
RISK MANAGEMENT AND INTERNAL CONTROL

We believe that effective risk management and internal control is critical to our success. We have established comprehensive risk management and internal control processes through which we monitor, evaluate and manage financial, operational, compliance and legal risks that we are exposed to in our business activities. We were among the few investment banks in China that were rated Class AA for the twelve months ended 30 April 2011 by the CSRC based on its most recent evaluation of our risk management capabilities, competitiveness and status of regulatory compliance. Class AA is the highest rating received by any investment bank in China during that period.

Governance Structure

We seek to monitor and control our risk exposure through various reporting systems covering financial, operational, compliance and legal aspects of our business. We have established a three-level risk management and internal control governance structure: our Board of Directors, senior management and the operational level.

Board of Directors

Our Board of Directors is the top level of our risk management and internal control governance structure. Under the Board of Directors, we have established six specialised committees, namely the Risk Management Committee, the Audit Committee, the Nomination Committee, the Strategic Planning Committee, the Remuneration and Appraisal Committee and the Related Party Transactions Control Committee. Our Board of Directors is responsible for reviewing and approving our risk management and internal control policies and strategies, implementing our risk management systems, and reviewing our periodic risk management and internal control assessment results.

Senior Management

At the senior management level, we have established two committees tasked with reviewing risks specific to particular areas of our operations: the Asset Allocation Committee and the Capital Commitment Committee.

- ***Asset Allocation Committee.*** Our Asset Allocation Committee is responsible for making asset allocation decisions. A working group of the committee, comprising leaders and senior managers from both revenue generating business units and internal control departments, meets every two weeks to discuss market developments, investment performance, risk exposures and make decisions on asset allocation and risk management.
- ***Capital Commitment Committee.*** Our Capital Commitment Committee approves and oversees our underwriting transactions, including related commitments of capital to ensure that applicable legal, regulatory and business standards are maintained. All corporate financing transactions involving the exposure of our capital must be approved by the Capital Commitment Committee. The working group of the committee comprises senior management members of our Investment Banking, Sales and Trading and Risk Management Departments.

Operational Level

At the operational level, our Risk Management Department works closely with our Legal Department, Compliance Department, Internal Audit Department and each business unit to implement risk management strategies, policies and procedures.

- Our Risk Management Department monitors and evaluates our risk exposure. It submits risk evaluation reports regularly to senior management and each business line on our overall risk exposure and the

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risk exposure of each business line and product. It also monitors the risk indicators on a daily basis and initiates corresponding alert procedures when the indicators approach or meet certain prescribed thresholds. Our Risk Management Department is also responsible for promoting and cultivating a proactive risk management culture within our Group. It regularly conducts workshops to educate our operational level personnel about risk management.

- Our Legal Department manages the legal risks faced by our businesses and provides day-to-day legal assistance and advice to our business units.
- Our Compliance Department oversees the compliance management of our business in general and fulfills our regulatory reporting obligations. Its primary responsibilities include establishing compliance policies, performing compliance checks and evaluations, conducting regular training for our business departments in areas such as insider training, as well as responding to whistle-blowing information concerning non-compliance.
- Our Internal Audit Department is responsible for the independent audit of our business units, branches and subsidiaries and the regular reporting of audit results to the Audit Committee.

We have set up several risk measurement models that perform risk identification, analysis, monitoring, reporting and management for all of our business lines. We also review risks relating to our business regularly in order to identify areas for improvement and enhance our risk management practices. The regular review of our corporate risk profile includes the analysis of current risk exposure, trends of value at risk, sensitivity analysis and stress tests. The scope of risks covered in the review includes, but is not limited to:

- market risks, reflecting potential loss due to market fluctuation;
- liquidity risks, reflecting potential loss due to the illiquid nature of investment or the lack of access to capital market;
- credit risks, reflecting potential loss due to the default or credit deterioration of our clients or counterparties;
- operational risks, reflecting potential loss due to operation errors;
- compliance risks, reflecting noncompliance with industry and listing rules released by various regulatory bodies; and
- legal risks, reflecting potential losses from lawsuits and arbitrations.

Implementation of Risk Management and Internal Control Policies

To better manage our risk exposure, we have established an integrated Risk Management System, which comprises the Brokerage Risk Management System and the Investment and Trading Risk Management System described below.

- ***Brokerage Risk Management System.*** We established the Brokerage Risk Management System to manage the risks faced by our brokerage business as well as to comply with relevant regulatory requirements. The system is composed of three modules, including a client risk-monitoring module focusing on monitoring abnormal client transactions, a broker risk-monitoring module focusing on monitoring abnormal behaviour of brokers and tellers and performing account checking, and a business risk-monitoring module focusing on monitoring our brokerage, margin financing and securities lending businesses.

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- **Investment and Trading Risk Management System.** To better manage the risks associated with our asset management and trading businesses, we have established an Investment and Trading Risk Management System, which is composed of a front-end risk control system that aims to identify and control risks before a transaction, as well as a back-end risk monitoring and reporting system focusing on risk monitoring, analysis and evaluation after a transaction. The front-end risk control system is integrated into our business operation system and automatically prevents execution of transactions that exceed predetermined thresholds. The back-end risk monitoring system is integrated into our settlement and trading system, which enables it to collect data relating to our asset management and trading businesses on a timely basis. It calculates and monitors daily risk measures and prepares relevant risk reports through functional modules, such as combination query, risk analysis, performance analysis, risk monitoring and risk reporting.

We have also implemented risk management procedures to manage risks specific to our business activities.

Investment Banking

We have an Internal Review Group and a Quality Control Group to control our risk exposure in our investment banking business. Our Internal Review Group, which is independent from our Investment Banking Department, is responsible for our internal review of financing transactions we manage. Our Quality Control Group, an independent division within our Investment Banking Department, is responsible for the quality control of the financing transactions we manage. Our Internal Review Group and Quality Control Group, among other things, participate in the approval of our underwriting transactions based on the due diligence findings of our execution teams, review the application materials of securities issuances and listing and major asset reorganisations to be sponsored by us, and review our response to queries from regulators such as the CSRC concerning listing applications. Our Internal Review Group and Quality Control Group manage the risks of our investment banking business by being involved in its operations, through project approval, on-site review, materials review, meetings and continual supervision as set forth in the table below.

Project Approval	Our Internal Review Group reviews and approves each underwriting transaction and advises on the restructuring plan and related technical issues.
On-site Review	Our Internal Review Group conducts on-site review in connection with each transaction, which includes, among other things, attendance at meetings, interviews with issuers and due diligence reviews.
Materials Review	Application materials are reviewed by two examiners from the Internal Review Group, each focusing on legal and financial aspects of the transaction, respectively. We also engage legal counsel and accountants to review the application materials. Our examiners render their opinion on each transaction based on their review of the application materials and opinions of legal counsel and the accountants. If any issue is identified, the examiners will submit a risk report to the heads of the Investment Banking Department and senior management for further action.
Meetings	Our Internal Review Group holds internal meetings to discuss whether to approve a particular underwriting transaction.
Continual Supervision	If any issue is identified during the post-transaction supervision period, including but not limited to operational, legal and accounting deficiencies of the issuer, the Internal Review Group will compile and submit a report to the Investment Banking Department for further action.

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Brokerage

To manage the risks associated with our brokerage business, we focus on investigating suspicious client data, unusual transactions and irregular conduct of brokers, and strengthening compliance awareness of our sales staff in our brokerage branches through client interviews, system account maintenance and investigations of brokers. To control the operational and legal risks associated with our brokerage business, we have formulated and implemented internal rules and guidelines including Measures for Monitoring Client Trading Activities (中信証券股份有限公司客戶交易行為監控辦法), Risk Management Measures for Securities Brokers (中信証券股份有限公司證券經紀人風險管理辦法), Monitoring Process for Brokerage Business (風險管理部經紀業務監控流程), Measures for Risk Management Responsibility of Securities Brokers (中信証券股份有限公司證券經紀人風險管理崗位職責管理辦法) and Risk Management Measures for Margin Financing and Securities Lending Business (融資融券業務風險管理辦法).

Measures we have taken to manage the credit risks arising from our margin financing and securities lending business include, among other things, customer education, credit reference checks, credit approval, daily mark to market, risk reminders to clients, forced liquidation of clients' positions and judicial recourse.

To comply with relevant laws and regulations in China and Hong Kong that govern cash held on behalf of customers, we maintain segregated deposit accounts with qualified commercial banks and authorized institutions to hold clients' monies, which limits the risks of loss or misappropriation of our clients' monies. In addition, we have formulated and implemented detailed guidelines that govern brokerage deposit, account management, contract execution, account transfer, settlement and deposit transfer.

Our Audit Department and Compliance Department conduct routine or special inspections on our brokerage branches to ensure that our risk management procedures are fully implemented at the branch level.

Asset Management

In line with the requirements set forth by the Board, the Execution Committee and the Asset Allocation Committee, our Risk Management Department, together with other internal control departments, monitors and evaluates our exposure to risks of capital loss, credit risk and regulatory risks potentially arising from our asset management business. It cooperates with the internal risk control team under our asset management business line to monitor market and credit risks to ensure that we effectively fulfil our entrusted duties, accurately disclose relevant risk-related information, conduct our businesses in a prudent manner and protect legitimate interests and rights of our investors.

We manage the risks associated with our asset management business by following the three steps below:

Risk Indicators Formulation	Our Asset Management Department formulates risk management guidelines for each investment account in accordance with the contracts entered into with clients and relevant laws and regulations. The guidelines set forth compliance indicators that apply to our investments in connection with each account and are signed by the personnel responsible, including the client manager, investment manager, trading manager and risk control manager.
Risk Indicators Monitoring	Our investment managers make investment decisions for each account in accordance with the risk management guidelines that apply to such account. Our risk control managers set thresholds for the compliance indicators in the Investment and Trading Risk Management System.
Risk Indicators Evaluation	The risk control team of our Asset Management Department and our Risk Management Department are responsible for reporting circumstances where the value of relevant indicators exceed their respective predetermined thresholds.

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Trading

We have established risk management procedures at three levels to manage the risks associated with our trading activities.

Committee/Department	Function
Asset Allocation Committee	<p>Our Asset Allocation Committee</p> <ul style="list-style-type: none">— sets limits on the size and maximum market risk exposure of our investments in different asset classes, as well as the lower limit of losses in connection with our investment portfolio.— the working group of the Asset Allocation Committee evaluates the risks associated with our investments in different asset classes and adjusts the amount of investment in each asset class based on the results of the evaluation.
Risk Management Department	<p>Our Risk Management Department</p> <ul style="list-style-type: none">— collects trading position data through our settlement and trading systems.— has established a market risk monitoring system based on risk indicators such as VaR, basis point value and portfolio beta.— evaluates and monitors our risk exposure to ensure our risk exposure is within the limit prescribed by the Asset Allocation Committee.— implements the “stop-loss” policy and monitors the performance of our investment portfolio on a daily basis to keep our loss within certain limits. When the actual loss approaches the predetermined limit, it will issue an alert requiring that the level of risk exposure be reduced.— with prior authorization of the Company, closes position in our investment portfolio when the amount of losses incurred exceeds the predetermined limit.— monitors and evaluates our hedging activities, including the use of stock index futures and interest rate swaps to hedge against fluctuations in stock prices and interest rates, to ensure our risk exposure does not exceed the limits set by our risk indicators.— establishes the counterparty credit approval policy and the blacklist policy to manage the credit risks associated with our investment in debt securities, and develops certain investment restrictions based on the ratings of credit products.— reports to senior management and relevant business lines the risk exposure associated with our trading activities.
Trading Department	<p>Our Trading Department</p> <ul style="list-style-type: none">— within the authorized limit, manages and adjusts our risk exposure.— closes a position in a portfolio when the amount of losses incurred exceeds the predetermined limit.

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Investment

Our Investment Management Department controls the investment risks associated with our principal investment activities by keeping the size of our investments within the limits authorized by the Asset Allocation Committee. We also hold discussions every two weeks among relevant departments to exchange investment-related information and evaluate the risk and return profile of our investment portfolios.

We engage in private equity direct investment primarily through our wholly-owned subsidiary, GoldStone. GoldStone has established its own investment decision committee that is responsible for reviewing and approving its investment decisions. The following table sets forth the three stages of its review process.

Preliminary Review of Proposed Investment	The investment decision committee reviews a proposal submitted by the general manager of GoldStone that contains a general overview of the investment project, as well as investment value analysis and the proposed amount of investment.
Review of Investment Decision	The investment decision committee commences formal review of an investment project upon completion of due diligence and preliminary negotiation. It then conducts internal discussions to decide whether to proceed with the investment.
Review of Project Execution	If there is any significant change to the document to be executed during the last stages of negotiation, the general manager of GoldStone is required to report the changes immediately and submit a proposal to the investment decision committee for approval.

At the subsidiary level, all of our subsidiaries have established their own risk management and internal control procedures and systems in line with our overall policies. In addition, we have established a performance evaluation and incentive system for each of our subsidiaries in relation to risk management and internal control. We designate certain directors, supervisors and members of senior management of our subsidiaries to supervise and monitor the risk management and internal control practices of our subsidiaries. We have also established a reporting system that requires our subsidiaries to report material risk management matters to us.

Money Laundering

We have established policies and procedures to prevent money laundering and terrorist financing. Money laundering covers a wide range of activities intended to mask or alter the source of illegally obtained money. Our employees who know, suspect or have a reasonable basis to believe that a client might have engaged in money laundering activities are required to immediately report to the Legal and Compliance Departments, which, in turn, will notify the appropriate regulatory authorities. We also have in place a client screening procedure to profile clients with a higher than average likelihood of engaging in money laundering and terrorist financing activities. When conducting such screening, factors we take into account include the client's background, nature of its business, its origin or place of establishment, associated entities and its ownership structure.

Chinese Walls

As a financial institution providing a wide range of financial services, we consistently face situations where two or more legitimate interests are conflicting in nature. We recognize the importance of managing such conflicts to protect the interests of our clients and our employees. We have implemented Chinese walls to limit conflicts of interest by controlling the flow of material non-public information. The Chinese wall is a barrier to ensure that material non-public information regarding listed companies which is obtained by one department is not released to

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another department. It is intended to separate those making investment decisions from those in possession of material non-public information. We have developed and implemented policies and procedures to safeguard such information and prevent improper trading. Due to potential conflicts of interest, we have established Chinese walls between our Investment Banking and Research Departments, our Sales and Research Departments, as well as our Trading and Brokerage Departments to prevent the flow of material non-public information. To enforce Chinese walls on an administrative level, we have established physical segregation and password-protected access among departments and functional units, including our Investment Banking, Equity Sales and Trading, Asset Management, Brokerage, Research, Legal and Compliance Departments.

As we continually seek to enhance our risk management and internal control functions, we are in the process of implementing the following:

- ***Firmwide Risk Pooling:*** We plan to measure and monitor our overall risk exposure to ensure that our risks fall within a tolerable range.
- ***Risk Limit Systems Based on Capital Allocation:*** We plan to establish a series of risk limit systems to dynamically control and adjust our risk exposure through risk limits, promote timely communication with the front-office business departments and improve the effectiveness of our risk management.
- ***Economic Capital Framework:*** We plan to establish an economic capital allocation framework in line with international standards and the capital requirements of the CSRC to help us measure the risk adjusted returns of our business units and optimise our resource allocation.

The Company confirms that during the Track Record Period, there were no risk management or internal control incidents that materially affected the Company's business and financial positions.

LEGAL AND REGULATORY

Licensing Requirements

We operate our business principally in the PRC and Hong Kong and we are subject to the relevant regulatory requirements in the PRC and Hong Kong. Our Directors and Jiayuan Law Firm, our PRC legal advisers, confirmed that, save as disclosed in this prospectus, during the Track Record Period and up to the Latest Practicable Date, our Company had complied with the relevant PRC regulatory requirements and guidelines in all material respects, and obtained the material permits and licenses for its operations pursuant to the PRC's laws and regulations. Since our A Share Offering on 6 January 2003 and up to the Latest Practicable Date, our Company and Directors had not been subject to any CSRC auditing, CSRC administrative punishment, or been criticised or publicly reprimanded by the Shanghai Stock Exchange due to violations of listing rules or other relevant applicable rules.

Due to the licensing regime of the SFC in Hong Kong, certain subsidiaries of our Group, whose businesses are subject to obtaining the requisite licenses in Hong Kong, have obtained the relevant licenses and have been in compliance with the relevant regulatory requirements.

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Set out below is a summary of the relevant licenses (including condition imposed) currently held by the relevant licensed subsidiaries of our Group in Hong Kong.

<u>Name of licensed subsidiary</u>	<u>Type 1 Dealing in securities</u>	<u>Type 2 Dealing in futures contracts</u>	<u>Type 4 Advising on securities</u>	<u>Type 6 Advising on corporate finance</u>	<u>Type 9 Asset management</u>
CITIC Securities Brokerage (HK) Limited	Yes		Yes		
CITIC Securities Futures (HK) Limited		Yes			
CITIC Securities International Investment Management (HK) Limited ⁽¹⁾			Yes		Yes
CITICS CF Hong Kong ⁽²⁾	Yes		Yes	Yes	

Notes:

- (1) Licensing condition: CITIC Securities International Investment Management (HK) Limited shall not hold client assets. The terms “hold” and “client assets” are defined under the SFO.
- (2) Licensing condition: For Type 1 regulated activity, CITICS CF Hong Kong shall not engage in dealing activities other than those relating to corporate finance.

Apart from the SFO, the operation of the securities market is also governed by the subsidiary legislation and regulations, administrative procedures and guidelines developed by the SFC, as well as by the rules and regulations introduced and administered by the Hong Kong Stock Exchange and The Hong Kong Futures Exchange Limited. For risks associated with the regulatory environment in which we operate, please see “Risk Factors — Our businesses are highly regulated in China and other jurisdictions in which we operate our businesses”.

Our Directors confirmed that, during the Track Record Period and up to the Latest Practicable Date, our Group had complied with the relevant Hong Kong regulatory requirements and guidelines in all material respects, and obtained the material permits and licenses for its operations pursuant to Hong Kong’s laws and regulations.

Legal Proceedings

We are a party to a number of legal proceedings arising from the ordinary course of our business. As at 31 March 2011, we had three pending legal proceedings each with an original potential claim or counterclaim amount of RMB10 million or above. As at the Latest Practicable Date, as far as the Directors are aware, the outstanding claim amount or judgment amount of the three legal proceedings, after subsequent amendment of the claim amount of two of the legal proceedings, was approximately RMB20.25 million in aggregate. Out of these three cases, we were the plaintiff in one case with a judgement amount of RMB758,314; and we were the defendants in two cases with an aggregate claim amount of RMB19.49 million. Due to the uncertainty of the results of these pending legal proceedings, we did not make any provision for contingent liabilities during the Track Record Period. The aforesaid legal proceedings are summarized as follows:

- In November 2010, we filed a claim against Shenzhen Jinniu Investment (Group) Limited (“Shenzhen Jinniu Investment Group”) and Guizhou Aluminum Factory in the People’s Court of Futian District of Shenzhen City for indemnification for losses arising from customer claims suffered by Shenzhen Gold Bull Futures Brokerage Limited (“Shenzhen Gold Bull Futures”) in the aggregate amount of RMB758,314. We acquired the equity interests in Shenzhen Gold Bull Futures, the predecessor of CITICS Futures, from the defendants who agreed to indemnify us in connection with the sale of their equity interests in Shenzhen Gold Bull Futures to us in 2007. In February 2011, Shenzhen Jinniu Investment Group filed a counterclaim against us and sought a declaration that the sale of Shenzhen Gold Bull Futures was void. A judgement was made in favour of us on 26 August 2011. The defendants

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were ordered to pay us an aggregate amount of RMB758,314 plus interest and the counterclaim filed by Shenzhen Jinniu Investment Group was dismissed. The judgement will become legally effective if the defendants do not lodge an appeal within 15 days from the date on which they received the judgement. The sale of Shenzhen Gold Bull Futures to us has been approved by the relevant supervisory authorities, and therefore we believe it is valid and has complied with applicable laws. If the defendants lodge any appeal, we will continue to defend our interests vigorously. CITICS Futures contributed less than 1% to our total annual revenue during the Track Record Period.

- In April 2003, Chongqing Huaneng Talc Powder Co., Ltd. (“**Chongqing Huaneng**”) filed a claim in the First Intermediate People’s Court of Chongqing against our Jiaochangkou Branch in respect of a contractual dispute on entrusted asset management services in the aggregate amount of RMB11.76 million plus interest. The First Intermediate People’s Court of Chongqing delivered a judgment in 2004 in favour of Chongqing Huaneng and ordered our Jiaochangkou Branch to pay an amount of RMB8.85 million plus interest to Chongqing Huaneng within 10 days from the date of the judgment being effective, and we were made jointly responsible for such payment. Both Chongqing Huaneng and we filed several appeals with the People’s Court at a higher level after that judgment. In March 2011, Chongqing Huaneng filed an enforcement claim against us in the amount of RMB14.59 million according to the final judgment of the Higher People’s Court of Chongqing on 2 December 2010. In April 2011, the Supreme People’s Court ordered a retrial of the case and suspended enforcement of the final judgment. As at the Latest Practicable Date, the case was still under review by the Supreme People’s Court.
- In April 2009, Guangdong Nanguodesai Law Firm filed a claim in the People’s Court of Xiangzhou District of Zhuhai City against us in respect of a contractual dispute over legal services in the amount of RMB13.09 million. During the trial held on 8 April 2010, the plaintiff modified its claim to RMB5.76 million. On 30 December 2010, the People’s Court of Xiangzhou District delivered a judgment by ordering us to provide a remedy of RMB4.90 million to the plaintiff. On 1 March 2011, we filed an appeal to the Intermediate People’s Court of Zhuhai City, but the judgment has not yet been delivered.

Our Directors confirmed that, as at the Latest Practicable Date, none of the legal proceedings to which we were a party, individually or in the aggregate, would have a material effect on our business, financial condition or results of operations. With respect to the claims and legal proceedings in the PRC, our PRC legal advisers confirmed that none of the legal proceedings to which we were a party, individually or in the aggregate, would have a material effect on our financial condition or results of operations.

Regulatory Review and Proceedings

We are subject to various regulatory requirements and guidelines set forth by the PRC and Hong Kong regulatory authorities, which include, without limitation, the CSRC, SAC, Shanghai Stock Exchange, SFC and the Hong Kong Stock Exchange, and their respective local bureaus and offices (if applicable).

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Regulatory non-compliance

We have, from time to time, detected incidents of regulatory non-compliance committed by us or our employees. These incidents of non-compliance have included delay in the transfer of equity ownership in certain entities, and violations of our internal procedures and guidelines by our employees in conducting business. Based on the amounts involved and the nature of the cases, the significant cases identified for the Track Record Period and up to the Latest Practicable Date are as follows.

Delay in the transfer of equity ownership in certain entities

The transfer of our investments in two entities did not timely comply with certain regulatory requirements during the Track Record Period and up to the Latest Practicable Date. Such incidents are summarized below.

- We, with the cooperation of Jianyin Investment Co., Ltd., acquired a 60% equity interest in Huaxia Securities Co., Ltd. and restructured it into China Securities. The acquisition and restructuring of China Securities were duly endorsed and approved by the regulatory authorities in 2005, including the CSRC. In December 2007, the CSRC promulgated the Trial Provisions, which provide that a securities company and its subsidiary, or subsidiaries under the control of the same securities company, shall not operate similar businesses which would result in conflicts of interest or competition. As both our Company and China Securities are nationwide securities companies providing comprehensive brokerage services, we were no longer permitted, after the promulgation of the Trial Provisions, to hold a controlling interest in China Securities and were required to divest most of our equity interest in China Securities within two years. We spent substantial efforts and time formulating different divestment proposals and clearing such proposals with the regulators. In January 2010, the Shenzhen Securities Regulatory Bureau decided that we had failed to complete the rectification within the prescribed time limit and requested us to accelerate the rectification process. To rectify the issue, we continued to actively pursue the divestment of our equity interest in China Securities. Pursuant to the relevant regulatory requirements, the divestment was required to comply with complicated procedures and was subject to various approvals and requirements, including the approval of our Shareholders, listing of the relevant equity interest in China Securities on an equity exchange for a certain period of time, and the approvals from the CSRC and the Ministry of Finance. The Ministry of Finance approved the divestment on 12 March 2010. On 21 May 2010, we filed the valuation report of China Securities with the Ministry of Finance. We convened a board meeting and a general meeting to approve the divestment on 1 June 2010 and 17 June 2010, respectively. We obtained the CSRC's approval on 11 November 2010. In late 2010, we completed the divestment of most of our equity interest in China Securities and our percentage ownership of China Securities decreased from 60% to 7%. China Securities accounted for 25.0% and 27.6% of our total revenue and other income for the years ended 31 December 2008 and 2009, respectively. Excluding gains from our divestment of equity interests in China Securities from total revenue and other income for the year ended 31 December 2010, China Securities would have accounted for 23.2% of our total revenue and other income for the year. Following our divestment of most of our equity interests in China Securities, we recognize any dividends paid on our remaining 7% equity interest in China Securities as "dividend income from available-for-sale financial assets". Please see "Financial Information — Impact of Divestments" for selected financial information of China Securities and "Recent Developments" for the impact of the divestment of China Securities on our financial performance for the six months ended 30 June 2011.
- In 2004, the CSRC issued "Management Measures on Securities Investment Fund Management Companies" and the relevant regulations, which provide that the capital contribution by a single

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shareholder of a fund management company shall not exceed 49% of the fund management company's total capital contributions. Despite the aforesaid measures and regulations, with the approval and guidance of the CSRC, in September 2007 we acquired 100% of the equity interests in China AMC and CITIC Fund with a view to reducing, as soon as possible but with no indicated specific timeframe, our interest in China AMC and CITIC Fund to the extent permitted by the aforesaid measures and regulations. As such, we proposed and proceeded to do this by: (i) having CITIC Fund merged with China AMC, and then (ii) divesting our equity interest in China AMC to below 50%. In December 2009, CITIC Fund merged into China AMC. As completion of the merger took longer than expected, the divestment was also delayed. In early 2010, the CSRC issued two letters requesting us to expedite the divestment. However, we were unable to finalise the divestment proposal because it had been amended from time to time during our discussions with the relevant regulatory authorities. On 22 June 2010, the divestment proposal was approved by the Ministry of Finance. Our Board immediately convened a meeting on 25 June 2010 to approve the divestment. We thereafter continued to improve the proposal. In July and October 2010, the CSRC issued two other letters requesting us to expedite the divestment and further prescribed that before completion of the divestment, some of China AMC's business activities had to be suspended or restricted, for example, it could not apply to launch any new products to the public, and the filing of asset management contracts of new specified clients was suspended. We continued to actively pursue the divestment and completed the valuation of China AMC in the interim. In May 2011, we filed the valuation report of China AMC with the Ministry of Finance. On 24 May 2011 and 9 June 2011, we convened a board meeting and a general shareholders meeting, respectively, to approve the divestment. In July 2011, we listed 51% of our equity interest in China AMC on the Beijing Financial Assets Exchange for sale. We were advised by the Beijing Financial Assets Exchange on 11 August 2011 that the public bidding process for 31% of our equity interest in China AMC had been duly completed. We will continue with the divestment of the remaining 20% equity interest in China AMC. Upon the completion of the entire sale process, and subject to review and approval by the CSRC of the proposed sale, our equity ownership in China AMC will be reduced to 49% and will comply with the relevant PRC regulatory requirements. The divestment is expected to be completed by the end of 2011. Upon completion of the divestment, we will hold a 49% minority interest in China AMC. At such time, we will include our portion of China AMC's profits and losses in our income statement as our "share of profits and losses of associates". China AMC accounted for 16.9%, 13.1% and 11.3% of our total revenue and other income for each of the years ended 31 December 2008, 2009 and 2010, respectively. Please see "Financial Information — Impact of Divestments" for selected financial information of China AMC.

Save for the suspension and restriction on China AMC's business as disclosed in the above, we have not been subject to any fine or penalties for the delay in the transfer of our equity interests in China Securities and China AMC. We believe that we have made our best efforts in rectifying all non-compliance in accordance with regulatory requirements. We will continue to stay vigilant for any update or change to the applicable legal and regulatory requirements. In the event that any of our operations are unable to meet updated or revised legal and regulatory requirements, we will take prompt action to make appropriate rectifications.

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Employee non-compliance incidents

Seven incidents involving regulatory employee non-compliance occurred and were discovered during the Track Record Period and up to the Latest Practicable Date. Details of each of the seven incidents of employee non-compliance during the Track Record Period and up to the Latest Practicable Date and our primary remedial actions adopted are set forth below.

Non-compliance incidents

- In May and June 2008, an employee of our business department on Shanghai Liaoyuan Xi Road violated our internal policy and procedures by opening a client account for, and providing third-party custody services to, an overseas customer.
- In July 2008, the NAO, during a usual audit, identified that certain individual employees were engaged in securities transactions in contravention of the relevant PRC regulations which prohibit securities practitioners from engaging in securities transactions, other than for customers.
- In May 2010, an employee of CITIC Kington's business department on Leqing Mingyang Road violated the internal policy and procedures in accounts opening and closing.
- In June 2011, two sponsor representatives of the Company received warning letters from the CSRC due to their failure to fully discharge their due diligence duties in an IPO in which they were the sponsor representatives.

Our primary remedial actions

- We requested the overseas customer to apply for approval for opening a RMB account to become eligible as an account holder. The relevant employee and the manager of the relevant business department were dismissed. We also submitted a report to the regulator, which did not raise any further comment. The regulatory authorities recognized our efforts on strengthening compliance monitoring and prevention of risks relating to employees' integrity and therefore did not impose any punishment on us.
- We ordered the employees to dispose their securities immediately and closed the securities accounts within a specified time of period. To prevent the reoccurrence of such incidents and to enhance compliance, we (i) conducted a comprehensive special review against such dealings; (ii) reissued our internal policy on dealings in securities to our securities practitioners; and (iii) required all employees to sign and provide an undertaking not to deal in securities.
- The relevant employee was dismissed. We reviewed our internal procedures and reinforced trainings to employees.
- The two sponsor representatives considered the issues mentioned in the warning letters, and then filed a response to the regulatory authorities. Other personnel in charge of supervising investment banking projects also initiated additional examination. We also warned the two sponsor representatives to improve their compliance awareness in the future. We reviewed our internal supervision and enhanced compliance among our staff. After the response was filed, the regulator did not raise any further comment.

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Non-compliance incidents

- In July 2011, eight branches of CITIC Kington were suspended by the Zhejiang Securities Regulatory Bureau from opening new client accounts for the period from August to October 2011 because it was found that certain sales employees in these branches opened new securities accounts to artificially boost their sales performance in 2008.
- In August 2011, the SFC suspended the licenses of two former account executives of CITIC Securities Brokerage (HK) Limited for four months and five months, respectively, as such former account executives entered into an arrangement with an unlicensed person to remunerate that unlicensed person to deal in clients' accounts.
- A former representative of CITIC Securities Brokerage (HK) Limited operated trading accounts of his family members without our knowledge and approval during the period from July 2006 to August 2008, and such representative was also alleged to have made unauthorised withdrawals from a client's account in a total of over HK\$400,000.

Our primary remedial actions

- We closed those accounts which could be identified with such activities and continue to monitor closely all suspected dormant and inactively traded accounts. We reviewed our internal supervision, implemented a compliance evaluation and responsibility system and enhanced compliance among our staff.
- The former account executives were dismissed. We reviewed our internal control system in respect of verifying the identity of our clients and the operators of the client accounts when taking trading orders, and enhanced compliance among our staff.
- The representative in question resigned in November 2009. In August 2011, we received a letter from the SFC which contained no adverse finding or implication against us and SFC did not propose to take any further action about the matter on the information then known to it. We have put in place systems and controls to identify and monitor the trading operations in staff related accounts and strengthened compliance awareness of our staff.

Other than the primary remedial actions we undertook immediately after each incident was discovered, we have also implemented general remedial measures aimed at preventing the reoccurrence of such incidents. These general remedial measures, among others, included: revision of internal policies and procedures, strict internal inspection and examination; enhanced staff training and strict internal sanction mechanism. Save for the temporary suspension of new account opening by certain branches of CITIC Kington as referred to in the above, we have not been subject to any fine or penalties for the employee non-compliance incidents.

None of our Directors or senior management of the Company was involved in, or the subject of, any of the above employee non-compliance incidents. Based on the details and total number and nature of the employee non-compliance incidents, and the details of corrective measures taken by us, neither the legality of the corporate existence of the Company or our subsidiaries has been affected, nor have any of the required approvals, permits, authorisations or filings necessary for our business operations been revoked as a result of these incidents of employee non-compliance. We have taken corrective measures, including, but not limited to, measures to rectify and prevent non-compliance and disciplining employees engaged in non-compliance.

Our Directors and Jiayuan Law Firm, our PRC legal advisers, have confirmed that the employee non-compliance incidents did not and will not, individually or collectively, have a material adverse effect on our business, financial condition or results of operations.

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Other regulatory non-compliance incidents

In addition to the employee non-compliance incidents, the CSRC or its local bureaus identified 12 other regulatory non-compliance incidents during the Track Record Period and up to the Latest Practicable Date. Details of two of these incidents are set forth below:

Non-compliance incidents

- In July 2008, the Shangdong Securities Regulatory Bureau issued a regulatory opinion in relation to the appointment of the person-in-charge of CITIC Wantong's Securities Business Department of Meishi Jie of Zibo, Shandong province, without prior approval.
- In September 2009, the Shangdong Securities Regulatory Bureau issued a warning letter in relation to existing problems in the business compliance, internal control measures, account management and sales business of CITIC Wantong's Securities Business Department of Meishi Jie of Zibo, Shandong province.

Our primary remedial actions

- The appointment of the relevant person-in-charge was subsequently rectified. We submitted a rectification report to the regulator, which did not raise any further comment.
- We rectified the issue by improving our business compliance and internal control systems and submitted a rectification report to the regulator, which did not raise any further comment.

In addition to the incidents disclosed above, we had 10 immaterial regulatory non-compliance incidents including minor breaches of operational guidelines of the regulators, minor defects in compliance with internal control measures and omitting to submit documents to the regulators. We have not been subject to any fines as a result of any such non-compliance incidents during the Track Record Period and up to the Latest Practicable Date. For each of the regulatory non-compliance incidents, we rectified the issues identified by the regulators by improving our business compliance and internal control systems and submitted rectification reports to the regulators. The regulators did not raise any follow-up comments to the reports.

Other than the primary remedial actions we undertook immediately after each incident was discovered, we have also implemented general remedial measures aimed at preventing the occurrence of such incidents. These general remedial measures included, among others, prompt revision of internal policies and procedures, strict internal inspection and examination, enhanced staff training and a strict internal sanction mechanism.

Our Directors and Jiayuan Law Firm, our PRC legal advisers, confirm that the above regulatory non-compliance incidents are not significant and do not have any material adverse impact on our business, financial condition or results of operations.

In each of the above cases, we have taken appropriate legal measures against the perpetrators and adopted corrective measures to address any operational or internal control-related deficiencies exposed by their misconduct. We believe that the financial losses and other adverse consequences of these incidents did not have, individually or in the aggregate, a material adverse effect on our business, financial condition or results of operations. We will continue to focus on improving and strengthening our internal control and risk management functions with the goal of successfully preventing similar incidents from recurring in the future.

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Regulatory investigations

We are subject to the following ongoing regulatory investigation as at the Latest Practicable Date:

- In October 2010, the SFC approached and investigated our subsidiary, CITICS CF Hong Kong, in relation to its involvement as a joint sponsor in the listing of the shares of a China-based company on the Hong Kong Stock Exchange in 2009. The investigation is still pending and no charge has been made by the SFC against us. We are unable to predict the outcome of this investigation. If any charge is made or any disciplinary proceeding is taken against CITICS CF Hong Kong, and if CITICS CF Hong Kong is found to be liable for any misconduct or has failed to meet the criteria of being a fit and proper person to engage in certain regulated activities, it may become subject to penalties such as censure, reprimand, fines, temporary restriction from undertaking certain activities, or suspension or revocation of its license to engage in regulated activities in Hong Kong. If this were to happen, our reputation, business, prospects, strategy and financial position could be materially and adversely affected.

In addition, as at the Latest Practicable Date, as far as our Directors are aware, there are two pending investigations against three of our former employees by the CSRC or its local bureaus, including (i) the suspected involvement of a former chief client manager from the Securities Business Department of Guangzhou in his client's abnormal trading activities and the suspected involvement of a broker in the same department in suspected non-compliance activities; and (ii) the involvement of a former employee of our Corporate Development and Financing Department in suspected insider trading. The investigations in the above cases are ongoing and we are not aware that any specific charge has been made against any of the above former employees.

None of our Directors or senior management was involved in, or the subject of, any of the above investigations. Our Directors confirm that the above investigations are not significant and do not have any material adverse impact on our business, financial condition or results of operations.

Findings of regulatory examinations

The regulatory authorities carry out periodic inspections, examinations and inquiries in respect of our compliance with the laws, regulations, guidelines and regulatory requirements applicable to us and our business. Certain routine or *ad hoc* examinations or inspections conducted by the PRC regulatory authorities, although not resulting in fines or other penalties imposed on us, have revealed certain deficiencies or incidents of non-compliance in various areas of our business operations, risk management and internal control. The results of the principal examinations or inspections are summarized below.

CSRC

The CSRC, its local offices and bureaus conduct routine and *ad hoc* inspections of our Company, including on-site inspections of our headquarters, branches and subsidiaries. Based on these inspections, the CSRC, its local offices and bureaus issue inspection reports setting forth their findings and recommendations.

During the Track Record Period, the CSRC and its local offices and bureaus carried out routine and *ad hoc* inspections of our headquarters, branches and subsidiaries. During the inspection, the CSRC or its local offices and bureaus identified certain incidents of non-compliance and weaknesses in, among other things, our internal control and corporate governance and business operations. The key recommendations made by the CSRC's local bureaus in its reports and our primary remedial measures adopted are set forth below:

- In May 2009, the Shanghai Securities Regulatory Bureau conducted an *ad hoc* onsite inspection of our securities brokerage branch in the Shanghai Times Building and issued a regulatory opinion, which

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provided that: (i) there was weak internal control over the account opening procedure as segregation of the front and back offices was not clear; (ii) there was a failure to properly follow the complaints procedure; (iii) there was no effective segregation of the trading and non-trading computer networks; and (iv) certain internal sales staff did not possess the necessary qualifications but still continued to engage in the securities brokerage business. By the end of July 2009, all brokers previously without licenses obtained the relevant licenses. Based on the regulatory findings, we also rectified the problems by reinforcing execution of proper accounting opening procedures by conducting more frequent inspections, providing the public with better access to complaint methods, segregating the trading and non-trading computer networks by physically segregating the computer terminals used, and strengthening control on the recruitment procedures and verification of qualifications of staff. During the rectification process, the Company promptly submitted the rectification report to the Shanghai Securities Regulatory Bureau, and thereafter on 15 July 2009, submitted a supplementary report on completion of the rectification. The Shanghai Securities Regulatory Bureau did not raise any follow-up comments to the reports.

- In June 2009, the Jiangsu Securities Regulatory Bureau conducted *ad hoc* onsite inspections of our five securities brokerage branches in Nanjing, Rugao, Suzhou, Changzhou and Xuzhou respectively, and issued “onsite inspection feedback letters” to four securities brokerage branches identifying certain deficiencies in their management systems. The Bureau issued a rectification order notice to the Suzhou securities brokerage branch, highlighting the existence of the following problems: (i) failure to enforce the Regulations on Management of Sales by Brokers, including solicitation of customers by unqualified personnel, the existence of cooperation with agencies, affiliation of unqualified personnel with qualified personnel to engage in business; and (ii) the existence of off-site account opening activity. In order to tackle the problems discovered in the inspection, we conducted rectification measures in accordance with the requirements of the Jiangsu Securities Regulatory Bureau, including: removing unqualified personnel, terminating cooperation with agencies, preventing off-site account-opening activity by conducting more frequent inspections, and strengthening control on the recruitment procedures and verification of qualifications of staff. We thereafter filed a rectification report to the Jiangsu Securities Regulatory Bureau, which did not raise any follow-up comments to the report.

NAO

The NAO conducts audits of state-owned and state-controlled enterprises, including us and financial institutions, from time to time. During its most recent audit on CITIC Group and its affiliated companies in 2008, the NAO audited the Company’s financial records. During the audit, the NAO identified that some of our employees were engaged in securities transactions for their own accounts, which were in contravention of the relevant PRC regulations which prohibit a securities practitioner from engaging in securities transactions for his or her own account. Other than that, the NAO did not identify any operational deficiencies which occurred in recent years nor did it make any recommendations on our internal controls or risk management.

SFC

The SFC conducted inspections on CITIC Securities Futures (HK) Limited and CITIC Securities Brokerage (HK) Limited during the Track Record Period. For the inspection on CITIC Securities Futures (HK) Limited, no exceptions were noted. For the inspection on CITIC Securities Brokerage (HK) Limited, the SFC raised several recommendations in relation to the margin lending policies and practice, and we have implemented improvements and remedial measures in accordance with the SFC’s recommendations. The SFC has also conducted an investigation on CITICS CF Hong Kong, details of which are set out in “Regulatory investigations” above.

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Our Directors confirm that, save as disclosed in this prospectus, there were no other material breaches or material incidents of regulatory non-compliance during the Track Record Period and up to the Latest Practicable Date, and the delay in transfer of equity ownership in China Securities and China AMC, and the non-compliance incidents and findings of the regulatory authorities during the Track Record Period and up to the Latest Practicable Date, did not reveal any material deficiencies in our operations, internal controls or risk management systems.

Our overseas branches, representative offices and subsidiaries are subject to local laws and regulations, as well as the regulatory oversight of relevant authorities in their respective jurisdictions. During the Track Record Period and up to the Latest Practicable Date, save as disclosed in this prospectus, our overseas subsidiaries complied with the applicable regulatory requirements and guidelines in all material respects, and obtained the material permits and licenses necessary for their operations pursuant to the applicable laws and regulations. During the Track Record Period, save as disclosed in this prospectus, our overseas subsidiaries were not subject to any material investigations or penalties in their respective jurisdictions.