

Pillar 3 Disclosures

Year End 2014

Bank of China (UK) Ltd



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1. Introduction

Background

Bank of China (UK) Ltd (“BOC UK” or “the Bank”) was incorporated as a private limited company on 15th October 2007, a wholly owned subsidiary of Bank of China Limited (BOC or BOC Group). BOC UK is regulated by the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) and authorised by the Prudential Regulation Authority, previously the Financial Services Authority (FSA)¹. The Bank has been Basel compliant since 2008.

The Bank provides a comprehensive range of retail banking, corporate banking, trade financing and financial markets services in the UK. The corporate and trade finance business encompass funding and advisory services for Chinese corporate seeking to expand in the UK and EU. Syndication loans play an important role at the Bank in gaining access to EU corporate clients. Our retail banking activities focus on branch banking. The Bank offers standard high street retail banking services including current accounts, savings accounts, debit and credit cards, mortgage products, personal and commercial loans.

BOC UK follows the mission and strategy of the BOC Group, with a main focus on the UK market development.

Basis of Disclosures

This disclosure is prepared in accordance with the requirements set out in PRA handbook BIPRU Chapter 11 Disclosures and should be read in conjunction with the “*Bank of China (UK) Limited Annual Report and Financial Statements for the year ended 31 December 2014*”².

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.

The Pillar 3 Disclosures 2014 have been prepared in accordance with regulatory capital adequacy concepts and rules, rather than in accordance with international Financial Reporting Standards (IFRS). Therefore, some information in this report is not directly comparable with the Bank’s Annual Report 2014.

¹ FSA was abolished and restructured to PRA and FCA with effect from 1 April 2013.

² See <http://www.bankofchina.com/uk/aboutus>

Regulatory Framework for Disclosures

BOC UK is supervised on a consolidated basis in the UK by the PRA. The Bank refers to the information from PRA for assessing capital adequacy and setting capital requirements. The capital was assessed for prudential regulatory reporting purposes in 2014 using the Basel III framework of the Basel Committee on Banking Supervision (“Basel Committee”) as implemented by the EU in the amended Capital Requirements Directive (CRD IV) and in the PRA’s Rulebook for the UK banking industry.

In 2014 and 2015, significant changes have been introduced to the Basel prudential requirements and regulatory reporting from EU Directives and CRD IV.

The Basel framework is structured under 3 pillars:

- Pillar 1 minimal capital requirements
- Pillar 2 supervisory review process
- Pillar 3 market disciplines.

Pillar 3 complements the Pillar 1 and Pillar 2. The aim for Pillar 3 is to enhance market discipline by developing a set of disclosure requirements which allow the market participants to assess certain specified information on the scope of application of Basel, capital, particularly risk exposures and risk assessment processes and hence the capital adequacy of the institution. Disclosures consist of both qualitative and quantitative information.

As part of Pillar 3 framework, the Bank is required to disclose all the material risks.

Verification

The Pillar 3 Disclosures 2014 have been verified internally but have not been audited by the Bank’s external auditor.

Frequency

The Bank produces its Pillar 3 disclosures on an annual basis, and publishes it as soon as practically possible.

Media and Location of Publication

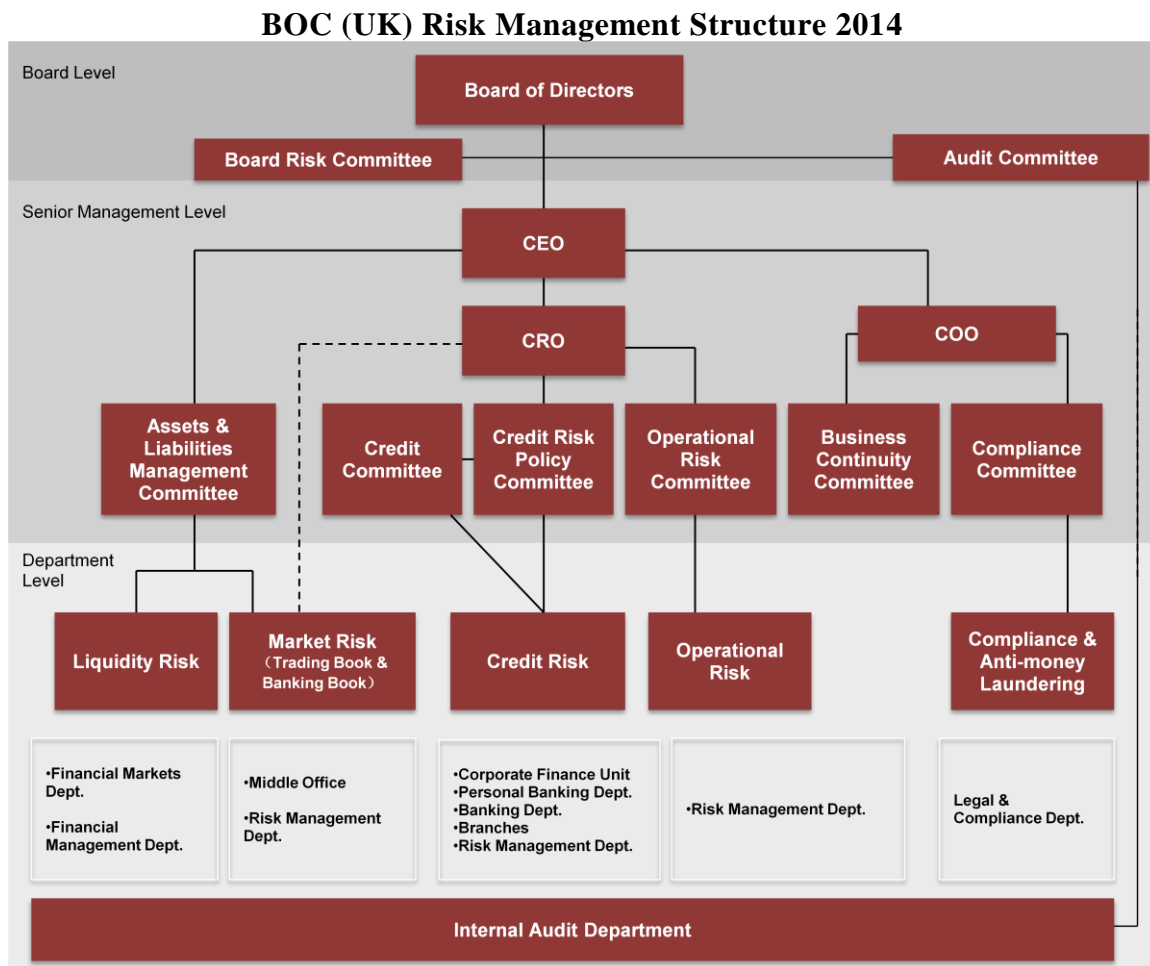
The Bank’s Pillar 3 Disclosures is published on the Bank of China (UK) Ltd website: <http://www.bankofchina.com/uk/aboutus/>

2. Risk Management Overview

An effective risk management is a key component of the Bank's strategy to deliver its excellence. The Bank's business model is supported by a risk culture grounded in ensuring a sustainable risk appetite.

Risk Governance

The Bank's committees monitor and challenge risk exposures against risk appetite. Each committee with the governance structures, illustrated in below chart, is responsible for ensuring the risk and control environment. The reporting lines are clearly defined through the committees, Senior Management and Board level.



The Board of Directors (the Board) is the primary governing body of the Bank. It has the ultimate responsibilities for defining and managing the Bank's risk appetite statement, setting risk management framework, and approving the Bank's risk policies and exposure limits.

Board Audit Committee performs oversight over internal controls and compliance, financial reporting issues and external auditor liaison.

Board Risk Committee (BRC) was established in March 2011 (previously Board Credit Committee). Its main responsibilities are for assisting the Board with established and ongoing review of the risk strategies, rules and policies, defining risk appetite statement, the bank-wide oversight of risk management performance, approval of non-standard credits, and credit above the delegated limits to the CEO (Chief Executive Officer), as well as approval of delegated limit authorities.

The Senior Management, including the CEO, CRO (Chief Risk Officer), COO (Chief Operating Officer) and committees are delegated with power for daily management and control.

Committees Reporting to BRC:

- **Asset and Liabilities Committee (ALCO):** establishes and maintains asset and liability management policies and procedures, reviews and approves policies relating to market risk and liquidity management.
- **Compliance Committee:** oversees and supports the implementation of an effective and proactive compliance function.
- **Credit Risk Policy Committee (CRPC):** establishes and reviews the Bank's credit policies and related matters.
- **Credit Committee:** is mainly responsible for new facility assessment, risk classification review and provisioning.
- **Operational Risk Committee:** is responsible for reviewing operational risk, monitoring framework and operational risk compliance.
- **Business Continuity Committee:** oversees and supports the implementation and maintenance of an effective business continuity infrastructure and disaster recovery planning function.

Risk Appetite

The Board, BRC and the Senior Management set risk appetite. The Risk Appetite Statement defines the aggregate amount and type of risk the Bank is willing to pursue or avoid in achieving the strategic goals. All strategic business plans for functional areas must be consistent with the risk appetite.

Three Lines of Defence

The bank adopts three lines of defence model/across all risk areas.

- The **first line defence** is provided by the Corporate Finance Units³, Financial Markets Department, Personal Banking Department and retail branches.
- The **second line defence** is provided by the Risk Management Department, Financial Management Department and Legal & Compliance Department.
- The **third line defence** complements the risk management structure and is provided by Internal Audit Department.

Stress Testing

Stress testing is an integral part of the ICAAP framework. It builds upon the results of financial forecasts and material risk assessment, and feeds into the Bank's capital planning process. The Bank applies stress testing under a set of economic factors, market factors, operational risk factors and regulatory factors. For each risk factor, project is made individually for Base Case Scenario, Moderate Scenario and Sever Scenario with 3 years forecast.

The scenario setting is in line with PRA anchor scenarios. Two levels of stress testing are applied at the Bank: Moderate Stress and Sever Stress.

As a capital risk management process, stress testing and scenario analysis provide an important complement to quantitative risk management approaches. The stress testing results for capital adequacy also provides a bridge between credit risk management and senior management's strategic actions for evaluating the impact of different business options on the risk appetite.

³ CFUs at the Bank consist of Corporate Banking Department, EMEA Syndication Department, Financial Institutions and Trade Finance Department.

3. Capital Resources

Total Capital Resources

The Bank builds up its capital base externally through capital injection from BOC Group. The Bank retains the option to increase the capital internally by retained earnings. The capital resource comprise of Tier 1 and Tier 2 capital as set out in Table 1. The PRA uses risk asset ratios as one of the measures of capital adequacy in the UK banking sector. All the risk asset ratios of the Bank are CRD IV compliant.

Table 1: Total capital resources and risk asset ratios

(£000)	31 Dec 2014	31 Dec 2013
CET 1 Capital: Ordinary share capital	250,000	250,000
Audited retained earnings ⁴	24,958	24,958
Total Tier 1 Capital	274,958	274,958
Tier 2 Capital:		
Qualifying subordinated debt	60,000	60,000
Total Tier 1 and 2 capital after deductions	334,958	334,958
Risk-weighted assets (RWA)	800,993	776,093
Risk Asset Ratios		
CET 1 capital ratio	34%	35%
Tier 1 capital ratio	34%	35%
Total capital ratio	42%	43%

CET 1 capital: consists of ordinary share capital and retained earnings. CET1 capital remained the same. The retained earnings represent the Bank's audited accumulated accounting profits. The Bank currently has not issued any innovative Tier 1 instruments. As at 31 Dec 2014, there is no reconciliation differences between the amounts disclosed as Tier 1 capital to those treated as equity under IFRS.

Tier 2 capital: includes qualifying subordinated debt of £60M, which was issued in Sep 2007 on terms for inclusion in the Bank's capital resources. The debt is repayable upon notice. In the event of the Bank's winding-up, the subordinated debt is subject to the claims of depositors and all other creditors of the Bank. Further details are in *note 28* of the Bank's *Annual Report 2014*.

The Bank's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence, and to sustain future business development. The impact of the capital level on shareholders' return is also recognised and the Bank recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position. There are various limits applicable to the capital base elements. The Bank does not have any deductions from either Tier 1 or Tier 2 capitals.

⁴ A dividend £25,955,000 was declared and paid representing the 2014 profit and loss. From a BIPRU perspective, the capital maintained the same as for 2013.

Leverage Ratio

In Jan 2014, the Basel Committee published a revised Basel III leverage ratio framework⁵, which includes a number of amendments to the original calculations of the exposure measure. It introduced a simple, transparent, non-risk based leverage ratio to act as a credible supplementary measure to the risk-based capital requirements. The framework requires a minimum leverage ratio of 3%.

A Bank's total leverage exposure measure is the sum of the following exposures: 1) on-balance sheet exposures; 2) derivative exposures; 3) securities financing transaction exposure; and 4) off-balance sheet items.

In Jan 2015, the existing CRD IV rules on the calculation of leverage ratio were amended to align with the European Commissions' interpretation of the revised Basel leverage ratio framework. According to CRD IV rules, the leverage ratio is calculated as Tier 1 capital divided by a defined measure of on-balance sheet assets and off-balance sheet items.

Table 2: Leverage ratio

Total Capital Resources (£000)	31 Dec 2014	31 Dec 2013
Tier 1 capital for leverage ratio:	274,958	274,958
CET 1 capital: Ordinary shares	250,000	250,000
Audited retained earnings	24,958	24,958
Statutory balance sheet assets	1,215,116	1,050,075
Derivative financial instruments	16,173	41,502
Cash and cash equivalent	69,321	43,289
Reverse repurchase agreements	135,000	120,000
Loans and advances and other assets	994,622	845,284
Derivatives adjustments	-	-
Securities financing transaction adjustments	-	-
Off-balance sheet assets	367,230	330,766
Off-balance sheet items	361,921	330,766
Regulatory deductions and other adjustments	5,309	-
Total leverage exposure	1,582,346	1,380,841
Leverage ratio	17%	20%

As shown in above Table 2, the leverage exposure in 2014 increased by £196M from 2013. As a result, the leverage ratio decreased to 17%, but is still well above Basel's requirement. The Bank does not face an issue of excessive leverage.

The main reasons contributing to a relative high leverage ratio are due to:

- Level of Tier 1 capital resources
- Small proportion of off-balance assets.

⁵ It is required to publicly disclose the leverage ratio disclosures on a consolidated basis from 1 Jan 2015.

4. Capital Adequacy

The Bank's capital requirement is supervised by the PRA. Since 2008, the Bank is compliant with Basel II framework in regulatory capital requirement and subsequently with Basel III framework implemented in 2010. Basel III strengthened the Basel rules, which feature a redefined and higher capital requirement.

Basel framework is structured around three pillars:

- Pillar 1 covers the minimum capital requirements for credit, market and operational risks.
- Pillar 2 is the supervisory review process, e.g. concentration risk and IRRBB.
- Pillar 3 complements Pillar 1 and Pillar 2, with an aim to encourage market disciplines by developing a set of disclosure requirements.

Capital ratios remain the international standards for measuring capital adequacy. The senior management uses regulatory capital ratios to monitor the Bank's capital base. PRA's approach to such measurement based upon Basel III is now primarily based on monitoring the relationship of the capital resources requirement, which is 8% of the risk-weighted assets (RWA) to available capital resources. PRA also sets individual guidance (ICG) in relationship to the Pillar 1 minimum capital requirement.

Internal Capital Adequacy Assessment Process (“ICAAP”)

A key input to the ICG setting process is the Bank's ICAAP. In line with the PRA requirements, the Bank has adopted the ICAAP approach since 2008. The ICG was agreed with the PRA in Mar 2012 in recognition of ICAAP Document 2011 submitted.

The Bank's ICAAP defines the internal process and methodology used to assess current and forecast future capital requirements under the Basel capital requirement framework. ICAAP is designed to cover a full scope of risks inherent in the Bank's business activities and operations. ICAAP is fully embedded in the corporate governance and risk management framework. It is conducted on an annual basis. The final submission has to seek internal approval from the Bank's Board Risk Committee and the Board.

Overview of RWA

RWA forms the denominator of the risk-based capital requirements. The RWA overview was brought into disclosures by the Basel Committee in Jan 2015. A further breakdown and quarterly comparison of the RWA are illustrated in below Table 3.

Table 3: Overview of RWA

£000	31 Dec 2014	
	RWA	Minimum Capital Requirements
Credit risk (excluding counterparty credit risk (CCR))	800,993	64,079
Of which standardised approach (SA)	800,993	64,079
Of which internal rating-based (IRB) approach	-	-
Counterparty credit risk	3,251	260
Of which standardised approach for counterparty credit risk	3,251	260
Of which internal model method (IMM)	-	-
Equity positions in banking book under market-based approach	-	-
Equity investments in funds-look-through approach	-	-
Equity investments in funds-mandate-based approach	-	-
Equity investments in funds-fall-back approach	-	-
Settlement risk	-	-
Securitisation exposure in banking book	-	-
Of which IRB ratings-based approach (RBA)	-	-
Of which IRB supervisory Formula Approach (SFA)	-	-
Of which SA/simplified supervisory formula approach (SSFA)	-	-
Market risk	13,244	1,059
Of which standardised approach (SA)	13,244	1,059
Of which internal model approaches (IMM)	-	-
Operational risk	107,314	8,585
Of which Basic Indicator Approach	107,314	8,585
Of which Standardised Approach	-	-
Of which Advanced Measurement Approach	-	-
Amounts below thresholds for deduction (subject to 250% RW)	-	-
Floor adjustment	-	-
Total	924,791	73,983

Credit Risk Capital Requirement: Standardised Approach

The Bank's minimum capital requirement for credit risk is expressed as 8% of the risk weighted exposure under each of the applicable standardised credit risk exposure classes, illustrated below:

Table 4: Capital requirement for credit risk under Standardised Approach

£000	31 Dec 2014		31 Dec 2013	
	RWA	Capital Requirement	RWA	Capital Requirement
Central governments or central banks	-	-	-	-
Corporate	445,251	35,620	418,306	33,465
Institutions	104,778	8,382	99,951	7,996
Retail	837	67	1,587	127
Secured by mortgages on residential property	155,864	12,469	116,116	9,289
Secured by mortgages on commercial real estate	5,397	432	6,502	520
Short term claims on institutions & corporates	25,876	2,070	23,748	1,900
Past due items	64	5	859	69
Other items	62,927	5,034	109,024	8,722
Total	800,993	64,079	776,093	62,087

As indicated in above Table 4, the RWA and capital requirement in 2014 experienced minor movements compared to previous year.

Capital Adequacy

Table 5: Capital adequacy under Pillar 1

(£000)	31 Dec 2014	31 Dec 2013
Credit Risk (Standardised Approach)	64,079	62,087
Market Risk (Foreign Exchange PRR)	1,060	267
Operational Risk (Basic Indicator Approach)	8,585	7,393
Counterparty Credit Risk (including CVA)	260	-
Total Pillar 1 minimum capital requirement	73,984	69,747
Total capital resources	334,958	334,958
Excess of capital resources over Pillar 1 minimum capital requirement	260,974	265,211

Countercyclical Capital Buffers (CCB)

In 2014, EBA developed a set of regulatory technical standards that specify the disclosure requirements relating to institutions' compliance with the requirement for CCB in line with CRD IV. EBA set out two tabular disclosures templates for the institution-specific CCB and the geographical location of the exposures determining this buffer.

The disclosure requirement for capital buffers is in final draft stage, with an indicative implementing date from 1 Jan 2016. It is not in force yet.

Global Systemically Important Banks (G-SIBs)

The Basel Committee issued a document in 2013. It requires the identified G-SIBs and the large institutions with an overall leverage exposure above EUR 200 billion to assess the systemic importance in a global context. Global systemic importance is measured in terms of the impact a bank's failure can have on the global financial system and the wider economy, rather than the risk that a failure could occur. In Jun 2014, EBA published guidelines and set out technical standards for the disclosures of G-SIBs. This requirement is included in CRD IV.

The measurement approach is indicator-based, reflecting the size, the interconnectedness, and the lack of readily available substitutes or financial institution infrastructure for the services they provide, the global activity and the complexity.

BOC UK is not identified as G-SIBs, although BOC Group is.

Consolidation Basis

The consolidation of financial statements purposes differ from that for regulatory purposes. A further breakdown of the regulatory risk categories are illustrated below.

Table 6: Reconciliation between IFRS and Regulatory balance sheets

2014 Reconciliation (£000)	IFRS/ Regulatory balance sheet	Subject to credit risk framework	Subject to counterparty credit risk framework	Subject to securitisation framework	Subject to market risk framework	Not subject to capital requirements or deductions
Assets						
Cash and cash equivalents	199,854	-	-	-	-	199,854
Loans and advances to banks	207,026	207,026	-	-	-	-
Loans and advances to customers	722,307	722,307	-	-	-	-
Derivative financial instruments	16,173	-	16,173	-	16,173	-
Prepayments, accrued income and other assets	27,820	1,621	-	-	-	26,199
Available for sale financial investments	37,469	10,490	-	-	-	26,979
Deferred tax assets	751	-	-	-	-	751
Property, plant and equipment	3,390	-	-	-	-	3,390
Intangible assets	326	-	-	-	-	326
Total Assets	1,215,116	941,444	16,173	-	16,173	257,499
Liabilities						
Deposits from banks	40,270	-	-	-	-	40,270
Deposits from customers	765,899	-	-	-	-	765,899
Derivative financial instruments	21,489	-	-	-	21,489	-
Other liabilities	18,089	-	-	-	-	18,089
Accruals and deferred income	4,016	-	-	-	-	4,016
Current tax liabilities	3,873	-	-	-	-	3,873
Deferred tax liabilities	-	-	-	-	-	-
Subordinated liabilities	60,000	-	-	-	-	60,000
Total liabilities	913,636	-	-	-	21,489	892,147
Equity						
Authorised and called up share capital	250,000	-	-	-	-	250,000
Retained earnings	50,913	-	-	-	-	50,913
Available for sale reserve	567	-	-	-	-	567
Total shareholders' equity	301,480	-	-	-	-	301,480
Total shareholders' equity & liabilities	1,215,116	-	-	-	-	-

As shown in above table, the consolidation of IFRS balance sheet scope is identical to that with regulatory scope in 2014. There is no reconciliation difference.

5. Credit Risks

Credit Risk Management and Controls

Credit risk is defined as the risk that parties with whom the Bank has contracted fail to meet their obligations (both on and off-balance sheet). Credit risk appetite is described and reported on a monthly basis through a suite of risk metrics derived from credit portfolio performance measures. Credit risk appetite statement and credit policies and procedures are reviewed regularly to ensure that the metrics continue to reflect the Bank's risk appetite appropriately.

Credit Risk Exposures

Table 7 below shows the credit exposures, broken down by credit exposure class and geographic locations of the counterparties.

Table 7: Geographic distribution of credit exposure

£000	UK	Other EU Countries	North America	Rest of the World	Total
2014					
Central governments or central banks	26,930	-	-	-	26,930
Corporates	362,444	24,931	8,029	60,947	456,351
Institutions	20,688	-	10,113	192,982	223,784
Retail	2,204	18	7	804	3,033
Secured by mortgages on residential property	435,836	-	-	-	435,836
Secured by mortgages on commercial real estate	5,397	-	-	-	5,397
Short term claims on institutions and corporates	203,713	69	3,529	8,964	216,275
Past due items	49	2	-	-	50
Other items	64,070	-	-	39	64,109
Grand Total	1,121,332	25,020	21,678	263,736	1,431,765
2013					
Central governments or central banks	-	-	-	-	-
Corporates	311,268	41,214	3,931	77,072	433,485
Institutions	44,982	-	10,387	98,706	154,075
Retail	2,598	24	9	831	3,461
Secured by mortgages on residential property	250,778	1,383	536	70,798	323,494
Secured by mortgages on commercial real estate	6,110	-	-	392	6,502
Short term claims on institutions and corporates	173,147	28	17,532	27,632	218,339
Past due items	108	-	-	513	621
Other items	110,761	-	-	-	110,761
Grand Total	899,752	42,649	32,394	275,944	1,250,739

Total credit exposure increased by £181M to £1,432M. Key movements by geographical area were as follows:

- Exposure in the UK increased by £222M to £1,121M driven mainly by residential mortgage portfolio expansion.

Table 8: Gross credit exposure under Standardised Approach

£000	2014		2013	
	Average Credit Exposure ⁶	Year End Exposure	Average Credit Exposure	Year End Exposure
Central governments or central banks	6,732	26,930	16	-
Corporates	423,873	456,351	422,390	433,485
Institutions	197,004	223,784	128,713	154,075
Retail	3,205	3,033	3,404	3,461
Secured by mortgages on residential property	394,493	435,836	289,529	323,494
Secured by mortgages on commercial real estate	5,640	5,397	6,330	6,502
Securitization positions	-	-	6,685	-
Short term claims on institutions and corporates	216,927	216,275	228,826	218,339
Past due items	107	50	262	621
Other items	72,963	64,109	100,660	110,761
Grand Total	1,320,944	1,431,765	1,186,815	1,250,739

Total average credit exposure increased by £140M.

Key movements:

- Average credit exposure for Secured by mortgage on residential mortgage increased approximately by £105M.
- Average credit exposure for Institutions increased approximately by £70M.
- The exposure for Securitisation positions ran off in 2014.

⁶ Quarterly average is used here.

Table 9: Industry distribution of gross credit exposure

31 Dec 2014		
(£000)		
Exposure Class	Industry Category	Gross exposure
Central governments or central banks	Public administration and defence	26,930
Corporates	Accommodation and food services activities	39,051
	Activities auxiliary to financial intermediation	2
	Agriculture, hunting and forestry	20,874
	Construction	1,631
	Education	4
	Electricity, gas and water supply	88,083
	Fincl intmdiation excl. insurance Co & pension funds	3,650
	Human health and social work	2
	Individuals and individual trusts	352
	Insurance companies and pension funds	61
	Manufacturing	125,322
	Mining and quarrying	31,928
	Public administration and defence	84
	Real estate, professional services and support activities	29,393
	Transport, storage and communication	66,974
	Wholesale and retail trade	48,938
Institutions	Fincl intmdiation excl. insurance Co & pension funds	223,784
Retail	Accommodation and food services activities	5
	Fincl intmdiation excl. insurance Co & pension funds	29
	Individuals and individual trusts	2,977
	Manufacturing	4
	Public administration and defence	8
	Transport, storage and communication	7
	Wholesale and retail trade	3
Secured by mortgages on commercial real estate	Individuals and individual trusts	5,397
Secured by mortgages on residential property	Construction	102
	Fincl intmdiation excl. insurance Co & pension funds	669
	Individuals and individual trusts	430,534
	Manufacturing	77
	Real estate, professional services and support activities	4,448
	Transport, storage and communication	6
Short term claims on institutions and corporates	Fincl intmdiation excl. insurance Co & pension funds	216,275
Past due items	Individuals and individual trusts	11
	Manufacturing	3
	Real estate, professional services and support activities	37
Other items	Fincl intmdiation excl. insurance Co & pension funds	64,075
	Individuals and individual trusts	34
Grand Total		1,431,765

Above Table 9 shows the credit exposure broken down by credit exposure class and the industrial sectors. The industry descriptions in 2014 differ from that in 2013. As a result, sector comparison is not appropriate to analyze here. The industry highlights are as follows:

- Individuals and individual trusts of £431M, 30% of the total portfolio, represent mainly the residential mortgages. The sector occupies the dominant sector.
- The exposure £27M under Central governments or central banks was due to a UK government bond in RMB issued in 2014.

Table 10: Residual contractual maturity of credit exposure

31 Dec 2014 (£'000)	Up to 12 months	1-5 years	More than 5 years	Total
Central governments or central banks	26,930	-	-	26,930
Corporates	76,950	128,716	250,685	456,351
Institutions	109,229	114,464	90	223,784
Retail	2,624	402	7	3,033
Secured by mortgages on residential property	39,305	239	396,291	435,836
Secured by mortgages on commercial real estate	-	-	5,397	5,397
Short term claims on institutions and corporates	216,275	-	-	216,275
Past due items	42	9	-	51
Other items	64,109	-	-	64,109
Grand Total	535,464	243,830	652,471	1,431,765
31 Dec 2013				
Corporates	1,385	252,334	179,766	433,485
Institutions	53,111	100,906	58	154,075
Retail	1,708	742	1,012	3,461
Secured by mortgages on residential property	-	-	323,494	323,494
Secured by mortgages on commercial real estate	-	-	6,502	6,502
Short term claims on institutions and corporates	218,339	-	-	218,339
Past due items	-	110	511	621
Other items	110,761	-	-	110,761
Grand Total	385,304	354,091	511,344	1,250,739

Key points:

- The exposure within 1 year residual maturity increased by £150M, mainly due to increased exposure by £76M on Corporates and £56M on Institutions.
- The exposure for between 1 and 5 years residual maturity decreased by £110M, mainly due to exposure reduction on Corporate by £124M.
- The exposure for more than 5 years residual maturity increased by £140M, mainly due to corporates (£71M) and Secured by mortgages on residential property (£73M).

Impairment Provisions

The Bank defines past due⁷ 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.

Table 11: Analysis of past due, impaired and provision to loans and advances by industry

31 Dec 2014 (£000)	Past Due	Impaired	Provision
Accommodation and food services activities	-	-	37
Construction	-	-	1
Electricity, gas and water supply	-	-	68
Fincl intmdiation excl. insurance Co & pension funds	-	-	331
Manufacturing	-	(3)	107
Mining and quarrying	-	-	51
Individuals and individual trusts	(11,263)	(683)	5
Real estate, professional services and support activities	-	-	28
Transport, storage and communication	-	-	62
Wholesale and retail trade	-	-	51
Grand Total	(11,263)	(686)	741
31 Dec 2013 (£000)	Past Due	Impaired	Provision
Business & other services	(5)	-	0.1
Financial	(0.3)	-	-
Garages, distribution, hotels & catering	(43)	-	-
Manufacturing industry	(0.1)	-	-
Persons	(8,077)	(21)	22
Grand Total	(8,126)	(21)	22

Table 12: Analysis of past due, impaired and provision by geographical region

31 Dec 2014 (£000)	Past Due	Impaired	Provision
UK	(11,261)	(684)	335
Other European Countries	-	(2)	27
Rest of the World	(2)	-	379
Grand Total	(11,263)	(686)	741
31 Dec 2013 (£000)	Past Due	Impaired	Provision
UK	(6,117)	(21)	22
Rest of the World	(2,009)	-	-
Grand Total	(8,126)	(21)	22

Key points:

- Past due exposure increased by £3M primarily due to overdue mortgages of individual and individual trusts in UK.
- Impaired exposure increased by £665K due to newly impaired mortgages in UK.
- Provision increased by £720K, mainly due to collective provisions introduced.

⁷ Past due assets is defined as overdue for minimum 0-3 months and 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.

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 borrower a concession that the lender would not otherwise consider;
- It is becoming probable that the borrower will enter bankruptcy or other financial reorganization;
- Disappearance of an active market for that financial asset due to 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.

The provisions movement in the impairment allowance between 2013 and 2014 year-end is shown in below Table 13. This table is also available in the 2014 annual report.

Table 13: Allowances for impairment: provisions to loans and advances

£000	Specific		Collective	
	Loans and advances to banks	Loans and advances to customers	Loans and advances to banks	Loans and advances to customers
Balance as at 1 Jan 2014	-	22	-	-
Increase in impairment	-	-	331	405
Reversal of impairment	-	(14)	-	-
Charge in income statement	-	(14)	331	405
Amounts written off	-	(3)	-	-
Balance as at 31 Dec 2014	-	5	331	405
Balance as at 1 Jan 2013	-	12,273	-	-
Increase in impairment	-	60	-	-
Reversal of impairment	-	-	-	-
Charge in income statement	-	60	-	-
Amounts written off	-	(12,311)	-	-
Balance as at 31 Dec 2013	-	22	-	-

Key movement analysis: A total of £736K collective provision to loans and advances was introduced new in 2014. In the final quarter of 2014, a specialized system was launched to automatically apply the preset provision ratio, calculate the provision and pass accounting entry on a daily basis.

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.

Table 14: Allowances for impairment: Available For Sale Financial Investments

£000	Movement in fair value recognized in equity	Impairment
Balance as at 1 Jan 2014	(1,027)	-
Changes in fair values	351	-
Reversal of impairment	-	-
Amounts written off	-	-
Exchange-rate movements	-	-
Balance as at 31 Dec 2014	(676)	-
Balance as at 1 Jan 2013	(1,029)	3,003
Changes in fair values	2	-
Reversal in impairment	-	(2,955)
Amounts written off	-	-
Exchange-rate movements	-	(48)
Balance as at 31 Dec 2013	(1,027)	-

Table 15: Impairment charges

£000	31 Dec 2014	31 Dec 2013
Loans and advances to customers:		
Specific	14	60
Collective	(405)	-
Loans and advances to banks:		
Specific	-	-
Collective	(331)	-
Available for sale financial investments	-	-
Total impairment charges in income statement	(722)	(60)

Credit Quality

Table 16: Credit quality of assets

31 Dec 2014 £000	Gross carrying values ⁸ of		Allowances/ impairment	Net values
	Defaulted exposures	Non-defaulted exposures		
Loans	2,493	927,581	741	929,333
Debt Securities	-	37,469	-	37,469
OBS exposures	-	361,921	-	361,921
Total	2,493	1,326,971	741	1,328,723

Table 17: Changes of defaulted loans and debt securities

	Carrying values (£000)
Defaulted loans and debt securities at 30 Jun 2014	354
Loans and debt securities that have defaulted since the last reporting period	2,493
Returned to non-defaulted status	(354)
Amounts written off	-
Other changes	-
Defaulted loans and debt securities at 31 Dec 2014	2,493

Movements highlight:

- The changes in stock relates to mortgage loans only. There was no default arising from debt securities.
- The defaulted amount £354K in Jun 2014 related to one residential mortgage, then it returned to non-defaulted status in full.
- The defaulted loans increased significantly due to 8 residential mortgages turning into non-performing status.

⁸ The amount is the gross exposure of any credit conversion factors (CCF) or credit risk mitigation (CRM) techniques, but after deduction of write-offs.

Credit Quality Step (“CQS”) Analysis

In the assessment of credit risk under Standardised Approach, the Bank uses ratings assigned by the PRA’s recognised External Credit Assessment Institutions (“ECAIs”) to determine risk weight and RWA.

Rated and unrated counterparties under the standardised approach governing rule, each exposure must be assigned to one of the six credit steps if a rating is available. After assignment to a quality step, exposure class and maturity are then used to determine the risk weight percentage. Where a credit rating is not available, a default treatment is applied as specified by regulatory guidance.

The Bank has not used any export credit agencies for rating purposes. The bank follows the provision of the CRD IV where external ratings cannot be obtained.

The breakdown of credit risk exposures under standardised approach by asset class and risk weight, corresponding to the riskiness attributed to the exposure.

Table 18: Credit exposures by asset classes and risk weights

Risk weight Asset classes 31 Dec 2014	Risk weight									Total credit exposures (post CCF&CRM)
	0%	10%	20%	35%	50%	75%	100%	150%	250%	
Central governments or central banks	26,930	-	-	-	-	-	-	-	-	26,930
Corporates	1,355	-	1,576	-	16,968	-	436,452	-	-	456,351
Institutions	-	-	22,559	-	201,224	-	-	-	-	223,784
Retail	1,917	-	-	-	-	1,116	-	-	-	3,033
Secured by mortgages on residential property	-	-	-	430,523	-	530	4,783	-	-	435,836
Secured by mortgages on commercial real estate	-	-	-	-	-	-	5,397	-	-	5,397
Short term claims on institutions and corporates	135,000	-	68,467	-	-	-	12,808	-	-	216,275
Past due items	-	-	-	-	-	-	-	43	-	43
Other items	1,555	-	-	-	-	-	62,307	-	248	64,109
Total	166,757	-	92,602	430,523	218,192	1,646	521,747	43	248	1,431,758

Exposure values for each of the standardised credit risk exposure classes associated with each credit quality step are presented in below tables.

Table 19: Credit risk exposure by CQS

31 Dec 2014	Risk weight	Moody's ratings	S&P ratings	Exposure values	RWA
CQS for Central governments or central banks					
1	0%	Baa1 to Baa3	BBB+ to BBB-	26,930	-
CQS for Corporates					
1	20%	Aaa to Aa3	AAA to AA-	1,576	315
2	50%	A1 to A3	A+ to A-	16,968	8,484
3	100%	Ba1 to Ba3	BB+ to BB-	15,771	15,771
4	100%	Baa1 to Baa3	BBB+ to BBB-	21,998	21,998
Unrated				400,038	398,683
Total				456,351	445,251
CQS for Institutions					
1	20%	A1 to A3	A+ to A-	22,555	4,511
2	50%	A1 to A3	A+ to A-	92,189	46,094
3	50%	Baa1 to Baa3	BBB+ to BBB-	73,084	36,542
Unrated				35,956	17,631
Total				223,784	104,778
CQS for Short term claims on institutions and corporates					
1	0%	Aaa to Aa3	AAA to AA-	135,000	-
Unrated				81,275	25,876
Total				216,275	25,876
CQS for Secured by mortgages on commercial real estate					
Unrated				5,397	5,397
Total				5,397	5,397
Retail				3,033	837
Secured by mortgages on residential property				435,836	155,864
Past due items					
Unrated				50	64
Total				50	64
Other items				64,109	62,927
Grand Total				1,431,765	800,993

31 Dec 2013	Risk weight	Moody's ratings	S&P ratings	Exposure values	RWA
CQS for Corporates					
1	20%	Aaa to Aa3	AAA to AA-	2,236	447
2	50%	A1 to A3	A+ to A- BBB+ to	24,975	12,487
3	100%	Baa1 to Baa3	BBB-	103,338	103,338
4	100%	Ba1 to Ba3	BB+ to BB-	17,133	17,133
Unrated				285,803	284,901
Total				433,485	418,306
CQS for Institutions					
1	50%	A1 to A3	A+ to A- BBB+ to	81,720	40,860
2	50%	Baa1 to Baa3	BBB-	14,025	7,013
3	100%	Ba1 to Ba3	BB+ to BB-	42,680	42,680
4	100%	B1 to B3	B+ to B-	3,146	3,146
Unrated				12,504	6,252
Total				154,075	99,951
CQS for Short term claims on institutions and corporates					
1	0%	Aaa to Aa3	AAA to AA-	120,000	-
2	20%	Aaa to Aa3	AAA to AA-	5,236	1,047
3	20%	A1 to A3	A+ to A- BBB+ to	18,035	3,607
4	20%	Baa1 to Baa3	BBB-	17,623	3,525
Unrated				57,444	15,569
Total				218,339	23,748
CQS for Secured by mortgages on commercial real estate					
Unrated				6,502	6,502
Total				6,502	6,502
Retail				3,461	1,587
Secured by mortgages on residential property				323,494	116,116
Past due items					
1	20%	A1 to A3	A+ to A-	37	7
Unrated				584	851
Total				621	859
Other items				110,761	109,024
Grand Total				1,250,739	776,093

Note:

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

Credit Risk Mitigation (CRM)

CRM is a key aspect of effective risk management. The Bank uses a range of approaches to mitigate credit risk.

- Collateral: in the Bank's retail residential and commercial real estate businesses, a mortgage over the property is usually taken to secure claims. Physical collateral is also taken in various forms of specialized lending, such as aircraft leasing.
- Financial guarantee: for some corporate lending, financial guarantees such as SBLC are taken to cover unforeseen risks.

Table 20 demonstrates the extent of use of CRM techniques on credit exposures.

Table 20: Credit exposure overview of CRM

31 Dec 2014 £000	Exposures unsecured: carrying amount	Exposures secured by collateral	Exposures secured by collateral of which secured amount	Exposures secured by financial guarantees	Exposures secured by financial guarantees, of which secured amount	Exposures secured by credit derivatives	Exposures secured by credit derivative, of which secured amount
Loans	486,477	434,637	434,637	8,219	8,219	-	-
Debt securities	37,469	-	-	-	-	-	-
Total	523,946	434,637	434,637	8,219	8,219	-	-
Of Which Defaulted	-	2,493	2,493	-	-	-	-

The effect of CRM on Standardised Approach capital requirements' calculations is illustrated in below table. RWA density which is the total RWA as a percentage of exposure post CCF and CRM, provides a synthetic metric on riskiness of each portfolio.

Table 21: CRM effects on credit exposures and RWA

Asset classes	Exposure before CCF & CRM		Exposure post CCF & CRM		RWA & RWA density	
	On-balance sheet amount	Off-balance sheet amount	On-balance sheet amount	Off-balance sheet amount	RWA	RWA density
31 Dec 2014						
Central governments or central banks	26,930	-	26,930	-	-	0%
Corporates	272,092	364,202	272,092	184,259	445,251	98%
Institutions	222,400	-	222,400	-	104,778	47%
Retail	1,116	1,917	1,116	1,917	837	28%
Secured by mortgages on residential property	435,306	1,061	435,306	530	155,864	36%
Secured by mortgages on commercial real estate	5,397	-	5,397	-	5,397	100%
Short term claims on institutions & corporates	212,362	-	212,362	-	25,876	12%
Past due items	-	-	-	-	-	-
Higher-risk categories ⁹	298	-	298	-	684	230%
Other items	63,812	54	63,811	50	62,307	98%
Total	1,239,713	367,233	1,239,712	186,756	800,993	56%

⁹ As required by the Basel Framework, the Bank must include the exposures that are not in other regulatory portfolios, e.g., exposure weight at 150% or higher reflecting higher risks associated with the assets.

6. Counterparty Credit Risk (“CCR”)

Counterparty credit risk refers to the risk that a counterparty to a transaction may default prior to the satisfactory final settlement of the cash flows of one of the following types of the transactions: derivative instruments, securities or commodities lending, long settlement transactions and margin lending transactions. The Bank only holds derivative instruments.

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

The derivative portfolio consisted of interest rate swap, FX swap and FX spot. All the transactions of the derivative contracts occurred between internal BOC Group entities. The Bank uses Current Exposure Method and Standardised CVA to calculate its total CCR capital charge.

Composition of Collateral for CCR Exposure:

The Bank has not received nor provided collateral in respect of derivative contracts. As a result, the impact of a downgrade of the Bank’s credit rating and the resulting increase in margin requirements is not expected.

Credit derivatives exposures:

The Bank does not hold any credit default swap (CDS) or total return swap (TRS) in either banking book or trading book. Disclosures for credit derivative transactions tilted down between derivatives bought or sold is not present.

Exposures to central counterparties: the derivative transactions in the Bank’s portfolio do not involve any qualifying or non-qualifying central counterparties. Therefore, there is no exposure to central counterparties and no capital allocation is needed.

Wrong-way (correlation) risks:

Wrong-way risk represents the risk of loss that arises when the risk factors driving the exposure to counterparty are positively correlated with the probability of default of that counterparty.

In addition to its usual credit approval and credit authority policies, the Bank manages its exposure to wrong-way risk through regular monitoring under regulatory guidance.

CCR Exposure by Current Exposure Method (CEM)

The Bank's applies Current Exposure Method (CEM) to calculate the default risk capital charge for CCR. CEM takes into account the replacement cost and potential future exposure. The replacement cost is obtained by marking the contracts to market. Potential future exposure is reflected by add-on factors, which is an estimate of the total notional principle amount split by residual maturity. The total CCR EAD is derived from the sum of replacement cost and potential future exposure.

Table 22: Analysis of CCR exposure under CEM by contract type

£000	31 Dec 2014
Interest rate swap	651
FX Swap	3,779
FX Spot	133
Total	4,563

Basel III in a paper issued in Jan 2015 requires banks to provide a comprehensive view of the methods used to calculate CCR regulatory requirements and the main parameters used within each method. The Standardised Approach for measuring CCR EAD was introduced by Basel III in Mar 2014 to replace Current Exposure Method (CEM) and Standardised Method (SM). The Basel Committee guides that before Standardised Approach enters into force in Jan 2017, banks should report SA-CCR according to the Current Exposure Method (CEM).

The derivative portfolio does not have Security Financing Transactions (SFTs).

Table 23: Analysis of CCR exposure by approach

31 Dec 2014 £000	Replacement cost	Potential future exposure	EEPE	α for regulatory EAD	EAD post-CRM	RWA
SA-CCR (for derivatives)	1,267	3,296		1.4	4,563	1,141
IMM (for derivatives & SFTs)			-	-	-	-
Simple Approach for CRM (for SFTs)					-	-
Comprehensive Approach for CRM (for SFTs)					-	-
VaR for SFTs					-	-
Total						1,141

Table 24: CCR exposure under standardised approach by counterparty and risk weight

Regulatory portfolio £000	Risk weight										Total credit exposure
	0%	10%	20%	25%	50%	75%	100%	150%	Others		
31 Dec 2014											
Institutions	-	-	-	4,563	-	-	-	-	-	-	4,563
Total	-	-	-	4,563	-	-	-	-	-	-	4,563

Credit Valuation Adjustment (CVA)

The CVA capital requirement was introduced by Basel III in Dec 2010 and then also adopted by CRD IV. In addition to the default capital requirements for CCR based on Standardised or Internal Rating-Based (IRB) Approaches, Basel III requires banks to add a capital charge to cover the unexpected risk of mark-to-market losses on the expected counterparty risk to OTC derivatives. In this context, CVA of an OTC derivative portfolio with a given counterparty is the market value of the credit risk due to any failure to perform on agreements with that counterparty.

There are two methodologies for calculating the CVA capital charge, the Advanced Approach and Standardised Approach. The Standardised Approach was adopted by the Bank in 2014, which incorporates the key drivers of the CVA risk weight, effective maturity and discounted EAD. The CVA risk weight¹⁰ is based on the external credit rating of the counterparty. The effective maturity is the notional weighted average maturity. Discounted EAD is the total EAD after applying discounting factor¹¹. The Bank's CVA for derivative portfolio is not hedged. The CVA breakdown is displayed in below table.

Table 25: CVA breakdown by Advanced and Standardised Approach

£000	31 Dec 2014	
	EAD post-CRM	RWA
Portfolio subject to Advanced CVA	-	-
i) VaR component	-	-
ii) Stressed VaR component	-	-
Portfolio subject to Standardised CVA	5,309	2,110
Total subject to CVA capital charge	5,309	2,110

Total CCR Capital Requirement

According to Basel III, the Bank's total CCR capital charge is determined as the sum of CEM based capital charge and the standardised CVA risk capital charge.

Table 26: Total CCR Capital Requirement

31 Dec 2014 £000	RWA	Capital
Current Exposure Method (CEM)	1,141	91
CVA	2,110	169
Total	3,251	260

¹⁰ CVA risk weight ranges from 0.7% to 10%.

¹¹ Discounting factor is defined as $[1 - \exp(-0.05 * M)] / (0.05 * M)$, M is the effective maturity.

7. Securitisation

A securitisation is defined as a transaction or scheme where the payments are dependent upon the performance of a single exposure or pool of exposures and where subordination of tranches determines the distribution of losses during the ongoing life the transaction or scheme.

As at 31st December 2014, the Bank had no exposure to asset backed securities (“ABS”).

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

8. Operational Risks

Operational risk is defined as any instance where there is a potential or actual impact to the Bank resulting from inadequate or failed internal process, people, systems, or from an external event. The impact to the Bank can be financial, including losses or an unexpected financial gain, as well as non-financial such as customer detriment, reputational or regulatory consequences.

Operational risks are inherent in the Bank's business activities. It's not cost effective to eliminate all operational risk and in any event it would not be possible to do so. Small losses from operational risks are expected to occur and are accepted as part of the normal course of business activities. The Bank seeks to reduce the likelihood of operational risk in line with the risk appetite.

The Operational Risk comprises the following Key Risks: fraud, transaction operations, people, premises, system and legal. In practice, the Bank's operational risk extends beyond the key risks.

The Bank has a comprehensive Operational Risk Framework in line with the CRD IV, Basel guideline 'Sound Practices for Management and Supervision of Operational Risk 2011'.

The Bank continues to use Basic Indicator Approach (BIA) to calculate the operational risk capital requirement, which is simple 15% of the average over the previous three years annual gross income. The capital calculated is higher when considering the losses, stress testing scenarios and effective controls. The Bank accumulates loss data to build the foundation for more advanced approach.

Table 27: Operational risk capital requirement using BIA

£000	Capital Allocation
31 Dec 2014	8,585
31 Dec 2013	7,393

Operational Risk Management

The Bank is committed to the management and measurement of operational risk. The Operational Risk Committee was set up to manage and monitor operational risk activities. The committee meet quarterly and report to BRC timely.

The Bank uses the following methods to manage operational risk:

- Control self-assessment (CSA): the Bank identifies and assesses all processes underlying in its department/business line against a library of potential threats and vulnerabilities and evaluates the key controls in place to mitigate the inherent material risks. The risk assessments are monitored on regular basis to ensure that each business continually understands the risks it faces.
- Key Risk Indicators (KRIs): KRIs are metrics and/or statistics which allow the Bank to monitor its operational risk profile. KRIs include measurable thresholds that reflect the risk appetite of the business and are monitored to alert management when risk levels exceed acceptable ranges or risk appetite levels and drive decision making and actions. KRIs are collected and reported monthly.
- Operational Risk Loss Event Report (ORER): a standard threshold is used at the Bank for reporting risk events and part of the analysis includes the identification of improvements to process or controls, to reduce the recurrence and/or magnitude of risk events. For significant events, both financial and non-financial, this analysis includes the competition of a formal less learnt. The Bank has a database of risk events which shows the status of the risk events. All events are classified in Basel loss event categories. ORER is collected and analyzed monthly.
- Operational risk Management Software: where all loss events and KRI are recorded and reported.

9. Market Risks

Market risk is defined as the risk that movements in market risk factors, including interest rates, foreign exchange rates, commodity prices, credit spreads and equity prices, will reduce the bank's income or the value of its asset portfolio.

The Bank does not undertake any proprietary trading activities. All trading activities are client driven and need to be promptly squared. Main source of market risk trading book relates to foreign exchange risk, which stems mainly from the difference between the assets and funding liabilities.

The Bank has identified key risk indicators for the purpose of monitoring, reporting and managing the market risk in the book.

Table 28: Market risk capital requirement under Standardised Approach

£000	31 Dec 2014 RWA	30 Jun 2014 RWA
Outright products		
Interest rate risk (general & specific)	-	-
Equity risk (general & specific)	-	-
Foreign exchange risk	13,244	5,525
Commodity risk	-	-
Options		
Simplified approach	-	-
Delta-plus method	-	-
Scenario approach	-	-
Securitisation	-	-
Total	13,244	5,525

Foreign Exchange (FX) Risk

Foreign exchange risk is the risk that movements in various currencies could materially impact on the financial statements. FX is monitored via dedicated FX gross position limits and covers both banking and trading book, excluding the accounting base currency GBP. FX risk arises from the foreign currency Profit/Loss across all business lines and FX financial instruments. In order to management this risk, the Bank uses derivative instruments.

Table 29: Foreign exchange position

£000	US Dollar	Euro	HK Dollars	YEN	Other
31 Dec 2014	593	(28)	(23)	(1)	171
31 Dec 2013	1,883	292	(54)	50	141

Interest Rate Risk in Banking Book (“IRRBB”)

The objective for IRRBB risk management is to minimise 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 based on the contractual maturity of the underlying investments. There are no assumptions made on loan prepayments.

The Bank mainly utilizes the interest rate sensitivity gap to analyse the re-pricing risk on a static basis from both the net interest income perspectives. Interest-generating assets, interest-bearing liabilities and the positions of off-balance sheet business are classified into different time buckets; interest rate-sensitive liabilities in each time bucket are subtracted from the corresponding interest rate-sensitive assets to produce a re-pricing gap for that time bucket.

The Bank adopts a key risk indicator for the purpose of monitoring, reporting and managing the IRRBB: the Net Interest Income (NII) Movement Ratio¹². The limit is presented as a percentage ratio in terms of net income volatility for an increase in interest rate of 200bp.

The Bank also monitors the One-year Cumulative Re-pricing Gap Ratio without defining a specific limit for all currencies, expressed in sterling.

The table below shows the sensitivity to a reasonable change in interest rates, with all other variables held constant, of the Bank’s income statement.

Table 30: Impact of 100 bps parallel shift on interest risk

£000	100 bps parallel increase	100 bps parallel decrease
Sensitivity of projected net interest income at 31 Dec 2014	(1,114)	1,114
31 Dec 2013	3,821	(3,821)
Sensitivity of reported equity to interest rate movements at 31 Dec 2014	225	(225)
31 Dec 2013	31	(31)

Interest rate movements affect reported equity in the following ways: (I) retained earnings; arising from increases or decreases in net interest income and the fair value changes reported in profit or loss and (II) fair value reserves; arising from increases or decreases in fair values of available for sale financial instruments reported directly in equity.

¹² An instrument that measures the maximum level of adverse variation of net interest income affected by a specified interest rate change on the book.

10. 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 (CRD). The Financial Conduct Authority ("the FCA") assumed the FSA's role on 1 April 2013. As an FCA 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. Further requirements regarding remunerations on CRD IV Chapter 8 have also been implemented on this report.

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 2014.

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 quarterly throughout the year and its primary purpose is to:

- Review 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 FCA Remuneration Code) and Material Risk Takers under the European Banking Authority regulatory technical standards;
- Undertake an annual independent review of the Bank's remuneration policy and framework;
- Review and approve the policies regarding recruitment, learning and development, assessment and performance appraisal.

The Terms of Reference of the Committee were last reviewed and updated in June 2014.

Remuneration Policy

The Committee is guided by the overarching principles of the Bank's Remuneration Policy; the objective of the 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;
- Encourages behaviour consistent with the Bank's core competency model and core values 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 May 2014 and it was amended to reflect the wider scope of the European Banking Authority and further iteration of CRD IV whereby variable remuneration would be capped at 100% and could be increased to 200% subject to shareholder approval.

Composition of the Remuneration Committee

The members of the Committee include three members, being:

- Jonathan Spence – Independent Non Executive Director, Bank of China (UK) Limited (Chairman of the Committee);
- Yu Sun – Chief Executive Officer, Bank of China (UK) Limited;
- Tracey Rutherford – Head of Human Resources, Bank of China (UK) Limited.

Role of the 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 external advice from PwC in relation to the

application of FCA Remuneration Code, and from Ernst & Young regarding application of EBA RTS and Material Risk Takers.

Application of Code Staff/Material Risk Takers

The Bank currently 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 FCA 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 in relation to the Bank's capital. It is recognised that in applying the EBA's extended scope of CRD IV requirements in relation to remuneration that Regulatory Technical Standards (RTS) have been established and define specific criteria to further identify categories of employees whose activities have a material impact on institutional risk (material risk takers); the Bank reviewed their application of Material Risk Takers when RTS came into force.

Link between Pay and Performance

The Bank's remuneration policies are designed to allow us to attract and retain talented individuals needed to deliver the 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 competences and values in order to take a rounded view of performance;
- Retaining the requirement to effect clawback and malus provisions of the Remuneration Policy in relation to any deferred bonus elements. Clawback and

malus 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 variable award period;
- That during any variable award 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 a 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 Remuneration Committee discuss and review Risk and Compliance/Senior Management 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/Material Risk Takers

Code Staff/Material Risk Takers participate in the annual discretionary 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/Material Risk Takers, 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 who 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/material risk takers only who fall outside of the current "de minimis" rules.

The Bank did not pay any guaranteed bonuses or sign on awards during the 2014 financial year.

Remuneration Awarded

Table 31: 2014 variable remuneration awarded

	31 Dec 2014
Number of staff receiving variable remuneration award	355
Total fixed pay (£)	15,226,347
Total variable pay (including discretionary bonus award, allowances and overtime) (£)	6,578,892
Total deferred remuneration paid out (£)	241,926
Total non deferred variable remuneration paid out (£)	3,666,295
Total outstanding deferred remuneration (to be paid 2016 -2017- 2018) (£)	1,147,468
Total severance payments made	N/A
Total Remuneration (£)	26,860,928
Variable pay/fixed pay ratio	43%

As referred above, the EBA requirements on remuneration state that variable pay shall not exceed 100% of fixed pay of total remuneration (can be increased to 200% subject to shareholder approval). As shown in above table, the variable pay over fixed pay ratio for 2014 was under 50%.

Table 32: Analysis of aggregate remuneration expenditure by division

31 Dec 2014 (£)	Retail Banking Business	Corporate Banking Business	Risk Management	Support Functions	Total
Aggregate Remuneration Expenditure	6,137,401	4,676,754	2,102,146	13,944,627	26,860,928

Table 33: Analysis of remuneration amount between fixed and variable pay for code staff

31 Dec 2014 (£)	Management Body	Senior Managers	Others	Total
Number of Code Staff	8	10	20	38
Fixed Pay	1,495,103	1,016,667	1,452,665	3,964,435
Variable Pay	1,455,456	437,429	628,322	2,521,207

All remuneration payments were made by cash. The Bank does not have non-cash vehicle payment.

The Bank did not pay any sign on or severance payments in 2014. There is no staff at the Bank who was paid over £779K (equivalent to €1M¹³). The highest paid Director was £377K (equivalent to €484K) in 2014.

¹³ Converted to Euros using the exchange rate at 31 Dec 2014 1£= €1.2833