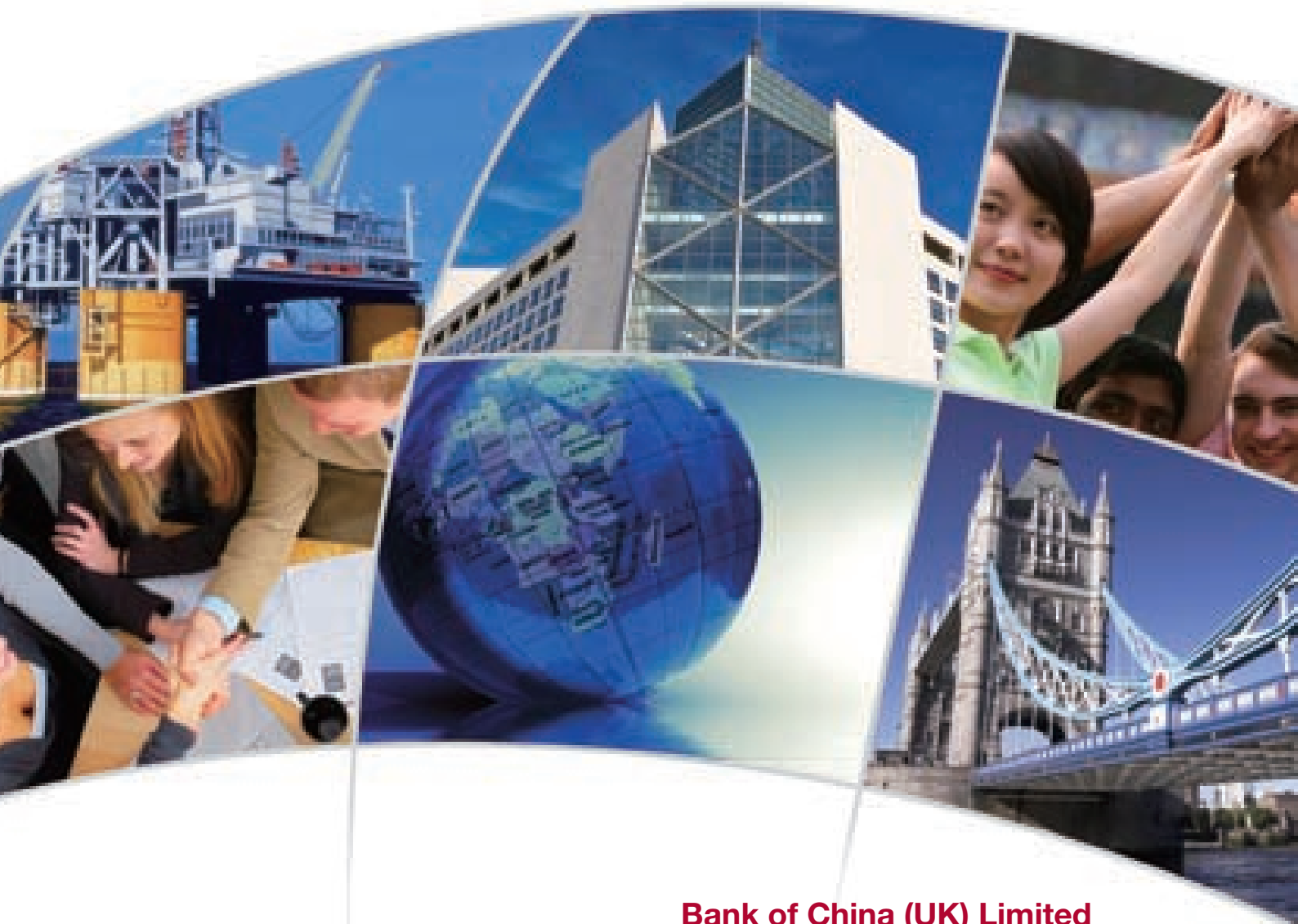




中國銀行(英國)有限公司  
BANK OF CHINA (UK) LIMITED

2009 Report and Financial Statements



**Bank of China (UK) Limited**

Delivering Growth and

**Excellence**

## Bank of China (UK) Limited

Bank of China (UK) Limited ("BOC UK" or the "bank") was incorporated in England and Wales as a private company with limited liability on 29 March 2007 and is authorised and regulated by the Financial Services Authority (the "FSA") in the United Kingdom (the "UK"). BOC UK is a full-service bank offering retail banking, corporate banking and trade finance services, and is a wholly-owned subsidiary of Bank of China Limited, Beijing ("BOC"), one of China's leading commercial banks.

## History of BOC UK

Although BOC has been active in the UK since November 1929 through its London Branch, the European Union (the "EU") Financial Groups Directive, implemented into the UK regulatory framework in January 2005, necessitated establishing a UK-authorized bank in order to

banking business and BOC Group function.

BOC UK is managed by the same general management team as London Branch. This arrangement has ensured from the very beginning that BOC UK has been managed by a team rich in UK experience and with extensive knowledge of the UK financial sector.

## Strategic Aims and Target Markets

BOC UK has taken advantage of BOC's strong international brand image and its positive relationships with its domestic customer base in order to assist Chinese corporate customers to raise corporate and project finance for UK and overseas investments, as well as providing trade-related services. Many Chinese corporations are turning global and look to BOC for a global presence: BOC UK is providing that worldwide access in Europe. BOC UK provides services

## BOC UK Subsidiaries

During 2008, BOC UK established and acquired its own subsidiary companies within the UK and Europe. These subsidiary companies are:

- Bank of China (Suisse) S.A.
- BOC (Suisse) Fund Management S.A.
- China Visa Services Limited

Bank of China (Suisse) S.A. ("BOCS") is a wholly-owned private banking subsidiary and is the first private banking entity in Switzerland that is part of a Chinese banking group. It opened for business in December 2008 with a highly experienced management team, which has long-standing established links to the Chinese business community in Europe and in China, and is expected to make a significant contribution to BOC UK future earnings.

BOC (Suisse) Fund Management S.A.



continue providing a full range of services to BOC customers in the UK and to support expansion within the European Economic Area (the "EEA") from London. London is not only the premier financial centre of Europe, through which a large proportion of the global trade in financial products is transacted, but there are also a great many Chinese companies listed on the London Stock Exchange: a significant factor in selecting London as the hub of the BOC Group's European aspirations.

The Financial Groups Directive required non-EEA banking groups operating in the EEA to be subject to "equivalent" worldwide supervision by their home country supervisor. In order to meet this requirement, the Board of Directors of BOC approved an arrangement whereby BOC UK would be established, whilst retaining a parallel operation via London Branch. The retail banking business of London Branch was transferred to BOC UK along with some wholesale business, subject to FSA capital adequacy requirements, and BOC UK opened for business on 15 October 2007. London Branch retained the larger wholesale

to retail and corporate customers with trading and/or personal links with China: a key target market is individuals and corporate customers of Chinese origin or with links into China, either operating in the UK or Europe or having some aspect of their operations in the EEA. BOC UK has proved an attractive choice for these customers because of its ability to take advantage of its Chinese links for its international operations, strong links to the Chinese domestic banking sector and access to the Chinese currency markets.

Similarly for global companies wishing to transact business in China, most prefer a local bank with a global presence to service their banking requirements in a seamless manner. BOC UK has provided such support for UK-based Chinese corporate customers and individuals, facilitating the China-based transactions of these UK-based corporate customers and providing access to the strengths and advantages of the BOC Group. BOC UK has also strengthened the BOC Group's international network, contributing to the growth of its domestic business.

("BOCS FM") is a majority-owned funds management company that offers fund management products to local clients and BOC Group clients in China and elsewhere. It was acquired in December 2008 and has already attracted major Chinese and EEA-based corporate investors to its funds.

The establishment of these entities in Switzerland marks an important milestone in the BOC Group's strategic aim to provide international private banking products and services to meet the needs and aspirations of its increasingly affluent international customer base.

China Visa Services Limited ("CVSL") is a wholly-owned subsidiary, set up with the assistance of the Ministry of Foreign Affairs of the People's Republic of China (the "PRC"). The first visa centre was opened for business in London in June 2008 and more centres are planned. CVSL has provided warm and efficient services which facilitate the clients, and has received favourable comments since establishment.

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Integrity



# Chairman's Statement

*The second full financial year of operations for Bank of China (UK) Limited ("BOC UK" or the "bank") has been eventful. Firstly, the repercussions from the market instability of 2008 have continued, causing substantial dislocation to the normal functioning of the financial system in the United Kingdom (the "UK").*

The second full financial year of operations for Bank of China (UK) Limited ("BOC UK" or the "bank") has been eventful. Firstly, the repercussions from the market instability of 2008 have continued, causing substantial dislocation to the normal functioning of the financial system in the United Kingdom (the "UK"). One important aspect of these changes has been the view expressed by the UK Government that it wishes to increase competition in the UK retail banking sector by encouraging new financial institutions to enter the market. This provides BOC UK with the opportunity to increase its retail banking activities, if it wishes to do so. Secondly, the business indicators suggest that although

the recession in the UK may have started to "bottom-out" in the fourth quarter of 2009, recovery will be a slow process and it will be late in 2010 before significant improvements are seen.

In spite of the difficult market conditions in 2009, BOC UK was able to achieve a positive after tax performance of £12,560,000, substantially ahead of the Board's expectations, for which the management team is to be congratulated.

The performance of the bank in 2009 has been excellent both in terms of financial performance and the effectiveness of the bank's

operations. Changes to the bank's governance policies and procedures that were introduced by management in 2008 have worked well and significant improvements have been made to the bank's operating model. These improvements have also provided greater transparency around the bank's decision-making functions. The bank's management continues to set itself the target of ensuring compliance with best practice in all aspects of the bank's activities.

Looking forward to 2010, the strong possibility of a slow economic recovery together with the inconclusive result of the recent UK General Election is likely to

suppress business confidence in the short term. The effect in the medium to long term of the creation of a coalition Government, the first in the UK for over 30 years, could be a further unsettling factor from a business perspective. Continued uncertainty about UK Government policy on a range of issues; reducing the public deficit, the restructuring of the UK taxation regime and relationships with the European Union (the "EU") could well damage economic prospects.

Although the economic prospects for 2010 are not entirely positive, I am confident that the bank's management team will be able to maximise the bank's performance

and achieve the business targets set by the Board.

One final comment in the context of BOC UK's membership of the wider Bank of China Group. 2009 marked the 80th Anniversary of the establishment of the BOC Group's first branch office in the UK. The successful celebrations to mark this event took place at the Guildhall in London on 11 May 2009 and were fully supported by colleagues from the BOC Group's Head Office, representatives from the markets and other banks and by the management and staff of BOC UK. The recently announced plan to relocate BOC UK's headquarters to a newly acquired building in the

City of London demonstrates the continuing commitment of the BOC Group to supporting its banking activities in the UK.



**Zhang Yanling**

*Chairman of the Board of Directors*

# Chief Executive Officer's Statement

*The financial performance of Bank of China (UK) Limited ("BOC UK" or the "Bank") during 2009 was substantially in excess of the financial targets set by its Board of Directors (the "Board"). After an unsatisfactory first half year, the bank's business development departments were able to source a much higher level of transactions which met the bank's credit and regulatory criteria, with the result that the bank achieved a full year after tax performance of £12,560,000.*

The financial performance of Bank of China (UK) Limited ("BOC UK" or the "Bank") during 2009 was substantially in excess of the financial targets set by its Board of Directors (the "Board"). After an unsatisfactory first half year, the bank's business development departments were able to source a much higher level of transactions which met the bank's credit and regulatory criteria, with the result that the bank achieved a full year after tax performance of £12,560,000.

Business conditions throughout 2009 were affected by the repercussions from the crisis in the financial markets in 2008. Although the withdrawal from the United Kingdom (the "UK") and international lending markets of many financial institutions presented BOC UK with significant business opportunities, it also required additional vigilance to ensure that the bank's risk management policies and procedures were fully observed. Asset quality has always been a key requirement for the bank and in this context, during the year, management initiated a detailed review of all the bank's outstanding transactions. Following this review, the decision was made to sell the bank's exposure to Cattles in the secondary market, resulting in a charge to the bank's profits of £4,850,000. Management is satisfied that the bank's current policies and procedures in respect

of loan asset quality remain appropriate.

In corporate banking, substantial progress was made in further developing the bank's established business lines of syndicated lending, corporate lending and trade services. In addition, substantial progress has been made in raising the bank's profile with the "outgoing" Chinese companies. A key strategy for the whole BOC Group is to fully support the efforts of Chinese companies expanding outside the People's Republic of China ("China" or the "PRC"). Given the strong and developing relationship between the UK and China, BOC UK has an important role to play in ensuring that the banking requirements of companies becoming more active in the UK, such as Geely and Shanghai Auto, are met.

In retail banking, in addition to expanding the bank's customer base, at mid-year the bank launched a new initiative regarding its retail mortgage loans, using independent third-party agencies to identify individual borrowers outside the bank's usual target market sectors, but who meet the bank's stringent lending criteria. The launch of this service, which coincided with a period in which a number of the traditional UK retail mortgage lenders were reducing their lending activity, coupled with the competitive pricing of our products, resulted in substantial interest from

new potential borrowers and the UK media. This innovative development raised the bank's profile in the UK and was representative of the progress made by the bank's Retail Banking department in improving the marketing of our retail products and services in 2009.

During the period under review, the bank continued to expand its non-banking services through the opening of a Manchester office of its subsidiary company, China Visa Services Limited ("CVSL"). This additional office in the UK, which opened on 7 July 2009 and other offices elsewhere in the EU that are currently under consideration, will both increase the bank's opportunities to cross-sell its banking services and to generate a much higher proportion of its revenue from non-interest sources, which is a key management objective.

An important strategic objective for the BOC Group is the establishment of viable and innovative private banking and wealth management services within the Group. The establishment of Bank of China (Suisse) SA ("BOCS") and a supporting funds management company BOC (Suisse) Funds Management SA ("BOCS FM") in December 2008 was an important initial step in meeting that objective. After the first full year of operations both of these companies have established a viable operational presence in the local

market and have made excellent progress in establishing effective lines of communication with other BOC Group entities. BOCS FM has launched a range of Renminbi-denominated investment funds, the first such funds to be available in the Swiss market. The management teams of both companies are to be congratulated for having successfully raised the profile of the BOC Group in this new strategic market.

We have continued to develop our internal risk and compliance policies and procedures. During the fourth quarter the bank's Legal and Compliance department implemented new Anti-Money Laundering and Anti Financial Crime software as part of a BOC Group EU-wide programme to upgrade the bank's ability to monitor customer account profiles and transactions. During 2010, software improvements will also be made that will allow the bank to enhance its ability to screen funds transfers against both internal and external Sanctions Lists. BOC UK will shortly be participating as a pilot site in a Group-wide project to implement new operational risk software. This system will meet the latest regulatory requirements with which the bank is required to comply.

The development of the bank's "soft resources" in the form of its staff, continued to be a high priority for management during 2009. The continuing increase in the bank's

overall staff numbers (approximately 10%) was in contrast to experience elsewhere in the industry where staff numbers in many other banks are being reduced through redundancy programmes. This has represented a continuing challenge to the Human Resources department which in addition to handling the assimilation of those new staff into the bank, is responsible for implementing updated staff development and assessment procedures and for managing the bank's increased training and development activities. Management is confident that the bank's objectives of maintaining a corporate culture that is based on honesty, integrity, creativity, compliance and harmony, have been met this year.

As mentioned earlier, this has been a challenging year in which the destabilisation of the financial markets that started in 2008, continued to have a substantial impact. Significant restructuring in the UK market has taken place, some of which, such as the UK Government's encouragement of new retail banking service providers to enter the market, will be to BOC UK's long term advantage. It was necessary for the management team to adopt a positive, flexible and innovative approach in order to maximise the bank's development during 2009. I am very pleased with the performance of the whole management team which has been

typified by strong cooperation and support across all business lines and departments within the bank.

Although the UK business indicators for 2010 are not positive, particularly in the light of the UK General Election which has recently taken place, management is confident that BOC UK's business will continue to grow in 2010. The increased focus on balance sheet strength and "brand" in the UK financial markets will be to BOC UK's advantage, given the support it enjoys from the BOC Group.

One final point is that BOC UK will be moving its headquarters into a new building in the City of London, during the third quarter of 2010, which was purchased by the BOC Group's Head Office. These new premises will accommodate a considerable expansion of BOC UK business in the future and is a clear statement of commitment by the BOC Group to our future activities in the UK.



**Dr. Kenneth Q. Ge**  
Chief Executive Officer  
Board Director



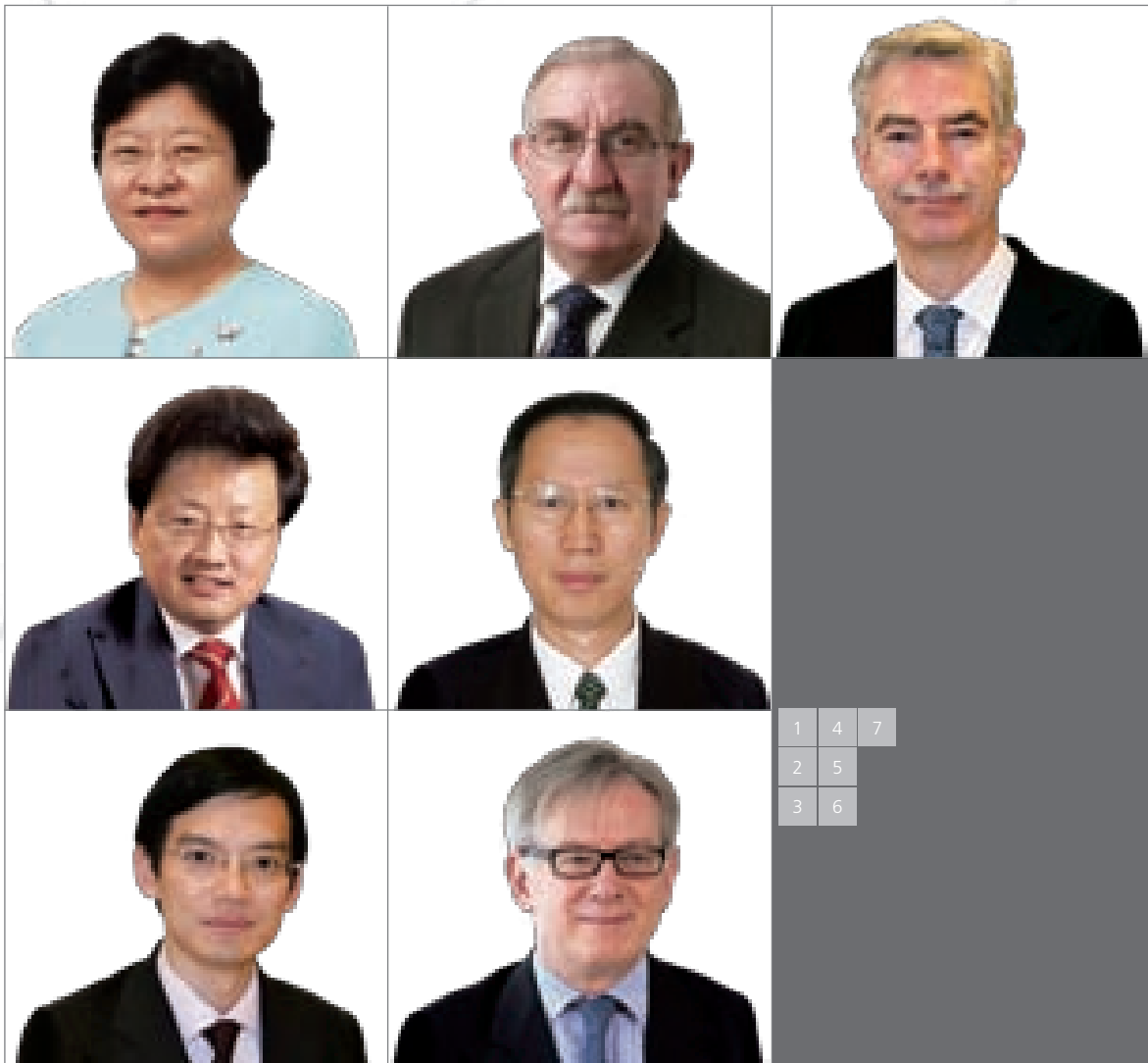
# Responsibility





# Directors

Working Experience and  
Other Positions Held by Directors



**1 ZHANG, Yanling,**  
Chairman

has served as Chairman of the Board of Directors of Bank of China (UK) Limited since 20 September 2007. Mrs. Zhang joined Head Office in 1977, holding various responsibilities, including Risk Management, Asset Recovery, Corporate Banking, Legal & Compliance, Audit and Inspection. Since 2002, she has served as Executive Vice President with responsibility for Overseas Business Management, International Settlements and Investment Banking and as Chief Legal Advisor. She also serves as Chairman of BOC Hungary, Vice-Chairman of BOCI Holdings Limited, Director of BOC Hong Kong (Holdings) Limited, and Director of BOC (Hong Kong) Limited. She is a member of many prestigious trade commissions in China, and author of marketing and settlement guides, articles and textbooks. She received a Bachelor of Literature degree from Liaoning University and a Master of Economics degree from Wuhan University. She is also a guest professor at the People's University.

**2 GE, Kenneth Q.,**  
Executive Director and  
Chief Executive Officer

has served as Executive Director and Chief Executive Officer of Bank of China (UK) Limited since 25 July 2007. Mr. Ge joined New York Branch in 1993 where he served in various roles, including Deputy General Manager and Head of Economic Research. He joined London Branch in 2004 as General Manager and continues in this role. He is also Chairman of BOC (Suisse) S.A., a Director of BOCI (UK), a Director of the Association of Foreign Banks in the UK, an active member of the Guild of International Bankers and a member of the prestigious EU Advisory Group. He received a PhD in Economics from the New School for Social Research, a Masters Degree in Economics from the University of Missouri-Kansas City and a BA degree majoring in Economics from Fudan University. He also spent several years at Drew University as an Assistant Professor in International Economics, as a Visiting Fellow of Economics at Yale University, and as a Research Fellow at the Institute of World Economy, Shanghai Academy of Social Sciences.

**3 FANG, Wenjian,**  
Executive Director and  
Chief Risk Officer

has served as Executive Director and Chief Risk Officer of Bank of China (UK) Limited since 25 July 2007. Mr. Fang joined Head Office in 1996 as a Project Manager in the Credit Business Department. In 1999 he became Deputy Chief of Business Division 3 in the Corporate Banking Department, and in 2002 became Chief of Business Division 3. He joined London Branch in 2004 as Deputy General Manager and continues in this role. He holds responsibility for the Risk Management functions of the Bank in the UK, including credit, market and operational risks, and also holds direct responsibility for the Risk Management Department and Treasury Middle Office. He is also Chairman of the Credit Risk Policy Committee, the Credit and Loan Approval Team and the Operational Risk Committee. He received a BA degree, majoring in English language and culture, and an MA degree in American Studies from the Beijing Foreign Studies University, an MBA with Distinction degree from the University of Hertfordshire, and he is also a CFA Charter holder and a member of the CFA Society of the UK.

**4 HINDS, Stephen,**  
*Executive Director and  
Chief Operating Officer*

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has served as Executive Director and Chief Operating Officer of Bank of China (UK) Limited since 25 July 2007. Mr. Hinds has had a distinguished career in international banking, with previous responsibilities in Operations, Internal Audit, Human Resources, Compliance and Corporate Governance. He has also set up London branches and subsidiaries for several major international banks, including BCI (1970), NMB (1980), ABC (1982) and the Islamic Bank of Britain (2003) – the first Islamic Bank in the UK. He joined London Branch in 2005 as Head of Regulatory Compliance and was appointed Deputy General Manager in 2006, a position he still holds. Current responsibilities include all administrative, operational support, compliance and transaction processing functions. He is Chairman of the following bank committees; Compliance, Executive Technology and Business Continuity Planning, and is a member of the Audit Committee. He is also a Director of BOC (Suisse) Fund Management S.A., an Associate of the Institute of Bankers, and member of the Guild of International Bankers.

**5 HUANG, Yangxin,**  
*Non-Executive Director*

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has served as a Non-Executive Director of Bank of China (UK) Limited since 20 September 2007. Mr. Huang joined Head Office in 1976 in the International Department and has served in locations all around the world, including the Americas and Hong Kong. Within Head Office, he has served as General Manager of International, Financial Institutions and Trade Settlement departments, and the Asia-Pacific Audit Centre. He currently serves as Chairman of BOC (Luxembourg) S.A., and as an Arbitrator at the China International Economic and Trade Arbitration Commission. He studied International Trade and Finance at the University of International Business and Economics, Settlements, Finance and Accounting at the Tianjin Finance College, and the Financing of International Trade at the City University. He achieved the prestigious British Government FCO China Senior Fellowship award in 1996, and received a Masters degree in Financial Law from the University of London.

6 **WORKMAN,  
Donald,**  
*Non-Executive Director*

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has served as a Non-Executive Director of Bank of China (UK) Limited since 20 September 2007. Mr. Workman has a wealth of experience within the international banking industry, most recently with Royal Bank of Scotland, where he is Chief Executive Officer of Global Banking and Markets for ABN AMRO Bank NV. He previously was responsible for the development and management of the Corporate Markets strategic partnership with Bank of China. In addition to his role as Non-Executive Director of Bank of China (UK) Limited, he is a Director of several other companies, both within the financial services sector and other general business sectors. He received an MA degree from Magdalen College Oxford, and is a fellow of the Chartered Institute of Bankers in Scotland. He is also Chairman of the Board of Governors of Edinburgh College of Art and a member of Court Edinburgh Academy. He also acted as co-Chairman of the International Monetary Fund (IMF) Conferences in Beijing (2005) and Washington (2006).

7 **FITZGIBBON,  
Christopher,**  
*Non-Executive Director*

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has served as a Non-Executive Director of Bank of China (UK) Limited since 20 September 2007. Mr. Fitzgibbon has a wealth of experience of the international financial services industry, and of China particularly, having served as Chairman of the China Desk for Deloitte UK for many years, and more recently as a Board member and Chairman of the Audit Committee of the Great Britain China Centre. He is an expert on Chinese business and has published several articles and reports on technical aspects of UK and international tax law, and guides for Chinese businesses investing in the UK. He has also co-authored a book on Taxation and Banking. He has contributed as a member of several trade agencies, including the Taiwan Britain Business Council, the Professional Firms and Inward Investment Agencies Committee, and the China Britain Business Council. He received a BA degree in Classics and Law from Oxford University, and is a qualified Barrister and Chartered Accountant (FCA).

# Senior Management



**1 GE, Kenneth Q.,**  
Executive Director and  
Chief Executive Officer

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has served as Executive Director and Chief Executive Officer of Bank of China (UK) Limited since 25 July 2007. Mr. Ge joined New York Branch in 1993 where he served in various roles, including Deputy General Manager and Head of Economic Research. He joined London Branch in 2004 as General Manager and continues in this role. He is also Chairman of BOC (Suisse) S.A., a Director of BOCI (UK), a Director of the Association of Foreign Banks in the UK, an active member of the Guild of International Bankers and a member of the prestigious EU Advisory Group. He received a PhD in Economics from the New School for Social Research, a Masters Degree in Economics from the University of Missouri-Kansas City and a BA degree majoring in Economics from Fudan University. He also spent several years at Drew University as an Assistant Professor in International Economics, as a Visiting Fellow of Economics at Yale University, and as a Research Fellow at the Institute of World Economy, Shanghai Academy of Social Sciences.

**2 LI, Chuang-Fei,**  
Chief Lending Officer

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has served as Chief Lending Officer of Bank of China (UK) Limited since September 2007, and as Deputy General Manager of London Branch since 1993. Mr. Li joined London Branch in 1978 as a researcher. He has held various responsibilities, including European Financial Institutions and Corporate Lending, Bullion Trading, Aircraft Financing and Advisory Services, and also set up the first SWIFT operating unit within a Chinese bank. In 1993, he joined General Management, with responsibility for Investment Banking and large lending. Under his leadership, London Branch obtained an investment banking license in the UK, and he set up the first Investment Banking business unit, which later became BOC International, and the first Syndications and Financial Institutions unit in the Group. Current responsibilities include the European African Syndication Centre, Corporate Banking, Trade Finance, and Financial Institutions business units. Mr. Li was a Fellow of the Asia Centre, Harvard University.

**3 FANG, Wenjian,**  
Executive Director and  
Chief Risk Officer

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has served as Executive Director and Chief Risk Officer of Bank of China (UK) Limited since 25 July 2007. Mr. Fang joined Head Office in 1996 as a Project Manager in the Credit Business Department. In 1999 he became Deputy Chief of Business Division 3 in the Corporate Banking Department, and in 2002 became Chief of Business Division 3. He joined London Branch in 2004 as Deputy General Manager and continues in this role. He holds responsibility for the Risk Management functions of the Bank in the UK, including credit, market and operational risks, and also holds direct responsibility for the Risk Management Department and Treasury Middle Office. He is also Chairman of the Credit Risk Policy Committee, the Credit and Loan Approval Team and the Operational Risk Committee. He received a BA degree, majoring in English language and culture, and an MA degree in American Studies from the Beijing Foreign Studies University, an MBA with Distinction degree from the University of Hertfordshire, and he is also a CFA Charter holder and a member of the CFA Society of the UK.

**4 SUN, Xixu,**  
*Chief Retail Banking  
Officer*

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has served as Chief Retail Banking Officer of Bank of China (UK) Limited since September 2007, and as Deputy General Manager of London Branch since June 2006. Mr Sun joined Shandong Branch in 1989 and served as Assistant Manager, Deputy Manager and Manager of the International Settlement, Foreign Exchange and Treasury departments, including two secondments to Italian Banks in 1993 and 1995. Between 1997 and 2001, he served as Senior Manager of BOC Group Investment Limited, Vice President of BOC International Investment Limited, and Senior Manager of BOC Hong Kong & Macao Regional Headquarters. In 2005, he worked in the Asset & Liability Management and Global Financial Market departments of Head Office. He also serves as Chairman of China Visa Services Limited, and as Director of BOC (Suisse) S.A. Mr Sun is an Arbitrator at Qingdao Municipal Arbitration Commission and also spent two years teaching at Tianjin University. He holds a BA degree and Postgraduate diploma from Tianjin University, as well as an EMBA degree from CASS Business School, City University, London.

**5 HINDS, Stephen,**  
*Executive Director and  
Chief Operating Officer*

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has served as Executive Director and Chief Operating Officer of Bank of China (UK) Limited since 25 July 2007. Mr. Hinds has had a distinguished career in international banking, with previous responsibilities in Operations, Internal Audit, Human Resources, Compliance and Corporate Governance. He has also set up London branches and subsidiaries for several major international banks, including BCI (1970), NMB (1980), ABC (1982) and the Islamic Bank of Britain (2003) – the first Islamic Bank in the UK. He joined London Branch in 2005 as Head of Regulatory Compliance and was appointed Deputy General Manager in 2006, a position he still holds. Current responsibilities include all administrative, operational support, compliance and transaction processing functions. He is Chairman of the following bank committees; Compliance, Executive Technology and Business Continuity Planning, and is a member of the Audit Committee. He is also a Director of BOC (Suisse) Fund Management S.A., an Associate of the Institute of Bankers, and member of the Guild of International Bankers.

**6 TRUSSLER, Stewart,**  
*Chief Financial Officer*

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has served as Chief Financial Officer of Bank of China (UK) Limited since August 2008, and as Assistant General Manager of London Branch since 2008. Mr. Trussler joined London Branch in 2005 as Financial Controller with responsibility for all financial and regulatory reporting, capital planning, corporate tax issues, and liaison with the Bank's external auditors, including direct responsibility for the Accounts Department and the Treasury function. He also serves as Chairman of the Bank's Asset and Liability Committee, and is a member of the Executive Technology Steering Committee. He is a qualified accountant, having achieved the Association of Chartered Certified Accountants (ACCA) qualification in 1993, being admitted as a Fellow of the ACCA in 1998. Prior to joining the Bank, he worked as a Financial Director in the media and broadcasting sector and held various senior positions in other financial institutions.

# Report of the Directors

## Principal Activities

Bank of China (UK) Limited (“BOC UK” or the “bank”) is a full service bank offering retail, corporate, and trade finance services in the United Kingdom (the “UK”). The bank is a wholly-owned subsidiary of Bank of China Limited, Beijing (“BOC”). The bank is authorised and regulated by the Financial Services Authority (the “FSA”).

BOC UK was incorporated in England and Wales as a private company with limited liability on 29 March 2007.

Following authorisation of the bank by the FSA on 24 September 2007, we took the decision to amend our annual reporting date to 30 September 2007 and reported the bank’s pre-trading activities to that date. Subsequent to that date the annual reporting date was amended to 31 December. This amendment now establishes us on the same reporting cycle adopted by the Bank of China Group (the “BOC Group”) and indeed by the majority of the financial services industry in the UK. Hence the comparative figures cover a 15-month period from 1 October 2007 to 31 December 2008.

Our corporate and trade finance business encompasses funding and advisory services for Chinese corporates seeking to expand in the UK and Europe. Syndication plays an important role for the bank in gaining access to European corporate clients. Our retail activities focus on branch banking. The bank offers standard high street retail banking services including current accounts, savings accounts, debit and credit cards, mortgage products and personal and business loans.

## Business Review

As at 31 December 2009 the bank had total assets of £982,073,000, (2008 £1,055,809,000).

The bank’s assets are primarily financed by inter-bank and intra-group deposits. The bank has, however, continued to increase its customer deposits and this reflects our determination to develop our corporate banking services as well as to help in meeting the bank’s funding requirements.

For the year ended 31 December 2009, the bank generated a post-tax profit of £12,560,000, (2008: £3,012,000) which was

substantially in excess of the budget set by the Board of Directors (the “Board”). This result was achieved after an impairment charge of £5,080,000 against a loan to Cattles. This asset was subsequently disposed of in the secondary market for a higher amount than the revised carrying amount resulting in a write-back of the impairment amount of £230,000.

The bank benefited from a higher than expected income from the provision of service charges to other BOC Group entities as disclosed in Note 35.

## Retail Banking

The bank continued to build its brand image and increase its customer base in the UK retail market. Its mortgage product became very competitive in 2009. This not only brought the bank an increased market share, but also enhanced the bank’s brand awareness. The deposit balance has increased 24% to £356 million by the end of 2009 showing, in the opinion of the directors, that customers regard the bank as a financially sound institution during uncertain times.

In addition to traditional retail products, the bank developed the Hong Kong Stocks Express service, which is the first Hong Kong stock investment product in the UK that enables customers to operate with a local account rather than an offshore account. A customer service hotline for both personal and business internet banking has also been set up and the service enhanced to offer a comprehensive internet banking service to existing customers.

## Corporate Banking

Whilst continuing to expand its presence in the syndicated loans market, the bank is also seeking to further develop its bilateral lending by offering a range of banking facilities to corporate customers including loans, trade services, cash management and foreign exchange. As well as addressing the UK market the bank is also focused on targeting new relationships in Europe, the Middle East and Africa.

A key objective for the wholesale lending business is to be the preferred bank for Chinese corporates conducting business in the UK and other European Union ("EU") countries.

## Financial Markets

The Financial Markets and Financial Institutions department comprises three divisions; foreign exchange, money market and fixed income investments. During the year, these activities have continued to focus upon efficient liquidity management and the funding requirements of the bank's activities. There was no proprietary trading activity during the year under review.

## Dividends

The directors do not recommend the payment of a dividend.

## Directors' Interest

The directors who held office during the period were as follows:

Mrs. Yanling Zhang  
*Chairman*  
Dr. Kenneth Q. Ge  
*Chief Executive Officer*  
Mr. Wenjian Fang  
*Chief Risk Officer*  
Mr. Stephen Hinds  
*Chief Operating Officer*  
Mr. Yangxin Huang  
*Non-Executive*  
Mr. Christopher Fitzgibbon  
*Non-Executive*  
Mr. Donald Workman  
*Non-Executive*

None of the directors who held office at the end of the financial period had any disclosable interest in the shares of the bank at that date.

## Directors' Emoluments

Information on emoluments of the directors of BOC UK, in accordance with the Companies Act 2006, is disclosed in Note 16 to the financial statements.

## Directors' Indemnities

The BOC UK Board believes that it is in the best interests of the bank to attract and retain the services of the most able and experienced directors by offering competitive terms of engagement, including the granting of indemnities on terms consistent with the applicable statutory provisions. Qualifying third party indemnity provisions (as defined by Section 234 of the Companies Act 2006) were accordingly in force during the course of the financial period ended 31 December 2009 for the benefit of the directors and, at the date of this report, are in force for the benefit of the directors in relation to certain losses and liabilities which they may incur (or have incurred) in connection with their duties, powers or office.

## Employees

There were 192 employees of BOC UK at 31 December 2009.

## Charitable and Political Contributions

For the year ended 31 December 2009, the bank did not fund any charities nor did it make any donations to political organisations.

## Financial Instruments

The bank's principal financial risk management objectives and policies including its exposure to credit risk, liquidity risk, and market risk are set out in pages 48 to 61 in Note 7 to the financial statements.

Further information regarding the bank's approach to risk management and its capital adequacy are contained in the

unaudited disclosures made under the requirements of Basel II Pillar 3 (the Pillar 3 disclosures). These disclosures will be published on the bank's website shortly after the approval of these financial statements at [www.bocukltd.co.uk](http://www.bocukltd.co.uk).

## Auditors

The directors who held office at the date of approval of this Director's Report confirm that:

- So far as they are each aware, there is no relevant audit information of which the bank's auditors are unaware.
- Each director has taken all steps that he/she ought to take as a director to make himself/herself aware of any relevant audit information and to establish that the bank's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 (2) of the Companies Act 2006.

Pursuant to Section 487 of the Companies Act 2006, the auditors will be deemed to be reappointed and PricewaterhouseCoopers LLP will therefore continue in office.

90 Cannon Street,  
London  
EC4N 6HA

By order of the Board,



**Dr Kenneth Q. Ge**  
*Chief Executive Officer*  
*Board Director*

21 May 2010

# Corporate Governance Statement

Bank of China (UK) Limited (“BOC UK” or the “bank”) is committed to the principles of corporate governance contained in the UK Combined Code on Corporate Governance (the “Combined Code”) issued by the Financial Reporting Council.

## Corporate Governance Framework

The bank’s corporate governance framework centres on the Board of Directors (“the Board”), which provides guidance and effective oversight of the senior management of the bank and of its subsidiaries. In order to run the business effectively, the Board delegates responsibility for the day-to-day management of the bank to the Chief Executive Officer, who is supported by the Executive Management Committee, which he chairs. Oversight of Bank of China (Suisse) S.A. and BOC (Suisse) Funds Management S.A. entities is achieved by representation on both Boards of Directors by at

least one executive director of the bank. China Visa Services Limited has a member of the Executive Management Committee as Chairman of its Board of Directors.

Board meetings are scheduled throughout the year as evenly as possible. Scheduled Board and Committee meetings are arranged in advance to ensure, as far as possible, that directors can manage their time commitments. All directors are provided with supporting papers and relevant information for each meeting and are expected to attend, unless there are exceptional circumstances that prevent them from doing so.

In the event that a director is unable to attend a meeting, he/she will still receive the papers for the meeting and will normally discuss any matters they wish to raise with the chairman of the meeting, to ensure their views are taken into account. In addition, all directors are able to discuss any issues with the Chairman of the Board and/or the Chief Executive Officer at any time. During the year ended 31

December 2009, it is considered that all directors contributed the time necessary to discharge their responsibilities to the Board.

The Chairman of the Board works closely with the Company Secretary to ensure that accurate, timely and clear information flows to the Board. Supporting papers for scheduled meetings are distributed in advance of each meeting. All directors have access to the services of the Company Secretary.

Following the provisions in the Articles of Association the appointment or removal of a member of the Board requires the approval of the shareholders. Independent non-executive directors are appointed for three-year renewable terms which may, in accordance with the Articles of Association, be terminated without notice or payment of compensation.

## Board Effectiveness

Under United Kingdom (the “UK”) Company Law, directors must act in a way they consider, in good faith,

would be most likely to promote the success of the bank for the benefit of the shareholders as a whole. In doing so, the directors must have regard (amongst other matters) to the following:

- The likely consequences of any decision in the long term
- The interests of the bank's employees
- The need to foster the bank's business relationships with suppliers, customers and others
- The impact of the bank's operations on the community and the environment

The Board is responsible to shareholders for creating and delivering sustainable shareholder value through the management of the bank's businesses. It therefore determines the goals and policies of the bank to deliver such long-term value and provides overall strategic direction within a

framework of rewards, incentives and controls. The Board aims to ensure that management strikes an appropriate balance between promoting long-term growth and delivering short-term objectives.

The Board is also responsible for ensuring that management maintains a system of internal controls that provide assurance of effective and efficient operations, internal financial controls and compliance with the laws and regulations. In carrying out this responsibility, the Board has regard to what is appropriate for the bank's business and reputation, the materiality of the financial and other risks inherent in the business, and the relative costs and benefits of implementing specific controls.

The Board is also the decision-making body for all other matters of such importance as to be of significance to the bank as a whole because of their strategic, financial or reputational implications or consequences.

A typical Board meeting receives reports from the Chief Executive Officer and will also be presented with an update on the execution of strategy in the main businesses and functions. It will also receive reports from each of the principal Board Committees and may also receive a report from the Company Secretary on any relevant corporate governance matters.

## Chairman and Chief Executive Officer

The roles of the Chairman and the Chief Executive Officer are separate. The Chairman's main responsibility is to lead and manage the work of the Board to ensure that it operates effectively and fully discharges its legal and regulatory responsibilities. The Board has delegated the responsibility for the day-to-day management of the bank to the Chief Executive Officer, who is responsible for recommending strategy to the Board, leading the executive directors and for making and implementing operational decisions.

## Board Balance and Independence

The Board has collective responsibility for the success of the bank, however, executive directors have direct responsibility for business operations, whereas non-executive directors are responsible for bringing independent judgement and scrutiny to decisions taken by the Board, providing objective challenge to management. The Board can draw on the wide range of skills, knowledge and experience they have built up as directors of other companies and as business leaders.

The Combined Code sets out circumstances that the Board may find relevant when determining the independence of a non-executive director. The Board considers that the following behaviours are essential in order for the Board to conclude that an individual is independent:

- Provides objective challenge to management
- Is prepared to challenge others' assumptions, beliefs or viewpoints as necessary for the good of the bank
- Questions intelligently, debates constructively, challenges rigorously and makes decisions dispassionately
- Is willing to stand up and defend their own beliefs and viewpoints in order to support the ultimate good of the bank
- Understands the bank's business and affairs, to enable them properly to evaluate the information and responses provided by management

All directors must report any changes in their circumstances to the Board and the shareholders reserve the right to terminate the appointment of a director if there are any material changes in their circumstances that may conflict with their commitments as a director of the bank, or that may impact on their independence.

## Information and Professional Development

A three-part training programme is in place for directors. This comprises:

- Induction training, when they join the Board;
- Training and awareness of the business of the bank; and
- Training and awareness of external technical matters.

A presentation is given to all new directors, which outlines their responsibilities as a director of a UK limited company and provides an overview of the bank and its businesses. Each new director then has a tailored induction programme to further familiarise themselves with the bank and its businesses. This takes the form of sessions with each of the executive directors and the heads of the main bank functions and includes opportunities to visit operational sites to meet with senior management and employees. Once they have completed the

first part of their induction, and have a good overview of the bank, they then have further sessions with the executive directors and senior managers from each of the principal business units to gain a detailed and in-depth understanding of their business, which includes the challenges, opportunities and risks that are faced by each.

There have been no new directors appointed during the year under review and therefore no further induction training has taken place.

In August 2009, the full Board attended Corporate Governance and Regulatory Responsibilities training sessions which continued from the previous training they attended on these subjects but comprised up-to-date information within each subject area that had changed since the previous training sessions.

## Performance Review

As with the previous year, annual performance contracts were established for the executive directors for 2009 to assess their performance across five key performance areas aligned to the bank's 'balanced scorecard' approach to performance management, being:

- Financial
- Business Processes and Technical Skills
- Customer Focus
- Leadership
- Team

The performance contracts provide an overall summary of their achievements throughout the year in their roles as directors of the bank.

## Internal Control

The Board is responsible for the bank's system of internal control. It is designed to facilitate effective and efficient operations and to ensure the quality of internal and external reporting and compliance with applicable laws and regulations. In devising internal controls, the Board considers the nature and extent of the risk, the likelihood of it crystallising and the cost of controls.

The Board receives regular reports and updates from the Executive Management and the Audit Committee on the effectiveness of the bank's internal control system. The system of internal controls is also subject to regulatory oversight and periodic FSA ARROW 2 assessment.

## Remuneration Committee Report

The Remuneration Committee (the "Committee") met on three occasions in 2009 and considered and approved the following:

- **Corporate Governance**

The Committee members considered how other global banks with overseas subsidiaries operate their Remuneration Committees specifically in relation to corporate governance structures i.e. global Head Office versus local requirement and agreed that alignment to global policies and procedures was a priority where practical but local regulations and legislation would always prevail.

- **The Implementation of a New Grading Structure**

To assist with career development and succession planning strategies, the Committee approved a new Grading Structure comprising 17 grades across Departmental and Management functions which was implemented with effect from 1 January 2009.

- **Training and Development**

In conjunction with staff development strategies, the Committee approved the Training and Development plan for 2009 to primarily focus on Management Development Programmes for staff across different levels of management grades, technical training including professional qualifications sponsorship, language/cultural awareness training, and preparation for the rollout of IT training in 2010.

- **Performance Management**

In alignment with Performance Management strategies, the Committee approved the review of the Performance Management process to streamline and clarify measurement application, weighting application and moderation of performance ratings. Performance Management workshops were subsequently rolled out across the bank in May 2009 to further embed Performance Management principles. The Committee approved the year-end Performance Management process which was also aligned to annual salary and discretionary bonus scheme allocation.

- **Revision of the Bank's Code of Conduct and Employment Related Policies**

The Committee approved a full review of the bank's Code of Conduct due to a number of new/amended European Union (the "EU") and UK employment legislation; the Committee additionally approved the amendment of specific terms and conditions of employment for staff as a result of new/amended employment legislation which has also resulted in the implementation and amendment of human resources-related policies. The newly revised Code of Conduct was implemented across the bank in January 2010.

- **Flexible Benefits Scheme**

The Committee considered the implementation of a Flexible Benefits Scheme (including salary exchange components if appropriate) to build the benefits package that is best for individuals considering that the diverse range of staff may have different needs/ life-styles. Further discussion will be undertaken upon production of supporting documentation.

The Chairman of the Committee reported on the aforementioned matters to the Board after each meeting and advised the Board on decision-making when required.

## Audit Committee Report

The Audit Committee (the "Committee") comprises: three non-executive directors who are voting members; Mr Chris Fitzgibbon (Chairman), Mr Huang Yangxin and Mr Donald Workman, and two non-voting members; Mr Stephen Hinds, Chief Operating Officer and Mr Yue Long, Head of Internal Audit. The Committee meets at least quarterly and four meetings were held in 2009; the external auditors were in attendance at each meeting. During the course of the year, the Committee considered the effectiveness of the bank's systems for internal control, risk management and compliance with financial services legislation and regulations. In addition the following key activities were undertaken:

- The Committee approved the scope of the external auditors' work, and separately assessed their effectiveness.
- The Committee reviewed the financial statements presented to the Board and the quality and acceptability of the related accounting policies, practices and financial reporting disclosures.
- The Internal Audit Department Plan was considered and approved. The effectiveness of the department and the adequacy of its resources were also considered and its ongoing performance monitored.
- Regular reports and updates from the Internal Audit department were received and considered.
- Reports were received from Risk Management and Legal and Compliance departments and these were reviewed and discussed.
- A self assessment as to the effectiveness of the Audit Committee was completed in September 2009 and the conclusion reached was that the Committee was operating effectively. This conclusion was endorsed by the Board at the November 2009 Board meeting.

Bank of China (Suisse) S.A., a subsidiary of the bank, has its own Audit Committee and governance structure. However the Board requires the Audit Committee to have oversight of all subsidiaries and asked Executive Management to facilitate this. Appropriate procedures were put in place in March 2010.

# Statement of Directors' Responsibilities in Respect of the Directors' Report and the Financial Statements

The directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial period. Under that law the Board of Directors (the "Board") of Bank of China (UK) Limited ("BOC UK" or the "bank") has elected to prepare the financial statements in accordance with International Financial Reporting Standards (the "IFRSs") as adopted by the European Union (the "EU"). The financial statements are required by law to give a true and fair view of the state of affairs of the bank and of the profit of the bank for the period reported.

International Accounting Standard 1 requires that financial statements present fairly the financial position, performance, and cash flow of the bank. The Companies Act 2006 provides references in relevant parts of that Act to financial statements giving a true and fair view, and references to financial statements achieving a fair presentation. In preparing these financial statements the directors are required to:

- Properly select suitable accounting policies and apply them consistently

- Make judgements and estimates that are reasonable and prudent
- State that the financial statements comply with IFRSs
- Present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information
- Provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions and other events and conditions on the entity's financial position and financial performance
- Prepare the financial statements on a going concern basis unless it is inappropriate to presume that the bank will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the bank and which enable them to ensure that the financial statements and the Directors' Report comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open

to them to safeguard the assets of the bank and to prevent and detect fraud and other irregularities.

## Directors' Responsibility Statement

On behalf of the directors of BOC UK, I confirm that to the best of my knowledge the following statements are true:

1. The financial statements, prepared in accordance with International Financial Reporting Standards, as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit of the bank.
2. The Directors' Report includes a fair review of the development and performance of the business and the position of the bank.



**Dr. Kenneth Q. Ge**  
*Chief Executive Officer*  
*Board Director*

21 May 2010

# Independent Auditors' Report



## To the Members of Bank of China (UK) Limited

We have audited the financial statements of Bank of China (UK) Limited ("the company") for the year ended 31 December 2009 which comprise the Income Statement, Statement of Comprehensive Income, Statement of Financial Position, Statement of Changes in Equity, Statement of Cash Flows, the Accounting Policies and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and as applied in accordance with the Companies Act 2006.

## Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 26, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

## Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

## Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2009 and of its cash flows for the year then ended;

## Independent Auditors' Report

- have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the Companies Act 2006; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

## Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

## Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

*PricewaterhouseCoopers LLP*

**Richard Oldfield** (Senior Statutory Auditor)  
for and on behalf of **PricewaterhouseCoopers LLP**  
Chartered Accountants and Statutory Auditors  
London

21 May 2010

# Income Statement

£000	Note	<b>12 months to 31 December 2009</b>	15 months to 31 December 2008
<b>Continuing operations</b>			
Interest income from financial investments		<b>9,761</b>	17,202
Other interest income		<b>10,861</b>	36,869
Interest expense		<b>(7,677)</b>	(35,584)
Net interest income	10	<b>12,945</b>	18,487
Fee and commission income		<b>3,689</b>	3,886
Fee and commission expense		<b>(135)</b>	(238)
Net fee and commission income	11	<b>3,554</b>	3,648
Net loss on derivative financial instruments	12	<b>(2,181)</b>	(3,314)
Foreign exchange gain		<b>303</b>	915
Other operating income	13	<b>19,368</b>	9,501
Profit on sale of debt securities		<b>534</b>	2,495
Non-interest income		<b>18,024</b>	9,597
<b>Total income</b>		<b>34,523</b>	31,732
Staff costs	14	<b>(11,761)</b>	(11,629)
Administration and general expenses	15	<b>(3,702)</b>	(5,767)
Depreciation of plant and equipment	24	<b>(496)</b>	(292)
Amortisation of intangible assets	25	<b>(106)</b>	(84)
Impairment charges	22 (c)	<b>(1,827)</b>	(9,386)
<b>Profit before income tax</b>		<b>16,631</b>	4,574
Income tax expense	17	<b>(4,071)</b>	(1,562)
<b>Profit for the year</b>		<b>12,560</b>	3,012

# Statement of Comprehensive Income

£000	Note	<b>12 months to 31 December 2009</b>	15 months to 31 December 2008
<b>Profit for the year</b>		<b>12,560</b>	3,012
<b>Other comprehensive income</b>			
Net change in fair value of available for sale financial assets	22	<b>22,656</b>	(34,234)
Net change in fair value of available for sale financial assets transferred to profit or loss	22	<b>(3,206)</b>	8,965
Net gain (loss) on available for sale financial assets		<b>19,450</b>	(25,269)
Income tax (expense)/income relating to components of other comprehensive income	17	<b>(5,466)</b>	7,115
<b>Other comprehensive income for the year, net of income tax</b>		<b>13,984</b>	(18,154)
<b>Total comprehensive income for the year</b>		<b>26,544</b>	(15,142)

# Statement of Financial Position

£000	Note	31 December 2009	31 December 2008
<b>Assets</b>			
Cash and cash equivalents	18	127,812	40,069
Loans and advances to banks	20	36,933	67,272
Loans and advances to customers	21	504,743	551,148
Derivative financial instruments	19	1,375	5,554
Prepayments, accrued income and other assets	27	29,780	21,197
Available for sale investments	23	249,004	330,093
Deferred tax asset	26	16	5,656
Intangible assets	25	440	321
Tangible fixed assets	24	2,025	2,371
Investment in group companies	35	29,945	32,128
<b>Total assets</b>		<b>982,073</b>	<b>1,055,809</b>
<b>Liabilities</b>			
Deposits from banks	28	366,763	560,116
Deposits from customers	29	378,219	290,289
Derivative financial instruments	19	5,766	5,390
Other liabilities	31	13,404	10,601
Accruals and deferred income	32	2,166	4,099
Current tax liabilities		4,106	195
Deferred tax liabilities	26	–	14
Subordinated liabilities	30	60,000	60,000
<b>Total liabilities</b>		<b>830,424</b>	<b>930,704</b>
<b>Equity</b>			
Authorised and called up share capital	33	140,000	140,000
Retained earnings		15,819	3,259
Available for sale reserve		(4,170)	(18,154)
<b>Total shareholders' equity</b>		<b>151,649</b>	<b>125,105</b>
<b>Total shareholders' equity and liabilities</b>		<b>982,073</b>	<b>1,055,809</b>

The financial statements were approved by the Board of Directors of Bank of China (UK) Limited and authorised for issue on 21 May 2010. They were signed on its behalf by:



**Dr Kenneth Q. Ge**  
Chief Executive Officer  
Board Director

## Statement of Changes in Equity

£000	Issued share capital	Retained earnings	Available for sale reserve	Total
<b>As of 1 January 2009</b>	<b>140,000</b>	<b>3,259</b>	<b>(18,154)</b>	<b>125,105</b>
<b>Unrealised profit on available for sale investments net of income tax</b>	<b>–</b>	<b>–</b>	<b>13,984</b>	<b>13,984</b>
<b>Profit for the financial year</b>	<b>–</b>	<b>12,560</b>	<b>–</b>	<b>12,560</b>
<b>As at 31 December 2009</b>	<b>140,000</b>	<b>15,819</b>	<b>(4,170)</b>	<b>151,649</b>
As of 1 October 2007	140,000	247	–	140,247
Unrealised loss on available for sale investments net of income tax	–	–	(18,154)	(18,154)
Profit for the financial period	–	3,012	–	3,012
<b>As at 31 December 2008</b>	<b>140,000</b>	<b>3,259</b>	<b>(18,154)</b>	<b>125,105</b>

# Statement of Cash Flows

£000	Note	12 months to 31 December 2009	15 months to 31 December 2008
<b>Cash flows from operating activities</b>			
Profit on ordinary activities before taxation		16,631	4,574
<b>Adjustments for non cash items</b>			
Depreciation and amortisation of plant and equipment and intangible assets		602	376
Net impairment loss on investment securities		(3,206)	8,965
Net impairment loss on loans and advances		5,033	421
Interest receivable from financial investments		(9,761)	(17,202)
Other interest receivable		(10,861)	(36,869)
Interest payable		7,677	35,584
Net profit on sale of available for sale investments		(569)	(2,657)
Amortisation of net premiums on available for sale investments		35	162
Exchange-rate movements on available for sale investments		23,990	(59,563)
Other exchange-rate movements		2,301	–
<b>Changes in operating assets and liabilities</b>			
Change in derivative assets held for risk management		4,179	(5,554)
Change in loans and advances to banks		30,339	(67,272)
Change in loans and advances to customers		41,372	(551,569)
Change in other assets		(10,407)	(16,295)
Change in derivative liabilities held for risk management		376	5,390
Change in deposits from banks		(191,170)	560,116
Change in deposits from customers		87,930	290,289
Change in other liabilities and provisions		3,438	11,254
<b>Adjustment for cash items</b>			
Interest and coupon received		25,680	43,862
Interest paid		(10,244)	(32,258)
Income tax paid		–	(1,815)
<b>Net cash generated from operating activities</b>		<b>13,365</b>	<b>169,939</b>
<b>Cash flows from investing activities</b>			
Acquisition of investment securities		–	(471,210)
Proceeds from sale of investment securities		77,230	176,536
Acquisition of property and equipment		(150)	(2,663)
Acquisition of intangible assets		(225)	(405)
Investment in group companies		–	(32,128)
<b>Net cash from/(used in) investing activities</b>		<b>76,855</b>	<b>(329,870)</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>			
Cash and cash equivalents at beginning of period		90,220	(159,931)
Effects of exchange-rate changes on cash and cash equivalents		40,069	200,000
		(2,477)	–
<b>Cash and cash equivalents at period end</b>	18	<b>127,812</b>	<b>40,069</b>

The statement of cash flows has been prepared under the indirect method.

# Notes to the Financial Statements

## Note

1. Reporting entity
2. Basis of preparation
3. Significant accounting policies
4. Critical estimates and judgements
5. New pronouncements
6. New standards and interpretations
7. Financial risk management
  - (a) Credit risk
  - (b) Liquidity risk
  - (c) Market risk
  - (d) Capital management
8. Pillar III disclosures
9. Financial assets and financial liabilities
10. Net interest income
11. Net fee and commission income
12. Net loss from derivative financial instruments
13. Other operating income
14. Staff costs
15. Administration and general expenses
16. Directors' emoluments
17. Income tax expense
18. Cash and cash equivalents

## Note

19. Derivative financial instruments
20. Loans and advances to banks
21. Loans and advances to customers
22. Allowances for impairment
23. Available for sale investments
24. Tangible fixed assets (Property, plant and equipment)
25. Intangible assets
26. Deferred tax assets and liabilities
27. Prepayments, accrued income and other assets
28. Deposits from banks
29. Deposits from customers
30. Subordinated liabilities
31. Other liabilities
32. Accruals and deferred income
33. Equity
34. Provisions
35. Related parties
36. Contingent liabilities and commitments
37. Subsequent event
38. Going concern assessment

## 1. REPORTING ENTITY

Bank of China (UK) Limited (“BOC UK” or the “bank”) is a company domiciled in the United Kingdom (the “UK”) with its registered office at 90 Cannon Street, London EC4N 6HA. The separate financial statements of the bank as at and for the year ended 31 December 2009 are presented below. The bank is primarily involved in retail and corporate banking.

Following authorisation of the bank by the Financial Services Authority (the “FSA”) on 24 September 2007, it was decided to amend the annual reporting date to 30 September 2007 and report the bank’s pre-trading activities to that date. Subsequent to that date the annual reporting date was amended to 31 December. This amendment now establishes the bank on the same reporting cycle adopted by the Bank of China Group (the “BOC Group”) and indeed by the majority of the financial services industry in the UK. Hence the comparative figures cover a 15-month period from 1 October 2007 to 31 December 2008.

## 2. BASIS OF PREPARATION

### (a) Statement of compliance

These financial statements have been prepared in accordance with International Financial Reporting Standards (the “IFRSs”) as adopted by the European Union (the “EU”) and therefore the financial statements comply with Article 4 of the EU IAS Regulation.

The bank has availed itself of the exemption election in IAS 27 *Consolidated and Separate Financial Statements* that permits an entity to prepare separate financial statements. The bank is a wholly-owned subsidiary of Bank of China Limited (“BOC”), which produces consolidated financial statements available for public use that comply with IFRS. BOC is domiciled in the People’s Republic of China (the “PRC”), with its head office located at 1 Fuxingmen Nei Dajie, Beijing 100818 PRC. The consolidated financial statements of the BOC Group are publicly available from this address.

The financial statements were authorised for issue by the Board of Directors (the “Board”) on 21 May 2010.

### (b) Basis of measurement

The financial statements have been prepared under the historical cost basis modified to include the fair valuation of certain financial instruments and contracts to buy or sell non-financial items to the extent required or permitted under accounting standards and as set out in the relevant accounting policies.

The following items are measured at fair value:

- Derivative financial instruments
- Available for sale financial assets

## 2. BASIS OF PREPARATION (Continued)

### (c) Functional and presentation currency

These financial statements are presented in Sterling (£), which is the bank's functional currency. Except as indicated, financial information presented in Sterling has been rounded to the nearest thousand.

### (d) Use of estimates and judgements

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expense. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements are described in Note 4.

## 3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these financial statements, and have been applied consistently by the bank.

### (a) Revenue recognition

Interest income and expense are recognised in the income statement for all interest-bearing financial instruments, except for those classified at fair value through profit or loss, using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. The effective interest rate is calculated on initial recognition of the financial asset or liability, estimating the future cash flows after considering all the contractual terms of the instrument but not future credit losses. The calculation includes all amounts paid or received by the bank including expected early redemptions and related penalties and premiums and discounts that are an integral part of the overall return as well as direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss (see Note 3 (f)).

Fees and commissions which are not an integral part of the effective interest rate are generally recognised when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan.

Dividend income is recognised when the right to receive payment is established.

### 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### (b) Available for sale financial assets

Debt securities are classified as available for sale and recognised in the statement of financial position at their fair value. Available for sale investments are those intended to be held for an indeterminate period of time and may be sold in response to need for liquidity or changes in interest rates, exchange rates or equity prices. Gains and losses arising from changes in the fair value of investments classified as available for sale are recognised directly in equity, until the financial asset is either sold, becomes impaired or matures, at which time the cumulative gain or loss previously recognised in equity is recognised in the income statement. Interest calculated using the effective interest method is recognised in the income statement.

The fair values of assets and liabilities traded in active markets are based on current bid and offer prices respectively. If the market is not active the bank establishes a fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis and other valuation techniques commonly used by market participants.

Purchases and sales of securities and other financial assets and liabilities are recognised on trade date, being the date that the bank is committed to purchase or sell an asset. Available for sale financial assets are initially recognised at fair value inclusive of transaction costs.

These financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the bank has transferred substantially all risks and rewards of ownership.

#### (c) Derivative financial instruments

All derivative instruments are held for risk management purposes and do not qualify for hedge accounting according to IAS 39. All derivatives are recognised at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and using valuation techniques, including discounted cash flow, as appropriate. Derivatives are carried in the statement of financial position as assets when their fair value is positive and as liabilities when their fair value is negative. All changes in the fair value of the derivative are recognised immediately in the income statement as a component of net loss on derivative financial instruments.

#### (d) Foreign currencies

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions are recognised in the income statement. Non-monetary assets that are measured at fair value are translated using the exchange rate at the date that the fair value was determined. Translation differences on monetary items, including available for sale investments, measured at fair value are recognised in the income statement.

### **3. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

#### **(e) Loans and advances to banks and customers**

Loans and advances to banks and customers are initially recognised at fair value and subsequently accounted for at amortised cost using the effective interest method less accumulated impairment losses. Loans and advances are initially recognised when cash is advanced to the borrowers at fair value inclusive of transaction costs. Loans and advances are derecognised when the rights to receive cash flows from them have expired or where the bank has transferred substantially all risks and rewards of ownership.

Loans and advances to banks and customers include both originated and syndicated loans. The bank does not originate loans to syndicate, rather it purchases syndicated loans from third party banks.

#### **(f) Impairment of financial assets**

At each reporting date the bank assesses whether, as a result of one or more events occurring after initial recognition, there is objective evidence that a financial asset or group of financial assets has become impaired.

The criteria that the bank uses to determine that there is objective evidence of an impairment loss may include:

- Delinquency in contractual payments of principal and/or interest.
- Indications that the borrower or group of borrowers is experiencing significant financial difficulty.
- Significant legal or regulatory disputes.
- Breach of loan covenants or conditions.
- Initiation of bankruptcy proceedings.
- Other objective evidence indicating impairment of the financial asset.

The estimated period between a loss occurring and its identification is determined by local management for each identified financial asset. In general, the periods used vary between one month and three months.

### 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### (f) Impairment of financial assets (Continued)

##### (i) *Assets accounted for at amortised cost*

If there is objective evidence that an impairment loss has been incurred, an allowance is established which is calculated as the difference between the carrying amount of the asset and the present value of estimated future cash flows discounted at that asset's original effective interest rate. Allowances are established on a case-by-case basis for all of the bank's lending activities which include residential mortgage, personal lending, credit cards and corporate lending. If an asset has a variable interest rate, the discount rate used for measuring the impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralised asset reflects the cash flows that may result from foreclosure less the costs of obtaining and selling the collateral, whether or not foreclosure is probable.

For credit card lending where there is no objective evidence of individual impairment the portfolio is collectively assessed for impairment based on historical loss experience and adjusted for current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, such as an improvement in the borrower's credit rating, the allowance is adjusted and the amount of the reversal is recognised in the income statement.

A loan or advance is normally written off, either partially or in full, against the related allowance when the proceeds from realising any available security have been received or there is no realistic prospect of recovery (as a result of the customer's insolvency, ceasing to trade or other reason) and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the income statement.

##### (ii) *Available for sale financial assets*

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

If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, the impairment loss is reversed through the income statement.

### 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### (f) Impairment of financial assets (Continued)

##### *(iii) Renegotiated loans*

Loans that are either subject to collective impairment assessment or individually significant and whose terms have been renegotiated are no longer considered to be past due but are treated as new loans. In subsequent years, the asset is considered to be past due and disclosed only if further renegotiated.

#### (g) Hedge accounting

Hedge accounting is applied to derivative and other instruments designated as hedges in hedging relationships provided certain criteria are met.

The bank documents, at the inception of the hedging relationship, the relationship between hedged items and hedging instruments, as well as the risk management objective and strategy for undertaking the hedge transaction. The bank also documents its assessment, both at inception and on an ongoing basis, of whether the instruments that are used in the hedging transaction are highly effective in offsetting changes in the fair values or cash flows of the hedged items.

##### *Fair value hedge*

When considered appropriate the bank hedges the foreign exchange risk arising from its investment in foreign subsidiaries using either derivative or other financial instruments. For such hedges, the foreign exchange difference arising on both the hedging instrument and the hedged item is recognised directly in the income statement. The hedged risk is adjusted for against the carrying amount of the investment in subsidiaries.

##### *Derivatives that do not qualify for hedge accounting*

All gains or losses from the changes in fair value of derivatives that do not qualify for hedge accounting are recognised immediately in the income statement.

#### (h) Derecognition of financial liabilities

The bank derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

#### (i) Subsidiaries

Subsidiaries are entities controlled by the bank. Control exists when the bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account.

The investment in subsidiaries is accounted for at cost less impairment adjusted for any foreign exchange risk that has been hedged.

### 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### (j) Tangible fixed assets

Tangible fixed assets are included at cost less accumulated depreciation and accumulated impairment losses. The value of land (included in premises) is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate the difference between the cost and the residual value over their estimated useful lives, as follows:

**Premises (excluding land):**

- Freehold/long and short leasehold premises: shorter of 50 years or the remaining period of the lease
- Leasehold improvements: shorter of 10 years or the remaining period of the lease

**Equipment:**

- Furniture and equipment: 4 – 5 years
- Computer equipment: 4 years
- Motor vehicles: 4 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. In the event that an asset's carrying amount is determined to be greater than its recoverable amount it is written down immediately. The recoverable amount is the higher of the asset's fair value less costs to sell and its value in use.

The cost of replacing a part of an item of property or equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the bank and its cost can be measured reliably. The carrying amount of the replaced part is derecognised. The costs of the day-to-day servicing of property and equipment are recognised in the income statement as incurred.

#### (k) Intangible assets

Software acquired by the bank is stated at cost less accumulated amortisation and accumulated impairment losses.

Amortisation is recognised in the income statement on a straight-line basis over the estimated useful life of the software, from the date that it is available for use. The estimated useful life of software is three to five years.

### 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### (k) Intangible assets (Continued)

Intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. In the event that an asset's carrying amount is determined to be greater than its recoverable amount it is written down immediately. The recoverable amount is the higher of the asset's fair value less costs to sell and its value in use.

#### (l) Leases

The bank enters into leases as the lessee. All of the leases are operating leases. Operating lease rentals are charged to the income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the end of the lease period, any payment made to the lessor by way of penalty is recognised as an expense in the period of termination.

#### (m) Offset

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right of set-off and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

#### (n) Cash and cash equivalent

For the purposes of the cash flow statement, cash and cash equivalents comprise cash and non-mandatory balances with central banks and amounts due from banks with an original maturity of less than three months.

#### (o) Borrowings

Borrowings (which include deposits from banks, customer accounts and subordinated liabilities) are recognised initially at fair value, being their issue proceeds net of transaction costs incurred. Borrowings are subsequently stated at amortised cost using the effective interest method.

#### (p) Employee benefits

##### (i) *Defined contribution plans*

Obligations for contributions to defined contribution pension plans are recognised as an expense in income statement when they are due.

##### (ii) *Defined benefit plans*

The bank is a participant of the Bank of China Pension and Life Assurance scheme offered by Bank of China Limited, London Branch (the "London Branch"). The London Branch is the sponsoring employer. There are no contractual arrangements for charging the net defined benefit cost for this plan. Contributions to the fund are recognised as an expense in the income statement in the accounting period to which they relate. Any unpaid contributions are recognised in the statement of financial position as a liability.

### 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### (q) Short-term benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

A provision is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the bank has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

#### (r) Taxation

Income tax on the profit for the year comprises current tax and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in other comprehensive income or directly in equity, in which case it is recognised in other comprehensive income or equity.

Current tax is the tax expected to be payable on the taxable profit for the year, calculated using tax rates enacted or substantially enacted at the reporting date.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the reporting date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

The tax effects of losses available for carry forward are recognised as a deferred tax asset when it is probable that future taxable profits will be available against which these losses can be utilised.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

#### (s) Provisions

Provisions are recognised in respect of present obligations arising from past events where it is probable that outflows of resources will be required to settle the obligations and they can be reliably estimated.

Contingent liabilities are possible obligations whose existence depends on the outcome of uncertain future events or those present obligations where the outflows of resources are uncertain or cannot be measured reliably. Contingent liabilities are not recognised in the financial statements but are disclosed unless they are remote.

### 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### (t) Share capital and reserves

Incremental costs directly attributable to the issue of an equity instrument are deducted from the initial measurement of the equity instrument.

### 4. CRITICAL ESTIMATES AND JUDGEMENTS

The bank makes estimates and assumptions concerning the future. The estimates and assumptions that could have significant risk of causing material adjustment to the carrying amounts of assets within the next financial year are highlighted below.

#### (i) *Impairment of loans and advances*

The bank reviews its loans and advances on an individual basis to assess impairment on a periodic basis unless a known circumstance occurs at or before the scheduled review date. In determining whether an impairment loss should be recorded in the income statement, the bank makes a judgement as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flow of a loan or advance. This evidence may include observable data indicating that there has been an adverse change in the payment status of the borrower e.g. payment delinquency, or default. Additional observable data that would be considered is set out in Note 3(f).

#### (ii) *Impairment of available for sale investments*

The bank follows the guidance of IAS 39 to determine when available for sale investment securities are impaired. This determination requires significant judgement. In making this judgement, the bank evaluates, among other factors, the duration and extent to which the fair value of an investment is less than its cost, the extent to which changes in fair value relate to credit events; and the financial health of and near-term business outlook for the investee/underlying portfolio, including factors such as industry and sector performance, credit ratings, and counterparty risk.

The methodology and assumptions used for impairment assessments are reviewed regularly. In evaluating impairment of asset backed securities ("ABS") and mortgage backed securities ("MBS") during the year, the bank continued to use a significant decline in market price to be a key indicator of impairment. The bank also considered other objective evidence of impairment, taking into account that during the year market prices continued to be impacted by liquidity and indicative prices were obtained for certain ABS and MBS held by the bank.

Details about the use of estimates and judgements are presented in Note 3.

## 5. NEW PRONOUNCEMENTS

In October 2008 the International Accounting Standards Board (the "IASB") issued Reclassification of Financial Assets (Amendments to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 7 Financial Instruments: Disclosures). The amendment to IAS 39 permits an entity to reclassify non-derivative financial assets, other than those designated at fair value through profit or loss upon initial recognition, out of the fair value through profit or loss category if they are no longer held for the purpose of being sold or repurchased in the near term. The amendment also permits an entity to transfer from the available for sale category to loans and receivables category a financial asset that would have met the definition of loans and receivables, if the assets had not been designated as available for sale, if the entity has the intention and ability to hold that financial asset for the foreseeable future.

The amendment to IFRS 7 introduces additional disclosure requirements if an entity has reclassified financial assets in accordance with the amendment to IAS 39. The amendments are effective retrospectively from 1 July 2008.

The bank did not reclassify any financial assets under this amendment.

## 6. NEW STANDARDS AND INTERPRETATIONS

### (a) Standards, amendments and interpretations effective on or after 1 January 2009

Revised IAS 1 Presentation of Financial Statements (2007) introduces the term "total comprehensive income," which represents changes in equity during a period other than those changes resulting from transactions with owners in their capacity as owners. Total comprehensive income may be presented in either a single statement of comprehensive income (effectively combining both the income statement and all non-owner changes in equity in a single statement), or in an income statement and a separate statement of comprehensive income. Revised IAS 1 became mandatory for the bank's 2009 financial statements. Since the change in accounting policy only impacts presentation aspects, there is no impact on retained earnings.

Amendments to IAS 32 and IAS 1 Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation require puttable instruments and instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation to be classified as equity if certain conditions are met. The amendments, which become mandatory for the bank's 2009 financial statements with retrospective application required have not had a significant impact on the financial statements.

IFRIC 13 Customer Loyalty Programmes addresses the accounting by entities that operate or otherwise participate in customer loyalty programmes under which the customer can redeem credits for awards such as free or discounted goods or services. IFRIC 13 becomes mandatory for the bank's 2009 financial statements and will be applicable retrospectively. The bank does not have any customer loyalty programmes and therefore there has been no impact on the financial statements.

## 6. NEW STANDARDS AND INTERPRETATIONS (Continued)

### (a) Standards, amendments and interpretations effective on or after 1 January 2009 (Continued)

IFRS 8 Operating Segments replaces IAS 14 Segment Reporting, and looks at segments from a management's perspective in contrast to a financial statement perspective. Under IFRS 8 segment disclosures are based on how information is reported internally to the chief operating decision maker for operational and performance matters. Segment disclosures are required by entities whose equity or debt securities are traded in a public market and by entities that are in the process of issuing equity or debt securities in public securities markets. The bank is incorporated as a limited entity and therefore is not required to provide such segment disclosures.

### (b) Standards and interpretations issued but not yet effective

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2009, and have not been applied in preparing these financial statements:

IFRS 1 and IAS 27, Cost of an Investment in a Subsidiary, Jointly-Controlled Entity or Associate. The amended standard allows for the first-time adopters to use a deemed cost of either fair value or the carrying amount under previous accounting practice to measure the initial cost of investment in subsidiaries, jointly controlled entities and associates in the separate financial statements. The amendment also removes the definition of the cost method from IAS 27 and requires an entity to present dividends from investment in subsidiaries, jointly controlled entities and associates as income in the separate financial statements of the investor.

Revised IFRS 3 Business Combinations (2008) incorporates the following changes that are likely to be relevant to the bank's operations:

- The definition of a business has been broadened, which may result in more acquisitions being treated as business combinations.
- Contingent consideration will be measured at fair value, with subsequent changes in fair value recognised through the income statement.
- Transaction costs, other than share and debt issue costs, will be expensed as incurred.
- Any pre-existing interest in an acquiree will be measured at fair value, with the related gain or loss recognised through the income statement.
- Any non-controlling (minority) interest will be measured at either fair value, or at its proportionate interest in the identifiable assets and liabilities of an acquiree, on a transaction-by-transaction basis.

## 6. NEW STANDARDS AND INTERPRETATIONS (Continued)

### (b) Standards and interpretations issued but not yet effective (Continued)

Revised IFRS 3, which becomes mandatory for the bank's 2010 financial statements, will be applied prospectively and therefore there will be no impact on prior periods in the bank's 2010 financial statements.

Amended IAS 27 Consolidated and Separate Financial Statements (2008) requires accounting for changes in ownership interests in a subsidiary that occur without loss of control, to be recognised as an equity transaction. When the bank loses control of a subsidiary, any interest retained in the former subsidiary will be measured at fair value with the gain or loss recognised in profit or loss. The amendments to IAS 27, which become mandatory for the bank's 2010 financial statements, are not expected to have a significant impact on the Notes to the financial statements.

Amendments to IAS 39 Financial Instruments: Recognition and Measurement – Eligible Hedged Items clarifies the application of existing principles that determine whether specific risks or portions of cash flows are eligible for designation in a hedging relationship. The amendments will become mandatory for the bank's 2010 financial statements, with retrospective application required.

Amendments to IFRS 5 Non-current Assets Held for Sale and Discontinued Operations specify that if an entity is committed to a sale plan involving the loss of control of a subsidiary, then all the subsidiary's assets and liabilities should be classified as held for sale when the held for sale criteria are met. The amendments will become mandatory for the bank's 2010 financial statements, and applied prospectively from the date the entity first applied IFRS 5. The bank does not expect these amendments to have any significant impact on the financial statements.

IFRIC 15 Agreements for the Construction of Real Estate provides guidance on determining whether revenue from the construction of real estate should be accounted for in accordance with IAS 11 Construction Contracts or IAS 18 Revenue, and the timing of revenue recognition. The bank is not involved in such activities and therefore the interpretation does not apply.

IFRIC 17 Distributions of Non-cash Assets to Owners provides guidance on distributions of non-cash assets to owners, and distributions in which the owner is given the choice of receiving either non-cash assets or a cash alternative. The interpretation will become mandatory for the bank's 2010 financial statements, and applied prospectively. The bank does not expect these amendments to have any significant impact on the financial statements.

IFRIC 18 Transfers of Assets from Customers provides guidance on transfers of property, plant and equipment for entities who receive such non-current assets from their customers. The contributed property, plant and equipment is used by the entity to provide continued access to a supply of goods or services to the contributor or a third party. IFRIC 18 only provides guidance to the entity receiving the contributed property, plant and equipment. The bank is not involved in the transfer of such assets and therefore does not expect these amendments to have any impact on the financial statements.

## 6. NEW STANDARDS AND INTERPRETATIONS (Continued)

### (b) Standards and interpretations issued but not yet effective (Continued)

IFRS 9, Financial Instruments Part 1; Classification and Measurement. IFRS 9 was issued in November 2009 and replaces those parts of IAS 39 relating to the classification and measurement of financial assets. Key features are as follows:

- Financial assets are required to be classified in to two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.
- An instrument is subsequently measured at amortised cost only if it is a debt instrument and both the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and the asset's contractual cash flow represents only payments of principal and interest (that is, it has only "basic loan features"). All other debt instruments are to be measured at fair value through the profit or loss.
- All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through the profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss.

There is to be no recycling of fair value gains or losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.

- Adoption of IFRS 9 is mandatory from 1 January 2013.

## 7. FINANCIAL RISK MANAGEMENT

### Introduction and overview

The bank has exposure to the following risks from financial instruments

- Credit risk
- Liquidity risk
- Market risk

This Note presents information about the bank's exposure to each of the above risks, the bank's objectives, policies and procedures for measuring and managing risk, and the bank's management of capital.

## 7. FINANCIAL RISK MANAGEMENT (Continued)

### Risk management framework

The Board has overall responsibility for the establishment and oversight of the bank's risk management framework. The Board has established the bank's Asset and Liability ("ALCO"), Credit and Operational Risk Committees, which are responsible for developing and monitoring the bank's risk management policies in their specified areas.

The bank's risk management policies are established to identify and analyse the risks faced by the bank, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. Internal Audit department undertakes both regular and ad-hoc reviews of the risk management controls and procedures, the results of which are reported to the Audit Committee.

The bank, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and responsibilities.

### (a) Credit risk

#### *Financial risk management*

Credit risk is the risk of financial loss to the bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the bank's loans and advances to customers and available for sale financial investments.

#### *Credit risk management framework*

The bank has established a set of credit risk management policies and procedures, and appropriate credit risk limits to manage and control credit risk that arises through the bank's normal business activities. These policies, procedures and limits are regularly reviewed in light of changes in markets and business strategies.

The bank's organisation structure establishes a clear set of authority and responsibilities for monitoring compliance with policies, procedures and limits, based on the principal of 'Three Lines of Defence'.

The business units are responsible for the day-to-day management of credit risk with the Risk Management department being responsible for risk oversight and ensuring procedural compliance as well as the drafting, reviewing and updating of credit risk management policies and procedures. The internal audit function represents the third line of defence.

The Board has the highest credit approval authority for BOC UK. The Board has delegated its authority to the Board Credit Committee, and the Chief Executive Officer ("CEO") of the bank. The CEO of the bank has delegated credit approval authority to Branch Managers, subject to Board approval.

## 7. FINANCIAL RISK MANAGEMENT (Continued)

### (a) Credit risk (Continued)

#### *Credit risk measurement and control*

##### *Loans and advances*

The approval of an individual credit risk proposition requires assessment of the customer, any existing credit exposure to the customer and the credit risks associated with the transaction, at the same time taking into account the reward being offered for the risk and the extent of risk mitigation available to offset the potential loss in the event of default. The Credit Risk department is responsible for making an independent assessment of all credit facilities.

There are three main areas of concentration risk that are monitored, reported and managed by the bank: single customer (group), industrial sector and country risk. The bank monitors changes to counterparties' credit risk, quality of the credit portfolio and risk concentrations, and reports regularly to the bank's Executive Management Committee and the Board Credit Committee. Consideration must be taken and compliance must be adhered to these three concentration risk management areas either during initiating a transaction or maintaining and managing the portfolio quality.

The bank's internal loan grading system divides loans into five categories as follows:

- Category 1: "Performing" represents loans where the borrower is currently meeting their repayment obligations and full repayment of interest and principal is not in doubt.
- Category 2: "Special Mention" represents loans where the borrower is experiencing difficulties which may threaten the banks position. Ultimate loss is not expected at this stage but could occur if adverse conditions persist.
- Category 3: "Sub-standard" represents loans where the borrower displays a definable weakness that is likely to jeopardise repayment.
- Category 4: "Doubtful" represents loans where collection in full is improbable and the bank expects to sustain a loss of principal and/or interest, taking into account the net realisable value of any collateral held.
- Category 5: "Loss" represents loans which are considered un-collectible after all collection options (such as the realisation of collateral or the initiation of legal proceedings) have been exhausted.

##### *Debt securities and derivatives*

For investment in debt securities and securitisation backed assets, the external credit rating and assessment on the credit quality of the underlying asset are used for managing the credit risk involved. Credit limits are established on a counterparty and security issuer basis. For derivatives, the bank sets customer limits to manage the credit risk involved and follows the same approval process as loans and advances. On-going monitoring of stop-loss limits is established.

## 7. FINANCIAL RISK MANAGEMENT (Continued)

### (a) Credit risk (Continued)

#### *Credit risk measurement and control (Continued)*

##### *Collateral held as security*

The bank has established a mechanism to update the value of its main type of collateral, residential properties, with the use of public index on a portfolio basis.

For loans guaranteed by a third party guarantor, the bank assesses the guarantor's financial condition, credit history and ability to meet their obligations if called to do so.

##### *Exposure to credit risk*

The carrying amount of financial assets represents the maximum credit exposure without taking account of any collateral held or other credit enhancements. The maximum exposure to credit risk at the reporting date was:

£000	31 December 2009	31 December 2008
On balance sheet		
Cash and cash equivalents	126,976	39,224
Loans and advances to banks	36,933	67,272
Loans and advances to customers	504,743	551,148
Derivative financial instruments	1,375	5,554
Available for sale financial investments	249,004	330,093
Total on balance sheet	919,031	993,291
Off balance sheet		
Loan commitments	270,596	223,350
Guarantees	27,435	66,847
Total off balance sheet	298,031	290,197
Total exposure	1,217,062	1,283,488

The fair value of collateral held at 31 December 2009 against amounts due from customer was £93,687,532 (31 December 2008: £75,047,773).

Cash and cash equivalents include exposures to the parent company, of £74,937,000 (31 December 2008: £35,866,000) which are supported by a legal netting agreement. No other significant concentration of credit risk exposure exists.

## 7. FINANCIAL RISK MANAGEMENT (Continued)

### (a) Credit risk (Continued)

#### *Credit risk measurement and control (Continued)*

#### *Credit risk exposure*

The tables below present further detail on the bank's exposure to credit risk.

(a) Based on external credit rating systems

£000	31 December 2009		31 December 2008	
	Cash and cash equivalents	Available for sale investments	Cash and cash equivalents	Available for sale investments
Gross exposure	126,976	254,588	39,224	339,423
Individually impaired	–	12,433	–	19,215
Allowance for impairment	–	(5,584)	–	(9,330)
Carrying amount	–	6,849	–	9,885
Past due but not impaired	–	–	–	–
<i>Ageing profile:</i>				
0-3 months	–	–	–	–
4-6 months	–	–	–	–
7-9 months	–	–	–	–
10-12 months	–	–	–	–
Neither past due nor impaired	126,976	242,155	39,224	320,208
<i>Credit rating</i>				
AAA	–	64,310	–	74,614
Aa1 – Aa3	51,992	62,794	3,358	174,555
A1 – A3	74,984	90,590	35,866	39,262
Baa1 – Baa3	–	24,461	–	31,777
Ba1 – Ba3	–	–	–	–
Unrated	–	–	–	–
Total carrying amount	126,976	249,004	39,224	330,093

## 7. FINANCIAL RISK MANAGEMENT (Continued)

### (a) Credit risk (Continued)

#### Credit risk measurement and control (Continued)

Credit risk exposure (Continued)

(b) Based on internal loan grading system mapped against external credit ratings

#### Loans and advances to banks

£000	31 December 2009	31 December 2008
Gross exposure	36,933	67,272
Neither past due nor impaired	36,933	67,272
<b>Performing</b>		
Aa1 – Aa3	–	14,496
A1 – A3	12,156	15,737
Baa1 – Baa3	24,777	13,685
Unrated	–	23,354
Total carrying amount	36,933	67,272

#### Loans and advances to customers

£000	31 December 2009	31 December 2008
Gross exposure	505,274	551,550
Individually impaired	531	457
Allowance for impairment	(531)	(402)
Carrying amount	–	55
Past due but not impaired	1,369	260
<i>Ageing profile:</i>		
0-3 months	1,259	206
4-6 months	–	52
7-9 months	110	–
10-12 months	–	2
Neither past due nor impaired	503,374	550,833
<b>Performing</b>	469,584	525,242

## 7. FINANCIAL RISK MANAGEMENT (Continued)

### (a) Credit risk (Continued)

#### Credit risk measurement and control (Continued)

#### Credit risk exposure (Continued)

(b) Based on internal loan grading system mapped against external credit ratings (Continued)

#### Loans and advances to customers (Continued)

£000	31 December 2009	31 December 2008
Aa1 – Aa3	5,003	–
A1 – A3	33,758	71,001
Baa1 – Baa3	38,770	90,811
Ba1 – Ba3	10,530	13,171
Unrated	381,523	350,259
<b>Special mention</b>	<b>33,275</b>	<b>25,591</b>
Baa1 – Baa3	17,456	–
Ba1 – Ba3	–	21,509
B1 – B3	15,010	–
Unrated	809	5,082
<b>Substandard</b>	<b>474</b>	<b>–</b>
Unrated	474	–
<b>Doubtful</b>	<b>36</b>	<b>–</b>
Unrated	36	–
<b>Loss</b>	<b>5</b>	<b>–</b>
Unrated	5	–
<b>Total carrying amount</b>	<b>504,743</b>	<b>551,148</b>

## 7. FINANCIAL RISK MANAGEMENT (Continued)

### (b) Liquidity risk

Liquidity risk is the risk that the bank will not be able to meet its financial obligations as they fall due.

The bank is exposed to the risk that it will be unable to meet its obligations as they fall due, arising from the differing maturity profiles of its assets and liabilities. To mitigate its exposure the bank places limits on the mismatch of maturity dates, and by holding stock of liquid assets which could be sold at short notice if the need arose.

The Board is the ultimate decision-making body and is responsible for compliance with the regulatory requirements. Formulation of the risk management procedures, implementation mechanism and monitoring of the compliance is the main responsibility of the ALCO. Daily management of liquidity is carried out by the Treasury function assisted by the Finance department who monitor the liquidity risk and provide regular reports to management and the FSA.

The following are the contractual (undiscounted) maturities of financial liabilities, including estimated interest payments and excluding the effect of any netting agreements if they were in place:

£000	Carrying amount	Contractual cash flows	Less than 1 month	1 – 3 months	3 months to 1 year	More than 1 year
<b>31 December 2009</b>						
Non-derivative financial liabilities						
Deposits from banks	366,763	(367,528)	(50,626)	(251,250)	(47,998)	(17,654)
Deposits from customers	378,219	(378,324)	(319,634)	(49,636)	(9,054)	–
Subordinated liabilities	60,000	(60,134)	–	(134)	–	(60,000)
Derivative financial instruments	5,766	–	–	–	–	–
Cash outflows	–	(269,291)	(258,470)	(255)	(2,053)	(8,513)
Cash inflows	–	258,588	258,588	–	–	–
	<b>810,748</b>	<b>(816,689)</b>	<b>(370,142)</b>	<b>(301,275)</b>	<b>(59,105)</b>	<b>(86,167)</b>
Loan commitments	270,596	(270,596)	(270,596)	–	–	–
	<b>1,081,344</b>	<b>(1,087,285)</b>	<b>(640,738)</b>	<b>(301,275)</b>	<b>(59,105)</b>	<b>(86,167)</b>
<b>31 December 2008</b>						
Non-derivative financial liabilities						
Deposits from banks	560,116	(564,398)	(209,478)	(303,209)	(51,711)	–
Deposits from customers	290,289	(290,869)	(253,034)	(28,554)	(9,281)	–
Subordinated liabilities	60,000	(60,454)	–	(454)	–	(60,000)
Derivative financial instruments	5,390	–	–	–	–	–
Cash outflows	–	(12,569)	(7,371)	(13)	(732)	(4,453)
Cash inflows	–	7,157	7,157	–	–	–
	<b>915,795</b>	<b>(921,133)</b>	<b>(462,726)</b>	<b>(332,230)</b>	<b>(61,724)</b>	<b>(64,453)</b>
Loan commitments	223,350	(223,350)	(223,350)	–	–	–
	<b>1,139,145</b>	<b>(1,144,483)</b>	<b>(686,076)</b>	<b>(332,230)</b>	<b>(61,724)</b>	<b>(64,453)</b>

## 7. FINANCIAL RISK MANAGEMENT (Continued)

### (b) Liquidity risk (Continued)

The previous table shows the undiscounted cash flows on the bank's financial liabilities and unrecognised loan commitments on the basis of their earliest possible contractual maturity. The bank-expected cash flows on these instruments vary significantly from this analysis and hence show a worst case scenario. For example, current accounts and demand deposits from customers are expected to maintain a stable or increasing balance; and unrecognised loan commitments are not all expected to be drawn down immediately but to be drawn over a period of time.

The contractual cash flow disclosed in the previous table represents the contractual undiscounted cash flows relating to the principal and interest on the financial liability or commitment. The disclosure for derivatives shows a net amount for derivatives that are settled on a net basis, (e.g. interest rate swaps) but on a gross outflow and inflow basis for derivatives that have simultaneous gross settlement (e.g. forward foreign exchange contracts and currency swaps).

### (c) Market risk

#### *Foreign exchange risk*

Foreign exchange risk is the risk that movements in the various currencies could materially impact the financial statements. The bank makes loans and takes deposits in a number of currencies. To manage its exposure to foreign exchange risk the bank holds derivative instruments.

At 31 December 2009 the bank held a net positive position as the sterling equivalent value of all currencies where the currency obligations were lower than currency receivables was £522,000 (31 December 2008: £467,000)

## 7. FINANCIAL RISK MANAGEMENT (Continued)

### (c) Market risk (Continued)

#### Foreign exchange risk (Continued)

The following tables shows the foreign exchange positions as at 31 December 2009 and 2008.

<b>£000</b>				
<b>31 December 2009</b>	<b>Sterling</b>	<b>US Dollars</b>	<b>EURO</b>	<b>Other</b>
Cash and cash equivalents	74,052	303	48,960	4,497
Loans and advances to banks	–	36,933	–	–
Loans and advances to customers	84,991	292,179	99,542	28,031
Derivative financial instruments (asset)	628	–	747	–
Available for sale financial investments	396	14,295	207,453	26,860
Other assets	31,061	835	205	30,105
Deposits from banks	–	(138,324)	(145,956)	(82,483)
Customer accounts	(191,216)	(162,673)	(19,597)	(4,733)
Derivative financial instruments (liability)	(104)	(1,187)	(4,475)	–
Other liabilities	(15,822)	(1,247)	(1,996)	(611)
Subordinated liabilities	(60,000)	–	–	–
Total shareholders' equity	(157,479)	(609)	3,528	2,911
Net on balance sheet exposure	(233,493)	40,505	188,411	4,577
Derivative financial instruments				
Currency swaps	229,569	(37,166)	(186,563)	(5,318)
Foreign exchange forwards	–	(372)	–	372
Total net exposure	(3,924)	2,967	1,848	(369)

## 7. FINANCIAL RISK MANAGEMENT (Continued)

### (c) Market risk (Continued)

#### Foreign exchange risk (Continued)

£000 31 December 2008	Sterling	US Dollars	EURO	Other
Cash and cash equivalents	4,898	679	26,919	7,573
Loans and advances to banks	–	52,776	5,236	9,260
Loans and advances to customers	146,809	204,135	158,163	42,041
Derivative financial instruments (asset)	4,840	–	714	–
Available for sale financial investments	15,542	14,051	271,905	28,595
Other assets	26,800	1,494	998	32,381
Deposits from banks	(5,378)	(188,559)	(260,551)	(105,628)
Customer accounts	(166,524)	(111,892)	(6,505)	(5,368)
Derivative financial instruments (liability)	(53)	(1,521)	(3,816)	–
Other liabilities	(10,813)	(1,657)	(2,143)	(296)
Subordinated liabilities	(60,000)	–	–	–
Total shareholders' equity	(150,004)	946	19,500	4,453
Net on balance sheet exposure	(193,883)	(29,548)	210,420	13,011
Derivative financial instruments				
Currency swaps	201,628	28,166	(215,722)	(13,593)
Foreign exchange forwards	(1,347)	1,335	–	–
Total net exposure	6,398	(47)	(5,302)	(582)

#### Sensitivity analysis

A 1% percent weakening of the following currencies against Sterling at 31 December 2009 would have increased (decreased) equity and the income statement by the amounts shown below. This calculation assumes that the change occurred at the reporting date and had been applied to risk exposures existing at that date.

This analysis assumes that all other variables, in particular other exchange rates and interest rates, remain constant.

£000	Equity		Income statement	
	31 December 2009	31 December 2008	31 December 2009	31 December 2008
Sterling	(92)	(77)	–	–
US Dollars	6	(10)	(6)	–
Euro	(36)	(228)	(67)	(71)
Other	(21)	(369)	(19)	(6)

A 1% percent strengthening of the above currencies against Sterling at 31 December 2009 would have had the equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

## 7. FINANCIAL RISK MANAGEMENT (Continued)

### (c) Market risk (Continued)

#### *Exposure to interest rate risk*

The bank does not operate a trading book.

The principal exposure to which the banking book portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instruments because of a change in market interest rates. Interest rate risk is managed principally through monitoring interest rate gaps and by having pre-approved limits for re-pricing bands. The ALCO is the monitoring body for compliance with these limits and is assisted by the Treasury department in its day-to-day monitoring activities. A summary of the bank's interest rate gap position in the banking books is as follows:

£000	Carrying amount	Less than 1 month	1 – 3 months	3 months to 1 year	1 – 5 years	Over 5 years	Non interest bearing
<b>31 December 2009</b>							
<b>Assets</b>							
Cash and cash equivalents	127,812	113,326	-	-	-	-	14,486
Loans and advances to banks	36,933	-	36,933	-	-	-	-
Loans and advances to customers	504,743	205,419	126,799	171,518	-	-	1,007
Derivative financial instruments	1,375	-	-	-	-	-	1,375
Available for sale financial investments	249,004	38,633	48,583	16,319	121,219	23,739	511
Other assets	62,206	-	-	-	-	-	62,206
Total assets	982,073	357,378	212,315	187,837	121,219	23,739	79,585
<b>Liabilities and Equity</b>							
<b>Liabilities</b>							
Deposits from banks	366,763	65,209	268,198	26,264	-	-	7,092
Deposits from customers	378,219	189,346	49,576	9,039	-	-	130,258
Derivative financial instruments	5,766	-	-	-	-	-	5,766
Other liabilities	19,676	-	-	-	-	-	19,676
Subordinated liabilities	60,000	-	60,000	-	-	-	-
<b>Equity</b>							
Shareholders' equity	151,649	-	-	-	-	-	151,649
Total equity and liabilities	982,073	254,555	377,774	35,303	-	-	314,441
Effect of derivatives held for risk management	-	-	60,690	-	(48,282)	(12,408)	-
Interest rate sensitivity gap	-	102,823	(104,769)	152,534	72,937	11,331	(234,856)
Cumulative gap	-	102,823	(1,946)	150,588	223,525	234,856	-

## 7. FINANCIAL RISK MANAGEMENT (Continued)

### (c) Market risk (Continued)

#### Exposure to interest rate risk (Continued)

£000	Carrying amount	Less than 1 month	1 – 3 months	3 months to 1 year	1 – 5 years	Over 5 years	Non interest bearing
31 December 2008							
<b>Assets</b>							
Cash and cash equivalents	40,069	6,426	–	–	–	–	33,643
Loans and advances to banks	67,272	34,690	22,945	9,637	–	–	–
Loans and advances to customers	551,148	369,812	114,181	66,899	8	–	248
Derivative financial instruments	5,554	–	–	–	–	–	5,554
Available for sale financial investments	330,093	41,151	57,863	8,118	184,799	37,823	339
Other assets	61,673	–	–	–	–	–	61,673
<b>Total assets</b>	<b>1,055,809</b>	<b>452,079</b>	<b>194,989</b>	<b>84,654</b>	<b>184,807</b>	<b>37,823</b>	<b>101,457</b>
<b>Liabilities and Equity</b>							
<b>Liabilities</b>	<b>930,704</b>	<b>397,818</b>	<b>389,505</b>	<b>60,393</b>	<b>–</b>	<b>–</b>	<b>82,988</b>
Deposits from banks	560,116	206,814	301,142	51,273	–	–	887
Deposit from customers	290,289	191,004	28,363	9,120	–	–	61,802
Derivative financial instruments	5,390	–	–	–	–	–	5,390
Other liabilities	14,909	–	–	–	–	–	14,909
Subordinated liabilities	60,000	–	60,000	–	–	–	–
<b>Equity</b>	<b>125,105</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>125,105</b>
Shareholders' equity	125,105	–	–	–	–	–	125,105
<b>Total equity and liabilities</b>	<b>1,055,809</b>	<b>397,818</b>	<b>389,505</b>	<b>60,393</b>	<b>–</b>	<b>–</b>	<b>208,093</b>
Effect of derivatives held for risk management	–	–	51,671	–	(29,680)	(21,991)	–
<b>Interest rate sensitivity gap</b>	<b>–</b>	<b>54,261</b>	<b>(142,845)</b>	<b>24,261</b>	<b>155,127</b>	<b>15,832</b>	<b>(106,636)</b>
<b>Cumulative gap</b>	<b>–</b>	<b>54,261</b>	<b>(88,584)</b>	<b>(64,323)</b>	<b>90,804</b>	<b>106,636</b>	<b>–</b>

The table below indicates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of the bank's income statement.

At the reporting date the exposure to interest rate risk was projected to be:

£000	100bps parallel increase	100bps parallel decrease
<b>Sensitivity of projected net interest income at</b>		
<b>31 December 2009</b>	<b>727</b>	<b>(727)</b>
31 December 2008	(532)	532
<b>Sensitivity of reported equity to interest rate movements at</b>		
<b>31 December 2009</b>	<b>5,479</b>	<b>(5,479)</b>
31 December 2008	10,552	(10,552)

## 7. FINANCIAL RISK MANAGEMENT (Continued)

### (c) Market risk (Continued)

#### *Exposure to interest rate risk (Continued)*

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

### (d) Capital management

#### *Regulatory capital*

The bank's lead regulator the FSA sets and monitors capital requirements for the bank. The parent company and individual banking operations are directly supervised by their local regulators.

With effect from 1 January 2008 the bank is required to comply with the provisions of the Basel II framework in respect of regulatory capital. The bank has adopted the standardised approach for credit and operational risk in the calculation of the bank's capital requirement as prescribed under the Basel II framework. As the bank does not have a trading book the capital requirement for the foreign exchange risk inherent in the banking book is the bank's only market risk, which is also calculated on the standardised approach.

The bank's regulatory capital comprises of tier 1 and tier 2 capital:

- tier 1 capital, which includes ordinary share capital, retained earnings, translation reserve and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes
- tier 2 capital, which includes qualifying subordinated liabilities, collective impairment allowances (limited to those credit portfolios where the standardised approach is used under Basel II) and the element of the fair value reserve relating to unrealised gains/losses on equity instruments classified as available for sale.

Various limits are applied to elements of the capital base. The amount of innovative tier 1 securities cannot exceed 15 percent of total tier 1 capital; qualifying tier 2 capital cannot exceed tier 1 capital; and qualifying term subordinated loan capital may not exceed 50 percent of tier 1 capital. There also are restrictions on the amount of collective impairment allowances that may be included as part of tier 2 capital. Other deductions from capital include the carrying amounts of investments in subsidiaries that are not included in the regulatory consolidation, investments in the capital of banks and certain other regulatory items.

Banking operations are categorised as banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures. As noted above, Basel II introduced a risk-weighted asset requirement in respect of operational risk.

The bank's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the bank recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

## 7. FINANCIAL RISK MANAGEMENT (Continued)

### (d) Capital management (Continued)

#### Regulatory capital (Continued)

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

The bank's regulatory capital position at 31 December 2009 was as follows:

£000	2009 Basel II Actual	2008 Basel II Actual
Tier 1 capital		
Ordinary share capital	140,000	140,000
Retained earnings	15,819	3,259
Tier 2 capital		
Collective allowances for impairment	–	24
Qualifying subordinated liabilities	60,000	60,000
Other regulatory adjustments	(29,945)	(32,128)
<b>Total regulatory capital</b>	<b>185,874</b>	171,155

Management uses regulatory capital ratios in order to monitor its capital base, and these capital ratios remain the international standards for measuring capital adequacy. The FSA's approach to such measurement based upon Basel II is now primarily based on monitoring the relationship of the Capital Resources Requirement (measured as 8 percent of risk-weighted assets) to available capital resources. The FSA also sets individual capital guidance ("ICG") for any bank that sets capital requirements in excess of the minimum Capital Resources Requirement. A key input to the ICG setting process is the bank's Internal Capital Adequacy Assessment Process ("ICAAP"). The bank submitted its ICAAP document to the FSA in October 2008 and the ICG was agreed with the FSA in March 2009. The agreed ICG remains confidential between each bank and the FSA in accordance with accepted practice.

## 8. PILLAR III DISCLOSURES

The European Union Capital Requirements Directive came into effect on 1 January 2007. It introduced consistent capital adequacy standards and an associated supervisory framework in the EU based on the Basel II rules agreed by the G-10.

Implementation of the Directive in the UK was by way of rules introduced by the FSA. Among them are disclosure requirements applicable to banks and building societies, which are known as Pillar III. These are designed to promote market discipline by providing market participants with key information on a firm's risk exposures and risk management processes. Pillar III also aims to complement the minimum capital requirements described under Pillar 1 of Basel II, as well as the supervisory review processes of Pillar 2 and aims to encourage market discipline by allowing market participants to assess key pieces of information on risk exposures and the risk assessment processes of the firm.

The bank adopted the Pillar 1 Standardised Approach to credit risk, market risk and operational risk from 1 January 2008, it also became subject to Pillar 2 & 3 from that date.

## 9. FINANCIAL ASSETS AND FINANCIAL LIABILITIES

### Fair values of financial instruments

The bank's valuation methodology is detailed in Note 3.

#### Fair values

The fair values for each class of financial assets and financial liabilities together with their carrying amounts shown in the reporting date are as follows:

£000	Financial instruments at fair value through profit and loss	Loans and receivables	Available for sale	Other amortised cost	Total carrying amount	Fair value
<b>31 December 2009</b>						
<b>Assets</b>						
<b>Cash and cash equivalents</b>	-	127,812	-	-	127,812	127,812
Cash and balances with banks	-	126,976	-	-	126,976	126,976
Cash in hand	-	836	-	-	836	836
<b>Loans and advances to banks</b>	-	36,933	-	-	36,933	36,928
<b>Loans and advances to customers</b>	-	504,743	-	-	504,743	504,544
Corporate loans and advances	-	456,028	-	-	456,028	455,829
Retail loans and advances	-	48,715	-	-	48,715	48,715
<b>Derivative financial instruments</b>	1,375	-	-	-	1,375	1,375
Interest rate swap	746	-	-	-	746	746
Cross currency swap	627	-	-	-	627	627
Foreign exchange forward	2	-	-	-	2	2
<b>Available for sale investments</b>	-	-	249,004	-	249,004	249,004
Debt securities	-	-	192,656	-	192,656	192,656
Asset backed securities	-	-	56,348	-	56,348	56,348
Total financial assets	1,375	669,488	249,004	-	919,867	919,663
<b>Liabilities</b>						
<b>Deposits from banks</b>	-	-	-	366,763	366,763	366,763
From subsidiaries	-	-	-	43,529	43,529	43,529
Other deposits from banks	-	-	-	323,234	323,234	323,234
<b>Deposits from customers</b>	-	-	-	378,219	378,219	378,219
Retail customers	-	-	-	356,145	356,145	356,145
Corporate customers	-	-	-	22,074	22,074	22,074
<b>Derivative financial instruments</b>	5,766	-	-	-	5,766	5,766
Interest rate swap	5,662	-	-	-	5,662	5,662
Cross currency swap	104	-	-	-	104	104
<b>Subordinated liabilities</b>	-	-	-	60,000	60,000	60,000
Total financial liabilities	5,766	-	-	804,982	810,748	810,748

## 9. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (Continued)

### Fair values of financial instruments (Continued)

#### Fair values (Continued)

£000	Financial instruments at fair value through profit and loss	Loans and receivables	Available for sale	Other amortised cost	Total carrying amount	Fair value
30 December 2008						
<b>Assets</b>						
<b>Cash and cash equivalents</b>	–	40,069	–	–	40,069	40,069
Cash and balances with banks	–	39,224	–	–	39,224	39,224
Cash in hand	–	845	–	–	845	845
<b>Loans and advances to banks</b>	–	67,272	–	–	67,272	67,219
<b>Loans and advances to customers</b>	–	551,148	–	–	551,148	549,836
Corporate loans and advances	–	516,902	–	–	516,902	515,590
Retail loans and advances	–	34,246	–	–	34,246	34,246
<b>Derivative financial instruments</b>	5,554	–	–	–	5,554	5,554
Interest rate swap	714	–	–	–	714	714
Cross currency swap	4,840	–	–	–	4,840	4,840
<b>Available for sale investments</b>	–	–	330,093	–	330,093	330,093
Debt securities	–	–	268,581	–	268,581	268,581
Asset backed securities	–	–	61,512	–	61,512	61,512
Total financial assets	5,554	658,489	330,093	–	994,136	992,771
<b>Liabilities</b>						
<b>Deposits from banks</b>	–	–	–	560,116	560,116	560,116
From subsidiaries	–	–	–	6,425	6,425	6,425
Other deposits from banks	–	–	–	553,691	553,691	553,691
<b>Deposits from customers</b>	–	–	–	290,289	290,289	290,289
Retail customers	–	–	–	282,130	282,130	282,130
Corporate customers	–	–	–	8,159	8,159	8,159
<b>Derivative financial instruments</b>	5,390	–	–	–	5,390	5,390
Interest rate swap	5,337	–	–	–	5,337	5,337
Cross currency swap	41	–	–	–	41	41
Foreign exchange forward	12	–	–	–	12	12
<b>Subordinated liabilities</b>	–	–	–	60,000	60,000	60,000
Total financial liabilities	5,390	–	–	910,405	915,795	915,795

## 9. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (Continued)

### Fair values of financial instruments (Continued)

#### Fair values (Continued)

The table below analyses financial assets and liabilities measured at fair value, by valuation method:

Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices).

Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

#### Fair value hierarchy

£000 31 December 2009	Level 1	Level 2	Level 3	Total
<b>Financial assets</b>				
Derivative financial instruments:	–	–	–	–
Interest rate swap	–	746	–	746
Cross currency swap	–	627	–	627
Foreign exchange forward	–	2	–	2
	–	1,375	–	1,375
Financial investments available for sale:				
Debt securities	188,174	4,482	–	192,656
Asset backed securities	52,394	3,954	–	56,348
	240,568	8,436	–	249,004
<b>Total assets</b>	<b>240,568</b>	<b>9,811</b>	<b>–</b>	<b>250,379</b>
<b>Financial liabilities</b>				
Derivative financial instruments:				
Interest rate swap	–	5,662	–	5,662
Cross currency swap	–	104	–	104
Foreign exchange forward	–	–	–	–
<b>Total liabilities</b>	<b>–</b>	<b>5,766</b>	<b>–</b>	<b>5,766</b>

## 9. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (Continued)

### Fair values of financial instruments (Continued)

#### *Fair value hierarchy (Continued)*

During the financial year ended 31 December 2009 no financial assets or liabilities were transferred between Level 1, Level 2 or Level 3.

## 10. NET INTEREST INCOME

£000	<b>31 December 2009</b>	31 December 2008
Interest income from financial investments	<b>9,761</b>	17,202
Other interest income:		
Cash	<b>3</b>	473
Loans and advances to banks	<b>441</b>	4,648
Loans and advances to customers	<b>10,417</b>	31,748
Total other interest income	<b>10,861</b>	36,869
Total interest income	<b>20,622</b>	54,071
Interest expense		
Deposits from banks	<b>5,732</b>	23,944
Customers' accounts	<b>847</b>	6,801
Subordinated liabilities	<b>1,098</b>	4,839
Total interest expense	<b>(7,677)</b>	(35,584)
Net interest income	<b>12,945</b>	18,487

Included within various line items under interest income for the year ended 31 December 2009 is a total of £85,000 (31 December 2008: £172,000) accrued for impaired financial assets.

## 11. NET FEE AND COMMISSION INCOME

£000	31 December 2009	31 December 2008
Fee and commission income		
Retail Banking customer fees	1,600	1,791
Corporate Banking credit related fees	2,025	1,739
Other	64	356
Total fee and commission income	3,689	3,886
Fee and commission expense		
Inter bank transaction fees	20	22
Other	115	216
Total fee and commission expense	(135)	(238)
Net fee and commission income	3,554	3,648

## 12. NET LOSS FROM DERIVATIVE FINANCIAL INSTRUMENTS

£000	31 December 2009	31 December 2008
Net loss from derivative financial instruments held for risk management purposes:		
Interest rate swaps	(2,191)	(3,311)
Foreign currency forwards	10	(3)
	(2,181)	(3,314)

There are no financial derivative instruments that qualify for hedge accounting in accordance with IAS 39.

At 31 December 2009 net losses of £4,276,000 (31 December 2008: net profit £4,799,000), on currency swap derivative instruments, have been recorded against foreign exchange gains and losses in the income statement, reflecting the effects of these derivatives instruments in mitigating the foreign exchange gains and losses on the net non-sterling assets of the bank held at these dates.

## 13. OTHER OPERATING INCOME

£000	31 December 2009	31 December 2008
Related party service charges	19,356	9,491
Other	12	10
	19,368	9,501

## 14. STAFF COSTS

£000	31 December 2009	31 December 2008
Wages and salaries	9,120	9,112
Contributions to defined contribution plans	957	897
Other	1,684	1,620
	<b>11,761</b>	11,629

In December 2009, the UK government announced that the Finance Bill 2010 will introduce a bank payroll tax of 50% applicable to discretionary bonuses over £25,000 awarded to UK bank employees between 9 December 2009 and 5 April 2010. Draft legislation and further guidance on its application has been published. Based on this, and in accordance with IAS 19, Employee Benefits, the bank has accrued for the estimated tax payable in respect of the employee service provided during the period. For 2009, £120,000 has been included within Other staff costs in respect of 2009 bonuses.

## 15. ADMINISTRATION AND GENERAL EXPENSES

£000	31 December 2009	31 December 2008
Administrative	3,117	4,554
Software licensing and other IT costs	221	533
Auditor fees	85	65
Other	279	615
	<b>3,702</b>	5,767

## 16. DIRECTORS' EMOLUMENTS

£000	31 December 2009	31 December 2008
Emoluments of directors in respect of services rendered		
Emoluments	724	603
Pension contributions	59	59
Highest paid director		
Emoluments	377	318
Pension contributions	45	42

## 17. INCOME TAX EXPENSE

### Recognised in the income statement

£000	31 December 2009	31 December 2008
<b>Current tax expense</b>		
Current period	3,912	1,548
Adjustments for prior years	(628)	–
<b>Total current tax</b>	<b>3,284</b>	<b>1,548</b>
<b>Deferred tax expense</b>		
Origination and reversal of temporary differences	826	14
Adjustments for prior years	(39)	–
<b>Total deferred tax</b>	<b>787</b>	<b>14</b>
<b>Total income tax expense</b>	<b>4,071</b>	<b>1,562</b>

### Reconciliation of effective tax rate

£000	31 December 2009	31 December 2008
Profit before income tax	16,631	4,574
Income tax using the domestic corporation tax rate	4,656	1,319
Non-deductible expenses	227	243
Non taxable income	(146)	–
Over-provided in prior years	(666)	–
<b>Total income tax expense in income statement</b>	<b>4,071</b>	<b>1,562</b>

### Income tax recognised in other comprehensive income

£000	31 December 2009	31 December 2008
<b>Current tax</b>		
UK current tax expense/(income)	–	(1,459)
Adjustments for prior years	627	–
<b>Total current tax</b>	<b>627</b>	<b>(1,459)</b>
<b>Deferred tax</b>		
Current year deferred tax expense/(income)	5,446	(5,656)
Adjustments for prior years	(607)	–
<b>Total deferred tax</b>	<b>4,839</b>	<b>(5,656)</b>
<b>Total income tax expense/(income)</b>	<b>5,466</b>	<b>(7,115)</b>

## 18. CASH AND CASH EQUIVALENTS

£000	31 December 2009	31 December 2008
Cash and balances with banks	126,976	39,224
Cash in hand	836	845
	<b>127,812</b>	40,069

## 19. DERIVATIVE FINANCIAL INSTRUMENTS

The bank holds derivatives instruments for risk management and cross currency funding purposes.

£000	31 December 2009		31 December 2008	
	Assets	Liabilities	Assets	Liabilities
<b>Instrument type:</b>				
Interest rate swap	746	5,662	714	5,337
Cross currency swap	627	104	4,840	41
Foreign exchange forward	2	–	–	12
	<b>1,375</b>	<b>5,766</b>	5,554	5,390

The bank did not designate any derivative financial instruments for hedging purposes during either period presented.

## 20. LOANS AND ADVANCES TO BANKS

£000	31 December 2009	31 December 2008
Loans and advances to banks	36,933	67,272

At 31 December 2009 £12,389,000 (31 December 2008: £40,797,000) of loans and advances to banks are expected to be recovered more than twelve months after the reporting date.

## 21. LOANS AND ADVANCES TO CUSTOMERS

£000	31 December 2009	31 December 2008
Corporate loans and advances	456,343	516,902
Retail loans and advances	48,931	34,648
Gross loans and advances	505,274	551,550
Less: allowance for impairments		
Specific	(531)	(378)
Collective	–	(24)
Total allowance for impairment	(531)	(402)
Loans and advances to customer net	504,743	551,148

At 31 December 2009 £239,023,000 (31 December 2008: £459,402,000) of loans and advances to customers are expected to be recovered more than twelve months after the reporting date.

### Loans and advances to customers at amortised cost

£000	31 December 2009			31 December 2008		
	Gross amount	Impairment allowance	Carrying amount	Gross amount	Impairment allowance	Carrying amount
Corporate loans and advances	456,373	(345)	456,028	516,902	–	516,902
Retail loans and advances	48,901	(186)	48,715	34,648	(402)	34,246
	505,274	(531)	504,743	551,550	(402)	551,148

## 22.ALLOWANCES FOR IMPAIRMENT

### (a) Loans and advances to banks and customers

£000	Specific		Collective	
	Loans and advances to banks	Loans and advances to customers	Loans and advances to banks	Loans and advances to customers
<b>Balance at 1 January 2009</b>	–	378	–	24
Transfers	–	–	–	–
Increase in impairment	–	5,488	–	–
Reversal of impairment	–	(431)	–	(24)
<b>Charge/(credit) in income statement</b>	–	5,057	–	(24)
Amounts written off	–	(4,904)	–	–
<b>Balance at 31 December 2009</b>	–	531	–	–
Balance at 1 October 2007	–	–	–	–
Transfers	–	44	–	–
Increase in impairment	–	400	–	24
Reversal of impairment	–	(3)	–	–
Charge/(credit) in income statement	–	397	–	24
Amounts written off	–	(63)	–	–
Balance at 31 December 2008	–	378	–	24

### (b) Available for sale financial investments

£000	Note	Movement in fair value recognised in equity	
			Impairment
<b>Balance at 1 January 2009</b>		25,269	9,330
Recoveries	23	(22,656)	(3,206)
Allocated as impaired	23	3,206	–
Write-offs		–	–
Exchange-rate movements		–	(540)
<b>Balance at 31 December 2009</b>		5,819	5,584
Balance at 1 October 2007		–	–
Charges	23	34,234	8,965
Allocated as impaired	23	(8,965)	–
Write-offs		–	–
Exchange-rate movements		–	365
Balance at 31 December 2008		25,269	9,330

## 22.ALLOWANCES FOR IMPAIRMENT (Continued)

### (c) Impairment charges

£000	31 December 2009	31 December 2008
Loans and advances to customers		
Specific	5,057	397
Collective	(24)	24
Available for sale financial investments	(3,206)	8,965
<b>Total impairment charges in income statement</b>	<b>1,827</b>	<b>9,386</b>

## 23.AVAILABLE FOR SALE INVESTMENTS

At 31 December 2009 there were £224,043,000 available for sale investments (31 December 2008: £321,975,000) which are expected to be recovered more than twelve months after the reporting date. The available for sale investments balance is comprised of fixed and floating interest rate bonds.

£000	Note	31 December 2009	31 December 2008
Debt securities		192,656	268,581
Asset backed securities		56,348	61,512
		<b>249,004</b>	<b>330,093</b>
Balance at 1 January 2009/1 October 2007		330,093	–
Acquisitions and transfers		–	471,210
Accrued interest		(3,059)	7,594
Disposals (through sale and redemptions)		(76,661)	(173,878)
Losses from changes in fair value recognised in equity	22 (b)	19,450	(25,269)
Impairment	22 (b)	3,206	(8,965)
Amortisation of discount/(premium)		(35)	(162)
Exchange-rate movement		(23,990)	59,563
Balance at 31 December		<b>249,004</b>	<b>330,093</b>

**24. TANGIBLE FIXED ASSETS (PROPERTY, PLANT AND EQUIPMENT)**

£000	Property, plant and fixtures	Furniture and equipment	Computer equipment	Motor vehicles	Total
<b>Cost</b>					
<b>Balance at 1 January 2009</b>	<b>4,863</b>	<b>528</b>	<b>325</b>	<b>67</b>	<b>5,783</b>
<b>Additions</b>	<b>37</b>	<b>65</b>	<b>48</b>	<b>–</b>	<b>150</b>
<b>Disposals</b>	<b>–</b>	<b>–</b>	<b>(1)</b>	<b>–</b>	<b>(1)</b>
<b>Balance at 31 December 2009</b>	<b>4,900</b>	<b>593</b>	<b>372</b>	<b>67</b>	<b>5,932</b>
Balance at 1 October 2007	–	–	–	–	–
Additions and transfers	4,863	589	325	67	5,844
Disposals	–	(61)	–	–	(61)
Balance at 31 December 2008	4,863	528	325	67	5,783
<b>Depreciation</b>					
<b>Balance at 1 January 2009</b>	<b>2,761</b>	<b>490</b>	<b>157</b>	<b>4</b>	<b>3,412</b>
<b>Depreciation for the year</b>	<b>411</b>	<b>17</b>	<b>51</b>	<b>17</b>	<b>496</b>
<b>Disposals</b>	<b>–</b>	<b>–</b>	<b>(1)</b>	<b>–</b>	<b>(1)</b>
<b>Balance at 31 December 2009</b>	<b>3,172</b>	<b>507</b>	<b>207</b>	<b>21</b>	<b>3,907</b>
Balance at 1 October 2007	–	–	–	–	–
Transfers	2,509	535	137	–	3,181
Depreciation for the period	252	16	20	4	292
Disposals	–	(61)	–	–	(61)
Balance at 31 December 2008	2,761	490	157	4	3,412
<b>Net carrying values at 31 December 2009</b>	<b>1,728</b>	<b>86</b>	<b>165</b>	<b>46</b>	<b>2,025</b>
31 December 2008	2,102	38	168	63	2,371

As at 31 December 2009 and 31 December 2008 the bank identified no events or circumstances that would indicate that the bank's tangible fixed assets might be impaired.

## 25. INTANGIBLE ASSETS

£000	IT Software	Total
<b>Cost</b>		
<b>Balance at 1 January 2009</b>	<b>408</b>	<b>408</b>
<b>Additions</b>	<b>225</b>	<b>225</b>
<b>Balance at 31 December 2009</b>	<b>633</b>	<b>633</b>
Balance at 1 October 2007	–	–
Additions and transfers	408	408
Balance at 31 December 2008	408	408
<b>Depreciation and Impairment loss</b>		
<b>Balance at 1 January 2009</b>	<b>87</b>	<b>87</b>
<b>Depreciation for the year</b>	<b>106</b>	<b>106</b>
<b>Balance at 31 December 2009</b>	<b>193</b>	<b>193</b>
Balance at 1 October 2007		
Transfers	3	3
Depreciation for the period	84	84
Balance at 31 December 2008	87	87
Net carrying value at <b>31 December 2009</b>	<b>440</b>	<b>440</b>
31 December 2008	321	321

As at 31 December 2009 and 31 December 2008 the bank identified no events or circumstances that would indicate that the bank's intangible assets might be impaired.

## 26. DEFERRED TAX ASSETS AND LIABILITIES

### Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

£000	31 December 2009			31 December 2008		
	Assets	Liabilities	Net	Assets	Liabilities	Net
Property and equipment, and software	16	–	16	–	(14)	(14)
Available for sale investments	–	–	–	5,656	–	5,656
Other	–	–	–	–	–	–
Net tax assets/(liabilities)	16	–	16	5,656	(14)	5,642

## 26. DEFERRED TAX ASSETS AND LIABILITIES (Continued)

### Unrecognised deferred tax assets

There were no unrecognised deferred tax assets as at 31 December 2009 and 31 December 2008.

### Movements in temporary differences during the year

£000	Opening balance 1 January 2009	Recognised in profit or loss	Recognised in equity	Closing balance 31 December 2009
Property and equipment, and software	(14)	30	–	16
Available for sale investments	5,656	(817)	(4,839)	–
	<b>5,642</b>	<b>(787)</b>	<b>(4,839)</b>	<b>16</b>

£000	Opening balance 1 October 2007	Recognised in profit or loss	Recognised in equity	Closing balance 31 December 2008
Property and equipment, and software	–	(14)	–	(14)
Available for sale investments	–	–	5,656	5,656
	–	(14)	5,656	5,642

## 27. PREPAYMENTS, ACCRUED INCOME AND OTHER ASSETS

£000	31 December 2009	31 December 2008
Accrued income	1,258	3,098
Prepaid expenses	275	171
Prepaid tax	1,815	1,815
Receivable from related party	26,134	15,823
Other	298	290
	<b>29,780</b>	<b>21,197</b>

## 28. DEPOSITS FROM BANKS

£000	31 December 2009	31 December 2008
From subsidiaries	43,529	6,425
Other deposits from banks	323,234	553,691
	<b>366,763</b>	560,116

At 31 December 2009 £nil (31 December 2008: £nil) of deposits from banks are expected to be settled more than twelve months after the reporting date.

## 29. DEPOSITS FROM CUSTOMERS

£000	31 December 2009	31 December 2008
Retail customers:		
Term deposits	149,940	145,685
Notice deposits	76,043	53,142
Current deposits	129,589	83,250
Other	573	53
	<b>356,145</b>	282,130
Corporate customers:		
Notice deposits	–	184
Current deposits	519	901
Other	21,555	7,074
	<b>22,074</b>	8,159
	<b>378,219</b>	290,289

At 31 December 2009 £nil (31 December 2008: £nil) of deposits from customers are expected to be settled more than twelve months after the reporting date.

### 30. SUBORDINATED LIABILITIES

£000	31 December 2009	31 December 2008
Subordinated note issued	60,000	60,000
	<b>60,000</b>	60,000

The subordinated note issued is expected to settle more than twelve months after the reporting date (31 December 2008: £60,000,000).

On 20 September 2007 the bank issued a £60,000,000 subordinated loan. Interest is payable on 31 March, 30 June, 30 September and 31 December at the three-month London Interbank Bank Offered Rate plus 30 basis points. The rate applicable to the loan as at the reporting date was 0.91% (31 December 2008: 3.07%). The loan is repayable upon giving 5 years and one day's notice.

The above liabilities will, in the event of the winding-up of the bank, be subordinated to the claims of depositors and all other creditors of the bank.

The bank has not had any defaults of principal, interest or other breaches with respect to its subordinated liabilities during the periods ended 31 December 2009 and 31 December 2008.

### 31. OTHER LIABILITIES

#### (a) Other liabilities

£000	31 December 2009	31 December 2008
Creditors and accruals	10,878	9,167
Other	2,526	1,434
	<b>13,404</b>	10,601

#### (b) Defined benefit obligations

The bank makes contributions to a group defined benefit scheme that provides pension benefits for employees upon retirement. This scheme entitles a retired employee to receive an annual payment equal to 1/60th of final salary for each year of service the employee provided. The scheme is sponsored by Bank of China Limited, London Branch and was closed to new employees on 31 December 2004.

The following tables set out details of the Bank of China Pension & Life Assurance Scheme (the "Scheme") as at 31 December 2009 and 2008. This disclosure is for the Scheme as a whole and does not represent the bank's allocation of the Scheme's assets and liabilities due to its participation in the Scheme. The Scheme prepares its financial statements as at 31 December annually, therefore the amounts stated in the tables below cover a 12-month period to 31 December 2009, and the comparatives a 12-month period to 31 December 2008.

## 31. OTHER LIABILITIES (Continued)

### (b) Defined benefit obligations (Continued)

#### *Changes in the present value of the Scheme's liabilities*

£000	31 December 2009	31 December 2008
Benefit obligations at beginning of year	26,517	28,446
Interest costs	1,605	1,661
Current service costs	721	757
Members' contributions	122	123
Actuarial (gain)/loss	5,048	(4,023)
Effects of curtailments or settlements	(79)	–
Benefits paid	(290)	(447)
Past service costs	–	–
Benefit obligations at the end of the year	33,644	26,517

#### *The benefit obligation arising from schemes that are wholly un-funded and wholly or partly funded as follows:*

£000	31 December 2009	31 December 2008
Un-funded obligations	–	–
Wholly or partly funded obligations	(3,486)	855
Total	(3,486)	855

#### *Changes in Scheme assets*

£000	31 December 2009	31 December 2008
Market value of assets at beginning of year	27,373	20,578
Expected return on Scheme assets	1,668	1,428
Actuarial gain/(loss)	(654)	438
Members' contributions	122	123
Employers' contributions	2,018	5,253
Effects of settlements	(79)	–
Benefits paid	(290)	(447)
Market value of assets at end of year	30,158	27,373

## 31. OTHER LIABILITIES (Continued)

### (b) Defined benefit obligations (Continued)

#### *Scheme assets as a percentage of total assets*

	<b>31 December 2009</b>	31 December 2008
Equities	<b>22.5%</b>	21.8%
Bonds	<b>20.4%</b>	27.1%
Property	<b>4.9%</b>	5.0%
Cash	<b>52.2%</b>	46.1%

#### *Principal actuarial assumptions*

The overall expected return on assets has been derived by considering the long-term expected rate of return for each asset class and taking the average rates weighted by the proportion invested in each asset class at the year end.

	<b>31 December 2009</b>	31 December 2008
Discount rate	<b>5.60%</b>	6.00%
Price inflation	<b>3.50%</b>	2.75%
Rate of increase in salaries	<b>5.00%</b>	4.25%
Rate of increase for pensions in payment (LPI)	<b>3.30%</b>	2.65%
Post retirement mortality table	<b>PM/FA 92 YOB (Long Cohort)</b>	PM/FA 92 YOB (Long Cohort)
Expected return on assets	<b>5.09%</b>	5.90%

The bank expects to pay £642,000 (2009: £648,000) in contributions to defined benefit plans in 2010.

## 32. ACCRUALS AND DEFERRED INCOME

£000	<b>31 December 2009</b>	31 December 2008
Deferred income	<b>1,746</b>	1,112
Accrued interest	<b>420</b>	2,987
	<b>2,166</b>	4,099

### 33. EQUITY

#### (a) Capital

At 31 December 2009 the authorised share capital comprised 140,000,000 ordinary shares (31 December 2008: 140,000,000). These instruments have a par value of £1 and are all issued shares and fully paid.

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the bank. All shares rank equally subordinated to the bank's assets.

#### (b) Available for sale reserve

The available for sale reserve includes the cumulative net change in the fair value of available for sale investments, excluding impairment losses, until the investment is derecognised or impaired.

#### (c) Dividends

There were no dividends declared for the periods ending 31 December 2009 or 31 December 2008.

### 34. PROVISIONS

There were no provisions or contingencies at the periods ended 31 December 2009 or 31 December 2008.

### 35. RELATED PARTIES

#### (a) Parent and ultimate controlling party

The immediate parent company of the bank is Bank of China Limited (a company incorporated in the People's Republic of China). The ultimate holding company is China Investment Corporation Limited.

The largest and smallest group which includes the bank and which prepares publicly available consolidated financial statements is the Bank of China Limited. Copies of its consolidated financial statements are publicly available from the Head Office of the Bank of China Limited, 1 Fuxingmen Nei Dajie, Beijing 100818 People's Republic of China.

During the period ended 31 December 2009 there were no transactions which resulted in there being a change in the ultimate controlling party of the bank.

The bank regards the following as being related parties that exercise significant influence:

- Bank of China Limited
- China Investment Corporation Limited

Related party transactions occurred between the bank and the London Branch. At 31 December 2009 the bank received £323,234,000 (31 December 2008: £553,258,000) which is 44% (31 December 2008: 65%) of its funding from London Branch in the form of short-term funding. The funding is interest bearing at market rate for the term and currency borrowed, and is repayable in accordance with the contractual maturity date of the deposit.

**35. RELATED PARTIES (Continued)****(a) Parent and ultimate controlling party (Continued)**

£000	Nature of related party	
	Significant influence	Subsidiary company
<b>Balance at 31 December 2009</b>		
Cash and cash equivalents	74,937	–
Loans and advances to customers	–	2
Derivative financial instruments	1,375	–
Prepayments, accrued income and other assets	26,134	–
Deposits from banks	323,234	43,529
Deposits from customers	–	1,376
Derivative financial instruments	5,766	–
Other liabilities	7,150	–
Subordinated liabilities	60,000	–
<b>Included in the income statement for the period</b>		
Interest receivable	357	–
Interest payable	(6,529)	(280)
Other operating income	19,029	327
Pension contributions	642	–
Balance at 31 December 2008		
Cash and cash equivalents	35,866	–
Loans and advances to customers	–	501
Derivative financial instruments	5,554	–
Prepayments, accrued income and other assets	15,531	292
Deposits from banks	553,258	6,425
Deposits from customers	–	1,194
Derivative financial instruments	5,390	–
Other liabilities	6,590	–
Subordinated liabilities	60,000	–
<b>Included in the income statement for the period</b>		
Interest receivable	4,947	25
Interest payable	(28,756)	(1)
Other operating income	9,238	253
Pension contributions	690	–

## 35. RELATED PARTIES (Continued)

### (b) Investment in non-consolidated subsidiaries

	Country of incorporation	Ownership interest	
		31 December 2009	31 December 2008
Bank of China (Suisse) S.A.	Switzerland	100%	100%
BOC (Suisse) Funds Management S.A. <sup>1</sup>	Switzerland	70%	70%
China Visa Services Limited	United Kingdom	100%	100%
China Visa Services Italy SRL <sup>2</sup>	Italy	100%	–
PT. China Visa Services Indonesia <sup>2</sup>	Indonesia	100%	–

<sup>1</sup> Indirect holding via Bank of China (Suisse) SA

<sup>2</sup> Indirect holding via China Visa Services Limited

At 31 December 2009, the bank holds an investment of £28,113,000 (CHF 50,000,000) (31 December 2008: £28,113,000 (CHF 50,000,000)) in Bank of China (Suisse) SA and £1 in China Visa Services Limited (31 December 2008: £1). These entities are wholly-owned, with head quarters at rue du General-Dufour 3, 1204 Geneva, Switzerland and Morley House, London, United Kingdom respectively.

The bank has availed itself of the consolidation exemption (refer to Note 2) and therefore does not consolidate these subsidiaries.

### (c) Key management compensation

Key management is comprised of directors and the members of the Executive Management Committee of the bank.

Key management personnel compensation for the period ended 31 December 2009 comprised of salaries and other short term benefits in the amount of £1,119,000 (31 December 2008: £1,306,762).

The bank does not provide non-cash benefits to any of the key management personnel.

### (d) Transactions with key management

	31 December 2009	31 December 2008
£000		
Loans and advances	24	2

## 36. CONTINGENT LIABILITIES AND COMMITMENTS

### (a) Loan commitments, guarantees and other financial facilities

At 31 December 2009, the bank had off-balance sheet financial instruments that commit it to extend credit to customers, guarantees and other facilities as follows:

£000	31 December 2009	31 December 2008
Loan commitments	270,596	223,350
Guarantees	27,435	66,847
<b>Total</b>	<b>298,031</b>	<b>290,197</b>

### (b) Operating lease commitments

Where the bank is the lessee, the future minimum lease payments under non-cancellable operating leases are as follows:

£000	31 December 2009	31 December 2008
Less than one year	434	433
Between one and five years	639	1,357
More than five years	56	115
<b>Total</b>	<b>1,129</b>	<b>1,905</b>

## 37. SUBSEQUENT EVENT

In January 2010 the bank granted a CHF 20 million subordinated loan facility to its wholly-owned subsidiary Bank of China (Suisse) S.A. Drawings against this facility will be used by the subsidiary to maintain its capital adequacy requirements under the Swiss banking regulations. At the date of the approval of these financial statements CHF 10 million has been drawn for this purpose. Drawn amounts under the facility are repayable upon the bank giving 5 years and one day's notice.

## 38. GOING CONCERN ASSESSMENT

The Board has given its consideration to the going concern status of the bank as at the reporting date. After due consideration the Board is of the opinion that the bank will continue as a going concern for the foreseeable future, generating cash flows from its continuing operations, but taking additional comfort from the Letter of Support from the parent company.



中國銀行(英國)有限公司  
BANK OF CHINA (UK) LIMITED

### **Bank of China (UK) Limited**

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