

Basel II

Pillar 3 Disclosure

2011

Bank of China (UK) Ltd



I. Overview

Background

Bank of China (UK) Ltd (“BOC UK” or “the bank”), authorised and regulated by the FSA, is a wholly owned subsidiary of Bank of China Limited. The bank has been Basel compliant since 2008.

Basis of Disclosures

This disclosure is prepared in accordance with the requirements set out in FSA handbook BIPRU Chapter 11 and should be read in accordance with the “Bank of China (UK) Limited Annual Report and Financial Statements for the year ended 31 December 2011”.

For accounting purposes, the Bank has availed itself of the exemption available under IAS27 *Consolidated and Separate Financial Statements* that permits an entity to prepare separate financial statements (referring to *Note 2: Basis of Preparation* in Annual Report and Financial Statements). Therefore this disclosure does not take into account of any subsidiaries.

Frequency

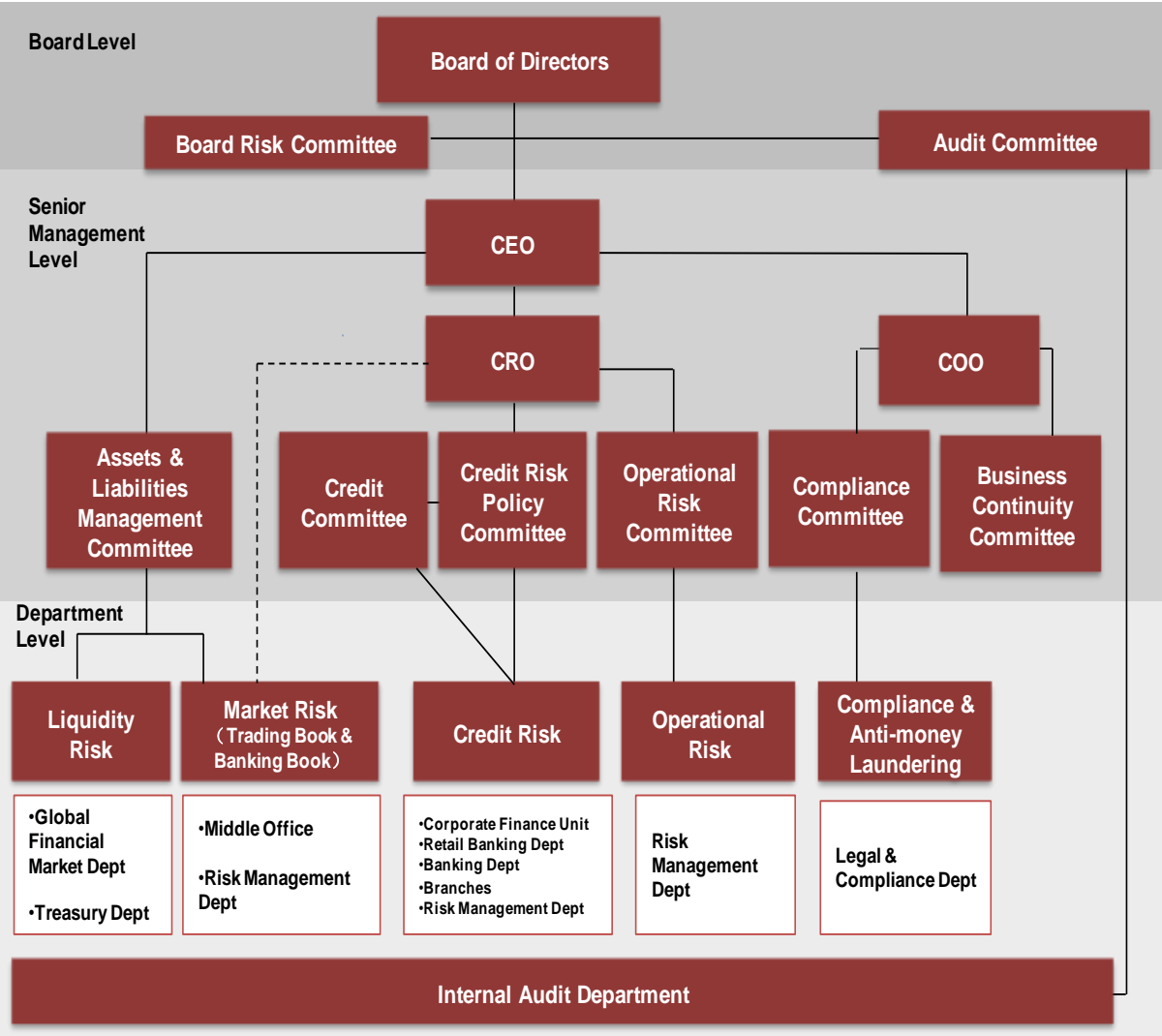
This report is produced on an annual basis, and published as soon as practical.

Media and Location of Publication

The report can be accessed on the BOC UK Ltd website: www.bank-of-china.com/uk

II. Risk Management Structure

BOC UK Ltd Risk Management Structure 2011



III. Capital Resources

Total Capital Resource	<i>31 December 2011</i>	<i>31 December 2010</i>
	£000	£000
Tier 1 Capital		
Share Capital	140,000	140,000
Profit and loss reserve	528	26,598
Tier 2 Capital		
Subordinated debt	60,000	60,000
Less: Investments in subsidiaries	(63,285)	(94,357)
Total Tier 1 and 2 capital after deductions	137,243	132,241

The Bank's **Tier 1 capital** consists of ordinary share capital and profit and loss reserves. The profit and loss reserves represent the Bank's audited accumulated accounting profits.

The Bank currently has no innovative Tier 1 instruments. As at 31 December 2011, there is no reconciliation differences between the amounts disclosed as Tier 1 capital to those treated as equity under IFRS.

The Bank's **Tier 2 capital** includes qualifying subordinated debt.

The subordinated debt is issued on terms which qualify for inclusion in the Bank's capital resources. Information on the terms of the subordinated debt is included in *note 29* of the Bank's *Annual Report and Financial Statements for the year ended 31 December 2011*.

The Bank does not hold any **Tier 3 capital**.

IV. Capital Adequacy

Internal Capital Adequacy Assessment Process (“ICAAP”)

In line with the FSA requirement, the bank has adopted the ICAAP approach for assessing the adequacy of the internal capital to support the current and future business activities. ICAAP is fully integrated in to the governance and risk management framework, including the risk appetite statement. It is conducted on an annual basis and approved by the Board.

The bank submitted the report to the FSA on request, as part of the ARROW review process, and the FSA has set Individual Capital Guidance (“ICG”) to the bank.

Credit Risk Capital Requirement: Standardised Approach

The Bank’s minimum capital requirement of credit risk is expressed as 8% of the risk weighted exposure amounts for each of the applicable standardised credit risk exposure classes.

Minimum Capital Requirement for Credit Risk by Exposure Classes under the Standardized Approach	As at 31 December 2011		As at 31 December 2010	
	RWA	Capital Requirement	RWA	Capital Requirement
£000				
Central governments or central banks	27	2	37	3
Institutions	36,946	2,956	44,471	3,558
Corporate	250,999	20,080	250,515	20,041
Retail	9,555	764	33,834	2,707
Secured by mortgages on residential property	45,790	3,663	1,570	126
Past due items ¹	0	0	74	6
Securitization positions	3,625	290	8,944	716
Short term claims on institutions and corporate	24,329	1,946	14,477	1,158
Other items	49,199	3,936	48,059	3,845
Total	420,470	33,638	401,981	32,158

¹ All past due items here are provided for, thus are assigned zero risk weight and zero risk capital.

Market risk Capital Requirement:

The market risk capital requirement is calculated using the standard Position Risk Requirement rule (“PRR”). The only market risk requirement is the foreign exchange PRR.

Operational risk Capital Requirement: Basic Indicator Approach

The Bank calculates the capital requirement for operational risk using the Basic Indicator Approach (BIA). The capital requirement is 15% of the average over the previous three years annual gross income.

Capital Adequacy

Capital Adequacy against Pillar 1 Capital Requirement	31 December 2011	31 December 2010
	£000	£000
Credit Risk (Standardized Approach)	33,638	32,158
Market Risk (Foreign Exchange PRR)	164	404
Operational Risk (“BIA”)	6,087	4,550
Total Pillar 1 minimum capital requirement	39,725	37,112
Total capital resources	137,243	132,241
Excess of capital resources over Pillar 1 minimum capital requirement	97,518	95,129

V. Credit Risk Measurement, Mitigation and Reporting

Credit Risk Management and Controls

The bank adopts Three Level of Defence for credit control.

The **first level** is the initial credit assessment process, where credit reports / business proposals are prepared by the relevant business divisions

The **second level** review refers the process that Risk Management Department performs credit risk assessment on the business proposals submitted by the respective business divisions. The results of RMD's risk assessment process, together with the original business proposals, are forwarded either to the approvers (depending on the materiality of the business proposal and the related credit risk exposures) or are presented for discussion in Credit Committee (CC) meeting.

The **third level review** is applied where recommendations of the CC are presented to the ultimate sanctioning authority (i.e. the CRO/CEO and / or the Board) for approval and sign off.

Credit Risk Exposures

Geographic Distribution of Credit Exposure

£'000	UK	Other European Countries	North America	Rest of the World	Total
2011					
Central governments or central banks	27	-	-	-	27
Corporates	206,539	70,154	5,259	16,243	298,195
Institutions	16,953	-	40,589	21,563	79,105
Retail	12,555	8	-	523	13,086
Secured by mortgages on residential property	130,828	-	-	-	130,828
Past due items	86	-	-	-	86
Securitisation positions	5,974	9,663	-	3,421	19,058
Short term claims on institutions and corporates	274,439	33	317	1,046	275,835
Other items	50,809	-	543	1	51,353
Grand Total	698,210	79,858	46,708	42,797	867,573
2010					
Central governments or central banks	18	-	-	19	37
Corporates	243,500	80	7	47,567	291,154
Institutions	37,565	13,289	272	59,348	110,473
Retail	67,612	1,301	-	13,281	82,193
Secured on real estate property	1,411	-	-	211	1,623
Past due items	437	-	-	1	437
Securitisation positions	32,893	-	-	14,728	47,622
Short term claims on institutions and corporates	211,588	-	-	-	211,588
Other items	49,408	102	-	-	49,510
Grand Total	644,433	14,772	278	135,155	794,638

Gross Credit Exposure under the Standardised Approach

£'000	2011		2010	
	*Average Credit Exposure	End of Year Exposure	Average Credit Exposure	End of Year Exposure
Central governments or central banks	17	27	17	37
Institutions	83,024	79,105	140,609	110,473
Corporates	296,661	298,195	484,759	291,154
Retail	59,070	13,086	68,576	82,193
Secured by mortgages on residential property**	64,103	130,828	1,624	1,623
Past due items	148	86	594	437
Securitisation positions	30,404	19,058	55,220	47,622
Short term claims on institutions and corporates	271,951	275,835	223,332	211,588
Other items	46,906	51,353	38,514	49,510
Grand Total	852,284	867,573	1,013,245	794,638

*Note 1: Quaterly average is adopted here.

**Note 2: For 2011 this item is referred to as Secured on real estate property

Remaining Contractual Maturity of Credit Exposure

£'000	Up to 12 months	1-5 yeas	More than 5 years	Total
2011				
Central governments or central banks	-	27	-	27
Institutions	47,919	20,763	10,423	79,105
Corporates	65,834	179,089	53,272	298,195
Retail	4	1,387	11,695	13,086
Secured by mortgages on residential property	11	1,086	129,731	130,828
Past due items	-	86	-	86
Securitisation positions	-	-	19,058	19,058
Short term claims on institutions and corporates	238,625	37,210	-	275,835
Other items	-	51,353	-	51,353
Grand Total	352,393	291,001	224,179	867,573
2010				
Central governments or central banks	-	37	-	37
Institutions	-	86,443	24,030	110,473
Corporates	7,132	198,360	85,662	291,154
Retail	-	378	81,816	82,193
Secured on real estate property	-	-	1,623	1,623
Past due items	-	437	-	437
Securitisation positions	-	249	47,373	47,622
Short term claims on intitutions and corporates	179,590	31,998	-	211,588
Other items	-	49,510	-	49,510
Grand Total	186,722	367,412	240,503	794,638

Industry Distribution of Gross Credit Exposure 2011

Exposure Class	Industry Category	Gross Exposure £'000
Central governments or central banks	Business and other services	27
Institutions	Financial	79,105
Corporates	Business and other services	90,238
	Construction	307
	Energy and water supply industries	41,424
	Financial	11,628
	Garages, distribution, hotels and catering	7,544
	Manufacturing industry	120,704
	Postal services & telecommunication	15,854
	Transport	10,496
Retail	Business and other services	7
	Garages, distribution, hotels and catering	1,109
	Persons	11,970
Secured by mortgages on residential property	Garages, distribution, hotels and catering	205
	Persons	130,623
Past due items	Persons	86
Securitisation positions	Financial	19,058
Short term claims on institutions and corporates	Garages, distribution, hotels & catering	14
	Financial	275,821
Other items	Business and other services	50,737
	Financial	612
	Postal services & telecommunication	4
Grand Total		867,573

Impairment Provisions

The bank defines past due loan as an instalment or the whole or a part of the loan is not repaid as past due. The bank identifies impairment through a list of prescribed credit events of the borrower. The impairment loss refers the difference between the carrying value of the loan and the present value of estimated future cash flow.

Industry and Country Distribution of Impairment Provisions

£000	UK			Rest of the World		
	Impaired	Provision	Past Due ²	Impaired	Provision	Past Due
<i>2011</i>						
Business & other services	(13,388)	7,000	(445)	-	-	-
Garages, distribution, hotels & catering	-	-	(485)	-	-	-
Persons	(296)	128	(1,797)	-	-	-
Grand Total	(13,683)	7,128	(2,727)	-	-	-
<i>2010</i>						
Garages, distribution, hotels & catering	(357)	357	(110)	(28)	19	(14)
Transport	-	-	(5)	-	-	-
Persons	(31)	31	(1,351)	(1)	1	(947)
Grand Total	(388)	388	(1,466)	(29)	20	(961)

Provisioning for Loans and Advances

An allowance for impairment is established when objective evidence is identified:

- Significant financial difficulty of the obligor;
- Breach of contract, such as a default or delinquency in interest or principal payments for a period exceeding 90 days;
- the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
- It becoming probable that the borrower will enter bankruptcy or other financial reorganization;
- Disappearance of an active market for that financial asset because of financial difficulties;
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:
 - (i) Adverse changes in the payment status of borrowers in the portfolio; and
 - (ii) National or local economic conditions that correlate with defaults on the assets in the portfolio
- Other observable evidence that an asset or a portfolio is impaired.

² Past due assets here is defined as overdue for 0-3 months for internal accounting purpose, which is different from the definition adopted for FSA004 Credit Exposure reporting, being that any item past due for more than 90 days.

The bank makes provisions on a case-by-case basis. If the amount of impairment losses decreases subsequently, the allowance is adjusted accordingly and the amount of reversal is recognised in the income statement.

A loan or advance is written-off, either partially or in full, against the identified allowance when the proceeds from available security have been received or no realistic prospect of recovery can be seen. Subsequent recoveries of amounts previously written-off decrease the amount of impairment losses recorded in the income statement. The bank does not have collectively assessed impairment in both the financial year 2011 and 2010.

Allowances for Impairment: Provisions to Loans and advances to banks and customers

£000	Specific Loans and advances	
	to banks	to customers
Balance as at 1 Jan 2011	-	408
Increase in impairment	-	7,167
Reversal of impairment	-	-
Charge in income statement	-	7,167
Amounts written off	-	(447)
Balance as at 31 Dec 2011	-	7,128
Balance as at 1 Jan 2010	-	531
Increase in impairment	-	37
Reversal of impairment	-	(152)
Credit in income statement	-	(115)
Amounts written off	-	(8)
Balance as at 31 Dec 2010	-	408

Provisioning for Available-for-sale Financial Assets

Impairment for available-for-sale financial assets is identified when there is a significant or prolonged decline in the fair value of the assets below its original cost.

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

If, in a subsequent period, the fair value of the asset increases, which can be objectively related to an event occurring after the recognition of the impairment loss, the impairment loss is reversed through the income statement.

(b) Allowances for Impairment : Available For Sale Financial Investments

£000	Movement in fair value recognized in equity	Impairment
Balance as at 1 Jan 2011	1,340	5,749
Changes in fair values	1,141	-
Increase in impairment	(1,105)	1,105
Amounts written off	-	(2,934)
Exchange-rate movements	-	10
Balance as at 31 Dec 2011	1,376	3,930
Balance as at 1 Jan 2010	5,819	5,584
Changes in fair values	(4,329)	-
Increase in impairment	(150)	150
Amounts written off	-	-
Exchange-rate movements	-	15
Balance as at 31 Dec 2010	1,340	5,749

(C) Impairment Charges

£000	31/12/2011	31/12/2010
Loans and advances to customers		
Specific	7,167	(115)
Collective	-	-
Available for sale financial investments	1,105	150
Total impairment charges in income statement	8,272	35

Credit Quality Step (“CQS”) Analysis

In its assessment of credit risk under the Standardised Approach, the Bank uses ratings assigned by the FSA’s recognised External Credit Assessment Institutions (“ECAIs”), namely, Standard and Poor’s (“S&P”) and Moody's Investors Service (“Moody’s”). The Bank has not used any export credit agencies. The bank follows the provision of the FSA Handbook where external ratings can not be obtained.

Exposure values for each of the standardised credit risk exposure classes associated with each credit quality step prescribed in BIPRU 3 as at 31 December 2011:

	Risk weight	Moody's	S&P ratings	Exposure	RWA
CQS for Central governments or central banks					
Unrated	100%			27	27
Total				27	27
CQS for Corporates					
1	20%	Aaa to Aa3	AAA to AA-	26,053	5,211
2	50%	A1 to A3	A+ to A-	43,135	20,364
3	100%	Baa1 to Baa3	BBB+ to BBB-	61,648	61,648
4	100%	Ba1 to Ba3	BB+ to BB-	15,164	15,164
5	150%	Caa1 and below	CCC+ and below	14,312	10,968
Unrated				137,883	137,644
Total				298,195	250,998
CQS for Institutions					
1	20%	Aaa to Aa3	AAA to AA-	8,688	1,738
2	50%	A1 to A3	A+ to A-	52,579	26,289
3	50%	Baa1 to Baa3	BBB+ to BBB-	17,838	8,919
Total				79,105	36,946
CQS for Short term claims on institutions and corporates					
1	20%	Aaa to Aa3	AAA to AA-	662	132
2	50%	A1 to A3	A+ to A-	563	113
Unrated				274,610	24,084
Total				275,836	24,329
CQS for Securitisation positions					
1	20%	Aaa to Aa3	AAA to AA-	19,058	3,625
Total				19,058	3,625
Retail				13,086	9,555
Secured on real estate property				130,828	45,790
Past due items				86	-
Other items				51,353	49,199
Grand Total				867,573	420,470

Note:

1. Exposure value is the amount after applying credit conversion factors to off balance sheet exposures in accordance with the FSA regulatory rules.
2. RWA figure of the 5th category in *CQS for Corporate* has taken into account the impact of specific provisions.

VI. Counterparty Credit Risk (“CCR”)

The Bank uses derivative instruments to hedge its exposure to market risk, including interest rate risk in the banking book and foreign exchange risk. The counterparty credit risk for derivative and foreign exchange instruments is subject to credit limits on the same basis as the Bank’s other credit exposures.

The Bank has not received nor provided collateral in respect of derivative contracts. Therefore, no collateral would need to be provided in the event of a downgrade in the Bank’s credit rating. The Bank only entered into derivative contracts with its group companies.

The Bank measures its counterparty credit exposure using the CCR mark-to-market method, which is the sum of current exposure (i.e. replacement cost) and potential future exposure. The potential future exposure is an estimate based on factors such as the residual maturity of the contracts and the types of contract.

Counterparty credit exposures for derivative contracts

£000	2011		2010	
	Assets	Liabilities	Assets	Liabilities
Interest rate swap	58	4,131	477	5,375
Cross currency swap	-	280	28	581
Foreign exchange forward	14	5	-	-
Total	72	4,416	505	5,956

Securitisation

The Bank holds positions in asset backed securities (“ABS”) solely for investment purpose. The holding position can be sub-divided into Automobile receivables and mortgage-backed securities (MBS). All ABS assets are classified as available-for-sale for accounting purposes.

The Bank adopted the Standardised approach to calculate its risk weighted exposure amounts of its investments in ABS. As at 31st December 2011, the Bank’s exposure to ABS is £ 18.9 million (of which £17.7 million relates to MBS and £1.2 million relates to Auto receivables).

The Bank uses ratings assigned by S&P and Moody’s for the quantification of credit risk capital requirement under BIPRU 9.

VII. Market Risks and Interest Rate Risk on Banking Book (“IRRBB”)

The Bank does not undertake proprietary trading activities, and any matched principal broking position is back to back squared. Main source of market risk relates to foreign exchange risk, which stems from treasury funding activity and the investment portfolio.

Foreign Exchange Risk

The Bank’s foreign exchange position as at 31 December 2011 are set out below:

£000	US Dollar	Euro	HK Dollars	YEN	Other
<i>2011</i>	(675)	373	(32)	96	(122)
<i>2010</i>	3,517	979	(502)	(1,645)	(282)

Interest Rate Risk in Banking Book (“IRRBB”)

Objective for IRRBB risk management is to decrease the sensitivity of the bank’s earnings and economic value to market rate fluctuations.

IRRBB mainly stems from the re-pricing mismatch of assets and liabilities. The sources of interest rate risk include re-pricing risk, yield curve risk, basis risk and embedded option risk.

Interest rate risk is managed base on the contractual maturity of the underlying investments. There are no assumptions made on loan prepayments.

The Bank adopts the interest rate sensitivity gap to analyse the re-pricing risk on a static basis from both the net interest income and economic value perspectives. The Bank also exercises a limit control utilising the one-year cumulative gap ratio (i.e. cumulative gap divided by interest-bearing assets) for all currencies expressed in sterling.

Impact of 100 bps parallel shift on projected net interest income

£000	100 bps parallel increase	100 bps parallel decrease
<i>2011</i>	978	(978)
<i>2010</i>	1,750	(1,750)