

China Construction Bank Corporation, Johannesburg Branch

Pillar 3 Disclosure
(Half Year ended 30 June 2017)

“Builds a better future”

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1. OVERVIEW

The following information is compiled in terms of the requirements of the Banks Act 1990 (as amended) and Regulation 43(1)(e)(ii) and 42(2) of the Regulations relating to Banks (“the Regulations”), whereby banks (including foreign branches) are obliged to publically report certain qualitative and quantitative information with regards to their risk profile and capital adequacy on a regular basis to the public. This disclosure is commonly known as the Pillar 3 of the Basel accord.

China Construction Bank Corporation (“head office” or “the group”) applies a centralised approach to risk management throughout the group. As such, China Construction Bank, Johannesburg Branch (“CCB JHB” or “the Branch”) approach to risk management follows group policies and procedures as a minimum standard. Where local requirements are more stringent than head office requirements, the local requirements are adopted.

This report should be read in conjunction with the group’s capital adequacy report for the year ending 2016.

2. FINANCIAL PERFORMANCE

In terms of the requirements of the Regulations, the financial results presented below have been extracted from the Branch’s regulatory returns and/or annual financial statements prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IASB) from time to time. Whilst branches of foreign banks are not required to publish financial statements in terms of local legislation, the information provided below is required in terms of Regulation 43 disclosures (Basel Pillar 3 disclosures).

	R'000 30 Jun 2017
Net interest income	270,576
Non-interest revenue	45,749
Total operating expenses and credit impairments	70,245
Operating profit	246,080

3. FINANCIAL POSITION

	R'000 30 Jun 2017
Total assets	38,107,017
Total liabilities	33,834,446
Total equity	4,272,571

Capital Adequacy

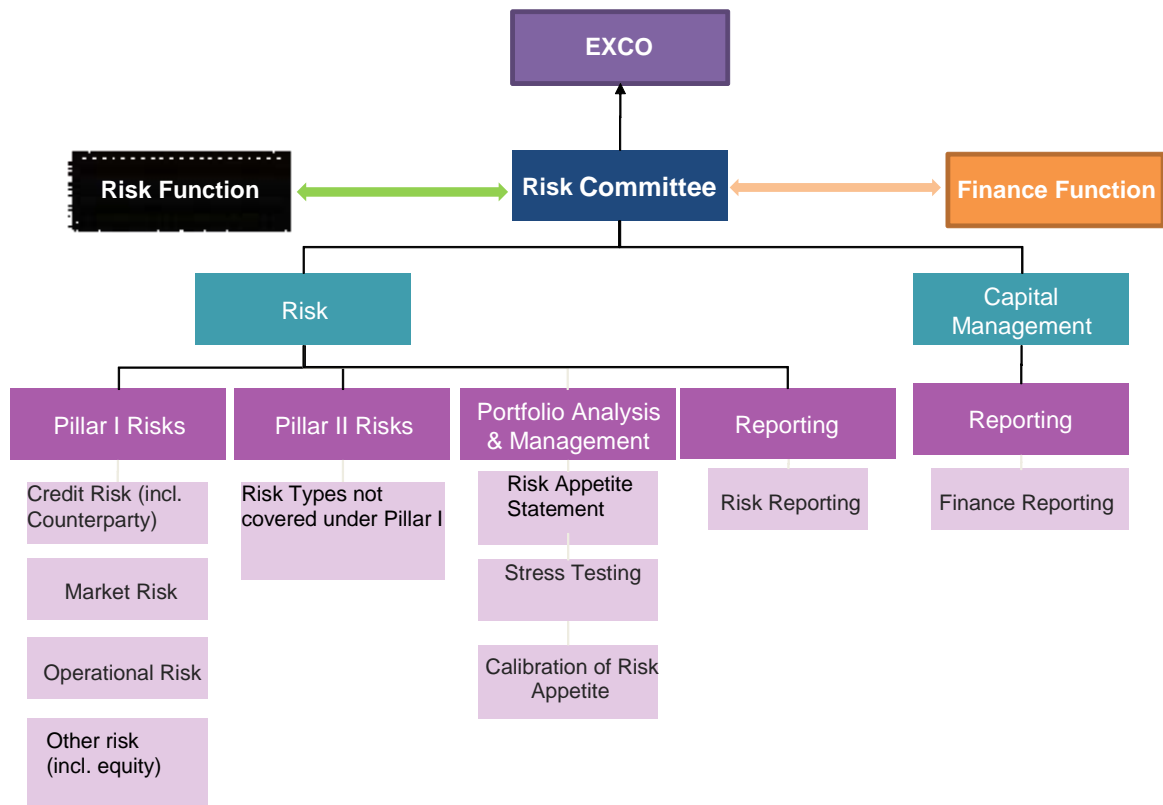
In terms of the requirements of the Banks Act and the Regulations, the Branch has complied with the minimum capital requirements for the period under review.

The minimum capital requirements are defined by 3 ratios:

- Common Equity tier 1 capital as a percentage of risk-weighted assets;
- Tier 1 capital as a percentage of risk-weighted assets; and
- Total qualifying capital as a percentage of risk-weighted assets.

Assessing the adequacy of capital

The Branch assesses the adequacy of its capital by considering the resources necessary to cover unexpected losses arising from risks, being those which it chooses to accept (such as credit risk and market risk), and risks which may arise in the operations environment. The Branch's capital management and policy is underpinned by the Group's capital management framework. The capital management framework and related policies define the Internal Capital Adequacy Assessment Process (ICAAP). In this regard, refer to the Branch's Risk Management Framework as summarized below:



This ensures that the Branch's level of capital:

- remains sufficient to support the Branch's risk profile and outstanding commitments;
- exceeds the Branch's minimum regulatory capital requirements by an appropriate buffer;
- is capable of withstanding a severe economic downturn stress scenario; and
- remains consistent with the Branch's strategic and operational goals, and Group's expectations.

Capital adequacy position – 30 Jun 2017	
	%
CET 1	23.18%
Tier 1	23.18%
Total	23.61%

4. Risk Management – the nature and extent of risk exposures

4.1 Credit Risk

Credit risk is defined as the current or prospective risk to earnings and capital arising from an obligor's failure to meet the terms of any contract with the institution or its failure to perform as agreed. Credit risk also arises from an adverse change in the value of a portfolio due to deterioration in the credit quality of counterparties.

The responsibility for credit risk resides with the Chief Credit Officer within the Branch. Governance of credit risk is through the Credit Management Committee and day-to-day responsibility for credit risk management is implemented by the Chief Credit Officer.

The Credit Management Committee is the Branch's approval authority for credit facilities, and it exercises its authority within limits and other parameters delegated by Head Office and reviewed from time to time. CEO is not a voting member of the Credit Committee but may use his own discretion to veto any facility approved by the Committee. Approval of credit facilities for banks and other financial institutions, and country limits for cross-border activities, is centralized in Head Office

Credit Risk Identification

The Branch is exposed to credit risk through its banking activities and where it acts as an intermediary on behalf of customers and other third parties. Credit risk is the largest component of the Pillar I capital requirements for the Branch. Currently, the Branch's credit capital requirements are calculated in accordance with the SARB regulations under the Standardized Approach for Credit Risk.

The Branch's primary exposure to credit risk arises through its loans and advances. The amount of credit exposure in this regard is represented by the carrying amounts of the financial assets on the statement of financial position. The Branch is exposed to credit risk to a lesser degree on various other financial assets, including derivative financial instruments and interest -bearing securities. In addition, the Branch is exposed to off-balance sheet credit risk through commitments in respect of letters of credit and guarantees.

Credit Risk Assessment

The vast majority of unsecured credit facilities granted by the Branch are to counterparties with a credit rating equivalent to investment grade. Collateral is obtained for most credit facilities approved to counterparties with a credit rating below investment grade. This serves to significantly mitigate the credit risk faced by the Branch.

The Branch applies internal rating criteria to classify the credit quality of borrowers. Where external credit rating agency information is available, it is used only for reference purposes in the credit assessment process.

Credit applications are prepared for borrowers or potential borrowers taking into account a wide range of factors, including the underlying credit rating. After considering available quantitative and qualitative information, a Relationship Manager, in conjunction with a Credit Analyst, proposes a credit rating (as well as associated pricing). The proposed credit rating is put to the Branch's Credit Management Committee for final approval.

A review of each borrower is conducted at least annually, and credit ratings are updated periodically, subject to the same approval process mentioned above, in the following instances:

- With each new credit application, and when changes in the existing facilities are applied for;
- As part of an annual review; and
- At any other time when new information comes to light that is expected to materially affect the risk profile of the borrower.

The following graphs provide an overview of the Branch's credit risk exposure.

- 1 Total gross credit exposure (before credit risk mitigation) per asset class as at 31 December 2016 and 30 June 2017:

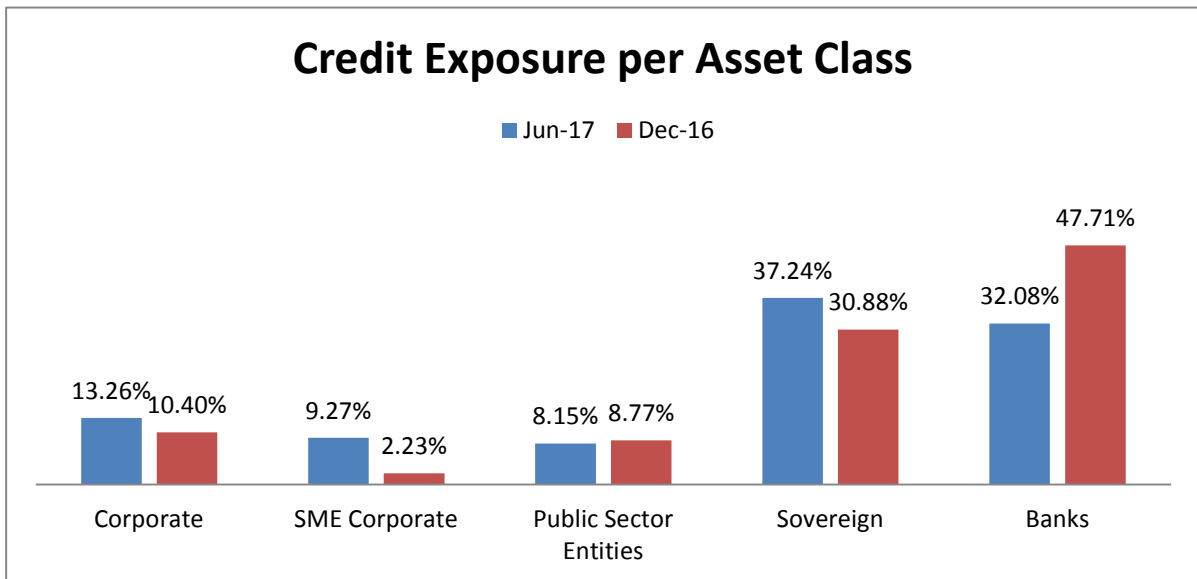


Figure 4.1: Credit Exposure per asset class June 2017 vs Dec 2016

- 2 Total gross credit exposure (before credit risk mitigation) per risk weight as at 31 December 2016 and 30 June 2017:

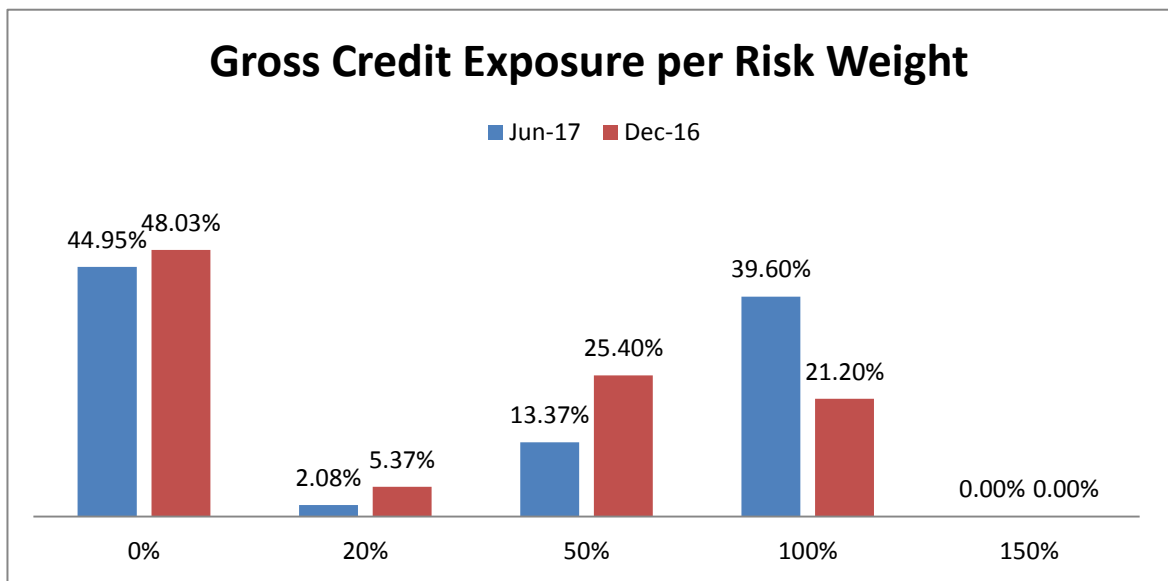


Figure 4.2: Gross Credit Exposure per risk weight June 2017 vs Dec 2016

3 Total gross credit exposure (before credit risk mitigation) per industry as at 30 June 2017 and 31 December 2016:

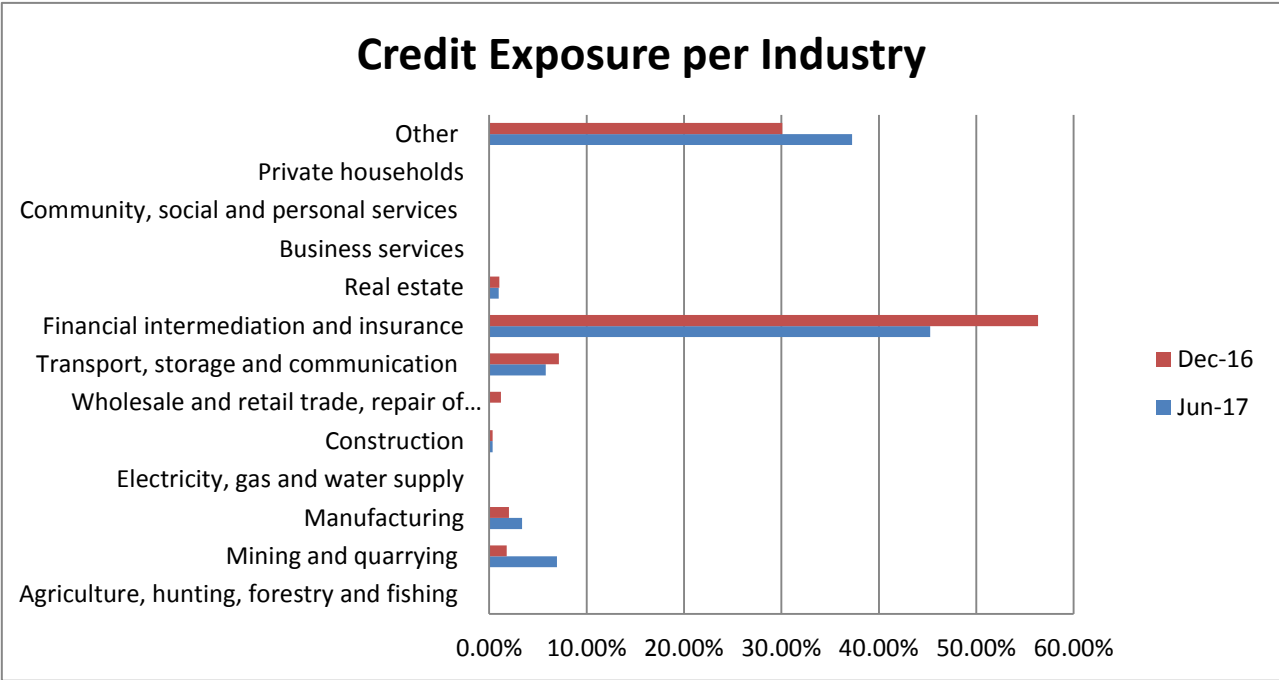


Figure 4.3: Credit Exposure per industry sector June 2017 vs Dec 2016

4 Total gross credit exposure (before credit risk mitigation) per region as at 30 June 2017 and 31 December 2016:

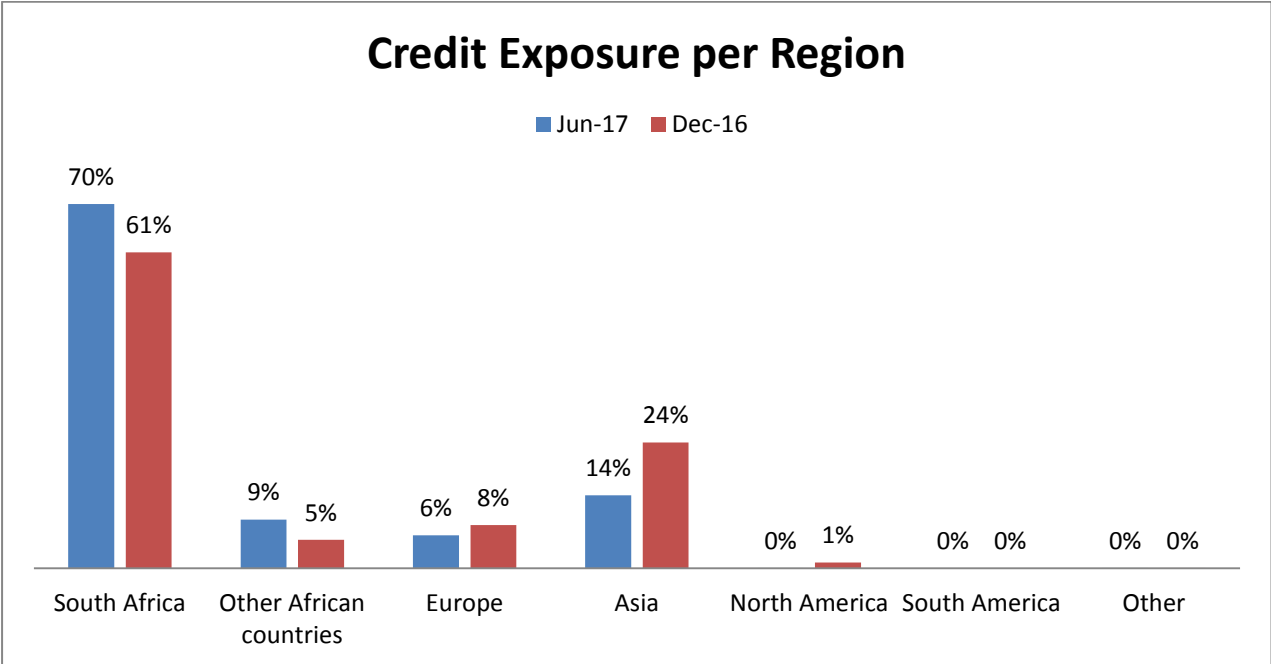


Figure 4.4: Credit Exposure by region 30 June 2017 vs 31 December 2016

Credit Risk Control and Mitigation

The Branch may grant credit facilities with or without obtaining any collateral or support, but collateral/support is sought wherever possible as a secondary source of repayment, and where necessary to maintain a 'pari-passu' position among the lenders. The Branch does not rely solely on collateral provided in the credit assessment of facilities, except in exceptional circumstances where the collateral is in the form of cash.

Processes and guidelines have been established for the lending activities of the Branch, to ensure the following:

- responsibility and obligations of lending staff are understood and properly carried out;
- all lending transactions are processed within the delegated approved limit;
- loan documentation is properly executed;
- loan documentation and collateral are effectively controlled; and
- transactions are properly executed in line with the approved procedures.

Impairments and provisioning

The Branch is prudent in raising general and specific provisions to provide adequate coverage for possible loan losses. Provisions are considered on a monthly basis and adjusted as considered necessary to meet internal requirements as well as the International Accounting Standards.

Specific provision is provided for whenever any account or transaction is classified as sub-standard or below.

	Jun 2017	Dec 2016
Loans and advances to customers and banks	R'000	R'000
Term loans to customers and banks	22 055 044	23 847 835
Impairment of loans and advances	(128 749)	(112 267)
	21 926 295	23 735 568
Impairment of loans and advances		
Balance at beginning of year	(112 267)	(82 385)
Current year write off	--	--
Bad debt recoveries	--	(13 560)
Current year charge	(16 482)	(16 800)
Balance at end of year	(128 749)	(112 267)
<i>Comprising:</i>		
Specific impairment	(49 072)	(49 903)
IBNR impairment allowance	(79 677)	(62 364)
	(128 749)	(112 267)

The Branch's credit risk management practices and conditions are assessed frequently to ensure appropriateness. This is performed via a review of controls by Internal and External Audit, on an annual basis. In addition, the Branch's Credit Management Committee is required to:

- evaluate the adequacy and efficiency of the risk policies, procedures, practices and controls applied within the Branch in the day-to-day management of its business on a regular basis;
- meet as required to approve credits within its authority.

A Non-Performing Loan Committee has been established to, inter alia, oversee the management of non-performing loans and remedial actions.

Credit Monitoring and Reporting

- All credit applications are considered by the Credit Management Committee, which endorses them indicating approval, disapproval or recommendation to Head Office, as appropriate. Credit Management Department, in conjunction with the Marketing and Relationship Management department (where necessary), periodically prepares credit risk reports to provide information to the Credit Management Committee and General Management of the Branch regarding the composition and status of the credit portfolio.

In terms of capital requirements, each loan is assessed together with the potential impact on the Capital Adequacy Ratio.

4.2 Market Risk

The Branch defines market risk as representing the potential impact on earnings of unfavourable changes in foreign exchange rates, interest rates, prices, market volatilities and trading liquidity.

The management of market risk is owned and managed by the Treasurer of the Branch who ultimately reports to the General Manager of the Branch.

4.2.1 Foreign Exchange Risk

The Branch's exposure to market risk primarily relates to foreign currency risk and is considered to be immaterial in relation to the total regulatory capital requirements of the Branch. Currently, the Branch is on the Standardised Approach for the measurement of its regulatory capital requirement in respect of its market risk exposure.

4.2.2 Interest Rate Risk in the Banking Book

The Branch defines interest rate risk as the risk of the Branch's net interest earnings being adversely affected by changes in interest rates.

Interest rate risk is closely related to liquidity risk and arises in times of changing interest rates, usually as a result of:

- a timing difference in the re-pricing characteristics of a Branch's assets and liabilities; and
- interest rates on assets and liabilities being based on different factors.

Interest rate risk is the risk that the Branch will experience deterioration in its financial position as interest rates move over time. Interest rate risk is split into two components: traded interest rate risk (which is captured under the market risk framework) and non-traded interest rate risk, where non-traded interest rate risk is the risk to the banking book. Interest rate risk in the banking book arises from core banking activities.

The risk is assessed as the loss in income and/or economic value that is expected to arise should market interest rates change. The Branch has a policy of reducing and mitigating this risk through the use of interest rate swaps to ensure that all fixed-rate exposures of 3 months or longer, are hedged.

Currently the Branch holds no additional capital for Interest Rate risk on the Banking Book, and mitigates this risk via controls (i.e. by hedging out IRRBB). These controls include the calculation of a maturity gap analysis for interest rate products in the banking book. Based on this analysis, interest rate derivatives and bonds are traded in order to align the roll dates of cash flows and so neutralise any anticipated interest rate risk. Value-at-Risk reports are created by CCB Head Office on a monthly basis to ensure that no delta (in terms of interest rate risk amongst other things) breaches set limits.

Basel requires that a standardised interest rate shock approach is used to express interest rate risk in the banking book in terms of economic value. The standardised shock suggested by the Basel II Accord is a shock of 200 basis points¹. This is compulsory for South African Banks as part of the BA 300 series reporting. The Branch currently applies this interest rate shock as part of its BA 300 series (i.e. BA330: Interest Rate on the Banking Book). The Branch is also assessing other potential stress tests for this risk.

IRRBB is an important consideration for new products and all new products are reviewed to evaluate their contributions to interest rate risk and marginal interest rate risk in the banking book.

Projected NII sensitivity to interest rate movements – 30 Jun 2017	
	Change in projected 12-month NII R'000
Downward 200 bps	59,050
Upward 200 bps	-94,232

4.3 Operational Risk

The Branch uses the standardised approach to assess its regulatory and internal capital requirements for Operational Risk.

Operational risk is considered to be immaterial in relation to the total regulatory capital requirements of the Branch.

4.4 Liquidity Risk

The Branch defines liquidity risk as the possibility of the Branch having insufficient cash or having to pay a premium for funds to meet its financial obligations fully and punctually. Losses may also arise from liquidity risk relating to the forced disposal of assets to source cash to meet funding requirements.

Liquidity risk is the potential exposure to funding mismatches due to contractual differences in maturity dates, as well as, repayment structures of assets and liabilities resulting in the Branch not being able to meet its financial obligations in a timely and cost efficient manner. This is also referred to as Funding Liquidity Risk.

Sound liquidity risk management requires, amongst other things, that the funding sources available to the Branch are sufficiently diverse and stable that the Branch can continue to function during times of liquidity stress. Excessive reliance upon a narrow range of funding sources, or one narrow industry segment, can result in the

Branch being overly dependent on the financial condition of its limited depositor base or funding sources.

Liquidity risk was a key driver of the financial crisis in 2008 and now receives much greater focus as a result.

Assets and liabilities are managed by the Branch as part of the existing Alco process. The Branch strives to maintain a balance between continuity of funding and flexibility through the use of liabilities with a range of maturities. The Branch continually assesses liquidity risk by identifying and monitoring changes in funding required to meet business goals and targets set in terms of the overall Branch strategy. Also, the Branch has access to Head Office borrowing at market related rates. In addition, the Branch holds a portfolio of liquid assets as part of its liquidity risk management strategy.

Overall Liquidity Risk Assessment

Business-as-usual liquidity management

The Treasury function is responsible for managing any funding mismatches.

The approach to managing liquidity risk focuses on a number of key areas, including:

- continuous monitoring and management of net anticipated cash flows (between assets and liabilities) within approved cash outflow limits;
- maintenance of a portfolio of highly liquid assets that can easily be liquidated as protection against any unforeseen interruption to cash flow;
- active participation in local money and capital markets in order to support day-to-day funding needed to refinance maturities, meet customer withdrawals and support growth in advances; and
- ongoing assessment and evaluation of various funding sources designed to grow and diversify the Branch's base in order to achieve an optimal funding profile and sound liquidity management.

The table below reflects the contractual maturity liquidity gap of the Branch as at 30 June 2017:

Contractual balance sheet mismatch	Total	Next day	Up to 1 month	More than 1 month to 6 months	More than 6 months to 1 year	More than 1 year	Non contractual
Contractual maturity of assets	38,235,765	734,010	1,658,612	7,071,839	6,073,303	22,427,443	270,558
Contractual maturity of liabilities	38,107,018	3,773,223	10,766,444	15,672,130	2,527,412	1,050,789	4,317,020
On-balance sheet contractual mismatch	128,751	-3,039,212	-9,107,831	-8,600,290	3,545,891	21,376,655	-4,046,462
Cumulative on-balance sheet contractual mismatch	0	-3,039,213	-18,564,839	-54,175,377	-17,201,444	6,252,428	128,749
Off-balance sheet exposure to liquidity risk	4,265,041	4,265,041	0	0	0	0	0

5. Remuneration

The Branch applies the remuneration philosophy and strategy of the Group, which can be located at:

http://www.ccb.com/en/newinvestor/upload/20150701_1435718267/2014%20Annual%20Report.pdf

No employees of the Branch are considered to represent “material risk takers” as envisaged in terms of Regulation 43.

DISCLAIMER: The Chinese version is a translation of the original in English for information purposes only. In case of a discrepancy, the English version will prevail.