Pillar 3 Disclosures

Year End 2015

Bank of China (UK) Ltd

Capital and Risk Management Pillar 3 Disclosures

Contents

Index of Tables

Abbreviations

Term	Definition	Term	Definition
Annual Report	Annual Report and Financial Statements	EMEA	Europe, the Middle East and Africa
ALCO	Asset and Liability Committee	EBA	European Banking Authority
BOC UK	Bank of China (UK) Limited	EMC	Executive Management Committee
the Bank	Bank of China (UK) Limited	FCA	Financial Conduct Authority
BOC Group	Bank of China Limited	FMD	Financial Management Department
Basel Committee	Basel Committee on Banking Supervision	FSA	Financial Services Authority
BIA	Basic Indicator Approach	G-SIBs	Global Systemically Important Banks
BRC	Board Risk Committee	ICG	Individual Capital Guidance
BCC	Business Continuity Committee	IRRBB	Interest Rate Risk on Banking Book
CRD IV	Capital Requirement Directives IV	ICAAP	Internal Capital Adequacy Assessment Process
CEO	Chief Executive Officer	IRB	Internal Rating-Based
CFO	Chief Financial Officer	IFRS	International Financial Reporting Standards
COO	Chief Operating Officer	KRIs	Key Risk Indicators
CRO	Chief Risk Officer	L&C	Legal & Compliance Department
CET1	Common Equity Tier 1	NII	Net Interest Income
CFUs	Corporate Finance Units	ORC	Operational Risk Committee
CCB	Countercyclical Capital Buffer	OTC	Over the Counter
CCR	Counterparty Credit Risk	PFE	Potential Future Exposure
CCF	Credit Conversion Factor	PRA	Prudential Regulation Authority
CQS	Credit Quality Step	RTS	Regulatory Technical Standards
CRM	Credit Risk Mitigation	RemCo	Remuneration Committee
CRPC	Credit Risk Policy Committee	RC	Replacement Cost
CVA	Credit Valuation Adjustment	RMD	Risk Management Department
CEM	Current Exposure Method	SFTs	Security Financing Transactions
EWIs	Early Warning Indicators	VaR	Value at Risk
EEPE	Effective Expected Positive Exposure		

1. Introduction

Background

BOC UK was incorporated as a private limited company on 29th March 2007, a wholly owned subsidiary of BOC Group. BOC UK is regulated by the PRA and FCA. The Bank is authorised by the PRA, previously the 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 corporates 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 cards, credit cards and mortgage products.

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

Basis of Disclosures

This disclosures report is prepared in accordance with the requirements set out in the Basel framework and CRD IV. The disclosures report is recommended to be read in conjunction with the Bank's Annual Report 2015[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 2015). Therefore this disclosure does not take into account any subsidiaries.

The Pillar 3 Disclosures 2015 have been prepared in accordance with regulatory capital adequacy concepts and rules, rather than in accordance with IFRS. Therefore, some information in this report is not directly comparable with the Bank's Annual Report 2015. Explanations and notes are given where appropriate.

Regulatory Framework for Disclosures

BOC UK is supervised by the PRA in the UK. 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 2015 using the Basel III

[1] FSA was abolished and restructured to PRA and FCA with effect from 1 April 2013.
[2] See http://www.bankofchina.com/uk/aboutus

framework of the Basel Committee as implemented by the EU in the amended 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 disciplines 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 disclosures presented within this report have been verified and approved by various senior management members, through internal governance procedure and Pillar 3 procedure. The disclosures report does not require to be audited by the Bank's external auditor.

Frequency, Media and Location of Publication

The Bank's full Pillar 3 disclosures report is produced on an annual basis and published as soon as practically possible on the Bank of China (UK) Ltd website: *http://www.bankofchina.com/uk/aboutus/*

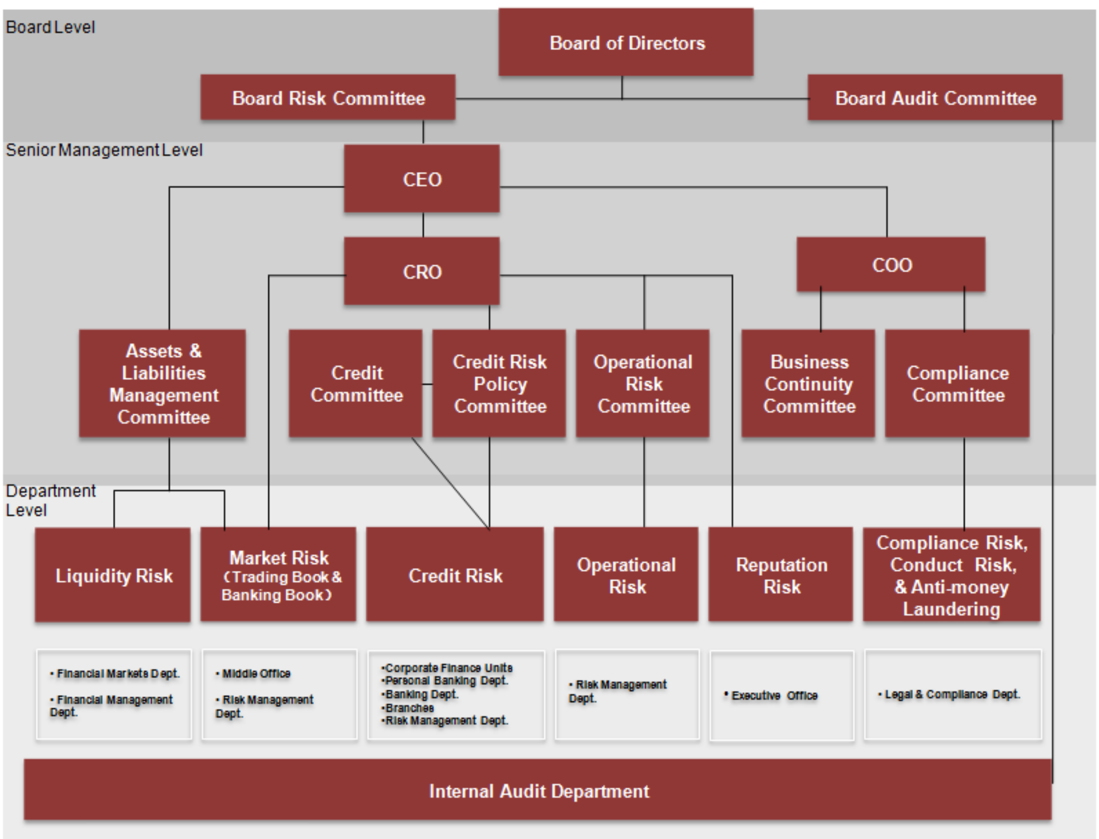
2. Risk Management Overview

Effective risk management is a key component of the Bank's strategy to deliver 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 within the governance structure, illustrated in below chart, is responsible for ensuring the risk and control environment. The reporting lines are clearly defined through the committee level, Senior Management level and Board level.

BOC UK Risk Management Structure 2015



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

During the reporting year, 10 directors served in the Board. The Board believes that it is of the Bank's best interests to attract and retain the most competent and experienced directors by offering competitive terms of engagement, including the granting of indemnities on terms consistent with applicable statutory provisions.

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, setting the risk management framework, defining the risk appetite statement, the bank-wide oversight of risk management performance, approval of non-standard credits, and credits above the delegated limits of the CEO, as well as approval of delegated limit authorities.

The Senior Management, including the CEO, CRO, COO, CFO 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 risk management.
- Credit Committee: is mainly responsible for new facility assessment, risk classification review and provisioning.
- Credit Risk Policy Committee (CRPC): establishes and reviews the Bank's credit policies and portfolio exposure limits.
- Operational Risk Committee (ORC): is responsible for reviewing operational risk, monitoring framework and operational risk compliance.
- Business Continuity Committee (BCC): oversees and supports the implementation and maintenance of an effective business continuity infrastructure and disaster recovery planning functions.
- Compliance Committee: oversees and supports the implementation of an effective and proactive compliance function.

Board meetings, Board Audit Committee, BRC, Compliance Committee, CRPC, ORC and BCC meet on a quarterly basis[3]. ALCO is held on a monthly basis. Credit Committee meets as required in response to credit limit applications.

---

[3] BRC and CRPC Adhoc meetings are held at request.

Risk Appetite

Risk Appetite is the core instrument for aligning overall business strategy, capital allocation and risk management. The Board, BRC and the Senior Management set risk appetite through balancing Risk and Return under BOC Group's principles "Rational, Stable and Prudent".

The Bank's 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 Units[4], 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. The scenario setting is in line with PRA anchor scenarios. For each risk factor, projection is made individually for Base Case Scenario, Moderate Scenario and Severe Scenario over 3 years forecast.

As a capital risk management process, stress testing and scenario analysis provide an important complement to quantitative risk management approaches. As credit risk is the Bank's dominant risk, 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.

[4] 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 established 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 resources comprise Tier 1 and Tier 2 capital as set out in Table 1. The PRA uses risk asset ratios as one of the measures for 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 December 2015**	31 December 2014
CET 1 Capital: Ordinary share capital	250,000	250,000
Audited retained earnings[5]	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)	**895,473**[6]	**924,791**
Risk Asset Ratios		
CET 1 capital ratio	31%	30%
Tier 1 capital ratio	31%	30%
Total capital ratio	37%	36%

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 December 2015, there are 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 of 5 years and one day. 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 2015.

The Bank's policy is to maintain a strong capital base so as to maintain market confidence and sustainable business development. The impact of the capital level on shareholders' return is also recognised by the Bank to strike a balance between higher returns and greater gearing risk. 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.

[5] A dividend £45,450,000 was declared and paid representing the 2015 profit and loss. For capital planning purpose, the capital maintained the same as for 2015.

[6] Due to the inclusion of SA-CCR (see Chapter 6), the total RWAs and ratios on this report are different to those contained in the Annual Report.

Leverage Ratio

In January 2014, the Basel Committee published a revised Basel III leverage ratio framework[7], which includes a number of amendments to the original calculations of the exposure measure. The framework 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 January 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 by dividing Tier 1 capital resources by a defined measure of on-balance sheet assets and off-balance sheet items.

Table 2: Leverage ratio

Total Capital Resources (£000)	31 December 2015	31 December 2014
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	**1,291,410**	**1,215,116**
Derivative financial instruments	8,173	16,173
Cash and cash equivalent[8]	178,138	69,321
Reverse repurchase agreements	170,000	135,000
Loans and advances and other assets	934,975	994,622
Derivatives adjustments	**-**	**-**
Securities financing transaction adjustments	**-**	**-**
Off-balance sheet assets	**301,793**	**367,230**
Off-balance sheet items	299,427	361,921
Regulatory deductions and other adjustments	2,366	**5,309**
Total leverage exposure	**1,593,203**	**1,582,346**
Leverage ratio	**17%**	**17%**

The leverage ratio remains 17%, which is 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.

[7] BOC UK is required to publicly disclose the leverage ratio on a consolidated basis from 1 January 2015.

[8] The cash and cash equivalent on this report differs from that on the Annual Report. 1) The cash and cash equivalent on the Annual Report include the reverse repurchase agreement (£170M), whereas it is listed separately on the Pillar 3 Report. 2) The cash and cash equivalent on the Pillar 3 Report include Tangible fixed assets (£3,515K), Intangible Assets (£180K) and Deferred tax asset (£425K), whereas they are listed individually on the Annual Report.

4. Capital Adequacy

The Bank's capital requirement is supervised by the PRA. Since 2008, the Bank has been 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.

Capital ratios remain the international standards for measuring capital adequacy. The senior management uses regulatory capital ratios to monitor the Bank's capital position. The 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 RWAs to available capital resources. PRA also sets ICG in relationship to Pillar 1 minimum capital requirement, as well as to the Bank's risk weighted assets.

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 Bank's ICG in force is subject to PRA's Supervisory Review and Evaluation Process. New ICG was revised in January 2016.

The Bank's ICAAP documents 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 and under close supervision by the Senior Management. The final submission has to seek internal approval from the BRC 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 January 2015. A further breakdown and comparison of the RWA and minimal capital requirements are illustrated in below Table 3.

Table 3: Overview of RWA

£000	31 December 2015 RWA	31 December 2015 Min Capital	31 December 2014 RWA	31 December 2014 Min Capital
Credit risk (excluding counterparty credit risk (CCR)	754,715	60,377	800,993	64,079
Of which standardised approach (SA)	754,715	60,377	800,993	64,079
Of which internal rating-based (IRB) approach	-	-	-	-
Counterparty credit risk	2,062	165	3,251	260
Of which standardised approach for counterparty credit risk	2,062	165	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	9,973	798	13,244	1,059
Of which standardised approach (SA)	9,973	798	13,244	1,059
Of which internal model approaches (IMM)	-	-	-	-
Operational risk	128,723	10,298	107,314	8,585
Of which Basic Indicator Approach	128,723	10,298	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	**895,473**	**71,638**	**924,791**	**73,983**

Capital Adequacy

Table 4: Capital adequacy under Pillar 1

(£000)	**31 December 2015**	31 December 2014
Credit Risk (Standardised Approach)	60,377	64,079
Market Risk (Foreign Exchange PRR)	798	1,060
Operational Risk (Basic Indicator Approach)	10,298	8,585
Counterparty Credit Risk (including CVA)	165	260
Total Pillar 1 minimum capital requirement	**71,638**	**73,984**
Total capital resources	**334,958**	**334,958**
Excess of capital resources over Pillar 1 minimum capital requirement	**263,320**	**260,974**

The Bank's Pillar 2 capital requirement is assessed to reflect IRRBB and concentration risk.

Countercyclical Capital Buffers (CCB)

CCB is identified in Basel III reforms and is determined by Basel Committee and vary according to a percentage[9] of risk weighted assets. In December 2010, Basel issued guidance regarding the CCB and required public disclosures at least the same frequency as the minimum capital requirements.

In December 2014, EBA developed a set of regulatory technical standards that specify the disclosure requirements of institution-specific CCB in line with CRD IV. The requirements with entry into force date in 2016 closely follow the Basel III framework. EBA set out two tabular disclosures templates for the institution-specific CCB amount and the geographical distribution of the exposures determining this buffer.

EBA requires the CCB disclosures on an individual level if the institution is not part of a group. If an institution is part of a group, disclosures must be provided by the parent on the basis of its consolidated situation.

BOC UK is a subsidiary of BOC Group, hence, CCB disclosures on an individual basis for BOC UK is not required.

Global Systemically Important Banks (G-SIBs)

The Basel Committee issued a document in 2013 requiring the identified G-SIBs and the large institutions with an overall leverage exposure above EUR200 billion to assess their systemic importance in a global context. Global systemic importance is measured in terms of the impact of a bank's failure on the global financial system and the wider economy, rather than the risk that a failure could occur. In June 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.

[9] The percentage varies between 0 and 2.5%, exemptions are strictly subject to Basel and CRD IV rules.

Reconciliation between IFRS and Regulatory Balance Sheets

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

Table 5: Reconciliation between IFRS and Regulatory balance sheets

2015 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	344,019	170,000[10]	170,000	-	-	174,019
Loans and advances to banks	62,633	62,633	-	-	-	-
Loans and advances to customers	810,776	810,776	-	-	-	-
Derivative financial instruments	8,173	-	8,173	-	8,173	-
Prepayments, accrued income and other assets	25,831	-	-	-	-	25,831
Available for sale financial investments	35,859	35,571	26,751[11]	-	-	288
Deferred tax assets	425	-	-	-	-	425
Property, plant and equipment	3,514	-	-	-	-	3,514
Intangible assets	180	-	-	-	-	180
Total Assets	**1,291,410**	**1,078,960**	**204,924**	-	**8,173**	**204,257**
Liabilities						
Deposits from banks	136,736	-	-	-	-	136,736
Deposits from customers	737,724	-	-	-	-	737,724
Derivative financial instruments	11,505	-	11,505	-	11,505	-
Other liabilities	17,145	-	-	-	-	17,145
Accruals and deferred income	4,512	-	-	-	-	4,512
Current tax liabilities	3,520	-	-	-	-	3,520
Deferred tax liabilities	-	-	-	-	-	-
Subordinated liabilities	60,000	-	-	-	-	60,000
Total liabilities	**971,142**	-	**11,505**	-	**11,505**	**959,637**
Equity						
Authorised and called up share capital	250,000	-	-	-	-	250,000
Retained earnings	70,408	-	-	-	-	70,408
Available for sale reserve	(140)	-	-	-	-	(140)
Total shareholders' equity	**320,268**	-	-	-	-	**320,268**
Total shareholders' equity & liabilities	**1,291,410**	-	**11,505**		**11,505**	**1,279,905**

As shown in above table, the consolidation of IFRS balance sheet scope is identical to that with regulatory scope in 2015. There is no reconciliation difference.

[10] A reverse repo of £170M (RW=0%) is subject to both credit risk and CCR framework.
[11] A government bond

5. Credit Risk

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 monitored and reported on a monthly basis through a suite of risk metrics derived from credit portfolio performance measures. Credit risk appetite limits and credit risk policies are reviewed regularly to ensure that the metrics continue to reflect the Bank's risk appetite appropriately.

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 6: Capital requirement for credit risk under Standardised Approach

£000	**31 December 2015**		31 December 2014	
	RWA	**Capital Requirement**	RWA	Capital Requirement
Central governments or central banks	-	-	-	-
Corporate	451,288	36,103	445,251	35,620
Institutions	18,288	1,463	104,778	8,382
Retail	475	38	837	67
Secured by mortgages on residential property	176,388	14,111	155,864	12,469
Secured by mortgages on commercial real estate	2,550	204	5,397	432
Short term claims on institutions & corporates	28,775	2,302	25,876	2,070
Past due items	1,013	81	64	5
Other items	75,938	6,075	62,927	5,034
Total	**754,713**	**60,377**	**800,993**	**64,079**

The past due items related to residential mortgages, credit and debit cards. Other items on the asset class relate to cash, fixed assets and Sundry debtors. The RWA reduction by £46M in 2015 was mainly due to some financial intuitions' exposure run off under the asset class of Institutions.

Credit Risk Exposures

Table 7 shows the gross credit exposures under Standardised Approach and Table 8 shows the credit exposure broken down by exposure class and geographic locations.

Table 7: Gross credit exposure under Standardised Approach

£'000	2015 Average Credit Exposure[12]	2015 Year End Exposure	2014 Average Credit Exposure	2014 Year End Exposure
Central governments or central banks	189,375	196,168	6,732	26,930
Corporates	389,702	458,119	423,873	456,351
Institutions	36,783	45,197	197,004	223,784
Retail	1,119	637	3,205	3,033
Secured by mortgages on residential property	472,491	493,743	394,493	435,836
Secured by mortgages on commercial real estate	4,729	5,104	5,640	5,397
Short term claims on institutions and corporates	205,731	185,592	216,927	216,275
Past due items	933	674	107	50
Other items	88,810	76,467	72,963	64,109
Grand Total	**1,389,672**	**1,461,700**	**1,320,944**	**1,431,765**

Table 8: Geographic distribution of credit exposure

£'000	UK	Other EU Countries	North America	Rest of the World	Total
2015					
Central governments or central banks	196,168	-	-	-	196,168
Corporates	297,805	56,497	23,304	80,513	458,119
Institutions	30,533	-	-	14,664	45,197
Retail	505	1	1	130	637
Secured by mortgages on residential property	493,743	-	-	-	493,743
Secured by mortgages on commercial real estate	5,104	-	-	-	5,104
Short term claims on institutions and corporates	173,661	23	2,320	9,587	185,592
Past due items	672	-	-	2	674
Other items	76,467	-	-	-	76,467
Grand Total	**1,274,658**	**56,521**	**25,625**	**104,896**	**1,461,700**
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**

[12] Quarterly average is used here.

Total average credit exposure increased by £70M. Total credit exposure increased by £30M to £1,462M.

Key movements by gross credit exposure and geographical area are as follows:

- The yearend exposure under asset class Institutions decreased by £178M (2015: £45M, 2014: £224M) was mainly due to some FI exposures ran off in 2015. This decrease is also reflected in the exposure movement reduction by £160M for Rest of World (2015: £105M, 2014: £264M).
- Exposure in the UK increased by £150M to £1,275M (2014: £1,121M) driven mainly by a new reverse repo (£170M) and residential mortgage portfolio expansion (£60M). This increase is also reflected in Average credit exposure for Central governments or central banks and on residential mortgage.

Table 9: Industry distribution of gross credit exposure

Industry Distribution of Gross Credit Exposure 2015 (£000)

Exposure Class	Industry Category	Gross Exposure
Central governments or central banks	Fincl intmdiation excl. insurance Co & pension funds	170,013
	Public administration and defence	26,155
Corporates	Accommodation and food services activities	3,691
	Agriculture, hunting and forestry	9,786
	Education	23,454
	Electricity, gas and water supply	57,034
	Fincl intmdiation excl. insurance Co & pension funds	44,818
	Manufacturing	96,621
	Mining and quarrying	36,880
	Real estate, professional services and support activities	92,445
	Transport, storage and communication	71,412
	Wholesale and retail trade	21,979
Institutions	Fincl intmdiation excl. insurance Co & pension funds	45,197
Retail	Fincl intmdiation excl. insurance Co & pension funds	59
	Individuals and individual trusts	578
Secured by mortgages on commercial real estate	Real estate, professional services and support activities	5,104
Secured by mortgages on residential property	Individuals and individual trusts	493,743
Short term claims on institutions and corporates	Fincl intmdiation excl. insurance Co & pension funds	185,592
Past due items	Individuals and individual trusts	671
	Manufacturing	3
Other items	Fincl intmdiation excl. insurance Co & pension funds	76,076
	Individuals and individual trusts	390
Grand Total		**1,461,700**

31 December 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
	Agriculture, hunting and forestry	20,874
	Construction	1,631
	Electricity, gas and water supply	88,083
	Fincl intmdiation excl. insurance Co & pension funds	3,650
	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	29,753
	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	Individuals and individual trusts	435,836
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**

Table 9 shows the credit exposure broken down by credit exposure class and the industrial sectors. The industry highlights are as follows:

- Individuals and individual trusts of £488M, 33% of the total portfolio, were mainly the residential mortgages. The sector occupies the dominant sector.
- The exposure £170M for Financial industry under Central governments or central banks was due to a short-term reverse repo.

Table 10: Residual contractual maturity of credit exposure

31 December 2015 (£000)	Up to 12 months	1-5 years	More than 5 years	Total
Central governments or central banks	170,013	26,155	-	196,168
Corporates	55,270	356,255	46,594	458,119
Institutions	44,346	851	-	45,197
Retail	635	3	-	637
Secured by mortgages on commercial real estate	29	514	4,561	5,104
Secured by mortgages on residential property	133	3,555	490,054	493,743
Short term claims on institutions and corporates	185,592	-	-	185,592
Past due items	331	-	343	674
Other items	76,467	-	-	76,467
Grand Total	**532,815**	**387,334**	**541,551**	**1,461,700**
31 December 2014				
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**

Key points:

- The short-term exposure experienced little movement.
- The exposure for between 1 and 5 years residual maturity increased by £140M and that for over 5 years decrased by £110M. This movement was mainly due to the maturity of long-term Corporate customers moves to medium term.
- The long-term exposure mainly related to residential mortgages.

Impairment Provisions

The Bank defines past due loan as an instalment on the whole or a part of the loan which is not received within 90 days 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.

The allowances for impairment charges at the Bank are categorized into collective and specific provisions. The collective provision is made to SMEs, corporate and financial institution customers. For retail customers, the Bank also makes specific provisions.

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.

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

31 December 2015 (£'000)	**Past Due**	**Impaired**	**Provision**
Accommodation and food services activities	(314)	-	5
Agriculture, hunting and forestry	-	-	3
Electricity, gas and water supply	-	-	52
Fincl intmdiation excl. insurance Co & pension funds	-	-	81
Individuals and individual trusts	(8,892)	(1,020)	33
Manufacturing	-	-	83
Mining and quarrying	-	-	33
Real estate, professional services and support activities	-	-	99
Transport, storage and communication	-	-	86
Wholesale and retail trade	-	-	14
Grand Total	**(9,205)**	**(1,020)**	**490**
31 December 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**

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

31 December 2015 (£'000)	Past Due	Impaired	Provision
UK	(9,205)	(1,020)	304
Other European Countries	-	-	38
North America	-	-	3
Rest of the World	-	-	145
Grand Total	**(9,205)**	**(1,020)**	**490**
31 December 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**

- The impaired amount of £1,020K consisted of 3 residential mortgages which fell into non-performing category and some overdue credit cards.
- The past due balances of £9,205K related to residential mortgages.
- The Provision amount reduced by £250K was mainly due to a fall in the outstanding balance of the collective provisional portfolio.

The provision movement in the impairment allowance between 2015 and 2014 year-end is shown in below Table 13. This table is also available in the 2015 annual report.

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

	Specific		**Collective**	
£000	Loans and advances to banks	Loans and advances to customers	Loans and advances to banks	Loans and advances to customers
Balance as at 1 January 2015	-	5	331	405
Increase in impairment	-	134	29	199
Reversal of impairment	-	-	(279)	(228)
Charge in income statement	-	-	-	-
Amounts written off	-	(106)	-	-
Balance as at 31 December 2015	-	**33**	**81**	**376**
Balance as at 1 January 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 December 2014	-	**5**	**331**	**405**

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 January 2015	(676)	**-**
Changes in fair values	886	**-**
Reversal of impairment	-	**-**
Amounts written off	-	**-**
Exchange-rate movements	-	**-**
Balance as at 31 December 2015	**210**	**-**
Balance as at 1 January 2014	(1,027)	**-**
Changes in fair values	351	**-**
Reversal in impairment	-	**-**
Amounts written off	-	**-**
Exchange-rate movements	-	**-**
Balance as at 31 December 2014	**(676)**	**-**

Credit Asset Quality

Table 15: Credit quality of assets

£'000	Gross carrying values[13] of		Allowances/ impairment	Net values
	Defaulted exposures[14]	Non-defaulted exposures		
31 December 2015				
Loans	1,020	872,898	490	873,437
Debt Securities	-	35,571	-	35,571
OBS exposures	-	299,427	-	299,427
Total	**1,020**	**1,207,896**	**490**	**1,208,435**
31 December 2014				
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 16: Changes of defaulted loans and debt securities

	Carrying values (£'000)
Defaulted loans and debt securities at 30 June 2015	**1,764**
Loans and debt securities that have defaulted since the last reporting period	627
Returned to non-defaulted status	(1,369)
Amounts written off	-
Other changes	(2)
Defaulted loans and debt securities at 31 December 2015	**1,020**
Defaulted loans and debt securities at 30 June 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 December 2014	**2,493**

Movements highlight:

- The above changes defaulted exposures related to retail loans only. There was no default arising from debt securities.
- The defaulted amount £1,764K in June 2015 related to 5 residential mortgages and some credit cards. £1,369K of the total defaulted amount returned to non-defaulted status.
- The debt securities consisted of 2 bonds.

[13] The amount is the gross exposure of any credit conversion factors (CCF) or credit risk mitigation (CRM) techniques, but after deduction of write-offs.
[14] The defaulted exposure refers to the non-performing exposure.

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 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 17: Credit exposures by asset classes and risk weights

Risk weight / Asset classes	0%	10%	20%	35%	50%	75%	100%	150%	250%	Total credit exposures (post CCF&CRM)
31 December 2015										
Central governments or central banks	196,168		-	-	-	-	-	-	-	196,168
Corporates	-		-	-	13,657	-	444,462	-	-	458,119
Institutions	-		14,623	-	30,420	2	152	-	-	45,197
Retail	-		-	-	-	637	-	-	-	637
Secured by mortgages on residential property	-		-	-	5,104	-	-	-	-	5,104
Secured by mortgages on commercial real estate	-		-	488,179	-	166	5,398	-	-	493,743
Short term claims on institutions and corporates	44,622		139,021	-	1,948	-	-	-	-	185,592
Past due items			-	-	-	-	-	674		674
Other items	1,661		-	-	-	-	74,055	-	751	76,467
Total	**242,451**		**153,644**	**488,179**	**51,129**	**805**	**524,067**	**674**	**751**	**1,461,700**
31 December 2014										
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	-	-	-	-	-	-		50	-	50
Other items	1,555	-	-	-	-	-	62,307	-	248	64,109
Total	**166,757**	**-**	**92,602**	**430,523**	**218,192**	**1,646**	**521,747**	**43**	**248**	**1,431,765**

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

Table 18: Credit risk exposure by CQS

31 December 2015 £000	Risk weight	Credit ratings	Credit ratings	Exposure values	RWA
CQS for Central governments or central banks					
1	0%	Aaa to Aa3	AAA to AA-	196,168	-
CQS for Corporates					
1	50%	A1 to A3	A+ to A-	13,657	6,828
2	100%	Baa1 to Baa3	BBB+ to BBB-	89,269	89,269
3	100%	Ba1 to Ba3	BB+ to BB-	8,154	8,154
Unrated				347,039	347,039
Total				**458,119**	**451,290**
CQS for Institutions					
1	50%	Baa1 to Baa3	BBB+ to BBB-	29,857	14,928
Unrated				15,341	3,360
Total				**45,197**	**18,289**
CQS for Short term claims on institutions and corporates					
Unrated				185,592	28,778
Total				**185,592**	**28,778**
CQS for Secured by mortgages on commercial real estate					
Unrated				5,104	2,552
Total				**5,104**	**2,552**
Secured by mortgages on residential property				**493,743**	176,385
Retail				**637**	**478**
Past due items					
Unrated				674	1,011
Total				**674**	**1,011**
Other items				**76,467**	**75,933**
Grand Total				**1,461,700**	**754,715**

31 December 2014 £000	Risk weight	Credit ratings	Credit 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**

Note: Exposure value is the amount after applying credit conversion factors (CCF) to off balance sheet exposures in accordance with the PRA regulatory rules.

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 standby letter of credit are taken to cover unforeseen risks.

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

Table 19: Credit exposure overview of CRM

£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
31 December 2015							
Loans	343,429	498,368	498,368	31,612	31,612	-	-
Debt securities	35,571	-	-	-	-	-	-
Total	**378,800**	**498,368**	**498,368**	**31,612**	**31,612**	-	-
Of Which Defaulted	-	996	996	-	-	-	-
31 December 2014							
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 exposures of £498M were mortgages, fully secured by 1st charge collateral over residential properties (£493M) and commercial real estate (£5M).
- The exposures of £32M consisted of 2 bilateral loans which were 100% guaranteed by standby letter of credit.
- The defaulted exposure of £996K related to 3 residential mortgages.

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 20: 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 December 2015						
Central governments or central banks	196,168	-	196,168	-	-	0%
Corporates	334,159	247,920	334,159	123,960	451,290	135%
Institutions	44,634	1,140	44,634	564	18,289	41%
Retail	637	4,135	637	-	478	75%
Secured by mortgages on residential property	493,577	332	493,577	166	176,385	36%
Secured by mortgages on commercial real estate	5,104	-	5,104	-	2,552	50%
Short term claims on institutions & corporates	185,333	1,290	185,333	258	28,778	16%
Past due items	-	-	-	-	-	-
Higher-risk categories	1,425	-	1,425	-	2,888	203%
Other items	75,716	-	75,716	-	74,055	98%
Total	**1,336,752**	**254,817**	**1,336,752**	**124,948**	**754,715**	**56%**
31 December 2014						
Central governments or central banks	26,930	-	26,930	-	-	0%
Corporates	272,092	364,202	272,092	184,259	445,251	164%
Institutions	222,400	-	222,400	-	104,778	47%
Retail	1,116	1,917	1,116	1,917	837	75%
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	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**	**65%**

Higher-risk categories refer to the assets with the risk weight at 150% or higher reflecting higher risks associated with RWA density of 203% (2014:230%). As required by the Basel Framework, the Bank discloses the higher-risk categories that are not in other regulatory portfolios. As indicated on the above table, all the exposures on past due items (£674K) are included in higher-risk category (£1,425K).

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 holds OTC derivatives and enters into SFTs.

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 applies Standardised Approach and Standardised CVA to calculate its total CCR capital charge.

The Bank's SFTs consisted of one reverse repo and one Treasury bond.

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.

One of the Bank's SFTs is fully collateralized.

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 are not applicable.

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 Standardised Approach (SA-CCR)

The Bank previously applied Current Exposure Method to calculate the default risk capital charge for CCR. Basel III in a paper issued in January 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 March 2014 to replace Current Exposure Method and Standardised Method. The Standardised Approach will be in force from 1 January 2017.

The limitations of Current Exposure Method are that it does not differentiate between margined and unmargined transactions, and the recognition of netting benefits is too simplistic. The weaknesses of Standardised Method are that the relationship misrepresentation between current exposure and potential future exposure, and inadequacy to provide a true non-internal model alternative for calculating EAD.

In order to address the deficiencies of the Current Exposure Method and Standardised Method, the Basel Committee's formulated the SA-CCR with main objectives to devise an approach that is suitable to be applied to a wide variety of derivatives transactions (both margined and unmargined, as well as bilateral and cleared). The SA-CCR applies to OTC derivatives, exchange-traded derivatives and long settlement transactions. The Bank holds unmargined OTC derivatives only.

SA-CCR takes two components the RC and PFE to calculate the EAD[15]. The total SA-CCR EAD is derived from the sum of RC and PFE.

The RC is obtained by marking the contracts to market. The PFE is reflected by add-on factors, which is an estimate of the total notional principle amount split by residual maturity. The PFE consist of a multiplier that allows for the partial recognition of excess collateral and an aggregate add-on, which is derived from add-ons developed for each asset class. The mechanics for calculating add-ons hinges on the key concept of a "hedging set", which is a set of transactions within a single netting set within which partial or full offsetting is recognised.

Table 21: Analysis of CCR exposure under Standardised Approach by contract type[16]

£000	31 December 2015	31 December 2014
Interest rate swap	2,498	651
FX Swap	149	3,779
FX Spot	3	133
Total	**2,650**	**4,563**

[15] Mathematically: SA-CCR EAD= α * (RC+PFE), α=1.4, which is set by the Basel Committee.
[16] The CCR exposure for 2014 was under CEM approach.

The CCR portfolio consisted of 2 Security Financing Transactions, where are a reverse repo and a treasury bond. The reverse repo has a RW of zero. The treasury bond is fully cash collateralized. Hence, the EAD post-CRM and RWAs are zero for SFTs.

Table 22: Analysis of CCR exposure by approach

£000	Replacement cost	Potential future exposure	EEPE	α for regulatory EAD	EAD post-CRM	RWA
31 December 2015						
SA-CCR (for derivatives)	392	1,501		1.4	2,650	663
IMM (for derivatives & SFTs)			-	-	-	-
Simple Approach for CRM (for SFTs)					-	-
Comprehensive Approach for CRM (for SFTs)					-	-
VaR for SFTs					-	-
Total						**663**

Table 23: CCR exposure under Standardised Approach by counterparty and risk weight

Regulatory portfolio £000 / Risk weight	0%	10%	20%	25%	50%	75%	100%	150%	Others	Total credit exposure
31 December 2015										
Institutions	-	-	-	2,650	-	-	-	-	-	2,650
Total	**-**	**-**	**-**	**2,650**	**-**	**-**	**-**	**-**	**-**	**2,650**

Credit Valuation Adjustment (CVA)

The CVA capital requirement was introduced by Basel III in December 2010 and then also adopted by CRD IV. In addition to the default capital requirements for CCR based on Standardised or 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 weight[17] 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 factor[18]. The

[17] CVA risk weight ranges from 0.7% to 10%.

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

Bank's CVA for derivative portfolio is not hedged. The CVA breakdown is displayed in the table below.

Table 24: CVA breakdown by Advanced and Standardised Approach

£000	31 December 2015		31 December 2014	
	EAD post-CRM	RWA	EAD post-CRM	RWA
Portfolio subject to Advanced CVA	-	-	-	-
i) VaR component	-	-	-	-
ii) Stressed VaR component	-	-	-	-
Portfolio subject to Standardised CVA	2,366	1,399	5,309	2,110
Total subject to CVA capital charge	**2,366**	**1,399**	**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 Standardised Approach capital charge and the standardised CVA risk capital charge.

Table 25: Total CCR Capital Requirement

£000	31 December 2015	
	RWA	Capital
Standardised Approach (SA)	663	53
CVA	1,399	112
Total	**2,062**	**165**

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 2015, the Bank had no exposure to asset backed securities (ABS).

8. Market Risk

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, little residual position in the trading book and the accrual of interest income in foreign currency.

The Bank has identified KRIs for the purpose of monitoring, reporting and managing the market risk in the book. Market risk limits are set for the Bank's trading book.

Table 26: Market risk capital requirement under Standardised Approach

£000	RWA 2015		RWA 2014	
	December	June	December	June
Outright products				
Interest rate risk (general & specific)	-	-	-	-
Equity risk (general & specific)	-	-	-	-
Foreign exchange risk	9,973	7,129	13,244	5,525
Commodity risk	-	-	-	-
Options				
Simplified approach	-	-	-	-
Delta-plus method	-	-	-	-
Scenario approach	-	-	-	-
Securitisation	-	-	-	-
Total	**9,973**	**7,129**	**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 manage this risk, the Bank squares the foreign currency Profit/Loss on a regular basis and uses FX financial instruments.

Table 27: Foreign exchange position

£000	US Dollar	Euro	HK Dollars	YEN	Other
31 December 2015	**93**	**23**	**34**	**(1)**	**7**
31 December 2014	593	(28)	(23)	(1)	171

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 repricing 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 NII Movement Ratio[19]. The limit is presented as a percentage ratio in terms of net income volatility for an increase in interest rate.

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 100bps change in interest rates, with all other variables held constant, of the Bank's income statement.

Table 28: 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 December 2014	**1,240**	**(1,240)**
31 December 2014	(1,114)	1,114
Sensitivity of reported equity to interest rate movements at		
31 December 2014	**89**	**(89)**
31 December 2014	225	(225)

Interest rate movements affect reported equity in the following ways: 1) retained earnings; arising from increases or decreases in net interest income and the fair value changes reported in profit or loss and 2) fair value reserves; arising from increases or decreases in fair values of available for sale financial instruments reported directly in equity.

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

9. Operational Risk

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 loses 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 management extends beyond the key risks.

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

The Bank continues to use Basic Indicator Approach to calculate the operational risk capital requirement, which is simple 15% of the average annual gross income over the previous three years. 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 29: Operational risk capital requirement using BIA

£000	Capital Allocation
31 December 2015	**10,298**
31 December 2014	8,585

Operational Risk Management

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

The Bank uses the following tools to identify, assess, monitor, report and control operational risk:

- Control self-assessment: the Bank assesses all processes underlying in its department/business lines against a library of potential threats and vulnerabilities and considers the potential impact. The Control self-assessment process evaluates inherent risk, the effectiveness of the control environment and residual risk.

  The Bank conducts Control self-assessment annually across all departments and remedial actions are derived with cooperation of relevant departments in order to mitigate risk occurrence in future.

- KRIs: are risk metrics and/or statistics that provide regular insights into a Bank's risk exposure. The aim is to ensure that all the major risk exposures are captured by KRIs in each department. The Bank has a well established list of KRIs for different departments which are reviewed annually and approved by the ORC and BRC. KRIs are collected and reported monthly on a R-A-G flag basis.

- Operational Risk Loss Event/ Data: Operational Risk Loss Data provides meaningful information for assessing the Bank's exposure to operational risk and effectiveness of internal controls. All events are classified in one of the 7 Basel II loss event categories.

  The Operational Risk Loss Event data is collected on a monthly basis from all departments irrespective of the amount. The Bank records all losses actual, potential or near miss. Operational Risk team then conduct critical events analysis and recommend actions plan in agreement with the correspondent department. The summary of Operational Risk Loss Event is reported monthly to the Senior Management and quarterly to the ORC and BRC.

- Control Affirmation Process: where the departments reassess existing controls and affirm the effectiveness in mitigating the risk and review if controls are still applicable. The Bank conducts Control Affirmation Process annually. The findings of Control Affirmation Process are presented annually to the ORC and BRC for recommendations and approvals.

- Stress Testing and Scenario Analysis: a process of obtaining expert opinion of business line/departments to identify potential operational risk events and assess the potential outcome. The Bank has developed various operational risk scenarios that provide potential sources of significant operational risk and the need for additional risk management controls or mitigation solutions.

10. Remuneration

Following implementation of the Remuneration Code ("the Code") by 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 which set out the FSA’s requirements in this regard.

The FCA assumed the FSA’s role on 1 April 2013. As an FCA regulated entity, 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 remuneration 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 2015.

Decision Making Process for Determining Remuneration Policy

The Remuneration Committee (‘RemCo’) of the Bank is responsible for the implementation of effective remuneration governance and related risk management practices. The RemCo 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 RemCo were last reviewed and updated in Mar 2015.

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 2015 and amended various clauses to update regulatory references and also to reflect the implementation of the European Banking Authority's Regulatory Technical Standards aligned to CRD IV and the changes to the local regulators Remuneration Code including definition of material risk takers and conditions of malus and clawback clauses.

Composition of the Remuneration Committee

The members of the Committee include three members, being:

- Jonathan Spence – Independent Non Executive Director, Chairman of the Remuneration Committee;
- Yu Sun – Chief Executive Officer;
- Tracey Rutherford – Head of Human Resources.

Role of the Relevant Stakeholders

The Committee is supported by the BRC 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 RemCo has sought 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 CEO, 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 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 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 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.

Independent 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 2015 financial year.

Remuneration Awarded

Table 30: 2015 variable remuneration awarded

	31 December 2015
Number of staff receiving variable remuneration award	397
Total fixed pay (£)	17,240,641
Total variable pay (including discretionary bonus award, allowances and overtime) (£)	4,341,221
Total deferred remuneration paid out (£)	439,922
Total non deferred variable remuneration paid out (£)	3,757,424
Total outstanding deferred remuneration (to be paid 2017 -2018- 2019) (£)	999,831
Total severance payments made	N/A
Total Remuneration (£)	**26,779,039**
Variable pay/fixed pay ratio	**25%**

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).

Table 31: Analysis of aggregate remuneration expenditure by division

31 December 2015 (£)	Retail Banking Business	Corporate Banking Business	Risk Management	Support Functions	**Total**
Aggregate Remuneration Expenditure	5,795,504	5,426,465	2,215,506	13,341,564	**26,779,039**

Table 32: Analysis of remuneration amount between fixed and variable pay for code staff

31 December 2015 (£)	Management Body	Senior Managers	Others	**Total**
Number of Code Staff	10	13	25	**48**
Fixed Pay	1,222,305	1,286,446	1,924,372	**4,433,123**
Variable Pay	429,946	133,465	526,002	**1,089,412**

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

The Bank did not pay any sign on or severance payments in 2015. There are no staff at the Bank who was paid over £735K (equivalent to €1M[20]). The highest paid Director was £227K (equivalent to €309K) in 2015.

[20] Converted to Euros using the exchange rate at 31 December 2015 1 £= €1.3598

Pillar 3 Disclosures 2015 for Bank of China (UK) Ltd

was prepared by Risk Management Department

and approved by the Board.

April 2016