PRC BANKING SUPERVISION AND REGULATION

Overview

The banking industry in the PRC is highly regulated. The principal regulatory authorities in the PRC banking industry include the CBRC and the PBOC. The CBRC is responsible for supervising and regulating banking institutions, and the PBOC, as the central bank of the PRC, is responsible for formulating and implementing monetary policies. We are also subject to regulation by the MOF. The principal laws and regulations relating to the PRC banking industry are the PRC Commercial Banking Law (中華人民共和國商業銀行法), the PRC PBOC Law (中華人民共和國中國人民銀行法) and the PRC Banking Supervision and Regulatory Law (中華人民共和國銀行業監督管理法), and the rules and regulations promulgated thereunder.

History and Development of the Regulatory Framework

Established on December 1, 1948, the PBOC was initially the primary 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 PRC Commercial Banking Law and the PRC PBOC Law. The PRC Commercial Banking Law was promulgated in May 1995 and laid down the fundamental principles of operations for PRC commercial banks. The PRC 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 has undergone further significant reform and development. The CBRC was established in April 2003 and took over from the PBOC its role as the primary regulator of the PRC banking industry. The CBRC was mandated to implement reforms, minimize overall risks, promote stability and development and enhance the international competitiveness of the PRC banking industry. In December 2003, the PRC Commercial Banking Law and the PRC PBOC Law were amended and, on February 1, 2004, the PRC Banking Supervision and Regulatory Law came into effect. The PRC Banking Supervision and Regulatory Law sets out the regulatory functions and responsibilities of the CBRC.

Principal Regulators

CBRC

Functions and Powers

The CBRC is the principal regulatory authority 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 the establishment of which is subject to the CBRC's approval. The CBRC is also responsible for the supervision and regulation of the entities established by domestic financial institutions outside the PRC and the overseas operations of the above-mentioned banking and non-banking financial institutions. According to the PRC Banking Supervision and Regulatory Law and relevant regulations, the CBRC's primary regulatory responsibilities include:

- formulating and promulgating rules and regulations governing banking institutions and their activities;
- examining and approving the establishment, change and termination of banking institutions and their scope of business, as well as granting banking licenses to commercial banks and their branches;
- regulating the business activities of banking institutions, including their products and services offered;
- approving or overseeing qualification requirements for directors and senior management personnel of banking institutions;
- setting prudential guidelines and standards for risk management, internal control, capital adequacy, asset quality, allowance for impairment losses, risk concentration, related party transactions and liquidity requirements for banking institutions;
- conducting on-site inspection and off-site surveillance of the business activities and risk levels of banking institutions;
- imposing corrective and punitive measures for violations of applicable banking regulations; and
- drafting and publishing statistics and financial reports of national banking institutions.

Examination and Supervision

The CBRC, through its head office in Beijing and its branches throughout the PRC, monitors the operations of banks and their branches through on-site examinations and off-site surveillance. On-site examinations generally include inspecting a bank's business premises, interviewing its employees, 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 to the CBRC.

If a banking institution is not in compliance with an applicable banking regulation, the CBRC is authorized to impose corrective and punitive measures, including imposing fines, ordering the suspension of certain business activities, imposing restrictions on dividends and other forms of distributions and asset transfers, and suspending the opening of new branches. In extreme cases or when a commercial bank fails to take corrective action within the time period specified by the CBRC, the CBRC may order a banking institution to suspend operations and revoke its financial operating license. In the event of crisis or failure within a banking institution, the CBRC may assume management control over, or arrange for the restructuring of, such banking institution.

PBOC

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

- promulgate and implement orders and regulations in relation to its duties;
- formulate and implement monetary policy in accordance with laws;
- issue Renminbi and administer its circulation;
- regulate the inter-bank money market and the inter-bank bond market;
- implement foreign exchange controls and regulate the inter-bank foreign exchange market;
- regulate the gold market;
- hold, administer and manage state reserves of foreign exchange and gold;
- manage the national treasury;
- safeguard the normal operation of payment and clearing systems;
- guide and orchestrate the financial industry in its anti-money laundering activities and take responsibility for monitoring capital in respect of anti-money laundering; and
- take responsibility for financial industry statistics, surveys, analyses and forecasts.

MOF

As a ministry under the State Council, the MOF is empowered to perform its duties in respect of state finance, tax and state-owned assets management. The MOF mainly regulates the performance review and compensation systems for senior management of state-controlled banks as well as state-owned assets appraisal. Since the PRC Accounting Standards and Accounting Regulations for Business Enterprises (企業會計準則) issued by the MOF came into effect on January 1, 2007, the MOF is also responsible for monitoring their implementation in the banking industry. The MOF's primary responsibilities include:

- drafting laws and regulations in respect of fiscal, finance and accounting management, enacting rules, organizing international negotiation regarding foreign-related finance and debt and agreeing the form of relevant agreements and accords;
- managing financial state-owned assets, participating in drafting rules in relation to state-owned assets management and administering assets appraisal; and
- monitoring and inspecting the implementation of financial and tax rules and policies, reporting critical issues in fiscal income and expenses management and managing supervision commissioners' offices.

Other Regulatory Authorities

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

Licensing Requirements

Basic Requirements

The PRC Commercial Banking Law and the Measures for Implementation of Administrative Licensing Matters Concerning Chinese-funded Commercial Banks (中資商業銀行行政許可事項實施辦法), effective from 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. The conditions include:

- the articles of association of the proposed commercial bank complying with relevant requirements of the PRC Commercial Banking Law and the PRC Company Law;
- the registered capital of the proposed commercial bank meeting the minimum requirement under the PRC Commercial Banking Law, which is RMB1 billion, RMB100 million and RMB50 million for a national commercial bank, a city commercial bank and a rural commercial bank, respectively;
- the directors and the senior management of the proposed commercial bank possessing the requisite qualifications;
- the organizational structure and management system of the proposed commercial bank being 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 complying with relevant requirements.

Significant Changes

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

- change of name;
- change of registered capital;
- change of location of head office;
- 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 total 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 jurisdictions. The bank making such application 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 was profitable for the past three consecutive fiscal years;
- the balance of its assets was no less than RMB100 billion 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 prudential controls and management fulfill regulatory requirements; and
- other prudential conditions required by the CBRC are satisfied.

Scope of Business

Under the PRC 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;
- engaging in foreign exchange trading 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 services; 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. Subject to approval by the SAFE, commercial banks can engage in settlement and sales of foreign exchange.

Regulation of Principal Commercial Banking Activities

Lending

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

The CBRC has also issued guidelines and measures to control risks in connection with related party loans. See "—PRC Banking Supervision and Regulation—Corporate Governance and Internal Control—Transactions with Related Parties."

On July 23, 2009, the CBRC issued the Interim Measures for the Administration of Fixed Asset Loans (固定資產貸款管理暫行辦法) to ensure that loans flow to efficient real economy and critical projects, prevent credit risk, optimize lending structure, improve lending management quality of banking institutions, avoid systematic risk in the banking industry as well as promote risk management capabilities of banking institutions.

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

- the Guidelines on the Management of Risks of Credit Granted by Commercial Banks to Group Borrowers (商業銀行集團客戶授信業務風險管理指引), which require commercial banks to establish a risk management system of credit granted to group borrowers and file with the CBRC. Under the circumstance that the credit exposure to a single group borrower of a commercial bank exceeds 15% of its regulatory capital, the commercial bank shall adopt measures, including syndicated loans, joint loans and transfer of loans, to disperse risks. In line with prudential supervision requirement, the CBRC may lower the ratio for credit exposure to a single group borrower;
- 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), which require commercial banks to establish real estate credit review and approval standards as well as a risk management and internal control system in connection with market risk, legal risk and operational risk to real estate credit. Commercial banks are not allowed to issue real estate development loans to borrowers without land use right certificate and relevant permissions. The CBRC conducts a periodic inspection of the implementation of the guidelines;
- the Automobile Loan Measures (汽車貸款管理辦法), which require commercial banks to establish a credit rating system and monitoring system in connection with automobile loans. The measures also set out certain conditions for automobile loans application. In addition, the amount of automobile loans shall not exceed 80% of the price of vehicles for

self-use purpose, 70% of the price of vehicles for commercial purpose and 50% of the price of second-hand vehicles. Commercial banks shall also require borrowers to provide security over their vehicles or other types of security for automobile loans;

- the Interim Measures for the Administration of Working Capital Loans (流動資金貸款管理暫行辦法), which require commercial banks to establish effective internal control and risk management systems to monitor the use of working capital loans and get full access to customer information. Commercial banks shall take reasonable and prudential measures to compute actual demand of clients and determine the amount of loans which shall not exceed actual demand of clients. Commercial banks shall set out definitive and legitimate purpose for working capital loans. Such working capital loans shall not be used for fixed assets investment and equity investment or for fields or purposes as prohibited by laws;

- the Guidelines on the Management of Risks of Merger and Acquisition Credit Granted by Commercial Banks (商業銀行併購貸款風險管理指引), which require commercial banks to establish an operation flow and internal control system pursuant to the guidelines and launch their implementation following reporting to the CBRC. Commercial banks are allowed to operate merger and acquisition credit business if they meet the following requirements: (i) a sound risk management system and an effective internal control system are established; (ii) allowance adequacy ratio for loan impairment is not less than 100%; (iii) capital adequacy ratio is not less than 10%; (iv) general reserve is not less than 1% of the balance of loans for the same period; and (v) professional team for due diligence and risk evaluation is formed. The guidelines also set out certain requirements for risks evaluation and control in relation to merger and acquisition, including overall strategic risk, legal and compliance risk, consolidation risk, operational risk and financial risk;

- the Interim Measures for the Administration of Personal Loans (個人貸款管理暫行辦法), which require commercial banks to establish an effective full process management mechanism and risk limit management system in connection with personal loans. The measures also set out certain conditions for personal loans application. The use of personal loans should comply with relevant laws and policies. Commercial banks must specify the purpose for personal loans; and

- the Guidelines on Project Financing Business (項目融資業務指引), which require banking institutions to establish a sound operation flow and risk management mechanism. Banking institutions shall fully identify and evaluate risks in association with project construction period and operation period, including policy risk, financing risk, completion risk, product market risk, over-budget risk, raw material risk, operational risk, exchange rate risk, environmental risk and other related risk. Banking institutions shall also focus on borrowers' repayment capability to evaluate risks on the aspects of technical and financial feasibility as well as repayment sources. In addition, banking institutions shall require borrowers to set up a designated account to receive all revenues from projects, monitor the account and take actions in case of unusual movements.

We adopt certain rules and measures to comply with the above regulations issued by the CBRC. We also further enhance our risk management and internal control capabilities in respect of loans and credit granted to certain specific industries and customers.

Foreign Exchange Business

Commercial banks are required to obtain approvals from the 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, financial institution bonds and 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 the securities investment fund custodian business, if, among other requirements, such commercial bank had net assets at the year-end of not less than RMB2 billion for each of the latest three fiscal years and its capital adequacy ratio fulfills the relevant regulatory requirements. 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, senior managers of a commercial bank's fund custody department must have certain qualifications and their appointments must obtain approval by the CSRC. According to the Interim Measures for the Administration of Corporate Annuity Funds (企業年金基金管理試行辦法) promulgated jointly by the Ministry of Labor and Social Security, the CBRC and other authorities on February 23, 2004 and effective on May 1, 2004, commercial banks are required to file with the CBRC to act as custodian for corporate annuity funds and establish a specialized funds custodian department.

Insurance

Commercial banks in the PRC are not permitted to underwrite insurance policies, but are permitted to act as agents to sell insurance products through their distribution networks. Commercial banks that conduct agency sales of insurance products are required to comply with applicable rules issued by the CIRC. 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 insurance agency business. Pursuant to the Notice Regarding Standardization of Insurance Agency 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.

On January 13, 2010, the CIRC and the CBRC jointly promulgated the Circular on Strengthening Restructuring and Improving the Healthy Development of Banks' Life Insurance Agency Services (關於加強銀行代理壽險業務結構調整促進銀行代理壽險業務健康發展的通知) which enhanced supervision over life insurance agency licenses. The circular requires all commercial banks to obtain a license issued by the CIRC before engaging in life insurance agency business through their outlets.

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 in an effort to further improve the reporting mechanism and risk control for personal wealth management services provided by commercial banks.

In addition to domestic wealth management business, the PBOC, the CBRC, and the SAFE jointly promulgated the Provisional Measures for Overseas Wealth Management by Commercial Banks (商業銀行開辦代客境外理財業務管理暫行辦法) which came into effect on April 17, 2006 and permit duly licensed commercial banks to make overseas investments in pre-approved financial products on behalf of domestic institutions and individuals.

Electronic Banking

In January 2006, the CBRC issued the Administrative Measures Regulating Electronic Banking Business (電子銀行業務管理辦法) and Security Evaluation Guidelines on Electronic Banking (電子銀行安全評估指引) in an effort to enhance risk management and security standards in this sector. All banking institutions applying to establish an e-banking business are required to have sound internal control and risk management systems and should not have 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, medium term notes and corporate bonds issued by qualified non-financial institutions, and certain derivative products. Unless approved by the PRC government, commercial banks in the PRC are prohibited from engaging in trust investment and securities businesses, investing in real property (other than for their own use) or 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 for the 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), amended the Tentative Administrative Measures on the Management of 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), and issued the Notice to Further Strengthen Risk Management of Derivative Product Transaction between Banking Institutions and Institutional Customer (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) on July 31, 2009 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 new products and increase the efficiency of the examination and approval process.

Supervision and Regulation of Agriculture-related Financial Services

The PRC regulatory authorities have issued a number of rules and policies to regulate and encourage agriculture-related financial services.

In December 2006, the CBRC issued the Guidelines on Adjustment to and Relaxation of Rural Area Banking Business Entry Policy and Better Support for Developing a New Countryside (關於調整放寬農村地區銀行業金融機構准入政策更好支持社會主義新農村建設的若干意見) which, under the principle of maintaining sustainable business, adjust and relax policy regarding business entry to rural areas by banking institutions and lower the entry threshold.

In January 2007, the CBRC issued the Practice Guidelines on Approval for Establishment of Township Banks (村鎮銀行組建審批工作指引) and the Provisional Rules on Township Bank Management (村鎮銀行管理暫行規定), which set out standards for establishment and management of township banks.

In August 2007, the CBRC released the Guidelines on Promotion of Rural Small Loans by Banking Institutions (關於銀行業金融機構大力發展農村小額貸款業務的指導意見), which allow all banking institutions to issue small loans to rural borrowers. Pursuant to such guidelines, rural borrowers eligible for such loans include traditional rural households and various small businesses; such small loans are targeted at important areas and key sectors which are conducive to the County Area development; the limit for such small loans is raised to the range of RMB100,000 to RMB300,000 in developed areas and RMB10,000 to RMB50,000 in less developed areas; jointly secured loan limits can be duly increased based on credit limits; and the maturities of the loans can be extended up to three years.

In April 2008, the PBOC and the CBRC jointly issued the Notice on Certain Policies Regarding Township Banks, Loan Companies, Rural Mutual Cooperatives and Small Loan Companies (關於村鎮銀行、貸款公司、農村資金互助社、小額貸款公司有關政策的通知), which sets out certain supervision measures, including measures regarding deposit reserve, interest rates for loan and deposit, payment and settlement and accounting management, to guide and boost sustainable development of such institutions.

In October 2008, the PBOC and the CBRC jointly promulgated the Guidelines on Acceleration of Innovation of Rural Financial Products and Services (關於加快農村金融產品和服務方式創新的意見), which allow pilot innovation programs for promoting rural financial product and service innovations in certain counties and municipalities located in the six provinces of Central China and the three provinces of Northeastern China which are main crop production areas or have solid bases for County Area economic development.

In December 2008, the General Office of State Council issued Several Opinions on Promotion of Economic Development with Financial Policies (關於當前金融促進經濟發展的若干意見), which enhance policy support for rural finance and direct more loans to rural areas.

In January 2009, the CBRC issued the Notice on Adjustment to Certain Loan Supervision Policy and Promotion of Stable Economic Development (關於當前調整部分信貸監管政策促進經濟穩健發展的通知), which makes proper adjustment to relevant loan supervision rules and requirements, emphasizes differentiating loan management and review policy for agriculture-related loans and strengthens issuance of agriculture-related loans.

In June 2009, the CBRC issued the Provisional Rules on Conversion of Small Loan Companies into Township Banks (小額貸款公司改制設立村鎮銀行暫行規定), which require banking institutions to promote the conversion of small loan companies into township banks to develop the financial market in the County Areas and enhance support for Sannong and SMEs.

In July 2009, the CBRC released the Notice on Relevant Issues to Implement Non-traditional Rural Financial Institutions Overall Work Arrangement for 2009-2011 (中國銀監會關於做好<新型農村金融機構2009年-2011年總體工作安排>有關事項的通知) to foster the development of new rural financial institutions.

In April 2010, the CBRC and the CIRC jointly promulgated the Guidelines on Enhancing Cooperation Between Agriculture-related Loans and Agriculture-related Insurance (關於加強涉農信貸與涉農保險合作的意見), which introduce mechanisms for agriculture-related insurance to disperse agriculture-related loan risks, improve loan availability for rural borrowers and further resolve the credit availability problem in rural areas.

In April 2009, the CBRC issued the Guidelines to Agricultural Bank of China's County Area Banking Division Reform and Regulations (中國農業銀行三農金融事業部制改革與監管指引) (the "Guidelines"), which require us to establish sound organizational structure and operational mechanism for our County Area Banking Business and set out certain regulatory indicators to be calculated under PRC GAAP, including (in particular those which are mandatory):

- the ratio of our new loans to new deposits in respect of our County Area Banking Business shall in principle reach 50% within the year following the completion of our financial restructuring;

- the ratio of our outstanding loans to outstanding deposits in respect of our County Area Banking Business shall strive to exceed 50% within five years;
- the loan growth rate of our County Area Banking Business shall not be less than the growth rate of our total loans;
- the percentage of the assets of our County Area Banking Business to our total assets and the percentage of the liabilities of our County Area Banking Business to our total liabilities, shall not be less than their respective percentages as of the end of the year in which our financial restructuring was completed and strive to reach stable growth;
- the cost-to-income ratio of our County Area Banking Business shall be less than 50% starting from the year following the completion of our financial restructuring;
- the return on assets in respect of our County Area Banking Business shall reach 0.5% in the year following the completion of our financial restructuring and shall exceed 0.8% within the next several years thereafter;
- the non-performing loan ratio of our County Area Banking Business shall in principle be less than 5%; and
- the allowance coverage ratio of our County Area Banking Business shall not be less than 60% at the end of the year in which our financial restructuring was completed and shall strive to increase to 100% within three years thereafter.

Pursuant to the requirements under the Guidelines, we endeavor to establish operational management, risk management and internal control systems in respect of our County Area Banking Business division and aim to improve the service and competitiveness of our County Area Banking Business. As of December 31, 2009, total assets of our County Area Banking Business amounted to 36.4% of our total assets; total liabilities of our County Area Banking Business amounted to 37.7% of our total liabilities; outstanding loans of our County Area Banking Business increased by 43.4% from December 31, 2008, 9.9 percentage points higher than the growth rate of our total loans; the loan-to-deposit ratio of our County Area Banking Business amounted to 39.3%, 6.2 percentage points higher than the ratio at December 31, 2008; and our return on assets, non-performing loan ratio, allowance coverage ratio and cost-to-income ratio were 0.62%, 3.69%, 98.3% and 50.5%, respectively (in each case calculated in accordance with PRC GAAP). According to the Guidelines, if we fail to comply with the relevant ratio requirements set in the Guideline, the CBRC will require us to rectify such non-compliance within a prescribed period and if we fail to rectify the non-compliance or do not take any rectification measures within the prescribed period, the CBRC may take further regulatory actions. Although the percentage of the assets of the County Area Banking Business in our total assets, the percentage of the liabilities of the County Area Banking Business in our total liabilities and the cost-to-income ratio at December 31, 2009 did not comply with the requirements of the Guideline, we have not been subject to any regulatory actions for such non-compliance as of the Latest Practicable Date.

We will adopt certain measures to comply with the requirements under the Guidelines, including: (i) endeavoring to boost the implementation of our County Area Banking Business development plan; (ii) promoting the implementation of our County Area Banking Business division reform to further improve our managerial system and operational mechanism; (iii) strengthening performance evaluation and improving our operational efficiency in our County Area Banking Business; (iv) enhancing our County Area market penetration and issuance of loans to the County Areas and improving our services and competitiveness; and (v) further building our risk management system in respect of our County Area

Banking Business to maintain its risk indicators in a reasonable range. We will endeavor to comply with the relevant requirements of the Guidelines.

Pricing of Products and Services

Interest Rates for Loans and Deposits

Interest rates for RMB-denominated loans and deposits were historically set by the PBOC. In accordance with the PRC Commercial Banking Law, each commercial bank is required to determine its loan rate in accordance with the minimum limit of loan rate and its deposit rate in accordance with the maximum limit of deposit rate set by the PBOC, respectively. In recent years, the PBOC has gradually liberalized 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 Since 10/29/2004[(1)]	Deposits Since 10/29/2004[(2)]
Maximum interest rates	No cap (up to 230% of the PBOC benchmark rate for rural and urban credit cooperatives)	PBOC benchmark rate, except for negotiated deposits
Minimum interest rates	Not lower than 90% of the PBOC benchmark rate	No minimum

(1) 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 August 19, 2006, the minimum interest rates for personal commercial residential mortgage loans have been changed to 85% of the PBOC loan benchmark rate. Since October 27, 2008, the minimum interest rates for personal commercial residential mortgage loans have been changed to 70% of the PBOC loan benchmark rate.

(2) Beginning on October 29, 2004, commercial banks in the PRC are permitted to set their own interest rates on RMB 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 provincial social security agencies in amounts of RMB500 million or more, both with a term longer than five years, or deposits by Postal Savings Bank of China in amounts of RMB30 million or more with a term longer than three years.

From August 19, 2006 to December 23, 2008, the PBOC adjusted the benchmark rate for RMB-denominated loans and the benchmark rate for RMB-denominated deposits upon 12 occasions and 11 occasions respectively. Since then and up to the Latest Practicable Date, the PBOC has not adjusted the benchmark rate for RMB-denominated loans and the benchmark rate for RMB-denominated deposits.

The following table sets forth the PBOC benchmark rates for Renminbi loans since August 19, 2006.

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	Residential Mortgage Loans		Housing Provident Fund Loans	
						Five years or less	More than five years	Five years or less	More than five years
	(Interest rate per annum %)								
August 19, 2006	5.58	6.12	6.30	6.48	6.84	6.48	6.84	4.14	4.59
March 18, 2007	5.67	6.39	6.57	6.75	7.11	6.75	7.11	4.32	4.77
May 19, 2007	5.85	6.57	6.75	6.93	7.20	6.93	7.20	4.41	4.86
July 21, 2007	6.03	6.84	7.02	7.20	7.38	7.20	7.38	4.50	4.95
August 22, 2007	6.21	7.02	7.20	7.38	7.56	7.38	7.56	4.59	5.04
September 15, 2007	6.48	7.29	7.47	7.65	7.83	7.65	7.83	4.77	5.22
December 21, 2007	6.57	7.47	7.56	7.74	7.83	7.74	7.83	4.77	5.22
September 16, 2008	6.21	7.20	7.29	7.56	7.74	7.56	7.74	4.59	5.13
October 9, 2008	6.12	6.93	7.02	7.29	7.47	7.29	7.47	4.32	4.86
October 30, 2008	6.03	6.66	6.75	7.02	7.20	7.02	7.20	4.05	4.59
November 27, 2008	5.04	5.58	5.67	5.94	6.12	5.94	6.12	3.51	4.05
December 23, 2008	4.86	5.31	5.40	5.76	5.94	5.76	5.94	3.33	3.87

The following table sets forth the PBOC benchmark rates for Renminbi deposits since August 19, 2006.

Date of adjustment	Demand deposits	Time deposits					
		Three months	Six months	One year	Two years	Three years	Five years
	(Interest rate per annum %)						
August 19, 2006	0.72	1.80	2.25	2.52	3.06	3.69	4.14
March 18, 2007	0.72	1.98	2.43	2.79	3.33	3.96	4.41
May 19, 2007	0.72	2.07	2.61	3.06	3.69	4.41	4.95
July 21, 2007	0.81	2.34	2.88	3.33	3.96	4.68	5.22
August 22, 2007	0.81	2.61	3.15	3.60	4.23	4.95	5.49
September 15, 2007	0.81	2.88	3.42	3.87	4.50	5.22	5.76
December 21, 2007	0.72	3.33	3.78	4.14	4.68	5.40	5.85
October 9, 2008	0.72	3.15	3.51	3.87	4.41	5.13	5.58
October 30, 2008	0.72	2.88	3.24	3.60	4.14	4.77	5.13
November 27, 2008	0.36	1.98	2.25	2.52	3.06	3.60	3.87
December 23, 2008	0.36	1.71	1.98	2.25	2.79	3.33	3.60

The PBOC generally does not regulate interest rates for foreign currency-denominated loans or deposits, except for US dollar-, Hong Kong dollar-, Japanese Yen- and Euro-denominated deposits of less than US$3 million (or the equivalent) and with a term of one year or less, the maximum interest rates on which may not exceed the PBOC benchmark rates for small foreign currency deposits.

Commercial banks may determine the discount rate based on the rediscount rate set by the PBOC provided that the discount rate is not in excess of the PBOC benchmark rates of the same period for Renminbi loans. On March 25, 2004, the PBOC set the rediscount rate to commercial banks at 3.24% per annum, which was raised to 4.32% on January 1, 2008, lowered to 2.97% on November 27, 2008 and then further lowered to 1.80% on December 23, 2008.

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 governmental pricing guidelines include basic RMB settlement services, such as bank drafts, bank acceptance drafts, promissory notes, checks, remittances and entrusted collection, and other services specified by the CBRC and the NDRC. Fees for other products and services are determined based on market conditions. Commercial banks are also required to report to the CBRC at least 15 business days prior to the implementation of any new fee schedules and to post such fee schedules at their business premises at least ten business days prior to such implementation.

Required 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, large state-owned commercial banks are required to maintain a deposit reserve equal to 17% of their total outstanding RMB deposits according to the relevant requirements of the PBOC.

The following table sets forth the historical values of the RMB statutory reserve ratios applicable to large deposit-taking financial institutions for recent years. Throughout the Track Record Period, we have complied with the relevant requirements of the PBOC. There has been no adjustment to the statutory reserve ratio from May 10, 2010 up to the Latest Practicable Date.

Date of adjustment	Renminbi required reserve ratios (%)
January 15, 2007	9.5
February 25, 2007	10.0
April 16, 2007	10.5
May 15, 2007	11.0
June 5, 2007	11.5
August 15, 2007	12.0
September 25, 2007	12.5
October 25, 2007	13.0
November 26, 2007	13.5
December 25, 2007	14.5
January 25, 2008	15.0
March 25, 2008	15.5
April 25, 2008	16.0
May 20, 2008	16.5
June 15, 2008	17.0
June 25, 2008	17.5
September 25, 2008	17.5
October 15, 2008	17.0
December 5, 2008	16.0
December 25, 2008	15.5
January 18, 2010	16.0
February 25, 2010	16.5
May 10, 2010	17.0

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%, calculated based on the following formulae under PRC GAAP:

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

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

On February 23, 2004, the CBRC promulgated the New Capital Adequacy Regulations, which became effective on March 1, 2004 and was amended on July 3, 2007. While the New Capital Adequacy Regulations did not change the pre-existing 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 a 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 allowance for various impairment losses, including those associated with loans, before calculating their capital adequacy ratios. These changes resulted in a more stringent capital adequacy requirement.

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

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

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

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 and general reserves;
- retained earnings; and
- minority interests.

Supplementary capital includes the following:

- up to 70% of the revaluation reserve;
- the general allowance 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";

- preferred shares;
- qualifying bonds convertible into common shares;
- qualifying subordinated debt, which may not exceed 25% of core capital for national commercial banks;
- hybrid capital bonds; and
- changes in fair value (the positive change, but no more than 50%, to the fair value of available-for-sale bonds that have been calculated as part of the owners' equity interests may be calculated into supplementary capital; and the negative change to the fair value shall be deducted from 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 allowance 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

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

Market Risk Capital

Market risk capital refers to the capital 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, exchange rate risk and commercial banking product-related risks. Since the first quarter of 2005, domestic banks with total trading books position 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.

Issuance of Subordinated Debt and Subordinated Bonds

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 debt issued by other banks in excess of 20% of their core capital. The issuance of subordinated debt 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合資本債券補充附屬資本有關問題的通知), permitting eligible commercial banks to issue hybrid capital bonds in the inter-bank market and include such bonds in their supplementary capital. The introduction of hybrid capital bonds in the PRC has opened a new channel for commercial banks to replenish their supplementary capital and improve their capital adequacy ratio.

On 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 requires major commercial banks and other banks to maintain a core capital adequacy ratio of no less than 7% and 5%, respectively, if they seek to issue long-term subordinated debt for the replenishment of supplementary capital. The major commercial banks and other banks should not issue long-term subordinated debt which constitutes more than 25% and 30% of their respective core capital. In the calculation of the capital adequacy ratio, after October 18, 2009, banks should fully deduct any long-term subordinated debt issued by other banks which they acquired after July 1, 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 semi-annual 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 requirements, depending on the degree of its undercapitalization, the CBRC may take various actions, including:

- issuing a supervisory notice;
- requiring the bank to submit and implement an acceptable capital replenishment 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 a capital replenishment 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.

Basel Accords

The Basel Capital Accord, or Basel I, was introduced by the Basel Committee on Banking Supervision, or the Basel Committee, in 1988. Basel I is a capital measurement system for banks that provides for the implementation of a credit risk measurement framework with a minimum capital standard of 8%. Since 1998, the Basel Committee has issued certain proposals for the New Capital Accord, or Basel II, to replace Basel I. Basel II retains the key elements of Basel I, including the general requirement for banks to hold total capital equivalent to at least 8% of their risk-weighted assets, but seeks to improve the capital framework in various key respects, including (i) establishment of the "three pillars" framework, namely the first pillar "minimum capital standard," the second pillar "supervision and regulation by regulatory authorities" and the third pillar "information disclosure"; and (ii) introducing material changes to the calculation of capital adequacy and adopting simple to complicated and diversified approaches.

The CBRC promulgated and amended the New Capital Adequacy Regulations on February 23, 2004 and July 3, 2007, respectively. The CBRC has advised that the New Capital Adequacy Regulations are based on Basel I while taking into consideration certain aspects of Basel II. On February 28, 2007, the CBRC issued the Guidelines on Implementation of the New Capital Accord in PRC Banking Industry (中國銀行業實施新資本協議指導意見), which require large commercial banks, which have set up active operational entities in other countries or regions (including Hong Kong and Macau) and have a significant international business, to implement Basel II by the end of 2010, or upon the CBRC's approval, no later than the end of 2013. To facilitate preparations for the implementation of Basel II, the CBRC adopted the first series of supervision guidelines in respect of implementation of Basel II in September 2008, including the Guidelines on Classification of Commercial Bank Account Credit Risks Exposure (商業銀行銀行賬戶信用風險暴露分類指引), the Guidelines on Supervision of Commercial Bank Internal Rating Based System for Credit Risks (商業銀行信用風險內部評級體系監管指引), the Guidelines on Computation of Commercial Bank Specialized Loan Regulatory Capital (商業銀行專業貸款監管資本計量指引), the Guidelines on

Computation of Commercial Bank Credit Risks Cushion Regulatory Capital (商業銀行信用風險緩釋監管資本計量指引), and the Guidelines on Computation of Commercial Bank Operational Risks Regulatory Capital (商業銀行操作風險監管資本計量指引). In March 2009, China officially joined the Basel Committee and participated in the establishment of international standards for banking supervision, which is conducive to the upgrading of supervision techniques and supervision levels in China's banking industry.

Since November 2009, the CBRC has issued the following five regulatory guidelines to implement Basel II: the Guidelines on Disclosure of Capital Adequacy Ratio (商業銀行資本充足率信息披露指引), the Guidelines on Verification of Advanced Approaches for Capital Measurement (商業銀行資本計量高級方法驗證指引), the Guidelines on Risk Management of Interest Rates of Commercial Bank Account (商業銀行銀行賬戶利率風險管理指引), the Guidelines on Supervision and Review on Capital Adequacy Ratio (商業銀行資本充足率監督檢查指引), and the Guidelines on Measurement of Risk Exposure Relating to Assets Securitization (商業銀行資產證券化風險暴露監管資本計量指引). These five regulatory guidelines facilitate the implementation of Basel II, among which, the Guidelines on Risk Management of Interest Rates of Commercial Bank Account also apply to those banks which are not yet implementing Basel II.

Loan Classification, Allowance 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 the Guidelines of Risk-based Classification of Loans (貸款風險分類指引). The five categories are "normal," "special mention," "substandard," "doubtful" and "loss." The primary factors for evaluating the likelihood of repayment include the borrower's cash flow, financial condition and credit history.

Loan Allowance

According to the Guiding Principles of Risk-based Classification of Loans (貸款風險分類指導原則), 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 guiding principles; 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), 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.

CBRC Supervision of Loan Classification and Loan Allowance

Commercial banks are required to formulate detailed internal procedures that clearly define the responsibilities of each relevant department with respect to loan classification, approval, review and related matters. In addition, beginning in 2004, commercial banks have been required to submit quarterly and annual reports to the CBRC on the classification of their loan portfolios and their allowance for loan losses. Based on the 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 examination 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 Provisioning for Non-performing Assets of Financial Institutions (金融企業呆賬準備提取管理辦法) and the subsequent Notice on Relevant Issues Concerning the Provisioning for Non-performing Assets (關於呆賬準備提取有關問題的通知), both issued by the MOF, financial institutions in the PRC are required to maintain adequate allowance for impairment losses. In addition, financial institutions are also required to set up a statutory general reserve to cover potential impairment losses that have yet to be identified. Financial institutions are required to assess the risk profile of their assets in determining the statutory general reserve level. In principle, such level 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 distributions to shareholders until adequate allowance for impairment losses and statutory general reserve has been made. Financial institutions, which could not meet these requirements in 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 2005.

Other Operational and Risk Management Ratios

The Core Indicators for the Risk Management of Commercial Banks (for Trial Implementation) ("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.

The following table sets forth the required ratios as provided in the Core Indicators (Provisional) and our Bank's ratios for the three years ended December 31, 2009, calculated under PRC GAAP.

Risk level	Primary indicators	Secondary Indicators	Requirement (%)	Ratios of our Bank (%) as of December 31, 2007	2008	2009
Risk Level						
Liquidity risk	Liquidity ratio(1)	RMB	≥25	37.04	44.79	40.99
		Foreign Currency		123.39	205.54	122.54
	Core liabilities ratio(2)		≥60	66.53	74.97	67.66
	Liquidity gap ratio(3)		≥(10)	(24.37)	(19.08)	(9.01)
Credit risk	Non-performing asset ratio(4)		≤4	15.87	2.27	1.49
		Non-performing loan(5) ratio	≤5	23.57	4.32	2.91
	Credit exposure to a single group borrower(6)		≤15	N/A	34.67	25.80
		Loan exposure to a single borrower(7)	≤10	N/A	6.04	4.41
	Overall credit exposure to related parties(8)		≤50	N/A	0.68	0.27
Market risk	Cumulative foreign currency exposure ratio(9)		≤20	N/A	64.45	14.14
Risk Cushion						
Profitability	Cost-to-income ratio(10)		≤45	33.52	44.71	43.11
	Return on assets(11)		≥0.6	0.88	0.84	0.82
	Return on capital(12)		≥11	N/A	N/A	20.53
Allowance adequacy	Allowance adequacy ratio for asset impairment(13)		>100	N/A	132.14	115.60
		Allowance adequacy ratio for loan impairment(14)	>100	108.07	86.56	108.55
Capital adequacy	Capital adequacy ratio(15)		≥8	N/A	9.41	10.07
		Core capital adequacy Ratio(16)	≥4	N/A	8.04	7.74

Calculated as follows:

(1) Liquidity ratio = Current assets/Current liabilities x 100%. Current assets include cash, gold, surplus deposit reserve, net placement and deposits with banks and financial institutions with maturities of one month or less, interest receivable and other receivables due within one month, qualified loans with maturities of one month or less, investment in debt securities with maturities of one month or less, debt securities that can be liquidated in the international secondary market at any time and other liquid assets with maturities of one month or less (excluding the non-performing portion of such assets). Current liabilities include demand deposits (excluding policy deposits), time deposits with remaining maturities of one month or less (excluding policy deposits), net placements and deposits from banks and financial institutions 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) Core liabilities ratio = Amount of core liabilities/amount of total liabilities x 100%. Core liabilities refer to the combined amount of time deposit with remaining maturities of three months or longer, issued debt securities and 50% of demand deposits. Total liabilities refer to total liabilities on the balance sheet prepared under PRC GAAP.

(3) Liquidity gap ratio = Liquidity gap/Amount of on- or off-balance sheet assets with maturities of 90 days or less x 100%. Liquidity gap refers to the amount of on- or off-balance sheet assets with maturities of 90 days or less minus the amount of on- or off-balance sheet liabilities with maturities of 90 days or less.

(4) Non-performing asset ratio = Amount of non-performing assets subject to credit risk/Amount of assets subject to credit risk x 100%. Non-performing assets include non-performing loans and other assets categorized as non-performing. The categorization of non-loan assets is in accordance with relevant CBRC regulations.

(5) Non-performing loan ratio = Amount of non-performing loans/Amount of total loans x 100%. Non-performing loans refer to loans in the substandard, doubtful and loss categories according to the PBOC and CBRC's five category loan classification system.

(6) Credit exposure to a single group borrower = Total credit granted to the largest group borrower/Regulatory capital x 100%. Largest group borrower refers to the single group borrower granted the highest credit limit at the end of the period.

(7) Loan exposure to a single borrower = Total loans to the largest borrower/Regulatory capital x 100%. Largest borrower refers to the borrower with the highest amount of loans outstanding at the end of the period.

(8) Overall credit exposure to related parties = Total granted credit limit to all related parties/Regulatory capital x 100%. 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 minus cash deposit guarantees and collateral in the form of bank deposits and PRC government bonds.

(9) Cumulative foreign currency exposure ratio = Amount of cumulative foreign currency exposure/Regulatory capital x 100%. Cumulative foreign currency exposure refers to exchange rate sensitive foreign currency assets subtracted by exchange rate sensitive foreign currency liabilities.

(10) Cost-to-income ratio = Operating and management expenses/Operating income x 100%.

(11) Return on assets = Net profit/Average balance of total assets for the period x 100%.

(12) Return on capital = Net profit/Average balance of shareholders' equity for the period x 100%.

(13) Allowance adequacy ratio for asset impairment = Actual amount of allowance for assets subject to credit risk/Required amount of allowance for assets subject to credit risk x 100%.

(14) Allowance adequacy ratio for loan impairment = Actual amount of allowance for loans/Required amount of allowance for loans x 100%. The required amount of allowance for loans is calculated based on the methodology under the PBOC guidelines as described under "—Loan Classification, Allowance and Write-offs—Loan Allowance."

(15) Capital adequacy ratio = (Capital – capital deductions)/(Risk-weighted assets + 12.5 x capital charge for market risk). The cash dividend of RMB20 billion declared in respect of the year of 2009 payable to the shareholders on our register of members as of December 31, 2009 was not deducted from regulatory capital in calculating the above capital adequacy ratio at December 31, 2009. Our capital adequacy ratio would have been 9.61% at December 31, 2009 if such cash dividend were deducted from regulatory capital at that date.

(16) Core capital adequacy ratio = (Core capital – core capital deductions)/(Risk-weighted assets + 12.5 x capital charge for market risk). The cash dividend of RMB20 billion declared in respect of the year of 2009 payable to the shareholders on our register of members as of December 31, 2009 was not deducted from the core capital in calculating the above core capital adequacy ratio at December 31, 2009. Our core capital adequacy ratio would have been 7.28% at December 31, 2009 if such cash dividend were deducted from core capital at that date.

In the past, we have failed to comply with certain regulatory ratios as required under the Core Indicators (Provisional). In particular:

- We did not comply with the regulatory requirement for liquidity gap ratio for the years ended December 31, 2007 and 2008, mainly due to a low ratio of short term liquid assets. We subsequently proactively adopted appropriate measures to comply with the applicable regulatory requirement, including: (i) increasing our high quality liquid asset reserve which can be quickly realized; (ii) increasing short term assets such as financial assets held under resale agreements, short term debt securities and discounted bills to shorten the maturities of our assets; and (iii) lengthening the maturities of certain liabilities. We met the applicable regulatory requirement for liquidity gap ratio as of December 31, 2009.

- Our allowance adequacy ratio for loan impairment as of December 31, 2008 was not in compliance with the applicable regulatory requirements, primarily as a result of the significant releases from loan loss allowance in connection with our financial restructuring. However, we believe that the amounts of our loan loss allowance assessed under IFRS reflect our reasonable estimates of the probable losses on our loans. The methodology of assessing loans for impairment to determine allowance for impairment losses under IFRS differs from the methodology under the PBOC's guidelines and therefore the amounts of loan loss allowance under IFRS and the PBOC's guidelines are generally different and not comparable. In 2009, we adopted a conservative approach to provisioning for impairment losses when macroeconomic conditions presented uncertainties. Our allowance adequacy ratio for loan impairment met the regulatory requirement as of December 31, 2009.
- Our credit exposure to a single group borrower ratio did not meet the regulatory requirement as of December 31, 2009. We have taken proactive measures to lower the credit exposure to our largest single group borrower. We met the relevant regulatory requirement of the CBRC as of April 30, 2010.

The CBRC supervises compliance by commercial banks with risk management ratios set out in the Core Indicators (Provisional) and takes regulatory action where it deems appropriate. However, the Core Indicators (Provisional) do not stipulate any penalties for non-compliance. Our directors believe that, as of March 31, 2010, we are in compliance with the regulatory ratios as required by the Core Indictors (Provisional) in terms of our domestic operation, except for the credit exposure to a single group borrower ratio which met the applicable requirement as of April 30, 2010. As of April 30, 2010, there had not been any penalty imposed on us for non-compliance with such core indicators.

In addition, the PRC Commercial Banking Law requires that the loan-to-deposit ratio of commercial banks shall not exceed 75%. As of December 31, 2007, 2008 and 2009, our loan-to-deposit ratios are 65.71%, 50.84% and 55.19%, respectively, which all comply with such requirement.

Corporate Governance and Internal Control

Corporate Governance

The PRC Company Law, the PRC Commercial Banking Law and other laws, regulations and regulatory documents provide for specific requirements relating to 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) set out standards for corporate governance best practice for PRC joint stock companies. Under the guidelines, PRC 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 shareholders meeting, the board of directors, the board of supervisors and the senior management. In addition, the Guidelines on Independent Directors and External Supervisors of Joint Stock Commercial Banks (股份制商業銀行獨立董事及外部監事指引) recommend that the board of directors of a commercial bank should have at least two independent directors, and the Guidelines on the Establishment of a System of Independent Directors by Listed Companies (關於在上市公司建立獨立董事制度的指導意見) require that at least one-third of the board members of a PRC listed company should be independent directors. 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. In accordance with our Articles of Association, our senior management includes all executive directors. We currently have four executive directors in our Board of Directors in compliance with such requirement. The Guidelines on the Corporate Governance and other Regulatory Issues regarding State-owned Commercial Banks (國有商業銀行公司治理及相關監管指引) provide that shareholders' general meetings are the governing bodies of the state-owned commercial banks and shareholders of state-owned commercial banks shall exercise their rights through shareholders' general meetings and comply with laws, regulations and their own articles of association. In addition, these guidelines set out, among other things, general principles of corporate governance applicable to the Large Commercial Banks.

In addition to the general qualification requirements applicable to directors and senior management of bank institutions under the PRC Company Law, the PRC Commercial Banking Law and other regulations and rules, the CBRC also sets out certain specific qualification requirements, for example:

- chairman and vice-chairman of the board of directors of a state-owned or joint stock commercial bank should at least hold a Bachelor's degree and have more than eight years work experience in the financial sector or 12 years work experience in related business sectors (including five years or more in the financial sector);
- secretary to the board of directors of a state-owned or joint stock commercial bank should at least hold a Bachelor's degree and have more than six years work experience in the financial sector or ten years work experience in related business sectors (including three years or more in the financial sector);
- president and vice-president of a state-owned or joint stock commercial bank should at least hold a Bachelor's degree and have more than eight years work experience in the financial sector or 12 years work experience in related business sectors (including four years or more in the financial sector);
- assistant president of a state-owned or joint stock commercial bank should at least hold a Bachelor's degree and have more than six years work experience in the financial sector or ten years work experience in related business sectors (including three years or more in the financial sector);
- chief auditor or principal of audit department of a Chinese-funded commercial bank should at least hold a Bachelor's degree, obtain nationally or internationally recognized senior auditing qualification (or pass nationally or internationally recognized auditing or accounting professional examinations) and have more than six years work experience in the financial, accounting or auditing sectors;
- chief accountant or principal of financial department of a Chinese-funded commercial bank should at least hold a Bachelor's degree, obtain nationally or internationally recognized senior accounting qualification (or pass nationally or internationally recognized accounting professional examinations) and have more than six years work experience in the financial, accounting or auditing sectors; and
- an independent director of a joint stock commercial bank shall not hold any positions in other commercial banks. A person shall not hold a position as independent director of a commercial bank if that person:

  (i) holds more than 1% of the registered capital of the commercial bank or holds management positions in the shareholder of the commercial bank;

(ii) holds management positions in the commercial bank or enterprises controlled by the commercial bank;

(iii) held management positions in the commercial bank or enterprises controlled by the commercial bank during the last three years;

(iv) holds management positions in enterprises that have overdue loans owed to the commercial bank;

(v) holds management positions in professional entities which have business relationships with the commercial bank;

(vi) may be controlled or materially influenced by the commercial bank; or

(vii) is a spouse, parent, son, daughter, grandparent, brother or sister of a person referred to above.

During the Track Record Period and up to the Latest Practicable Date, we complied with the above qualification requirements.

Internal Control

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 control 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. In the event of non-compliance with the Interim Measures for the Evaluation of Internal Control, 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 licenses of persons involved, or delaying approval or rejecting applications for the establishment of new branch outlets or new business.

On June 27, 2006, the CBRC issued the Guidelines on Internal Audit for Banking 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, in principle representing no less than 1% of the bank's total number of employees. The number of employees responsible for our internal auditing function is determined based on our risk management requirements. Our internal control and compliance department is responsible for regulatory compliance, internal control assessment and certain audit functions of our Bank. As of the Latest Practicable Date, the personnel in our internal control and compliance department who, together with our internal audit personnel, comprise more than 1% of our total number of employees.

On May 22, 2008, the Basic Rules on Enterprise Internal Control (企業內部控制基本規範) were issued jointly by the MOF, the CBRC, the NAO, the CSRC and the CIRC and became effective on July 1, 2009. The rules require enterprises to establish and implement internal control systems, utilize information technology to strengthen internal control, and establish information systems addressing their operational and management needs, among other matters.

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 on 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 Information Disclosure Rules on Companies Publicly Offering Securities No.26—Special Disclosure Rules on Commercial Banks (公開發行證券的公司信息披露編報規則第26號—商業銀行信息披露特別規定), which was issued by the CSRC and became effective on September 1, 2008, set out guidelines on information disclosure, including financial and risk-related disclosure by commercial banks offering securities to the public. The rules also require commercial banks to publish announcements in relation to certain events which may have a material impact on their operational capability or profitability.

Apart from the disclosure requirements above, PRC listed commercial banks are also required to comply with the relevant disclosure requirements imposed by the CSRC through the Administrative Measures on Listed Companies Information Disclosure (上市公司信息披露管理辦法) and the relevant stock exchanges.

Transactions with Related Parties

Apart from the general rules regarding related party transactions issued by the CSRC and the relevant stock exchanges, the CBRC promulgated the Administrative Measures for Related Party Transactions between 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) in April 2004, which provided more stringent and detailed requirements on related party transactions of PRC commercial banks. The measures require PRC commercial banks to adhere to the principles of honesty and fairness in conducting related party transactions. PRC commercial banks are not allowed to grant unsecured loans to related parties or grant secured loans to related parties on terms more favorable than those offered to other third party borrowers.

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

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

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 of the CBRC. If any existing shareholder of a commercial bank increases its shareholding to 5% or more threshold without obtaining the CBRC's prior approval, that shareholder will be subject to CBRC sanctions, which include, among others, rescission of the acquisition, disgorgement of profits, if any, for that shareholder and fines.

Under the Measures for the Administration of the Investment and Shareholding in Chinese-funded Financial Institutions by Foreign Financial Institutions (境外金融機構投資入股中資金融機構管理辦法), foreign financial institutions 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 any domestic commercial bank. In addition, if aggregate foreign investment 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 the aggregate foreign investment 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 maintain 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 PRC Company Law and relevant CBRC rules and regulations impose certain restrictions on the ability of a commercial bank's shareholders to pledge their shares. For example, a joint stock commercial bank may not accept its own shares as collateral. Moreover, there are legal limitations on the ability of shareholders in a joint stock commercial bank to pledge to any other party their shares in the bank. According to the Guidelines on Corporate Governance of Joint Stock Commercial Banks, (i) any shareholder of a joint stock commercial bank must give prior notice to the board of directors of the bank if it wishes to pledge its shares as collateral, and (ii) if the outstanding amount of the bank's loans to a shareholder exceeds the audited value of such shareholder's equity in the bank for the immediately preceding year, and such shareholder does not pledge any government bonds or bank deposit certificates as collateral, the shareholder may not pledge its shares.

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, including credit risk management, operational risk management, market risk management, compliance risk management and risk rating system, in addition to guidelines concerning loan and credit to certain specific industries and customers and guidelines in respect of the implementation of Basel II, see "—Regulation of Principal Commercial Banking Activities—Lending" and "—Supervision over Capital Adequacy—Basel Accords." The CBRC also promulgated the Core Indicators (Provisional) as a basis of supervising the risk management of PRC commercial banks. The CBRC established requirements for certain ratios relating to risk levels and risk provisions in the Core Indicators (Provisional) and is expected to establish requirements for certain ratios relating to risk mitigation for the purpose of evaluating and monitoring the risks of PRC commercial banks. See "—PRC Banking Supervision and Regulation — Other Operational and Risk Management Ratios." The CBRC periodically collects data through off-site surveillance to analyze such indicators and evaluate and issue early warnings of the risks on a timely basis.

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 risks. Under this circular, commercial banks are required to establish internal policies and procedures specifically for the management and control of operational risks. A bank's internal audit department and business operations department are required to conduct independent and ad hoc reviews and examinations of the bank's business operations from time to time, and ongoing reviews and examinations for business areas involving a greater degree of operational risks. Moreover, a commercial bank's head office is required to assess the implementation of, and compliance with, its internal policies and procedures on operational risks.

In addition, the circular sets out detailed requirements relating to, among other things, establishing a system under which 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 the use and keeping of chops, specimen signatures and evidential vouchers.

Furthermore, on May 14, 2007, the CBRC issued the Guidelines on Operational Risk Management of Commercial Banks (商業銀行操作風險管理指引) to enhance risk management abilities of the PRC commercial banks. These guidelines mainly address, among other things, the supervision and controls of the board of directors, responsibilities of senior management, proper organizational structure, and policies, approaches and procedures for operational risk management. Those policies and procedures shall be submitted to the CBRC for filing. If a commercial bank incurs a significant operational incident and fails to adopt effective corrective measures within a required period, the CBRC shall take relevant regulatory measures.

Market Risk Management

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

Compliance Risk Management

In order to strengthen the compliance risk management of commercial banks and maintain the safety and stability of the operations of PRC commercial banks, the CBRC promulgated the Guidelines on Compliance Risk Management of Commercial Banks (商業銀行合規風險管理指引) on October 20, 2006. These guidelines have clarified the responsibilities of the board of directors and the senior management of a PRC commercial bank with respect to compliance risk management, standardized the organizational structure for compliance risk management and set out the regulatory mechanisms for a bank's risk management.

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 its 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 its senior management qualification. These risk ratings are currently not publicly available.

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 these 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 Customer Identity Identification and Materials and Transaction Recording of Financial Institutions (金融機構客戶身份識別和客戶身份資料及交易記錄保存管理辦法) promulgated jointly by the PBOC, the CBRC, the CSRC and the CIRC, which became effective on 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 Transactions and Suspicious 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, where 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 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.

Other Requirements

Use of Funds

Under the PRC Commercial Banking Law, commercial banks are not permitted to engage in trust investment or securities business, 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.

Upon obtaining approvals from relevant authorities, including the CBRC, commercial banks are permitted to invest in insurance companies, fund management companies and financial leasing companies.

On February 20, 2005, the PBOC, the CBRC and the CSRC jointly promulgated and implemented the Pilot Administrative Measures on Establishment of Funds Management Companies by Commercial Banks (商業銀行設立基金管理公司試點管理辦法), pursuant to which state-owned commercial banks and joint stock commercial banks are allowed to set up or acquire fund management companies after obtaining approvals from the CBRC and the CSRC. In addition, commercial banks shall adopt effective measures to prevent risks associated with capital markets and banking industry.

In accordance with the Administrative Measures on Financial Leasing Companies (金融租賃公司管理辦法) which were amended by the CBRC in 2007, commercial banks can invest in financial leasing companies where commercial banks are able to meet relevant requirements for capital adequacy, profitability, corporate governance and other matters.

On November 5, 2009, the CBRC enacted the Pilot Administrative Measures on Investment by Commercial Banks in Insurance Companies (商業銀行投資保險公司股權試點管理辦法). These pilot administrative measures require a pilot plan for investment by a commercial bank in an insurance company to be filed to the relevant regulator for the approval of the State Council. Each commercial bank is allowed to invest in one insurance company only. The pilot administrative measures also set out rules for the qualifications of a commercial bank which intends to invest in an insurance company, and for the target insurance company.

SUPERVISION AND REGULATION OF OUR OVERSEAS OPERATIONS

Our branch in Hong Kong, and certain of our subsidiaries, namely ABCI Securities Company Limited, ABCI Insurance Company Limited and ABCI Insurance Broker Limited, which are subsidiaries under ABC International Holdings Limited, are subject to the regulation of the Hong Kong Monetary Authority, the SFC and the Office of the Commissioner of Insurance of Hong Kong. Our branch in Singapore is subject to the regulation of the Monetary Authority of Singapore. We are duly licensed to operate in Hong Kong and Singapore by the respective regulatory authorities.

Banking activities in Hong Kong are primarily governed by the Banking Ordinance and are regulated by Hong Kong Monetary Authority. The principal function of the Hong Kong Monetary Authority is to promote the general stability and effectiveness of the banking system in Hong Kong. The Hong Kong Monetary Authority is responsible for supervising compliance with the provisions of the Banking Ordinance and the Hong Kong Monetary Authority's guidelines and legislation promulgated by the SFC. The Hong Kong Monetary Authority is responsible for regulating banking institutions and granting banking licenses, and has the discretion to attach conditions to a bank's operating license. The Hong Kong Monetary Authority requires every authorized institution to implement a comprehensive risk management system to identify, measure, monitor and control the various types of risks relating to its activities and, where appropriate, to hold capital against those risks.

The Banking Ordinance requires banks to report to the Hong Kong Monetary Authority certain periodic returns and other information and establishes certain minimum standards and ratios relating to capital adequacy, liquidity, capitalization, limitations on shareholdings, exposure to any single customer, unsecured advances to persons affiliated with the bank and holdings of interests in land, with which all banks operating in Hong Kong must comply.

Banking activities in Singapore are primarily governed by the Singapore Banking Act and are regulated by the Monetary Authority of Singapore. The principal functions of the Monetary Authority of Singapore are to (i) act as the central bank of Singapore, including the conduct of monetary policy, the issuance of currency, the oversight of payment systems and serving as banker to and financial agent of the Singapore government; (ii) conduct integrated supervision of financial services and financial stability surveillance; (iii) manage the official foreign reserves of Singapore; and (iv) develop Singapore as an international financial center.

We have six overseas representative offices located in New York, London, Tokyo, Frankfurt, Seoul and Sydney, respectively. These representative offices are subject to the regulation of Federal Reserve Bank of New York and Banking Department of State of New York, the UK Financial Services Authority, the Financial Services Agency of Japan, the Federal Financial Services Supervisory Authority of Germany, the Financial Services Commission of the Republic of Korea and the Australian Prudential Regulation Authority, respectively. Our overseas branches and representative offices are also subject to the local banking regulatory requirements, including requirements with respect to internal control, capital adequacy and others.