# Basel II
# Pillar 3 Disclosure
# 2012

**Bank of China (UK) Ltd**

# I. Overview

## Background

Bank of China (UK) Ltd ("BOC UK" or "the bank"), authorised and regulated by the FSA for the period under review, is a wholly owned subsidiary of Bank of China Limited. The bank has been Basel compliant since 2008.

## Basis of Disclosures

This disclosure is prepared in accordance with the requirements set out in FSA handbook BIPRU Chapter 11 and should be read in conjunction with the "Bank of China (UK) Limited Annual Report and Financial Statements for the year ended 31 December 2012".

For accounting purposes, the Bank has availed itself of the exemption available under IAS27 *Consolidated and Separate Financial Statements* that permits an entity to prepare separate financial statements (referring to *Note 2: Basis of Preparation* in Annual Report and Financial Statements). Therefore this disclosure does not take into account any subsidiaries.

## Frequency

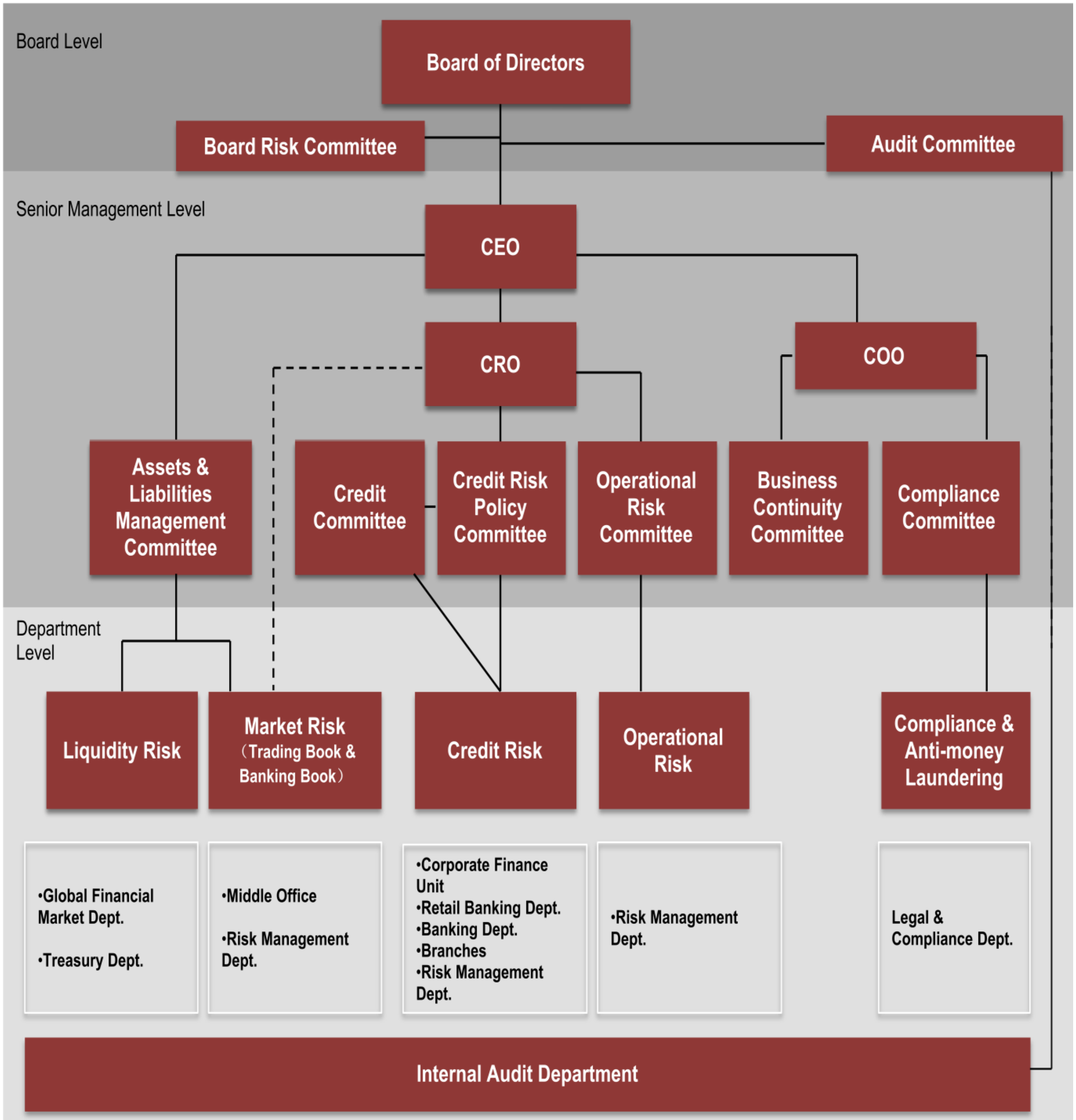
This report is produced on an annual basis, and published as soon as practically possible.

## Media and Location of Publication

The report can be accessed on the BOC UK Ltd website: www.bank-of-china.com/uk

# II. Risk Management Structure

**BOC UK Ltd Risk Management Structure 2012**



# III. Capital Resources

| **Total Capital Resources** | ***31 December 2012*** | *31 December 2011* |
|---|---|---|
| | **£000** | £000 |
| **Tier 1 Capital** | | |
| Share Capital | 250,000 | 140,000 |
| Profit and loss reserve | 24,958 | 528 |
| **Tier 2 Capital** | | |
| Subordinated debt | 60,000 | 60,000 |
| Less: Investments in subsidiaries | - | (63,285) |
| **Total Tier 1 and 2 capital after deductions** | **334,958** | **137,243** |

The Bank's **Tier 1 capital** consists of ordinary share capital and profit and loss reserves. The profit and loss reserves represent the Bank's audited accumulated accounting profits.

The Bank currently has no innovative Tier 1 instruments. As at 31 December 2012, there are no reconciliation differences between the amounts disclosed as Tier 1 capital to those treated as equity under IFRS.

The Bank's **Tier 2 capital** includes qualifying subordinated debt.

The subordinated debt is issued on terms which qualify for inclusion in the Bank's capital resources. Information on the terms of the subordinated debt is included in *note 29* of the Bank's *Annual Report and Financial Statements for the year ended 31 December 2012*.

The Bank does not hold any **Tier 3 capital**.

# IV. Capital Adequacy

## Internal Capital Adequacy Assessment Process ("ICAAP")

In line with the FSA requirements, the bank has adopted the ICAAP approach for assessing the adequacy of the internal capital to support the current and future business activities. ICAAP is fully integrated in to the governance and risk management framework. It is conducted on an annual basis and approved by the Board.

The bank submitted the 2011 report to the FSA on request, as part of the ARROW review process, and the FSA has set Individual Capital Guidance ("ICG") to the bank.

## Credit Risk Capital Requirement: Standardised Approach

The Bank's minimum capital requirement of credit risk is expressed as 8% of the risk weighted exposure amounts for each of the applicable standardised credit risk exposure classes.

| **Minimum Capital Requirement for Credit Risk by Exposure Classes under the Standardised Approach** | **As at *31 December 2012*** | | As at *31 December 2011* | |
|---|---|---|---|---|
| £000 | **RWA** | **Capital Requirement** | RWA | Capital Requirement |
| Central governments or central banks | 22 | 2 | 27 | 2 |
| Institutions | 40,861 | 3,269 | 36,946 | 2,956 |
| Corporate | 374,840 | 29,987 | 250,999 | 20,080 |
| Retail | 8,392 | 671 | 9,555 | 764 |
| Secured by mortgages on residential property | 84,724 | 6,778 | 45,790 | 3,663 |
| Past due items | 89 | 7 | - | - |
| Securitization positions | 2,729 | 218 | 3,625 | 290 |
| Short term claims on institutions and corporate | 5,595 | 448 | 24,329 | 1,946 |
| Other items | 80,887 | 6,471 | 49,199 | 3,936 |
| **Total** | **598,139** | **47,851** | **420,470** | **33,638** |

## Market risk Capital Requirement:

The market risk capital requirement is calculated using the standard Position Risk Requirement rule ("PRR"). The only market risk requirement is for foreign exchange PRR.

## Operational risk Capital Requirement: Basic Indicator Approach

The Bank calculates the capital requirement for operational risk using the Basic Indictor Approach (BIA). The capital requirement is 15% of the average over the previous three years annual gross income.

## Capital Adequacy

| **Capital Adequacy against Pillar 1 Capital Requirement** | ***31 December 2012*** **£000** | *31 December 2011* £000 |
|---|---|---|
| Credit Risk (Standardised Approach) | 47,851 | 33,638 |
| Market Risk (Foreign Exchange PRR) | 146 | 164 |
| Operational Risk ("BIA") | 5,923 | 6,087 |
| **Total Pillar 1 minimum capital requirement** | **53,920** | **39,725** |
| **Total capital resources** | **334,958** | **137,243** |
| **Excess of capital resources over Pillar 1 minimum capital requirement** | **281,038** | **97,518** |

# V. Credit Risk Measurement, Mitigation and Reporting

## Credit Risk Management and Controls

The bank adopts Three Lines of Defence for credit control.

The **first line** is the initial credit assessment process, where credit reports / business proposals are prepared by the relevant business divisions

The **second line** review refers the credit risk assessment that Risk Management Department (RMD) performs on the business proposals submitted by the respective business divisions. The results of RMD's risk assessment process, together with the original business proposals, are forwarded either to the approvers (depending on the materiality of the business proposal and the related credit risk exposures) or are presented for discussion in Credit Committee (CC) meeting.

The **third line review** is applied where recommendations of the CC are presented to the ultimate sanctioning authority (i.e. the CRO/CEO and / or the Board Risk Committee) for approval and sign off.

# Credit Risk Exposures

**Geographic Distribution of Credit Exposure**

| £'000 | UK | Other European Countries | North America | Rest of the World | Total |
|---|---|---|---|---|---|
| *2012* | | | | | |
| Central governments or central banks | 16 | - | - | 6 | **22** |
| Corporates | 277,440 | 55,105 | 5,756 | 78,459 | **416,760** |
| Institutions | 758 | 22,005 | 30,232 | 28,885 | **81,880** |
| Retail | 11,020 | 14 | - | 867 | **11,900** |
| Secured by mortgages on residential property | 193,841 | 787 | 480 | 38,291 | **233,400** |
| Past due items | 105 | - | - | 1 | **106** |
| Securitisation positions | 3,009 | 8,033 | - | 2,602 | **13,643** |
| Short term claims on institutions and corporates | 197,571 | 29 | 279 | 2,114 | **199,994** |
| Other items | 82,966 | - | 686 | 1 | **83,653** |
| **Grand Total** | **766,726** | **85,973** | **37,433** | **151,225** | **1,041,358** |
| *2011* | | | | | |
| Central governments or central banks | 26 | - | - | - | **27** |
| Corporates | 206,539 | 70,154 | 5,259 | 16,243 | **298,195** |
| Institutions | 16,953 | - | 40,589 | 21,563 | **79,105** |
| Retail | 12,556 | 8 | - | 523 | **13,086** |
| Secured by mortgages on residential property | 130,828 | - | - | - | **130,828** |
| Past due items | 86 | - | - | - | **86** |
| Securitisation positions | 5,974 | 9,663 | - | 3,421 | **19,058** |
| Short term claims on institutions and corporates | 274,439 | 33 | 317 | 1,046 | **275,835** |
| Other items | 50,810 | - | 543 | 1 | **51,353** |
| **Grand Total** | **698,211** | **79,857** | **46,708** | **42,797** | **867,573** |

**Gross Credit Exposure under the Standardised Approach**

| | *2012* | | *2011* | |
|---|---|---|---|---|
| **£000** | ***Average Credit Exposure** | **End of Year Exposure** | **Average Credit Exposure** | **End of Year Exposure** |
| Central governments or central banks | 49 | 22 | 17 | 27 |
| Institutions | 69,185 | 81,880 | 83,024 | 79,105 |
| Corporates | 338,049 | 416,760 | 296,661 | 298,195 |
| Retail | 13,116 | 11,900 | 59,070 | 13,086 |
| Secured by mortgages on residential property | 186,763 | 233,400 | 64,103 | 130,828 |
| Past due items | 105 | 106 | 148 | 86 |
| Securitisation positions | 14,665 | 13,643 | 30,404 | 19,058 |
| Short term claims on institutions and corporates | 355,498 | 199,994 | 271,951 | 275,835 |
| Other items | 58,826 | 83,653 | 46,906 | 51,353 |
| **Grand Total** | **1,036,256** | **1,041,358** | **852,816** | **867,573** |

*Note 1: Quarterly average is adopted here.

| Remaining Contractual Maturity of Credit Gross Exposure | | | | |
|---|---|---|---|---|
| **£'000** *2012* | **Up to 12 months** | **1-5 yreas** | **More than 5 years** | **Total** |
| Central governments or central banks | - | 22 | - | 22 |
| Institutions | 32,383 | 39,271 | 10,226 | 81,880 |
| Corporates | 26,281 | 148,690 | 241,789 | 416,760 |
| Retail | - | 384 | 11,516 | 11,900 |
| Secured by mortgages on residential property | - | - | 233,400 | 233,400 |
| Past due items | - | 106 | - | 106 |
| Securitisation positions | - | - | 13,643 | 13,643 |
| Short term claims on institutions and corporates | 199,994 | - | - | 199,994 |
| Other items | 686 | 82,967 | - | 83,653 |
| **Grand Total** | **259,344** | **271,440** | **510,574** | **1,041,358** |
| ***2011*** | | | | |
| Central governments or central banks | - | 27 | - | 27 |
| Institutions | 47,919 | 20,763 | 10,423 | 79,105 |
| Corporates | 65,834 | 179,089 | 53,272 | 298,195 |
| Retail | 4 | 1,387 | 11,695 | 13,086 |
| Secured by mortgages on residential property | 11 | 1,086 | 129,731 | 130,828 |
| Past due items | - | 86 | - | 86 |
| Securitisation positions | - | - | 19,058 | 19,058 |
| Short term claims on institutions and corporates | 238,625 | 37,210 | - | 275,835 |
| Other items | - | 51,353 | - | 51,353 |
| **Grand Total** | **352,393** | **291,001** | **224,179** | **867,573** |

**Industry Distribution of Gross Credit Exposure 2012**

| Exposure Class | Industry Category | Gross Exposure £'000 |
|---|---|---|
| Central governments or central banks | Business & other services | 22 |
| Institutions | Financial | 81,880 |
| Corporates | Agriculture, Forestry & fishing | 14,387 |
| | Business & other services | 70,109 |
| | Construction | 236 |
| | Energy & water supply industries | 63,385 |
| | Financial | 12,951 |
| | Garages, distribution, hotels & catering | 21,591 |
| | Manufacturing industry | 151,941 |
| | Postal services & telecommunications | 32,054 |
| | Transport | 50,106 |
| Retail | Business & other services | 7 |
| | Garages, distribution, hotels & catering | 823 |
| | Persons | 11,070 |
| Secured by mortgages on residential property | Business & other services | 4,473 |
| | Construction | 63 |
| | Manufacturing industry | 104 |
| | Persons | 228,739 |
| | Transport | 21 |
| Past due items | Business & other services | 19 |
| | Financial | 36 |
| | Persons | 51 |
| Securitisation positions | Financial | 13,643 |
| Short term claims on institutions and corporates | Financial | 199,994 |
| Other items | Business & other services | 82,966 |
| | Financial | 687 |
| **Grand Total** | | **1,041,358** |

## Impairment Provisions

The bank defines past due loan as an instalment on the whole or a part of the loan which is not received by the due date of the instalment. The bank identifies impairment through a list of prescribed credit events of the borrower. The impairment loss refers the difference between the carrying value of the loan and the present value of estimated future cash flow.

| £'000 | UK | | | Rest of the World | | |
|---|---|---|---|---|---|---|
| *2012* | **Impaired** | **Provision** | **Past Due*** | **Impaired** | **Provision** | **Past Due*** |
| Business & other services | (12,231) | 12,231 | (2) | - | - | - |
| Garages, distribution, hotels ( | - | - | (12) | - | - | - |
| Persons | (42) | 42 | (2,864) | - | - | (258) |
| Grand Total | (12,273) | 12,273 | (2,878) | - | - | (258) |
| *2011* | Impaired | Provision | Past Due | Impaired | Provision | Past Due |
| Business & other services | (13,388) | 7,000 | (445) | - | - | - |
| Garages, distribution, hotels & | - | - | (485) | - | - | - |
| Persons | (296) | 128 | (1,797) | - | - | - |
| Grand Total | (13,683) | 7,128 | (2,727) | - | - | - |

## Provisioning for Loans and Advances

An allowance for impairment is established when objective evidence is identified:

- Significant financial difficulty of the obligor;
- Breach of contract, such as a default or delinquency in interest or principal payments for a period exceeding 90 days;
- The lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
- It becoming probable that the borrower will enter bankruptcy or other financial reorganization;
- Disappearance of an active market for that financial asset because of financial difficulties;
- Observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:
  (i) Adverse changes in the payment status of borrowers in the portfolio; and
  (ii) National or local economic conditions that correlate with defaults on the assets in the portfolio
- Other observable evidence that an asset or a portfolio is impaired.

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*Past due assets here is defined as overdue for 0-3 months for internal accounting purpose, which is different from the definition adopted for FSA004 Credit Exposure reporting, being any item past due for more than 90 days.

The bank makes provisions on a case-by-case basis. If the amount of impairment losses decreases subsequently, the allowance is adjusted accordingly and the amount of reversal is recognised in the income statement.

A loan or advance is written-off, either partially or in full, against the identified allowance when the proceeds from available security have been received or no realistic prospect of recovery can be seen. Subsequent recoveries of amounts previously written-off decrease the amount of impairment losses recorded in the income statement. The bank does not have collectively assessed impairment in both the financial year 2012 and 2011.

**Allowances for Impairment: Provisions to Loans and advances to banks and customers**

| | Specific Loans and advances | |
|---|---|---|
| £000 | to banks | to customers |
| **Balance as at *1 Jan 2012*** | - | **7,128** |
| Increase in impairment | - | **5,278** |
| Reversal of impairment | - | **(55)** |
| Charge in income statement | - | **5,223** |
| Amounts written off | - | **(78)** |
| **Balance as at *31 Dec 2012*** | - | **12,273** |
| Balance as at *1 Jan 2011* | - | 408 |
| Increase in impairment | - | 7,167 |
| Reversal of impairment | - | - |
| Charge in income statement | - | 7,167 |
| Amounts written off | - | (447) |
| Balance as at *31 Dec 2011* | - | 7,128 |

## Provisioning for Available-for-Sale Financial Assets

Impairment for available-for-sale financial assets is identified when there is a significant or prolonged decline in the fair value of the assets below its original cost.

If there is objective evidence that an impairment loss has been incurred, the cumulative loss is measured as the difference between the acquisition cost (net of any principal repayment and amortisation) and the current fair value, less any impairment loss on that asset previously recognised. The cumulative loss is then removed from equity and recognised in the income statement.

If, in a subsequent period, the fair value of the asset increases, which can be objectively related to an event occurring after the recognition of the impairment loss, the impairment loss is reversed through the income statement.

**(a) Allowances for Impairment : Available For Sale Financial Investments**

| £000 | Movement in fair value recognized in equity | Impairment |
|---|---|---|
| **Balance as at *1 Jan 2012*** | **1,376** | **3,930** |
| Changes in fair values | **(3,173)** | **-** |
| Reversal of impairment | **768** | **(768)** |
| Amounts written off | **-** | **-** |
| Exchange-rate movements | **-** | **(159)** |
| **Balance as at *31 Dec 2012*** | **(1,029)** | **3,003** |
| Balance as at *1 Jan 2011* | 1,340 | 5,749 |
| Changes in fair values | 1,141 | - |
| Increase in impairment | (1,105) | 1,105 |
| Amounts written off | - | (2,934) |
| Exchange-rate movements | - | 10 |
| Balance as at *31 Dec 2011* | 1,376 | 3,930 |

**(b) Impairment Charges**

| £000 | **31/12/2012** | **31/12/2011** |
|---|---|---|
| **Loans and advances to customers** | | |
| Specific | **5,223** | 7,167 |
| Collective | **-** | - |
| Available for sale financial investments | **(768)** | 1,105 |
| **Total impairment charges in income statement** | **4,455** | 8,272 |

## Credit Quality Step ("CQS") Analysis

In its assessment of credit risk under the Standardised Approach, the Bank uses ratings assigned by the FSA's recognised External Credit Assessment Institutions ("ECAIs").

The Bank has not used any export credit agencies. The bank follows the provision of the FSA Handbook where external ratings can not be obtained.

**Exposure values for each of the standardised credit risk exposure classes associated with each credit quality step prescribed in BIPRU 3 as at 31 December 2012:**

| | Risk weight | Moody's | Exposure | RWA |
|---|---|---|---|---|
| **CQS for Central governments or central banks** | | | | |
| Unrated | 100% | | 22 | 22 |
| *Total* | | | **22** | **22** |
| **CQS for Corporates** | | | | |
| Unrated | 0% | Unrated | 364 | - |
| 1 | 20% | Aaa to Aa3 | 3,847 | 769 |
| 2 | 50% | A1 to A3 | 49,148 | 24,902 |
| 3 | 100% | Baa1 to Baa3 | 100,360 | 100,360 |
| 4 | 100% | Ba1 to Ba3 | 34,371 | 34,371 |
| Unrated | 100% | Unrated | 213,424 | 213,424 |
| 5 | 150% | Caa1 to Caa3 | 12,410 | 234 |
| Unrated | 150% | Unrated | 2,837 | 780 |
| *Total* | | | **416,760** | **374,840** |
| **CQS for Institutions** | | | | |
| 1 | 20% | Aaa to Aa3 | 264 | 53 |
| 2 | 50% | A1 to A3 | 3,623 | 1,811 |
| 3 | 50% | Baa1 to Baa3 | 48,740 | 24,370 |
| Unrated | 50% | Unrated | 29,254 | 14,627 |
| *Total* | | | **81,880** | **40,861** |
| **CQS for Short term claims on institutions and corporates** | | | | |
| 1 | 0% | Aaa to Aa3 | 125,000 | - |
| 2 | 20% | Aaa to Aa3 | 1,268 | 254 |
| 3 | 20% | A1 to A3 | 69,401 | 4,476 |
| Unrated | 20% | Unrated | 4,325 | 865 |
| *Total* | | | **199,994** | **5,595** |
| **CQS for Securitisation positions** | | | | |
| 1 | 20% | Aaa to Aa3 | 13,643 | 2,729 |
| *Total* | | | **13,643** | **2,729** |
| **Retail** | | | **11,900** | **8,392** |
| **Secured on real estate property** | | | **233,400** | **84,724** |
| **Past due items** | | | **106** | 89 |
| **Other items** | | | **83,653** | **80,887** |
| **Grand Total** | | | **1,041,358** | **598,139** |

Note:

1. Exposure value is the amount after applying credit conversion factors to off balance sheet exposures in accordance with the FSA regulatory rules.
2. RWA figure of the 5th category in *CQS for Corporate* has taken into account the impact of specific provisions.

# VI. Counterparty Credit Risk ("CCR")

The Bank uses derivative instruments to hedge its exposure to market risk, including interest rate risk in the banking book and foreign exchange risk. The counterparty credit risk for derivative and foreign exchange instruments is subject to credit limits on the same basis as the Bank's other credit exposures.

The Bank has not received nor provided collateral in respect of derivative contracts. Therefore, no collateral would need to be provided in the event of a downgrade in the Bank's credit rating.

The Bank measures its counterparty credit exposure using the CCR mark-to-market method, which is the sum of current exposure (i.e. replacement cost) and potential future exposure. The potential future exposure is an estimate based on factors such as the residual maturity of the contracts and the types of contract.

**Counterparty credit exposures for derivative contracts**

| £000 | | ***2012*** | | *2011* |
|---|---|---|---|---|
| | **Assets** | **Liabilities** | Assets | Liabilities |
| Interest rate swap | **-** | **3,365** | 58 | 4,131 |
| Cross currency swap | **1,949** | **70** | - | 280 |
| Foreign exchange forward | **-** | **-** | 14 | 5 |
| Total | **1,949** | **3,435** | 72 | 4,416 |

## Securitisation

The Bank holds positions in asset backed securities ("ABS") solely for investment purpose. The holding position can be sub-divided into Automobile receivables and mortgage-backed securities (MBS). All ABS assets are classified as available-for-sale for accounting purposes.

The Bank adopted the Standardised approach to calculate its risk weighted exposure amounts of its investments in ABS. As at 31st December 2012, the Bank's exposure to ABS is £ 12.8 million.

The Bank uses ratings assigned by ECAIs for the quantification of credit risk capital requirement under BIPRU 9.

# VII. Market Risks and Interest Rate Risk on Banking Book ("IRRBB")

The Bank does not undertake proprietary trading activities, and any matched principal broking position is back to back squared. Main source of market risk relates to foreign exchange risk, which stems mainly from foreign exchange profit.

## Foreign Exchange Risk

The Bank's foreign exchange position as at 31 December 2012 are set out below:

| £'000 | US Dollar | Euro | HK Dollars | YEN | Other |
|---|---|---|---|---|---|
| ***2012*** | **(2,170)** | **1,321** | **(55)** | **90** | **(176)** |
| ***2011*** | (675) | 373 | (32) | 96 | (122) |

## Interest Rate Risk in Banking Book ("IRRBB")

Objective for IRRBB risk management is to decrease the sensitivity of the bank's earnings and economic value to market rate fluctuations.

IRRBB mainly stems from the re-pricing mismatch of assets and liabilities. The sources of interest rate risk include re-pricing risk, yield curve risk, basis risk and embedded option risk.

Interest rate risk is managed Basel on the contractual maturity of the underlying investments. There are no assumptions made on loan prepayments.

The Bank adopts the interest rate sensitivity gap to analyse the re-pricing risk on a static basis from both the net interest income and economic value perspectives. The Bank also exercises a limit control utilising the one-year cumulative gap ratio (i.e. cumulative gap divided by interest-bearing assets) for all currencies, expressed in sterling.

**Impact of 100 bps parallel shift on projected net interest income**

| £000 | 100 bps parallel increase | 100 bps parallel decrease |
|---|---|---|
| ***2012*** | **1,314** | **(1,314)** |
| ***2011*** | 978 | (978) |

# VIII. Remuneration

Following implementation of the Remuneration Code ("the Code") by the Financial Services Authority ("the FSA") for a number of Banks in 2010, the FSA sought to undertake further consultation and in September 2012, they issued their "General Guidance on Proportionality: The Remuneration Code (SYSC 19A) & Pillar 3 Disclosures on Remuneration (BIPRU 11)" which set out the FSA's requirements in this regard.

The Financial Services Authority implemented its Code with effect from 1 January 2011, as required by the Capital Requirements Directive. As a regulated entity, Bank of China (UK) Limited ("the Bank") is required to comply with the requirements of the Code and has been classified a Level Two entity for proportionality purposes under the Code.

The following constitutes the Company's remuneration disclosure under Pillar 3 and sets out the details required under the Code and Pillar 3 Disclosures on Remuneration as they apply to the Bank for the year ended 31 December 2012.

## Decision-making process for determining remuneration policy

The Remuneration Committee (the "Committee") of the Bank is the executive body responsible for the implementation of effective remuneration governance and related risk management practices. The Committee meets regularly throughout the year and its primary purpose is to:

- Recommend the Executive Directors' remuneration to the Board for consideration prior to submitting to Head Office for approval;

- Recommend and monitor remuneration structures for second tier management and defined "Code Staff" (as defined under the Remuneration Code);

- Undertake an annual independent review of the Bank's remuneration policy and framework; and

- Review and approve of policies regarding recruitment, learning and development, assessment and performance appraisal.

The Terms of Reference of the Committee were last reviewed and updated in July 2012.

## Remuneration Policy

The Committee is guided by the overarching principles of the Bank's Remuneration Policy; the objective of the Bank's Remuneration Policy is to clearly document the practices of the Bank in regards to the remuneration of its employees.

The Bank's Remuneration Policy recognises and supports the fact that appropriate levels of remuneration and compensation are necessary to attract, retain and motivate high quality people required to lead, manage and serve the Bank in a competitive financial services environment.

The Bank has a robust framework in place to ensure that the level and composition of remuneration:

- Is reasonable and both clearly and measurably linked to performance;
- Is appropriate for results achieved; and
- Encourages behaviour consistent with the Bank's core competency model which leads to excellence and the appropriate balance in financial performance, governance, controls, risk management, customer service, people management, brand and reputation management.

The Committee reviewed the Remuneration Policy in November 2012; no significant changes were made to it at that time.

## Composition of the Committee

The members of the Committee include three members, being:

Donald Workman – Independent Non Executive Director (Chairman of the Committee)
Wenjian Fang – Chief Executive Officer, Bank of China (UK) Limited
Tracey Rutherford – Head of Human Resources, Bank of China (UK) Limited

## Role of relevant stakeholders

The Committee is supported by the Board Risk Committee on risk related matters including the specific measures and wider issues relating to risk and business protection and also by Legal and Compliance department on risk and performance related issues.

In no case is any person present when their own remuneration is discussed. In performing its duties, the Committee has sought the advice of professional advisers specifically in relation to the application of FSA Remuneration Code.

## Application of Material Risk Takers

The Bank considers the following categories of staff to be material risk takers and senior managers:

- Staff who perform significant influence functions for the Bank (as defined within the FSA Handbook);
- Staff with responsibility for management and supervision, and who report directly to the governing body, a member of the governing body, the Chief Executive Officer, or a Deputy/Assistant General Manager responsible for significant business lines;.
- Staff whose total remuneration takes them into the same bracket as Senior Management; and
- Staff whose professional activities could have a material impact on the firm's risk profile including market, credit and interest rate risk, and funding, liquidity, reputational and operational risk, with particular focus on risk on the Bank's capital.

## Link between pay and performance

The Bank's remuneration policies are designed to allow us to attract and retain talented individuals needed to deliver business strategy. The Bank manages the risk implications of its remuneration arrangements in a number of ways, including:

- Striking the optimal balance between 'fixed' elements of pay (base salary, benefits and pension), and 'variable' pay (annual discretionary bonus) to ensure variable pay overall and on an individual-by-individual basis remains an appropriate proportion of total pay;

- Ensuring performance for all variable pay plans is measured by reference to a range of factors including non-financial objectives, which take into account risk, sustainability of performance and the Bank's core competence values in order to take a rounded view of performance;

- Retaining the discretion to implement the clawback provisions of the Remuneration Policy in relation to any deferred bonus elements. Clawback will be initiated and enforced in line with the Bank's Risk Management risk adjustment and performance adjustment assessment and the Bank's disciplinary procedure; and

- Ensuring that any discretionary bonus scheme will not be applied unless the Bank achieves performance objectives as determined at the beginning of each financial year.

## Risk and Performance Adjustments

The Risk and Performance Adjustment considerations that would be applied by the Bank are:

- Consideration of the ongoing performance of the Bank that could be impacted by an individual, including profitability, specific losses incurred or written off and any new provisions made during any deferral period;

- That during any deferral period investigations by external auditors and regulators are without material qualification or disclose undue risk (taken by an individual);

- That future risks to be considered for Credit and Market Risk include through the non performing loans (NPLs) ratio and value at risk (VAR); and

- That any misstatement or misconduct or breach of policy or procedure by any individual be considered accordingly with Compliance, Operational Risk, Internal Audit or any other internal reports to be considered as appropriate.

## Design and structure of remuneration

The composition of remuneration and benefits comprises:

- Basic salary which is determined by having regard to external market salary benchmarking data and other relevant information;
- Benefits which are also determined by having regard to the external market and the requirements of the Bank's employees as part of a flexible benefit scheme;
- Discretionary Bonus Scheme which is performance based variable remuneration scheme determined by the outcome and achievement of performance measures and competences applied to employees within a balance scorecard framework; and
- Discretionary exceptional merit awards which are based on exceptional performance.

Discretionary awards as referred above qualify as "variable remuneration" as defined in the Remuneration Code.

The Committee discuss and review Risk and Compliance employee's remuneration on an annual basis to ensure they are remunerated independently of the businesses they oversee. This process is completed in the 4th quarter to align to the annual salary review which is effective January and the discretionary bonus awards which are generally paid in March annually.

Non Executive Code Staff do not participate in variable pay arrangements.

## Annual Discretionary Bonus Award for Code Staff

Code Staff participate in the discretionary annual bonus scheme that aims to recognise and reward an employee's personal contribution to the success of the Bank. As referred to above, contribution and success is typically based on the measure of a mix of corporate and personal pre agreed objectives for the year which results in a performance rating for the individual.

For the majority of Code Staff, discretionary bonus awards will be paid from a discretionary bonus pool which is determined following the end of the financial year based on corporate performance. This is paid as a cash award in March following the end of the financial year. The level of funding for the pool based scheme is related to the financial performance of the Bank.

Individual discretionary bonus awards will be reduced where the Bank becomes aware of any action by an individual which has exposed the Bank to any form of unplanned risk (including, but not limited to, regulatory, legal or reputational risk).

The Bank's Remuneration Policy enables deferral of discretionary bonus awards on the following basis:

- Year 1 – 60% of bonus paid in cash
- Year 2 - 4 – 40% of deferred bonus paid in cash in equal instalments

The Bank's Remuneration Policy does not allow for vesting of variable remuneration deferral elements.

The deferral of variable remuneration applies to defined code staff only who fall outside of the current "de minimis" rules.

## 2012 Variable Remuneration Awarded

| | |
|---|---|
| Number of staff receiving variable remuneration award | 249 |
| Total fixed pay | £11,124,119.00 |
| Total variable pay (including discretionary bonus award, allowances and overtime) | £4,546,413.00 |
| Total deferred remuneration paid out | £114,739.00 |
| Total non deferred variable remuneration paid out | £3,765,775.00 |
| Total outstanding deferred remuneration (to be paid 2013 - 2016) | £598,329.00 |
| Total severance payments made | £15,662.00 |

The Bank did not pay any guaranteed bonuses or sign on awards during the 2012 financial year.