## Risk Management

## >> RISK MANAGEMENT MECHANISM

ICBC regards risk management as the most important aspect of bank operations. Risk management in banks comprises the identification, early warning, and control of credit risk, liquidity risk, market risk, operational risk and other risks. The Head Office established the Risk Management Committee, Credit Policy Committee, Assets and Liabilities Management Committee, and Auditing and Supervisory Committee to take the respective responsibilities of establishing and amending all risk management policies, rules and methods. The Asset Risk Management Department, Credit Management Department, Financial Planning Department and the Auditing and Supervisory Department are responsible for the stipulation of detailed rules, management methods and working procedures. The related departments in all branches are responsible for the implementation, feedback and proposed amendments of those policies.

Risk Management Committee: responsible for the research and analysis of the economic and financial situation, both domestic and abroad, and the influence of the change of laws, regulations, policies and rules upon the Bank's business risk. The committee is also responsible for setting up goals and important policies on bank-wide risk management and control. Reports on asset quality and risk supervision from relevant functional departments will also be discussed at this committee. Further, the committee is responsible for setting the key focus at different phases of risk management, evaluating risk management of all branches and departments, and establishing key objectives for them.

• Credit Policy Committee: responsible for the review and implementation of bank-wide credit operations management structure and credit policy, and for the research on the developmental direction of credit business and risk management measures. The credit analysis reports on key industries and products will be discussed at the committee. The committee takes the responsibilities of evaluating customers' annual general credit line review and industry and regional limits, and approving large value credit applications. A credit approval center is under the committee as a functional institution.

• Assets and Liabilities Management Committee: responsible for the establishment of capital evaluation procedures, the determination of the capital management measures suitable for the Bank's overall risk level and operating environment; for the analysis of changes in bank-wide assets and liabilities management indicators to give directive opinions for the enhancement of assets and liabilities management; for the research on impact of interest rate risk and liquidity risk on bank-wide assets and liabilities businesses and development of corresponding management policies.

• Auditing and Supervisory Committee: responsible for the examination and approval of the rules and methods to evaluate internal auditing and internal control; for guiding all branches to implement internal control; for the review and discussion of treatment of bank-wide severe non-compliance cases; for finalization and issuance of important auditing instructions and notices; and responsible for the prevention and remediation of severe non-compliance activities.

Internal risk rating method is one of the core elements in "New Basel Capital Accord", which involves all aspects of bank risk management. In order to strengthen the risk management system and to meet the risk supervisory guidelines set by New Basel Capital Accord, the Bank launched an internal

risk rating project in February 2004 and PWC was engaged as the advisor through public bidding. The project adopts an approach of overall planning with phased implementation. During the phase of overall planning, a comprehensive diagnostic review of the current status of risk management and gap analysis against the "New Basel Capital Accord" and international best practices will be performed. Based on that, a comprehensive risk management system will be designed.

## >> CREDIT RISK MANAGEMENT

Credit risk is the risk that occurs when the transaction counter-parties or borrowers cannot or are not willing to honor their agreements. Credit risk mainly comes from loan, trade finance, investment and other business. It can be divided into two categories: credit facility risk and special asset credit risk.

#### Credit Facility Risk Management

Credit facility risk management is implemented through personal consumer customer management system and corporate customer management system respectively. In 2003, the Bank continued its dynamic credit policy strategy which considered: 1) industry focus — continuously increased credit facilities to energy, transportation, telecom and city infrastructure, and reduced the credit to steel, construction materials, textiles and other processing and manufacturing industries; 2) regional focus — increased the credit to eastern coastal areas, including capital economic zone, the Yangtze delta economic zone and Pearl River delta economic zone, appropriately increased the credit to middle-west area , and adjusted the credit structure in northeastern area; 3) customer focus — increased the credit concentration in AA- and above customers , exited low credit level customers, continuously increased credit facilities to large and good quality customers such as large shareholding companies, Fortune's Top 500 companies in the world (that have operations in China ) and big state-owned enterprises, and increased the support to small and medium sized companies that have good management, flexible operations, promising products and high risk resistance abilities; and 4) increased individual consumer credit and gained experience in managing credit risk of individuals.

#### I 、Risk Management of Corporate Customer

The credit risk management policies for corporate customers are reflected in the entire process of loan management, with its core in the credit management system dually controlled by leveled approval authorization and customer credit limit control.

	Risks Management Steps	<b>Risk Management Policy and Improvement</b>
Р	Credit Policy and Management Rules	Based on customers and their industries, national policies and regional economic situations, classify different industries, regions and customers and apply different credit policies accordingly.
Pre-lending Controls	Customers Credit Rating	Use internal rating system to judge customers' grading from AAA to B, twelve grades in total, accurately, objectively and fairly. Form a business evaluation system, which uses an enterprise evaluation standard value designed for different industries and scales as measures of corporate credit conditions, focuses on solvency, and uses quantitative evaluation index, quantitative rectification index and qualitative evaluation index for gradual correction.
ls	Centralized Review of Customer Credit Limits	Establish credit granting center and carry out centralized credit lines review for corporate customers. Based on customer's actual operating and financial performance with solvency as the core factor, conduct comprehensive customer risk analysis to set credit limit ceiling for single corporate customer, for related companies under one group, which will be strictly applied for all financing activities of the customer.

#### (Continued)

	Risks Management Steps	<b>Risk Management Policy and Improvement</b>
On le Con	Authorization Management	Compose of an annual basic authorization, re-authorization and special authorization to domestic branches and functional departments.
On lending Controls	Approval of Credit Business	Adopt properly centralized credit business approval mechanism with Chief Reviewer responsibility system established at different levels . Large value credit deals and special designated credit business have to be approved by the Head Office's Credit Policy Committee and Credit Approval Center, and tier-one and tier-two branches can approve credit business within their authorization limit.
Post-lending	Credit Monitoring	Monitor credit business through comprehensive credit management system and specialized reports. Check the quality of new credit facilities on a daily and case-by-case basis, and also by regions, industries and accounts. Penalties such as warning circular, warning and rectification on business, and even suspension of business would be levied on those branches not complying with internal credit rules.
g Controls	Field Inspection	Analyze and identify risk level and risk developing trends through on the spot internal audit. Based on credit risks, launch early warning signal, adopt measures to resolve problem credits, and prevent and control credit risk promptly.

#### Risk Control of Real Estate Loans

In 2003, the State Council and PBoC successively issued the "State Council's Notice on Driving Real Estate Market's Continuous Healthy Development" and the "Notice on Further Strengthening the Management of Real Estate Credit Business". In response to the new policy framework, housing finance department actively adjusted policy, and issued "Opinion on Further Strengthening the Management of Real Estate Credit Business". At the same time, the Bank strengthened internal structural adjustment in the process of business development, supported quality housing projects developed by large and quality developers, and ensured the proper ratio of real estate loans to housing mortgage loans.

In the process of controlling risk, the Bank continued to reduce non-performing real estate loans and strengthened supervision of outstanding loans. For loans with great potential risk, the Bank used credit management system to monitor and check the granting circumstances, loan status, risk level, loss situation and reasons for loss and resolution progress one by one. The system of authorizations and re-authorizations was strictly implemented, and approval authority for commercial property development loans and land reserve loans was withdrawn from branches. The approval of new project reserve credit was suspended. The Bank actively monitored the risks concerning affiliated enterprises, and prevented over-extension of financing. Centralized credit facilities granting for real estate enterprises were in full force. At the end of 2003, NPL ratio of real estate loans in the Bank was 7.3%, 5 percentage points down from the previous year.

#### **Risk Control of Bills Business**

Bills business is composed of bills acceptance business and bills financing business. Bills acceptance business belongs to bills issuance market (primary market) business. Bills financing business belongs to bills trading market (secondary market) business, which is the investment and financing business of commercial banks in the money market to make profits with the bills as trading tools. Types of trading include bills discount, bills re-discount, bills repo, bills reverse repo, and re-discount bills from central bank. Since credit risk and operational risk appeared due to the rapid growth of bills business in the first half-year of 2003, the Bank organized specific audit to strengthen the implementation of bills discount approval mechanism and operation procedures, to strengthen the verification of truthfulness of bills supporting documents, and to strengthen cooperation with other banks on inter-bank acceptance bills operations inquiry and response to ensure the sustainable development of the bills business. At the end of 2003, the NPL ratio of the bills finance loans was 0.05%.

#### II 、 Risk Management of Personal Customer

Based on the operating characteristics of different credit products, different risk management measures were established for personal customer risk control. The "one on one" in person interview system was carried out, and emphasis was placed on pre-lending investigations and post-lending management, to improve the ability of risk prevention.

#### Risk Control of Housing Mortgage Loans

Operational and management procedures from loan application to loan collection were established covering all kinds of housing mortgage loan products. The development of housing mortgage loan management system, being the first among peer banks to use computer system to monitor each stage of housing mortgage loan from loan application to loan collection, greatly enhanced the level of risk monitoring and management on individual customer credit risk. Further improvements in the establishment of relevant systems were achieved in 2003, with improved investigations on individual cases as well as audits designed to cover specific areas, which effectively prevented "fraudulent mortgages". As of the end of 2003, the NPL ratio of housing mortgage loans was 1.12%.

#### Risk Control of Other Consumer Loans

Other types of consumer loans are of good quality. According to five-category classification system, non-performing ratio of other personal consumer loans was controlled at 0.73%. The Bank is a leader in the PRC banking industry in terms of both volume of consumer credit and the ability to control risk. In face of the potential risk occuring with auto loans, the Personal Banking Department put forward five specific instructions: firstly, to carry out the review of validity of the auto loan and the approval process, to exert stricter loan guarantee procedures, standardize loan operation flow, and prevent the risk of getting bank finance illegally; secondly, to exert stricter management of down payments, loan term and interest rate of auto loans, prohibit from extending loans to those that do not pay adequate down payment; thirdly, to strengthen the examination of car dealers' qualification, prohibit relying solely on car dealers to extend auto loans, prevent dealers from cheating the bank with fake auto purchase contracts; fifthly, to carry out self-examination on all newly extended auto loans in 2003. As of the end of 2003, the non-performing ratio of auto loans was 0.9%.

#### Special Asset Risk Management

In the entire process of using capital, apart from loan assets, all the other forms of using capital constitute non-loan assets. The special risk assets include advances for interest receivables, settled assets, assets received to be liquidated, housing reform losses to be disposed and so no.

#### Details of Special Risk Assets

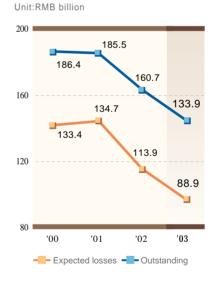
	Dec.31,2003	Dec.31,2002	Increase	%of Increase
Interest receivable	31.5	43.5	-12.0	-27.59
Settled assets	37.0	41.3	-4.3	-10.41
Assets received to be liquidated	17.3	18.3	-1.0	-5.46
Entrusted shares	13.1	12.7	0.4	3.15
Housing reform losses to be disposed	11.1	14.0	-2.9	-20.71
Accounts receivables to be disposed	7.8	14.2	-6.4	-45.07
Placements to financial institutions to be liquidated	8.5	8.4	0.1	1.19
Long-term investments to be liquidated	4.8	5.0	-0.2	-4.00
Bonds to be liquidated	2.3	2.7	-0.4	-14.81
Others	0.5	0.6	-0.1	-16.67
Total	133.9	160.7	-26.8	-16.68

Note: For comparable analysis, special risk assets for 2002 include both branches in China and abroad and overseas institutions.

At the end of 2003, the special risk assets of the whole bank amounted to RMB 133.9 billion, accounting for 6.96% of total non-loan assets. The projected rate of loss on these assets was 66%. The formation of these special risk assets is mainly due to policy changes (such as advances for interest receivables resulting from the change in accounting policies, losses arising from housing reforms, etc.) and operational factors (potential losses on settled assets, losses related to external investments and placements, etc.). From the year of 2000 onwards, special risk asset management method has been gradually refined, the definition of special risk asset, measurement parameters and the responsible departments have been clearly defined; risk evaluation standards and accountability mechanism have been formalized; more and more attention has been paid to deal with these issues year by year. Liquidation and cleaning up of issues related to

SPECIAL RISK ASSETS

Unit: RMB billion



investments made in the past was in full force. As of the end of 2003, seventy-two domestic entities have been liquidated or cleaned up, while the work for overseas entities is near completion as well.

#### Credit Risk Exposure

#### I 、 Distribution of Loan Balances

At the end of 2003, total loan balances amounted to RMB 3,392.9 billion, an increase of RMB 390.7 billion for the year, or 13%. This is much lower than the growth rate of 21.4% for loans issued

by all financial institutions in China, which maintained a healthy growth of the loan portfolio, and prevented credit risks that could occur due to fast growth of loan balances.

As of the end of 2003, the total loan balance for the largest single customer as a percentage of the Bank's not conital was below 10% which is in line with CBPC's

Wholesale and retail 11.08%

Manufacturing 35.69%

Overseas lending 0.17%

Others 6.41%

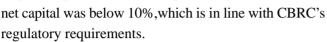
Mining 2.31%

chnology 3.23%

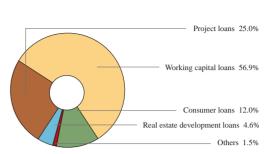
Service 4.80%

Energy 6.00%

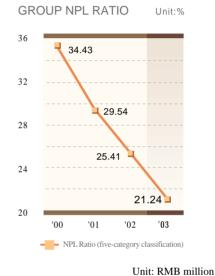
Consumer 12.26%



LOAN PORTFOLIO BY INDUSTRY



LOANS OUTSTANDING



#### Distribution of Loan Balances According to Risk Classification

Transportation and logistics 8,91%

As of Dec. 31, 2003 As of Dec. 31, 2002 Balance (%) Balance (%) 2,993,979 **Total loans** 3,392,937 100.00 100.00 Normal 69.23 62.41 2,348,901 1,868,498 Special mention 323,279 9.53 364,598 12.18 Non-performing loans 720,757 21.24 760,883 25.41 Substandard 73,397 3.94 2.16 118,036 Doubtful 460,592 13.58 459,138 15.33 186,768 5.50 183,709 6.14 Loss

Note: For comparable analysis, balance of total loans as of Dec.31, 2002 include both branches in China and abroad and overseas institutions.

In 2003, the effort to reduce the amount of NPL increased, and the quality of assets continued to improve. Balance of NPL in accordance with five-category classifications decreased by RMB 40,126 million, the ratio of NPL reduced by 4.17 percentage points to 21.24%. The main reasons for the reduction in NPL were improved quality of new loans, improved risk management measures, and increased efforts of NPL dispositions by promoting the implementation of the non-performing asset disposition center model.

#### Aging of Delinquent Loans

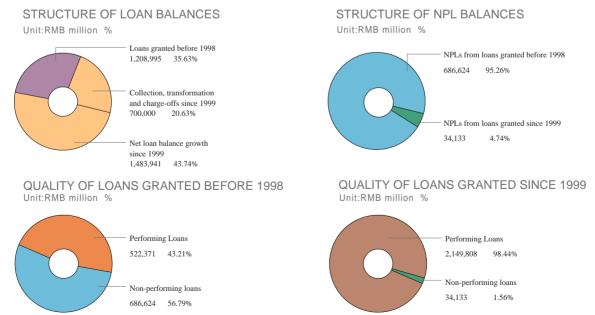
	As of Dec	2. 31, 2003	As of Dec. 31, 2002		
	Balance	(%)	Balance	(%)	
Total loans	3,392,937	100.00	2,993,979	100.00	
Delinquent loans	642,844	18.95	657,758	21.97	
0 - 90 days overdue	25,807	0.76	21,520	0.72	
90 days or above overdue	578,433	17.05	593,437	19.82	
Loss (classified according to criteria of MoF)	38,604	1.14	42,801	1.43	

Note: For comparable analysis, balance of total loans as of Dec.31, 2002 include both branches in China and abroad and overseas institutions.

#### II 、 Quality of New Loans Granted Since 1999

Since 1999, the Bank has focused its efforts to adjust the credit structure of industries, regions, and customer segments. The Head Office has formed an industry analysis center, to improve guidance on lending policies for focused industries and customers, and to strictly control the direction of lending. The Chief Reviewer mechanism has been set up, to better control and approve loans. Through using computer application tools – Credit Management System (CM2002), the Bank reengineered the original management methods and business process, gradually formalized the loan working procedures, to make it more standardized and scientific. For new loans granted, full monitoring and follow-up investigations systems were implemented, which effectively controlled risk. These measures allowed the quality of new loans granted since 1999 to meet international standard.

As of the end of 2003, the total balance of new loans granted since 1999 amounted to RMB 2.2 trillion, accounting for 64% of the total current loan balance. Of these new loans, RMB 1.5 trillion was net balance growth from 1999, and RMB 0.7 trillion was incremental loan balance after collection, transformation or write-off of NPLs and the "sub-healthy" loans. The NPLs related to the new loans only accounted for 4.74% of the total NPLs, with NPL ratio of 1.56%.



Note: Non-performing loans refer to the last three categories of the five-category classification system, which include the substandard, doubtful, and loss; Performing loans refer to the top two categories which include normal and special mention.

Unit: RMB million

#### NPL Ratio Summary

	Loans extended prior to 98	Since 1999	Since 2000	Since 2001	Since 2002	Since 2003
NPL ratio	56.79	1.56	0.89	0.56	0.29	0.13
Corporate customers	56.92	1.69	0.90	0.55	0.30	0.14
Retail customers	9.66	0.98	0.85	0.61	0.26	0.07

#### Asset Quality Ш

III Asset Quality Unit: RMB million									
	As of Dec.	. 31, 2001	As of Dec.	31, 2002	As of Dec. 31, 2003				
	Balance	(%)	Balance	(%)	Balance	(%)			
Total assets	4,338,985	100.00	4,776,773	100.00	5,279,120	100.00			
Loan assets	2,680,191	61.77	2,988,755	62.57	3,371,950	63.87			
Non-loan assets	1,658,794	38.23	1,788,018	37.43	1,907,170	36.13			

Note: Loan assets are net of provision for credit losses, non-loan assets are net of specific provision for non-performing assets disposition losses.

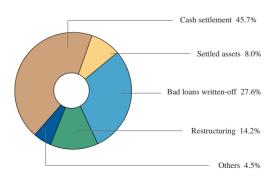
Non-performing Assets Summary Unit: RMB million								
	As of Dec. 31, 2000	of Dec. 31, 2000 As of Dec. 31, 2001 As of Dec. 31, 200						
Non-performing assets	1,017,399	977,489	921,600	854,665				
Non-performing loans	830,999	791,989	760,883	720,757				
Special risk assets	186,400	185,500	160,717	133,908				
Non-performing assets ratio(%)	25.45	22.53	19.29	16.19				

As of the end of 2003, total non-performing assets of the Bank amounted to RMB 854.7 billion, a reduction of RMB 66.9 billion from the prior year. Non-performing assets ratio decreased by 3.1 percentage points to 16.19%. Among them, NPLs decreased by RMB 40.1 billion, while special risk assets decreased by RMB 26.8 billion. NPL ratio and special asset ratio decreased to 21.24% and 6.96%, respectively, reductions of 4.17 percentage points and 1.97 percentage points from the prior year.

#### **Recovery of Assets**

During 2003, total non-performing assets recovered and disposed of by domestic branches amounted to RMB 126.2 billion, of which RMB 89.3 billion were NPL, an increase of RMB 19.5 billion from last year. The ratio of recovery and disposal of NPL to total NPLs was 11.73%, increased by 2.95 percentage points compared to the previous year, among which cash settlement reached RMB 40.8 billion, increased by RMB 5 billion over the previous year, with the cash settlement rate of 5.35%; resolution in form of settled assets reached RMB 7.1 billion, and





Unit. 06

bad loans written off was RMB 24.7 billion; loan restructuring by various ways amounted to RMB 12.7 billion and recovery through other means reached RMB 4 billion.

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At the same time, the Bank improved efforts in recovery and disposal of special risk assets. The special risk asset recovery and disposal plans were distributed to branches and sub-branches. Non-performing asset ratio included in the indicators for overall performance evaluation of branch presidents has broadened from just loans to include special risk assets. The branches have implemented administrative, economic, and legal measures, as well as other methods such as entrusting third party intermediaries to strengthen recovery and disposal efforts, which showed beneficial results. Recovery and disposal of special risk assets for domestic branches amounted to RMB 36.9 billion in 2003, of which cash and tangible assets settlement reached RMB 9.7 billion, and write-offs of RMB 27.2 billion were achieved through provisioning, non-operating expenses, netting off against interest receivables and other means.

In May 2003, the Head Office set up the Risk Asset Resolution Center to further propel specialized and market-oriented non-performing asset disposition. Certain tier-one branches have set up risk asset resolution centers, while tier-two branches have also set up specialized departments for the resolution of risk assets. At the end of 2003, thirty three tier-one branches and branches directly controlled by the Head Office had set up such centers and over two hundred and forty tier-two branches had set up such centers and specialized non-performing asset disposition sub-branches. The risk asset disposition units at the Head Office, tier-one branches and tier-two branches have formed a three-level concerted system and a rapid resolution mechanism is coming into being.

The Bank has achieved breakthrough progress in the resolution methods of non-performing assets. Firstly, through cooperation with local municipal governments, significant advances were made in resolutions of non-performing loans in bulk. The Bank reached agreements with local governments on resolutions of NPLs valued at RMB 31.4 billion, and the implementation has been completed. Secondly, a Memorandum of Understanding has been signed with Goldman Sachs to form a strategic partnership for non-performing assets management. Thirdly, an agreement to cooperate on the disposal of settled assets under the "multi-layer income stratification method" was signed between ICBC Ningbo branch and Hangzhou Branch of China Huarong Assets Management Corporation, which acted as an model for the further cooperation in the field of disposing non-performing assets in the future.

## >> LIQUIDITY RISK MANAGEMENT

Liquidity risk is defined as the loss arising from a commercial bank's inability to meet its contractual obligations when due.

#### **RMB Liquidity Management**

To smooth the daily customer deposit and withdrawal activities and help develop the various businesses of the Bank, the Bank has established a layered liquidity reserve system. The Bank also achieves an efficient combination of liquidity and profitability through improved adjustments made to the structures of assets, and increased the portion of liquid and profitable bond assets among the total assets. RMB liquidity management is centrally managed. The fund clearing between Head Office and tier-one branches is based on the principles of "real deposit, real-time clearing, cash position control and centralized management". The Bank's overall positions are centrally controlled and managed by the Head Office; the Head Office timely monitors the position status of each branch with particular attention to the stability of savings deposit, corporate deposit and inter-bank deposit, and in event of inadequate liquidity, allocates funds to those branches for payment outward and intra-bank clearing.

On September 21, 2003, the rate of deposit reserve was increased from 6% to 7% by PBoC. The Head Office strengthened inter-branch liquidity management to prevent any failure in external payment. The term structure of short term financing has been properly arranged to ensure full payment of statutory reserves on time. At the same time, capitalizing on the favorable conditions of strong market demand and high interest rate, the Bank made more placement to other banks in the money market to both keep the stability of the money market and increase the profitability of the funding operations. Also, with the support of adequate fund resources, the credit and other businesses could run smoothly in 2003.

Liquidity Index	Loan / Deposit Ratio (%)	Liquidity Ratio (%)
2003	70.24	39.85

Note: Calculation of loan /deposit ratio follows PBoC's requirement.

#### Foreign Currency Liquidity Management

The Bank has "centralized operation and management" in foreign currency liquidity management. The Head Office is responsible for the control and adjustment of the liquidity of foreign currency capital. Foreign currency deposits are the main source of foreign currency funding. In 2003, the development and promotion of innovative new products such as foreign currency wealth management and personal foreign currency trading helped to attract more foreign currency deposits and ensured the long-term and stable foreign currency fund resources. In addition, through participation in financing from the international financial market, the source of foreign funding was further diversified. In treasury operation, the Head Office is responsible for the fund operation in international market and adjusts the internal positions between branches. The Head Office monitors the foreign currency assets portfolio in time and through the money market placement and investment in some highly rated and liquid bonds.

Margin management has been adopted for local branches' foreign currency position. With the internal system, the Bank was able to monitor the cash positions of the branches in real time. In addition, the Bank has set limits for foreign branches' foreign currency positions. The Bank specifically defined on the foreign branches' foreign currency liquidity management by authorization limits, and the foreign branches were required to report to the Head Office their liquidity position while satisfying the local regulatory requirements.

In 2003, due to the anticipated appreciation of RMB, and the widened spread in interest rates between RMB and foreign currencies, foreign currency loans grew substantially by USD 6.6 billion. The deposits of foreign currencies decreased by USD 1.4 billion which added pressures to the liquidity of foreign currencies. To ensure the liquidity of foreign currencies, the following steps were taken: firstly, strengthen the supervision of liquidity of foreign currencies through foreign currency funding daily and monthly reports, and released foreign currency funding monitoring report for important liquidity index; secondly, enhanced the performance evaluation on marketing of foreign currency deposit to steadily expand sources of foreign currencies deposits while reducing branches' approval power on foreign exchange loans and strictly control the increase of them; and thirdly, guided branches on the pricing of deposits and loans through the internal transfer price of foreign currency funds.

## >> MARKET RISK MANAGEMENT

Market risk refers to the profit or loss arising from the change of interest rate, foreign exchange rate and changes in value of financial derivatives.

#### Interest Rate Risk Management

#### RMB Interest Rate Risk Management

RMB deposit and loan interest rates are executed according to those set by PBoC, while the loan rate can fluctuate within a range of 30% above and 10% below the PBoC rate. At the end of 2003, PBoC issued " the Notice on Issues Related to Enlarging the Interest Rate Fluctuation Range of Financial Institutions" and "the Notice on the Interest Rate of RMB Loan", which enlarged the floating range of loan interest rate of financial institutions. Financial institutions have the discretion to decide the interest rates of loans above 5-year in maturity on the basis of the comparable rates declared by PBoC.

As the deregulation of the interest rate continues, financial institutions have more flexibility for loan pricing. The room to negotiate with borrower is also expanded. However, this has led to increasing market fluctuation for interest rates. The interest rate risk has become a major risk borne by the commercial banks. Therefore, ICBC has taken various measures to manage the interest rate risk: a specific interest rate risk management unit was set up to supervise the interest rate risk management and to make the interest rate management methods and duties more clear; accelerated the establishment of loan pricing system and interest rate risk system; tightened the approval and authorization processes and monitoring and controls over loan interest rate floating; speeded up the construction of interest rate risk management data platform to realize early warning and monitoring of interest rate risk; and through adjusting assets and liabilities structures, strived to improve control and hedging of interest rate risks, and to increase net interest income.

#### Foreign Exchange Interest Rate Risk Management

China's current policy on foreign exchange interest rate is to liberalize the interest rate of foreign currency loans and large value foreign currency deposits, in which both rates can be decided by commercial banks themselves. The maximum limits of the interest rate of small value deposits in USD, EUR, HKD and JPY are set by PBoC and commercial banks can decide their own rates within the limits. Commercial banks also have the discretion to decide the interest rate of small value deposits in other foreign currencies .

Due to highly marketization of foreign currency interest rates, various efforts have been made to closely monitor the market trends of the interest rates, adjust the foreign currency interest rates of loans and deposits and the approval limits for the loan and deposit interest rates at the branch level, thereby manage the balanced foreign currency asset-liability structure and a stable interest margin. The Bank improved the market rate based inter-branch fund transfer pricing system, strengthened the interest rate exposures sensitivity analysis, and actively used financial derivatives to further balance the overall foreign currency asset-liability term structure to ward off and mitigate interest rate risk.

#### Exchange Rate Risk Management

China currently adopts a regulated floating exchange rate system based on demand and supply in the market. RMB exchange rate has maintained its stability under this exchange rate system. In consideration of the regulatory requirements and the Bank's actual cash positions, strict measures on authorization on types, terms, counter-parties and amount and stop-loss limit allow the Bank to ensure a reasonable matching between the foreign currency structure of the assets and liabilities of the entire bank. In 2003, based on the currency movement in the international market and the business development needs of the Bank, the Bank adjusted and matched the foreign currency structure of the assets and liabilities through the use of currency swaps, and effectively managed the exchange rate risk.

#### **Derivatives Risk**

The Bank provides foreign currency asset management and risk management services to corporate and individual customers with a full range of derivative products including forward, option, swap and other synthetic products. These positions would square with foreign financial institutions in an effort to eliminate any market risks incurred. Additionally, the Bank has signed derivative products transaction protocols (ISDA) with each and every party which transacts with it and related operation procedures were established to strictly control the credit risk of the counterparts.

## >> OPERATIONAL RISK AND OTHER RISKS MANAGEMENT

Operational risk refers to the risks that exist in the internal control or corporate governance system, staff errors or fraud in the process of business transactions, and risks occurring in information management system caused by the system itself or human factors.

During 2003, the Bank standardized the authorization and delegation system, improved the credit approval Chief Reviewer system, standardized the operation procedures and supervision analysis of credit business, promoted the "Risk Monitoring System" from an accounting perspective, realized post-transaction automatic supervision management on all business outlets' internal account balances; further tightened the risk management and control over foreign exchange business, funds custody, inter-bank financing, bank card, institutional banking, E-banking, and intermediary business. Special audits were conducted on rapidly growing businesses such as E-banking, bills business, housing mortgage loans and bank card. The use of financial authorization management system was started, which can control the authorization and indicators of relevant financial items. The safety and effectiveness of the information system was inspected, and the management of anti-virus and anti-hacking system was enhanced. The performance of the statistics reporting rules was reviewed in twelve branches. The Bank continually evaluated the internal control in some sub-branches, re-evaluated the result of last year's evaluation and supervised their remediation, which improved the management over internal control.

## **Corporate Governance**

As China's financial reform and openness of financial market progresses, in order to establish an excellent corporate governance system and to realize the protection and value-added for state-owned assets, ICBC is committed to establishing scientific and efficient decision-making processes, clearly defined business strategy, objective and transparent information disclosure system, and effective system of personnel motivation and management.

## >> DECISION-MAKING AND MANAGEMENT SYSTEM

The decision-making process is a matrix that combines a bank-wide policy-making process and a vertical authorization process at different layers. The former is responsible for the making, adjusting and evaluating of policies, and the latter is responsible for the implementation, feedback and proposals of policies. The Head Office set up committees to be responsible for making important policies, strategies and plans in different business and management fields. These committees include the Assets and Liabilities Management Committee, Risk Management Committee, Financial Audit Committee, Credit Policy Committee, Credit Evaluation Committee, Intermediary Business Management Committee, Branch Office Management Committee, Auditing and Supervisory Committee and Technology Approval Committee. These committees delineated and transferred to all level of branches the authorization system at different layers. Branches at all levels also set up similar committees, which are responsible for the interpretation, guidance and arrangement of business strategies in the branch after consideration of practical situations. Branch manager takes charge of the implementation of policies and the fulfillment of business plans, and reports to their upper-level branch. All committees are composed of the head of different departments and internal experts (some committees contain external experts), and a member of the executive board will lead and coordinate the decision-making of the committees.

Assets and Liabilities Management Committee:	responsible for the planning, control and adjusting the balance and the structures of all assets, liabilities and capital (including core capital and subordinate capital), in order to realize long-term and periodic business purposes.
Risk Management Committee:	responsible for the research and the analysis of international and domestic economic development trends including financial situations, laws, regulations, policies, rules, and the effects of those changes upon the business risk of the Bank; also responsible for setting the goals and important policies on bank-wide risk management and control.
Financial Audit Committee:	responsible for auditing, analyzing, and monitoring significant financial matters of the Head Office and its subordinate units, and to give considerations to financial expense items.
Credit Policy Committee:	responsible for reviewing and discussing the credit management framework proposals and credit policy, for researching on the development trends of credit business and on the risk management measures; for discussing of credit reports on key industries and products; for reviewing client's annual general credit granting plans as well as industries and regional limits; and for approving large credit exposure.
Credit Evaluation Committee:	responsible for evaluating important credit positions; and for investigating and researching on theory and practice of credit evaluation.

Decision-making	Committees:
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#### Decision-making Committees:(continued)

Intermediary Business Management Committee:	responsible for researching and analyzing the influence of economic and financial trends, laws, regulations and policies upon the intermediary business; for making development strategy of intermediary business, for making authorization standards and schemes to branches; for generally coordinating, guiding, and deciding important cases in the process of developing, marketing and managing intermediary business.
Branch Office Management Committee:	responsible for organizing and coordinating the management and monitoring of all branch offices of the Bank (with focus on tier-two branches), including the monitoring and analysis of operational status, internal ratings for branch offices, guidance on distribution of resources, management and monitoring of branch office personnel, and research on the reform of the branch office management systems.
Auditing and Supervisory Committee:	responsible for deciding the relevant regulations and methods concerning auditing and internal control; for instructing the internal control measures in all branches; for deciding the resolution of severe non- compliance cases; for deciding the release of important auditing instructions and notices.
Technology Approval Committee:	responsible for deciding technology development strategies and technology investment plans; for analyzing and discussing important IT projects in the whole bank; and for organizing analysis and evaluation after the development and implementation of important projects.

#### Reform Aimed at Vertical Management System

The Bank in recent years has been carrying out the management system of "managing the direct next tier branches and monitor the next level sub-branches". This means the Head Office manages the tier-one branches, meanwhile monitors the tier-two branches; and tier-one branches manage the tiertwo branches, meanwhile monitor the sub-branches. Head Office is strengthening its control over tiertwo branches. Through improving the management information system, overall operation information and product supervision and penalty information from the tier-two branches are pooled into one platform. This makes the Head Office's supervision of the tier-two branches change from by product to by institution. As a result, the Head Office can identify the operational risk of the tier-two branches. The management power of the Head Office is strengthened to exert significant control on the activities of the large and medium sized city branches. The comprehensive function of the front office outlets is improved, and the layers of management decrease. As the flat management structure is pushed forward, the total number of branch units has been further reduced and their geographic distribution has been reorganized as well. In 2003, 1800 banking outlets were closed or merged, which made the total number of banking outlets fall to 24,000. The comprehensive function of branches and offices was improved as the regional distribution of outlets was optimized further. 1200 institutions were upgraded to improve service levels and standards.

#### Restructuring at the Head Office Level

As the rapid growth of custodial service business in scope and scale, the original Fund Custodian Department was renamed as Asset Custody Service Department, whose internal business flow and organization structure were adjusted in response to market forces. A new Central Purchasing Department was set up under the Financial Planning Department for the reinforcement of restriction and the effective control of cost. A Risk Assets Resolution Center was set up under the Asset Risk Management Department to better manage the risk assets resolution. A Parameter Management Center was set up

under the Accounting Department to regulate and centralize the parameter management of the entire bank. An Institution Management Department was set up within the Human Resources Department to reinforce the development planning, supervisory analysis and management guidance of the domestic network. The vertical management and internal corporatization of "Peony" Card business and bills business began to win initial success.

## >> INDEPENDENT INTERNAL AND EXTERNAL AUDITING SYSTEMS

ICBC actively engaged in researching auditing management system reform and basically set up a sound and effective two-level auditing and supervision system conforming to the requirements of modern commercial banks. The Head Office organized Auditing and Supervisory Committee and established Auditing and Supervisory Department as its functional institution. Six Auditing and Supervisory Offices were set up in the whole country according to regional division, which take the responsibility of auditing and supervision of branches in designated region. All tier-one branches have set up Internal Control Management Committee and Auditing and Supervisory Department. Some branches further set up a number of Auditing and Supervisory Centers within the branch territory, responsible for the auditing and supervision of branch headquarters, business departments and sub-branches in the designated territory of the Auditing and Supervisory Centers established by tier-one branches were set up by region, which are independent of the branches and sub-branches respectively. They are under direct control of the Head Office and the tier-one branches respectively.

At the same time of implementing and perfecting internal control systems, the Bank strengthened independent audits, to solidify the basis of management in accordance with international standards and real and prudent principles of accounting. ICBC appointed Ernst & Young to audit various branches in accordance with international standards. During 2003, Ernst &Young audited the 2002 financial statements (specially prepared under International Accounting Standards) of six branches including Shanghai and etc., with asset coverage of 18% of the Bank's total assets. Ernst &Young applied generally accepted International Auditing Standards, and issued unqualified opinions for all six branches.Importantly the results of Ernst & Young's audit did not indicate any significant difference in risk classification or NPL ratio from ICBC's risk classifications.

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	Shanghai	Zhejiang	Shenzhen	Fujian	Ningbo	Guizhou	Average
NPL Ratio (ICBC unaudited)	10.2	5.7	15.6	15.3	12.2	22.3	11.0
NPL Ratio (E&Y audited)	10.6	5.8	15.7	16.1	12.3	23.4	11.4

ICBC unaudited NPL ratio vs. E&Y audited ratio

In 2004, Ernst & Young will audit the 2003 asset quality and financial statements for 16 branches, which will cover 54% of the Bank's total assets.

Unit · %

## >> IMPROVED TRANSPARENCY

In 2003, the Bank further improved timeliness and transparency of information disclosures. Firstly, significant adjustments were made to the 2002 annual report based on the requirements of "Provisional Measures on Information Disclosures for Commercial Banks" issued by PBoC, risk management and corporate governance contents of the report were strengthened, and footnotes to the financial statements and other detailed financial information were added. Next, the Bank has appointed Ernst & Young as advisors for information disclosure for two consecutive years, to assist with the improvements in the standardization of information disclosures according to international practices. The Bank was amongst the first to disclose the 2002 annual report to the public in "Financial Times" and "China Securities". At the same time, communications with domestic and international media, rating agencies, and international financial services organizations were strengthened through websites, newspapers, magazines, and other means. Updated operational results and reform measures of the Bank were timely published, to allow better understanding of the Bank by the public.

## >> THE SUPERVISORY BOARD

The State Council appointed the new Supervisory Board of ICBC in August 2003. The Supervisory Board is composed of the Chairman, full-time supervisors, part-time supervisors and other staff.

In accordance with the "Provisional Ordinance for Supervisory Board of Key State-owned Financial Institutions", the main roles of the Supervisory Board include: to inspect the status of ICBC's implementation of the state's financial and economic laws, rules and regulations; to verify the truthfulness and legitimacy of the financial and treasury reports; to examine the operating results, profit distribution, appreciation and maintenance of the value of state assets, and fund operations; and to oversee the activities of senior executives and assess the operating performance of ICBC, and put forward proposals for the promotion or demotion, and recognition or punishment of senior executives.

The Supervisory Board fulfills these duties through meetings, studying materials, organizing internal audit assignments and engaging external audit. The Supervisory Board delivers its annual supervisory report and special supervisory report to the State Council. The Supervisory Board also provides guidelines to the work of internal audit and other supervisory functions. The purpose is to promote the management and profitability of ICBC in its growth into a world-class commercial bank.

## >> PERSONNEL MOTIVATION AND MANAGEMENT MECHANISM

#### To Strengthen Efforts in Selection of Elite Personnel

In 2003 the Bank expanded the scale of competition for the post of management, covering senior management, middle management, overseas assignments, exchange personnel and even normal vacant positions. This produced an attractive environment for excellent personnel. As a result, some people were promoted to the position of deputy head of tier-one branches from open selection. This open selection system is basically applied to Head Office division managers and the regional auditing supervisors.

## To Further Improve the Recruitment System and the Labor Contract Management

In 2003 over 193,000 employees' labor contracts expired and the contract renewal process followed the principles of "open information", "fair play" and "the best get the job". During the process, formal guidelines for the conditions and process of contract renewal and termination were set up. Therefore the personnel entry and exit system was considerably improved. The Bank also expedited the process of personnel restructuring and laid off redundant personnel. Personnel in active employment decreased by 17,000 to 389,000.

## To Speed Up the Establishment of Employee Performance and Competency Evaluation System

Through the cooperation with an outside consulting

firm, the Bank successfully completed the consulting project of employee performance evaluation system in Shenzhen branch and "Peony" Card Center and introduced advanced human resources management concept, method and tools. At the same time, Zhejiang branch started its employee performance and competency evaluation systems consulting project, which laid a solid foundation for setting up scientific and rational employee performance and competency evaluation methods and indicator system.

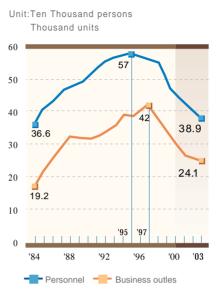
#### To Deepen the Reform of Income Allocation System

The Bank gradually set up the system of paying employees according to business performance. According to the principle of "efficiency as the priority with fairness considered at the same time", the reform to salary system which distinguished those excellent middle and senior managers and excellent staff from the average in terms of salary, making their salary level closer to the market level, was pushed forward. The Bank also set up the enterprise annuity committee and piloted the annuity system in five different branches as an incentive for the employees. Tools like deferred compensation and accommodation allowance were also tried out, in order to diversify the Bank's compensation methods.

## To Establish and Optimize Business Title Sequence and Restructure Personnel Promotion System

By reference to the general practices of international commercial banks, the Bank established sequence of business titles based on business lines, setting up five types of sequences positions which were legal advice personnel, account manager, technical personnel, dealers and business manager in the preliminary stage. Accordingly, managerial guidelines covering nine core businesses including institution, corporation and personal banking, which would be gradually introduced to the whole bank, were established. It would help resolve the problem of having the administrative promotion as the only way of career development.

### HEADCOUNT AND NUMBER OF BUSINESS OUTLETS



#### **Education and Training**

Education and training are aimed at improving personnel quality and establishing a learning culture in the Bank. In 2003, the Bank provided 1.03 million people/times of training to staff of different levels and positions and days of training per person on average reached 7.94 days, which provided strong intellectual support for the reform and development of the Bank.

Launched personnel training project and provided tailor-made training for the staff. The Bank continued with the rotating training of "EMBA" core curriculum for branch presidents, IMBA training for middle and senior management and reserve managers, and senior executives overseas assignments, to stimulate new business and managerial ideas and improve managerial skills. During 2003, altogether thirty two different types of subject matter training materials were compiled introducing a wide range of new businesses and products timely and accurately. A series of special training courses on the forward-looking businesses for investment banking personnel, asset appraisers and customer managers was also organized.

The post-doctoral research workstation recruited the first batch of post-doctoral personnel to research on forward-looking and strategic topics and in this way to cultivate, attract and make use of the talents.

Strengthened the organization of training centers to optimize the resources allocation for training. With the training institues in Changchun and Hangzhou as the avant-garde, and the thirty-two provincial financial training schools as the main body, a well located, specialized, and complementary internal training network was developed. In 2003 the Bank provided training to 127,000 people/times, and developed 385 training courses.

Increased efforts on the development of online training to speed up the construction of remote education network. The Bank provided network remote education system in addition to the face-to-face training as a move to make the most of the function of on-line education system. During the year, 86,000 people received training in this manner. During SARS period, the on-line education system was essential in providing timely new business and technical training to personnel for gaining preemptive in the market.

## >> FUTURE DEVELOPMENT STRATEGY

In the next three years between 2004 and 2006, the Bank will deepen reforms and speed up the disposition of non-performing assets. Our goals are: to realize operating profit of RMB 240 billion within three years; to dispose of RMB 300 billion in non-performing assets; to reduce the ratio of NPL to less than 18% by the end of 2004, and less than 10% by the end of 2006. In addition, the Bank will reduce ratio of non-performing assets to 13% in 2004, and to approximately 6% in 2006.

The Bank shall continue to improve corporate governance, to initially complete the corporate governance structure and operational system of modern commercial banks within the next three years. Using 2004 as the starting year, the Bank will try its best to perform well in the following seven areas:

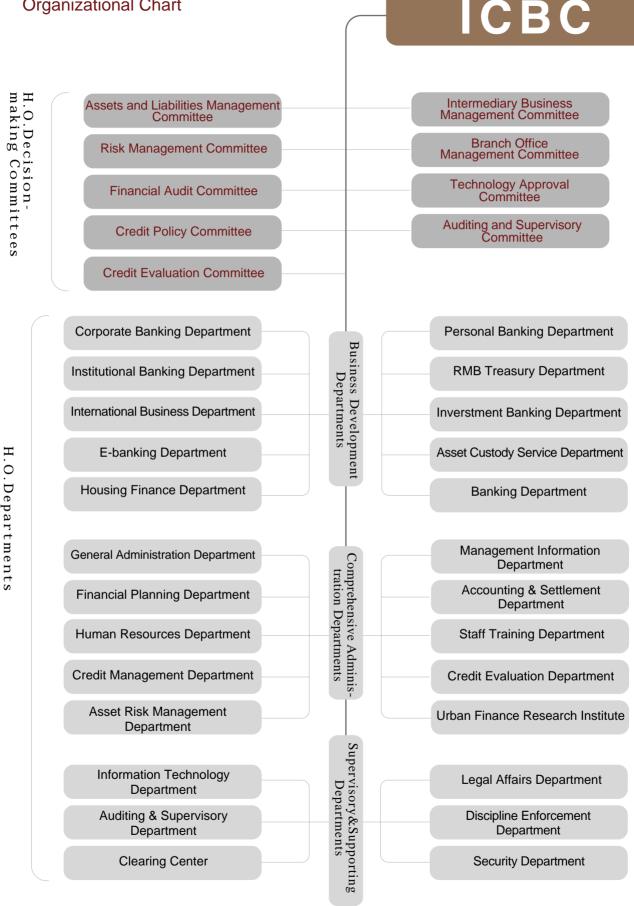
1. to expedite the implementation of internal reforms, to provide the conditions necessary for jointstock reforms, and to speed up the creation of standardized systems of modern financial institutions; 2. to create scientific performance evaluation systems, to put the ROE ratio as the core factor in appraisal of profitability, to eliminate the ratio reduction measure in asset quality performance evaluation and focus on the assessment of reduction in absolute value (of non-performing assets) and deficiencies of risk provisions; 3. to perfect the internal control systems, to form monitoring systems for management, business, finance, and technical personnel at various levels; to expand international audits to the entire bank within this year; 4. to establish comprehensive risk management systems, to speed up the implementation of introductory internal ratings project, and to improve the overall control and management abilities of various types of risks; 5. to push forward reconstruction of business processes and reorganization of corporate structures, to explore the organizational structure of Head Office - branch - sub - branch system; 6. to promote for the implementation of total cost management and treasury management system reforms; and 7. to perfect the systems of personnel motivation and management.

## **Organizational Chart**

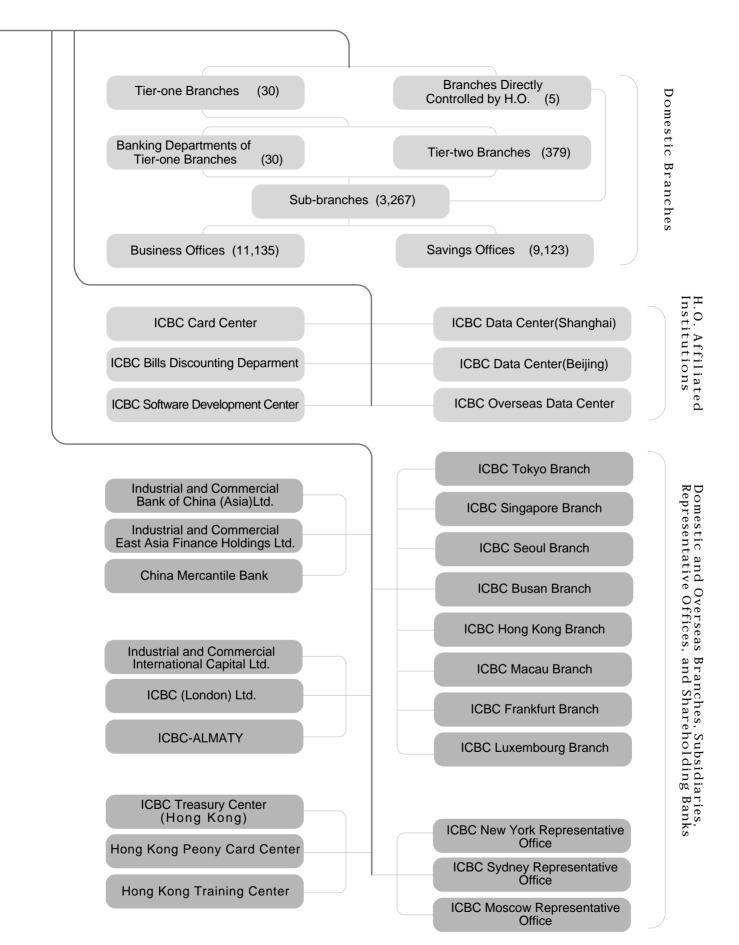
Corporate Governance

50

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Note: By the end of 2003, the Bank had 24,129 domestic outlets, 70 overseas branches and offices and a total headcount of 389,045.



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## >> FIGHT AGAINST SARS

Facing the outbreak of SARS disease in the spring of 2003, the Bank quickly set up a response mechanism and offered ten special financial service items through its "Green Channel" while maintaining

normal business operation during that period. In the meantime, the Bank donated nearly RMB 7 million to society, which improved the Bank's social image and reputation. The Bank was awarded for "Good Performance in Fighting SARS, Beijing" by the local government. In addition, the Bank staff donated nearly RMB 1.98 million and 140,000 pieces of needed items to show their respect to the medical community.

## >> "HAPPINESS PROJECT" TO HELP POOR MOTHER

"Happiness Project" is a charitable sponsorship, which helps poor mothers through improving their physical living condition, educational level and social position. A total of RMB 1.14 million was donated by the Bank which supported poor mothers in Yi County, Hebei Province and Wuli County, Shangdong Province .

## >> PROJECTS TO HELP THE POOR

The Bank has dispatched qualified people to be the county leader for some seletced poor areas (Wanyuan City, Tongjiang County, Nanjiang County in Sichuan Province), helping to implement a series of strategies in education, technology support, hygiene support, and natural disaster rescue etc. and to fight against poverty. ICBC has donated about RMB 150,000 and 4,600 pieces of clothing, 6,100 kilograms of grain and 9.3 tons of fertilizers, medical equipment valued at RMB 300,000 and 3,500 books and 100 personal computers. ICBC also helped establish another new primary school for the Hope Project and set up an award named "Good Teacher in Rural Area, ICBC".

## >> OTHER CHARITABLE ACTIVITIES

ICBC has organized a number of charitable activities during the year. The Bank donated 4,846 pieces of household goods and RMB 2,279,907 in cash to assist the poor children's schooling. In addition, the Bank donated RMB 267,288 in cash and 707 pieces of household goods for charitable purpose, RMB 5,973,009 in cash and 51,887 pieces of household goods for helping the poor, RMB 123,826 for the "Germination Project" and RMB 7,799,037 for other sponsorships.



