中国银行(英国)有限公司
BANK OF CHINA (UK) LIMITED

BANK OF CHINA (UK) LIMITED

Annual Report & Financial Statements for the year ended 31st December

2012

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Business Review

Chairman's Statement

2012 was a memorable year for the UK as a whole, marked by its huge success in hosting the Olympic Games and its celebration of the Queen's Diamond Jubilee. Meanwhile, the UK economy entered its third year of recession and the UK banking sector remained troubled by the Euro Zone debt crisis and the global economic downturn. However, Sino-UK trade still achieved exceptional growth, making Britain the only country among China's major trading partners in the EU to show positive growth in its trade with China.

Against this background, I am delighted to report that Bank of China (UK) Limited has performed well this year despite challenging market and economic conditions. In 2012, we delivered good growth with total assets up 6.4% and total income up 71.1%. All the financial results were well ahead of target ranges set by the board.

The capability of the bank to provide cross border services to its clients has been further strengthened. During last year the bank continued to expand its customer base by focusing on Chinese going-out enterprises, leading European and UK multinational corporations, median and high end private customers and financial institutions. In addition, during 2012 we further reinforced the bank's position as a leading provider of RMB products and services by continuing to actively participate in the City of London's initiative to make London an offshore centre for RMB activities. The bank continues to have a very strong and healthy growth in its mortgage business. Improvements were also made in risk control management, internal control and regulatory compliance.

In October 2012, as part of a strategic collaboration agreement between Bank of China Limited and Bank Julius Baer & Co Limited, Bank of China (Suisse) SA was integrated with Bank Julius Baer. The integration process was implemented very smoothly. As a result, both the Board and the management of the bank are able to give greater focus to the development of its commercial banking business and its UK operations.

On behalf of the Board, I would like to thank the executive management team and all other employees for their hard work in very difficult market conditions and their contribution to the development of Bank of China (UK) Limited.

Although we enter 2013 with a strongly growing business, we face uncertainty in the projected recovery of global economic activities and continued weakness in the UK and EU economies over the next 12 months. However, given our ability to serve both European and Chinese customers, by working more closely with domestic branches of the Group, we will provide the bank with a good platform for continued growth in 2013 and the future.

Yi Yue
Chairman of the Board of Directors

Chief Executive Officer's Statement

2012 was an excellent year for Bank of China (UK) Limited, as we delivered record financial results, even though the year was marked by challenging market and economic conditions. As a result of management`s successful execution of strategy set by the Board, our total income increased by 71.1% to £63.9m. Net profit after tax was £24.4m from a loss of £26m in 2011, including the effect of a further impairment in respect of Yell totalling £5.3m. All financial results for 2012 are well ahead of the average level achieved in previous years. For the two years from 31st December 2010 to 31st December 2012, the bank`s net profit after tax rose by 126%.

With total assets reaching £827.5m, our core tier 1 capital adequacy ratio is 41.9%, much higher than the average level of the UK banking sector. We still face a substantial challenge to improve the bank's return on equity to expected levels. We continue to make great improvements in risk management, internal control, asset and liability management and liquidity management.

We also made great efforts to expand and improve our products and services for example, RMB products and services, mortgage products and delivery channels to our customers. I am pleased to report that our mortgage product won a Money Facts Award for the second year consecutively.

I am pleased to report that good progress was made with key projects during 2012. Under the terms of a strategic agreement with Bank Julius Baer, Bank of China (Suisse) SA, a wholly owned subsidiary of Bank of China (UK) Limited was integrated successfully and smoothly into their operations in Geneva. The bank`s retail banking unit in the City of London has been relocated to its main banking premises at No 1 Lothbury where a wealth management centre has also been opened officially with the aim of providing a superior service to high net wealth customers. The bank's subsidiary, China Bridge Group (UK) Limited, opened another Chinese Visa application centre in Edinburgh to extend coverage to the whole of the UK.

I wish to thank all members of staff of Bank of China (UK) Limited, whose dedication and creativity makes it possible for us to achieve these excellent results. Let me also extend our thanks to the Board for bringing a wealth of experience and insight in financial services to the bank.

Looking forward to 2013, we still expect a very challenging external environment, given that the UK economy is recovering very slowly from recession and growth in the Chinese economy is expected to continue but at a lower level. However management is confident that we are well positioned to drive further growth given that our capacity of serving both European and Chinese corporates has become well established. A major task for this year will be the Group IT Integration and Transformation project in which London will be an active participant. Management is confident that this project will provide improvements to the IT infrastructure and operational environment in London.

Wenjian Fang
Chief Executive Officer
Board Director

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"). During the period the bank was 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. The bank's registration number at Companies House is 6193060.

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 2012 the bank had total assets of £827,527,000 (2011: £777,725,000).

The bank's assets are primarily financed by retail and intra-group deposits. The bank continues to focus its attention on developing the customer deposits base and this reflects our determination to develop our corporate banking services as well as to help in meeting the bank's funding requirements.

On the 12 March 2012 Bank of China Limited, the bank's parent company, remitted £110,000,000 for the purpose of subscribing for 110,000,000 £1 ordinary shares in the bank. On the 30 March 2012 the bank issued and allotted 110,000,000 £1 ordinary shares to Bank of China Limited.

For the year ended 31 December 2012, the bank generated a post-tax profit of £24,430,000 (2011: loss £26,070,000), after an impairment charge of £5,254,000 against one loan facility in the Corporate Banking portfolio.

On the 1 October 2012 the bank disposed of its investment in Bank of China (Suisse) S.A. resulting in a loss of £1,074,000 which has been charged to the income statement.

Retail Banking

The bank continued to build its brand awareness and increase its customer base in the UK retail market. The bank's buy-to-let mortgage product was selected as a "Best Buy" by Moneyfacts, an independent organisation that monitors financial products. The bank also received the highly commended award for "Best Service" from a buy-to-let mortgage provider, for the second year running. These accolades contributed towards a steady increase in the mortgage loan book. As at 31 December 2012 there were no non-performing loans and the bank continues to lend prudently in a challenging market.

The bank also achieved a healthy growth in commission business and total commission income for retail banking increased by 23% compared with last year.

In addition to traditional retail products, the bank focused its attention on Renminbi ("RMB") denominated business, providing a number of RMB services including RMB currency exchange, RMB current account, RMB remittances and a range of RMB accounts. During the year the bank launched its Wealth Management Centre which provides a unique platform to serve its high net wealth customers.

Corporate Banking

Seizing on the opportunity of China's strong economic growth as well as fast growing Sino-British bilateral trade, the bank continued to develop its relationships with existing and targeted corporate clients by offering a comprehensive range of banking products and services including credit facilities, deposits, trade services, cash management, foreign exchange and RMB business. 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 corporate banking business is to be a major bank servicing the local companies involved in the trade and investment between UK and China and China's "going-out" enterprises in the UK, Europe and Africa regions.

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, (31 December 2011; Nil).

Directors' Interest

The directors of the bank who were in office during the year and up to the date of signing the financial statements were:

Mr. Yi Yue	Chairman
Mr. WenJian Fang	Chief Executive Officer
Mr. Stephen Hinds	Chief Operating Officer
Mr. Christopher Fitzgibbon	Non-Executive
Mr. Donald Workman	Non-Executive
Ms. Li Ren	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 15 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 2012 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

The average number of employees for the year ended 31 December 2012 was 296 (31 December 2011: 254).

- **Disabled employees**

The bank is committed to employment policies, which follow best practice, based on equal opportunities for all employees, irrespective of sex, race, colour, disabilities or marital status. The bank gives full and fair consideration to applications for employment from disabled persons, having regard to their particular aptitudes and abilities. Appropriate arrangements are made for the continued employment and training, career development and promotion of disabled persons employed by the bank. If members of staff become disabled the bank continues employment either in the same or an alternative position, with appropriate retraining being given if necessary.

- **Employee involvement**

The bank systematically provides employees with information on matters of concern to them, consulting them or their representatives regularly, so that their views can be taken into account when making decisions that are likely to affect their interests. Employee involvement in the bank is encouraged, as achieving a common awareness on the part of the employees of the financial and economic factors affecting the bank plays a major role in maintaining its performance. The bank encourages the involvement of the employees by means of a employee representative forum which is held on a quarterly basis and chaired by a member of the Executive Management Committee.

Charitable and Political Contributions

For the year ended 31 December 2012, 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, market risk and liquidity risk are set out in Note 6, pages 34 to 44, 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.bankofchina.com/uk.

Principal Risks and Uncertainties

The bank is subject to a number of risk factors that could cause its future results to differ materially from current expectations. These risk factors are of uncertainties concerning the current and future business climate, and risks which are naturally inherent in a banking environment.

The current business climate is subject to significant uncertainties in 2013 and beyond, most notably:

- The rate and sustainability of the recovery of the UK economy
- The potential impact of increasing inflation on economic growth and corporate profitability
- The rate and extent of the rise of interest rates in the UK and the Eurozone
- The potential fall of residential property prices.

The effect of one or a combination of the above factors could make the business environment a challenging one with regard to possible credit impairments being incurred and difficulty in identifying new assets/business opportunities that meet the bank's risk appetite.

Principal Risks: The bank is exposed to a number of financial and non-financial risks namely credit risk, market risk, liquidity risk and operational risk. Of these risks, credit risk and liquidity risk are deemed to be the principal risks which the bank is exposed to.

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 is considered a principal risk due to the composition of the Bank's balance sheet and lending being its primary business.

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.

Further information on the management of credit risk is disclosed in Note 6 (a) of the notes to the financial statements.

Liquidity risk is the risk that the bank is unable to meet its obligations as they fall due resulting in an inability to support normal business activity and/or failing to meet liquidity regulatory requirements.

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, as part of the going concern assessment, took additional comfort from the Letter of Support from the bank's parent company which, by direct implication, has a significant impact on the bank's assessment of its exposure to liquidity risk. A further mitigating factor is a committed short-term loan facility granted by the bank's parent company which is in support of the Intra Group Liquidity Modification granted to the bank by the FSA.

Further information on the management of liquidity risk is disclosed in Note 6 (b) of the notes to the financial statements.

Key performance indicators

The bank's Key Performance Indicator ("KPI") is monitoring the financial performance of the bank against financial targets set at the beginning of the financial year by the Board. The financial targets monitored include the main income streams of the bank by income type and business department, personnel and business expenses and net profit after tax.

Subsequent events

As disclosed in note 36 to the financial statements, there were no subsequent events.

Disclosure of Information to the Auditors

The directors who held office at the date of approval of this Directors' 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.

The bank's parent company, Bank of China Limited, has appointed Ernst & Young Hua Ming as its external auditor for auditing its financial statements and internal control in 2013. In accordance with Group policy on use of external auditors, the Board will appointed Ernst & Young LLP as the bank's external auditor for the financial year ending 31 December 2013.

1 Lothbury
London
EC2R 7DB

By order of the Board,

Wenjian Fang
Chief Executive Officer
Board Director

19 April 2013

02/ Governance

Corporate Governance

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 Corporate Governance Code (the "Governance Code") issued by the Financial Reporting Council on 28 May 2010.

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.

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 2012, 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 Governance 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.

During 2012, the Board was provided with regular updates on Corporate Governance and Regulatory Responsibilities.

Performance Review

As with the previous year, annual performance contracts were established for the executive Directors for 2012 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 ARROW2 assessment, the most recent of which was in October/November 2011.

Remuneration Committee Report

The Remuneration Committee ("the Committee") currently comprises two directors, Mr Donald Workman (non executive director and the Committee Chairman) and Mr WenJian Fang (Chief Executive Officer) and Ms Tracey Rutherford, Head of Human Resources ("HR").

The Committee is responsible for supporting the implementation of an effective remuneration programme within BOC UK and ensuring that BOC UK meets all applicable statutory and regulatory requirements within an effective human resource function.

The Committee aims to meet on a quarterly basis and met on three occasions in 2012. Key activities undertaken were as follows:

- Review, approval and monitoring of the HR annual work plan
- Review of the headcount information/staff turnover throughout 2012 confirming that nothing adverse was noticed. Should anything adverse be noted, appropriate actions would be taken accordingly.
- In conjunction with staff development strategies, the Committee approved the Training and Development plan for 2012 to primarily focus on:
  - Internal regulatory training
  - IT skills training
  - Cultural Awareness training
  - Client relationship/customer services training
  - Project Management training
  - Project Finance training
  - Market Risk training
  - Corporate Banking and Risk Management training
  - Structured Trade and Commodity Finance consultative training
  - Language Skills
  - Continued Implementation of a professional banking qualification provided by CIOBS (Chartered Institute of Bankers in Scotland)

- In alignment with Performance Management strategies, the Committee approved the continual review of the Performance Management process to streamline and clarify measurement/target application, weighting application and moderation of performance ratings and ensure it achieves the bank's and the employees' objectives. The Committee approved the year-end performance management process which was also aligned to annual salary and discretionary bonus scheme allocation and also the implementation of new Performance Management software which will include talent management, succession planning, personal development and staff survey modules.
- The Committee continued to review the implementation of the FSA Remuneration Code and the impact on the bank and employees and finalised the Remuneration Policy and Remuneration Policy Statement with Tier 2 Pillar 3 remuneration disclosure to follow.
- The Committee discussed and agreed the process to be undertaken to recruit a new Non Executive Director and appointment of a new member to the Committee.
- The Committee discussed and considered the HRM Reform paper sent by Head Office and will continue to monitor progress.

Audit Committee Report

The Audit Committee (the "Committee") currently comprises of: two non-executive directors who are voting members; Mr Chris Fitzgibbon (Chairman) 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 2012; 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 the Risk Management and Legal and Compliance Departments and these were reviewed and discussed.

Board Risk Committee Report

In line with FSA guidelines and following the Walker recommendations to reinforce Enterprise-wide Risk Management (ERM); the Board Risk Committee (BRC) was established with the approval of the Board on 23rd March 2011.

BRC comprises two directors who are voting members; Mr Donald Workman (non-executive director and BRC Chairman) and Mr WenJian Fang (Chief Executive Officer).

The Committee is responsible for the oversight and implementation of risk strategy and risk appetite within the bank, oversight of risk management performance and the executive committees including Compliance Committee, Operational Risk Committee, Assets and Liabilities Management Committee, Credit Risk Policy Committee and Credit Committee. BRC also approves all credit limits, provisions (and/or write-offs) above the delegated limits of the CEO.

The BRC has regular meetings on a quarterly basis. During these meetings the Committee also reviewed, discussed and challenged the bank's Risk Appetite Statement, Individual Capital Adequacy Assessment ("ICAAP") and Individual Liquidity Adequacy Assessment ("ILAA") documents prior to them being presented to the Board for approval.

In addition, during 2012 five further committee meetings were held to consider specific credit proposals.

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 directors have prepared the financial statements in accordance with International Financial Reporting Standards (the "IFRSs") as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the bank for that period. In preparing these financial statements the directors are required to:

- 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 as adopted by the European Union
- 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 adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Going concern

The directors have assessed, in the light of current and ongoing uncertain economic conditions, the bank's ability to continue as a going concern. The directors confirm they are satisfied that the bank has adequate resources, together with parental support, to continue in business for the foreseeable future and continue to adopt the "going concern" basis for preparing the financial statements.

The directors are responsible for the maintenance and integrity of the company's website. Legislation in the United Kingdom governing the preparation and disseminating of financial statements may differ from legislation in other jurisdictions.

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.

Wenjian Fang
Chief Executive Officer
Board Director

19 April 2013

Statement on Non-Statutory Accounts

This Annual Report & Financial Statements is not Bank of China (UK) Limited's statutory accounts and has been prepared for marketing purposes.

The content of this Annual Report & Financial Statements are identical to Bank of China (UK) Limited's statutory accounts for the year ended 31 December 2012 except for, in accordance with 435 (2) of the Companies Act 2006, the Independent Auditor's Report which has not been reproduced.

Bank of China (UK) Limited's statutory accounts for the year ended 31 December 2012 were filed at Companies House on 30 April 2013. These statutory accounts contain an unqualified Independent Auditors' Report.

03/

Financial Statements

Financial Statements

Income Statement

£000	Note	**12 months to 31 December 2012**	12 months to 31 December 2011
Interest income from financial investments		**2,279**	3,425
Other interest income		**12,244**	9,531
Interest expense		**(2,828)**	(2,828)
Net interest income	9	**11,695**	10,128
Fee and commission income		**7,448**	6,353
Fee and commission expense		**(783)**	(507)
Net fee and commission income	10	**6,665**	5,846
Net loss from derivative financial instruments	11	**(1,478)**	(927)
Foreign exchange gain/(loss)		**1,688**	(2,080)
Other operating income	12	**45,390**	25,698
Loss on sale of debt securities		**(23)**	(1,298)
Non-interest income		**45,577**	21,393
Total income		**63,937**	37,367
Staff costs	13	**(19,227)**	(16,203)
Other expenses	14	**(5,779)**	(4,657)
Depreciation of plant and equipment	23	**(589)**	(507)
Amortisation of intangible assets	24	**(105)**	(160)
Impairment charges	21 (c)	**(4,455)**	(8,272)
Loss on disposal of subsidiary	34	**(1,074)**	–
Impairment of investment in subsidiary		**–**	(31,432)
Profit / (loss) before income tax		**32,708**	(23,864)
Income tax expense	16	**(8,278)**	(2,206)
Profit / (loss) for the year		**24,430**	(26,070)

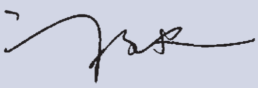
Statement of Comprehensive Income

£000	Note	12 months to 31 December 2012	12 months to 31 December 2011
Profit / (loss) for the year		**24,430**	(26,070)
Other comprehensive income			
Net change in fair value of available for sale financial assets	21 (b)	**3,173**	(1,141)
Net change in fair value of available for sale financial assets transferred to profit or loss	21 (b)	**(768)**	1,105
Net gain / (loss) on available for sale financial assets		**2,405**	(36)
Income tax (expense) / income relating to components of other comprehensive income	16	**(589)**	10
Other comprehensive income / (expense) for the year, net of income tax		**1,816**	(26)
Total comprehensive income / (expense) for the year		**26,246**	(26,096)

Statement of Financial Position

£000	Note	31 December 2012	31 December 2011
Assets			
Cash and cash equivalents	17	**197,622**	275,821
Loans and advances to banks	19	**48,779**	12,865
Loans and advances to customers	20	**464,479**	290,752
Derivative financial instruments	18	**1,949**	72
Prepayments, accrued income and other assets	26	**64,084**	37,692
Available for sale financial investments	22	**46,270**	95,671
Deferred tax assets	25	**206**	30
Tangible fixed assets	23	**4,032**	1,374
Intangible assets	24	**106**	163
Investment in subsidiary companies	34	**–**	63,285
Total assets		**827,527**	777,725
Liabilities			
Deposits from banks	27	**62,384**	202,684
Deposits from customers	28	**398,239**	352,176
Derivative financial instruments	18	**3,435**	4,416
Other liabilities	30	**19,123**	15,290
Accruals and deferred income	31	**4,828**	3,602
Current tax liabilities		**3,715**	–
Subordinated liabilities	29	**60,000**	60,000
Total liabilities		**551,724**	638,168
Equity	32		
Authorised and called up share capital		**250,000**	140,000
Retained earnings		**24,958**	528
Available for sale reserve		**845**	(971)
Total shareholders' equity		**275,803**	139,557
Total shareholders' equity and liabilities		**827,527**	777,725

The financial statements on pages 22 to 62 were approved by the Board of Directors of Bank of China (UK) Limited and authorised for issue on 19 April 2013.They were signed on its behalf by:



Wenjian Fang
Chief Executive Officer
Board Director

Statement of Changes in Equity

£000	Issued share capital	Retained earnings	Available for sale reserve	Total
As of 1 January 2012	**140,000**	**528**	**(971)**	**139,557**
Unrealised profit on available for sale investments net of income tax	**–**	**–**	**1,816**	**1,816**
Profit for the financial year	**–**	**24,430**	**–**	**24,430**
Total comprehensive income	**–**	**24,430**	**1,816**	**26,246**
Issue of ordinary shares	**110,000**	**–**	**–**	**110,000**
As at 31 December 2012	**250,000**	**24,958**	**845**	**275,803**
As of 1 January 2011	140,000	26,598	(945)	165,653
Unrealised loss on available for sale investments net of income tax	–	–	(26)	(26)
Loss for the financial year	–	(26,070)	–	(26,070)
Total comprehensive expense	–	(26,070)	(26)	(26,096)
As at 31 December 2011	140,000	528	(971)	139,557

Statement of Cash Flows

£000	Note	12 months to 31 December 2012	12 months to 31 December 2011
Cash flows from operating activities			
Profit / (loss) on ordinary activities before taxation		**32,708**	(23,864)
Adjustments for non cash items			
Depreciation and amortisation of plant and equipment and intangible assets		**694**	667
Net impairment (profit)/loss on investment securities		**(768)**	1,105
Net impairment loss on loans and advances		**5,223**	7,167
Loss on disposal of subsidiary		**1,074**	–
Impairment of investment in subsidiary		**–**	31,432
Interest receivable from financial investments		**(2,279)**	(3,425)
Other interest receivable		**(12,243)**	(9,531)
Interest payable		**2,828**	2,828
Loss on the sale of debt securities		**23**	1,298
Loss on disposal of tangible fixed assets		**–**	6
Loss on disposal of intangible assets		**4**	–
Exchange-rate movements on available for sale investments		**4,642**	489
Changes in operating assets and liabilities			
Change in derivatives held for risk management		**(2,858)**	(1,107)
Change in loans and advances to banks		**(35,913)**	(48)
Change in loans and advances to customers		**(178,951)**	(83,295)
Change in other assets		**(27,419)**	792
Change in deposits from banks		**(140,301)**	26,254
Change in deposits from customers		**46,063**	55,887
Change in other liabilities and provisions		**5,651**	1,174
Adjustment for cash items			
Interest and coupon received		**14,354**	16,421
Interest paid		**(3,418)**	(2,451)
Income tax paid		**(3,729)**	(11,131)
Net cash generated from operating activities		**(294,615)**	10,668
Cash flows from investing activities			
Proceeds from sale of investment securities		**47,505**	50,279
Proceeds from the issue of ordinary shares		**110,000**	–
Acquisition of property and equipment		**(3,247)**	(275)
Acquisition of intangible assets		**(52)**	(6)
Investment in subsidiaries		**62,210**	–
Net cash from investing activities		**216,416**	49,998
Net (decrease) / increase in cash and cash equivalents		**(78,199)**	60,666
Cash and cash equivalents at beginning of period		**275,821**	215,155
Cash and cash equivalents at year end	17	**197,622**	275,821

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

Notes to the Financial Statements

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 1 Lothbury, London EC2R 7DB. The bank is primarily involved in retail and corporate banking.

Accounting policies for the year ended 31 December 2012

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

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"), IFRIC interpretations and the Companies Act 2006.

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 IFRSs. 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 19 April 2013.

(b) Basis of measurement

The financial statements have been prepared on a going concern basis under the historical cost convention 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

(c) Functional and presentational 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 (g)).

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.

Other operating income is recognised when the bank is entitled to receive that income.

(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 residential and commercial mortgages, originated and syndicated loans. The bank does not originate loans to syndicate, rather it purchases syndicated loans from third party banks.

(f) Loan commitments, guarantees and other financial facilities

Provision is made for undrawn loan commitments, guarantees and other financial facilities if it is probable that the facility will be drawn and result in the recognition of an asset as an amount less than the amount advanced.

(g) 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.

(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 mortgages, 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.

(h) 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.

(i) 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.

(ii) 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.

(i) Derecognition of financial liabilities

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

(j) 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.

A subsidiary is derecognised when the bank loses control over the subsidiary. The carrying value of the subsidiary is measured against the fair value of the consideration received with any resulting gain or loss being recognised through the income statement.

(k) 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:

Property (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.

3. Significant accounting policies *continued*

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.

(l) 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.

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.

(m) 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.

(n) 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.

(o) Cash and cash equivalent

For the purposes of preparing these financial statements, 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.

(p) 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.

(q) Employee benefits

(i) Defined contribution plans

Obligations for contributions to defined contribution pension plans are recognised as an expense in the 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.

(r) 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.

(s) 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.

(t) 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.

(u) Share capital and reserves
Ordinary shares are classified as equity. 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(g).

(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.

5. New pronouncements

New and amended standards and interpretations:

(i) Mandatory for the first time for the financial year beginning 1 January 2012 but not currently relevant to the bank although they may affect the accounting of future transactions and events.

Following the Financial Reporting Council's report "Cutting clutter" the aim of the disclosures, required by IAS 8 "Accounting policies, changes in accounting estimates and errors" is to enable the users to assess the possible impact of the new standard or interpretation on the bank's financial statements and not to provide a general update on accounting developments.

A number of new standards became effective from 1 January 2012. The directors have reviewed and considered the effect of these new standards on the financial statements of the bank and have concluded that they are either not applicable or do not have a material effect.

(ii) Issued but not effective for the financial year beginning 1 January 2012 and not early adopted.

The bank has assessed the impact of these new standards and interpretations and concluded that they are either not material or are not expected to have a material effect, except for:

- IFRS9, "Financial instruments", issued in November 2009. This standard is the first step in the process to replace IAS 39, "Financial instruments: recognition and measurement". IFRS 9 introduces new requirements for the classifying and measuring of financial assets and is likely to affect the bank's accounting for financial assets. The standard is not applicable until 1 January 2013 but is available for early adoption. However, the standard has not yet been endorsed by the EU.

  The bank is yet to assess IFRS 9's full impact. However, initial indications are that it may affect the bank's accounting for its debt available for sale financial assets, as IFRS 9 only permits the recognition of fair value gains and losses in other comprehensive income if they relate to equity investments that are not held for trading. Fair value gains and losses on available for sale debt investments will therefore have to be recognised directly in profit and loss. In the current reporting period the bank recognised £2,405,000 of such gains in other comprehensive income.

6. 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.

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 Board Risk Committee ("BRC") which is responsible for the oversight and implementation of risk strategy and risk appetite within the bank, oversight of risk management performance and the executive committees including, Asset and Liability ("ALCO"), Credit Risk Policy, Credit and Operational Risk Committees. These committees 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 polices, procedures and limits, based on the principle 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 Risk Committee, and the Chief Executive Officer (the "CEO") of the bank. The CEO of the bank has delegated credit approval authority to Branch Managers, subject to Board approval.

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 Risk 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 bank's 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. Ongoing monitoring of stop-loss limits is established.

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 a publicly available 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.

6. Financial risk management *continued*

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 2012**	31 December 2011
On balance sheet		
Cash and cash equivalents	**195,700**	274,203
Loans and advances to banks	**48,779**	12,865
Loans and advances to customers	**464,479**	290,752
Derivative financial instruments	**1,949**	72
Available for sale financial investments	**46,270**	95,671
Total on balance sheet	**757,177**	673,563
Off balance sheet		
Loan commitments	**356,073**	254,967
Guarantees	**14,072**	10,394
Total off balance sheet	**370,145**	265,361
Total exposure	**1,127,322**	938,924

The fair value of collateral held at 31 December 2012 against amounts due from customers was £445,653,000 (31 December 2011; £283,140,000). The collateral is in the form of real estate properties and this collateral reduces the maximum amount of credit risk by £241,111,000 as at 31 December 2012 (31 December 2011; £144,632,000).

Cash and cash equivalents include exposures to the parent company of £65,127,000 (31 December 2011: £269,743,000) which are supported by a legal netting agreement. No other significant concentration of credit risk exposure exists.

Cash and cash equivalents exclude cash in hand for the purposes of the assessment of credit risk.

Credit risk exposure

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

(a) Based on external credit rating system

£000	31 December 2012 Cash and cash equivalents	31 December 2012 Available for sale financial investments	31 December 2011 Cash and cash equivalents	31 December 2011 Available for sale financial investments
Gross exposure	195,700	49,273	274,203	99,601
Individually impaired	–	3,612	–	7,182
Allowance for impairment	–	(3,003)	–	(3,930)
Carrying amount	–	609	–	3,252
Past due but not impaired	–	–	–	–
Ageing profile:				
0-3 months	–	–	–	–
4-6 months	–	–	–	–
7-9 months	–	–	–	–
10-12 months	–	–	–	–
Neither past due nor impaired	195,700	45,661	274,203	92,419
Credit rating:				
AAA	–	12,491	–	14,765
Aa1 – Aa3	127,875	1,160	3,398	16,860
A1 – A3	67,825	3,137	270,805	41,365
Baa1 – Baa3	–	28,873	–	19,429
Ba1 – Ba3	–	–	–	–
Unrated	–	–	–	–
Total carrying amount	195,700	46,270	274,203	95,671

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

Loans and advances to banks

£000	31 December 2012	31 December 2011
Gross exposure	48,779	12,865
Neither past due nor impaired	48,779	12,865
Performing		
A1 – A3	22,452	–
Baa1 – Baa3	2,790	12,865
Unrated	23,537	–
Total carrying amount	48,779	12,865

6. Financial risk management *continued*

Loans and advances to customers

£000	31 December 2012	31 December 2011
Gross exposure	**476,752**	297,880
Individually impaired	**12,273**	13,683
Allowance for impairment	**(12,273)**	(7,128)
Carrying amount	**–**	6,555
Past due but not impaired	**3,682**	2,728
Ageing profile:		
0-3 months	**3,136**	2,728
4-6 months	**546**	–
7-9 months	**–**	–
10-12 months	**–**	–
Neither past due nor impaired	**460,797**	281,469
Performing	**449,095**	280,412
Aa1 – Aa3	**2,992**	3,853
A1 – A3	**43,890**	22,809
Baa1 – Baa3	**15,638**	22,393
Ba1 – Ba3	**–**	5,392
Unrated	**386,575**	225,965
Special mention	**11,685**	1,053
Baa1 – Baa3	**–**	–
Ba1 – Ba3	**10,828**	–
B1 – B3	**–**	–
Unrated	**857**	1,053
Substandard	**–**	–
Unrated	**–**	–
Doubtful	**17**	4
Unrated	**17**	4
Loss	**–**	–
Unrated	**–**	–
Total carrying amount	**464,479**	290,752

(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 Financial Services Authority (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
31 December 2012						
Non-derivative financial liabilities						
Deposits from banks	**62,384**	**(62,781)**	**(20,473)**	**(16,019)**	**(26,289)**	**–**
Deposits from customers	**398,239**	**(398,718)**	**(329,124)**	**(56,943)**	**(12,651)**	**–**
Subordinated liabilities	**60,000**	**(60,117)**	**–**	**(117)**	**–**	**(60,000)**
Derivative financial instruments	**3,435**	**–**	**–**	**–**	**–**	**–**
Cash outflows		**(153,918)**	**(150,554)**	**(113)**	**(845)**	**(2,406)**
Cash inflows		**152,085**	**152,085**	**–**	**–**	**–**
	524,058	**(523,449)**	**(348,066)**	**(73,192)**	**(39,785)**	**(62,406)**
Loan commitments	**356,073**	**(356,073)**	**(356,073)**	**–**	**–**	**–**
	880,131	**(879,522)**	**(704,139)**	**(73,192)**	**(39,785)**	**(62,406)**
31 December 2011						
Non-derivative financial liabilities						
Deposits from banks	202,684	(203,957)	(53,252)	(59,278)	(91,427)	–
Deposits from customers	352,176	(352,477)	(300,724)	(38,638)	(13,115)	–
Subordinated liabilities	60,000	(60,206)	–	(206)	–	(60,000)
Derivative financial instruments	4,416	–	–	–	–	–
Cash outflows		(167,515)	(162,855)	(201)	(1,317)	(3,142)
Cash inflows		162,206	162,206	–	–	–
	619,276	(621,949)	(354,625)	(98,323)	(105,859)	(63,142)
Loan commitments	254,967	(254,967)	(254,967)	–	–	–
	874,243	(876,916)	(609,592)	(98,323)	(105,859)	(63,142)

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 this table shows 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).

6. Financial risk management *continued*

(c) Market risk

Foreign exchange risk

Foreign exchange risk is the risk that movements in the various currencies could materially impact the financial statements. To manage its exposure to foreign exchange risk the bank enters into derivative transactions.

The following table shows the foreign exchange positions as at 31 December 2012 and 2011.

£000

31 December 2012	Sterling	US Dollar	EURO	Other	Total
Cash and cash equivalents	**135,342**	**25,674**	**8,430**	**28,176**	**197,622**
Loans and advances to banks	**-**	**21,815**	**-**	**26,964**	**48,779**
Loans and advances to customers	**283,385**	**98,544**	**54,923**	**27,627**	**464,479**
Derivative financial instruments (asset)	**1,949**	**–**	**–**	**–**	**1,949**
Available for sale financial investments	**306**	**3,747**	**39,683**	**2,534**	**46,270**
Other assets	**61,204**	**2,033**	**56**	**5,135**	**68,428**
Deposits from banks	**–**	**(35,645)**	**–**	**(26,739)**	**(62,384)**
Deposits from customers	**(270,973)**	**(78,127)**	**(24,215)**	**(24,924)**	**(398,239)**
Derivative financial instruments (liability)	**(85)**	**(170)**	**(3,180)**	**-**	**(3,435)**
Other liabilities	**(23,874)**	**(2,301)**	**(886)**	**(605)**	**(27,666)**
Subordinated liabilities	**(60,000)**	**–**	**–**	**–**	**(60,000)**
Total shareholder equity	**(274,758)**	**(98)**	**(1,014)**	**67**	**(275,803)**
Net on balance sheet exposure	**(147,504)**	**35,472**	**73,797**	**38,235**	**–**
Net off balance sheet exposure	**152,085**	**(36,874)**	**(73,992)**	**(39,334)**	**1,885**
Loan commitments	**232,616**	**81,765**	**41,692**	**–**	**356,073**

£000

31 December 2011	Sterling	US Dollar	EURO	Other	Total
Cash and cash equivalents	86,204	94,096	64,335	31,186	275,821
Loans and advances to banks	–	12,865	-	–	12,865
Loans and advances to customers	205,201	38,595	46,956	–	290,752
Derivative financial instruments (asset)	14	–	58	–	72
Available for sale financial investments	349	6,261	69,347	19,714	95,671
Other assets	37,975	1,002	243	63,324	102,544
Deposits from banks	(1,319)	(81,450)	–	(119,915)	(202,684)
Deposits from customers	(242,132)	(68,829)	(19,630)	(21,585)	(352,176)
Derivative financial instruments (liability)	(285)	(663)	(3,468)	–	(4,416)
Other liabilities	(16,074)	(1,641)	(409)	(768)	(18,892)
Subordinated liabilities	(60,000)	–	–	–	(60,000)
Total shareholder equity	(172,307)	(184)	1,114	31,820	(139,557)
Net on balance sheet exposure	(162,374)	52	158,546	3,776	–
Net off balance sheet exposure	160,224	–	(157,074)	(3,420)	(270)
Loan commitments	119,530	86,076	49,361	–	254,967

Sensitivity analysis

A 1% percent weakening of the following currencies against Sterling at 31 December 2012 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 31 December 2012	Equity 31 December 2011	Income statement 31 December 2012	Income statement 31 December 2011
Sterling	**(100)**	(41)	**–**	–
US Dollars	**–**	(28)	**(51)**	(50)
EURO	**10**	(21)	**(33)**	(5)
Other	**–**	82	**(16)**	(14)

A 1% percent strengthening of the above currencies against Sterling at 31 December 2012 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.

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 the cumulative interest rate gap position and by having pre-approved limits for the time 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
31 December 2012							
Assets							
Cash	197,622	141,791	15,364	–	–	–	40,467
Loans and advances to banks	48,779	-	22,452	26,327	–	–	–
Loans and advances to customers	464,479	442,532	21,826	27	–	–	94
Derivative financial instruments	1,949	–	–	–	–	–	1,949
Available for sale financial investments	46,270	10,274	6,514	–	28,873	–	609
Other assets	68,428	–	–	–	–	–	68,428
Total assets	**827,527**	**594,597**	**66,156**	**26,354**	**28,873**	**–**	**111,547**
Equity and liabilities							
Liabilities	**551,724**	**341,950**	**132,598**	**38,458**	**–**	**–**	**38,718**
Deposits from banks	62,384	20,281	15,995	25,916	–	–	192
Deposits from customers	398,239	321,669	56,603	12,542	–	–	7,425
Derivative financial instruments	3,435	–	–	–	–	–	3,435
Other liabilities	27,666	–	–	–	–	–	27,666
Subordinated liabilities	60,000	–	60,000	–	–	–	–
Equity							
Shareholders' equity	**275,803**	**–**	**–**	**–**	**–**	**–**	**275,803**
Total equity and liabilities	**827,527**	**341,950**	**132,598**	**38,458**	**–**	**–**	**314,521**
Effect of derivatives held for risk management	**–**	**(61,299)**	**–**	**–**	**61,299**	**–**	**–**
Interest rate sensitivity gap	**–**	**191,348**	**(66,442)**	**(12,104)**	**90,172**	**–**	**(202,974)**
Cumulative gap	**–**	**191,348**	**124,906**	**112,802**	**202,974**	**202,974**	**–**

6. Financial risk management *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 2011							
Assets							
Cash	275,821	237,032	–	–	–	–	38,789
Loans and advances to banks	12,865	–	12,865	–	–	–	–
Loans and advances to customers	290,752	259,045	25,421	6,059	–	–	227
Derivative financial instruments	72	–	–	–	–	–	72
Available for sale financial investments	95,671	12,639	30,657	–	41,356	10,175	844
Other assets	102,544	–	–	–	–	–	102,544
Total assets	777,725	508,716	68,943	6,059	41,356	10,175	142,476
Equity and liabilities							
Liabilities	638,168	340,369	157,587	103,353	–	–	36,859
Deposits from banks	202,684	51,783	59,114	90,337	–	–	1,450
Deposits from customers	352,176	288,586	38,473	13,016	–	–	12,101
Derivative financial instruments	4,416	–	–	–	–	–	4,416
Other liabilities	18,892	–	–	–	–	–	18,892
Subordinated liabilities	60,000	–	60,000	–	–	–	–
Equity							
Shareholders' equity	139,557	–	–	–	–	–	139,557
Total equity and liabilities	777,725	340,369	157,587	103,353	–	–	176,416
Effect of derivatives held for risk management		31,069	16,552	(13,381)	(34,240)	–	–
Interest rate sensitivity gap		199,416	(72,092)	(110,675)	7,116	10,175	(33,940)
Cumulative gap		199,416	127,324	16,649	23,765	33,940	–

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
Sensitivity of projected net interest income at		
31 December 2012	**1,314**	**(1,314)**
31 December 2011	978	(978)
Sensitivity of reported equity to interest rate movements at		
31 December 2012	**600**	**(600)**
31 December 2011	1,020	(1,020)

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

Below reference is made to the FSA which was our regulator during the period under review. From the 1 April 2013 our regulator is the Prudential Regulatory Authority.

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 as these 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.

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

6. Financial risk management *continued*

The bank's regulatory capital position at 31 December 2012 was as follows:

£000	**2012 Basel II Actual**	2011 Basel II Actual
Tier 1 capital		
Ordinary share capital	**250,000**	140,000
Retained earnings	**24,958**	528
Tier 2 capital		
Qualifying subordinated liabilities	**60,000**	60,000
Other regulatory adjustments	**–**	(63,285)
Total regulatory capital	**334,958**	137,243

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 2011 and the ICG was agreed with the FSA in March 2012. The agreed ICG remains confidential between each bank and the FSA in accordance with accepted practice.

7. Pillar III Disclosures

The European Union Capital Requirements Directive (the "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 I of Basel II, as well as the supervisory review processes of Pillar II 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 I Standardised Approach to credit risk, market risk and operational risk from 1 January 2008, it also became subject to Pillar II & III from that date.

8. 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 at 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
31 December 2012						
Assets						
Cash and cash equivalents	–	197,622	–	–	197,622	197,622
Cash and balances with banks	–	195,700	–	–	195,700	195,700
Cash in hand	–	1,922	–	–	1,922	1,922
Loans and advances to banks	–	48,779	–	–	48,779	48,779
Loans and advances to customers	–	464,479	–	–	464,479	464,554
Corporate loans and advances	–	220,601	–	–	220,601	220,676
Retail loans and advances	–	243,878	–	–	243,878	243,878
Derivative financial instruments	1,949	–	–	–	1,949	1,949
Interest rate swaps	–	–	–	–	–	–
Cross currency swaps	1,949	–	–	–	1,949	1,949
Foreign exchange forwards	–	–	–	–	–	–
Available for sale investments	–	–	46,270	–	46,270	46,270
Debt securities	–	–	33,477	–	33,477	33,477
Asset backed securities	–	–	12,793	–	12,793	12,793
Total financial assets	1,949	710,880	46,270	–	759,099	759,174
Liabilities						
Deposits from banks	–	–	–	62,384	62,384	62,384
From subsidiaries	–	–	–	–	–	–
Other deposits from banks	–	–	–	62,384	62,384	62,384
Deposits from customers	–	–	–	398,239	398,239	398,239
Retail customers	–	–	–	391,398	391,398	391,398
Corporate customers	–	–	–	6,841	6,841	6,841
Derivative financial instruments	3,435	–	–	–	3,435	3,435
Interest rate swaps	3,365	–	–	–	3,365	3,365
Cross currency swaps	70	–	–	–	70	70
Subordinated liabilities	–	–	–	60,000	60,000	60,000
Total financial liabilities	3,435	–	–	520,623	524,058	524,058

The fair value of financial assets and liabilities that are not accounted for at fair value are deemed to be equal to their carrying value. The interest rates on these financial assets and liabilities re-price on a regular and short term basis resulting in the fair value calculation being not materially different from the carrying value.

8. Financial assets and financial liabilities *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
31 December 2011						
Assets						
Cash and cash equivalents	–	275,821	–	–	275,821	275,821
Cash and balances with banks	–	274,203	–	–	274,203	274,203
Cash in hand	–	1,618	–	–	1,618	1,618
Loans and advances to banks	–	12,865	–	–	12,865	12,865
Loans and advances to customers	–	290,752	–	–	290,752	290,752
Corporate loans and advances	–	143,606	–	–	143,606	143,606
Retail loans and advances	–	147,146	–	–	147,146	147,146
Derivative financial instruments	72	–	–	–	72	72
Interest rate swaps	58	–	–	–	58	58
Cross currency swaps	–	–	–	–	–	–
Foreign exchange forwards	14	–	–	–	14	14
Available for sale investments	–	–	95,671	–	95,671	95,671
Debt securities	–	–	77,243	–	77,243	77,243
Asset backed securities	–	–	18,428	–	18,428	18,428
Total financial assets	72	579,438	95,671	–	675,181	675,181
Liabilities						
Deposits from banks	–	–	–	202,684	202,684	202,684
From subsidiaries	–	–	–	47,602	47,602	47,602
Other deposits from banks	–	–	–	155,082	155,082	155,082
Deposits from customers	–	–	–	352,176	352,176	352,176
Retail customers	–	–	–	345,300	345,300	345,300
Corporate customers	–	–	–	6,876	6,876	6,876
Derivative financial instruments	4,416	–	–	–	4,416	4,416
Interest rate swaps	4,131	–	–	–	4,131	4,131
Cross currency swaps	285	–	–	–	285	285
Subordinated liabilities	–	–	–	60,000	60,000	60,000
Total financial liabilities	4,416	–	–	614,860	619,276	619,276

The table opposite 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

During the financial year ended 31 December 2012 no financial assets or liabilities were transferred between Level 1, Level 2 or Level 3.

£000

31 December 2012	Level 1	Level 2	Level 3	Total
Financial assets				
Derivative financial instruments:				
Interest rate swaps	–	–	–	–
Cross currency swaps	–	1,949	–	1,949
Foreign exchange forwards	–	-	–	-
	–	1,949	–	1,949
Financial investments available for sale:				
Debt securities	33,477	–	–	33,477
Asset backed securities	12,793	–	–	12,793
	46,270	–	–	46,270
Total assets	46,270	1,949	–	48,219
Financial liabilities				
Derivative financial instruments:				
Interest rate swaps	–	3,365	–	3,365
Cross currency swaps	–	70	–	70
Foreign exchange forwards	–	–	–	–
Total liabilities	–	3,435	–	3,435

£000

31 December 2011	Level 1	Level 2	Level 3	Total
Financial assets				
Derivative financial instruments:				
Interest rate swaps	–	58	–	58
Cross currency swaps	–	–	–	–
Foreign exchange forwards	–	14	–	14
	–	72	–	72
Financial investments available for sale:				
Debt securities	77,243	–	–	77,243
Asset backed securities	18,428	–	–	18,428
	95,671	–	–	95,671
Total assets	95,671	72	–	95,743
Financial liabilities				
Derivative financial instruments:				
Interest rate swaps	–	4,131	–	4,131
Cross currency swaps	–	280	–	280
Foreign exchange forwards	–	5	–	5
Total liabilities	–	4,416	–	4,416

9. Net interest income

£000	**31 December 2012**	31 December 2011
Interest income from financial investments	**2,279**	3,425
Other interest income:		
Cash and cash equivalents	**15**	8
Loans and advances to banks	**1,803**	1,347
Loans and advances to customers	**10,426**	8,176
Total other interest income	**12,244**	9,531
Total interest income	**14,523**	12,956
Interest expense:		
Deposits from banks	**1,471**	1,789
Customers accounts	**635**	358
Subordinated liabilities	**722**	681
Total interest expense	**(2,828)**	(2,828)
Net interest income	**11,695**	10,128

Included within various line items under interest income for the year ended 31 December 2012 is a total of £168,000 (31 December 2011: £175,000) accrued for non performing impaired financial assets.

10. Net fee and commission income

£000	**31 December 2012**	31 December 2011
Fee and commission income:		
Retail Banking customer fees	**5,159**	3,966
Corporate Banking credit-related fees	**2,215**	2,319
Other	**74**	68
Total fee and commission income	**7,448**	6,353
Inter-bank transaction fees	**11**	21
Other	**772**	486
Total fee and commission expense	**(783)**	(507)
Net fee and commission income	**6,665**	5,846

11. Net loss from derivative financial instruments

£000	**31 December 2012**	31 December 2011
Net loss from derivative financial instruments held for risk management purposes:		
Interest rate swaps	**(1,469)**	(936)
Foreign currency forwards	**(9)**	9
	(1,478)	(927)

There are no financial derivative instruments that qualify for hedge accounting in accordance with IAS39.

At 31 December 2012 net gains of £2,160,000 (31 December 2011: net gains £272,000), 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.

12. Other operating income

£000	31 December 2012	31 December 2011
Related party service charges	**45,354**	25,690
Other	**36**	8
	45,390	25,698

The related party service charges represents the net amount receivable by the bank for services provided and received under service level agreements with related parties as disclosed in note 34.

13. Staff costs

£000	31 December 2012	31 December 2011
Wages and salaries	**15,166**	12,580
Contributions to defined contribution plans	**1,299**	1,143
Social security costs	**1,604**	1,313
Other	**1,158**	1,167
	19,227	16,203

14. Other expenses

£000	31 December 2012	31 December 2011
Administrative	**5,175**	4,100
Software licensing and other IT costs	**222**	153
Other	**382**	404
	5,779	4,657

Auditor's remuneration:

£000	31 December 2012	31 December 2011
Fees payable to the company's auditors for the audit of the company's financial statements		
Current year	**147**	125
Prior years	**23**	14
Fees payable to the company's auditor and its associates for other services		
The audits of the company's subsidiaries, pursuant to legislation	**64**	70
Other services pursuant to legislation	**163**	169
Other services	**16**	45

15. Directors' emoluments

£000	31 December 2012	31 December 2011
Emoluments of directors in respect of services rendered		
Emoluments	**653**	956
Pension contributions	**15**	70
Highest paid director		
Emoluments	**399**	470
Pension contributions	**–**	54

16.Income tax expense

£000	31 December 2012	31 December 2011
Current tax expense		
Current period	**8,110**	2,173
Adjustments for prior years	**344**	59
Total current tax	**8,454**	2,232
Deferred tax expense		
Origination and reversal of temporary differences	**(3)**	(19)
Adjustments for prior years	**(173)**	(7)
Total deferred tax	**(176)**	(26)
Total income tax expense	**8,278**	2,206

The tax on the bank's profit before tax differs from the theoretical amount that would arise using the weighted average tax rate applicable to profits of the bank as follows:

Reconciliation of effective tax rate

£000	31 December 2012	31 December 2011
Profit / (loss) before income tax	**32,708**	(23,864)
Income tax using the standard rate of corporation tax in the UK 24.5% (2011: 26.5%)	**8,014**	(6,324)
Non-deductible expenses	**182**	130
Loss on disposal of subsidiary	**263**	–
Non taxable income	**(385)**	–
Impairment of investment in subsidiary	**–**	8,329
Over-provided in prior years	**171**	53
Other - tax rate adjustment	**21**	2
Foreign tax not fully creditable	**12**	16
Total income tax expense in income statement	**8,278**	2,206

Income tax recognised in other comprehensive income

£000	31 December 2012	31 December 2011
Current tax		
UK current tax expense	**589**	(10)
Adjustments for prior years	**–**	–
Total current tax	**589**	(10)
Deferred tax		
Current year deferred tax expense	**–**	–
Adjustments for prior years	**–**	–
Total deferred tax	**–**	–
Total income tax expense	**589**	(10)

During the year, as a result of the changes in the UK corporation tax rate to 24% which was substantially enacted on 26 March 2012 and was effective from 1 April 2012; and to 23% which was substantially enacted on 3 July 2012 and will be effective from 1 April 2013, the relevant deferred tax balances have been re-measured. A further reduction to the UK corporation tax rate has been announced. The change proposes to reduce the rate to 22% from 1 April 2014. The change had not been substantively enacted at the balance sheet date and, therefore, is not recognised in these financial statements.

17. Cash and cash equivalents

£000	31 December 2012	31 December 2011
Cash and cash equivalents with banks	**195,700**	274,203
Cash in hand	**1,922**	1,618
	197,622	275,821

18. Derivative financial instruments

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

	31 December 2012		31 December 2011	
£000	Assets	Liabilities	Assets	Liabilities
Instrument type:				
Interest rate swap	**–**	**3,365**	58	4,131
Cross currency swap	**1,949**	**70**	–	280
Foreign exchange forward	**–**	**–**	14	5
	1,949	**3,435**	72	4,416

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

19. Loans and advances to banks

£000	31 December 2012	31 December 2011
Loans and advances to banks	**48,779**	12,865

At 31 December 2012 £21,510,000 (31 December 2011: £nil) of loans and advances to banks are expected to be recovered more than twelve months after the reporting date.

20. Loans and advances to customers

£000	31 December 2012	31 December 2011
Corporate loans and advances	**232,832**	150,606
Retail loans and advances	**243,920**	147,274
Gross loans and advances	**476,752**	297,880
Less: allowance for impairments		
Specific	**(12,273)**	(7,128)
Collective	**–**	–
Total allowance for impairment	**(12,273)**	(7,128)
Loans and advances to customers net	**464,479**	290,752

At 31 December 2012 £393,717,000 (31 December 2011: £242,694,000) 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

	31 December 2012			31 December 2011		
£000	Gross amount	Impairment allowance	Carrying amount	Gross amount	Impairment allowance	Carrying amount
Corporate loans and advances	**232,832**	**(12,231)**	**220,601**	150,606	(7,000)	143,606
Retail loans and advances	**243,920**	**(42)**	**243,878**	147,274	(128)	147,146
	476,752	**(12,273)**	**464,479**	297,880	(7,128)	290,752

21. Allowances for impairment

(a) Loans and advances to banks and customers

£000	Specific: Loans and advances to banks	Specific: Loans and advances to customers	Collective: Loans and advances to banks	Collective: Loans and advances to customers
Balance at 1 January 2012	**–**	**7,128**	**–**	**–**
Increase in impairment	**–**	**5,278**	**–**	**–**
Reversal of impairment	**–**	**(55)**	**–**	**–**
Charge in income statement	**–**	**5,223**	**–**	**–**
Amounts written off	**–**	**(78)**	**–**	**–**
Balance at 31 December 2012	**–**	**12,273**	**–**	**–**
Balance at 1 January 2011	–	408	–	–
Increase in impairment	–	7,167	–	–
Reversal of impairment	–	–	–	–
Charge in income statement	–	7,167	–	–
Amounts written off	–	(447)	–	–
Balance at 31 December 2011	–	**7,128**	–	–

(b) Available for sale financial investments

£000	Note	Movement in fair value recognised in equity	Impairment
Balance at 1 January 2012		**1,376**	**3,930**
Changes in fair values		**(3,173)**	**–**
Reversal of impairment		**768**	**(768)**
Amounts written off		**–**	**–**
	22	**(2,405)**	**(768)**
Exchange-rate movements		**–**	**(159)**
Balance at 31 December 2012		**(1,029)**	**3,003**
Balance at 1 January 2011		1,340	5,749
Changes in fair values		1,141	–
Increase in impairment		(1,105)	1,105
Amounts written off		–	(2,934)
	22	36	(1,829)
Exchange-rate movements		–	10
Balance at 31 December 2011		1,376	3,930

(c) Impairment charges

£000	**31 December 2012**	31 December 2011
Loans and advances to customers		
Specific	**5,223**	7,167
Collective	**–**	–
Available for sale financial investments	**(768)**	1,105
Total impairment charges in income statement	**4,455**	8,272

22. Available for sale investments

At 31 December 2012 there were £41,671,000 of available for sale investments (31 December 2011: £51,695,000) 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 2012	31 December 2011
Debt securities		**33,477**	77,243
Asset backed securities		**12,793**	18,428
		46,270	95,671
Balance at 1 January		**95,671**	149,677
Accrued interest		**(404)**	(799)
Disposals through sale and redemptions		**(47,486)**	(54,463)
Gains / (loss) from changes in fair value recognised in equity	21 (b)	**2,405**	(36)
Movements in impairment amounts	21 (b)	**768**	1,829
Amortisation of premium		**(42)**	(48)
Exchange-rate movement		**(4,642)**	(489)
Balance at 31 December		**46,270**	95,671

23. Tangible fixed assets (Property, plant and equipment)

£000	Property, plant and fixtures	Furniture and equipment	Computer equipment	Motor vehicles	Total
Cost					
Balance at 1 January 2012	**4,909**	**744**	**539**	**100**	**6,292**
Additions	**2,146**	**1,026**	**75**	**–**	**3,247**
Disposals	**–**	**–**	**(9)**	**–**	**(9)**
Balance at 31 December 2012	**7,055**	**1,770**	**605**	**100**	**9,530**
Balance at 1 January 2011	4,909	616	443	67	6,035
Additions	–	141	101	33	275
Disposals	–	(13)	(5)	–	(18)
Balance at 31 December 2011	4,909	744	539	100	6,292
Depreciation					
Balance at 1 January 2012	**3,964**	**555**	**344**	**55**	**4,918**
Depreciation for the year	**371**	**101**	**96**	**21**	**589**
Disposals	**–**	**–**	**(9)**	**–**	**(9)**
Balance at 31 December 2012	**4,335**	**656**	**431**	**76**	**5,498**
Balance at 1 January 2011	3,585	533	267	38	4,423
Depreciation for the year	379	30	81	17	507
Disposals	–	(8)	(4)	–	(12)
Balance at 31 December 2011	3,964	555	344	55	4,918
Net carrying values at					
31 December 2012	**2,720**	**1,114**	**174**	**24**	**4,032**
31 December 2011	945	189	195	45	1,374

As at 31 December 2012 and 31 December 2011 the bank identified no events or circumstances that would indicate that the bank's tangible fixed assets might be impaired.

24.Intangible assets

£000	IT Software	Total
Cost		
Balance at 1 January 2012	**677**	**677**
Additions	**52**	**52**
Disposals	**(49)**	**(49)**
Balance at 31 December 2012	**680**	**680**
Balance at 1 January 2011	671	671
Additions	6	6
Balance at 31 December 2011	677	677
Depreciation and Impairment loss		
Balance at 1 January 2012	**514**	**514**
Depreciation for the year	**105**	**105**
Disposals	**(45)**	**(45)**
Balance at 31 December 2012	**574**	**574**
Balance at 1 January 2011	354	354
Depreciation for the year	160	160
Balance at 31 December 2011	514	514
Net carrying value at		
31 December 2012	**106**	**106**
31 December 2011	163	163

As at 31 December 2012 and 31 December 2011 the bank identified no events or circumstances that would indicate that the bank's intangible assets might be impaired.

25.Deferred tax assets and liabilities

Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

		31 December 2012			31 December 2011	
£000	**Assets**	**Liabilities**	**Net**	Assets	Liabilities	Net
Property and equipment, and software	**32**	**–**	**32**	**30**	–	30
Deferred employees benefits	**174**	**–**	**174**	**–**	–	–
Net tax assets	**206**	**–**	**206**	**30**	–	30

Unrecognised deferred tax assets

There were no unrecognised deferred tax assets as at 31 December 2012 and 31 December 2011.

Movements in temporary differences during the year

£000	Opening balance 1 January 2012	Recognised in profit or loss	Recognised in equity	Closing balance 31 December 2012
Property and equipment, and software	**30**	**2**	**–**	**32**
Deferred employees benefits	**–**	**174**	**–**	**174**
	30	**176**	**–**	**206**

£000	Opening balance 1 January 2011	Recognised in profit or loss	Recognised in equity	Closing balance 31 December 2011
Property and equipment, and software	4	26	–	30
Available for sale investments	–	–	–	–
	4	26	–	30

26. Prepayments, accrued income and other assets

£000	31 December 2012	31 December 2011
Accrued income	**1,503**	901
Prepaid expenses	**447**	295
Prepaid tax	**–**	1,599
Receivable from related party	**55,120**	33,588
Other	**7,014**	1,309
	64,084	37,692

27. Deposits from banks

£000	31 December 2012	31 December 2011
From subsidiaries	**–**	47,602
Other deposits from banks	**62,384**	155,082
	62,384	202,684

At 31 December 2012 £nil (31 December 2011: £nil) of deposits from banks are expected to be settled more than twelve months after the reporting date.

28. Deposits from customers

£000	31 December 2012	31 December 2011
Retail customers:		
Term deposits	**106,278**	95,498
Notice deposits	**66,997**	60,237
Current deposits	**217,235**	189,131
Other	**888**	434
	391,398	345,300
Corporate customers:		
Current deposits	**6,385**	6,583
Other	**456**	293
	6,841	6,876
	398,239	352,176

At 31 December 2012 £nil (31 December 2011: £nil) of deposits from customers are expected to be settled more than twelve months after the reporting date.

29. Subordinated liabilities

£000	31 December 2012	31 December 2011
Subordinated note issued	**60,000**	60,000
	60,000	60,000

The subordinated note issued is expected to settle more than twelve months after the reporting date (31 December 2011: £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 0.82% (31 December 2011: 1.38%). 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 2012 and 31 December 2011.

30. Other liabilities

(a) Other liabilities

£000	31 December 2012	31 December 2011
Creditors and accruals	**15,892**	13,415
Other	**3,231**	1,875
	19,123	15,290

(b) Defined benefit obligations

The bank makes contributions to a group defined benefit scheme, the Bank of China Pension & Life Assurance Scheme (the "Scheme"), that provides pension benefits for employees upon retirement. The 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 Scheme as at 31 December 2012 and 2011. 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.

Changes in the present value of the Scheme's liabilities

£000	31 December 2012	31 December 2011
Benefit obligations at beginning of year	**39,549**	36,468
Interest costs	**1,870**	2,023
Current service costs	**901**	858
Members' contributions	**123**	126
Actuarial loss	**3,322**	427
Effects of curtailments or settlements	**(76)**	(67)
Benefits paid	**(481)**	(286)
Benefit obligations at the end of the year	**45,208**	39,549

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

£000	31 December 2012	31 December 2011
Un-funded obligations	**6,997**	4,578
Wholly or partly funded obligations	**–**	–
Total	**6,997**	4,578

30. Other liabilities *continued*

Changes in Scheme assets

£000	31 December 2012	31 December 2011
Market value of assets at beginning of year	**34,971**	32,531
Expected return on Scheme assets	**1,517**	1,667
Actuarial gain/(loss)	**633**	(79)
Members' contributions	**1,524**	126
Employer's contributions	**123**	1,079
Effects of settlements	**(76)**	(67)
Benefits paid	**(481)**	(286)
Market value of assets at end of year	**38,211**	34,971

Scheme assets as a percentage of total assets

	31 December 2012	31 December 2011
Equities	**23.60%**	24.90%
Bonds	**25.40%**	26.10%
Property	**5.20%**	4.10%
Cash	**45.80%**	44.90%

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.

	31 December 2012	31 December 2011
Discount rate	**4.30%**	4.70%
Price inflation	**2.80%**	2.80%
Rate of increase in salaries	**4.30%**	4.30%
Rate of increase for pensions in payment (LPI)	**2.80%**	2.80%
Post retirement mortality table	**PM/FA 92 YOB**	PM/FA 92 YOB
	(Long Cohort)	(Long Cohort)
Expected return on assets	**5.06%**	5.06%

The bank expects to pay £807,000 (2012: £754,000) in contributions to defined benefit plans in 2013.

31.Accruals and deferred income

£000	31 December 2012	31 December 2011
Deferred income	**4,574**	2,759
Accrued interest	**254**	843
	4,828	3,602

32. Equity

(a) Capital

At 31 December 2012 the authorised share capital comprised 250,000,000 ordinary shares (31 December 2011:140,000,000). 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 years ended 31 December 2012 or 31 December 2011.

33. Provisions

There were no provisions at the years ended 31 December 2012 or 31 December 2011.

34. 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 year ended 31 December 2012 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 of Bank of China Limited. At 31 December 2012 the bank received £47,019,000 (31 December 2011: £155,082,000) which is 10% (31 December 2011: 28%) of its funding from Bank of China Limited, 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.

34. Related parties *(continued)*

£000	Nature of related party: Significant influence	Significant company
Balance at 31 December 2012		
Cash and cash equivalents	**65,127**	**990**
Loans and advances to customers	**–**	**3**
Derivative financial instruments	**1,949**	**–**
Prepayments, accrued income and other assets	**55,006**	**114**
Deposits from banks	**47,019**	**15,364**
Deposits from customers	**–**	**3,907**
Derivative financial instruments	**3,435**	**–**
Other liabilities	**9,948**	**–**
Subordinated liabilities	**60,000**	**–**
Included in the income statement for the period		
Interest receivable	**296**	**–**
Interest payable	**(2,168)**	**(25)**
Other operating income	**55,006**	**290**
Pension contributions	**–**	**–**
Net loss on derivative financial instruments	**(2,055)**	**–**
Balance at 31 December 2011		
Cash and cash equivalents	269,743	–
Loans and advances to customers	–	3
Derivative financial instruments	72	–
Prepayments, accrued income and other assets	33,476	112
Deposits from banks	155,082	47,602
Deposits from customers	–	2,482
Derivative financial instruments	4,416	–
Other liabilities	8,525	–
Subordinated liabilities	60,000	–
Included in the income statement for the period		
Interest receivable	442	–
Interest payable	(2,133)	(199)
Other operating income	25,381	309
Pension contributions	(692)	–
Net loss on derivative financial instruments	(1,648)	–

(b) Investment in non-consolidated subsidiaries

	Country of incorporation	Ownership interest 31 December 2012	Ownership interest 31 December 2011
Bank of China (Suisse) SA	Switzerland	–	100%
China Bridge Group (UK) Limited	United Kingdom	100%	100%
China Visa Services Italy SRL[1]	Italy	100%	100%
PT. China Visa Services Indonesia[1]	Indonesia	99%	99%

[1] Indirect holding via China Bridge Group (UK) Limited

At 31 December 2012, the bank held an investment of £1 in China Bridge Group (UK) Limited (31 December 2011: £1). This entity is wholly-owned, with head quarters at 12 Old Jewry, London, United Kingdom.

On the 1 October 2012 the bank disposed of its investment in Bank of China (Suisse) S.A., the resulting loss of £1,074,000 has been charged to the income statement.

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 2012 comprised of salaries and other short term benefits in the amount of £1,510,000 (31 December 2011 £1,358,000).

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

(d) Transactions with key management

£000	31 December 2012	31 December 2011
Loans and advances	610	14

35.Contingent liabilities and commitments

(a) Loan commitments, guarantees and other financial facilities

At 31 December 2012, 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 2012	31 December 2011
Loan commitments	**356,073**	254,967
Guarantees	**14,072**	10,394
Total	**370,145**	265,361

(b) Operating lease commitments

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

£000	31 December 2012	31 December 2011
Less than one year	**530**	158
Between one and five years	**1,928**	209
More than five years	**1,455**	–
Total	**3,913**	367

(c) Sale and purchase agreement Bank of China (Suisse) S.A.

On the 20 July 2012 the bank entered into a sale and purchase agreement (“SPA”) to dispose of its investment in Bank of China (Suisse) S.A. (“BOCS”). The SPA contained provisions for the purchaser to be indemnified against additional costs relating to third party claims in two circumstances.

Firstly for litigation claims identified at the date of the SPA and where the cost of settlement or court judgement exceeded the provisions made for these claims as recorded in the accounts of BOCS as at the closing date.

Secondly, for any claim, action, arbitration, investigation or proceeding by or before any court, tribunal or arbitral body, administrative board, commission or other authority against BOCS by third parties for events that occurred whilst the bank had control of BOCS. The period of this indemnity is for 5 years starting from the closing date being 1 October 2012. At the date of approval of these accounts additional matters have been advised by the purchaser to the bank under this provision. At present it is not possible to predict the ultimate outcome of these claims, including the financial impact, and no provision has been recognised in respect of these items. However the bank does not currently expect the final outcome of any such claims to have a material adverse effect on the bank’s financial position.

36.Subsequent events

There are no subsequent events to be disclosed.

37.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.

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