PRC BANKING SUPERVISION AND REGULATION

Overview

The banking industry is highly regulated in the PRC, with the CBRC and the PBOC acting as the principal regulatory authorities. The CBRC is responsible for supervising and regulating banking institutions, and the PBOC, as the central bank of the PRC, is responsible for formulating and implementing monetary policies. The principal laws and regulations relating to PRC banking industry are the PBOC Law (中國人民銀行法), the Commercial Banking Law (商業銀行法) and the Banking Regulatory Law (銀行業監督管理法), and the rules and regulations promulgated thereunder.

History and Development of the Regulatory Framework

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

The current regulatory framework of the PRC banking industry began to emerge in 1995 with the enactment of the Commercial Banking Law and the PBOC Law. The Commercial Banking Law was enacted in May 1995 and laid down the fundamental principles of operations for PRC commercial banks. The PBOC Law, which was enacted in March 1995, provided for the scope of responsibilities and the organizational structure of the PBOC, and authorized the PBOC to administer the Renminbi, implement monetary policies and regulate and supervise the PRC financial industry.

Since then, the regulatory regime of the PRC banking industry went through further significant reform and development in 2003. The CBRC was established in April 2003 and took over from the PBOC its role as the primary regulator of the PRC banking industry. The CBRC was given the mandate to implement reforms, minimize overall risks, promote stability and development and enhance the international competitiveness of the PRC banking industry. In December 2003, the Commercial Banking Law and the PBOC Law were amended, and the Banking Regulatory Law was enacted. The Banking Regulatory Law sets out the regulatory functions and responsibilities of the CBRC.

Principal Regulators

CBRC

Functions and Powers

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

- formulating and promulgating rules and regulations governing banking institutions and their activities;
- examining and approving the establishment, change and dissolution of banking institutions and their scope of business, as well as granting banking licenses for commercial banks and their branches;

- regulating the business activities of banking institutions, including their product and service offerings;
- setting qualification requirements for, and approving or overseeing the nomination of, directors and senior management personnel of banking institutions;
- setting guidelines and standards for the internal controls, risk exposure and corporate governance of, and disclosure requirements for, banking institutions;
- conducting on-site inspection and off-site surveillance of the business activities and risk levels of banking institutions;
- monitoring the financial condition of banking institutions, including establishing standards or requirements for capital adequacy, asset quality and other financial ratios; and
- imposing corrective and punitive measures for violations of applicable banking regulations, including suspending the operations of banking institutions.

Examination and Supervision

The CBRC, through its head office in Beijing and its branches in various provinces, municipalities directly under the central government and autonomous regions, monitors the operations of commercial banks and their branches through on-site examinations and off-site surveillance. On-site examinations generally include inspecting a bank's business premises and interviewing its employees, and asking its senior management and directors to explain significant issues relating to its operations and risk management, as well as reviewing relevant documents and materials kept by the bank. Off-site surveillance generally includes reviewing various business reports, financial statements and other reports regularly submitted by banks.

PBOC

As the central bank of the PRC, the PBOC is responsible for formulating and implementing monetary policies and maintaining the stability of PRC financial markets. According to the PBOC Law, the PBOC is empowered to:

- formulate and implement monetary policies by establishing benchmark interest rates, setting the deposit required reserve ratios for commercial banks, extending loans to commercial banks, accepting discounted bills and conducting open market operations;
- issue PRC treasury bills and other government bonds to financial institutions, as the agent of the MOF;
- regulate the domestic inter-bank lending market and the trading by institutional investors in the inter-bank bond market of debt instruments issued by the PRC government and its agencies and by financial institutions;
- determine foreign exchange rate policies and manage the foreign exchange reserves and gold reserves of the PRC;
- regulate and examine foreign exchange activities; and
- establish anti-money laundering guidelines and monitor fund transfers for compliance with anti-money laundering regulations.

Other Regulatory Authorities

In addition to the CBRC and the PBOC, commercial banks in the PRC are also subject to supervision and regulation by other regulatory authorities, including the SAFE, the CSRC and the CIRC.

Licensing Requirements

Basic Requirements

The Commercial Banking Law and the Measures of CBRC for the Implementation of Administrative Licensing Matters Concerning Chinese-funded Commercial Banks effective from February 1, 2006 set out the permitted scope of business, licensing standards and other requirements in respect of commercial banks. The establishment of a commercial bank requires the CBRC's approval and issuance of an operating license. In general, the CBRC will not approve an application to establish a commercial bank unless certain conditions are satisfied, including, among others, that:

- the articles of association of the proposed commercial bank must comply with relevant requirements of the Commercial Banking Law and the Company Law;
- the registered capital of the proposed commercial bank must meet the minimum requirement under the Commercial Banking Law, which is RMB1.0 billion, RMB100 million and RMB50 million for a national commercial bank, a city commercial bank and a rural commercial bank, respectively;
- the directors and senior management of the proposed commercial bank must possess the requisite qualifications;
- the organizational structure and management system of the proposed commercial bank must be properly established; and
- the safety and security of the business premises and other facilities of the proposed commercial bank, as well as their security measures must comply with relevant requirements.

Significant Changes

Banks are required to obtain the CBRC's approval to undertake significant changes, including, among others:

- change of name;
- change of registered capital;
- change of the location of the head office or a branch;
- change of business scope;
- purchase of an equity interest in the bank that results in the purchaser becoming a holder of 5% or more of the bank's shares, and any change of shareholders holding 5% or more of the bank's total capital or shares;
- amendment to the articles of association;
- merger or division; and
- dissolution and liquidation.

Establishment of Branches

Domestic Branches

A commercial bank must apply to the CBRC (or its local offices) for approval and issuance of a business license and banking license to establish a branch. To obtain such business license and banking license, the branch must have sufficient operating funds commensurate with its scale and must meet other operating requirements. A commercial bank is required to allocate a minimum amount of operating funds for each branch, and the total of the operating funds provided to all branches of a commercial bank may not exceed 60% of its regulatory capital.

Overseas Branches

The establishment of overseas branches by a PRC commercial bank is subject to the CBRC's approval in addition to compliance with all applicable regulations in the relevant foreign jurisdiction. The applying bank must comply with the following conditions:

- its capital adequacy ratio should not be lower than 8%;
- in principle, the balance of equity investment should not exceed 50% of its net assets;
- it generated profits in latest three consecutive fiscal years;
- the balance of its assets was no less than RMB100 billion as at the end of the year immediately prior to the application;
- it has legal and sufficient foreign exchange sources;
- it has a good corporate governance system as well as sound and efficient internal control measures in place;
- the major indicators for its prudent control and management fulfill regulatory requirements; and
- other prudent conditions required by the CBRC are satisfied.

Scope of Business

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

- taking deposits from the public;
- making short-term, medium-term and long-term loans;
- effecting domestic and overseas payment settlements;
- accepting and discounting instruments;
- issuing bonds;
- acting as agents to issue, honor and underwrite government bonds;
- trading government bonds and financial institution bonds;
- engaging in inter-bank lending;
- trading foreign exchange as principal or as agent;
- engaging in bank card business;
- providing letters of credit and guarantee services;
- collecting and making payment as agents and acting as insurance agents;
- providing safe deposit box service; and
- other businesses approved by the CBRC.

Commercial banks in the PRC are required to stipulate their scope of business in their articles of association and submit their articles of association to the CBRC for approval.

Regulation of Principal Commercial Banking Activities

Lending

To control credit risks relating to the extension of credit, PRC banking regulations require that commercial banks should, among other things: (1) establish a strict and unified credit risk management system; (2) establish standard operation procedures for each step in the extension of credit, including conducting due diligence investigations before granting credit facilities, monitoring borrowers' repayment ability and preparing credit assessment reports on a regular basis; and (3) make arrangements to appoint qualified risk control personnel.

To control market risks relating to related party loans, the CBRC issued corresponding guidelines and measures. See "— Corporate Governance — Transactions with Related Parties."

In addition, the CBRC issued regulations regulating loans and credit granted to certain specific industries and customers in an effort to control the credit risk of PRC commercial banks. These include:

- the Guidelines on the Management of Risks of Credit Granted by Commercial Banks to Group Clients (商業銀行集團客戶授信業務風險管理指引);
- the Guidelines on the Management of Risks of Real Estate Credit Granted by Commercial Banks (商業銀行房地產貸款風險管理指引);
- the Automobile Loan Measures (汽車貸款管理辦法); and
- the Interim Measures for the Administration of Fixed Asset Loans (固定資產貸款管理暫行辦法).

Foreign Exchange Business

Commercial banks are required to obtain approvals from the CBRC and the SAFE to conduct foreign exchange businesses. Under the PRC's anti-money laundering laws and regulations, PRC financial institutions are required to report to the SAFE on a timely basis any large or suspicious foreign exchange transactions which they encounter.

Securities and Asset Management Businesses

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

- underwrite and deal in PRC government bonds and financial institution bonds, and starting from May 2005, commercial bonds issued by qualified non-financial institutions;
- act as agents in transactions involving securities, including bonds issued by the PRC government, financial institutions and other corporate entities;
- provide institutional and individual investors with comprehensive asset management advisory services;
- act as financial advisors in connection with large infrastructure projects, mergers and acquisitions transactions and bankruptcy reorganizations; and
- act as custodians for funds, including securities investment funds and corporate annuity funds.

Under the Administrative Measures on Qualifications for Securities Investment Fund Custodianship (證券投資基金託管資格管理辦法) promulgated jointly by the CSRC and the CBRC on November 29, 2004 and effective on January 1, 2005, a commercial bank is permitted to apply for the qualification to engage in fund custodian business of securities investment funds, if, among other requirements, such commercial bank has net assets at the year-end totaling no less than RMB2 billion for each of the latest three fiscal years and its capital adequacy ratio fulfills the relevant regulatory requirement. The fund custodian must ensure the separation of its custodian business from its other businesses, as well as the independence of its fund assets. The CSRC and the CBRC are jointly responsible for examining and approving the qualifications and supervising the activities of fund custodians. In addition, the senior manager of a commercial bank's fund custody department must have certain qualifications and be approved by the CSRC.

Insurance

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

Personal Wealth Management Services

In September 2005, the CBRC issued the Provisional Administrative Measures on the Personal Wealth Management Business of Commercial Banks (商業銀行個人理財業務管理暫行辦法). Under these measures, commercial banks are required to obtain CBRC approval to provide certain wealth management services whereas in respect of certain other wealth management services, they are only required to submit a report to the CBRC. Commercial banks are also subject to certain restrictions on offering products under personal wealth management plans. In addition, under the Guidelines on Risk Management Regarding Personal Wealth Management Services of Commercial Banks (商業銀行個人理財業務風險管理指引) issued by the CBRC in September 2005, commercial banks are required to establish an auditing and reporting system in respect of their wealth management services and to report to the relevant authorities any material risk management problems. Thereafter, the CBRC issued a series of documents, including the Notice on Risk Alert for Personal Wealth Management Services Provided by Commercial Banks (關於商業銀行開展個人理財業務風險提示的通知) on June 13, 2006, Notice on Adjusting the Relevant Provisions on the Administration of the Personal Wealth Management Business of Commercial Banks (關於調整商業銀行個人理財業務管理有關規定的通知) on January 28, 2007, Notice on Issues Relating to Further Regulating Personal Wealth Management Services Provided by Commercial Banks (關於進一步規範商業銀行個人理財業務管理有關問題的通知) on April 3, 2008, Notice on Issues Relating to Further Regulating Investment Management of Personal Wealth Management Services Provided by Commercial Banks (關於進一步規範商業銀行個人理財業務投資管理有關問題的通知) on July 6 2009 and Notice on Issues Relating to Further Regulating Report Management of Personal Wealth Management Services Provided by Commercial Banks (關於進一步規範商業銀行個人理財業務報告管理有關問題的通知) on April 28, 2009, in an effort to further improve the reporting mechanism and risk control for personal wealth management services provided by commercial banks.

Electronic Banking

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

Proprietary Investments

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

Derivatives

On February 4, 2004, the CBRC issued the Provisional Administrative Measures on Derivative Business of Financial Institutions (金融機構衍生產品交易業務管理暫行辦法), which set out, among other things, detailed regulations on market access and risk management of derivatives business conducted by financial institutions. In accordance with the provisional measures, commercial banks in the PRC seeking to conduct derivatives business must meet relevant qualification requirements and obtain prior approval from the CBRC. On March 22, 2005, the CBRC issued the Circular on Risk Alert Regarding Trading of Derivative Products by Domestic Banks (關於對中資銀行衍生產品交易業務進行風險提示的通知), and amended the Tentative Administrative Measures on the Management of the Dealings in Derivative Products of Financial Institutions (金融機構衍生產品交易業務管理暫行辦法) on December 28, 2006 (effective from July 3, 2007), issued the Notice to Further Strengthen Risk Management of Derivative Product Transaction between Banking Financial Institutions and Institutional Customer on July 31, 2009 (關於進一步加強銀行業金融機構與機構客戶交易衍生產品風險管理的通知) in an effort to further strengthen the risk management of derivatives business conducted by commercial banks in the PRC.

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

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

Pricing of Products and Services

Interest Rates for Loans and Deposits

Interest rates for RMB-denominated loans and deposits were historically set by the PBOC. In recent years, the PBOC has been gradually liberalizing its regulation of interest rates, allowing banks more discretion to determine the interest rates for RMB-denominated loans and deposits. The following table sets forth, for the periods indicated, the permitted range of interest rates for RMB-denominated loans and deposits.

	Loans		Deposits	
	Between 1/1/04 and 10/28/04[1]	Since 10/29/04[2]	Between 1/1/04 and 10/28/04	Since 10/29/04[3]
Maximum interest rates	Up to 170% of the PBOC benchmark rate (up to 200% for rural credit cooperatives)	No cap (up to 230% of the PBOC benchmark rate for rural and urban credit cooperatives)	PBOC benchmark rate, except for negotiated deposits	PBOC benchmark rate, except for negotiated deposits
Minimum interest rates	Not lower than 90% of the PBOC benchmark rate	Not lower than 90% of the PBOC benchmark rate	PBOC benchmark rate, except for negotiated deposits	No minimum

Notes:

(1) Interest rates for residential mortgage loans, public assistance loans, policy loans and certain other loans specified by the State Council may not exceed the PBOC benchmark rate.

(2) From March 17, 2005 to August 18, 2006, interest rates for residential mortgage loans were regulated in the same way as most other types of loans. Since October 27, 2008, the minimum interest rates for commercial personal residential mortgage loans have been changed to 70% of the PBOC loan benchmark rate.

(3) Beginning on October 29, 2004, commercial banks in the PRC are permitted to set their own interest rates on Renminbi deposits so long as such interest rates are not higher than the relevant PBOC benchmark rates. However, these restrictions do not apply to interest rates on negotiated deposits, which are deposits by domestic insurance companies in amounts of RMB30 million or more or deposits by the SSF in amounts of RMB500 million or more, both with a term longer than five years, or deposits by China Postal Savings Bank in amounts of RMB30 million or more with a term longer than three years.

From April 28, 2006 to December 23, 2008, the PBOC adjusted the RMB loan benchmark interest rate and RMB deposit benchmark interest rate by 13 instances and 11 instances respectively. Since then and up till the Latest Practicable Date, the PBOC has not adjusted the RMB loan benchmark interest rate or the RMB deposit benchmark interest rate.

The following table sets forth the PBOC benchmark rates for RMB loans during the past three years.

(interest rate per annum:%)

Date of adjustment	Six months or less	Six months to one year (inclusive of one year)	One to three years (inclusive of three years)	Three to five years (inclusive of five years)	More than five years
2006.04.28	5.40	5.85	6.03	6.12	6.39
2006.08.19	5.58	6.12	6.30	6.48	6.84
2007.03.18	5.67	6.39	6.57	6.75	7.11
2007.05.19	5.85	6.57	6.75	6.93	7.20
2007.07.21	6.03	6.84	7.02	7.20	7.38
2007.08.22	6.21	7.02	7.20	7.38	7.56
2007.09.15	6.48	7.29	7.47	7.65	7.83
2007.12.21	6.57	7.47	7.56	7.74	7.83
2008.09.16	6.21	7.20	7.29	7.56	7.74
2008.10.09	6.12	6.93	7.02	7.29	7.47
2008.10.30	6.03	6.66	6.75	7.02	7.20
2008.11.27	5.04	5.58	5.67	5.94	6.12
2008.12.23	4.86	5.31	5.40	5.76	5.94

The following table sets forth the PBOC benchmark rates for RMB deposits during the past three years.

(interest rate per annum:%)

		Time deposits					
Date of adjustment	Demand deposits	Three months	Six months	One year	Two years	Three years	Five years
2006.08.19	0.72	1.80	2.25	2.52	3.06	3.69	4.14
2007.03.18	0.72	1.98	2.43	2.79	3.33	3.96	4.41
2007.05.19	0.72	2.07	2.61	3.06	3.69	4.41	4.95
2007.07.21	0.81	2.34	2.88	3.33	3.96	4.68	5.22
2007.08.22	0.81	2.61	3.15	3.60	4.23	4.95	5.49
2007.09.15	0.81	2.88	3.42	3.87	4.50	5.22	5.76
2007.12.21	0.72	3.33	3.78	4.14	4.68	5.40	5.85
2008.10.09	0.72	3.15	3.51	3.87	4.41	5.13	5.58
2008.10.30	0.72	2.88	3.24	3.60	4.14	4.77	5.13
2008.11.27	0.36	1.98	2.25	2.52	3.06	3.60	3.87
2008.12.23	0.36	1.71	1.98	2.25	2.79	3.33	3.60

The PBOC generally does not regulate interest rates for both foreign currency–denominated loans and deposits, except for U.S. dollar, Hong Kong Dollar, Japanese Yen and Euro–denominated deposits of less than US$3 million (or the equivalent), the interest rates on which may not exceed the maximum interest rates based on the PBOC benchmark rates.

Pricing for Fee and Commission-based Products and Services

Under the Tentative Administrative Measures on Pricing of Commercial Banking Services (商業銀行服務價格管理暫行辦法) jointly promulgated by the CBRC and the NDRC on June 26, 2003 and effective on October 1, 2003, services which are subject to government price guidelines include basic RMB settlement services, such as bank drafts, bank acceptance drafts, promissory notes, checks, remittances and entrusted collection, and other services specified by the CBRC and the NDRC. Fees for other products and services are determined based on market conditions. Commercial banks are also required to report to the CBRC at least 15 business days prior to the implementation of new fee schedules and to post such fee schedules on their business premises at least ten business days prior to such implementation.

Required Deposit Reserve and Surplus Deposit Reserve

Commercial banks are required to maintain a percentage of their total deposits as reserves with the PBOC to ensure they have sufficient liquidity to meet customer withdrawals. Currently, the Other Joint Stock Commercial Banks are required to maintain a deposit reserve equal to 13.5% of their total outstanding Renminbi deposits according to the relevant requirements of the PBOC.

The following table sets forth, for the Track Record Period, the historical values of the Renminbi required reserve ratios applicable to us. Throughout the Track Record Period, we have complied with the relevant requirements of the PBOC. There has been no adjustment to the required reserve ratio from June 30, 2009 till the Latest Practicable Date.

Date of adjustment	Renminbi required reserve ratios
2006.07.05	8.0%
2006.08.15	8.5%
2006.11.15	9.0%
2007.01.15	9.5%
2007.02.25	10.0%
2007.04.16	10.5%
2007.05.15	11.0%
2007.06.05	11.5%
2007.08.15	12.0%
2007.09.25	12.5%
2007.10.25	13.0%
2007.11.26	13.5%
2007.12.25	14.5%
2008.01.25	15.0%
2008.03.25	15.5%
2008.04.25	16.0%
2008.05.20	16.5%
2008.06.15	17.0%
2008.06.25	17.5%
2008.09.25	16.5%
2008.10.15	16.0%
2008.12.05	14.0%
2008.12.25	13.5%

From January 15, 2005 to September 14, 2006, both domestic and foreign-invested banks were required to maintain a reserve with the PBOC equal to at least 3% of their total foreign currency-denominated deposits at the end of the previous month, which was increased to 4% beginning September 15, 2006 and further increased to 5% on September 15, 2007.

Supervision Over Capital Adequacy

Capital Adequacy Guidelines

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

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

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

On February 23, 2004, the CBRC promulgated the New Capital Adequacy Regulations, which became effective on March 1, 2004. On July 3, 2007, the CBRC promulgated a decision to make certain amendments to the New Capital Adequacy Regulations. While the New Capital Adequacy Regulations did not change the preexisting requirements of an 8% capital adequacy ratio and a 4% core capital adequacy ratio, it amended the risk weighting for various assets, adjusted the components of capital and included capital charge for market risk in the calculation of capital adequacy ratios. In addition, the New Capital Adequacy Regulations require commercial banks to make adequate allowances for various impairment losses, including those associated with loans, before calculating their capital adequacy ratios. These changes resulted in a more stringent capital adequacy requirement.

In accordance with the New Capital Adequacy Regulations, capital adequacy ratio and core capital adequacy ratio are calculated based on the following formula under PRC GAAP:

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

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

Components of Capital

Regulatory capital is composed of core capital and supplementary capital after subtracting relevant capital deductions. Supplementary capital may not exceed core capital.

Core capital includes the following:

- paid-in capital or common shares;
- capital reserves;
- surplus reserves;
- retained earnings; and
- minority interests.

Supplementary capital includes the following:

- up to 70% of the revaluation reserve;
- the general allowances for impairment losses under the CBRC's requirements. See "— PRC Banking Supervision and Regulation — Loan Classification, Allowances and Write-offs — Loan Classification" and "— PRC Banking Supervision and Regulation — Loan Classification, Allowances and Write-offs — Loan Allowances";
- preference shares;

- qualifying bonds convertible into common shares;
- qualifying subordinated debt, but may not exceed 25% of core capital;
- hybrid capital bonds; and
- changes in fair value (the positive alteration, but no more than 50%, to the fair value of available-for-sale bonds that have been calculated as part of the owners' interests may be calculated into the supplementary capital; and the negative alteration to the fair value shall be deducted from the supplementary capital. When a commercial bank calculates the capital adequacy ratio, it shall transfer the fair value of available-for-sale bonds that have been calculated into the capital reserves from the core capital into the supplementary capital).

Capital deductions consist of the following:

- goodwill;
- equity investments in non-consolidated financial institutions; and
- capital investments in real estate not used for the bank's own operations or equity investments in non-banking financial institutions and enterprises.

Core capital deductions consist of the following:

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

Risk-weighted Assets

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

Risk Weighting	Assets
0%	• cash on hand • gold • claims on PRC incorporated commercial banks with an original maturity of four months or less • claims on the PRC central government or deposits at the PBOC • claims on the PBOC • claims on PRC policy banks • bonds issued by PRC financial asset management companies for the purpose of acquiring non-performing loans from state-owned banks • claims on non-PRC central governments or central banks in countries or regions where the sovereign or region is rated AA− or above[1] • claims on multilateral development banks
20%	• claims on PRC incorporated commercial banks with an original maturity of more than four months • claims on non-PRC commercial banks and securities companies incorporated in other countries or regions where the sovereign or region is rated AA− or above[1]
50%	• personal residential mortgages • claims on PRC public-sector entities invested by the PRC central government • claims on non-PRC public-sector entities invested by governments of countries or regions where the sovereign or region is rated AA− or above[1]
100%	• all other assets

Note:

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

Market Risk Capital

Since the first quarter of 2005, domestic accounts with trading books greater than the lower of RMB8.5 billion and 10% of the bank's total on- and off-balance sheet assets are required to take into consideration market risk arising from trading activities when determining capital adequacy. Market risk capital refers to the capital reserve that a bank is required to maintain for the market risks relating to its assets. Market risk refers to the risk of losses in on- and off-balance sheet asset value arising from movements in market prices and includes risks relating to interest rate-sensitive financial instruments and securities under trading accounts, foreign exchange risk and commercial banking product-related risks.

Issuance of Subordinated Debt and Subordinated Bonds

Since November 26, 2003, pursuant to the Notice of Including the Fixed-term Subordinated Debt in the Supplementary Capital (關於將次級定期債務計入附屬資本的通知) issued by the CBRC, PRC commercial banks have been permitted to issue fixed-term debt where the repayment of the principal and interest is subordinated to the bank's other liabilities but is senior to the bank's equity capital. PRC commercial banks may include such fixed-term subordinated debt in the bank's supplementary capital. To qualify for inclusion in supplementary capital, the subordinated debt must have a minimum term of five years and the proceeds must not be used to offset a bank's operating losses. Subordinated debt can be issued only through private placements to certain legal person institutions. Moreover, subordinated debt cannot be issued to other commercial banks. The issuance of subordinated debt by PRC commercial banks is subject to the approval of the CBRC.

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

On December 12, 2005, the CBRC issued the Notice Regarding the Issuance of Hybrid Capital Bonds by Commercial Banks for the Replenishment of Supplementary Capital (關於商業銀行發行混業資本債券補充附屬資本有關問題的通知), permitting eligible commercial banks to issue hybrid capital bonds in the inter-bank market and include such bonds in their supplementary capital. The introduction of hybrid capital bonds in the PRC has opened a new channel for commercial banks to replenish their supplementary capital and improve their capital adequacy ratio.

On October 18, 2009, the CBRC issued the Notice on Improving the Mechanism for Capital Replenishment of Commercial Banks (關於完善商業銀行資本補充機制的通知) which provides that the core capital adequacy ratios of national commercial banks and other commercial banks upon the issuance of long-term subordinated debt for the replenishment of supplementary capital should not be lower than 7% and 5% respectively. The limit for the issuance of long-term subordinated debts for national commercial banks and other commercial banks should not be more than 25% and 30% of their respective core capitals. In calculation of the capital adequacy ratio, the long-term subordinated debts issued by other commercial banks after July 1, 2009 should be fully deducted after October 18, 2009.

CBRC Supervision of Capital Adequacy

The CBRC is responsible for supervising the capital adequacy of banking institutions in the PRC. It reviews and evaluates banking institutions' capital adequacy through both on-site examination and off-site surveillance. Commercial banks are required to report to the CBRC their period-end unconsolidated capital adequacy ratios on a quarterly basis and their consolidated capital adequacy ratios on a semiannual basis. Commercial banks are classified into three categories based on their capital adequacy ratios as follows:

Category	Capital adequacy ratio		Core capital adequacy ratio
Adequately capitalized banks	not less than 8%	and	not less than 4%
Undercapitalized banks	less than 8%	or	less than 4%
Significantly undercapitalized banks.	less than 4%	or	less than 2%

If a bank is not in compliance with the capital adequacy requirement, depending on the degree of its undercapitalization, the CBRC may take various actions, including:

- issuing a supervisory notice letter;
- requiring the bank to submit and implement an acceptable capital restoration plan within two months;
- restricting asset growth;
- reducing higher-risk assets;
- restricting the purchase of fixed assets; and
- restricting dividends and other forms of distributions.

In addition, depending on the risk level of the bank and its implementation of the capital restoration plan, the CBRC may prohibit such bank from establishing new branches or launching new services or suspend the bank's entire business (except for low-risk activities).

The CBRC may require significantly undercapitalized banks to take further actions, including changes to senior management, transfer of control, restructuring of operations, or, in the most severe case, closure in accordance with relevant laws and regulations.

We have satisfied the relevant regulatory requirements on capital adequacy since the relevant requirements became effective on January 1, 2007. For example, as of December 31, 2007, our capital adequacy ratio was 10.73%, while our core capital adequacy ratio was 7.40%; as of December 31, 2008, our capital adequacy ratio was 9.22%, while our core capital adequacy ratio was 6.60%. In light of the growth of our assets, we have implemented various capital management measures. In addition to issuing new shares by private placement and issuing hybrid capital bonds, we have taken the following measures: (1) monitoring the capital market for opportunities to raise funds; (2) evaluating the performance of our branches based on their risk capital returns; (3) reducing higher risk-weighting assets; (4) increasing the proportion of fee and commissioned-based business; and (5) adjusting the risk portfolio of our business by gradually decreasing the proportion of higher-risk assets and increasing the proportion of our lower-risk business, such as retail banking.

Loan Classification, Allowances and Write-offs

Loan Classification

Banks in the PRC are currently required to classify loans under a five-category loan classification system based on the estimated likelihood of repayment of principal and interest according to Guidelines of Risk-based Classification of Loans. The primary factors for evaluating the likelihood of repayment include the borrower's cash flow, financial conditions and credit history.

Loan Allowances

According to the Guidelines of Risk-based Classification of Loans a loan classified as substandard, doubtful or loss is considered to be non-performing, and commercial banks are required to make provisions based on a reasonable estimate of the probable loss on a prudent and timely basis. Allowance for impairment losses consists of general allowance, specific allowance and special allowance. General allowance refers to the allowance for all unidentified but possible losses, which are made based on certain percentages of the balance of total outstanding loans; specific allowance refers to the allowance made for specific losses in connection with an individual loan based on its categorization under the Guidelines of Risk-based Classification of Loans; and special allowance refers to the allowance made for the risks specifically related to certain countries, regions, industries, or certain types of loans.

Under the Guidelines on Loan Loss Provisions (貸款損失準備計提指引) (the "***Provisioning Guideline***"), commercial banks are required to make provisions for impairment losses on a quarterly basis and to have a general allowance of not less than 1% of the total loans outstanding as of December 31 of any year. The guidelines further provide guidance on the level of specific provisions as a percentage of the outstanding amount of loans for each loan category: 2% for special mention loans; 20%-30% for substandard loans; 40%-60% for doubtful loans and 100% for loss loans. Commercial banks may make special provisions in accordance with special risk factors (including risks in association with certain industries and countries), probability of losses and historical experience.

The PBOC issued a notice with the promulgation of the Guidelines on Provisioning Guideline, permitting banks to increase (or decrease) their loan loss provisions gradually to meet the requirements listed in the Provisioning Guideline, but the requirement must be met by no later than 2005. The Guidelines on Loan Loss Provisions further provide that banks are not permitted to distribute profit after tax if they do not have sufficient loan loss provisions. As of the date of this prospectus, the Bank is in full compliance with the Provisioning Guideline.

CBRC Supervision of Loan Classification and Loan Allowances

Commercial banks are required to formulate detailed internal procedures that clearly define the responsibilities of each relevant department with respect to loan classification, approval, review and related matters. In addition, beginning in 2002, commercial banks have been required to submit quarterly and annual reports to the CBRC on the classification of their loan portfolios and their allowances for loan losses. Based on a review of these reports, the CBRC may require commercial banks to explain significant changes in loan classification and loan loss allowance levels, or may carry out further inspections.

Loan Write-offs

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

Allowance and Statutory General Reserve for Impairment Losses

Pursuant to the Administrative Measures for the Withdrawal of Reserves for Non-performing Debts of Financial Enterprises (金融企業呆賬準備提取管理辦法) and the subsequent Notice on Relevant Issues Concerning the Withdrawal of Reserves for Non-performing Debts (關於呆賬準備提取有關問題的通知), both issued by the MOF, financial institutions in the PRC are required to maintain adequate allowance for impairment losses. In addition, financial institutions are also required to set up a statutory general reserve to cover potential impairment losses that have yet to be identified. Financial institutions are required to assess the risk profile of their assets in determining the statutory general reserve level. In principle, such level shall not be less than 1% of the aggregate amount of each financial institution's risk-bearing assets before allowance for impairment losses at the balance sheet date. Financial institutions are not allowed to make profit distribution to shareholders until adequate allowance for impairment losses and statutory general reserve has been made. Financial institutions, which could not meet these requirements on July 1, 2005 were required to take necessary steps to ensure that they could fulfill such requirements within approximately three years, but in any case by no later than five years, from July 1, 2005. As of December 31, 2008, the aggregate amount of our risk-bearing assets before allowance for impairment losses amounted to RMB800.0 billion, and we have set aside RMB8.0 billion as our statutory general reserve.

Other Operational and Risk Management Ratios

The Core Indicators for the Risk Management of Commercial Banks (for Trial Implementation) (the "***Core Indicators (Provisional)***") (商業銀行風險監管核心指標(試行)) promulgated by the CBRC became effective on January 1, 2006, superseding the Examination Measures and Supervision Indicators Relating to the Administration of Assets and Liabilities Ratios of Commercial Banks (the "***Examination Measures***") (資產負債比率管理監控、監測指標和考核辦法) issued by the PBOC in 1996. The Core Indicators (Provisional) amended certain liquidity and operating ratios required under the Examination Measures and introduced certain new ratios. The Core Indicators (Provisional) are implemented on a trial basis in 2006, and the CBRC has encouraged commercial banks to submit suggestions for amending the Core Indicators (Provisional) to the CBRC.

The following table sets forth the required ratios as provided in the Core Indicators (Provisional) and our Bank's ratios as of September 30, 2009, which were calculated based on our unaudited balance sheet data prepared in accordance with PRC GAAP. Although the CBRC has not requested commercial banks to report these ratios, it has requested commercial banks to submit certain data that are used to calculate some of these ratios.

Risk level	Primary indicators	Secondary Indicators	Requirement	As of September 30, 2009	
Risk Level					
Liquidity risk	Liquidity ratio(1)		≥25%	Renminbi	32.46%
				Foreign Currency	96.85%
	Core liabilities ratio(2)		≥60%		55.34%
	Liquidity gap ratio(3)		≥−10%		−7.93%
Credit risk	Non-performing asset ratio(4)		≤4%		0.60%
		Non-performing loan(5) ratio	≤5%		0.82%
	Credit concentration to a single group customer(6)		≤15%		7.81%
		Loan concentration to a single customer(7)	≤10%		9.30%
	Overall credit exposure to related parties(8)		≤50%		1.82%
Market risk	Cumulative foreign currency exposure ratio(9)		≤20%		5.34%
Risk Cushion					
Profitability	Cost to income ratio(10)		≤45%		36.24%
	Return on assets(11)		≥0.6%		1.13%
	Return on capital(12)		≥11%		23.08%
Allowance adequacy	Allowance adequacy ratio for asset impairment(13)		≥100%		unable to calculate(14)
		Allowance adequacy ratio for loan impairment(15)	≥100%		142.54%
Capital adequacy	Capital adequacy ratio(16)		≥8%		8.38%
		Core capital adequacy Ratio(16)	≥4%		5.91%

Notes:

(1) Calculated as follows: Liquidity ratio = Current assets/Current liabilities. Current assets include cash, gold, surplus deposit reserve, net inter-bank money market placement with maturities of one month or less, interest receivable and other receivables due within one month, qualified loans with maturities of one month or less, investment in debt securities with maturities of one month or less, debt securities that can be liquidated in the international secondary market any time and other liquid assets with maturities of one month or less (excluding the non- performing portion of such assets). Current liabilities include demand deposits (excluding policy deposits), time deposits with remaining maturities of one month or less (excluding policy deposits), inter-bank borrowing due within one month, issued debt securities with maturities of one month or less, interest payable and other payables due within one month, borrowings from the PBOC due within one month and other liabilities due within one month.

(2) Calculated as follows: Core Liabilities ratio = Amount of core liabilities/amount of total liabilities. Core liabilities refer to the combined amount of time deposit with remaining maturities of three months or longer, issued debt securities and 50% of demand deposits. Total liabilities refer to total liabilities on the balance sheet prepared under PRC GAAP.

(3) Calculated as follows: Liquidity gap ratio = Liquidity gap/Amount of on- or off-balance sheet assets with maturities of 90 days or less. Liquidity gap refers to the amount of on- or off-balance sheet assets with maturities of 90 days or less subtracted by the amount of on- or off-balance sheet liabilities.

(4) Calculated as follows: Non-performing asset ratio = Amount of non-performing assets/Amount of assets subject to credit risk. Non-performing assets include non-performing loans and other assets categorized as non-performing. The categorization of non-loan assets is in accordance with relevant CBRC regulations.

(5) Calculated as follows: Non-performing loan ratio = Amount of non-performing loans/Amount of total loans. Non-performing loans refer to loans in the substandard, doubtful and loss categories according to the PBOC and CBRC's five-category loan classification system.

(6) Calculated as follows: Credit concentration to a single group customer = Total credit granted to the largest group customer/Regulatory capital. Largest group customer refers to the single group customer granted with the highest credit limit at the end of the period.

(7) Calculated as follows: Loan concentration to a single customer = Total loans to the largest customer/Regulatory capital. Largest customer refers to the customer with the highest amount of loans outstanding at the end of the period.

(8) Calculated as follows: Overall credit exposure to related parties = Total granted credit limit to all related parties/ Regulatory capital. Related parties refer to parties defined in the Related Party Transactions Measures. Total granted credit limit to all related parties refers to total credit limit granted to such parties subtracted by cash deposit guarantees and collateral in the form of bank deposits and PRC government bonds.

(9) Calculated as follows: Cumulative foreign currency exposure ratio = Amount of cumulative foreign currency exposure/ Regulatory capital. Cumulative foreign currency exposure refers to interest sensitive foreign currency assets subtracted by interest sensitive foreign currency liabilities.

(10) Calculated as follows: Cost to income ratio = Operating expenses (including amortization)/Operating income.

(11) Calculated as follows: Return on assets = Net profit/Average balance of total assets for the period.

(12) Calculated as follows: Return on capital = Net profit/Average balance of shareholders' equity for the period.

(13) Calculated as follows: Allowance adequacy ratio for asset impairment = Actual amount of allowance for assets subject to credit risk/Required amount of allowance for assets subject to credit risk.

(14) As the CBRC has not provided the required level of allowance for assets subject to credit risk other than loans, we were not able to calculate our ratio.

(15) Calculated as follows: Allowance adequacy ratio for loan impairment = Actual amount of allowance for loans/required amount of allowance for loans.

(16) See "— PRC Banking Supervision and Regulation — Supervision Over Capital Adequacy."

As of September 30, 2009, we did not comply with the core liabilities ratio of the Core Indicators (Provisional). Also, as the CBRC has yet to specify the required level of allowance for assets subject to credit risk other than loans, thus we were unable to calculate our allowance adequacy ratio for asset impairment. According to the Core Indicators (Provisional) regulations, the CBRC may issue risk alerts to banks based on their analysis of data submitted by commercial banks.

In addition, the Core Indicators (Provisional) defined certain other ratios without providing the regulatory requirement for those ratios, including ratios relating to interest rate risk sensitivity, operational risk and loan migration. The CBRC may provide the regulatory requirement for those ratios in the future.

Before the Core Indicators (Provisional) taking effect, commercial banks are required to calculate some operating ratios in accordance with the Examination Measures. The following table sets forth, at the dates indicated, these required operational ratios for commercial banks. Unless otherwise indicated, such ratios are calculated in accordance with the formula promulgated by the PBOC in 1996 and based on our unaudited balance sheet data prepared in accordance with the applicable PRC GAAP.

	As of December 31,				As of June 30,	As of September 30,
	Requirement	2006	2007	2008	2009	2009
Liquidity ratios						
RMB current assets to Renminbi current liabilities	≥25.0%	51.42%	34.94%	45.50%	39.65%	32.46%
Foreign currency current assets to foreign currency current liabilities	≥60.0%	66.15%	97.37%	119.16%	113.05%	96.85%
RMB Loan-to-deposit ratios						
Renminbi loans to Renminbi deposits	≤75.0%	69.72%	74.44%	75.00%	82.74%	78.75%
Foreign currency loans to foreign currency deposits	≤85.0%	51.52%	61.67%	38.98%	33.96%	56.31%
Borrower concentration ratios						
Total loans to one single borrower to regulatory capital	≤10.0%	5.88%	3.75%	4.49%	9.11%	9.30%
Total loans granted to top ten borrowers to regulatory capital	≤50.0%	43.74%	28.17%	27.34%	45.76%	48.93%
Inter-bank ratios						
Total RMB inter-bank borrowings from other banks and financial institutions to total RMB deposits	≤4.0%	0.19%	0.29%	0.04%	1.72%	0.48%
Total RMB inter-bank lending to other banks and financial institutions to total RMB deposits	≤8.0%	1.70%	2.54%	2.11%	1.48%	2.09%

Corporate Governance

Corporate Governance

The Company Law of the People's Republic of China (中華人民共和國公司法), the Commercial Banking Law of the People's Republic of China (中華人民共和國商業銀行法) and other laws, regulations and regulatory documents provided for specific requirements for corporate governance, of which the Guidelines on Corporate Governance of Joint Stock Commercial Banks (股份制商業銀行公司治理指引) provide for the best practice of corporate governance for PRC joint stock companies. Under the Guidelines on Corporate Governance of Other Joint Stock Commercial Banks, PRC Other Joint Stock Commercial Banks should establish a sound corporate governance system and a clear organizational structure, with management and supervisory powers, functions and responsibilities being clearly divided among the board, the supervisory board and the senior management. In addition, the Guidelines on Independent Directors and External Supervisor of Joint Stock Commercial Banks (股份制商業銀行獨立董事及外部監事指引) recommend that the board of directors of a commercial bank should have at least two independent directors, and the Guiding Opinions on the Establishment of Independent Director Systems by Listed Companies (關於在上市公司建立獨立董事制度的指導意見) requires that at least one-third of the board members of a PRC listed company should be independent directors, while the Guidelines on Corporate

Governance of Joint Stock Commercial Banks recommend that senior management should comprise at least one-quarter but not more than one-third of the board of directors.

Internal Controls

Under the Internal Control Guidelines for Commercial Banks (商業銀行內部控制指引) issued by the PBOC and the CBRC in 2002 and 2007 respectively, commercial banks are required to establish internal controls to ensure effective risk management for their business activities. PRC commercial banks are also required to establish a risk management department that formulates and implements risk management policies and procedures. In addition, PRC banks are required to establish an internal audit department that can independently supervise and evaluate all aspects of their operations.

On December 25, 2004, the CBRC published the Interim Measures for the Evaluation of the Internal Control Systems of Commercial Banks (商業銀行內部控制評價試行辦法) which set forth the procedures, measures and ranking standards for the CBRC's internal control evaluation of commercial banks. The CBRC can, based on its evaluation of the performance of PRC commercial banks' internal control system, take various supervisory measures, such as interviewing the person in charge of internal controls or the chairman of the board, issuing warnings, and increasing the scope and frequency of on-site examinations. In the event of non-compliance with the Interim Measures for the Evaluation of Internal Controls, the CBRC may impose sanctions including, among others, requesting a change of the bank's senior management, suspending the bank's business, revoking the practice license of persons involved, or delaying approval or not accepting applications for the establishment of new branch outlets or new business. Since February 2005, the CBRC has been conducting such evaluations periodically and has taken regulatory actions based on the results of its evaluations.

On June 27, 2006, the CBRC issued the Guidelines on Internal Audit for Banking Financial Institutions (銀行業金融機構內部審計指引) which became effective on July 1, 2006. Pursuant to the guidelines, banks are required to establish an audit committee of the board with at least three members, a majority of whom must be non-executive directors. Banks are also required to have an internal audit department with employees who meet certain qualifications, which shall in principle represent 1% of the bank's total number of employees. The guidelines set forth the required scope of the internal audit. Banks are required to evaluate the risk of each business unit at least once per year and conduct internal audit of each business unit at least once every two years. The number of employees responsible for our internal auditing function is based on our risk management demand. As of September 30, 2009, we had 115 internal audit employees, representing 0.5% of our total number of employees. Although the 1% requirement set forth in the above guidelines was not met, it fulfilled our risk management demand. Such guidelines do not specify any penalties or disciplinary measures for banks that do not fulfill the 1% requirement. Our Directors confirm that such non-compliance will not have a material adverse effect on our business and financial condition.

Information Disclosure Requirements

On July 3, 2007, the CBRC issued the Measures for the Information Disclosure of Commercial Banks (商業銀行信息披露辦法) which became effective the same day. Under the measures, a PRC commercial bank is required to publish an audited annual report within four months after the end of each financial year, disclosing its financial position and operational results. The only exception is, for a commercial bank with assets of less than RMB1 billion or a deposit balance of less than RMB500 million, if it encounters difficulties while conducting information disclosure in accordance with the provisions of the Measures on the Information Disclosure of Commercial Banks, it may provide explanations to the CBRC and submit its future information disclosure plan to the CBRC for approval. Upon the CBRC's approval, such commercial bank may be exempted from the information disclosure requirements.

Apart from the disclosure requirements of the CBRC, PRC commercial banks listed on a stock exchange in the PRC are also required to comply with the disclosure requirements imposed by the CSRC and the relevant stock exchanges.

Transactions with Related Parties

In April 2004, the CBRC promulgated the Administrative Measures for Related Party Transactions between the Commercial Banks and their Insiders or Shareholders (商業銀行與內部人和股東關聯交易管理辦法), which provided more stringent and detailed requirements on connected transactions of PRC commercial banks. The measures require PRC commercial banks to adhere to the principles of honesty and fairness in conducting connected transactions. PRC commercial banks are not allowed to grant unsecured loans to related parties or grant secured loans to related parties on terms more favorable than those offered to other borrowers.

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

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

We have established the Related Party Transactions Supervision Committee under our Board and have adopted approval procedures for connected transactions in August 2004 in accordance with the measures and other applicable laws and regulations. In addition, we have adopted a tiered system for the approval of connected transactions by setting out in our Articles of Association the relevant approval requirements in accordance with the applicable laws and regulations.

Risk Management

Since its inception, the CBRC has published numerous risk management guidelines and rules in an effort to improve risk management of PRC commercial banks. For example, CBRC published guidelines in an effort to control credit risk relating to real estate loans, loans to group borrowers, automobile loans and derivatives transactions. See "— PRC Banking Supervision and Regulation — Regulation of Principal Commercial Banking Activities." The CBRC also promulgated the Core Indicators (Provisional) as a basis of supervising the risks of PRC commercial banks. The CBRC established requirements for certain ratios relating to risk levels and risk provisions in the Core Indicators (Provisional) and is expected to establish requirements for certain ratios relating to risk migration for the purpose of evaluating and monitoring the risks of PRC commercial banks. See "— PRC Banking Supervision and Regulation — Other Operational and Risk Management Ratios." The CBRC periodically collects data through off-site surveillance to analyze such indicators, and evaluate and issue early warnings of the risks, on a timely basis. The CBRC also published regulations concerning operational risk management, market risk management and risk rating.

Operational Risk Management

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

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

Market Risk Management

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

Compliance Risk Management

In order to strengthen the compliance risk management of commercial banks and maintain the safety and stability of the operations of PRC commercial banks, the CBRC promulgated the Guidelines for Compliance Risk Management of Commercial Banks (商業銀行合規風險管理指引) on October 25, 2006. These guidelines have clarified the responsibilities of the board of directors and senior management of a PRC commercial bank with respect to compliance risk management, have standardized the organizational structure for compliance risk management and have set out the regulatory mechanisms for a bank's risk management.

To meet the regulatory requirements in respect of compliance risk management, we established a special compliance management department in 2005 to manage all our compliance issues to prevent the occurrence of any material compliance risks.

Risk Rating System

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

Ownership and Shareholder Restrictions

Regulations on Equity Investment in Banks

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

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

Restrictions on Shareholders

The Guidelines on Corporate Governance of Joint Stock Commercial Banks impose certain additional requirements on shareholders of PRC joint stock commercial banks. For example:

- in the event that a PRC commercial bank encounters liquidity problems, its shareholders are required to immediately repay outstanding loans due and repay in advance outstanding loans not yet due from the bank;
- if a PRC commercial bank fails to meet the required capital adequacy ratios, its shareholders are obligated to support measures determined by the bank's board of directors that are aimed at increasing the capital adequacy level; and
- if shareholders of a PRC commercial bank fail to repay outstanding loans when due, their voting rights will be restricted for the period during which the relevant loan is overdue.

In addition, the Company Law and relevant CBRC rules and regulations impose certain restrictions on the ability of a commercial bank's shareholders to pledge their shares. For example, an Other Joint Stock Commercial Bank may not accept its own shares as collateral.

Anti-money Laundering Regulation

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

Regulation of Foreign-invested Banks in the PRC

Starting from December 11, 2006, the PRC government has lifted the restrictions regarding the geographic presence and customer base for RMB-denominated businesses by foreign-invested banks. Pursuant to the relevant provisions of the Regulations on the Administration of Foreign-invested Banks (外資銀行管理條例) promulgated by the State Council and the related implementation rules, foreign-invested banks may extend their RMB-denominated businesses to PRC citizens and there shall be no restriction on the geographic presence of foreign-invested banks operating in the PRC in respect of RMB-denominated businesses. However, wholly-foreign-owned banks and Sino-foreign joint venture banks are currently not allowed to issue financial bonds in the PRC, while branches of foreign banks in the PRC are only allowed to take RMB-denominated deposits from PRC citizens with each transaction of no less than RMB1 million. The PRC government allows foreign banks to submit applications for the establishment of wholly foreign-owned banks and Sino-foreign joint venture banks, as well as the establishment of their branches and representative offices in the PRC subject to the satisfaction of statutory conditions. Upon their establishment, any such institutions may conduct financial business in accordance with applicable laws and regulations and subject to the CBRC's supervision and inspection in accordance with the law.

Other Requirements

Use of Funds

Under the PRC Commercial Banking Law, commercial banks are not permitted to engage in trust investment or securities investment business, or invest in real property other than for their own use, or invest in non-banking financial institutions and enterprises, unless otherwise approved by the relevant government authorities. The use of funds by commercial banks is limited to the following:

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

PRC SECURITIES LAWS AND REGULATIONS

As our A Shares have been listed on the Shanghai Stock Exchange since December 19, 2000, we are subject to Securities Law and the Shanghai Listing Rules. The Shanghai Listing Rules regulate share listing and information disclosure by the listed companies, including us, and seek to maintain the orderly operation of the stock exchange market and protect the interests of the investors. As a company with A Shares listed on the Shanghai Stock Exchange, we are subject to a number of obligations under the Shanghai Listing Rules, including:

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