Bank of China (UK) Limited

Annual Report and Financial Statements

For the year ended 31 December 2017

Contents

	Page
Business Review	
Chairman's Statement	3
Chief Executive Officer's Statement	4
Directors' Report	5
Strategic Report of the Directors	8
Governance	
Corporate Governance Statement	10
Statement of Directors' Responsibilities	15
Independent Auditors' Report	16
Financial Statements	
Income Statement	23
Statement of Other Comprehensive Income	24
Statement of Financial Position	25
Statement of Changes in Equity	26
Statement of Cash Flows	27
Notes to the Financial Statements	28

Chairman's Statement

In 2017, the UK economy started to slow down following the Referendum decision to leave the EU in June 2016. GDP grew by 1.4% year-on-year in 2017, the slowest rate of expansion since Q2 2012. The unemployment rate however maintained a near 42 year low of 4.4% at the end of 2017, averaging 4.3% throughout the year. Against this economic backdrop, the bank performed well in 2017.

Despite the turbulent business environment, the bank still managed to achieve satisfactory financial performance in 2017. The bank witnessed income increase by £3 million, and total assets remained at £1.5 billion as of year-end 2017. Management in London is to be congratulated on this performance.

The UK's golden-era relationship with China is a very positive factor for the UK economy, and the ties between the two countries can only grow stronger after Brexit. China needs the UK for its strong expertise, and the UK needs China for its strong market. During Prime Minister Theresa May's recent visit to China, trade deals amounting to over £9 billion were secured. The increasing involvement of outgoing Chinese companies, as well as further engagement of British companies in China, will provide the bank with significant business opportunities, further reinforcing its role as the first choice bank in the UK for China related business.

Looking forward, there are numerous external factors that may impact the bank's business either directly or indirectly. Among these, the UK's process of leaving the EU continues to bring uncertainties to our business and for our long-term strategic planning. However, the increasingly positive Sino-British relationship, and the many deep-rooted strengths in the UK economy, in both the short and medium term, point to a positive environment in which the Board is confident that the management team will deliver further development in the bank's business.

Yingxin Gao

Chairman of the Board of Directors

Chief Executive Officer's Statement

Business conditions in the UK in 2017 continue to be impacted by the Brexit process. Negotiations with the EU are still continuing without clarity as to the end result. This has resulted in great uncertainty, not only for the financial markets but business investment in general. The UK economy has started to show signs of slowdown especially when compared to its peers in Europe. Nevertheless, despite such an eventful year, Bank of China (UK) Limited achieved a decent performance, with stable growth in its retail operations.

The strategic direction of the bank's retail business in the UK remains focused on three main areas: providing retail services to the UK Chinese community, developing our services to the UK SME sector and supporting those outgoing Chinese companies establishing operations in the UK. The bank successfully launched new products in 2017 in support of its continuing policy of achieving prudent organic business growth in these target market sectors. As a result, retail loans and advances increased from £573 million at 2016 year-end to £669 million at 2017 year-end.

The bank's total assets remain at £1.5 billion as of year-end 2017, with total profit after tax of £32 million. Total income increased from £91 million in 2016 to £94 million in 2017, with a notable increase in net fee and commission income from £3.3 million to £4.7 million, a 44% increase, reflecting the bank's evolving business model.

Looking forward, the short-term impact of Brexit is unlikely to adversely affect the bank's UK business, although the uncertainty caused by the nature of the ongoing Brexit negotiations may impact the planning of BOC group in the longer term. On a more positive note, the continuing improvement in Sino-British relations, including Prime Minister Theresa May's recent visit to China, will bring closer ties between the UK and Chinese enterprises and will provide significant opportunities for the management team to further develop the bank's business.

Yu Sun

Chief Executive Officer

Board Director

Directors' report

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 registered in England and Wales and is a private company limited by shares which is a wholly owned subsidiary of Bank of China Limited, Beijing ("BOC"). The bank is regulated by the Prudential Regulation Authority and Financial Conduct Authority and authorised by the Prudential Regulation Authority.

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 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 business loans. Our corporate and trade finance business encompasses funding 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.

Future Developments

The directors intend to maintain the strategy and policies that have generated growth and preserved value of the business in recent years by continuing to provide banking services to the Chinese community based in the UK.

The bank is subject to a number of factors that could cause its future results to differ materially from current expectations. These factors are uncertainties concerning the current and future business/economic climate and risks which are naturally inherent in a banking environment. The current business climate is subject to uncertainties in 2018 and beyond, most notably:

- The rate and sustainability of growth in relevant economies, particularly the UK and Eurozone
- The impact of UK exit from the EU
- The potential impact of consumer price changes on economic growth and corporate profitability
- The rate and extent of anticipated interest rate changes
- Risk of potential decline in property values

Dividends

The directors recommend the payment of a dividend of £31,606,000 in 2017 (2016: £35,690,000).

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. Yingxin Gao	Chairman
Mr. Yu Sun	Chief Executive Officer
Mr. Stephen Hinds	Chief Operating Officer (resigned 13 December 2017)
Mrs. Wei Shi	Chief Risk Officer
Ms. Li Ren	Non-Executive
Mr. Jonathan Spence	Non-Executive
Mr. Charles Hardy	Non-Executive
Dr. Gerard Lyons	Non-Executive
Mr. Stewart Trussler	Chief Financial Officer (appointed 30 November 2017)

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.

During the year, the board determined that Mr. Jonathan Spence, Mr. Charles Hardy, and Dr. Gerard Lyons performed their roles as independent non-executive directors.

Directors' report (continued)

Board and Committee Meetings

	Board	Remuneration Committee	Audit Committee	Risk Committee
Scheduled Meetings	4	4	4	4
Attended Meetings:				
Mr. Yingxin Gao	4	-	-	-
Mr. Yu Sun	4	4	-	4
Mr. Stephen Hinds	4	-	4*	4*
Mrs. Wei Shi	4	-	2*	4*
Ms. Li Ren	4	-	-	-
Mr. Jonathan Spence	4	-	4	4
Mr. Charles Hardy	4	4	4	1
Dr. Gerard Lyons	4	4	-	4
Mr Stewart Trussler	1	-	1*	1*

*By invitation.

Directors attendance at these meetings are either as members or observers.

Directors' Remuneration

Information on remuneration of the directors of BOC UK, in accordance with the Companies Act 2006, is disclosed in Note 14 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 2017 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.

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 a two year financial forecast to support this assumption.

Financial Instruments

The bank's principal financial risk management objectives and policies including its exposure to credit risk, liquidity risk and market risk are set out in Note 6, pages 35 to 48, to the financial statements.

Employees

- Diversity

The bank is committed to employment policies, which follow best practice, based on equal opportunities for all employees, irrespective of sex, race, colour, disabilities, sexual orientation 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.

Directors' report (continued)

Employees (continued)

- 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 an employee representative forum which is held on a quarterly basis and chaired by a member of the Executive Management Committee.

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.

Ernst & Young LLP have indicated their willingness to continue in office and a resolution that they be reappointed will be proposed at the 2018 AGM.

1 Lothbury
London
EC2R 7DB

On behalf of the Board,

Yu Sun
Chief Executive Officer
Board Director

17 April 2018

Strategic report of the Directors

Business Review

As at 31 December 2017, Bank of China (UK) Limited ("BOC UK" or the "bank") had total assets of £1,539,221,000 (2016: £1,549,898,000).

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.

The bank generated a post-tax profit of £32,064,000 during 2017 (2016: £35,690,000).

The bank disposed of its investment in Bank of China (Suisse) S.A. during 2012 but continued to enjoy a share of income from the client base that existed on the signing of the sale and purchase agreement (SPA) dated 20 July 2012. Under the terms of the agreement, this arrangement persisted until 1 October 2017 when the agreement came to an end.

Dublin Branch

On 3 July 2017, our Dublin Branch was officially opened. It is the first branch of Bank of China (UK) Limited in Ireland. The branch will focus on corporate lending, targeting Chinese companies operating in Ireland, Irish groups with interests in China and multinationals with large offices in Ireland.

In 2018, the branch will seek business opportunities in industries such as aircraft leasing, food and agriculture and infrastructure construction in Ireland.

Retail Banking

In order to implement the group development strategy of "Serving Society, Delivering Excellence", maintaining our leading position against local Chinese peers and continuously enhancing the profit contribution of the bank, the Personal Banking business line has a clearly defined development plan for the next five years. This follows on from the products, services, channels and the Head Office support perspective, drawing out the blue ocean strategic step by step plan as established in 2017.

With strong support from the parent, the bank and domestic branches have established good relations to promote our cross border business focusing on creating a robust financial services platform. The Private Banking Service Centre (London) has been launched in 2017, whilst the Platinum Card and Offset Mortgage products have also been introduced to the market. Together with the continuous work of our Operational Working Group we have optimised the bank's personal customer structure, and laid a solid foundation for our future business development and customer service in 2018 and beyond.

Corporate Banking

Seizing on the opportunity of China's economic growth as well as fast growing China-UK bilateral trade and investment, the bank continues to develop its relationships with existing and target corporate clients by offering a comprehensive range of banking products and services including credit facilities, deposits, trade services, cash management, foreign exchange, debt capital market and RMB related products. 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 our corporate banking business is to be the first choice for China related business in the local market, which includes companies involved in trade and investment between the UK and China as well as China's "Going Out" enterprises in the UK, Europe and Africa regions.

Financial Markets

Financial markets activities consists of foreign exchange, money market and fixed income investments. During the year, there was focus on efficient liquidity management, the funding requirements of the bank's activities and servicing client needs. There was no proprietary trading activity during the year under review.

Strategic report of the Directors (continued)

Principal Risks and Uncertainties

The effect of one or a combination of factors, referred to on page 5 under future developments, 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.

The Board, Board level Committees and other senior key staff carry out a continual assessment of the principal risks facing the bank and are of the opinion that systems and controls are sufficiently robust to identify threats to its business model, future performance, solvency or liquidity.

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 holds a stock of liquid assets which could be sold at short notice if the need arose. In addition to meeting Pillar 1 and Pillar 2 liquidity regulatory requirements, the Bank assesses a measure of survival days under a number of stress scenarios using a range of plausible risk factors. The Board, as part of the going concern assessment, took additional comfort from a two year financial forecast which also provided comfort 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. 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 main Key Performance Indicator ("KPI") is monitoring its financial performance against financial targets set at the beginning of the financial year. The financial targets monitored include; the main income streams of the bank by income type and business department, operating expenses and net profit after tax.

1 Lothbury
London
EC2R 7DB

On behalf of the Board,

Yu Sun
Chief Executive Officer
Board Director

17 April 2018

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 in April 2016. Although the bank is not required to comply with the Governance Code, it observes the provisions of the Code where practical and relevant, as a matter of good governance.

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 2017, 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.

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.

Corporate Governance Framework (continued)

The Board delegates to the Audit Committee the responsibility for ensuring that management maintain systems of internal control that provide assurance of effective and efficient operations, internal financial controls and compliance with UK laws and regulations. It has fulfilled its obligation by assessing their effectiveness during the year. In carrying out this responsibility, the Board and the Audit Committee have had 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 judgment 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 behaviour is 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 beliefs and viewpoints in order to support the ultimate good of the bank
- Understands the bank's business and affairs to enable them to properly 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 non-executive Directors. This comprises:

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

A presentation is given to all new non-executive 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 program 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 2017, the Board was provided with regular updates on Corporate Governance and Regulatory Responsibilities.

Performance Review and Evaluation

As with the previous year, annual performance contracts were established for the executive Directors for 2017 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.

Furthermore, the effectiveness of the Board and the three Board level committees is assessed by participants of each of these groups each year with plans to engage external consultants to perform a further review.

The internal performance evaluation process takes the form of a detailed questionnaire for the Board collectively and for each of the Board level committees. Submitted results are reported to the Board and relevant Board Committees which are then discussed thoroughly, agreed by all parties involved with detailed action plans formulated for future implementation.

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 control is also subject to regulatory oversight.

Remuneration Committee Report

The Remuneration Committee comprises three directors, Dr. Gerard Lyons, the Committee Chairman, Mr. Charles Hardy (both independent non-executive directors), and Mr. Yu Sun (Chief Executive Officer and Executive Director). Ms. Tracey Rutherford, Head of Human Resources, ("HR") is also a Committee member.

The Committee is responsible for supporting and overseeing the implementation of an effective remuneration programme within the bank and ensuring that the bank meets all applicable statutory and regulatory requirements within an effective human resource function. The Committee is not involved in setting the remuneration of its members.

The Committee aims to meet on a quarterly basis and met on four occasions in 2017.

The Committee reviewed its terms of reference in order to focus on areas consistent with that needed for a HR function to support the Bank's five year strategic plan. This has led to a number of developments including the improvement of the management information pack which now addresses a wider range of issues that are attracting greater scrutiny, including the gender pay gap, and to ensure that the Bank is operating an equal pay policy for similar roles, and better assessment of the increased turnover in the Bank, which, while below industry standards, has risen.

Key activities undertaken in 2017 were as follows:

- Review, approval and monitoring of the HR annual work plan: including supporting business development initiatives i.e. Dublin Branch, annual reward programmes, implementation of the Employee Recognition Programme, annual performance management programme, Learning and Development initiatives including internal workshops that were raised at the Bank's strategy event, the impact and implementation of the Senior Manager & Certification Regime, consideration of the implementation of a HR information system with integrated payroll system to ensure efficiencies can be considered in relation to HR processes whilst ensuring HR information and management information reporting requirements can be met in the future.
- Review of the headcount budget for 2017 and achievement of headcount increase in alignment with business strategy and staff turnover data throughout 2017 with appropriate actions being taken should anything adverse be noted.

Remuneration Committee Report (continued)

- The Committee continued to review the implementation of the FCA Remuneration Code and the impact on the bank and employees as well as the Remuneration Policy and application and impact of Capital Requirements IV Directive. In addition, they considered the outcome of the European Banking Authority's remuneration guidelines on UK remuneration strategies.

There are a number of priority areas that the Committee plans to continue to focus on in coming meetings, including:

- The Learning and Development plan for 2018 and a focus on various technical training programmes and further internal workshops as required at the Bank's strategy event;
- The implementation of a formalised Career Development Framework (learning pathways) which will outline the departmental development framework to clarify employee's future career opportunities; and
- A reassessment of the year end performance management process to ensure it was aligned fully to the annual salary review and discretionary bonus allocations

Audit Committee Report

During 2017, four meetings were held on a quarterly basis, all chaired by Mr. Charles Hardy with Mr. Jonathan Spence in attendance. The Chief Operating Officer, the Chief Financial Officer, the Chief Risk Officer, the Head of Risk Management Department, the Chief Compliance Officer and the Head of Internal Audit Department were all standing attendees. The external auditors attended three of the four 2017 meetings.

During the course of the year, the Committee considered: the effectiveness of the bank's internal control systems, risk management, and compliance with financial services legislation and regulations, via the following key activities:

- The Committee received and reviewed all internal audit reports issued during the year. Progress in resolving the issues arising from those reports was monitored.
- The Committee also received and reviewed a report prepared following a visit by group internal audit and monitored the remedial actions carried out as a result of this visit.
- Quarterly reports were received from the Risk Management and Legal and Compliance Departments and these were reviewed and discussed.

In addition, the Committee:

- Considered and approved the annual Internal Audit Department Plan.
- Approved the scope of the external auditors' work and separately assessed their effectiveness. The appointment and remuneration of external audit is dealt with at Group level. Non-audit services were undertaken as disclosed in Note 13.
- Carried out an assessment of the effectiveness of both the Internal Audit Department and the Committee itself. Both were felt to be operating effectively. The adequacy of the resources available to the Internal Audit Department was also considered, and deemed to be satisfactory.
- Reviewed in detail the annual financial statements and the quality and acceptability of the related accounting policies, practices and financial reporting disclosures.

After each meeting, a report to the Board was presented on the principal matters discussed to ensure all Directors were informed of the Committee's work.

Board Risk Committee Report

The Board Risk Committee ("the Committee") comprises three directors: Mr. Jonathan Spence, Chairman, Dr. Gerard Lyons and Mr. Yu Sun are voting members; Mrs. Wei Shi is a non-voting member.

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. The Committee also approves all credit limits, provisions (and/or write-offs) above the delegated limits of the Chief Executive Officer.

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

In addition, during 2017 an additional committee meeting was held to consider both specific credit proposals and credit policy proposals.

Country by Country Reporting

Further information regarding the bank's approach to the requirements of increased financial and tax transparency of the Capital Requirements Directive ("CRD IV"), as enacted by the Financial Services and Markets Act 2000, will be published on the bank's website shortly after the approval of these financial statements at www.bankofchina.com/uk.

Pillar III Disclosures

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.

Modern Slavery Act

Further information regarding the bank's approach to modern slavery are contained in the Slavery and Human Trafficking Statement made under the requirements of the Modern Slavery Act 2015. This statement will be published on the bank's website shortly after the approval of these financial statements at www.bankofchina.com/uk.

Gender Pay

Further information relating to the bank's Gender Pay Gap has been published on its website www.bankofchina.com/uk and the designated government website www.gov.uk/genderpaygap on 4 April 2018 in compliance with the Equality Act 2010 (Gender Pay Gap Information) Regulations 2017.

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

The following statement, which should be read in conjunction with the independent auditors report on page 16 to 22, is made by the directors to explain their responsibilities in relation to the preparation of the Directors' Report, Strategic Report and Financial Statements.

The directors are responsible for preparing the Directors' Report, Strategic Report and the Financial Statements in accordance with applicable laws and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU) and applicable law.

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 bank and of the profit of the bank for that period.

In preparing these financial statements, the directors are required to:

- select suitable accounting policies in accordance with IAS 8: Accounting Policies, Changes in Accounting Estimates and Errors and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements of IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the bank's financial position and financial performance; and
- state that the bank had complied with IFRSs, subject to any material departures disclosed and explained in the financial statements.

The directors are responsible for keeping adequate accounting records that disclose with reasonable accuracy at any time, the financial position of the bank, 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 bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are satisfied that the bank has adequate resources to continue in business for the foreseeable future. For this reason, the financial statements are prepared on a going concern basis.

Yu Sun
Chief Executive Officer
Board Director
17 April 2018

Independent Auditors' Report to the Members of Bank of China (UK) Limited

Opinion

We have audited the financial statements of Bank of China (UK) Limited ("the Bank") for the year ended 31 December 2017 which comprise the Income Statement, the Statement of Other Comprehensive Income, the Statement of Financial Position, the Statement of Changes in Equity, the Statement of Cash Flows and the related notes 1 to 34, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

In our opinion, the financial statements:

- give a true and fair view of the Bank's affairs as at 31 December 2017 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the Bank in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Use of our report

This report is made solely to the Bank's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Bank's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Bank and the Bank's members as a body, for our audit work, for this report, or for the opinions we have formed.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Bank's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Overview of our audit approach

• Risks of material misstatement	• Improper recognition of fee and commission income • Inadequate provisions for impaired loans and advances to customers • Contingent liabilities relating to legal claims
• Materiality	• Overall materiality of £2.65m which represents 6% of profit before tax.

Independent Auditors' Report to the Members of Bank of China (UK) Limited (continued)

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Improper recognition of fee and commission income Fee and commission income amounts to £5.5 million (2016 £4.0 million) Refer to the accounting policies (note 3); and note 9 of the financial statements The key risks of improper recognition of fee and commission income are: (i) recorded income is not complete and accurate; and (ii) fee and commission income is improperly recognised fully in the year instead of being amortised over the duration of the related loan under the effective interest rate method. There is no change in this risk in 2017.	Our approach focused on: • Assessing the design effectiveness and testing the operating effectiveness of key controls over fee and commission income processes with the assistance, where required, of IT audit professionals; • Sample testing of fee and commission income to and from contractual evidence; • Assessing contracts to understand the nature of the fee or commission income; • Recalculating on a sample basis the effective interest rate (EIR); • Challenging management's assumptions underpinning the EIR calculation; • Checking the consistency of application of management's assumptions. • Performing year-end cut-off testing; and Checking to supporting evidence any adjustments to the accounting records that we have identified that have characteristics that could indicate unusual or inappropriate adjustments.	As a result of the procedures performed we did not identify any evidence of material misstatement in the recording of fee and commission income.

Independent Auditors' Report to the Members of Bank of China (UK) Limited (continued)

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Inadequate provisions for impaired loans and advances to customers Loans and advances to customers amount to £1,054 million (2016 £1,159 million) Refer to the accounting policies (note 3); and note 19 of the financial statements The key risks of inadequate provisions for loans and advances to customers is that: (i) credit loss events may have occurred but may not have been recognised by the Bank; (ii) factors impacting the recoverability of loans and advances may not have been identified; and (iii) calculation of impairment provisions may be inaccurate. There is no change in this risk in 2017.	Our approach focused on: • Assessing the design effectiveness and testing the operating effectiveness of key controls for identifying credit events; • Searching for evidence of impaired loans and advances that have not been provided for by reviewing a sample of credit files, arrears statistics, any changes in terms in corporate loan contracts and, where appropriate, collateral arrangements and valuations, as well as for corporate loans publicly available information that we judge to be relevant. • Assessing the appropriateness and adequacy of any impairment provisions; • Assessing the basis of the collective provision and recalculating it.	As a result of the procedures performed we are satisfied that management's judgements are reasonable and that there is no evidence of material misstatement in the provisions for impaired loans and advances.
Contingent liabilities relating to legal claims In 2012 the bank sold its investment in Bank of China (Suisse) SA. The sale and purchase agreement contained provisions for the purchaser to be indemnified against certain third party claims. Claims covered by this indemnity were subsequently received. Refer to the accounting policies (note 3); and note 33(c) of the financial statements. There is no change in this risk in 2017.	Our approach focused on: • Confirming directly with the purchaser's external legal advisors the details of the claims, including developments during the year in the claims and also the likely outcomes; • Discussing with and challenging the purchaser's external legal advisors to clarify the current status of the legal claims and likely outcomes; • Assessing the effectiveness of management's review process and the appropriateness of the conclusions reached regarding their assessment as to the probability of likely outcomes; and • Considering the reasonableness of management's view that it is not possible to predict the outcome of these claims, including the financial impact, and management's expectation that the outcome will not have a material adverse effect on the Bank's financial position.	The contingent liability disclosure in note 33(c) is appropriate.

Independent Auditors' Report to the Members of Bank of China (UK) Limited (continued)

An overview of the scope of our audit

Tailoring the scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine the extent of our audit work. This enables us to form an opinion on the financial statements. We take into account the size, risk profile, the organisation of the Bank and effectiveness of controls and changes in the business environment when assessing the level of work to be performed. All audit work including, as required, for all subsidiaries, was performed by the audit engagement team, with the exception of specific audit work performed on the processes and systems centrally managed by Bank of China Ltd, which are tested by EY Beijing including IT audit professionals as required.

Our application of materiality

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of any misstatements identified on the audit and in forming our audit opinion.

Materiality

The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined that materiality for the purposes of our audit of the financial statements should be 6% of profit before tax, which is £2.65 million. We determined our materiality on the basis of profit before tax due to our expectation that users of the financial statements, such as the parent bank, view profitability as a key consideration.

Performance materiality

The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments and past experiences with the Bank, together with our assessment of the Bank's overall control environment, our judgement was that an appropriate performance materiality was 75% of our planning materiality, namely £1.99 million.

Reporting threshold

An amount below which identified misstatements are considered as being clearly trivial.

We have reported to the audit committee all uncorrected audit differences in excess of £0.13 million, which is set at 5% of performance materiality.

We evaluated any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Independent Auditors' Report to the Members of Bank of China (UK) Limited (continued)

Other information

The other information comprises the information included in the annual report and financial statements other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the directors' report and the strategic report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the directors' report and the strategic reports have been prepared in accordance with applicable legal requirements.

Matters on which we are required to report by exception

In the light of the knowledge and understanding of the Bank and its environment obtained in the course of the audit, we have not identified material misstatements in the directors' report and the strategic report.

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

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

Responsibilities of directors

As explained more fully in the statement of directors' responsibilities set out on page 15, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Bank or to cease operations, or have no realistic alternative but to do so.

Independent Auditors' Report to the Members of Bank of China (UK) Limited (continued)

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Explanation as to what extent the audit was considered capable of detecting irregularities including fraud

The objectives of our audit in respect to fraud, are; to identify and assess the risks of material misstatement of the financial statements due to fraud; to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and to respond appropriately to fraud or suspected fraud identified during the audit. However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the Bank and management.

Our approach was as follows:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Bank and determined that the most significant are Companies Act 2006, Financial Services and Markets Act 2000, Financial Services Act 2012, Capital Requirements Regulation, and relevant Prudential Regulation Authority and Financial Conduct Authority regulations.
- We understood how the Bank complies with these legal and regulatory frameworks by making enquiries of management, internal audit, and those responsible for legal and compliance matters. We also reviewed correspondence between the Bank and UK regulatory bodies, reviewed minutes of the Board, the Audit Committee, and Board Risk Committee; and gained an understanding of the Bank's approach to governance demonstrated by the Board's approval of the Risk Management Framework and the internal controls processes.
- We assessed the susceptibility of the Bank's financial statements to material misstatement, including how fraud might occur, by considering the controls that the Bank has established to address risks identified by the Bank, or that otherwise seek to prevent, deter, or detect fraud. We also considered performance incentives and their potential to influence management to manage earnings.
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations identified in the paragraphs above. Our procedures included inquiries of management, internal audit, and those responsible for legal and compliance matters; as well as focused testing as referred to in the Key Audit Matters section above. In addition we performed procedures to identify any significant items inappropriately held in suspense and also any significant inappropriate adjustments made to the accounting records.
- As the audit of banks requires specialised audit skills, the senior statutory auditor considered the experience and expertise of the audit team to ensure that the team had the appropriate competence and capabilities, and included the use of specialists where appropriate.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: https://www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Independent Auditors' Report to the Members of Bank of China (UK) Limited (continued)

Other matters we are required to address

- We were appointed as auditors by Bank of China (UK) Limited from 1 January 2013 and our engagement letter was signed on 11th October 2013.
- Non-audit services prohibited by the FRC's Ethical Standard were not provided to the Bank and we remained independent of the Bank in conducting the audit.
- The audit opinion is consistent with our additional report to the audit committee.

Kenneth Eglinton (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London
April 2018

Income Statement

£000	Note	**12 months to 31 December 2017**	12 months to 31 December 2016
Interest income from financial investments		**788**	1,216
Other interest income		**37,446**	33,375
Interest expense		**(5,788)**	(4,629)
Net interest income	8	**32,446**	29,962
Fee and commission income		**5,502**	4,029
Fee and commission expense		**(813)**	(776)
Net fee and commission income	9	**4,689**	3,253
Net fair value gain on financial instruments	10	**51**	241
Foreign exchange gain		**2,593**	2,827
Other operating income	11	**54,704**	54,899
Non-interest income		**57,348**	57,967
Total income		**94,483**	91,182
Staff costs	12	**(41,365)**	(32,821)
Other expenses	13	**(7,870)**	(6,914)
Depreciation of plant and equipment	22	**(794)**	(918)
Amortisation of intangible assets	23	**(45)**	(144)
Impairment releases (charges)	20 (c)	**187**	(527)
Profit before income tax		**44,596**	49,858
Income tax expense	15	**(12,532)**	(14,168)
Profit for the year		**32,064**	35,690

Statement of Other Comprehensive Income

£000	Note	**12 months to 31 December 2017**	12 month to 31 December 2016
Profit for the year		**32,064**	35,690
Other comprehensive income			
Amounts that will be reclassified to the income statement			
Net change in fair value of available for sale financial assets	20 (b)	**420**	(189)
Income and deferred tax credit relating to components of other comprehensive income	15	**(104)**	45
Other comprehensive income (expense) for the year, net of income and deferred tax credit or expense		**316**	(144)
Total comprehensive income for the year		**32,380**	35,546

Statement of Financial Position

£000	Note	**31 December 2017**	31 December 2016
Assets			
Cash and cash equivalents	16	**281,944**	311,917
Loans and advances to banks	18	**83,706**	24,270
Loans and advances to customers	19	**1,054,454**	1,159,696
Derivative financial instruments	17	**1,717**	4,577
Prepayments, accrued income and other assets	25	**5,204**	4,762
Available for sale financial investments	21	**12**	40,716
Held to maturity financial investments	21	**107,478**	-
Deferred tax assets	24	**1,462**	562
Property, plant and equipment	22	**3,149**	3,276
Intangible assets	23	**95**	122
Investment in subsidiary companies	32	**-**	-
Total assets		**1,539,221**	1,549,898
Liabilities			
Deposits from banks	26	**123,122**	164,849
Deposits from customers	27	**1,019,007**	982,361
Derivative financial instruments	17	**257**	4,150
Other liabilities	29	**20,158**	13,620
Accruals and deferred income	30	**4,176**	5,874
Current corporation tax liabilities		**5,447**	8,680
Subordinated liabilities	28	**60,000**	60,000
Total liabilities		**1,232,167**	1,239,534
Equity	31		
Authorised and called up share capital		**250,000**	250,000
Retained earnings		**57,022**	60,648
Available for sale reserve		**32**	(284)
Total shareholders' equity		**307,054**	310,364
Total shareholders' equity and liabilities		**1,539,221**	1,549,898

The financial statements on pages 23 to 66 were approved by the Board of Directors of Bank of China (UK) Limited and authorised for issue on 29 March 2018.They were signed on its behalf by:

Yu Sun
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 2017	**250,000**	**60,648**	**(284)**	**310,364**
Unrealised gain on available for sale investments net of income tax	**-**	**-**	**316**	**316**
Profit for the financial year	**-**	**32,064**	**-**	**32,064**
Total comprehensive income	**-**	**32,064**	**316**	**32,380**
Dividend paid	**-**	**(35,690)**	**-**	**(35,690)**
As at 31 December 2017	**250,000**	**57,022**	**32**	**307,054**
As of 1 January 2016	250,000	70,408	(140)	320,268
Unrealised loss on available for sale investments net of income tax	-	-	(144)	(144)
Profit for the financial year	-	35,690	-	35,690
Total comprehensive income (expense)	-	35,690	(144)	35,546
Dividend paid	-	(45,450)	-	(45,450)
As at 31 December 2016	250,000	60,648	(284)	310,364

Statement of Cash Flows

£000	Note	**12 months to 31 December 2017**	12 months to 31 December 2016
Cash flows from operating activities			
Profit on ordinary activities before taxation		**44,596**	49,858
Adjustments for non cash items			
Depreciation and amortisation of plant and equipment and intangible assets		**839**	1,062
Net impairment (gain) loss on loans and advances		**(187)**	527
Interest receivable from financial investments		**(692)**	(1,216)
Other interest receivable		**(38,599)**	(33,375)
Interest payable		**5,788**	4,629
Net loss on sale of available for sale investments		**45**	-
Loss on disposal of fixed assets		**1**	-
Amortisation of premiums on held to maturity investments		**96**	-
Other income receivable		**(504)**	-
Exchange-rate movements on available for sale investments		**-**	(4,958)
Changes in operating assets and liabilities			
Change in derivative financial instruments assets held for risk management		**2,860**	3,596
Change in loans and advances to banks		**(59,436)**	37,836
Change in loans and advances to customers		**105,429**	(348,920)
Change in other assets		**574**	20,998
Change in derivative financial instruments liabilities held for risk management		**(3,893)**	(7,355)
Change in deposits from banks		**(41,727)**	28,113
Change in deposits from customers		**36,646**	244,637
Change in other liabilities and provisions		**6,672**	(3,584)
Adjustment for cash items			
Interest and coupon received		**37,848**	34,582
Dividend paid		**(35,690)**	(45,450)
Interest paid		**(7,487)**	(4,527)
Income tax paid		**(16,749)**	(7,780)
Net cash generated from operating activities		**36,430**	31,327
Cash flows from investing activities			
Acquisition of investment securities		**(106,425)**	(8)
Proceeds from maturity of investment securities		**40,708**	-
Acquisition of property and equipment		**(668)**	(681)
Acquisition of intangible assets		**(18)**	(86)
Net cash from investing activities		**(66,403)**	(775)
Net cash from financing activities		**-**	-
Net (decrease) increase in cash and cash equivalents		**(29,973)**	(32,102)
Cash and cash equivalents at beginning of period		**311,917**	344,019
Cash and cash equivalents at year end	**16**	**281,944**	311,917

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

Notes to the Financial Statements

Note

1. Reporting entity
2. Basis of preparation
3. Significant accounting policies
4. Critical estimates and judgements
5. New pronouncements
6. Financial risk management
   (a) Credit risk
   (b) Liquidity risk
   (c) Market risk
   (d) Capital management
7. Financial assets and financial liabilities
8. Net interest income
9. Net fee and commission income
10. Net fair value gain on financial instruments
11. Other operating income
12. Staff costs
13. Other expenses
14. Directors' remuneration
15. Income tax expense
16. Cash and cash equivalents
17. Derivative financial instruments
18. Loans and advances to banks
19. Loans and advances to customers
20. Allowances for impairment
21. Financial investments
22. Property, plant and equipment
23. Intangible assets
24. Deferred tax assets
25. Prepayments, accrued income and other assets
26. Deposits from banks
27. Deposits from customers
28. Subordinated liabilities
29. Other liabilities
30. Accruals and deferred income
31. Equity
32. Related parties
33. Contingent liabilities and commitments
34. Going concern assessment

Notes to the Financial Statements (continued)

1. Reporting entity

Bank of China (UK) Limited (the “bank”) is a company domiciled and incorporated in the United Kingdom (the “UK”) with its registered office at 1 Lothbury, London EC2R 7DB. The bank is primarily involved in retail, corporate and trade finance services. These financial statements present information for the company and not its subsidiaries.

Accounting policies for the year ended 31 December 2017

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to 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 29 March 2018.

(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.

The following items are measured at fair value:

- Fixed rate loans
- 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.

Notes to the Financial Statements (continued)

3. Significant accounting policies

(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 fees, 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 (h)).

Fees and commissions which are not an integral part of the effective interest rate are 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) Financial assets

(i) Available for sale

Debt securities classified as available for sale are 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 bond 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.

(ii) Held to maturity

Debt securities classified as held to maturity are recognised in the statement of financial position at their original cost inclusive of premium paid on purchase. This premium is amortised to profit and loss from date of acquisition out to the maturity dates of the investments, leaving a nominal value that is recovered in cash.

Interest receivable is accrued to profit and loss based on the nominal value of the investments and their contractual interest rates. Accrued interest is settled on receipt of half yearly coupons.

Notes to the Financial Statements (continued)

3. Significant accounting policies (continued)

(c) Derivative financial instruments

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 fair value gain on 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 arising on monetary items at year-end are recognised in the income statement.

(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.

(f) Loans designated at fair value through profit and loss (FVPL)

Loans classified in this category are those that have been designated by management upon initial recognition. Management may only designate an instrument at FVPL upon initial recognition when the designation eliminates, or significantly reduces, the inconsistent treatment that would otherwise arise from measuring the assets or recognising gains or losses on them on a different basis

Loans at FVPL are recorded in the statement of financial position at fair value. Changes in fair value are recorded in net fair value gain on financial instruments in the income statement. Interest earned is accrued in interest income using the effective interest rate method, taking into account any discount/premium and qualifying transaction costs being an integral part of the instrument.

(g) 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.

Issued financial guarantees are initially recognised at fair value and adjusted for transaction costs that are directly attributable to the issuance of the guarantee. Subsequent to initial recognition they are measured at the higher of the amount initially recognised less cumulative amortisation (determined in accordance with IAS 18 Revenue where relevant) and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee. Subsequent to initial measurement, changes in the amount of the guarantee are recognised in the income statement.

(h) 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.

Notes to the Financial Statements (continued)

3. Significant accounting policies (continued)

(i) Assets accounted for at amortised cost

If there is objective evidence that an impairment loss has been incurred, an allowance is established which is calculated as the difference between the carrying amount of the asset and the present value of estimated future cash flows discounted at that asset's original effective interest rate. Allowances are established on a case-by-case basis for all of the bank's lending activities which include residential 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.

(i) 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.

(j) Derecognition of financial liabilities

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

(k) 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.

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.

Notes to the Financial Statements (continued)

3. Significant accounting policies (continued)

(l) Property, plant and equipment

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 a straight-line method to allocate the difference between cost and 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.

(m) 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.

(n) Cash and cash equivalents

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

(o) Leases

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

(p) 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.

(q) 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.

(r) 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.

Notes to the Financial Statements (continued)

3. Significant accounting policies (continued)

(r) Employee benefits (continued)

(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. The scheme is now closed to future accrual and no further contributions will be made.

(s) 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.

(t) 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 paid 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 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.

(u) 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.

(v) 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(h).

Notes to the Financial Statements (continued)

4. Critical estimates and judgements (continued)

(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 convertible preference shares 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 held by the bank.

5. New pronouncements

New and amended standards and interpretations:

Issued but not effective for the financial year beginning 1 January 2017 and not early adopted.

- IFRS 9 Financial Instruments, issued in July 2014, introduces new requirements for classifying and measuring financial assets, hedge accounting and impairments will affect the bank's accounting for financial assets. The standard is effective from 1 January 2018. Based on 31 December 2017 data and the current implementation status of IFRS 9, the bank estimates the adoption of IFRS 9 to lead to an overall reduction in the bank's total shareholders' equity of £458,000 after tax. This reduction is predominately driven by the impairment requirements of IFRS 9.
- IFRS 15 Revenue from contracts with customers replaces existing revenue requirements and outlines a five step model an entity must apply to measure and recognise revenue. The standard is effective for annual periods beginning on or after 1 January 2018. The impact of the new accounting guidance will be to enhance disclosures around Bank of China (UK) Limited's fee and commission income. Retail and corporate lending fee income is recognised using the effective interest rate method (see Note 3 (a)). Based on 31 December 2017 data, the residual balance falling within scope of IFRS 15 is not material.
- IFRS 16 Leases, issued in January 2016, does not significantly change the accounting for leases by lessors. However, it does require lessees to recognise most leases on their balance sheets as lease liabilities, with the corresponding right-of-use assets. Lessees must apply a single model for all recognised leases, but will have the option not to recognise 'short-term' leases and leases of 'low-value' assets. Generally, the profit or loss recognition pattern for recognised leases will be similar to today's finance lease accounting, with interest and depreciation expense recognised separately in the statement of profit or loss. IFRS 16 is effective for annual periods beginning on or after 1 January 2019. The bank does not anticipate early adopting IFRS 16 and is currently evaluating its impact.

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.

Notes to the Financial Statements (continued)

6. Financial risk management (continued)

Risk management framework

The Board has overall responsibility for the establishment and oversight of the bank's risk management framework. The Board has established the bank's 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 clear authority and responsibilities for monitoring compliance with policies, 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 the bank. 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 Risk Management 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.

Notes to the Financial Statements (continued)

6. Financial risk management (continued)

(a) Credit risk (continued)

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.

Where loans are classified as impaired and impairment allowances are raised, they are separately analysed and excluded from the categories listed above. Impairment usually occurs when loans have been classified in categories 4 or 5.

Debt securities and derivatives

For investment in debt securities and collateralised assets, an 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.

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. Collateral held as security cannot be sold or repledged in the absence of a default.

Notes to the Financial Statements (continued)

6. Financial risk management (continued)

(a) Credit risk (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 2017**	31 December 2016
On statement of financial position:		
Cash and cash equivalents	**280,615**	310,070
Loans and advances to banks	**83,706**	24,270
Loans and advances to customers	**1,054,454**	1,159,696
Derivatives and other financial instruments	**1,717**	4,577
Available for sale financial investments	**12**	40,716
Held to maturity financial investments	**107,478**	-
Total financial assets	**1,527,982**	1,539,329
Undrawn loan commitments	**262,292**	250,115
Guarantees	**29,324**	1,353
Total contingent liabilities and commitments	**291,616**	251,468
Total exposure	**1,819,598**	1,790,797

The fair value of collateral held at 31 December 2017 against amounts due from customers was £1,498,544,000 (31 December 2016; £1,487,790,000). The collateral is in the form of real estate properties and this collateral reduces the maximum amount of credit risk by £675,020,000 as at 31 December 2017 (31 December 2016: £573,762,000).

Cash and cash equivalents include exposures to the parent company of £26,988,000 (31 December 2016: £77,291,000). No other significant concentration of credit risk exposure exists. Cash and cash equivalents exclude cash in hand of £1,329,000 (31 December 2016: £1,847,000) for the purposes of the assessment of credit risk.

Notes to the Financial Statements (continued)

6. Financial risk management (continued)

(b) Credit risk (continued)

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 2017**		31 December 2016	
	Cash and cash equivalents	**Financial investments**	Cash and cash equivalents	Financial investments
Gross exposure	**280,615**	**107,490**	310,070	40,716
Individually impaired	**-**	**-**	-	-
Allowance for impairment	**-**	**-**	-	-
Carrying amount	**-**	**-**	-	-
Past due but not impaired	**-**	**-**	-	-
Ageing profile:				
0-3 months	**-**	**-**	-	-
4-6 months	**-**	**-**	-	-
7-9 months	**-**	**-**	-	-
10-12 months	**-**	**-**	-	-
Neither past due nor impaired	**280,615**	**107,490**	310,070	40,716
Credit rating:				
Aaa	**-**	**-**	-	-
Aa1 - Aa3	**259,521**	**107,478**	218,064	30,035
A1 - A3	**21,086**	**-**	89,800	-
Baa1 - Baa3	**-**	**-**	2,188	10,673
Unrated	**8**	**12**	18	8
Total carrying amount	**280,615**	**107,490**	310,070	40,716

Notes to the Financial Statements (continued)

6. Financial risk management (continued)

(a) Credit risk (continued)

Loans and advances to banks

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

£000	**31 December 2017**	31 December 2016
Gross exposure	**83,706**	24,317
Allowance for impairment	**-**	(47)
Carrying amount	**83,706**	24,270
Neither past due nor impaired	**83,706**	24,270
Credit rating:		
Aa1 – Aa3	**-**	-
A1 - A3	**83,706**	-
Baa1 - Baa3	**-**	24,316
Ba1 – Ba3	**-**	-
Unrated	**-**	1
Allowance for Impairment	**-**	(47)
Total carrying amount	**83,706**	24,270

Loans and advances to customers

£000	**31 December 2017**	31 December 2016
Gross exposure	**1,055,142**	1,160,586
Allowance for impairment	**(688)**	(890)
Carrying amount	**1,054,454**	1,159,696
Individually impaired	**1**	3
Allowance for impairment	**(1)**	(3)
Carrying amount	**-**	-
By age profile		
Neither past due nor impaired	**1,041,377**	1,147,306
Past due but not impaired	**13,077**	12,390
Ageing profile:		
0-3 months	**12,614**	11,060
4-6 months	**459**	1,222
7-9 months	**1**	2
10-12 months	-	-
Over 12 months	3	106
Total carrying amount	**1,054,454**	1,159,696

Notes to the Financial Statements (continued)

6. Financial risk management

(a) Credit risk (continued)

By categories		
Performing	**1,013,454**	1,110,954
A1 - A3	**-**	-
Baa1 - Baa3	**38,061**	9,342
Ba1 - Ba3	**50,634**	121,899
Unrated	**924,759**	979,713
Special mention (unrated)	**40,645**	46,426
Substandard (unrated)	**354**	2,209
Doubtful (unrated)	**-**	-
Loss (unrated)	**1**	107
Total carrying amount	**1,054,454**	1,159,696

(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 a 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 department. Financial Management Department monitor the liquidity risk and provide regular reports to management and the Prudential Regulation Authority (the “PRA”).

Notes to the Financial Statements (continued)

6. Financial risk management (continued)

(b) Liquidity risk (continued)

The following are the contractual (undiscounted) maturities of financial liabilities, including the next expected 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 to 3 months	3 months to 1 year	More than 1 year
31 December 2017						
Non-derivative financial liabilities:						
Deposits from banks	**123,122**	**(123,481)**	**(103,117)**	**(260)**	**(20,104)**	**-**
Deposits from customers	**1,019,007**	**(1,019,709)**	**(964,112)**	**(18,575)**	**(37,022)**	**-**
Subordinated liabilities	**60,000**	**(60,121)**	**-**	**(121)**	**-**	**(60,000)**
Derivative financial instruments:	**257**	**-**	**-**	**-**	**-**	**-**
Cash outflows		**(17,845)**	**(6,409)**	**(157)**	**(1,404)**	**(9,875)**
Cash inflows		**6,092**	**6,092**	**-**	**-**	**-**
	1,202,386	**(1,215,064)**	**(1,067,546)**	**(19,113)**	**(58,530)**	**(69,875)**
Undrawn loan commitments	**262,292**	**(262,292)**	**(262,292)**	**-**	**-**	**-**
	1,464,678	**(1,477,356)**	**(1,329,838)**	**(19,113)**	**(58,530)**	**(69,875)**
31 December 2016						
Non-derivative financial liabilities:						
Deposits from banks	164,849	(168,811)	(2,923)	(38,431)	(34,244)	(93,213)
Deposits from customers	982,361	(982,741)	(947,673)	(18,797)	(16,267)	(4)
Subordinated liabilities	60,000	(60,100)	-	(100)	-	(60,000)
Derivative financial instruments:	4,150	-	-	-	-	-
Cash outflows		(143,068)	(123,016)	(861)	(2,416)	(16,775)
Cash inflows		123,362	123,362	-	-	-
	1,211,360	(1,231,358)	(950,250)	(58,189)	(52,927)	(169,992)
Undrawn loan commitments	250,115	(250,115)	(250,115)	-	-	-
	1,461,475	(1,481,473)	(1,200,365)	(58,189)	(52,927)	(169,992)

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's 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).

The bank has the benefit of a committed short-term loan facility granted by its parent company. The facility is repayable at call and no amounts were drawn at 31 December 2017 (31 December 2016: £nil).

Notes to the Financial Statements (continued)

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 2017 and 2016.

£000

31 December 2017	**Sterling**	**US Dollar**	**Euro**	**Other**	**Total**
Cash and cash equivalents	**254,694**	**14,450**	**6,772**	**6,028**	**281,944**
Loans and advances to banks	**13,000**	**55,870**	**-**	**14,836**	**83,706**
Loans and advances to customers	**795,933**	**178,792**	**59,704**	**20,025**	**1,054,454**
Derivatives financial instruments (asset)	**1,459**	**258**	**-**	**-**	**1,717**
Available for sale financial investments	**12**	**-**	**-**	**-**	**12**
Held to maturity investments	**107,478**	**-**	**-**	**-**	**107,478**
Other assets	**8,471**	**551**	**241**	**647**	**9,910**
Deposits from banks	**(72,848)**	**(368)**	**(29,758)**	**(20,148)**	**(123,122)**
Deposits from customers	**(719,052)**	**(243,070)**	**(36,492)**	**(20,393)**	**(1,019,007)**
Derivatives financial instruments (liability)	**(2)**	**(255)**	**-**	**-**	**(257)**
Other liabilities	**(26,121)**	**(3,174)**	**(298)**	**(188)**	**(29,781)**
Subordinated liabilities	**(60,000)**	**-**	**-**	**-**	**(60,000)**
Total shareholder equity	**(307,054)**	**-**	**-**	**-**	**(307,054)**
Net financial assets/(liabilities)	**(4,030)**	**3,054**	**169**	**807**	**-**
Net forward foreign exchange positions	**(10,496)**	**14,249**	**(3,061)**	**(692)**	**-**
Undrawn loan commitments	**88,328**	**122,330**	**39,947**	**11,687**	**262,292**

£000

31 December 2016	Sterling	US Dollar	Euro	Other	Total
Cash and cash equivalents	239,274	55,876	4,671	12,096	311,917
Loans and advances to banks	-	24,270	-	-	24,270
Loans and advances to customers	712,080	368,646	57,827	21,143	1,159,696
Derivative financial instruments (asset)	1,498	3,079	-	-	4,577
Available for sale financial investments	8	-	10,673	30,035	40,716
Other assets	7,145	834	166	577	8,722
Deposits from banks	(2,526)	(93,610)	(38,349)	(30,364)	(164,849)
Deposits from customers	(661,320)	(265,625)	(39,842)	(15,574)	(982,361)
Derivative financial instruments (liability)	(627)	(3,523)	-	-	(4,150)
Other liabilities	(23,338)	(3,612)	(280)	(944)	(28,174)
Subordinated liabilities	(60,000)	-	-	-	(60,000)
Total shareholder equity	(310,763)	-	(36)	435	(310,364)
Net financial assets (liabilities)	(98,569)	86,335	(5,170)	17,404	-
Net forward foreign exchange positions	(797)	(3,267)	2,828	1,236	-
Undrawn loan commitments	65,104	135,654	38,349	11,008	250,115

Notes to the Financial Statements (continued)

6. Financial risk management (continued)

(c) Market risk (continued)

Foreign exchange risk (continued)

Sensitivity analysis

A 1% percent weakening of the following currencies against Sterling at 31 December 2017 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

	Other Comprehensive Income		**Income statement**	
£000	**31 December 2017**	31 December 2016	**31 December 2017**	31 December 2016
US Dollars	**-**	-	**(22)**	(1,140)
Euro	**-**	(6)	**1**	-
Other	**-**	(97)	**-**	(92)

A 1% percent strengthening of the above currencies against Sterling at 31 December 2017 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.

Notes to the Financial Statements (continued)

6. Financial risk management (continued)

(c) Market risk (continued)

Exposure to interest rate risk

The bank does not operate a trading book.

The principal exposure 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 Financial Management department in its day-to-day monitoring activities. A summary of the bank's interest rate gap position 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 2017							
Assets							
Cash	281,944	281,635	-	-	-	-	309
Loans and advances to banks	83,706	83,706	-	-	-	-	-
Loans and advances to customers	1,054,454	105,247	859,948	11,096	26,253	51,854	56
Derivative financial instruments	1,717	-	-	-	-	-	1,717
Financial investments	107,490	-	-	-	106,329	-	1,161
Other assets	9,910	-	-	-	-	-	9,910
Total assets	1,539,221	470,588	859,948	11,096	132,582	51,854	13,153
Equity and liabilities							
Liabilities	1,232,167	1,065,777	79,199	56,612	-	-	30,579
Deposits from banks	123,122	103,025	-	20,087	-	-	10
Deposits from customers	1,019,007	962,752	19,199	36,525	-	-	531
Derivative financial instruments	257	-	-	-	-	-	257
Other liabilities	29,781	-	-	-	-	-	29,781
Subordinated liabilities	60,000	-	60,000	-	-	-	-
Equity							
Shareholders' equity	307,054	-	-	-	-	-	307,054
Total equity and liabilities	1,539,221	1,065,777	79,199	56,612	-	-	337,633
Interest rate sensitivity gap	-	(595,189)	780,749	(45,516)	132,582	51,854	(324,480)
Cumulative gap	-	(595,189)	185,560	140,044	272,626	324,480	-

Notes to the Financial Statements (continued)

6. Financial risk management (continued)

(c) Market risk (continued)

Exposure to interest rate risk (continued)

£000	Carrying amount	Less than 1 Month	1-3 months	3 months to 1 year	1-5 years	Over 5 years	Non Interest Bearing
31 December 2016							
Assets							
Cash	311,917	311,602	-	-	-	-	315
Loans and advances to banks	24,270	-	1	24,269	-	-	-
Loans and advances to customers	1,159,696	1,755	600,257	16,820	366,265	158,840	15,759
Derivative financial instruments	4,577	-	-	-	-	-	4,577
Financial investments	40,716	10,681	-	30,035	-	-	-
Other assets	8,722	-	-	-	-	-	8,722
Total assets	1,549,898	324,038	600,258	71,124	366,265	158,840	29,373
Equity and liabilities							
Liabilities	1,239,534	738,070	310,319	49,650	93,214	-	48,281
Deposits from banks	164,849	2,916	38,405	30,308	93,213	-	7
Deposits from customers	982,361	735,154	211,914	19,342	1	-	15,950
Derivative financial instruments	4,150	-	-	-	-	-	4,150
Other liabilities	28,174	-	-	-	-	-	28,174
Subordinated liabilities	60,000	-	60,000	-	-	-	-
Equity							
Shareholders' equity	310,364	-	-	-	-	-	310,364
Total equity and liabilities	1,549,898	738,070	310,319	49,650	93,214	-	358,645
Interest rate sensitivity gap	-	(414,032)	289,939	21,474	273,051	158,840	(329,272)
Cumulative gap	-	(414,032)	(124,093)	(102,619)	170,432	329,272	-

The table below indicates the impact on the income statement for possible change in interest rates, with all other variables held constant.

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

£000	100bps parallel Increase	100bps parallel Decrease
Sensitivity of projected net interest income at		
31 December 2017	**1,913**	**(1,913)**
31 December 2016	(1,245)	1,245
Sensitivity of reported equity to interest rate movements at		
31 December 2017	**-**	**-**
31 December 2016	100	(100)

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.

Notes to the Financial Statements (continued)

6. Financial risk management (continued)

(d) Capital management

Regulatory capital

Reference is made below to the Prudential Regulation Authority ("PRA") which along with the Financial Conduct Authority ("FCA") are the bank's regulators.

The PRA sets capital requirements for the bank in line with international supervisory standards and guidelines known as Basel III which are contained within legislation passed by the EU, i.e. CRD IV Regulation and Directives. The parent company is directly supervised by their local regulators.

In calculating capital requirements, the bank has adopted the standardised approach for credit risk and the basic indicator approach for operational risk. As the bank does not have a trading book, the capital requirement for the foreign exchange risk inherent in the banking book has been captured as market risk, which is also calculated on the standardised approach.

The bank's regulatory capital resources comprise tier 1 and tier 2 capital as set out in the table below.

The bank does not have any deductions from either tier 1 or tier 2 capital and is not limited by the restriction that qualifying term subordinated loan capital (tier 2) may not exceed 50 percent of tier 1 capital.

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.

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.

The bank's regulatory capital position at 31 December 2017 and 2016 was as follows:

£000	**2017 Actual**	2016 Actual
Tier 1 capital		
Ordinary share capital	**250,000**	250,000
Retained earnings *	**24,958**	24,958
Tier 2 capital		
Qualifying subordinated liabilities	**60,000**	60,000
Total regulatory capital	**334,958**	334,958

		Regulatory Minimum
Risk exposure amount	**931,206**	n.a.
Fully loaded CRD IV CET1 ratio	**29.5%**	4.5%
Total capital ratio	**36.0%**	8.0%
Leverage ratio	**15.3%**	4.0%

* Retained earnings for regulatory capital purposes at the reporting date is restricted to audited retained earnings at 31 December 2016 after deducting the 2016 dividend paid in 2017.

The bank maintains a buffer to regulatory minimum capital ratios.

Notes to the Financial Statements (continued)

6. Financial risk management (continued)

(d) Capital management (continued)

Regulatory capital (continued)

The PRA also sets individual capital guidance ("ICG") for the bank as part of its Supervisory Review and Evaluation Process. The agreed ICG was in force and respected as at the reporting date and remains confidential between each bank and the PRA in accordance with accepted practice.

7. 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 2017						
Assets						
Cash and cash equivalents	**-**	**281,944**	**-**	**-**	**281,944**	**281,944**
Cash and balances with banks	-	280,615	-	-	280,615	280,615
Cash in hand	-	1,329	-	-	1,329	1,329
Loans and advances to banks	**-**	**83,706**	**-**	**-**	**83,706**	**83,706**
Loans and advances to customers	**41,621**	**1,012,833**	**-**	**-**	**1,054,454**	**1,055,215**
Corporate loans and advances	41,621	343,520	-	-	385,141	385,902
Retail loans and advances	-	669,313	-	-	669,313	669,313
Derivative financial instruments	**1,717**	**-**	**-**	**-**	**1,717**	**1,717**
Interest rate swaps	1,459	-	-	-	1,459	1,459
Cross currency swaps and FX forwards	-	-	-	-	-	-
Other derivatives	258	-	-	-	258	258
Financial investments	**-**	**-**	**12**	**107,478**	**107,490**	**107,490**
Debt securities	-	-	-	107,478	107,478	107,478
Convertible preference shares	-	-	12	-	12	12
Total financial assets	**43,338**	**1,378,483**	**12**	**107,478**	**1,529,311**	**1,530,072**
Liabilities						
Deposits from banks	**-**	**-**	**-**	**123,122**	**123,122**	**123,122**
Deposits from customers	**-**	**-**	**-**	**1,019,007**	**1,019,007**	**1,019,007**
Retail customers	-	-	-	574,540	574,540	574,540
Corporate customers	-	-	-	444,467	444,467	444,467
Derivative financial instruments	**257**	**-**	**-**	**-**	**257**	**257**
Interest rate swaps	-	-	-	-	-	-
Cross currency swaps and FX forwards	3	-	-	-	3	3
Other derivatives	254	-	-	-	254	254
Subordinated liabilities	**-**	**-**	**-**	**60,000**	**60,000**	**60,000**
Total financial liabilities	**257**	**-**	**-**	**1,202,129**	**1,202,386**	**1,202,386**

Loans and advances designated to fair value of £41,621,000 would have had a carrying value of £42,382,000 (31 December 2016: £37,202,000) if classified as amortised cost. The carrying value of all other financial assets and liabilities are materially equal to their fair 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.

Notes to the Financial Statements (continued)

7. Financial assets and financial liabilities (continued)

Fair values (continued)

£000	Financial instruments at fair value through profit and loss	Loans and receivables	Available for sale	Other amortised cost	Total carrying amount	Fair value
31 December 2016						
Assets						
Cash and cash equivalents	-	311,917	-	-	311,917	311,917
Cash and balances with banks	-	310,070	-	-	310,070	310,070
Cash in hand	-	1,847	-	-	1,847	1,847
Loans and advances to banks	-	24,270	-	-	24,270	24,270
Loans and advances to customers	36,607	1,123,089	-	-	1,159,696	1,160,291
Corporate loans and advances	36,607	550,149	-	-	586,756	587,351
Retail loans and advances	-	572,940	-	-	572,940	572,940
Derivative financial instruments	4,577	-	-	-	4,577	4,577
Interest rate swaps	1,040	-	-	-	1,040	1,040
Cross currency swaps and FX forwards	458	-	-	-	458	458
Other derivatives	3,079	-	-	-	3,079	3,079
Available for sale investments	-	-	40,716	-	40,716	40,716
Debt securities	-	-	40,708	-	40,708	40,708
Convertible preference shares	-	-	8	-	8	8
Total financial assets	41,184	1,459,276	40,716	-	1,541,176	1,541,771
Liabilities						
Deposits from banks	-	-	-	164,849	164,849	164,849
Deposits from customers	-	-	-	982,361	982,361	982,361
Retail customers	-	-	-	569,534	569,534	569,534
Corporate customers	-	-	-	412,827	412,827	412,827
Derivative financial instruments	4,150	-	-	-	4,150	4,150
Interest rate swaps	594	-	-	-	594	594
Cross currency swaps and FX forwards	33	-	-	-	33	33
Other derivatives	3,523	-	-	-	3,523	3,523
Subordinated liabilities	-	-	-	60,000	60,000	60,000
Total financial liabilities	4,150	-	-	1,207,210	1,211,360	1,211,360

Certain amounts in the above table have been reclassified to be consistent with the current year presentation.

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

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

During the reporting period ending 31 December 2017, there were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into and out of the Level 3 fair value measurements. The carrying value of short-term receivables and payables are assumed to approximate to their fair values where discounting is not material.

Loans to customers designated at fair value are valued by discounting the amount derived from the gap between their fixed interest rates against floating interest rate swap rates to maturity.

For derivative financial instruments not traded in an active market for which no quoted market price is available the fair value is determined using valuation techniques. Forward currency exchange contracts fair value was determined using quoted forward exchange rates matching the maturities of the contracts. While for interest rate swaps fair value was determined using discounted cash flow analysis at quoted interest rates.

Notes to the Financial Statements (continued)

7. Financial assets and financial liabilities (continued)

The fair value of other financial assets and borrowings has been calculated by discounting the expected future cash flows at prevailing market interest rates for instruments with substantially the same terms and characteristics.

Fair value hierarchy

During the financial years ended 31 December 2017 and 31 December 2016 no financial assets or liabilities were transferred between Level 1, Level 2 or Level 3.

£000 **31 December 2017**	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial assets				
Designated fair value loans	-	-	**41,625**	**41,625**
Derivative financial instruments:				
Interest rate swaps	**-**	**1,459**	**-**	**1,459**
Cross currency swaps and FX forwards	**-**	**-**	**-**	**-**
Other derivatives	**-**	**258**	**-**	**258**
	-	**1,717**	**-**	**1,717**
Financial investments:				
Debt securities	**107,478**	**-**	**-**	**107,478**
Convertible preference shares	**-**	**-**	**12**	**12**
	-	**-**	**12**	**107,490**
Total assets	**107,478**	**1,717**	**41,637**	**150,832**
Financial liabilities				
Derivative financial instruments:				
Interest rate swaps	**-**	**-**	**-**	**-**
Cross currency swaps and FX forwards	**-**	**3**	**-**	**3**
Other derivatives	**-**	**254**	**-**	**254**
Total liabilities	**-**	**257**	**-**	**257**

Notes to the Financial Statements (continued)

7. Financial assets and financial liabilities (continued)

Fair value hierarchy (continued)

£000 31 December 2016	Level 1	Level 2	Level 3	Total
Financial assets				
Designated fair value loans	-	-	36,607	36.607
Derivative financial instruments:				
Interest rate swaps	-	1,040	-	1,040
Cross currency swaps and FX forwards	-	458	-	458
Other derivatives	-	3,079	-	3,079
	-	4,577	-	4,577
Financial investments:				
Debt securities	40,708	-	-	40,708
Convertible preference shares	-	-	8	8
	40,708	-	8	40,716
Total assets	40,708	4,577	36,615	81,900
Financial liabilities				
Derivative financial instruments:				
Interest rate swaps	-	594	-	594
Cross currency swaps and FX forwards	-	33	-	33
Other derivatives	-	3,523	-	3,523
Total liabilities	-	4,150	-	4,150

Notes to the Financial Statements (continued)

8. Net interest income

£000	31 December 2017	31 December 2016
Interest income from financial investments	**788**	1,216
Other interest income:		
Cash and cash equivalents	**185**	511
Loans and advances to banks	**608**	470
Loans and advances to customers	**36,653**	32,394
Total other interest income	**37,446**	33,375
Total interest income	**38,234**	34,591
Interest expense:		
Deposits from banks	**3,881**	2,547
Customers accounts	**1,524**	1,584
Subordinated liabilities	**383**	498
Total interest expense	**(5,788)**	(4,629)
Net interest income	**32,446**	29,962

Included within various line items under interest income for the year ended 31 December 2017 is a total of £nil (31 December 2016: £nil) accrued for non performing impaired financial assets.

9. Net fee and commission income

£000	31 December 2017	31 December 2016
Retail Banking customer fees	**2,061**	1,509
Corporate Banking credit-related fees	**3,257**	2,511
Other	**184**	9
Fee and commission income	**5,502**	4,029
Inter-bank transaction fees	**349**	360
Other	**464**	416
Fee and commission expense	**(813)**	(776)
Net fee and commission income	**4,689**	3,253

10. Net fair value gain on financial instruments

£000	31 December 2017	31 December 2016
Net fair value gain (loss) on financial instruments held for risk management purposes:		
Designated fair value loans	**(166)**	106
Interest rate swaps	**213**	(463)
Other derivatives	**4**	598
	51	241

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

At 31 December 2017 unrealised net gain of £nil (31 December 2016: unrealised net loss of £27,000), 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.

Notes to the Financial Statements (continued)

11. Other operating income

£000	**31 December 2017**	31 December 2016
Related party service charges	**53,742**	52,160
Other	**962**	2,739
	54,704	54,899

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 32.

Other income in 2016 included £2.0m profit on disposal of the bank's investment in Visa Europe.

12. Staff costs

£000	**31 December 2017**	31 December 2016
Wages and salaries	**33,698**	26,405
Contributions to defined contribution plans	**1,668**	1,716
Social security costs	**4,467**	3,532
Other	**1,532**	1,168
	41,365	32,821

Average number of employees	**31 December 2017**	31 December 2016
Retail Banking	**133**	130
Corporate Banking	**85**	74
Support Functions	**221**	206
Total average number of employees	**439**	410

13. Other expenses

£000	**31 December 2017**	31 December 2016
Administrative	**5,188**	4,859
Rent on operating leases	**1,147**	511
Software licensing and other IT costs	**331**	263
Other	**1,204**	1,281
	7,870	6,914

Auditor's remuneration:

£000	**31 December 2017**	31 December 2016
Fees payable to the company's auditors for the audit of the company's financial statements:		
Current year	**141**	141
Fees payable to the company's auditor and its associates for other services:		
The audits of the company's subsidiaries, pursuant to legislation	**10**	10
Other assurance services	**35**	15

Notes to the Financial Statements (continued)

14. Directors' remuneration

£000	**31 December 2017**	31 December 2016
Remuneration of directors in respect of services rendered:		
Remuneration	**1,015**	734
Pension contributions	**15**	-
Highest paid director:		
Remuneration	**396**	282
Pension contributions	**-**	-

15. Income tax expense

£000	**31 December 2017**	31 December 2016
Current tax expense		
Current period	**13,203**	14,264
Adjustments for prior years	**318**	(27)
Total current tax	**13,521**	14,237
Deferred tax expense		
Origination and reversal of temporary differences	**(727)**	(139)
Adjustments for prior years	**(262)**	70
Total deferred tax	**(989)**	(69)
Total income tax expense in income statement	**12,532**	14,168

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 2017**	31 December 2016
Profit before income tax	**44,596**	49,858
Income tax using the standard rate of corporation tax in the UK 27.25% (2016: 28.00%)	**12,152**	13,960
Non-deductible expenses	**271**	293
Over (under)-provided in prior years	**55**	42
Other - tax rate adjustment	**66**	(127)
Other	**(12)**	-
Total income tax expense in income statement	**12,532**	14,168

Notes to the Financial Statements (continued)

15. Income tax expense (continued)

Income tax recognised in other comprehensive income

£000	**31 December 2017**	31 December 2016
Current tax		
UK current tax expense	**15**	23
Total current tax	**15**	23
Deferred tax		
Current year deferred tax charge (credit)	**89**	(68)
Total deferred tax	**89**	(68)
Total income and deferred tax credit in other comprehensive income	**104**	(45)

Reductions in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) and 18% (effective from 1 April 2020) were substantively enacted on 26 October 2015. A banking surcharge tax of 8% also applies to the bank (effective from 1 January 2016) and this change was substantively enacted on 26 October 2015.

In 2016, the UK government announced a further reduction to the rate of corporation tax to 17% from 1 April 2020, and this change was substantively enacted on 6 September 2016. Deferred tax has been calculated by reference to the most appropriate rate based on forecasts.

16. Cash and cash equivalents

£000	**31 December 2017**	31 December 2016
Cash and cash equivalents with banks	**280,615**	310,070
Cash in hand	**1,329**	1,847
	281,944	311,917

17. Derivative financial instruments

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

£000	**31 December 2017**		31 December 2016	
	Assets	**Liabilities**	Assets	Liabilities
Instrument type:				
Interest rate swaps	**1,459**	**-**	1,040	594
Cross currency swaps and FX forwards	**-**	**3**	458	33
Other derivatives	**258**	**254**	3,079	3,523
	1,717	**257**	4,577	4,150

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

The bank sub-participated a loan but retained the risks and rewards of ownership of the interest strip relating to it. The bank de-recognised the principal element of the loan as it retained none of the risks or rewards associated with it. The bank has unrestricted use of interest received from the interest strip however it has also assumed an obligation to pay interest. The bank is restricted from selling or transferring the interest strip, and associated liability to pay interest. At 31 December 2017, the fair value of the interest strip amounted to £258,000 (31 December 2016: £3,079,000) and the associated liability was £254,000 (31 December 2016: £3,523,000).

Notes to the Financial Statements (continued)

18. Loans and advances to banks

£000	**31 December 2017**	31 December 2016
Loans and advances to banks	**83,706**	24,317
Collective impairment provision	**-**	(47)
	83,706	24,270

At 31 December 2017 £nil (31 December 2016: £nil) of loans and advances to banks are expected to be recovered more than twelve months after the reporting date.

19. Loans and advances to customers

£000	**31 December 2017**	31 December 2016
Corporate loans and advances	**385,829**	587,645
Retail loans and advances	**669,314**	572,944
Gross loans and advances	**1,055,143**	1,160,589
Less: specific allowance for impairments	**(1)**	(3)
collective allowance for impairments	**(688)**	(890)
Total allowance for impairment	**(689)**	(893)
Loans and advances to customer net	**1,054,454**	1,159,696

At 31 December 2017 £51,854,000 (31 December 2016: £158,840,000) of loans and advances to customers are expected to be recovered more than five years after the reporting date.

Loans and advances to customers at amortised cost and fair value

£000	**31 December 2017**			31 December 2016		
	Gross amount	**Impairment allowance**	**Carrying amount**	Gross amount	Impairment allowance	Carrying amount
Corporate loans and advances	**385,829**	**(688)**	**385,141**	587,645	(890)	586,755
Retail loans and advances	**669,314**	**(1)**	**669,313**	572,944	(3)	572,941
	1,055,143	**(689)**	**1,054,454**	1,160,589	(893)	1,159,696

At 31 December 2017, loans and advances designated to fair value of £41,621,000 would have had a carrying value of £42,382,000 (31 December 2016: £37,202,000) if classified as amortised cost.

Notes to the Financial Statements (continued)

20. 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 2017	**-**	**3**	**47**	**890**
Increase in impairment	**-**	**15**	**-**	**91**
Recovery	**-**	**(4)**	**-**	**-**
Reversal of impairment	**-**	**-**	**(47)**	**(293)**
Charge (release) in income statement	**-**	**11**	**(47)**	**(202)**
Amounts written off	**-**	**(13)**	**-**	**-**
Balance at 31 December 2017	**-**	**1**	**-**	**688**
Balance at 1 January 2016	-	33	81	376
Increase in impairment	-	83	21	574
Recovery	**-**	(4)	**-**	**-**
Reversal of impairment	-	-	(55)	(60)
Charge (release) in income statement	-	79	(34)	514
Amounts written off	-	(109)	-	-
Balance at 31 December 2016	-	3	47	890

Amounts written off during 2017 and 2016 mostly represent fraud losses.

(b) Financial Investments

£000	Note	Movement before tax in fair value recognised in equity	Impairment
Balance at 1 January 2017		**399**	**-**
Changes in fair values		**(420)**	**-**
Reversal in impairment		**-**	**-**
Amounts written off		**-**	**-**
	21 (a)(b)	**(420)**	**-**
Exchange-rate movements		**-**	**-**
Balance at 31 December 2017		**(21)**	**-**

The cumulative tax credit on this fair value amounts to £11,000 (31 December 2016: £115,000).

Balance at 1 January 2016		210	-
Changes in fair values		189	-
Reversal in impairment		-	-
Amounts written off		-	-
	21 (a)	189	-
Exchange-rate movements		-	-
Balance at 31 December 2016		399	-

Notes to the Financial Statements (continued)

20. Allowances for impairment (continued)

(c) Impairment (charges) / release

£000	**31 December 2017**	31 December 2016
Loans and advances to customers		
Specific	**(11)**	(79)
Collective	**202**	(514)
Loans and advances to banks		
Specific	**-**	-
Collective	**47**	34
Financial investments	**-**	-
Foreign exchange movement	**(51)**	32
Total impairment (charges) / releases in income statement	**187**	(527)

21. Financial investments

(a) Available for sale financial investments

£000	Note	**31 December 2017**	31 December 2016
Debt securities		**-**	40,708
Convertible preference shares		**12**	8
		12	40,716
Balance at 1 January		**40,716**	35,859
Accrued interest		**-**	76
Disposals through sale and redemptions		**(40,708)**	-
Acquisition		**-**	8
Changes in fair value recognised in equity	**20 (b)**	**4**	(189)
Amortisation of premium		**-**	4
Exchange-rate movement		**-**	4,958
Balance at 31 December		**12**	40,716

At 31 December 2017 there were £12,000 of available for sale investments (31 December 2016: £8,000) which are expected to be recovered more than twelve months after the reporting date. These are comprised of preference shares in Visa Inc.

(b) Held to maturity financial investments

£000	Note	**31 December 2017**	31 December 2016
Debt securities		**107,478**	-
		107,478	-
Balance at 1 January		**-**	-
Accrued interest		**1,149**	-
Acquisition		**106,425**	-
Changes in fair value recognised in equity	**20 (b)**	**416**	**-**
Amortisation of premium		**(512)**	-
Balance at 31 December		**107,478**	-

During 2017 the bank acquired £100 million nominal UK government securities which are classified as held to maturity investments.

Notes to the Financial Statements (continued)

22. Property, plant and equipment

£000	Property, plant and fixtures	Furniture and equipment	Computer equipment	Motor vehicles	Total
Cost					
Balance at 1 January 2017	**5,973**	**1,869**	**1,474**	**214**	**9,530**
Additions	**273**	**115**	**280**	**-**	**668**
Transfers	**-**	**3**	**15**	**-**	**18**
Disposals	**-**	**(12)**	**(51)**	**-**	**(63)**
Balance at 31 December 2017	**6,246**	**1,975**	**1,718**	**214**	**10,153**
Balance at 1 January 2016	5,627	1,646	1,386	214	8,873
Additions	346	225	110	-	681
Transfers	-	-	5	-	5
Disposals	-	(2)	(27)	-	(29)
Balance at 31 December 2016	5,973	1,869	1,474	214	9,530
Depreciation					
Balance at 1 January 2017	**3,544**	**1,347**	**1,237**	**126**	**6,254**
Charge for the year	**344**	**250**	**182**	**18**	**794**
Transfers	**-**	**3**	**9**	**-**	**12**
Disposals	**-**	**(11)**	**(45)**	**-**	**(56)**
Balance at 31 December 2017	**3,888**	**1,589**	**1,383**	**144**	**7,004**
Balance at 1 January 2016	3,187	1,048	1,002	122	5,359
Charge for the year	357	300	257	4	918
Transfers	-	-	3	-	3
Disposals	-	(1)	(25)	-	(26)
Balance at 31 December 2016	3,544	1,347	1,237	126	6,254
Net carrying values at					
31 December 2017	**2,358**	**386**	**335**	**70**	**3,149**
31 December 2016	2,429	522	237	88	3,276

As at 31 December 2017 and 31 December 2016 the bank identified no events or circumstances that would indicate that the bank's tangible fixed assets might be impaired.

23. Intangible assets

£000	IT Software	Total
Cost		
Balance at 1 January 2017	**1,904**	**1,904**
Additions	**18**	**18**
Balance at 31 December 2017	**1,922**	**1,922**
Balance at 1 January 2016	1,818	1,818
Additions	86	86
Balance at 31 December 2016	1,904	1,904

Notes to the Financial Statements (continued)

23. Intangible assets (continued)

Amortisation		
Balance at 1 January 2017	**1,782**	**1,782**
Amortisation for the year	**45**	**45**
Balance at 31 December 2017	**1,827**	**1,827**
Balance at 1 January 2016	1,638	1,638
Amortisation for the year	144	144
Balance at 31 December 2016	1,782	1,782
Net carrying value at		
31 December 2017	**95**	**95**
31 December 2016	122	122

As at 31 December 2017 and 31 December 2016 the bank identified no events or circumstances that would indicate that the bank's intangible assets might be impaired.

24. Deferred tax assets

Recognised deferred tax assets

Deferred tax assets are attributable to the following:

£000	**31 December 2017**	31 December 2016
Property and equipment, and software	**85**	96
Available for sale investments	**(21)**	68
Deferred employees' benefits	**1,536**	532
Other	**(138)**	(134)
	1,462	562

There were no unrecognised deferred tax assets as at 31 December 2017 and 31 December 2016.

Movements in temporary differences during the year

£000	**Opening balance 1 January 2017**	**Recognised In income**	**Recognised in equity**	**Closing balance 31 December 2017**
Property and equipment, and software	**96**	**(11)**	**-**	**85**
Available for sale investments	**68**	**-**	**(89)**	**(21)**
Deferred employees' benefits	**532**	**1,004**	**-**	**1,536**
Other	**(134)**	**(4)**	**-**	**(138)**
	562	**989**	**(89)**	**1,462**

£000	Opening balance 1 January 2016	Recognised In income	Recognised in equity	Closing balance 31 December 2016
Property and equipment, and software	39	57	-	96
Available for sale investments	-	-	68	68
Deferred employees' benefits	441	91	-	532
Other	(55)	(79)		(134)
	425	69	68	562

Notes to the Financial Statements (continued)

25. Prepayments, accrued income and other assets

£000	**31 December 2017**	31 December 2016
Accrued income	**2,153**	1,989
Prepaid expenses	**596**	512
Receivable from related party	**722**	635
Other	**1,733**	1,626
	5,204	4,762

26. Deposits from banks

£000	**31 December 2017**	31 December 2016
From fellow group companies	**115,381**	161,926
Other deposits from banks	**7,741**	2,923
	123,122	164,849

At 31 December 2017 £nil (31 December 2016: £nil) of deposits from banks are expected to be settled more than twelve months after the reporting date.

27. Deposits from customers

£000	**31 December 2017**	31 December 2016
Retail customers:		
Term deposits	**177,518**	145,268
Notice deposits	**110,746**	112,185
Current deposits	**285,669**	311,482
Other	**607**	599
	574,540	569,534
Corporate customers:		
Notice deposits	**43,032**	91,103
Current deposits	**390,205**	319,509
Other	**11,230**	2,215
	444,467	412,827
	1,019,007	982,361

At 31 December 2017 £nil (31 December 2016: £1,000) of deposits from customers are expected to be settled more than twelve months after the reporting date.

28. Subordinated liabilities

£000	**31 December 2017**	31 December 2016
Subordinated note issued	**60,000**	60,000
	60,000	60,000

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 0.64% (31 December 2016: 0.67%). 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.

29. Other liabilities

(a) Other liabilities

£000	**31 December 2017**	31 December 2016
Creditors and accruals	**19,396**	13,338
Other	**762**	282
	20,158	13,620

(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 2017 and 2016. 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 2017**	31 December 2016
Benefit obligations at beginning of year	**76,145**	47,976
Interest costs	**1,650**	1,869
Current service costs	**-**	203
Members' contributions	**-**	31
Actuarial loss	**674**	10,038
Insured annuitants	**(3,260)**	16,478
Effects of curtailments or settlements	**-**	242
Benefits paid	**(3,559)**	(692)
Benefit obligations at the end of the year	71,650	76,145

Notes to the Financial Statements (continued)

29. Other liabilities (continued)

(b) Defined benefit obligations (continued)

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

£000	**31 December 2017**	31 December 2016
Un-funded (surplus) obligations	**(4,641)**	(2,371)
Wholly or partly funded obligations	**-**	-
Total	**(4,641)**	(2,371)

Changes in Scheme assets:

£000	**31 December 2017**	31 December 2016
Market value of assets at beginning of year	**78,516**	44,771
Expected return on Scheme assets	**1,728**	1,777
Insured annuitants	**(3,260)**	16,478
Actuarial gain	**2,128**	13,929
Members' contributions	**738**	2,239
Employer's contributions	**-**	31
Administration expenses	**-**	(17)
Benefits paid	**(3,559)**	(692)
Market value of assets at end of year	**76,291**	78,516

Scheme assets as a percentage of total assets:

	31 December 2017	31 December 2016
Equities	**23.70%**	23.70%
Bonds	**25.90%**	23.70%
Property	**2.40%**	2.10%
Cash	**48.00%**	50.50%

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 2017	31 December 2016
Discount rate	**2.66%**	2.85%
Price inflation	**3.30%**	3.36%
Rate of increase in salaries	**2.30%**	2.36%
Rate of increase for pensions in payment (LPI)	**3.20%**	3.26%
Post retirement mortality table	**S2PA adjusted CMI 2016 (Long Term Improvement)**	PCMA00 adjusted for CMI 2014 (Long Term Improvement)
Expected return on assets	**1.75% (M), 1.25% (F)**	1.75% (M), 1.25% (F)

The bank expects to pay £nil (31 December 2016: £nil) in contributions to defined benefit plans in 2017.

Notes to the Financial Statements (continued)

30. Accruals and deferred income

£000	**31 December 2017**	31 December 2016
Deferred income	**3,710**	5,246
Accrued interest	**466**	628
	4,176	5,874

31. Equity

(a) Capital

At 31 December 2017 the authorised share capital comprised 250,000,000 ordinary shares (31 December 2016 : 250,000,000). 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.

(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

A dividend of £31,606,000 has been recommended for the year ended 31 December 2017 (31 December 2016: £35,690,000). The recommended dividend consists of current year post-tax profits of £32,064,000 less the 2018 impact on shareholders equity following the adoption of IFRS 9 from 1 January 2018 of £458,000. Payment of a dividend adjusted for IFRS 9 will leave CET1 regulatory capital unchanged for 2018 compared with 2017.

32. 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 2017 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 (parent)
- China Investment Corporation Limited (ultimate parent)

Significant companies of the bank are; subsidiaries of the bank, subsidiaries and associated companies of the immediate parent company.

Related party transactions occurred between the bank and the London Branch of Bank of China Limited. At 31 December 2017 the bank received £115,381,000 (31 December 2016: £161,926,000) which is 10% (31 December 2016: 14%) 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.

Notes to the Financial Statements (continued)

32. Related parties (continued)

£000	Nature of related party Significant influence	 Significant company
Balance at 31 December 2017		
Cash and cash equivalents	**30,464**	**-**
Loans and advances to banks	**83,706**	**-**
Loans and advances to customers	**-**	**1**
Derivative financial instruments (assets)	**1,459**	**-**
Prepayments, accrued income and other assets	**4,321**	**-**
Deposits from banks	**115,381**	**-**
Deposits from customers	**-**	**10,633**
Derivative financial instrument (liabilities)	**2**	**-**
Other liabilities	**4,247**	**-**
Subordinated liabilities	**60,000**	**-**
Included in the income statement for the period		
Interest receivable	**185**	**-**
Interest payable	**(4,255)**	**-**
Other operating income	**53,742**	**418**
Net gain on derivative financial instruments	**51**	**-**
Balance at 31 December 2016		
Cash and cash equivalents	80,942	-
Loans and advances to banks	-	1
Loans and advances to customers	4	-
Derivative financial instruments	1,498	-
Prepayments, accrued income and other assets	4,603	-
Deposits from banks	161,926	
Deposits from customers	-	10,014
Derivative financial instruments	627	-
Other liabilities	3,615	-
Subordinated liabilities	60,000	-
Included in the income statement for the period		
Interest receivable	110	-
Interest payable	(3,541)	-
Other operating income	52,149	54
Net loss on derivative financial instruments	(1)	-

(b) Investment in non-consolidated subsidiaries

	Country of incorporation	**Ownership interest** **31 December 2017**	 31 December 2016
China Bridge Group (UK) Limited	United Kingdom	100%	100%
China Visa Services Italy SRL[1]	Italy	100%	100%

[1]Indirect holding via China Bridge Group (UK) Limited. The Italian entity has not had its licence renewed and during 2018 the directors will decide on the future of this company.

At 31 December 2017, the bank held an investment of £1 in China Bridge Group (UK) Limited (31 December 2016: £1). This entity is wholly-owned, with registered office at 12 Old Jewry, London, United Kingdom. The bank has availed itself of the consolidation exemption (refer to Note 2) and therefore does not consolidate this subsidiary.

Notes to the Financial Statements (continued)

32. Related parties (continued)

(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 2017 comprised of salaries and other short-term benefits in the amount of £2,039,000 (31 December 2016: £1,540,000).

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

(d) Transactions with key management

The bank has no transactions with key management.

33. Contingent liabilities and commitments

(a) Loan commitments, guarantees and other financial facilities

£000	**31 December 2017**	31 December 2016
Loan commitments	**262,292**	250,115
Guarantees	**29,324**	1,353
Total	**291,616**	251,468

(b) Operating lease commitments

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

£000	**31 December 2017**	31 December 2016
Less than one year	**875**	555
Between one and five years	**2,431**	1,874
More than five years	**1,599**	925
Total	**4,905**	3,354

(c) Legal claims

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 financial statements certain matters have been advised by the purchaser to the bank under this clause. 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 because 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.

34. 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 also taking additional comfort from a two year financial forecast.