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BANK OF CHINA

卢森堡有限公司

LUXEMBOURG S.A.

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# Bank of China (Luxembourg) S.A.

## Pillar III Disclosure Report of 2020



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## List of Acronyms

ALCO	Assets & Liabilities Committee
AM	Authorized Management and or General Management
AML	Anti Money Laundering
BAC	Board Audit Committee
BCBS	Basel Committee on Banking Supervision
BCM	Business Continuity Management
BCP	Business Continuity plan
BIA	Basic Indicator Approach
BOD	Board of Directors
Branch	Bank of China Limited – Luxembourg Branch
BRCC	Board Risk & Compliance Committee
CAR	Capital Adequacy Ratio
CBD	Corporate Banking Department
CCF	Credit Conversion Factor
CCR	Counterparty Credit Risk
CCP	Central Counterparty
CCO	Chief Compliance Officer
CET 1	Common Equity Tier 1
CRD IV	Capital Requirements Directive IV
CRM	Credit Risk Mitigate
CRO	Chief Risk Officer
CRR	Capital Requirements Regulation
CSSF	Commission de Surveillance du Secteur Financier
DRP	Disaster Recovery plan
EAD	Exposure at Default
EBA	European Banking Authority
ECAI	External Credit Assessment Institution
ECL	Expected Credit Loss
EMIR	European Market Infrastructure Regulation
EVA	Economic Value Added
EVE	Economic Value of Equity
FBEs	Forborne Exposures



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## List of Acronyms

FD	Financial Department
FMID	Financial Market and Institution Department
GDPR	the General Data Protection Regulation
H.O.	Head Office
HQLA	High Quality Liquid Asset
IAD	Internal Audit Department
IASA	International Accounting Standards Board
IASB	International Accounting Standards Board
IBOR	Inter-Bank Offered Rate
ICAAP	Internal Capital Adequacy Assessment Process
ICT	Information and Communication Technology
IFRS	International Financial Reporting Standards
ILAAP	Internal Liquidity Adequacy Assessment Process
IMM	Internal Model Method
IRRBB	Interest Rate Risk on the Banking Book
ITS	Implementing Technical Standards
KPI	Key Performance Indicator
KRI	Key Risk Indicator
LCR	Liquidity Coverage Ratio
LDC	Loss Data Collection
LFS	Law of 5 April 1993 on the financial sector
L/G	Letter of Guarantee
L/C	Letter of Credit
LTV	Loan to Value
MiFID II	Markets in Financial Instruments Directive 2014/65
MtM	Mark to Market
NACE	Nomenclature des Activités Économiques dans la Communauté Européenne
NII	Net Interest Income
NSFR	Net Stable Funding Ratio
NPLs	Non Performing Loans
OCR	Overall Capital Requirement
OPRC	Operational Risk Concentration



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## List of Acronyms

OTC	Over the Counter
PLN	Polish zloty
PSD II	Payment Services Directive 2015/2366
PVBP	Price value of a Basis Point
RACA	Risk and Control Assessment
RCSF	Reglement CSSF
RMD	Risk Management Department
RMICC	Risk Management and Internal Control Committee
RWA	Risk Weighted Asset
SA	Standardised Approach
Sek	Swedish krona
SFR	Short Form Report
SFT	Security Financing Transaction
SREP	Supervisory Review and Evaluation Process
TREA	Total Risk Exposure Amount
TSCR	Total SREP Capital Requirement
VAR	Value at Risk
VAT	Value-added Tax
VPN	Virtual Private Network
UTP	Unlikely to Pay



## EBA tables and templates

Key Metrics and Overview of Risk-weighted Exposure Amount		CRR articles	Reference
EU KM1	Overview of risk weighted exposure amounts	Article 447 (a) to (g) Article 438 (b)	Section Key Indicators
EU OV1	Overview of risk weighted exposure amounts	Article 438 (d)	Table 3.6.1 using old template
EU OVC	ICAAP information	Article 438 (a) (c)	Section 4
EU INS1	Insurance participations	Article 438 (f)	N/A
EU INS2	Financial conglomerates information on own funds and capital adequacy ratio	Article 438 (g)	N/A
Disclosure of risk management policies and objectives		CRR articles	Reference
EU OVA	Institution risk management approach	Article 435 (1)	Section 2.3
EU OVB	Disclosure on governance arrangements	Article 435 (2)	Section 2.1 and 2.2
Disclosure of the scope of application		CRR articles	Reference
EU LI1	Differences between accounting and regulatory scopes of consolidation and mapping of financial statement categories with regulatory risk categories	Article 436 (c)	Table 3.4.1
EU LI3	Outline of the differences in the scopes of consolidation (entity by entity)	Article 436 (b)	N/A
EU LI2	Main sources of differences between regulatory exposure amounts and carrying values in financial statements	Article 436 (d)	N/A
EU LIA	Explanations of differences between accounting and regulatory exposure amounts	Article 436 (b)	Section 3.4
EU PV1:	Prudent valuation adjustments (PVA)	Article 436 (e)	N/A
EU LIB	Other qualitative information on the scope of application	Article 436 (f) (g) (h)	Section 1.3
Disclosure of own funds		CRR articles	Reference
EU CC1	Composition of regulatory own funds	Article 437 (a) (d) (e) (f)	Table 3.3.1
EU CC2	Reconciliation of regulatory own funds to balance sheet in the audited financial statements	Article 437 (a)	N/A
EU CCA	Main features of regulatory own funds instruments and eligible liabilities instruments	Article 437 (b) (c)	Table 3.5.1
Disclosure of countercyclical capital buffers		CRR articles	Reference
EU CCyB1	Geographical distribution of credit exposures relevant for the calculation of the countercyclical buffer	Article 440 (a)	Table 3.7.1
EU CCyB2	Amount of institution-specific countercyclical capital buffer	Article 440 (b)	Table 3.7.2
Disclosure of the leverage ratio		CRR articles	Reference
EU LR1 - LRSum	Summary reconciliation of accounting assets and leverage ratio exposures	Article 451(1) (b)	Table 3.8.1
EU LR2 - LRCom	LRCom: Leverage ratio common disclosure	Article 451(1) (2) (3)	Table 3.8.2
EU LR3 - LRSpI	Split-up of on balance sheet exposures (excluding derivatives, SFTs and exempted exposures)	Article 451(1) (b)	Table 3.8.3
EU LRA	Free format text boxes for disclosure on qualitative items	Article 451(1) (d) (e)	Section 3.8
Disclosure of liquidity requirements		CRR articles	Reference
EU LIQA	Liquidity risk management	Article 435(1) Article 451a(4)	Section 8
EU LIQ1	Quantitative information of LCR	Article 451a(2)	Table 8.4.1
EU LIQB	On qualitative information on LCR, which complements template EU LIQ1	Article 451a(2)	Section 8.4
EU LIQ2	Net Stable Funding Ratio	Article 451a(3)	Table 8.4.2
Disclosure of credit risk quality		CRR articles	Reference
EU CRA	General qualitative information about credit risk	Article 435(1) (a) (b) (d) (f)	Section 5.1
EU CRB	Additional disclosure related to the credit quality of assets	Article 442 (a) (b)	Section 5.1
EU CQ3	Credit quality of performing and non-performing exposures by past due days	Article 442 (c) (d)	Table 5.2.5
EU CR1-A	Maturity of exposures	Article 442 (g)	Table 5.2.2
EU CR2	Changes in the stock of non-performing loans and advances	Article 442 (f)	Table 5.2.3
EU CR1	Performing and non-performing exposures and related provisions	Article 442 (c) (f)	Table 5.2.1
EU CQ1	Credit quality of forborne exposures	Article 442 (c)	Table 5.2.4
EU CQ4	Quality of non-performing exposures by geography	Article 442 (c) (e)	Table 5.2.6
EU CQ5	Credit quality of loans and advances by industry	Article 442 (c) (e)	Table 5.2.7
EU CQ7	Collateral obtained by taking possession and execution processes	Article 442 (c)	N/A
EU CR2a	Changes in the stock of non-performing loans and advances and related net accumulated recoveries	Article 442 (c) (f)	N/A
EU CQ2	Quality of forbearance	Article 442 (c)	N/A
EU CQ6	Collateral valuation - loans and advances	Article 442 (c)	N/A
EU CQ8	Collateral obtained by taking possession and execution processes – vintage breakdown	Article 442 (c)	N/A



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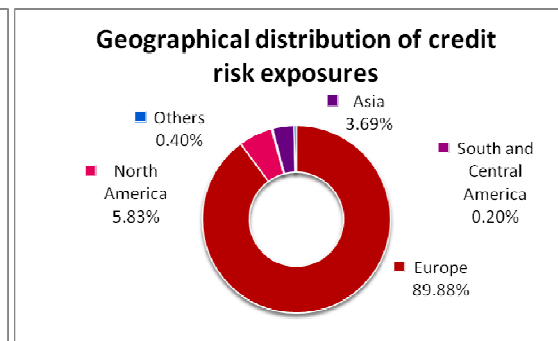
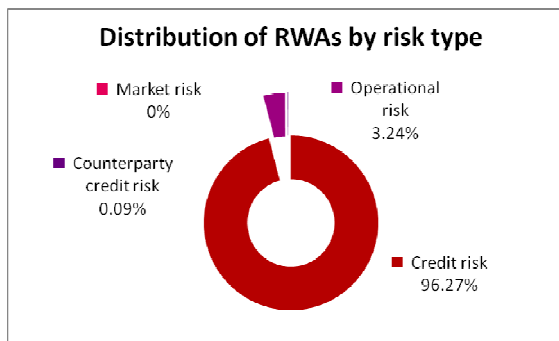
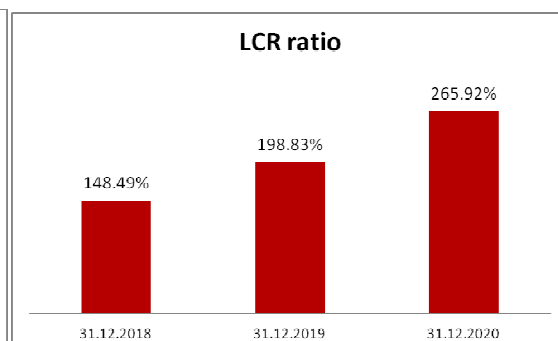
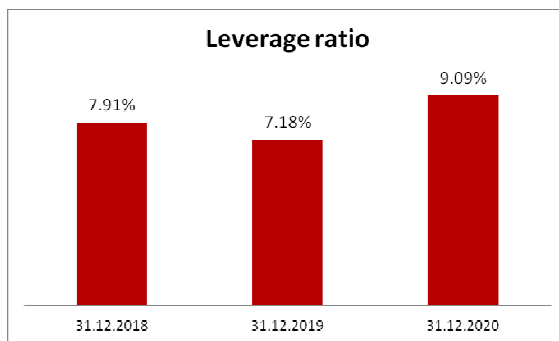
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Disclosure of the use of standardised approach and internal model for market risk		CRR articles	Reference
EU MR1	Market risk under the standardised approach	Article 445	Table 6.5.1
EU MRA	Qualitative disclosure requirements related to market risk	Article 435 (1) (a) to (d)	Section 6.2
EU MRB	Qualitative disclosure requirements for institutions using the internal Market Risk Models	Article 455 (a) (b) (c) (f)	N/A. The Bank uses the standardised approach
EU MR2-A	Market risk under the internal Model Approach (IMA)	Article 455 (e)	N/A. The Bank uses the standardised approach
EU MR2-B	RWA flow statements of market risk exposures under the IMA	Article 438 (h)	N/A. The Bank uses the standardised approach
EU MR3	IMA values for trading portfolios	Article 455 (d)	N/A. The Bank uses the standardised approach
EU MR4 -	Comparison of VaR estimates with gains/losses	Article 455 (g)	N/A
Disclosure of operational risk		CRR articles	Reference
EU ORA	Qualitative information on operational risk	Articles 435(1) Article 446 and 454	Section 7
EU OR1	Operational risk own funds requirements and risk-weighted exposure amounts	Articles 446 and 454	Table 7.4.1
Disclosure of remuneration policy		CRR articles	Reference
EU REMA	Remuneration policy	Article 450(1) (a) (b) (c) (d) (e) (f) (j) and (k) Article 450(2)	Section 10
EU REM1	Remuneration awarded for the financial year	Article 450(1) (h)(i)-(ii)	Table 10.6.1
EU REM2	Special payments to staff whose professional activities have a material impact on institutions' risk profile (identified staff)	Article 450(1) (h)(v) to (vii)	N/A
EU REM3	Deferred remuneration	Article 450(1) (h)(iii) and (iv)	Table 10.6.2
EU REM4	Remuneration of 1 million EUR or more per year	Article 450(1) (i)	N/A
EU REM5	Information on remuneration of staff whose professional activities have a material impact on institutions' risk profile (identified staff)	Article 450(1) (g)	Table 10.6.3
Encumbered and unencumbered assets		CRR articles	Reference
EU AE1	Encumbered and unencumbered assets	Article 443	Table 8.6.1
EU AE2	Collateral received and own debt securities issued	Article 443	Table 8.6.2
EU AE3	Sources of encumbrance	Article 443	Table 8.6.3
EU AE4	Accompanying narrative information	Article 443	Section 8.6



### Key Indicators as at 31 December 2020

	Solvency ratio		
	31.12.2018	31.12.2019	31.12.2020
CET1 Capital ratio	12.27%	11.52%	<b>12.23%</b>
Tier 1 ratio	12.27%	11.52%	<b>15.86%</b>
Total Capital ratio	15.16%	14.03%	<b>18.44%</b>





EU KM1 - Key metrics template

	(In EUR'000)	a	b	c	d	e
		31/12/2020	31/12/2019	31/12/2018	31/12/2017	31/12/2016
<b>Available own funds (amounts)</b>						
1	Common Equity Tier 1 (CET1) capital	504,989.88	488,759.46	451,741.59	421,968.31	417,866.53
2	Tier 1 capital	655,004.14	488,759.46	451,741.59	421,968.31	417,866.53
3	Total capital	761,412.18	595,161.53	558,178.99	430,317.35	427,360.43
<b>Risk-weighted exposure amounts</b>						
4	Total risk-weighted exposure amount	4,128,678.37	4,240,938.27	3,681,029.83	3,078,164.86	2,186,287.64
<b>Capital ratios (as a percentage of risk-weighted exposure amount)</b>						
5	Common Equity Tier 1 ratio (%)	12.23%	11.52%	12.27%	13.71%	19.11%
6	Tier 1 ratio (%)	15.86%	11.52%	12.27%	13.71%	19.11%
7	Total capital ratio (%)	18.44%	14.03%	15.16%	13.98%	19.55%
<b>Additional own funds requirements based on SREP (as a percentage of risk-weighted exposure amount)</b>						
EU 7a	Additional CET1 SREP requirements (%)	1.00%	0.00%	0.00%	0.00%	0.00%
EU 7b	Additional AT1 SREP requirements (%)	0.00%	0.00%	0.00%	0.00%	0.00%
EU 7c	Additional T2 SREP requirements (%)	0.00%	0.00%	0.00%	0.00%	0.00%
EU 7d	Total SREP own funds requirements (%)	9.00%	8.00%	8.00%	8.00%	8.00%
<b>Combined buffer requirement (as a percentage of risk-weighted exposure amount)</b>						
8	Capital conservation buffer (%)	2.50%	2.50%	2.50%	2.50%	2.50%
EU 8a	Conservation buffer due to macro-prudential or systemic risk identified at the level of a Member State (%)	0.00%	0.00%	0.00%	0.00%	0.00%
9	Institution specific countercyclical capital buffer (%)	0.04%	0.31%	0.21%	0.19%	0.20%
EU 9a	Systemic risk buffer (%)	0.00%	0.00%	0.00%	0.00%	0.00%
10	Global Systemically Important Institution buffer (%)	0.00%	0.00%	0.00%	0.00%	0.00%
EU 10a	Other Systemically Important Institution buffer	0.00%	0.00%	0.00%	0.00%	0.00%
11	Combined buffer requirement (%)	2.54%	2.81%	2.71%	2.69%	2.70%
EU 11a	Overall capital requirements (%)	11.54%	10.81%	10.71%	10.69%	10.70%
12	CET1 available after meeting the total SREP own funds requirements (%)	6.73%	7.02%	7.77%	9.21%	14.61%
<b>Leverage ratio</b>						
13	Leverage ratio total exposure measure	7,206,214.17	6,807,465.10	5,711,745.10	5,404,143.62	3,526,982.23
14	Leverage ratio	9.09%	7.18%	7.91%	7.81%	11.85%
<b>Additional own funds requirements to address risks of excessive leverage (as a percentage of leverage ratio total exposure amount)</b>						
EU 14a	Additional CET1 leverage ratio requirements (%)	-	-	-	-	-
EU 14b	Additional AT1 leverage ratio requirements (%)	-	-	-	-	-
EU 14c	Additional T2 leverage ratio requirements (%)	-	-	-	-	-
EU 14d	Total SREP leverage ratio requirements (%)	-	-	-	-	-
EU 14e	Applicable leverage buffer	-	-	-	-	-
EU 14f	Overall leverage ratio requirements (%)	-	-	-	-	-
<b>Liquidity Coverage Ratio</b>						
15	Total high-quality liquid assets (HQLA) (Weighted value - average)	637,416.19	912,018.00	386,454.62	568,141.65	198,338.09
EU 16a	Cash outflows - Total weighted value	958,802.39	1,834,813.11	1,041,050.58	1,625,394.27	483,404.60
EU 16b	Cash inflows - Total weighted value	1,933,873.44	1,376,109.83	952,843.05	1,357,204.51	362,553.45
16	Total net cash outflows (adjusted value)	239,700.60	458,703.28	260,262.65	406,348.57	120,851.15
17	Liquidity coverage ratio (%)	265.92%	198.83%	148.49%	139.82%	164.12%
<b>Net Stable Funding Ratio</b>						
18	Total available stable funding	3,350,938.91	-	-	-	-
19	Total required stable funding	3,093,276.07	-	-	-	-
20	NSFR ratio (%)	108.33%	-	-	-	-



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## 1. Introduction

### 1.1. Regulatory framework

This Pillar III report complements the capital adequacy assessment and the supervisory review process of Bank of China (Luxembourg) S.A. (hereinafter “the Bank”<sup>1</sup>). Its aim is to encourage market discipline by developing a set of disclosure requirements which allow market participants to assess certain specified information on the scope of application of Basel II capital, particular risk exposures and risk assessment processes, and hence the capital adequacy of the institution. Disclosures consist of both quantitative and qualitative information and are provided at the individual level as per RCSSF 15-02 Article 3.

On 16 April 2019, the European Parliament (EP) approved the final agreement on a package of reforms proposed by EC to strengthen the resilience and resolvability of European banks. The package of reforms comprises certain amendments to CRR and CRD IV commonly referred to as ‘CRR II’ and CRD V’. On 27 June 2019, the Banking Reform Package came into force, subject to various transitional and staged timetables.

The Basel Committee’s framework is based on three pillars. Pillar I on minimum capital requirements, which defines the rules for the calculation of credit, market and operational risk. Pillar II is about Supervisory Review and Evaluation Process (SREP), which requires banks to undertake an internal capital adequacy assessment process (ICAAP) to identify and assess risks, also those not included in Pillar I, and maintain sufficient capital to face these risks, and an internal liquidity adequacy assessment process (ILAAP) focusing on maintaining sufficient liquidity (and funding) risk management. Pillar III is on market discipline and transparency, requiring disclosures to allow investors and other market participants to understand the risk profiles of individual banks.

The Pillar III disclosure have been enhanced with the implementation of Basel III, through Regulation EU No. 575/2013 on prudential requirement for credit institutions and investment firms (“CRR”) as well as Directive 2013/36/EU on access to the activity of credit institutions, the prudential supervision of credit institutions and investment firms (“CRD IV”). The above-mentioned legal

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<sup>1</sup> For purposes of this report, unless the context otherwise requires, the terms “the Bank”, “we”, “us” and “our” mean Bank of China (Luxembourg) S.A., including its Rotterdam Branch, Brussels Branch, Poland Branch, Stockholm Branch and Lisbon Branch, namely Bank of China (Luxembourg) S.A. Rotterdam Branch, Bank of China (Luxembourg) S.A. Brussels Branch, Bank of China (Luxembourg) S.A. Poland Branch, Bank of China S.A. (Luxembourg) Stockholm Branch, Bank of China S.A. (Luxembourg) Lisbon Branch and Bank of China S.A. (Luxembourg) Athens Branch.

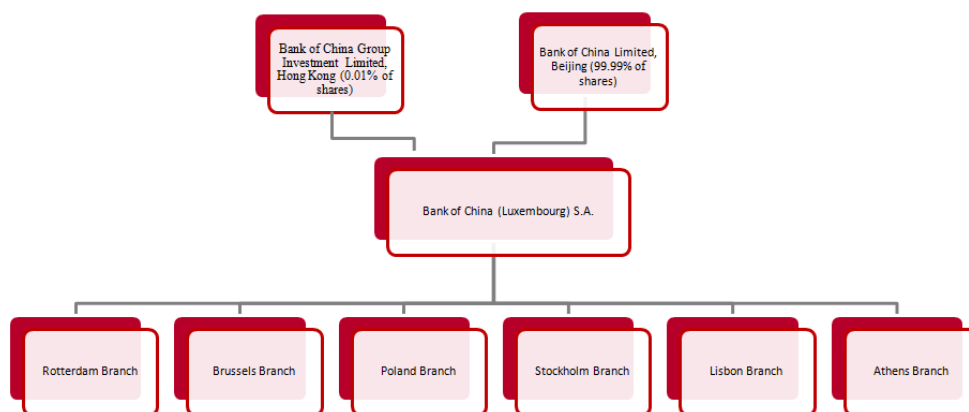
framework is effective from 1st January 2014.

The Pillar III report as ended on 31 December 2020 is prepared in accordance with the highest standard. In June 2020, the EBA published the final ITS on public disclosures (Pillar III) that implements changes introduced in the revised Capital Requirements Regulation (CRR II). Those EBA templates in order to comply with CRR II will be applicable as of June 2021.

## 1.2. Bank of China (Luxembourg) S.A.

Bank of China (Luxembourg) S.A. is a fully-owned subsidiary of Bank of China Limited, Beijing, P.R. of China, though 0.01% is indirectly held by Bank of China Group Investment Limited, Hong Kong. The Bank maintains 6 cross-border branches in continental Europe.

Chart 1.2.1: Organizational structure



## 1.3. Scope of Application

In accordance with Arti.436 of the CRR, the Bank, as an affiliated entity of a parent institution located in a third country, it provides regulatory reporting to the CSSF on an individual basis as a credit institution established under Luxembourg Law and complied with all requirements of Regulation (EU) No. 575/2013 and Directive 2013/36/EU.

The report includes the Bank and its six branches.

## 1.4. Frequency and Means of Disclosure (Art.433 and 434 CRR)

The Bank publishes the Pillar III Report in accordance with Art. 433 of the CRR on annual basis. The Bank will assess the need to disclose information more often in accordance with the EBA Guidelines 2014/14.



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## 1.5. Key Events in 2020

### **Capital enhancement through a perpetual loan agreement**

In 2020, the Bank successfully issued EUR 150 million in perpetual bonds, subscribed by Bank of China Limited, Luxembourg Branch.

This capital increase project was conducted to reinforce the Bank's capital structure, based on capital planning to support the Bank's sustainable development and to improve the resilience in term of loss absorption.

The recognition of the additional Tier I capital had a positive impact of 2 - 3% on CAR.

### **Quick response, timely adjustment of credit policy**

The Bank had adopted strategies and special process based on risks and consequence induced by Covid-19 crisis.

Regarding commercial strategy, more detailed guidelines are elaborated and communicated to all the core business lines and material legal entities.

## 1.6. Key changes in 2020 Pillar III Report

### **Regulatory updates**

The following regulatory updates formed part of CRR as amended by CRR II prior to 31 December 2020 and EBA guidelines have already been applied into this disclosures, whereas the implementation of the draft ITS will be done after the European Commission has approved them.

### **EBA Guidelines on reporting and disclosure as a result of the CRR “quick fix” adjustments in response to the COVID - 19 pandemic**

Regulation (EU) 2020/873 of the European Parliament and of the Council of 24 June 2020 amending Regulations (EU) No 575/2013 and (EU) 2019/876 (CRR II) as regards certain adjustments in response to the Covid-19 pandemic (CRR ‘quick fix’) was published in the Official Journal of the EU on 26 June 2020.

The CRR ‘quick fix’ is part of a series of measures taken by European institutions to mitigate the impact of the Covid-19 pandemic on institutions across EU Member States. In addition to the flexibility already provided in the existing rules, the CRR ‘quick fix’ introduces certain adjustments to the CRR, including temporary measures, intended to enhance credit flows to companies and households, thereby supporting the EU’s economy. The adjustments that have an impact on our



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disclosures are as follows:

- frontloading from CRR II the possibility of temporarily excluding certain exposures to central banks from the calculation of an institution's total exposure measure (Article 500b of Regulation (EU) No 575/2013);
- frontloading from CRR II the possibility to not deduct from CET1 capital certain software assets, but assign RWA instead. The scope of assets subject to this exemption was defined by Commission Delegated Regulation (EU) 2020/2176 published on 22 December 2020; and
- A 2 years extension transitional arrangements for mitigating the impact on own funds of the introduction of IFRS 9 (Article 473a (8) of Regulation (EU) No 575/2013).

In August 2020, the EBA issued guidelines to provide institutions with the necessary clarifications on how to apply the measures set out in the CRR 'quick fix'. These Guidelines are an interim solution until the new comprehensive Implementing Technical Standards (ITS) on disclosure start to apply (June 2021).

#### **EBA Guidelines on reporting and disclosure of exposures subject to measures applied in response to the COVID-19 crisis**

In response to the need to address negative economic consequences of COVID-19 pandemic, the European Union (EU) and Member States have introduced a wide range of mitigating measures to support the real economy and the financial sector. As part of such measures, some Member States have introduced legislative moratoria on loan repayments granting the borrowers various forms of payment holidays on their existing loans. In other Member States similar measures have been introduced under individual institutions' industry-coordinated initiatives. Many Member States have also introduced various forms of public guarantees to be applied to new lending.

As a coordinated approach to the collection of information regarding the application of the payment moratoria to the existing loans and public guarantees to new lending in response to COVID-19 pandemic, the EBA introduced additional disclosure requirements covering both aspects. The guidelines are built on the existing definitions of Commission Implementing Regulation (EU) No 680/2014 (FINREP) and put forward strictly in the context of the Covid-19 pandemic, and are therefore expected to be time-limited.

This report includes 3 new tables per the EBA guidelines (EBA/GL/2020/07) published in June 2020 which introduced additional disclosure requirements in relation to the application of payment moratoria to existing loans as well as new lending subject to public guarantees schemes.

#### **Final draft ITS on institutions' public disclosures of the information referred to in Titles II and III of Part Eight of Regulation (EU) No 575/2013**

In June 2020, the EBA published the final draft ITS on public disclosures by institutions that



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implements changes introduced in the revised Capital Requirements Regulation (CRR II). The publication of the ITS is a major step forward towards promoting market discipline through enhanced and comparable public disclosures for stakeholders, and towards keeping the reporting requirements in line with the evolving needs for Supervisory Authorities' risk assessments.

The disclosure ITS optimise the Pillar III policy framework for credit institutions by providing a single overarching package that brings together all previous pieces of regulation and incorporates all prudential disclosures, thus facilitating implementation by institutions and improving clarity for users of such information. The ITS implement the disclosures in a way to ensure that market participants have sufficient and comparable information to assess the risk profiles of institutions, in line with the Basel Committee's Pillar III standards and with the increased standardisation of institutions' public disclosures. This reinforces the ultimate objective of market discipline. The CRR II definitions for 'small and non-complex institutions' and 'large institutions' support proportionality of Pillar III disclosures. In addition, the ITS include thresholds to trigger additional disclosures for large banks based on their risk profiles. The ITS on disclosure have been developed in accordance with the mandate included in Article 434a of Regulation (EU) N0 575/2013.

## 2. Risk Management

The Bank continued to improve its risk management systems in line with the BOC Group's strategies and ensuring compliant operation. Amid the global spread of COVID-19 and the economic downturn, the Bank strengthened emergency management, established a pandemic response mechanism at the Group level, focused on potential risks in key areas, and reinforced the risk management and control of the Bank and its branches.

The Bank continued to improve the compliance of its effective risk data aggregation and risk reporting, actively responded to reform of the inter-bank offered rate (IBOR), so as to ensure compliant operation. The Bank also refined its risk management system, promoted the building of the "Three Lines of Defence" for risk management, and strengthened the development of business departments as the middle office of risk control. At present, the risk function of the Bank is operating stably and all aspects of risk are and were within our capacity and appetite.

### 2.1. Internal Governance

As stated in article 9 of the CSSF Circular 12/552 and amended by 20/759, Internal Governance shall ensure in particular sound and prudent business management, including the risks inherent in them.

### 2.2. Structure and Organization of Risk Management

#### 2.2.1. Board of Directors



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The Board of Directors have the overall responsibility for the Bank. They monitor and bear responsibility for the implementation of key elements of the central administration, internal governance and risk management arrangements, including but not limited to the followings:

- the business strategy and its long-term financial interests, solvency, liquidity situation and risk appetite. The development and maintenance of a sustainable business model requires that account be taken of all material risks, including environmental, social and governance risks;
- the risk strategy, including the risk appetite and the overall framework for risk-taking and risk management of the institution;
- the strategy with respect to regulatory and internal capital and liquidity reserves;
- the guiding principles relating to the remuneration policy;
- the guiding principles relating to business continuity and crisis management.

The Board of Directors meet regularly, directs and oversees the Bank. It has the duty to individually and collectively exercise their powers in the best interest of the Bank. In addition, the board is supported by two specialised committees for performing its duties: the Board Audit Committee and the Board Risk and Compliance Committee.

During the year of 2020, a total of 4 Board of Directors' ordinary meetings and 7 decisions in writing, 4 Board Audit Committee meetings and 4 Board Risk and Compliance Committee and one Recovery Plan workshop were carried out, which deliberated on various topics with the consultation of Authorised Management and the internal control functions as appropriate.

Furthermore, the BOD receives on a quarterly basis, the overall risk assessment of the Bank based on the previous quarter activity. These quarterly risk reports include a systematic dashboard where all the Key Performance Indicators and limits are indicated, as well as deliver stress testing results on liquidity to the BOD.

All the material matters which would affect the Bank's overall risk profile and any breaches on the internal limits are promptly reported to the BOD. There were no significant deficiencies or breaches in 2020 to be reported.

**The Board Audit Committee (BAC)** assists the Board of Directors in the areas of financial information, internal control, including internal audit as well as the audit by the réviseur d'entreprises agréé.

During the year 2020, four BAC meetings were held.

The BAC ensured to cover their responsibilities outlined in the revised Audit Committee charter during the year such as:



- 
- Supervision of the external auditor by:
    - Reviewing the annual financial statements, Management Letter...;
    - Debriefing with the external auditor;
    - Following up of the Management Letter points;
    - Recommendation for the appointment of external auditor to the BOD.
  
  - Supervision of the internal audit function by :
    - Reviewing the internal audit reports;
    - Approving the internal audit plan and all major changes to the plan;
    - Ensuring the appropriate follow up of the recommendations of the internal audit function.

The BAC reported to the BOD on the different topics it discussed.

**The Board Risk & Compliance Committee ("BRCC").** BRCC advises the Board of Directors on aspects related to the overall risk and risk appetite strategy and also to assist it in assessing the correlation between the incurred risks, the Bank's ability to manage these risks, and the internal and regulatory capital and liquidity reserves..

In 2020, four meetings were held during the year; regular risk and compliance function reports, annual ICAAP/ILAAP report, annual recovery plan, Pillar III report, liquidity risk management policy, asset encumbrance policy and KRI dashboard monitoring, compliance plan, Customer Due Diligence (CDD) measures, best execution policy, Anti-Money Laundering & Terrorist Financing and Sanctions Risk Appetite Framework etc. were reviewed. The BRCC also participated actively on the Bank's internal risk policies/regulations elaboration and approval. In 2020, the BRCC also focused on the risks induced by COVID-19 and closely followed the asset quality through the moratorium list, special mention list, IFRS 9 Stage 2 list and ECL provision level. The potential operational risk related to remote working during the Covid-19 is also a recurring topic.

#### 2.2.2. General management

It is composed of the General Manager and Deputy General Managers, the Authorised Management (AM) in charge of the effective, sound and prudent day-to-day management of the activities (and inherent risks). AM exercise in compliance with the strategies and guiding principles approved by the Board of Directors and the applicable regulations, by considering and safeguarding the Bank's long-term financial interests, solvency and liquidity situation. The authorised management critically assess all the proposals, explanations and information submitted to it for decision which includes following main responsibilities:

- To ensure the activities of the Bank are in compliance with the existing law;
- To ensure the implementation of strategies and guiding principles lay down by BOD through internal written policies and procedures;



- To implement promptly and effectively the corrective measures to address the weaknesses identified by second/third line of defence as well as regulators;
- To oversee and manage the Bank's risks, including the compliance with requirements for internal and regulatory own funds and for liquidity.

### 2.2.3. Roles and responsibilities of the management committees

Different committees are set up for the management of various risks, to which the Bank is exposed. In 2020, the Bank had the following committees:

Committee	Responsibilities
<b>Assets &amp; Liabilities Committee</b>	Responsible for the review of the Bank's current assets and liabilities situation, the reporting to the General Management on issues raised regarding assets/liabilities mismatch, shortfall of funding, etc. It aims at harmonizing asset/liability match on currency, term and interest rate. It bears also the responsibility of the liquidity risk management, including liquidity stress test and contingency funding plan.
<b>Risk Management and Internal Control Committee</b>	Responsible for deliberating and evaluating the various operational risk-controlling objectives and managing means of the Bank, including but not limited to the credit risk, market risk, interest rate risk on banking book, liquidity risk, and operational risk exposures. RMICC also bears the responsibility for the subsequent appraisal of risks control and implementation.
<b>Credit Review Committee</b>	Responsible for appraising the credit risk on the Bank's loan project.
<b>New Product Committee</b>	Takes the responsibilities to ensure that new product development adhere to the local regulatory requirements, including approval by the General Management, prior risk assessment and analysis carried out by relevant departments, pricing and risk control etc. The new product management policy is reviewed in 2019 so as to enhance the preliminary risk assessment and post appraisal of the product launched.
<b>Compliance Committee</b>	Is responsible to strengthen the overall compliance risk management, a Compliance Committee was formed in 2014 which replaced the Anti-Money Laundering Group (AML Group), and the scope of the Compliance Committee encompasses that of the AML Group and includes all Compliance matters. The objective of the Committee is to ensure that there is an effective Compliance framework within the Bank and compliance risks are adequately managed.
<b>Bulk Purchase Committee</b>	Is responsible for appraising and approving on the Bank's bulk acquisition of products or services above € 30,000 (excluding VAT) through purchase, lease and / or other methods of assignment.
<b>Investment Committee</b>	Is responsible for constructing, implementing and monitoring the investment policy, model portfolios, and the selection of products that customers' assets will be invested in, chaired by the Deputy General Manager in charge of Banking Department and composed of all investment advisers, a member of the Risk Management Department and a member of the Financial Department.
<b>Personal Data Protection Committee</b>	PDPC had been formed in the scope of implementation of GDPR, the roles of PDPC are to support Data Protection Officer in carrying his tasks and providing oversight and guidance on data protection matters of the Bank. PDPC is chaired by a member of the General Management and its members are from representatives of Compliance, IT, Risk management & HR functions. PDPC meets at least quarterly and keeps an oversight on the adherence to requirements of GDPR.
<b>Asset Disposal Committee</b>	ADC is a newly established committee in 2019 for the purpose to assure an appropriate level of discipline and compliance of asset disposal is established and write-off work is carried out across the Bank. The committee discusses the asset disposal related matters in order to achieve the best possible return of problem credit asset.

## 2.3. Risk management framework

In order to achieve governance objectives, institutions establish internal arrangements which are consistent with the three-lines-of-defense model.



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The first line of defense consists of the business units that take or acquire risks under a predefined policy and limits, operating the first level of control to mitigate risks. It also includes the supporting function such as the Finance and IT functions.

The second line is formed by compliance and risk control functions which contribute to the independent risk control.

The third line consists of the internal audit function which provides an independent, objective and critical review of the first two lines of defense.

### First line of defense

The Bank's first line of defense consists of the **Front Office and Operational** units, which are directly involved in the daily operational work. The operating staff should carry out day-to-day work on a four-eye's principle to prevent the possible errors and omissions that occurred during the processing of the transactions.

**The Finance Department (FD)** maintains adequate controls over its accounting and record-keeping processes for all business activities on a daily basis. It is also responsible for effective management and control of all its operations as well as for financial and regulatory reporting to the H.O. and regulators. Finance Department bears the responsibility to formulate and monitor processes of the liquidity risk management, and to allocate and manage the regulatory capital and large risk exposure of the Bank.

**The IT Department (FD)** is responsible for the reliability and security of processed data. The Bank has in place, physical access controls, environmental controls, logical security controls, and controls over access to information systems. The Bank has a well-documented and regularly tested Disaster Recovery Plan and a documented Business Continuity Plan covering all its critical business processes and activities.

On an annual basis, the Bank carries out its annual 'Internal Control Self Assessment' which is independently reviewed by the Internal Auditor and supervised by the H.O. since 2007. The last Internal Control Self Assessment was performed in 2020.

### Second line of defense

**The Risk Management Department (RMD)** has the responsibility of the day-to-day management pertaining to credit risk, market risk, and operational risk of the Bank. It is responsible for performing risk assessment, informing and reporting on any major changes to relevant departments, to monitor all categories of risks and reviewing the efficiency of the Bank's risk management framework. It is also responsible for drafting risk management policies and procedures, developing risk management



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techniques, and coordinating the anticipation, identification, measurement, monitoring, control and reporting of various risks which the Bank is exposed to. RMD is also in charge of the management, review and supervision of all entities regarding risk management.

**The Compliance & Regulatory Department (CRD)** is an independent function with the objective to anticipate, identify and evaluate the compliance risks within the Bank. It organizes, coordinates and structures compliance-related centralized controls, as well as controls and monitors all measures taken to manage the compliance risks, reporting accordingly to Authorized Management and the BOD, as appropriate, and acts as an adviser in compliance matters within the Bank.

**The legal team** has the responsibility to effectively identify legal risks of the Bank, and to proactively manage these risks. Legal handles all legal matters of the Bank, which inter alia includes identifying legal obligations e.g. applicable laws and regulations which the Bank must adhere to in the exercise of its businesses, as well as perform a legal watch on legal developments that may impact the Bank, and to advise them to the Bank.

### Third line of defense

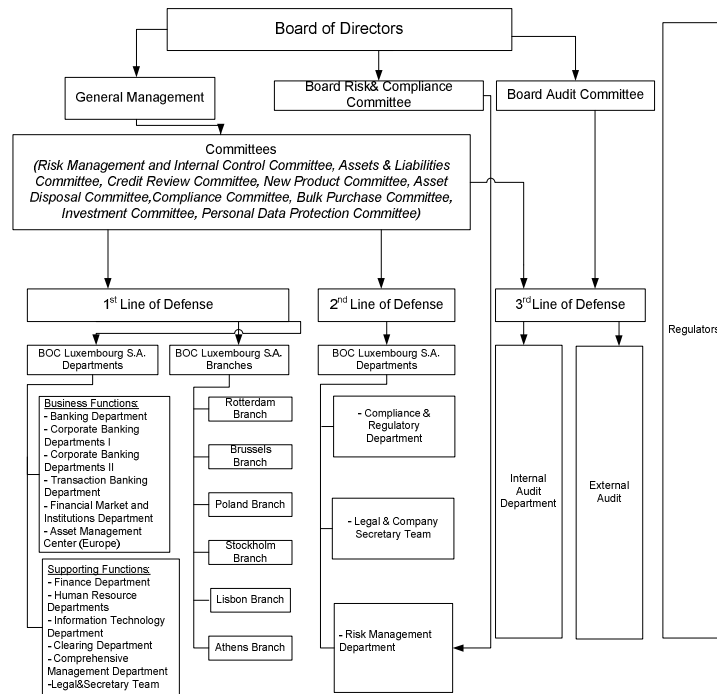
**The Internal Audit Department (IAD)** is an independent, objective supervision and evaluation activity which helps the organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate the adequacy and effectiveness of risk management and internal control.

The Internal audit function reviews and assesses whether central administration and internal governance arrangements are adequate and operate effectively, as set out in the Internal Audit Charter approved by the BOD, including internal controls' efficiency and effectiveness, safeguarding of the securities and assets, adequacy of the segregation of duties and the execution of the transactions, adequacy of the risk and capital management.

The Internal Auditor reports functionally to the BAC and the BOD, administratively to the General Management and is under the supervision of the Parent Bank's internal audit department.



The control governance and framework



2.3.1. Risk management process and policies

The purpose of the Bank’s Risk Management Policy is to ensure the implementation of an effective risk management framework and internal control environments which is in line with the Bank’s risk strategy and risk appetite. In doing so, it follows the Luxembourg regulator’s laws and regulations, H.O.’s procedures and guidelines, as well as standard adopted by other peer financial institutions.

Risk Management is part of the management function in the organization. It has the mission and objective to evaluate the Bank’s risk profile, to put in place appropriate internal controls and to monitor the effectiveness of these controls. The aim is to ensure that the risk management is embedded in the Bank’s processes and culture, thus contributing to the achievement of its core objectives. This process is supplemented with a review of BOD, General Management and RMICC.

In line with risk appetite, the Bank develops a five steps risk management process:

- ❖ **Risk anticipation.** The Bank should anticipate the potential risk related to its business activities, and proactively prevent, reduce the likelihood of damage and loss.
- ❖ **Risk identification.** The Bank should identify the various risk categories and risk factors, and pay close attention to the transformation between different risks.



- ❖ **Risk assessment.** The Bank is required to elaborate a risk assessment program, including assessment scope and method for each identified risk category and finally draw assessment result on each risk category as well as overall risk.
- ❖ **Risk monitoring and reporting.** The Bank sets and continuously improves the monitoring indicators, analyzing results by using relevant monitoring tool and system. Periodical reports are produced and reported to the General Management and the BOD. Necessary risk information is disclosed to investors or public pursuant to the regulators' requirements.
- ❖ **Risk control.** The Bank is required to accurately assess and monitor risks and carry out the risk management by using measures such as: diversification, hedging, transfer, prevention, compensation and mitigation. The proper and effective measures should be taken when there are early warning indicators (limits, KRI threshold etc). In case there are exceptions, it is necessary to respond with an appropriate plan and management procedures. In case of weaknesses or failures identified, the risk control function should follow up on the corrective measures taken by relevant departments.

### 2.3.2. Risk reporting

The risk situation of the Bank is communicated via a comprehensive reporting system to the Management and other relevant persons and any significant events or material risks are escalated to the Board of Directors.

Reporting to the management includes:

- Risk management report;
- Compliance report;
- Internal audit report;
- Common reporting (COREP) and Large Exposures reports.

### 2.3.3. Risk management strategy

The Bank's Risk Management Policy ensures the implementation of an effective risk management framework and internal control environment, which is in line with the Bank's risk strategy and risk appetite. In doing so, it follows Luxembourg laws and regulations, Head Office procedures and guidelines, as well as standards adopted by other financial peers.

Risk Management is an integral part of the management function in the organization. It has the vocation to evaluate the Bank's risk profile, to set up appropriate internal controls and to monitor the effectiveness of these controls. The aim is to ensure that the risk management is embedded in the Bank's processes and culture, thus contributing to the achievement of the Bank's core objectives. This process is supplemented with a review by the BOD, AM and RMICC.

### 2.3.4. Risk identification and quantification



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The Bank assesses its material risks and non-material risks by taking into consideration the size and complexity of the Bank's business.

The quantification of the risks is through the standardised method defined in the CRR. Moreover, the Bank performs various stress tests to assess the financial viability and the adequacy of capital and liquidity.

### 2.3.5. Risk appetite

The risk appetite refers to the overall risk type and level that the Bank is willing to bear within its risk capacity in order to satisfy the expectation of shareholders, depositors, investors, regulators and other stakeholders and ensure stable operations and sustainable development to achieve strategic goals and business plans.

The risk appetite is an important component of the business and risk strategies of the Bank, and guides operation and management.

The Bank aims to see steady business development and continuous profit growth; ensure effective risk control and fully-implemented compliance; gain better corporate governance practices and optimize management procedures; and complete institutional integration and make integrated regional development more mature, seeking to become a "localized", "modernized" and "digitalized" bank.

The Bank applies rigorous control over credit extension to industries with high energy consumption, high pollution and overcapacity.

At the Bank's level, we developed a comprehensive set of KRIs and high-level tolerance for all risk categories as a way to closely monitor the risk appetite. The BOD reviews and approves both risk appetite and tolerance for selected KPIs. The cross-border branches have been assigned separate credit risk, market risk and operational risk indicators.

## 3. Own Funds

The calculation of our regulator capital incorporates the capital requirements following the "Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firm" (Capital Requirements Regulation or CRR) and the "Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms" (Capital Requirement Directive IV or CRD IV) as implemented into Luxembourg Law. The information in this section is based on the regulatory principles of consolidation.



As at 31 December 2020, the breakdown of prudential regulatory capital requirement was the following:

Regulatory minimum of capital requirement	31/12/2020	31/12/2019
Minimum requirement for CET1 capital	4.50%	4.50%
Tier 1 capital	6.00%	6.00%
Additional CET1 SREP requirements	1.00%	
Total SREP capital requirement	9.00%	8.00%
Minimum requirement for capital conservation buffer	2.50%	2.50%
countercyclical buffer	0.04%	0.31%
<b>Overall Capital Requirement (OCR)</b>	<b>11.54%</b>	<b>10.81%</b>

As of 1 January 2014, the CRR/CRD IV capital rules entered into force. According to CRR/CRD IV capital adequacy rules, the Common Equity Tier 1 ratio has to be at least 4.5%, the Tier 1 ratio at least 6 % and the total capital ratio at least 8% of all risk-weighted assets. This was not changed in the CRR II /CRD V.

Additional prudential requirement for the Bank was complied with. As of 1 January 2020, the Bank maintains an overall capital requirement (OCR) which is sum of the total SREP capital requirement (TSCR) and the combined buffer requirement.

### 3.1. Total SREP Capital Requirement

The TSCR, which must be met at all times, is set at 9% of the Bank's Total Risk Exposure Amount as defined in article 92(3) of CRR.

Of these 9% of TREA:

- 8% of TREA represent own funds requirements as specified in Article 92(1) of CRR;
- 1% of TREA represent the additional own funds (in excess of the requirements specified in Article 92 of CRR) further to article 28(1) of CSSF Regulations 15-02, of which 100% must be CET1 capital.

### 3.2. The Combined buffer Requirement

The combined buffer requirement is the CET1 capital corresponding to the sum of the following:

- 2.5% of TREA corresponding to the capital conservation buffer as defined in Article 59-5 LFS;
- The amount of CET1 resulting from the application of CSSF Regulation 15-01(countercyclical capital buffer), if applicable;



- The higher of the amount of CET1 resulting from the application of Article 59-9 LFS (buffer for the other systemically important institutions – OSII-buffer) and Article 59-10 and 59-11 LFS (systemic risk buffer), if applicable.

### 3.3. Structure of Own fund

The Bank's own funds are calculated in compliance with Art. 72 of the CRR: Own funds consist of the sum of Tier I capital (Common Equity Tier 1 (CET1) and Tier 2 Capital.

The Bank's own regulatory funds as at 31<sup>st</sup> December 2020 are composed of:

- Tier 1 capital consists of paid-up capital and eligible reserves (including reported profit/loss and valuation spread, subject to prudential filter), the subscribed capital of the Bank is fixed at EUR400 million, represented by fifty thousand shares without any par value since 28th November 2016.
  - Additional Tier I capital which consists of with EUR150 million of perpetual loan issued on 24th June 2020 in compliance with CRR art 52-54. This loan is subscribed by Bank of China Limited, Luxembourg Branch.
  - The Bank has a Tier 1 capital of EUR655.00 million as at 31st December 2020. The increase in 2020 is mainly due to the 2019's profit brought forward and the new perpetual loan.
- Tier 2 capital consists of a subordinated loan amounted to EUR106 million granted by Bank of China Luxembourg Branch in compliance with CRR art 63. The Bank disposes a total Tier 2 capital of EUR106.40 million as at 31st December 2020.

The following table details the own fund disclosure in accordance with the Annex IV of the Regulation (EU) No 1423/2013:

TABLE 3.3.1 Regulatory capital composition, prudential filters and deduction items



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Own funds disclosure template		2020 ('000)
<b>Common Equity Tier 1 (CET1) capital: instruments and reserves</b>		
1	Capital instruments and the related share premium accounts	
	of which: Instrument type 1 (ordinary shares)	400,000.00
	of which: Instrument type 2	
	of which: Instrument type 3	
2	Retained earnings	81,131.43
3	Accumulated other comprehensive income (and other reserves)	24,056.23
3a	Fund for general banking risk	
4	Amount of qualifying items referred to in Article 484 (3) and the related share premium accounts subject to phase out from CET1	
5	Minority interest (amount allowed in consolidated CET1	
5a	Independently reviewed interim profits net of any foreseeable charge or dividend	
6	Common Equity Tier 1 (CET1) capital before regulatory adjustments	505,187.67
<b>Common Equity Tier 1 (CET1) capital before regulatory adjustments</b>		
7	Additional value adjustments	
8	Intangible assets (net of related tax liability)(negative amount)	(197.79)
9	<b>Total regulatory adjustments to Common Equity Tier 1 (CET1)</b>	<b>(197.79)</b>
10	<b>Common Equity Tier 1 (CET1) capital</b>	<b>504,989.88</b>
<b>Additional Tier 1 (AT1) capital: instruments</b>		
	Capital instruments and related share premium accounts	150,014.26
	of which: classified as equity under applicable accounting standards	
	of which: classified as liabilities under applicable accounting standards	150,014.26
	<b>Additional Tier 1 (AT1) capital before regulatory adjustments</b>	<b>150,014.26</b>
<b>Tier 2 (T2) capital: instruments and provisions</b>		
11	Capital instruments and the related share premium accounts	106,408.04
12	Amount of qualifying items referred to Article 484(5) and the related share premium accounts subject to phase out from T2	
13	Qualifying own funds instruments included in consolidated T2 capital (including minority interests and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties	
14	of which: instruments issued by subsidiaries subject to phase out	
15	Credit risk adjustments	
16	<b>Tier 2 (T2) capital before regulatory adjustments</b>	<b>106,408.04</b>
<b>Tier 2 (T2) capital: regulatory adjustments</b>		
17	<b>Total regulatory adjustments to Tier 2 (T2) capital</b>	
18	<b>Tier 2 (T2) capital</b>	<b>106,408.04</b>
19	<b>Total capital (TC=T1+T2)</b>	<b>256,422.30</b>
20	<b>Total risk weighted assets</b>	<b>4,128,678.37</b>
<b>Capital ratios and buffers</b>		
21	Common Equity Tier 1 (as a percentage of total risk exposure amount)	12.23
22	Tier 1 (as a percentage of total risk exposure amount)	15.86
23	Total capital (as a percentage of total risk exposure amount)	18.44



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24	Institution specific buffer requirement (CET1 requirement in accordance with article 92 (1) (a) plus capital conservation and countercyclical buffer requirements, plus systemically important institution buffer expressed as a percentage of risk exposure amount)	2.54
25	of which: capital conservation buffer requirement	2.50
26	of which: countercyclical buffer requirement	0.04
27	of which: systemic risk buffer requirement	0
28	of which: Global Systemically Important Institution (G-SII) or Other Systemically Important Institution (O-SII) buffer	0
29	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)	12.23
<b>Amounts below the thresholds for deduction (before risk weighting)</b>		
30	Direct and indirect holding of the capital of financial sector entities where the institution does not have a significant investment in those entities (amount below 10% threshold and net of eligible short position)	
<b>Applicable caps on the inclusion of provisions in Tier 2</b>		
31	Credit risk adjustments included in T2 in respect of exposures subject to standardised approach (prior to the application of the cap)	
<b>Capital Instruments subject to phase-out arrangements (only applicable between 1 Jan 2014 and 1 Jan 2022)</b>		
32	Current cap on CET1 instruments subject to phase out arrangement	

### 3.4. Reconciliation of Accounting and Regulatory Equity

This section provides information about the differences of carrying amounts presented in the financial statements and the regulatory exposure of the Bank in accordance with the requirement of Art. 437 1 (a) of the CRR. The following table is the breakdown of the balance sheet into the risk framework used to calculate the regulatory capital requirement.

TABLE 3.4.1 EU LI1 – Differences between accounting scope and the scopes of prudential consolidation and mapping of financial statement categories with regulatory risk categories

(in EUR'000)	Carrying values as reported in published financial statements	Carrying values under scope of regulatory consolidation	Subject to the credit risk framework	Subject to the counterparty credit risk framework	Carrying values of items:		Not subject to capital requirements or subject to deduction from capital
					Subject to the securitisation framework	Subject to the market risk framework	
<b>Assets</b>							
Cash in hand, balances with central banks	521,492	521,492	521,072	-	-	-	419.84
Loans and advances to credit institutions	2,458,124	2,457,949	2,457,949	-	-	-	-
a. repayable on demand	1,408,124	1,408,124	-	-	-	-	-
b. other loans and advances	1,050,000	1,049,825	-	-	-	-	-
Loans and advances to customers	3,363,957	3,372,835	3,372,835	-	-	-	-
Debt securities	146,556	148,237	148,237	-	-	-	-
a. issued by public bodies	146,556	148,237	-	-	-	-	-
Derivatives held for trading	-	11,659	-	11,659	-	-	-
Tangible assets	5,778	17,483	17,483	-	-	-	-
Intangible assets	198	198	-	-	-	-	198
Other assets	6,051	8,037	8,037	-	-	-	-
Prepayments and accrued income	10,769	-	-	-	-	-	-
<b>Total asset</b>	<b>6,512,925</b>	<b>6,537,890</b>	<b>6,525,613</b>	<b>11,659</b>	<b>-</b>	<b>-</b>	<b>618</b>



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Liabilities and Equity						
<b>Amounts owed to credit institutions</b>	<b>1,847,604</b>	<b>1,853,076</b>	-	-	-	<b>1,853,076</b>
a. repayable on demand	28,897	28,897				
b. with agreed maturity dates or periods of notice	1,818,707	1,824,178				
<b>Amounts owed to customers</b>	<b>3,016,103</b>	<b>3,018,172</b>	-	-	-	<b>3,018,172</b>
a. repayable on demand	310,938	310,938				
b. with agreed maturity dates or periods of notice	2,705,164	2,707,234				
<b>Debt evidenced by certificates</b>	<b>798,143</b>	<b>799,102</b>	-	-	-	<b>799,102</b>
<b>Other liabilities</b>	<b>47,446</b>	<b>66,557</b>	-	-	-	<b>66,557</b>
<b>Accruals and deferred income</b>	<b>23,218</b>		-	-	-	
<b>Provisions</b>	<b>21,806</b>	<b>16,990</b>	-	<b>11,872</b>	-	<b>2,323</b>
a. provision for taxation		1,417				
b. other provisions	21,806	15,573		11,872		11,872
<b>Deferred tax liabilities</b>		<b>249</b>	-	-	-	<b>249</b>
<b>Other financial liabilities - IFRS16</b>		<b>12,148</b>	-	-	-	<b>12,148</b>
<b>Subordinated liabilities</b>	<b>256,000</b>	<b>256,422</b>	-	-	-	<b>256,422</b>
<b>Subscribed capital</b>	<b>400,000</b>	<b>400,000</b>	-	-	-	<b>400,000</b>
<b>Legal reserve</b>	<b>6,566</b>		-	-	-	
<b>Other reserve</b>	<b>96,429</b>	<b>103,993</b>	-	-	-	<b>103,993</b>
<b>Currency translation reserve</b>	<b>(397)</b>	<b>(397)</b>	-	-	-	<b>(397)</b>
<b>Fair value changes of debt instruments measured at fair value through other comprehensive income</b>		<b>1,591</b>				<b>1,591</b>
<b>Profit for the financial year</b>	<b>7</b>	<b>9,986</b>	-	-	-	<b>9,986</b>
<b>Total liabilities and Equity</b>	<b>6,512,925</b>	<b>6,537,890</b>	-	<b>11,872</b>	-	<b>6,523,223</b>

The followings are the key differences between regulatory exposure amounts and accounting carrying values under the regulatory scope of consolidation:

- The unrealized gain/loss of derivatives which is accounted in the regulatory exposure but not recognized in accounting carrying values.
- The accrued interest receivable/payable is accounted separately in accounting carrying value, but incorporated in the principal in regulatory exposure.
- Unrealized gain on the Bond portfolio investment are not recognized in accounting carrying value but incorporated in regulatory exposure.
- The deferred tax liabilities are not recognized in accounting carrying value but incorporated in the regulatory liabilities.
- Implementation of IFRS16 for long-term payables of leases is included under regulatory exposure amount but not recognized in accounting carrying amount.

Other differences are due to the consideration of the deferred income tax liabilities.

### 3.5. Regulatory capital

In order to meet the requirements for disclosure specific items on own fund and the nature and amounts of the prudential filters and restrictions applied to the calculation of own funds in accordance with the Article 437(1) of the CRR are specified in the Commission Implementing Regulation (EU) No 1423/2013 of 20 December 2013.

The capital instruments main features are detailed in the table below, in accordance with the Annex II of the Regulation (EU) No 1423/2013.



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Table 3.5.1 EU CCA: Main features of regulatory own funds instrument and eligible liabilities instrument

Capital Instruments main features template								
1	Issuer	Bank of China (Luxembourg) S.A.	Bank of China (Luxembourg) S.A.	Bank of China (Luxembourg) S.A.	Bank of China (Luxembourg) S.A.	Bank of China (Luxembourg) S.A.	Bank of China (Luxembourg) S.A.	Bank of China (Luxembourg) S.A.
2	Unique identifier (eg CUSIP, ISIN or Bloomberg identifier for private placement)	N/A	N/A	N/A	N/A	N/A	N/A	N/A
3	Governing law(s) of the instrument	Luxembourg Law	Luxembourg Law	Luxembourg Law	Luxembourg	Luxembourg	Luxembourg	Luxembourg Law
Regulatory treatment								
4	Transitional CRR rules	CET1	CET1	CET1	CET1	CET1	AT1	Tier 2
5	Post-transitional CRR rules	CET1	CET1	CET1	CET1	CET1	AT1	Tier 2
6	Eligible at solo/(sub-)consolidation/ solo & (sub-)consolidated	Solo & consolidated	Solo & consolidated	Solo & consolidated	Solo & consolidated	Solo & consolidated	Solo & consolidated	Solo & consolidated
7	Instrument type (types to be specified by each jurisdiction)	Registered shares	Registered shares	Registered shares	Registered shares	Registered shares	Perpetual loan	Subordinated debt
8	Amount recognised in regulatory capital (currency in EUR, as of most recent reporting date)	500,000,000 LUF (corresponding to 12,394,676.24 EUR)	EUR 5,323,76	EUR 67.6 million	EUR 120 million	EUR 200 million	EUR 150 million	EUR 106.40 million
9	Nominal amount of instrument	EUR 12,394,676.24	EUR 5,323,76	EUR 67.6 million	EUR 120 million	EUR 200 million	EUR 150 million	EUR 106 million
9a	Issue price	N/A	N/A	N/A	N/A	N/A	N/A	N/A
9b	Redemption price	N/A	N/A	N/A	N/A	N/A	N/A	N/A
10	Accounting classification	Shareholder's equity	Shareholder's equity	Shareholder's equity	Shareholder's equity	Shareholder's equity	Subordinated Liability	Subordinated Liability
11	Original date of issuance	7/5/1991	21/5/2002	2/7/2008	14/8/2012	28/11/2016	5/6/2020	16/07/2018
12	Perpetual or dated	Perpetual	Perpetual	Perpetual	Perpetual	Perpetual	Perpetual	Dated
13	Original maturity date	N/A	N/A	N/A	N/A	N/A	N/A	17/07/2028
14	Issuer call subject to prior supervisory approval	N/A	N/A	N/A	N/A	N/A	N/A	N/A
15	Optional call date, contingent call dates and redemption amount	N/A	N/A	N/A	N/A	N/A	N/A	N/A
16	Subsequent call dates, if applicable	N/A	N/A	N/A	N/A	N/A	N/A	N/A



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<b>Coupons / dividends</b>								
17	Fixed or floating dividend/coupon	N/A	N/A	N/A	N/A	N/A	Floating	Floating
18	Coupon rate and any related index	N/A	N/A	N/A	N/A	N/A	euribor	euribor
19	Existence of a dividend stopper	N/A	N/A	N/A	N/A	N/A	N/A	N/A
20a	Fully discretionary, partially discretionary or mandatory (in term of timing)	N/A	N/A	N/A	N/A	N/A	Fully	Mandatory
20b	Fully discretionary, partially discretionary or mandatory (in term of amount)	N/A	N/A	N/A	N/A	N/A	Fully	Mandatory
21	Existence of step up or other incentive to redeem	N/A	N/A	N/A	N/A	N/A	N/A	N/A
22	Noncumulative or cumulative	N/A	N/A	N/A	N/A	N/A	Non-cumulative	Non-cumulative
23	Convertible or non-convertible	N/A	N/A	N/A	N/A	N/A	Non-convertible	Non-convertible
24	If convertible, conversion trigger(s)	N/A	N/A	N/A	N/A	N/A	N/A	N/A
25	If convertible, fully or partially	N/A	N/A	N/A	N/A	N/A	N/A	N/A
26	If convertible, conversion rate	N/A	N/A	N/A	N/A	N/A	N/A	N/A
27	If convertible, mandatory or optional conversion	N/A	N/A	N/A	N/A	N/A	N/A	N/A
28	If convertible, specify instrument type convertible into	N/A	N/A	N/A	N/A	N/A	N/A	N/A
29	If convertible, specify issuer of instrument it converts into	N/A	N/A	N/A	N/A	N/A	N/A	N/A
30	Write-down features	N/A	N/A	N/A	N/A	N/A	Yes	N/A
31	If write-down, write-down trigger(s)	N/A	N/A	N/A	N/A	N/A	Write down trigger is 7% of CET 1 Ratio of	N/A
32	If write-down, full or partial	N/A	N/A	N/A	N/A	N/A	Permanent and irrevocable.	N/A
33	If write-down, permanent or temporary	N/A	N/A	N/A	N/A	N/A	N/A	N/A
34	If temporary write-down, description of write-up mechanism	N/A	N/A	N/A	N/A	N/A	N/A	N/A
35	Position in subordination, hierarchy in liquidation (specify instrument type immediately senior to instrument)	N/A	N/A	N/A	N/A	N/A	N/A	N/A
36	Non-compliant transitioned features	N/A	N/A	N/A	N/A	N/A	N/A	N/A
37	If yes, specify non-compliant features	N/A	N/A	N/A	N/A	N/A	N/A	N/A

### 3.6. Overview of RWAs

In accordance with Article 138 (c) to (f) in the CRR, the following table shows RWA and regulatory capital requirements broken down by risk types and model approaches compared to previous year end in 2019. The capital requirement amounts have been obtained by applying 8% to the corresponding weighted risks.

Table 3.6.1 EU OV1- Overview of RWAs

(in EUR'000)	RWAs		Minimum capital requirements
	31/12/2020	31/12/2019	31/12/2020
Credit risk (excluding CCR)	3,961,002.49	4,082,786.51	316,880.20
Of which the standardised approach	3,961,002.49	4,082,786.51	316,880.20
Counterparty credit risk (CCR)		2,866.09	
Of which mark to market			
Of which original exposure			
Of which: standardised approach for counterparty credit risk	3,698.52	2,866.09	295.88
Market risk		17,677.81	
Of which the standardised approach (SA)		17,677.81	
Operational risk	163,977.35	137,607.87	13,118.19
Of which basic indicator approach	163,977.35	137,607.87	13,118.19
Of which standardised approach			
Of which advanced measurement approach			
Total	4,128,678.37	4,240,938.27	329,998.39

The total RWA for the Bank was EUR 4.13 billion and decreased about 2.65% compared to previous year end, the decrease of RWA is mainly due to decrease in credit risk as the result of loan matured and less new development for corporate loan portfolio in local markets. Counterparty credit risk was increased 30% to EUR3.7 million.

Market Risk was not subject to own fund requirement at year end while RWA for Operational Risk increased by EUR 26 million in 2020.

### 3.7. Capital Buffer

The Pillar 1 CET 1 minimum capital requirement applicable to the Bank is 4.5% of the risk-weighted assets, the Pillar 1 total capital requirement is 8% and the Bank is not subject to an additional Pillar 2 requirement (SREP add-on). In addition to this minimum capital requirement, the following combined capital buffers were fully effective in 2020. The capital conservation buffer requirement in accordance with the Art 129 of the CRD IV is 2.5% CET 1 capital of RWA. The institution-specific countercyclical buffer that applies to the Bank is the weighted average of the countercyclical capital buffers that apply in the jurisdictions where the relevant credit exposures are located. As of 31 December 2020, the countercyclical capital buffer rate was at 0.04 %.



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### 3.7.1. Capital conservation buffer

As per the requirement in Art 129 of CRD IV, the Bank maintained a capital conservation buffer of 2.5% of its total exposures, under the form of Common Equity Tier 1.

### 3.7.2. Countercyclical Buffer

In accordance with Article 440 (a) and (b) of the CRR, the following table disclose the Bank's specific countercyclical buffer as well as the geographical distribution of credit exposures relevant for the calculation as set out in Commission Delegated Regulation (EU) 2015/1555.

Countercyclical capital buffer rates are determined by Basel Committee member jurisdictions. The final bank-specific buffer add-on rate applies the weighted average of countercyclical capital buffer rates in jurisdictions to which the bank has credit exposures. The Bank does not have Trading book exposure and Securitisation exposure that relates to the calculation of specific countercyclical capital buffer as the 31 December 2020.

TABLE 3.7.1 EU CCyB1 - Geographical distribution of credit exposures relevant for the calculation of the countercyclical capital buffer



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2020	General credit exposures	Own fund requirements				
In EUR'000	Exposure value under the standardised approach	Relevant credit risk exposures - Credit risk	Total	Risk-weighted exposure amounts	Own fund requirements weights (%)	Countercyclical buffer rate (%)
<b>Breakdown by country:</b>						
Belgium	214,000	17,120	17,120	235,182	6.46%	0.00%
Bermuda	34,993	2,799	2,799	34,993	1.06%	0.00%
Colombia	7,666	613	613	7,666	0.23%	0.00%
Curacao	7,894	632	632	7,894	0.24%	0.00%
Denmark	113,528	9,544	9,544	119,333	3.60%	0.00%
Spain	163,919	9,875	9,875	123,439	3.73%	0.00%
Finland	92,499	7,400	7,400	92,499	2.79%	0.00%
France	76,986	6,159	6,159	76,986	2.32%	0.00%
United Kingdom	195,911	19,146	19,146	243,426	7.22%	0.00%
Ghana	39,607	3,169	3,169	39,607	1.20%	0.00%
Grace	439	35	35	641	0.01%	0.00%
Hong Kong	12,601	1,008	1,008	63,786	0.38%	1.00%
Italy	100,474	8,038	8,038	100,474	3.03%	0.00%
Luxembourg	227,485	18,103	18,103	654,988	6.83%	0.25%
Monaco	19,863	2,384	2,384	1	0.90%	0.00%
Netherland	737,661	63,484	63,484	799,676	23.95%	0.00%
Norway	73,318	5,865	5,865	73,321	2.21%	1.00%
Poland	699,777	46,324	46,324	579,413	17.48%	0.00%
Portugal	344,406	25,475	25,475	318,447	9.61%	0.00%
Sweden	164,653	13,172	13,172	172,519	4.97%	0.00%
Singapore	19,178	1,534	1,534	19,178	0.58%	0.00%
United State	37,699	3,016	3,016	76,803	1.14%	0.00%
British Virgin Islands	1,632	131	131	42,152	0.05%	0.00%
<b>Total</b>	<b>3,386,188</b>	<b>265,025</b>	<b>265,025</b>	<b>3,882,423</b>	<b>100.00%</b>	

The table below provides an overview of the Bank's countercyclical exposure and buffer requirements.

TABLE 3.7.2 EU CCyB2 - Amount of institution-specific countercyclical capital buffer

Total risk exposure amount in EUR'000	4,128,678
Institution specific countercyclical capital buffer rate	0.04%
Institution specific countercyclical capital buffer requirement	1,651

### 3.7.3. Supervisory Review and Evaluation Process (SREP) buffer requirement

As per CSSF regulation 17-04, the Bank is not considered a systemically important credit institution in Luxembourg. As a consequence, the systemically important buffer for the Bank is 0%.

## 3.8. Leverage Ratio



The Bank manages leverage ratio on a consolidated basis. RMD is responsible for monitoring the leverage ratio via the Bank's Key Risk Indicators, reporting on a quarterly basis. Internal limits were set as follows:

- Leverage ratio  $\geq$  4% Green Zone
- 3.5%  $\leq$  Leverage ratio < 4% Amber Zone
- Leverage ratio < 3.5% Red Zone

The Bank considers that there is excessive leverage risk when the leverage ratio falls below 3.5%. In case of an internal limit breach, a meeting should be convened by the Risk Management Department, together with the Finance Department and other relevant Departments. The reason of the breach and the remediation action are then analyzed and reported promptly to the Management Body and to the Board of Directors, as appropriate.

The mitigation measures may include, but are not limited to:

- Adjusting the Balance sheet and Off-Balance sheet structure
- Increasing the Tier 1 capital by capital injection, incorporation of previous profit etc.

Under CRR/CRD framework the non-risk based leverage ratio is intended to act as a supplementary measure to the risk based capital requirements. Its objectives are to constrain the build-up of leverage in the banking sector, helping avoid destabilizing deleveraging processes which can damage the broader financial system and the economy, and to reinforce the risk based requirements with a simple, non-risk based "backstop" measure. The current framework does not provide for a mandatory minimum leverage ratio to be complied with.

The leverage ratio is calculated in accordance with Article 429 of the CRR as per Delegated Regulation (EU) 2015/62 of 10 October 2014 published in the Official Journal of the European Union on January 17 2015. As at 31<sup>st</sup> December 2020, the Leverage Ratio amounts to 9.09%, using the fully phased-in definition of Tier 1. This exceeds regulatory minimum requirement of 3%.

The following tables disclose template is in accordance of the Commission Implementing Regulation (EU) No 2016/200 of 15 February 2016.

Table 3.8.1 EU LR1 - LRSum: Summary reconciliation of accounting assets and leverage ratio exposures



	In EUR'000	Applicable amount
1	Total assets as per published financial statements	6,523,435.53
2	Adjustments for derivative financial instruments	7,966.18
3	Adjustment for securities financing transactions (SFTs)	
4	Adjustment for off-balance sheet items (ie conversion to credit equivalent amounts of off-balance sheet exposures)	675,010.25
5	(Adjustment for prudent valuation adjustments and specific and general provisions which have reduced Tier 1 capital)	-197.79
6	Other adjustments	
7	<b>Leverage ratio total exposure measure</b>	<b>7,206,411.97</b>

Table 3.8.2 EU LR2 - LRCom: Leverage ratio common disclosure

In EUR'000		CRR leverage ratio exposures	
		2020	2019
<b>On-balance sheet exposures (excluding derivatives and SFTs)</b>			
1	On-balance sheet items (excluding derivatives, SFTs, but including collateral)	6,523,435.53	6,074,699.59
2	Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the applicable accounting framework		
3	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)		
4	(Adjustment for securities received under securities financing transactions that are recognised as an asset)		
5	(General credit risk adjustments to on-balance sheet items)		
6	(Asset amounts deducted in determining Tier 1 capital)	-197.79109	-251.38113
7	<b>Total on-balance sheet exposures (excluding derivatives and SFTs)</b>	<b>6,523,237.74</b>	<b>6,074,448.21</b>
<b>Derivative exposures</b>			
8	Replacement cost associated with SA-CCR derivatives transactions (ie net of eligible cash variation margin)		
EU-8a	Derogation for derivatives: replacement costs contribution under the simplified standardised approach		
9	Add-on amounts for potential future exposure associated with SA-CCR derivatives transactions		
EU-9a	Derogation for derivatives: Potential future exposure contribution under the simplified standardised approach		
EU-9b	Exposure determined under Original Exposure Method	7,966.18	10,330.43
10	(Exempted CCP leg of client-cleared trade exposures) (SA-CCR)		



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EU-10a	(Exempted CCP leg of client-cleared trade exposures) (simplified standardised approach)		
EU-10b	(Exempted CCP leg of client-cleared trade exposures) (original exposure method)		
11	Adjusted effective notional amount of written credit derivatives		
12	(Adjusted effective notional offsets and add-on deductions for written credit derivatives)		
13	<b>Total derivatives exposures</b>	7,966.18	10,330.43
<b>Other off-balance sheet exposures</b>			
19	Off-balance sheet exposures at gross notional amount	675,010.25	722,435.08
20	(Adjustments for conversion to credit equivalent amounts)		
21	(General provisions associated with off-balance sheet exposures deducted in determining Tier 1 capital)		
22	<b>Off-balance sheet exposures</b>	675,010.25	722,435.08
<b>Capital and total exposure measure</b>			
23	<b>Tier 1 capital</b>	655,004.14	488,759.46
24	<b>Leverage ratio total exposure measure</b>	7,206,214.17	6,807,716.48
<b>Leverage ratio</b>			
25	Leverage ratio	9.09%	7.18%

The capital measure for the leverage ratio is the Tier 1 capital taking into fully phased-in definition in accordance with Article 499(1)(a) of Regulation (EU) No 575/2013, the exposure measure corresponds to the sum of the following exposures: (a) on-balance sheet exposures; (b) derivative; (c) off-balance sheet items.

As at 31 December 2020, the Bank's leverage ratio increased significantly to 9.09% compare with previous year of 7.18% due to increase in Tier 1 capital. The main factors that impacted the leverage ratio were the on-balance-sheet exposure of loans and the off-balance-sheet exposure of loan commitments, there was no other specific factors identified which had any material impact on the calculation of leverage ratio in 2020.

Table 3.8.3 EU LR3 - LRSpl: Split-up of on balance sheet exposures (excluding derivatives, SFTs and exempted exposures)

in EUR'000		CRR leverage ratio exposures
EU-1	Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:	6,523,435.53
EU-2	Trading book exposures	
EU-3	Banking book exposures, of which:	
EU-4	Covered bonds	
EU-5	Exposures treated as sovereigns	732,309.01
EU-6	Exposures to regional governments, MDB, international organisations and PSE <b>not</b> treated as sovereigns	
EU-7	Institutions	2,892,127.20
EU-8	Secured by mortgages of immovable properties	471,174.41
EU-9	Retail exposures	
EU-10	Corporate	2,421,216.33
EU-11	Exposures in default	
EU-12	Other exposures (eg equity, securitisations, and other non-credit obligation assets)	6,608.59

## 4. Capital Adequacy

The capital management approach of the Bank is driven by its strategic and organizational requirements, taking into account the regulatory, economic and commercial environments in which it operates. It is our objective to maintain a strong capital base to support the business development and to meet regulatory capital requirements at all time.

As per relevant provisions set in CRR, CRD IV and CSSF 07/301, the Tier 1 and Tier 2 capitals of the Bank are used to mitigate:

### Pillar 1

- Credit risk, with an allocated capital of 8% of Risk Weighted Assets;
- Counterparty credit risk capital allocation resulted from derivative transactions are calculated according to the original method with original maturity option;
- Market risk (mainly foreign currency risk), with an allocated capital of 8% of the overall net currency position, if the net position exceeds 2% of the Bank's own funds;
- Operational risk, with an allocated capital of 15% of basic indicator.

### Pillar 2

- IRRBB risk, concentration risk, counterparty credit risk, are assessed and internal capital are allocated based on the stress test results. The liquidity risk is considered separately in ILAAP report.

### 4.1. Internal Capital Adequacy Assessment Process (“ICAAP”)

Concerning the internal capital adequacy assessment method, the Bank follows a “Pillar II” approach to calculate its own internal capital requirements. In this approach, the Bank assesses Regulatory

Capital Requirements for the risks of the Pillar 1 (Credit Risk, Market Risk and Operational Risk) in accordance with the methods laid down in CRR, in which a minimum prudential own funds is required.

Additionally, the Bank performs an Internal Assessment of Capital Requirement to address the risks which are not covered or not fully captured by the minimum prudential own funds requirements. The stress test method is used to quantify the capital requirement.

The purpose of ICAAP report is as the followings:

- Informs the Bank's Board of Directors on how the Bank assesses its risks; how the Bank intends to mitigate those risks, and how much current and future capital, as well as liquidity capacity are deemed necessary to support the Bank's operations in light of those risks.
- Allow CSSF to collect the relevant information to perform the SREP assessment.
- Be used by the management of the Bank in the strategic management.

The ICAAP report is regularly reviewed at the highest levels of the firm's organization structure means that the Bank's risk management policies and processes are regularly being challenged. Within an institution's internal governance framework, the ICAAP is a process to ensure that the AM:

- Adequately anticipates, identifies, measures, aggregates and monitors the Bank's risks;
- Ensures that the Bank holds adequate internal capital in relation to the Bank's risk profile;
- Uses sound risk management systems and develops them further.

Maintaining and continuously reviewing the Bank's ICAAP helps to ensure that the Bank keeps focusing on the risks it faces.

The results of this assessment are summarized below:

As at 31st December 2020, the capital adequacy ratio under Pillar II of the Bank was standing at 17.54%, increased 3.8% compared to the year-end 2019.

The Bank's ICAAP and ILAAP assessment was approved by the Board Risk Committee on 25 March 2021.

## 4.2. Capital Planning

The basis for the capital planning model is the Bank's three-year business plan. The objective of internal capital planning is to ensure the future capital adequacy ratio would be in line with the business strategy and within the risk appetite tolerance.

Although the Bank's business model remains traditional corporate lending driven, some forward looking strategic adjustment has been made so as to:

- Promote green and sustainable economy through favourable credit access conditions for specific environment friendly, infrastructure construction sectors;
- Reduce RWA by investing in high quality rating clients.
- Seeking new business opportunity in light of fintech revolution;

- Manage the existing loan portfolio with multiple options such as securitization, asset disposal and transfer if necessary;

The forecast capital adequacy ratio in the 2020-2022 will meet total SREP capital requirements.

The capital planning incorporates the RWA of BOC EE with Serbia S.A. into its forecast. Assuming a direct capital injection from H.O. of EUR 436 million in 2022, the Bank's CAR ratio in the following year would reach to 21.42% and 19.55%, reaching its objective of 18% minimum. The Bank is currently redesigning its five-year strategy for 2021-2026. In case of a substantial change in strategic orientation, the Bank may issue an updated capital plan during the year 2021.

#### 4.2.1. Capital planning back testing

The Bank has performed back-testing of its previous year's capital planning. As the table above illustrates, the last version's ICAAP forecast a total own fund of EUR 763.71 million and a total CAR ratio of 16.73% which was in line with the actual results of EUR761,42 million and CAR ratio of 18.44%

### 4.3. Stress and Scenario Testing

In accordance with the Circular CSSF 11/506, the Bank performs stress tests covering all material risks exposed. With the validation of AM, we performed a scope analysis on stress tests, elaborated the stress test method and integrated the results into Pillar 2 capital requirement considerations.

The AM is regularly informed on results and decides on corrective measures, written annual plan required including main characteristics. Heads of relevant departments contribute to efficiency, ensure flexibility to easily and quickly react to changed situations, competent and sufficient personnel and adequate infrastructure, e.g. by mentioning tools and IT systems used.

In 2020, a set of stress tests were performed on:

- Liquidity Risk
- Interest rate Risk on Banking Book
- Net Interest Income Ratio
- Concentration Risk
- Counterparty Credit Risk
- Operational Risk

#### Results and capital requirement

Based on the stress test of Pillar II risks, we deducted the additional capital requirement related to the Pillar II risk. Pillar II capital requirement as in below table:

**Stress test result as per 31.12.2020 ( in EUR)**

Liquidity Risk	No capital requirement, covered by liquidity contingency plan
Market Risk - IRRBB	14,458,233.82
Concentration Risk (Credit)	5,109,208.04
Counterparty credit risk	2,160,000.00
Operational Risk	722,392.12
Other Risk	7,614,121.80
<b>Total</b>	<b>30,063,955.78</b>

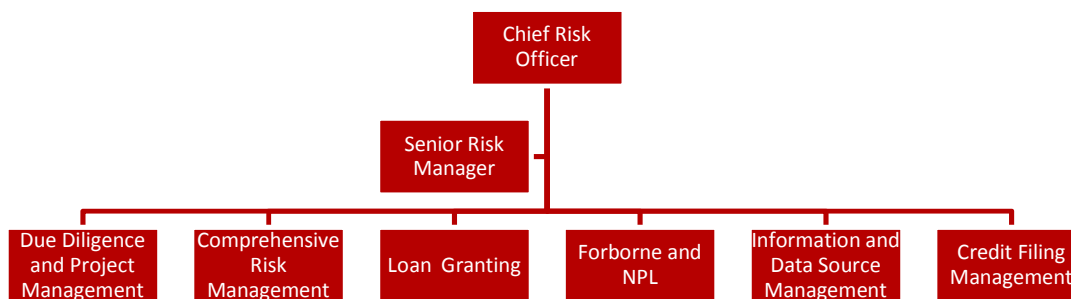
## 5. Credit Risk

Credit risk is defined as the potential that a bank borrower or counterparty will fail to meet its obligations in accordance with agreed terms, including the counterparty credit risk, concentration credit risk and country credit risk. Credit risk exists in all activities where success depends on counterparty, issuer or borrower performance. The Bank's credit risk can be found in the traditional lending activities (both on the balance sheet and off the balance sheet), and in financial market activities where a money market or derivatives contract is concluded. More widely, credit risk can be accentuated by the concentration factor and by country risk. Among the risks the Bank takes in the normal course of business, credit risk is the most important and generates the largest regulatory capital requirement.

### 5.1. Credit risk governance

The goal of credit risk management in the Bank is to maximise a bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters. The CRO and each team need to manage the credit risk inherent in the entire portfolio as well as the risk in individual credits or transactions. The Bank maintains efficient and effective internal system to identify, measure, monitor and control credit risk as well as to determine that they hold adequate capital against these risks and that they are adequately compensated for risks incurred.

#### 5.1.1. Risk management framework



### 5.1.2. Policy

Risk Management department of the Bank has established general and specific procedural policies which are in line with the Bank's risk appetite. These policies guide the analysis, monitoring, reporting thought the whole credit life in the Bank. Risk Management takes the responsibilities of credit issuance and drawdown operation of the Bank to strengthen the prevention and control of credit risk. As part of the loan monitoring task, the Information and Data Source Management supervises changes in the credit risks with regards to the bank's credit portfolio by analysing loan indicators and reviewing counterparties' ratings. The Risk Management department also draw up the policies covers corporate credit portfolio management and loan provision, NPL management etc.

### 5.1.3. Reporting of material credit risk events

The Bank issues Administrative Measure for reporting material credit risk events in order to enhance and regulate active risk management and improve the Bank's speed of response to and ability to mitigate material credit risk. Event refers to any material negative impact on credit asset safety and asset quality of the Bank.

The management of material credit risk events shall put prevention first, strengthen the monitoring and analysis of external macro economy, financial market, industry credit status, enterprise operation and its changes, and judge the risk status, so as to guarantee early detection, reporting, handling and mitigation of risks. The material credit risk events shall be responded to and handled in a quick and efficient manner. The branches at different levels shall present timely reports to Risk Management department.

### 5.1.4. Risk control measure

Credit risk measurement is primarily done through internal rating system before the Bank allocates any credit line to the customer. The credit rating of each customer corresponds to an evaluation of the level of default risk borne by the counterparty and is expressed by means of an internal rating scale. The Bank operating on a single credit limit system for customers, which means credit risk limit is set for each counterparty and with a maximum acceptable level for each one. Country limits, industry limits, and products limit may also be imposed by the Risk Management department in light

of changes in the latest macro or micro economy situation. Risk Management monitors credit exposures, and issues risk notices where necessary.

#### **Facility limit management**

The facility management adopts the hierarchical management at the bank level and customer level respectively. The Bank formulated the measure on limit usage, splitting and transferring corporate customer valid credit line

#### **Credit asset risk classification**

The Bank establishes regulation of credit asset risk classification in order to effectively identify and measure credit risk, objectively reflect credit asset quality and enhance risk control of credit asset. The risk classification of credit assets is managed in a centralized manner, and the experts of Risk Management department are responsible for reviewing and determining the risk classification of credit assets. RMD conduct credit asset risk classification under the respective authorities. Among various factors that affecting credit assets classification, the Bank identifies key factors to assess and classify credit assets, based on the importance under the primary definition of risk classification.

#### **Credit rating of corporate customers**

Customers' credit rating, as a component of the Bank's bi-dimensions internal rating system for non-retail credit risk exposure, is used by the Bank to evaluate the debtors' default risk based on internal data and standards. The credit rating results only represent the ordinal ranking of debtors' relative risk across the Bank.

Customers' credit rating results an important reference for the Bank to carry out credit approval, customer access, risk monitoring, limit management, post-lending management, credit policy, risk reporting, economic capital, risk appetite, provision, risk pricing and performance evaluation. The rating is reviewed on quarterly base, which helps to identify any adverse change of client credit situation.

The Bank established an adequate internal governance around credit rating management, to regulate client internal rating regular review procedure and to incorporate the result of internal rating into credit approval, client's risk profile assessment and risk monitoring, limit management, post-lending management, risk reporting, economic capital allocation, provision, risk pricing and internal performance assessment.

#### **IFRS ECL management**

In accordance with IFRS 9 requirements, based on the change in credit quality since initial recognition of financial instruments, ECL under different periods of time should be recognised, and the new standard outlines a "three-stage" model to calculate the ECL. The Bank establishes criteria for identify and recognize the indicators for each stage, and list of information may be relevant in assessing significant increase since initial recognition of credit risk.

#### **5.1.5. Post-lending management**

Post-lending management of corporate loans refers to the behaviour of management covering from the time of corporate loan drawdown or activation through to the time of full repayment and

settlement.

Customers of the Bank are classified by its risk level and put under differentiated management with different frequencies of post-lending management reporting. Customer-specific risk management shall be carried out in combination with the post-lending management guidelines on customers, products and guarantees, where differentiated risk identification and control measures will be taken, and post-lending management strategies be fixed. A series of risk identification, assessment and reporting measures shall be actively taken against high-risk customers and significant credit risk events, while strengthening efficient and targeted management.

#### 5.1.6. Definition of default

The bank includes all products and positions that are potentially at risk. Default is defined in the Basel II context (Article 178 CRR) as follows:

Default of an obligor (debtor or guarantor): A default shall be considered to have occurred with regard to a particular obligor when either or both of the following have taken place:

- a) the Bank considers that the obligor is unlikely to pay (hereinafter referred to as the “UTP”) its credit obligations to the Bank, including the parent undertakings and all cross border branches, in full, without recourse by the Bank to actions such as realizing security(if held);
- b) the obligor is past due more than 90 days on any material credit obligation to the Bank, including the parent undertakings and all cross border branches.

Our Bank assesses the materiality of a credit obligation past due against the following threshold, which comprises two components:

- a. Absolute component  
The absolute component shall be expressed as a maximum amount of the sum of all amounts past due owed by a non- retail obligor to our Bank, including the parent undertaking and all cross-border branches (hereinafter the ‘credit obligation past due’). The maximum amount shall not exceed EUR 500 or the equivalent of that amount in the relevant original currency.
- b. Relative component  
The relative component shall be expressed as a percentage reflecting the amount of the credit obligation past due in relation to the total amount of all on-balance sheet exposures to that a non-retail obligor of our Bank, including the parent undertaking and all cross-border branches, excluding equity exposures. The percentage is set at 1 % currently.

The Bank has a granular risk classification on its assets taking into account specific characteristics. The five loan quality categories are:

- Performing
- Special Mention
- Substandard
- Doubtful
- Loss

The “performing” and “special mention” categories are considered as performing, while the “substandard”, “doubtful” and “loss” categories are classified as non-performing loans (NPL), for which ECL should be recognized as stage 2 or stage 3..

“Past due” loan: A “past due” loan is a loan for which contractual payments are not being made in time. Loans are placed in non-accrual status when they become 90 days past due.

#### 5.1.7. Provisions for credit facilities

The Bank evaluates its loan situation in a timely, accurate and prudent manner and makes ample provision, pursuant to the principle of "categorizing accurately and making ample provision to reflect actual profits and operating performance" during routine business, and according to the requirements of local regulatory authorities and external auditors.

The allowance for loan impairment losses to non-performing loans is now 100%, further enhancing risk resilience.

#### Expected Credit Loss (ECL) under IFRS9 standard

In July 2014, the International Accounting Standards Board (IASB) added the impairment requirements related to the accounting for expected credit losses on an entity's financial assets and commitments to “International Financial Reporting Standard 9 Financial Instruments” in order to extend credit. Those requirements eliminate the threshold that was in IAS 39 for the recognition of credit losses. Under the impairment approach in “International Financial Reporting Standard 9 Financial Instruments”, it is no longer necessary for a credit event to have occurred before credit losses are recognised. Instead, an entity always accounts for expected credit losses, and changes in those expected credit losses. The amount of expected credit losses is updated at each reporting date to reflect changes in credit risk since initial recognition, consequently, more timely information is provided about expected credit losses.

The Bank adopted IFRS 9 standards from 1st January 2018. After two year’s operation under the Bank’s Internal Rating model, the Bank has engaged a series of measure to improve the calibration of internal rating model and to increase the accuracy of credit provision.

The “Internal Credit Rating Policies” will strengthen the Bank’s IFRS 9 rating review governance.

In order to facilitate early identification of changes in risk profiles and ensure the internal rating to be more responsive to indicators of potential or actual deterioration in credit risk, including improvement on the application of internal rating in credit grating process, credit review process and post loan management.

#### ECL recognition

At 31st December 2020, the total on- & off-balance amount of ECL (SA Consolidated) was EUR 71.55 million, of which EUR67.85 million for on the balance sheet, together with EUR 3.7 million for off balance sheet exposures.

## 5.2. Exposures to Credit Risk, Dilution Risk and Credit Quality

The Bank's credit risk exposure will be analysed at this section, includes information that reflect the quality of credit risk exposures in terms of classification and composition: performing/non-performing exposures, default/non-defaulted exposures and related impairments/credit risk adjustment. It is fully integrated with supervisory reporting and fully based on existing disclosure templates already implemented in the EU through the following guideline:

- a) EBA/GL/2016/11 on disclosure requirements under Part Eight of Regulation (EU) no.575/2013
- b) EBA/GL2018/10 on disclosure of non-performing and forborne exposures.

### 5.2.1. Credit quality of exposures

According to Article 442 (g) of the CRR, the tables below provide asset quality information of the Bank. The amounts shown are based on IFRS accounting values according to the regulatory scope of consolidation. An exposure is being classified as default if the default criteria are met according to Article 178 of the CRR. Credit risk adjustment refers to only the specific credit risk adjustment and it consist of all types of allowance for credit losses held against financial instruments subject to impairment according to IFRS 9 for the current year.

Table 5.2.1 EU CR1: Performing and non-performing exposures and related provisions



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In EUR'000	Gross carrying amount/nominal amount						Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions						Accumulated partial write-off	Collateral and financial guarantees received	
	Performing exposures			Non-performing exposures			Performing exposures – accumulated impairment and provisions			Non-performing exposures – accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions				On performing exposures	On non-performing exposures
		Of which stage 1	Of which stage 2		Of which stage 2	Of which stage 3		Of which stage 1	Of which stage 2		Of which stage 2	Of which stage 3			
Cash balances at central banks and other demand deposits	1,929,199.09	1,929,199.09					(3.42)	(3.42)							
Loans and advances	4,459,503.47	4,150,699.90	308,803.57	31,000.00		31,000.00	(36,842.99)	(11,971.84)	(24,871.15)	(31,000.00)		(31,000.00)		701,193.46	
<i>Central banks</i>															
<i>General governments</i>															
<i>Credit institutions</i>	1,049,825.19	1,049,825.19													
<i>Other financial corporations</i>	254,477.25	254,477.25					(1,018.71)	(1,018.71)							
<i>Non-financial corporations</i>	3,150,611.38	2,841,807.81	308,803.57	31,000.00		31,000.00	(35,818.65)	(10,947.50)	(24,871.15)	(31,000.00)		(31,000.00)		696,609.44	
<i>Of which SMEs</i>															
<i>Households</i>	4,589.65	4,589.65					(5.63)	(5.63)						4,584.03	
Debt securities	148,237.30	148,237.30													
<i>Central banks</i>															
<i>General governments</i>	148,237.30	148,237.30													
<i>Credit institutions</i>															
<i>Other financial corporations</i>															
<i>Non-financial corporations</i>															
Off-balance-sheet exposures	1,219,908.11	1,209,903.26	10,004.86				(3,700.40)	(2,520.96)	(1,179.44)					183,722.43	
<i>Central banks</i>															
<i>General governments</i>															
<i>Credit institutions</i>	88,747.93	88,747.93					(31.01)	(31.01)							
<i>Other financial corporations</i>	79,966.96	79,966.96					(121.45)	(121.45)						16,500.00	
<i>Non-financial corporations</i>	1,051,193.22	1,041,188.36	10,004.86				(3,547.94)	(2,368.50)	(1,179.44)					167,222.43	
<i>Households</i>															
<b>Total</b>	<b>7,756,847.98</b>	<b>7,438,039.55</b>	<b>318,808.43</b>	<b>31,000.00</b>	<b>-</b>	<b>31,000.00</b>	<b>(40,546.81)</b>	<b>(14,496.22)</b>	<b>(26,050.59)</b>	<b>(31,000.00)</b>	<b>-</b>	<b>(31,000.00)</b>	<b>-</b>	<b>884,915.89</b>	

### 5.2.2. Exposure breakdown by residual maturity

According to Article 442 (f) of the CRR, the table below shows the net value of exposure broken down by exposure class and residual maturities at 31 December 2020.

Table 5.2.2 EU CR1-A: Maturity of exposures

	In EUR'000	Net exposure value					Total
		On demand	<= 1 year	> 1 year <= 5 years	> 5 years	No stated maturity	
1	Loans and advances	499.33	1,803,394.18	3,288,424.15	546,550.54		5,638,868.20
2	Debt securities		148,237.30				148,237.30
3	<b>Total</b>	<b>499.33</b>	<b>1,951,631.47</b>	<b>3,288,424.15</b>	<b>546,550.54</b>	-	<b>5,787,105.50</b>

The above table shows 91% of the total exposure does not exceed 5 years term. Only 9% of the exposure over a longer period of five years and these exposures consist of mainly retail banking mortgage activity and syndication loan to corporate. The proportion of tenor in Middle and Long Term exposures increased due to development of longer term loans to the local market (bilateral and syndicated loans).

There was no exposure classified as “no stated maturity”.

### 5.2.3. Non-performing exposures

According to EBA definition, non-performing exposures correspond to loans in default, or overdue period > 90 days. As at end of 2020, the Bank non-performing exposures amount remain unchanged of EUR 31 million as the previous year of 2019.

Table 5.2.3 EU CR2: Changes in the stock of non-performing loans and advances

	In EUR'000	Gross carrying amount
<b>010</b>	<b>Initial stock of non-performing loans and advances</b>	31,000.00
020	Inflows to non-performing portfolios	
030	Outflows from non-performing portfolios	
040	Outflows due to write-offs	
050	Outflow due to other situations	
<b>060</b>	<b>Final stock of non-performing loans and advances</b>	31,000.00

### 5.2.4. Forborne exposures

Forborne exposures are debt contracts in respect of which forbearance measures have been extended. Forbearance measures consist of concessions towards a debtor facing or about to face difficulties in meeting their financial commitments. Those measures include in particular the granting of extensions, postponements, renewals or changes in credit terms and conditions, including the

repayment plan.

Once certain forbearance criteria are met, the credit files are re-classified as restructured loans and are added to a forbearance list closely followed by RMD. In order to comply with the regulatory standard, the Bank has set up a special committee called the Asset Disposal Committee which (i) identifies the criteria leading to the forbore classification including updating client's rating, (ii) deploys a strategy for changing loan terms and conditions, such as determine the new repayment interest rate and extension period, (iii) promotes the regulation and compliance of asset disposal and write-offs.

As at 31 December 2020, the Bank's forbore exposures amounted to EUR108.88 million of which performing forbore of EUR 77.88 million related to six companies that modified terms and condition from the original contract mainly due to COVID-19 impact. Non-performing forbore loans were unchanged at EUR31 million.

Table 5.2.4 EU CQ1: Credit quality of forbore exposures

In EUR'000	Gross carrying amount/nominal amount of exposures with forbearance measures				Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions		Collateral received and financial guarantees received on forbore exposures	
	Performing forbore	Non-performing forbore			On performing forbore exposures	On non-performing forbore exposures		Of which collateral and financial guarantees received on non-performing exposures with forbearance measures
			Of which defaulted	Of which impaired				
Cash balances at central banks and other demand deposits								
Loans and advances	77,879.57	31,000.00	31,000.00	-	(12,190.24)	(31,000.00)	11,534.87	-
<i>Central banks</i>								
<i>General governments</i>								
<i>Credit institutions</i>								
<i>Other financial corporations</i>								
<i>Non-financial corporations</i>	77,879.57	31,000.00	31,000.00		(12,190.24)	(31,000.00)	11,534.87	
<i>Households</i>								
Debt Securities								
Loan commitments given								
<b>Total</b>	<b>77,879.57</b>	<b>31,000.00</b>	<b>31,000.00</b>	<b>-</b>	<b>(12,190.24)</b>	<b>(31,000.00)</b>	<b>11,534.87</b>	<b>-</b>

The following table shows the credit quality of performing and non-performing exposures by past due days. At the end of 2020 the Bank maintains stable good quality of credit exposure, only one non-performing loan that is past due with less than two years, others are all performing loan and not past due.



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Table 5.2.5 EU CQ3: Credit quality of performing and non-performing exposures by past due days

In EUR'000	Gross carrying amount/nominal amount											
	Performing exposures			Non-performing exposures								
		Not past due or past due ≤ 30 days	Past due > 30 days ≤ 90 days	Unlikely to pay that are not past due or are past due ≤ 90 days	Past due > 90 days ≤ 180 days	Past due > 180 days ≤ 1 year	Past due > 1 year ≤ 2 years	Past due > 2 years ≤ 5 years	Past due > 5 years ≤ 7 years	Past due > 7 years	Of which defaulted	
Cash balances at central banks and other demand deposits	1,929,199.09	1,929,199.09										
Loans and advances	4,459,503.47	4,459,503.47					31,000.00					31,000.00
<i>Central banks</i>												
<i>General governments</i>												
<i>Credit institutions</i>	1,049,825.19	1,049,825.19										
<i>Other financial corporations</i>	254,477.25	254,477.25										
<i>Non-financial corporations</i>	3,150,611.38	3,150,611.38					31,000.00					31,000.00
<i>Of which SMEs</i>												
<i>Households</i>	4,589.65	4,589.65										
Debt securities	148,237.30	148,237.30										
<i>Central banks</i>												
<i>General governments</i>	148,237.30	148,237.30										
<i>Credit institutions</i>												
<i>Other financial corporations</i>												
<i>Non-financial corporations</i>												
Off-balance-sheet exposures	1,219,908.11											
<i>Central banks</i>												
<i>General governments</i>												
<i>Credit institutions</i>	88,747.93											
<i>Other financial corporations</i>	79,966.96											
<i>Non-financial corporations</i>	1,051,193.22											
<i>Households</i>												
<b>Total</b>	<b>7,756,847.98</b>	<b>6,536,939.86</b>					<b>31,000.00</b>					<b>31,000.00</b>



### 5.2.5. Geographical breakdown of credit exposures

In the Article 442 (d) of the CRR, the table below shows the total exposure expressed in terms of net value broken down by exposure classes and geographic areas at year end of 2020. The geographical distribution is based on the legal residence of the counterparty or issuer.

Table 5.2.6 EU CQ4: Quality of non-performing exposures by geography

In EUR'000	Gross carrying/nominal amount				Accumulated impairment	Provisions on off-balance-sheet commitments and financial guarantees given	Accumulated negative changes in fair value due to credit risk on non-performing exposures
		Of which non-performing		Of which subject to impairment			
			Of which defaulted				
<b>On-balance-sheet exposures</b>	<b>6,567,939.86</b>	<b>31,000.00</b>	<b>31,000.00</b>	<b>6,567,939.86</b>	<b>(67,846.41)</b>		
Luxembourg	2,791,007.35	31,000.00	31,000.00	2,791,007.35	(35,076.29)		
Netherlands	770,271.37			770,271.37	(14,679.30)		
Poland	706,411.75			706,411.75	(3,861.96)		
Other countries	2,300,249.39			2,300,249.39	(14,228.85)		
<b>Off-balance-sheet exposures</b>	<b>1,219,908.11</b>					<b>3,700.40</b>	
Denmark	160,907.08					326.55	
Luxembourg	89,993.34					320.12	
Netherlands	320,746.45					2,051.00	
Poland	171,317.97					239.04	
Sweden	138,097.30					251.63	
Other countries	338,845.97						
<b>Total</b>	<b>7,787,847.98</b>	<b>31,000.00</b>	<b>31,000.00</b>	<b>6,567,939.86</b>	<b>(67,846.41)</b>	<b>3,700.40</b>	<b>0.00</b>

As at 31 December 2020, majority of the on-balance risk exposure was mainly concentrated in Europe (89% of total) with exposure for Luxembourg of 42.49%, Netherlands of 11.73% and Poland of 10.76% are higher than 10% of the total (domestic and non-domestic) original exposure. The Bank's credit activities are more and more oriented towards European clients. With regards to Central Governments and Central Banks exposures, the main counterparties of the bank are the Central Bank of the United States. While off-balance risk exposures came mainly from the Denmark, Netherlands, Poland and Sweden for 13.76%, 26.3%, 14.04% and 11.32% respectively.

### 5.2.6. Exposure breakdown by industry

According to Article 442 (c) (e) of the CRR, the table below shows the gross carrying subject to impairment and broken down by exposure class and industry at the end of year 2020. The industry classification is based on NACE codes (NACE = *Nomenclature des Activités Économiques dans la Communauté Européenne* is a European industry standard classification system for classifying business activities).

Table 5.2.7 EU CQ5: Credit quality of loans and advances to non-financial corporations by industry



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In EIR'000	Gross carrying amount				Accumulated impairment	Accumulated negative changes in fair value due to credit risk on non-performing exposures
		Of which non-performing		Of which loans and advances subject to impairment		
			Of which defaulted			
Agriculture, forestry and fishing	17,992.44			17,992.44	(52.12)	
Mining and quarrying	30,117.33			30,117.33	(140.66)	
Manufacturing	663,330.25			663,330.25	(6,610.85)	
Electricity, gas, steam and air conditioning supply	182,310.77			182,310.77	(837.59)	
Water supply	35,098.68			35,098.68	(105.75)	
Construction	122,543.09			122,543.09	(1,568.74)	
Wholesale and retail trade	525,821.09	31,000.00	31,000.00	525,821.09	(38,612.54)	
Transport and storage	241,835.25			241,835.25	(4,004.64)	
Accommodation and food service activities	37,895.14			37,895.14	(6,847.92)	
Information and communication	315,498.87			315,498.87	(1,315.39)	
Financial and insurance activities	-			-	-	
Real estate activities	670,451.88			670,451.88	(5,116.16)	
Professional, scientific and technical activities	137,612.11			137,612.11	(585.86)	
Administrative and support service activities	93,883.09			93,883.09	(383.65)	
Public administration and defense, compulsory social security	-			-	-	
Education	-			-	-	
Human health services and social work activities	39,027.92			39,027.92	(210.27)	
Arts, entertainment and recreation	38,153.46			38,153.46	(283.44)	
Other services	30,040.00			30,040.00	(143.06)	
<b>Total</b>	<b>3,181,611.38</b>	<b>31,000.00</b>	<b>31,000.00</b>	<b>3,181,611.38</b>	<b>(66,818.65)</b>	<b>-</b>

### 5.3. Exposure subject to measures applied in response to the COVID-19 crisis

In response to the need to address negative economic consequences of COVID by industry Écon European Union (EU) and Member States have introduced a wide range of mitigating measures to support the real economy and the financial sector. As part of such measures, some Member States have introduced legislative moratoria on loan repayments granting the borrowers various forms of payment holidays on their existing loans. In other Member States similar measures have been introduced under individual institutions' industry-coordinated initiatives. Many Member States have also introduced various forms of public guarantees to be applied to new lending. Subsequently, the EBA issued guidelines covering:

- (1) disclosure requirements for the exposures subject to the payment moratoria in accordance with the GL on moratoria;
- (2) disclosure requirements for the new loans subject to the specific public guarantees set up to mitigate the effects of COVIDo19 crisis.

The EBA Guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis which clarifies a set of criteria and conditions under which such measures do not trigger forbearance classification of loans and advances and the assessment of distressed structuring of loans and advances benefiting from these moratoria and they do not automatically lead to default classification.

The following table shows information on loans and advances subject to legislative and non-legislative moratoria:

Table 5.3.1 Template 1: Information on loans and advances subject to EBA-compliant moratoria (legislative and non-legislative)

(In EUR'000)		Gross carrying amount			Accumulated impairment, accumulated negative changes in fair value due to credit risk		
			Performing			Performing	
				Of which: exposures with forbearance measures		Of which: Instruments with significant increase in credit risk since initial recognition but not credit-impaired (Stage 2)	
1	Loans and advances subject to moratorium	8,415.66	8,415.66	8,415.66	(2,084.18)	(2,084.18)	(2,084.18)
2	of which: Households	5.10	5.10	5.10	(0.13)	(0.13)	(0.13)
3	of which: Collateralised by residential immovable property	5.10	5.10	5.10	(0.13)	(0.13)	(0.13)
4	of which: Non-financial corporations	8,410.56	8,410.56	8,410.56	(2,084.04)	(2,084.04)	(2,084.04)
5	of which: Small and Medium-sized Enterprises				-	-	-
6	of which: Collateralised by commercial immovable property	500.00	500.00	500.00	(759.91)	(759.91)	(759.91)

At year-end 2020, the Bank had 4 borrowers from its Lisbon branch who applied under the Law Degree 10-J/2020 (Moratorium on existing financing) which allowed the deferral of instalments during the moratorium period. The extension approved by the Portuguese Government allowed borrower to benefit from that measure until September 2021. The Bank does not have non-performing exposure under this category as end of 2020.

Table 5.3.2 Template 2: Breakdown of loans and advances subject to legislative and non-legislative moratoria by residual maturity of moratoria

	(In EUR'000)	Number of obligors	Gross carrying amount							
				Of which: legislative moratoria	Of which: expired	Residual maturity of moratoria				
						<= 3 months	> 3 months <= 6 months	> 6 months <= 9 months	> 9 months <= 12 months	> 1 year
1	Loans and advances for which moratorium was offered	4	131,624.30							
2	Loans and advances subject to moratorium (granted)	4	8,415.66	8,415.66		5.10		8,410.56		
3	of which: Households		5.10	5.10		5.10				
4	of which: Collateralised by residential immovable property		5.10	5.10		5.10				
5	of which: Non-financial corporations		8,410.56	8,410.56				8,410.56		
6	of which: Small and Medium-sized Enterprises		-	-						
7	of which: Collateralised by commercial immovable property		500.00	500.00				500.00		

Furthermore, as part of the response to the COVID-19 pandemic, a number of Member States introduced public guarantee schemes to be applied to newly originated loans and advances. These public guarantee schemes may vary in their characteristics, such as in the level of guarantee given to different counterparties (e.g. households, SMEs and large corporates) and in the duration of the guarantee.

As at end of 2020, the Bank did not provide new lending to any borrower who made the use of the public guarantee.

#### 5.4. Credit risk mitigation

When granting credit facilities to a customer the Bank's approach is based on the capacity to repay by the borrower rather than placing primary reliance on credit risk mitigates. Depending on a customer's risk portfolio and type of product, unsecured facilities may be provided. Mitigation of credit risk is a key aspect of effective risk management and takes many forms.

The most common method of mitigating credit risk is to obtain collaterals. The Bank divides collateral into Tier I and Tier II, and managed separately by different class. Tier I collateral refers to cash, cash equivalent and others that can be evaluated through external professional institution with easy realization or liquidation such as cash, bonds, time deposits etc., whereas Tier II collateral refers to those collaterals with difficulties to evaluate, liquidate or register, including inventory, trade receivable and equipment etc. The Bank's collateral policies cover the acceptability, structuring and terms with regards to the availability of credit risk mitigation, together with the setting of suitable valuation parameters. Internal policies are subject to regular review to ensure that they are supported by solid evidence and continue to fulfil the intended purpose.

##### Main types of collateral

The Bank has the following main categories of collateral under the regulatory point of view:

- Pledges of liquid assets

- 
- Mortgages - residential
  - Mortgages - commercial
  - Pledges of business asset

### Guarantee

Guarantee refers to personal guarantee, first demand guarantees which complements the borrower's ability to fulfil its obligation under the legal contract and as such is provided by third parties, such as letter of credit, letter of guarantee and insurance contract.

### Main type of guarantor and their creditworthiness

The main type of guarantor are other entities within BOC's group, other financial institutions and corporate. The Creditworthiness of guarantee provider is incorporated with the credit assessment process for borrowers.

### Collateral valuation

Valuation of collaterals refers to the conduct and process where the external specialized valuation agency recognised by the Bank appraises and delivers opinion on the value of the collateral. Valuation management is a dynamic and continual process ranging from pre-lending and valuation when a transaction is initiated and approved to collateral revaluation in the existence of credit and in disposal of assets. Valuation should be conducted in an objective, independent and scientific and prudent manner, following generally applied valuation standards.

Additional haircuts may then be applied to the valuation of the collateral if there is a currency mismatch between the currency of the loan exposure and the currency of the pledged securities after the initial LTV ratio is considered.

### Information about market or credit risk concentrations

Concentration risk within credit risk mitigation taken may occur if collateral is related to one issuer, country, industry or market. The Bank is proactively monitoring the collateral concentration risk by using a number of tools and setting threshold during the credit assessment process.

### Recognition of credit risk mitigation in capital calculation

Credit risk mitigation is used to reduce credit risk associated with an exposure, which may reduce potential losses in the event of obligor default or other specified credit events.

Credit risk mitigation that meets certain regulatory criteria may be used to improve risk parameters and reduce RWA charge against a given obligor. Collateral that meets the regulatory condition is referred as eligible collateral. Eligibility criteria are specified in Article 195 to 204 of the CRR. The Bank recognises of collateral as eligible credit risk mitigation is fully consistent with all applicable local regulations and regulatory permission.

### Overview of credit risk mitigation techniques

In the Article 453(f) and (g) of the CRR, the below table provides an overview of the loan and advance exposure value covered by regulatory eligible CRM and includes all collateral and financial guarantees used as credit risk mitigates for all secured exposures based on the standardised approach is used for RWA calculations.

Table 5.4.1 EU CR3 – CRM techniques overview: Disclosure of the use of credit risk mitigation techniques

In EUR'000	Unsecured carrying amount	Secured carrying amount			
			Of which secured by collateral	Of which secured by financial guarantees	
					Of which secured by credit derivatives
	a	b	c	d	e
Loans and advances	5,448,220.56	971,482.01	971,482.01	270,288.54	
Debt securities	148,237.30				
Total	5,596,457.85	971,482.01	971,482.01	270,288.54	
<i>Of which non-performing exposures</i>	31,000.00				
<i>Of which defaulted</i>	31,000.00				

The Bank does not have any credit derivatives as credit risk mitigant.

## 5.5. Standardised approach

The Bank uses the standardised approach for credit risk to determine its minimum capital requirement in accordance with the CRR. The standardised approach provides weighted risk figures based on external ratings given by External Credit Assessment Institutions (ECAI's) as indicated in the CRR. In order to apply the standardised approach for risk weighted exposure, the Bank uses external ratings assigned by the following rating agencies: Standard & Poor, Moody and Fitch.

The rating used for regulatory capital calculation is the lowest amongst the three ratings. If no external rating is available, the standardised approach provides specific risk weights defined by the regulator.

Table 5.5.1 Credit rating agencies and credit quality step under the standardised approach

Standard & Poor's	Moody's	Regulatory credit quality step
AAA to AA-	Aaa to Aa3	1
A+ to A-	A1 to A3	2
BBB+ to BBB-	Baa1 to Baa3	3
BB+ to BB-	Ba1 to ba3	4
B+ to B-	B1 to B3	5
CCC+ and below	Caa and below	6

Risk weights are mainly determined in relation to the credit quality step and the exposure class.

The following table shows credit risk exposure before credit conversion factor (CCF) and credit risk mitigation (CRM) and the exposure-at-default (EAD) broken down by exposure classes and split into on- and off-balance sheet exposures under the standardised approach.

Table 5.5.2 EU CR4 – standardised approach – Credit risk exposure and CRM effects



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Exposure classes	Exposures before CCF and before CRM		Exposures post CCF and post CRM		RWAs and RWAs density	
	On-balance-sheet exposures	Off-balance-sheet exposures	On-balance-sheet exposures	Off-balance-sheet amount	RWAs	RWAs density (%)
	a	b	c	d	e	f
Central governments or central banks	669,309.01		732,309.01	82,184.21	-	-
Regional government or local authorities						
Public sector entities						
Multilateral development banks						
International organisations						
Institutions	2,474,682.64	88,716.92	2,892,127.20	108,070.92	651,885.02	21.73%
Corporates	2,880,996.01	1,123,862.07	2,401,353.28	484,755.12	3,041,959.10	105.40%
Retail	801.83					
Secured by mortgages on immovable property	471,174.41		471,174.41		235,071.37	49.89%
Exposures in default						
Exposures associated with particularly high risk	19,863.04		19,863.04		29,794.56	150.00%
Covered bonds						
Institutions and corporates with a short-term credit						
Collective investment undertakings						
Equity						
Other items	6,410.80		6,410.80		5,990.96	93.45%
<b>TOTAL</b>	<b>6,523,237.74</b>	<b>1,212,578.98</b>	<b>6,523,237.74</b>	<b>675,010.25</b>	<b>3,964,701.01</b>	<b>55.08%</b>

In the application of Article 444(e), the following table shows the exposure-at-default post conversion factor and risk mitigation broken down by exposure classes and risk weights, under the standardised approach.

Table 5.5.3 EU CR5 – standardised approach

Exposure classes - In EUR'000	Risk weight						Total	Of which unrated
	0%	20%	35%	50%	100%	150%		
	a	e	f	g	j	k		
Central governments or central banks	814,493.22						814,493.22	
Regional government or local authorities							-	
Public sector entities							-	
Multilateral development banks							-	
International organisations							3,005,532.70	
Institutions	130,434.37	2,618,880.47		256,217.85			5,894,272.70	
Corporates					2,582,301.82	306,438.19	2,888,740.01	
Retail exposures							471,174.41	
Exposures secured by mortgages on immovable property			3,438.92	467,735.50			471,174.41	
Exposures in default							19,863.04	
Exposures associated with particularly high risk						19,863.04	19,863.04	
Covered bonds							-	
Exposures to institutions and corporates with a short-term credit assessment							-	
Units or shares in collective investment undertakings							-	
Equity exposures							-	
Other items	419.84				5,990.96		6,410.80	
<b>TOTAL</b>	<b>945,347.43</b>	<b>2,618,880.47</b>	<b>3,438.92</b>	<b>723,953.35</b>	<b>2,588,292.78</b>	<b>326,301.23</b>	<b>7,206,214.17</b>	

## 5.6. Counterparty Credit Risk

Counterparty credit risk (“CCR”) means the risk that the counterparty defaults before the last cash flow under contract is paid and fails to make payment in accordance with the contract.

All OTC transactions are monitored within the credit limits that are set for each individual counterparty, the customer relationship manager shall initiate the credit application with the support

of the financial market and institutions departments and manage overall credit limit. CCR limit shall be included in the overall credit granted by the Bank to the customer, subject to approval in accordance with the total credit approval authority and procedure and should follow global post-lending management. The limit is reviewed annually. The market value of the derivatives and the margin level are daily controlled and report via EMIR. The counterparty credit risk is managed under the “Counterparty Credit Risk Management Measure” framework, whose scope is detailed below:

- Over-the-Counter (“OTC”) transactions;
- Security financing transactions, including repurchase/reverse repurchase, security lending and margin lending transaction;
- Transactions with central counterparty.

At the current stage, the Bank is only exposed to a number of OTC derivatives transactions which belongs to the first category. As at 31 December 2020, there were three counterparties with which the Bank has concluded OTC derivatives and under the scope of the CCR framework.

In order to determine exposure value, the Bank has decided to apply the original exposure method with option of original maturity as per article 275 of CRR.

#### 5.6.1. CCR limit setting

The CCR limit of corporate customers is divided into OTC derivatives, SFTs and CCP transactions by type of product. It is valid for one year.

Regarding banking institutions, CCR limit shall be included into category-II risks. As for non-banking institutions, the treasury transaction limit (non-banking) shall be set.

#### 5.6.2. CCR reporting

A regular CCR report with the information is prepared and reported to the management body on a monthly basis. And the results showed that the collateral adequacy ratio is high enough to cover the potential loss borne by client.

Regarding the nature of these transactions, a cap/floor is concluded to cap the client’s interest rate risk on loan granted by the Bank. The Forward transaction is to limit the exchange rate risk of the future business in flow. The combined IRS/Floor option is to hedge the potential future EUR interest rate increase. And Finally HUI LI DA is a FX forward product combined with a trade finance product. Since the derivatives are used as a risk hedging tool, there is no positive correlation between the market risk factor and the client’s default probability. Thus there is no wrong way risk in these transactions.

The three transactions are concluded with a non-financial counterparty. A capital requirement is calculated according to the Original Exposure Method with the option of original maturity as per CRR art. 275, the CVA calculation is exempted accordingly.

#### 5.6.3. Analysis of CCR exposures by model approach

In the application of Article 439(f) in CRR, the following table shows the methods used for calculating the regulatory requirements for CCR exposure including the main parameters for each method. The

bank uses the Original exposure method to measure the exposure value of instruments subject to capital requirements for CCR.

Table 5.6.1 EU CCR1 – Analysis of CCR exposure by approach

	In EUR'000	Replacement cost (RC)	Potential future exposure (PFE)	EEPE	Alpha used for computing regulatory exposure value	Exposure value pre-CRM	Exposure value post-CRM	Exposure value	RWEA
EU1	EU - Original Exposure Method (for derivatives)				1.4	7,966.18	7,966.18	7,966.18	3,698.52
EU2	EU - Simplified SA-CCR (for derivatives)				1.4				
1	SA-CCR (for derivatives)				1.4				
2	IMM (for derivatives and SFTs)								
2a	<i>Of which securities financing transactions netting sets</i>								
2b	<i>Of which derivatives and long settlement transactions netting sets</i>								
2c	<i>Of which from contractual cross-product netting sets</i>								
3	Financial collateral simple method (for SFTs)								
4	Financial collateral comprehensive method (for SFTs)								
5	VaR for SFTs								
6	<b>Total</b>					<b>7,966.18</b>	<b>7,966.18</b>	<b>7,966.18</b>	<b>3,698.52</b>

#### 5.6.4. Standardised approach - CCR exposures by exposure class and risk weight

Pursuant to Article 444 (e) in the CRR, the following table provides the counterparty credit risk exposures under the standardised approach, broken down by risk weights and regulatory exposure classes. “Unrated” includes all exposures for which a credit assessment by a nominated ECAI is not available, and therefore the standard risk weights are used according to their exposure classes as described in CRR.

Table 5.6.2 EU CCR3 – Standardised approach – CCR exposures by regulatory exposure class and risk weights



Exposure classes (In EUR'000)	Risk weight		I
	e	i	
	20%	100%	Total exposure value
Central governments or central banks			
Regional government or local authorities			
Public sector entities			
Multilateral development banks			
International organisations			
Institutions	1,066.92		
Corporates		1,000.00	
Retail		1,631.61	
Institutions and corporates with a short-term credit assessment			
Other items			
<b>Total exposure value</b>	<b>1,066.92</b>	<b>2,631.61</b>	<b>3,698.52</b>

## 6. Market Risk

Market risk is the risk of an adverse changes in market price (interest rate, exchange rate, stock price and commodity price), which cause loss to a bank's on- and off-balance-sheet businesses. Market risk is directly linked to a bank's regulatory capital for market risk. Market risk under the second pillar includes interest rate risk in the banking book, and mainly refers to the negative impact caused by interest rate changes on a bank's net interest income or on the value of its equity.

### 6.1. Market risk governance

#### 6.1.1. Market risk management framework

The Bank's management on market risk split into Banking Booking and Trading Booking respectively,

##### Banking Book Related Risk Management

The Bank's treasury risk management's scope includes investment portfolio, funding activities, interbank money market activities as well as derivatives in the banking book. The "Treasury Risk Management Policy (2018 version)" has been elaborated to the followings:

- Specify the risk management measures for each type of treasury business;
- Define the risk limit (indicator) for treasury business;
- Clarify the reporting line and timeframe for any breach and incident;
- Integrate the new product management principal during the new treasury activities approval.

#### Trading Book Related Risk Management:

Promoted by the “loan +” strategy, the Bank starts to develop more OTC derivatives activities on behalf of clients. To follow this business trend and the risk profile change in trading book, the Bank has introduced widely the counterparty credit risk management as well as EMIR Implementation project.

The above-mentioned risk management regulation has the following objectives:

- Counterparty acceptance review. According to the derivatives risk management capacity, the counterparties are classified into two categories towards which the Bank applies the differentiation management in term of collateral requirement, counterparty credit risk exposure limit, etc.
- Monitor effectively the collateral adequacy ratio;
- Define the segregation of duties between front office, middle office and back office regarding the MtM valuation, collateral management, as well as dispute resolution, etc.
- Determine the risk exposure measurement method in order to calculate the capital requirement;
- Clarify the reporting line and the triggered threshold as well as the timeframe;
- Allocate adequately capital requirement resulted from counterparty credit risk.

#### 6.1.2. Market risk policy

The “Market Risk Management Policy” covers the overall market risk management framework which includes the definition of market risk, the classification of the banking book and trading book, the internal governance, the identification, monitoring, measurement, reporting of market risk as well as the capital allocation.

The Bank does not take any speculative positions for its own account. The management of market risk results from mainly the trading book on behalf of clients and the Banking Book (including investment portfolio).

“Emir” policy clarifies the responsibilities of dispute resolution. A periodical legal enforceability of collateral assessment is also performed by legal function of the Bank.

## 6.2. Market risk monitoring

Addressing the different types of transactions, the Bank maintains control guidance in respect of market risk management, and performs monitoring based on stated frequency and methods. As at 31st December 2020, various indicators indicated that the current operating situation is in excellent state (please refer to the following table for details), and are well controlled, within limits and benchmarks.

Table 6.2.1 Market risk indicators as at 31 December 2020



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Portfolio	Risk Indicator	Tolerance Level Limit	Monitoring Frequency	31/12/2020
Banking Book	SWAP Authorization (USD/CNH FX Swap_Adjusted Volume in USD)	\$270,000,000	Daily/Monthly	0
	SWAP Authorization (Other Currency FX Swap_Adjusted Volume in USD)	\$930,000,000	Daily/Monthly	\$4,691,273.95
	SWAP Authorization (FX Swap Nominal / Total Assets)	FX Swap Nominal / Total Assets < 20%	Monthly	0.01839%
Investment Book	PVBP	\$300,000	Daily	(\$95,539.72)
	Stress test on bond portfolio	\$40,000,000	Daily	(\$18,771,887.73)
Trading Book	Foreign Exchange Position	\$600,000	Daily	\$55,624.76
	PVBP	\$3,000	Daily	\$132.79
	VaR	\$150,000	Daily	\$5,208.99
	P&L	Loss > - \$60,000	Daily	\$279,810.60

Along with the market risk indicator, the fair-value check, late trading transaction as well as cancelled (&reissued) transactions are investigated daily to detect any potential dealer’s “operational risk” linked to the transactions.

### 6.3. Risk control measurement

A set of market risk management tools is in place to effectively measure and mitigate market risk. The IRRBB is measured by the ratio of Economic Value of Equity versus Own Funds. The exchange rate risk is calibrated by the foreign exposure limit. Market risk measurement tools such as VAR2 and PVBP3 were implemented and the results are monitored daily against internal limits. In conclusion, the market risk management framework in place allows the Bank to prepare and anticipate remedial actions in case of adverse market movements.

#### 6.3.1. Interest risk in the Banking Book

IRRBB is the risk that the banking book of the Bank experiences a material impact on its net interest income (hereafter “NII”) and / or a material impact on the economic value of equity (hereafter “EVE”) due to adverse changes of level or term structure of interest rates.

#### IRRBB management

IRRBB management is aimed at, through effective management, controlling the adverse impact on the overall earnings and economic value of the Bank due to the movement of interest rates within the acceptable level under the overall business strategy and risk appetite, and promoting a sustainable growth of the Bank’s earnings.

The Bank’s activity consists almost exclusively of the banking book, meaning that client lending/deposit and market funding. As a consequence, IRRBB is a material risk for the Bank.

Since the Bank has largely followed the provisions stated in EBA/GL/2018/02, the new CSSF circular 20/762 should have no material impact on the Bank. However, in 2021, a revision is planned to incorporate the requirement of the new circular into the Bank’s IRRBB management.

<sup>2</sup> VAR: Value at Risk

<sup>3</sup> PVBP: Price Value of a Basis Point

The Bank's RMD is responsible to oversight IRRBB management under risk appetite and tolerance defined and approved by management body.

#### IRRBB policy

The latest IRRBB policy from 2019 set up internal governance, defines IRRBB identification model, adopts an adequate measurement approach, designs stress test scenarios with reasonable assumptions and finally establishes an effective reporting line.

Defined in IRRBB Policy, the sources of Interest Rate Risk include the (reprising) gap risk, basis risk and option risk.

IRRBB mitigation tools are in place such as banking book interest rate derivatives as well as management measures to change the asset/liability structure.

#### Risk monitoring

Closely linked with liquidity risk management, the Bank's IRRBB focuses on (reprising) gap risk which arises from the term structure of banking book positions. The basis risk and option risk is minor for the following reasons:

- Majority of the loan are priced at floating rate;;
- The retail mortgage loan portfolio is insignificant (less than 1% of portfolio size).

#### IRRBB stress scenario

Stress testing on IRRBB is mainly used for assessing the potential loss of earning and economic value of the Bank under extremely adverse market conditions.

The Bank has implemented the six stress test scenarios documented in the EBA guidelines. As a starting point, the Bank identifies currencies eligible for IRRBB calculation. The selected currencies must form at least 90% of total exposure and the selected currency should be at least 5% of Bank's total assets or liabilities.

The Bank categorizes its interest-sensitive assets, liabilities and off-balance sheet positions into a series of re-pricing time bands resulting in a maturity/re-pricing schedule gap forming the basis of the calculation. The re-pricing time bands (re-pricing tenors or time buckets) that are taken into account are in full compliance with guidelines at EBA/GL/2018/02 as transposed by CSSF circular. The re-pricing time bands shall be applicable to each material currency separately.

For non-maturity deposits (NMDs), the Bank can analyze customers' behavior based on relevant historical data of the business, validate and calibrate results of customer behavior analysis results regularly. Under this regulatory waiver, Risk Management Department applies average re-pricing tenor of up to 5 years for corporate deposits on demand. Regarding retail deposits on demand, no modifications are applied, hence in that case all retail deposits on demand are presented in the nearest re-pricing tenor possible (overnight), until further notice. The rationale behind this approach relies on the deposit profile the Bank, based on which retail deposits do not represent material risk.

The stress test result is obtained by EVE/NII change, all material currencies aggregated under each

scenario. The worst case of the six prescribed stress test is taken into consideration for the EVE ratio as well as internal capital allocation.

The Bank has set up an alert threshold to get early warnings for significant negative impacts to EVE from IRRBB calculation results. The threshold of an “early warning signal” has been set at 15% of Tier 1 capital. Where the decline in EVE is greater than 15% of the institution’s Tier 1 capital under any of the six scenarios, RMD must report within 5 working days to BOD, authorized management and inform CSSF.

The NII fluctuation ratio threshold is set up as 20% of the interest income forecast.

As of 31st December 2020, the worst result is an EVE decline of 14.45 million under the parallel up scenario, which represent -1.90% of own fund and -2.86% of Tier I capital. The below table shows the detailed stress test results:

Table 6.3.1 IRRBB stress test

Scenarios	Significant Currencies			Impact on EV (in thousands of EUR)	% of Own Fund	% of Tier I capital
	EUR	USD	PLN			
Parallel up	(4,939.96)	(7,853.54)	(1,664.74)	(14,458.23)	-1.90%	-2.86%
Parallel down	-	1,670.29	659.28	1,164.78	0.15%	0.23%
Short rate positive	10,489.65	(1,119.96)	1,149.67	4,699.70	0.62%	0.93%
Short rate negative	-	-	657.99	328.99	0.04%	0.07%
Flatten	10,985.94	(1,714.56)	583.14	4,069.98	0.53%	0.81%
Steepen	6.73	(466.60)	(188.15)	(651.38)	-0.09%	-0.13%

As of 31st December 2020, the NII ratio is between 5.02% and 0.06%

Scenarios	Significant Currencies			Impact on NII (in thousands of EUR)	% of Interest Income forecast
	EUR	USD	PLN		
Parallel up	-4939.96	-7853.54	-1664.74	4063.05	5.02%
Parallel down	0.00	1670.29	659.28	49.32	0.06%

## 6.4. Market risk exposures

The Bank’s market risk exposures mainly come from foreign exchange risk and interest rate risk. According to the Market Risk Standardised approach, total exposure to be considered for foreign exchange risk is the maximum between the total of long and short positions in the foreign currency, net short and long positions in each currency other than the capital currency shall be translated at spot rates into the capital currency. The higher of these two totals, regardless of its sign, shall constitute the credit institution’s overall net currency position, if the net position exceeds 2% of the Bank’s own funds.

The following table provide the breakdown of the net currency position of the foreign exchange exposure.

Table 6.4.1 Net currency position as at the 31 December 2020



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Currency	Currency Code	Net Position (In EUR'000)
Euro	EUR	4,392.88
Canadian Dollar	CAD	13.72
Danish Krone	DKK	0.63
Pound Sterling	GBP	12.28
Zloty	PLN	690.75
Rumanian Leu	RON	255.67
Swedish Krona	SEK	3,863.19
Swiss Franc	CHF	3.38
US Dollar	USD	119.71
Norwegian Krone	NOK	22.92
Yuan Renminbi	CNY	33.83
Other		5.88
<b>Total</b>		<b>9,414.84</b>

At the 31 December 2020, total net currency exposure amount to EUR 9.14 million, of which Euro represented highest exposure of 46.66%, followed by Swedish Krona of 41.03%. "Other" refers to Croatian Kuna, which represents an insignificant foreign exchange exposure for the Bank.

### 6.5. Capital requirement for market risk

Market risks of the Bank are treated under the Basel III standardised approach. The table below presents the bank's regulatory capital required broken down by risk type.

At end of 2020, the Bank's RWEAs under foreign exchange risk amount to EUR9.41 million, the net position is less than 2% of the Bank's own funds, therefore is not subject to market risk capital requirement.

Table 6.5.1 EU MR1 - Market risk under the standardised approach

In EUR'000	RWEAs
<b>Outright products</b>	
Interest rate risk (general and specific)	
Equity risk (general and specific)	
Foreign exchange risk	9,414.84
Commodity risk	
<b>Options</b>	
Simplified approach	
Delta-plus approach	
Scenario approach	
Securitisation (specific risk)	
<b>Total</b>	<b>9,414.84</b>

## 7. Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, staff and IT system, or from external events. It includes legal risk but excludes strategic and reputation risk. It is relevant to every aspect of the Bank's business and covers a wide spectrum of issues. Losses arising through fraud, unauthorized activities, errors, omission, inefficiency, systems failure or from external events all fall within the definition of operational risk.

### 7.1. Operational risk governance

#### 7.1.1. Policy

The Operational Management Policy established for the purpose to improve the Bank's operational risk management framework, enhancing the operational risk management capacity, effectively managing the operational risk, reducing impact of incidents and the losses from operational risk.

The operational risk management system penetrates into each business process and each operational sector, cover all the departments, branches and positions, and it should be performed by all the staffs.

#### 7.1.2. Risk reporting and monitoring

The operational risk management matches our Bank's internal and external environments, make timely adjustment and improvement based on the changes in the business strategies, concepts, as well as changes in external economic, political and regulatory environments.

Risk Management department make reports on operational risk to the Risk and Internal Control Committee, the Board Risk Committee of the Bank on quarterly basis. All staffs from the First Line of defense department shall report to the Head of department for any operational risk matter.

In the aspect of operational risk management, the Risk and Internal Control Committee maintains the overall operation of the Bank's operational risk management framework, assessing the effectiveness of operational risk management framework and system, identifying the deficiencies and weaknesses of operational risk management framework, making decision on relevant improvement measures and supervising the implementation thereof.

#### 7.1.3. Risk control

The operational risk management measures accommodate the specific business scale, complexity and characteristic, and seek for a reasonable balance between the risk management cost and return.

To ensure an effective control over the operational risk in operation management activities, our Bank's operational risk management must regularly assess the adequacy of the operational risk control measures or other mitigation measures and determine the acceptability of operational risk after implementation of those measures.

The inherent risk is attributed for each of these processes taking into account the potential impact of the specified activity and its likelihood of occurrence. The residual risk is calculated after mitigation factor which consists of the quality of the controls in place (control design and effectiveness implementation, systems supporting the activity, documentation and human resources). Should the residual risk (final result) is not acceptable, remediation/action plans have to be initiated to reduce the identified risk at the required (the “acceptable”) level. High residual risks have to be prioritized.

If the operational risk is unacceptable due to the residual risk, the remedial measures are to be adopted and must be recorded formally. The person liable for rectification must be specific, and he or she should, regularly monitor the implementation of the remedial measures and ensure that this operational risk problem could be resolved within the limited rectification time.

## 7.2. Risk measurement

The Bank classifies operational risk in respect of the cause, event and impact of operational risk risk cause, operational risk event and its impact, in order to have a unified and consistent “common language” for operational risk management of the whole bank.

The Bank uses three tools to manage residual operational risk: KRI, LDC and RACA. In addition, the Bank monitors operational risk alerts generated by an in-house operational risk system called G-map. Key risk models related to the main business line are monitored by the system. In case one of the models is triggered by an “abnormal transaction”, an alert appears in the system. Investigations and supporting documents are required for each alert in order to exclude the operational risk factor.

## 7.3. Operational risk event and data collection

The LDC tool has been significantly enhanced by implementing a timely and detailed assessment of each operational risk event. The accountability of the person in charge of process improvement and the follow-up of the rectification are put in place. 2020 witnessed a significant improvement in risk incidents and loss in comparison to 2019.

## 7.4. Capital requirement for operational risk

The Bank uses the Basic Indicator Approach for operational risk to determine its minimum capital requirements, in accordance with the CRR.

This capital requirement is equal to 15% of the basic indicator defined in CRR art 315. The calculation of the basic indicator is based on the simple arithmetic average over three years of the sum of net interest income and net non-interest income of the Bank.

Table 7.4.1 EU OR1 - Operational risk own funds requirements and risk-weighted exposure amounts



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	Banking activities (In EUR'000)	a	b	c	d	e
		Relevant indicator			Own funds requirements	Risk weighted exposure amount
		Year-3	Year-2	Last year		
1	Banking activities subject to basic indicator approach (BIA)	87,100.53	90,797.64	84,465.60	13,118.19	163,977.35
2	Banking activities subject to standardised (TSA) / alternative standardised (ASA) approaches					
3	<i>Subject to TSA:</i>					
4	<i>Subject to ASA:</i>					
5	Banking activities subject to advanced measurement approaches AMA					

## 8. Liquidity Risk

Liquidity risk is a bank's capacity to an fund increase in assets and meet both expected and unexpected cash and collateral obligations at a reasonable cost and without incurring unacceptable losses.

Regarding the nature of liquidity risk, it can be divided into inherent liquidity risk despite of the Bank's business model and specific liquidity risk linked to the bank's operations.

The inherent risk can exist in two situations: Market Risk and Funding Liquidity Risk. The Market Risk refers to the risk that a position cannot easily be unwound or offset at short notice without significantly influencing the market price. The Funding Liquidity Risk refers the current or prospective risk arising from a bank's inability to meet its liabilities as they come due without incurring unacceptable losses.

Taking into consideration the Bank's business model and main activities, the liquidity risk could be a result of credit risk, market risk, concentration risk, operational risk and reputational risk. As a consequence, liquidity risk cannot be managed on a stand-alone basis.

### 8.1. Liquidity Risk Management Framework

The responsibility of Risk Management of the Bank lies with its Board of Directors. The Board is responsible for establishing and communicating to the Authorised Management (AM) the liquidity policy, governing liquidity risk taking and liquidity risk management as well as liquidity planning, management and adequacy. The Board entrusts the AM with the implementation of this Policy through adequate procedures. The Board monitors this implementation at least once a year, to ensure that the Bank manages its liquidity and the related risks.

The Board determines and approves the strategy and objectives in relation to risk taking and management, including liquidity planning, management and adequacy as per Group guidelines and delegates the implementation to the AM. The Board monitors the implementation of the policy by the AM and is committed to maintain and strengthen the control environment to ensure that risks are

minimized and properly monitored.

In order for the Board to formulate and approve a sound liquidity strategy that will adequately cover relevant risks in the Bank's operations, that will support its business plan and will adhere to EU rules and regulations,

The Board reviews and approves ILAAP on a yearly basis. Additionally, governance structure of liquidity risk management includes BRCC, the AM, ALCO, Board Audit Committee and Internal Audit Department and other functional departments of the Bank such as FD, FMID and RMD.

Additionally, the governance structure of liquidity risk management includes BRCC, the AM, ALCO, Board Audit Committee and Internal Audit Department and other functional departments of the Bank such as FD, FMID and RMD.

FD acts as a first line of defense for liquidity management. It liaises with FMID, cross-border branches and business departments on a daily basis to manage the daily liquidity inflow/outflow and calculate the liquidity risk indicators.

RMD is the second line of defense. It reviews and controls the liquidity risk appetite, tolerance and limits, in line with the existing regulations or H.O.'s requirement. It proposes the amendment of the internal monitoring threshold if needed and oversees the overall liquidity adequacy of the Bank.

IAD is the third line of defense. It assesses independently the compliance of ILAAP report and formulates the observations and recommendations if needed. The internal audit report should be communicated to the regulator.

#### 8.1.1. Liquidity Risk Strategy

The tolerable liquidity risk of the Bank against normal situation and under stress is that the shortest survival period is not less than 30 days. The Bank shall assess its tolerable liquidity risk at least once a year, and revise if necessary.

Based on the bilateral communications with the cross-border Branches regarding the liquidity management, the Bank sets the yearly Key Performance Indicators at both a consolidated and individual basis to ensure proper control and full compliance of the whole spectrum of liquidity operations.

#### 8.1.2. Funding strategy management

In 2020, on the funding side, the Bank has mainly borrowed and lent within BOC group, including cross-border branches and Branch. In principle, the Bank does not directly get funding source from the market as it has no external rating. Market participants outside of the BOC group have no transaction limit with the Bank. In case the Bank needs to finance a small currency loan (PLN, SEK etc), it obtains the corresponding currency via currency swaps.

## 8.2. Liquidity Contingency Funding Plan

The Liquidity Contingency Funding Plan standardizes the workflow in a liquidity crisis in order to regulate the liquidity crisis response process of the Bank, to improve the liquidity contingency funding plan implementation mechanism, and to ensure the Bank responds to the crisis quickly and takes effective measures to smoothly stand the crisis and restore normal operation.

Based on the source of liquidity crises, it can be divided by two categories: market (external) and self (internal) crisis.

These following crisis events can lead to a series of consequences which may have liquidity impact for the Bank:

- Client in financial difficulties may draw the granted credit lines;
- Client may reduce the maturity of their deposits in the Bank;
- Client may try to negotiate the extension of the repayment schedule;
- Client may negotiate a higher deposit rate ;
- Client may withdraw their funds deposit in the Bank, etc

In case one of the early warning indicators is breached, the liquidity contingency funding plan will be enacted and a process of escalation will be followed. Additionally, based on the result of the stress test, the management of the Bank can also decide to activate the contingency funding plan. The Bank has contingency funding tools to meet the liquidity shortfall

## 8.3. Risk measurement

FD acts as a first line of defense for liquidity management. It liaises with FMID, cross-border branches and business departments on a daily basis to manage the daily liquidity inflow/outflow and calculate the liquidity risk indicators. These indicators include liquidity ratios and liquidity gaps, which compare liquidity reserves with liquidity needs and ratio then report to the regulatory body.

## 8.4. Liquidity coverage ratio

As the main short-term liquidity reference indicator, the LCR requires the bank to hold sufficient High-Quality Liquid Assets (HQLA) to cover its total net cash outflows over 30 days.

The Bank has set as a liquidity priority to maintain a solid liquidity coverage ratio, enabling smooth management of operational outflows without needing to activate additional liquidity measures. This area is at 130% and above and is considered by the Bank to be the LCR green area, where no further actions needed. Based on the monthly calculations applied by the Bank, the Bank remained well above the internally set green threshold of 130% (which acts as an “early warning area” for the LCR performance and is set between 120% and 130%) throughout the year.

Apart from the monthly calculation and monitoring of the LCR, the Bank also monitors its LCR performance on a daily basis. As demonstrated in the following chart, the Bank was compliant with the regulatory requirements of LCR throughout 2020.



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Table 8.4.1 EU LIQ1 - Quantitative information of LCR

EU 1a	In EUR'000 Quarter ending on (DD Month YYY)	Total unweighted value (average)				Total weighted value (average)			
		31/12/2020	30/09/2020	30/06/2020	31/03/2020	31/12/2020	30/09/2020	30/06/2020	31/03/2020
EU 1b	Number of data points used in the calculation of averages	12	12	12	12	12	12	12	12
<b>HIGH-QUALITY LIQUID ASSETS</b>									
1	Total high-quality liquid assets (HQLA)					637,416.19	531,827.54	500,222.47	759,727.05
<b>CASH - OUTFLOWS</b>									
2	Retail deposits and deposits from small business customers, of which:	52,439.09	49,910.96	48,466.37	44,445.84	6,564.32	7,159.58	6,810.76	6,025.18
3	Stable deposits								
4	Less stable deposits	52,439.09	49,910.96	48,466.37	44,445.84	6,564.32	7,159.58	6,810.76	6,025.18
5	Unsecured wholesale funding	1,072,709.25	1,263,805.43	1,507,963.29	2,066,264.06	741,403.07	923,237.10	1,162,415.73	1,534,638.87
6	Operational deposits (all counterparties) and deposits in networks of cooperative banks								
7	Non-operational deposits (all counterparties)	1,072,709.25	1,263,805.43	1,507,963.29	2,066,264.06	741,403.07	923,237.10	1,162,415.73	1,534,638.87
8	Unsecured debt								
9	Secured wholesale funding								
10	Additional requirements	1,075,138.51	1,052,683.71	774,594.81	680,374.83	164,525.76	163,421.13	131,115.85	93,666.78
11	Outflows related to derivative exposures and other collateral requirements	1.05				1.05			
12	Outflows related to loss of funding on debt products								
13	Credit and liquidity facilities	1,075,137.46	1,052,683.71	774,594.81	680,374.83	164,524.71	163,421.13	131,115.85	93,666.78
14	Other contractual funding obligations	50,628.71	11,264.59	11,989.95	506,249.84	46,309.23	6,945.10	7,670.47	501,930.36
15	Other contingent funding obligations	137,859.04	148,599.39	187,493.63	236,340.43	-	-	-	-
16	TOTAL CASH OUTFLOWS					958,802.39	1,100,762.92	1,308,012.80	2,136,261.18
<b>CASH - INFLOWS</b>									
17	Secured lending (e.g. reverse repos)								
18	Inflows from fully performing exposures	1,959,746.31	2,199,289.07	2,110,562.67	2,390,370.81	1,933,872.40	2,172,491.26	2,079,071.11	2,357,301.51
19	Other cash inflows	1.04	44.07	213.05	122.80	1.04	44.07	213.05	122.80
EU-19a	(Difference between total weighted inflows and total								
EU-19b	(Excess inflows from a related specialised credit institution)								
20	TOTAL CASH INFLOWS	1,959,747.35	2,199,333.13	2,110,775.72	2,390,493.61	1,933,873.44	2,172,535.33	2,079,284.16	2,357,424.31
EU-20a	Fully exempt inflows								
EU-20b	Inflows subject to 90% cap								
EU-20c	Inflows subject to 75% cap	1,959,747.35	2,199,333.13	2,110,775.72	2,390,493.61	1,933,873.44	2,172,535.33	2,079,284.16	2,357,424.31
<b>TOTAL ADJUSTED VALUE</b>									
EU-21	LIQUIDITY BUFFER					637,416.19	531,827.54	500,222.47	759,727.05
22	TOTAL NET CASH OUTFLOWS					239,700.60	275,190.73	327,003.20	534,065.30
23	LIQUIDITY COVERAGE RATIO					265.92%	193.26%	152.97%	142.25%

The above table shows that the LCR ratio has increased substantially to 265.92% in the fourth quarter compared to 142.25% at beginning of 2020. The total external funding sources include bond issuance, corporate, financial institution and retail deposits, of which deposits from credit institution of 35%

represented the highest funding source of the Bank. The funding structure of the Bank can be considered as stable and diversified. The following shows detailed information in accordance with the circular CSSF 18/676 on LCR disclosure.

The Bank anticipates that it will continue to be fully compliant with the minimum applicable level of LCR for the whole year 2021, with a focus on increasing the frequency of LCR performances at closer to 200% levels. January 2021 is on track with this strategy, with LCR measurements steadily around and above 200%.

The observations that fall below the internal early warning buffer are monitored and investigated by FD to ensure the source of the issue, the duration and if required the application of supplementary actions. In the vast majority of the cases, the source of the relatively lower LCR performance is commonly attributed to changes in the outflow part of the LCR equation (e.g. money transfers on behalf of a client), rather than changes in HQLA.

## 8.5. Net Stable Funding Ratio

This is the Liquidity standard requiring banks to hold enough long-term stable funding to cover the duration of their long term assets. For both funding and assets, long term available stable funding (ASF), the portion of capital and eligible liabilities mainly defined as > 1 year, with declining allowable amounts of stable funding < 1 year. Required stable funding (RSF) is the denominator of the ratio, being the amount of stable funding that the bank is required to hold, given the liquidity requirements of its on and off-balance sheet exposures.

Additionally, and in full compliance with the regulatory requirements for stable funding monitoring and periodic stable funding measurements, the Bank performs Net Stable Funding Ratio (NSFR) calculations on a quarterly basis. As demonstrated in the following charts:

- The Bank constantly met the minimum regulatory requirements for NSFR throughout 2020
- The Bank is steadily meeting the updated requirements imposed by BCL / CSSF for 2020 (75%), and is on track to meeting the upgraded regulatory requirements 2021 (90% since January 2021 and 100% since June 2021) as already all four quarters of 2020 surpassed the enhanced regulatory obligation and aim in further improving its performance for 2021.

The ratio is calculated and monitored daily, NSFR daily calculations are communicated to relevant management departments and include all cross-border branches.

The table below shows the detailed information for NSFR:

Table 8.5.1 EU LIQ2: Net Stable Funding Ratio



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(In EUR'000)		Unweighted value by residual maturity				Weighted value
		No maturity	< 6 months	6 months to < 1yr	≥ 1yr	
<b>Available stable funding (ASF) Items</b>						
1	Capital items and instruments	<b>761,412.18</b>				<b>761,412.18</b>
2	Own funds	761,412.18				761,412.18
3	Other capital instruments					
4	Retail deposits		<b>49,508.90</b>	<b>10,170.39</b>	<b>3,017.55</b>	<b>58,396.75</b>
5	Stable deposits		29,011.78	4,344.79	153.20	31,841.95
6	Less stable deposits		20,497.12	5,825.60	2,864.35	26,554.80
7	Wholesale funding:		<b>3,769,596.15</b>	<b>353,418.48</b>	<b>685,536.80</b>	<b>1,732,027.72</b>
8	Operational deposits					
9	Other wholesale funding		3,769,596.15	353,418.48	685,536.80	1,732,027.72
10	Interdependent liabilities					
11	Other liabilities:					
12	NSFR derivative liabilities					
13	All other liabilities and capital instruments not included in the above categories		81,276.33		810,974.40	799,102.26
14	<b>Total available stable funding (ASF)</b>					<b>3,350,938.91</b>
<b>Required stable funding (RSF) Items</b>						
15	Total high-quality liquid assets (HQLA)					
EU-15a	Assets encumbered for more than 12m in cover pool					
16	Deposits held at other financial institutions for operational purposes					
17	Performing loans and securities:					
18	Performing securities financing transactions with financial customers collateralised by Level 1 HQLA subject to 0% haircut			148,237.30		7,411.86
19	Performing securities financing transactions with financial customer collateralised by other assets and loans and advances to financial institutions		2,457,949.15			368,692.37
20	Performing loans to non-financial corporate clients, loans to retail and small business customers, and loans to sovereigns, and PSEs, of which:			349,543.01	302,182.49	325,862.75
21	With a risk weight of less than or equal to 35% under the Basel II Standardised Approach for credit risk				2,717,670.88	2,310,020.25
22	Performing residential mortgages, of which:				3,438.92	2,235.30
23	With a risk weight of less than or equal to 35% under the Basel II Standardised Approach for credit risk				3,438.92	2,235.30
24	Other loans and securities that are not in default and do not qualify as HQLA, including exchange-traded equities and trade finance on-balance sheet products					
25	Interdependent assets					
26	Other assets:					
27	Physical traded commodities					
28	Assets posted as initial margin for derivative contracts and contributions to default funds of CCPs					
29	NSFR derivative assets					2,374.43
30	NSFR derivative liabilities before deduction of variation margin posted					
31	All other assets not included in the above categories		22,922.24			22,922.24
32	Off-balance sheet items		<b>1,212,578.98</b>			<b>53,756.87</b>
33	<b>Total RSF</b>					<b>3,093,276.07</b>
34	<b>Net Stable Funding Ratio (%)</b>					<b>108.33%</b>

## 8.6. Encumbered assets

An asset is considered encumbered if it has been pledged or if it is subject to any form of arrangement to secure, collateralize or credit enhance any transaction from which it cannot be freely withdrawn and used for funding purposes. The Bank fully recognizes the risks associated with increased levels of asset encumbrance; these risks can be summarized into four categories:

- Limited reserves to pledge in case of emergency: potentially encumbered balance sheets have fewer assets available for encumbrance, i.e. Assets that act an available liquidity buffer and that can be used for unexpected future liquidity needs, such as liquidity outflows from committed credit lines, margin calls on derivative positions, significant deposits outflows etc.
- Strong connection between liquidity and market valuation and / or haircuts: whenever the cash value of encumbered assets decreases for any reason, the Bank has to provide additional collateral (additional encumbrance occurs) to offset the above decrease of the value
- Increased structural subordination of unsecured depositors / “crowding out” of unsecured funding: the shift towards secured funding and the resulting asset encumbrance may imply lower recovery rates for unsecured creditors and hence increased costs of unsecured wholesale funding, potentially leading to crowding – out of unsecured wholesale funding. Bank funding excessively skewed towards secured funding and increasing encumbrance of high quality assets can negatively impact the rating received by institutions and hence generate further increases in encumbrance and additional downgrades.
- In conjunction with the previous point, high levels of encumbrance can precipitate depositors’ loss of confidence in time of crisis.

As per EBA Guidelines on the disclosure of encumbered and unencumbered assets (the EBA Guidelines 2014/03) transposed in Luxembourg through CSSF circular 15/605, the Bank has assessed its encumbered and unencumbered asset level.

The Bank has had very limited encumbered assets in December 2020; encumbrance stems primarily from non-withdrawable central bank reserves, which are part of the Bank’s own funds and cannot be withdrawn in time of stress. Additionally, there is a limited amount of EUR3.09 million stemming from variation margin purposes. The total encumbered asset amount reached EUR51.35 million at year end.

Table 8.6.1 EU AE1 - Encumbered and unencumbered assets

(In EUR'000)	Carrying amount of encumbered assets		Fair value of encumbered assets		Carrying amount of unencumbered assets		Fair value of unencumbered assets	
	010	of which notionally eligible EHQLA and HQLA	040	of which notionally eligible EHQLA and HQLA	060	of which EHQLA and HQLA	090	of which EHQLA and HQLA
		030		050		080		100
<b>Assets of the reporting institution</b>	51,352.66	32,312.66			6,483,741.83	636,996.35		
Equity instruments								
Debt securities					148,237.30	148,237.30	148,237.30	148,237.30
of which: covered bonds								
of which: securitisations								
of which: issued by general governments					148,237.30	148,237.30	148,237.30	148,237.30
of which: issued by financial corporations								
of which: issued by non-financial corporations								
Other assets	51,352.66	32,312.66			6,335,504.53	488,759.05		



Table 8.6.2 EU AE2 - Collateral received and own debt securities issued

(In EUR'000)	Fair value of encumbered collateral received or own debt securities issued		Unencumbered	
			Fair value of collateral received or own debt securities issued available for encumbrance	
	010	of which notionally eligible EHQLA and HQLA 030	040	of which EHQLA and HQLA 060
<b>Collateral received by the reporting institution</b>				
Loans on demand				
Equity instruments				
Debt securities				
of which: covered bonds				
of which: securitisations				
of which: issued by general governments				
of which: issued by financial corporations				
of which: issued by non-financial corporations				
Loans and advances other than loans on demand				
Other collateral received				
<b>Own debt securities issued other than own covered bonds or securitisations</b>				
<b>Own covered bonds and asset-backed securities issued and not yet pledged</b>				
<b>TOTAL ASSETS, COLLATERAL RECEIVED AND OWN DEBT SECURITIES ISSUED</b>	51,353	32,313		

Table 8.6.3 EU AE3 - Sources of encumbrance

(In EUR'000)	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and securitisations encumbered
	010	030
<b>Carrying amount of selected financial liabilities</b>		51,353

The asset encumbrance ratio<sup>4</sup> measures the asset encumbrance of credit institutions in Europe in a harmonised way. The overall weighted average encumbrance ratio calculated and published regularly by the EBA, in June 2020, the asset encumbrance ratio rose to 27.5%. and the Bank had ratio of 0.79% as at the end of 2020 which is very low level of asset encumbrance compared to other institutions.

Table 8.6.4 ratio of encumbrance asset as at 31<sup>st</sup> December 2020

(in EUR'000)	31/12/2020
<b>Ratio of asset encumbrance</b>	
Encumbered assets	51,352.66
Collateral received	-
Total encumbered assets	51,352.66
Total non-encumbered Assets	6,483,741.83
<b>Total assets</b>	<b>6,535,094.49</b>
<b>Ratio</b>	<b>0.79%</b>

<sup>4</sup> Asset encumbrance ratio = (Encumbered assets + Collateral received re-used) / (Total assets + Total collateral received).

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## 9. Other Risks

### 9.1. Concentration Risk

#### Identification

Concentration risk refers to the losses an institution could suffer from a group of exposures or activities whose intrinsic value depends on a common set of risk factors. It is part of specific risks required to be assessed as part of Pillar II framework.

As per Article 81 of CRD IV and Part Four of CRR related to large exposures requirements, the Bank has assessed its concentration risk and implemented concentration risk identification, measurement and control, mitigation and reporting process.

#### Mitigation

The Bank is exposed to a concentration of risks due to the fact that a certain volume of business is conducted with few clients. The Bank monitors the concentration risk on a dynamic basis.

- *Credit Concentration Risk*

The credit concentration risk is the most material concentration risk that the Bank is exposed to. The Bank has continuously improved its technical standards to identify, on one side, the connected client as per EBA/GL/2017/15's requirement, and used diversification tools to pilot the composition of the credit portfolio with multi-dimensional limit monitoring. By doing so, the Bank believes to reduce the correlation between the borrowers, as well as the implied credit risk factors.

- *Connected client and Large Exposure management*

In previous years, the Bank endeavoured to enhance the client related information and risk data exploration in order to effectively identify connected clients. The Bank closely follows up the requirement change induced by CRR II regarding large exposure calculation and has taken anticipated measure to ensure the compliance when CRR rule enters into force.

- *Portfolio diversification management*

The Bank has a corporate credit portfolio management scheme to control concentration risk by monitoring the following limits and report to General Management at least every quarter. In Q2 2020, the Bank has issued a new "Corporate Credit Portfolio Management Scheme", in which some adjustments regarding industry classification and appetite were approved with regards to the Covid-19 impact on economy. The risk exposure contains both on and off-balance sheet positions.

- *Liability Concentration Risk*

The Bank analyzed liability concentration risk. The funding sources are mainly intergroup financing and corporate client deposits. Taking into consideration the diversification and number of clients, the funding concentration risk is medium.

- *Operational Concentration Risk*

Operational risk concentration (OPRC) means any single operational risk exposure or group of



operational risk exposures with the potential to produce losses large enough to worsen the Bank's overall risk profile so that its financial health or its ability to maintain its core business is threatened. It may not always be apparent that multiple risk factors are correlated as this may only be revealed under stressed market conditions.

- *Credit-Liquidity Concentration Risk*  
Failure of material counterparties impairs the Bank's cash flow and its ability to meet commitments. Its liquidity management process (including compliance with the liquidity coverage ratio, the Bank's recovery plan, ...) ensures that the Bank's cash flow will not suffer to the point where the institution cannot fulfil its obligations in terms of liquidity.

- *Credit-Market Concentration Risk*  
Counterparties may be closely related, or identical, or where unsystematic or un-diversifiable risk (i.e. the part of the market risk which derives not from general price movements but from specific ones due to, for example, changes in the perception of the inherent credit risk of an issuer) may exist. We believe that this type of inter-risk concentration is unlikely to occur as we do not grant credit facilities in addition to investing in the equity of a company. We have strict exposure limits on our clients.

Inter-risk concentration between credit risk and market risk based on the FX rate. Lending in foreign currency to domestic borrowers is exposed to both market (FX rate) and credit risk. When the domestic currency depreciates, the value of the loan in the domestic currency increases which (by increasing the cost of instalments) may reduce the ability of borrowers to repay. Our portfolio is more and more oriented in Euro currency and therefore less subject of this type of risk.

- *Market-Liquidity Concentration Risk*  
Interruptions, increased volatility, rapid changes in value or the drying up of markets for certain instruments may negatively affect the liquidity of a given institution.  
The diversification of our funding source is a mitigation factor for such inter-risk concentration. These scenarios are also considered in our recovery plan. The Bank operates mostly floating rate both for asset and liability side. In term of investment portfolio, there are only sovereign bonds qualified as HQLA. The Bank's main currency is USD, EUR and PLN that the forex market is relatively stable.

Another cause of market risk concentration is a change in risk preference of market participants. E.g greater uncertainty about the economic outlook could lead to reluctance to buy risky positions. Risk premiums on all risky products will rise and their prices will fall. This increases the correlations between different asset classes. Some markets will possibly even dry up completely because market participants are no longer willing to buy those products. The Bank, although holding a diversified portfolio, could theoretically suffers losses. This risk concentration caused by a change in the risk premium and the accompanying change in correlations ("correlation breakdown") is immaterial to the Bank as our activity is limited to low-risk countries.

The rise in the risk premium could also be the source of an inter-risk concentration between

market risk and liquidity risk. The Bank could generate less liquidity by selling assets because of the lower prices. It is possible that some assets cannot be sold at acceptable prices if the markets are illiquid as a consequence of market participants' risk aversion. Our analysis of the portfolio demonstrates that assets (loans) being sold on secondary market are always profitable for the Bank and this selling is driven only to balance our overall loan balance (portfolio). No premiums are therefore considered here.

- *Collateral Concentration risk*

Concentrations with credit risk mitigation taken may occur if a number of guarantors and credit derivative provider with similar economic characteristics are engaged in comparable activities with changes in economic or industry conditions affecting their ability to meet contractual obligations.

The Bank's derivative transactions' collateral is constituted exclusively of cash. The concentration risk is very limited.

Loan assets with financial collateral and guarantee collateral are assessed regularly. Loan assets with corporate guarantee as collateral make up the most significant portion with 21.47%. Overall, the collaterals are rather diversified combined with BOC group guarantee, mortgage, and other peers' guarantee

#### Measurement

The quantification of concentration risk is performed through stress test which is part of ICAAP process.

## 9.2. Business/Strategy Risk

#### Identification

Business/Strategic risk results from adverse business decisions or the improper implementation of those decisions. This risk is a function of the compatibility of an organization's strategic goals, the business strategies developed to achieve those goals, the resources deployed to support achievement of those goals, and the quality of implementation. Strategic risk includes the misalignment of business and technology strategic plans, the failure to achieve economies of scale in scale-driven businesses or improper market positioning and pricing of products and services.

Properly managing these risks is not only critical to the conduct of safe and sound banking activities, but also crucial to the success of the Bank.

#### Mitigation

Bank of China's business strategy is defined by H.O. Beijing and readjusted each year. However, the Bank has the ability to adapt and elaborate its own strategy by incorporating the specificity of the Bank's business profile and local business environment features (e.g. commercial, legal, culture etc). Management and monitoring of these risks are performed through various means across the Bank and the oversight of the BOD.

The business/strategy risk is managed through early identification of future business/product

exposure and related implementation of risk mitigation tools. These processes are facilitated by the New Product Committee, which provides a dialogue platform for the various departments involved.  
Measurement

Both business and strategy risks are subject to the internal capital assessment process. An additional amount is allocated to the capital requirement regarding these risks.

### 9.3. Compliance Risk

#### Identification

Compliance risk arises from breaches of laws, regulations and market best practice. Compliance risks of the Bank have been assessed as mainly in the field of money laundering and terrorist financing prevention (“AML”) and the effective implementation of new regulations.

Legal risk arises from the potential that unenforceable contracts, lawsuits, adverse judgments can disrupt, negatively affect the operations or condition of the Bank. Legal risk in particular can arise from counterparty default or unenforceable guarantees or collateral arrangements, which can result in great credit losses. Legal risk can also arise from violations of or non-conformity with laws, regulations, prescribed practices, or industry or ethical standards. Legal risks may potentially subject the Bank and its branches as well as its general management to fines and civil or criminal sanctions by competent courts and regulators. Such fines could potentially be important and unexpected. Lawsuits by customers and counterparties which are often long and costly are also typical legal & compliance risks.

#### Mitigation

To mitigate legal risk, each legal matter should refer to the Legal function of the Bank. When necessary the service of external law firms is used.

### 9.4. Business Continuity

#### Identification

Physical disasters affecting the Bank’s premises and continued operations come in many different forms – fire, flood, terrorism, failure of IT systems, etc. Each of these different threats presents a risk to the Bank in terms of total or partial unavailability of staff and/or ICT and/or premises.

#### Mitigation

The Bank has a well-documented and regularly tested Business Continuity plan (hereinafter “BCP”) and Disaster Recovery plan (hereinafter “DRP”). The core component of this plan is an agreement providing a suitable “hot site” enabling the restoration of the Bank’s operations on selected IT equipment and recovery positions for staff. In addition, the Bank also has a documented Business Continuity Plan covering all its critical business processes and activities as part of the business impact assessments (BIA).

The BCM (Business Continuity Management) management framework has been significantly improved during the past years with a clearly defined governance process and an efficient

communication plan in case of crisis.

Tests are conducted every year to assess if the IT system, the back-up location and the staff available are sufficient resource to ensure the continuity of the business activities in time of crisis as defined in the BCP/DRP plan.

Under COVID-19 breakout and government decision to impose lockdown to Luxembourg and its cross-border countries, remote work become reality very quickly. The Bank has successfully faced the challenge within these following measures:

- On the human resources side, the Bank has immediately and systematically applied sanitary measures (first from the Chinese Health Services and after from the local authorities) to prevent staff from being infected. The Bank also took the decision to split the teams into two groups (Team A and B), alternating work from home and office to ensure that in case of suspected infection, a team can ensure the continuity of the operations.
- On the premises resource side, the Bank is organized around 3 buildings in Luxembourg City. In total, the staffs working on the premises is distributed over a total of 12 floors. Hence, human contact in the office is very limited.

Since 2019, the Bank has contracted a renowned Professional of the Financial Sector for its DRP and BCP solutions. This provider is a well-established and recognized actor in Luxembourg providing state-of-the-art data centers and recovery solutions. The Bank has a contract for 25 working positions in Luxembourg. The DRP and BCP solutions are tested (successfully) on yearly basis. This recovery solution was also considered in the peak of the crisis should we have to evacuate one of our premises but, so far, we never invoked the business continuity plan with our provider.

On the IT and communication side, the H.O. has deployed the use of the VPN (Virtual Private Network) to allow staff working from home to be able to access the Bank's systems. The usage of the VPN is strictly controlled from Luxembourg (logs) and from China (Head Office). This solution works well and allows teleworking in good condition.

## 9.5. Reputational Risk

### Identification

Reputation risk is the potential that negative publicity regarding an institution's business practices, whether true or not, will cause a decline in the customer base, costly litigation, or revenue reductions, often as a result of poor earnings, regulatory censure, significant fraud or litigation and failure to provide services or products in conformity to the local market. This type of risk is often closely linked to operational risk and would affect the Bank's ability to establish new relationships or services or to continue servicing existing relationships.

### Mitigation

A regular assessment of reputational risk is performed, including collecting information on the reputational risk issues and the loss occurred, preventing future occurrence by improving the existing

procedures and services.

Regarding a confirmed reputational issue, a complete evaluation is done by identifying the exact cause, the degree of impact (from 1- 5) on the following aspects:

- 1) Public image and market position;
- 2) External rating and share price (if applicable);
- 3) Legal and supervision;
- 4) Comprehensive management and procedure flow;
- 5) Enterprise culture and deontology.

The probability to transfer to other types of risk is also evaluated.

#### Measurement

The reputational risk is subject to the internal capital assessment. An additional amount is allocated to the capital requirement regarding this risk.

## 10. Remuneration Policy and Practices

### 10.1. Internal Governance

The Board of Directors, the executive members, and the control functions are involved in the governance of the present Remuneration Policy.

#### 10.1.1. Board of Directors

The Bank is headed by an effective Board of Directors which meets regularly, directs and controls the Bank. As at 31/12/2020, the BOD was composed of six board members including 2 non-executive Directors (one located in Luxembourg acting as a Chairman and one located in Beijing occupying a prominent position with Bank of China Limited), 3 independent non-executive members and the General Manager of the Bank. It is the Bank's senior "governing body". Non- executive Directors who are not compensated through a variable remuneration for their role as Directors at the Bank and are therefore not subject to the specific requirements for variable remuneration applicable to staff whose professional activities have a material impact on the institution's risk profile (Material Risk Takers). During the year, a total of 4 Board of Directors' meetings were carried out, which deliberated on various topics with the consultation of Authorized Management and the internal control functions. The Remuneration Policy is adopted by the BOD. It is reviewed on an annual basis by the Human Resource Department with the support of the control functions. Any update related to the strategy made to the Policy is subject to the authorization of the BOD.

The Bank's BOD handles the following responsibilities:

- Approving this Policy, including if and where relevant, any subsequent material exemptions as well as significant changes to the Policy (and monitoring their effects);
- Ensuring the supervision of/oversee the implementation of this Policy;
- Reviewing this Policy as well as any update as suggested by the Authorized Management in accordance with applicable guidelines and generally ensure that the Policy is up to date;
- Ensuring, on a regular basis, that the Bank has the appropriate Remuneration procedures in place



- Determining and overseeing that the policy practices are aligned with the Bank's overall corporate governance framework, corporate culture, risk appetite and the related governance processes;
- Assessing the mechanisms and systems adopted to ensure that the remuneration system properly takes into account all types of risks, liquidity and capital levels (promotion of sound and effective risk management, alignment with business strategy, objectives, culture, values and long-term interests of the Bank);
- Approving and periodically review the identification process policy, being involved in the design of the self-assessment of material risk takers and ensure that such assessment is properly carried out/oversee the identification process and approve material exemptions and exclusions of staff in accordance with Commission Delegated Regulation No 604/2014;
- Ensuring the adequacy of the information provided to shareholders on remuneration policies and practices,
- Assessing the achievement of performance targets of the bank and the need for ex-post risk adjustment, including the application of malus and clawback arrangements;
- Ensuring that the Policy and practices of the Bank are subject to a central and independent internal review on an annual basis.

#### 10.1.2. Authorized Management

The Authorized Management of the Bank is responsible for the implementation of the present remuneration policy by:

- Taking all necessary measures for implementing the present Remuneration Policy and keep the present policy and the remuneration falling within its scope under review in the light of legislative, regulatory and market developments;
- Reporting as often as it deems necessary, but at least once a year, to the Board of Directors about the implementation of the present Remuneration Policy;
- Proposing for approval to the Board of Directors the global amount to be allocated to the increase of the fixed remuneration and to the variable remuneration (budgeting phase);
- Defining the people and the amounts of the discretionary salary increases once the global amounts are approved;
- Defining the people and the amounts for the discretionary bonuses once the global amounts are approved;
- Defining the people and the target amounts of the standard bonus in line with the approved budget.

#### 10.1.3. Control Functions

In accordance with the provisions set out in the Circulars, all competent control functions are involved in the design, ongoing oversight of the Bank's remuneration policy, as well as conducting a yearly internal review of the Policy. The Policy is reviewed on an annual basis.

The Chief Risk Officer is responsible for:

- Assessing whether the Variable Remuneration structure affects the risk profile of the Bank. The Chief Risk Officer also determines the capital allocation associated with the

Remuneration Policy, the annual ICAAP report, assists on the definition of appropriate ex-post risk adjustments mechanisms and validates and assesses risk adjustment data.

The Chief Compliance Officer is responsible for:

- Assessing if the Remuneration structure is compliant with legislation, regulations and internal policies and reporting all identified compliance risks and issues of non-compliance to the Authorized Management and the Board of Directors.

The Chief Internal Auditor function is responsible for:

- Assessing the Remuneration Policy according to article 38-5 d) of the law of 23 July 2015.

#### 10.1.4. Human Resource Function

The Policy is updated by Human Resource Department under the review of the Authorized Management to include any changes which would be introduced by the Board of Directors and by updating the appendices to the Remuneration Policy if necessary, the updated Policies then reported to and adopted by the Board of Directors. A copy of the Policy must be transmitted to the Chief Internal Auditor and can be consulted by the CSSF upon request.

#### 10.1.5. Others

Remuneration of the senior staff responsible for heading the control functions is available for the oversight of the Board of Directors.

- The remuneration structure of control functions personnel does not compromise their independence or create conflicts of interest in their advisory role to Board of Directors.
- Variable remuneration for control functions is therefore based on function-specific objectives and not determined directly by the Bank-wide performance criteria.

## 10.2. Policy

The Policy aims at regulating the Remuneration of Staff Members of the Bank, including the ones whose activity has a material impact on the risk profile of the Bank and its activities, and at adhering to the principle of effective risk management and sound business practices in line with the business strategy, objectives, values and long-term interests of the Bank. The provisions set out hereinafter shall, in general, outline the principle of implementing sound remuneration practices, and shall, in particular, apply the performance criteria and assessment process as defined and annually revised by BOC HO and the Bank.

Maintain a sound and effective risk management framework: The Policy and its associated practices aim at defining the remuneration within Bank of China (Luxembourg) S.A. with a view to protect the interests of Bank of China (Luxembourg) S.A.'s clients, providers, employees, shareholders as well as Bank of China (Luxembourg) S.A.'s financial sustainability in a long-term perspective. The Policy is consistent with and promotes sound and effective risk management, does not induce excessive risk-taking and is fully aligned with Bank of China (Luxembourg) S.A.'s aim to efficiently manage conflicts of interests and promote best banking practices.

- Attract and retain talent with competitive remuneration packages: Client satisfaction and protection remain at the heart of the philosophy of Bank of China (Luxembourg) S.A. Bank of



China (Luxembourg) S.A. wishes to attract, retain and motivate highly qualified professionals in their respective domains. Therefore, Bank of China (Luxembourg) S.A. offers remuneration packages that, while in line with market practices, are attractive and competitive, both in terms of amounts and structure. The remuneration components granted by Bank of China (Luxembourg) S.A. to its staff are regularly benchmarked through market studies performed by internal or external consultants, in order to verify the positioning of its remuneration packages in comparison to any given reference market. The remuneration analyses may be carried out at local or international level and aim to provide a benchmark of Bank of China (Luxembourg) S.A.'s position against comparable financial institutions. By decision of the BoD, *ad hoc* measures may be envisaged in certain entities of Bank of China (Luxembourg) S.A. when significant distortions are observed, with a view to enable Bank of China (Luxembourg) S.A. to attract the talent it needs and keep those already in position. Although remuneration must be kept attractive, it must respect the budgetary framework set by the BoD and not jeopardize the financial situation of Bank of China (Luxembourg) S.A.

- Link between performance and remuneration: Variable remuneration is part of the standard compensation package offered by Bank of China (Luxembourg) S.A. To protect the interests of all stakeholders, variable remuneration must be aligned with short, mid and long-term collective and individual performance. Effective performance is therefore subject to strict assessment rules that primarily aim at preventing excessive risk-taking behaviour. More generally, Bank of China (Luxembourg) S.A. does not reward failure.
- Comply with the regulatory framework: The Policy complies with the requirements on remuneration policy and practices in the financial sector that has been defined by applicable rules and competent regulators, including the CSSF.
- Foster transparency: Transparency is a keystone of the Policy. Detailed information on the Policy's rules and practices is made available both internally and externally. It is essential for Bank of China (Luxembourg) S.A.'s employees to have clarity about the rules governing their remuneration and it is Bank of China (Luxembourg) S.A.'s responsibility to inform its staff members in a timely and appropriately way about any amendments which might affect them.
- Ensure group consistency: BANK OF CHINA (LUXEMBOURG) S.A. has established and maintained this Policy at Group level to ensure a group-wide consistency in its remuneration practices. In this context, the Policy is applied as such throughout all Bank of China (Luxembourg) S.A. subsidiaries and branches in Luxembourg and in all other countries where Bank of China (Luxembourg) S.A. is present. The Boards of Directors of these entities are responsible for its implementation locally. Local adaptations are however at times introduced in order to (i) face local market demands or (ii) apply potentially more restrictive regulatory provisions imposed by the local regulators. Bank of China (Luxembourg) S.A. regularly carries out internal audits in entities in Luxembourg and abroad to verify the compliance by such entities with the Policy.

#### 10.2.1. Scope

The Policy outlines the philosophy and governing principles for remuneration at Bank of China (Luxembourg) S.A., and all the existing branches in EU (ie: Rotterdam, Lisbon, Stockholm, Poland, Brussels and Athens branches).

Each branch is responsible to adapt this policy locally and formulate relevant local rules. In the event of any conflict between this Policy and the local laws or regulations, the latter shall prevail to the extent where such a conflict exists. In the event of discrepancy between standards the most stringent ones shall apply.

The Policy applies to all Staff Members of the Bank, including Transferred Chinese Staff.

#### 10.2.2. Designated Identified Staff (“Material Risk Takers”)

Staff Members who can have a material impact on the risk profile of the Group/the Bank are considered as Material Risk Takers and therefore subject, in addition to the rules applicable to all Staff Members, to the rules specifically applicable to Material Risk Takers.

Material Risk Takers are identified by the Bank based on the qualitative and/or quantitative criteria laid down in Commission Delegated Regulation (EU) No 604/2014.

The following Executive Members, Control Functions and Heads of Department shall be considered as Material Risk Takers.

#### Executive Members (4 persons):

- General Manager/CEO (1 person)
- Deputy General Manager (3 persons)

#### Other Executive Members (12 persons):

- Rotterdam Branch: General Manager (1 person) and Deputy General Manager (1 person)
- Brussels Branch: General Manager (1 person) and Deputy General Manager (2 persons)
- Poland Branch: General Manager (1 person) and Deputy General Manager (1 person)
- Stockholm Branch: General Manager (1 person) and Deputy General Manager (1 person)
- Lisbon Branch: General Manager (1 person) and Deputy General Manager (1 person)
- Athens Branch: General Manager (1 person)

#### Control Functions (3 persons):

- Head of Risk Management – Chief Risk Officer (CRO) (1 person)
- Head of Internal Audit – Chief Audit Officer (CAO) (1 person)
- Head of Compliance – Chief Compliance Officer (CCO) (1 person)

#### Other Heads of Departments (12 persons):

- Company Secretary, Comprehensive Management Department, Human Resources Department, Finance Department, Corporate Banking Department I, Corporate Banking Department II, Transaction Banking Department, Banking Department, Financial Markets and Institutions Department, Asset Management Centre-Europe, Clearing Department, Information Technology Department

#### Compliance Officers (6 persons):

- Compliance Officers of 6 branches

As at 31 December 2020, there were total of 37 material risk takers in the Bank. The above roles delegate some functions to their direct subordinates. This delegation respects proper approval

procedures.

#### 10.2.3. Board of Directors

The Board of Directors of Bank of China (Luxembourg) S.A. is currently composed of six members:

- Three of them are independent non-executive Directors
- Two of them are non-executive Directors and among them, one was elected as a Chairman of the Board
- One is an Executive Director in charge of the day-to-day management of the Bank

Even though these five non-executive Directors are not compensated through a Variable Remuneration for their role, they have been identified as Material Risk Takers in compliance with Commission Delegated Regulation EU 604/2014.

#### 10.2.4. Risk Assessment Process

Material Risk Takers are determined based on the qualitative criteria (i.e. job function, level of responsibilities) and/or quantitative criteria (i.e. based on the level of Remuneration), as defined in the aforementioned Commission Delegated Regulation.

Staff Members qualifying as Material Risk Takers are assessed on a regular basis (e.g. at the time of recruitment, in case of change of functions, etc.) and in any case at least once a year. Irrespective of the potential application of the proportionality principle (see section 1.1), the Board of Directors has the responsibility to identify Material Risk Takers while the staff identification exercise is carried out through the involvement of the Human Resources function and the control functions (risk and compliance).

The below provides an overview of the key risks regarding to the Bank's current and future risks are taken into account in the remuneration processes:

##### Credit Risk:

Risk that a customer or counterparty does not meet his/her financial obligation for full value, either when due or any time thereafter, and primarily arises in the Bank's lending activities. It also includes concentration and counterparty risks.

##### Market Risk:

Risk that market risk related factors, (i.e.: foreign exchange, commodity, interest rates, credit spread and equity prices) reduce the Bank's income or the value of its portfolios.

##### Operational Risk:

Risk of operational errors which could give rise to financial / reputational loss or accounting misstatements

##### Liquidity Risk:

Risk that the Bank does not fulfil its liquidity obligations.

Interest Rate Risk in the Banking Book:

Risk that the asset value negatively changes due to a change in the absolute level of interest rates, in the spread between two rates, in the shape of the yield curve or any other interest rates relationship.

Concentration Risk:

Risk refers to the loss an institution can suffer from a group of exposures or activities whose intrinsic value depends on a common set of risk factors.

Compliance Risk:

Risk related to a failure to comply with applicable laws, regulation, codes of conduct and standards of good practice.

Business Continuity Risk:

Risk associated with the inability to adequately recover the Bank's activities after a disaster (partial or total unavailability of human, technology, communication, premises and resources etc.).

### 10.3. Remuneration Structure

The remuneration structure is designed in accordance with the objectives set out in the strategy of the Bank. This includes, in particular:

- a proper balance of Variable to Fixed Remuneration;
- the measurement of performance which impacts the Variable Remuneration.
- a structure of the Variable Remuneration for material risk takers who enter into the scope to ensure the Bank takes the appropriate action to align the Policy with its long-term interests, including:
  - o the deferral over three years of at least 40.1% of the Variable Remuneration;
  - o the Variable Remuneration composed of at least 50% in financial instruments subject to a retention period of 12 months and validation of the implementation approved by BOC Group.
  - o the potential ex-post risk adjustment of the Variable Remuneration (through Malus and Clawback);

In that context, the Bank offers Remuneration packages based on the following components:

- Fixed Remuneration components;
- Variable Remuneration components.

#### 10.3.1. Fixed Remuneration components

The Fixed Remuneration is composed of the Base Salary and the benefits listed below.

##### Base Salary

The Base Salary set by the Bank is strictly in compliance with applicable regulations and conservative market practices. The Base Salary mentioned in the contract of the Employee is calculated based on the role of the individual employee, his/her responsibility, competency, job complexity, and local market conditions.

##### Overtime compensation

Overtime, where applicable and provided that it has been carried out at the Bank's request, is payable to Staff Members under the collective bargaining agreement for bank employees.

#### Other benefit

Other benefits are provided on the basis of individual employment contracts and local market practice, as listed in the below.

- Lunch vouchers;
- Birthday allowance;
- Festival allowance;

#### Pension Plan

All Employees who have their permanent work place in Luxembourg, who have an unlimited contract in Luxembourg and who are not affiliated under another pension scheme within Bank of China (The Group) are affiliated to a pension plan

#### Other Fixed Benefits

The Bank offers Staff Members a variety of fringe and other benefits that are designed to be market competitive, that assist them in carrying out their duties efficiently and are valued by the Staff Members.

#### 10.3.2. Variable Remuneration components

The Bank's employees are eligible for an annual variable remuneration, which is granted in accordance with the applicable performance criteria and assessment process. The assessment of performance is not only on the basis of the Bank's financial results, but also on other non-quantifiable factors, including but not limited to the staff's improvement that positively contributes to the long-term benefits of the Bank.

Employees engaged in control functions are remunerated in accordance with the achievements of the objectives linked to their functions, independent of the performance of the business areas they control. The remuneration of the senior officers in the risk management and compliance functions is available for the oversight of the Board of Directors.

Remunerations are linked to the Bank's business performance which is reflected through its overall key performance indicator. The score of the indicator is calculated by using a multi-year roll-over weighted formula fixed by the H.O., ensuring that the assessment process is based on longer-term performance spreading over the business cycle.

Based on the score according to the indicator, remunerations are calculated using the formula and coefficients fixed by the H.O., and revised on a yearly basis. Maximum limits (where applicable) on the percentage of A-rated individual performance are also set by HO according to the Bank's performance, while in line with the local policy, CSSF circular 15/622, the total amount of the variable remuneration allocated to a person falling in the category of "Identified staff", may not exceed maximum of 100% of the total fixed remunerations. For higher ratios, approval of the shareholders is required, but limited to a ratio of 200%. Any approval should be notified to the CSSF with standard templates as provided by circular CSSF 15/622. The Bank ensures, in any case, an appropriate ratio

between the Variable and the Fixed Remuneration.

#### Indicative Settings of Maximum Variable Remuneration

The following indicative settings may apply to the maximum Variable Remuneration in general. The Authorized management retains discretion to propose the settings which should be flagged to and decided by the Board of Directors in its supervisory function.

Position	Maximum variable remuneration(as % of the total remuneration)
Executive members	Up to 50%
Other Executive members	Up to 50%
Control functions	Up to 45%
Additional management personnel	Up to 50%
Staff	Up to 45%

#### 10.3.3. Pay out process of Variable Remuneration for Material Risk Takers

Where the proportionality principle does not apply at bank's level and individual level;

The non-deferred part of Variable Remuneration related to a given performance year (i.e. maximum 59.9%) is paid during the next year. The deferred part of Variable Remuneration (i.e. minimum 40.1%), has to be deferred over a period of at least 3 years.

At least 50% of the Variable Remuneration would be awarded in financial instruments subject to a retention period of 12 months and proper implementation of instruments validated through internal procedure of the Group.

The deferred portion of Variable Remuneration is only paid out provided that the Material Risk Taker is still under contract within BOC group and hasn't provided notice of termination at the time of vesting.

#### 10.3.4. Remuneration Budget

The Remuneration budget includes both Fixed Remuneration and Variable Remuneration parts. The Fixed Remuneration part is based on previous year total Remuneration and takes into account the local living cost, the market salary level, regulation requests and variation of staff number.

The envelope of Variable Remuneration is related to the Bank's performance and key business indicators completion. This budget is made according to the performance targets of the Bank at the beginning of year and the prediction of the increase of staff mainly.

#### 10.3.5. Performance Measurement Indicators

In order to enhance the management of our human resources, to encourage our staff to strive at their best effort, and to build an effective incentive mechanism, the General Management has implemented a performance-based reward and disciplinary system in the Bank on an annual basis. The bonus, promotions, trainings and job assignments are linked to the evaluation results.

The Human Resources Department is responsible for organizing the individual performance assessment process. The result of assessment is based on both quantitative and qualitative criteria which are mainly from key performance indicators (KPI) designed by BOC HO and partly from assessment from Department Heads and General Managers, Deputy General Managers.

#### The Bank's Key Performance Indicator (KPI)

The financial and business indicators of the Bank are calculated quantitatively according to net income, business volume or limit control set by BOC HO. The result of these indicators could be measured through accomplishment, increasing or comparing with previous year. All the indicators are calculated by year-end volume or yearly-average volume.

According to the overall strategy development of BOC and market changes, BOC Group can adjust the key performance indicators on an annual basis.

The fulfilment of the Bank's KPIs, results to a coefficient (coefficient of bank performance) applicable to the Staff Members of the Bank and used as a bonus base.

#### 10.3.6. Specific situations

##### Guaranteed Variable Remuneration (cash-based compensation)

The Bank does not offer guaranteed Variable Remuneration, except for specific cases such as welcome packages and limited to the first year of employment in the framework of hiring new Staff Members. Such Variable Remuneration components may only be used in exceptional circumstances, and would be subject to strict internal review and governance.

##### Severance Pay

The Bank does not offer guaranteed retention or exit packages. In cases of early termination of a contract, the Bank will only make severance payments which are in accordance with the provisions of the applicable employment law and contract law. In addition any severance payment should reflect performance achieved over time and should not reward failure.

##### Severance Pay

The Bank does not offer guaranteed exit package. In case of early termination of a contract, the Bank only makes severance payments in accordance with the provisions of the applicable employment law. In addition any severance payment should reflect performance achieved over time and should not reward failure or misconduct

##### Personal Hedging

Staff members are not allowed to use personal hedging strategies to mitigate the risk related to the variation in their remuneration.

Aggregate quantitative information on remuneration, broken down by senior management and members of staff whose actions have a material impact on the risk profile of the institution indicating the following:



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## 10.4. Disclosure

### 10.4.1. Disclosure of Remuneration strategy and procedure internally

The Human Resource Department is in charge of disclosure of Remuneration strategy and procedure internally through the release of policy, website, statement etc., ensuring that:

- The member of staff concerned should know in advance the criteria that will be used to determine their remuneration;
- The information regarding the policy which is disclosed internally should reveal at least the details which are disclosed externally;
- Confidential quantitative aspects of the remuneration of staff members shall not be subject to internal disclosure;
- The information of Annex 2, regarding the remuneration policy and practices of the institution for those categories of staff whose professional activities have a material impact on its risk profile.

### 10.4.2. Disclosure of Remuneration strategy and procedure externally

Disclosure of the Remuneration strategy and procedure is included in the Bank's financial statements. According to the article 450 of CRR and the proportionality aspect that applicable to Bank of China (Luxembourg) S.A. The following information is disclosed for Bank of China (Luxembourg) S.A.:

- information concerning the decision-making process used for determining the remuneration policy, as well as the number of meetings held by the main body overseeing remuneration during the financial year, including, if applicable, information about the composition and the mandate of the remuneration committee, the external consultant whose services have been used for the determination of the remuneration policy and the role of the relevant stakeholders;
- information on link between remuneration and performance;
- the most important design characteristics of the remuneration system, including information on the criteria used for performance measurement and risk adjustment, deferral policy and vesting criteria;
- the ratios between fixed and variable components of the remuneration;
- Information on the performance criteria on which the entitlement to shares, options or variable components of remuneration is based;
- The main parameters and rationale for any variable component scheme and any other non-cash benefits;
- Aggregate quantitative information on remuneration broken down by business area;
- Aggregate quantitative information on remuneration, broken down by senior management and members of staff whose actions have a material impact on the risk profile of the institution, indicating the following:
  - (i) The amounts of remuneration for the financial year split into fixed and variable remuneration, and the number of beneficiaries;
  - (ii) The amounts and forms of variable remuneration, split into cash, shares, share-linked instruments and other types;
  - (iii) The amounts of outstanding deferred remuneration split into vested and unvested portions;



- (iv) The amounts of deferred remuneration awarded during the financial year, paid out and reduced through performance adjustments.
- (v) New sign-on and severance payments made during the financial year, if any and the number of beneficiaries;
- (vi) The amounts of severance payments awarded during the financial year, number of beneficiaries and highest such award to a single person;
- With reference to the article 38-10 of the Law of 23 July 2015 and the article 450 of the CRR, the following information about individuals in the EUR 1 million pay brackets would be annually communicated to the CSSF: number of individuals, business area involved, and main elements of salary, bonus, long-term award and pension contribution. For the financial year 2018, the Bank has no individual staff whose remuneration equals to or has exceeded the amount of EUR 1 million.

## 10.5. Diversity and recruitment policy

The Bank wants to attract, motivate and retain high-calibre staff necessary to obtain business results and ensure that:

- Position design shall be standardized, and recruitment qualifications and standards shall be rationally defined according to the business development strategy and business management requirements of the Bank. Local laws and regulations as well as rules of the Bank shall be strictly observed, and the recruitment procedures shall be performed in a standardized and complete manner.
- Select excellent talents through competition, and prioritize quality over quantity. Candidates may take part in exams and appraisals
- Steps are taken to achieving diversity in the employee profile of the Bank, including members of the Board, to represent a variety of views and experience. This will include, amongst others, such factors as age, gender, and educational and professional background. It will also include achieving an appropriate balance between locally-hired employees and expatriates from the BOC H.O.
- Control cost and enhanced efficiency. Within the total annual headcount and allocation plan, yearly recruitment shall be conducted in line with business development targets. Staff allocation priorities shall be clarified, and staff distribution structure shall be optimized in order to improve input-output efficiency.

Regarding the recruitment policy for the selection and appointment of the Management Body member to fill vacancies, the assessment will consider the candidate good repute, the balance of knowledge, skills, diversity, time and availability to perform his/her duties, gender, experience and the number of executive and non-executive directorships of the candidate.

The members of the Management Body and Key function holders have sufficient knowledge, skills and experience to fulfil their individual position in the Bank, and the management body collectively possess adequate knowledge, skills and experience to understand the bank's activities including the main risks. The suitability of the Management Body member is assessed according to the EBA guidelines.



## 10.6. Quantitative information

Aggregate quantitative information on remuneration, broken down into four categories of people has a material impact on the risk profile of the Bank. The amounts of remuneration further split into fixed and variable remuneration and the number of beneficiaries. Detailed information as showed in the following table:

Table 10.6.1 EU REM1 - Remuneration awarded for the financial year of 2020

(In EUR)		MB Supervisory function	MB Management function	Other senior management	Other identified staff
Fixed remuneration	Number of identified staff	3	17	15	6
	Total fixed remuneration	252,000.00	3,397,963.00	1,846,500.00	428,225.00
	Of which: cash-based		3,397,963.00	1,846,500.00	428,225.00
	(Not applicable in the EU)				
	Of which: shares or equivalent ownership interests				
	Of which: share-linked instruments or equivalent non-cash				
	Of which: other instruments				
	(Not applicable in the EU)				
Variable remuneration	Number of identified staff				
	Total variable remuneration		1,764,903.00	1,228,012.00	48,239.00
	Of which: cash-based		1,764,903.00	1,228,012.00	48,239.00
	Of which: deferred		853,449		33,944.00
	Of which: shares or equivalent ownership interests				
	Of which: deferred				
	Of which: share-linked instruments or equivalent non-cash				
	Of which: deferred				
	Of which: other instruments				
	Of which: deferred				
Of which: other forms					
Of which: deferred					
Total remuneration (2 + 10)		252,000.00	5,162,866.00	3,074,512.00	476,464.00

Table 10.6.1 EU REM3 - Deferred remuneration

Deferred and retained remuneration	Total amount of deferred remuneration awarded for previous performance periods	Of which due to vest in the financial year	Of which vesting in subsequent financial years	Amount of performance adjustment made in the financial year to deferred remuneration that was due to vest in the financial year	Amount of performance adjustment made in the financial year to deferred remuneration that was due to vest in future performance years	Total amount of adjustment during the financial year due to ex post implicit adjustments (i.e. changes of value of deferred remuneration due to the changes of prices of instruments)	Total amount of deferred remuneration awarded before the financial year actually paid out in the financial year	Total amount of deferred remuneration awarded for previous performance period that has vested but is subject to retention periods
MB Management function	853,449.00						508,676.00	
Cash-based	853,449.00						508,676.00	
Shares or equivalent ownership interests								
Share-linked instruments or equivalent non-cash instruments								
Other instruments								
Other forms								
Total amount	853,449.00						508,676.00	

Deferred remuneration was only applicable for MB Management function. Amounts of total outstanding deferred remuneration was EUR853,449.00 and EUR 508,676.00 was actually paid out in 2020.



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Table 10.6.3 EU REM5 - Information on remuneration of staff whose professional activities have a material impact on institutions' risk profile (identified staff)

In EUR	Management body remuneration			Business areas						Total
	MB Supervisory function	MB Management function	Total MB	Investment banking	Retail banking	Asset management	Corporate functions	Independent internal control functions	All other	
<b>Total number of identified staff</b>										<b>41</b>
<b>Of which: members of the MB</b>	3	17	20							
<b>Of which: other senior management</b>				1	5	0	5	3	1	
<b>Of which: other identified staff</b>								6		
<b>Total remuneration of identified staff</b>	252,000.00	5,162,866.00	5,414,866.00	351,418.00	632,963.00	-	1,157,388.00	1,188,967.00	220,240.00	
<b>Of which: variable remuneration</b>		1,764,903.00	1,764,903.00	180,340.00	310,044.00	-	483,096.00	228,579.00	74,192.00	
<b>Of which: fixed remuneration</b>	252,000.00	3,397,963.00	3,649,963.00	171,078.00	322,919.00	-	674,292.00	960,388.00	146,048.00	

Based on the current version of the remuneration policy, we came to the opinion that no capital should be allocated to the risk associated with the remuneration of the Bank.