中国建设银行(伦敦)有限公司
China Construction Bank (London) Limited

Pillar 3 Disclosures Report

For Financial Year Ended 31st December 2012

1. Overview

1.1. Background

China Construction Bank (London) Limited ('CCBL' or 'the Bank') is a wholly owned subsidiary of China Construction Bank Corporation ('CCBC', domiciled in Beijing, China) It has been authorised and regulated by the Financial Services Authority (FSA) since 9 March 2009. It has a passport to operate within the 30 countries of the EEA/EU.

The Bank will concentrate on wholesale banking activities - accepting deposits, providing trade finance and lending, foreign exchange, interest rate and foreign exchange derivatives, and bond investments. The Bank's treasury activity performs a liquidity management function, including the management of a portfolio of investments to assist with liquidity. It also provides a service to CCBC to trade foreign exchange and gold on an agency basis. CCBL is not exposed to any market risk on this activity so it does not consume any capital. Syndicated loans are provided for general funding requirements to banks and corporate entities. Bilateral and direct loans to customers are to support working capital financing, capital expenditure and trading activities. In April 2012 the Bank set up a department to provide a marketing service for the investment bank services offered by China Construction Bank International Ltd. CCBL is not exposed to any market risk or credit risk for this activity.

The European Union Capital Requirements Directive ('CRD') came into effect on 1 January 2007. It introduced consistent capital adequacy standards and an associated supervisory framework in the EU based on the Basel II framework. Implementation of the Directive in the UK was by way of rules introduced by the Financial Services Authority ('the FSA')[1].

Since its authorisation as a licensed financial institution, CCBL has adopted the Standardised Approach for credit within the Basel Market Risk Framework and the Basic Indicator Approach for operational risk under the CRD.

On 9 May 2012 the Bank set up a subsidiary Public Limited Company, CCBL Funding PLC, to facilitate the issuance of bonds to fund the activities of the Bank. The financial statements of CCBL Funding PLC are consolidated with those of the Bank to form China Construction Bank (London) Limited (the "Bank"). CCBL Funding PLC is engaged in no activities other than providing funding to the Bank.

1.2. Purpose

The purpose of this Pillar 3 disclosures report is to detail the implementation by the Bank of the Basel II framework and risk assessment processes in accordance with the Pillar 3 requirements.
Pillar 3 complements the minimum capital requirement ('Pillar 1') and the supervisory review process ('Pillar 2').

[1] FSA Handbook – General Prudential sourcebook ("GENPRU") and Prudential Sourcebook for Banks, Building Societies and Investment Firms ("BIPRU").

1.3. Review

These disclosures have been approved by the Board, but have not been subject to external audit although the underlying positions they are based on have been. The Board, having taken into account the size and complexity of the Bank's operations, believe that an unaudited annual disclosure is appropriate. Future reviews will be published as soon as practicable after publishing the annual financial statements. More frequent disclosures may be made where considered necessary.

CCBL's accounting year end is 31st December and CCBL's Pillar 3 disclosures have been aligned with its financial reporting. The Pillar 3 disclosures for 31st December 2012 are available on the Bank's website: www.uk.ccb.com .

2. Risk management objectives and policies.

2.1. Strategies and Processes to Manage Risks

The principal risks faced by CCBL are credit risk, liquidity risk, market risk and operational risk. These principal risks are reviewed and reassessed at least annually as a part of the Internal Capital Adequacy Assessment Process ('ICAAP') and the Internal Liquidity Adequacy Assessment Process ('ILAA'). The ICAAP and ILAA analyse capital and liquidity with reference to severe stressed scenarios in order to assess their adequacy.

The Board has adopted a "Three Lines of Defence" model. The first line of defence consists of the front office business staff who are responsible for adhering to agreed business mandates as well as firm wide policies. The second line of defence is the oversight provided by control functions such as Risk and Compliance who set and monitor adherence to policies and define work practices. The third line of defence is the independent internal audit and risk process overseen by the Board Audit & Risk Committee which has oversight for and undertakes reviews of the overall risk management and compliance practices within CCBL. The Audit and Risk Committee meets quarterly, and more frequently if necessary.

CCBL's risk management is built on a formal governance framework and a process of ongoing identification, measurement and monitoring of risk. It relies on individual responsibility and collective oversight. Ultimate responsibility for risk governance lies with the Board of Directors ('the Board') who is responsible for determining risk strategy and setting risk appetite.

The risk appetite of CCBL reflects the level of risks it is willing to take with its economic capital to achieve its organisational objectives, business plans, and stakeholder expectations. This is accomplished by utilising the skills, resources and technology available to it and is inclusive of defined tolerances for loss or negative events that can be reasonably quantified.

The risk appetite objectives of CCBL may be summarised as follows:

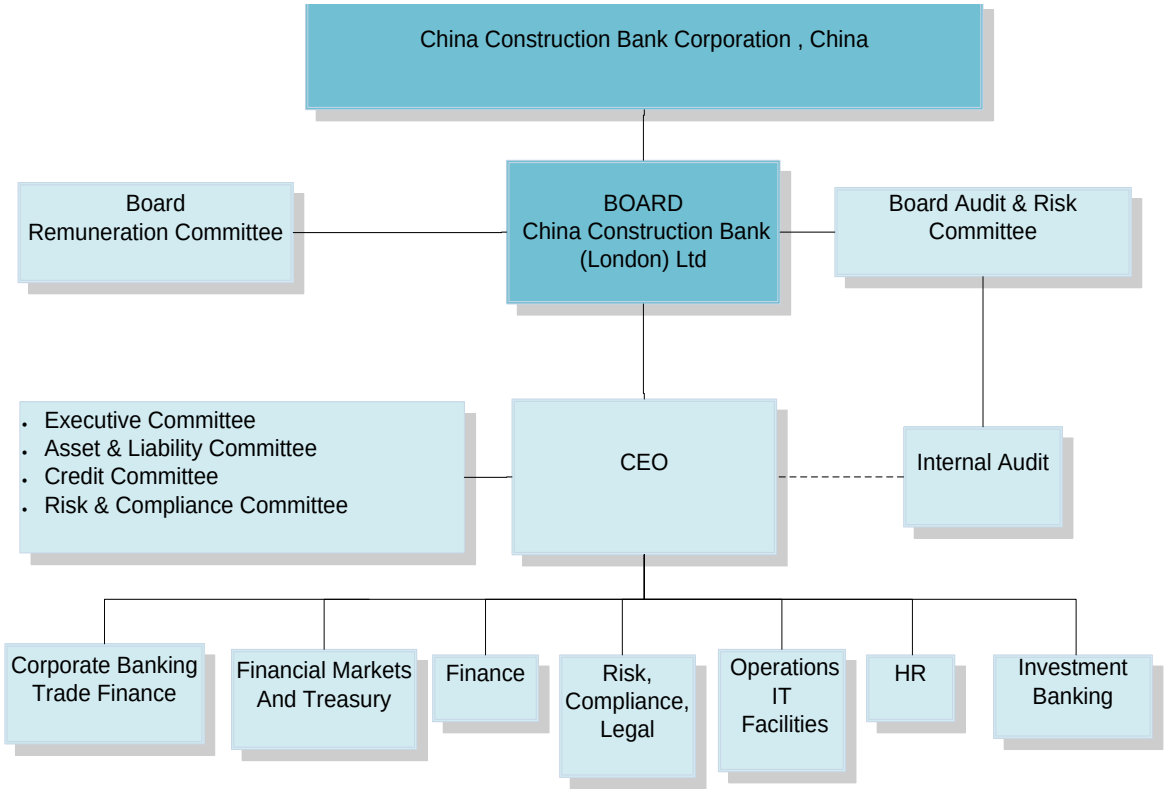
- To protect the ongoing franchise of the business;
- To minimise risks (credit, market, liquidity, operational, legal, reputational) through a thorough understanding of potential counterparties' business;
- To optimise risk and return through appropriate pricing;
- To ensure regulatory and legal compliance.

2.2. Risk Department

The Risk Department is responsible for:

i. Developing and reviewing risk policies and procedures;
ii. Monitoring and reporting market, credit, operational, legal and reputational risk;
iii. Supporting the Credit Committee, Risk and Compliance Committee, Asset and Liability Committee and Executive Committee, the Board Audit and Risk Committee and the Board Remuneration Committee with respect to risk; and
iv. Reviewing and commenting on credit and market risk proposals.

2.3. Structure and Organisation of Governance



2.3.1.The Board

The Board is responsible for strategic direction, overall control of the Bank and establishing a clearly defined governance and risk management structure. The Board has created a risk framework within the Bank's strategic objectives in accordance with CCB Group delegated authorities and UK compliance and legal authorities and has delegated risk approval powers to the Bank's CEO within that framework. The CEO can further delegate these powers and responsibilities as he sees fit.

2.3.2.Board Audit & Risk Committee

The Audit & Risk Committee provides oversight of the Bank's internal and external auditors and risk and compliance functions, thereby assisting the Board in providing an independent review of the effectiveness of processes and internal control systems of the Bank. It approves any proposed significant changes to risk authority levels, policies and product range as described above. Such approved changes will be reported to the full CCBL Board, and in appropriate circumstances will be discussed by the Board for final approval. The committee also informs the Board of any suspected abnormality which comes to its attention.

2.3.3.Board Remuneration Committee

The Remuneration Committee agrees the performance management and reward practices of CCBL within Group policy guidelines and those of the FSA. CCBL reward policies are set with continual recognition of the signals they give staff on the management of current and potential future risk. The Committee agrees appropriate levels of staff remuneration including bonus payments with particular focus on Code staff.

2.3.4.Executive Committee (ExCo)

The risk-related responsibilities of the ExCo include monitoring the risk profile of the Bank, and regulatory and legal developments. Major proposed changes to risk powers, policies and the product range are approved by Exco before submission to the Board Audit and Risk Committee for final approval.

2.3.5.Risk and Compliance Committee

The Risk and Compliance Committee has delegated responsibility from the CEO to ensure effective executive day to day oversight of the risk management and compliance framework of CCBL. The Risk and Compliance Committee reports its findings to ExCo. Responsibilities include implementation of risk management policies, reviewing appropriateness of risk management with external and internal auditors and to determine the priorities of the Risk and Compliance Departments. This committee also focuses on monitoring and managing individual exposures and assessing the quality of the credit portfolio and the adequacy of provisions.

2.3.6.Credit Committee

The Credit Committee has been delegated authority by the CEO to approve and oversee credit risks within the terms of the Parent Company Delegation of Authority and CCBL Board Authority. It monitors the Bank's credit risk profile, industry risk, concentration risk and operates an "early alert" procedure to detect any potential weakening of counterparty exposures.

2.3.7.Asset and Liability Committee (ALCo)

The ALCo is granted authority, within the terms of the Parent Company Delegation of Authority and CCBL Board Authority, by the CEO, to review and monitor the Bank's liquidity, risk management and balance sheet structure. The ALCo establishes various trigger limits, control ratios and guidelines in accordance with statutory and local regulatory requirements. ALCo reports to EXCO and the CEO.

3. Capital Resources

a) Capital

The Company's authorised share capital is US$200,000,000 divided into 200,000,000 shares of US$1.

At 31 December 2012 the issued and fully paid up share capital amounted to $200,000,000.

(b) Available-for-sale reserve

The available-for-sale reserve includes the cumulative net change in the fair value of available-for-sale investments, excluding impairment losses, until the investment is derecognised or impaired.

(USD000s)

	As at 31/12/2012	As at 31/12/2011
Core tier 1 Capital		
Called up share capital	200000	200,000
Share premium account		-
Retained earnings and other reserves	4146	(8,435)
Externally verified profits		
Preference shares		
Perpetual non cumulative preference shares	-	-
Deductions from tier 1 capital		
Intangible assets	-	-
Net losses on securities held in the available for sale financial assets category	(13)	(13)
Tier 1 capital after deductions	204,133	191,552
Innovative tier 1 instruments	-	-
Tier 2 capital		
Subordinated debt	-	-
Collective provisions	-	-
Deductions from tier 2 capital		
Expected losses	-	-
Tier 2 capital after deductions	-	-
Deductions from total of tier 1 and tier 2 capital	-	-
Total capital resources	204,133	191,552

4. Credit and Counterparty Risk.

CCBL distinguishes between three types of credit risk:

- *Default risk:* the risk that counterparties fail to meet a contractual payment obligations.
- *Settlement risk:* the risk that the settlement or clearance of a transaction will fail.
- *Concentration risk:* the risk of large exposures to particular countries, currencies or industries.

'Counterparty' refers to any party on whom CCBL takes credit risk.

4.1. Credit risk minimum capital requirement

Basel II provides three approaches of increasing sophistication to the calculation of Pillar 1 credit risk capital requirements. The most basic, the "standardised" approach, requires banks to use external credit ratings to determine the risk weightings applied to rated counterparties, to group other counterparties into broad categories and to apply standardised risk weightings to these categories.

The next level, the internal ratings-based ('IRB') foundation approach, allows banks to calculate their credit risk capital requirements on the basis of their internal assessment of the probability that a counterparty will default, but subjects their quantified estimates of exposure at default and loss given default to standard supervisory parameters. Finally, the IRB advanced approach allows banks to use their own internal assessment in both determining probability of default and quantifying exposure at default and loss given default.

CCBL has adopted the standardised approach for calculating credit risk capital requirements. Under the standardised approach, the amount of capital set aside for each transaction is given by the following equation: Credit Risk Requirement = 8% x Risk Weighted Assets.

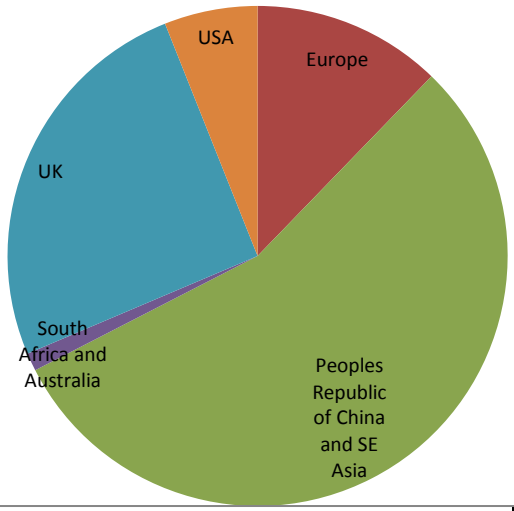
The following table shows exposure values associated with each credit quality step for credit exposures in accordance with the FSA's credit quality assessment scale under the Standardised Approach as at 31/12/2012

	External credit Risk	Credit Quality Step	Risk Weight	Exposure 31/12/2012	Exposure 31/12/2011
				$000	$000
Central governments or central banks	AAA to AA-	1	0%	50,158	-
Multilateral development banks	AAA to AA-	1	0%		15,015
Institutions with a residual maturity less than 3 months	AAA to AA-	1	20%	6,650	7,324
	A+ to A-	2	20%	273,526	288,692
	BBB+ to BBB-	3	100%	16,370	10,030
	BB+ to BB- and unrated	4	100%	12,019	67,740
Institutions with a residual maturity greater than 3 months	A to A-	2	50%	249,619	124,179
	BBB+ to BBB-	3	100%		-
	BB+ to BB- and unrated	4	100%	25,000	29,138
Corporates	A+ to A-	2	50%		522
	BBB+ to BBB-	3	100%		10,000
	BB+ to BB- and unrated	4	100%	166,394	299,160
Other				59,984	26,172
Total Exposure				859,720	877,972

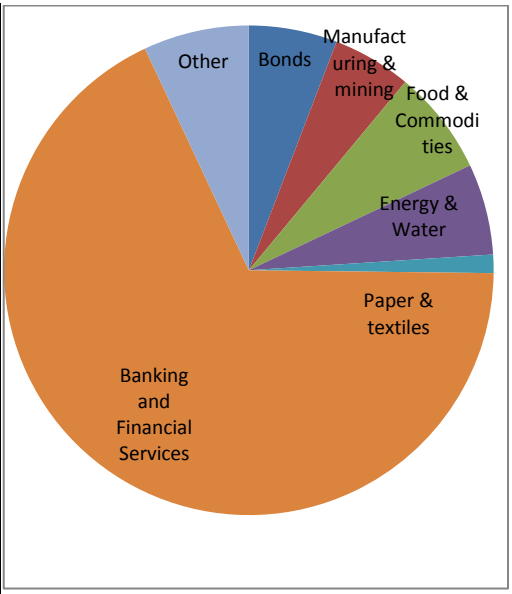
There were no impaired exposures during the year and as of 31 December 2012 (2011: None).

The following tables show the credit exposures as at 31/12/2012 by geography, industry sector and residual maturity of the exposure.

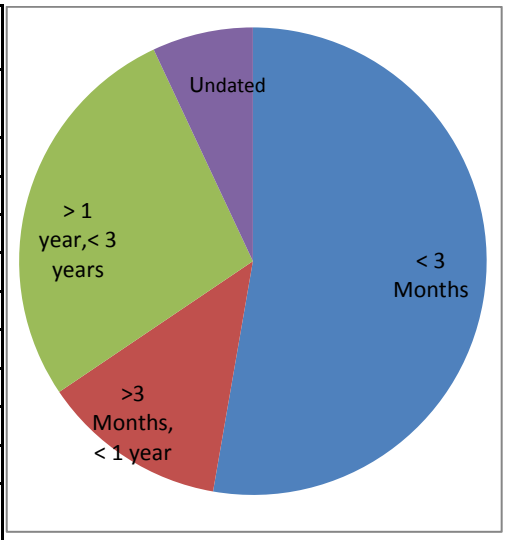
Geographic distribution by Exposure		31-Dec-12 $000	31-Dec-11 $000
Peoples Republic of China	Institutions	429,887	345,822
	Corporates	44,684	64,225
	Other	-	855
Australia	Institutions	5	5
Europe	Multilateral development banks	-	15,015
	Institutions	45,357	21,927
	Corporates	59,918	211,739
South Africa	Corporates	10,000	10,000
UK	Institutions	106,199	159,349
	Corporates	51,792	23,196
	Other	59,984	25,317
USA	Central governments or central banks	50,158	0
	Institutions	1,736	0
	Corporates	-	522
		859,720	**877,972**



Industrial Sector Distribution by Exposure		31-Dec-12 $000	31-Dec-11 $000
Central governments or central banks	Liquidity buffer-eligible investments	50,158	-
Multilateral development banks	Liquidity buffer-eligible investments	-	15,015
Institutions	Banking	583,185	527,103
Corporates	Financial Services	-	5,000
	Brewing	-	-
	Chemical	-	10,000
	Construction		-
	Commodities	47,473	522
	Manufacturing	34,727	266,510
	Media	-	-
	Mining	10,000	2,000
	Electricity	31,543	16,816
	Water Supply	20,203	4,627
	Retail Trade	-	1,894
	Food production	12,002	
	Paper	9,957	
	Textiles	488	
	Professional , Scientific	-	2,313
Other Items		59,984	26,172
		859,720	**877,972**



Residual maturity of Exposure		31-Dec-12	31-Dec-11
		$000	$000
Up to and including 3 months	–		0
	Corporates	144,761	18,748
	Institutions	308,566	373,786
	Multilateral development banks		15,015
Between 3 months & 1 year	Corporates	21,632	58,503
	Institutions	88,577	153,317
	Other		855
Between 1 year and 3 years	Corporates		30,561
	Institutions	186,042	
	Central governments or central banks	50,158	
Between 3 years and 5 years	Corporates		200,634
Undated	Other	59,984	26,553
		859,720	**877,972**



4.2. External Credit Assessment Institutions (ECAI)

The following ECAI's have been nominated to calculate credit risk capital requirements for all exposure classes and are recognised under the Capital Requirements Regulations 2006 for purposes of the standardised approach:

- Standard and Poor's;
- Moody's Investor Service; and
- Fitch.

Where multiple ECAIs provide credit ratings, the worst rating of the best two ratings is applied. Where available, the long term senior unsecured rating is applied. The issue rating is used for bonds and the issuer rating is used in other instances.

4.3. Monitoring Credit and Counterparty Risk

The following are monitored on a regular basis:

- Counterparty credit ratings;
- Counterparty credit exposures and limits; and
- Concentration risk (country, currency, industry and issuer).
- Country risk

4.4. Mitigating Credit Risk

CCBL manages its credit risks by

- Utilising netting and collateral agreements where possible;
- Diversifying exposures across different counterparties to reduce the impact of a single counterparty default;
- Setting hard limits on the amount of exposure to each counterparty at group level;
- Ensuring robust credit analysis (initially and ongoing);
- Settling through assured payment systems or on a delivery-versus-payment basis;
- Where possible, to reduce the risk of loss via parental or third party guarantees; and
- Where possible, to reduce the loss given default by using acceptable collateral as security.

5. Counterparty Credit Risk for Derivative Transactions.

Counterparty credit risk ("CCR") is the risk that the counterparty to a derivative transaction could default before the final settlement of the transaction's cash flows.

The Bank measures the exposure value on counterparty credit exposures under the CCR mark to market method. This exposure value is derived by adding the gross positive fair value of the contract (replacement cost) to the contracts potential future credit exposure, which is derived by applying a multiple based on the contracts residual maturity to the notional value of the contract in accordance with BIPRU 13.4.5 .

Table of Potential Future Credit Exposure Percentages in accordance with BIPRU 13.4.5					
Residual maturity	Interest-rate contracts	Contracts concerning foreign currency rates and gold	Contracts concerning equities	Contracts concerning precious metals except gold	Contracts concerning commodities other than precious metals
One year or less	0%	1%	6%	7%	10%
Over one year, not exceeding five years	0.5%	5%	8%	7%	12%
Over five years	1.5%	7.5%	10%	8%	15%

The following table shows the counterparty risk and its relevant capital components as at 31/12/2012 and 31/12/2011

	31 December 2012($000's)		31 December 2011($000's)	
	Gross positive fair value	Counterparty Risk Capital Component	Gross positive fair value	Counterparty Risk Capital Component
Forward Foreign Exchange contracts	56,949	783	22,591	1,383
Interest rate swaps	11	-	854	164
	56,960	783	23,445	1,547

6. Market Risk

Market risk is the risk of loss due to changes in market factors such as interest rates, implied volatility, commodity prices, credit spreads and foreign exchange rates. The Bank is exposed to market risk arising from customer orders that the Treasury Department and Corporate Banking Department transacts and from operational requirements (such as the cost of overheads payable in Sterling from capital expressed in dollars.)

6.1. Interest Rate Risk

Interest rate risk in the non-trading book arises from financial investments designated as available for sale and held to maturity. Interest rate risk arises principally from mismatches between the future yields on assets and their funding costs, as a result of interest rate changes. The Bank's interest rate risk in the non-trading book is governed by Group policy.

The table below shows the impact of a 100 basis point rise or fall in the base rate on net interest income at 31 December 2012:

	31-Dec-12		31-Dec-11	
	100bps parallel Increase	100bps parallel Decrease	100bps parallel Increase	100bps parallel Decrease
	$000's	**$000's**	**$000**	**$000**
Sensitivity of projected net interest income				
USD	**(189)**	**189**	**(428)**	**428**
GBP	**(110)**	**110**	**(7)**	**7**
CNY	**(8)**	**8**	**-**	**-**
EUR	**(15)**	**15**	**-**	**-**
	(322)	**322**	**(435)**	**435**

Related to the Bank's capital base, therefore, interest rate risk is minimal.

6.2. Foreign Exchange Risk

Foreign exchange risk is the risk that movements in the various currencies could materially impact the financial statements. The Bank makes loans and takes deposits in a number of currencies. The Bank manages foreign exchange risk by assigning notional limits on foreign exchange positions, assigning value at risk limits and tenor limits. The table below shows the impact of a one cent increase or decrease in the value of the Dollar against other currencies to which the Bank is exposed:

	31 December 2012		31 December 2011	
Change in value of the dollar compared with Sterling , Euros and Renmimbi	1 cent Increase	1 cent Decrease	1 cent Increase	1 cent Decrease
$000				
Sensitivity of foreign exchange				
At 31 December 2012/2011	**28**	**(28)**	**54**	**(54)**

The Bank's exposure to Foreign Exchange risk is minimal with respect to its capital base.
CCBL has approved a Trading Book Policy Statement. As at 31st December 2012, FX Trading is the only permitted trading activity.

6.3. Monitoring Market Risk

The following are monitored on a daily basis:

- Mark-to-market of profit and loss;
- Value at risk (calculated on a one day horizon with a 99% confidence interval); the 99% daily VaR limit represents 0.5% of capital and there were no breaches of the limit during 2012.
- Sensitivity to adverse moves in interest rates and foreign exchange.

6.4. Mitigating Market Risk

CCBL manages its market risk by:

- Placing a limit on the sensitivity to interest rates. In particular, a maximum DV01 (the gain or loss suffered from a 0.01% parallel movement in the yield curve) is specified;
- Operating an early alert program
- Placing a limit on foreign exchange exposures; and
- Placing a limit on the value at risk.

7. Operational Risk

Operational risk is the risk of financial loss resulting from inadequate or failed internal processes, people and systems or from external events. It could also result in loss of reputation and/or legal costs.

There are three approaches to measuring capital requirements for Operational risk under Basel II each with varying levels of sophistication. The capital required under the basic indicator approach ('BIA') is a simple percentage of a relevant indicator, whereas under the standardised approach it is one of three different percentages of relevant indicators allocated to each defined business lines. Finally, the advanced measurement approach uses Banks' own statistical analysis and modelling of operational risk data to determine capital requirements.

CCBL has adopted the basic indicator approach in determining its operational risk capital requirements. The relevant indicator used is the average over three years of the sum of net interest income and net non-interest income. The BIA multiplier is 15%. If for any observation, the sum of net interest income and net non-interest income is negative, this figure is not taken into account in the calculation of the three-year average.

Operational risk data is collected from all departments based on actual incidents as well as potential operational risk events. In conjunction with the Risk Department, the probability of events and the severity of events are captured and simulations are run in order to assess operational risk versus risk appetite.

Operational losses amounted to less than $1,000 in 2012.

8. Capital adequacy

In assessing the adequacy of its capital, the Bank considers its risk appetite, the risk types to which the Bank is exposed and the appropriate management strategies for each of the Bank's material risks. In addition to capital adequacy quarterly reporting to the FSA, an internal capital adequacy assessment is performed daily in order to assess the Bank's capital adequacy and to determine the levels of capital

required going forward to support the current and future risks of the Bank's growing business. Capital adequacy reports are produced by the Finance Department and reviewed, monthly, by ALCo and Senior Management. If the daily surplus capital falls within a predetermined, (currently 20%) of the Individual Capital Guidance ('ICG' – a prudential measure specific to each financial institution set by the FSA), ALCo is notified immediately. ALCo will then monitor the situation closely and make any necessary recommendations to ExCo who will decide what actions are required to rectify the situation.

The Risk department is responsible for ensuring that the Bank's current and expected future risks are reflected in the Internal Capital Adequacy Assessment Process (ICAAP) document which is approved, at least, annually by the Board. The Finance and Risk departments are jointly responsible for ensuring that sufficient capital is maintained to provide the Bank with adequate headroom to cover expected risks of current and potential business activities and stress testing scenarios.

The amount and composition of the Bank's capital requirements is determined by assessing the minimum capital requirements under Pillar 1 of the Capital Requirements Directive (CRD), the applicable approach for risk assessment being the Standardised Approach for credit risks and the Basic Indicator Approach for operational risk and the ICG of the Bank.

The following table shows the Bank's Pillar 1 capital requirement by asset class :

Credit Risk - Standardised Approach	31 December 2012		31 December 2011	
(USD000s)	Exposure Value	Capital Requirement	Exposure Value	Capital Requirement
Central governments or Central Banks	50,158	-		-
Multilateral Development Banks	-	-	15,015	-
Institutions	276,701	7901	153,317	6133
Corporates	30,483	2,439	309,682	8,770
Short term claims on institutions and corporates	442,393	14,326	373,786	10,958
Other items	59,985	242	26,172	218
Capital Component for Credit Risk	**859,720**	**24,908**	**877,972**	**26,079**
Operational risk – Basic Indicator Approach		**3,955**		**3,975**
Counterparty Risk Capital Component		**783**		**1,547**
Foreign exchange PRR		**794**		**389**
		371		
Total Pillar 1 capital requirement		**31,990**		**31,990**
Total capital resources		**204,133**		**191,552**
Excess capital resources over Pillar 1 capital requirement		**172,143**		**159,562**

9. Impairments and Provisions

In the first instance, the Relationship Manager is responsible for monitoring loan covenants and identifying overdue or non-performing loans for his/her customers. The Risk Department is responsible for classifying the loans and notifying the appropriate committees and Head Office. The committees recommend courses of action following the *Early Alert* Process which is discussed below.

9.1. Definition of Impaired

CCBL recognises impairment if objective evidence of a risk problem exists as a result of one or more events that occur after the initial recognition of the asset and those events have an impact on the estimated future cash flows of the financial asset that can be reliably estimated. Objective evidence that a financial asset is impaired includes observable data that comes to the attention of the holder of the asset as a result of the following events:

- Significant financial difficulty of the issuer or obligor;
- A breach of contract, such as default or delinquency in interest or principal payments;
- The lender, for economic or legal reasons relating to the borrower's financial difficulty, grants the borrower a concession to weaken the original terms of the transaction;
- Weakening of security taken against a counterparty transaction:
- It becoming probable that the borrower will enter bankruptcy or financial reorganization;
- The disappearance of an active market for the financial asset because of financial difficulties; or
- A measurable decrease in the estimated future cash flows because of observable data including:
    a. adverse changes in the payments status of borrowers; or
    b. national or local economic conditions.

9.2. Definition of Past Due

Past due refers to amounts that are unsettled on the scheduled or expected date and refers to all payment types including principal, interest and fee payments and failed collateral calls.

9.3. Impairment Reporting

The Risk Department prepares a monthly loan impairment report for Head Office. This report consolidates all loan accounts with details such as loan nature, loan grading, company class, country risk, final maturity date and security. This report also provides an analysis on the exposure to each industry and the exposure distribution to each company class, loan grading, nature of loan facilities, country risk, final maturity and security.

9.4. Provisioning Process

An account is considered non-performing (or non-accrual) if:

- There is a question as to the obligor's ability or willingness to pay interest or principal. The Risk Department, or a member of the Credit Committee can recommend that an account be placed on non-performing status to the Credit Committee;
- Principal and / or interest remains unpaid for ninety days after its due date or more; or
- The account is classified Substandard or Doubtful or Loss through the Account Classification Process (see definitions below).

The Bank's Credit Policy details the valuation process for impairments.

The amount of the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses) discounted at the original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount shall be reduced either directly or through use of an allowance account and the loss shall be recognised in profit or loss.

When a decline in the fair value of an available-for-sale financial asset has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss that had been recognised directly in equity shall be removed from equity and recognised in profit or loss.

Any accrued and unpaid interest on a non-performing exposure is reversed and only recognized as interest income when cash payments are received. However, it may continue to be classified adversely.

Once an account is put on non-performing status, it is classified at Substandard or lower (see definitions below). It can be restored to performing status only after all outstanding payments of principal and interest have been received in cash or a suitable restructuring/rescheduling agreement has been signed and the obligor has fulfilled all its obligations under the revised agreement. This is accompanied by evidence of a relative improvement in the Obligor's condition and debt service capacity and clear commitment to repay. An important factor is a reasonable period of demonstrated payment performance in accordance with the modified terms.

Under the *Early Alert* process, the Risk Department, overseen by the CEO, has the ongoing responsibility to identify signs of weakness or other signs of deterioration in each credit. The recommendations are presented to the Credit Committee.

The *Early Alert* Process may lead to placing the account on any of the following statuses:

- Watch;
- Substandard;
- Doubtful; or
- Loss.

Watch: assets subject to conditions that, if left uncorrected, could raise concerns about full repayment are to be classified "Watch". Examples of such conditions are weaknesses in the customer's financial condition or deterioration in the security or weaknesses that have been detected in the documentation. These require more than normal attention by the client relationship managers.

Substandard: assets that do not have adequate protection (e.g. obligor net worth or collateral) and/or interest or principal or both are more than 90 days overdue. No loss is foreseen, but a protracted workout is a possibility. Prompt corrective action is required to strengthen the Bank's position as a creditor, to reduce its exposure and to ensure that the customer takes adequate remedial measures. All non-performing accounts are classified as Substandard at best.

Doubtful: assets for which collection / liquidation in full is determined by the Bank's management to be improbable due to current conditions and/or interest or principal or both are overdue more than 180 days. Assets in this category are considered impaired but are not yet considered total losses because some pending factors may strengthen the asset's quality (e.g. merger, new financing or capital injection). Placing the account on non-accrual is normally required. The principal should be reserved or written off to the extent deemed necessary, after obtaining the approval of the Credit Committee.

Loss: an asset is classified Loss when management considers the facility to be virtually not collectible and/or when interest or principal or both are overdue more than one year. A Loss classification does not mean that there is no potential for eventual recovery. The client relationship manager is expected to continue a vigorous collection effort until it is decided that no further repayment or recovery is possible.