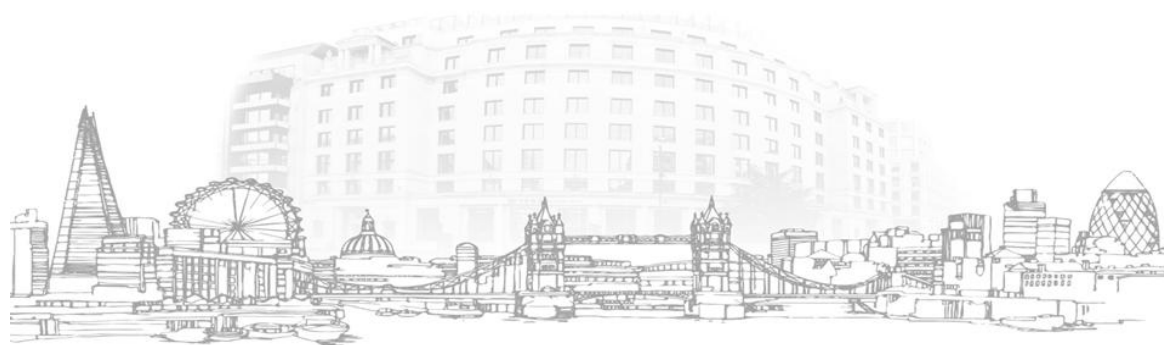




Bank of China (UK) Limited

Pillar 3 Disclosures

31 December 2018



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Version Control

Version	Date	Prepared by	Reviewed & Approved by	Main Changes
V1	14.03.2019	Ricardo Melgarejo	Mathias Yi (Head of RMD)	As suggested
V2	14.03.2019	Ricardo Melgarejo	Jonathan Curry (VP FMD) Paul Brend (Deputy Head of FMD)	As suggested
V3	21.03.2019	Ricardo Melgarejo	Steward Trussler (CFO)	As suggested
V4	21.03.2019	Ricardo Melgarejo	Wei Shi (CRO)	As suggested
V5	03.04.2019	Ricardo Melgarejo	Board	Approved

Glossary

Term	Definition	Term	Definition
ALCO	Asset and Liability Committee	G-SIBs	Global Systemically Important Banks
Annual Report	Annual Report and Financial Statements	HQLA	High-Quality Liquid Assets
BCBS	Basel Committee on Banking Supervision	HR	Human Resources
BCC	Business Continuity Committee	IAS	International Accounting Standards
BIA	Basic Indicator Approach	ICAAP	Internal Capital Adequacy Assessment Process
BIS	Bank for International Settlements	ICG	Individual Capital Guidance
BOC Group	Bank of China Limited	IFRS	International Financial Reporting Standards
BRC	Board Risk Committee	ILAAP	Internal Liquidity Adequacy Assessment Process
CCB	Capital Conversion Buffer	IRB	Internal Rating-Based
CCF	Credit Conversion Factor	IRRBB	Interest Rate Risk on Banking Book
CCR	Counterparty Credit Risk	KRIs	Key Risk Indicators
CCyB	Countercyclical Capital Buffer	L&C	Legal & Compliance Department
CEO	Chief Executive Officer	LCR	Liquidity Coverage Requirement
CET1	Common Equity Tier 1	MO	Middle Office
CFO	Chief Financial Officer	NII	Net Interest Income
CFUs	Corporate Finance Units	NSFR	Net Stable Funding Ratio
CMD	Credit Management Department	ORC	Operational Risk Committee
CQS	Credit Quality Step	OSIT	Overseas System Integration Technology
CRD IV	Capital Requirement Directives IV	OTC	Over the Counter
CRM	Credit Risk Mitigation	PBD	Personal Banking Department
CRPC	Credit Risk Policy Committee	PFE	Potential Future Exposure
CVA	Credit Valuation Adjustment	PRA	Prudential Regulation Authority
D-SIB	Domestic Systemically Important Banks	RAIM	Risk Appetite Indicator Monitoring Report
EBA	European Banking Authority	RBD	Retail Banking Department
ECAI	External Credit Assessment Institutions	RemCo	Remuneration Committee
EMC	Executive Management Committee	RMD	Risk Management Department
EMEA	Europe, the Middle East and Africa	RTS	Regulatory Technical Standards
EO	Executive Office	RWA	Risk-Weighted Assets
EU	European Union	SA	Standardised Approach
EVE	Economic Value	SREP	Supervisory Review and Evaluation Process
EWIs	Early Warning Indicators	TCR	Total Capital Requirement
FCA	Financial Conduct Authority	TD	Treasury Department
FMD	Financial Management Department	The Bank	Bank of China (UK) Limited
FS	Financial Statements	UK	United Kingdom
FPC	Financial Policy Committee	VaR	Value at Risk
FX	Foreign Exchange		

1. Introduction

Background

Bank of China UK Limited (the Bank) was incorporated as a private limited company on 29th March 2007, a wholly owned subsidiary of BOC Group. The Bank is authorised by the PRA and regulated by the PRA and FCA. 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. 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. The corporate and trade finance business encompass funding and advisory services for Chinese companies seeking to expand in the UK and EU.

To expand the territory of corporate clients and implement the globalisation strategy of the Group, the Bank opened its Dublin Branch on 3rd July 2017. The strategy of the Dublin Branch is to focus on corporate lending.

The Group strategic objective is to build Bank of China into a world-class bank in the new era. The Bank follows the mission and strategy of 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 and Financial Statement 2018¹.

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 the Annual Report and Financial Statements 2018). Therefore this disclosure does not take into account any subsidiaries.

The Pillar 3 Disclosures 2018 have been prepared in accordance with regulatory capital adequacy concepts and rules, rather than in accordance with IFRS. Some information in this report is not directly comparable with the Bank's Annual Report and Financial Statement 2018. Explanations and notes are given where appropriate.

¹ See <http://www.bankofchina.com/uk/aboutus>

Regulatory Framework for Disclosures

The Basel Capital Accord provides a global regulatory framework for capital and liquidity. It is detailed in the “International Convergence of Capital Measurement and Capital Standards: “A Revised Framework – Comprehensive Version” June 2006 (Basel II). This standard was revised in 2010 following the financial crisis through a number of reforms collectively known as Basel III and in particular, “Basel III: a Global regulatory framework for more resilient banks and banking systems” and “Revisions to the Basel II market risk framework – updated as of 31 December 2010”.

The revised Basel Capital Accord has been implemented in the EU via the CRD and the Capital Requirements Regulation (collectively known as CRD IV). These new requirements took effect from 1 January 2014. However, certain aspects of CRD IV are subject to phased implementation and may also be dependent on final technical standards to be issued by the EBA and adopted by the European Commission, and ultimately implemented in the UK.

Prudential requirements under the Basel framework are categorised under three pillars as described below:

- Pillar 1 – Minimum capital requirements: defines rules for the calculation of credit, market and operational risk;
- Pillar 2 – Supervisory review process: including a requirement for firms to undertake an Internal Capital Adequacy Assessment (ICAAP);
- Pillar 3 – Market discipline: requires expanded disclosures to allow investors and other market participants to understand capital adequacy, particular risk exposures and risk management processes of individual firms.

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.

Frequency

CRD IV and EBA guidelines require the Bank discloses information at a minimum on an annual basis. To ensure the effective communication of the Bank's business and risk profile, the Bank also pays particular attention to the possible need to provide information more frequently than annually.

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.

Media and Location of Publication

The Bank's full Pillar 3 disclosures report is produced on an annual basis and published concurrently with the Annual Report and Financial Statements for the corresponding period on the Bank's website: <http://www.bankofchina.com/uk/aboutus>

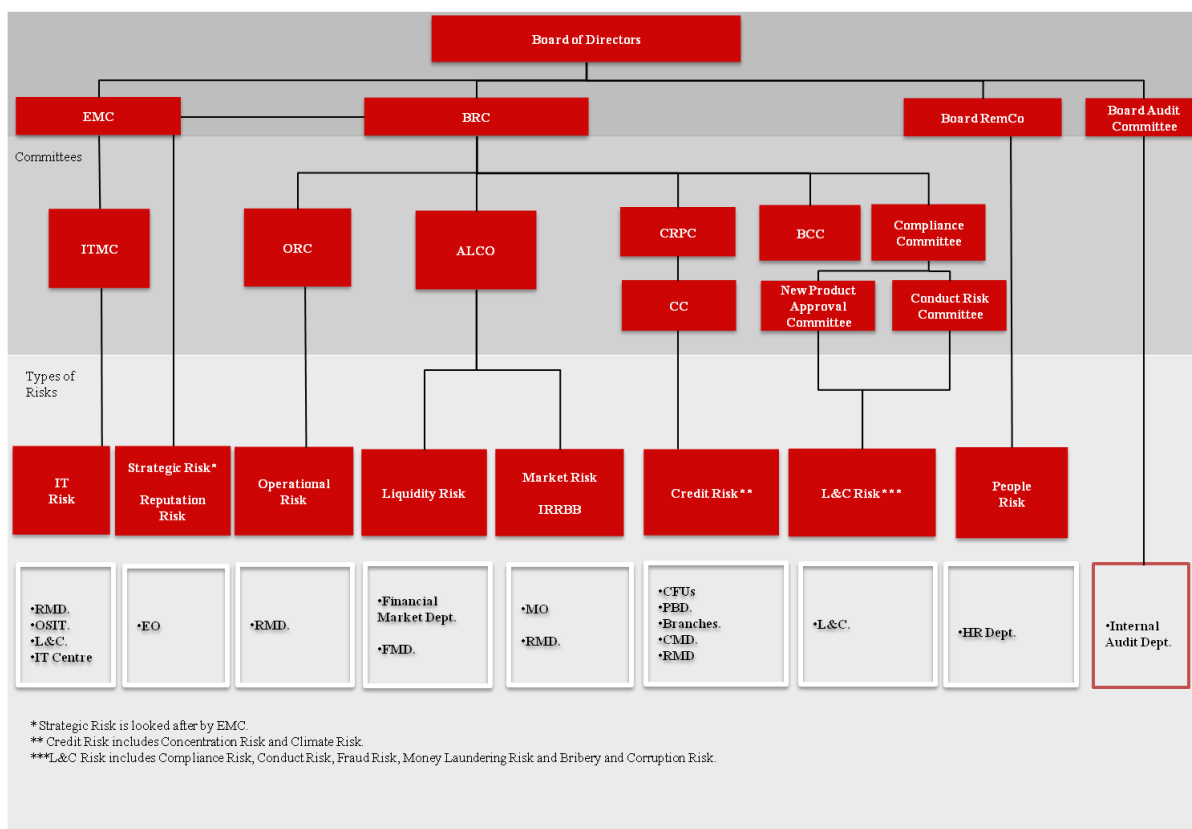
2. Risk Management Overview

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 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.

Risk Management Structure



Risk types

The Bank's activities give rise to various risks. The key risks can predominantly be grouped into the following categories:

Credit risk

Credit risk is defined as the potential loss that a borrower or counterparty will fail to meet contractual obligations in accordance with agreed terms. Credit risk is the most significant risk for the Bank, which arises principally from credit lending and debt securities investment, and also from off-balance sheet financial instruments.

The Bank's medium-low risk appetite towards credit risks is reflected in a conservative approach towards lending, with a focus on investment grade corporate customers, collateralised mortgage lending of residential property, selective personal loans; and also in a conservative view towards high leverage financial projects and a tight restriction over such facilities.

Market risk

It is defined as the potential losses arising from fluctuations of market price that can be categorised into interest rate risk, FX risk, equity risk and commodity risk.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external causes, whether deliberate, accidental or natural.

Legal and compliance risk

Legal and Compliance risk at the Bank consists of compliance risk, conduct risk, fraud risk and money laundering risk. The Bank has defined a stand-alone risk appetite statement for each type of the risk

Liquidity risk

Liquidity risk refers to the risk of the inability to meet payment obligations when they become due. The Bank has adopted a medium-low risk appetite which is fully reflected in the conditions set within its own stress scenarios, aligned to the Bank's business profiles and the prescribed stresses set by the PRA.

Concentration risk

It describes the level of risk in the Bank's portfolio arising from concentration to a single counterparty, sector or country.

Strategic risk

Strategic risk refers to the loss arising either from the Bank's poor business decision-making, from substandard executions of decisions, from inadequate resources allocation or from failure to respond to external market changes.

Reputational risk

Reputational risk is defined as a derivative risk, referring to the risk of negative impacts or losses on the Bank's image, brand and reputation that are caused by media attention to or negative news coverage on BOC Group's business operation, management and other behaviors or external events involving BOC Group.

Information Technology (IT) risk

It covers both daily operations and ongoing enhancements to the Bank including technology service availability, security and technology change management. The Bank is committed to ensuring that all IT risks are mitigated.

People risk - HR

It refers to the risk that people do not follow the Bank's procedures, practices and/or rules, thus deviating from expected behaviour in a way that could potentially harm the business's performance and reputation.

Climate-related risks

The Bank has divided climate-related risks into two major categories which can have an impact on achieving the Bank's business plan, its continued safety and soundness and the protection of shareholders, investors and deposit holders:

- **Transition risks:** High carbon industries will face challenges in transitioning for low carbon resilience. Transitional risk is most likely to affect the fossil fuel sector, utility and automotive companies and industrials. Companies that have not adapted their business models could be impacted by demand destruction, stranded assets and even bankruptcy.
- **Physical risks:** These are direct impacts of climate change which are already having an observable effect in many parts of the world today. Implications include ecosystem disruption, extreme weather events, rising sea levels, resource scarcity and poor crop yields – compounding existing issues of conflict, poverty and migration.

Governance and Committees

The Board of Directors (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 end, the Board composition was 8 members. However, throughout 2018 there were 9 members having held directorship due to succession planning.

Mr. Wenjian Fang	Chief Executive Officer (appointed 2 November 2018)
Mr. Yu Sun	Chief Executive Officer (resigned 2 November 2018)
Mr. Yu Sun	Chairman (appointed 11 December 2018)
Mr. Yingxin Gao	Chairman (resigned 11 December 2018)
Mr. Stewart Trussler	Chief Financial Officer
Mrs. Wei Shi	Chief Risk Officer
Ms. Li Ren	Non-Executive
Mr. Jonathan Spence	Non-Executive
Mr. Charles Hardy	Non-Executive
Dr. Gerard Lyons	Non-Executive

The Board believes that it is in 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 Risk Committee (BRC) is responsible for assisting the Board with the establishment and ongoing review of risk strategies, policies, risk appetite, oversight of risk management performance across the Bank, approval of non-standard credits and credits above the delegated limits of the CEO as well as approval of delegated limit authorities.

Board Remuneration Committee (Board RemCo) is responsible for the implementation of effective remuneration governance and related risk management practices.

Board Audit Committee assists the Board in carrying out its responsibilities relating to internal control, accounting policies, financial reporting, and compliance. Whilst the BRC is the primary forum for risk identification and management, the Audit Committee compliments BRC in respect of risk management relating to the third line of defence.

Executive Management Committee (EMC) is to oversee and manage all aspects of the Bank's business and operations, to ensure consistencies with the strategy, business plan and policies and procedures respectively, and to protect the interest of the Bank, the BOC Group, and all relevant stakeholders, under the delegated authority from the Board.

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, including industry and country concentration limits.
- Credit Committee (CC) is responsible for new facility assessment, classification review, provisioning, and other related matters.
- 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 function.

IT Management Committee (ITMC) oversees and supports the implementation of an effective and proactive IT function (including IT related security and risk) within the Bank.

Board related meetings, CRPC, ORC, BCC and Compliance Committee meet on a quarterly basis² whereas EMC will meet on a weekly basis. ALCO will meet physically as deemed required by the Chairman or Deputy Chairman of the Committee. CC meets as required in response to credit limit applications.

² BRC and CRPC Adhoc meetings are held as required.

Strategic Plan

The Development Strategy is reviewed on an annual basis to enhance the integration between Risk Appetite and strategic planning. The core mission of the Bank is to upgrade its business model. A comprehensive risk management framework and system has been established to overcome challenges. Through the plan period, the focus is on maintaining efficient and effective risk management practice to support the business development by identifying and managing risks. To achieve this, the key focus areas are as follows:

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 "Responsibility, Integrity, Professionalism, Innovation, Prudence and Performance".

The Bank's Risk Appetite Statement defines the aggregate amount and type of risk the Bank is willing to pursue or avoid in achieving its strategic goals. All strategic business plans for functional areas must be consistent with the risk appetite.

Risk Culture

The Bank has a clear articulation from EMC members on the importance of a strong risk culture which can be reflected as of the following with a forward looking approach:

- Tone from the top – (1) Many of the Bank's KPI focus on Risk Management, Compliance and internal control, which are very well cascaded to department and individual's KPI. (2) CRO dialogue: held regularly, to address the Bank's key risk issues, raise risk awareness, and integrate risk appetite implementation.
- Accountability – Three Lines of Defence is the foundation of good risk awareness and accountability. The Bank established detailed policies and procedures to clarify roles and responsibility of Three Lines and ensure the right procedure of risk awareness, risk identification, risk control, reporting and escalation.
- Effective communication and challenge – The Bank's risk functions are managed in Committee Mechanism. The Committee meetings promote cross functional open discussion before any decision is made.
- Risk Training –The Bank provides risk training for new joiners, operational risk coordinators and regular compliance risk training for all staff.

Ongoing Enhancement of the Comprehensive Risk Management System

The Bank's long-term risk management objective is to enhance the efficiency of the overall risk management system and strengthen risk management while supporting business sustainable development. The Bank also has established and continues an effective reporting system. RMD prepares Management Information Risk Report monthly and quarterly along with the Risk Appetite Indicator Monitoring Report (RAIM). The comprehensive report covers credit, operational, market risk disclosure and analysis and also liquidity and capital indicators.

Three Lines of Defence

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

- The **first line of defence** consists of the business frontline staff (i.e. the customer-facing business / processing departments) who are responsible for ensuring that the risk and control environment is established as part of the day-to-day operations, this will involve the identification, design and implementation of controls within the business.
- The **second line of defence** consists of the oversight functions within the Bank, being L&C, CMD, RMD, MO and the various Committees within the Bank each of these functions reports into.
- The **third line of defence** consists of the Internal Audit function of the Bank, which reports directly in to the Board Audit Committee.

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 its capital internally by retained earnings. The capital resources comprise Tier 1 and Tier 2 capital as set out in table below. 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.

Minimum capital requirements are referred to as Pillar 1 requirements. These requirements apply to the credit, market and operational risk generated by the Bank. Regulatory capital adequacy is measured through three risk-based ratios i.e. CET1, Tier 1 and Total Capital ratios.

CET 1 capital: it consists of ordinary share capital and retained earnings. CET1 capital remained the same over the reporting period. The retained earnings represent the Bank's audited accumulated accounting profits after proposed and paid dividends. The Bank has not issued any Tier 1 instruments. As at 31 December 2018, there is no reconciliation differences between the amounts disclosed as Tier 1 capital to those treated as equity under IFRS.

Tier 1 capital: CET 1 plus perpetual, non-cumulative instruments with principal loss absorption features issued under the CRD IV rules less capital deductions, divided by total risk-weighted assets.

Tier 2 capital: it includes qualifying subordinated debt of £60M, which was issued on 20 September 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 and Financial Statement 2018.

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. The Bank has complied with all externally imposed capital requirements throughout the period.

Table 1: Key metrics**£000**

Available capital (amounts)	2018	2017
Common Equity Tier 1 (CET1)	274,958	274,958
Tier 1	274,958	274,958
Total capital	334,958	334,958
Risk-weighted assets (amounts)		
Total risk-weighted assets (RWA)	941,052	931,206
Risk-based capital ratios as a percentage of RWA		
Common Equity Tier 1 ratio (%)	29.2%	29.5%
Tier 1 ratio (%)	29.2%	29.5%
Total capital ratio (%)	35.6%	36.0%
Additional CET1 buffer requirements as a percentage of RWA		
Capital conservation buffer requirement (2.5% from 2019) (%)	1.875%	1.25%
Countercyclical buffer requirement (%)	0.43%	0.47%
Bank G-SIB and/or D-SIB additional requirements (%)	0%	0%
Total of bank CET1 specific buffer requirements (%)	2.3%	1.7%
CET1 available after meeting the bank's minimum capital requirements (%)	24.7%	25%
Basel III leverage ratio		
Total Basel III leverage ratio exposure measure	1,860,587	1,790,997
Basel III leverage ratio (%)	14.8%	15.4%
Liquidity Coverage Ratio		
Total HQLA	381,928	337,759
Total net cash outflow	164,459	202,820
LCR ratio (%)	232%	167%
Net Stable Funding Ratio		
Total available stable funding	1,219,968	1,076,665
Total required stable funding	843,948	946,695
NSFR ratio	145%	114%

Leverage Ratio

The Basel Committee on Banking Supervision (BCBS) introduced a leverage ratio in the 2010 Basel III package of reforms. Basel III leverage ratio framework and disclosure requirements followed in January 2014 with detailed specification of the leverage ratio framework (the framework).

An underlying cause of the global financial crisis was the build-up of excessive on- and off-balance sheet leverage in the banking system. In many cases, banks built up excessive leverage while reporting strong risk-based capital ratios. At the height of the crisis, financial markets forced the banking sector to reduce its leverage in a manner that amplified downward pressures on asset prices. This deleveraging process exacerbated the feedback loop between losses, falling bank capital and contracting credit availability.

The Basel III framework introduced a simple, transparent, non-risk-based leverage ratio to act as a credible supplementary measure to the risk-based capital requirements. The leverage ratio is intended to:

- restrict the build-up of leverage in the banking sector to avoid destabilising deleveraging processes that can damage the broader financial system and the economy; and
- reinforce the risk-based requirements with a simple, non-risk-based “backstop” measure.

The Committee is of the view that a simple leverage ratio framework is critical and complementary to the risk-based capital framework, and that the leverage ratio should adequately capture both the on- and off-balance sheet sources of banks’ leverage.

The leverage ratio is defined as the capital measure (the numerator) divided by the exposure measure (the denominator), with this ratio expressed as a percentage.

$$\text{Leverage Ratio} = \frac{\text{Capital measure}}{\text{Exposure measure}}$$

The capital measure for the leverage ratio is Tier 1 capital – comprising CET 1 and/or Additional Tier 1 (AT1) instruments. In other words, the capital measure used for the leverage ratio at any particular point in time is the Tier 1 capital measure applicable at that time under the risk-based framework.

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.

The Bank meets a 4% leverage ratio at all times.

Table 2: Leverage ratio

£000

	2018	2017
On-balance sheet exposures		
On-balance sheet exposures (excluding derivatives and securities financing transactions (SFTs), but including collateral)	1,630,506	1,543,090
(Asset amounts deducted in determining Basel III Tier 1 capital)	-	-
Total on-balance sheet exposures (excluding derivatives and SFTs)	1,630,506	1,543,090
Derivative exposures		
Replacement cost associated with all derivatives transactions (where applicable net of eligible cash variation margin and/or with bilateral netting)	-	-
Derivatives: Add-on Mark-to-Market Method	2,748	1,500
Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the operative accounting framework	-	-
(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	-	-
(Exempted CCP leg of client-cleared trade exposures)	-	-
Derogation for derivatives: Original Exposure Method	1,351	977
(Adjusted effective notional offsets and add-on deductions for written credit derivatives)	-	-
Total derivatives not subject to a cross-product netting agreement	4,099	2,476
Securities financing transaction exposures		
Total securities financing transaction exposures	-	-
Other off-balance sheet exposures		
Off-balance sheet exposure at gross notional amount	225,983	245,430
(Adjustments for conversion to credit equivalent amounts)	-	-
Off-balance sheet items	225,983	245,430
Capital and total exposures		
Tier 1 capital	274,958	274,958
Total exposures	1,860,587	1,790,997
Leverage ratio		
Total Basel III leverage ratio exposure measure	14.8%	15.4%

The leverage ratio is 14.8%, which is well above Basel's requirement. The Bank does not face an issue of excessive leverage. The main reasons contributing to a relatively high leverage ratio are:

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

4. Capital and Liquidity Risk Management

The Bank's capital requirement is set 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. Senior Management use 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.

Objective

The Bank's capital management function lies within RMD and FMD. They ensure that regulatory capital requirements are met at all times under both business as usual conditions and under stressed conditions. The functions advise Senior Management on the quantum and form of capital required, and if the required capital should be raised in line with business requirements.

Governance

The Board has the ultimate responsibility for the oversight of risk and capital management. The Board also ensure that the Bank complies with all regulatory requirements set by the regulatory bodies.

ALCO is a subcommittee of the BRC. ALCO is the primary forum for maintaining oversight of the size and composition of the balance sheet, including the capital and liquidity positions.

ALCO is responsible for reviewing the current capital, large exposures, liquidity, funding, leverage, encumbrance and where also appropriate, the projected positions. It is also responsible for making appropriate operational level decisions regarding these matters.

Pillar 1 – Minimum Capital Adequacy

Minimum capital requirements are referred to as Pillar 1 requirements. These requirements apply to the credit, market and operational risk generated by the Bank. Regulatory capital adequacy is measured through three risk-based ratios i.e. CET1, Tier 1 and Total Capital ratios (see section 3 for details – Capital Resources).

Under CRD IV, the minimum CET1, Tier 1 capital and Total capital adequacy ratios are supplemented by a number of capital buffers. The capital buffers applicable to the Bank are collectively referred to as the Combined Buffer Requirement.

Pillar 2

The Pillar 2 capital framework is intended to ensure the Bank has adequate capital to support the relevant risks in its business. In addition to the Pillar 1 and the Combined Buffer Requirement mentioned above, the PRA performs a periodic supervisory review of the Bank's ICAAP, which leads to a final determination by the PRA of Total Capital Requirement (TCR) amount under Pillar 2A. The Pillar 2A requirement is an additional capital requirement that a firm needs to hold to cover risks that are not adequately captured in Pillar 1. This is a point in time assessment of the minimum amount of capital the PRA considers that an entity should hold.

The PRA may also require firms to hold an additional capital buffer (referred to as the PRA buffer) to enable firms to meet its minimum capital requirements under stress. Any PRA buffer requirement is set after taking into account the existing amount of Capital Conservation Buffer (CCB) already held by the firm.

The PRA buffer is subject to a phasing in period, which requires 100% of the buffer to be made up of CET1 capital by 2019.

Capital Buffers (Combined Buffer Requirement)

Capital Conservation Buffer (CCB)

The CCB introduced under CRD IV is designed to ensure that banks build up capital buffers outside periods of stress which can be drawn down as losses are incurred. The CCB is subject to phased implementation at 25% per annum from 2016 with the buffer coming into full effect at 2.5%, from 2019. As per the phased implementation, the CCB has been set at 1.875% for 2018, increasing to 2.5% in 2019.

Countercyclical Capital Buffers (CcyB)

In December 2010, Basel issued guidance for global regulatory standards on bank capital adequacy and liquidity, including a countercyclical capital buffer.

The CcyB aims to ensure that banking sector capital requirements take account of the macro-financial environment in which banks operate. Its primary objective is to use a buffer of capital to achieve the broader macro-prudential goal of protecting the banking sector from periods of excess aggregate credit growth that have often been associated with the build-up of system-wide risk.

Due to its countercyclical nature, the countercyclical capital buffer is a tool that enables the Financial Policy Committee (FPC) in the UK, and the equivalent in other countries, to require an additional cushion of capital when risks are building up.

In downturns, the FPC and overseas equivalent can reduce the buffer requirement to reduce the risk that the supply of credit will be constrained by regulatory capital requirements that could undermine the performance of the real economy and result in additional credit losses in the banking system.

The Basel III countercyclical capital buffer is calculated as the weighted average of the buffers in effect in the jurisdictions to which the Bank has a credit exposure. It is implemented as an extension of the capital conservation buffer. It consists entirely of CET 1 capital and, if the minimum buffer requirements are breached, capital distribution constraints will be imposed on the Bank. Consistent with the capital conservation buffer, the constraints imposed relate only to capital distributions, not the operation of the Bank.

The Bank must ensure that its CCyB requirement is calculated and publically disclosed with at least the same frequency as its minimum capital requirements. In addition, when disclosing its buffer requirement, the Bank must also disclose the geographic breakdown of its private sector credit exposures used in the calculation of the buffer requirement.

The countercyclical buffer regime will be phased-in in parallel with the capital conservation buffer between 1 January 2016 and year end 2018 becoming fully effective on 1 January 2019. Countries that experience excessive credit growth during this transition period will consider accelerating the build-up of the capital conservation buffer and the countercyclical buffer. In addition, jurisdictions may choose to implement larger countercyclical buffer requirements. In such cases the reciprocity provisions of the regime will not apply to the additional amounts or earlier time-frames.

The document entitled “Guidance for national authorities operating the countercyclical capital buffer”, sets out the principles that national authorities have agreed to follow in making buffer decisions. To give banks time to adjust to a buffer level, a jurisdiction will pre-announce its

decision to raise the level of the countercyclical buffer by up to 12 months. Decisions by a jurisdiction to decrease the level of the countercyclical buffer will take effect immediately.

The pre-announced buffer decisions and the actual buffers in place for all Committee member jurisdictions are published on the BIS website.

Member jurisdictions								
Jurisdiction	CCyB regulations	Current CCyB			Future CCyB			Last updated
		Policy announcement	Effective date	Add-on (per cent of RWA)	Policy announcement	Effective date	Add-on (per cent of RWA)	
France		HCSF decision regarding the CCyB (30.12.2015)	30/12/2015	0.00%	HCSF decision regarding the CCyB	01/07/2019	0.25%	29/06/2018
Hong Kong SAR	Implementation of the CCyB in Hong Kong	HK CCyB announcement (27 Jan 2017)	01/01/2018	1.875%	HK CCyB announcement (10 Jan 2018)	01/01/2019	2.50%	10/01/2018
Sweden	Swedish Buffer Capital Act (in Swedish only)	Regulations amending Finansinspektionen's regulations (FFFS 2014:33) regarding the countercyclical capital buffer rate (21.03.2016)	19/03/2017	2.00%	Regulations amending Finansinspektionen's regulations (FFFS 2014:33) regarding the countercyclical buffer rate (19.09.2018)	19/09/2019	2.50%	19/09/2018
United Kingdom	Statutory Instruments - Financial Services and Markets: The Capital Requirements (Capital Buffers and Macro-prudential Measures) Regulations 2014	FPC decision to increase the CCyB rate from 0.5% to 1% (27.11.2017)	28/11/2018	1.00%	-		1.00%	28/11/2018

Non-member jurisdictions								
Jurisdiction	CCyB regulations	Current CCyB			Future CCyB			Last updated
		Policy announcement	Effective date	Add-on (per cent of RWA)	Policy announcement	Effective date	Add-on (per cent of RWA)	
Norway	Norwegian Financial Institutions Act Section 2-9e (in Norwegian only)	Press release: Countercyclical buffer increases (15.12.2016 - in English)	31/12/2017	2.00%	n/a	n/a	n/a	06/01/2017

The table below summarises the Bank's total exposures and own funds requirements based on country of economic operation of the customer.

Table 3: CCyB - geographical distribution of credit exposures and capital requirement

Geographical breakdown	Countercyclical capital buffer rate applicable as at 31.12.2018	Exposure values and RWA used in the computation of the CCyB		Bank-specific CCyB rate	Countercyclical buffer amount (£'000)
		Credit Exposure (£'000)	RWAs		
United Kingdom*	1%	391,587	216,401	0.43%	4,066
Sweden*	2%	-	-		
Hong Kong*	1.875%	166,908	58,327		
Norway**	2%	-	-		
Other countries	0%	788,401	479,273		
TOTAL		1,346,897	754,002		

* Basel Committee member jurisdictions

** Non-member jurisdictions

Where applicable, a countercyclical capital buffer rate is applied to the own funds requirement for the geographic region to capture an additional countercyclical requirement.

General credit and trading book exposures exclude those with central governments/banks, regional governments, local authorities, public sector entities, multilateral development banks, international organisations and institutions. The exposures therefore differ to those in the Credit and Counterparty risk sections.

Global Systemically Important Banks (G-SIBs)

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

Approach to Managing Capital

External requirements

During the period under review, the Bank complied with all externally imposed capital requirements, and in particular to the relevant regulatory requirements of the PRA.

EU banking regulations applicable to the Bank are based on the global guidelines developed by the Basel committee under the auspices of the BIS. The latest guidelines issued by the Basel committee (Basel III), as implemented by the EU CRD IV package, were fully implemented by the Bank from 1 January 2014. The impacts of these regulatory requirements, including any relevant transitional requirements have been reviewed by the Bank and have been factored into all internal capital projections.

The requirement to maintain adequate financial resources is assessed both by the Bank and the PRA in relation to the Bank's activities and the risks to which they give rise. The capital adequacy ratio, which reflects the capital strength of an entity compared to the minimum regulatory requirement, is calculated by dividing the capital held by that entity by its risk-weighted assets. The Bank maintains a healthy capital adequacy ratio, in excess of the regulatory requirements.

Internal requirements

The Bank assesses its capital adequacy against the capital requirement to absorb unexpected losses that may arise from the risks inherent in the business. Regulatory capital requirements are determined on the basis of prescribed regulatory approaches that apply to each of the main risk types and in each of the jurisdictions in which the Bank operates. In addition, the Bank adopts an ICAAP which reflects management's internal assessment of risk. The ICAAP requires capital to be held for risks as assessed by management instead of a prescribed regulatory formula, and as such encompasses a wide spectrum of risks.

The Bank's governance process includes a robust assessment of capital forecasts and stress testing, allowing for capital raising and usage reductions to be expedited in a timely manner. This ensures that minimum capital ratios are maintained at all times.

Measurement and Planning

The Bank measures the amount of capital it holds using the regulatory framework, as per the requirements under the CRD IV. These requirements are implemented in the UK by the PRA.

As part of the capital planning process, capital positions are subjected to extensive quantitative and qualitative stress analysis to determine the adequacy of the Bank's capital resources against the minimum requirements, including the Bank specific TCR set by the PRA, over the forecast period. The outputs from some of these stress analyses are used by the PRA to review and set an additional PRA Buffer for the Bank.

This PRA buffer comprises a minimum level of capital buffer over and above the minimum regulatory requirements that should be maintained in non-stressed conditions as mitigation against potential future periods of stress. The PRA buffer is set after taking into account the overall level of capital, including the capital conservation buffer that firms need to hold.

The Bank has a capital management framework including policies and procedures that are designed to ensure that it operates within its risk appetite, continues to comply with regulatory requirements on an ongoing basis as well as under stress, and is positioned to meet anticipated future changes to its capital requirements.

Regulatory capital ratios are also a key factor in the Bank's planning processes and stress analyses.

Four year forecasts of the Bank's capital position are produced at least annually whilst shorter term forecasts are more frequently undertaken to understand and respond to variations of the Bank's actual performance against internal plans.

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 the Annual Cyclical Scenario set by the PRA anchor scenarios.

The capital plans are tested for capital adequacy using a range of stress scenarios covering adverse economic conditions and the Bank maintains a Recovery Plan which sets out a range of potential mitigating actions that could be taken in response to a stress.

Capital policies and procedures are subject to independent oversight. Regular reporting of actual and projected ratios, including those in stressed scenarios, is undertaken, including submissions to ALCO and BRC.

Monitoring

The Bank uses Early Warning Indicators (EWIs), which are monitored on a daily/monthly/quarterly basis to ensure that minimum regulatory capital requirements are not likely to be breached. In addition, the Bank Risk Appetite Statement metrics are reviewed at least annually.

In the event that a particular concern needs to be escalated to Senior Management, the prominence of the metric is considered together with the time available to the Bank to remediate the issue. Serious capital issues are escalated to EMC and ALCO which can operate under its contingency management terms of reference if deemed necessary. This allows the Bank to select the most appropriate management action to remediate the issue.

If a particular action fails to have the desired impact, further escalation to the BRC and ultimately to the Board will take place where, increasingly severe actions can be selected and actioned. This process is subject to annual review and approval by the Board.

Capital Position Summary

The Bank complied with all externally imposed capital requirements during the current and prior year. The Bank's CET 1 capital was £275 million as at 31 December 2018 (same as 2017). The Bank's total capital was £335 million as at 31 December 2018 (same as 2017).

The ratios are measured against the regulatory minimum requirements. The table below shows the capital position of the Bank as at 31 December 2018 and 2017.

Table 4: Composition of regulatory capital

£000		2018	2017
Common equity tier 1 capital: Instruments and reserves			
1	Capital Instruments and the related share premium accounts of which: Ordinary share capital	250,000	250,000
2	Retained Earnings*	24,958	24,958
6	Common equity tier 1 (CET 1) capital before regulatory adjustments	274,958	274,958
Common equity tier 1 (CET 1) capital regulatory adjustments			
28	Total regulatory adjustments to Common equity tier 1 (CET 1)	-	-
29	Common equity tier 1 (CET 1) capital	274,958	274,958
Additional tier 1 (AT1) Capital: instruments and provisions			
44	Additional Tier 1 (AT1) capital	-	-
45	Tier 1 capital (T1 = CET 1 + AT1)	274,958	274,958
Tier 2 (T2) capital: instruments and provisions			
46	Capital instruments and subordinated loans eligible as T2 Capital	60,000	60,000
51	Tier 2 (T2) capital before regulatory adjustments	60,000	60,000
58	Tier 2 (T2) capital	60,000	60,000
59	Total capital (TC = T1+T2)	334,958	334,958
60	Total risk weighted assets	941,052	931,206
Capital ratios and buffers			
61	Common Equity Tier 1 (as a percentage of risk-weighted assets)	29.2%	29.5%
62	Tier 1 (as a percentage of risk-weighted assets)	29.2%	29.5%
63	Total capital (as a percentage of risk-weighted assets)	35.6%	36.0%
64	Institution specific buffer requirement (CET1 requirement in accordance with article 92 (1)(a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus the systemically important institution buffer (G-SII or O-SII buffer), expressed as a percentage of risk exposure amount)	6.81%	6.22%
65	Of which: capital conservation buffer requirement**	1.875%	1.25%
66	Of which: bank-specific countercyclical buffer requirement	0.43%	0.47%
67	Of which: Bank G-SIB and/or D-SIB additional requirements (%)	0%	0%
68	CET1 available to meet buffers***	24.7%	25.0%

* Net of recommended £51.1M dividend for year ended 2018. Capital resources are therefore expected to be unchanged.

** The capital conservation buffer is being phased in from 1 January 2016 to 1 January 2019. The 2017 buffer of 1.25% will increase to 2.5% by 1 January 2019.

*** This represents the CET1 ratio less the CRR minimum of 4.5%.

As at 31 December 2018 the total capital adequacy ratio was 35.67% (2017: 36.00%) based on the EU Capital Requirements Regulations.

The Bank has not issued any AT 1 capital instruments. The current regulatory minimum CET1 and Tier 1 capital ratios of 4.5% and 6% respectively are therefore met with CET1 capital.

Following the latest publication of Policy Statement 30/17 ‘Pillar 2A capital requirements and disclosure’ and the latest Supervisory Review and Evaluation Process (SREP) the term ‘Individual Capital Guidance (ICG)’ was discontinued, and the term ‘Total Capital Requirement (TCR)’ introduced to refer to the sum of Pillar 1 plus Pillar 2A capital requirements. TCR is compared with the Bank’s self assessment for capital requirements (ICAAP).

The PRA expects the TCR to be met with at least 56% CET1 capital, no more than 44% AT 1 capital and no more than 25% Tier 2 capital. The Bank strictly follows this requirement and the TCR is fully met with CET1.

Risk Based Capital Requirements

The CRD IV capital requirements for the Bank are calculated and disclosed in accordance with the risk based approaches described in the table below.

Table 5: Risk Based Capital Requirements

Risk Type	Approach
Credit Risk	Standardised Approach (SA)
Counterparty Credit Risk	Standardised Approach (SA)
Market Risk	Standardised Approach (SA)
Operational Risk	Basic Indicator Approach (BIA)
Credit Valuation Adjustment	Standardised Approach (SA)

Further details on the approaches per risk type approved by regulators are provided in the relevant sections.

Overview of RWA

The RWA overview was brought into disclosures by the Basel Committee in January 2015. Minimum capital requirements are calculated as 8% of the RWAs. A further breakdown and comparison of the RWA and minimal capital requirements are illustrated in the table below.

Table 6: Overview of RWA

£000

	RWA		Minimum Capital requirements
	2018	2017	2018
Credit risk (excluding counterparty credit risk)	754,002	757,906	60,320
Of which: standardised approach (SA)	754,002	757,906	60,320
Of which: foundation internal ratings-based (F-IRB) approach	-	-	-
Of which: supervisory slotting approach	-	-	-
Of which: advanced internal ratings-based (A-IRB) approach	-	-	-
Counterparty credit risk (CCR)	-	-	-
Of which: standardised approach for counterparty credit risk	-	-	-
Of which: Internal Model Method (IMM)	-	-	-
Of which: other CCR	-	-	-
Credit valuation adjustment (CVA)	2,757	2,526	221
Equity positions under the simple risk weight 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 exposures in banking book	-	-	-
Market risk	8,927	9,694	714
Of which: standardised approach (SA)	8,927	9,694	714
Of which: internal model approaches (IMA)	-	-	-
Capital charge for switch between trading book and banking book	-	-	-
Operational risk	175,366	161,079	14,029
Amounts below the thresholds for deduction (subject to 250% RW)	-	-	-
Floor adjustment	-	-	-
Total	941,052	931,205	75,284

Liquidity Risk Management

Liquidity risk refers to the risk of the inability to meet payment obligations when they become due. The Bank has adopted a medium-low risk appetite which is fully reflected in the conditions set within its own stress scenarios, aligned to the Bank's business profiles and the prescribed stresses set by the PRA.

Governance

The liquidity risk control, monitoring and processes are controlled by Treasury team within the Global Financial Markets Department, which is mandated by ALCO to manage liquidity risk in the Bank.

The liquidity risk related governance and policies are discussed and reviewed at ALCO at least annually, more frequently should any member of the Board request, which are then submitted to BRC and the Board for approval. The discussion and review ensure the liquidity risk governance and management are up to date and still appropriate for the Bank's current and projected business and economic environment.

The Board takes ultimate responsibility for the liquidity risk management of the Bank. It delegates the responsibility of developing and implementing policies and procedures for managing liquidity risk to the EMC, who in turn assign part of the responsibilities to ALCO.

EMC/ALCO ensures that the decision of the Board as the governing body are monitored and well integrated into the Bank's risk management process.

The policies and procedures related to liquidity risk are defined and formalised in the form of Liquidity Policy, Liquidity Risk Pricing Policy, Liquidity Stress Testing Policy and Recovery Plan, which have been effectively communicated throughout the Bank via ALCO.

Stress Testing

In line with the PRA's liquidity rules, the Bank produces an annual Internal Liquidity Adequacy Assessment Process (ILAAP) document to assess the adequacy of its liquidity risk management practices. The ILAAP also complies with the EBA guidelines on common procedures and methodologies for the SREP and aligns with the further guidance provided by the PRA.

In addition, the Bank regularly updates the Recovery Plan and Resolution Pack, which details the actions to take in the event of a liquidity stress that is regularly tested to ensure it is appropriate and adoptable.

Monitoring

The Bank uses EWIs, which are monitored on a daily/monthly/quarterly basis to ensure that minimum regulatory liquidity requirements are not likely to be breached. In addition, the Bank Risk Appetite Statement metrics are reviewed at least annually.

In the event that a particular concern needs to be escalated to Senior Management, the prominence of the metric is considered together with the time available to the Bank to remediate the issue. Serious liquidity issues are escalated to EMC and ALCO which can operate under its contingency management terms of reference if deemed necessary. This allows the Bank to select the most appropriate management action to remediate the issue.

If a particular action fails to have the desired impact, further escalation to the BRC and ultimately to the Board will take place where, increasingly severe actions can be selected and actioned. This process is subject to annual review and approval by the Board.

Liquidity Coverage Ratio (LCR)

Since the formal introduction of the LCR as a minimum regulatory requirement in October 2015, the Bank has assigned the daily measurement, monitoring and reporting as a formal function within the FMD.

The CFO has taken direct responsibility for ensuring that the relevant Articles of the EC Delegated Act 2015/61 (Delegated Act) to supplement Regulation EU 575/2013 have been interpreted and the requirements formalised into policy and procedure.

The LCR is measured, monitored and reported daily. The Bank met the LCR regulatory and internal limits at all times during 2018. At 31 December 2018, the average LCR (see table 7) closed at 232%.

The table on the next page shows the 12-month average of the liquidity buffer, net cash outflow and LCR as at the end of each quarterly period. The Bank has consistently maintained sufficient counterbalancing capacity for the running of its operations.

Table 7: Liquidity Coverage Ratio (LCR)

£000	Total unweighted value (average)	Total weighted value (average)
	2018	2018
High-quality liquid assets		
Total HQLA		381,928
Cash outflows		
Retail deposits and deposits from small business customers, of which:	706,015	73,987
Unsecured wholesale funding, of which:	412,381	175,552
Operational deposits (all counterparties) and deposits in networks of cooperative banks	-	-
Non-operational deposits (all counterparties)	412,381	175,552
Unsecured debt	-	-
Secured wholesale funding		-
Additional requirements, of which: Outflows related to derivative exposures and other collateral requirements	1,072	1,072
Other contractual funding obligations	259,722	25,625
Other contingent funding obligations	6,127	1,979
TOTAL CASH OUTFLOWS		278,215
Cash inflows		
Inflows from fully performing exposures	117,891	113,755
TOTAL CASH INFLOWS	117,891	113,755
		Total adjusted value
Total HQLA		381,928
Total net cash outflows		164,460
Liquidity Coverage Ratio (%)		232%

Reconciliation between IFRS and Regulatory Balance Sheets

The IFRS balance sheet scope is identical to that with regulatory scope in 2018, therefore there are no reconciliation differences. For further information see Financial Statements (FS) 2018.

Table 8: Reconciliation between IFRS and Regulatory balance sheets

£000	Note in FS	2018	2017
Assets			
Cash on hand	16	1,931	-
Cash balances with the central bank	16	277,907	-
Other demand deposits	16	53,437	-
Cash and cash equivalents	16	-	281,944
Loans and advances to banks	18	61,391	83,706
Loans and advances to customers	19	1,044,570	1,054,454
Derivative financial instruments	17	1,344	1,717
Prepayments, accrued income and other assets	25	6,273	5,204
Financial assets at fair value through profit and loss	21(a)	76,171	-
Debt instruments at amortised cost	21(b)	103,189	-
Available for sale financial investments	21(a)	-	12
Held to maturity financial investments	21(b)	-	107,478
Deferred tax assets	24	1,546	1,462
Property, plant and equipment	22	2,761	3,149
Intangible assets	23	462	95
Investment in subsidiary companies	32	-	-
Total assets		1,630,982	1,539,221
Liabilities			
Deposits from banks	26	102,919	123,122
Deposits from customers	27	1,107,439	1,019,007
Derivative financial instruments	17	1,977	257
Other liabilities	29	21,359	20,158
Accruals and deferred income	30	6,207	4,176
Current corporation tax liabilities		4,908	5,447
Impairment provision on off balance sheet products		97	-
Subordinated liabilities	28	60,000	60,000
Total liabilities		1,304,906	1,232,167
Equity			
	31		
Authorised and called up share capital		250,000	250,000
Retained earnings		76,076	57,022
Available for sale reserve		-	32
Total shareholders' equity		326,076	307,054
Total shareholders' equity and liabilities		1,630,982	1,539,221

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 management and controls also depend on increase of the professional personnel for key products, to proactively adjust credit portfolios to achieve more effective portfolio risk management through industry, country and other quota allocation mechanism.

The Bank manages credit risk through:

- maintaining a strong culture of responsible risk taking and a robust risk policy and control framework;
- identifying, assessing and measuring credit risk clearly and accurately across the Bank, from the level of individual facilities up to the total portfolio;
- defining, implementing and re-evaluating its risk appetite under actual and stress conditions;
- monitoring credit risk relative to limits;
- ensuring that there is expert scrutiny and independent approval of credit risks and their mitigation.

Credit Risk Exposure and Capital Requirement

The standardised approach is applied for credit risk. 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 9: Gross exposures Capital requirement by exposure class

£000	2018			
	Asset Class	Year End Exposure	RWA	Capital Requirement
	Central Governments or central banks	382,249	-	-
	Corporate	455,823	447,597	35,808
	Institutions	9,331	1,866	149
	Other items	9,548	10,084	807
	Past due items	1,898	2,847	228
	Retail	1,251	862	69
	Secured by mortgages of immovable properties	773,489	271,030	21,682
	Short term claims on institutions and corporate	95,555	19,716	1,577
	Total	1,729,145	754,002	60,320

£000	2017			
	Asset Class	Year End Exposure	RWA	Capital Requirement
	Central Governments or central banks	337,882	-	-
	Corporate	508,043	497,628	39,810
	Institutions	2,415	483	39
	Other items	13,887	13,401	1,072
	Past due items	2,478	3,716	297
	Retail	873	613	49
	Secured by mortgages of immovable properties	674,350	236,310	18,905
	Short term claims on institutions and corporate	23,268	5,755	460
	Total	1,563,196	757,906	60,632

As at 31 December 2018, the credit risk exposures of the Bank before credit risk mitigation were predominantly to central governments and central banks, corporates and mortgages, as shown in the table above.

The past due items are related to residential mortgages and credit cards. The other items on the asset class mainly relates to prepayments, accrued income and other assets.

Concentration risk

The Bank actively aims to prevent undue concentration by ensuring a diversified credit portfolio. Single customer, industry, geography and maturity specific concentrations are actively assessed and managed against risk appetite limits.

Geographic Region

In general, credit risk exposures in the UK take the largest part of total exposure.

Table 10: Geographic distribution by exposure class

2018 - £000

Geographical Regions	UK	Other EU Countries	North America	Rest of the World	Total
Asset classes					
Central Governments or central banks	382,249	-	-	-	382,249
Corporate	198,399	39,068	37,497	180,859	455,823
Institutions	-	-	-	9,331	9,331
Other items	9,062	-	486	-	9,549
Past due items	1,400	-	-	498	1,898
Retail	1,131	-	0	121	1,252
Secured by mortgages of immovable properties	247,718	4,902	1,533	519,336	773,489
Short term claims on institutions and corporate	18,413	30	203	76,909	95,555
Total	858,372	44,000	39,719	787,054	1,729,145

2017 - £000

Geographical Regions	UK	Other EU Countries	North America	Rest of the World	Total
Asset classes					
Central Governments or central banks	337,882	-	-	-	337,882
Corporate	262,343	54,672	66,422	124,606	508,043
Institutions	-	-	-	2,415	2,415
Other items	13,887	-	-	-	13,887
Past due items	1,796	-	-	682	2,478
Retail	775	1	10	87	873
Secured by mortgages of immovable properties	258,395	5,241	1,009	409,705	674,350
Short term claims on institutions and corporate	19,045	31	629	3,563	23,268
Total	894,123	59,945	68,070	541,058	1,563,196

The geographic distribution of “Secured by mortgages on residential property” follows the Capital Requirement Regulation “the risk of the borrower shall not materially depend on upon the performance of the underlying property, but on the underlying capacity of the borrower”.

Industry

A breakdown of exposures by industry is shown below.

Table 11: Industry distribution by exposure class

£000

Asset classes and Industries	2018	2017
Central Governments or central banks	382,249	337,882
Financial industry (bank and non-bank)	382,249	337,882
Corporate	455,824	508,042
Financial industry (bank and non-bank)	14,059	23,764
Manufacturing	79,336	137,307
Mining and quarrying	-	289
Real estate (commercial)	81,615	106,312
Services and other	53,663	50,939
Transport, storage and utilities	211,381	172,017
Wholesale and retail trade	15,770	17,414
Institutions	9,331	2,415
Financial industry (bank and non-bank)	9,331	2,415
Other items	9,548	13,888
Financial industry (bank and non-bank)	528	-
Services and other	8,534	13,888
Transport, storage and utilities	486	-
Past due items	1,898	2,478
Retail	1,898	2,478
Retail	1,251	873
Retail	928	638
Services and other	323	235
Secured by mortgages of immovable properties	773,489	674,350
Mortgages	773,489	674,350
Short term claims on institutions and corporate	95,555	23,268
Financial industry (bank and non-bank)	95,555	23,268
Total	1,729,145	1,563,196

As at 31 December 2018, “Mortgages” accounts for 45% of the total portfolio.

Maturity

Table 12: Residual maturity distribution by exposure class

2018 - £'000

Exposure Class	Up to 12 months	1-5 years	More than 5 years	Total
Central governments or central banks	-	382,249	-	382,249
Corporate	54,225	308,080	93,519	455,824
Institutions	4,199	5,132	-	9,331
Other items	9,548	-	-	9,548
Past due items	614	-	1,284	1,898
Retail	1,251	-	-	1,251
Secured by mortgages of immovable properties	4	7,227	766,258	773,489
Short term claims on institutions and corporate	95,555	-	-	95,555
Total	165,396	702,688	861,061	1,729,145

2017 - £'000

Exposure Class	Up to 12 months	1-5 years	More than 5 years	Total
Central governments or central banks	-	337,882	-	337,882
Corporate	45,260	370,995	91,787	508,042
Institutions	2,415	-	-	2,415
Other items	13,888	-	-	13,888
Past due items	2,478	-	-	2,478
Retail	855	0	18	873
Secured by mortgages of immovable properties	58	6,039	668,253	674,350
Short term claims on institutions and corporate	23,268	-	-	23,268
Total	88,222	714,916	760,058	1,563,196

Key changes:

- The exposure up to 12 months increased by £77M due to new short term claims on institutions and corporate.
- The long-term exposure is 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 defines non-performing loan as an instalment on the whole or a part of the loan which is not received more than 90 days of the instalment.

Provisioning for Loans and Advances

Prior to 2018 the Bank identify impairment through a list of prescribed credit events of the borrower. The impairment loss refers to the difference between the carrying value of the loan and the present value of estimated future cash flow.

From 1 January 2018 in accordance with IFRS9, the Bank has been recording the allowance for expected credit losses for all loans and other debt financial assets not held at fair value through profit or loss (FVPL), together with loan commitments and financial guarantee contracts, in this section all referred to as ‘financial instruments’. Equity instruments are not subject to impairment under IFRS 9. For further information please see the Financial Statements Note 6. Comparing Table 14 to the Financial Statements, there is a difference in categorisation and the rationale relates to the geographical location of the ‘asset’ against the geographical location of the ‘borrower’.

Table 13: Analysis of past due, impaired and provision to loans and advances by industry

2018 - £000

Industry Distribution	Past Due but not impaired	Of which Non-Performing	Provision
Agriculture, forestry and fishing	-	-	-
Construction	-	-	-
Financial industry (bank and non-bank)	-	-	39
Manufacturing	-	-	57
Mining and quarrying	-	-	-
Real estate (commercial)	-	-	45
Retail	29,960	680	644
Services and other	-	-	12
Transport, storage and utilities	-	-	118
Wholesale and retail trade	-	-	5
Total	29,960	680	920

2017 - £000

Industry Distribution	Past Due but not impaired	Of which Non-Performing	Provision
Agriculture, forestry and fishing	-	-	-
Construction	-	-	-
Financial industry (bank and non-bank)	-	-	77
Manufacturing	-	-	61
Mining and quarrying	-	-	-
Real estate (commercial)	-	-	49
Retail	13,077	463	396
Services and other	-	-	22
Transport, storage and utilities	-	-	76
Wholesale and retail trade	-	-	8
Total	13,077	463	689

Table 14: Analysis of past due, impaired and provision by geographical region

2018 - £000

Geographic Distribution	Past Due but not impaired	Of which Non-Performing	Provision	Provision (Retail Transfers)	Provision (As per FS)
North America	-	-	17	4	13
Other EU Countries	-	-	26	(10)	36
Rest of the World	-	-	598	526	72
UK	29,960	680	279	124	155
Total	29,960	680	920	644	276

2017 - £000

Geographic Distribution	Past Due but not impaired	Of which Non-Performing	Provision
North America	-	-	30
Other EU Countries	-	-	26
Rest of the World	-	-	238
UK	13,077	463	394
Total	13,077	463	689

- The impaired amount of £680,000 consisted of 3 residential mortgages which fell into non-performing category and some overdue credit cards.
- The provision amount increased due to the implementation of IFRS9 on 1 January 2018.

Credit Asset Quality

The tables below should be read in conjunction with Financial Statements for the year ended 31 December 2018.

Table 15: Credit quality of assets

£000	Gross carrying values of		Allowances/ impairments	Net values
2018	Non-performing exposures	Performing exposures		
Loans	680	1,106,104	(823)	1,105,961
Debt Securities	-	103,189	-	103,189
Off-balance sheet exposures	-	252,768	(97)	252,671
Total	680	1,462,061	(920)	1,461,821

£000	Gross carrying values of		Allowances/ impairments	Net values
2017	Non-performing exposures	Performing Exposures		
Loans	463	1,138,386	(689)	1,138,160
Debt Securities	-	107,478	-	107,478
Off-balance sheet exposures	-	291,616	-	291,616
Total	463	1,537,480	(689)	1,537,254

Table 16: Changes of non-performing loans and debt securities

	£'000
Non-performing loans and debt securities at 31/12/2017	463
Newly non-performing loans and debt securities since the last reporting period	442
Returned to performing status	(212)
Amounts written off	-
Other changes	(13)
Non-performing loans and debt securities at 31/12/2018	680

Other changes relates to customer still under non-performing which made some repayment.

The non-performing exposures relates to mortgages and credit cards only. There was no default arising from loans or debt securities.

Credit Quality Step (CQS) Analysis

In the assessment of credit risk under Standardised Approach, the Bank uses ratings assigned by two of the recognised External Credit Assessment Institutions (ECAI) to calculate RWA.

If only one rating is available from one of the Bank's designated ECAIs for a rated exposure, this rating is used to determine the risk weight of that exposure.

If there are two ratings available for a rated exposure from the Bank's designated ECAIs and they result in differing risk weights, the higher risk weight is assigned.

Rated and unrated counterparties exposure under the standardised approach governing rule 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 table below shows that the gross exposure amount as at 31 December 2018 subject to the use of ECAIs was £796.6m. The exposures include both on and off-balance sheet items. In the case of off-balance sheet exposures, the Bank applies a Credit Conversion Factor ('CCF') as prescribed under CRD IV.

Table 17: Exposure amounts subjected to the use of ECAIs**2018 - £000**

Exposure Class	Gross Exposure
Central governments or central banks	382,256
Corporate	269,559
Institutions	28,778
Other items	-
Past due items	-
Retail	-
Secured by mortgages of immovable properties	-
Short term claims on institutions and corporate	115,995
Total	796,588

The table below shows exposures after credit risk mitigation ('CRM'). As at 31 December 2018, 98% of assets were risk-weighted under CQS 1 to 3 which represent investment grades AAA to BBB- (S&P equivalent rating).

Approximately 58% of the Bank's assets, mainly mortgages and some corporates exposures, are not externally-rated but all assets are internally-rated and assessed. The Bank considers the asset quality of its unrated counterparties to be good on the basis of their financial standing, credit profiles and low probability of default underpinned by well-structured credit and an identified source of repayment.

Table 18: Credit exposures by CQS**2018 - £000**

CQS	Gross Exposure	Exposure after CRM
1	496,928	475,889
2	58,556	24,110
3	231,029	164,348
4	10,075	10,075
Total	796,588	674,422

*There are no exposures under CQS 5 and 6.

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 19: Credit exposures by asset classes and risk weights

2018 - £000

Risk weight	0%	20%	35%	50%	75%	100%	150%	250%	Total credit exposures amount (post CCF and post-CRM)
Asset classes									
Central Governments or central banks	382,249	-	-	-	-	-	-	-	382,249
Corporate	-	-	-	14,125	-	441,699	-	-	455,824
Institutions	-	9,331	-	-	-	-	-	-	9,331
Other items	1,946	-	-	-	-	5,947	-	1,655	9,548
Past due items	-	-	-	-	-	-	1,898	-	1,898
Retail	-	-	-	-	1,251	-	-	-	1,251
Secured by mortgages of immovable properties	-	-	765,044	8,197	248	-	-	-	773,489
Short term claims on institutions and corporate	-	93,537	-	2,018	-	-	-	-	95,555
Total	384,195	102,868	765,044	24,340	1,499	447,646	1,898	1,655	1,729,145

2017 - £000

Risk weight	0%	20%	35%	50%	75%	100%	150%	250%	Total credit exposures amount (post CCF and post-CRM)
Asset classes									
Central Governments or central banks	337,882	-	-	-	-	-	-	-	337,882
Corporate	-	-	-	18,411	-	489,631	-	-	508,042
Institutions	-	2,415	-	-	-	-	-	-	2,415
Other items	1,330	-	-	-	-	11,996	-	562	13,888
Past due items	-	-	-	-	-	-	2,478	-	2,478
Retail	-	-	-	-	873	-	-	-	873
Secured by mortgages of immovable properties	-	-	665,066	9,284	-	-	-	-	674,350
Short term claims on institutions and corporate	-	19,597	-	3,671	-	-	-	-	23,268
Total	339,212	22,012	665,066	31,366	873	501,627	2,478	562	1,563,196

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 always taken to secure claims.
- Financial guarantee: for some corporate lending, financial guarantees such as standby letter of credit are taken to cover unforeseen risks.

The table below demonstrates the extent of use of CRM techniques on credit exposures.

Table 20: Credit exposure overview of CRM

2018 - £'000	Exposures unsecured: carrying amount	Exposures secured by collateral	Exposures secured by financial guarantees	Exposures secured by credit derivatives
Loans	329,758	773,754	2,449	-
Debt securities	103,189	-	-	-
Total	432,947	773,754	2,449	-
Of which non-performing	-	680	-	-

2017 - £'000	Exposures unsecured: carrying amount	Exposures secured by collateral	Exposures secured by financial guarantees	Exposures secured by credit derivatives
Loans	428,064	676,548	33,548	-
Debt securities	107,478	-	-	-
Total	535,542	676,548	33,548	-
Of which non-performing	-	463	-	-

- The exposures of £773,754,000 are to mortgages, fully secured by first charge over residential and commercial properties.
- The exposures of £2,449,000 consisted of 1 bilateral loan which was 100% guaranteed by standby letter of credit.
- The non-performing exposure of £680,000 relates to 3 mortgages.
- The non-performing exposure of credit card is not considered here.

The effect of CRM on Standardised Approach capital requirements' calculations is illustrated in the table below. 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

2018 - £000	Exposures before CCF and CRM		Exposure post CCF and CRM		RWA and RWA density	
Asset classes	On-balance sheet amount	Off-balance sheet amount	On-balance sheet amount	Off-balance sheet amount	RWA	RWA density
Central governments or central banks	382,256	-	382,249	-	-	0%
Corporate	346,977	220,810	346,768	109,056	447,597	98%
Institutions	-	35,078	-	9,331	1,866	20%
Other items	7,894	-	7,894	-	5,947	75%
High-risk categories	3,597	-	3,553	-	6,984	197%
Retail	1,266	4,982	1,252	-	862	69%
Secured by mortgages of immovable properties	773,680	1,792	773,131	358	271,030	35%
Short term claims on institutions and corporate	114,836	1,159	94,396	1,159	19,716	21%
Total	1,630,506	263,821	1,609,243	119,904	754,002	44%

2017 - £000	Exposures before CCF and CRM		Exposure post CCF and CRM		RWA and RWA density	
Asset classes	On-balance sheet amount	Off-balance sheet amount	On-balance sheet amount	Off-balance sheet amount	RWA	RWA density
Central governments or central banks	337,882	-	337,882	-	-	0%
Corporate	380,279	273,119	380,279	127,763	497,628	98%
Institutions	-	2,506	-	2,415	483	20%
Other items	13,326	-	13,326	-	11,996	90%
High-risk categories	3,040	-	3,040	-	5,121	168%
Retail	873	4,756	873	-	613	70%
Secured by mortgages of immovable properties	673,789	2,805	673,789	561	236,310	35%
Short term claims on institutions and corporate	133,901	61	23,207	61	5,755	25%
Total	1,543,090	283,247	1,432,396	130,800	757,906	48%

Higher-risk categories refer to assets with risk weight at 150% or higher reflecting higher risks associated with RWA density of 197% (2017: 168%). As required by the Basel Framework, the Bank discloses the higher-risk categories that are not in other regulatory portfolios. As indicated in the above table, all the exposures on past due items (£1.9M) are included in higher-risk category (£3.5M).

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 uses Murex system for CCR measurement purpose.

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.

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 swaps (CDS) or total return swaps (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.

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 SA for measuring CCR exposure at default (EAD) was introduced by Basel III in March 2015 to replace Current Exposure Method and Standardised Method. The Standardised Approach was 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 replacement cost (RC) and the potential future exposure (PFE) to calculate the EAD³. 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 single netting set within which partial or full offsetting is recognised.

Under CRR, the Bank applies a 0% risk weight to intragroup transactions. Intragroup transactions have been taken into account when calculating the total risk exposure for CVA (See next section).

³ Mathematically: SA-CCR EAD= α * (RC+PFE), $\alpha=1.4$, which is set by the Basel Committee.

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 2015, which incorporates the key drivers of the CVA risk weight, effective maturity and discounted EAD. The CVA risk weight 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 factor⁴.

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

Table 22: CVA capital charge

2018	EAD post-CRM (£'000)	RWA
Total portfolios subject to the Advanced CVA capital charge	-	-
(i) VaR component (including the 3x multiplier)		-
(ii) Stressed VaR component (including the 3x multiplier)		-
All portfolios subject to the Standardised CVA capital charge	4,099	2,757
Total subject to the CVA capital charge	4,099	2,757

⁴ Discounting factor is defined as $[1 - \exp(-0.05 * M)] / (0.05 * M)$, M is the effective maturity.

7. 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 are 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 Key Risk Indicators (KRIs) for the purpose of monitoring, reporting and managing the market risk in the book.

Table 23: Market risk capital requirement under Standardised Approach

2018 - £'000	Capital requirement
General interest rate risk	-
Equity risk	-
Commodity risk	-
Foreign exchange risk	714
Credit spread risk - non-securitisations	-
Credit spread risk - securitisations (non-correlation trading portfolio)	-
Credit spread risk - securitisations (correlation trading portfolio)	-
Default risk - non-securitisations	-
Default risk - securitisations (non-correlation trading portfolio)	-
Default risk - securitisations (correlation trading portfolio)	-
Residual risk add-on	-
Total	714

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 24: Foreign exchange position

£000	2018	2017
US Dollar	1,059	885
Euro	(966)	290
CNY	(132)	(415)
AUD	(173)	682
Other	129	41

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 re-pricing 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 in the near term earnings perspective and the long term earnings perspective. 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 Ratio⁵. 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 25: IRRBB1- Impact of 100 bps parallel shift on interest risk

£000	ΔEVE		ΔNII	
	2018	2017	2018	2017
Parallel up (+100bp)	(721)	(2,229)	2,808	1,928
Parallel down (-100bp)	721	2,229	(2,808)	(1,928)

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.

⁵ An instrument that measures the maximum level of adverse variation of net interest income affected by a specified interest rate change on the book.

8. Operational Risk

Operational risk is defined as risk of loss resulting from inadequate or failed internal processes, people and systems, or from external causes, where deliberate, accidental or natural. 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 and impact of operational risk to be in line with the risk appetite.

The Operational Risk comprises the following key risks: fraud, transaction operations, people, premises, systems 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 uses the BIA to calculate the operational risk capital requirement, which is 15% of the average annual gross income over the previous three years. The losses, stress testing scenarios and effective controls are taken into consideration when calculating capital. The Bank accumulates loss data to build the foundation for more advanced approach.

Table 26: Operational risk capital requirement using BIA

£000	RWA		Minimum Capital requirements
	2018	2017	2018
Operational risk	175,366	161,079	14,029

Operational Risk Management

The Bank established an efficient operational risk framework to identify, assess, control and mitigate operational risk. The Operational Risk Committee (ORC) was set up to monitor and review operational risk activities. The committee meets quarterly and reports 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 regularly collected and reported on a R.A.G flag basis (Red – Amber – Green results).
- 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 periodically from all departments irrespective of the amount. The Bank records all losses actual, potential or near miss. Operational Risk team then conducts critical events analysis and recommend actions plan in agreement with the correspondent department. The summary of Operational Risk Loss Event is reported to the Senior Management, ORC and BRC.
- Control Affirmation Process: a 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 and risk managers to identify potential operational risk events and assess the potential outcomes. 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.
- The Bank uses Group Operational Risk Monitoring & Analysis Platform (ORMIS) for risk reporting and monitoring purposes.

9. Remuneration

In alignment with the Capital Requirements Regulation remuneration disclosure requirements, the FCA's General Guidance on Proportionality: The Remuneration Code (the Code) (SYSC 19) and the PRA's LSS8/13, "Remuneration Standards: the Application of Proportionality", the Bank has been classified as a proportionality Level Two firm.

The following constitutes the Bank'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 2018.

Remuneration Committee - Governance

The Remuneration Committee ('RemCo') of the Bank is responsible for the implementation of effective remuneration governance and related risk management practices. The RemCo met quarterly throughout 2018 and its primary purpose is to:

- Review local Executive Directors' remuneration to ensure alignment with external/internal salary bandings prior to submitting to the Board for review and Head office for approval.
- Review expatriate Executive Directors' remuneration aligned to appropriate external/internal salary bandings for the role being fulfilled.
- Review the variable pay allocations of certified staff and identified Material Risk Takers or employees who could be involved in a material failure of risk or compliance management
- Set the principles and parameters of the Remuneration Policy.
- Undertake annual independent review of the Remuneration Policy and framework.
- Review and approve people related policies regarding recruitment, learning and development, assessment and performance appraisal.

The Terms of Reference of the RemCo were last reviewed and updated in June 2018.

The Board Remuneration Committee has oversight for People Risk which can simply be defined as being the risk that people do not follow the Bank's procedures, practices and/or rules, thus deviating from expected behaviour in a way that could potentially harm the business's performance and reputation.

The Bank has a strong organisational culture and a clear and developed governance structure that, in conjunction with required policies, procedures and processes, supports the management of people risk accordingly.

In addition, there is organisational alignment in relation to values, behaviours and purpose ensuring the Bank's employees are culturally and directionally aligned.

Composition of the Remuneration Committee

The RemCo comprises five members, being:

- Dr Gerard Lyons – Independent Non Executive Director, Chairman of the RemCo;
- Mr Charles Hardy – Independent Non Executive Director;
- Mr Wenjian Fang – CEO and Director;
- Ms Tracey Rutherford – Head of Human Resources; and
- Ms Wen Liu – Deputy Head of Human Resources.

Role of Relevant Stakeholders

The RemCo is supported by the Bank's BRC on risk related matters including the specific measures and wider issues relating to risk and business protection and also by the 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 the FCA Remuneration Code, from Ernst & Young regarding application of EBA Regulatory Technical Standards (RTS) and Material Risk Takers and from McLagan (part of Aon plc) in relation to remuneration benchmarking including market practice and peer group methodology.

Remuneration Policy

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

The policy recognises and supports the fact that appropriate levels of remuneration and compensation are necessary to attract, retain and motivate high calibre staff required to lead, manage and serve the Bank in a competitive financial services environment whilst complying with all relevant regulatory requirements.

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.

In addition, the policy operates in conjunction with the Bank's business goals and its other HR policies. It is compliant with the provisions of the Equality Act 2010 and ensures that remuneration practices are fair and consistent with the Bank's view on equality and diversity.

Remuneration Framework

The composition of remuneration and benefits comprise:

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

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

The RemCo 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 first quarter annually to align to annual remuneration reviews.

Independent Non Executive Directors do not participate in variable pay arrangements.

Link between Pay and Performance

The Bank's remuneration policies are designed to allow the Bank 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 are 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.

Application of Material Risk Takers

The Remuneration Code requires that banks identify relevant staff who could be determined at Material Risk Takers; the Bank currently considers the following categories of staff to be material risk takers

- 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 General Manager responsible for significant business lines;
- Staff engaged in control functions;
- 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 in relation to remuneration that RTS (qualitative and quantitative) 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.

Annual Discretionary Bonus Award for Material Risk Takers

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 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.

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 in alignment with regulatory requirements. The deferral of variable remuneration applies to defined material risk takers only who fall outside of the current "de minimis" rules.

The Bank's Remuneration Policy does not allow for vesting of variable remuneration deferral elements as all variable remuneration is paid in cash

The Bank did not pay any guaranteed bonuses or sign on awards during the 2018 financial year.

Remuneration Awarded

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) and this requirement is included in the Bank's Remuneration Policy.

Table 27: Variable remuneration awarded

	31 Dec 2018
Number of staff receiving variable remuneration award	420
Total fixed pay (£)	24,527,903
Total variable pay (including discretionary bonus award, allowances and overtime) (£)	9,664,071
Total deferred remuneration paid out (£)	599,519
Total non deferred variable remuneration paid out (£)	7,657,186
Total outstanding deferred remuneration (to be paid 2020 -2026) (£)	1,106,403
Total severance payments made	N/A
Total Remuneration (£)	43,575,152
Variable pay/fixed pay ratio	39%

Table 28: Analysis of remuneration amount between fixed and variable pay for code staff

31 Dec 2018 (£)	Management Body	Senior Managers	Others	Total
Number of Code Staff	12	20	53	85
Fixed Pay	2,172,284	2,432,741	4,390,617	8,995,642
Variable Pay	885,347	944,189	1,602,600	3,432,137

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

The Bank did not pay any severance payments in 2018. There is no staff at the Bank who was paid over £893K (equivalent to €1M⁶). The highest paid Director was paid £366K (equivalent to €409K) in 2018.

⁶ Converted to Euros using the exchange rate at 31 December 2018. £1=€1.119493



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