

**Bank of China (UK) Limited**

**Annual Report and Financial Statements  
For the year ended 31 December 2018**

Bank of China (UK) Limited  
Financial Statements for the year ended 31 December 2018

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### Chairman's Statement

In 2018, the UK economy showed signs of weakness as the country braces for Brexit. 2018 saw the slowest growth rate since 2009 when the economy was in the midst of the global financial crisis. UK consumer confidence at the end of 2018 was recorded at the lowest level since the Brexit result. A continued slide in the pound was also witnessed in 2018. The UK's labour market was resilient.

With the more challenging UK economic environment, the bank achieved a positive growth in financial performance in 2018, in line with the bank's budget target. The bank experienced an increase of 21.3% in total income to £114.6 million, and an increase of 6.0% in total assets to £1.6 billion by year-end 2018. The bank's profitability continued to increase, with net interest income of £34.2 million, 5.4% higher than last year.

2018 marks the 10th anniversary of the UK-China Economic and Financial Dialogue (EFD) mechanism. With China pursuing high-quality growth that will be driven by innovation, a golden opportunity for the development of China-UK relations is provided as the UK is a world leader in innovation and scientific research. With China opening its market wider, the economic and trade cooperation between the two countries will be further strengthened. This will provide significant business opportunities for the bank, reinforcing its role as the first choice bank in the UK for China related business.

Looking forward, the uncertainties from the UK's withdrawal from the EU are likely to persist for some time and have influences on our business and long-term strategic planning. However, Brexit also provides more business opportunities for Chinese and British companies. A free trade agreement between China and the UK may occur following Brexit. The business environment generally remains uncertain but the Board is confident that the management team will continue to deliver stable performance in the bank's business.

As I start my new role in the group, I wish all the best for my successor Mr Fang. He will play a leading role in enhancing the quality of the bank. With his leadership, the bank will achieve further improvements. I look forward to working closely with Mr Fang.

Yu Sun

Chairman of the Board of Directors

### **Chief Executive Officer's Statement**

The UK economy and business environment has continued to suffer from Brexit-related uncertainties. Although the negotiation between the UK and the EU reached a major milestone in November 2018 with the proposed introduction of the Withdrawal Agreement and Political Declaration agreed by the EU and the UK, there is little clarity over the outcome and terms on which the UK will leave the EU. Both the financial market and business investment have been influenced by mounting uncertainties. Nevertheless, the bank achieved a respectable performance.

The strategic direction of the bank's retail business in the UK remains to be a specialist mortgage lender in the UK market, becoming the top choice for the UK Chinese community and those outgoing Chinese companies with operations in the UK as well as developing our services to UK clients. The bank successfully launched new products in 2018 in support of its continuing policy of achieving prudent organic business in these target market sectors. As a result, retail loans and advances increased from £669 million at 2017 year-end to £768 million at the end of 2018, with a growth rate of 14.8%.

The bank's total assets increased from £1.5 billion as of year-end 2017 to £1.6 billion as of year-end 2018, with a notable increase in total profit after tax from £32.1 million to £51.1 million. Total income increased from £94.5 million at 2017 year-end to £114.6 million at 2018 year-end, which is mostly attributed to higher non-interest income in 2018 which saw a 31.9% increase, from £57.3 million as of year-end 2017 to £76.4 million as of year-end 2018, including a one-off dividend of £10.5 million from its subsidiary company China Bridge Group (UK) Limited. Net interest income rose by 5.4%, to £34.2 million. The bank's business structure remains stable.

I would like to thank Mr Sun for his valuable service and support to the bank. The bank has seen rapid business growth during his tenure, and the bank's image is enhanced in the UK. The bank will introduce further improvement and spare no effort to push forward the implementation of the group's strategy of "building a world-class bank in the new era".

Wenjian Fang

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.

In accordance with Schedule 7 of the Companies Act 2006, reference is made to the existence of the Dublin Branch outside the UK, disclosed in the Strategic Report on page 8.

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 the 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 2019 and beyond, most notably:

- The rate and sustainability of growth in relevant economies, particularly the UK and the Eurozone;
- The impact of the UK's 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;
- The risk of potential decline in property values.

### Dividends

The directors recommend the payment of a dividend of £51,118,000 in 2018 (2017: £31,606,000).

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

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. Wenjian Fang	1	1	-	1
Mr. Yu Sun	4	2	-	2
Mr. Yingxin Gao	-	-	-	-
Mr. Stewart Trussler	4	-	4*	4*
Mrs. Wei Shi	3	-	2*	4
Ms. Li Ren	2	-	-	-
Mr. Jonathan Spence	4	-	4	4
Mr. Charles Hardy	4	4	4	1*
Dr. Gerard Lyons	4	4	-	4

\*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 2018 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 of 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 its 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.

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London  
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On behalf of the Board,



Wenjian Fang  
Chief Executive Officer  
Board Director

8 April 2019

## Strategic report of the Directors

### Business Review

As at 31 December 2018, Bank of China (UK) Limited ("BOC UK" or the "bank") had total assets of £1,630 million (2017: £1,539 million).

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

The bank generated a post-tax profit of £51.1 million during 2018 (2017: £32.1 million). A significant part of the year on year increase relates to a £10.5 million one-off dividend received from its subsidiary company China Bridge Group (UK) Limited and £8.7 million increase in related party service charge.

### Brexit

To address the economic uncertainty in the UK as a result of Brexit, a sensitivity analysis was performed using our IFRS 9 impairment model. The sensitivity analysis assumed a 10% decline in UK commercial and retail property prices from Q4 2019 and is based on an internal risk assessment of the severity of potential Brexit impact and a number of UK based corporate customers either being added to the watchlist or having their credit rating downgraded. The model yielded an increase in the impairment provision of £1.1 million made up of:

	'Brexit' model	Main model	Change
	£000	£000	£000
Stage 1	1,620	802	818
Stage 2	304	70	234
Stage 3	113	48	65
<b>Total</b>	<b>2,037</b>	<b>920</b>	<b>1,117</b>

The change in the model is made up of:

	Property price effect	Customer change effect	Total
	£000	£000	£000
Stage 1	(15)	833	818
Stage 2	51	183	234
Stage 3	0	65	65
<b>Total</b>	<b>36</b>	<b>1,081</b>	<b>1,117</b>

Due to the uncertainty around the assumptions in the sensitivity analysis and the potential timing of any impact, the bank's management have decided that, based on their judgement, they will not utilise an additional management impairment overlay as a result of Brexit.

The bank has assessed the effects of either a hard or soft Brexit in FY 2019 on its operations and future financial performance and has concluded neither scenario will have a material impact.

### Dublin Branch

The Dublin Branch has been operating since July 2017 and is the first branch of Bank of China (UK) Limited in Ireland. The Dublin Branch's main activities focus on corporate lending. It targets Chinese companies operating in Ireland, Irish groups with interests in China and multinationals with large offices in Ireland.

The UK exit from the EU single market means that the Dublin Branch, as a passported entity of BOC UK, can no longer operate unless it obtains authorisation under section 9 of the Central Banking Act 1971 ("CBA 1971") from the Central Bank of Ireland ("CBI"). Should authorisation not be forthcoming, the bank has also applied for an exemption to section 8 of the CBA 1971 to allow it to maintain operations in Ireland, albeit on a limited basis providing only corporate lending. Dublin Branch continues to work with the CBI to explore its options to continue to service Irish customers after Brexit.

## Strategic report of the Directors (continued)

### Retail Banking

In order to implement the group development strategy of “to build BOC into a world-class bank in the new era”, 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 strategic step by step plan as established in 2017.

With strong support from the parent, the bank and Chinese domestic branches have established good relations to promote our cross border business focusing on creating a robust financial services platform. Since the launch of Private Banking Service Centre (London) in 2017, both Platinum Card and Offset Mortgage products have been introduced, whilst the merchant development offering achieved a very positive result. A three-in-one branch management mechanism has been set up, including bi-weekly managers meeting, operational working group and on-site inspection, to lay a solid foundation for our future business development and customer service in 2019 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 establishing 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 consist of Foreign Exchange and Money Market. There was no proprietary trading activity during the year under review. There was focus on efficient liquidity management, the funding requirements of the bank’s activities and bond investments.

### 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 its 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.

**Strategic report of the Directors (continued)**

**Principal Risks and Uncertainties (continued)**

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 monitors its financial performance against financial targets set at the beginning of each year. These are contained in the following table:

	<b>Actual performance</b>	<b>Target performance</b>	<b>Variance</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>
Net interest income	34,206	32,843	1,363
Net fee and commission income	3,964	4,792	(828)
Non-interest income	76,391	57,800	18,591
Total operating expenses	50,469	49,907	562
Profit after tax	51,123	32,478	18,645

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On behalf of the Board,



Wenjian Fang  
Chief Executive Officer  
Board Director

8 April 2019

## 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. The code has recently been updated and takes effect from 1 January 2019; no material change is expected. 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 2018, 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 judgement and scrutiny to decisions taken by the Board, providing objective challenge to management. The Board can draw on the wide range of skills, knowledge and experience they have built up as directors of other companies and as business leaders.

The Governance Code sets out circumstances that the Board may find relevant when determining the independence of a non-executive director. The Board considers that the following 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 business. 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 2018, the Board was provided with regular updates on Corporate Governance and Regulatory Responsibilities.

## Bank of China (UK) Limited Financial Statements for the year ended 31 December 2018

### **Performance Review and Evaluation**

As with the previous year, annual performance contracts were established for the Executive Directors for 2018 to assess their performance across five key performance areas aligned to the bank's 'balanced scorecard' approach to performance management, being:

- Financial;
- Compliance, Risk and Business Processes;
- 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 members of the Board/Committees annually.

The internal Board/Committee 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 with detailed action plans formulated for future implementation.

In addition, an external company was engaged in 2018 to undertake a formal Board Effectiveness Review, including the three Board level committees. This comprised the external company meeting with Board Members, Board level committee members, attending Board and Committee meetings to observe proceedings and preparing a report based on their findings and observations accordingly.

### **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, Chairman and Mr. Charles Hardy are voting members; Mr. Wenjian Fang is a non-voting member. Ms. Tracey Rutherford, Head of Human Resources, ("HR") and Ms. Wen Liu, Deputy Head of Human Resources are non-voting Committee members.

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 six occasions in 2018.

The Committee has 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 staff turnover in the bank, which, while below industry standards, has risen.

### Remuneration Committee Report (continued)

Key activities undertaken in 2018 were reviewing, approving and monitoring of the HR annual work plan which supports the five year strategic plan including:

- Supporting business development initiatives i.e. Dublin Branch;
- Undertaking annual reward programmes;
- Implementation of the Employee Recognition Programme;
- Undertaking the annual performance management process;
- Implementation relevant Learning and Development initiatives;
- Implementation of a Management Development Programme aligned to the bank's succession planning framework;
- 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;
- Undertaking tender processes for flexible benefits and pension providers;
- Review of the headcount budget for 2018 and achievement of headcount increase in alignment with business strategy and staff turnover data throughout 2018 with appropriate actions being taken should anything adverse be noted;
- 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;
- In alignment with the culture strategy implemented by the bank in Q2 2018, implementing new core values to be applied to all staff through the Performance Management process.

To ensure the above was undertaken, two additional unscheduled meetings were held in 2018. There are also a number of priority areas that the Committee plans to continue to focus on in coming meetings, including:

- The Learning and Development plan for 2019 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;
- 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

The Audit Committee comprises two non-executive directors: Mr. Charles Hardy, Chairman, and Mr. Jonathan Spence who are voting members. 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 standing attendees. During 2018, four meetings were held on a quarterly basis. The external auditors attended three of the four 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.

### **Audit Committee Report (continued)**

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, providing recommendation to the group to support their appointment and remuneration of external audit. 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 comprises four directors: Mr. Jonathan Spence, Chairman, Dr. Gerard Lyons and Mr. Wenjian Fang 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, Internal Capital Adequacy Assessment ("ICAAP") and Internal Liquidity Adequacy Assessment ("ILAAP") documents prior to them being presented to the Board for approval.

In addition, during 2018 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](http://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](http://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](http://www.bankofchina.com/uk).

### **Gender Pay**

Further information relating to the bank's Gender Pay Gap will be published on its website [www.bankofchina.com/uk](http://www.bankofchina.com/uk) and the designated government website [www.gov.uk/genderpaygap](http://www.gov.uk/genderpaygap) on 4 April 2019 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 17 to 24, 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.



Wenjian Fang  
Chief Executive Officer  
Board Director  
8 April 2019

## 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 2018 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 2018 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.

### 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

<ul style="list-style-type: none"><li>• Key audit matters</li></ul>	<ul style="list-style-type: none"><li>• Risk of improper recognition of fee and commission on retail loans;</li><li>• Adequacy of the inputs and appropriateness of the assumptions used in calculating ECL;</li><li>• Contingent liabilities relating to legal claims.</li></ul>
<ul style="list-style-type: none"><li>• Materiality</li></ul>	<ul style="list-style-type: none"><li>• Overall materiality of £2.69m which represents 4% of profit before tax.</li></ul>

**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
<p><b>Risk of improper recognition of fee and commission on mortgage loans (2018: £844k, 2017: £874k)</b></p> <p>Refer to the Accounting policies (page 30); and Note 9 of the Financial Statements (page 72)</p> <p>The risk exists around incomplete and/or incorrect historical data used by management to estimate the average useful life of the retail loan, resulting in inappropriate amortisation of fee and commission income over the duration of the loan life.</p>	<p>Our approach focused on:</p> <ul style="list-style-type: none"> <li>• Assessing the design and testing the operating effectiveness of key controls over the calculation and recognition of fee and commission income of retail loans;</li> <li>• Reviewing management assessment of average loan life;</li> <li>• Verifying the accuracy and completeness of the historical data used by management to estimate the average loan life;</li> <li>• Benchmarking the management estimated average loan life of retail loans against the market; and</li> <li>• Recalculating the EIR amortisation of fee and commission income of retail loans during the year.</li> </ul>	<p>As a result of the procedures performed we did not identify any evidence of material misstatement in the recording of fee and commission income. We concluded that the average loan life applied in the calculation is reasonable and representative of the bank's loan portfolio, and that the fees amortised are recognised appropriately.</p>

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

**Key audit matters (continued)**

Risk	Our response to the risk	Key observations communicated to the Audit Committee
<p><b>Adequacy of the inputs and appropriateness of the assumptions used in calculating expected credit loss (ECL) on loans and advances, bond investments and off-balance sheet commitments (2018: £0.9m, 2017: £1.4m (IFRS 9) / £688k (IAS 39))</b></p> <p>Refer to the Accounting policies (page 30); Strategic Report (page 8); Critical estimates and judgements (page 40), Changes in accounting policies and disclosures (page 42); and Note 6 of the Financial Statements (page 43)</p> <p>The risk exists due to the lack of sufficient historical data, and the subjectivity involved in preparing forward-looking information which may impact the ECL. The ECL model incorporates a number of management assumptions including staging criteria, multiple economic scenarios, probability weighting, the amount and timing of future cash flows and collateral values. There is a risk that the assumptions made by management are not appropriate, resulting in misstatement of the ECL.</p>	<p>Our approach focused on:</p> <ul style="list-style-type: none"> <li>• Assessing the design effectiveness of key controls over ECL process;</li> <li>• Reviewing credit assessment files on a sample basis to assess the appropriateness and adequacy of the bank's assessment process and to identify indicators if any significant increase in credit risk since origination;</li> <li>• Reviewing arrears at year-end and assessing whether there are any recoverability considerations;</li> <li>• Identifying concentrations to individual debtors and considering the implications based on the bank's prior experience with those debtors;</li> <li>• Reviewing exposures to particular geographic regions and considering the impact of any sanctions;</li> <li>• Understanding and validating forward-looking assumptions applied;</li> <li>• Engaging internal specialists in reviewing the ECL, PD, LGD and EAD models and assumptions underlying the models;</li> <li>• Verifying the completeness and accuracy of the data used in the model;</li> <li>• Recalculating the ECL based on the model; and</li> <li>• Verifying the IFRS 9 opening balance sheet transitional adjustment through reperforming the underlying calculations and assessing the adequacy and appropriateness of disclosures for compliance with IFRSs, including disclosure of transition from IAS 39, with the support from the technical reviewers.</li> </ul>	<p>Our testing of the model and model assumptions did not identify any evidence of material misstatement in the recording of the ECL. The staging allocation applied by management was assessed as in line with IFRS 9.</p>

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

**Key audit matters (continued)**

**Provision for claims in respect of the Bank of China (Suisse) SA sale agreement (2018: nil, 2017: nil)**

Refer to the Accounting policies (page 40); and Note 33c of the Financial Statements (page 88)

While the existence of legal cases can be confirmed with external legal counsel, there remains a high degree of judgement in the interpretation of the facts in order to arrive at a conclusion as to whether a contingent liability or provision should be recorded.

Our approach focused on:

- Confirming directly with the 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 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.

As a result of the procedures performed we concur with management assessment of the disclosure of a contingent liability in the financial statements.

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In the prior year, our auditor's report included a key audit matter in relation to improper recognition of fee and commission income. This matter related to revenue recognition across all significant revenue streams. In the current year, we have revised the key audit matter to focus specifically on revenue streams most subject to risk, being the amortisation of fee and commission income on mortgage loans which involves a degree of judgement and management estimation.

In the prior year, our auditor's report also included a key audit matter in relation to inadequate provisions for impaired loans and advances. Given IFRS 9 became effective in 2018, we have tailored the risk in line with the new approach.

## **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 our audit scope for the bank. This enables us to form an opinion on the financial statements. We take into account size, risk profile, the organisation of the bank and effectiveness of controls, including 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 Limited, 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 identified misstatements 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 materiality for the Company to be £2.69 million (2017: £2.65 million), which is 4% (2017: 6%) of profit before tax. 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.

During the course of our audit, we reassessed initial materiality and determined that no changes were necessary in the final materiality basis from our original assessment at planning.

#### **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, together with our assessment of the bank's overall control environment, our judgement was that performance materiality was 75% (2017: 75%) of our planning materiality, namely £2.02m (2017: £1.99m). We have set performance materiality at this percentage based on our understanding of the entity and past experience of executing the audit.

#### **Reporting threshold**

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

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.14m (2017: £0.13m), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate 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, 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 strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and directors' report 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 strategic report or directors' 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 directors' responsibilities statement set out on page 16, 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.

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 entity 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 is complying with those 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 process.
- 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. Our procedures involved 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 Financial Reporting Council's website at <https://www.frc.org.uk/auditorsresponsibilities>. This description forms part of our auditor's report.

**Other matters we are required to address**

- We were appointed by the bank on 11 October 2013 to audit the financial statements for the year ending 31 December 2013 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments is 6 years, covering the years ending 2013 to 2018.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the bank and we remain independent of the bank in conducting the audit.
- The audit opinion is consistent with the additional report to the audit committee.

Bank of China (UK) Limited  
Financial Statements for the year ended 31 December 2018

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

**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.

*Ernst & Young LLP*

Helen Joseph (Senior statutory auditor)  
for and on behalf of Ernst & Young LLP,  
London  
9 April 2019

Bank of China (UK) Limited  
 Financial Statements for the year ended 31 December 2018

**Income Statement**

£000	Note	12 months to 31 December 2018	12 months to 31 December 2017
Interest income from financial investments		116	788
Other interest income		40,643	37,446
Interest expense		(6,553)	(5,788)
<b>Net interest income</b>	8	<b>34,206</b>	<b>32,446</b>
Gross fee and commission income		4,850	5,502
Gross fee and commission expense		(886)	(813)
<b>Net fee and commission income</b>	9	<b>3,964</b>	<b>4,689</b>
Net fair value gain (loss) on financial instruments	10	(331)	51
Foreign exchange gain		3,167	2,593
Other operating income	11	73,555	54,704
<b>Non-interest income</b>		<b>76,391</b>	<b>57,348</b>
<b>Total income</b>		<b>114,561</b>	<b>94,483</b>
Staff costs	12	(41,868)	(41,365)
Other expenses	13	(7,857)	(7,870)
Depreciation of plant and equipment	22	(691)	(794)
Amortisation of intangible assets	23	(53)	(45)
Impairment releases	20	458	187
<b>Profit before income tax</b>		<b>64,550</b>	<b>44,596</b>
Income tax expense	15	(13,427)	(12,532)
<b>Profit for the year</b>		<b>51,123</b>	<b>32,064</b>

Bank of China (UK) Limited  
 Financial Statements for the year ended 31 December 2018

**Statement of Other Comprehensive Income**

£000	Note	12 months to 31 December 2018	12 month to 31 December 2017
<b>Profit for the year</b>		<b>51,123</b>	<b>32,064</b>
<b>Other comprehensive income</b>			
<b>Amounts that will be reclassified to the income statement</b>			
Net change in fair value of available for sale financial assets		-	420
Income and deferred tax credit relating to components of other comprehensive income	15	-	(104)
<b>Other comprehensive income for the year, net of income and deferred tax credit or expense</b>		<b>-</b>	<b>316</b>
<b>Total comprehensive income for the year</b>		<b>51,123</b>	<b>32,380</b>

Bank of China (UK) Limited  
Financial Statements for the year ended 31 December 2018

**Statement of Financial Position**

£000	Note	31 December 2018	31 December 2017
<b>Assets</b>			
Cash and cash equivalents	16	333,275	281,944
Loans and advances to banks	18	61,391	83,706
Loans and advances to customers	19	1,044,570	1,054,454
Derivative financial instruments	17	1,344	1,717
Prepayments, accrued income and other assets	25	6,273	5,204
Financial assets at fair value through profit and loss	21(a)	76,171	-
Debt instruments at amortised cost	21(b)	103,189	-
Available for sale financial investments	21(a)	-	12
Held to maturity financial investments	21(c)	-	107,478
Deferred tax assets	24	1,546	1,462
Property, plant and equipment	22	2,761	3,149
Intangible assets	23	462	95
Investment in subsidiary companies	32	-	-
<b>Total assets</b>		<b>1,630,982</b>	<b>1,539,221</b>
<b>Liabilities</b>			
Deposits from banks	26	102,919	123,122
Deposits from customers	27	1,107,439	1,019,007
Derivative financial instruments	17	1,977	257
Other liabilities	29	21,359	20,158
Accruals and deferred income	30	6,207	4,176
Current corporation tax liabilities		4,908	5,447
Impairment provision on off balance sheet products		97	-
Subordinated liabilities	28	60,000	60,000
<b>Total liabilities</b>		<b>1,304,906</b>	<b>1,232,167</b>
<b>Equity</b>			
	31		
Authorised and called up share capital		250,000	250,000
Retained earnings		76,076	57,022
Available for sale reserve		-	32
<b>Total shareholders' equity</b>		<b>326,076</b>	<b>307,054</b>
<b>Total shareholders' equity and liabilities</b>		<b>1,630,982</b>	<b>1,539,221</b>

The financial statements on pages 25 to 88 were approved by the Board of Directors of Bank of China (UK) Limited and authorised for issue on 3 April 2019. They were signed on its behalf by:



Wenjian Fang  
Chief Executive Officer  
Board Director

Bank of China (UK) Limited  
 Financial Statements for the year ended 31 December 2018

**Statement of Changes in Equity**

£000	Issued share capital	Retained earnings	Available for sale reserve	Total
<b>As of 1 January 2018</b>	<b>250,000</b>	<b>57,022</b>	<b>32</b>	<b>307,054</b>
<b>Impact of adopting IFRS 9 (Note 6 (a))</b>	<b>-</b>	<b>(463)</b>	<b>(32)</b>	<b>(495)</b>
<b>Restated opening balance under IFRS 9</b>	<b>250,000</b>	<b>56,559</b>	<b>-</b>	<b>306,559</b>
<b>Profit for the financial year</b>	<b>-</b>	<b>51,123</b>	<b>-</b>	<b>51,123</b>
<b>Total comprehensive income</b>	<b>-</b>	<b>51,123</b>	<b>-</b>	<b>51,123</b>
<b>Dividend paid</b>	<b>-</b>	<b>(31,606)</b>	<b>-</b>	<b>(31,606)</b>
<b>As at 31 December 2018</b>	<b>250,000</b>	<b>76,076</b>	<b>-</b>	<b>326,076</b>
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

**Statement of Cash Flows**

£000	Note	12 months to 31 December 2018	12 months to 31 December 2017
<b>Cash flows from operating activities</b>			
Profit on ordinary activities before taxation		64,550	44,596
Adjustments for non cash items			
Depreciation and amortisation of plant and equipment and intangible assets		744	839
Net impairment gain on loans and advances		(458)	(187)
Interest receivable from financial investments		-	(692)
Other interest receivable		(41,792)	(38,599)
Interest payable		6,553	5,788
Net gain on sale of available for sale investments		-	45
(Loss) gain on disposal of fixed assets		(1)	1
Amortisation of premiums of debt instruments at amortised cost/held-to-maturity investment		116	96
Other income receivable		-	(504)
Changes in operating assets and liabilities			
Change in derivative financial instruments assets held for risk management		372	2,860
Change in loans and advances to banks		22,315	(59,436)
Change in loans and advances to customers		(31,910)	105,429
Change in financial assets at amortised cost/fair value		(30,262)	-
Change in other assets		2,055	574
Change in derivative financial instruments liabilities held for risk management		1,720	(3,893)
Change in deposits from banks		(20,203)	(41,727)
Change in deposits from customers		88,432	36,646
Change in other liabilities and provisions		(793)	6,672
Adjustment for cash items			
Interest and coupon received		40,643	37,848
Dividend paid		(31,606)	(35,690)
Interest paid		(4,522)	(7,487)
Income tax paid		(13,859)	(16,749)
<b>Net cash generated from operating activities</b>		<b>52,094</b>	<b>36,430</b>
<b>Cash flows from investing activities</b>			
Acquisition of investment securities		-	(106,425)
Proceeds from maturity of investment securities		-	40,708
Acquisition of property and equipment		(318)	(668)
Acquisition of intangible assets		(419)	(18)
<b>Net cash from investing activities</b>		<b>(737)</b>	<b>(66,403)</b>
<b>Net cash from financing activities</b>			
		-	-
<b>Net increase (decrease) in cash and cash equivalents</b>		<b>51,357</b>	<b>(29,973)</b>
Cash and cash equivalents at beginning of period		281,944	311,917
Current year reclassification adjustments*		(26)	-
<b>Cash and cash equivalents at year end</b>	<b>16</b>	<b>333,275</b>	<b>281,944</b>

\*This balance relates to illiquid assets and has therefore been reclassified to other assets. The statement of cash flows has been prepared under the indirect method.

**Notes to the Financial Statements**

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## 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 bank and not its subsidiaries.

#### Accounting policies for the year ended 31 December 2018

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 from Section 401 of the Companies Act 2006 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 3 April 2019.

#### (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 (in the prior year).

#### (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

The bank calculates interest income by applying the effective interest rate to the gross carrying amount of financial assets other than credit-impaired assets. 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 contractual 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. When a financial asset becomes credit-impaired (as set out in Note 6 (a)) and is, therefore, regarded as stage 3, the bank calculates interest income by applying the effective interest rate to the net amortised cost of the financial asset. If financial assets cure (as outlined in Note 6 (a)) and are no longer credit-impaired, the bank reverts to calculating interest income on a gross basis.

Interest income on all trading assets and financial assets mandatorily required to be measured at fair value through profit and loss (FVPL) is recognised using the contractual interest rate in net trading income and net gains/(losses) on financial assets at fair value through profit or loss, respectively.

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.

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 bank's revenue streams have been reviewed to assess the impact of the new accounting guidance on its disclosures. Fee and commission income that falls outside the scope of IFRS 15, consists of contractual performance obligations with retail and corporate lending fee income recognized using the effective interest rate method (see above). Fee and commission income in scope of IFRS 15 is assessed using a product driven approach and depicted in the table contained in Note 9. Income is recorded at the point in time when the service is performed or amortised over the service period.

Revenue streams categorised under other operating income, interest income, foreign exchange gain and interest income from financial investments have been assessed as outside the scope of IFRS 15 as they are governed by alternative accounting standards, predominantly IFRS 9 Financial Instruments and IAS 21 The Effects of Changes in Foreign Exchange Rates.

## Notes to the Financial Statements (continued)

### 3. Significant accounting policies (continued)

#### (b) Derivative financial instruments

Derivative instruments are held for risk management purposes and do not qualify for hedge accounting according to IAS 39 or IFRS 9. 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 (loss) on financial instruments.

#### (c) 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.

#### (d) Impairment of financial assets accounted for at amortised cost (policy applicable up to 31 December 2017)

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.

#### (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.

From 1 January 2018, the bank only measures amounts due from banks, loans and advances to customers and other financial investments at amortised cost if both of the following conditions are met:

- The financial asset is held within a business model with the objective to hold financial assets in order to collect contractual cash flows;
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding.

The details of these conditions are outlined below.

## Notes to the Financial Statements (continued)

### 3. Significant accounting policies (continued)

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

##### Business model assessment

The bank determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective.

The bank's business model is not assessed on an instrument-by-instrument basis, but at a higher level of aggregated portfolios and is based on observable factors such as:

- How the performance of the business model and the financial assets held within that business model are evaluated and reported to the entity's key management personnel;
- The risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed;
- How managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected);
- The expected frequency, value and timing of sales are also important aspects of the bank's assessment.

The business model assessment is based on reasonably expected scenarios without taking 'worst case' or 'stress case' scenarios into account. If cash flows after initial recognition are realised in a way that is different from the bank's original expectations, the bank does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

##### The SPPI test

As a second step of its classification process, the bank assesses the contractual terms of financial assets to identify whether they meet the SPPI test.

'Principal' for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (for example, if there are repayments of principal or amortisation of the premium/discount).

The most significant elements of interest within a lending arrangement are typically the consideration for the time value of money and credit risk. To make the SPPI assessment, the bank applies judgement and considers relevant factors such as the period for which the interest rate is set.

In contrast, contractual terms that introduce a more than de minimis exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement do not give rise to contractual cash flows that are solely payments of principal and interest on the amount outstanding. In such cases, the financial asset is required to be measured at FVPL.

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.

## Notes to the Financial Statements (continued)

### 3. Significant accounting policies (continued)

#### (g) Debt instruments at fair value through other comprehensive income (FVOCI)

The bank applies the new category under IFRS 9 of debt instruments measured at FVOCI when both of the following conditions are met:

- The instrument is held within a business model, the objective of which is achieved by both collecting contractual cash flows and selling financial assets;
- The contractual terms of the financial asset meet the SPPI test.

These instruments largely comprise assets that had previously been classified as financial investments available for sale under IAS 39.

FVOCI debt instruments are subsequently measured at fair value with gains and losses arising due to changes in fair value recognised in other comprehensive income (OCI). Interest income and foreign exchange gains and losses are recognised in profit or loss in the same manner as for financial assets measured at amortised cost as explained in Note 3 (d). The expected credit loss (ECL) calculation for debt instruments at FVOCI is explained in Note 3 (i). Where the bank holds more than one investment in the same security, they are deemed to be disposed of on a first-in first-out basis. On derecognition, cumulative gains or losses previously recognised in OCI are reclassified from OCI to profit or loss.

#### (h) 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 total facility.

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 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.

From 1 January 2018, both undrawn loan commitments and guarantees are within the scope of IFRS 9 and ECL requirements are applied to them.

#### (i) Impairment of financial assets (policy applicable from 1 January 2018)

##### Overview of the expected credit loss principles (ECL)

From 1 January 2018, the bank has been recording the allowance for expected credit losses for all loans and other debt financial assets not held at FVPL, together with undrawn loan commitments and financial guarantee contracts, in this section all referred to as 'financial instruments'. Equity instruments are not subject to impairment under IFRS 9.

The ECL allowance is based on the credit losses expected to arise over the life of the asset (the lifetime expected credit loss or LTECL), unless there has been no significant increase in credit risk since origination, in which case, the allowance is based on 12 months expected credit loss (12mECL) as outlined below. The bank's policies for determining if there has been a significant increase in credit risk are set out in Note 4 (b).

The 12mECL is the portion of LTECLs that represent the ECLs that result from default events on a financial instrument that are possible within the 12 months after the reporting date.

Both LTECLs and 12mECLs are calculated on either an individual basis or a collective basis, depending on the nature of the underlying portfolio of financial instruments. The Bank's policy for grouping financial assets measured on a collective basis is explained in Note 6 (a).

The bank has established a policy to perform an assessment, at the end of each quarter, of whether a financial instrument's credit risk has increased significantly since initial recognition, by considering the change in the risk of default occurring since initial recognition of the financial instrument.

## Notes to the Financial Statements (continued)

### 3. Significant accounting policies (continued)

#### Overview of the Expected Credit Loss (ECL) principles (continued)

Based on the above process, the bank groups its loans into stage 1, stage 2 and stage 3 (refer to the calculation of ECLs below). For financial assets for which the bank has no reasonable expectations of recovering either the entire outstanding amount, or a proportion thereof, the gross carrying amount of the financial asset is reduced. This is considered a (partial) derecognition of the financial asset.

#### The calculation of ECLs – General Policy

The bank calculates ECLs based on a three probability-weighted scenarios to measure the expected cash shortfalls, discounted at an approximation to the effective interest rate (EIR). A cash shortfall is the difference between the cash flows that are due to an entity in accordance with the contract and the cash flows that the entity expects to receive.

The mechanics of the ECL calculations are outlined below and the key elements are, as follows:

- PD (Probability of Default) is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period, if the facility has not been previously derecognised and is still in the portfolio;
- EAD (Exposure at Default) is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, whether scheduled by contract or otherwise, expected drawdowns on committed facilities, and accrued interest from missed payments;
- LGD (Loss Given Default) is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from the realisation of any collateral. It is usually expressed as a percentage of the EAD.

When estimating the ECLs, the bank considers three scenarios (a base case, an upside, a downside). Each of these is associated with different PDs, EADs and LGDs. When relevant, the assessment of multiple scenarios also incorporates how defaulted loans are expected to be recovered, including the probability that the loans will cure and the value of collateral or the amount that might be received for selling the asset.

With the exception of credit cards and other revolving facilities, for which the treatment is separately set out on page 37, the maximum period for which the credit losses are determined is the contractual life of a financial instrument unless the bank has the legal right to call it earlier.

Provisions for ECLs for undrawn loan commitments are assessed as set out on page 37. The calculation of ECLs (including the ECLs related to the undrawn element) of revolving facilities such as credit cards is explained further on page 37.

The mechanics of the ECL method are summarised below:

- Stage 1: When loans are first recognised, the bank recognises an allowance based on 12mECLs. Stage 1 loans also include facilities where the credit risk has improved and the loan has been reclassified from Stage 2. The 12mECL is calculated as the portion of LTECLs that represent the ECLs that result from default events on a financial instrument that are possible within the 12 months after the reporting date. The bank calculates the 12mECL allowance based on the expectation of a default occurring in the 12 months following the reporting date. These expected 12-month default probabilities are applied to a forecast EAD and multiplied by the expected LGD and discounted by an approximation to the original EIR. This calculation is made for each of the three scenarios, as explained above;
- Stage 2: When a loan has shown a significant increase in credit risk since origination, the bank records an allowance for the LTECLs. Stage 2 loans also include facilities, where the credit risk has improved and the loan has been reclassified from Stage 3. The mechanics are similar to those explained above, including the use of multiple scenarios, but PDs and LGDs are estimated over the lifetime of the instrument. The expected cash shortfalls are discounted by an approximation to the original EIR;
- Stage 3: The bank recognises the lifetime expected credit losses for these loans (LTECLs). The method is similar to that for Stage 2 assets, with the PD set at 100%.

## Notes to the Financial Statements (continued)

### 3. Significant accounting policies (continued)

- Undrawn loan commitments and letters of credit

When estimating ECLs for undrawn loan commitments, the bank estimates the expected portion of the loan commitment that will be drawn down over its expected life. The ECL is then based on the present value of the expected shortfalls in cash flows if the loan is drawn down, based on a probability-weighting of the three scenarios. The expected cash shortfalls are discounted at an approximation to the expected EIR on the loan.

For credit cards and revolving facilities that include both a loan and an undrawn commitment, ECLs are calculated and presented together with the loan. For undrawn loan commitments and letters of credit, the ECL is recognised within provisions as separately disclosed on the liabilities side of the financial position.

- Financial guarantee contracts

The bank's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the income statement, and the ECL provision. For this purpose, the bank estimates ECLs based on the present value of the expected payments to reimburse the holder for a credit loss that it incurs. The shortfalls are discounted by the risk-adjusted interest rate relevant to the exposure. The calculation is made using a probability-weighting of the three scenarios. The ECLs related to financial guarantee contracts are recognised within provisions.

#### The calculation of ECLs - Credit cards and other revolving facilities

The bank's product offering includes a variety of corporate and retail overdraft and credit cards facilities, in which the bank has the right to cancel and/or reduce the facilities with one day's notice. The bank does not limit its exposure to credit losses to the contractual notice period, but, instead calculates ECL over a four year period which reflects the bank's expectations of the customer behaviour, its likelihood of default and the bank's future risk mitigation procedures, which could include reducing or cancelling the facilities.

The ongoing assessment of whether a significant increase in credit risk has occurred for revolving facilities is similar to other lending products. This is based on shifts in the customer's internal credit grade, as explained in Note 6 (a), but greater emphasis is also given to qualitative factors such as changes in usage.

The interest rate used to discount the ECLs for credit cards is based on the average effective interest rate that is expected to be charged over the expected period of exposure to the facilities. This estimation takes into account that many facilities are repaid in full each month and are consequently charged no interest.

The calculation of ECLs, including the estimation of the expected period of exposure and discount rate is made, as explained above, on credit cards and account overdrafts.

#### Forward looking information

In its ECL models, the bank relies on a broad range of forward looking information as economic inputs, such as:

- GDP growth;
- Unemployment rates;
- Central Bank base rates;
- House price indices.

The inputs and models used for calculating ECLs may not always capture all characteristics of the market at the date of the financial statements. To reflect this, qualitative adjustments or overlays are occasionally made as temporary adjustments when such differences are significantly material. Detailed information about these inputs and sensitivity analysis are provided in Note 6 (a).

## Notes to the Financial Statements (continued)

### 3. Significant accounting policies (continued)

#### Collateral valuation

To mitigate its credit risks on financial assets, the bank seeks to use collateral, where possible. The collateral comes in various forms, such as cash, securities, letters of credit/guarantees, real estate, receivables, inventories, other non-financial assets and credit enhancements such as netting agreements. The bank's accounting policy for collateral assigned to it through its lending arrangements under IFRS 9 is the same as it was under IAS 39. Collateral, unless repossessed, is not recorded on the bank's statement of financial position. However, the fair value of collateral affects the calculation of ECLs. It is generally assessed, at a minimum, at inception and re-assessed on a quarterly basis. However, some collateral, for example, cash or securities relating to margining requirements, is valued daily. Details of the impact of the bank's various credit enhancements are disclosed in Note 6 (a).

To the greatest extent possible, the bank uses active market data for valuing financial assets held as collateral. Other financial assets which do not have readily determinable market values are valued using models. Non-financial collateral, such as real estate, is valued based on housing price indices.

#### Collateral repossessed

The bank's accounting policy under IFRS 9 remains the same as it was under IAS 39 i.e. to determine whether a repossessed asset can be best used for its internal operations or should be sold. Assets determined to be useful for internal operations are transferred to their relevant asset category at the lower of their repossessed value or the carrying value of the original secured asset. Assets for which selling is determined to be a better option are transferred to assets held for sale at their fair value (if financial assets) and fair value less cost to sell for non-financial assets at the repossession date in line with the bank's policy.

In its normal course of business, the bank does not physically repossess properties or other assets in its retail portfolio, but engages external agents to recover funds, generally at auction, to settle outstanding debt. Any surplus funds are returned to the customers/obligors. As a result of this practice, the residential properties under legal repossession processes are not recorded on the balance sheet.

#### Write-offs

The bank's accounting policy under IFRS 9 remains the same as it was under IAS 39. Financial assets are written off either partially or in their entirety only when the bank has stopped pursuing recovery. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to credit loss expense.

#### Forborne and modified loans

The bank does not make any concessions or modifications to the original terms of loans as a response to the borrower's financial difficulties.

#### (j) Derecognition of financial liabilities

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

## Notes to the Financial Statements (continued)

### 3. Significant accounting policies (continued)

#### (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.

#### (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.

## Notes to the Financial Statements (continued)

### 3. Significant accounting policies (continued)

#### (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

##### Defined contribution plans

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

##### 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. The bank makes contributions, to make good any shortfall between the value of scheme assets and pension obligations and there are no contractual arrangements for charging the net defined benefit cost for this plan (refer to Note 29 (b)). The scheme is now closed to future accrual.

#### (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

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.

## Notes to the Financial Statements (continued)

### 4. Critical estimates and judgements (continued)

#### (a) Impairment losses on financial assets

The measurement of impairment losses both under IFRS 9 and IAS 39 across all categories of financial assets requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances.

The bank's ECL calculations are outputs from complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgements and estimates include:

- The bank's internal credit grading model, which assigns PDs to the individual grades;
- The bank's criteria for assessing if there has been a significant increase in credit risk and so allowances for financial assets should be measured on a LTECL basis and the qualitative assessment;
- The segmentation of financial assets when their ECL is assessed on a collective basis;
- Development of ECL models, including the various formulae and the choice of inputs;
- Determination of associations between macroeconomic scenarios and, economic inputs, such as unemployment levels and collateral values, and the effect on PDs, EADs and LGDs;
- Selection of forward-looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models.

#### (b) Determining a significant increase in credit risk since initial recognition

IFRS 9 requires the recognition of 12 months expected credit losses (the portion of lifetime expected credit losses from default events that are expected within 12 months of the reporting date) if credit risk has not significantly increased since initial recognition (stage 1), and lifetime expected credit losses for financial instruments for which the credit risk has increased significantly since initial recognition (stage 2) or which are credit impaired (stage 3). The bank assesses when a significant increase in credit risk has occurred based on quantitative and qualitative assessments. Exposures are considered to have resulted in a significant increase in credit risk and are moved to stage 2 when:

- Quantitative Test

The annualised cumulative weighted average lifetime PD has increased by more than the agreed threshold relative to the equivalent at origination. The relative thresholds are defined as percentage increases and set at an origination score band and segment level.

- Qualitative Test

Accounts that meet the portfolio's 'high risk' criteria and are subject to closer credit monitoring.

- Backstop Criteria

Accounts that are 30 days past due. The past due criteria is a backstop rather than a primary driver of moving exposures into stage 2.

Exposures move back to stage 1 once they no longer meet the criteria for a significant increase in credit risk and when any cure criteria used for credit risk management are met. This is subject to all payments being up to date and the customer evidencing ability and willingness to maintain future payments. Staging for accounting purposes is aligned with the management of credit risk.

## Notes to the Financial Statements (continued)

### 4. Critical estimates and judgements (continued)

Determining the probability of default at initial recognition requires management estimates, in particular for exposures issued before the effective date of IFRS 9. For certain revolving facilities such as credit cards and overdrafts, this is when the facility was first entered into which could be a long time in the past.

Management overlays and other exceptions to model outputs are applied only if consistent with the objective of identifying significant increases in credit risk.

For the IFRS 9 impairment assessment, the bank's impairment models are used to determine the PD, LGD and EAD. For stage 2 and 3, the bank applies lifetime PDs but uses 12 month PDs for stage 1. The ECL drivers of PD, EAD and LGD are modelled at an account level which considers vintage, among other credit factors. Also, the assessment of significant increase in credit risk is based on the initial lifetime PD curve, which accounts for the different credit risk underwritten over time.

#### (c) Definition of default

According to the IFRS9 guideline, a facility is generally considered as default when the facility is 90 days past due.

#### (d) Expected life

Lifetime expected credit losses must be measured over their expected life. This is restricted to the maximum contractual life and takes into account expected prepayment, extension, call and similar options. The exceptions are certain revolver financial instruments, such as credit cards and bank overdrafts, that include both a drawn and an undrawn component where the entity's contractual ability to demand repayment and cancel the undrawn commitment does not limit the entity's exposure to credit losses to the contractual notice period. The expected life for these revolver facilities is their behavioural life. Where data is insufficient or analysis inconclusive, an additional 'maturity factor' may be incorporated to reflect the full estimated life of the exposures, based upon experienced judgement and/or peer analysis. Potential future modifications of contracts are not taken into account when determining the expected life or exposure at default until they occur.

### 5. Changes in accounting policies and disclosures

#### New and amended standards and interpretations

In these financial statements, the bank has applied IFRS 9, IFRS 15 and IFRS 7R, effective for annual periods beginning on or after 1 January 2018, for the first time.

#### IFRS 9 Financial Instruments

IFRS 9 replaces IAS 39 for annual periods starting on or after 1 January 2018. The bank has not restated comparative information for 2017 for financial instruments in scope of IFRS 9. Differences arising from the adoption of IFRS 9 have been recognised directly in retained earnings as of 1 January 2018 and are disclosed in Note 6 (a)(viii) Statement of Financial Position - IFRS 9 transition disclosure.

#### Changes to classification and measurement

To determine their classification and measurement category, IFRS 9 requires all financial assets, except financial assets measured at fair value through profit or loss, to be assessed based on a combination of the bank's business model for managing the assets and the instruments' contractual cash flow characteristics.

The IAS 39 measurement categories of financial assets [fair value through profit or loss (FVPL), available for sale (AFS), held-to-maturity and loans and receivables] have been replaced by:

- Debt instruments at amortised cost;
- Debt instruments at fair value through other comprehensive income (FVOCI), with gains or losses recycled to profit or loss on derecognition;
- Equity instruments at FVOCI, with no recycling of gains or losses to profit or loss on derecognition;
- Financial assets FVPL.

Accounting for financial liabilities remains the same as it was under IAS 39 with no changes impacting the bank.

## Notes to the Financial Statements (continued)

### 5. Changes in accounting policies and disclosures (continued)

#### Changes to the impairment calculation

The adoption of IFRS 9 has fundamentally changed the bank's accounting for loan loss impairments by replacing IAS 39's incurred loss approach with a forward-looking expected credit loss (ECL) approach. IFRS 9 requires the bank to record an allowance for ECLs for all loans and other debt financial assets not held at FVPL, together with undrawn loan commitments and financial guarantee contracts. The allowance is based on the ECLs associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination. If the financial asset meets the definition of purchased or originated credit impaired (POCI), the allowance is based on the change in the ECLs over the life of the asset.

Details of the bank's impairment method are disclosed in Note 6.

#### IFRS 7R

To reflect the differences between IFRS 9 and IAS 39, IFRS 7 Financial Instruments: Disclosures was updated and the bank has adopted it, together with IFRS 9, for the year beginning 1 January 2018. Changes include transition disclosures as shown in Note 6 (a) (viii) Statement of Financial Position - IFRS 9 transition disclosure and detailed qualitative and quantitative information about the ECL calculations such as the assumptions and inputs used as set out in Note 6 (a).

Reconciliations from opening to closing ECL allowances are presented in Note 6.

#### IFRS 15

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 as set out in Note 3 (a).

#### Issued but not effective until the year beginning 1 January 2019 and not early adopted.

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 with a number of recognition exemptions and also practical expedients permitted in the transition period, including having 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 income statement. IFRS 16 is effective for annual periods beginning on or after 1 January 2019 and the bank does not intend to early adopt. As lessee the bank will:

- Apply IFRS 16 to contracts that were previously identified as leases when applying IAS 17;
- Not apply IFRS 16 to contracts not previously identified as containing a lease when applying IAS 17;
- Apply IFRS 16 retrospectively with the cumulative effect recognised at the date of initial recognition, not requiring restatement of comparative information;
- Measure the right-of-use asset at an amount equal to the lease liability.

The measurement of the lease liability and corresponding right-of-use asset will be recognised on the date of initial application at 1 January 2019. Under this method, there is no impact to equity on first time application of IFRS 16 as the amount to be recognised for lease liabilities and right-to-use assets will be the same. Based on 31 December 2018 data and the current implementation status of IFRS 16, the bank estimates the adoption of IFRS 16 to result in the recognition of lease liabilities and corresponding right-of-use assets of approximately £7,920,000 on 1 January 2019.

### 6. Financial risk management

#### Introduction and overview

The bank has exposure to the following risks from financial instruments:

- Credit risk
- Liquidity risk
- Market risk
- Capital management

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"), Compliance, Business Continuity, 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)

##### 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.

#### (i) Impairment assessment (policy applicable from 1 January 2018)

The references below show where the bank's impairment assessment and measurement approach is set out in these financial statements. It should be read in conjunction with the summary of significant accounting policies.

- The bank's definition and assessment of default and cure;
- An explanation of the bank's internal grading system;
- How the bank defines, calculates and monitors the probability of default, exposure at default and loss given default) (Note 3 (i));
- When the bank considers there has been a significant increase in credit risk of an exposure;
- The bank's policy of segmenting financial assets where ECL is assessed on a collective basis;
- The details of the ECL calculations for stage 1, stage 2 and stage 3 assets.

The bank has not changed its risk appetite nor its risk management strategy as a consequence of the change in timing of reporting credit losses. Although management review the ECL information, they do not base any risk management nor economic capital decisions allocation on it due to other existing and robust governance processes in place.

#### (ii) Definition of default and cure

The bank considers a financial instrument defaulted and therefore stage 3 (credit-impaired) for ECL calculations in all cases when the borrower becomes 90 days past due on its contractual payments.

As a part of a qualitative assessment of whether a customer is in default, the bank also considers a variety of instances that may indicate unlikelihood to pay. When such events occur, the bank carefully considers whether the event should result in treating the customer as defaulted and therefore assessed as stage 3 for ECL calculations or whether stage 2 is appropriate. Such events include:

- Internal rating of the borrower indicating default or near-default;
- The borrower requesting emergency funding from the bank;
- The borrower is deceased;
- A material decrease in the underlying collateral value where the recovery of the loan is expected from the sale of the collateral;
- A material decrease in the borrower's turnover or the loss of a major customer;
- A covenant breach not waived by the bank;
- The debtor (or any legal entity within the debtor's group) filing for bankruptcy application/protection.

IFRS9 does not specify or require any cure period and therefore the bank has opted not to have one. Loans are assessed for creditworthiness on a monthly basis and when a loan moves from unrecoverable to recoverable, the bank moves the loans from stage 3 back into stage 2 and if the loan no longer shows any significant increase in credit risk, the bank moves the loans from stage 2 back into stage 1.

## Notes to the Financial Statements (continued)

### 6. Financial risk management (continued)

#### (a) Credit risk (continued)

##### (ii) Definition of default and cure (continued)

IFRS 9 contains a rebuttable presumption that default occurs no later than when a payment is 90 days past due. The bank uses this 90 day backstop for all its products except for mortgages. For mortgages, the bank has assumed a backstop of 180 days past due as mortgage exposures more than 90 days past due, but less than 180 days, typically show high cure rates and this aligns to the bank's risk management practices.

There is no difference between the accounting definition of default, the definition used for internal credit risk management purposes and the regulatory definition of default.

##### (iii) The bank's internal rating and PD estimation process

The bank's independent Credit Management Department operates its internal rating models for corporate lending. The model incorporates both qualitative and quantitative information and, in addition to information specific to the borrower, utilise supplemental external information that could affect the borrower's behaviour. Where practical, they also build on information from Standard and Poor's Rating Agency. These information sources are first used to determine the PDs within the bank's Basel III framework. The internal credit grades are assigned based on these Basel III grades. PDs are then adjusted for IFRS 9 ECL calculations to incorporate forward looking information and the IFRS 9 stage classification of the exposure. This is repeated for each economic scenario as appropriate. Retail lending, which includes mortgages, does not have internal ratings and data is based on historical past due data.

#### Treasury, trading and interbank relationships

The bank's treasury, trading and interbank relationships and counterparties comprise financial services institutions and banks. For these relationships, the bank's credit management department analyses publicly available information such as financial information and other external data, e.g. the rating of Standard and Poor's Rating Agency, and assigns the internal rating, as shown in the table on the next page.

#### Corporate lending

For corporate lending, the borrowers are assessed by specialised credit risk employees of the bank. The credit risk assessment is based on a credit scoring model that takes into account various historical, current and forward-looking information such as:

- Historical financial information together with forecasts and budgets prepared by the client. This financial information includes realised and expected results, solvency ratios, liquidity ratios and any other relevant ratios to measure the client's financial performance. Some of these indicators are captured in covenants with the clients and are, therefore, measured with greater attention;
- Any publicly available information on the clients from external parties. This includes external rating grades issued by rating agencies, independent analyst reports, publicly traded bond or CDS prices or press releases and articles;
- Any macro-economic or geopolitical information, e.g. GDP growth relevant for the specific industry and geographical segments where the client operates;
- Any other objectively supportable information on the quality and abilities of the client's management relevant for the company's performance.

The complexity and granularity of the rating techniques varies based on the exposure of the bank and the complexity and size of the customer.

#### Retail lending

Retail lending comprises unsecured personal loans, credit cards and overdrafts. These products along with retail mortgages and some of the less complex small business lending are rated primarily by days past due. Other key inputs into the models are:

- Consumer lending products: use of limits and volatility thereof, GDP growth, unemployment rates;
- Retail mortgages: GDP growth, unemployment rates.

**Notes to the Financial Statements (continued)**

**6. Financial risk management (continued)**

**(a) Credit risk (continued)**

**The Bank's internal credit rating grades**

Internal Rating Grade	Internal Rating Score	Internal Rating Description	12 Month Basel III PD Range*	Equivalent S&P Rating	Classification
<b>Performing</b>					
aaa1	1	Above Investment Grade - Lowest Default Risk Group - Strongest	0.01%	aaa	Performing
aaa2	2	Above Investment Grade - Extremely Low Default Risk Group - Strong	0.01% - 0.02%	aa+	Performing
aaa3	3	Above Investment Grade - Extremely Low Default Risk Group - Medium	0.01% - 0.02%	aa	Performing
aaa4	4	Above Investment Grade - Extremely Low Default Risk Group - Low	0.02% - 0.04%	aa-	Performing
aaa5	5	Above Investment Grade - Low Default Risk Group - Strong	0.04% - 0.06%	a+	High grade
aaa6	6	Above Investment Grade - Low Default Risk Group - Medium	0.06% - 0.09%	a	High grade
aaa7	7	Above Investment Grade - Low Default Risk Group - Low	0.10% - 0.14%	a-	High grade
aa1	8	Above Investment Grade - Relatively low Default Risk Group - Strong	0.15% - 0.21%	bbb+	High grade
aa2	9	Above Investment Grade - Relatively low Default Risk Group - Medium	0.24% - 0.33%	bbb	High grade
aa3	10	Above Investment Grade - Relatively low Default Risk Group - Low	0.37% - 0.51%	bbb-	High grade
a1	11	Below Investment Grade - Medium Default Risk Group - Strongest	0.57% - 0.78%	bb+	Standard grade
a2		Below Investment Grade - Medium Default Risk Group - Strong			
a3	12	Below Investment Grade - Medium Default Risk Group - Relatively Strong	0.88% - 1.20%	bb	Standard grade
a4		Below Investment Grade - Medium Default Risk Group - Medium			
bbb1	13	Below Investment Grade - Medium Default Risk Group - Medium Low	1.34% - 1.85%	bb-	Standard grade
bbb2		Below Investment Grade - Medium Default Risk Group - Low			
bbb3	14	Below Investment Grade - Medium High Default Risk Group - Strong	2.05% - 2.84%	b+	Standard grade
bb1		Below Investment Grade - Medium High Default Risk Group - Low			
bb2	15	Below Investment Grade - High Default Risk Group - Strong	3.14% - 4.37%	b	Standard grade
b1		Below Investment Grade - High Default Risk Group - Low			
b2	16	Below Investment Grade - Relatively High Default Risk Group - Strong	4.81% - 6.72%	b-	Standard grade
ccc1		Below Investment Grade - Relatively High Default Risk Group - Medium			
ccc2		Below Investment Grade - Relatively High Default Risk Group - Low			
cc1	17	Below Investment Grade - Extremely High Default Risk Group - Strong	7.36% - 10.35%	ccc+	Sub-standard grade
cc2	18	Below Investment Grade - Extremely High Default Risk Group - Medium	11.27% - 16.10%	ccc	Sub-standard grade
c	19	Below Investment Grade - Extremely High Default Risk Group - Low	17.25% - 25.64%	ccc-	Past due
<b>Non-Performing</b>					
d		Overdue over 90 days or not able to fully repay	100%	d	Non-performing individually impaired

\*The ranges are derived by taking the maximum and minimum PD values (where different) from the Global, Europe, US and UK regions

**Notes to the Financial Statements (continued)**

**6. Financial risk management (continued)**

**(a) Credit risk (continued)**

**(iv) Exposure at default**

Exposure at default (EAD) represents the gross carrying amount of financial instruments subject to impairment calculation, addressing both the client's ability to increase its exposure while approaching default and potential early repayments too. To calculate the EAD for a Stage 1 loan, the bank assesses the possible default events within 12 months for the calculation of the 12mECL. For Stage 2, Stage 3 and purchased or originated credit-impaired (POCI) financial assets, EAD is considered for events over the lifetime of the instruments.

The bank determines EADs by modelling the range of possible exposure outcomes at various points in time, corresponding to the multiple scenarios. The IFRS 9 PDs are then assigned to each economic scenario based on the outcome of the bank's models.

**(v) Loss given default**

Under IFRS 9, LGD rates are estimated for the Stage 1, Stage 2, Stage 3 IFRS 9 segment of each asset class.

For corporate loans, LGD values are assessed by an externally developed model. The credit risk assessment is based on a standardised LGD assessment framework that results in a certain LGD rate. These LGD rates take into account the expected EAD in comparison to the amount expected to be recovered or realised from any collateral held.

The bank segments its retail lending products into smaller homogeneous portfolios, based on key characteristics that are relevant to the estimation of future cash flows. The applied data is based on historically collected loss data and involves a wider set of transaction characteristics such as product and collateral types as well as borrower characteristics.

Further recent data and forward-looking economic scenarios are used in order to determine the IFRS 9 LGD rate for each group of financial instruments. When assessing forward-looking information, the expectation is based on multiple scenarios. Examples of key inputs involve changes in collateral values, including property prices for mortgages, payment status or other factors that are indicative of losses in the group.

**(vi) Significant increase in credit risk**

The bank continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12mECL or LTECL, the bank assesses whether there has been a significant increase in credit risk since initial recognition. The bank considers an exposure to have significantly increased in credit risk when the score, derived from internal rating at the calculation date, has worsened by more than as defined below compared with the score at the time of the contract origination.

S&P Rating	Rating Score	Notches Downgrade Stage 2
aaa	1	9
aa+	2	8
aa	3	7
aa-	4	6
a+	5	5
a	6	4
a-	7	3
bbb+	8	2
bbb	9	1
bbb-	10	2
bb+	11	1
bb	12	1
bb-	13	1
b+	14	1
b	15	1
b-	16	1
ccc+	17	1
ccc	18	1
ccc-	19	1

The bank also applies a secondary qualitative method for triggering a significant increase in credit risk for an asset, such as moving a customer/facility to the watch list. In certain cases, the bank may also consider that events are a significant increase in credit risk as opposed to a default. Regardless of the change in credit grades, if contractual payments are 30 days past due, the credit risk is deemed to have increased significantly since initial recognition.

**Notes to the Financial Statements (continued)**

**6. Financial risk management (continued)**

**(a) Credit risk (continued)**

**(vi) Significant increase in credit risk (continued)**

When estimating ECLs on a collective basis for a group of similar assets, the bank applies the same principles for assessing whether there has been a significant increase in credit risk since initial recognition.

**(vii) Grouping financial assets measured on a collective basis**

Independent of the factors below, the bank calculates ECLs either on a collective or an individual basis.

Asset classes where the bank calculates ECL on an individual basis include:

- Corporate loans
- Mortgage loans
- Government bonds
- Interbank loans

Asset classes where the bank calculates ECL on a collective basis include:

- Credit cards
- Account overdrafts

**(viii) Statement of Financial Position - IFRS 9 transition disclosure**

The following table sets out the impact of adopting IFRS 9 on the statement of financial position, and retained earnings including the effect of replacing IAS 39's incurred credit loss calculations with IFRS 9's ECLs.

Bank of China (UK) Limited  
Financial Statements for the year ended 31 December 2018  
**Notes to the Financial Statements (continued)**

**(viii) Statement of Financial Position - IFRS 9 transition disclosure (continued)**

	IAS 39 measurement		Reclassification	Remeasurement			IFRS 9 measurement		
	Category	Amount		ECL - Stage 1	ECL - Stage 2	ECL - Stage 3	Other	Amount	Category
		£000	£000	£000	£000	£000	£000	£000	
<b>Assets</b>									
Cash and cash equivalents	L&R	281,944	-	(3)	-	-	-	281,941	AC
Loans and advances to banks	L&R	83,706	-	-	-	-	-	83,706	AC
Loans and advances to customers	L&R	1,012,833	631	(748)	(158)	(61)	-	1,012,497	AC
Loans and advances to customers	FVPL	41,621	(41,621)	-	-	-	-	-	N/A
Derivatives and other financial instruments	FVPL	1,717	-	-	-	-	-	1,717	FVPL
Prepayments, accrued income & other assets	L&R	5,204	1,206	-	-	-	-	6,410	AC
Available for sale investments	AFS	12	(12)	-	-	-	-	-	N/A
Held to maturity Investments	HTM	107,478	(107,478)	-	-	-	-	-	N/A
Debt instruments at amortised cost	AC	-	106,329	-	(21)	-	-	106,308	AC
Financial assets at fair value through PL	N/A	-	41,633	-	-	-	-	41,633	FVPL
Deferred tax asset	N/A	1,462	-	-	-	-	194	1,656	N/A
Property, plant and equipment	N/A	3,149	-	-	-	-	-	3,149	N/A
Intangible assets	N/A	95	-	-	-	-	-	95	N/A
<b>Total assets</b>		<b>1,539,221</b>	<b>688</b>	<b>(751)</b>	<b>(179)</b>	<b>(61)</b>	<b>194</b>	<b>1,539,112</b>	
<b>Liabilities</b>									
Deposits from banks	AC	123,122	-	-	-	-	-	123,122	AC
Deposits from customers	AC	1,019,007	-	-	-	-	-	1,019,007	AC
Derivatives and other financial instruments	FVPL	257	-	-	-	-	-	257	FVPL
Other liabilities	AC	20,158	-	-	-	-	-	20,158	AC
Accruals and deferred income	AC	4,176	-	-	-	-	-	4,176	AC
Current tax liabilities	AC	5,447	-	-	-	-	-	5,447	AC
Provisions	AC	-	-	181	205	-	-	386	AC
Subordinated liabilities	AC	60,000	-	-	-	-	-	60,000	AC
<b>Total liabilities</b>		<b>1,232,167</b>	<b>-</b>	<b>181</b>	<b>205</b>	<b>-</b>	<b>-</b>	<b>1,232,553</b>	

Bank of China (UK) Limited  
 Financial Statements for the year ended 31 December 2018  
**Notes to the Financial Statements (continued)**

**(viii) Statement of Financial Position - IFRS 9 transition disclosure (continued)**

	IAS 39 measurement		Reclassification*	Remeasurement			Other	IFRS 9 measurement	
	Category	Amount		ECL - Stage 1	ECL - Stage 2	ECL - Stage 3		Amount	Category
		£000		£000	£000	£000		£000	£000
<b>Equity</b>									
Authorised and called up share capital	N/A	250,000	-	-	-	-	-	250,000	N/A
Retained earnings	N/A	57,022	720	(932)	(384)	(61)	194	56,559	N/A
Available for sale reserve revaluation reserve	N/A	32	(32)	-	-	-	-	-	N/A
<b>Total shareholders' equity</b>		<b>307,054</b>	<b>688</b>	<b>(932)</b>	<b>(384)</b>	<b>(61)</b>	<b>194</b>	<b>306,559</b>	
<b>Total shareholders' equity and liabilities</b>		<b>1,539,221</b>	<b>688</b>	<b>(751)</b>	<b>(179)</b>	<b>(61)</b>	<b>194</b>	<b>1,539,112</b>	

\*Reclassification includes reversal of £688,000 collective impairment provision under IAS 39, replaced by re-measurement of the provision under IFRS 9.

**(ix) Credit exposure loan to value ratios of the mortgage portfolio**

The tables below summarise the bank's retail portfolio (gross values of exposures) loan to value (LTV) ratios.

Financial Position Category	Business Model Portfolio	Lending Type	0-30%	30-60%	60-90%	90-100%	100-120%	120+%	Total
			£000	£000	£000	£000	£000	£000	£000
Loans and advances to customers	Housing loans	Buy-to-Let Mortgages	1,138	3,870	885	-	-	-	5,893
Loans and advances to customers	Mortgage loans	Owner Occupied Mortgages	33,534	153,142	44,559	-	-	-	231,235
Loans and advances to customers	Mortgage loans	Buy-to-Let Mortgages	24,844	228,171	280,818	-	-	-	533,833
Loans and advances to customers	Mortgage loans	Commercial	1,189	1,602	-	-	-	-	2,791
<b>At 31 December 2018</b>			<b>60,705</b>	<b>386,785</b>	<b>326,262</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>773,752</b>

Bank of China (UK) Limited  
 Financial Statements for the year ended 31 December 2018  
**Notes to the Financial Statements (continued)**

**(x) Credit loss charges**

The table below shows the ECL provisions on financial instruments for the year recorded in the financial position.

Financial Position Category Business Model Portfolio	Global			Europe			US			UK			Retail			Total
	Stage			Stage			Stage			Stage			Stage			
	1	2	3	1	2	3	1	2	3	1	2	3	1	2	3	
	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
Other demand deposits																
On demand deposits	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Loans and advances to customers																
Wholesale loans	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Housing loans	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Consortium loan	63	-	-	18	-	-	-	-	-	127	-	-	-	-	-	208
Factoring financing	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Overdraft on corporate accounts	-	-	-	-	-	-	-	-	-	1	-	-	-	-	-	1
Overdraft on personal accounts	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Credit Cards	-	-	-	-	-	-	-	-	-	-	-	-	10	-	6	16
Mortgage loans	-	-	-	-	-	-	-	-	-	-	-	-	480	69	42	591
Financing Order	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Debt instruments at amortised cost																
Other bonds held to maturity	-	-	-	-	-	-	-	-	-	7	-	-	-	-	-	7
	63	-	-	18	-	-	-	-	-	135	-	-	490	69	48	823
Off Balance Sheet																
OBS - Letter of credit	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
OBS - Guarantee	3	-	-	-	-	-	-	-	-	5	1	-	-	-	-	9
OBS - Other	6	-	-	18	-	-	13	-	-	14	-	-	37	-	-	88
	9	-	-	18	-	-	13	-	-	19	1	-	37	-	-	97
<b>At 31 December 2018</b>	<b>72</b>	<b>-</b>	<b>-</b>	<b>36</b>	<b>-</b>	<b>-</b>	<b>13</b>	<b>-</b>	<b>-</b>	<b>154</b>	<b>1</b>	<b>-</b>	<b>527</b>	<b>69</b>	<b>48</b>	<b>920</b>

Bank of China (UK) Limited  
 Financial Statements for the year ended 31 December 2018  
**Notes to the Financial Statements (continued)**

**(xi) Analysis of risk concentration in the financial position**

Business Model Portfolio	Global Stage			Europe Stage			US Stage			UK Stage			Retail Stage			Total
	1	2	3	1	2	3	1	2	3	1	2	3	1	2	3	
	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	
Other demand deposits																
On demand deposits	42	-	-	30	-	-	587	-	-	18,024	-	-	-	-	-	18,683
Loans and advances to customers																
Wholesale loans	2,450	-	-	-	-	-	-	-	-	2,772	-	-	-	-	-	5,222
Housing loans	-	-	-	-	-	-	-	-	-	5,894	-	-	-	-	-	5,894
Consortium loan	49,648	-	-	49,989	-	-	-	-	-	163,684	-	-	-	-	-	263,321
Factoring financing	-	-	-	-	-	-	-	-	-	1,043	-	-	-	-	-	1,043
Overdraft corporate accounts	-	-	-	-	-	-	-	-	-	258	-	-	-	-	-	258
Overdraft personal accounts	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Credit Cards	-	-	-	-	-	-	-	-	-	-	-	-	2	-	-	2
Mortgage loans	-	-	-	-	-	-	-	-	-	-	-	-	762	16	6	784
Financing Order	-	-	-	-	-	-	1,009	-	-	-	-	-	737,900	29,280	680	767,860
Debt instruments at amortised cost																
Other bonds held to maturity	-	-	-	-	-	-	-	-	-	102,625	-	-	-	-	-	102,625
	52,140	-	-	50,019	-	-	1,596	-	-	294,300	-	-	738,664	29,296	686	1,166,701
Off Balance Sheet																
OBS - Letter of credit	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
OBS - Guarantee	31,958	-	-	324	-	-	-	-	-	3,774	310	-	-	-	-	36,366
OBS - Other	9,938	-	-	64,873	-	-	28,131	-	-	113,460	-	-	6,954	-	-	223,356
	41,896	-	-	65,197	-	-	28,131	-	-	117,234	310	-	6,954	-	-	259,722
<b>At 31 December 2018</b>	<b>94,036</b>	<b>-</b>	<b>-</b>	<b>115,216</b>	<b>-</b>	<b>-</b>	<b>29,727</b>	<b>-</b>	<b>-</b>	<b>411,534</b>	<b>310</b>	<b>-</b>	<b>745,618</b>	<b>29,296</b>	<b>686</b>	<b>1,426,423</b>

The bank's concentrations of risk are managed by client/counterparty and geographical region. The maximum on balance sheet credit exposure to any client or counterparty as of 31 December 2018 was £36 million (2017: £39 million), before taking into account the fair value of collateral held of £1,659 million (2017: £1,499 million), or other credit enhancements and the maximum off balance sheet credit exposure to any client or counterparty as of 31 December 2018 was £54 million (2017: £51 million). The table above shows the risk concentration by geography for the business model portfolios in the statement of financial position when classified as amortised cost measurement has been made. Additional disclosures for credit quality and the maximum exposure for credit risk per categories based on the bank's internal credit rating system and year-end stage classification are further disclosed below.

Bank of China (UK) Limited  
 Financial Statements for the year ended 31 December 2018  
**Notes to the Financial Statements (continued)**

**(xii) Impairment allowance analysis**

The following provides an analysis of how significant changes in gross balances over the year have contributed to changes in ECLs.

<b>On Balance Sheet</b>	<b>Stage 1 £000</b>	<b>Stage 2 £000</b>	<b>Stage 3 £000</b>	<b>Total £000</b>
<b>Gross carrying amount as at 1 January 2018</b>	1,012,666	126,423	462	1,139,551
New assets originated or purchased	326,855	3,978	6	330,839
Assets derecognised or repaid (excluding write offs)	(254,188)	(7,632)	(7)	(261,827)
Transfers to Stage 1	115,745	(115,742)	(3)	-
Transfers to Stage 2	(23,567)	23,771	(204)	-
Transfers to Stage 3	(206)	(265)	471	-
Changes to contractual cash flows due to modifications not resulting in derecognition	(42,157)	(1,237)	(39)	(43,433)
Amounts written off	-	-	-	-
Foreign exchange adjustments	1,570	-	-	1,570
<b>Gross carrying amount as at 31 December 2018</b>	<b>1,136,718</b>	<b>29,296</b>	<b>686</b>	<b>1,166,700</b>

Bank of China (UK) Limited  
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**Notes to the Financial Statements (continued)**

**(xiii) Credit loss expense**

	Stage 1	Stage 2	Stage 3	Total
<b>On Balance Sheet</b>				
	£000	£000	£000	£000
<b>ECL allowance as at 31 December 2017</b>				688
New assets originated or purchased				303
<b>ECL allowance as at 1 January 2018</b>	751	179	61	991
New assets originated or purchased	350	33	6	389
Assets derecognised or repaid (excluding write offs)	(270)	(146)	-	(416)
Transfers to Stage 1	31	(28)	(3)	-
Transfers to Stage 2	(12)	13	(1)	-
Transfers to Stage 3	-	-	-	-
Impact on year end ECL of exposures transferred between stages during the year	(20)	20	5	5
Unwind of discount	-	-	-	-
Changes to contractual cash flows due to modifications not resulting in derecognition	(104)	(1)	(19)	(124)
Changes to models and inputs used for ECL calculations	(23)	-	-	(23)
Recoveries	-	-	-	-
Amounts written off	-	-	-	-
Foreign exchange adjustments	1	-	-	1
<b>ECL allowance as at 31 December 2018</b>	<b>704</b>	<b>70</b>	<b>49</b>	<b>823</b>

Bank of China (UK) Limited  
 Financial Statements for the year ended 31 December 2018  
**Notes to the Financial Statements (continued)**

(xiii) Credit loss expense (continued)

Off Balance Sheet	Stage 1	Stage 2	Stage 3	Total
	£000	£000	£000	£000
<b>Gross carrying amount as at 1 January 2018</b>	281,038	18,260	-	299,298
New assets originated or purchased	34,150	110	-	34,260
Assets derecognised or repaid (excluding write offs)	(55,192)	(18,260)	-	(73,452)
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	(200)	200	-	-
Transfers to Stage 3	-	-	-	-
Changes to contractual cash flows due to modifications not resulting in derecognition	(4,827)	-	-	(4,827)
Amounts written off	-	-	-	-
Foreign exchange adjustments	4,443	-	-	4,443
	-	-	-	-
<b>Gross carrying amount as at 31 December 2018</b>	<b>259,412</b>	<b>310</b>	<b>-</b>	<b>259,722</b>

Bank of China (UK) Limited  
 Financial Statements for the year ended 31 December 2018  
**Notes to the Financial Statements (continued)**

**(xiii) Credit loss expense (continued)**

<b>Off Balance Sheet</b>	<b>Stage 1</b>	<b>Stage 2</b>	<b>Stage 3</b>	<b>Total</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
<b>ECL allowance as at 31 December 2017</b>				-
New assets originated or purchased				386
<b>ECL allowance as at 1 January 2018</b>	181	205	-	386
New assets originated or purchased	13	-	-	13
Assets derecognised or repaid (excluding write offs)	(16)	(205)	-	(221)
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	-	-	-	-
Impact on year end ECL of exposures transferred between stages during the year	-	-	-	-
Unwind of discount	-	-	-	-
Changes to contractual cash flows due to modifications not resulting in derecognition	(6)	-	-	(6)
Changes to models and inputs used for ECL calculations	(83)	-	-	(83)
Recoveries	-	-	-	-
Amounts written off	-	-	-	-
Foreign exchange adjustments	6	-	-	6
	-	-	-	-
<b>ECL allowance as at 31 December 2018</b>	<b>97</b>	<b>-</b>	<b>-</b>	<b>97</b>

Bank of China (UK) Limited  
 Financial Statements for the year ended 31 December 2018  
**Notes to the Financial Statements (continued)**

**(xiv) Impairment allowance analysis – internal rating grading**

The following provides an analysis of the ECL is split by the internal rating grade.

<b>On Balance Sheet</b>	<b>Stage 1</b>	<b>Stage 2</b>	<b>Stage 3</b>	<b>Total</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
<b>Internal rating grade</b>				
Performing	498	-	-	498
High grade	142	-	-	142
Standard grade	65	-	-	65
Sub-standard grade	-	70	-	70
Past due	-	-	48	48
Non-performing individually impaired	-	-	-	-
<b>ECL allowance as at 31 December 2018</b>	<b>705</b>	<b>70</b>	<b>48</b>	<b>823</b>
<b>Off Balance Sheet</b>				
	<b>Stage 1</b>	<b>Stage 2</b>	<b>Stage 3</b>	<b>Total</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
<b>Internal rating grade</b>				
Performing	39	-	-	39
High grade	50	-	-	50
Standard grade	8	-	-	8
Sub-standard grade	-	-	-	-
Past due	-	-	-	-
Non-performing individually impaired	-	-	-	-
<b>ECL allowance as at 31 December 2018</b>	<b>97</b>	<b>-</b>	<b>-</b>	<b>97</b>

Bank of China (UK) Limited  
 Financial Statements for the year ended 31 December 2018  
**Notes to the Financial Statements (continued)**

**(xv) Impairment allowance analysis – base case vs. probability weighted**

The following provides an analysis of the ECL if just a base case scenario was used.

<b>On Balance Sheet</b>	<b>Base case</b>	<b>Probability weighted</b>	<b>Difference</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>
<b>ECL allowance as at 31 December 2018</b>	742	823	81

<b>Off Balance Sheet</b>	<b>Base case</b>	<b>Probability weighted</b>	<b>Difference</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>
<b>ECL allowance as at 31 December 2018</b>	96	97	1

**Notes to the Financial Statements (continued)**

**(xvi) Analysis of inputs to the ECL model under multiple economic scenarios per geographic regions**

An overview of the approach to estimating ECLs is set out in Note 3 and in Note 4. To ensure completeness and accuracy, the bank obtains the data used from third party sources (Moody's) and the Risk Management Department verifies the accuracy of inputs to the bank's ECL models including determining the weights attributable to the multiple scenarios. The purpose of using multiple scenarios is to model the non-linear impact of assumptions about macroeconomic factors on ECL and that any presented ECL outcomes for different economic scenarios do not represent ECL forecasts.

The following tables set out the key drivers of expected loss and multiple economic scenarios and their assigned probabilities, as at 31 December 2017 and 31 December 2018. The probabilities assigned are based on the midpoint probability weights approach recommended in the Scenario Severity and Probability Weights methodology issued by Moody's Analytics dated October 2017. This approach is used as it is more conservative than other approaches available, consistent with the bank's risk profile. Estimating ECL involves forecasting future economic conditions over a number of years. These longer term forecasts are subject to management judgement and those judgements may be sources of measurement uncertainty that have a significant risk of resulting in a material adjustment to a carrying amount within the next financial year.

1 January 2018		
Key Drivers	ECL Scenario	Assigned Probabilities %
CPI GDP Growth House Price Index Interest Rates Unemployment rates	Upside	30
	Base case	40
	Downside	30

31 December 2018*								
Key Drivers	ECL Scenario	Assigned Probabilities %	2019 %	2020 %	2021 %	2022 %	2023 %	Subsequent Years %
UK CPI Increase	Upside	30	0.84	0.69	0.55	0.49	0.47	0.47
	Base case	40	0.55	0.48	0.46	0.46	0.47	0.48
	Downside	30	0.15	0.08	0.43	0.56	0.55	0.50
UK GDP Growth	Upside	30	0.91	0.62	0.47	0.39	0.39	0.42
	Base case	40	0.39	0.35	0.46	0.43	0.43	0.43
	Downside	30	(0.47)	0.03	0.58	0.51	0.49	0.48
UK House Price Index Increase	Upside	30	1.63	1.43	0.63	0.25	0.33	0.59
	Base case	40	0.51	0.18	0.30	0.40	0.68	0.91
	Downside	30	(0.79)	(1.90)	(0.33)	0.74	1.37	1.60
UK Interest Rates	Upside	30	1.04	1.46	1.75	2.15	2.56	3.03
	Base case	40	1.01	1.32	1.58	1.95	2.36	2.87
	Downside	30	0.56	0.24	0.18	0.48	0.87	1.37
UK Unemployment Rates	Upside	30	3.86	3.35	3.48	3.77	4.06	4.29
	Base case	40	4.40	4.67	4.89	5.00	5.07	5.06
	Downside	30	5.16	6.69	7.27	7.17	6.81	6.25

\*For conciseness only UK data has been shown since it makes up the majority of the bank's corporate retail lending book.

**Notes to the Financial Statements (continued)**

**6. Financial risk management (continued)**

**(a) Credit risk (continued)**

**Exposure to credit risk (as applicable up to 31 December 2017 under IAS 39)**

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
<hr/>	
On statement of financial position:	
Cash balances with the central bank	230,404
Other demand deposits	50,211
Loans and advances to banks	83,706
Loans and advances to customers	1,054,454
Derivatives and other financial instruments	1,717
Debt instruments at amortised cost	-
Financial assets at fair value through profit and loss	-
Available for sale financial investments	12
Held to maturity financial investments	107,478
<b>Total financial assets</b>	<b>1,527,982</b>
<hr/>	
Undrawn loan commitments	262,292
Guarantees	29,324
<b>Total contingent liabilities and commitments</b>	<b>291,616</b>
<hr/>	
<b>Total exposure</b>	<b>1,819,598</b>

The fair value of collateral held at 31 December 2017 against amounts due from customers was £1,498,544,000. 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.

As at 31 December 2017, cash and cash equivalents include exposures to the parent company of £26,988,000. No other significant concentration of credit risk exposure exists. Cash and cash equivalents exclude cash on hand of £1,314,000 for the purposes of the assessment of credit risk.

**Notes to the Financial Statements (continued)**

**6. Financial risk management (continued)**

**(a) Credit risk (continued)**

**Credit risk exposure**

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

Based on external credit rating system

£000	31 December 2017	
	Cash and cash equivalents	Financial investments
Gross exposure	280,615	107,490
Individually impaired	-	-
Allowance for impairment	-	-
Carrying amount	-	-
Past due but not impaired	-	-
<i>Ageing profile:</i>		
0-3 months	-	-
4-6 months	-	-
7-9 months	-	-
10-12 months	-	-
Neither past due nor impaired	280,615	107,490
<i>Credit rating:</i>		
Aaa	-	-
Aa1 - Aa3	259,521	107,478
A1 - A3	21,086	-
Baa1 - Baa3	-	-
Unrated	8	12
<b>Total carrying amount</b>	<b>280,615</b>	<b>107,490</b>

**Notes to the Financial Statements (continued)**

**6. Financial risk management (continued)**

**(a) Credit risk (continued)**

**Loans and advances to banks**

Based on internal loan grading system mapped against external credit ratings

£000	31 December 2017
Gross exposure	83,706
Allowance for impairment	-
<b>Carrying amount</b>	<b>83,706</b>
Neither past due nor impaired	83,706
<i>Credit rating:</i>	
Aa1 – Aa3	-
A1 - A3	83,706
Baa1 - Baa3	-
Ba1 – Ba3	-
Unrated	-
Allowance for Impairment	-
<b>Total carrying amount</b>	<b>83,706</b>

**Loans and advances to customers**

£000	31 December 2017
Gross exposure	1,055,142
Allowance for impairment	(688)
<b>Carrying amount</b>	<b>1,054,454</b>
Individually impaired	1
Allowance for impairment	(1)
<b>Carrying amount</b>	<b>-</b>
<b>By age profile</b>	
Neither past due nor impaired	1,041,377
Past due but not impaired	13,077
<i>Ageing profile:</i>	
0-3 months	12,614
4-6 months	459
7-9 months	1
10-12 months	-
Over 12 months	3
<b>Total carrying amount</b>	<b>1,054,454</b>

**Notes to the Financial Statements (continued)**

**6. Financial risk management**

**(a) Credit risk (continued)**

**By categories**

Performing	1,013,454
A1 - A3	-
Baa1 - Baa3	38,061
Ba1 - Ba3	50,634
Unrated	924,759
Special mention (unrated)	40,645
Substandard (unrated)	354
Doubtful (unrated)	-
Loss (unrated)	1
<b>Total carrying amount</b>	<b>1,054,454</b>

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
<b>31 December 2018</b>						
Non-derivative financial liabilities:						
Deposits from banks	102,919	(104,439)	(82,527)	(92)	(21,820)	-
Deposits from customers	1,107,439	(1,109,907)	(967,372)	(17,438)	(125,097)	-
Subordinated liabilities	60,000	(60,175)	-	(175)	-	(60,000)
Derivative financial instruments:	1,977	-	-	-	-	-
Cash outflows		(138,923)	(116,496)	(384)	(1,849)	(20,194)
Cash inflows		115,272	115,272	-	-	-
	<b>1,272,335</b>	<b>(1,298,172)</b>	<b>(1,051,123)</b>	<b>(18,089)</b>	<b>(148,766)</b>	<b>(80,194)</b>
Undrawn loan commitments	216,402	(216,402)	(216,402)	-	-	-
	<b>1,488,737</b>	<b>(1,514,574)</b>	<b>(1,267,525)</b>	<b>(18,089)</b>	<b>(148,766)</b>	<b>(80,194)</b>
<b>31 December 2017</b>						
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	-	-	-
	<b>1,202,386</b>	<b>(1,215,064)</b>	<b>(1,067,546)</b>	<b>(19,113)</b>	<b>(58,530)</b>	<b>(69,875)</b>
Undrawn loan commitments	262,292	(262,292)	(262,292)	-	-	-
	<b>1,464,678</b>	<b>(1,477,356)</b>	<b>(1,329,838)</b>	<b>(19,113)</b>	<b>(58,530)</b>	<b>(69,875)</b>

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 flows disclosed in the previous table represent 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 subordinated loan is repayable upon giving 5 years and one day's notice. As at the date of signing the financial statements notice had not been given, therefore making the subordinated loan undated making expected interest payments beyond one year indeterminable.

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 2018 (31 December 2017: £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 2018 and 31 December 2017.

£000

<b>31 December 2018</b>	<b>Sterling</b>	<b>US Dollar</b>	<b>Euro</b>	<b>Other</b>	<b>Total</b>
Cash and cash equivalents	308,061	11,933	7,451	5,830	333,275
Loans and advances to banks	-	12,112	33,944	15,335	61,391
Loans and advances to customers	865,395	146,778	12,029	20,368	1,044,570
Derivatives financial instruments (asset)	1,344	-	-	-	1,344
Debt instruments at amortised cost	103,189	-	-	-	103,189
Financial assets at fair value through profit and loss	(419)	76,590	-	-	76,171
Other assets	10,155	635	83	169	11,042
Deposits from banks	(3,932)	(78,507)	(39)	(20,441)	(102,919)
Deposits from customers	(755,067)	(277,827)	(53,779)	(20,766)	(1,107,439)
Derivatives financial instruments (liability)	(1,977)	-	-	-	(1,977)
Other liabilities	(27,501)	(4,211)	(561)	(298)	(32,571)
Subordinated liabilities	(60,000)	-	-	-	(60,000)
Total shareholder equity	(326,076)	-	-	-	(326,076)
Net financial assets/(liabilities)	113,172	(112,497)	(872)	197	-
Net forward foreign exchange positions	(18,231)	20,514	(2,865)	582	-
Undrawn loan commitments	55,010	111,257	40,197	9,938	216,402

£000

<b>31 December 2017</b>	<b>Sterling</b>	<b>US Dollar</b>	<b>Euro</b>	<b>Other</b>	<b>Total</b>
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
Derivative 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)
Derivative 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

**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 2018 would have increased (decreased) equity and the income statement by the amounts shown below. This calculation assumes that the change occurred at the reporting date and had been applied to risk exposures existing at that date.

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

£000	Other Comprehensive Income		Income statement	
	31 December 2018	31 December 2017	31 December 2018	31 December 2017
US Dollars	-	-	(93)	(22)
Euro	-	-	(3)	1
Other	-	-	(8)	-

A 1% percent strengthening of the above currencies against Sterling at 31 December 2018 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
<b>31 December 2018</b>							
<b>Assets</b>							
Cash and cash equivalents	333,275	333,216	-	54	-	-	5
Loans and advances to banks	61,391	58,218	3,173	-	-	-	-
Loans and advances to customers	1,044,570	89,350	866,026	11,166	29,579	49,265	(816)
Derivative financial instruments	1,344	-	-	-	-	-	1,344
Debt instruments at amortised cost	103,189	-	-	-	103,196	-	(7)
Financial assets at fair value through profit and loss	76,171	-	-	-	76,159	-	12
Other assets	11,042	-	-	-	-	-	11,042
<b>Total assets</b>	<b>1,630,982</b>	<b>480,784</b>	<b>869,199</b>	<b>11,220</b>	<b>208,934</b>	<b>49,265</b>	<b>11,580</b>
<b>Equity and liabilities</b>							
<b>Liabilities</b>	<b>1,304,906</b>	<b>1,049,072</b>	<b>77,344</b>	<b>143,406</b>	<b>-</b>	<b>-</b>	<b>35,084</b>
Deposits from banks	102,919	82,447	-	20,440	-	-	32
Deposits from customers	1,107,439	966,625	17,344	122,966	-	-	504
Derivative financial instruments	1,977	-	-	-	-	-	1,977
Other liabilities	32,571	-	-	-	-	-	32,571
Subordinated liabilities	60,000	-	60,000	-	-	-	-
<b>Equity</b>	<b>326,076</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>326,076</b>
Shareholders' equity	326,076	-	-	-	-	-	326,076
<b>Total equity and liabilities</b>	<b>1,630,982</b>	<b>1,049,072</b>	<b>77,344</b>	<b>143,406</b>	<b>-</b>	<b>-</b>	<b>361,160</b>
Interest rate sensitivity gap	- (568,288)	791,855	(132,186)	208,934	49,265	(349,580)	-
Cumulative gap	- (568,288)	223,567	91,381	300,315	349,580	-	-

**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
<b>31 December 2017</b>							
<b>Assets</b>							
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
<b>Total assets</b>	<b>1,539,221</b>	<b>470,588</b>	<b>859,948</b>	<b>11,096</b>	<b>132,582</b>	<b>51,854</b>	<b>13,153</b>
<b>Equity and liabilities</b>							
<b>Liabilities</b>	<b>1,232,167</b>	<b>1,065,777</b>	<b>79,199</b>	<b>56,612</b>	<b>-</b>	<b>-</b>	<b>30,579</b>
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	-	-	-	-
<b>Equity</b>	<b>307,054</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>307,054</b>
Shareholders' equity	307,054	-	-	-	-	-	307,054
<b>Total equity and liabilities</b>	<b>1,539,221</b>	<b>1,065,777</b>	<b>79,199</b>	<b>56,612</b>	<b>-</b>	<b>-</b>	<b>337,633</b>
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	-

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
<b>Sensitivity of projected net interest income at</b>		
<b>31 December 2018</b>	<b>1,845</b>	<b>(1,845)</b>
31 December 2017	1,913	(1,913)
<b>Sensitivity of reported equity to interest rate movements at</b>		
<b>31 December 2018</b>	<b>-</b>	<b>-</b>
31 December 2017	-	-

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 in 2017 only.

**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.

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 2018 and 31 December 2017 was as follows:

£000	<b>2018 Actual</b>	2017 Actual
Tier 1 capital		
Ordinary share capital	<b>250,000</b>	250,000
Retained earnings *	<b>24,958</b>	24,958
 Tier 2 capital		
Qualifying subordinated liabilities	<b>60,000</b>	60,000
 <b>Total regulatory capital</b>	<b>334,958</b>	334,958

\* Retained earnings for regulatory capital purposes at the reporting date is restricted to audited retained earnings at 31 December 2018 after deducting the 2018 dividend to be paid in 2019.

The bank maintains a buffer to regulatory minimum capital ratios.

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

**Notes to the Financial Statements (continued)**

**7. Financial assets and financial liabilities**

**Fair values of financial instruments**

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

**Fair values**

The carrying value of financial assets and liabilities at amortised cost materially approximates 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.

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).

IFRS 9 replaced IAS 39 for annual periods starting on or after 1 January 2018, changing the classification and measurement of financial assets (Note 5). 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.

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.

**Notes to the Financial Statements (continued)**

**7. Financial assets and financial liabilities (continued)**

**Fair value hierarchy**

During the financial year ended 31 December 2018, financial assets at fair value were assessed under IFRS 9 criteria for Level 1, Level 2 or Level 3.

£000				
<b>31 December 2018</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Financial assets</b>				
Designated fair value loans	-	-	76,159	76,159
Derivative financial instruments:				
Interest rate swaps	-	1,344	-	1,344
Cross currency swaps and FX forwards	-	-	-	-
Other derivatives	-	-	-	-
	-	1,344	-	1,344
Financial investments:				
Debt securities	-	-	-	-
Convertible preference shares	-	-	12	12
	-	-	12	12
<b>Total assets</b>	-	1,344	76,171	77,515
<b>Financial liabilities</b>				
Derivative financial instruments:				
Interest rate swaps	-	-	-	-
Cross currency swaps and FX forwards	-	1,977	-	1,977
Other derivatives	-	-	-	-
<b>Total liabilities</b>	-	1,977	-	1,977

In accordance with IFRS 13, Level 3 assets consists of convertible preference shares in Visa Inc. based on the Visa Inc.'s quoted share price and the fair value gain or loss in loans designated at fair value during the year (refer to Note 10).

**Notes to the Financial Statements (continued)**

**7. Financial assets and financial liabilities (continued)**

**Fair value hierarchy (continued)**

£000				
31 December 2017	Level 1	Level 2	Level 3	Total
<b>Financial assets</b>				
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
	107,478	-	12	107,490
<b>Total assets</b>	<b>107,478</b>	<b>1,717</b>	<b>41,637</b>	<b>150,832</b>
<b>Financial liabilities</b>				
Derivative financial instruments:				
Interest rate swaps	-	-	-	-
Cross currency swaps and FX forwards	-	3	-	3
Other derivatives	-	254	-	254
<b>Total liabilities</b>	<b>-</b>	<b>257</b>	<b>-</b>	<b>257</b>

**Reconciliation of Level 3 financial assets**

£000	Note	31 December 2018
Balance at 1 January 2018		41,637
Issues of loans to new counterparties		38,342
Repayment of loans		(4,137)
Total gain for the period recognised in the profit and loss	10	329
<b>Balance at 31 December 2018</b>		<b>76,171</b>

Designated fair value loans are valued using discounted cash flows, any changes in the discount rate would not have a material impact on the fair value of the loans.

**Notes to the Financial Statements (continued)**

**8. Net interest income**

£000	31 December 2018	31 December 2017
Interest income from financial investments	116	788
Other interest income:		
Cash and cash equivalents	1,840	185
Loans and advances to banks	980	608
Loans and advances to customers	37,823	36,653
Total other interest income	40,643	37,446
Total interest income	40,759	38,234
Interest expense:		
Deposits from banks	3,173	3,881
Customers accounts	2,790	1,524
Subordinated liabilities	590	383
Total interest expense	(6,553)	(5,788)
Net interest income	34,206	32,446

**9. Net fee and commission income**

(a) Analysis by business area

£000	31 December 2018	31 December 2017
Retail Banking customer fees	1,904	2,061
Corporate Banking credit-related fees	2,782	3,257
Other	164	184
Gross fee and commission income	4,850	5,502
Interbank transaction fees	400	349
Other	486	464
Gross fee and commission expense	(886)	(813)
Net fee and commission income	3,964	4,689

(b) Analysis of gross fee and commission income by product

£000	31 December 2018	31 December 2017
Letter of guarantee	225	57
Remittance	402	425
Account and service fees	189	190
Letter of credit	46	21
Settlement & commitment	201	168
Credit and debit cards	702	630
Other	105	525
Fee and commission income in scope of IFRS 15	1,870	2,016
Consortium loans	1,884	2,145
Structural financing	252	467
Retail loans	844	874
Fee and commission income in scope of IFRS 9	2,980	3,486
Gross fee and commission income	4,850	5,502

**Notes to the Financial Statements (continued)**

**10. Net fair value gain/(loss) on financial instruments**

£000	31 December 2018	31 December 2017
Net fair value gain (loss) on financial instruments held for risk management purposes:		
Designated fair value loans	329	(166)
Interest rate swaps	744	213
Cross currency swaps and FX forwards	(1,404)	-
Other derivatives	-	4
	<b>(331)</b>	<b>51</b>

**11. Other operating income**

£000	31 December 2018	31 December 2017
Related party service charges	62,476	53,742
Dividends from subsidiaries	10,493	-
Other	586	962
	<b>73,555</b>	<b>54,704</b>

The related party service charges represent the net amount receivable by the bank for the following services provided and received under service level agreements with related parties as disclosed in Note 32:

- Income earned by Bank of China Limited, London Branch (the "London Branch") beyond return on capital, repatriated to the bank;
- Expenses incurred directly by the bank that are recharged to the London Branch for services provided;
- Credit guarantee fee.

**12. Staff costs**

£000	31 December 2018	31 December 2017
Wages and salaries	33,635	33,698
Contributions to defined contribution plans	1,781	1,668
Social security costs	4,659	4,467
Other	1,793	1,532
	<b>41,868</b>	<b>41,365</b>

	31 December 2018	31 December 2017
Average number of employees		
Retail Banking	132	133
Corporate Banking	107	85
Support Functions	228	221
Total average number of employees	<b>467</b>	<b>439</b>

**Notes to the Financial Statements (continued)**

**13. Other expenses**

£000	31 December 2018	31 December 2017
Administrative	5,369	5,188
Rent on operating leases	1,122	1,147
Software licensing and other IT costs	214	331
Other	1,152	1,204
	<b>7,857</b>	<b>7,870</b>

Auditor's remuneration:

£000	31 December 2018	31 December 2017
Fees payable to the bank's auditors for the audit of the company's financial statements:		
Current year	143	141
Fees payable to the bank's auditor and its associates for other services:		
The audits of the company's subsidiaries, pursuant to legislation	12	10
Other assurance services	26	35

**14. Directors' remuneration**

£000	31 December 2018	31 December 2017
Remuneration of directors in respect of services rendered:		
Remuneration	988	1,015
Pension contributions	5	15
Highest paid director:		
Remuneration	366	396
Pension contributions	-	-

**15. Income tax expense**

£000	31 December 2018	31 December 2017
<b>Current tax expense</b>		
Current period	15,299	13,203
Adjustments for prior years	(1,981)	318
<b>Total current tax</b>	<b>13,318</b>	<b>13,521</b>
<b>Deferred tax expense</b>		
Origination and reversal of temporary differences	211	(727)
Adjustments for prior years	(102)	(262)
<b>Total deferred tax</b>	<b>109</b>	<b>(989)</b>
<b>Total income tax expense in income statement</b>	<b>13,427</b>	<b>12,532</b>

**Notes to the Financial Statements (continued)**

**15. Income tax expense (continued)**

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 2018	31 December 2017
Profit before income tax	64,550	44,596
Income tax using the standard rate of corporation tax in the UK 27.00% (2017: 27.25%)	17,429	12,152
Non-deductible expenses	118	271
Allowance against banking tax surcharge	(2,000)	-
(Over) under provided in prior years	(2,082)	55
Other - tax rate adjustment	(29)	66
Other	(9)	(12)
<b>Total income tax expense in the income statement</b>	<b>13,427</b>	<b>12,532</b>

Adjustments for prior years include the utilisation by the bank of the £25,000,000 group surcharge allowance in respect of the Bank Corporation Tax Surcharge. The group surcharge allowance was previously utilised in full by another group member.

**Income tax recognised in other comprehensive income**

£000	31 December 2018	31 December 2017
<b>Current tax</b>		
UK current tax expense	-	15
<b>Total current tax</b>	<b>-</b>	<b>15</b>
<b>Deferred tax</b>		
Current year deferred tax charge (credit)	-	89
<b>Total deferred tax</b>	<b>-</b>	<b>89</b>
<b>Total income and deferred tax credit in other comprehensive income</b>	<b>-</b>	<b>104</b>

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 2018	31 December 2017
Cash on hand	1,931	1,340
Cash balances with the central bank	277,907	230,404
Other demand deposits	53,437	50,200
	<b>333,275</b>	<b>281,944</b>

**Notes to the Financial Statements (continued)**

**17. Derivative financial instruments**

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

£000	31 December 2018		31 December 2017	
	Assets	Liabilities	Assets	Liabilities
<b>Instrument type:</b>				
Interest rate swaps	1,344	-	1,459	-
Cross currency swaps and FX forwards	-	1,977	-	3
Other derivatives	-	-	258	254
	<b>1,344</b>	<b>1,977</b>	<b>1,717</b>	<b>257</b>

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

**18. Loans and advances to banks**

£000	31 December 2018	31 December 2017
Loans and advances to banks	61,391	83,706

At 31 December 2018 £nil (31 December 2017: £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 2018	31 December 2017
Corporate loans and advances	277,074	385,829
Retail loans and advances	768,312	669,314
Gross loans and advances	1,045,386	1,055,143
Less: specific allowance for impairments – Stage 3	(48)	(1)
collective allowance for impairments – Stages 1 & 2	(768)	(688)
Total allowance for impairment	(816)	(689)
Loans and advances to customer net	1,044,570	1,054,454

At 31 December 2018 £49,265,000 (31 December 2017: £51,854,000) of loans and advances to customers are expected to be recovered more than five years after the reporting date. Corporate loans and advances included £5,893,000 (31 December 2017: £6,178,000) housing loans.

**Loans and advances to customers at amortised cost**

£000	31 December 2018			31 December 2017		
	Gross amount	Impairment allowance	Carrying amount	Gross amount	Impairment allowance	Carrying amount
Corporate loans and advances	277,074	(209)	276,865	385,829	(688)	385,141
Retail loans and advances	768,312	(607)	767,705	669,314	(1)	669,313
	<b>1,045,386</b>	<b>(816)</b>	<b>1,044,570</b>	<b>1,055,143</b>	<b>(689)</b>	<b>1,054,454</b>

**Notes to the Financial Statements (continued)**

**20. Allowances for impairment**

(a) Impairment (charges) / release

£000	31 December 2018	31 December 2017
Loans and advances to customers	162	191
Loans and advances to banks	-	47
Debt instruments at amortised cost	7	-
Off balance sheet	289	-
Foreign exchange movement	-	(51)
<b>Total impairment releases in income statement</b>	<b>458</b>	<b>187</b>

Refer to Note 6 for the movement in the impairment charge for the year ended 31 December 2018 for on and off balance sheet products and for the tables below.

(b) Loans and advances to banks and customers (as applicable up to 31 December 2017)

£000	Specific		Collective	
	Loans and advances to banks	Loans and advances to customers	Loans and advances to banks	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

Amounts written off during 2017 mostly represent fraud losses.

(c) Financial Investments (as applicable up to 31 December 2017)

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

The cumulative tax credit on this fair value amounted to £11,000 on 31 December 2017.

**Notes to the Financial Statements (continued)**

**21. Financial investments**

(a) Financial assets at fair value through profit and loss

£000	Note	31 December 2018	31 December 2017
Loans designated at fair value		76,159	-
Convertible preference shares		12	12
		<b>76,171</b>	<b>12</b>
<b>Balance at 1 January</b>		<b>12</b>	40,716
Disposals through sale and redemptions		-	(40,708)
Changes in fair value recognised in equity		-	4
IFRS 9 re-classification of fair valued loans		<b>76,159</b>	-
<b>Balance at 31 December</b>		<b>76,171</b>	<b>12</b>

The bank holds £12,000 preference shares in Visa Inc. (31 December 2017: £12,000) which are expected to be recovered more than twelve months after the reporting date. For the period ended 31 December 2018 these shares were re-classified in accordance with IFRS 9 from Available for sale financial investments to Financial assets at fair value through profit and loss.

(b) Debt instruments at amortised cost

£000	Note	31 December 2018	31 December 2017
Debt securities		103,189	-
		<b>103,189</b>	<b>-</b>
<b>Balance at 1 January</b>		-	-
Reclassification from Held to maturity financial investments		107,478	-
IFRS 9 adjustment (Note 6 (a))		(1,169)	-
Accrued interest		-	-
Acquisition		-	-
Changes in fair value recognised in equity		-	-
Amortisation of premium		(3,120)	-
<b>Balance at 31 December</b>		<b>103,189</b>	<b>-</b>

(c) Held to maturity financial investments

£000	Note	31 December 2018	31 December 2017
Debt securities		-	107,478
		-	107,478
<b>Balance at 1 January</b>		<b>107,478</b>	-
Accrued interest		-	1,149
Acquisition		-	106,425
Changes in fair value recognised in equity		-	416
Amortisation of premium		-	(512)
Reclassification to Debt instruments at amortised cost		<b>(107,478)</b>	-
<b>Balance at 31 December</b>		<b>-</b>	<b>107,478</b>

**Notes to the Financial Statements (continued)**

**22. Property, plant and equipment**

£000	Property, plant and fixtures	Furniture and equipment	Computer equipment	Motor vehicles	Total
<b>Cost</b>					
<b>Balance at 1 January 2018</b>	<b>6,246</b>	<b>1,975</b>	<b>1,718</b>	<b>214</b>	<b>10,153</b>
<b>Additions</b>	<b>18</b>	<b>30</b>	<b>264</b>	<b>-</b>	<b>312</b>
<b>Transfers</b>	<b>-</b>	<b>-</b>	<b>6</b>	<b>-</b>	<b>6</b>
<b>Disposals</b>	<b>(4)</b>	<b>(30)</b>	<b>(56)</b>	<b>-</b>	<b>(90)</b>
<b>Balance at 31 December 2018</b>	<b>6,260</b>	<b>1,975</b>	<b>1,932</b>	<b>214</b>	<b>10,381</b>
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
<b>Depreciation</b>					
<b>Balance at 1 January 2018</b>	<b>3,888</b>	<b>1,589</b>	<b>1,383</b>	<b>144</b>	<b>7,004</b>
<b>Charge for the year</b>	<b>373</b>	<b>149</b>	<b>151</b>	<b>18</b>	<b>691</b>
<b>Transfers</b>	<b>-</b>	<b>-</b>	<b>6</b>	<b>-</b>	<b>6</b>
<b>Disposals</b>	<b>(4)</b>	<b>(27)</b>	<b>(50)</b>	<b>-</b>	<b>(81)</b>
<b>Balance at 31 December 2018</b>	<b>4,257</b>	<b>1,711</b>	<b>1,490</b>	<b>162</b>	<b>7,620</b>
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
Net carrying values at					
<b>31 December 2018</b>	<b>2,003</b>	<b>264</b>	<b>442</b>	<b>52</b>	<b>2,761</b>
31 December 2017	2,358	386	335	70	3,149

As at 31 December 2018 and 31 December 2017 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
<b>Cost</b>		
<b>Balance at 1 January 2018</b>	<b>1,922</b>	<b>1,922</b>
<b>Additions</b>	<b>420</b>	<b>420</b>
<b>Balance at 31 December 2018</b>	<b>2,342</b>	<b>2,342</b>
Balance at 1 January 2017	1,904	1,904
Additions	18	18
Balance at 31 December 2017	1,922	1,922

**Notes to the Financial Statements (continued)**

**23. Intangible assets (continued)**

**Amortisation**

<b>Balance at 1 January 2018</b>	<b>1,827</b>	<b>1,827</b>
<b>Amortisation for the year</b>	<b>53</b>	<b>53</b>
<b>Balance at 31 December 2018</b>	<b>1,880</b>	<b>1,880</b>
Balance at 1 January 2017	1,782	1,782
Amortisation for the year	45	45
Balance at 31 December 2017	1,827	1,827
Net carrying value at		
<b>31 December 2018</b>	<b>462</b>	<b>462</b>
31 December 2017	95	95

As at 31 December 2018 and 31 December 2017 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 2018	31 December 2017
Property and equipment, and software	78	85
Available for sale investments	(8)	(21)
Deferred employees' benefits	1,283	1,536
Other	193	(138)
	<b>1,546</b>	<b>1,462</b>

There were no unrecognised deferred tax assets as at 31 December 2018 and 31 December 2017.

**Movements in temporary differences during the year**

£000	Opening balance 1 January 2018	Recognised in income	Recognised in equity	Closing balance 31 December 2018
Property and equipment, and software	85	(7)	-	78
Available for sale investments	(21)	102	(89)	(8)
Deferred employees' benefits	1,536	(253)	-	1,283
Other	(138)	138	193	193
	<b>1,462</b>	<b>(20)</b>	<b>104</b>	<b>1,546</b>
£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)
	<b>562</b>	<b>989</b>	<b>(89)</b>	<b>1,462</b>

**Notes to the Financial Statements (continued)**

**25. Prepayments, accrued income and other assets**

£000	31 December 2018	31 December 2017
Accrued income	3,597	2,153
Prepaid expenses	332	596
Tax receivable	118	-
Receivable from related party	827	722
Other	1,399	1,733
	<b>6,273</b>	<b>5,204</b>

**26. Deposits from banks**

£000	31 December 2018	31 December 2017
From fellow group companies	20,440	115,381
Other deposits from banks	82,479	7,741
	<b>102,919</b>	<b>123,122</b>

At 31 December 2018 £nil (31 December 2017: £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 2018	31 December 2017
Retail customers:		
Term deposits	256,445	177,518
Notice deposits	92,761	110,746
Current deposits	305,321	285,669
Other	233	607
	<b>654,760</b>	<b>574,540</b>
Corporate customers:		
Notice deposits	54,188	43,032
Current deposits	387,431	390,205
Other	11,060	11,230
	<b>452,679</b>	<b>444,467</b>
	<b>1,107,439</b>	<b>1,019,007</b>

At 31 December 2018 £nil (31 December 2017: £nil) of deposits from customers are expected to be settled more than twelve months after the reporting date.

**28. Subordinated liabilities**

£000	31 December 2018	31 December 2017
Subordinated note issued	60,000	60,000
	<b>60,000</b>	<b>60,000</b>

**Notes to the Financial Statements (continued)**

**28. Subordinated liabilities (continued)**

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 0.98% (31 December 2017: 0.64%). 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 2018	31 December 2017
Creditors and accruals	19,510	19,396
Other	1,849	762
	<b>21,359</b>	<b>20,158</b>

**(b) Defined benefit obligations**

The bank makes contributions, to make good any shortfall between scheme assets and pension obligations 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 in December 2004 and to future accrual in March 2016.

The following tables set out details of the Scheme as at 31 December 2018 and 31 December 2017. 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. No allowance has been made for the possible effect of any requirement to equalize Guaranteed Minimum Pension ("GMPs").

Changes in the present value of the Scheme's liabilities:

£000	31 December 2018	31 December 2017
Benefit obligations at beginning of year	71,650	76,145
Interest costs	1,527	1,650
Actuarial loss	(2,051)	674
Insured annuitants	(1,413)	(3,260)
Benefits paid	(2,032)	(3,559)
Benefit obligations at the end of the year	<b>67,681</b>	<b>71,650</b>

**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 2018	31 December 2017
Un-funded (surplus) obligations	(5,159)	(4,641)
Wholly or partly funded obligations	-	-
<b>Total</b>	<b>(5,159)</b>	<b>(4,641)</b>

Changes in Scheme assets:

£000	31 December 2018	31 December 2017
Market value of assets at beginning of the year	76,291	78,516
Expected return on Scheme assets	1,662	1,728
Insured annuitants	(1,413)	(3,260)
Actuarial gain/ (loss)	(2,484)	2,128
Employers' contributions	816	738
Member's contributions	-	-
Administration expenses	-	-
Benefits paid	(2,032)	(3,559)
<b>Market value of assets at the end of the year</b>	<b>72,840</b>	<b>76,291</b>

Scheme assets as a percentage of total assets:

	31 December 2018	31 December 2017
Equities	25.50%	23.70%
Bonds	24.00%	25.90%
Property	1.30%	2.40%
Cash	49.20%	48.00%

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 2018	31 December 2017
Discount rate	2.90%	2.66%
Price inflation	3.37%	3.30%
Rate of increase in salaries	2.37%	2.30%
Rate of increase for pensions in payment (LPI)	3.25%	3.20%
Post retirement mortality table	S2PA adjusted CMI 2017 (Long Term Improvement)	
Expected return on assets	1.75% (M), 1.25% (F)	

The bank expects to pay £nil (31 December 2017: £nil) in contributions to defined benefit plans in 2018.

**Notes to the Financial Statements (continued)**

**30. Accruals and deferred income**

£000	31 December 2018	31 December 2017
Deferred income	4,760	3,710
Accrued interest	1,447	466
	<b>6,207</b>	<b>4,176</b>

**31. Equity**

**(a) Capital**

At 31 December 2018 the authorised share capital comprised 250,000,000 ordinary shares (31 December 2017: 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) Dividends**

A dividend of £51,118,000 has been recommended for the year ended 31 December 2018 (31 December 2017: £31,606,000). The recommended dividend consists of current year post-tax profits of £51,123,000 less an additional 2018 impact on shareholders equity following the adoption of IFRS 9 from 1 January 2018 of £5,000 beyond the £458,000 IFRS 9 impact estimated in the 2017 financial statements. Payment of a dividend adjusted for IFRS 9 will leave CET1 regulatory capital unchanged for 2019 compared with 2018.

**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 2018 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 2018 the bank received £20,440,000 (31 December 2017: £115,381,000) which is 2% (31 December 2017: 10%) 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
<b>Balance at 31 December 2018</b>		
Cash on hand, cash balances with the central bank and other demand deposits	32,931	-
Loans and advances to banks	61,391	-
Loans and advances to customers	-	4
Derivative financial instruments	1,344	-
Prepayments, accrued income and other assets	827	-
Deposits from banks	20,440	-
Deposits from customers	-	7,221
Derivative financial instrument	1,977	-
Other liabilities	5,090	-
Subordinated liabilities	60,000	-
<b>Included in the income statement for the period</b>		
Interest receivable	1,282	-
Interest payable	(1,867)	-
Other operating income	62,415	10,555
Net loss on derivative financial instruments	(1,075)	-
<b>Balance at 31 December 2017</b>		
Cash on hand, cash balances with the central bank and other demand deposits	30,464	-
Loans and advances to banks	83,706	-
Loans and advances to customers	-	1
Derivative financial instruments	1,459	-
Prepayments, accrued income and other assets	4,321	-
Deposits from banks	115,381	-
Deposits from customers	-	10,633
Derivative financial instruments	2	-
Other liabilities	4,247	-
Subordinated liabilities	60,000	-
<b>Included in the income statement for the period</b>		
Interest receivable	185	-
Interest payable	(4,255)	-
Other operating income	53,742	418
Net gain on derivative financial instruments	51	-

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

	Country of incorporation	Ownership interest	
		31 December 2018	31 December 2017
China Bridge Group (UK) Limited	United Kingdom	100%	100%
China Bridge Group Italy SRL <sup>1</sup>	Italy	100%	100%

<sup>1</sup>Indirect holding via China Bridge Group (UK) Limited. The Italian entity has not had its licence renewed to grant visas for visitors to China and is in the process of being liquidated.

At 31 December 2018, the bank held an investment of £1 in China Bridge Group (UK) Limited (31 December 2017: £1). This entity is wholly-owned, with registered office at 1 Lothbury, London, EC2R 7DB. 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 2018 comprised of salaries and other short-term benefits in the amount of £2,012,000 (31 December 2017: £2,039,000).

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

**(d) Transactions with key management**

Transactions with key management for the period ended 31 December 2018 comprised of retail mortgages transacted on an arms' length basis to the amount of £151,000 (31 December 2017: £nil).

**33. Contingent liabilities and commitments**

**(a) Undrawn loan commitments, guarantees and other financial facilities**

£000	31 December 2018	31 December 2017
Undrawn loan commitments	216,402	262,292
Guarantees	36,366	29,324
Other	6,954	7,652
<b>Total</b>	<b>259,722</b>	<b>299,268</b>

**(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 2018	31 December 2017
Less than one year	884	875
Between one and five years	1,845	2,431
More than five years	1,193	1,599
<b>Total</b>	<b>3,922</b>	<b>4,905</b>

**(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 financial statements 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.

**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.