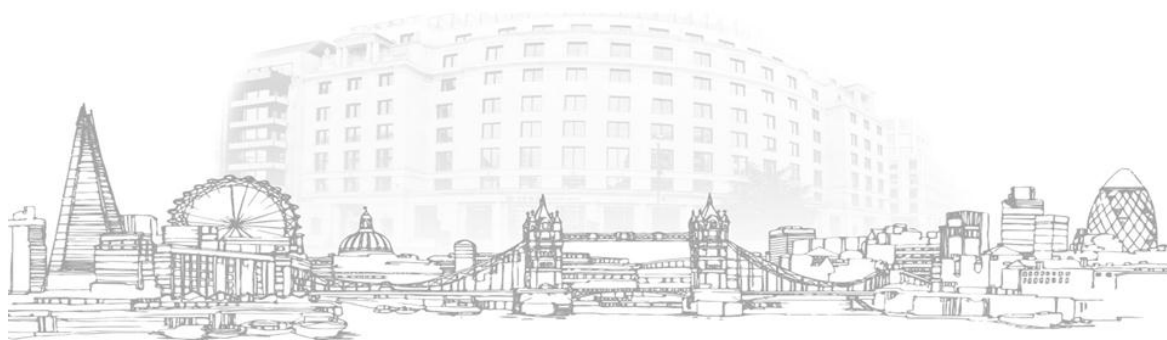




Pillar 3 Disclosures

31 December 2020



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PILLAR 3

Table 1: Key metrics

		2020	2019
Available capital (£'000)			
1	Common equity tier 1 capital (CET1)	307,058	274,958
2	Tier 1 capital	307,058	274,958
3	Total regulatory capital	367,058	334,958
Risk-weighted assets ('RWAs')			
4	Total risk-weighted assets (RWA)	1,151,516	988,901
Risk-based capital ratios as a percentage of RWA (%)			
5	Common Equity Tier 1 ratio	26.7	27.8
6	Tier 1 ratio	26.7	27.8
7	Total capital ratio	31.9	33.9
Additional CET1 buffer requirements as a percentage of RWA (%)			
8	Capital conservation buffer requirement	2.5	2.5
9	Countercyclical buffer requirement	0.1	0.4
10	Bank G-SIB and/or D-SIB additional requirements	0	0
11	Total of bank CET1 specific buffer requirements	2.6	2.9
12	CET1 available after meeting the bank's minimum capital requirements	22.2	23.3
Basel III leverage ratio			
13	Total Basel III leverage ratio exposure measure (£'000)	2,147,455	1,894,456
14	Basel III leverage ratio (%)	14.3	14.5
Liquidity Coverage Ratio			
15	Total HQLA	360,820	302,154
6	Total net cash outflow	148,715	139,559
17	LCR ratio (%)	243	217
Net Stable Funding Ratio			
18	Total available stable funding	1,429,700	1,263,428
19	Total required stable funding	884,460	797,680
	NSFR ratio (%)	162	158

1. INTRODUCTION

BACKGROUND

Bank of China UK Limited (the Bank or BOC UK) was incorporated as a private limited company on 29th March 2007, a wholly owned subsidiary of BOC Group ('the Group'). The Bank is regulated by the Prudential Regulation Authority ('PRA') and Financial Conduct Authority ('FCA') and is authorised by PRA as a full service credit institution offering retail, corporate and trade finance services in the UK since 24 September 2007. The Bank opened for business on 15 October 2007 with an authorised and paid up capital of £200 million of which £140million was core equity tier one capital and £60 million was subordinated debt. Subsequently an additional £110 million of tier one capital

was injected on 30 March 2012¹. The Bank now operates four branches located within the UK and one branch located outside of the UK in Dublin, Republic of Ireland.

The Group long-term strategic objective is to build Bank of China into a world-class bank in the new era. To survive the critical challenges unseen in a century, the Group has set out the short-term objective to stimulate vitality, make agile responses, and achieve breakthroughs in key areas. 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 2020².

For accounting purposes, the bank has availed itself of the exemption election from Section 401 of the Companies Act 2006 that permits an entity to prepare separate financial statements. (Referring to Note 2: Basis of Preparation in the Annual Report and Financial Statement 2020). Therefore this disclosure does not take into account any subsidiaries.

The Pillar 3 Disclosures 2020 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 2020. Explanations and notes are given where appropriate.

REGULATORY FRAMEWORK FOR DISCLOSURES

Pillar 3 rules apply to banks, building societies and investment banks. There are designed to promote market discipline through the disclosure of key information about risk exposures and risk management processes. CRD IV also make changes to rules on corporate governance, including remuneration, and introduced standardised regulatory reporting within the EU.

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'); and
- 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 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

¹ As evidence of strong support from BOC, the parent bank, the Bank's capital resources were increased to cover the cost of an impairment provision due to adverse market developments for the Bank's subsidiary, Bank of China (Suisse) S.A. ('BOCS') located in Geneva, and to provide additional capital resources for the Bank's future business development plans. The subsidiary was subsequently divested on 01 October 2012.

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

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>

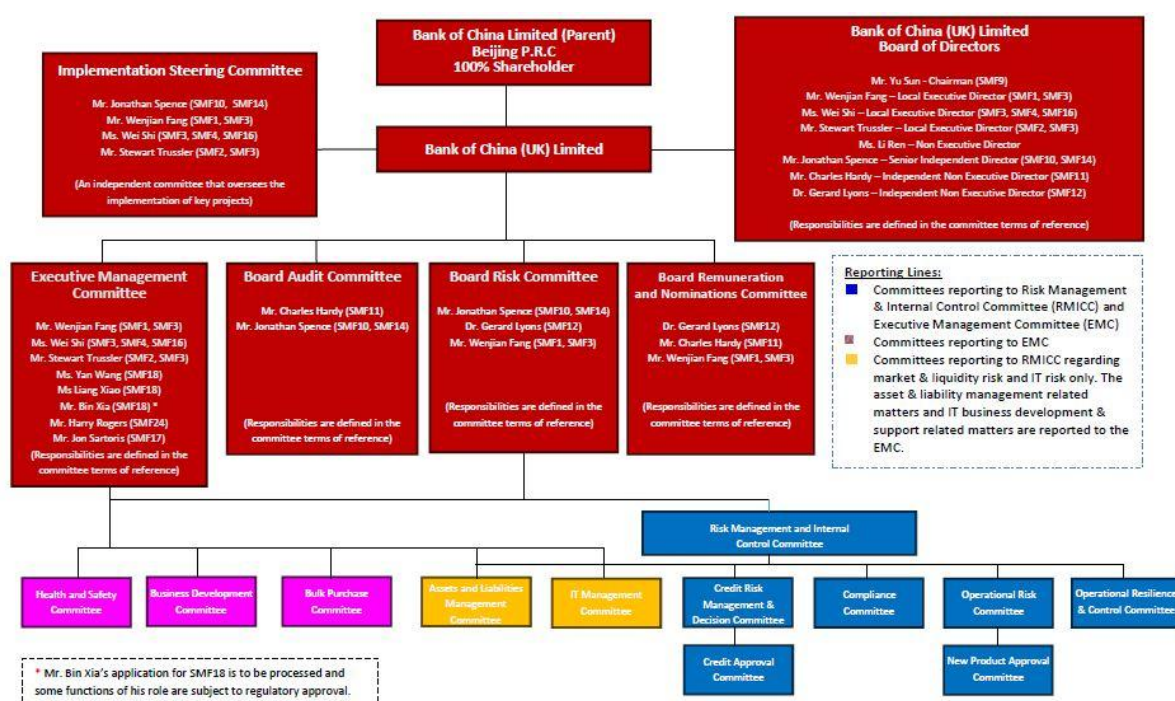
2. RISK MANAGEMENT OVERVIEW

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 has established a sound risk governance with a 3-tier Management structure to ensure that the risk profile are well within the parameters set by the Board. The Bank believes that this structure is commensurate with the size, complexity and diversity of the Bank's activities and facilitates effective oversight and efficient execution of risk management and control processes.

The Bank's committees monitor and challenge risk profile against risk appetite. Each committee within the governance structure is responsible for maintaining an appropriate risk and control environment. The reporting lines are clearly defined through the Committee level, Senior Management level and Board level.



Roles and Responsibilities

Board Level

The Board level comprises the Board of directors of the BOC UK and different board-level committees such as Implementation Steering Committee ('ISC'), Board Risk Committee ('BRC') and Board Audit Committee ('BAC').

The Board is responsible for establishing the Bank's overall strategy and approval of significant policies relating to the management of individual risk elements which the Bank is exposed to. The responsibilities of the Board include:

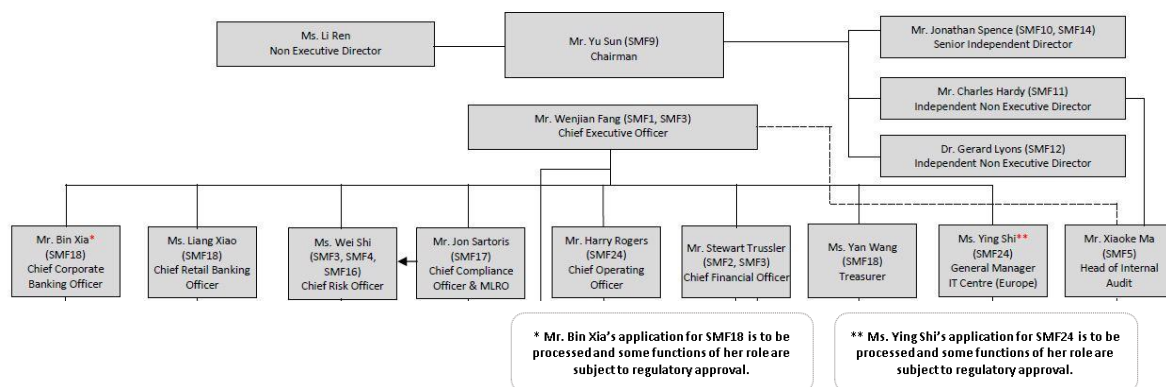
- Approving the Bank's risk appetite framework and risk appetite statement, ensuring annual business plans are in line with the approved risk appetite.
- Ensuring that the Bank maintains various risks at prudent levels.

- Ensuring that senior management as well as individuals responsible for managing individual risks possesses sound expertise and knowledge to accomplish the risk management function.
- Ensuring that the Bank implements sound fundamental principles that facilitate the identification, measurement, monitoring, escalation, reporting and control of all risks.
- Ensuring that appropriate strategies and measures for managing individual risk element are in place.

Board Risk Committee main responsibilities are to assist the Board with established and ongoing review of risk strategies, rules and policies, defining risk appetite, the bank-wide oversight of risk management performance, approval of non-standard credits and any credit above the limits delegated to the CEO. To keep the BRC independent, the Chairman of BRC is a non-executive director.

Board Audit Committee complements BRC in respect of risk management. The Board Audit Committee’s main responsibilities include assisting the Board in carrying out its responsibilities relating to internal control, accounting policies, financial reporting and compliance and provide to the Board assurance in respect of the effectiveness of these areas; approving the scope of internal audit reviews and risk management framework; assisting the EMC with financial reporting issues and keeping the accounting policies compliant with the law, best practice and ensuring the integrity of the financial statements.

Implementation Steering Committee (‘ISC’) is established for the purpose of overseeing the implementation of recommendations arising from recent external reviews, and of deciding whether or not to accept any proposals of the ISC Working Group as to the scope of implementation action required in relation to Recommendations, including whether any Recommendations do not require implementation. The ISC is chaired by the Senior Independent Non-Executive Director of the Subsidiary, who will also be authorised by London Branch regarding the implementation oversight of the reviews. Each of the other ISC members hold senior leadership positions in both Subsidiary and London Branch.



Senior Management Level

The Senior Management level includes the **Executive Management Committee (‘EMC’)** and different risk-focused committees at the executive and senior management level.

EMC is responsible for the overall monitoring of operations, approval of new products and services, new systems and procedures, as well as approval of expenditure budget and business budget. It is also ultimately responsible for the implementation of risk policies and procedures in line with the strategic

direction and risk appetite specified by the Board.

With the approval and full delegation from the EMC, the **Risk Management & Internal Control Committee** ('RMICC') was established in 2019 and is chaired by the CRO and is composed of all EMC members. RMICC provides central oversight of all key risk types in the Bank and receives regular risk updates from all specialized risk-related management committees. RMICC's responsibilities include:

- The development and implementation of procedures and practices that translate the Board's goals, objectives and risk tolerances and embed them into operating standards;
- Establishing lines of authority and responsibilities for managing individual risk elements in line with the Board's overall direction;
- Risk identification, measurement, monitoring and control procedures;
- Ensuring risk escalation and reporting procedures are implemented within the risk management structure;
- Establishing effective internal controls over each risk management process; and
- Establishing and approving appropriate risk limits. Ensuring that the Bank's risk policies, appetite and tolerance are well documented and clearly communicated throughout the Bank such that staff at all levels are responsible for identifying the Bank's declared priority of risk management by recognizing real and anticipated risks in their normal course of duty and taking appropriate action. This ensures that the Bank's risk management culture is sustained throughout the operations.

The following committees report to RMICC on relevant risk related matters:

Table 2 Committees report to RMICC on relevant risk related matters

Committee	Chair	Function
Credit Risk Management & Decision Committee ("CRDC")	CRO	It establishes and reviews the Bank's credit policies and related matters, including industry and country concentration limit, oversee and support the Credit Approval Committee, and make critical credit decision such as divestment as appropriate.
Operational Risk Committee ("ORC")	CRO	It is responsible for reviewing operational risk, monitoring framework and operational risk compliance. The committee also provides oversight of the Bank's conduct risk exposure, governance of material outsourcing and new product risk assessment.
Compliance Committee	CCO	It assists the EMC in fulfilling its oversight responsibilities for an effective and proactive legal and compliance framework within the Bank and the governance structure that supports it.
Operational Resilience & Control Committee ("ORCC")	COO	The committee oversees and support the effective control, management and reporting of the Bank's operational resilience, which includes but not limited to operational continuity and resilience of operations, system and technology.
Asset and Liability Committee ("ALCO")	CEO	It reports directly to the EMC, provides liquidity and market risk specific updates to the RMICC and also reports to the BRC as a subcommittee. The ALCO establishes and maintains asset and liability management policies and procedures and is responsible for ensuring the optimal allocation of financial resources. The committee also reviews and approves policies relating to market risk and liquidity management.
IT Management Committee ("ITMC")	GM of ITCE	It oversees and supports the implementation of an effective and proactive IT function and management practice within the Bank. The committee also oversees and supports IT risk management within the Bank, reporting to RMICC on such matter only.

Amongst above, Board related meetings, RMICC, CRDC, ORC, Compliance Committee and ORCC meet every quarter whereas EMC meets every week. ALCO is held monthly and additionally when

deemed necessary or as required by the Chair or Deputy Chair of the Committee. Credit Approval Committee meets as required in response to credit limit applications.

Department Level

This level is composed of the different risk-focused departments, which including but is not limited to Credit Management Department ('CMD'), Risk Management Department ('RMD'), Treasury (excl. Money Market Desk), Financial Management Department ('FMD'), Legal & Compliance Department ('L&C'), the Middle Office and Data & Process Management Office ('DPM') amongst others.. Internal Audit Department will act as an additional assurance.

THREE LINES OF DEFENCE MODEL

First Line - Business units and support functions

As the first line of defence for risk management, business units, which includes front office and various support functions, should implement the risk management policy and develop procedures for their operations and should take primary responsibilities for identifying and assessing risk, establishing appropriate controls to manage the risk, monitoring risk and control environment and reporting any issues or residual risk that is not mitigated by control and communicating with respective risk management functions promptly.

Second Line - Risk and compliance functions

The responsibilities of second line function include:

- Establishing risk management framework and policie;
- Establishing standards or expectation relating to first line of defence's risk identification, measurement, monitoring, escalation, reporting and control of risks;
- Overseeing risk exposure against limits or boundaries established by the Board;
- Overseeing first line of defence compliance with risk parameters and prudential limits established by the Board;
- Supporting or overseeing first line of defence in risk management life cycle including risk in identification and remediation;
- Conducting or coordinating stress testing (if applicable); and
- Independent risk reporting.

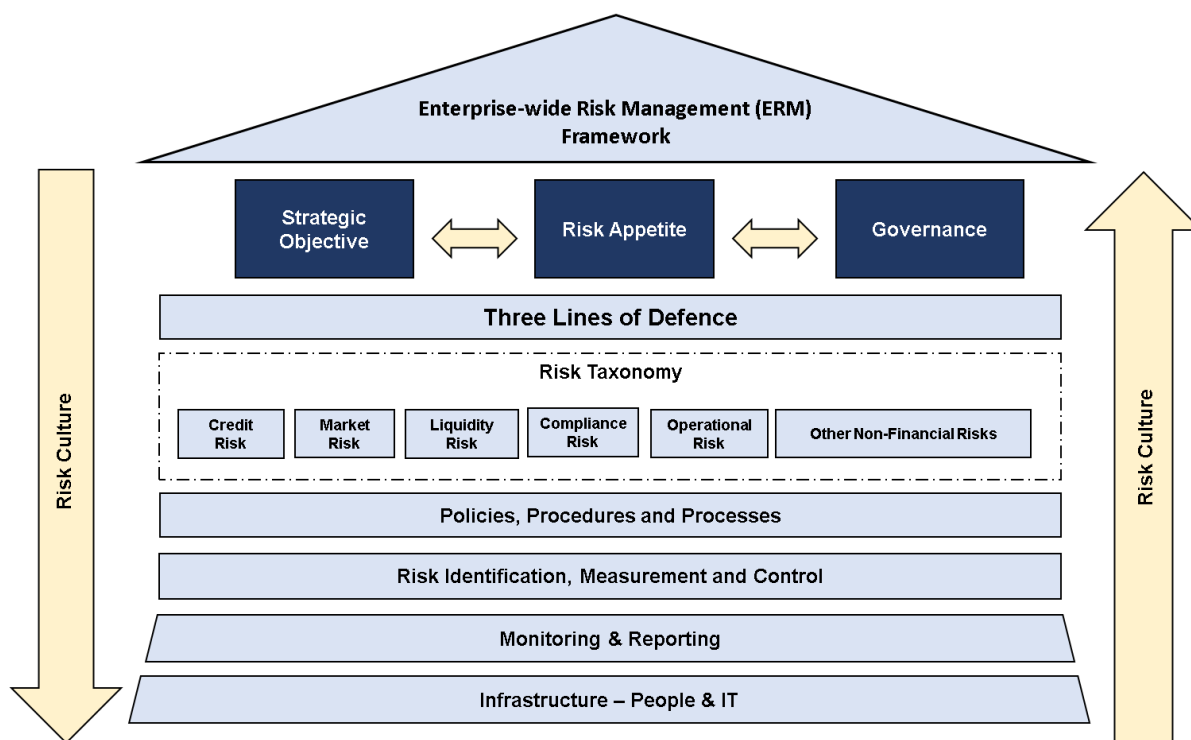
Third Line - Internal Audit

The Internal Audit Department reports to the Board Audit Committee and is independent from daily management and implementation. The primary role is to help the Board and Executive Management to protect the assets, reputation and sustainability of the Bank. It does this by assessing whether all significant risks are identified and appropriately reported by business management and the risk function; assessing whether these risks are adequately controlled and by challenging Executive Management to improve the effectiveness of risk governance, risk management and internal control.

RISK MANAGEMENT FRAMEWORK

The Bank has established an Enterprise-wide Risk Management Framework ('RMF' or 'Framework') in order to implement the overall development strategy of the Bank. The Framework has been set in accordance with the General Principles of the Risk Management of Bank Group.

The Framework covers the Bank's primary risk management objectives which includes an optimised capital allocation to maximize the interest of shareholders while managing risks within acceptable limits. The following chart illustrates the Bank's RMF.



STRATEGY

The Bank takes a prudent approach to its strategy and future development. The Bank has a continuous strategy management mechanism which is reviewed yearly to keep strategy and future developments plan are up to date.

The Bank has developed a strategic plan ('Plan') to determine both quantitative and qualitative goals of the Bank over the 5 year period. The plan proposes concrete and detailed actions to achieve these goals based on the robust analysis of the context within which the Bank is operating and the resources the Bank has. The plans also take into account of the Markets, regulatory requirements, and the BOC Group's requirements while creating and implementing the strategic plan.

RISK APPETITE FRAMEWORK ('RAF') AND RISK APPETITE STATEMENT ('RAS')

RAF refers to the overall approach, including policies, processes, controls, and systems through which risk appetite is established, communicated, and monitored. It includes a risk appetite statement, risk limits, and an outline of the roles and responsibilities of those overseeing the implementation and monitoring of the RAF.

The Bank follows the Financial Stability Board ('FSB')'s principles to establish its bank-specific risk appetite framework and review it periodically.

The Bank's RAS details the aggregate level and types of risk that the Bank is willing to accept, or to avoid, in order to achieve its business objectives. It is linked to the Bank's short- and long-term strategic, capital and financial plans, taking into account the interests of its customers and the fiduciary duty to shareholders, as well as capital and other regulatory requirements.

The Bank's risk appetite is established in accordance with the Bank's risk capacity and in general should be maintained for a relatively long period and is not expected to change frequently unless deemed appropriate otherwise. It is forward looking and, where applicable, subject to scenario and

stress testing to ensure that the Bank understands what events might push it outside its risk appetite and/or risk capacity. The RAS is set in accordance with the RAF.

The Bank has set clear risk appetite boundaries and expectations by establishing qualitative statements, as well as quantitative measures which are referred to as Risk Appetite Indicators (‘RAI’). The qualitative statements adopted by the Bank follow a 6-stage classification model in order to articulate the Bank’s overall risk appetite and that to each specific risk categories. Each stage represents a different level risk propensity for taking higher risk for anticipated higher returns.

Table 3 Risk appetite description

Risk Appetite	Description
Averse	Zero-appetite of underlying risk and uncertainty
Minimal	Prefer ultra-safe business opportunities or options that have a low degree of inherent risk
Cautious	Prefer safe business opportunities or options that have a low degree of inherent risk
Moderate	Willingness to consider potential business opportunities or options with moderate degree of inherent risk
Open	Willing to consider all potential business opportunities or options and choose the one that is most likely to result in successfully business delivery and an acceptable level of reward and value for money
Seeking	Eager to be innovative and to choose business options offering potentially higher reward, despite greater degree of inherent risk

The risk appetite statement defines the amount and type of risk that the Bank is willing to undertake, with the aim to ensure a sustainable business growth and to maximise the potential benefits for the shareholders, while meeting all regulatory requirements and its obligations to the external stakeholders, such as customer, counterparties, etc. Using the principle of “Security, Liquidity and Profitability”, the Bank has set a cautious risk appetite allowing to balance between risk and return. As it is illustrated below, the overall approach to risk-taking can be considered as “Cautious”, suggesting a preference for safe business options that have a low degree of inherent risk.

Table 4 Risk-taking approach by risk type

Risk Type	Propensity to Take Risk
Credit Risk (including Counterparty Credit Risk)	Cautious
Market Risk (including IRRBB)	Cautious
Operational Risk	Cautious
Liquidity Risk	Cautious
Legal Risk	Cautious
Compliance Risk	Averse
Conduct Risk	Averse
Financial Crime Risk	Averse
Market Abuse Risk	Averse
Cyber Security and Data Protection Risk	Averse
IT Risk	Cautious
Reputational Risk	Minimal
Strategic Risk	Cautious

The Bank’s risk appetite statement is reviewed by RMICC before being submitted to BRC, and is subject to final approval of the Board of Directors.

RISK TAXONOMY

The Bank defines the risks to which it exposed as presented below to and applies this classification consistently throughout the Bank:

Table 5 Risk type and definition

Risk Type	Definition
Credit Risk (including Counterparty Credit Risk)	Credit risk is defined as the potential loss should a borrower or counterparty fail to meet contractual obligations in accordance with agreed terms. Counterparty credit risk could arise from counterparty default before settlement of a trading transaction. A financial loss would occur if the transactions or portfolio of transactions with the counterparty has a positive economic value at the time of default.
Market Risk (including Interest Rate Risk in the Banking Book)	Market risk is defined as the risk of losses in on and off-balance-sheet positions arising from movements in market prices. IRRBB refers to the risk of adverse changes in interest rate and maturity structure that cause contingent loss to the overall income and economic value of the banking book, which comes from re-pricing risk, yield curve risk, basis risk and embedded option 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.
Liquidity Risk	Liquidity risk refers to the risk of incurring losses due to an inability to meet payment obligations in a timely manner when they become due.
Legal Risk	Legal risk includes any risk faced by the business with a legal component from which significant legal consequences flow from actions attributable to the business. Legal risk is broader than risk from legal work product and examples could include those arising from laws and regulations, outdated procedures, new risk areas through business growth, exposures to fines, penalties or damages from regulators and in private settlements.
Compliance Risk	Compliance risk is the risk of failing to comply with the regulatory and legislative requirements the Bank is subject to. A breach of such requirements may result in poor outcomes for the Bank's customers, regulatory censure, reputational damage and/or cause the regulator to lose confidence in the Bank.
Conduct Risk	Conduct risk is the risk that the decisions and behaviours of staff; product design, sales and post-sales; and the culture and governance of the Bank could lead to detriment for customers and other stakeholders.
Market Abuse Risk	Market abuse risk refers to the risk of involvement with actual or attempted insider dealing, market manipulation and/or the dissemination of information which gives false or misleading signals as to the supply of, demand for, or price of, a financial instrument, including the dissemination of rumours.
Financial Crime Risk	Financial crime risk consists of several areas, money laundering and terrorist financing, sanctions, tax evasion, bribery and corruption and fraud.
IT Risk	IT risk covers both daily operations and ongoing enhancements to the Bank due to use of software, hardware and network, including technology service availability, security and technology change management.
Cyber Security and Data Protection Risk	Cyber security risk is the risk to electronic information assets posed by malicious and accidental threats that could impact the processing, storage, and transportation by internetworked information systems without adequate protection. Data Protection Risk refer to the non-compliance of the legal and regulatory requirements applying to the organisation to manage and process personal data in a manner that does not impact on the individual who the data belongs to.
Reputational Risk	Reputational risk is defined as the risk the BOC Group and/or BOC UK receive negative perception from its stakeholders, including customers, employees, counterparties, investors, supervisory authorities and the public, on account of operation, management, association, action or inaction and related external events, which is perceived to be inappropriate or unethical.
Strategic Risk	Strategic risk refers to the loss that arising from the Bank making poor business decision, or substandard executions of decisions, or from inadequate resources allocation, or from failure to respond to external market changes
Other Considerations	
Climate-related Financial Risks	Climate-related risks could arise from the physical impacts of climate change as well as the transition to a lower-carbon economy and might incur costs and affect the Bank's returns on investment. The Bank will continue to monitor its development and impact, in particular on main risk types such as credit risk, and to keep senior management and the board a breast of latest changes.
Contagion Risk	The Bank recognises potential contagion risk from its ties with Bank of China Limited London Branch. Management are fully informed of such risks, and the General Management provides an update at each Board meeting on business development and key risks in the Branch.

RISK MANAGEMENT POLICIES & PROCEDURES

The Bank classifies the risk management document suites into three board categories that are:

- **Policy-type Documents:** These typically includes policy or any other documentation covering high-level principles governing activities and/or outline course thought to be prudent or tactically advantageous, control standards documents that set requirement for an activity or activities to deliver policy conformance and/or overarching framework documents that links relevant activities to ensure their consistent execution etc.
- **Procedural-type Documents:** These are normally documents, like process or procedure manuals, that include detailed specifications for the execution of activities, conforming control standards and carried out in accordance with framework and policy guidance.
- **Other Documents:** These are other varieties of documents such as templates, forms, process maps or other reference documents such as BOC Group policy documents or guidelines etc.

As part of the Bank's on-going effort to strengthen our internal infrastructure, a digital policy and procedure library has been introduced a central repository for the Bank's released documents since late 2019. Further functional enhancements were made to the library in late 2020, which includes improvements on user interface ('UI') and introduction of automated workflow and system-enforced controls.

RISK MANAGEMENT PROCESSES

The process of risk management is a continuous cycle. It starts with risk identification and then moves to risk measurement/assessment, risk mitigation/control and ends with risk monitoring and reporting.

- **Risk Identification:** The Risk management process begins with the Risk Identification stage. During this stage, the Bank is constantly working to identify any potential risks even before they arise.
- **Risk Measurement/Assessment:** The risk measurement process starts as soon as possible after the risk has been identified. The Bank has developed risk measurement models and methods for each of the different types of risk and continuously measures the risk impact on the business.
- **Risk Mitigation/Control:** The Bank manages risks by means of diversification, offsetting, transfer, hedge, compensation and mitigation, based on accurate assessment and measurement of risks. The Bank takes appropriate and effective measures to control the risk by closely monitoring early warning indicators (limit, KRIs threshold value).
- **Risk Monitoring:** Risk monitoring is performed on an ongoing basis in the bank to ensure amended and emerging risks can be identified at the earliest and dealt with through the other processes in the risk management cycle.
- **Risk Reporting:** When a problem or issue has been identified via risk monitoring process, e.g. limit breach or above the target level, then such risks are escalated and reported accordingly to ensure prompt and appropriate actions could be taken to mitigate them.

RISK CULTURE

Risk culture refers to the unified consensus of the Bank's risk awareness, risk-taking behaviour and risk management concept.

The Bank is committed to building a bank-wide risk culture, advocating and establishing values of "being committed, responsible, forward-looking, proactive and professional". The Bank reflects the risk culture requirements in clear risk appetite, risk management strategy and policies.

Key elements of the Bank's risk culture include:

- Strong support from the Board & senior management;
- Accountability and ownership of risk;
- Risk transparency, effective communication & continuous training; and
- Increasing use of risk adjusted return on capital as measure or indicator; Strong integrated risk management framework.

The Bank has a clear articulation from the EMC members on the importance of a strong risk management culture. The Bank's risk culture comprises the following elements:

- **The tone from the top:**
 - (1) About 40% of the Bank's KPIs focus on risk management, compliance and internal control, which are cascaded down into departmental and individual KPIs.
 - (2) CRO dialogue: the CRO organises regular meetings with different business lines, to address the Bank's key risk issues, raise risk awareness, and integrate risk appetite implementation; and
 - (3) Manager's Meeting: Manager's Meeting include a review of risk reports, any key risk and control issues will be reviewed and discussed.
- **Accountability:** – Three Lines of Defence is the foundation of good risk awareness and accountability. The Bank has established detailed policies and procedures to clarify the roles and responsibility of three lines and to 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 by bottom up and top down committee governance. The Board and management committees promote cross-functional open discussion to ensure efficient decision-making.
- **Training Programme** – The Bank provides risk and compliance training within the Bank, including operational risk coordinators and regular compliance risk training for all staff, and different training programmes or sessions for different levels of manager responsibilities within the bank.

The Bank will further continue to develop a professional risk management team and establish the mechanism of cultivation, development and reserve of risk management talents.

OTHER CONSIDERATIONS

OPERATIONAL RESILIENCE

Operational Resilience has also become a key area of focus for both PRA and FCA and the Bank has undertaken a transformation project, led by the dedicated operational resilience team and the Bank's COO (SMF24) to design and implement an Operational Resilience programme.

Operating as part of the Enterprise Risk Management Framework ('ERMF'), and aligned with the recent Bank of England, FCA and PRA consultation paper (CP 29/19) requirements, this programme will support EMC and the Board to develop a sound understanding the Operational Resilience, and Impact Tolerance of their Important Business Services.

This, in turn will help support decision making and investment into technology, process improvement and risk management approaches.

Further development to the operational resilience programme will continue with the release of the new regulatory policies.

CLIMATE -RELATED FINANCIAL RISKS

During 2020, the Bank of England provided additional guidance in regards to the PRA's initial expectation of firms on the subject of managing the climate-related financial risks and set a deadline of end 2021 for firms to embed climate change considerations in risk management and day-to-day operations.

The Bank has established a Climate Change Working Group ('CCWG') with representation from all relevant Three Lines of Defence function in order to integrate climate change considerations into the existing governance structure and risk management framework and processes and to implement four key deliverables outlined under supervisory statement (SS3/19), namely, climate change governance framework design and implementation, climate risk management integration to existing process, climate scenario analysis, and external disclosure in relation to climate change.

3. 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, namely CET1, Tier 1 and Total Capital ratios.

CET 1 CAPITAL

As at 31 December 2020, the Bank's capital base was made up of £307 million (31 December 2019: £275 million) of CET 1 capital. CET 1 capital consists of ordinary share capital and retained earnings. CET1 capital increased due to retained earnings. Retained earnings are eligible for inclusion as regulatory Tier 1 capital once audited. Similarly, dividends are deducted from regulatory capital once declared. Therefore, as both events occur after the balance sheet date regulatory capital at the reporting dates will differ to the amount disclosed above. **TIER 1 CAPITAL**

This is CET 1 capital plus perpetual, non-cumulative instruments with principal loss absorption features issued under the CRD IV rules, additional Tier 1 instruments ('AT1'), less capital deductions. The Bank has not issued any AT1 instruments.

TIER 2 CAPITAL

Tier 2 capital includes qualifying subordinated debt of £60 million, which was issued on 20 September 2007 on terms eligible 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 2020.

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.

CAPITAL COMPOSITION

The Bank complied with all externally imposed capital requirements during the current and prior year. The Bank's CET 1 capital was £307 million as at 31 December 2020 (31 December 2019: £275 million). The Bank's total capital was £367 million as at 31 December 2020 (31 December 2019: £335 million).

The ratios are measured against the regulatory minimum requirements. Table 6 shows the capital position of the Bank as at 31 December 2020 and 2019.

REQUIRED LEVELS OF OWN FUNDS

CRR article 92 describes the calculation of capital ratios and the use of different tiers of capital resource. The Bank has at all times complied with these requirements.

As at 31 December 2020 the total capital adequacy ratio was 31.88% (31 December 2019: 33.87%) 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.

Table 6 Capital composition

		2020	2019
Common equity tier 1 capital: Instruments and reserves (£'000)			
1	Capital Instruments and the related share premium accounts of which: Ordinary share capital	250,000	250,000
2	Retained Earnings	57,058	24,958
6	Common equity tier 1 (CET 1) capital before regulatory adjustments	307,058	274,958
Common equity tier 1 (CET 1) capital regulatory adjustments (£'000)			
28	Total regulatory adjustments to Common equity tier 1 (CET 1)	-	-
29	Common equity tier 1 (CET 1) capital	307,058	274,958
Additional tier 1 (AT1) Capital: instruments and provisions (£'000)			
44	Additional Tier 1 (AT1) capital	-	-
45	Tier 1 capital (T1 = CET 1 + AT1)	307,058	274,958
Tier 2 (T2) capital: instruments and provisions (£'000)			
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)	367,058	334,958
60	Total risk weighted assets	1,151,516	988,901
Capital ratios and buffers (%)			
61	Common Equity Tier 1 (as a percentage of risk-weighted assets)	26.7	27.8
62	Tier 1 (as a percentage of risk-weighted assets)	26.7	27.8
63	Total capital (as a percentage of risk-weighted assets)	31.9	33.9
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)	7.1	7.4
65	Of which: capital conservation buffer requirement	2.5	2.5
66	Of which: bank-specific countercyclical buffer requirement	0.1	0.4
67	Of which: Bank G-SIB and/or D-SIB additional requirements (%)	0	0
68	CET1 available to meet buffers*	22.2	23.3

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

LEVERAGE RATIO

The leverage ratio was introduced into the Basel III framework as a non-risk based limit, to supplement risk-based capital requirements. The leverage ratio measures the relationship between our capital resources and total assets, as well as certain off balance sheet exposures. The purpose of monitoring and managing this metric is to enable regulators to limit the build-up excessive leverage in the banking systems and at individual institutions.

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.

The capital measure for the leverage ratio is Tier 1 capital – comprising CET 1 and/or Additional Tier 1 capital 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.

The Bank's leverage ratio at 31 December 2020 was 14.3% (31 December 2019: 14.5%) and was above the internal minimum of 4% at all times during 2020.

The movement in the leverage ratio in the year was caused by the growth in the balance sheet. The Bank does not face an issue of excessive leverage.

Table 7 Leverage ratio

	2020	2019
On-balance sheet exposures (£'000)		
1	1,883,998	1,680,964
2	-	-
3	1,883,998	1,680,964
Derivative exposures (£'000)		
4	48,168	4,612
5	22,850	4,049
6	-	-
7	-	-
8	-	-
9	-	-
10	-	-
11	71,018	8,661
Securities financing transaction exposures (£'000)		
16	-	-
Other off-balance sheet exposures (£'000)		
17	192,439	204,831
18	-	-
19	192,439	204,831
Capital and total exposures (£'000)		
20	307,058	274,958
21	2,147,455	1,894,456
Leverage ratio (%)		
22	14.3%	14.5%

Table 8 Summary comparison of accounting assets and leverage ratio exposure measure

	2020	2019
Total assets as per published financial statements	1,941,105	1,687,388
Adjustments for derivative financial instruments	22,850	8,661
Adjustments for securities financing transactions ("SFT"s)	-	-
Adjustments for off-balance sheet items	192,439	204,831
Other adjustments	(8,939)	(6,424)
Total exposures	2,147,455	1,894,456

4. CAPITAL REQUIREMENTS

MINIMUM CAPITAL REQUIREMENTS

The Bank maintain sufficient headroom above the regulatory minimum requirements as defined by the Bank's ICAAP process. The CET1 ratio as at 31 December 2020 was 26.7% (31 December 2019: 27.8%), total capital ratio was 31.9% (31 December 2019: 33.9%), and regulatory leverage ratio was 14.3% (31 December 2019: 14.5%).

Table 9 sets out the Bank's RWAs and Pillar 1 capital requirements. The Bank has applied the Standardised Approach to measure credit risk RWAs and the Basic Indicator Approach ('BIA') to measure operational risk RWAs.

Table 9 Overview of risk weighted assets

		RWAs		Minimum Capital requirements
		2020 £'000	2019 £'000	2020 £'000
1	Credit risk (excluding counterparty credit risk)	822,496	783,214	65,800
2	<i>Of which: standardised approach (SA)</i>	822,496	783,214	65,800
3	<i>Of which: foundation internal ratings-based (F-IRB) approach</i>	-	-	-
4	<i>Of which: supervisory slotting approach</i>	-	-	-
5	<i>Of which: advanced internal ratings-based (A-IRB) approach</i>	-	-	-
6	Counterparty credit risk (CCR)	-	-	-
7	<i>Of which: standardised approach for counterparty credit risk</i>	-	-	-
8	<i>Of which: Internal Model Method (IMM)</i>	-	-	-
9	<i>Of which: other CCR</i>	-	-	-
10	Credit valuation adjustment (CVA)	114,722	12,598	9,178
11	Equity positions under the simple risk weight approach	-	-	-
12	Equity investments in funds – look-through approach	-	-	-
13	Equity investments in funds – mandate-based approach	-	-	-
14	Equity investments in funds – fall-back approach	-	-	-
15	Settlement risk	-	-	-
16	Securitisation exposures in banking book	-	-	-
17	<i>Of which: securitisation internal ratings-based approach (SEC-IRBA)</i>	-	-	-
18	<i>Of which: securitisation external ratings-based approach (SEC-ERBA), including internal assessment approach (IAA)</i>	-	-	-
19	<i>Of which: securitisation standardised approach (SEC-SA)</i>	-	-	-
20	Market risk	11,621	5,448	930
21	<i>Of which: standardised approach (SA)</i>	11,621	5,448	930
22	<i>Of which: internal model approaches (IMA)</i>	-	-	-
23	Capital charge for switch between trading book and banking book	-	-	-
24	Operational risk	202,676	187,641	16,214
25	Amounts below the thresholds for deduction (subject to 250% risk weight)	-	-	-
26	Floor adjustment	-	-	-
27	Total	1,151,516	988,901	92,121

Table 10 Capital requirements

	2020 (%)		2019 (%)	
	CET1	Total Capital	CET1	Total Capital
Pillar 1	4.50	8.00	4.50	8.00
Pillar 2A	1.81	3.24	1.81	3.24
Total capital requirement (TCR)	6.31	11.24	6.31	11.24
Capital conservation buffer	2.50	2.50	2.50	2.50
Countercyclical capital buffer (CCyB)	0.08	0.08	0.41	0.41
Total (excluding PRA buffer)	8.89	13.82	9.22	14.15

PILLAR 1

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, CET1, Tier 1 and Total Capital ratios (see section 3 for details – Capital Resources). The Bank use the Standardised Approach for credit risk and the BIA for operational risk. Under Basel III, the Bank must set aside capital equal to 8% of total risk weighted assets to cover Pillar 1 capital requirements.

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 2A

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’) and Countercyclical Capital Buffer (‘CCyB’) already held by the firm.

ICAAP

The purpose of the Bank’s ICAAP is to define the internal processes and methodologies applied to assess current and forecast capital requirements over the planning period as well as to present the results of this assessment.

The ICAAP represents the on-going assessment of the risks faced by the Bank and the level of capital that needs to be allocated for these risks to ensure that the Bank continues to meet its capital requirements. The document is designed so to provide the Board a comprehensive view on the sufficiency of the current and projected capital resources, material risks and exposures, risk management framework and risk quantification process, the estimated capital requirements and the projections under stress scenarios.

CAPITAL BUFFERS

In addition to the minimum capital requirements, CRD IV requires institutions to hold capital buffers that can be utilised to absorb losses in stressed conditions.

CAPITAL CONSERVATION BUFFER ('CCB')

The CCB introduced under CRD IV is designed to ensure that institution build up capital buffers outside periods of stress which can be drawn down as losses are incurred. As at 31 December 2020, the capital conservation buffer was 2.5%. This is the highest level required under the current rules.

COUNTERCYCLICAL CAPITAL BUFFER ('CCyB')

The CCyB requires financial institutions to hold additional capital to reduce the build-up of systemic risk in a credit boom by providing additional loss absorbing capacity and acting as an incentive to limit further credit growth.

The Financial Policy Committee ('FPC') in the UK is responsible for setting the UK CCyB rate for credit exposure located in the UK. On 11 March 2020, the Bank of England issued a statement on measures to respond to the economic shock from COVID-19. This listed several actions that the Bank of England would implement, including reducing the UK CCyB to 0% with immediate effect. In its December 2020 Financial Stability Report, FPC updated its guidance on the path for the UK CCyB rate. It now expects this rate to remain at 0% until at least the last quarter of 2021 meaning that any subsequent increase is not expected to take effect until the last quarter of 2022 at the earliest given the 12-month implementation lag.

The geographical distribution of the Bank's credit exposures relevant for the calculation of its CCyB is disclosed in the table below.

Table 11 Countercyclical capital buffer

	2020				Bank-specific countercyclical capital buffer rate (%)	Countercyclical buffer amount (£'000)
	Countercyclical capital buffer rate applicable as at 31.12.2020 %	Exposure values and/or RWA used in the computation of the countercyclical capital buffer		Counter-cyclical capital buffer rate (%)		
		Credit Exposure (£'000)	RWAs (£'000)			
United Kingdom*	0.00	382,591	199,773	0.08***	918	
France*	0.00	222	78			
Sweden*	0.00	189	66			
Hong Kong*	1.00	185,527	65,513			
Luxembourg*	0.25	418	146			
Ireland**	0.00	3,447	2,481			
Other countries	0.00	997,840	554,302			
TOTAL		1,570,628	822,496			

2019					
	Countercyclical capital buffer rate applicable as at 31.12.2019 %	Exposure values and/or RWA used in the computation of the countercyclical capital buffer		Bank-specific countercyclical capital buffer rate (%)	Countercyclical buffer amount (£'000)
		Credit Exposure (£'000)	RWAs (£'000)		
United Kingdom*	1.00	338,946	187,899		
France*	0.25	287	100		
Sweden*	2.50	195	68		
Hong Kong*	2.00	192,153	64,193		
Denmark**	1.00	393	138	0.41***	4,029
Ireland**	1.00	3,447	2,481		
Other countries	0.00	911,396	528,335		
TOTAL		1,446,817	783,214		

* Basel Committee member jurisdictions

** Non-member jurisdictions

*** CRD article 140 (4) requires only relevant exposures for the CCyB. Article 140 defines in reference to CRR 112 to exclude CRR 112 (a) to (f) which is (summarised) Govt and financial institutions.

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 INSTITUTIONS ('G-SIIS') BUFFER

Financial Institutions that are considered to represent a higher risk to the global financial system, based on a number of key factors, are defined as G-SIIs. G-SIIs are categorised into buckets based on size, interconnectedness, substitutability, complexity and global activity. As a result of its bucket allocation, each G-SII's capital requirement is determined from within the range of 1% to 2.5% of RWAs.

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

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 12 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)

5. CREDIT RISK

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:

- Defining, implementing and re-evaluating its risk appetite under actual and stress conditions;
- 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;
- Monitoring credit risk relative to limits;
- Regular credit inventory review.

CREDIT RISK EXPOSURES

CREDIT RISK EXPOSURES BY EXPOSURE CLASS

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.

Total credit risk exposures as at 31 December 2020 had increased by £181 million, primarily due to increases on lending secured on immovable property (£81 million) and institutions (£61 million) in line with the overall lending growth and increases in cash held with the Bank of England (£57 million).

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.

Table 13 Total net amount of exposures

Exposure subject to the Standardised Approach	2020		
	Year End Exposure (£'000)	RWA (£'000)	Capital Requirement (£'000)
Central governments or central banks	360,127	-	-
Corporate	394,919	394,762	31,581
Institutions	106,502	42,693	3,415
Other items	20,189	20,374	1,630
Past due items	6,214	9,321	746
Retail	443	296	24
Secured by mortgages on immovable properties	912,464	319,663	25,573
Short term claims on institutions and corporate	129,897	35,388	2,831
Total	1,930,755	822,496	65,800

Exposure subject to the Standardised Approach	Year End Exposure (£'000)	RWA (£'000)	Capital Requirement (£'000)
Central governments or central banks	302,641	-	-
Corporate	414,793	407,046	32,564
Institutions	45,253	15,721	1,258
Other items	41,872	41,845	3,348
Past due items	2,059	3,089	247
Retail	852	587	47
Secured by mortgages on immovable properties	831,353	291,217	23,297
Short term claims on institutions and corporate	110,634	23,709	1,897
Total	1,749,458	783,214	62,657

GEOGRAPHIC DISTRIBUTION OF CREDIT RISK EXPOSURES

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. The Bank's credit risk exposures as at 31 December 2020 and 31 December 2019 by geography are detailed in the table below.

In general, credit risk exposures in the rest of the world take the largest part of total exposure. The geographic distribution of "Secured by mortgages on residential property" follows the Capital Requirement Regulation that "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".

Table 14 Geographical breakdown of exposures

Standardised Credit Risk	2020				Total (£'000)
	UK (£'000)	Other EU Countries (£'000)	North America (£'000)	Rest of the World (£'000)	
Central governments or central banks	360,127	-	-	-	360,127
Corporate	158,128	14,704	13,835	208,252	394,919
Institutions	66,862	-	-	39,640	106,502
Other items	20,189	-	-	-	20,189
Past due items	3,577	-	-	2,637	6,214
Retail	374	-	-	69	443
Secured by mortgages on immovable properties	174,990	4,794	2,030	730,649	912,464
Short term claims on institutions and corporate	30,352	448	35,189	63,907	129,897
Total	814,601	19,946	51,054	1,045,154	1,930,755

Standardised Credit Risk	2019				Total (£'000)
	UK (£'000)	Other EU Countries (£'000)	North America (£'000)	Rest of the World (£'000)	
Central governments or central banks	302,641	-	-	-	302,641
Corporate	151,155	34,295	36,318	193,025	414,793
Institutions	8,466	-	-	36,787	45,253
Other items	40,318	1,553	-	-	41,872
Past due items	969	-	-	1,091	2,059
Retail	704	-	-	148	852
Secured by mortgages on immovable properties	201,195	4,850	1,852	623,457	831,353
Short term claims on institutions and corporate	17,405	1,775	24,735	66,719	110,634
Total	722,853	42,474	62,904	921,227	1,749,458

INDUSTRY DISTRIBUTION OF CREDIT RISK EXPOSURES

The Bank's exposures at 31 December 2020 and 31 December 2019 analysed by industry are detailed below.

Table 15 Concentration of exposures by industry

Asset classes and Industries (£'000)	2020	2019
Central Governments or central banks	360,127	302,641
Financial industry (bank and non-bank)	360,127	302,641
Corporate	394,919	414,793
Financial industry (bank and non-bank)	6,606	2,584
Human Health And Social Work	-	22,608
Manufacturing	97,409	77,220
Real estate (commercial)	53,347	81,134
Services and other	2,438	2,434
Transport, storage and utilities	219,327	212,442
Wholesale and retail trade	15,535	16,370
Construction	256	-
Institutions	106,502	45,253
Financial industry (bank and non-bank)	106,502	45,253
Other items	20,189	41,872
Financial industry (bank and non-bank)	20,189	3
Services and other	-	41,869
Past due items	6,214	2,059
Retail	6,214	2,059
Retail	443	852
Retail	443	852
Secured by mortgages of immovable properties	912,464	831,353
Retail	909,066	831,353
Real estate (commercial)	3,123	-
Services and other	8	-
Transport, storage and utilities	266	-
Short term claims on institutions and corporate	129,897	110,634
Financial industry (bank and non-bank)	129,897	76,161
Services and other	-	34,473
Total	1,930,755	1,749,458

RESIDUAL CONTRACTUAL MATURITY OF CREDIT RISK EXPOSURES

The Bank's exposure as at 31 December 2020 and 31 December 2019 analysed by remaining contractual maturity are detailed in the table below.

Table 16 Residual maturity of exposures

		2020			
	Standardised Credit Risk (£'000)	Up to 12 months	1-5 years	More than 5 years	Total
	Central governments or central banks	360,127	-	-	360,127
	Corporate	152,870	55,029	187,020	394,919
	Institutions	35,363	1,688	69,451	106,502
	Other items	20,189	-	-	20,189
	Past due items	1	36	6,177	6,214
	Retail	443	-	-	443
	Secured by mortgages on immovable properties	95	16,162	896,206	912,464
	Short term claims on institutions and corporate	129,897	-	-	129,897
	Total	698,986	72,915	1,158,855	1,930,755

		2019			
	Standardised Credit Risk (£'000)	Up to 12 months	1-5 years	More than 5 years	Total
	Central governments or central banks	302,641	-	-	302,641
	Corporate	3,302	263,271	148,219	414,793
	Institutions	15,440	28,554	1,260	45,253
	Other items	41,872	-	-	41,872
	Past due items	321	36	1,702	2,059
	Retail	848	0	4	852
	Secured by mortgages on immovable properties	1,379	11,958	818,016	831,353
	Short term claims on institutions and corporate	110,634	-	-	110,634
	Total	476,438	303,819	969,201	1,749,458

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.

The performance of loan assets is monitoring monthly.

PROVISIONING FOR LOANS AND ADVANCES

The Bank assess on a forward-looking basis the Expected Credit Losses ('ECL') associated with 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.

The Bank calculates ECL using three main components, a probability of default ('PD'), a loss given default ('LGD'), and the exposure at default ('EAD'). ECL include impairment allowances (or provision in the case of commitments and guarantees) for the 12-month ECL (12-month ECL) and lifetime ECL, and on financial assets that are considered to be in default or otherwise credit impaired.

ECL resulting from default events that are possible within the next 12 months are recognised for financial instruments in stage 1. An assessment of whether credit risk has increased significantly since initial recognition is performed at each reporting period by considering the change in the risk of default occurring over the remaining life of the financial instrument. Unless identified at an earlier stage, all financial assets are deemed to have suffered a significant increase in credit risk when past due. ECL resulting from default events that are possible beyond 12 months (Lifetime ECL) are recognised for financial instruments in stage 2 & 3.

Change in ECL and other credit impairment charges represent the movement in the ECL during the year.

The Bank's ECL as at 31 December 2020 had increased by £3 million, primarily due to the COVID-19 pandemic which affected the asset quality of the Bank's portfolio.

Comparing Table 18 to the Financial Statements, there are differences in categorisation and the rationale relates to the geographical location of the 'asset' against the geographical location of the 'borrower'.

Table 17 Analysis of past due, impaired and provision to loans and advances by industry

Industry Distribution	2020		
	Past Due but not impaired (£'000)	Non-Performing (£'000)	Provision (£'000)
Construction	-	-	13
Financial industry (bank and non-bank)	-	-	42
Manufacturing	-	-	184
Real estate (commercial)	-	-	126
Retail	31,809	3,939	1,129
Services and other	-	-	42
Transport, storage and utilities	-	-	2,907
Wholesale and retail trade	-	-	30
Total	31,809	3,939	4,473
	2019		
Industry Distribution	Past Due but not impaired (£'000)	Non-Performing (£'000)	Provision (£'000)
Financial industry (bank and non-bank)	-	-	10
Human Health And Social Work	-	-	99
Manufacturing	-	-	21
Real estate (commercial)	-	-	21
Retail	21,670	1,777	778
Services and other	-	-	8
Transport, storage and utilities	-	-	359
Wholesale and retail trade	-	-	5
Total	21,670	1,777	1,301

Table 18 Analysis of past due, impaired and provision by geographical region

2020					
Geographic Distribution (£'000)	Past Due but not impaired	Non-Performing	Provision	Provision (Retail Transfers)	Provision (excl. Retail)
North America	-	-	12	1	11
Other EU Countries	-	-	35	(154)	189
Rest of the World	-	-	3,839	2,585	1,253
UK	31,809	3,939	588	(1,302)	1,890
Total	31,809	3,939	4,473	1,131	3,342
2019					
Geographic Distribution (£'000)	Past Due but not impaired	Non-Performing	Provision	Provision (Retail Transfers)	Provision (excl. Retail)
North America	-	-	116	100	16
Other EU Countries	-	-	31	(44)	75
Rest of the World	-	-	1,025	782	243
UK	21,670	1,777	130	(59)	189
Total	21,670	1,777	1,301	779	523

Table 19 Credit quality of assets

2020 (£'000)	Gross carrying values of		Allowances/ impairments	Net values
	Non-performing exposures	Performing exposures		
Loans	3,939	1,160,759	(4,163)	1,160,535
Debt Securities	-	-	-	-
Off-balance sheet exposures	-	253,244	(310)	252,934
Total	3,939	1,414,003	(4,473)	1,413,469
2019 (£'000)	Gross carrying values of		Allowances/ impairments	Net values
	Non-performing exposures	Performing exposures		
Loans	1,777	1,182,768	(1,199)	1,183,346
Debt Securities	-	50,431	-	50,431
Off-balance sheet exposures	-	240,480	(102)	240,378
Total	1,777	1,473,679	(1,301)	1,474,155

The non-performing exposures relates to mortgages and credit cards only.

Table 20 Change of non-performing loans and debt securities

	2020 £'000	2019 £'000
Non-performing loans and debt securities at 31/12/2019	1,777	686
Newly non-performing loans and debt securities since the last reporting period	3,076	1,633
Returned to performing status	(580)	(242)
Amounts written off	-	-
Other changes	(335)	(300)
Non-performing loans and debt securities at 31/12/2020	3,939	1,777

Other changes relates to customer still under non-performing which made some repayment and foreign exchange adjustments.

CREDIT QUALITY STEP ('CQS')

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 2020 subject to the use of ECAIs was £967 million. 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 21 Exposure amounts subject to the use of ECAIs

Exposure Class	2020	2019
	Gross Exposure (£'000)	Gross Exposure (£'000)
Central governments or central banks	360,127	302,443
Corporate	229,667	247,175
Institutions	172,232	86,240
Short term claims on institutions and corporate	204,897	142,480
Total	966,923	778,339

The table below shows exposures after credit risk mitigation ('CRM'). As at 31 December 2020, 89% of assets were risk-weighted under CQS 1 to 3 (31 December 2019: 96%) which represent investment grades AAA to BBB- (S&P equivalent rating).

Approximately 56% 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 22 Credit exposures by CQS

CQS	2020		2019	
	Gross Exposure (£'000)	Exposure after CRM (£'000)	Gross Exposure (£'000)	Exposure after CRM (£'000)
1	591,069	516,069	400,795	368,949
2	165,871	80,485	151,638	101,793
3	106,949	58,579	194,470	127,725
4	52,191	46,851	7,237	7,237
5	46,387	46,248	24,197	24,168
6	4,456	4,456	-	-
Total	966,923	752,688	778,339	629,873

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 23 Credit exposures by asset classes and risk weights

Risk weight	2020								Total credit exposures amount (post CCF and post-CRM)
	0%	20%	35%	50%	75%	100%	150%	250%	
Asset Class (£'000)									
Central Governments or central banks	360,127	-	-	-	-	-	-	-	360,127
Corporate	-	-	-	68	-	390,395	4,456	-	394,919
Institutions	-	71,769	-	12,788	-	21,945	-	-	106,502
Other items	1,820	-	-	-	-	17,033	-	1,336	20,189
Past due items	-	-	-	-	-	-	6,214	-	6,214
Retail	-	-	-	-	443	-	-	-	443
Secured by mortgages on immovable properties	-	-	907,502	4,639	-	322	-	-	912,464
Short term claims on institutions and corporate	-	100,604	-	28,053	-	1,241	-	-	129,897
Total	361,947	172,373	907,502	45,548	443	430,936	10,670	1,336	1,930,755

2019

Risk weight	0%	20%	35%	50%	75%	100%	150%	250%	Total credit exposures amount (post CCF and post-CRM)
Asset Class (£'000)									
Central Governments or central banks	302,641	-	-	-	-	-	-	-	302,641
Corporate	-	-	-	13,681	-	401,112	-	-	414,793
Institutions	-	21,137	-	22,705	-	1,411	-	-	45,253
Other items	2,017	-	-	-	-	38,528	-	1,327	41,872
Past due items	-	-	-	-	-	-	2,059	-	2,059
Retail	-	-	-	-	852	-	-	-	852
Secured by mortgages on immovable properties	-	-	824,986	6,242	125	-	-	-	831,353
Short term claims on institutions and corporate	-	105,361	-	5,273	-	-	-	-	110,634
Total	304,658	126,499	824,986	47,901	978	441,051	2,059	1,327	1,749,458

CREIT 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 24 Credit exposure overview of CRM

2020 (£'000)	Exposures unsecured: carrying amount	Exposures secured by collateral	Exposures secured by financial guarantees	Exposures secured by credit derivatives
Loans	243,285	917,250	-	-
Debt securities	-	-	-	-
Total	243,285	917,250	-	-
Of which non-performing	13	3,926	-	-

2019 (£'000)	Exposures unsecured: carrying amount	Exposures secured by collateral	Exposures secured by financial guarantees	Exposures secured by credit derivatives
Loans	351,231	832,115	-	-
Debt securities	50,431	-	-	-
Total	401,662	832,115	-	-
Of which non-performing	12	1,766	-	-

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.

Higher-risk categories refer to assets with risk weight at 150% or higher reflecting higher risks associated with RWA density of 161% (2019: 189%). 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 (£6.2 million) are included in higher-risk category (£12.0 million).

Table 25 CRM effects on credit exposures and RWA

2020						
Asset classes	Exposures before CCF and CRM		Exposure post-CCF and CRM		RWA and RWA density	
	On-balance sheet amount (£'000)	Off-balance sheet amount (£'000)	On-balance sheet amount (£'000)	Off-balance sheet amount (£'000)	RWA (£'000)	RWA density
Central governments or central banks	360,127	-	360,127	-	-	0%
Corporate	298,564	216,843	295,513	94,950	388,078	99%
Institutions	77,314	95,146	31,175	75,328	42,693	40%
Other items	18,853	-	18,853	-	17,033	90%
High-risk categories	12,088	-	12,006	-	19,346	161%
Retail	450	5,612	443	-	296	67%
Secured by mortgages on immovable properties	912,303	5,782	911,309	1,155	319,663	35%
Short term claims on institutions and corporate	204,299	597	129,299	597	35,388	27%
Total	1,883,998	323,981	1,758,726	172,030	822,496	43%

2019						
Asset classes	Exposures before CCF and CRM		Exposure post-CCF and CRM		RWA and RWA density	
	On-balance sheet amount (£'000)	Off-balance sheet amount (£'000)	On-balance sheet amount (£'000)	Off-balance sheet amount (£'000)	RWA (£'000)	RWA density
Central governments or central banks	302,642	-	302,641	-	-	0%
Corporate	317,206	197,820	316,753	98,040	407,046	98%
Institutions	42,656	43,805	30,064	15,189	15,721	35%
Other items	40,545	-	40,545	-	38,528	95%
High-risk categories	3,411	-	3,386	-	6,406	189%
Retail	863	5,342	852	-	587	69%
Secured by mortgages on immovable properties	831,742	1,594	831,035	319	291,217	35%
Short term claims on institutions and corporate	141,900	581	110,054	581	23,709	21%
Total	1,680,964	249,142	1,635,330	114,128	783,214	45%

MORTGAGE PAYMENT HOLIDAY ('MPH')

In March 2020, the UK government issued guidance for lenders to provide a payment holiday to all mortgage borrowers that were directly or indirectly affected financially by the impact of COVID-19. This requirement was enforceable on all lenders irrespective of whether they offered a payment holiday option within their current mortgage product suite.

A dedicated MPH project team was set up for the Bank to implement its strategy following on from the FCA's guidance. Two phases, namely: 1) application and implementation phase and 2) exit strategy phase, were introduced and included forbearance measures with extra support provided to residential and arrears customers. The deadline for the MPH scheme is 31 March 2021. There are 113 MPH applications had been made with 22 Residential MPH applications and 91 BTL MPH applications. As at 31 December 2020, 73 cases out of 113 had resumed payment (64%) following on from a payment deferral or extension. 40 cases were still live within the MPH scheme.

RECONCILIATION BETWEEN IFRS AND REGULATORY BALANCE SHEETS

The IFRS balance sheet scope is identical to that with regulatory scope in 2020 and there are no reconciliation differences. For further information see the Bank's Financial Statements 2020.

Table 26 Reconciliation between IFRS9 and regulatory balance sheets

£000	Note	2020	2019
Assets			
Cash and cash equivalents	16	481,379	332,542
Loans and advances to banks	18	110,446	85,247
Loans and advances to customers	19	1,138,583	1,064,347
Derivative financial instruments	17	48,163	4,614
Prepayments, accrued income and other assets	25	78,769	58,405
Financial assets at fair value through profit and loss	21(a)	77,482	83,928
Debt instruments at amortised cost	21(b)	-	50,431
Deferred tax assets	24	1,227	787
Property, plant and equipment	22	4,527	6,328
Intangible assets	23	529	759
Investment in subsidiary companies	32	-	-
Total assets		1,941,105	1,687,388
Liabilities			
Deposits from banks	26	219,378	128,590
Deposits from customers	27	1,215,647	1,132,193
Derivative financial instruments	17	56,924	8,771
Other liabilities	29	36,086	43,609
Accruals and deferred income	30	5,705	6,390
Current corporation tax liabilities		4,891	675
Impairment provision on off balance sheet products		310	102
Subordinated liabilities	28	60,000	60,000
Total liabilities		1,598,941	1,380,330
Equity			
Authorised and called up share capital	31	250,000	250,000
Retained earnings		92,164	57,058
Total shareholders' equity		342,164	307,058
Total shareholders' equity and liabilities		1,941,105	1,687,388

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: over-the-counter (OTC) derivatives, exchange-traded derivatives, long settlement transactions and securities financing transactions.

The Bank is a clearing member of the London Clearing House ('LCH') which is a qualified central counterparty ('QCCP'). The Bank's CCR mainly arises from derivative transactions when acting as clearing agency for the Bank of China Group. The Bank has provided cash collateral in respect of derivative contracts with LCH under its QCCP standard.

The Bank does not hold any credit default swaps (CDS) or total return swaps (TRS), disclosures for credit derivative transactions is therefore not applicable.

The Bank measures the risk of counterparty default and a credit valuation adjustment (CVA) when calculate its total CCR capital charge.

CAPITAL CHARGES FOR DEFAULT RISK

The Bank applies SA-CCR approach to calculate CCR exposure (CCR EAD). SA-CCR takes two components, the replacement cost (RC) and the potential future exposure (PFE). The total 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).

CAPITAL CHARGES FOR CVA RISK

The Bank is exposed to the risk of loss on FX and derivatives instruments caused by changes in the credit spread of counterparty due to changes in its credit quality. In order to address this risk, CVA is estimated as an adjustment to the mid-market valuation of the portfolio of transactions with a counterparty that reflects the current market value of the risk of the deterioration of counterparty credit quality at times of market stress and cyclical changes.

The Bank adopts SA set out by the CRR in order to calculate the CVA capital requirement. The approach uses the key drivers of the CVA, such as discounted EAD, applicable risk weights and effective maturity, defined as follows:

- Discounted EAD is the total EAD after applying discounting factor estimated in accordance with the regulatory requirements (maturity-based);
- Risk weights are based on the external credit rating of the counterparty;
- The effective maturity is the notional weighted average maturity.

The Bank's CVA for derivative portfolio is not hedged. The CVA breakdown is displayed in the table below, the increase in 2020 is mainly related to LCH business.

Table 27 CVA capital charge

2020	EAD post-CRM (£'000)	RWA (£'000)
Total portfolios subject to the Advanced CVA capital charge	-	-
(i) VaR component (including the 3×multiplier)		-
(ii) Stressed VaR component (including the 3×multiplier)		-
All portfolios subject to the Standardised CVA capital charge	59,494	114,722
Total subject to the CVA capital charge	59,494	114,722

2019	EAD post-CRM (£'000)	RWA (£'000)
Total portfolios subject to the Advanced CVA capital charge	-	-
(i) VaR component (including the 3×multiplier)		-
(ii) Stressed VaR component (including the 3×multiplier)		-
All portfolios subject to the Standardised CVA capital charge	8,661	12,598
Total subject to the CVA capital charge	8,661	12,598

7. MARKET RISK

Market risk is defined as the risk that movements in market risk factors, including interest rate, foreign exchange rates, equity prices, commodity prices, and credit spreads, could materially impact 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 offset in the market. The main source of market risk relates to foreign exchange risk, due to de minimis residual FX position in the trading book and the accrual of interest income in foreign currencies.

The Bank has identified Key Risk Indicators ('KRIs') for the purpose of monitoring, reporting and managing its market risk.

The table below shows capital requirements for standardised market risk split between outright products, options, and securitisation. This table includes an exposure subject to the Standardised approach only.

Table 28 Market risk under the standardised approach

	2020	2019
	Capital charge (£'000)	Capital charge (£'000)
General interest rate risk	-	-
Equity risk	-	-
Commodity risk	-	-
Foreign exchange risk	930	436
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	930	436

FOREIGN EXCHANGE ('FX') RISK

Foreign exchange risk is the risk that movements in various currencies could materially impact the financial statements. FX risk is monitored via dedicated gross position limits and covers both banking and trading book.

FX risk arises from the foreign currency gains and losses across business lines and from FX financial instruments. In order to manage this risk, the Bank squares its foreign currency gains and losses into GBP on a regular basis.

The Bank's distribution of FX positions by currency type is presented below:

Table 29 Foreign exchange position³

	US Dollar (£'000)	Euro (£'000)	CNY (£'000)	AUD (£'000)	Other (£'000)
31 December 2020	6,800	4,351	(52)	278	180
31 December 2019	(5,315)	588	(126)	167	126

INTEREST RATE RISK IN THE BANKING BOOK ('IRRBB')

The objective for IRRBB risk management is to minimise the sensitivity of the Bank's earnings and economic value to interest rate fluctuations.

IRRBB mainly stems from the re-pricing mismatch between assets and liabilities. The sources of interest rate risk include re-pricing risk, yield curve risk, basis risk and embedded optional 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 gaps to analyse the re-pricing risk on a static basis from both the near-term earnings perspective and the long-term earnings perspective. Interest-generating assets, interest-bearing liabilities and the off-balance sheet position 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 two key risk indicators ('KRIs') for the purpose of monitoring, reporting, and managing the IRRBB:

- Change in Net Interest Income (' Δ NII') is an earnings metric that measures the potential impact of a specified interest rate change on the net interest income for banking book over specified reporting period; and
- Change in Economic Value of Equity (' Δ EVE') is a valuation metric that measures the potential impact of a specified interest rate change on the economic value of equity (the net economic value of all on and off balance sheet assets and liabilities using present value calculations).

The table below shows the sensitivity to a 100bps change in interest rates, with all other variables held constant, on both Δ NII and Δ EVE.

Table 22: Impact of 100 bps parallel shift in interest rates

	100 bps parallel increase (£'000)	100 bps parallel decrease (£'000)
Δ NII (Net Interest Income) as at 31 December 2020	3,701	(3,701)
31 December 2029	3,070	(3,070)
Δ EVE (Economic Value of Equity) as at 31 December 2020	(150)	150
31 December 2019	(216)	216

³ The FX position figures are calculated following methodology set out by regulatory reporting requirements in accordance with CRD IV. The methodology might differ from that used in internal market risk limit control.

8. 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. It is inherent in the Bank's business activities and the impact can be financial as well as non-financial such as customer detriment, reputational or regulatory censure.

It's not cost effective, and in many cases impossible, to eliminate all operational risk, and operational risks losses are expected to occur and are accepted as part of the normal course of business activities. Therefore, the Bank has established a comprehensive Operational Risk Framework in line with the CRD IV and Basel guidelines in order to manage operational risk within its risk appetite.

The Bank also 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 Bank is accumulating operational loss data to build the foundation for a more advanced approach.

Table 30 Operational risk capital requirements using BIA

£'000	Total Risk Exposure		Minimum Capital requirements
	2020	2019	2020
Operational risk	202,676	187,641	16,214

OPERATIONAL RISK MANAGEMENT PROGRAMME

The Bank has been operating a number of operational risk management programme in order to assist the first line of defence to identify, assess, monitor, report and mitigate operational risk within the Bank. These includes, but is not limited to, the following:

- **Risk and Control self-assessment ('RCSA')**: A business as usual exercise, signed off quarterly, in which first line of defence departments review and assess their risk control environment, operational risk exposure and emerging concerns, subject to second line of defence validation. The process evaluates inherent risk, the effectiveness of the control environment and residual risk.
- **Key Risk Indicators ('KRI')**: Operational Risk KRIs are risk metrics and/or statistics used to monitor the main drivers and control points associated with key risks in order to provide an early warning signals when risk levels approach or exceed thresholds or limits and to undertake remedial actions promptly.
- **Operational Risk Event ('ORE') Reporting**: First line of defence departments are required to report all operational risk events ('ORE'), including root cause analysis and the resulting remedial actions to Operational Risk Management ('ORM') for monitoring and independent review. ORE could result in actual losses, near-misses, potential losses or timing impact and are classified in accordance with the Basel loss event categories

- **Scenario Analysis:** Scenario analysis is a joint initiative by both first and second line of defence to identify and assess potential financial impact of hypothetical low probability but high impact operational risk events as part of the annual ICAAP;
- **Operational Risk Awareness Program:** A strong risk culture and level of awareness are critical in achieving effective operational risk management. As a result, the ORM has put in place a number of awareness programmes for all the staff, including bank-wide training and seminars, an online e-learning programme, and induction training.

9. LIQUIDITY & FUNDING RISK MANAGEMENT

Liquidity risk refers to the risk that the Bank is unable to fund its assets and/or meet its obligations as they become due or can only do so at excessive cost.

The Bank has adopted a ‘cautious’ approach to take liquidity which is fully reflected in the conditions set within its own stress scenarios, and is aligned to the Bank’s business profiles and to the liquidity risk measures prescribed by the PRA. As such the Bank aims to maintain sufficient and adequate liquidity resources in terms of both quality and quantity at all times, during both business as usual and periods of stress.

The Bank achieves these objectives through the establishment of policies, liquidity risk limits, ongoing monitoring and management, stress testing and by maintaining a sufficient stock of high quality liquid assets.

GOVERNANCE

The Board takes ultimate responsibility for liquidity and funding risk management of the Bank. It has delegated the responsibility of developing and implementing policies and procedures for managing liquidity and funding risk to the EMC, which in turn has delegated these responsibilities to the ALCO.

The EMC and the ALCO ensure that the decision of the Board as the governing body are integrated into the Bank’s liquidity and funding risk management process. Liquidity risk is managed by the Treasury function within the Global Financial Markets Department as mandated by the ALCO.

The ALCO discusses, reviews and approves all liquidity and funding risk related policies, assessments and governance matters as often as is required and at least annually, or more frequently should any member of the Board request. Following ALCO approvals the governance framework requires notification to the RMICC and for some key policies, such as the Internal Liquidity Adequacy Assessment Process (ILAAP) submission to the BRC and the Board for their respective approvals. The challenge and review provided by the ALCO, BRC and the Board ensure that the liquidity and funding risk governance and management framework are up to date and continue to remain appropriate for the Bank’s current and projected business and economic environment.

The policies and procedures related to liquidity and funding risk are defined and formalised into the Liquidity Policy, Funds Transfer Pricing Policy, Liquidity Stress Testing Policy and the Recovery Plan, which have all been effectively communicated throughout the Bank via ALCO.

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

LIQUIDITY AND FUNDING RISK MANAGEMENT

Overall liquidity adequacy: In line with the PRA's liquidity rules, the Bank produces an ILAAP document at least annually to assess how the Bank achieves overall liquidity adequacy, in both normal times and during potential stressed conditions, and involves an internal quantitative and qualitative assessment of its management systems and controls and assessment of the adequacy of its liquidity and funding resources. The conclusion of the Board approved ILAAP is that the Bank continues to maintain sufficient and adequate liquidity resources in terms of both quality and quantity and that the Bank has the appropriate governance structure and operational infrastructure to identify, measure, monitor and manage compliance with the regulatory and internal liquidity risk appetite. The ILAAP also aligns with the EBA guidelines on common procedures and methodologies for the SREP and complies with the guidance provided by the PRA. In addition, the Bank regularly updates the Recovery Plan which details the actions the Bank might take in the event of a liquidity stress. The Recovery Plan details how limit breaches are handled, including the escalation, invocation, communication plans and procedures, starting from the point at which any deterioration in metrics is first observed to enable management sufficient time to take remediating actions.

Liquidity Stress Testing: The Bank performs liquidity stress testing on a monthly basis and as a part of the quantitative assessments of the ILAAP to ensure and test the adequacy of the Bank's liquidity resources under various stressed scenarios and to ensure that the Bank can continue to operate under such stressed conditions.

High Quality Liquid Assets ('HQLA'): The Bank's liquidity risk appetite specifies the level of HQLA that should be maintained on an ongoing basis in order to meet both regulatory (i.e. Pillar 1 and Pillar 2) and internal requirements during business as usual and stressed conditions.

Liquidity Risk Appetite: The Board approved liquidity risk appetite defines the aggregate level and type of risk that the Bank is willing to assume within its risk capacity to achieve its strategic objectives and business plan and adopted a 'cautious' approach to take liquidity risk. The liquidity risk appetite is directly linked to the Bank's stress testing results and to regulatory requirements and also determines the size of the Bank's liquidity buffers. The liquidity risk appetite embeds an early warning threshold mechanism by way of RAG (Red, Amber, Green) rating the defined metrics to ensure that minimum regulatory liquidity requirements are not likely to be breached. The Bank's risk appetite statement metrics are reviewed at least annually.

Liquidity Coverage Ratio ('LCR'): The LCR assesses whether the Bank has an adequate stock of unencumbered HQLA that can be converted easily and immediately in private markets into cash to meet its liquidity needs for a 30 calendar day liquidity stress scenario. The regulatory minimum LCR set at 100%. Since the ratio's formal introduction, the Bank has assigned the daily measurement, monitoring and reporting of the LCR to the Regulatory Reporting Team within the Financial Management Department. The LCR is measured, monitored and reported daily. The Bank met the LCR regulatory requirement at all times during 2020. At 31 December 2020, the average LCR closed at 243% (see table 31).

COVID-19: Throughout 2020 and the ongoing COVID-19 pandemic the Bank met the LCR regulatory requirement and remained in compliance with OLAR. During this period the Bank did not experience any stresses to liquidity and funding and the Bank's monthly liquidity stress testing did not reveal any vulnerabilities.

The below table shows the average of the liquidity buffer, net cash outflow and LCR as at the end of each quarterly period.

Table 31 Liquidity coverage ratio (LCR)

	Total unweighted value (average)	Total weighted value (average)	Total unweighted value (average)	Total weighted value (average)
£'000	2020	2020	2019	2019
High-quality liquid assets				
Total HQLA		360,820		302,154
Cash outflows				
Retail deposits and deposits from small business customers	812,233	84,690	790,447	84,777
Unsecured wholesale funding, of which:	404,593	164,630	368,139	165,011
Operational deposits (all counterparties) and deposits in networks of cooperative banks	-	-	-	-
Non-operational deposits (all counterparties)	404,593	164,630	368,139	165,011
Unsecured debt	-	-	-	-
Secured wholesale funding		-		-
Additional requirements, of which:	659	659	452	452
Outflows related to derivative exposures and other collateral requirements	659	659	452	452
Other contractual funding obligations	252,962	24,717	240,480	23,692
Other contingent funding obligations	6,598	1,211	6,165	1,898
TOTAL CASH OUTFLOWS		275,908		275,830
Cash inflows				
Secured lending (eg reverse repos)				
Inflows from fully performing exposures	134,731	127,193	141,334	136,271
TOTAL CASH INFLOWS	134,731	127,193	141,334	136,271
		Total adjusted value		Total adjusted value
Total HQLA		360,820		302,154
Total net cash outflows		148,715		139,559
Liquidity Coverage Ratio (%)		243%		217%

10. ASSET ENCUMBRANCE

An asset shall be treated as encumbered if it has been pledged or if it is subject to any form of arrangement to secure, collateralise or credit enhance any transaction from which it cannot be freely withdrawn.

As at 31 December 2020 the Bank have £14 million (31 December 2019: nil) of encumbered assets and £1,870 million (31 December 2019: £1,681 million) of unencumbered asset.

Table 32 Encumbered and unencumbered assets

	2020		
	Encumbered asset (£'000)	Unencumbered assets (£'000)	Total (£'000)
Loans	14,000	1,849,120	1,863,120
Equity instruments	-	19	19
Debt securities	-	-	-
Other items	-	20,859	20,859
Total	14,000	1,869,998	1,883,998

	2019		
	Encumbered asset	Unencumbered assets	Total
Loans	-	1,587,367	1,587,367
Equity instruments	-	17	17
Debt securities	-	51,188	51,188
Other items	-	42,392	42,392
Total	-	1,680,964	1,680,964

11. 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 2020.

REMUNERATION AND NOMINATIONS COMMITTEE ('RNC') – GOVERNANCE

The Remuneration Committee was extended in 2020 to form the Remuneration & Nominations Committee ('RNC'). The RNC of the Bank is responsible for the implementation of effective remuneration governance and related risk management practices. The RNC met quarterly throughout 2020 and also held one ad hoc meeting. Its primary purpose is to:

- Ensure that the Board and Executive Management Committee retain an appropriate structure, size and balance of skills to support the strategic objectives and values of the organisation;
- Ensure that the Board and EMC engage a broad set of qualities and competences when recruiting members to the management body and for that purpose put in place a policy promoting diversity on the management body;
- Identify and recommend for approval by the management body candidates to fill management body vacancies having evaluated the balance of knowledge, skills, diversity and experience of the management body;
- Periodically, and at least annually, assess the knowledge, skills and experience of individual members of the management body and the management body collectively, and report this to the management body;
- Periodically review the policy of the management body for selection and appointment of senior managers and make recommendations to the management body;

On an annual basis, the RNC is responsible for:

- Ensuring the relevant regulatory requirements of the Remuneration Code, and subsequent Remuneration Policies, are applied in practice and aligned policies reviewed on annual basis
- Reviewing local Executive Directors remuneration to ensure alignment with external and internal salary bandings prior to submitting to Group HR for review and approval;
- Reviewing expatriate Executive Directors' remuneration to ensure alignment with the appropriate external and internal salary bandings for the role being fulfilled;
- Reviewing the discretionary bonus allocations of certified staff (including local and expatriate staff) and identified Material Risk Takers or employees who could be involved in a material failure of risk or compliance management, whether or not escalated via the Board Risk

Committee, including for relevant staff i.e. Material Risk Takers in BOC Limited London Branch

- Reviewing and approving policies regarding recruitment, learning and development, assessment and performance appraisal.

The Terms of Reference of the RNC were last reviewed in October 2020 with updates being made to the RNC responsibilities.

The Board RNC 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 RNC comprises five members, being:

- Dr Gerard Lyons – Independent Non Executive Director, Chairman of the RNC;
- 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.

The RNC includes representatives from Board Audit and Board Risk Committees who bring their relevant experience to the process.

ROLE OF RELEVANT STAKEHOLDERS

The RNC 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 instance is any member of RNC present when their own remuneration is discussed.

In performing its duties, the RNC has sought external advice from McLagan (part of AON plc) in relation to the application of the FCA Remuneration Code, and remuneration benchmarking including market practice and peer group methodology.

REMUNERATION POLICY

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

The 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; and
- 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 reference to external market remuneration benchmarking data and reviewed, although not necessarily changed, annually. Increases are typically to ensure appropriate pay positioning relative to market range and relative pay of others doing the same or similar role;
- Benefits; which are also determined by having regard to external market benchmarking data and are designed to be market competitive, to meet the requirements of the Bank's employees and ensure they make appropriate health and lifestyle decisions as part of a wider flexible benefit scheme;
- Discretionary Bonus (both cash and deferred elements) 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.

These three elements are managed together to ensure that total reward is appropriate and aligned with our business objectives, strategy and risk appetite.

The RNC 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 Code. 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 as 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 an executive management member 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 Regulatory Technical Standards (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).

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 2020 financial year.

REMUNERATION AWARDED

The EBA requirements on remuneration state that variable pay shall not exceed 100% of fixed pay (can be increased to 200% subject to shareholder approval) and this requirement is included in the Bank's Remuneration Policy.

Table 33 Variable remuneration awarded

	2020
Number of staff receiving variable remuneration award	482
Total fixed pay (£)	29,610,790
Total variable pay (including discretionary bonus award, allowances and overtime) (£)	9,185,245
Total deferred remuneration paid out (£)	577,908
Total non deferred variable remuneration paid out (£)	7,681,036
Total outstanding deferred remuneration (to be paid 2021-2026) (£)	607,724
Total severance payments made	-
Total Remuneration (£)	47,657,864
Variable pay/fixed pay ratio	31%

Table 34 Analysis of remuneration amount between fixed and variable pay for code staff

2020	Management Body	Senior Managers	Others	Total
Number of Code Staff	10	21	73	104
Fixed Pay (£)	1,842,421	2,781,671	6,312,583	10,936,675
Variable Pay (£)	687,851	829,511	2,007,916	3,525,277

All remuneration payments were made by cash. The Bank does not have any non-cash vehicles in place.

The Bank did not pay any severance payments in 2020. There are no staff at the Bank who were paid over £898k (equivalent to €1 million⁴). The highest paid Director was paid £290k (equivalent to €323k) in 2020.

⁴ Converted to Euros using the exchange rate at 31 December 2020. £1=€1.113332