Pillar 3 Disclosures Report

For Financial Year Ended 31st December 2009

1. Overview

1.1. Background

China Construction Bank (London) Limited ('CCBL' or 'the Bank') is a wholly owned subsidiary of China Construction Bank Corporation (domiciled in Beijing, China) and has been authorised and regulated by the Financial Services Authority (FSA) since 9 March 2009.

The Bank will concentrate on wholesale banking activities - accepting deposits, providing trade finance and lending, foreign exchange, interest rate and foreign exchange derivatives, commodity financing, commodity derivatives and bond investments. The Bank's treasury activity performs a liquidity management function, including the management of a portfolio of investments to assist with liquidity. Syndicated loans are provided for general funding requirements to banks and corporate entities. Bilateral and direct loans to customers are to support working capital financing, capital expenditure and trading activities.

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

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

As the Bank only received its authorisation during 2009, there is no comparative Pillar 3 data to disclose in this document.

1.2. Purpose

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

1.3. Review

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

CCBL's accounting year end is 31st December and CCBL's Pillar 3 disclosures have been aligned with its financial reporting. The Pillar 3 disclosures for 31st December 2009 are available on the Bank's website: www.ccb.com .

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

2. Risk management objectives and policies.

2.1. Strategies and Processes to Manage Risks

The principal risks faced by CCBL are credit risk, market risk and operational risk. These principal risks are reviewed and reassessed at least annually as a part of the Internal Capital Adequacy Assessment Process ('ICAAP').

The Board has adopted a "Three Lines of Defence" model. The first line of defence consists of the front office business staff who are responsible for adhering to individual trader mandates as well as firm wide policies. The second line of defence is the oversight provided by control functions such as Risk and Compliance who set and monitor adherence to policies and define work practices. The third line of defence is the independent internal audit and the directors who undertake reviews of the overall risk management and compliance function.

Risk is managed through a process of ongoing identification, measurement and monitoring, subject to prudent risk limits and controls.

CCBL's risk management is built on a formal governance framework and processes and relies on individual responsibility and collective oversight. Ultimate responsibility for risk governance lies with the Board of Directors ('the Board') who are responsible for determining risk strategy and setting risk appetite.

Risk appetite is the nature and the amount of risk China Construction Bank (London) Limited ('CCBL') is willing to take or is prepared to accept in pursuing its strategic objectives.

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

- Protect the ongoing franchise of the business;
- Minimise risks (credit, market, liquidity, operational, legal, reputational); and
- Ensure regulatory compliance.

2.2. Scope and Nature of Risk Reporting

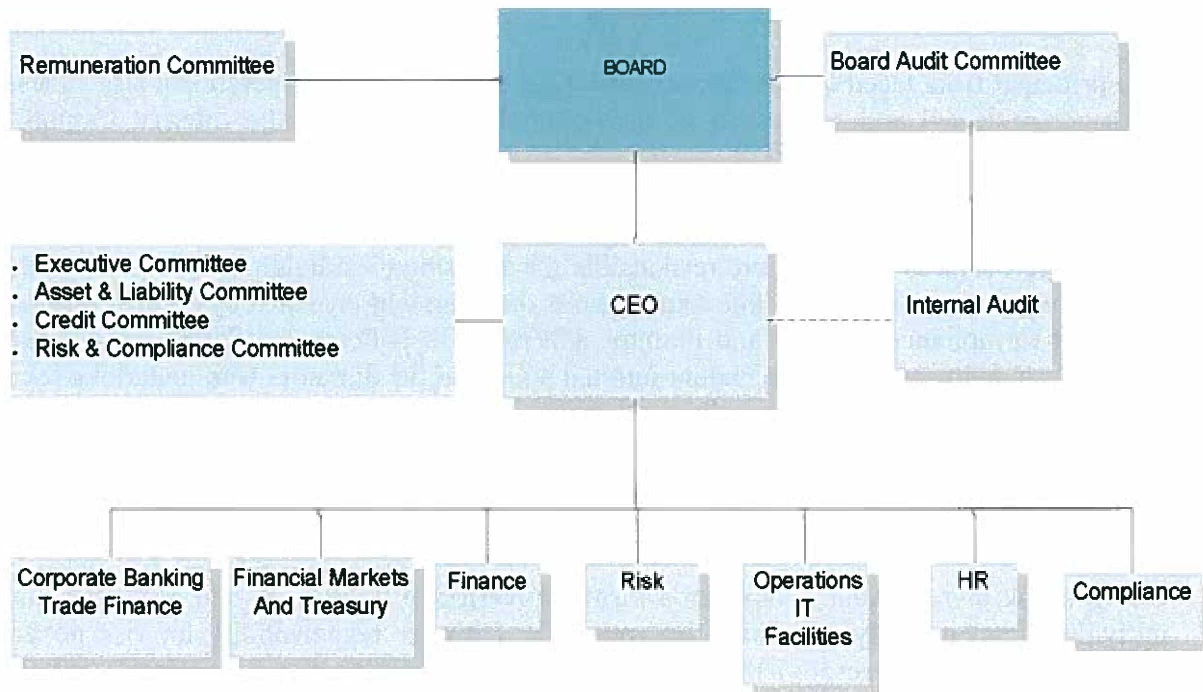
CCBL had not yet undertaken any trading book activities therefore all risks arose from the non-trading book. The instruments that were monitored include loans, deposits, bonds and foreign exchange.

2.3. Risk Department

The Risk Department is responsible for:

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

2.4.Structure and Organisation of Governance



2.4.1.The Board

The Board is responsible for strategic direction, overall control of the Bank and establishing a clearly defined governance and risk management structure. The Board has delegated certain powers and responsibilities to board-committees and the CEO, and the Board maintains responsibility for approving and reviewing those committee policies.

2.4.2.Executive Committee (ExCo)

The risk-related responsibilities of the ExCo include discussions of regulatory and legal developments, the profit & loss account and the trend of the important financial ratios. The ExCo reports to the Board.
ExCo has oversight of all new products.

2.4.3.Audit Committee

The Audit Committee provides oversight of the Bank's internal and external auditors and thereby assists the Board in providing an independent review of the effectiveness of the financial reporting process and internal control systems of the Bank.

2.4.4.Remuneration Committee

The Remuneration Committee monitors staffing levels and performance, and will recommend appropriate levels of remuneration including bonus payments.

2.4.5.Risk and Compliance Committee

The Risk and Compliance Committee has delegated responsibility from the CEO to ensure effective executive oversight of the risk management and compliance framework of CCBL. The Risk and Compliance Committee reports its findings to the CEO and ExCo. Responsibilities include implementation of risk management policies, reviewing appropriateness of risk management with external and internal auditors and to determine the priorities of the Risk and Compliance Departments.

2.4.6.Credit Committee

The Credit Committee has been delegated authority by the CEO to oversee credit risk. This committee also focus on monitoring and managing individual exposures and assessing the quality of the credit portfolio and the adequacy of provisions.

2.4.7.Asset and Liability Committee (ALCo)

The ALCo is granted authority by the CEO to review and monitor the Bank's liquidity, interest rate risk and balance sheet structure. The ALCo establishes various trigger limits, control ratios and guidelines in accordance with statutory and local regulatory requirements. ALCo reports to EXCO and the CEO.

3. Capital Resources

a) Capital

The Company's authorised share capital is £1 divided into 1 share of £1 and US$100,000,000 divided into 100,000,000 shares of US$1.

At 31 December 2009 the issued and fully paid up share capital amounted to $100,000,000 (US$1 equivalent at 31 December 2008 exchange rate).

(b) Available-for-sale reserve

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

(USD000s)

	As at 31/12/2009
Core tier 1 Capital	
Called up share capital	100,000
Share premium account	NIL
Retained earnings and other reserves	(9,900)
Externally verified profits	NIL
Preference shares	
Perpetual non cumulative preference shares	NIL
Deductions from tier 1 capital	
Intangible assets	NIL
Net losses on securities held in the available for sale financial assets category	(35)
Tier 1 capital after deductions	**90,065**
Innovative tier 1 instruments	NIL
Tier 2 capital	
Subordinated debt	NIL
Collective provisions	NIL
Deductions from tier 2 capital	
Expected losses	NIL
Tier 2 capital after deductions	NIL
Deductions from total of tier 1 and tier 2 capital	NIL
Total capital resources	**90,065**

4. Credit Risk.

CCBL distinguishes between three types of credit risk:

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

4.1. Credit risk minimum capital requirement

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

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

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

The following table shows exposure values associated with each credit quality step for credit exposures in accordance with the FSA's credit quality assessment scale under the Standardised Approach as at 31/12/2009:

Credit Quality Step	Risk Weight	External Credit Assessment[2]	Residual maturity	Exposure
				$000
1	20%	AAA to AA-		15,238
2	20%	A+ to A-	Institutions with less than 3 months residual maturity	37,761
2	50%	A+ to A-		17,065
3	100%	BBB+ to BBB-		10,004
U	100%	Unrated		9,943
Other assets	100%	Unrated		3,437
				93,448

There were no impaired exposures during the year and as of 31 December 2009.

[2] Second worst of Moodys , Standard &Poors or Filtch ratings.

Geographic distribution by Exposure

$000	Europe	Peoples Republic of China	UK	USA	Total
Institutions		17,065			17,065
Corporates				15,034	15,034
Short term claims on institutions and corporates	10,004		10,148	37,760	57,912
Other items		281	3,156		3,437
	10,004	17,346	13,304	52,794	93,448

Industrial sector distribution by Exposure

$000	Brewing	Construction	Financial Services	Media	Other	Total
Institutions			17,065			17,065
Corporates				15,034		15,034
Short term claims on institutions and corporates	10,004	9,942	37,966			57,912
Other items					3,437	3,437
	10,004	9,942	55,031	15,034	3,437	93,448

Residual maturity of Exposure

$000	Up to 3 months	Between 3 months & 1 year	Between 1 year & 3 years	Undated	Total
Institutions	17,065				17,065
Corporates			17,215		17,215
Short term claims on institutions and corporates	55,731				55,731
Other items		280		3,157	3,437
	72,796	280	17,215	3,157	93,448

4.2.External Credit Assessment Institutions

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

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

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

4.3. Monitoring Credit Risk

The following are monitored on a daily basis:

- Counterparty credit ratings;
- Counterparty credit default swap spreads;
- Counterparty equity prices; and
- Concentration risk (country, currency, industry and issuer).

Counterparty refers to customers, brokers, intermediaries, settlement agents, issuers, parent entities and guarantors.

4.4. Mitigating Credit Risk

CCBL has attempted to mitigate credit risk by:

- Diversifying exposures across different counterparties to reduce the impact of a single counterparty default;
- Limiting the maturity of inter-bank lending (up to one month) to allow flexibility should credit quality deteriorate;
- Setting hard limits on the amount of exposure to each counterparty at group level;
- Ensuring robust credit analysis (initially and ongoing);
- Regularly stress testing credit rating downgrades and credit spread widening;
- Settling through assured payment systems or on a delivery-versus-payment basis;
- Where possible, to reduce the probability of default via parental or third party guarantees; and
- Where possible, to reduce the loss given default by using collateral as security.

5. Market Risk

Market risk is the risk of loss due to changes in market factors such as interest rates, credit spreads and foreign exchange rates. Whilst there is no trading book, the Bank is exposed to market risk arising from customer orders and operational requirements (such as overheads) that the Treasury Department performs.

5.1. Interest Rate Risk

Interest rate risk in the non-trading book arises from financial investments designated as available for sale and held to maturity. Interest rate risk arises principally from mismatches between the future yields on assets and their funding costs, as a result of interest rate changes. Analysis of this risk is complicated by having to make assumptions on optionality in certain product areas, for example, loan prepayments and callable bonds.

The table below shows the impact of a 100 basis point rise or fall in the base rate on net interest income at 31 December 2009:

	100bps parallel Increase	100bps parallel Decrease
$000		
Sensitivity of projected net interest income		
USD	*(214)*	*214*
GBP	*(6)*	*6*
	(220)	*220*

5.2. Credit Spread Risk

Credit spread risk arises from the change in credit worthiness of financial investments designated as available for sale and held to maturity. Credit spread risk arises principally as a result of credit spread changes of the bond issuer, the deposit taking institution or the loan borrowing firm.

5.3. Foreign Exchange Risk

Foreign exchange risk is the risk that movements in the various currencies could materially impact the financial statements. The Bank makes loans and takes deposits in a number of currencies. The Bank manages foreign exchange risk by putting limits on spot and forward positions held.

The table below shows the impact of a one cent increase or decrease in the value of the Dollar against other currencies to which the Bank is exposed:

Change in value of the dollar compared with Sterling and Euros	1 cent Increase	1 cent Decrease
$000		
Sensitivity of foreign exchange		
At 31 December 2009	*(55)*	*55*

5.4. Monitoring Market Risk

The following are monitored on a daily basis:

- Mark-to-market of profit and loss;
- Value at risk (calculated on a one day and ten day horizon with a 99% confidence interval);
- Sensitivity to adverse moves in interest rates, credit spreads, foreign exchange; and
- Scenario analysis such as credit rating downgrades and counterparty default.

5.5. Mitigating Market Risk

CCBL has attempted to mitigate market risk by:

- Placing monies in securities that reference floating rate indices such as LIBOR;
- Placing a limit on the sensitivity to interest rates. In particular, a maximum PV01 (present value of a basis point) is specified;
- Placing a limit on foreign exchange exposures; and
- Placing a limit on the value at risk.

6. Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk.

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

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

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

7.Capital adequacy

In assessing the adequacy of its capital, the Bank considers its risk appetite, the risk types to which the Bank is exposed and the appropriate management strategies for each of the Bank's material risks. In addition to capital adequacy quarterly reporting to the FSA, an internal capital adequacy assessment is performed daily in order to assess the Bank's capital adequacy and to determine the levels of capital required going forward to support the current and future risks of the Bank's growing business. Capital adequacy reports are produced by the Finance Department and reviewed, monthly, by the ALCO Committee and Senior Management. If the daily surplus capital falls within a predetermined amount of the Individual Capital Guidance ('ICG'), ALCO is notified immediately. ALCO will then monitor the situation closely and make any necessary recommendations to ExCo who will decide what actions are required to improve the situation.

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

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

The following table shows the Bank's Pillar 1 capital requirement by asset class as at 31 December 2009.

Credit Risk - Standardised Approach

(USD000s)

	Notes	Exposure Value	Capital Requirement
Central governments or central banks		-	-
Institutions		17,065	683
Corporates		15,034	241
Retail		-	-
Short term claims on institutions and corporates		57,912	2,202
Other items		3,437	275
Capital Component for Credit Risk	1.	**93,448**	**3,401**
Operational risk – Basic Indicator Approach	2.		**940**
Foreign exchange PRR			**611**
Total Pillar 1 capital requirement			**4,952**
Total capital resources			**90,065**
Excess capital resources over Pillar 1 capital requirement			**85,213**

Notes:

1. Under the Standardised Approach for credit risk, the relevant risk weights are determined based on the assigned external credit ratings by three eligible ECAI's including Standard & Poor's, Moody's and Fitch Ratings.

2. Operational Risk Capital Requirement is determined using the Basic Indicator Approach. In view of the Bank's lack of historical data these calculations are based on three year's projections set at the time of authorisation.

8. Impairments and Provisions

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

8.1. Definition of Impaired

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

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

8.2. Definition of Past Due

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

8.3. Impairment Reporting

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

8.4. Provisioning Process

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

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

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

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

When a decline in the fair value of an available-for-sale financial asset has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss that had been recognised directly in equity shall be removed from equity and recognised in profit or loss even though the financial asset has not been unrecognised.

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

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

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

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

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

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

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

Doubtful: assets for which collection / liquidation in full is determined by the Bank's management to be improbable due to current conditions and/or interest or principal or both are overdue more than 180 days. Assets in this category are considered impaired but are not yet considered total losses because some pending factors may strengthen the asset's quality (e.g. merger, new financing or

capital injection). Placing the account on non-accrual is normally required. The principal should be reserved or written off to the extent deemed necessary, after obtaining the approval of the Credit Committee.

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