Guidelines for the Categorization of Banking-Book Credit Risk Exposures of Commercial Banks

(September 18, 2008)

Chapter I General Principles

Article 1 To regulate the categorization of banking-book credit risk exposures of commercial banks and enhance the credit risk management level of commercial banks, these Guidelines have been made in accordance with the Law of the People’s Republic of China on Banking Supervision, the Law of the People’s Republic of China on Commercial Banks, and other laws and regulations.

Article 2 These Guidelines shall apply to the Basel II banks as determined in the Guiding Opinions on the Implementation of New Basel Capital Accord in the Banking Industry of China and other commercial banks voluntarily implementing the New Basel Capital Accord.

Article 3 A commercial bank using internal ratings to measure the credit risk capital requirement shall categorize the banking-book credit risk exposures of a commercial bank under these Guidelines. According to the features of credit risks, the banking-book credit risk exposures shall be divided into sovereign, financial institution, retail, corporate, equity and other exposures.

Article 4 The “banking-book credit risk exposures” as mentioned in these Guidelines means the part of credit risks on all on-balance-sheet and off-balance-sheet financial instruments not included in the trading book.

The “trading book” means a commercial bank’s proprietary positions in financial instruments which are intentionally held for short-term resale and/or which are taken on by the bank for profits in the short term from actual and/or expected differences between their buying and selling prices, or from other price or interest-rate variations, and positions in financial instruments arising from matched principal brokering and market making, or positions taken in order to hedge other elements of the trading book.

Article 5 The categorization of banking-book credit risk exposures shall adhere to the following principles:

1. Materiality. The material business operations and asset classes of a commercial bank shall be separately categorized, and those with a smaller scale and a lower degree of risk may be categorized in a simplified or consolidated way.

2. Timeliness. According to the client classes and business practicality, a commercial bank shall timely determine the risk exposure class of each business operation.

3. Continuity. The criteria for categorization of banking-book credit risk exposures of a commercial bank shall remain relatively stable, and any adjustment of the categorization of risk exposures shall adhere to strict and prudent policies and processes.

4. Comprehensiveness. All credit risk exposures in the banking book shall be categorized into the corresponding classes.

Article 6 The China Banking Regulatory Commission (CBRC) shall conduct a supervisory review of the validity and reasonableness of categorization of banking-book credit risk exposures of a commercial bank according to these Guidelines.

Chapter II Policies and Procedures for the Categorization of Banking-book Credit Risk Exposures

Article 7 A commercial bank shall make its policies for categorization of banking-book credit risk exposures, clarify the procedures and internal control requirements for the division and adjustment of risk exposures, and improve the management of the corresponding reporting and information systems according to these Guidelines.

Article 8 A commercial bank shall determine the criteria and processes for categorization of risk exposures according to the bank’s management structure, asset structure and risk features. Where the categorization criteria of a commercial bank are different from the requirements of these Guidelines, such criteria shall be reported to the regulatory authority for archival purposes.

Article 9 A commercial bank shall specify a department to take the lead in categorization of risk exposures of the whole bank. Two relatively independent posts or departments shall take charge of the division and determination of risk exposures, respectively.

Article 10 In the categorization of risk exposures, a commercial bank shall categorize assets into the corresponding risk exposure classes according to the criteria for division of different risk exposure classes. Assets that do not meet the criteria for sovereign, financial institution, retail, equity or other exposures but take on credit risks shall be included in the corporate exposures.

Article 11 A commercial bank shall adjust its risk exposure classes according to the changes in the risk exposure characteristics. The adjustment of risk exposure classes shall be completed within half a year after the characteristics for adjusting risk exposure classes appear.

Article 12 A commercial bank shall establish a system for reporting the categorization and adjustment of banking-book credit risk exposures, for the regular reporting of categorization and risks to the board of directors and senior management.

Article 13 A commercial bank shall flag the risk exposure class of each business operation in the relevant information system.

Article 14 A commercial bank shall establish an internal audit system of the categorization of banking-book credit risk exposures for the regular audit of the implementation of the categorization of banking-book credit risk exposures.

Chapter III Sovereign Exposures

Article 15 The term “sovereign exposures” means the claims on a sovereign state or economic entity and its central bank, a non-central government public sector entity, a multilateral development bank, the Bank for International Settlements, the International Monetary Fund, and so on.

Article 16 The multilateral development banks (MDBs) as mentioned in the preceding article include: the World Bank Group, the Asian Development Bank (ADB), the African Development Bank (AfDB), the European Bank for Reconstruction and Development (EBRD), the Inter-American Development Bank (IADB), the European Investment Bank (EIB), the Nordic Investment Bank (NIB), the Caribbean Development Bank (CDB), the Islamic Development Bank (IDB), and the Council of Europe Development Bank (CEDB).

Chapter IV Financial Institution Exposures

Article 17 The term “financial institution exposures” means a commercial bank’ s claims on financial institutions. According to the different attributes of financial institutions, a commercial bank shall divide the financial institution exposures into banking institution exposures and non-banking financial institution exposures.

Article 18 The banking institutions as mentioned in these Guidelines include the commercial banks, urban credit cooperatives and other financial institutions absorbing the public savings formed within the territory of the People’ s Republic of China, and the savings financial institutions registered outside the territory of the People’ s Republic of China and approved by the financial regulatory authority of the host country or region.

Article 19 The non-banking financial institutions as mentioned in these Guidelines include the securities companies, insurance companies, trust companies, finance companies, financial leasing companies, car financing companies, currency brokerage companies, asset management companies, fund companies and other institutions formed upon the approval, and subject to the supervision, of the financial regulatory authority.

Chapter V Retail Exposures

Article 20 Retail exposures shall have all of the following characteristics:

1. One or more natural persons as the debtor;

2. Large number of exposures and low value of individual exposures; and

3. Management on a pooled basis.

Article 21 Retail exposures shall be divided into residential mortgage loans, qualifying revolving retail exposures, and other retail exposures. A commercial bank shall be encouraged to make more detailed division on the above basis according to the bank’s own business conditions and management practice.

Article 22 A residential mortgage loan is a loan made for the purpose of purchasing a housing unit and secured by the purchased housing unit.

Article 23 Qualifying revolving retail exposure means a revolving and unsecured loan granted to an individual. In a qualifying revolving retail exposure, the maximum exposure to a single individual shall be 1 million yuan or less.

Article 24 Other retail exposures mean the claims on natural persons other than the residential mortgage loans and qualifying revolving retail exposures.

Article 25 The enterprise risk exposures of a commercial bank may be included in other retail exposures, if all of the following characteristics are met:

1. The total lines of credit granted by the commercial bank to a single debtor do not exceed 5 million yuan and the total assets of the debtor do not exceed 10 million yuan; or the total lines of credit do not exceed 5 million yuan and the annual total sales volume of the debtor do not exceed 30 million yuan.

2. It is managed on a pooled basis within the commercial bank.

Chapter VI Corporate Exposures

Article 26 Corporate exposures are a commercial bank’ s claims on companies, partnerships, proprietorships and other (non-natural person) entities, but exclude the claims on enterprises included in the sovereign, financial institution and retail exposures as defined in these Guidelines.

Article 27 According to the types of debtors and their risk features, the corporate exposures shall be divided into small- and medium-sized entities (SME), specialized lending and ordinary corporate exposures.

Article 28 SME exposures mean a commercial bank’ s claims on entities that have annual total sales of not more than 300 million yuan each (average of total sales in the past three years).

Article 29 Specialized lending means the claims that have all of the following characteristics in corporate exposure:

1. The debtor is typically a special purpose entity (SPE) which is created specifically to finance and/or operate physical assets;

2. The debtor has little or no other material assets or activities, and therefore little or no independent capacity to repay the obligation, apart from the income that it receives from the assets being financed; and

3. The contractual arrangement gives the lender a substantial degree of control over the assets and the income that they generate.

Article 30 Specialized lending shall be divided into project finance, object finance, commodities finance, and income-producing real estate.

Article 31 In addition to the characteristics of specialized lending, project finance shall have all of the following characteristics:

1. The financing is usually for the construction of one or a set of large production installations or infrastructures, including the refinancing of an existing project;

2. The debtor is usually a special purpose corporate entity that is formed for the construction and operation of the project or for the financing of the project; and

3. The lender is paid almost exclusively out of the sales revenue, subsidies or other income generated by the project, and the debtor usually has no other source for repayment.

Article 32 In addition to the characteristics of specialized lending, the object finance shall have all of the following features:

1. The funding is used by the debtor for the acquisition of specific physical assets (e.g. ships, aircrafts, and railcars); and

2. The repayment is mainly dependent on the cash flows generated by the specific assets that have been financed and pledged or assigned to the lender. A primary source of these cash flows may be rental or lease contracts with one or several third parties.

Article 33 In addition to the characteristics of specialized lending, the commodities finance shall have all of the following features:

1. It is structured short-term lending used to finance reserves, inventories, or receivable commodities traded at an exchange (e.g. crude oil, metals, or crops);

2. The exposure is repaid from the proceeds of the sale of the commodity, and the debtor has no other material assets; and

3. The lending’ s rating mainly reflects its self-liquidating nature and the debtor’ s skills in structuring the transaction rather than the credit quality of the debtor.

Article 34 In addition to the features of specialized lending, an income-producing real estate shall have all of the following features:

1. The debtor is usually an SPE, or an operating company focused on real estate construction or holding real estates;

2. The funding is used for the development, sale or rental of real estate (such as, office buildings to let, retail space, multifamily residential buildings, industrial or warehouse space, and hotels), as well as land arrangement, development and reserve; and

3. The repayment is mainly dependent on the rental or sales income or land transfer income of the funded real estate.

Article 35 Ordinary corporate exposures mean the corporate exposures other than the SME exposures and specialized lending.

Chapter VII Equity Exposures

Article 36 Equity exposures mean a commercial bank’ s direct and indirect ownership interests.

Article 37 A financial instrument is considered to be an equity exposure, if it meets all of the following requirements:

1. The primary source of proceeds from the financial instrument is the future capital gains rather than the benefits accrued over time;

2. It is irredeemable and does not embody an obligation on the part of the issuer; and

3. It conveys a residual claim on the assets or income of the issuer.

Article 38 A financial instrument that meets either of the following conditions shall be categorized as an equity exposure:

1. An instrument with the same structure as those permitted as Tier 1 capital for commercial banks.

2. An instrument that embodies an obligation on the part of the issuer and meets any of the following conditions:

(1) The issuer may defer indefinitely the settlement of the obligation;

(2) The obligation requires (or permits at the issuer’s discretion) settlement by issuance of a fixed number of the issuer’s equity shares;

(3) The obligation requires (or permits at the issuer’s discretion) settlement by issuance of a variable number of the issuer’s equity shares, and any change in the value of the obligation is highly related to the change in the value of a variable number of the issuer’s equity shares; or

(4) The holder has the right to require that the obligation be settled in equity shares, unless either (i) in the case of a traded instrument, the regulatory authority is content that the bank has demonstrated that the instrument trades more like the debt of the issuer, or (ii) in the case of non-traded instruments, the regulatory authority is content that the bank has

demonstrated that the instrument should be treated as a debt position.

Chapter VIII Other Exposures

Article 39 Eligible purchased receivables mean the assets formed by the conveyance by the seller of its current or future receivables arising from the commodity, product or service sales contracts concluded with the purchaser to a commercial bank, with or without recourse, on a deed basis. Eligible purchased receivables may be divided into corporate and retail receivables.

Article 40 Eligible purchased retail receivables shall be included in the retail exposures. In principle, eligible purchased corporate receivables shall be included in the corporate exposures, but a commercial bank may also categorize the eligible purchased corporate receivables as a separate category of risk exposure. The eligible purchased corporate receivables shall meet all of the following conditions:

1.The sales contracts concluded by the seller and purchaser are authentic, fair, legal and valid, and the seller can provide complete certificates of claims on the receivables;

2. The receivables are purchased by the commercial bank from unrelated sellers, and as such the bank has not originated the receivables either directly or indirectly;

3. The intercompany account receivable and receivables subject to contra-accounts between firms that buy and sell to each other are ineligible; and

4. The commercial bank has a claim on all proceeds from the pool of receivables or a pro-rata interest in the proceeds.

Article 41 Securitization exposures mean the credit risk exposures formed in the process of a commercial bank’ s participation in securitization. The securitization exposures include, but are not restricted to, asset-backed securities, credit enhancements, liquidity facilities, interest rate or currency swaps, credit derivatives and tranched cover.

Chapter IX Supplementary Provisions

Article 42 The power to interpret these Guidelines shall remain with the CBRC.

Article 43 These Guidelines shall come into force on October 1, 2008.