

Bank of China (UK) Limited

**Annual Report and Financial Statements
For the year ended 31 December 2019**

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Chairman's Statement

The global economy was in slowdown in 2019 amid the rising of global trade protectionism and other risks including geopolitical tensions and Brexit. The central banks of the major economies eased monetary policies to mitigate the risks on the economic development. The Brexit-related uncertainties are the major reason for the weak growth of the UK economy last year.

The bank still managed to deliver a robust performance in 2019 in this ever challenging environment.

2019 marks the 65th anniversary of China-UK diplomatic relations. During the 10th UK China Economic and Financial Dialogue (EFD), both China and the UK have reiterated their commitment to foster a global comprehensive strategic partnership for the 21st Century. The "Golden Era" of China-UK relation was further strengthened. The good relationship between the UK and China will also benefit the development of the bank in the UK.

As the first Chinese bank to go global, Bank of China has always served as the connecting bridge between the UK and China, and has been committed to promoting UK-China relations by serving clients from both countries. The bank implements the Group's technology-led growth strategy for the business development. London has always been a very important hub in Bank of China's global layout and we will set more milestones in the future.

Early in the new year, the Covid-19 pandemic has fundamentally changed the global macroeconomic environment. All businesses now have to be prepared for a deep economic recession which is now unfolding. The bank will need to closely monitor the risks it is exposed to under the unprecedented situation. While making best efforts to protect the health and safety of its staff, the bank must continue to serve its customers and maintain its operational resilience.

I firmly believe that with the strong support of all staff, the bank will be able to get through this crisis and reinforce its position in the UK market.

Yu Sun

Chairman of the Board of Directors

Chief Executive Officer's Statement

The global economy has experienced headwinds in 2019 due in part to the escalation of the trade war between China and US. EU maintained low inflation and it is at the risk of economic recession. The UK economy grew modestly at 1.4% in 2019 due to the Brexit-related uncertainty. Even in this ongoing political and economic uncertainty environment, Bank of China (UK) Limited has continuously achieved robust financial performance in 2019.

The bank's total assets increased slightly from £1.63 billion as of year-end 2018 to £1.69 billion as of year-end 2019. Total income has increased slightly from £114.6 million to £115.2 million in 2019. The bank's total profit after tax has decreased from £51.1 million in 2018 to £32.1 million. The bank had received a £10.5m one-off dividend from the China Bridge Group in 2018.

The bank's strategic focus remains unchanged, which is to establish itself as a specialist mortgage lender in the UK market, the primary choice for the local Chinese community and domestic Chinese enterprises with operations in the UK, as well as expanding our UK client base. The bank will continue to build up the efficient and effective risk management practice to support the business development, and is committed to ensuring it meets all relevant obligations under law and regulation. We will implement the technology-led growth strategy by further embracing the adoption of technologies, such as upgrading the Internet Banking and Mobile Banking platforms.

Given the breakthrough progress of Brexit and stable political environment, we have seen a pick-up in the UK consumer confidence, and private investment at the start of 2020. However, this was quickly dissipated by the outbreak of Covid-19. The pandemic has caused unprecedented disruption to the world economy and huge challenges to all businesses around the globe.

As the virus is still spreading in the UK, the bank is continuously monitoring and assessing the risks its business is faced with. To ensure staff health and safety while maintaining operational resilience are the dual challenges for the management.

Looking forward, with the strong support of the Board and of all our staff, we are confident that we will be able to get through this difficult period and deliver a satisfactory performance in 2020 for all stakeholders.

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 2020 and beyond, most notably:

- The economic impact arising from Covid-19;
- 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 purchase of Goodbody Stockbrokers pending regulatory approval;
- Membership of LCH with the objective of becoming the BOC global derivatives clearer;
- The rate and extent of anticipated interest rate changes;
- The risk of potential decline in property values.

Dividends

The directors do not recommend the payment of a dividend in 2019 (2018: £51,118,000).

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. Yu Sun	Chairman & Non-Executive Director
Ms. Li Ren	Non-Executive Director
Mr. Wenjian Fang	Chief Executive Officer & Executive Director
Mrs. Wei Shi	Chief Risk Officer & Executive Director
Mr. Stewart Trussler	Chief Financial Officer & Executive Director
Mr. Jonathan Spence	Senior Independent Non-Executive Director
Mr. Charles Hardy	Independent Non-Executive Director
Dr. Gerard Lyons	Independent Non-Executive Director

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	4	4	-	4
Mr. Yu Sun	4	-	-	-
Mr. Stewart Trussler	4	-	4*	4*
Mrs. Wei Shi	4	-	1*	4
Ms. Li Ren	3	-	-	-
Mr. Jonathan Spence	4	-	4	4
Mr. Charles Hardy	4	4	4	4*
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 2019 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, part of that assessment included the potential economic impact of Covid-19. The going concern assessment considered specific Covid-19 stresses on the bank's mortgage and aircraft portfolios, and downward revisions to the financial forecast over the assessment period and the effect of these stresses on capital resources which remains strong. The Board has taken into consideration the bank's ability to continue to meet customer's needs whilst taking measures to protect the health and safety of staff. This has largely been achieved by the resilience over business operations provided by the ability for staff to be able to work from home.

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 and a strong capital position 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.

1 Lothbury
London
EC2R 7DB

On behalf of the Board,



Wenjian Fang
Chief Executive Officer
Board Director

23 June 2020

Strategic report of the Directors

Business Review

As at 31 December 2019, Bank of China (UK) Limited (“BOC UK” or the “bank”) had total assets of £1,687 million (2018: £1,631 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 its 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 £32.1 million during 2019 (2018: £51.1 million). A significant part of the year-on-year decrease relates to a £10.5 million one-off dividend received in 2018 from its subsidiary company China Bridge Group (UK) Limited, and a £11.4 million increase in administrative expenses driven by project related professional fees.

Covid-19

To assess the economic impact arising as a result of the coronavirus the bank has performed an internal risk assessment of its corporate customers, with the airline and travel industry identified as particularly at risk. The bank has also considered the potential future impact as part of the going concern assessment (see page 6). The bank will continue to monitor and stress test movements in credit ratings to mitigate risks as they evolve.

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.

In 2020, with regard to Brexit, the Dublin Branch will continue to operate as a licenced bank under passporting rules during the transition period.

Goodbody

On the 8 November 2019 the bank entered in to an agreement to purchase Goodbody Stockbrokers based in Ireland for a price of €154 million. The purchase is subject to regulatory approval which has been sought but has not yet been granted. There is currently no indication of when this regulatory approval might be granted.

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 Parent 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 developing merchant acquiring offering achieved a very positive result. In addition, a featured payment service was launched to enable UK merchants to be able to accept Wechat Pay and Alipay in 2019.

Branches are supervised using a three-in-one branch management mechanism established in 2017, which includes holding bi-weekly managers meetings, operational working groups and on-site inspections. This has laid a solid foundation for future business development and customer service in 2020 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 the internationalisation of China’s domestic “Going Out” enterprises in the UK, Europe and Africa regions.

Strategic report of the Directors (continued)

Financial Markets

Financial markets activities consist of foreign exchange and money market. There has been no proprietary trading activity during the year under review. There was focus on efficient liquidity and funding management.

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 and present difficulties 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, operational risk, legal & compliance risk, IT risk, strategic risk and reputational 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.

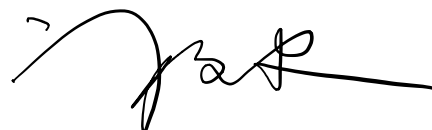
The bank has established a set of credit risk management policies and procedures, and appropriate credit risk limits to manage and control credit risk that arises through its normal business activities. These policies, procedures and limits are regularly reviewed in light of changes in markets and business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

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

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 monitors 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 its compliance with the overall liquidity adequacy rule (OLAR) on an ongoing basis and under a number of severe and plausible stress scenarios. 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.

1 Lothbury
London
EC2R 7DB

On behalf of the Board,



Wenjian Fang
Chief Executive Officer
Board Director

23 June 2020

Corporate Governance Statement

Bank of China (UK) Limited (“BOC UK” or the “bank”) is committed to best practice in corporate governance. The Board of Directors (the “Board”) gives regard to the Wates Corporate Governance Principles for Large Private Companies (“Wates Principles”), published by the Financial Reporting Council in December 2018, which are applicable to companies reporting for financial years starting on or after 1 January 2019.

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 its shareholder, and in doing so, to have regard (amongst other matters) to the following (the “S172(1) matters”):

- the likely consequences of any decision in the long term;
- the interests of the Company’s employees;
- the need to foster the Company’s business relationships with suppliers, customers and others;
- the impact of the Company’s operations on the community and the environment;
- the desirability of the Company maintaining a reputation for high standards of business conduct; and
- the need to act fairly as between members of the Company

The Wates Principles enable the Board to use them as a framework to ensure that the bank complies with the requirements of the “S172(1) matters, as noted below under Wates Principles 1-6:

Principle 1 – Purpose and Leadership

The bank was incorporated in 2007 and together with Bank of China Limited London Branch, has been one of the preferred choices for both Chinese “Going-out” customers and local customers seeking to establish relationships with Chinese banks.

The Board Terms of Reference has stated its primary responsibility for “establishing a culture of ethical conduct and ensuring delivery of good outcomes for stakeholders as far as possible”. The Board is responsible to our shareholder for creating and delivering sustainable shareholder value through the management of the bank’s businesses. The Board aims to ensure that Executive Management strikes an appropriate balance between promoting long-term growth and delivering short-term objectives.

The bank’s core values align with its parent’s, i.e. Responsibility, Integrity, Professionalism, Innovation, Prudence and Performance. The purpose of the bank will be re-communicated to the workforce through a culture project which started in 2019 and running through to 2020. It builds on the bank’s existing commitment to good governance and social responsibility.

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, the Chief Finance 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 such reports as legal and regulatory updates from the Chief Compliance Officer and relevant corporate governance updates from the Company Secretary.

Principle 2 – Board Composition

The Board comprises a Chairman, Chief Executive Officer, Chief Financial Officer, Chief Risk Officer, a Group Non-Executive Director, and three Independent Non-Executives (“iNEDs”), one of them being the Senior Independent Director (“SID”). This size and composition of the Board is appropriate to the bank’s size and nature of business. With four Chinese nationals, four British nationals, and two being women, we consider the diversity on the Board is good. The Board is also committed to making the bank an increasingly inclusive environment (also see note on Diversity on page 6).

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

Principle 2 – Board Composition (continued)

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.

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 being asked of the Board, providing objective challenge to Executive 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 independence of a Non-Executive Director is determined by assessing against the following essential criteria:

- 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 bank's sole shareholder reserves 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.

The iNEDs attend and act as respective chairs to relevant committees (as noted on pages 14 to 16) so that they are able to effectively challenge and influence a diverse areas of the bank. The Executive Management Committee ensures that the right tones are set and communicated consistently to all levels of the workforce - for example through regular Managers Meetings, departmental meetings and team meetings.

Directors update their skills, knowledge and familiarity with the bank by meeting with Executive Management, Heads of Department, and by attending appropriate external seminars and training courses. 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.

In addition to the above, the bank also creates opportunities for the iNEDs to have access to the shareholder – for example arranging a Board Meeting in July 2019 in Beijing, thus introducing iNEDs to relevant senior contacts at the shareholder's global head quarter.

All Directors have access to the advice and services of the Company Secretary and may, if they wish, take professional advice at the company's expense. During 2019, the Board was provided with regular updates on Corporate Governance and Regulatory Responsibilities.

Principle 3 – Director Responsibilities

Clear lines of Accountability and Responsibility supports effective decision-making. Responsibilities Map and Statement of Responsibilities introduced by the Senior Managers Regime ensure that each Board member has a clear understanding of their accountability and responsibilities. The Board has a programme of four Board meetings every year, plus potentially additional time for strategic planning. There was a two-day strategic event in March 2019.

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.

Principle 3 – Director Responsibilities (continued)

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, the Senior Independent Director (SID) and/or the Chief Executive Officer at any time. During the year ended 31 December 2019, it is considered that all Directors contributed the time necessary to discharge their responsibilities to the Board. Potential conflicts of interest need were declared and managed.

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.

Committees The Board delegates authority for day-to-day management of the company to the Executive Management Committee which meets weekly, and is chaired by the Chief Executive Officer. Its membership includes the Chief Risk Officer, the Chief Financial Officer, the Treasurer, the Chief Retail and Corporate Banking Officer, the Chief Operating Officer and the Chief Compliance Officer.

The Independent Non-Executive Directors are wholly independent in that they have no material business or relationships with the company that might influence their independence or judgement. In addition, certain governance responsibilities are delegated to other Board committees, specified below (as noted on pages 14 to 16).

The Board pays close attention to the **Integrity of Information** as it relies on good management information (MI) to monitor and challenge the performance of the bank and make informed decisions. 2019 has seen significant improvement to the MI packs presented to respective Board committees and the Board. The bank has introduced a standard template for Board papers, with executive summary in front and encourages more in-depth and forward analysis to inform and enable effective decision making and challenge.

Principle 4 – Opportunity and Risk

The Board promotes a prudent approach to risk whilst seeking out opportunity.

Opportunity Long term strategic opportunities are highlighted in the rolling Five-Year Strategic Plan, which is presented to the Board for approval every year. Short term opportunities to discussed at management committee levels at a more regular interval.

Risk The bank's key risks, uncertainties and mitigations are outlined in the Strategic Report (on page 8). The company's systems and controls are designed to manage, rather than to entirely eliminate, the risk of failure to achieve business objectives and can only provide reasonable and not an absolute assurance against a risk materialising.

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.

Principle 5 – Remuneration

The Board established a Remuneration Committee to discharge its responsibilities for designing remuneration structures and policies. It benefits from the Chairmanship of an iNED to ensure that executive remuneration structures are aligned to the long-term health of the company, taking into account pay and conditions elsewhere in the industry, the local market and shareholder influence.

The Remuneration Committee's work in detail is set out on page 15. The Directors' remuneration is disclosed on page 90.

Principle 6 – Stakeholder Relationships and Engagement

The Board recognises the importance of stakeholder engagement, which means good relationships with all our stakeholder community including our sole shareholder, regulators, customers, employees, suppliers and the local communities:

During 2019, the Board continues to seek to align the company's strategic direction with its stated values and to the **shareholder's** aspirations for long-term growth, transformation and social responsibility.

Principle 6 – Stakeholder Relationships and Engagement (continued)

The direction of the BOC UK's shareholder continued to cascade down into the strategy planning of the bank. For example, the Board approved the proposal for the BOCUK to apply for the membership of London Clearing House (LCH). Becoming the first Chinese Clearing Member of LCH allows the bank to participate directly in LCH clearing counterparty (CCP) business and provide multi-currency clearing services for interest rate swap transaction across the global financial markets. It marks the first time for Chinese financial institutions to self-clear and settle OTC derivatives transactions with LCH and it will also encourage other Chinese institutions to participate in the central clearing and settlement of international derivatives.

The Board recognises the importance of continuous open and honest dialogue with our **regulators**. The Chairman would visit the UK regulators to exchange views whenever he visits the UK. The CEO also engages with our regulators on a regular basis.

During 2019, the Executive Directors and other members of Executive Management attended meetings with the PRA and the Head of Internal Audit also separately met with the PRA. The PRA were provided with management information throughout 2019 and the PRA delegates also had a meeting with our Parent in Beijing when they visited Beijing for the 2019 regulatory college hosted by the Chinese regulator, the China Banking and Insurance Regulatory Commission.

In supporting our **customers** over the last year, the bank has made the following efforts:

- Expanding Our Product Range – the bank has improved Mobile Banking functionalities, supported the Open Banking (PSD2) initiative in Europe, introduced digital payment functions for our Merchant Acquiring business (Alipay and WeChat Pay), and launched a lower rate Buy To Let mortgage proposition specifically for the directed market.
- Improving Our Processing Capability - the bank has delivered a faster mortgage underwriting and pre-drawdown process, with the average case processing speed now at least 30% faster than the previous year. The bank has also taken steps to significantly improve the production of its debit cards for customers, and developed new distribution channels for our intermediary business (Twenty7tec, Knowledge Bank) which have delivered a 20% increase in referrals.
- Bringing Further Convenience to our clients - the bank's recent strides in supporting Mobile Banking has included improved biometric security measures for authentication, access to execution services and consolidated reporting via our new app capability. Additionally, our Call Centre has worked to expand its operating timeframes in cooperation with Head Office, and the bank has also introduced a seamless switching functionality between a number of our existing Mortgage Products, as well as introducing a proactive reminder to borrowers approaching the end of their initial loan deal.

In view of increasing number of UK Small Medium Enterprises that are interested in exporting to China and require assistance in accessing to the China market, by leveraging our extensive branch network advantage in China and the UK, the bank brought 18 UK companies in November 2019 to the 2nd Shanghai Import Expo. During the Expo, the UK companies successfully participated in various activities including match making event held by Bank of China Limited, which was aimed to bring the overseas exporters and Chinese domestic importers together in order to promote mutual business opportunities.

Recent years have witnessed the enhanced menu of flexible benefits and wellbeing initiatives on offer to **employees**, such as hosting Vitality Days each year to provide onsite health checking services, etc.

The bank continues to take active part in the **local communities**, via the annual City Giving Day, for example, and pay close attention to carbon emission obligation.

Members of the Board also took every opportunity to maintain a visible presence in the bank for better engagement, promoting an ethical corporate culture.

An annual Management Performance Self-Assessment Presentation delivered to staff representatives provides a briefing on Management performance and allows individuals to raise questions and concerns. If any employee wishes to highlight any potential breaches to the Code of Conduct, they can contact the independent whistleblowing hotline or contact the Whistleblowers' Champion directly. Whistleblowing cases will be investigated. The quarterly bank newsletter continues to share best practice, achievements and success throughout the bank.

The bank engages with its suppliers through its contractual arrangements and requirements to ensure prompt payment, adhering to the Small Business, Enterprise and Employment Act 2015 (Section 3) to report on the bank's payment performance biannually.

Bank of China (UK) Limited

Financial Statements for the year ended 31 December 2019

Annual Performance Review Process

As with previous years, and in alignment with the bank's annual and interim performance management process, annual performance contracts were established for the Executive Directors for 2019 to assess their performance across four 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 detailed Key Performance Indicators across the four Key Performance Areas and 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 Board undertook its 2019 effectiveness review via a focused questionnaire, facilitated by external advisors, following its 2018 review via interviews by the same independent external advisor. The result of these effectiveness reviews assessed that the Board was balanced, competent and well run, with potential for further improvement with future strategic 'deep dives', etc.

Board Audit Committee Report

The Audit Committee comprises two iNEDs; Mr. Charles Hardy, Chairman, and Mr. Jonathan Spence, who are the only voting members. The Chief Risk Officer, the Chief Financial Officer, the Chief Operating Officer, the Chief Compliance Officer and the Head of Internal Audit Department were standing attendees together with the heads of the second line risk departments. During 2019, 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.
- Quarterly updates were received from the Credit Management, Risk Management and Legal and Compliance Departments and these were considered and discussed.

In addition, the Committee:

- Considered and approved the annual Internal Audit Department Plan.
- Approved the scope of the external auditors' work and separately assessed their effectiveness. Non-audit services were approved by the Committee.
- Carried out an assessment of the effectiveness of the Internal Audit Department which was felt to be operating effectively. The adequacy of the resources available to the Internal Audit Department was also considered. During the year the size of the team increased from seven to nine, and included a data analyst to assist with the data analytics activity now being undertaken. It is anticipated that there will be a further increase in the current year. The effectiveness of the Audit Committee itself was considered as part of the Board assessment.
- Reviewed in detail the annual financial statements and the quality and acceptability of the related accounting policies, practices and financial reporting disclosures.

Board Audit Committee Report

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 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. The Head of Human Resources, ("HR") and 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 operates an effective human resources function that meets all applicable statutory and regulatory requirements. 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 2019 (four quarterly Committee meetings and two ad hoc meetings).

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 continued improvement of the MI 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.

Key activities undertaken in 2019 were reviewing, approving and monitoring of the HR annual work plan which supports the five year strategic plan including:

- Supporting business development initiatives and relevant organization development
- Undertaking annual reward programmes
- Undertaking the annual Employee Recognition Programme;
- Undertaking the annual performance management process;
- Implementing relevant Learning and Development initiatives including participation in "Learning at Work" week, internal stay connected sessions, technical and soft skills programmes to continue to develop internal capabilities
- Implementation of a Management Development Programme with an external business school aligned to the bank's succession planning framework;
- Continued consideration of the impact of the Senior Manager & Certification Regime;
- Implementation of a HR information system with integrated payroll system to ensure efficiencies can be considered in relation to HR processes whilst ensuring HR information and management information reporting requirements, can be met in the future;
- Review of the annual flexible benefits scheme
- Implementation of a new defined contribution pension scheme provider;
- Review of the headcount budget for 2019 and achievement of headcount increase in alignment with business strategy and staff turnover data throughout 2019 with appropriate actions being taken should anything adverse be noted;
- Continued review of 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 and the European Banking Authority's remuneration guidelines on UK remuneration strategies;
- Continued focus on the corporate culture of the bank, including the development of a culture framework to be implemented throughout 2020.

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

- The Learning and Development plan for 2020 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 departmental development framework to clarify employee's future career opportunities in addition to development of a formal Employee Value Proposition
- Development of the bank's health and wellbeing strategy to provide tools and support to all employees including a new employee assistance plan provider
- Implementation of the FCA's Register for all certified employees under the SMCR
- Continued focus on the resourcing strategy of the bank
- A reassessment of the year end performance management process to ensure it was aligned fully to the annual salary review and discretionary bonus allocations.

Bank of China (UK) Limited Financial Statements for the year ended 31 December 2019

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 Risk Management & Internal Control Committee, Credit Risk Management & Decision Committee, Operational Risk Committee, Compliance Committee, Operational Resilience & Controls Committee, Assets and Liabilities Management Committee, and IT Management Committee. The Committee also approves all credit limits, provisions (and/or write-offs) above the delegated limits of the Chief Risk 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"), Internal Liquidity Adequacy Assessment ("ILAAP") and Recovery Plan documents prior to them being presented to the Board for approval.

Country by Country Reporting

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

Pillar III Disclosures

Further information regarding the bank's approach to risk management and its capital adequacy are contained in the unaudited disclosures made under the requirements of Basel II Pillar 3 (the Pillar 3 disclosures). These disclosures will be published on the bank's website shortly after the approval of these financial statements at www.bankofchina.com/uk.

Modern Slavery Act

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

Gender Pay

Further information relating to the bank's Gender Pay Gap was published on its website www.bankofchina.com/uk and the designated government website www.gov.uk/genderpaygap on 3 April 2020 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 18 to 29, 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
23 June 2020

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” or “the company”) for the year ended 31 December 2019 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 2019 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 company 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 company'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

Key audit matters	<ul style="list-style-type: none"> • Provisions / contingent liabilities in respect of potential non-compliance with regulations; • Adequacy of the inputs and appropriateness of the assumptions used in calculating ECL; • Risk of improper recognition of fee and commission on retail loans; • Appropriateness of the discount rate used in calculating the fair value loans; • Provisions / contingent liabilities for claims in respect of the Bank of China (Suisse) SA sale agreement; • The impact of the Coronavirus global pandemic (Covid-19) on the bank’s ability to continue as a going concern.
Materiality	<ul style="list-style-type: none"> • Overall materiality of £2.8m which represents 5% of profit before tax.

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

Key audit matters

Key audit matters are those matters that, in our professional judgment, 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>Provisions / contingent liabilities in respect of potential non-compliance with foreign payments regulations;</p> <p><i>Refer to the Accounting policies (page 49); and Note 33c of the Financial Statements (page 101)</i></p> <p>There is a high degree of judgement in the interpretation of the facts of possible non-compliance with foreign payments regulations in order to arrive at a conclusion as to whether a provision/ contingent liability should be recorded.</p>	<p>Our procedures included:</p> <ul style="list-style-type: none"> • Engaged EY specialists team on the matter to provide support to the audit team in understanding fact pattern, and in assessing the potential impact on the financial statements; • Obtained an understanding of management's response, including the scope and findings from management's investigation; • Considered the impact on the bank's Entity Level Controls to identify the impacts on the audit work, considering the potential for management override of controls; • Discussed with the bank's legal counsel the status of work performed to determine if the criteria under IAS 37 for recording a provision or disclosing a contingent liability had been met; • Validated whether disclosures made were appropriate and in line with IAS 37. 	<p>We have gained reasonable assurance that the disclosure of a contingent liability in relation to the matter is reasonable and in line with IAS 37.</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>Adequacy of the inputs and appropriateness of the assumptions used in calculating expected credit loss (ECL) (ECL: 2019: £1.3m, 2018: £0.9m; Loans and advances to customers: 2019: £1,065m 2018: £1,045m)</p> <p><i>Refer to the Accounting policies (page 40); and Note 6 of the Financial Statements (page 53)</i></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 the following judgement areas:</p> <ul style="list-style-type: none"> • The rationale used by management to determine those financial assets considered as part of the ECL model; • The judgments and rationale used by management to determine the staging of credit facilities and the identification of impairment triggers; • Probability of Default (PD) and Loss Given Default (LGD) inputs within the ECL impairment model; and • Derivation and weightings of the scenarios used within the ECL calculation. <p>Our procedures included:</p> <ul style="list-style-type: none"> • Assessed the design and operating effectiveness of key controls over the ECL process, considering the potential for management override of controls; • Inspected a sample of credit assessment files to identify indicators of significant increase in credit risk since origination; • Considered whether there were any concerns regarding recoverability for positions in arrears at year-end; • Tested the completeness and accuracy of the credit portfolio data and macroeconomic inputs used in the model, including the internal ratings, overdue days and collateral valuation; • Reviewed credit files, arrears statistics, and watchlists, and assessed the collateral valuation over the retail and corporate books to test whether the Loan to Value (LTV) percentage and LGD applied are appropriate; • Identified concentrated exposures to individual debtors or particular industries and geographic regions within the bank's portfolio and considered implications based on the bank's prior experience; 	<p>We concluded that the ECL and staging allocations were in line with IFRS 9.</p> <p>Our benchmarking results indicated that the bank's coverage ratios, overall, are comparable in size to peers. However, the ratios are on the lower side for stage 2 wholesale exposures and stage 3 retail exposures, given the level of collateral and the low historic default rates.</p>

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

Key audit matters (continued)

- Engaged internal modelling specialists in performing audit procedures on the ECL models and the corresponding assumptions underlying the models;
 - Obtained understanding of the basis for the weightings assigned to each ECL scenario and benchmarked these to the market to verify the reasonableness;
 - Obtained an understanding of and assessed forward-looking assumptions used within the ECL models;
 - Obtained an understanding of how the weightings of scenarios were decided and the linkages to the severity of the chosen scenarios. Challenged the level of severity on the downside scenario and tested the response of the model to the scenarios, and benchmarked the scenarios and weights to the market for reasonableness where appropriate;
 - Performed independent benchmarking of coverage ratio to peers;
 - Assessed the adequacy and appropriateness of disclosures.
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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>Risk of improper recognition of fee and commission on retail loans (2019: £921k, 2018: £844k)</p>	<p>Our approach focused on the following judgement areas:</p> <ul style="list-style-type: none"> • Distinguish between the fee that is integral to the loan and thus is included within IFRS 9 EIR amortisation and the fee that is not integral to the loan and thus is accounted for in accordance with IFRS 15; and • The use of an estimate for the average loan life using historical data. <p>Our procedures included:</p> <ul style="list-style-type: none"> • Assessing the design and testing the operating effectiveness of key controls over the calculation and recognition of fee and commission income of retail loans, considering the potential for management override of controls; • Testing the completeness and accuracy of the historical loan data used by management in their calculation of the average loan life; • Benchmarking the management estimated average loan life of retail loans against the market; • Performed sensitivity analysis on the average loan life; and • Recalculating the amortisation of fee and commission income of retail loans during the year. 	<p>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>
<p>Refer to the Accounting policies (page 37); and Note 9 of the Financial Statements (page 88)</p>		
<p>The risk exists as the use of incorrect/incomplete data to estimate the average useful life of retail loans may result in inappropriate amortisation of fee and commission income over the duration of the loan life. Determining an average useful life involves a level of judgement when estimating the average loan life by applying historical data.</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>Appropriateness of the discount rate used in calculating the fair value loans (2019: £83.9m, 2018: £76.2m)</p>	<p>Our approach focused on the following judgement areas:</p> <ul style="list-style-type: none"> • The discount rate applied to future cashflows to calculate the net present value of the fair value loans as at 31 December 2019 and the appropriateness of the input data; and • The valuation technique applied. 	<p>We concluded that the fair value recorded at 31 December 2019 was in line with the accounting standards.</p>
<p><i>Refer to the Accounting policies (page 48); and Note 7 of the Financial Statements (page 85)</i></p>	<p>Our procedures included:</p> <ul style="list-style-type: none"> • Assessed the design effectiveness of key controls in the process, considering the potential for management override of controls; • Independently sourced the three-month USD Spot LIBOR curve as at 31 December 2019 from Bloomberg and applied those rates plus the margin rates to the future repayments to re-calculate the net present value of the respective loans; • Challenged the appropriateness of the margin rate used by management, as to whether it is reflective of client credit risk; • Performed sensitivity analysis on the discount rates used; • Engaged our valuation specialists to assess the methodology applied; • Agreed other inputs (for example interest rates, repayment schedules) into the fair value calculation to underlying loan documentation; and • Recalculated the mark-to-market value and compared it with the bank's value. 	
<p>The risk exists as due to use of incorrect discount rates to estimate the net present value of loans recorded at fair value may result in the corresponding loans being valued inaccurately. Also, based on the manual nature of the calculation, there is a risk that incorrect data is used in the calculation.</p>		
<p>This risk has been identified as Key Audit Matter in 2019 due to the materiality of the mark to market movements of the loans.</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>Provisions / contingent liabilities for claims in respect of the Bank of China (Suisse) SA sale agreement</p> <p><i>Refer to the Accounting policies (page 49); and Note 33(c) of the Financial Statements (page 101)</i></p> <p>There is a high degree of judgement in the interpretation of the facts of legal cases in order to arrive at a conclusion as to whether a provision should be recorded.</p>	<p>Our approach focused on:</p> <ul style="list-style-type: none"> • Gained an understanding of the bank's identification, estimation, monitoring and disclosure of provisions, considering the potential for management override of controls; • Challenged the reasonableness of management's assessment of the outcome of the legal claims, including the financial impact on the bank's financial statements and related provision; • Obtained written confirmation and discussed the matter directly with the bank's external legal counsel, including the details of the claims, including developments during the year and the likely outcomes; • Assessing the recognition of provisions and the appropriateness of disclosures in accordance with the accounting criteria. 	<p>We concluded that, based on the likelihood of outflow and potential value of outflow, that the provision recorded and disclosures were in line with the accounting standards.</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>The impact of the Coronavirus global pandemic (Covid-19) on the bank's ability to continue as a going concern</p> <p><i>Please refer to the Significant accounting policies (page 48) and the Subsequent events note (page 101) of the Financial Statements.</i></p> <p>The global outbreak of Covid-19 has had and will continue to have a significant impact on the Global and UK economy, and presents operational, market and financial challenges to the bank, with a consequent impact on the directors' assessment of going concern.</p> <p>There is a risk that the Directors have drawn inappropriate conclusions regarding the going concern basis and that the disclosures in the financial statements are inadequate or inappropriate.</p>	<p>Our approach focused on:</p> <ul style="list-style-type: none"> • Obtaining the bank's forecast and challenging the key assumptions, including the assumptions to reflect the potential impact of Covid-19, and the reasonableness of the forecast over the going concern period of 12 months from the date of approval of these financial statements; • Assessing the stress testing performed, to confirm the Directors had considered downside scenarios and the impacts on the bank's going concern; • Reviewing the bank's liquidity and capital position over the going concern period under the stress testing scenarios; • Reviewing the year to date actual 2020 financial results to identify if there are any indicators that might cause material doubt about the bank's going concern; • Assessing, with the support of the auditors of the bank's parent company, the going concern ability of the bank's parent company, should it be required to strategically or financially support the bank; • Assessing the operational challenges arising from Covid-19 on the bank and their ability to remain in operation over the lockdown period; and • Assessing the extent of the disclosures relating to the impact of Covid-19, particularly in relation to the Directors' assessment of going concern, the key assumptions used, and the sufficiency of the disclosures of non-adjusting events that have occurred subsequent to the year end. 	<p>We concluded that the Directors had a reasonable basis on which to conclude that Covid-19 does not give rise to a material uncertainty in respect of going concern and therefore to prepare the 2019 financial statements on a going concern basis. We also concluded that the bank's disclosures relating to Covid-19 were sufficient.</p>

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 directly 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 bank to be £2.56 million (2018: £2.69 million), which is 5% (2018: 5%) 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 performance indicator.

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% (2018: 75%) of our planning materiality, namely £1.92m (2018: £2.02m). 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 £0.13m (2018: £0.14m), 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 company 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 17, 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 company'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 company 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 company 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 Bank of China (UK) Limited 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 to identify 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 and those responsible for legal and compliance matters; as well as focussed 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.

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

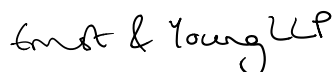
We were appointed by the company on 11 October 2013 to audit the financial statements for the year ending 31 December 2013 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments is 7 years, covering the years ending 2013 to 2019.

- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the company and we remain independent of the company in conducting the audit.
- The audit opinion is consistent with the additional report to the audit committee.

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

Use of our report

This report is made solely to the company'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 company'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 company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.



Helen Joseph (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London
24 June 2020

Bank of China (UK) Limited
 Financial Statements for the year ended 31 December 2019

Income Statement

£000	Note	12 months to 31 December 2019	12 months to 31 December 2018
Interest income from financial investments		93	116
Other interest income		45,600	40,643
Interest expense		(9,313)	(6,553)
Net interest income	8	36,380	34,206
Gross fee and commission income		4,674	4,850
Gross fee and commission expense		(1,170)	(886)
Net fee and commission income	9	3,504	3,964
Net fair value loss on financial instruments	10	(1,165)	(331)
Foreign exchange gain		4,767	3,167
Other operating income	11	71,751	73,555
Non-interest income		75,353	76,391
Total income		115,237	114,561
Staff costs	12	(47,279)	(41,868)
Other expenses	13	(23,048)	(7,857)
Depreciation of plant and equipment	22	(2,498)	(691)
Amortisation of intangible assets	23	(100)	(53)
Impairment (charge) release	20	(377)	458
Profit before income tax		41,935	64,550
Income tax expense	15	(9,830)	(13,427)
Profit for the year		32,105	51,123

Statement of Other Comprehensive Income

£000	Note	12 months to 31 December 2019	12 month to 31 December 2018
Profit for the year		32,105	51,123
Other comprehensive income			
Amounts that will be reclassified to the income statement			
Income and deferred tax credit relating to components of other comprehensive income	15	-	-
Other comprehensive income for the year, net of income and deferred tax credit or expense		-	-
Total comprehensive income for the year		32,105	51,123

Statement of Financial Position

£000	Note	31 December 2019	31 December 2018
Assets			
Cash and cash equivalents	16	332,542	333,275
Loans and advances to banks	18	85,247	61,391
Loans and advances to customers	19	1,064,347	1,044,570
Derivative financial instruments	17	4,614	1,344
Prepayments, accrued income and other assets	25	58,405	6,273
Financial assets at fair value through profit and loss	21(a)	83,928	76,171
Debt instruments at amortised cost	21(b)	50,431	103,189
Deferred tax assets	24	787	1,546
Property, plant and equipment	22	6,328	2,761
Intangible assets	23	759	462
Investment in subsidiary companies	32(b)	-	-
Total assets		1,687,388	1,630,982
Liabilities			
Deposits from banks	26	128,590	102,919
Deposits from customers	27	1,132,193	1,107,439
Derivative financial instruments	17	8,771	1,977
Other liabilities	29	43,609	21,359
Accruals and deferred income	30	6,390	6,207
Current corporation tax liabilities		675	4,908
Impairment provision on off balance sheet products		102	97
Subordinated liabilities	28	60,000	60,000
Total liabilities		1,380,330	1,304,906
1Equity			
	31		
Authorised and called up share capital		250,000	250,000
Retained earnings		57,058	76,076
Total shareholders' equity		307,058	326,076
Total shareholders' equity and liabilities		1,687,388	1,630,982

The financial statements on pages 30 to 101 were approved by the Board of Directors of Bank of China (UK) Limited and authorised for issue on 23 June 2020. They were signed on its behalf by:



Wenjian Fang
 Chief Executive Officer
 Board Director

Statement of Changes in Equity

£000	Issued share capital	Retained earnings	Available for sale reserve	Total
As of 1 January 2019	250,000	76,076	-	326,076
Profit for the financial year	-	32,105	-	32,105
Total comprehensive income	-	32,105	-	32,105
Foreign exchange and other	-	(5)	-	(5)
Dividend paid	-	(51,118)	-	(51,118)
As at 31 December 2019	250,000	57,058	-	307,058
As of 1 January 2018	250,000	57,022	32	307,054
Impact of adopting IFRS 9 (Note 6 (a))	-	(463)	(32)	(495)
Restated opening balance under IFRS 9	250,000	56,559	-	306,559
Profit for the financial year	-	51,123	-	51,123
Total comprehensive income	-	51,123	-	51,123
Dividend paid	-	(31,606)	-	(31,606)
As at 31 December 2018	250,000	76,076	-	326,076

Statement of Cash Flows

£000	Note	12 months to 31 December 2019	12 months to 31 December 2018
Cash flows from operating activities			
Profit on ordinary activities before taxation		41,935	64,550
Adjustments for non cash items			
Depreciation and amortisation of plant and equipment and intangible assets		2,599	744
Net impairment gain on loans and advances		377	(458)
Interest receivable from financial investments		93	116
Other interest receivable		(46,357)	(41,792)
Interest payable		9,313	6,553
Gain (loss) on disposal of fixed assets		-	(1)
Amortisation of premiums of debt instruments at amortised cost		-	-
Other income receivable		-	-
Changes in operating assets and liabilities			
Change in derivative financial instruments assets held for risk management		(3,270)	372
Change in loans and advances to banks		(23,856)	22,315
Change in loans and advances to customers		(20,154)	(31,910)
Change in financial assets at amortised cost/fair value		(4,241)	(30,262)
Change in other assets		(57,250)	2,055
Change in derivative financial instruments liabilities held for risk management		6,794	1,720
Change in deposits from banks		25,671	(20,203)
Change in deposits from customers		24,754	88,432
Change in other liabilities and provisions		22,251	(793)
Adjustment for cash items			
Interest and coupon received		45,600	40,643
Dividend paid		(51,118)	(31,606)
Interest paid		(9,313)	(4,522)
Income tax paid		(13,293)	(13,859)
Net cash generated from operating activities		(49,465)	52,094
Cash flows from investing activities			
Acquisition of investment securities		-	-
Proceeds from maturity of investment securities		50,000	-
Acquisition of property and equipment		(870)	(318)
Acquisition of intangible assets		(398)	(419)
Net cash from investing activities		48,732	(737)
Net cash from financing activities			
		-	-
Net (decrease) increase in cash and cash equivalents		(733)	51,357
Cash and cash equivalents at beginning of period		333,275	281,944
Prior year reclassification adjustments		-	(26)
Cash and cash equivalents at year end	16	332,542	333,275

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

Notes to the Financial Statements

Note	Note
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2. Basis of preparation	30. Accruals and deferred income
3. Significant accounting policies	31. Equity
4. Critical estimates and judgements	32. Related parties
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6. Financial risk management	34. Subsequent events
7. Financial assets and financial liabilities	
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9. Net fee and commission income	
10. Net fair value gain/ (loss) on financial instruments	
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13. Other expenses	
14. Directors' remuneration	
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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 2019

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 23 June 2020.

(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 designated at fair value;
- Derivative financial instruments.

(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 outlines a five step model an entity must apply to measure and recognise revenue.

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 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) 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 customers 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.

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.

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;

Notes to the Financial Statements (continued)

3. Significant accounting policies (continued)

(d) Loans and advances to banks and customers (continued)

Business model assessment (continued)

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.

(e) 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.

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

The bank applies IFRS 9 for 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.

Notes to the Financial Statements (continued)

3. Significant accounting policies (continued)

(f) Debt instruments at fair value through other comprehensive income (FVOCI) (continued)

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(h). 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.

(g) Loan commitments, guarantees and other financial facilities

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

(h) Impairment of financial assets

Overview of the expected credit loss principles (ECL)

The bank records an 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 on page 44.

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.

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.

Notes to the Financial Statements (continued)

3. Significant accounting policies (continued)

The calculation of ECLs – General Policy (continued)

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 42, 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 42. The calculation of ECLs (including the ECLs related to the undrawn element) of revolving facilities such as credit cards is explained further on page 42.

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% and is detailed in Note 6.

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(c).

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. 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 is 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

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 as a matter of course make any concessions or modifications to the original terms of loans as a response to the customer's financial difficulties.

Impairment losses on financial assets

The measurement of impairment losses under IFRS 9 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 whether 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.

Notes to the Financial Statements (continued)

3. Significant accounting policies (continued)

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 have been quantified and are set out in Note 6(a).

- 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.

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.

Definition of default

According to the IFRS 9 guideline, a facility is generally considered as default when the facility is 90 days past due.

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.

Notes to the Financial Statements (continued)

3. Significant accounting policies (continued)

(i) Derecognition of financial liabilities

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

(j) Subsidiaries

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

The investment in subsidiaries is accounted for at cost less impairment.

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

(k) 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.

(l) Intangible assets

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

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

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

(m) 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.

(n) Leases

Leases (Policy applicable before 1 January 2019)

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.

Leases (Policy applicable as of 1 January 2019)

The bank assesses at contract inception whether a contract is, or contains, a lease. That is, if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

Notes to the Financial Statements (continued)

3. Significant accounting policies (continued)

Bank as a lessee

The bank applies a single recognition and measurement approach for all leases, except for short-term leases and leases of low-value assets. The bank recognises lease liabilities to make lease payments and right-of-use assets representing the right to use the underlying assets.

Right-of-use assets

The bank recognises right-of-use assets at the commencement date of the lease (i.e., the date the underlying asset is available for use). Right-of-use assets are measured at cost, less any accumulated depreciation and impairment losses, and adjusted for any re-measurement of lease liabilities. The cost of right-of-use assets includes the amount of lease liabilities recognised, initial direct costs incurred, and lease payments made at or before the commencement date less any lease incentives received. Right-of-use assets are depreciated on a straight-line basis over the lease term.

The right-of-use assets are presented within Note 22 Fixed assets and right-of-use assets and are subject to impairment in line with the bank's policy as described in Note 3 Impairment of financial assets.

Lease liabilities

At the commencement date of the lease, the bank recognises lease liabilities measured at the present value of lease payments to be made over the lease term. The lease payments include fixed payments (less any lease incentives receivable), variable lease payments that depend on an index or a rate, and amounts expected to be paid under residual value guarantees. The lease payments also include the exercise price of a purchase option reasonably certain to be exercised by the bank and payments of penalties for terminating the lease, if the lease term reflects exercising the option to terminate. Variable lease payments that do not depend on an index or a rate are recognised as expenses in the period in which the event or condition that triggers the payment occurs.

Bank as a lessor

IFRS 16 does not change substantially how a lessor accounts for leases. Under IFRS 16 leases for which the bank is a lessor are classified as finance or operating leases. Whenever the terms of the lease transfer substantially all the risks and rewards incidental to ownership of an asset to the lessee, the contract is classified as a finance lease. Amounts due from lessees under finance leases are recognised as receivables at the amount of the bank's net investment in the leases.

The bank as an intermediate lessor derecognises the right-of-use asset relating to the head lease that it transfers to the sublessee and recognises the net investment in the sublease. At recognition any differences between the right-of-use asset and the net investment in the sublease is recognised in the profit or loss, and retains the lease liability relating to the head lease which represents the lease payments owed to the head lessor. During the term of the sublease, the bank recognises both finance income on the sublease and interest expense on the head lease.

All other leases are classified as operating. Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised over the lease term on the same basis as rental income. Contingent rents are recognised as revenue in the period in which they are earned.

Determination of the lease term for contracts with renewal and termination options (bank as a lessee)

The bank determines the lease term as the non-cancellable term of the lease, together with any periods covered by an option to extend the lease if it is reasonably certain to be exercised, or any periods covered by an option to terminate the lease, if it is reasonably certain not to be exercised.

The bank has several lease contracts that include extension and termination options. The bank applies judgement in evaluating whether it is reasonably certain whether or not to exercise the option to renew or terminate the lease. That is, it considers all relevant factors that create an economic incentive for it to exercise either the renewal or termination. After the commencement date, the bank reassesses the lease term if there is a significant event or change in circumstances that is within its control that affects its ability to exercise or not to exercise the option to renew or to terminate (e.g., construction of significant leasehold improvements or significant customisation of the leased asset).

Notes to the Financial Statements (continued)

3. Significant accounting policies (continued)

Estimating the incremental borrowing rate

The bank cannot readily determine the interest rate implicit in the lease, therefore, it uses its incremental borrowing rate ('IBR') to measure lease liabilities. The IBR is the rate of interest that the bank would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment. The IBR therefore reflects what the bank 'would have to pay', which requires estimation when no observable rates are available (such as for subsidiaries that do not enter into financing transactions) or when they need to be adjusted to reflect the terms and conditions of the lease (for example, when leases are not in the subsidiary's functional currency). The bank estimates the IBR using observable inputs (such as market interest rates) when available and is required to make certain entity-specific adjustments (such as the subsidiary's stand-alone credit rating, or to reflect the terms and conditions of the lease).

(o) 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.

(p) Borrowings

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

(q) Employee benefits

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 Participating Employer in the Bank of China Pension and Life Assurance Plan ("the Plan") that provides pension benefits for employees upon retirement. The Bank of China Limited is the Principal Employer of the Plan and through its London Branch the sponsor ("the sponsor"). The Plan was closed to new employees in December 2004 and to future accrual in March 2016. There is no contractual obligation on the bank to make good any shortfall between the Plans assets and liabilities, pay any contributions or receive any of the surplus should one exist.

(r) Short-term benefits

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

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

(s) Taxation

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

Current tax is the tax expected to be 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.

Notes to the Financial Statements (continued)

3. Significant accounting policies (continued)

(t) Provisions

The bank operates in a regulatory and legal environment that, by nature, has a heightened element of litigation risk inherent to its operations. As a result, it is involved in various litigation, arbitration and regulatory investigations and proceedings both in the UK and in other jurisdictions, arising in the ordinary course of the bank's business.

When the bank can reliably measure the outflow of economic benefits in relation to a specific case and considers such outflows to be probable, the bank records a provision against the case. Where the probability of outflow is considered to be remote, or probable, but a reliable estimate cannot be made, a contingent liability is disclosed. However, when the bank is of the opinion that disclosing these estimates on a case-by-case basis would prejudice their outcome, then the bank does not include detailed, case-specific disclosures in its financial statements.

Given the subjectivity and uncertainty of determining the probability and amount of losses, the bank takes into account a number of factors including legal advice, the stage of the matter and historical evidence from similar incidents. Significant judgement is required to conclude on these estimates.

For further details on provisions and other contingencies see Note 33(c).

(u) 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.

(v) Going concern

The Board has made an assessment of its ability to continue as a going concern taking into consideration the possible future economic impact of Covid-19 on the bank's business model, financial forecast and capital requirements and is satisfied that it has the resources to continue in business for the foreseeable future. Refer to note 34, subsequent events, for further details of specific consideration made. Furthermore, management is not aware of any material uncertainties that may cast significant doubt on the bank's ability to continue as a going concern. Therefore, the financial statements continue to be prepared on the going concern basis.

(w) Effective interest rate method

The bank's EIR method recognises interest income using a rate of return that represents the best estimate of a constant rate of return over the expected behavioural life of loans and deposits and recognises the effect of potentially different interest rates charged at various stages and other characteristics of the product life cycle (including prepayments and penalty interest and charges). This estimation, by nature, requires an element of judgement regarding the expected behaviour and life-cycle of the instruments, as well expected changes to the UK's base rate and other fee income/expense that are integral parts of the 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 and within Note 6.

(a) Fair value of financial instruments

The fair value of financial instruments is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e., an exit price) regardless of whether that price is directly observable or estimated using another valuation technique. When the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of valuation models. The inputs to these models are taken from observable markets where possible, but where this is not feasible, estimation is required in establishing fair values.

(b) Deferred tax assets

Deferred tax assets are recognised in respect of tax losses to the extent that it is probable that future taxable profit will be available against which the tax losses can be utilised. Although in the UK tax losses can be utilised indefinitely, judgement is required to determine the amount of deferred tax assets that can be recognised, based on the likely timing and level of future taxable profits, together with future tax-planning strategies.

Notes to the Financial Statements (continued)

4. Critical estimates and judgements (continued)

(c) Provisions and other contingent liabilities

The bank operates in a regulatory and legal environment that, by nature, has a heightened element of litigation risk inherent to its operations. As a result, it is involved in various litigation, arbitration and regulatory investigations and proceedings both in the UK and in other jurisdictions, arising in the ordinary course of the bank's business.

When the bank can reliably measure the outflow of economic benefits in relation to a specific case and considers such outflows to be probable, the bank records a provision against the case. Where the probability of outflow is considered to be remote, or probable, but a reliable estimate cannot be made, a contingent liability is disclosed. However, when the bank is of the opinion that disclosing these estimates on a case-by-case basis would prejudice their outcome, then the bank does not include detailed, case-specific disclosures in its financial statements.

Given the subjectivity and uncertainty of determining the probability and amount of losses, the bank takes into account a number of factors including legal advice, the stage of the matter and historical evidence from similar incidents. Significant judgement is required to conclude on these estimates. For further details on provisions and other contingencies see note 33(c).

5. Changes in accounting policies and disclosures

New and amended standards and interpretations

In these financial statements, the bank has applied IFRS 16 for the first time.

IFRS 16 Leases

IFRS 16 supersedes IAS 17 Leases, IFRIC 4 in determining whether an Arrangement contains a Lease, SIC-15 Operating Leases-Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease. The standard sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to recognise most leases on the balance sheet.

Lessor accounting under IFRS 16 is substantially unchanged from IAS 17. Lessors will continue to classify leases as either operating or finance leases using similar principles as in IAS 17. Therefore, IFRS 16 did not have an impact for leases where the bank is the lessor.

The bank adopted IFRS 16 using the modified retrospective method with the date of initial application of 1 January 2019. Under this method, the standard is applied retrospectively with the bank choosing to measure the right-of-use asset at an amount equal to the lease liability immediately before its date of initial recognition. The bank elected to use the transition practical expedient to not reassess whether a contract is or contains a lease at 1 January 2019. Instead, the bank applied the standard only to contracts that were previously identified as leases applying IAS 17 and IFRIC 4 at the date of initial application.

The bank has lease contracts for various office premises, bank branches and staff residences. Before the adoption of IFRS 16, the bank classified each of its leases (as lessee) at the inception date as either a finance lease or an operating lease. Refer to Note 3 for the accounting policy prior to 1 January 2019.

Upon adoption of IFRS 16, the bank applied a single recognition and measurement approach for all leases except for short-term leases and leases of low-value assets. Refer to Note 3 for the accounting policy beginning 1 January 2019. The standard provides specific transition requirements and practical expedients, which have been applied by the bank.

Notes to the Financial Statements (continued)

5. Changes in accounting policies and disclosures (continued)

Leases previously accounted for as operating leases

The bank recognised right-of-use assets and lease liabilities for those leases previously classified as operating leases, except for short-term leases and leases of low-value assets. The right-of-use assets for most leases were recognised based on the carrying amount as if the standard had always been applied, apart from the use of incremental borrowing rate at the date of initial application. In some leases, the right-of-use assets were recognised based on the amount equal to the lease liabilities, adjusted for any related prepaid and accrued lease payments previously recognised. Lease liabilities were recognised based on the present value of the remaining lease payments, discounted using the incremental borrowing rate at the date of initial application.

The bank also applied the available practical expedients wherein it:

- Used a single discount rate to a portfolio of leases with reasonably similar characteristics;
- Relied on its assessment of whether leases are onerous immediately before the date of initial application;
- Applied the short-term leases exemptions to leases with lease term that ends within 12 months of the date of initial application;
- Excluded the initial direct costs from the measurement of the right-of-use asset at the date of initial application;
- Used hindsight in determining the lease term where the contract contained options to extend or terminate the lease.

Based on the above, as at 1 January 2019:

- Right-of-use assets of £5,198,000 were recognised and presented in the statement of financial position (Note 22).
- Receivable from net investment in lease property to China Bridge Group (UK) Limited of £2,674,000.
- Additional lease liabilities of £7,933,000 (included in “Other liabilities”) were recognised.
- The adoption of IFRS 16 had no impact on the bank’s retained earnings and no material impact on its CET1 ratio.

The lease liabilities as at 1 January 2019 can be reconciled to the operating lease commitments as of 31 December 2018, as follows:

Assets

	£000
Operating lease commitments as at 31 December 2018	9,102
Weighted average incremental borrowing rate as at 1 January 2019	1.9%
Discounted operating lease commitments as at 1 January 2019	8,251
Less commitments relating to short-term assets	(318)
Lease liabilities as at 1 January 2019	7,933

Notes to the Financial Statements (continued)

5. Changes in accounting policies and disclosures (continued)

IFRIC Interpretation 23 Uncertainty over Income Tax Treatment

The Interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of IAS 12 Income Taxes. It does not apply to taxes or levies outside the scope of IAS 12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments. The Interpretation specifically addresses the following:

- Whether an entity considers uncertain tax treatments separately
- The assumptions an entity makes about the examination of tax treatments by taxation authorities
- How an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates
- How an entity considers changes in facts and circumstances

The bank determines whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments and uses the approach that better predicts the resolution of the uncertainty.

The bank applies judgement in identifying uncertainties over income tax treatments.

Amendments to IFRS 9: Prepayment Features with Negative Compensation

Under IFRS 9, a debt instrument can be measured at amortised cost or at fair value through other comprehensive income, provided that the contractual cash flows are 'solely payments of principal and interest on the principal amount outstanding' (the 'SPPI' criterion) and the instrument is held within the appropriate business model for that classification. The amendments to IFRS 9 clarify that a financial asset passes the SPPI criterion regardless of the event or circumstance that causes the early termination of the contract and irrespective of which party pays or receives reasonable compensation for the early termination of the contract. Early termination can result from a contractual term or from an event outside the control of the parties to the contract, such as a change in law or regulation leading to the early termination of the contract. Where the prepayment is made at current fair value or at an amount that includes the fair value of the cost to terminate an associated hedging instruments, the bank assesses the specific contractual cash flows for the relevant debt instruments in order to determine whether they meet the SPPI criterion.

Interest Rate Benchmark Reform: Amendments to IFRS 9, IAS 39 and IFRS 7

Interest Rate Benchmark Reform Amendments to IFRS 9, IAS 39 and IFRS 7 includes a number of reliefs, which apply to all hedging relationships that are directly affected by interest rate benchmark reform. A hedging relationship is affected if the reform gives rise to uncertainties about the timing and or amount of benchmark based cash flows of the hedged item or the hedging instrument. The bank has elected not to apply hedge accounting.

LIBOR Transition

The bank has established an London Interbank Offered Rate (LIBOR) Transition Working Group (ITWG) to manage the transition from LIBOR to alternative reference rates (ARRs) in accordance with UK regulators' expectations to stop all new issuance of sterling LIBOR-referencing loan products by the end of the first quarter of 2021, and to transfer all existing exposures to new ARRs prior to the end of 2021.

The bank has minimal exposures to corporate lending and derivative contracts referencing LIBOR past December 2021 and there is no LIBOR exposure on the retail lending book. The bank has not early adopted the IBOR amendment.

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 Risk Management & Internal Control Committee, Credit Risk Management & Decision Committee, Operational Risk Committee, Compliance Committee, Operational Resilience & Controls Committee, Assets and Liabilities Management Committee, and IT Management Committee. 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, loans designated at fair value through profit and loss and debt securities.

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.

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.

Notes to the Financial Statements (continued)

6. Financial risk management (continued)

Collateral held as security

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are in place covering the acceptability and valuation of each type of collateral. The main types of collateral obtained are, as follows:

- For corporate and small business lending, charges over real estate properties, inventory and trade receivables
- For retail lending, mortgages over residential properties with the use of a publicly available index on a portfolio basis

The bank also obtains guarantees from 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.

Management monitors the market value of collateral and will request additional collateral in accordance with the underlying agreement.

(i) Impairment assessment

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(h));
- 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.

(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 customer 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 customer indicating default or near-default;
- The customer requesting emergency funding from the bank;
- The customer 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 customer'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.

IFRS 9 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.

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.

Notes to the Financial Statements (continued)

6. Financial risk management (continued)

(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 customer, utilise supplemental external information that could affect the customer'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 customers 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
Performing					
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
Non-Performing					
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 customer 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

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 Financial Statements for the year ended 31 December 2019
 Notes to the Financial Statements (continued)

(viii) 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+%
			£000	£000	£000	£000	£000	£000
Loans and advances to customers	Housing loans	Buy-to-Let Mortgages	1,364	2,190	965	-	-	-
Loans and advances to customers	Mortgage loans	Owner Occupied Mortgages	28,462	129,091	33,177	-	-	-
Loans and advances to customers	Mortgage loans	Buy-to-Let Mortgages	27,448	242,185	365,474	-	-	-
Loans and advances to customers	Mortgage loans	Commercial	629	1,130	-	-	-	-
At 31 December 2019			57,903	374,596	399,616	-	-	-

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

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

(ix) 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
Cash and cash equivalents																
Cash balances with banks	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other demand deposits	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Loans and advances to banks																
Syndicated loans	99	-	-	-	-	-	-	-	-	-	-	-	-	-	-	99
Loans and advances to customers																
Wholesale loans	-	-	-	-	-	-	-	-	-	8	-	-	-	-	-	8
Housing loans	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Syndicated loans	133	-	-	47	-	-	-	-	-	169	-	-	-	-	-	349
Factoring financing	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Overdraft on corporate accounts	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Overdraft on personal accounts	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Credit Cards	-	-	-	-	-	-	-	-	-	-	-	-	9	1	20	30
Mortgage loans	-	-	-	-	-	-	-	-	-	-	-	-	634	76	12	722
Financing Order	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Debt instruments at amortised cost																
Other bonds held to maturity	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
	232	-	-	47	-	-	-	-	-	177	-	-	643	77	32	1,208
Off Balance Sheet																
OBS - Letter of credit	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
OBS - Guarantee	5	-	-	-	-	-	-	-	-	4	2	-	-	-	-	11
OBS - Other	5	-	-	28	-	-	16	-	-	6	-	-	36	-	-	91
	10	-	-	28	-	-	16	-	-	10	2	-	36	-	-	102
At 31 December 2019	242	-	-	75	-	-	16	-	-	187	2	-	678	77	32	1,310

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Notes to the Financial Statements (continued)

(ix) Credit loss charges (continued)

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	
Cash and cash equivalents																
On demand deposits	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Loans and advances to customers																
Wholesale loans	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Housing loans	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Syndicated loans	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
At 31 December 2018	72	-	-	36	-	-	13	-	-	154	1	-	527	69	48	920

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 Notes to the Financial Statements (continued)

(x) Analysis of risk concentration in the financial position

The table below shows the analysis of risk concentration in the financial position excluding intercompany balances, cash on hand and assets measured at fair value through profit and loss.

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
Cash and cash equivalents																
Cash balances with bank	-	-	-	-	-	-	-	-	-	251,255	-	-	-	-	-	251,255
Other demand deposits	213	-	-	1,776	-	-	26,212	-	-	15,974	-	-	-	-	-	44,175
Loans and advances to banks																
Syndicated loans	22,707	-	-	-	-	-	-	-	-	-	-	-	-	-	-	22,707
Loans and advances to customers																
Wholesale loans	-	-	-	-	-	-	-	-	-	2,629	-	-	-	-	-	2,629
Housing loans	-	-	-	-	-	-	-	-	-	4,519	-	-	-	-	-	4,519
Syndicated loans	39,684	-	-	64,691	-	-	-	-	-	124,777	-	-	-	-	-	229,152
Factoring financing	-	-	-	-	-	-	-	-	-	686	-	-	-	-	-	686
Overdraft corporate accounts	-	-	-	-	-	-	-	-	-	1	-	-	-	-	-	1
Overdraft personal accounts	-	-	-	-	-	-	-	-	-	-	-	-	2	-	-	2
Credit Cards	-	-	-	-	-	-	-	-	-	-	-	-	732	34	12	778
Mortgage loans	-	-	-	-	-	-	-	-	-	-	-	803,540	22,290	1,766	-	827,596
Financing Order	-	-	-	-	-	-	93	-	-	-	-	-	-	-	-	93
Debt instruments at amortised cost																
Other bonds held to maturity	-	-	-	-	-	-	-	-	-	50,431	-	-	-	-	-	50,431
Other Assets																
Margin Deposits	-	-	-	-	-	-	-	-	-	19,948	-	-	-	-	-	19,948
	62,604	-	-	66,467	-	-	26,305	-	-	470,220	-	-	804,274	22,324	1,778	1,453,972
Off Balance Sheet																
OBS - Letter of credit	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
OBS - Guarantee	35,548	-	-	321	-	-	-	-	-	2,051	434	-	-	-	-	38,354
OBS - Other	7,306	-	-	68,482	-	-	27,249	-	-	91,977	-	-	7,112	-	-	202,126
	42,854	-	-	68,803	-	-	27,249	-	-	94,028	434	-	7,112	-	-	240,480
At 31 December 2019	105,458	-	-	135,270	-	-	53,554	-	-	564,248	434	-	811,386	22,325	1,778	1,694,453

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 Notes to the Financial Statements (continued)

(x) Analysis of risk concentration in the financial position (continued)

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
Cash and cash equivalents																
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
Syndicated loans	49,648	-	-	49,989	-	-	-	-	-	163,684	-	-	-	-	-	263,321
Factoring financing	-	-	-	-	-	-	-	-	-	1,043	-	-	-	-	-	1,043
Overdraft corporate accounts	-	-	-	-	-	-	-	-	-	258	-	-	-	-	-	258
Overdraft personal accounts	-	-	-	-	-	-	-	-	-	-	-	-	2	-	-	2
Credit Cards	-	-	-	-	-	-	-	-	-	-	-	-	762	16	6	784
Mortgage loans	-	-	-	-	-	-	-	-	-	-	-	-	737,900	29,280	680	767,860
Financing Order	-	-	-	-	-	-	1,009	-	-	-	-	-	-	-	-	1,009
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
At 31 December 2018	94,036	-	-	115,216	-	-	29,727	-	-	411,534	310	-	745,618	29,296	686	1,426,423

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 2019 was £38 million (2018: £36 million), before taking into account the fair value of collateral held of £1,715 million (2018: £1,659 million), or other credit enhancements and the maximum off balance sheet credit exposure to any client or counterparty as of 31 December 2019 was £38 million (2018: £54 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.

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Notes to the Financial Statements (continued)

(xi) Impairment allowance analysis

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

On Balance Sheet	Stage 1 £000	Stage 2 £000	Stage 3 £000	Total £000
Gross carrying amount as at 1 January 2019	1,136,717	29,296	686	1,166,699
New assets originated or purchased	528,813	3,278	5	532,096
Assets derecognised or repaid (excluding write offs)	(234,354)	(6,117)	(301)	(240,772)
Transfers to Stage 1	15,350	(15,350)	-	-
Transfers to Stage 2	(12,005)	12,247	(242)	-
Transfers to Stage 3	(598)	(1,030)	1,628	-
Amounts written off	-	-	-	-
Foreign exchange adjustments	(4,051)	-	-	(4,051)
Gross carrying amount as at 31 December 2019	1,429,872	22,324	1,776	1,453,972

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Notes to the Financial Statements (continued)

(xi) Impairment allowance analysis (continued)

On Balance Sheet	Stage 1 £000	Stage 2 £000	Stage 3 £000	Total £000
Gross carrying amount as at 1 January 2018	1,012,666	126,423	462	1,139,551
New assets originated or purchased	329,988	3,978	6	333,972
Assets derecognised or repaid (excluding write offs)	(299,479)	(8,869)	(45)	(308,393)
Transfers to Stage 1	115,745	(115,742)	(3)	-
Transfers to Stage 2	(23,567)	23,771	(204)	-
Transfers to Stage 3	(205)	(265)	470	-
Amounts written off	-	-	-	-
Foreign exchange adjustments	1,570	-	-	1,570
Gross carrying amount as at 31 December 2018	1,136,718	29,296	686	1,166,700

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(xii) Credit loss expense

	Stage 1	Stage 2	Stage 3	Total
On Balance Sheet	£000	£000	£000	£000
ECL allowance as at 1 January 2019	704	70	49	823
New assets originated or purchased	377	-	-	377
Assets derecognised or repaid (excluding write offs)	(177)	(6)	-	(183)
Transfers to Stage 1	55	(55)	-	-
Transfers to Stage 2	(6)	44	(38)	-
Transfers to Stage 3	-	-	-	-
Impact on year end ECL of exposures transferred between stages during the year	(44)	21	4	(19)
Unwind of discount	-	-	-	-
Changes to models and inputs used for ECL calculations	193	3	8	204
Recoveries	-	-	-	-
Amounts written off	-	-	-	-
Foreign exchange adjustments	(4)	-	-	(4)
ECL allowance as at 31 December 2019	1,098	77	23	1,198

Bank of China (UK) Limited
 Financial Statements for the year ended 31 December 2019
Notes to the Financial Statements (continued)

(xii) Credit loss expense	Stage 1	Stage 2	Stage 3	Total
On Balance Sheet	£000	£000	£000	£000
ECL allowance as at 1 January 2018	751	179	61	991
New assets originated or purchased	349	-	-	349
Assets derecognised or repaid (excluding write offs)	(353)	(146)	-	(499)
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)	53	11	44
Unwind of discount	-	-	-	-
Changes to models and inputs used for ECL calculations	(43)	(1)	(19)	(63)
Recoveries	-	-	-	-
Amounts written off	-	-	-	-
Foreign exchange adjustments	1	-	-	1
ECL allowance as at 31 December 2018	704	70	49	823

Bank of China (UK) Limited
 Financial Statements for the year ended 31 December 2019
Notes to the Financial Statements (continued)

(xii) Credit loss expense (continued)

Off Balance Sheet	Stage 1	Stage 2	Stage 3	Total
	£000	£000	£000	£000
Gross carrying amount as at 1 January 2019	259,412	310	-	259,722
New assets originated or purchased	49,239	174	-	49,413
Assets derecognised or repaid (excluding write offs)	(64,413)	(110)	-	(64,523)
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	(60)	60	-	-
Transfers to Stage 3	-	-	-	-
Amounts written off	-	-	-	-
Foreign exchange adjustments	(4,132)	-	-	(4,132)
Gross carrying amount as at 31 December 2019	240,046	434	-	240,480

Bank of China (UK) Limited
 Financial Statements for the year ended 31 December 2019
Notes to the Financial Statements (continued)

(xii) Credit loss expense (continued)

Off Balance Sheet	Stage 1	Stage 2	Stage 3	Total
	£000	£000	£000	£000
ECL allowance as at 1 January 2019	95	1	-	97
New assets originated or purchased	9	-	-	9
Assets derecognised or repaid (excluding write offs)	(12)	-	-	(12)
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 models and inputs used for ECL calculations	10	-	-	10
Recoveries	-	-	-	-
Amounts written off	-	-	-	-
Foreign exchange adjustments	(1)	-	-	(1)
ECL allowance as at 31 December 2019	101	1	-	102

Bank of China (UK) Limited
 Financial Statements for the year ended 31 December 2019
Notes to the Financial Statements (continued)

(xii) Credit loss expense (continued)

Off Balance Sheet	Stage 1	Stage 2	Stage 3	Total
	£000	£000	£000	£000
Gross carrying amount as at 1 January 2018	281,038	18,260	-	299,298
New assets originated or purchased	35,505	110	-	35,615
Assets derecognised or repaid (excluding write offs)	(61,374)	(18,260)	-	(79,634)
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	(200)	200	-	-
Transfers to Stage 3	-	-	-	-
Amounts written off	-	-	-	-
Foreign exchange adjustments	4,443	-	-	4,443
Gross carrying amount as at 31 December 2018	259,412	310	-	259,722

Bank of China (UK) Limited
 Financial Statements for the year ended 31 December 2019
Notes to the Financial Statements (continued)

(xii) Credit loss expense (continued)

Off Balance Sheet	Stage 1	Stage 2	Stage 3	Total
	£000	£000	£000	£000
ECL allowance as at 1 January 2018	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	-	1	-	1
Unwind of discount	-	-	-	-
Changes to models and inputs used for ECL calculations	(88)	-	-	(88)
Recoveries	-	-	-	-
Amounts written off	-	-	-	-
Foreign exchange adjustments	6	-	-	6
	-	-	-	-
ECL allowance as at 31 December 2018	96	1	-	97

Bank of China (UK) Limited
 Financial Statements for the year ended 31 December 2019
Notes to the Financial Statements (continued)

(xiii) Impairment allowance analysis – internal rating grading

The following provides an analysis of the gross carrying amounts split by the internal rating grade.

On Balance Sheet	Stage 1	Stage 2	Stage 3	Total
	£000	£000	£000	£000
Internal rating grade				
Performing	1,163,909	-	-	1,163,909
High grade	156,065	-	-	156,065
Standard grade	109,896	-	-	109,896
Sub-standard grade	-	22,325	-	22,325
Past due	-	-	1,777	1,777
Non-performing individually impaired	-	-	-	-
Gross carrying amounts as at 31 December 2019	1,429,870	22,325	1,777	1,453,972
Off Balance Sheet				
	£000	£000	£000	£000
Internal rating grade				
Performing	72,276	-	-	72,276
High grade	166,349	-	-	166,349
Standard grade	1,422	434	-	1,856
Sub-standard grade	-	-	-	-
Past due	-	-	-	-
Non-performing individually impaired	-	-	-	-
Gross carrying amounts as at 31 December 2019	240,046	434	-	240,480

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 Financial Statements for the year ended 31 December 2019
Notes to the Financial Statements (continued)

(xiii) Impairment allowance analysis – internal rating grading (continued)

On Balance Sheet	Stage 1	Stage 2	Stage 3	Total
	£000	£000	£000	£000
Internal rating grade				
Performing	870,342	-	-	870,342
High grade	227,471	-	-	227,471
Standard grade	38,904	-	-	38,904
Sub-standard grade	-	29,296	-	29,296
Past due	-	-	686	686
Non-performing individually impaired	-	-	-	-
Gross carrying amounts as at 31 December 2018	1,136,717	29,296	686	1,166,699
Off Balance Sheet				
	£000	£000	£000	£000
Internal rating grade				
Performing	58,722	-	-	58,722
High grade	195,254	-	-	195,254
Standard grade	5,436	310	-	5,746
Sub-standard grade	-	-	-	-
Past due	-	-	-	-
Non-performing individually impaired	-	-	-	-
Gross carrying amounts as at 31 December 2018	259,412	310	-	259,722

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 Financial Statements for the year ended 31 December 2019
Notes to the Financial Statements (continued)

(xii) Impairment allowance analysis – internal rating grading (continued)

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

On Balance Sheet	Stage 1	Stage 2	Stage 3	Total
	£000	£000	£000	£000
Internal rating grade				
Performing	648	-	-	648
High grade	71	-	-	71
Standard grade	379	-	-	379
Sub-standard grade	-	78	-	78
Past due	-	-	32	32
Non-performing individually impaired	-	-	-	-
ECL allowance as at 31 December 2019	1,098	78	32	1,208
Off Balance Sheet				
	£000	£000	£000	£000
Internal rating grade				
Performing	37	-	-	37
High grade	59	-	-	59
Standard grade	4	2	-	6
Sub-standard grade	-	-	-	-
Past due	-	-	-	-
Non-performing individually impaired	-	-	-	-
ECL allowance as at 31 December 2019	100	2	-	102

Bank of China (UK) Limited
 Financial Statements for the year ended 31 December 2019
Notes to the Financial Statements (continued)

(xiii) Impairment allowance analysis – internal rating grading (continued)

On Balance Sheet	Stage 1	Stage 2	Stage 3	Total
	£000	£000	£000	£000
Internal rating grade				
Performing	497	-	-	497
High grade	142	-	-	142
Standard grade	65	-	-	65
Sub-standard grade	-	70	-	70
Past due	-	-	49	49
Non-performing individually impaired	-	-	-	-
ECL allowance as at 31 December 2018	704	70	49	823
Off Balance Sheet				
	£000	£000	£000	£000
Internal rating grade				
Performing	39	-	-	39
High grade	50	-	-	50
Standard grade	8	-	-	8
Sub-standard grade	-	-	-	-
Past due	-	-	-	-
Non-performing individually impaired	-	-	-	-
ECL allowance as at 31 December 2018	97	-	-	97

Bank of China (UK) Limited
 Financial Statements for the year ended 31 December 2019
Notes to the Financial Statements (continued)

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

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

On Balance Sheet	Base case	Probability weighted	Difference
	£000	£000	£000
ECL allowance as at 31 December 2019	1,102	1,208	106
ECL allowance as at 31 December 2018	742	823	81

Off Balance Sheet	Base case	Probability weighted	Difference
	£000	£000	£000
ECL allowance as at 31 December 2019	103	102	(1)
ECL allowance as at 31 December 2018	96	97	1

Notes to the Financial Statements (continued)

(xv) 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. 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 2019. 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 2019		
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 2019*								
Key Drivers	ECL Scenario	Assigned Probabilities %	2020 %	2021 %	2022 %	2023 %	2024 %	Subsequent Years %
UK CPI Increase	Upside	30	0.80	0.71	0.62	0.53	0.51	0.50
	Base case	40	0.51	0.53	0.52	0.52	0.50	0.52
	Downside	30	0.11	0.02	0.03	0.05	0.10	0.55
UK GDP Growth	Upside	30	1.11	0.63	0.43	0.28	0.19	0.40
	Base case	40	0.26	0.27	0.26	0.26	0.26	0.40
	Downside	30	(0.99)	(0.58)	(0.32)	(0.04)	0.10	0.54
UK House Price Index Increase	Upside	30	1.42	1.69	1.78	1.74	1.44	0.23
	Base case	40	0.36	0.33	0.32	0.26	0.16	0.56
	Downside	30	(1.02)	(1.55)	(1.87)	(2.08)	(2.09)	1.32
UK Interest Rates	Upside	30	0.92	0.95	1.00	1.10	1.19	2.80
	Base case	40	0.89	0.90	0.95	1.00	1.06	2.60
	Downside	30	0.46	0.30	0.13	0.09	0.08	1.10
UK Unemployment Rates	Upside	30	3.62	3.42	3.24	3.09	3.02	4.03
	Base case	40	4.16	4.21	4.26	4.30	4.34	4.88
	Downside	30	4.92	5.35	5.74	6.08	6.37	6.28

*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)

(b) Liquidity risk

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

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

The Board is the ultimate decision-making body and is responsible for compliance with the regulatory requirements. Formulation of the risk management procedures, implementation mechanism and monitoring of 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").

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

£000	Carrying amount	Contractual cash flows	Less than 1 month	1 to 3 months	3 months to 1 year	More than 1 year
31 December 2019						
Non-derivative financial liabilities:						
Deposits from banks	128,590	(129,732)	(21,265)	(12,814)	(76,730)	(18,923)
Deposits from customers	1,132,193	(1,134,167)	(976,877)	(78,747)	(78,543)	-
Subordinated liabilities	60,000	(60,163)	-	(163)	-	(60,000)
Derivative financial instruments:	8,771	-	-	-	-	-
Cash outflows	-	(90,503)	(58,716)	(699)	(2,873)	(28,215)
Cash inflows	-	58,025	58,025	-	-	-
	1,329,553	(1,356,541)	(998,834)	(92,422)	(158,146)	(107,138)
Undrawn loan commitments	195,014	(195,014)	(195,014)	-	-	-
	1,524,567	(1,551,555)	(1,193,848)	(92,422)	(158,146)	(107,138)
31 December 2018						
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	-	-	-
	1,272,335	(1,298,172)	(1,051,123)	(18,089)	(148,766)	(80,194)
Undrawn loan commitments	216,402	(216,402)	(216,402)	-	-	-
	1,488,737	(1,514,574)	(1,267,525)	(18,089)	(148,766)	(80,194)

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.

Notes to the Financial Statements (continued)

6. Financial risk management (continued)

(b) Liquidity risk (continued)

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 £nil were drawn at 31 December 2019 (31 December 2018: £nil).

The table below shows an analysis of assets and liabilities analysed according to when they are expected to be recovered or settled:

£000	Within 12 months	After 12 months	Total
31 December 2019			
Assets			
Cash on hand	2,002	-	2,002
Cash balances with the central bank	249,787	1,468	251,255
Other demand deposits	79,285	-	79,285
Loans and advances to banks	62,639	22,608	85,247
Loans and advances to customers	41,006	1,023,341	1,064,347
Derivatives and other financial instruments	4,614	-	4,614
Prepayments, accrued income and other assets	41,283	17,122	58,405
Debt instruments at amortised cost	50,431	-	50,431
Financial assets at fair value through profit and loss	2,584	81,344	83,928
Deferred tax asset	182	605	787
Property, plant and equipment	-	6,328	6,328
Intangible assets	-	759	759
Total assets	533,813	1,153,575	1,687,388
Liabilities			
Deposits from banks	109,667	18,923	128,590
Deposits from customers	1,132,193	-	1,132,193
Derivatives and other financial instruments	8,771	-	8,771
Other liabilities	38,337	5,345	43,609
Accruals and deferred income	6,390	-	6,390
Current tax liabilities	675	-	675
Provisions	8	94	102
Subordinated liabilities	-	60,000	60,000
Total liabilities	1,295,968	84,362	1,380,330
Net	(762,155)	1,069,213	307,058

Notes to the Financial Statements (continued)

6. Financial risk management (continued)

(b) Liquidity risk (continued)

£000	Within 12 months	After 12 months	Total
31 December 2018			
Assets			
Cash on hand	1,932	-	1,932
Cash balances with the central bank	277,907	-	277,907
Other demand deposits	53,437	-	53,437
Loans and advances to banks	61,391	-	61,391
Loans and advances to customers	5,698	1,038,872	1,044,570
Derivatives and other financial instruments	1,345	-	1,345
Prepayments, accrued income and other assets	6,273	-	6,273
Debt instruments at amortised cost	51,985	51,204	103,189
Financial assets at fair value through profit and loss	12	76,159	76,171
Deferred tax asset	-	1,546	1,546
Property, plant and equipment	-	2,761	2,761
Intangible assets	-	462	462
Total assets	459,979	1,171,002	1,630,982
Liabilities			
Deposits from banks	102,919	-	102,919
Deposits from customers	1,107,439	-	1,107,439
Derivatives and other financial instruments	1,977	-	1,977
Other liabilities	21,358	-	21,358
Accruals and deferred income	6,207	-	6,207
Current tax liabilities	4,908	-	4,908
Provisions	8	89	97
Subordinated liabilities	-	60,000	60,000
Total liabilities	1,244,817	60,089	1,304,906
Net	(784,837)	1,110,913	326,076

(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 2019 and 31 December 2018.

Notes to the Financial Statements (continued)

6. Financial risk management (continued)

Foreign exchange risk (continued)

£000

31 December 2019	Sterling	US Dollar	Euro	Other	Total
Cash and cash equivalents	296,756	22,851	4,769	8,165	332,541
Loans and advances to banks	(99)	37,846	33,111	14,389	85,247
Loans and advances to customers	916,457	124,591	10,582	12,717	1,064,347
Derivatives financial instruments (asset)	4,611	3	-	-	4,614
Debt instruments at amortised cost	50,431	-	-	-	50,431
Financial assets at fair value through profit and loss	2,584	81,343	-	-	83,927
Other assets	64,049	661	1,493	77	66,281
Deposits from banks	(1,328)	(109,988)	(566)	(16,708)	(128,590)
Deposits from customers	(854,718)	(210,333)	(49,326)	(17,815)	(1,132,192)
Derivatives financial instruments (liability)	(8,771)	-	-	-	(8,771)
Other liabilities	(36,695)	(5,944)	(7,641)	(497)	(50,777)
Subordinated liabilities	(60,000)	-	-	-	(60,000)
Total shareholder equity	(307,058)	-	-	-	(307,058)
Net financial assets/(liabilities)	66,219	(58,970)	(7,577)	328	-
Net forward foreign exchange positions	(21,827)	25,784	(4,458)	501	-
Undrawn loan commitments	75,552	73,951	38,205	7,306	195,014

£000

31 December 2018	Sterling	US Dollar	Euro	Other	Total
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

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 2019 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	31 December	31 December	31 December
	2019	2018	2019	2018
US Dollars	-	-	(30)	(93)
Euro	-	-	38	(3)
Other	-	-	(4)	(8)

A 1% percent strengthening of the above currencies against Sterling at 31 December 2019 would have had the equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

Notes to the Financial Statements (continued)

6. Financial risk management (continued)

(c) Market risk (continued)

Exposure to interest rate risk

The bank does not operate a trading book.

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

£000	Carrying Amount	Less than 1 month	1-3 months	3 months to 1 year	1-5 years	Over 5 years	Non Interest Bearing
31 December 2019							
Assets							
Cash and cash equivalents	332,542	329,026	-	-	-	1,468	2,048
Loans and advances to banks	85,247	62,638	22,708	-	-	-	(99)
Loans and advances to customers	1,064,347	75,803	894,082	10,613	58,059	26,898	(1,108)
Derivative financial instruments	4,614	-	-	-	-	-	4,614
Debt instruments at amortised cost	50,431	-	50,431	-	-	-	-
Financial assets at fair value through profit and loss	83,928	-	-	-	33,400	50,511	17
Other assets	66,279	-	-	-	-	-	66,279
Total assets	1,687,388	467,467	967,221	10,613	91,459	78,877	71,751
Equity and liabilities							
Liabilities	1,380,330	997,464	150,967	153,241	18,923	-	59,735
Deposits from banks	128,590	21,169	12,785	75,692	18,923	-	21
Deposits from customers	1,132,193	976,295	78,182	77,549	-	-	166
Derivative financial instruments	8,771	-	-	-	-	-	8,771
Other liabilities	50,776	-	-	-	-	-	50,777
Subordinated liabilities	60,000	-	60,000	-	-	-	-
Equity							
Shareholders' equity	307,058	-	-	-	-	-	307,058
Total equity and liabilities	1,687,388	997,464	150,967	153,241	18,923	-	366,793
Interest rate sensitivity gap	-	(529,997)	816,254	(142,628)	72,536	78,877	(297,042)
Cumulative gap	-	(529,997)	286,257	143,629	216,165	295,042	-

Notes to the Financial Statements (continued)

6. Financial risk management (continued)

(c) Market risk (continued)

Exposure to interest rate risk (continued)

£000	Carrying Amount	Less than 1 month	1-3 months	3 months to 1 year	1-5 years	Over 5 years	Non Interest Bearing
31 December 2018							
Assets							
Cash and cash equivalents	333,275	331,285	-	54	-	-	1,936
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
Total assets	1,630,982	478,853	869,199	11,220	208,934	49,265	13,511
Equity and liabilities							
Liabilities	1,304,906	1,049,072	77,344	143,406	-	-	35,084
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	-	-	-	-
Equity	326,076	-	-	-	-	-	326,076
Shareholders' equity	326,076	-	-	-	-	-	326,076
Total equity and liabilities	1,630,982	1,049,072	77,344	143,406	-	-	361,160
Interest rate sensitivity gap	-	(570,219)	791,855	(132,186)	208,934	49,265	(347,649)
Cumulative gap	-	(570,219)	221,636	89,450	298,384	347,649	-

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

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

£000	100bps parallel Increase	100bps parallel Decrease
Sensitivity of projected net interest income at		
31 December 2019	1,913	(1,913)
31 December 2018	1,845	(1,845)
Sensitivity of reported equity to interest rate movements at		
31 December 2019	-	-
31 December 2018	-	-

Interest rate movements affect reported equity in the following ways: retained earnings; arising from increases or decreases in net interest income and the fair value changes reported in profit or loss.

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 2019 and 31 December 2018 was as follows:

£000	2019 Actual	2018 Actual
Tier 1 capital		
Ordinary share capital	250,000	250,000
Retained earnings *	24,958	24,958
Tier 2 capital		
Qualifying subordinated liabilities	60,000	60,000
Total regulatory capital	334,958	334,958

* Retained earnings for regulatory capital purposes at the reporting date is restricted to audited retained earnings at 31 December 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).

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 calculating the net present value of their discounted cash flows.

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 2019, financial assets at fair value were assessed under IFRS 9 criteria for Level 1, Level 2 or Level 3.

£000 31 December 2019	Level 1	Level 2	Level 3	Total
Financial assets				
Designated fair value loans	-	-	83,911	83,911
Derivative financial instruments:				
Interest rate swaps	-	4,614	-	4,614
	-	4,614	-	4,614
Financial investments:				
Convertible preference shares	-	-	17	17
	-	-	17	17
Total assets	-	4,614	83,928	88,542
Financial liabilities				
Derivative financial instruments:				
Cross currency swaps and FX forwards	-	8,771	-	8,771
Total liabilities	-	8,771	-	8,771

In accordance with IFRS 13, Level 3 assets includes convertible preference shares in Visa Inc. based on a proxy of 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)

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

Reconciliation of Level 3 financial assets

£000	Note	31 December 2019	31 December 2018
Balance at 1 January		76,171	41,637
Issues of loans to new counterparties		17,031	38,342
Repayment of loans		(12,282)	(4,137)
Total gain for the period recognised in the profit and loss	10	3,008	329
Balance at 31 December		83,928	76,171

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 2019	31 December 2018
Interest income from financial investments	93	116
Other interest income:		
Cash and cash equivalents	987	1,840
Loans and advances to banks	2,009	980
Loans and advances to customers	42,604	37,823
Total other interest income	45,600	40,643
Total interest income	45,693	40,759
Interest expense:		
Deposits from banks	3,701	3,173
Customers accounts	4,939	2,790
Subordinated liabilities	673	590
Total interest expense	(9,313)	(6,553)
Net interest income	36,380	34,206

Interest income presented above represents interest revenue calculated using the effective interest method.

9. Net fee and commission income

(a) Analysis by business area

£000	31 December 2019	31 December 2018
Retail Banking customer fees	1,939	1,904
Corporate Banking credit-related fees	2,381	2,782
Other	354	164
Gross fee and commission income	4,674	4,850
Interbank transaction fees	(419)	(400)
Other	(751)	(486)
Gross fee and commission expense	(1,170)	(886)
Net fee and commission income	3,504	3,964

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

£000	31 December 2019	31 December 2018
Letter of guarantee	224	225
Remittance	417	402
Account and service fees	246	189
Letter of credit	45	46
Settlement & commitment	390	201
Credit and debit cards	658	702
Other	105	105
Fee and commission income in scope of IFRS 15	2,085	1,870
Consortium loans	1,358	1,884
Structural financing	310	252
Retail loans	921	844
Fee and commission income in scope of IFRS 9	2,589	2,980
Gross fee and commission income	4,674	4,850

Notes to the Financial Statements (continued)

10. Net fair value loss on financial instruments

£000	31 December 2019	31 December 2018
Net fair value loss on financial instruments:		
Designated fair value loans	3,003	329
Interest rate swaps	3	744
Convertible preference shares	5	-
Cross currency swaps and FX forwards	(4,176)	(1,404)
	(1,165)	(331)

11. Other operating income

£000	31 December 2019	31 December 2018
Related party service charges	70,889	62,476
Dividends from subsidiaries	-	10,493
Other	862	586
	71,751	73,555

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.
- The movement from 2018 has been driven by a reduction in the capital charge paid to the London Branch due to a decrease in the weighted average cost of capital and the average loan balance.

12. Staff costs

£000	31 December 2019	31 December 2018
Wages and salaries	37,698	33,635
Contributions to defined contribution plans	2,076	1,781
Social security costs	5,395	4,659
Other	2,110	1,793
	47,279	41,868

	31 December 2019	31 December 2018
Average number of employees		
Retail Banking	135	132
Corporate Banking	113	107
Support Functions	246	228
Total average number of employees	494	467

Notes to the Financial Statements (continued)

13. Other expenses

£000	31 December 2019	31 December 2018
Administrative	16,789	5,369
Rent on operating leases	(15)	1,122
Software licensing and other IT costs	753	214
Other	5,521	1,152
	23,048	7,857

The movement in administrative expenses is driven by increases in professional fees. Administrative expenses include expenses relating to short-term and low-value asset leases of £51,000.

Auditor's remuneration:

£000	31 December 2019	31 December 2018
Fees payable to the bank's auditors for the audit of the company's financial statements:		
Current year	293	143
Fees payable to the bank's auditor and its associates for other services:		
The audits of the company's subsidiaries, pursuant to legislation	25	12
Other assurance services	31	26

14. Directors' remuneration

£000	31 December 2019	31 December 2018
Remuneration of directors in respect of services rendered:		
Remuneration	855	988
Pension contributions	5	5
Highest paid director:		
Remuneration	228	366
Pension contributions	-	-

15. Income tax expense

£000	31 December 2019	31 December 2018
Current tax expense		
Current period	11,844	15,299
Adjustments for prior years	(2,772)	(1,981)
Total current tax	9,072	13,318
Deferred tax expense		
Origination and reversal of temporary differences	100	211
Adjustments for prior years	658	(102)
Total deferred tax	758	109
Total income tax expense in income statement	9,830	13,427

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 2019	31 December 2018
Profit before income tax	41,935	64,550
Income tax using the standard rate of corporation tax in the UK 27.00% (2018: 27.00%)	11,322	17,429
Non-deductible expenses	2,626	118
Allowance against banking tax surcharge	(2,000)	(2,000)
(Over) under provided in prior years	(2,113)	(2,082)
Other - tax rate adjustment	(8)	(29)
Other	3	(9)
Total income tax expense in the income statement	9,830	13,427

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 2019	31 December 2018
Current tax		
UK current tax expense	-	-
Total current tax	-	-
Deferred tax		
Current year deferred tax charge (credit)	-	-
Total deferred tax	-	-
Total income and deferred tax credit in other comprehensive income	-	-

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. In March 2020 the UK government substantively enacted the retention of the 19% corporation tax rate from 1 April 2020. Deferred tax has been calculated using the substantively enacted corporation tax rate of 17%

16. Cash and cash equivalents

£000	31 December 2019	31 December 2018
Cash on hand	2,002	1,931
Cash balances with the central bank	251,255	277,907
Other demand deposits	79,285	53,437
	332,542	333,275

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 2019		31 December 2018	
	Assets	Liabilities	Assets	Liabilities
Instrument type:				
Interest rate swaps	4,614	-	1,344	-
Cross currency swaps and FX forwards	-	8,771	-	1,977
	4,614	8,771	1,344	1,977

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 2019	31 December 2018
Loans and advances to banks	85,247	61,391

19. Loans and advances to customers

£000	31 December 2019	31 December 2018
Corporate loans and advances	237,385	277,074
Retail loans and advances	828,071	768,312
Gross loans and advances	1,065,456	1,045,386
Less: specific allowance for impairments – Stage 3	(32)	(48)
collective allowance for impairments – Stages 1 & 2	(1,077)	(768)
Total allowance for impairment	(1,109)	(816)
Loans and advances to customer net	1,064,347	1,044,570

Loans and advances to customers at amortised cost

£000	31 December 2019			31 December 2018		
	Gross amount	Impairment allowance	Carrying amount	Gross amount	Impairment allowance	Carrying amount
Corporate loans and advances	237,385	(492)	236,893	277,074	(209)	276,865
Retail loans and advances	828,071	(617)	827,454	768,312	(607)	767,705
	1,065,456	(1,109)	1,064,347	1,045,386	(816)	1,044,570

Notes to the Financial Statements (continued)

20. Allowances for impairment

Impairment (charges) / release

£000	31 December 2019	31 December 2018
Loans and advances to customers	(283)	162
Loans and advances to banks	(99)	-
Debt instruments at amortised cost	7	7
Off balance sheet	(5)	289
Foreign exchange movement	3	-
Total impairment release/ (charge) in income statement	(377)	458

Refer to Note 6 for the movement in the impairment charge for the year ended 31 December 2019 for on and off balance sheet products.

21. Financial investments

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

£000	Note	31 December 2019	31 December 2018
Loans designated at fair value		83,911	76,159
Convertible preference shares		17	12
		83,928	76,171

Included in financial assets designated at fair value through profit and loss is a portfolio of fixed rate corporate loans which is economically hedged by credit derivatives. The hedges do not meet the criteria for hedge accounting and the loans are recorded at fair value to avoid an accounting mismatch.

The bank holds £17,000 preference shares in Visa Inc. (31 December 2018: £12,000) which are expected to be recovered more than twelve months after the reporting date.

(b) Debt instruments at amortised cost

£000	Note	31 December 2019	31 December 2018
Debt securities		50,431	103,189
		50,431	103,189

The bank holds £50 million nominal UK government securities, which are classified as debt instruments held at amortised cost.

Notes to the Financial Statements (continued)

22. Property, plant and equipment

(a) Fixed assets

£000	Property, plant and fixtures	Furniture and equipment	Computer equipment	Motor vehicles	Total
Cost					
Balance at 1 January 2019	6,260	1,975	1,932	214	10,381
Additions	57	254	512	46	869
Transfers	-	-	-	-	-
Disposals	-	(74)	(9)	-	(83)
Foreign exchange movement	(3)	-	(1)	-	(4)
Balance at 31 December 2019	6,314	2,155	2,434	260	11,163
Balance at 1 January 2018	6,246	1,975	1,718	214	10,153
Additions	18	30	264	-	312
Transfers	-	-	6	-	6
Disposals	(4)	(30)	(56)	-	(90)
Foreign exchange movement	-	-	-	-	-
Balance at 31 December 2018	6,260	1,975	1,932	214	10,381
Depreciation					
Balance at 1 January 2019	4,257	1,711	1,490	162	7,620
Charge for the year	372	171	294	23	860
Transfers	-	-	-	-	-
Disposals	-	(77)	(9)	-	(86)
Foreign exchange movement	1	-	1	-	2
Balance at 31 December 2019	4,630	1,805	1,776	185	8,396
Balance at 1 January 2018	3,888	1,589	1,383	144	7,004
Charge for the year	373	149	151	18	691
Transfers	-	-	6	-	6
Disposals	(4)	(27)	(50)	-	(81)
Foreign exchange movement	-	-	-	-	-
Balance at 31 December 2018	4,257	1,711	1,490	162	7,620
Net carrying value at					
31 December 2019	1,684	350	658	75	2,767
31 December 2018	2,003	264	442	52	2,761

As at 31 December 2019 and 31 December 2018 the bank identified no events or circumstances that would indicate that the bank's tangible fixed assets might be impaired.

Notes to the Financial Statements (continued)

22. Property, plant and equipment (continued)

(b) Right-of-use assets

£000	Property, plant and fixtures	Furniture and equipment	Computer equipment	Motor vehicles	Total
Cost					
IFRS 16 measurement at 1 January 2019	5,188	-	-	10	5,198
Balance at 31 December 2019	5,188	-	-	10	5,198
Depreciation					
Balance at 1 January 2019	-	-	-	-	-
Charge for the year	1,628	-	-	10	1,638
Balance at 31 December 2019	1,628	-	-	10	1,638
Net carrying value at					
31 December 2019	3,560	-	-	-	3,560

23. Intangible assets

£000	IT Software	Total
Cost		
Balance at 1 January 2019	2,342	2,342
Additions	397	397
Balance at 31 December 2019	2,739	2,739
Balance at 1 January 2018	1,922	1,922
Additions	420	420
Balance at 31 December 2018	2,342	2,342
Amortisation		
Balance at 1 January 2019	1,879	1,879
Amortisation for the year	100	100
Balance at 31 December 2019	1,979	1,979
Balance at 1 January 2018	1,826	1,826
Amortisation for the year	53	53
Balance at 31 December 2018	1,879	1,879
Net carrying value at		
31 December 2019	759	759
31 December 2018	462	462

As at 31 December 2019 and 31 December 2018 the bank identified no events or circumstances that would indicate that the bank's intangible assets might be impaired.

Notes to the Financial Statements (continued)

24. Deferred tax assets

Recognised deferred tax assets

Deferred tax assets are attributable to the following:

£000	31 December 2019	31 December 2018
Property and equipment, and software	(67)	78
Available for sale investments	(5)	(8)
Deferred employees' benefits	766	1,283
Other	93	193
	787	1,546

Deferred tax has been valued using the substantively enacted corporation tax rate of 17%. In March 2020 the UK government substantively enacted the retention of the 19% corporate tax rate from 1 April 2020. The effect of this would increase the deferred tax asset from £787,000 to £850,000.

There were no unrecognised deferred tax assets as at 31 December 2019 and 31 December 2018.

Movements in temporary differences during the year

£000	Opening balance 1 January 2019	Recognised in income	Recognised in equity	Closing balance 31 December 2019
Property and equipment, and software	78	(145)	-	(67)
Available for sale investments	(8)	3	-	(5)
Deferred employees' benefits	1,283	(517)	-	766
Other	192	(99)	-	93
	1,545	(758)	-	787

£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	192	192
	1,462	(20)	103	1,545

25. Prepayments, accrued income and other assets

£000	31 December 2019	31 December 2018
Accrued income	3,027	3,597
Prepaid expenses	282	332
Tax receivable	988	118
Receivable from related party	29,318	827
Other	24,790	1,399
	58,405	6,273

Transfer pricing receivable from related party of £24,194,000 (31 December 2018: £nil) was received on 3 January 2020. Other assets of £19,948,000 (31 December 2018: £nil) deposited with LCH.

Notes to the Financial Statements (continued)

26. Deposits from banks

£000	31 December 2019	31 December 2018
From fellow group companies	31,846	20,440
Other deposits from banks	96,744	82,479
	128,590	102,919

27. Deposits from customers

£000	31 December 2019	31 December 2018
Retail customers:		
Term deposits	306,918	256,445
Notice deposits	108,045	92,761
Current deposits	323,054	305,321
Other	57	233
	738,074	654,760
Corporate customers:		
Notice deposits	104,215	54,188
Current deposits	287,230	387,431
Other	2,674	11,060
	394,119	452,679
	1,132,193	1,107,439

28. Subordinated liabilities

£000	31 December 2019	31 December 2018
Subordinated note issued	60,000	60,000
	60,000	60,000

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 1.12% (31 December 2018: 0.98%). 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

£000	31 December 2019	31 December 2018
Creditors and accruals	35,026	19,510
Lease liabilities	7,167	-
Other	1,416	1,849
	43,609	21,359

30. Accruals and deferred income

£000	31 December 2019	31 December 2018
Deferred income	4,775	4,760
Accrued interest	1,615	1,447
	6,390	6,207

31. Equity

(a) Capital

At 31 December 2019 the authorised share capital comprised 250,000,000 ordinary shares (31 December 2018: 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

No dividend has been recommended for the year ended 31 December 2019 (31 December 2018: £51,118,000).

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 2019 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.

Notes to the Financial Statements (continued)

32. Related parties (continued)

(a) Parent and ultimate controlling party

Related party transactions occurred between the bank and the London Branch of Bank of China Limited. At 31 December 2019 the bank received £31,846,000 (31 December 2018: £20,440,000) which is 2% (31 December 2018: 2%) 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.

£000	Nature of related party Significant influence	Significant company
Balance at 31 December 2019		
Cash on hand, cash balances with the central bank and other demand deposits	34,497	-
Loans and advances to banks	62,639	-
Loans and advances to customers	-	2
Derivative financial instrument assets	4,582	-
Prepayments, accrued income and other assets	32,824	2,973
Deposits from banks	31,846	-
Deposits from customers	-	9,511
Derivative financial instrument liabilities	4,541	-
Other liabilities	11,595	468
Subordinated liabilities	60,000	-
Included in the income statement for the period		
Interest receivable	251	76
Interest payable	(1,347)	-
Other operating income	70,813	76
Net loss on derivative financial instruments	(4,176)	-
Balance at 31 December 2018		
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 instrument assets	1,344	-
Prepayments, accrued income and other assets	827	-
Deposits from banks	20,440	-
Deposits from customers	-	7,221
Derivative financial instrument liabilities	1,977	-
Other liabilities	5,090	-
Subordinated liabilities	60,000	-
Included in the income statement for the period		
Interest receivable	1,282	-
Interest payable	(1,867)	-
Other operating income	62,415	10,555
Net gain on derivative financial instruments	(1,075)	-

Notes to the Financial Statements (continued)

32. Related parties (continued)

(b) Investment in non-consolidated subsidiaries

	Country of incorporation	Ownership interest	
		31 December 2019	31 December 2018
China Bridge Group (UK) Limited	United Kingdom	100%	100%
China Bridge Group Italy SRL ¹	Italy	100%	100%

¹Indirect 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 2019, the bank held an investment of £1 in China Bridge Group (UK) Limited (31 December 2018: £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.

(c) Key management compensation

Key management is comprised of directors and the members of the Executive Management Committee of the bank. The bank does not provide non-cash benefits to any of the key management personnel.

£000	2019	2018
Compensation of Key Management Personnel:		
Short-term employee benefits	1,603	1,995
Post-employment benefits	11	17
Total	1,614	2,012

(d) Transactions with key management

Transactions with key management for the period ended 31 December 2019 comprised retail mortgages transacted on an arms' length basis to the amount of £144,000 (31 December 2018: £151,000).

33. Provisions, contingent liabilities and commitments

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

£000	31 December 2019	31 December 2018
Undrawn loan commitments	195,014	216,402
Guarantees	38,354	36,366
Other	7,112	6,954
Total	240,480	259,722

(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 2019	31 December 2018
Less than one year	358	884
Between one and five years	-	1,845
More than five years	-	1,193
Total	358	3,922

Notes to the Financial Statements (continued)

33. Provisions, contingent liabilities and commitments (continued)

(c) Legal claims and regulatory investigations

In the ordinary course of business the bank is subject to complaints and threatened or actual legal proceedings (including class or group action claims) brought by or on behalf of current or former employees, customers, investors or other third parties, as well as legal and regulatory reviews, challenges, investigations and enforcement actions, both in the UK and overseas. All such material matters are periodically reassessed, with the assistance of external professional advisers where appropriate, to determine the likelihood of the bank incurring a liability. In those instances where it is concluded that it is more likely than not that a payment will be made, a provision is established to management's best estimate of the amount required at the relevant balance sheet date. There is a potential claim resulting from indemnity provided in respect of the Bank of China (Suisse) SA sale agreement. In accordance with IAS 37.92 the bank does not provide further information on this claim, in order not to seriously prejudice the outcome of the claim.

In some cases it will not be possible to form a view, for example because the facts are unclear or because further time is needed properly to assess the merits of the case, and no provisions are held in relation to such matters. In these circumstances, specific disclosure in relation to a contingent liability will be made where material. There is an ongoing review of a number of historical payments for possible non-compliance with foreign payment regulations. The outcome of the review is uncertain and not quantifiable at the date of the signing of the financial statements.

34. Subsequent events

At a time close to the end of 2019 the coronavirus outbreak known as Covid-19 emerged, initially in Wuhan, in China's Hubei province. This virus has spread throughout the world in the ensuing period and on 11 March the World Health Organisation announced that this outbreak can be characterised as a pandemic. Measures have been taken in many countries to slow the progress of the infection rates. These measures have resulted in disruption to business and economic activity across the globe and this may affect our ability to meet our financial targets.

The Expected Credit Losses (ECL) at 31 December 2019 were estimated on economic conditions as at that date however we have recalculated the ECL based upon current external ratings and we have found that whilst higher, ECL increase of £3.3m, these would not create a significant threat to the banks going concern status.

The bank has taken measures to protect the health and safety of its employees with the majority of employees currently working from home adopting remote working practices whilst maintain appropriate controls and risk processes. At this point in time it is not possible to predict the specific repercussions of the economic effect of the Covid-19 pandemic on the bank.

The bank has performed stress testing to assess the impact of Covid-19 on its financial results and capital. The stress considered the impact of the government announced mortgage holiday on the mortgage portfolio, a material write down of the aircraft portfolio, reduction of income of the related party service charges and a downward revision to the financial plan in respect of loan book growth and the resulting negative effect this will have on income. As this is a high level estimate it is hard to quantify the financial effect. The testing considered but did not identify any material increase in costs, as the facilities and equipment we have proved to be sufficient.

Notwithstanding the foregoing the bank has solid foundations having strong capital and liquidity bases to withstand a significant downturn in the local and global economies, therefore the Directors consider that the banks going concern status remains unaltered.

After considering the above the Directors have concluded that Covid-19 is a non-adjusting post balance sheet event as at 31 December 2019 on the basis that at that date

- The World Health Organisation had not declared a global health emergency: and
- There was no significant spread of the virus outside of China

The analysis performed to date of the effect of Covid-19 on the bank's business and experiences to date has not identified anything material that will impact the financial results, capital or liquidity.