OVERVIEW

We seek to establish an independent, comprehensive and dedicated risk management system with a vertical reporting line and develop a risk management culture with an emphasis on maximizing risk-adjusted returns. To this end, we implemented a risk management strategy focusing on "high quality industries and high quality enterprises" and "mainstream markets and mainstream customers" and seek to proactively manage credit, liquidity, market and operational risks at all levels and aspects of our operations. We have undertaken the following initiatives in an effort to establish a prudent risk management system:

- In 1999, we revamped corporate credit extension procedures and centralized the credit approval of a majority of our corporate loans at our head office and established the positions of trained personnel that are dedicated to the administration and recovery of non-performing loans. We also developed a corporate credit rating system with assistance from McKinsey & Co and implemented such system throughout our bank.
- In 2003, we centralized the appointment of the heads of credit assessment units of our branches at our head office, established the positions of product managers who have knowledge and experience in identifying credit risk and strengthened our credit investigation process, and established disbursement centers to reduce operational risks during the loan disbursement process.
- In 2004, we established the position of chief risk officer and were the first PRC commercial bank which centralized the appointment of risk managers at all branches, who oversee risk management at their branches and report directly to the chief risk officer.
- Between late 2004 and early 2005, in an effort to strengthen our control over the entire credit extension process and enhance the independence of our risk management function, we revamped the credit extension procedures to the effect that (i) our risk management department began to centrally manage the functions of our disbursement centers and post-disbursement loan management processes in addition to the credit approval function, (ii) we began to require all credit extensions to be approved by the relevant credit approval committee and limit the credit approval power of our president and branch general managers to veto power only, (iii) we established the position of dedicated credit approval officers, and (iv) we began to impose first-in-line responsibility on the credit investigation team, consisting of a relationship manager and a product manager, in credit extension and post disbursement loan management processes.
- Since 2005, in an effort to meet Basel II requirements, we have been developing a new corporate credit rating system with the assistance from Moody's KMV. We believe this system, which consists of 21 default probability scoring models based on customer type and one general default probability econometric model, is a leading corporate credit rating system among those used by PRC commercial banks in terms of industry segmentation and default probability measurement. This system would enable us to quantify the probability of default and loss given default and is expected to meet the requirements of internal rating based approach in three years. During the same period, we also developed a corporate credit management system in an effort to further computerize, and provide more control and information sharing for, the credit extension process. We have implemented this system on a pilot basis as of the date of this prospectus.
- In 2006, (i) in an effort to proactively manage our credit risk, we implemented a strategy focusing on "high quality industries and high quality enterprises" and "mainstream markets and mainstream customers" and adjusted the structure of our loan portfolio by industry, product and customer, (ii) in an effort to strengthen the management of our credit, market and operational risks, we established subcommittees under our head-office risk management committee dedicated to managing each of credit, market and operational risks, (iii) in an effort to enhance our decision-making abilities in credit extension process, we assembled a team of in-house and outside experts to strengthen our credit extension policies for target industries, and (iv) we began to promote on a bank-wide basis the concept of risk-adjusted returns and assess the performance of our tier one branches by calculating and allocating economic capital based on regulatory capital.

The asset quality of our loan portfolio has improved in recently years. We believe the implementation of the above initiatives as part of our continuous effort to enhance our risk management function over recent years has contributed to the improvement in our asset quality. For details on the changes in our asset quality, see "Assets and Liabilities — Assets — Asset Quality of Our Loan Portfolio". See, however, "Risk Factors — Risks Relating to Our Business — We cannot assure you that our risk management and internal control policies and procedures can adequately control or protect us against credit and other risks."

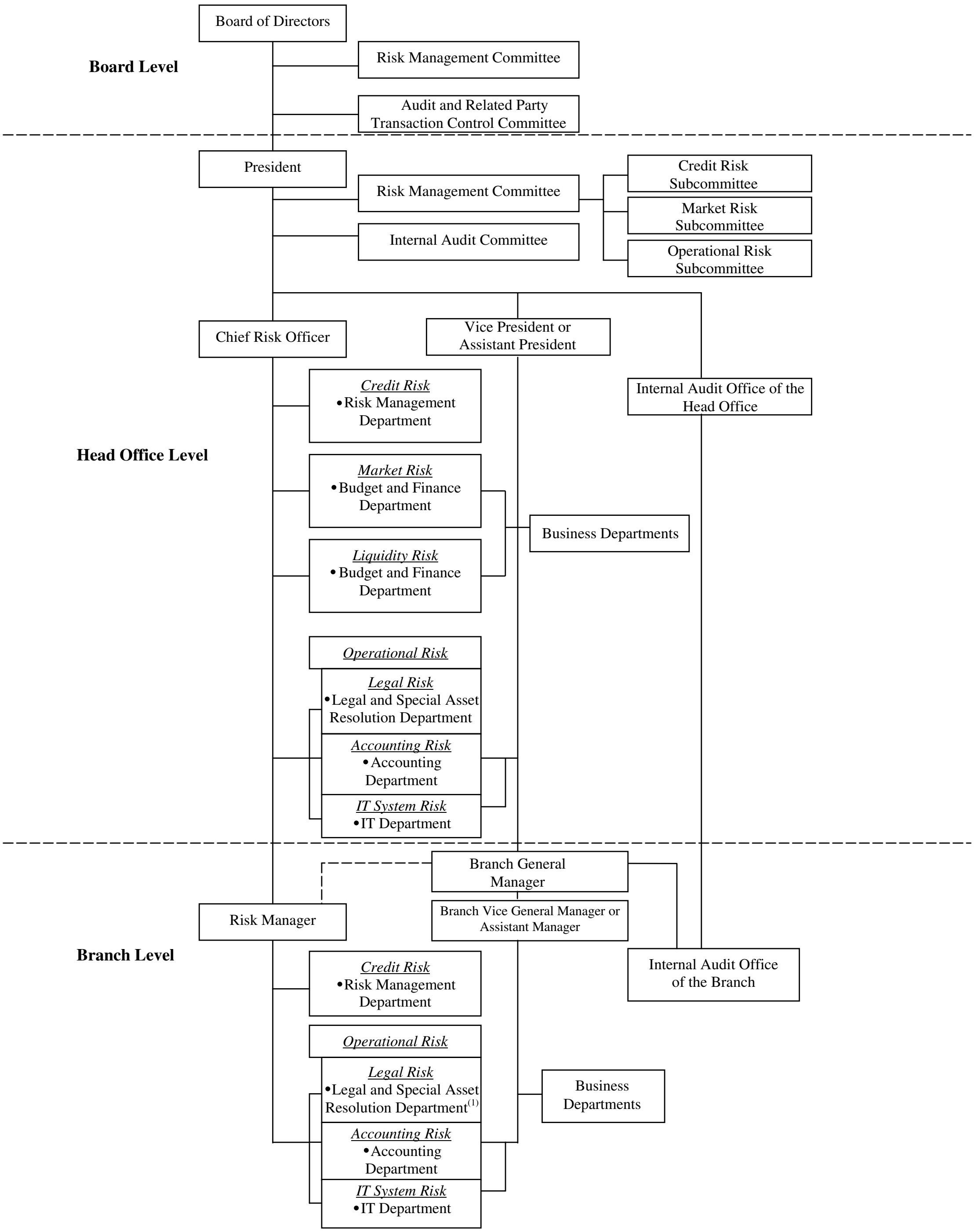
RISK MANAGEMENT CULTURE

We seek to cultivate a corporate culture that focuses on maximizing risk-adjusted returns and develop a management philosophy consisting of three components: prudence, compliance and reputation. We believe such corporate culture will contribute to a work environment that fosters a prudent risk management and a higher level of employee awareness of risk management issues. Key aspects of the risk management culture we seek to cultivate include:

- *A culture of striving for prudent growth.* We have introduced a performance assessment program based on the concept of economic capital to increase awareness of capital constraint and risk management in general. We endeavour to educate our employees to avoid "blind pursuit" of higher growth rate and larger portfolio size, but strive to achieve a balanced growth among profit, asset quality and portfolio size.
- *A culture of compliance.* We seek to foster a culture of compliance with laws, regulatory regulations, and our internal policies and procedures in all aspects of our business operations by continuously improving our rules and regulations and strengthening our accountability system.
- *A culture that values our reputation.* With a view to fostering a corporate culture that values our reputation and adds value to our bank, we seek to promote the long-term interests of our shareholders, society and our employees, instead of focusing on short-term profits.

RISK MANAGEMENT REPORTING LINE STRUCTURE

The chart below illustrates the primary reporting line structure of our risk management function.



(1) Some of our branches do not have a legal and special asset resolution department. For such branches, we have trained personnel who specialize in the administration and recovery of non-performing assets at the branch risk management department.

Board Level

Risk Management Committee

The risk management committee of the board of directors is composed of five members, including two independent directors. It reports to the board of directors and its primary responsibilities include, among other things, the following:

- supervising and evaluating the state of affairs in the management of various types of risk, including credit, market and operational risks, by our senior management;
- reviewing the procedures and performance of the internal audit department;
- performing periodic risk assessment; and
- proposing suggestions to improve our risk management and internal controls.

Audit and Related Party Transaction Control Committee

The audit and related party transaction control committee is composed of six members, including five independent directors, one of them serves as chairman of the committee. The audit and related party transaction control committee reports to the board of directors and is mainly responsible for, among other things, the following:

- recommending the hiring or firing of the external auditor;
- reviewing our internal audit policies and procedures and supervising their implementation;
- facilitating the communication between the internal and external auditors;
- reviewing our financial information and disclosure;
- reviewing our internal control policies;
- identifying our related parties and disclosing such parties to our board of supervisors, board of directors and other relevant personnel;
- preliminarily reviewing the related party transactions required to be approved by the board of directors, and submitting its reviews to the board of directors; and
- reviewing or filing the related party transactions within the authorization limit of the board of directors.

Head Office Level

Risk Management Committee

The risk management committee at our head office is responsible for making decisions on significant risk management issues of our bank, including setting and approving risk management policies and procedures and monitoring their implementation, and supervising the risk management committees and risk managers at our branches. The committee also makes certain significant operating decisions such as approving loan write-offs. Our risk management committee consists of members from our senior management, risk management department, business departments and other relevant departments, with the president of our bank as chairman and our chief risk officer as vice chairman.

In April 2006, in an effort to increase efficiency, we established three subcommittees under the risk management committee to focus on credit risk, market risk and operational risk, respectively. As a result, a significant portion of the committee's powers and responsibilities have been delegated to each of the subcommittees. The subcommittees will bring to the attention of the risk management committee on the risk management issues which exceed the authorized limit of the subcommittees.

The credit risk subcommittee, chaired by our chief risk officer, is responsible for formulating credit policies and credit risk management procedures of the bank. The credit approval committee under the credit risk subcommittee is generally responsible for approving credit applications for loans (other than low risk loans) of RMB 100 million or more. The credit risk subcommittee is only responsible for approving (i) loans of RMB 1.5 billion or more to any single borrower; (ii) loans of RMB 2.0 billion or more to any group borrower; (iii) credit lines to our ten largest borrowers; and (iv) other applications for credit extensions submitted by the credit approval committee.

The market risk subcommittee, chaired by a senior vice president or assistant president of our bank, is responsible for determining the overall level of market risk exposure of our bank, and making preliminary determination on allocation of capital, organizational structure of market risk management, and other significant market risk policies and procedures.

The operational risk subcommittee, chaired by a senior vice president or assistant president, is responsible for determining the strategy and the overall policies and procedures for operational risk management of the bank, enhancing the corporate governance structure for operational risk management and implementing operational risk policies and procedures.

The day-to-day functions of the risk management committee and its three subcommittees are supported by various departments at our bank. Our risk management department, which is responsible for developing and implementing the overall risk management policies and procedures of our bank, also supports the day-to-day functions of the risk management committee and the credit risk subcommittee. Our budget and finance department and treasury and capital markets department support the market risk subcommittee. Our accounting department, legal and special asset resolution department and information technology department support the operational risk subcommittee.

Chief Risk Officer

We established the position of the chief risk officer in 2004 with a view to strengthening the independence of our risk management function. The chief risk officer is responsible for overseeing the risk management of our bank. Specifically, the chief risk officer oversees our risk management department and has the authority to nominate members of the credit approval committee. The chief risk officer concurrently serves as the vice chairman of the risk management committee at the head-office level and chairman of the credit risk subcommittee and the credit approval committee at the head-office level, and has veto power over all credit applications submitted to the credit risk subcommittee and the head-office level credit approval committee. In addition, the chief risk officer supervises the performance of each of our risk management functions. The chief risk officer reports to our head-office risk management committee and the president of our bank, and is directly responsible for supervising our branch risk managers.

Branch Level

Risk Management Committee

The risk management committee at our tier one branches is responsible for implementing risk management strategies, policies and procedures set by our head office and setting specific rules and regulations for the relevant branches. Each branch-level risk management committee consists of members from the branch management, risk management department, business departments and other relevant departments, and includes the branch general manager and risk manager. The risk management committee at our tier one branches reports directly to our head-office risk management committee.

Risk Managers

The risk manager is responsible for overseeing risk management at that branch. The risk manager is also responsible for implementing risk management policies and procedures, and overseeing the personnel and other significant decisions relating to risk management at that branch. In addition, the risk manager serves as the vice chairman of the risk management committee and the chairman of the credit approval committee of the relevant branch. The risk manager is appointed by our head office and reports directly to the chief risk officer and secondly to the branch general manager. The performance assessment and compensation of risk managers are determined by our head office.

CREDIT RISK MANAGEMENT

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

In managing our exposure to credit risk, we have adopted standardized credit extension policies and procedures throughout our bank, which are regularly reviewed and updated by the risk management department in conjunction with other relevant departments.

The overall credit policy adopted by our head office provides guidance on extending credit based on industry, customer type and product type, and is reviewed and updated annually by our risk management department. Each tier one branch may adopt more specific regulations based on the head office policy.

The credit extension process for both corporate loans and personal loans revolve around our core principle that the risk management function is to be separate from front-office activities. The process can be broadly divided into three stages: (i) credit origination and analysis, (ii) credit approval, and (iii) fund disbursement and post-disbursement management.

Credit Risk Management for Corporate Loans

We impose various risk control mechanisms during the credit extension process for our corporate loans:

- Product manager, who is experienced with identifying risks associated with credit products, works with the relationship manager in the credit investigation process and the post-disbursement management;
- Risk manager, who reports directly to the chief risk officer, has veto powers over the credit approval decisions; dedicated credit approval officers, who are devoted to approving credit applications on a full-time basis, form a majority of a credit approval committee; and credit review staff are responsible for conducting compliance reviews and risk analysis;
- Disbursement centers, which are separate from front offices, are responsible for ensuring all disbursement conditions are met, thereby reducing operational risks;
- A dedicated credit management unit under the risk management department in each branch is responsible for centrally managing post-disbursed loans; and
- A legal and special asset resolution department for the management of non-performing assets.

Credit Origination and Analysis

The initial step in the credit extension process consists of screening by our relationship managers, who either interview credit applicants which approach us or by proactively solicit creditworthy prospective customers. Upon completion of this screening, a product manager, who is experienced with identifying risks associated with credit products, becomes the responsible person of the credit investigation team and takes the lead in carrying out credit investigation which forms an integral part of the credit extension process. The credit investigation team, consisting of a relationship manager and a product manager, conducts a preliminary due diligence on the applicant. The preliminary due diligence generally consists of field investigations to evaluate the borrower's management skills, creditworthiness, operating results, financial condition, use of proceeds, potential source of repayment, collaterals and guarantees, and industry risks.

Our credit investigation team then assists the prospective customer in preparing an application package, which consists of a formal credit application with applicable supporting documents, which generally include the borrower's organizational documents, audited financial statements for the most recent two years, material contracts, valuation reports, and relevant documents of the guarantor, where applicable. In addition, our credit investigation team will input the information obtained from the application package into our internal credit rating system for a credit rating, if applicable. We have focused on improving our ability to identify group borrowers in an effort to reduce loan concentration risk. Historically, our information technology system had difficulties in accurately identifying group borrowers with very complicated or non-standard legal structures, which has limited our ability to define the scope of group borrowers. See also "Risk Factors — Risks Relating to Our Business — Our business is highly dependent on the proper functioning and improvement of our information technology infrastructure". We are in the process of implementing, on a bankwide basis, a corporate credit management system. Upon full implementation, we believe that this system significantly enhances our ability to, among others, identify related party loans, manage information on group borrowers, and conduct more effective on-going credit monitoring for group borrowers. See "— Credit Risk Management Technology".

Based on the application package and the credit rating, the credit investigation team will prepare a due diligence report containing an assessment of the borrower's credit risk, major areas of risk, ability to make repayment, and a proposal for credit extension. The credit investigation team then submits the due diligence report, the application package and the credit rating to the credit assessment unit under the risk management department for review by credit review staff and dedicated credit approval officers. From 2003 to 2004, the credit assessment managers of our branches were appointed by our head office. Since 2004, these positions have been nominated by the branch risk managers, who are centrally appointed by our head office, and appointed by the branch. Generally, at least one dedicated credit approval officer will conduct the review, and produce a brief report assessing borrower's financial condition and cash flow, ability to make repayment, guarantor's creditworthiness, an analysis of potential risks and ways to reduce risks, and a recommendation on whether to extend the credit.

We conduct valuation of underlying collateral in connection with credit applications for secured loans. Generally, we retain independent appraisers to evaluate collaterals for loans other than residential mortgage loans and new automobile loans. For loans classified as "normal", we review the collateral internally on a quarterly basis. For loans in other categories, we conduct such review on a monthly basis. If the collateral becomes the subject of a legal dispute or significant changes occur which may adversely affect the value of the collateral, we immediately re-appraise the value of the collateral and seek additional collateral if necessary. Collateralized loans are subject to loan-to-value ratio limits based on the type of collateral, as follows:

Type of Collateral	Maximum Loan-to-Value Ratio
Real Properties	
Land use rights	50%
Urban real estate	60%
Movable assets	
Manufacturing equipment	40%
Automobiles and ships	40%
Other permitted collaterals	40%
Monetary assets	
Cash deposits with us, government bonds, banker's acceptance, and cashier's check	100%(1)
Legal person shares of public companies	60% (based on net asset value)

(1) Value of collateral cannot be less than the sum of principal and total interest. For foreign currency denominated monetary assets, the ratio will be adjusted based on the volatility of the exchange rate.

For loans guaranteed by third-parties, the guarantor's financial condition, credit history and ability to meet its obligations are evaluated according to the same procedures and criteria used for the primary obligor.

Credit Approval

All credit extensions are required to be approved by the relevant credit approval committee, including extension of loans to related parties and extension of terms of existing loans that are not in default. Decisions on courses of actions taken on non-performing loans are made under the same procedures as those adopted by the credit approval committee meetings. See "— Disbursement and Post-disbursement Management — Administration of Non-Performing Assets." For each loan, the credit approval committee at each level has certain credit authorization limit and is required to conduct its meeting in accordance with our detailed procedures.

Credit Authorization Limits

Each branch is subject to a specific credit authorization limit on the maximum total credit line it may commit to any single borrower or, to the extent identifiable and practical, any group borrower. Each credit application is required to be approved at a credit approval committee meeting that has the required credit authorization limits. If the proposed credit line exceeds such committee's authorization limit, the credit application is required to be submitted directly to the committee with the required authority.

Our head office sets and reviews credit authorization limits of our tier one branches based on a score system, which considers, among other things, management ability, the quality and size of the branch's loan portfolio and local credit culture. Credit authorization limits are reviewed at least once every year. Tier one branches may also delegate credit authorization limits to tier two branches if approved by the head office. In general, sub-branches are not authorized to approve credit extensions.

Credit Approval Committee Meeting Procedures

Credit approval committee meetings are held at our head office, tier one branches and selected tier two branches. The following table sets forth the participants with voting power and the number of votes required to approve a credit application at each level.

Level	Credit authorization limit	Number of participants	Participants	Votes required	Veto power
Head Office Level					
Credit risk subcommittee	Over RMB 1.5 billion to single borrower; over RMB 2.0 billion to group borrower	10 or more	• Chief risk officer, as chairman; • Head-office risk management consultant, as vice-chairman; • Head of risk management department, as vice-chairman; • Heads of relevant business departments; • Heads of relevant units of risk management department; an • At least two dedicated credit approval officers	2/3 of participants with voting power	Chief risk officer

Level	Credit authorization limit	Number of participants	Participants	Votes required	Veto power
Credit approval committee under the credit risk subcommittee	Loans with general to high risks with an amount over RMB 100 million	7 to 9	• Chief risk officer, as chairman; • Head of risk management department; • Heads of relevant units of the risk management department or dedicated credit approval officer(s); and • One member of relevant business departments	2/3 of participants with voting power	Chief risk officer; Two vice chairman voting together
Credit approval committee meeting held under risk management department	Loans with general to high risk with an amount of RMB 100 million or less; low-risk loans whose amount exceeds the authorization limits of the relevant branches	5 or more	• Head of risk management department of the head office, as chairman; • Head of credit assessment unit, as vice chairman; • Dedicated credit approval officer(s) from the head office; and • At least one member of the legal and special asset resolution department	2/3 of participants with voting power	Head of risk management department; chief risk officer(1)
Branch Level					
Credit approval committee	Loans with general risk with an amount of RMB 30 million to 100 million; low-risk loans with an amount of RMB 100 million to 300 million	5 or more	• Risk manager; • Head of credit assessment unit; • Two or more dedicated credit approval officers; and • One or two members of relevant business departments.	2/3 of participants with voting power	Risk manager

(1) Chief risk officer does not participate in credit approval meetings, but has veto power.

Members from the risk management function account for a majority of the participants at meetings of credit approval committee while no more than two members from business departments participate such meetings. Other participants at meetings of credit approval committee include primarily dedicated credit approval officers. In order to maintain the independence of our dedicated credit approval officers, the primary responsibilities of such officers are limited to reviewing credit applications and participating in credit approval committee meetings. These officers are required to possess experience and qualifications set by our head office. The president of our bank and our branch general managers may attend credit approval committee meetings, but have no voting power. They may only exercise veto rights on credit applications approved by credit approval committee.

At each credit approval meeting, the dedicated credit approval officer first presents a brief report on the application file and his credit recommendation. This is followed by a discussion among the participants of the meeting. A confidential ballot is taken at the end of the meeting, the results of which may not be disclosed without special permission.

Disbursement and Post-Disbursement Management

Funds Disbursement

We established disbursement centers in 2003 to reduce operational risks during the disbursement process. After a credit application is approved, funds are disbursed centrally through a disbursement center in each tier one and tier two branch where loans were originated. The disbursement center does not disburse funds unless the disbursement conditions are satisfied.

On-going Credit Monitoring

Credit monitoring is an integral part of our credit risk management, and our risk management department performs a critical role in loan monitoring. We have created the credit management unit under the risk management department dedicated to supervising the credit investigation team in post-disbursement management and carrying out periodical examinations of the status of certain loans classified as "normal" and "special mention".

The credit investigation team is responsible for on-going monitoring of loans to detect any signs of potential delinquency at an early stage and to facilitate prompt remedial action. We focus on factors that might adversely affect the borrower's ability to make repayment, including (i) the borrower's overall credit risk profile, including levels of the borrower's accounts receivable and inventory, changes in operating cash flow, and capital outflows not in the ordinary course of business; (ii) use of proceeds of the loan; and (iii) the status of any security interests.

The credit investigation team gathers information on the status of our corporate loans through both on-site visits and off-site investigations. On-site visits consist of interviews with the senior management of the borrower, inspections of operating facilities, reviewing management accounts and inspecting inventory. On-site visits are carried out by both the relationship manager and product manager that originate the loan. In addition, the risk management department also conducts on-site visits to the borrowers of significant loans with signs of delinquency. Off-site investigations generally consist of gathering publicly available information as well as information from the PBOC nationwide credit information system.

The credit investigation team and the credit management unit are required to analyze the financial condition and repayment ability of the borrower, and provide a specifically formulated plan of repayment and collection if the loan is due for the upcoming quarter, such plan including collection of the loan, extension of term, roll-over and restructuring for each loan. The plan is then tested against the actual results of repayment and collection. In addition, the risk managers lead the efforts in the post-disbursement management of (i) loans of our cross-region group borrowers, (ii) loans of key borrowers specified by the head office, (iii) loans of our ten largest borrowers, (iv) loans for which early warnings have been issued and which may be degraded to "special mention" within three months, and (v) loans that are classified as "special mention" and with an outstanding amount of RMB 30 million or more. We conduct post-disbursement examinations of borrowers at intervals determined based on the classification of the loan. For loans classified as "normal," we conduct such examinations every three months; for loans classified as "special mention," we conduct monthly examinations. Non-performing loans are transferred to the legal and special asset resolution department for administration.

Through our on-site visits and off-site investigations, if we become aware of an event which could significantly and adversely affect a borrower's ability to make payment, such event is required to be reported immediately as one of two types of early warning, general warning or the special warning, based on risk level. Events reported as special warning include significant deterioration of financial condition and material property dispute. Once identified, all early warnings are required to be reported to the risk management department, and in the case of an early warning that is required to be handled on an urgent basis, to the relevant branch manager as well. The risk management department is required to conduct an immediate review of the credit quality and repayment ability of the borrower concerned and monitor or work with the front office departments to take appropriate preventive measures, which may include adjusting the credit line or suspending draw-downs, acceleration of due dates, loan collection, requesting additional security interests or third-party guarantees, as applicable. We generally prohibit the granting of additional credit to a borrower until early warnings are removed. Borrowers in the category of special warning are placed in a "watchlist". We are required to adopt measures to extricate from all credit business relationships with the borrower placed in a "watchlist" and are prohibited from granting new credit facilities to such borrowers.

Loan Classification

Our credit investigation team preliminarily classifies loans based on the information gathered in our loan-monitoring process. Loan classification reviews are generally conducted on a monthly basis. If a loan is the subject of an early warning, that loan undergoes a classification review immediately. The branch-level risk management department reviews, analyzes and approves the preliminary classification of each loan. Final results of loan classification are determined by the head office and audited by an external auditor at least once a year. Generally, the head-office risk management department conducts an off-site classification review of all loans once every six months. As part of the off-site classification review, we require each branch-level risk management departments to submit the basis for classification of all loans under that branch in an effort to maintain consistency in our classification standards. In addition, the head-office risk management department conducts an on-site investigation at least once a year which focuses on procedural compliance in the branch's classification and on-going monitoring processes. Results of on-site and off-site classification reviews form an integral part of our assessment of a branch's asset quality.

Administration of Non-Performing Assets

Our legal and special asset resolution department administers our non-performing assets and certain other special assets, such as foreclosed assets. For further information on the classification of our loans, see "Assets and Liabilities — Assets — Asset Quality of Our Loan Portfolio — Distribution of Loans by Loan Classification." The legal and special asset resolution department seeks to maximize recovery of our non-performing assets in a cost-effective manner. We have established a separate legal and special asset resolution department at our head office and a majority of our tier one branches. Some of our branches do not have a legal and special asset resolution department. Such branches generally have higher asset quality than the average of our asset quality. For branches without a legal and special asset resolution department, we have trained personnel, who are specialized in the administration and recovery of non-performing assets, to take such duties at the branch risk management department.

Non-performing assets are transferred to our legal and special asset resolution department for administration and recovery in accordance with the recovery procedures. A collection officer formulates a proposal for recovery, which will then be submitted to credit approval committee for approval. The recovery proposal is then subject to approval by the general manager of the relevant branch, and reviewed by the legal and special asset resolution department of our head office before being approved by the credit approval committee under the credit risk subcommittee. The head-office legal and special asset resolution department will supervise the branch-level legal and special asset resolution department on the implementation of the final decision on recovery.

Recovery methods generally include the following: (i) collection notice; (ii) restructuring; (iii) realization on collateral or guarantees; and (iv) collection through litigation or arbitration proceedings.

Collection notice. We notify non-performing borrowers and guarantors, if applicable, of payment default by telephone or in writing. We may also deliver the notice in person. If we are not able to collect the non-performing loan within a reasonable time after the collection notice has been given, we may choose to restructure the loan or commence litigation or arbitration collection proceedings.

Restructuring of non-performing loans. Restructurings of non-performing loans (i.e., loans classified as substandard or lower) generally involve negotiated amendments to the original loan documentation, including, among others, extending the maturity of the loan, requiring additional collateral or guarantees, or waiving overdue interest. 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.

Once we determine to waive any overdue interest, or to extend a new loan for purposes of collecting interest or enhancing our security interest, the non-performing loan may not be upgraded into a higher loan classification category until after an observation period of six months. If the restructured principal and interest payments are repaid throughout the observation period, we will review the loan's classification when the observation period ends and upgrade the loan if appropriate. If the borrower subsequently becomes delinquent in paying the restructured principal or interest, we will downgrade the loan. Interest accrues in the same way on restructured loans during the observation period as on other loans. We prohibit the extension of a new loan if the proceeds will be used to pay interest on an existing loan with our bank.

In recent years, we have increasingly limited the granting of loan restructurings as we have increasingly sought recovery through other methods.

Collecting on collateral or guarantees. If we are not able to obtain repayment of the loan from the borrower, and if the borrower has ceased operations or its financial condition has deteriorated, we may choose to collect the collateral securing the loan or make a demand for payment under the guarantee, as applicable. We obtain an independent valuation on any collateral we collect. Generally, we will sell or realize any collateral through public auctions or negotiated sales to maximize recovery to the fullest extent possible.

Collection through litigation or arbitration proceedings. We typically commence litigation or arbitration proceedings against the borrower if the borrower does not exhibit the intent to repay. The court judgment or arbitration ruling may take the form of an order to the borrower to make repayment or a declaration that the borrower is bankrupt. Upon obtaining a court judgment or an arbitration ruling, we will: (1) accept the payments from the borrower and/or guarantor; (2) foreclose on the properties (including collateral, if any) of the borrower and/or guarantor; or (3) work with the borrower and/or guarantor to restructure the non-performing loan under the court's supervision, as applicable.

We write off a loan classified as loss once we have exhausted all means of collection and recovery and the circumstances surrounding the borrower meet the standards for write-offs established by the MOF and the State Administration of Taxation. Loan write-offs must be approved by the relevant tier one branch or the head office depending on the amount of the write-off. Generally, loans to be written off are selected by our branch-level legal and special asset resolution department, which, together with the accounting department and the compliance department of the branch, prepare reports on such loans. These reports are subject to approval by the head office-level risk management committee. Even after we have written off a loan, we generally continue to pursue our recovery efforts on such loan. We monitor the status of loans written off and, based on our analysis, focus our recovery efforts on the loans which we believe are more recoverable. Our legal and special asset resolution department is responsible for recovering loans written-off.

Credit Risk Management for Personal Loans

We classify personal loans into those for commercial purposes and those for consumption purposes. Personal loans for commercial use primarily consist of individual commercial property mortgage loans, commercial automobile loans and individual commercial loans. Personal loans for consumption purposes primarily consist of residential mortgage loans, automobile loans, education loans and other consumption loans. The credit origination and approval process for personal loans for commercial purposes is substantially the same as those for corporate loans. The description below applies only to personal loans for consumption purposes. The following branches are authorized to approve personal loans for consumption purposes: (i) our tier one branches, (ii) tier two branches and (iii) sub-branches not located in the same city as the tier one branch to which they report. Our sub-branches located in the same city as the branch to which they report may only approve low-risk loans, which are generally loans collateralized with cash deposits at our bank.

Credit Origination and Analysis

Our personal loan relationship managers initiate the credit extension process by interviewing credit applicants and reviewing forms completed by the applicants. We assess applicants based on, among other things, their income, credit history, ability to repay the loan and the value of and likelihood of realizing the collateral securing the loan. If the applicant passes the preliminary screening conducted by our personal loan relationship managers, he or she will draft and file a formal credit application together with supporting documents, such as identification documents, employment letters and proof of income. Based on such evaluations and the applicant's credit request, the relationship manager formulates a credit recommendation and submits the application package for approval.

Credit Approval

Personal loans are generally required to be evaluated and approved by two dedicated credit approval officers in the branch-level risk management department. The application packages are generally evaluated by our dedicated credit approval officers, within their authorization limits approved by the head office, based on the credit risk of the applicants and the value of and the likelihood of realizing the collateral securing the loans. In addition to the information included in the application packages, where further confirmation is required, our dedicated credit approval officers also make telephone inquiries, conduct field investigations and consider information from other sources. Our analysis of the credit risk associated with personal loans primarily focuses on the borrower's ability to make repayment, as determined by (i) the ratio of the borrower's monthly repayment obligations to monthly income and (ii) the ratio of the borrower's monthly household repayment obligations to monthly household income. Our collateralized personal loans are primarily residential mortgages. For mortgage loans on the purchase of new residential properties, the value of the collateral is generally determined based on the purchase price of the residential property. For mortgage loans on the purchase of second-hand residential properties, we conduct appraisals both internally and through third parties for each loan, and apply the lower of the appraised value as the value of the collateral.

We primarily rely on information provided by the applicant and obtained through our investigation as the basis for extending personal credit. If the applicant's credit profile is recorded in PBOC's credit information system, we will also consider credit information from such system.

Disbursement and Post-Disbursement Management

In monitoring personal loans, we focus on the borrower's repayment status and changes in the value and status of the collateral securing a loan. Within 15 days after disbursement of a loan, the relationship manager is required to conduct a review on the use of proceeds of the loan and monitor the credit status of the borrower through PBOC's credit information system. Three days before a loan is due, our personal credit management system automatically examines the borrower's account with us designated for loan repayment to confirm that the borrower has sufficient balance in his account for the loan repayment. If the balance is insufficient for the repayment, we send a short mobile message to the borrower (to the extent he provided us his mobile phone number) reminding him of his upcoming repayment obligation on the day immediately following the automatic account examination. Within one month after any outstanding loan becomes overdue, the call center contacts the borrower for loan repayment by short mobile messages or telephone, or, under certain circumstances, may delegate the collection responsibilities to the relevant branch. For any loan that is overdue for more than 30 days, our collection personnel at the relevant branch meets the borrower, issues a collection letter to the borrower and, if applicable, his guarantor, and seeks to identify the reason for default. Our personal loans are classified primarily based on the number of days the loan is overdue. We review the risk profile of our ten customers with the largest personal loans outstanding on a quarterly basis. Our legal and special asset resolution department formulates comprehensive plans to assess and administer our non-performing assets and such plans are implemented by our personal banking department.

Credit Risk Management for Credit Cards

Through a centralized credit management system, our credit card center in Shenzhen manages the credit risks of our credit card business. Our credit card risk management team, primarily consisting of personnel from the credit management department of our head-office and our credit card center, is responsible for formulating credit card risk management policies and monitoring credit risks. We have also adopted standardized credit card approval procedures and criteria. We use a credit assessment system that combines credit scoring and a manual examination and approval process to analyze income profile and credit risks of a potential cardholder. In an effort to reduce the risk of fraud and intentional default, we have established an information sharing mechanism and regularly upgrade our credit-score model. We constantly monitor credit use of cardholders through our credit authorization system and the predictive risk management system. We also monitor individual card usage for fraudulent and other suspicious transactions through a real-time risk monitoring system. We collect overdue credit card balances primarily through telephone, third-party agents and legal proceedings.

Credit Risk Management for Treasury Operations

Our treasury operations are exposed to credit risk through our investment activities and inter-bank lending activities. Our RMB-denominated investment portfolio primarily consists of debt securities issued by the PRC Government and other domestic issuers. Our foreign currency-denominated investment portfolio primarily consists of investment-grade bonds. We establish credit limits on a counterparty and geographical region basis and review them annually.

Credit Risk Management Technology

In recent years, we have focused on bringing us more in line with international best practices and enhancing our risk management technology.

In 1999, in cooperation with McKinsey & Co., we developed a corporate credit rating system, which has been implemented throughout the bank.

In 2005, we formed a dedicated team responsible for research and development of risk management technologies and tools in accordance with the requirements of Basel II. In addition to developing a new corporate credit rating system with assistance from Moody's KMV, this team has independently developed a number of core technologies, including a credit rating consistency adjustment method used in the development stage of credit rating models.

Since 2005, with assistance from Moody's KMV, we have been developing a new corporate credit rating system in accordance with the internal rating method requirements of Basel II, which consists of a customer rating module and a liability rating module. This system includes 21 default probability scoring models based on customer type, and a general default probability econometric model that can be used for all industries. We believe this system is a leading corporate credit rating system among those used by PRC commercial banks in term of industry segmentation and default probability measurement. All of our non-financial institution corporate banking customers, or approximately 90% of our customers, are rated by this system. In addition, this system includes a module for loss given measurement targeted at unsecured loans, guaranteed loans and secured loans, which we expect to complete in three years and upon completion will satisfy internal rating method requirements of Basel II. This new corporate credit rating system provides efficient technological support to risk cost measurement, loan pricing and approval, asset portfolio management, risk-adjusted performance evaluation, the measurement and allocation of credit exposure, and the capital measurement and allocation of regulatory and risk capital. As of the date of this prospectus, this system has been implemented on a pilot basis.

From 2005 to November 2006, we developed a corporate credit management system to further computerize our credit extension process. This customer-oriented credit management computer system centrally manages credit to corporate borrower throughout the bank and it is an information technology platform that facilitates corporate banking business information sharing, process control and efficient operations. This system consists of eight modules, namely, customer information management, credit investigation, credit extension review and approval, fund disbursement, post-disbursement management and five-category loan classification, rating system interface, statistics and inquiry, and system maintenance modules. We started implementing this system throughout the bank on a pilot basis in November 2006.

We are also in the process of upgrading our personal credit rating system for our credit card customers and personal loan customers. We expect to complete the establishment of a quantified risk measurement technology system that satisfies the internal rating method requirements of Basel II within three to five years.

LIQUIDITY RISK MANAGEMENT

Liquidity risk is the risk of the inability to meet payment obligations in full that arises from the mismatch between asset and liability cash flows. We are exposed to liquidity risk primarily in the repayment of deposits and the funding of our lending, and trading and investment activities. Our objective in liquidity management is to comply with regulatory liquidity guidelines and to be able to meet all our payment obligations and fund our investment and lending opportunities on a timely basis.

Our head office centrally manages our bank-wide liquidity risk, while each of our branches is responsible for managing liquidity risks that arise at that branch. Our head-office budget and finance department is responsible for the liquidity management of our RMB-denominated assets, while our treasury and capital markets department is responsible for the liquidity management of our foreign-currency-denominated assets.

Our head office sets, on an annual basis, our bank-wide liquidity management targets, which are adjusted periodically based on market changes. Such liquidity management targets include liquidity ratios, inter-bank lending and borrowing ratios and loan-to-deposit ratios. See "Regulation and Supervision — PRC Regulation and Supervision — Operating Requirements". With a view to achieving such targets, our head office seeks to identify, measure and monitor liquidity risks by applying, among others, maturity gap analyses, managing branch liquidity risks through tools such as interest rate leverage, and generating reports periodically or from time to time. Our head office manages liquidity positions at our branches by setting liquidity management targets for the branches. The internal fund transfer between the head office and branches is facilitated by our internal fund transfer system platform and accomplished through an electronic transaction system. Funds are transferred based on our funds transfer pricing mechanism, through which a branch may receive additional liquidity from our head office when liquidity requirements arise, and transfer funds to our head office in cases of excess liquidity.

Based on our liquidity risk management requirements, we determine maturity profile of our liquidity asset portfolio and formulate plans for the use of funding. Our head office manages our liquidity risk by appropriately planning our liquidity position or meeting potential liquidity requirements through accessing inter-bank market. We encourage diversification of liquid assets. We have significant holdings in liquid assets such as deposits with the PBOC, PBOC bills, short-term debt issued by the PRC Government, financial bonds and discounted bank acceptances. Such liquid assets may be used to make payments directly or liquidated in the market to meet potential liquidity requirements. In addition, if further liquidity requirements arise, we may borrow from market or enter into repurchase transactions or currency swaps to acquire liquid assets. In an effort to ensure that we can effectively manage liquidity risks under various adverse conditions, we conduct stress testing from time to time to analyze liquidity risk. If we detect signs of an urgent liquidity shortage, we implement contingency plans which are developed for events of a liquidity emergency.

See also "Risk Factors — Risks Relating to Our Business — We are subject to liquidity risk."

MARKET RISK MANAGEMENT

Market risk is the risk of loss in on- and off-balance sheet positions arising from movements in market prices. Such movements may arise from movements in observable market variables such as interest rates, exchange rates, equity prices and commodity prices. We are exposed to market risk primarily through the assets and liabilities on our balance sheet, as well as our off-balance sheet commitments. The principal objective of our market risk management is to manage potential market losses within acceptable levels and enhance earnings stability through independent identification, assessment and monitoring of the market risks inherent to our day-to-day businesses. In measuring and monitoring market risk, we primarily employ sensitivity analysis, foreign currency exposure analysis, gap analysis, scenario analysis, stress testing and value-at-risk analysis. In managing market risk, we apply strict authorization limits, which are determined based on factors such as our bank's overall ability to bear market risk, product type and our business strategy.

Historically, RMB-denominated interest rates and exchange rates were controlled and set by the PRC Government and we were not exposed to significant market risk. See "Regulation and Supervision — PRC Regulation and Supervision — Pricing of Products and Services." As the government gradually liberalizes interest rates and exchange rates and the financial services sector becomes more competitive, market risk management becomes an increasingly important part of our overall risk management.

Our market risk subcommittee is responsible for formulating market risk management policies and procedures, approving new products, and approving risk exposure limits. Our budget and finance department is responsible for the day-to-day tasks of managing market risk, including formulating procedures to identify, assess, measure and control market risks. Our treasury and capital markets department is responsible for managing RMB and foreign currency denominated investment portfolio, conducting proprietary trading and transactions on behalf of customers, implementing market risk management policies and procedures, and ensuring that risk levels are within those set by the market risk subcommittee.

Interest Rate Risk Management

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

We manage the interest rate risk exposure of our RMB-denominated assets and liabilities on our balance sheet primarily through adjusting the interest rate and maturity profile. We seek to reduce mismatches in repricing periods by adjusting the repricing frequency and setting the pricing structure of corporate deposits. We perform duration analysis on debt instruments in our investment portfolio to assess the potential price volatility of a bond by measuring its sensitivity to interest rate fluctuations. We set limits on the duration of interest rate sensitive instruments based on our duration analysis. To measure exposures to potential interest rate changes in our investment portfolio, we use interest rate sensitivity analysis, stress testing and scenario analysis. Our treasury operations enter into derivatives contracts, such as swaps, forwards and options, to hedge our interest rate risk exposures on our foreign currency-denominated assets and liabilities on our balance sheet and on the investment portfolios. We generally do not use interest rate hedging instruments to hedge our interest rate risk on RMB-denominated debt instruments, as hedging instruments are not well developed in the domestic market.

Exchange Rate Risk Management

Exchange rate risk primarily results from mismatches in the currency denomination of our on- and off-balance sheet assets and liabilities and mismatches in our currency position resulting from foreign currency transactions.

All currency positions at our branch level are closed through back-to-back settlement, with exposure managed centrally at the head-office treasury and capital markets department. Our treasury and capital markets department seeks to control our exposures within limits set by the market risk subcommittee by closing positions in the markets or entering into derivative transactions for hedging purposes. Commencing at the end of 2004, in response to the increasing pressure on the Renminbi to appreciate, we have increased our focus on foreign exchange risk management. In this regard, we have implemented the following initiatives:

- launched treasury transactions systems at our head office and our branches. Each branch is required to timely settles its foreign currency positions with our head office, which centrally manages all remaining bank-wide currency exposure;
- established a price transmission mechanism which transmits the foreign currencies from the head office to the branches and from the branches to the sub-branches in a highly efficient manner so as to conduct effective foreign exchange management;
- maintained the bank-wide foreign currency exposure at a level below the limits set by the market risk subcommittee; and
- achieved real-time monitoring of foreign currency positions at our head office and branches.

Market Risk Management Information Technology

We began using the PANORAMA system from Sungard in 2002, and were one of the first commercial banks in China to use professional system to manage market risk. PANORAMA is a computerized transaction processing system integrating the functions of trading platform, risk management and account management. In 2005, we began using the YieldBook pricing analysis system, which is designed to analyze the relatively sophisticated structural products. YieldBook also assists our traders in analyzing collateral debt and other complex structured products.

We began the development of an assets and liabilities management, or ALM system in September 2005 and completed its implementation on a pilot basis in June 2006. We believe the ALM system enables us to manage our liquidity, interest rate, exchange rate and other risks more efficiently through data analyses.

OPERATIONAL RISK MANAGEMENT

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including information technology system failures and natural disasters.

Our operational risk subcommittee under the risk management committee is primarily responsible for monitoring and managing bank-wide operational risk and formulating operational risk management polices. It conducts reviews and evaluations of the operational risks on a regular basis. The accounting department works in cooperation with the internal audit department, the legal and special asset resolution department and other relevant departments to evaluate the overall effectiveness of our bank-wide operational risk prevention and control system.

Our operating units both at our head office and at our branches are responsible for self-assessing their operational risk and implementing our operational risk management policies and procedures. Our risk management department, in addition to assessing operational risk during the credit extension process, regularly conducts reviews to evaluate compliance by various departments with our policies and procedures.

We consider our legal risk part of our operational risk. Legal risk is the risk that unenforceable contracts or adverse judgments may disrupt or otherwise negatively affect our operations or financial condition as well as the risk of legal and regulatory sanctions, financial losses or damages to reputation that we may suffer as a result of our failure to comply with all applicable laws, regulations, international practices, local trade standards and codes of conduct. Our legal and special asset resolution department is responsible for proactively identifying, assessing, preventing, managing and resolving legal risk. By establishing and maintaining appropriate policies and procedures and oversight measures our legal and special asset resolution department enhances our ability to conduct business in compliance with the requirements of relevant laws and regulations.

Management of Operational Risk

We focus on enhancing our internal controls and training our employees to implement our policies and procedures, particularly those that have been recently promulgated. Since the mid-1990s, we have formulated and implemented standardized policies and procedures for many of our principal business activities at various branch levels. The procedures we have implemented include:

- conducting large-scale general and specific on-site inspections as well as regular off-site inspections in order to identify deficiencies in operational procedures and monitor our employees' operational compliance;
- establishing disbursement centers with a view to ensuring disbursement conditions are satisfied;
- establishing discounted bills centers dedicated to conducting discounted bills transactions at branches with large transaction volumes. We are in the process of establishing these centers at all branches;
- establishing post-incident monitoring center at branches to conduct independent review and examination of original transaction records and to identify and rectify potential operational mistakes or fraud, with a view to improving the accuracy of our accounting information; and
- establishing account reconciliation center at branches to check and confirm our records against our customers' records. We are launching a computerized reconciliation system designed to prevent internal or external frauds more effectively and provide enhanced security for our bank and our customers.

We have enhanced our authorization management, including formulating specific written rules regarding authorization scopes and procedures, and conducted reviews to ensure the proper implementation of such rules.

In order to establish checks and balances in our operating processes, we delineated responsibilities among our departments and separating positions with potential conflicts of interest. We implemented a centralized appointment and rotation system for key positions, under which our head office appoints tier one branch accounting managers and tier one branches appoint sub-branch accounting managers who rotate regularly.

We have strengthened our anti-money laundering monitoring efforts by assigning a department with anti-money laundering function, analyzing data generated by our information technology systems, and implementing relevant policies and procedures in accordance with the PBOC guidelines.

Other initiatives we have adopted to manage operational risk include the following:

- providing trainings for employees, such as job orientations for new employees and ongoing operational compliance trainings, and regularly examining employees at our head office and branches on such trainings;
- strengthening employee management and codifying the disciplinary measures for employee misconduct;
- formulating network and security plans by the head office and applying such plans throughout the bank;
- enhancing the security of our information systems by requiring identity verification for access to all information systems and maintaining daily log-in records;
- establishing and continuously improving project and operation management systems;
- conducting drills on a regular basis to ensure the effectiveness of our procedures, system backup mechanisms and disaster response plans; and
- reviewing the implementation of our policies and procedures through system security checks and special information system audits.

Reporting and Monitoring of Non-compliance

We have established internal reporting procedures and disciplinary measures for any employee misconduct that affects our business. Under our internal reporting system, statistical data relating to incidents of employee misconduct at branches are required to be reported to our head office periodically, and cases of misconduct are required to be reported within 24 hours of their discovery. In addition, we are required to report to the CBRC significant cases of misconduct involving an amount of more than RMB 1 million.

During the period between the beginning of 2006 and the date of this prospectus in 2007, there was one reported incident of criminal offense involving a total amount of RMB 40 million. In 2005, there were no reported incident of criminal offenses. In 2004, there were five reported incidents of criminal offenses involving a total amount of RMB 56.4 million. These incidents of criminal offenses include, among other things, fraud, theft and misappropriation of customer's funds. Some of these incidents implicated potential internal controls weakness at certain of our branches. However, these incidents have not, individually or in the aggregate, had a material adverse effect on our business, financial condition or results of operations. We have imposed severe penalties on these employees, including termination of employment. For risks relating to the misconduct by our employees, see "Risk Factors — Risks Relating to Our Business — We cannot assure you that our risk management and internal control policies and procedures can adequately control or protect us against credit and other risks."

MANAGEMENT OF OTHER RISKS

Other risks that we are exposed to include reputation risk and strategic risk. Reputation risk is the risk that negative publicity regarding our business practices, whether or not genuine, will cause a potential decline in the customer base or lead to costly litigation or revenue erosion. The general office department at our head office is in charge of the public relations at our bank to protect our reputation and monitor events that may damage our reputation. Strategic risk generally refers to the risks that may induce some current or future negative impacts on the earnings, capital, reputation or market position of our bank because of poor strategic decisions, improper implementation of strategies and lack of response to the market. The planning and development department is in charge of our strategy to ensure that we develop in the right direction taking into account the changes within and outside our bank.

INTERNAL CONTROL SYSTEM

We have been continuously enhancing our internal control functions and corporate governance structure in a view to creating an internal control system with standards consistent with practices of international banks.

Our internal control management structure has three levels: decision-making level, implementation level and supervision and evaluation level.

- *Decision-making level.* Our board of directors is responsible for determining internal control strategic target and policies, approving internal control procedures for various business activities, and assessing the overall integrity and effectiveness of our internal control system.

- *Implementation level.* Our senior management at head-office level is responsible for implementing internal control strategies and policies adopted by the board, establishing internal control reporting structure promulgating procedures to identify, measure and manage various risks, and taking necessary steps to rectify internal control weaknesses through the president meeting.

  The special committees under the president meeting, including the risk management committee, the development and assets and liabilities committee, the information technology committee and the auditing committee are responsible for risk management and internal controls within their respective scope of duty.

  The various business departments at head-office level are responsible for implementing internal control policies and procedures in their respective scope of business, conducting internal control examinations of the corresponding business departments at branch level and rectifying internal control weaknesses, and reporting the results to the senior management.

Our management at branch level is responsible for establishing and enhancing internal control procedures at the respective branch, and formulating detailed implementation procedures of internal control system.

- *Supervision and evaluation level.* Our board of supervisors and the internal audit committee are responsible for overseeing and evaluating the integrity and effectiveness of our internal control systems. The internal audit department is responsible for carrying out internal audits over various business activities, conducting independent evaluations on the adequacy and effectiveness of our internal control system and reporting the results to the senior management and the internal audit committee.

We have established a comprehensive internal control system covering business and procedures in line with the requirements under the Internal Control Guidelines for Commercial Banks, including internal controls over credit extension, treasury operation, accounting and front office operation, budget and finance, non-interest income business, information technology system and anti-money laundering.

INTERNAL AUDIT

We recognize the importance of the internal audit function at our bank. Our internal audit department examines and independently evaluates our risk management policies and procedures and internal controls with a view to protecting the value of our assets. As of December 31, 2006, we had 173 employees in the internal audit department.

The reporting structure of our internal audit function may be characterized as a "dual reporting" structure. Our internal audit personnel report to both the internal audit department of the next higher level and to the relevant branch general manager. The branch general managers are responsible for compensation reviews and performance assessments of our internal audit personnel. In addition, the branch general managers also make nominations for key internal audit positions, which are subject to reviews and vetoes by the internal audit department of the head office. Our internal audit department reports directly to our president.

In 2005, in an effort to improve the quality and efficiency of our internal audit department, we reorganized the department into three units, consisting of the general management unit, the on-site audit unit and the off-site audit unit. The general management unit is responsible for formulating annual internal audit plans; formulating internal audit policies and procedures, supervising the implementation of internal audit plan, and communicating with external regulatory agencies. The on-site audit unit is responsible for conducting general and specific on-site inspections, as well as assessing internal control risks of our bank. The off-site audit unit is responsible for implementing off-site inspections and identifying, tracking, monitoring and evaluating risks associated with various business lines.

Starting at the end of 2004, we began to implement a series of measures to strengthen the role of the internal audit function. In 2005, we established an internal audit committee, on which our president is serving as chairman. The internal audit committee is responsible for reviewing internal audit plans, policies and procedures and reviewing, supervising and evaluating the performance of our internal audit functions.

We adopted an internal audit manual which standardizes procedures for all internal audit-related activities and defines the roles and responsibilities of internal audit personnel. We began a large scale on-site inspection campaign in 2005, which consisted of comprehensive examinations of all of our branches in an effort to identify deficiencies related to internal controls. In formulating internal audit plans for our branches, we take into consideration of the difference among our branches in management skills and business development level.

We endeavor to improve our internal audit function with a view to establishing a more independent, unified and standard internal audit system. To this end, we intend to adopt the following measures:

- establishing a new reporting structure based on the newly created corporate governance structure that includes the board of directors;
- establishing the position of chief audit officer and regional audit offices which report to our head office with an view to increasing the independency of our internal audit function;
- increasing efficiency of our audits by determining the frequency and priority of our audits at each of our operations based on an assessment of the risk level at that operations;
- enhancing efforts in developing and using computerized audit tools, strengthening the distance audit work, increasing the efficiency and quality of audit; and
- increasing internal audit training, and establishing a performance review system to improve our internal audit quality and efficiency.