

RISK MANAGEMENT

We have established a number of aggressive, but achievable, business objectives as discussed above. We recognize, though, that there are risks inherent in all of our business activities and that these risks are becoming increasingly complex. Consistent with the practices of leading global banks, we have commenced the development of a world-class risk management structure to ensure that we meet our business objectives while managing the risks faced by CDB within acceptable tolerances. Our primary risk management objectives are to manage risk within acceptable limits and to provide the support to our people that they need in their daily decision-making related to implementing our risk management policies.

We have made tremendous progress during 2003 in continuing to develop a practical risk management infrastructure that will enable us to successfully meet our risk management objectives.

At the beginning of 2003, for example, we established the Asset Liability Management Committee ("ALCO") that was charged with creating a framework, designing policies, procedures and implementation guidance, setting risk appetite and objectives, reviewing annual and long-term plans, as well as developing an Enterprise-wide Risk Management ("ERM") process for the Bank. With assistance from globally recognized consulting firms, the Bank has also commenced the development of an economic capital allocation framework. We completed the initial design of the capital allocation of credit risk, and made significant progress in the capital allocation of market and operational risks. We have created a roadmap outlining the process and related milestones that will need to be achieved towards full implementation. Further refinement and implementation of this framework will be undertaken over the next several years.

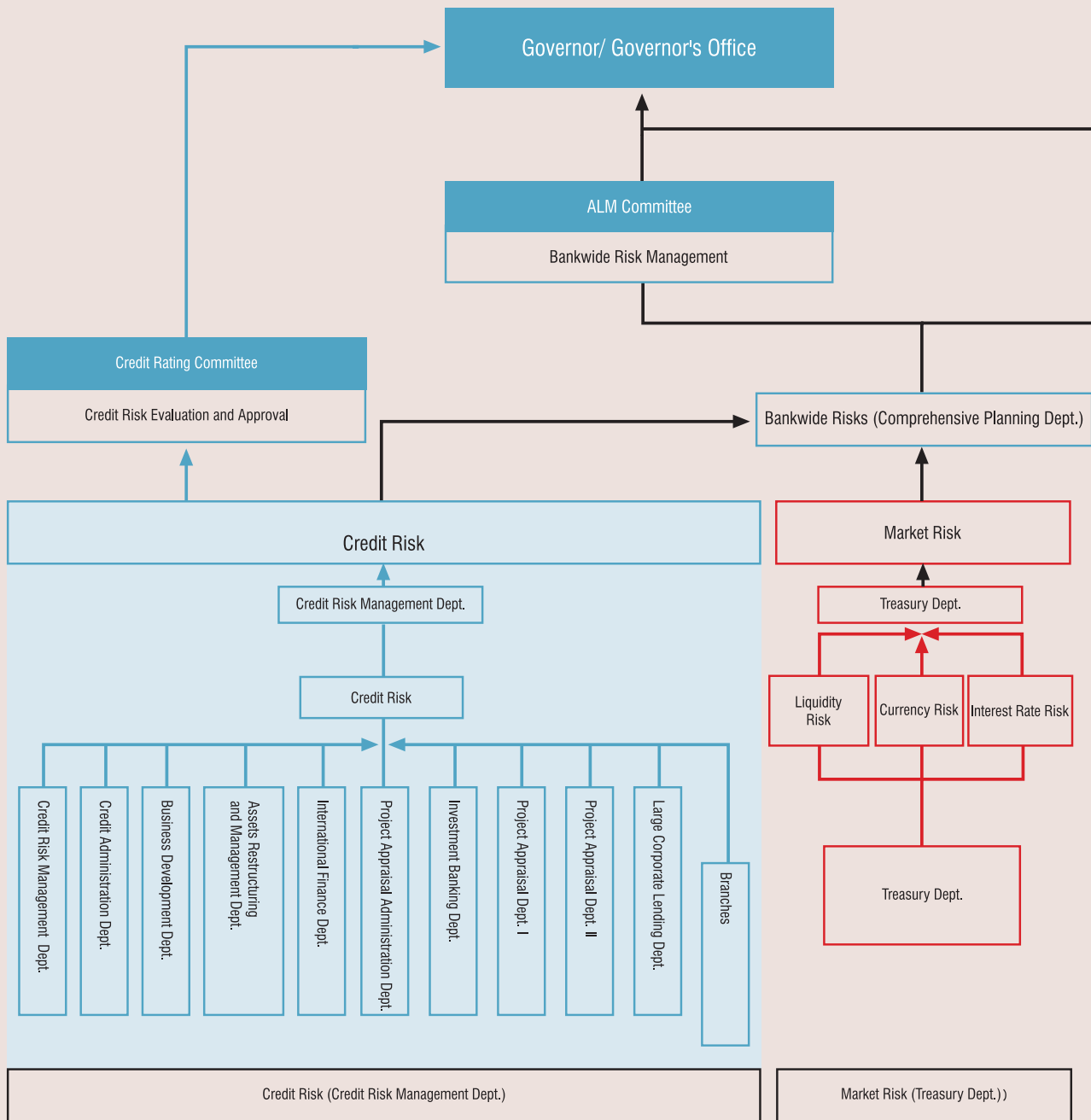
In order to bring the essence of the new BASLE Accord into our risk management, we actively participated in the third Quantitative Impact Study ("QIS3") organized by the BASLE Committee, with our testing results submitted during the year. Through this study, we further clarified our goal and direction of implementing a comprehensive risk management system. In addition, we commenced a project in designing an internal risk rating system, with the help of international consultants.

RISK MANAGEMENT FRAMEWORK

In 2003, we made significant progress towards the creation of a comprehensive risk management structure that is intended to identify, monitor and manage our risks efficiently and effectively. Our risk management framework is comprised of four key elements: i) a robust organization structure that reinforces individual responsibility and accountability regarding the management of risk through effective communication; ii) well defined policies and procedures, reinforced with intense training; iii) proprietary methodologies and tools; and iv) a comprehensive risk reporting system designed to continuously monitor pre-defined risk metrics to identify potential risk management issues before they fully develop.

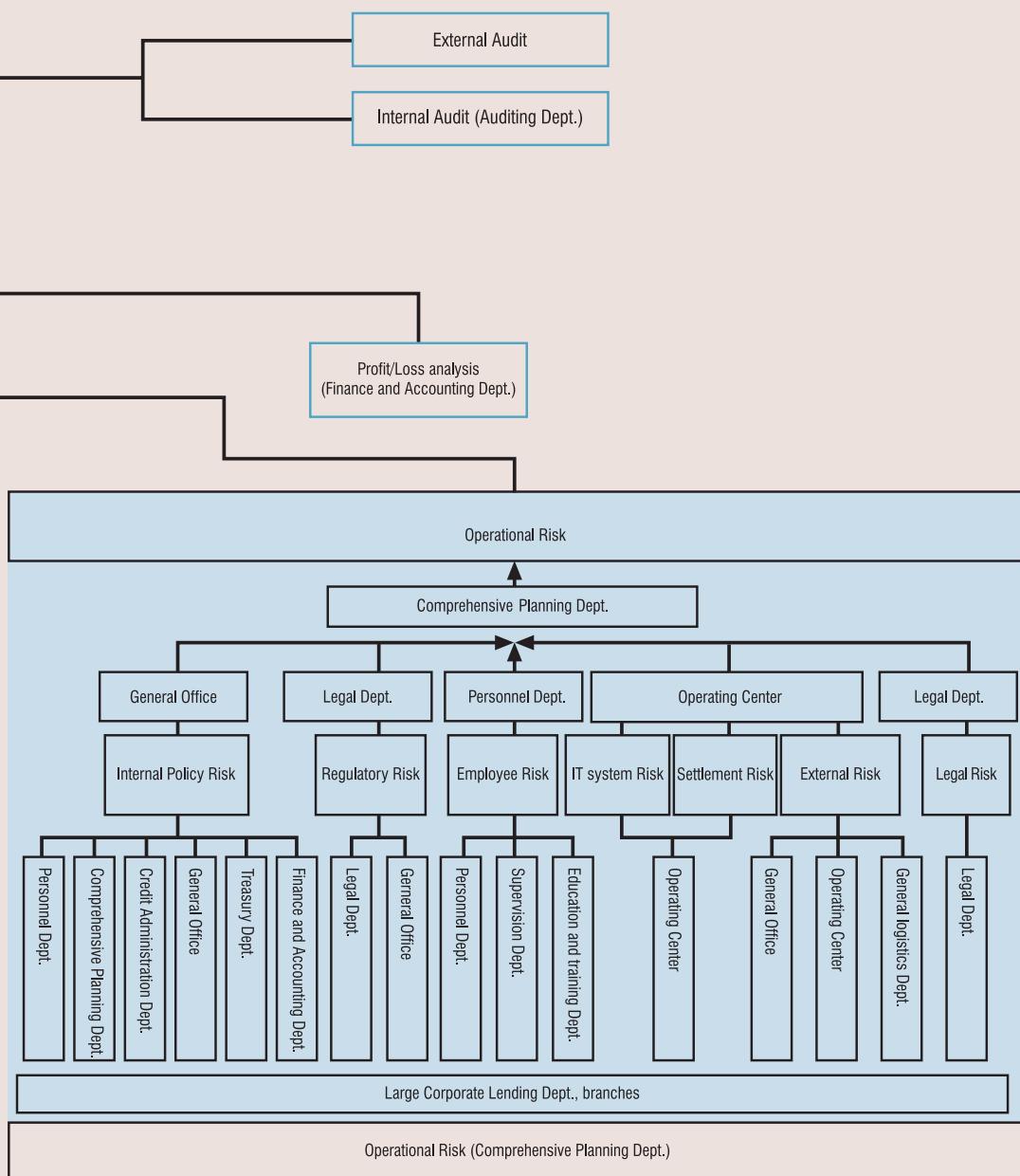
In 2003, we identified three functional streams that were aligned with our management efforts related to credit, market and operational risks - three major risk areas (21 categories) of focus, in accordance with the principles of the New BASLE Accord (CP3). The functional streams reflect the individuals and departments that are responsible for a specified risk area at various levels and reporting lines. Our Governor oversees CDB's risk management strategy and the definition of our risk appetite. All of CDB's risk management activities are directed by our Asset Liability Management Committee, which is comprised of senior executives from many departments. The Comprehensive and Planning Department is responsible for the daily operations of risk management and reports to ALCO on a periodic basis.

BANKWIDE RISK MANAGEMENT ORGANIZATION STRUCTURE



→ Bankwide Risk Reporting Line

→ Credit Risk Reporting Line



After a thorough analysis of risk assessment methodologies adopted by leading global banks and overseas regulators, we developed a two-dimensional scoring system for our own risk assessment that is focused on (i) the inherent risk (low/medium/high) of our business activities and (ii) the risk management capabilities (strong/acceptable/weak). Each score is rated independently first, and an aggregate rating is determined based on the combination of the levels of the inherent risk and the quality of our risk management. A final review and adjustment on the aggregate ratings will be made after considering the future moving trend of the particular risk unit (increase/stable/decrease). The initial assessments are to be performed by individual departments and the results should be reviewed by ALCO in order to arrive at the final results and identify the top 10 risk areas that require management's attention. A final report, which includes the projection of overall risk indicators, is then prepared and submitted to our Governor. Operational departments are responsible for implementing policies and procedures to mitigate the risks identified.

Risk Matrix		Risk Management Quality		
		Strong	Acceptable	Weak
Inherent risk	High	level 3	level 4	level 5
	Medium	level 2	level 3	level 4
	Low	level 1	level 2	level 3

Level 1: low inherent risk with strong risk identification and management capabilities

Level 2: low to medium inherent risk with relatively strong risk identification and management capabilities

Level 3: medium inherent risk with average risk identification and management capabilities

Level 4: medium to high inherent risk with weak risk identification and management capabilities

Level 5: high inherent risk with no risk identification and management capabilities

In the fourth quarter of 2003, using the above matrix system and other assessment criteria judgements, we completed an assessment of credit, market and operational risks in all areas of the Bank. All results were summarised in a Risk Profile Report, which was submitted to ALCO. In addition, we have developed benchmark risk metrics and key performance indicators in order to evaluate the effectiveness of management's efforts at managing risk.

CDB is exposed to three principal types of risk - (i) credit risks, (ii) market risks, and (iii) operational risk.

CREDIT RISK

Credit risk is the risk that a borrower may not meet its obligation according to the original contractual terms of its facility with CDB, and it is the most significant risk faced by CDB. Given the nature of our lending - large balance, long term and high concentration in a few industries - effective management of credit risk is our top risk management priority. Our credit risk management approach is comprised of the following key elements:

1. Segregation of the underwriting, credit administration and risk monitoring functions.
2. Sound underwriting procedures and quality control standards designed to ensure a high level of asset quality up-front.
3. Proprietary credit grading techniques and methodologies that provide a consistent basis for effectively managing our credits.
4. Portfolio exposure and concentration limits to diversify our risk to the extent possible given the nature of our business.
5. Robust collection efforts and other loss mitigation procedures to resolve non-performing loans.

SEGREGATION OF DUTIES

The ultimate responsibility for credit risk management rests with our Governor. The Asset/Liability Management and Credit Risk Rating Committees, which are independent of our business units and report directly to our Governor, have been delegated the authority for directing our credit risk management activities. The Credit Risk Management Department, which reports to the Credit Risk Rating Committee, is responsible for the implementation of our risk management activities. Through the independence of these functions and their clearly defined roles, CDB has established clear risk management responsibilities at both the head office and branch levels. Transactions are executed in our branches and subject to the controls put into place by management.

SOUND UNDERWRITING PROCEDURES AND CREDIT ENHANCEMENT

Because of the relatively large size of individual loans in our loan portfolio, our underwriting procedures have become very thorough and stringent. The underwriting of our large loans also involves industry specialists who are familiar with the unique funding needs and related risks. They get involved in the project due diligence process long before the actual credit application is submitted. As the approval of local and provincial governments is often required for large infrastructure loans, CDB also assesses the budgetary capacity of these governments to support infrastructure development loans in default. While many loans are not explicitly guaranteed by any government body, CDB has established mutually productive relationships with many local and provincial governments that have facilitated the collection of payments on defaulted loans.

When credit applications are submitted, thorough analysis is performed by an independent underwriting group. The underwriting process focuses on the borrower's past credit performance, its financial position and debt payment capacity, the proposed credit facility terms and structure, its industry, local government support (explicit and implicit) and economic trends. Of course, collateral and third party guarantees are also considered. Such analysis is normally prepared by both the loan officer and industry specialist to ensure its objectivity. The approval of loans rests with the Credit Risk Rating Committee.

RISK RATING TOOLS AND METHODOLOGIES

We have started the design of an Internal Based Rating system that includes both borrower (13 grades) and facility ratings (7 grades) in accordance with the new BASLE Accord. In addition, we have also developed industry ratings (10 grades) and geographical ratings (12 grades), as supplements to the borrower and facility ratings. With the help of international consultants, we developed a framework for our internal risk rating system. In addition, we have completed our preliminary calculation of Probability of Default (PD) and Loss Given Default (LGD). Of course, the quality of our data will need to be further enhanced. We intend to improve the precision of our calculation once the data enhancement is completed.

LIMIT AND PORTFOLIO MANAGEMENT

The Bank uses exposure and concentration limits to maintain our credit risk within acceptable tolerance. Our portfolio concentration limits address both industry and geographical concentrations. These concentration limits are strictly adhered to on a bank-wide basis during the underwriting process.

ROBUST COLLECTION EFFORTS AND OTHER LOSS MITIGATION PROCEDURES

Despite our strong underwriting and monitoring standards, some of our loans, like some of those at all global banks, will eventually become non-performing due to changes in general economic conditions, deterioration in the financial strength of an individual borrower, and other factors. Over the years, we have developed rigorous and disciplined collection and recovery procedures. Notifications on repayments are sent to borrowers days before the loans are due. In addition to periodic borrower site visits and financial reviews, loan officers are required to rate each credit at least quarterly to detect any early signs of deterioration in a borrower's ability to repay its loan. If the repayment ability of a particular borrower becomes questionable or the payment is past due, the responsible individuals at branch level will work with the Credit Risk Management Department in the Head Office and take effective actions to collect on the principal and interest. Because of our unique status as the key policy bank in supporting regional economic development, we have been very successful in leveraging our excellent relationship with local governments in our loan collections.

Percentage of payment collection :

	2003	2002	2001	2000	1999
Current year	99.9%	100%	99.0%	99.2%	84.3%
Accumulated	99.2%	98.4%	95.0%	91.1%	64.5%

ASSET QUALITY

Because of the enhancement of our credit risk management, our asset quality was further improved in 2003. We continued to classify our loans according to the 12 categories developed internally and mapped with the five categories required by the PBOC. At the end of 2003, non-performing loans stood at RMB 15.2 billion, or 1.34% of the total loan portfolio, down by 0.44 percentage points from a year ago.

Loan classifications(not including the loans to banks)

(Balances are in billions of RMB)

	31 December 2003		31 December 2002	
	Balance	Percentage	Balance	Percentage
Pass	862.5	75.78%	627.8	70.22%
Special Mention	260.4	22.88%	250.4	28.00%
Sub-total: Performing loans	1,122.9	98.66%	878.2	98.22%
Substandard	8.8	0.78%	7.3	0.82%
Doubtful	5.9	0.52%	8.1	0.91%
Loss	0.5	0.04%	0.5	0.05%
Sub-total: non-performing	15.2	1.34%	15.9	1.78%
Total	1,138.1	100%	894.1	100%

Non-performing loan at 31 December

(Balances are in billions of RMB)

	2003	2002	2001	2000	1999
Balance	15.2	15.9	29.8	58.2	101.8
Ratio	1.34%	1.78%	3.96%	8.78%	18.66%

Non-performing loans by industry

(Balances are in millions of RMB)

As at 31 December 2003

	Power	Road construction	Petrochemical	Railway	Others	Total
Balance	5,303.1	34.4	678.9	3,608.7	5,590.5	15,215.6
Percentage	34.9%	0.2%	4.5%	23.7%	36.7%	100%

(Balances are in millions of RMB)

As at 31 December 2002

	Power	Road construction	Petrochemical	Railway	Others	Total
Balance	8,561.0	164.0	796.1	823.6	5,576.1	15,920.8
Percentage	53.8%	1.0%	5.0%	5.2%	35.0%	100%

MARKET RISK

Market risk is the risk of loss caused by changes in prices, principally influenced by interest and foreign exchange rates of financial instruments. The ALCO has the primary responsibility in managing the market risk, including liquidity risk, at CDB. Successfully managing market related risks requires consistently maintaining acceptable levels of risk exposure while meeting other business and operational objectives.

INTEREST RATE RISK

Interest rate risk is the risk of loss arising from changes in the level of interest rates or changes in the shape of yield curves that could adversely affect the market value of our financial instruments and future earnings of CDB. There are four types of interest rate risk faced by CDB: (i) replacement (or duration mismatching) risk, (ii) yield curve risk, (iii) basis point risk, and (iv) option risk.

In order to prepare for the emerging challenges related to the opening of China's financial markets, ALCO further strengthened our analysis capabilities on the macro economy, government policies on currencies and interest rate movements. In addition, we developed an advanced measurement system that includes benchmarking indicators and limits for interest rate risk management. Through this measurement system, ALCO is able to continuously monitor, measure and report on these risks. In addition, ALCO prepared the "Implementation Guidance of Interest Rate Risk Management of CDB" manual to support the implementation of risk management processes based on the related principles developed by the BASLE Committee.

Our management of interest rate risk is achieved primarily through gap analysis performed on sensitivity, duration and fair value. By the end of 2003, our duration gap stood at -1.97 years. If the level of interest rate increases by 100 basis points, total net interest income will

increase by about 6.62% and net assets will increase by about 29.49%.

CDB enters into interest rate swaps and collars for the purpose of hedging the long-term fixed rate debt denominated in foreign currency. We do not engage in such transactions for speculative purposes. These derivative transactions expose CDB to additional credit risk, which represents potential costs to replace the derivative contracts if the counter parties fail to perform their obligations. This risk is monitored on a continuous basis with reference to the current fair value, the notional amount of the contracts and the liquidity of the market. To control the level of credit risk taken, the Bank assesses the credit risk of its counterparties, using the same techniques used in our lending activities. In the future, we will increase the use of derivative transactions to improve our management of interest rate risks.

CURRENCY RISK

Currency risk is the risk of loss arising from the fluctuation of exchange rates. Our activities in foreign currencies have been limited, and the majority of the foreign currency transactions are in US dollars or hedged to US dollars, if in other foreign currencies. In recent years, the PBOC has maintained a stable exchange rate with USD. Therefore, we do not believe our exposure to currency risk is significant. Should the current practice of our government in this area change, our risk to foreign exchange could be increased.

CDB enters into currency forwards and swap agreements principally at the request of our customers. To hedge the potential risks of these transactions, we enter into similar agreements with other counter-parties. In addition, the management seeks to minimise the Bank's exposure to interest rate and foreign exchange fluctuations by matching the maturities of its loans and guarantees to those of the liabilities denominated in the same currencies.

LIQUIDITY RISK

Liquidity risk is the risk that the Bank is unable to fund its current obligations and operations in the most cost efficient manner.

Based on the key principles and practice guide on liquidity management from BASLE, we developed a mechanism that effectively monitors the short-, medium- and long-term liquidity risks and completed the Guidance on Liquidity Risk Management for CDB, as well as created the necessary early warning tools in 2003.

Our primary funding source is our bond issuance in the domestic bond market. Due to our quasi-sovereign rating, we are able to maintain our debt issuance cost at relatively low levels. With the current market condition and our successful track record, we do not foresee difficulties in raising the finances in the near term. In addition to the bond market, we have other financing sources such as the inter-bank market, borrowing from the PBOC, and overseas capital market.

We periodically perform a maturity analysis of the Bank's assets and liabilities and future commitments required to assess the needs for additional funding and to determine the best source and cost of the funds. This analysis serves as the basis of our bank-wide management of liquidity risk. At the same time, we calculate the maturity gap on the average years outstanding for loans and bonds issuance. Through the enhancement of our gap analysis, Bank's average maturity gap has been decreased from -1.15 years at the beginning of the year to -0.51 years at end of 2003.

OPERATIONAL RISK

Operational risk is the risk of loss arising from failed internal control processes and/or systems, human factors, and/or external events. Operational risk is inherent in all aspects of a business and covers a wide range of issues. Our risk management efforts in this area are focused on seven key elements of operational risk - i) internal policies risk, ii) regulatory risk, iii) legal risk, iv) settlement risk, v) IT system risk, vi) employee risk, and vii) external risk. We completed an assessment of these seven risk elements during 2003, and developed a prioritised list of issues that need to be resolved in order to reduce our operational risk exposure to acceptable levels.

Management maintains an internal control framework designed to identify, measure, monitor and manage all significant operational risks on an ongoing basis. CDB continuously assesses its operational and financial reporting infrastructure to ensure it is adequate to handle emerging business and financial reporting developments, and we have been working hard to make further improvement every year.

CDB mitigates the risk of human error by adequately training our employees, documenting and adhering to comprehensive policies and procedures as well as by regularly evaluating the effectiveness of our internal control structure. As an integrated component of the Bank's internal control, our Internal Audit Department regularly monitors the compliance with established policies and procedures.