENT

Credit risk is the risk that a bank borrower or counterparty fails to meet its obligations in accordance with agreed terms. We are exposed to credit risk primarily through our loan portfolio, investment portfolio, guarantees and other payment commitments.

Our primary goal in respect of credit risk management is to increase our risk-adjusted return on capital. We have developed and adopted extensive policies and procedures to identify, measure, monitor and manage credit risk at a reasonable level in order to achieve the stable growth of our business.

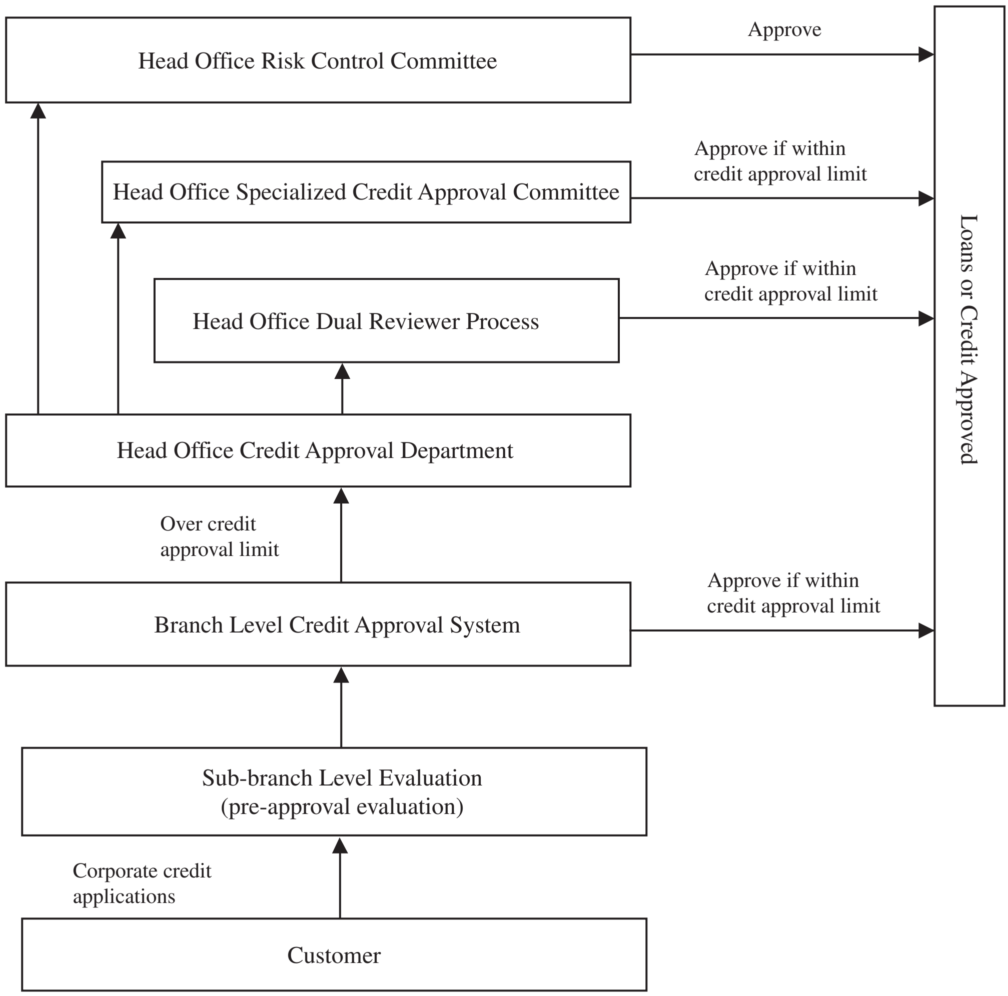
Our credit management system has the following features:

- strict separation of loan origination and credit approval to maintain the independence of our credit approval system;
- strict credit approval limits at each branch, which may vary from branch to branch depending on each branch's risk management capabilities;
- a capital allocation system that allocates capital based on the risk level of different businesses;
- clearly defined credit risk management responsibilities assigned to each relevant operating unit and specific risk management personnel and strict disciplinary measures in response to violation of credit management policies; and
- continued supervision of our asset quality and post-disbursement inspection and monitoring of loans.

We publish annual credit policy guidelines, which contain policy statements regarding, among other things, the credit approval process, critical aspects of our credit risk management practices, customer classification and the industries that we intend to focus on. Because our branches are located in diverse regions in China with very different economic conditions and risk profiles, we allow our branches to formulate local credit extension practice guidelines, which may deviate from the general framework of the guidelines to a limited extent. Local credit extension practice guidelines must be approved by the head office. In addition, we use credit monitoring indicators, such as the non-performing loan ratio and the exposure to the largest borrower as a percentage of regulatory capital, to evaluate our loan portfolio and credit approval process.

Credit Management for Corporate Loans

The following flow chart illustrates our general procedures for credit approval of corporate loans.



Credit Origination and Analysis

Credit Origination and Pre-approval Evaluation

Generally, our corporate loan departments at the sub-branch level initiate the corporate credit origination process by either interviewing credit applicants that approach us or soliciting potential creditworthy customers. A credit applicant that passes a preliminary screening by a relationship manager is asked to submit a formal credit application with supporting documents, including its and its guarantor's (if any) organizational documents, authorization documents, audited financial statements for the most recent two years and the most recent interim period, the valuation report of the collateral (if necessary) and other documents relating to the use of proceeds from the loan.

We typically assign two relationship managers to conduct a pre-approval evaluation by analyzing written documents submitted by the applicants and conducting on-site visits. The evaluation generally consists of:

- verifying the basic information and analyzing the management structure of the applicant, including business relationships between the applicant and its parent or affiliated companies;
- analyzing the financial condition and business operations of the applicant;
- evaluating the applicant's management strength;
- analyzing the planned use of loan proceeds and the source for loan repayment;
- requesting a valuation report of the collateral, if any, issued by an independent third-party appraiser approved by us;
- analyzing the financial condition and business operations of the guarantor, if any;
- analyzing the applicant's credit history, including any credit information obtained from the PBOC's credit information database;
- evaluating the future business prospect with the applicant; and
- for fixed asset project loans, evaluating the risk, return and cash flow of the underlying project.

In addition, our relationship managers may also consider industry risks associated with the corporate credit applicant, such as:

- government policies relating to the industry;
- industry characteristics, such as the importance of the industry to the economy, its growth outlook and cyclicality;
- the competitiveness of the industry; and
- financial and operating information relating to the industry, including return on capital, operating margins and earnings stability.

Our relationship managers are required to prepare a pre-approval evaluation report including the results of their quantitative and qualitative analyses. Such report and credit application materials are submitted for approval according to the credit approval procedure.

Credit Rating

We developed a corporate customer credit rating system in 1995 and have gradually expanded its use as part of our bank-wide corporate loan approval process. In 2002, we began to develop a new credit rating system in accordance with Basel II. In collaboration with Moody's Investor Service, we implemented our new credit rating system in 2005.

Our new credit rating system uses both scoring cards and a default model (for estimating the probability of default). The scores obtained from our scoring cards have exhibited a certain level of matching relationship with the probability of default obtained from the default model. Based on the scores, we give our corporate customers a rating from 1 to 10, each rating corresponding to a specific range of probability of default.

The following table sets forth our ten-level credit rating system (from 1 to 10, with 1 being the best), the corresponding credit scores and descriptions of the related financial condition represented by such ratings and the corresponding percentage of our total rated corporate credit applicants, customers and their guarantors at June 30, 2006 accounted for by each category.

Credit Rating	Credit Score	Description	% of Rated Customers and Guarantors
1	90-100	Perfect. There is no foreseeable negative factor that would materially affect the quality of the borrower's operations and financial condition.	0.41%
2	80-89	Excellent. It is unlikely that a negative factor would materially affect the borrower's operations and financial condition.	4.93
3	70-79	Very good. The borrower's current financial condition is very good, but it may be able to withstand only one to two years of economic depression.	19.06
4	60-69	Good. The borrower's current financial condition is good, but it may deteriorate if the borrower's operations experience unexpected difficulties, and the borrower may not be able to withstand economic depression.	31.08
5	50-59	Acceptable. The borrower's current financial condition can provide sufficient security for loan repayment, but it may face certain difficulties in the next one to two years that may affect its general repayment capability.	24.73
6	40-49	Barely acceptable. The borrower's current financial condition is barely acceptable, and it may rapidly and materially deteriorate even after a short period of operational difficulty.	12.17
7	30-39	Weak. The borrower's current financial condition is weak, and any operational difficulty may render it unable to repay the loan.	4.90
8	20-29	Very weak. The borrower's current financial condition is very weak, and it may not be able to survive even in the short term.	1.81
9	10-19	Extremely weak. The borrower's current financial condition is extremely weak, and it is very questionable that it can survive even in the short term.	0.79
10	0-9	Bankrupt or close to bankrupt.	0.12
			100.00%

Our credit rating system utilizes different scoring methods for companies operating in different industries, each with a corresponding scoring card. We calculate the credit scores for our credit applicants and their guarantors (if applicable) based on the industry in which they operate. We currently have nine industry categories. Our scoring cards also take into account the applicant's or guarantor's financial statements and other factors that in our experience affect their ability to repay the loan.

Our relationship managers initially assign the appropriate industry category for a corporate credit applicant or a guarantor (if applicable) and input the information obtained from the credit application into our computer system. Based on the information provided and the industry category assigned, the system calculates a credit score and the corresponding credit rating. Our relationship managers may suggest adjustment of the raw credit rating based on their knowledge of the creditworthiness of the applicant. The credit score, credit rating and the suggested adjustment, if any, are reviewed by our credit rating reviewer at the branches, who may adjust the credit score and credit rating. We generally re-rate each customer and guarantor on an annual basis. We may also re-rate the customer or guarantor when material changes in the general macroeconomic conditions, industry environment, or a customer's or guarantor's business operations and debt repayment history render it necessary to adjust the credit score and credit rating.

In general, we strive to rate most of our corporate credit applicants, borrowers and their guarantors. At June 30, 2006, we had rated a total of 13,762 of corporate entities, 80.2% of our customers and their guarantors we rated had credit ratings of five or better.

We are in the process of developing a facility rating system in collaboration with Moody's Investment Services to further improve our customer credit rating system in accordance with Basel II. This facility rating system, which we expect to launch in 2007, is designed to enable us to estimate loss on a given default. Our credit rating system and our facility rating system (upon completion) are expected to enhance our capabilities in respect of credit assessment, credit approval, loan pricing, credit management, allocation of economic capital and performance reviews and strengthen our ability to identify, measure, monitor and control credit risk.

Collateral Appraisal

For corporate credit applications that involve collateral, we generally require the value of collateral to be determined by an independent appraiser approved by us. Collateralized loans are generally subject to loan-to-value ratio limits based on the type of collateral. The maximum loan-to-value ratios of our principal types of collateral for corporate loans are as follows:

Principal Types of Collateral	General Maximum Loan-to-Value Ratio
Tangible Assets	
Residential real estate[(1)]	60%
Office buildings	50%
Other properties	40%
Monetary Assets	
Cash deposits	100% of principal and interest
Bank notes, government bonds and short-term bonds	90%
Bank acceptance bills	based on discount rate
Other monetary assets	<90% of market value

(1) Except corporate mortgage loans, which can be as high as 80%.

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

Credit Approval Procedures

Credit Approval Limits

We have a multi-tiered credit approval process, with credit applications approved at branches or the head office, depending on the credit amount. Set forth below is an overview of our credit approval limits:

- *Branch Level.* We grant branches different credit approval limits according to the economic condition in their local market, their credit management capacity and their asset quality. Our branches generally have a credit approval limit for short-term loans (*i.e.*, one year or less) from RMB40 million to RMB300 million for individual borrowers, from RMB80 million to RMB600 million for group companies, and from RMB20 million to RMB150 million for corporate acceptance bills discounting and corporate mortgage loans. The general manager of a branch has a veto right on credit applications approved at the branch.

- *Dual Reviewer Process in the Head Office.* Credit applications exceeding the credit approval limit of the originating branch but below that of the Specialized Credit Approval Committee are generally reviewed and approved by our dual reviewer process in the head office. Most of the discounted bills that exceed the credit approval limit of the originating branch are reviewed and approved by the dual reviewer process. The two reviewers consist of an experienced credit approval officer and a vice general manager or an assistant general manager of the Credit Approval Department. Both reviewers must approve the credit application, and the general manager of the Credit Approval Department can veto credit applications approved by the dual reviewer process.

- *Specialized Credit Approval Committee in the Head Office.* The Specialized Credit Approval Committee generally reviews short-term (*i.e.*, one year or less) credit applications exceeding the credit approval limit of the originating branch and over RMB200 million for individual borrowers. It also reviews all medium-term (*i.e.*, between one to three years) and long-term (*i.e.*, greater than three years) loan applications, as well as most credit applications from group companies that exceed the credit approval limit of the originating branch. The committee is composed of executive vice president in charge of credit risk and members in the general manager's office of the Credit Approval Department and the Credit Management Department. Credit approval by the Specialized Credit Approval Committee requires a three-fourths majority vote of its committee members at the credit approval meetings.

- *Risk Control Committee in the Head Office.* The Risk Control Committee is involved in the credit approval decision only when the loan application presents particularly complex issues or in special circumstances when there is a significant disagreement between the originating branch and the Specialized Credit Approval Committee on whether a credit application should be approved. Credit approval by the Risk Control Committee requires a majority vote of its committee members. See "— Risk Management Structure — Senior Management and its Committees — Risk Control Committee."

Our newly established branches must undergo six to twelve months of preparation under the guidance of the head office, and during this period they have no credit approval authority except for low-risk credit applications. We grant credit approval authority to newly established branches only after they have undergone such preparation and have passed inspection by the head office. Our branches currently do not have credit approval authority for certain types of high risk loans, such as loans to property developers and medium- to long-term loans.

General Credit Approval Procedures

Credit applications prepared by relationship managers are submitted to sub-branch management for review. Supplemental due diligence may be conducted if required by the sub-branch management. Credit applications approved by the sub-branch management are submitted for review and approval at the corresponding branch. If the credit application is for an amount exceeding the credit approval limit of the branch, or is of a type that the branch does not have any credit approval authority, the credit application is submitted to the Credit Approval Department in the head office for approval.

To develop credit review expertise, we established in February 2006 four industry-specific credit review offices within our Credit Approval Department, which reviews credit applications from an industry perspective. The reviewers from the industry-specific credit review offices issue review reports for the credit applications. Based on the type and amount requested in the credit application, the credit application is submitted for review and approval by either the dual reviewer process or the Specialized Credit Approval Committee. We believe industry-specific credit review enables us to better recognize credit risks in different industries and improves the efficiency of our credit review process.

Processing of Loan Documents and Disbursement

We have established procedures for processing loan documents, including guidelines for preparing, executing, categorizing and filing such documents. Substantially all of our loan documents are either prepared based on our standard forms or are agreements that have been reviewed by our legal personnel. The branch disbursement centers are responsible for disbursing the funds. The disbursement centers examine the documents to ensure that they have been validly authorized and properly completed before disbursing the funds. The disbursement centers are also responsible for categorization, storing and managing the loan documents and for entering the relevant information into our credit management information system. For certain loans directly processed at the head office, our Head Office Banking Department is responsible for disbursement.

Post-disbursement Management

Loan Classification

Commercial banks in China are required by the CBRC to classify their outstanding loans based on the five-category classification system initially established by the PBOC (*i.e.*, normal, special mention, substandard, doubtful and loss) and report the classification data to the CBRC on a monthly basis. We classify our loans into these five categories and report such classification data monthly to the CBRC. Since September 2005, solely for internal risk management purposes, we have introduced two sub-categories for loans classified as normal, namely, excellent and good, and two sub-categories for loans classified as special mention, namely, general mention and particular mention. Solely for credit risk management purposes, we plan to sub-classify our loans into additional sub-categories to enable us to more accurately judge the quality of our loan portfolio and better manage our credit risk.

Our relationship managers classify outstanding loans based primarily on the borrower's repayment ability, giving consideration to other factors such as guarantees, collateral and length of any overdue period. Sub-branches and branches collect, examine and verify such classifications and report such information to the Credit Management Department. The Credit Management Department may, based on its knowledge and information obtained from loan monitoring and other channels, request branches to adjust the classification. The Credit Management Department ensures that the classification system is uniformly applied across our bank and compiles the bank-wide loan classification data. We review the information on loan downgrades monthly and adjust provisions accordingly, and conduct re-classification for all corporate loans quarterly. In respect of certain significant loans, we may adjust the classification as appropriate based on information obtained from post-disbursement inspections.

Post-disbursement Inspection

We conduct periodic post-disbursement inspections in respect of our loans in order to timely identify potential risks associated with our outstanding loans and take corrective measures to reduce the default risk. Typically, our relationship managers seek to verify the use of proceeds of a loan within one week following disbursement to ensure that the proceeds are applied or used in accordance with the credit application. The frequency of subsequent post-disbursement inspections may vary, depending on the classification of loans, ranging from semiannual inspections for loans internally classified as excellent to monthly inspections for loans classified as particular mention. For non-performing loans, the frequency of inspections can be higher depending on circumstances.

The scope of our inspection includes analysis of the customer's financial statements, business operations and project progress and evaluation of the customer's sources and ability for loan repayment. In addition, we closely monitor any significant changes in the customer's management or products or any development in respect of legal proceedings and evaluate the impact of such changes or developments to the customer's financial condition. We also monitor the creditworthiness of guarantors of the loans, including their financial condition, their ability and qualification to meet their obligations under the guarantees and any related legal documents. In respect of collateral, we examine characteristics such as ownership and physical form and conduct internal evaluations in connection with loan classification. Relationship managers are generally required to submit post-disbursement inspection reports to the branch credit management department.

For significant loans or loans with potential risk of default, the credit management departments of the head office and branches send an inspection team to the borrower to conduct an independent inspection of the borrower's operations and financial condition. The direct inspection process enables us to obtain timely and detailed information of our potentially risky loans and closely monitor our significant loans to detect signs of potential risk early in the process.

Risk Alert and Monitoring

We obtain information regarding our loan customers from various sources, including regulatory authorities, industry reports, research analysts reports, third-party communications, consulting firms, media and other sources. When we have information about a particular industry or customer that may adversely affect a customer's ability to repay the loan, we generally disseminate such information as soon as practicable to relevant departments within our bank through telephone, email, intranet information bulletin board and other channels and take timely precautionary measures, including limiting our future credit extension to a particular industry or customer.

Loan Repayment

We use our credit management information system to monitor the repayment of our corporate loans. Through this system, we are able to obtain information such as the maturity date, overdue status, repayment schedule and accrued interest of the loans. For overdue loans, we require our relationship managers to analyze the reasons for the loans becoming overdue and consider remedial measures, and submit such overdue loan analysis report and all the post-disbursement inspection reports to the Credit Management Department for review and monitoring. Our relationship managers seek to closely follow the financial and business condition of the customers with overdue loans and take timely measures to reduce the extent of impairment of the overdue loans.

Management and Collection of Non-performing Loans

We currently determine non-performing loans according to the five-category classification system and classify substandard loans or lower as non-performing loans in accordance with the CBRC requirements. Our Credit Management Department is responsible for the management, coordination, monitoring and analysis of the non-performing loans, and our Special Assets Management Center is responsible for matters relating to the collection or restructuring of, arbitration or litigation relating to, or auction, lease, transfer or other disposition of non-performing loans.

To recover on non-performing loans, we generally take, to the extent necessary, the following actions: (1) issue a collection notice, (2) seek to restructure the non-performing loan, (3) enforce our rights in respect of the collateral or guarantees, and (4) initiate litigation or arbitration proceedings to collect on the loan. In the event that we are unsuccessful in making any recovery, we generally write off the asset in accordance with relevant MOF regulations.

Collection Notice. We notify non-performing loan borrowers and guarantors, if applicable, of payment default by telephone, in writing or in person. If we are not able to collect on a non-performing loan within a reasonable time after collection notice has been given, depending on the specific circumstance of the borrowers, we may choose to restructure the loan, initiate proceedings to enforce our rights in respect of the collateral or guarantee (if any), or commence litigation or arbitration proceedings to collect on the loan.

Restructuring of Non-performing Loans. Restructuring of non-performing loans generally involves negotiating amendments to the original terms of the loan, including extending the maturity or requiring additional collateral or guarantees. The restructuring of any non-performing loan is subject to the regular credit approval procedure. In restructuring non-performing loans, we may also agree to substitute a new borrower or guarantor for the original borrower or guarantor, as the case may be. For restructured non-performing loans, we generally maintain its old classification for an observation period of six months. If the restructured principal and interest payments are current throughout the observation period, and the borrower's operations and its loan repayment ability have materially improved, we then re-classify the loan after such observation period. If the borrower is delinquent in paying the restructured principal or interest, we downgrade the loan to doubtful or lower. Interest accrues in the same way on restructured loans during the observation period as on other loans.

Collecting on Collateral or Guarantees. If we are unable to obtain repayment of the loan from the borrower, and if the borrower has ceased operations or its financial condition has deteriorated, we may decide to collect on the collateral securing the loan or make a demand for payment under the guarantee, as the case may be. We obtain an independent valuation on any collateral we collect. We typically liquidate the collateral through public auctions to maximize our cash recovery.

Collection through Litigation or Arbitration Proceedings. We typically commence litigation or arbitration proceedings against the borrower or the guarantor, as the case may be, to collect on the non-performing loans if the borrower or the guarantor, as the case may be, does not demonstrate an intention to repay, is involved in other major legal proceedings that could threaten our ability to collect or exhibits other characteristics or takes other actions that could compromise our ability to obtain repayment of the loan.

Write-offs. We write off a loan classified as a loss once we have exhausted all means of collection and recovery and such loan meets the relevant regulations for write-offs established by the MOF. All corporate loan write-offs must be reviewed first by the Credit Management Department and then by the senior management. If the amount involved for loans made to a single borrower equals to or exceeds RMB30 million, the Board of Directors must approve such write-off. Even after we have written off a loan, we generally continue to pursue our recovery efforts on that loan and have dedicated substantial resources at both the branch and head office level to continue to manage and collect the written-off loans.

Credit Risk Management Involving International Banking, Offshore Banking and Financial Institutions Customers

Our credit approval procedures for international banking and offshore banking customers are similar to those for regular corporate customers.

Upon request by the branches or the Financial Institutions Department at the head office, a financial institution customer is generally extended a credit line in accordance with our credit approval procedures. According to the needs of our business, the Financial Institutions Department at the head office allocates the appropriate credit approval limit such credit line to the Planning and Finance Department, the Treasury Trading Department and the branches. The Financial Institutions Department, within its authority, is also responsible for monitoring the use of such credit allocation.

Credit Risk Management for Non-credit Card Related Retail Loans

Our non-credit card related retail loans are primarily residential mortgage loans, automobile loans, general consumption loans and education loans.

Credit Origination, Analysis and Approval

We require all of our non-credit card related retail loan applicants to complete applications containing the applicants' basic information, including sources of income, employment, bank account and credit history. Our relationship managers are responsible for verifying such information and obtaining supporting documents. If collateral is involved, our relationship managers are also responsible for verifying the value of the collateral by requesting appraisal reports issued by third-party appraisers approved by us. We generally extend residential mortgage loans in an amount no more than 80% of the purchase price of a residential property, and we generally extend automobile loans in an amount no more than 80% of the purchase price of an automobile.

As part of our credit approval process, we check our applicants' credit information in the PBOC's national credit information database. For applicants in Shanghai and Shenzhen, we also check the information collected by the respective local credit bureau. An evaluation report is prepared by the relationship manager, which, if favorable, is submitted along with the supporting documents for approval similar to the procedure for corporate loans.

Disbursement and Post-Disbursement Management

The procedures for disbursement of non-credit card retail loans are similar to those for corporate loans. We conduct post-disbursement inspections of our non-credit card retail loans. We closely monitor the loan repayment progress and manage the collection after payment default. Collection of our non-performing non-credit card related retail loans is conducted by our sub-branches. Beginning in the second half of 2005, we utilize our call center to collect retail loans in default. Compared with loan collection through our branches and sub-branches, loan collection through our call center has generated significant savings in personnel and other costs and improved collection efficiency.

We also classify retail loans into five categories, which is based on the number of days by which the loans are overdue. See "Assets and Liabilities — Assets — Asset Quality of Our Loan Portfolio — Loan Classification Criteria." As with corporate loans, we have introduced two sub-categories for loans classified as normal, namely, excellent and good, and two sub-categories for loans classified as special mention, namely, general mention and particular mention, solely for internal credit risk management purposes. Our Retail Banking Department conducts statistical analysis and compiles a monthly table summarizing such data and uses such information to evaluate the overall quality of our non-credit card retail loan portfolio. See "Assets and Liabilities — Assets — Asset Quality of Our Loan Portfolio."

Credit Risk Management for Credit Card Loans

Our Credit Card Center in Shanghai has the authority to approve credit card applications. Similar to applicants for our other retail loans, applicants for our credit cards are required to complete applications containing basic information about the applicants. The applications are submitted for processing to our Credit Card Center or one of our branch office credit card departments in Beijing, Shenzhen or Guangzhou. In evaluating credit card applications, the Credit Card Center and the credit card departments primarily consider such factors as an applicant's monthly income, stability of income, profession and credit information obtained from the PBOC's national credit information database, if available. For applicants in Shanghai and Shenzhen, we also check the information collected by the respective local credit bureau.

We generally provide credit lines corresponding to the assets, cash flow, income and creditworthiness of the applicant. We utilize different criteria in different regions in our credit approval process to account for differences in demographics, consumer spending habits and economic development.

We classify credit card balances in accordance with the five-category classification system, which is based on the length of the period during which the minimum payment is overdue. See "Assets and Liabilities — Assets — Asset Quality of Our Loan Portfolio — Loan Classification Criteria." Solely for internal risk management purposes, we have introduced sub-categories for loans in the normal category. We monitor the classification as part of our risk management for our credit card business.

Customers who fail to make the minimum payment on time are sent a delinquency notice. The risk management departments at our Credit Card Center generally take actions to collect balances that are overdue for less than 60 days. For credit card balances that are overdue for more than 60 days, we suspend the credit card and use a combination of methods to collect the outstanding balances, including mail, legal notices and legal proceedings. We write off credit card loans based on relevant regulations enacted by the MOF and our internal rules.

Credit Risk Management for Treasury Operations

Our treasury operations are exposed to credit risk through our investment activities and inter-bank lending activities. We generally establish a maximum credit line for each customer in our treasury business in accordance with our credit approval procedures, and our Planning and Finance Department and Treasury Department conduct treasury operations within such limit. Our Renminbi-denominated investment portfolio consists of securities issued by the PRC government, the PBOC and other domestic financial institutions and a small amount of commercial paper issued by non-financial institutions. Our foreign currency-denominated investment portfolio consists of investment-grade bonds and, to a lesser extent, corporate bonds issued by PRC companies.

LIQUIDITY RISK MANAGEMENT

Liquidity risk is the risk of being unable to liquidate a position in a timely manner at a reasonable price to fund our obligations. We are exposed to liquidity risk primarily in the funding of our lending, trading and investment activities, as well as in the management of our liquidity positions. Our objective in liquidity management is to formulate and implement prudent liquidity risk management policies according to the principle of balancing liquidity, stability and profitability to maintain an appropriate balance of assets and liabilities. Through optimizing asset allocation and employing a flexible funding strategy, we seek to meet the need for deposit withdrawal by our customers, to fulfill obligations for loan disbursement to our customers, to obtain repayment of our debts when they become due and to establish new asset portfolios when it is advantageous for us to do so.

Our Assets and Liabilities Management Committee is the senior management body responsible for the overall management of liquidity risk. The committee studies the impact of macroeconomic developments on our assets and liabilities and establishes and implements related strategies and policies. We have also established a liquidity emergency response committee as our highest decision-making body to handle liquidity emergency situations in order for us to maintain an orderly and effective operation under such emergency situations.

Our Planning and Finance Department conducts day-to-day liquidity risk management, monitors and analyzes the daily, monthly and quarterly liquidity indicators, and makes liquidity risk management decisions within its authorization. The department sets ratio requirements and transaction value limits based on the assets and liabilities of the entire bank, such as loan-to-deposit ratios and ratios for surplus deposit reserves. In establishing ratios for surplus deposit reserves, the department analyzes historical assets and liabilities fluctuation patterns and determines the required ratios based on certain confidence levels. The department also establishes guidance ratios based on the specific conditions of each branch as guidelines for such branch. The department has established a liquidity alert system and monitors on a daily basis the liquidity position of each branch through a liquidity management system.

The assets and liabilities management committees in the branches and their planning and finance departments provide liquidity risk management functions for the branches. They generally establish branch liquidity risk management policies based on the requirements from the head office and their specific conditions and monitor liquidity related ratios within the branch. Our internal fund transfer system enables our branches to rapidly and effectively adjust their liquidity positions. To provide an additional layer of protection against liquidity risk, we authorize certain branches to obtain funding locally through inter-bank borrowing.

We manage our liquidity risk through the following methods:

- *Improving the structure of our assets and liabilities*. We seek to develop stable and high-quality corporate and retail deposit customers, and maintain an appropriate proportion of our assets in highly liquid discounted bills.
- *Centralizing our liquidity management*. We move funds internally through a pricing mechanism using internal interest rates to meet the liquidity needs of each branch and sub-branch. We have begun to use FTP as a pricing mechanism in our internal transfer of foreign currency denominated funds to enable us to implement a centralized internal fund management system.
- *Establishing a liquidity alert system*. Our liquidity alert system, which was established in 2005, enables us to perform daily monitoring of dozens of key operational ratios and market indicators.
- *Broadening funding sources*. In addition to customer deposits and borrowings from the PBOC open market, inter-bank money market, inter-bank discounted bills market, we started issuing debt securities in 2005 to provide us with a source of lower-cost funding. Our shareholders have authorized management at a shareholders' general meeting in May 2006 to issue additional debt securities based on a set percentage of our liabilities within the next three years.

We implemented the ALM system in June 2004. In the first quarter of 2005, we began to use the ALM system to assist us in managing our liquidity risk. Our ALM system enhances our ability to measure and monitor our liquidity gap and liquidity ratios and perform liquidity scenario analysis and stress testing. We adopted methodologies used by the HKMA, which we modified to fit our needs, in our design of scenarios for stress testing. Through our ALM system, we collect liquidity related data on our assets and liabilities positions and perform various quantitative analyses on a regular basis.

MARKET RISK MANAGEMENT

Market risk is the risk that values of our assets and liabilities or net income will be adversely affected by changes in market conditions. Such risk may arise from movements in market variables such as interest rates, exchange rates, equity prices and commodity prices and other market changes that affect market risk-sensitive instruments. Market-risk sensitive assets and liabilities are generated through, among other things, loans and deposits associated with our traditional banking businesses as well as our treasury operations.

We are exposed to market risk in respect of our investment and trading portfolio and our banking portfolio. The primary market risk associated with our investment and trading portfolio businesses is the fluctuation of market values of our trading and investment positions, which are affected by numerous market factors, including interest rates and exchange rates. The primary market risks associated with our non-trading businesses are interest rate risk and exchange rate risk. We set different exposure limits to manage the different types of market risk in our investment and trading portfolio and banking portfolio and have started to use different quantitative measures to help us manage market risk.

Our Assets and Liabilities Management Committee is responsible for the overall management of market risk, including establishing strategies and policies for market risk management. Our Planning and Finance Department, under the supervision of the Assets and Liabilities Committee, establishes our market risk management guidelines, grants treasury trading authorizations, sets market risk exposure limits regarding our investment and trading portfolio and supervises their implementation. Our market risk management objective is to manage such risk at a reasonable level to achieve a maximum risk-adjusted return on capital.

Historically, our exposure to significant market risk was limited because interest rates and exchange rates were controlled and set by the PRC government. See "Regulation and Supervision — PRC Regulation and Supervision — Pricing of Products and Services." As the PRC government has gradually liberalized China's interest rate and exchange rate regimes, and as the financial services sector in China has become more market-oriented, we have increasingly become subject to market risk.

Interest Rate Risk Management

Interest rate risk is the exposure of a bank's financial condition to adverse fluctuations in interest rates. The primary interest rate risk for us is the mismatch in the maturity or re-pricing periods of our banking portfolio. Mismatches may cause net interest income or the market value of our assets to be affected by changes in the prevailing level of interest rates.

Commencing in June 2005, we have begun to use quantitative measures such as gap analysis, duration analysis and scenario analysis to monitor our interest risk on our entire assets and liabilities portfolio. Our ALM system enables us to conduct these analyses at a regular or ad-hoc basis.

We have also begun to use earnings-at-risk, or EaR, to monitor our interest risk since June 2005. EaR refers to the maximum income loss within a set period based on a set confidence level due to fluctuations in the market environment. It is generally used to measure interest rate risk on assets and liabilities of the banking book.

The short-term objective of our interest rate risk management is to increase our net interest income, and our long-term objective is to increase market value of our assets. We monitor and analyze the domestic and international interest rate environment and manage our interest rate risk based on such analysis.

We also manage our interest rate risk exposure by adjusting the various components of our assets and liabilities. In addition, we conduct certain derivative transactions to reduce our exposure to interest rate risk.

Exchange Rate Risk Management

Exchange rate risk primarily results from mismatches in the currency denomination of our assets and liabilities and mismatches in our currency position resulting from foreign currency transactions both for our own account and on behalf of our customers. We are exposed to exchange rate risk because we hold loans, deposits, securities and financial derivatives that are denominated in currencies other than the RMB. We manage our exchange rate risk by seeking to match our lending and borrowing on a currency-by-currency basis, by performing timely back-to-back transactions to limit our open positions, and by performing hedging activities in the currency exchange markets. In addition, we mitigate exchange rate risk by establishing exposure limits and stop-loss limits.

We have been paying particular attention to the exchange rate relating to Renminbi, as there has been, and continues to be, widespread speculation on the appreciation of Renminbi against the U.S. dollar. Historically, we have cleared our positions on the day following the transaction on our open positions arising from foreign exchange services between Renminbi and major foreign currencies. In anticipation of a possible appreciation of Renminbi, in June 2005, we changed this practice and started to clear our positions on the same day, which, along with our strict control on foreign currency exposure limits and the strict requirement that foreign currency-denominated collateral has sufficient value, enabled us to significantly limit our loss in association with the approximate 2% appreciation of Renminbi against the U.S. dollar in July 2005.

Market Risk Management in Our Investment and Trading Portfolio

Our Planning and Finance Department is primarily responsible for market risk management in our trading businesses. It grants authorization limits with regard to transaction type and transaction volume conducted by our Treasury Department and branches. It also publishes and updates annually market risk management guidelines and monitors their implementation.

We establish limits on concentration ratio, duration, price value of a basis point, exposure and stop-loss limit to manage our market risk associated with our investment and trading portfolio. We have also started to use on a trial basis certain quantitative measures to manage our market risk. In the first quarter of 2004, we started to conduct duration analysis, and in the first quarter of 2005, we started to conduct gap analysis and sensitivity analysis. We introduced a treasury trading and risk management system in the second quarter of 2005, which was aimed at enhancing our ability to conduct such quantitative analyses. We monitor daily our market risk associated with our investment and trading portfolio, and periodically re-evaluate our positions according to the market value.

OPERATIONAL RISK MANAGEMENT

Operational risk is the risk of loss resulting from inadequate or failed internal control procedures and systems from human error, fraud or from external events. We are exposed to many types of operational risks in our business.

Incidents of Operational Breaches and Regulatory Non-compliance

From 2003 to 2005, there were in total nine reported criminal incidents involving operational breaches by our employees. Four of the incidents occurred in 2003 with a total amount of RMB4.40 million. Three of the incidents occurred in 2004 with a total amount of RMB1.14 million. The remaining two incidents occurred in 2005 with a total amount of RMB0.41 million. The total amount involved in these nine incidents was approximately RMB5.95 million.

Among these nine incidents, three involved embezzlement of funds with a total amount of RMB2.37 million, two involved theft of bank assets with a total amount of RMB2.18 million, two involved theft of customer deposits with a total amount of RMB1.13 million, one involved credit card fraud with an amount of RMB0.27 million, and one involved an internal and external connected fraud that was detected and stopped before its occurrence. Seven of the nine incidents occurred at the sub-branch level, one at the head office and one at the credit card center.

Some of these incidents implicated potential internal control weakness at certain of our business units. However, these incidents, individual or in aggregate, have not had a material adverse effect on our business, financial condition or results of operations. We have implemented corrective measures intended to reduce the risk of similar breaches occurring in the future.

In addition, we have been found to be not in compliance with certain PRC regulations. See "Business — Legal and Administrative Proceedings — Administrative Proceedings." We are also a party to certain legal proceedings involving our offshore business that may implicate internal control weakness in respect of certain loans made in the late 1990s. See "Business — Legal and Administrative Proceedings — Legal Proceedings."

Management of Our Operational Risk

We have established operational risk management policies and procedures, and we conduct regular bank-wide inspections on the implementation of these policies and procedures. In addition, each of our departments and branches is responsible for the implementation of the policies and procedures within the department or the branch, and for the identification, evaluation and control of its own operational risk.

In 2005, we formulated plans on operational risk management according to the requirements under Basel II. Under these plans, we seek to improve our operational risk management by further streamlining our operational risk management organizational structure, enhancing our internal analysis and assessment system regarding operational risk management, developing and implementing operational risk management measurement and alert system and optimizing the current operational process of the front-, middle- and back-offices.

We have formed an anti-money-laundering committee to manage our anti-money-laundering related matters and have established a system to monitor and report any suspicious transactions. Our Legal and Compliance Department is in charge of compliance with the anti-money-laundering laws and regulations as well as other compliance issues to reduce such risk.

We have established the Internal Control Review Committee to review our internal control system, which organizes quarterly meetings to discuss policies and significant developments in the management of operational risks and past incidents of operational breaches, suggest any improvement measures and supervise their implementation. The branches and sub-branches have also established internal control review processes to identify and resolve internal control deficiencies and breaches within the branch or sub-branch and suggest improvement measures. Due to recent frequent incidents occurring in China's banking industry, we have further enhanced our inspection and monitoring efforts, especially in our operating units. We have taken a number of measures to improve operational risk management, including, among other things, implementing special initiatives to identify and prevent employee fraud throughout the bank, enacting and refining internal rules and guidelines, and reforming our rules and procedures for supervising and reviewing accounting personnel.

We have also established an independent internal audit system to conduct periodic internal audits on our implementation of risk management regulations, including operational risk management regulations. See "— Internal Audit."

We have implemented the following initiatives to monitor and control operational risks:

- delineated responsibilities among our departments and segregated positions with potential conflicts of interest to establish checks and balances in our operating processes;
- implemented an operational risk detection and review system in the development of new products and services;
- established an authorization and approval system at each management level and operation stage and enforced strict management accountability;
- implemented a mandatory rotation system for key positions;
- adopted a code of conduct with strict disciplinary measures for employee misconduct;
- provided a reporting channel for violations and abnormal conduct or incidents;
- established an emergency system including a disaster recovery center in Nanjing, which backs up the major data relating to our operations to enable us to carry on vital operations and provide limited services in case of catastrophic disasters or accidents.
- devised a comprehensive training scheme to ensure that the employees are properly trained;
- established a system to identify and correct defects in our operational risk management; and
- strengthened the management, control and supervision of operational risk at the branches and the sub-branches.

We emphasize the importance of education to our management of operational risk. We conduct annual and semiannual training sessions for senior management personnel, including branch presidents and department general managers in the head office, and we have compiled a comprehensive internal control handbook for use in our various bank-wide internal training programs.

We were the first commercial bank in China to obtain certification of the ISO9000 international quality management standards system based on the International Organization for Standardization. We obtained the ISO9001: 1994 certification in 1997 in respect of our deposit-taking services in Shenzhen. In 2005, we obtained ISO9001:2000 certification for our head office and most of our branches in respect of the design of retail banking services and the provision of certain banking services including retail banking, accounting process and settlement. ISO9000 certification has enabled us to standardize our management processes and better manage our operational risk.

INTERNAL AUDIT

We recognize the importance of an independent internal audit function to the successful operation of our business.

Our Audit and Supervision Department (which reports directly to the Office of the President and the Audit and Supervision Management Committee) is responsible for conducting our audit. It directly manages four regional offices in Beijing, Shanghai, Shenzhen and Xi'an. The department is managed independently from our business departments that it audits to ensure the independence and integrity of the auditing process. The Auditing and Supervision Department also reports periodically to our Board of Directors and Board of Supervisors. To improve corporate governance, we have six independent directors and two outside supervisors, and we have established committees within the Board of Directors and the Board of Supervisors to supervise our internal audits.

We have adopted guidelines that set forth the procedures and scope of internal audits. In recent years, our Audit and Supervision Department has conducted annual bank-wide comprehensive examinations on our credit, treasury, accounting, finance and retail banking business as well as the integrity of our computer system. Our annual audit covers our branches and sub-branches. During the audit process, we particularly focus on:

- compliance with all applicable laws, regulations and internal policies and guidelines relating to auditing;
- effectiveness of our risk management policies and procedures;
- scope and effectiveness of our internal control systems; and
- supervision and post-audit monitoring of the progress of the issues identified during the audit process.

We emphasize the implementation of corrective measures for deficiencies identified through our internal audits. The business unit with the identified deficiencies and the department in the branch or head office that directly manages the business unit are responsible for implementing such corrective measures. We consider the results of our audit and the implementation of corrective measures, if any, in our performance review of the branches and sub-branches.