葉茂

Extensive Network

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following sections provide metrics and analytics of the Group's performance, financial position, and risk management. These should be read in conjunction with the financial statements included in this Annual Report.

PERFORMANCE MEASUREMENT

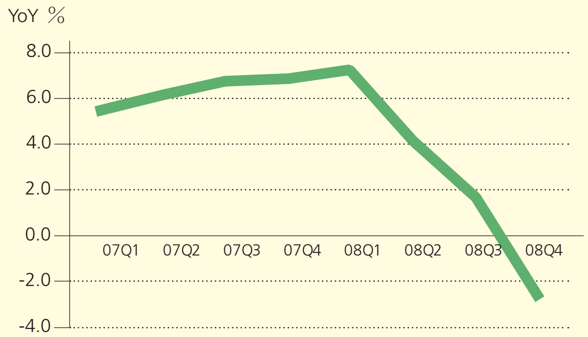
The following table highlights the Group's financial performance in terms of earnings, dividend payout, cost efficiency, asset growth, loan quality, and capital strength in 2008.

Financial Indicators	Performance	Result Highlights
Earnings	Profitability declined as a result of the global economic slowdown and increased volatility in financial markets. • Operating profit before impairment allowances decreased by 14.0% to HK$16,755 million. • Profit attributable to shareholders decreased by 78.4% to HK$3,343 million.	**• Operating profit before impairment allowances: down 14.0%** **• Profit attributable to shareholders: down 78.4%**
ROE[1] and ROA[2]	• ROE and ROA were 3.81% and 0.27% respectively. • ROE and ROA before impairment allowances were 19.09% and 1.52% respectively.	**• ROE: 3.81%** **• ROA: 0.27%**
Dividend payout ratio	An interim dividend of HK$0.438 per share was paid to the shareholders. The Board proposes not to pay a final dividend for 2008.	**• Total dividend per share for 2008: HK$0.438**
Net interest income and net interest margin	• Net interest income increased by 3.9% to HK$20,157 million. • Net interest margin was 2.00% in 2008. Net interest spread rose but was offset by the decline in contribution from net free fund because of falling market interest rates. The pricing of new corporate loan facilities also improved with the tightened credit environment.	**• Net interest income: up 3.9%** **• Net interest margin: 2.00%**
Non-interest income[3]	Non-interest income to operating income[4] ratio was 21.03%, a drop of 7.81 percentage points primarily due to the decrease in investment-related agency fee income as well as the operating loss of the life insurance business.	**• Non-interest income to operating income ratio: 21.03%**
Cost efficiency	Cost-to-income ratio rose by 5.84 percentage points to 34.36% as operating expenses increased by 12.8% while operating income decreased by 6.3%.	**• Cost-to-income ratio: 34.36%, maintained well below the market average**
Total assets	• Total assets grew by 7.5% to HK$1,147.2 billion. Loans and deposits[5] rose by 11.5% and 1.5% respectively.	**• Total assets: up 7.5%**
Loan quality	• Formation of new classified loans[6] remained at a low level of less than 0.4% of total loans. • Classified or impaired loan[7] ratio was slightly up 0.02 percentage point from 0.44% at end-2007 to 0.46% at end-2008.	**• Classified or impaired loan ratio: 0.46%, well below the market average**
Capital strength and liquidity	• Capital adequacy ratio was up 3.09 percentage points to 16.17% with improved capital structure. Tier one ratio stood at 10.86%. • Liquidity remained abundant.	**• Capital adequacy ratio: 16.17%** **• Liquidity ratio: 41.74%**

(1) ROE represents return on average capital and reserves attributable to the equity holders of the Company.
(2) ROA represents return on average total assets and is defined in "Financial Highlights".
(3) Non-interest income represents net fees and commission income, net trading income, net gain/(loss) on financial instruments designated at fair value through profit or loss, net gain/(loss) on investments in securities, net insurance premium income, other operating income and net insurance benefits and claims.
(4) Operating income comprises net interest income and non-interest income as defined in (3) above.
(5) Including structured deposits.
(6) Classified loans are advances to customers which have been classified as "substandard", "doubtful" or "loss" under the Group's classification of loan quality.
(7) Classified or impaired loans represent advances which have been classified as "substandard", "doubtful" or "loss" under the Group's classification of loan quality, or individually assessed to be impaired. Repossessed assets are initially recognised at the lower of their fair value less costs to sell or the amortised cost of the related outstanding loans on the date of repossession. The related loans and advances are deducted from loans and advances.

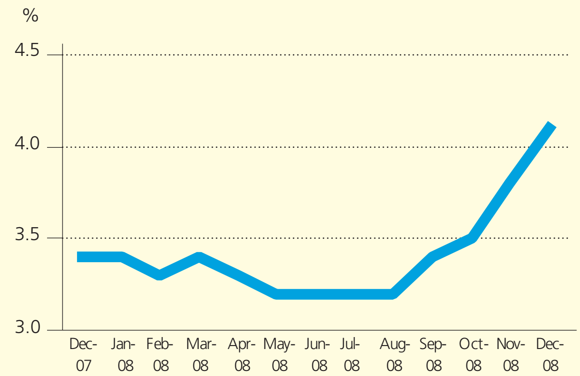
BUSINESS ENVIRONMENT

Hong Kong Real GDP



Source: Bloomberg

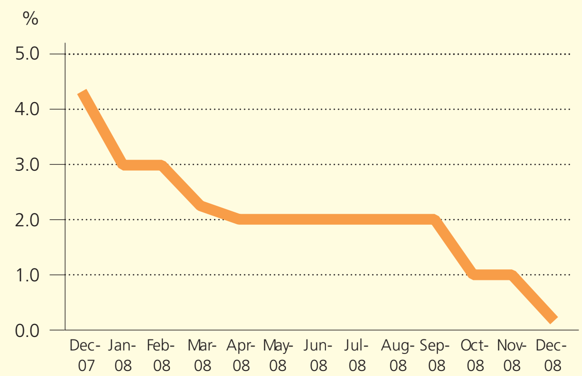
Hong Kong Unemployment Rate



Source: Bloomberg

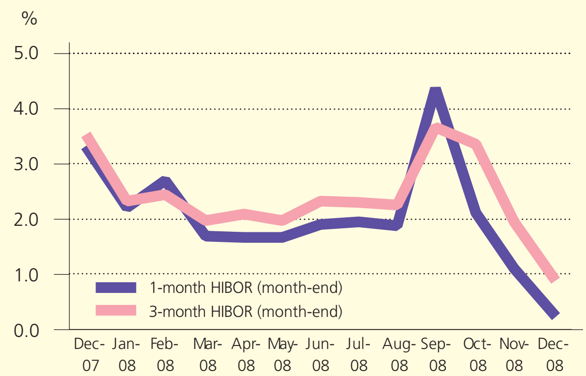
The economic environment deteriorated drastically in 2008 and made it unusually challenging for the operation of the banking industry. In the first half of the year, there were already signs of a global economic slowdown subsequent to the US subprime mortgage crisis. In the second half of the year, the US subprime crisis deepened and spread to other credit markets. The global financial landscape turned gloomy and the financial system came under severe strain. The need for rescuing the two US mortgage agencies, Fannie Mae and Freddie Mac, by the US government, the bankruptcy of the investment bank Lehman Brothers Holdings Inc. ("Lehman Brothers"), and the possible collapse of the insurance giant AIG sparked widespread concerns about the stability of financial institutions and the global interbank market was severely affected as counterparty risk surged. The global financial crisis and economic downturn inevitably had an adverse impact on Hong Kong. The Hong Kong economy recorded quarter-on-quarter contraction starting from the second quarter of 2008 following an extended period of expansion for four years. The slowing down of economic activity was primarily caused by weak private consumption, diminished merchandise exports and rising unemployment rate which reached 4.1% at the end of 2008. Inflationary pressure in Hong Kong was unabated in the first half of the year with the composite consumer price index ("CCPI") rising by 3.3% in July compared with end-2007. The pressure was somewhat relieved in the second half as commodity and oil prices as well as wages began to fall, causing the CCPI to rise by a more modest 2.1% by end-2008.

Federal Funds Target Rate



Source: Bloomberg

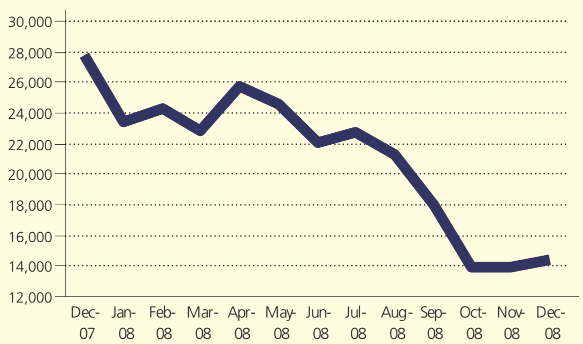
HIBOR



Source: Bloomberg

Central governments around the world have taken drastic measures to rescue their respective financial systems and economies. The US Federal Reserve continued with the interest rate cut cycle since September 2007 and slashed the US Federal Funds Target Rate by an aggregate of 400 basis points in 2008 to 0.25% by the end of 2008. Meanwhile, banks in Hong Kong also lowered their Prime rates. Average 1-month HIBOR and 1-month LIBOR declined substantially from 4.97% and 5.49% respectively in September 2007 to 1.46% and 2.51% respectively in May 2008 but then rose in September to 2.75% and 2.93% respectively because of the higher counterparty risk and surging demand for liquidity after the bankruptcy of Lehman Brothers. Interest rate volatility rose and the HIBOR-LIBOR spread fluctuated sharply. To ease the money market stress, the Hong Kong Monetary Authority ("HKMA") injected liquidity into the banking system and at the same time took other pre-emptive measures such as providing liquidity assistance and lowering the borrowing costs to banks. As a result, HIBORs declined substantially along with LIBORs.

Hang Seng Index



Source: Bloomberg

The downward trend of local stock market continued in 2008, with the Hang Seng Index ("HSI") falling further still. Local share prices rebounded in April after the announcements by major corporations of strong earnings. However, equity prices fell sharply during the second half of the year as the global financial crisis intensified. HSI closed at 14,387 points at end-2008, versus 27,813 points at end-2007, shedding almost half of the total market value.

In the local residential property market, prices declined notably in the third quarter of 2008 after the sharp increases recorded in late 2007 and early 2008. The transaction volume plunged as tightened credit sentiment and weakened economic prospects put a brake on housing demand and speculative activities. With a high degree of uncertainty still looming over the economy and labour market conditions, housing demand remained sluggish in the second half of 2008. Transaction volume, in terms of the number of agreements for sale and purchase of all building units, contracted by 22.2% compared to 2007.

The financial crisis and economic downturn posed a number of formidable challenges to the local banking sector in 2008 and banks' profitability was severely eroded. Asset quality worsened, leading to a rise in the provisions for loans and investment portfolios. The classified loan ratio of retail banks rose to an average of 1.24% at end-2008.

CONSOLIDATED FINANCIAL REVIEW

The financial crisis took its toll on the global economy, including Hong Kong, in 2008, particularly in the second half of the year. The intensification of the financial crisis and increased volatility in financial markets led to the rapid deterioration of both the market sentiments and the operating environment. Against this background, the banking sector as a whole suffered. After registering satisfactory financial results with strong growth in core earnings in the first six months of the year, the Group's financial performance for the whole year of 2008 was severely tarnished by the drastic change in the market environment in the second half of the year. As a result, the Group's operating profit before impairment allowances decreased by HK$2,726 million, or 14.0%, to HK$16,755 million. There was growth in both net interest income and net trading income of the banking operation. However, these increases were more than offset by the operating loss recorded by the Group's insurance segment, lower net fees and commission income as well as higher operating expenses. The Group's profit attributable to shareholders decreased by HK$12,103 million, or 78.4%, to HK$3,343 million, due to the significant increase in impairment charge on securities investments, a net charge of loan impairment allowances as well as the deficit arising from the revaluation of properties. Earnings per share were HK$0.3162. Return on average total assets ("ROA") and return on average shareholders' funds ("ROE") were 0.27% and 3.81% respectively. ROA and ROE before impairment allowances were 1.52% and 19.09% respectively.

Financial Highlights

HK$'m, except percentage amounts	**2008**	2007
Operating income	**25,526**	27,254
Operating expenses	**(8,771)**	(7,773)
Operating profit before impairment allowances	**16,755**	19,481
Net (charge)/reversal of impairment allowances	**(12,573)**	(1,448)
Others	**(104)**	1,093
Profit before taxation	**4,078**	19,126
Profit attributable to equity holders of the Company	**3,343**	15,446
Earnings per share (HK$)	**0.3162**	1.4609
Return on average total assets	**0.27%**	1.53%
Return on average shareholders' funds*	**3.81%**	17.40%
Return on average total assets before impairment allowances	**1.52%**	1.89%
Return on average shareholders' funds before impairment allowances*	**19.09%**	21.95%
Net interest margin (NIM)	**2.00%**	2.07%
Adjusted NIM**	**2.07%**	2.10%
Non-interest income to operating income ratio	**21.03%**	28.84%
Cost-to-income ratio	**34.36%**	28.52%

* Shareholders' funds represent capital and reserves attributable to the equity holders of the Company.

** Adjusted for the estimated impact of BOCHK's RMB clearing function. Since December 2003, the Bank has been the clearing bank to provide RMB clearing services for banks in Hong Kong that operate RMB business. Acting as the clearing bank, the Bank deposits those RMB deposits taken in Hong Kong by the participating banks with the People's Bank of China ("PBOC"). At the same time, the Bank earns an interest spread between the RMB funds taken from participating banks and those placed with the PBOC. As RMB deposits grow, the impact on the Group's average interest-earning assets and net interest margin ("NIM") becomes more material. It is, therefore, considered necessary to also provide information on NIM before incorporating the estimated impact of RMB clearing services (hereafter called "Adjusted net interest margin").

Analyses of the Group's financial performance and business operations are set out in the following sections.

Net Interest Income and Margin

HK$'m, except percentage amounts	2008	2007
Interest income	**35,281**	46,056
Interest expense	**(15,124)**	(26,661)
Net interest income	**20,157**	19,395
Average interest-earning assets	**1,006,440**	938,377
Net interest spread	**1.78%**	1.65%
Net interest margin	**2.00%**	2.07%
Adjusted net interest margin*	**2.07%**	2.10%

* Excluding the estimated impact of BOCHK's RMB clearing function

Net interest income increased by HK$762 million, or 3.9%, to HK$20,157 million in 2008. Average interest-earning assets grew by HK$68,063 million, or 7.3%, to HK$1,006,440 million. Although net interest spread rose by 13 basis points, net interest margin fell by 7 basis points to 2.00% mainly due to a decline of 20 basis points in the contribution from net free fund. The significant increase in RMB deposits from participating banks in 2008 also led to the decrease in the net interest margin. Should the estimated impact of BOCHK's RMB clearing function in Hong Kong be excluded, the adjusted net interest margin would have been 2.07%, showing a fall of 3 basis points only.

Market interest rates fluctuated widely in 2008. Following the interest rate cut cycle kicked off by the US Federal Reserve in September 2007, market interest rates declined substantially and stayed at low levels in the first half of 2008. However, as the financial crisis continued to unfold and Lehman Brothers filed bankruptcy in mid-September 2008, the money market was under severe stress. One-month LIBOR once climbed to the peak of 4.59% in early October 2008. Further cuts in the Federal Funds Target Rate and the US government's US$700 billion financial bailout package helped ease the interbank credit market tension. One-month LIBOR then dropped to 0.44% at end-2008. Meanwhile, HKD interest rates followed broadly the same direction as their USD counterparts. Average one-month HIBOR in 2008 fell by 228 basis points to 2.00% while average one-month LIBOR fell by 257 basis points to 2.68% compared to 2007. The Group's average HKD Prime rate decreased by 219 basis points to 5.40%, thus widening the HKD Prime-to-one month HIBOR spread (hereafter called "Prime-HIBOR spread") by 9 basis points to 3.40%.

The increase in net interest income was mainly attributable to the growth in average interest earning assets, driven by the increase in average customer deposits as well as average deposits of banks and other financial institutions. Net interest spread increased with the widened securities spread in the falling interest rate environment. Average higher yielding loans, such as Mainland lending and trade finance, continued to grow. At the same time, the pricing of new corporate loan facilities had improved under the tightening credit environment. Loan spread, however, was compressed by the lower average pricing on the mortgage portfolio. The Group also took extra care in managing funding costs and its deposit mix continued to improve with an increase in the proportion of average demand deposits and current accounts* as well as savings deposits in its average total deposits. Deposit spread decreased with lower market rates as deposits rates were already at a very low level. Contribution from net free fund decreased as market interest rates dropped significantly.

* excluding IPO-related funds

The summary below shows the average balances and average interest rates of individual assets and liabilities:

ASSETS	**Year ended 31 December 2008** Average balance HK$'m	**Year ended 31 December 2008** Average yield %	Year ended 31 December 2007 Average balance HK$'m	Year ended 31 December 2007 Average yield %
Loans to banks	**261,660**	**2.11%**	207,454	4.01
Debt securities investments	**306,807**	**4.27%**	331,422	4.92
Loans and advances to customers	**424,187**	**3.83%**	382,040	5.45
Other interest-earning assets	**13,786**	**2.92%**	17,461	3.73
Total interest-earning assets	**1,006,440**	**3.51%**	938,377	4.91
Non interest-earning assets	**92,758**	**–**	94,200	–
Total assets	**1,099,198**	**3.21%**	1,032,577	4.46

LIABILITIES	**Year ended 31 December 2008** Average balance HK$'m	**Year ended 31 December 2008** Average rate %	Year ended 31 December 2007 Average balance HK$'m	Year ended 31 December 2007 Average rate %
Deposits and balances of banks and other financial institutions	**79,969**	**1.91%**	45,819	3.38%
Current, savings and fixed deposits	**767,006**	**1.65%**	742,152	3.27%
Certificate of deposits issued	**1,474**	**3.73%**	2,266	3.58%
Other interest-bearing liabilities	**27,597**	**3.08%**	27,189	2.92%
Total interest-bearing liabilities	**876,046**	**1.73%**	817,426	3.26%
Non interest-bearing deposits	**37,053**	**–**	36,866	–
Shareholders' funds* and non interest-bearing liabilities	**186,099**	**–**	178,285	–
Total liabilities	**1,099,198**	**1.38%**	1,032,577	2.58%

* Shareholders' funds represent capital and reserves attributable to the equity holders of the Company.

Second Half Performance

Compared to the first half of 2008, net interest income increased by HK$99 million, or 1.0%. Average interest-earning assets grew by HK$35,292 million, or 3.6%. Net interest margin and net interest spread fell by 6 basis points and 2 basis points respectively. Contribution from net free funds fell by 4 basis points.

The increase in net interest income was mainly attributable to the growth in average interest earning assets, driven by the increase in average customer deposits as well as average deposits and balances of banks and other financial institutions. The increase was partially offset by the decline in contribution from net free funds with lower market interest rates. Gross rate of debt securities declined due to repricing and increase in lower yielding liquefiable securities in the intensifying financial crisis. Average pricing of new corporate loan facilities continued to improve, however, loan spread was compressed as Prime-HIBOR spread was narrowed by 48 basis points compared to the first half of 2008. Deposit mix improved with an increase in the proportion of average demand deposits and current accounts* as well as savings deposits in the Group's average total deposits. Deposit spread increased as the Group managed its funding costs more prudently.

* excluding IPO-related funds

Net Fees and Commission Income

HK$'m	**2008**	2007
Investment and insurance fee income	**2,964**	4,511
Securities brokerage (Stockbroking)	**2,380**	3,560
Securities brokerage (Bonds)	**259**	211
Sale of funds	**218**	683
Life insurance*	**107**	57
Credit cards	**1,220**	1,027
Bills commissions	**683**	588
Loan commissions	**513**	347
Payment services	**486**	464
Account services	**261**	290
RMB business	**223**	137
Currency exchange	**204**	184
Trust services	**173**	153
General insurance	**102**	96
Correspondent banking	**44**	37
Guarantees	**37**	32
Custody	**45**	4
IPO-related business	**30**	105
Others	**229**	202
Fees and commission income	**7,214**	8,177
Fees and commission expenses	**(2,035)**	(1,903)
Net fees and commission income	**5,179**	6,274

* Fee income from life insurance only included that from the Group's insurance business partner after group consolidation elimination.

Net fees and commission income decreased by HK$1,095 million, or 17.5%, to HK$5,179 million, mainly due to the decline in investment-related fee income, which will be discussed in the next section "Investment and Insurance Business". Fee income from the Group's traditional banking businesses improved. Loan commission grew strongly by HK$166 million or 47.8%. This was mainly attributed to the successful implementation of the Group's new business model as well as the increase in syndicated loans following the Group's appointment as the "Asia-Pacific Syndicated Loan Centre" of the BOC Group in early 2008. Fees from the credit card business showed a satisfactory growth of HK$193 million or 18.8% as cardholder spending and merchant acquiring volume were up 12.7% and 19.9% respectively. Fee income from bills, RMB-related business and currency exchange recorded double-digit growths of 16.2%, 62.8% and 10.9% respectively. Following the introduction of custody business in 2007, its contribution to the Group's fee income was encouraging in 2008. However, fee income from IPO-related business decreased markedly by 71.4% as IPO activities reduced significantly. Meanwhile, fees and commission expenses increased by HK$132 million or 6.9%, mainly due to increase in credit card, currency exchange service and RMB-related business expenses.

Second Half Performance

Compared to the first half of 2008, net fees and commission income decreased by HK$619 million or 21.4%, largely because of the decline in investment-related fee income, which will be discussed in the next section. Meanwhile, fees and commission income from RMB-related business and card business increased by 25.3% and 11.1% respectively. Fees and commission expenses were up 15.1%, mainly because of higher credit card, currency exchange service and RMB-related business expenses.

Investment and Insurance Business

HK$'m	2008	2007
Investment and insurance fee income		
Securities brokerage (Stockbroking)	**2,380**	3,560
Securities brokerage (Bonds)	**259**	211
Sale of funds	**218**	683
Life insurance*	**107**	57
	2,964	4,511
Insurance and investment income of BOC Life		
Net insurance premium income	**5,891**	8,426
Interest income	**1,122**	788
Net (loss)/gain on financial instruments designated at fair value through profit or loss	**(136)**	893
Others	**17**	15
Gross insurance and investment income of BOC Life#	**6,894**	10,122
Less: net insurance benefits and claims	**(7,709)**	(9,440)
	(815)	682
Total investment and insurance income	**2,149**	5,193
Of which: Life insurance fee income*	**107**	57
Insurance income of BOC Life#	**(815)**	682
Total life insurance income	**(708)**	739
Investment fee income	**2,857**	4,454
Total investment and insurance income	**2,149**	5,193

* Fee income from life insurance only included that from the Group's insurance business partner after group consolidation elimination.

\# Before commission expenses.

In 2008, particularly in the second half, as the financial crisis intensified, investors' appetite for investment and wealth management products weakened further. This had a negative impact on the Group's investment and insurance related business which declined significantly following an exceptionally strong 2007. The Group's total investment and insurance income decreased by HK$3,044 million, or 58.6% to HK$2,149 million, mainly due to the decrease in both the income from stock broking and sale of funds coupled with the loss incurred by its insurance segment. Income from stock broking declined by HK$1,180 million or 33.1% due to lower business volume along with the fall in market transactions. Income from the sale of funds decreased by HK$465 million or 68.1% as the sales of open-end funds fell with diminished demand. Meanwhile, commission from the sales of bonds rose by HK$48 million, or 22.7% as sales of structured notes rose by 15.8% resulting from the successful private placement service introduced by the Group in the first half of the year. Fee income from the Group's insurance business partner also increased by HK$50 million, or 87.7% on the back of the 56.9% increase in sales volume. As for BOC Life, insurance income decreased by HK$1,497 million, which was mainly attributable to the weak performance of its investment assets with a loss of HK$136 million compared to a gain of HK$893 million in 2007. Net insurance premium income declined by HK$2,535 million, or 30.1%, as sales slowed down. During the first half of the year, the Group launched several large-scale promotional and marketing activities to reinforce the Group's brand image and boost the sales of regular pay products. Product mix continued to improve with net insurance premium income from regular premium products increasing by 39.6% year-on-year.

Second Half Performance

Compared to the first half of 2008, total investment and insurance income decreased by HK$1,443 million, or 80.3%. There was a broad-based decrease in investment and insurance fee income of HK$522 million or 29.9% as market demand further weakened in the second half of the year. The insurance income of BOC Life was down HK$921 million mainly due to the weak performance of its investment assets, lower net insurance premium income coupled with the increase in net insurance benefits and claims amid a falling interest rate environment.

Net Trading Income

HK$'m	**2008**	2007
Foreign exchange and foreign exchange products	**1,809**	800
Interest rate instruments	**(127)**	30
Equity instruments	**119**	181
Commodities	**113**	2
Net trading income	**1,914**	1,013

Net trading income was HK$1,914 million, up HK$901 million or 88.9% year-on-year mainly due to the surge in net trading income from foreign exchange and foreign exchange products by HK$1,009 million or 126.1%. During 2008, the currency market became volatile and the anticipated appreciation of the RMB boosted customers' appetite for currency-related products. Taking advantage of higher demand, the Group successfully grew its income from foreign exchange activities by HK$482 million or 42.1%. Meanwhile, net trading income from mark-to-market on foreign exchange swap contracts* significantly improved by HK$662 million. The increase was partially offset by a foreign exchange loss arising from the revaluation of Nanyang Commercial Bank (China), Limited's ("Nanyang (China)") Hong Kong Dollar capital funds against the appreciated RMB during the course of approval for conversion into RMB. Net trading income from interest rate instruments declined by HK$157 million, which was caused by the mark-to-market loss on interest rate swap contracts. Net trading income of equity instruments decreased by HK$62 million or 34.3%, mainly due to decline in the fair value of certain equity instruments. The decline was partly offset by the option premium income from the newly launched "Equity-Linked Investments". Net trading income from commodities increased by HK$111 million because of higher customer demand for bullion products in a volatile commodity market.

* Foreign exchange swap contracts are usually used for the Group's liquidity management and funding activities. Under foreign exchange swap contracts, the Group exchanges one currency (original currency) for another (swapped currency) at the spot exchange rate (spot transaction) and commits to reverse the spot transaction by exchanging the same currency pair at a future maturity at a predetermined rate (forward transaction). In this way, surplus funds in original currency are swapped into another currency for liquidity and funding purposes without any foreign exchange risk. Under HKAS 39, the exchange difference between the spot and forward contracts is recognised as foreign exchange gain or loss (as included in "net trading income"), while the corresponding interest differential between the surplus funds in original currency and swapped currency is reflected in net interest income.

Second Half Performance

Compared to the first half of 2008, net trading income declined by HK$560 million or 45.3% in the second half of the year. The decrease was mainly attributable to the decreased fair value of interest rate swap contracts. Income from foreign exchange transactions and structured deposits also dropped with lower customer demand when market sentiments deteriorated drastically and the US Dollar turned strong in the second half of 2008. This decline was offset by the mark-to-market gain on foreign exchange swap contracts.

Net (Loss)/Gain on Financial Instruments Designated at Fair Value through Profit or Loss (FVTPL)

HK$'m	**2008**	2007
Net (loss)/gain on financial instruments designated at FVTPL of the banking business	**(316)**	(25)
Net (loss)/gain on financial instruments designated at FVTPL of BOC Life	**(136)**	893
Net (loss)/gain on financial instruments designated at FVTPL	**(452)**	868

Compared to the net gain of HK$868 million recorded in 2007, a net loss on financial instruments designated at fair value through profit or loss of HK$452 million was recorded in 2008. This was mainly due to the net loss on equity investments held by BOC Life against the net gain recorded in 2007. In addition, the Group's banking business and BOC Life registered mark-to-market loss on their certain debt securities designated at fair value through profit and loss as their market values were adversely affected by the financial crisis. This included a net loss of HK$130 million with respect to the bonds issued by Lehman Brothers.

Second Half Performance

Compared to the net loss of HK$1,484 million recorded in the first half of 2008, net gain on financial instruments designated at fair value through profit or loss in the second half of 2008 was HK$1,032 million. This was mainly caused by the mark-to-market gain of certain debt securities investments of BOC Life recorded in the second half of 2008 under a low interest rate environment.

Operating Expenses

HK$'m, except percentage amounts	**2008**	2007
Staff costs	**4,554**	4,656
Premises and equipment expenses (excluding depreciation)	**1,076**	958
Depreciation on owned fixed assets	**992**	787
Other operating expenses	**2,149**	1,372
Operating expenses	**8,771**	7,773
Cost-to-income ratio	**34.36%**	28.52%

In view of the weakening local economy and intensifying global financial crisis, the Group took pre-emptive measures by launching various cost containment programmes in the second half of the year. As a result, performance-related remuneration, promotional expenses and other business-related expenses had been well contained. These programmes proved to be effective as the growth in operating expenses in the second half of the year significantly slowed down versus the first half of the year.

Total operating expenses were up HK$998 million, or 12.8%, to HK$8,771 million which included the expenses* mainly related to the Lehman Brothers Mini-bonds issue ("Mini-bonds issue") totalling HK$769 million. Cost-to-income ratio rose by 5.84 percentage points over 2007 to 34.36%. Should the said expenses mainly related to the Mini-bonds issue be excluded, the Group's operating expenses would have increased by HK$229 million or 2.9% while the cost-to-income ratio would have risen by 2.83 percentage points to 31.35%.

Staff costs fell by HK$102 million, or 2.2%, primarily due to lower performance-related remuneration. Compared to end-2007, headcount measured in full-time equivalents rose slightly by 36 to 13,463 at end-2008.

Premises and equipment expenses increased by HK$118 million or 12.3% mainly because of higher IT costs and rental in 2008 and as inflationary pressure mounted in the first half of the year.

Depreciation on owned fixed assets rose by HK$205 million, or 26.0%, to HK$992 million due to the increase in computer equipment as the Group continued its infrastructure improvement as well as the effect of the appreciation of the value of bank premises in the first half of the year.

Other operating expenses were up HK$777 million, or 56.6%, mainly due to the additional expenses in relation to the Mini-bonds issue. Higher business taxes due to increased business in the Mainland as well as a larger amount of donations also contributed to the rise. Promotional expenses, however, were lower. Should the expenses* mainly related to the Mini-bonds issue be excluded, other operating expenses would have increased slightly by HK$8 million or 0.6%.

Second Half Performance

Compared to the first half of 2008, total operating expenses rose by HK$595 million, or 14.6%, mainly due to additional expenses incurred in relation to the Mini-bonds issue. If the expenses* mainly related to the Mini-bonds issue were excluded, operating expenses would have decreased by HK$174 million or 4.3%.

* including the related legal expenses

Net (Charge)/Reversal of Loan Impairment Allowances

HK$'m	**2008**	2007
Net (charge)/reversal of loan impairment allowances		
Individual assessment		
– new allowances	**(813)**	(330)
– releases	**83**	299
– recoveries	**722**	1,311
Collective assessment		
– new allowances	**(691)**	(625)
– releases	**10**	–
– recoveries	**28**	30
Net (charge)/reversal to Income Statement	**(661)**	685

In 2008, the Group recorded a net charge of loan impairment allowances of HK$661 million. Compared to a net reversal of HK$685 million in 2007, this change in net charge of loan impairment allowances was mainly due to the increase in the net charge of allowances (before recoveries) from individual assessment and the decline in loan recoveries.

Net charge of individual impairment allowances (before recoveries) was HK$730 million, up HK$699 million from HK$31 million recorded in 2007. The increase in net impairment charge (before recoveries) was caused by the increase in new allowances made to cover the formation of new impaired loans and further deterioration of existing impaired accounts as the repayment capability of borrowers deteriorated in the economic downturn. The reduction in the release of allowances, due to the repayment made by certain large accounts in 2007, also contributed to the increase in net impairment charge.

Net charge of collective impairment allowances (before recoveries) was HK$681 million. The new allowances were mainly attributable to the expanded loan portfolio and the deterioration in asset quality of loans and advances amid the financial crisis.

The Group continued to make recoveries of loans that were previously written off. Total recoveries in individual and collective assessment amounted to HK$750 million, down HK$591 million compared to 2007 during which certain large accounts were recovered.

Second Half Performance

Net charge of loan impairment allowances increased by HK$519 million in the second half of 2008, mainly because of the increase in new allowances from individual assessment as the formation of new impaired loans occurred mainly in the second half of the year when the economy began to slow down. Impairment charge from collective assessment increased as asset quality of loans and advances deteriorated in the second half of the year. The increase in impairment charge from individual and collective assessment was partially offset by the increase in recoveries.

Net Charge of Impairment Allowances on Securities Investments

HK$'m	**2008**	2007
Held-to-maturity securities	**(4,061)**	(1,844)
Available-for-sale securities	**(7,839)**	(289)
Net charge of impairment allowances on securities investments	**(11,900)**	(2,133)

As the global financial crisis intensified in the second half of the year, the Group's investments in securities were negatively affected. In view of the increased volatility in major capital markets, the Group carried out a comprehensive assessment on its impairment charges, taking into account the relevant criteria and specific features of the investments, and increased its provisions accordingly. As a result, the Group recorded a total of HK$9,170 million of net charge of impairment allowances for its portfolio of US non-agency residential mortgage-backed securities ("RMBS") and other debt securities. The Group also recorded a charge of impairment allowance of HK$2,730 million against its investments in The Bank of East Asia, Limited, the share price of which fell sharply in the financial turmoil. The table below illustrates the breakdown of the Group's net charge of impairment allowances against its investments in securities in 2008 and 2007.

HK$'m	2008	2007
US non-agency residential mortgage-backed securities		
Subprime	**522**	(1,513)
Alt-A	**(1,734)**	(574)
Prime	**(7,041)**	(46)
	(8,253)	(2,133)
Other debt securities	**(917)**	–
Sub-total	**(9,170)**	(2,133)
Investment in Bank of East Asia, Limited	**(2,730)**	–
Total net (charge)/reversal of impairment allowances on securities investments	**(11,900)**	(2,133)

For details about the composition of the Group's investment securities portfolio, and the impairment and provisioning policies on investments, please refer to Note 28, Note 2 and Note 3 to the Financial Statements.

Second Half Performance

Compared to the first half of 2008, the net charge of impairment allowances rose significantly by HK$7,602 million in the second half of the year.

As at 31 December 2008, the carrying value of the Group's exposure to bonds issued by Lehman Brothers was HK$39 million, comprising solely senior unsecured bonds. In 2008, the Group recorded HK$352 million net charge of impairment allowances and HK$130 million of net loss on financial instruments designated at fair value through profit or loss with respect to the aforesaid bonds.

Property Revaluation

HK$'m	2008	2007
Net (loss)/gain on revaluation of premises	**(24)**	19
Net (loss)/gain on fair value adjustments on investment properties	**(132)**	1,056
Deferred tax	**93**	(143)
Net (loss)/gain on fair value adjustments on investment properties, after tax	**(39)**	913

The aggregate impact of property revaluation before tax on the income statement in 2008 was a loss of HK$156 million, of which HK$132 million came from the revaluation of investment properties and HK$24 million from the revaluation of premises. This was a reversal to the aggregate gain recorded in the first half of the year as property prices in Hong Kong suffered a slump since the third quarter after the sharp increase recorded in late 2007 and early 2008. The related deferred tax credit on revaluation of investment properties amounted to HK$93 million. As a result, the net impact of fair value adjustments on investment properties on the Group's profit attributable to equity holders in 2008 was a loss of HK$39 million.

Second Half Performance

A net loss of HK$687 million from revaluation of investment properties after tax was recorded in the second half of 2008, against the net gain of HK$648 million in the first half of 2008. This was broadly in line with the decline in property prices since the third quarter of the year.

Financial Position

HK$'m, except percentage amounts	At 31 December 2008	At 31 December 2007
Cash and balances with banks and other financial institutions	**153,269**	159,065
Placements with banks and other financial institutions maturing between one and twelve months	**89,718**	53,154
Hong Kong SAR Government certificates of indebtedness	**34,200**	32,770
Securities investments[1]	**335,493**	335,623
Advances and other accounts	**469,493**	420,234
Fixed assets and investment properties	**30,522**	31,351
Other assets[2]	**34,549**	35,440
Total assets	**1,147,244**	1,067,637
Hong Kong SAR currency notes in circulation	**34,200**	32,770
Deposits and balances of banks and other financial institutions	**88,779**	60,599
Deposits from customers	**802,577**	793,606
Debt securities in issue at amortised cost[3]	**1,042**	2,089
Insurance contract liabilities	**28,274**	22,497
Other accounts and provisions	**80,501**	61,018
Subordinated liabilities[4]	**27,339**	–
Total liabilities	**1,062,712**	972,579
Minority interests	**1,813**	2,216
Capital and reserves attributable to the equity holders of the Company	**82,719**	92,842
Total liabilities and equity	**1,147,244**	1,067,637
Loan-to-deposit ratio	**56.74%**	51.66%

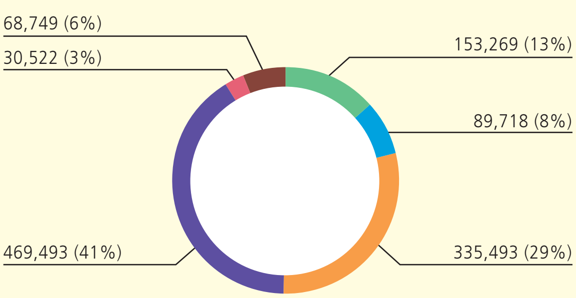
1 Securities investments comprise investment in securities and financial assets at fair value through profit or loss.

2 Interests in associates, deferred tax assets and derivative financial instruments are included in other assets.

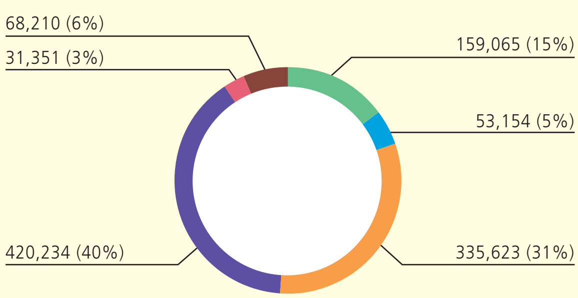
3 Debt securities in issue at amortised cost represents the notes issued under the Group's notes programme.

4 Subordinated liabilities represent the subordinated loans granted by the Group's parent bank, Bank of China Limited.

Balance Sheet Mix as at 31 December 2008



Balance Sheet Mix as at 31 December 2007



- Cash and balances with banks and other financial institutions
- Placements with banks and other financial institutions maturing between one and twelve months
- Securities investments
- Advances and other accounts
- Fixed assets and investment properties
- Other assets

The Group's total assets were HK$1,147,244 million as at 31 December 2008, up HK$79,607 million or 7.5% from the end of 2007. Key changes include:

- Cash and balances with banks and other financial institutions decreased by HK$5,796 million or 3.6% mainly due to the decrease in placements with banks and other financial institutions maturing within one month. This was partially offset by the increase in RMB deposits from participating banks placed with the PBOC.

- Placements with banks and other financial institutions maturing between one and twelve months increased by HK$36,564 million, or 68.8%, as the Group lengthened its interbank placements in the low interest rate environment.

- Advances and other accounts increased by HK$49,259 million, or 11.7%, mainly due to the growth of advances to customers by HK$47,385 million or 11.5%.

- Securities investments decreased slightly by HK$130 million. To ensure liquidity and safeguard its surplus funds, the Group increased investments in short-term government bills and expanded its investments in debt securities of governments and government guaranteed agencies. As of 31 December 2008, the carrying value of the Group's total exposure to US non-agency RMBS dropped to HK$19.3 billion from HK$39.7 billion as of end-2007. The Group had exposures to structured investment vehicles ("SIV"s) held by its 51% owned subsidiary, BOC Life. The carrying value of total exposure to the SIV's amounted to HK$57 million at end-2008 (At end-2007: approximately HK$100 million). The Group did not have exposure to collateralised debt obligations at end-2008 (At end-2007: nil).

Advances to Customers

HK$'m, except percentage amounts	**At 31 December 2008**	**%**	At 31 December 2007	%
Loans for use in Hong Kong	**336,597**	**73.1**	305,677	74.0
Industrial, commercial and financial	**188,774**	**41.0**	168,656	40.8
Individuals	**147,823**	**32.1**	137,021	33.2
Trade finance	**24,555**	**5.3**	24,275	5.9
Loans for use outside Hong Kong	**99,295**	**21.6**	83,110	20.1
Total advances to customers	**460,447**	**100.0**	413,062	100.0

Total advances to customers rose by HK$47,385 million or 11.5% to HK$460,447 million, due to the growth in both corporate and individual loans as well as loans for use outside Hong Kong. This was attributable to the successful implementation of the Group's business strategies under its new business model, effective marketing, together with the Bank's appointment as the "Asia-Pacific Syndicated Loan Centre" of the BOC Group in early 2008.

Loans for use in Hong Kong grew by 10.1%.

- Lending to the industrial, commercial and financial sectors increased by HK$20,118 million, or 11.9%, to HK$188,774 million, driven by the growth in loans for property investment, wholesale and retail trade, information technology, property development, as well as manufacturing.

- Residential mortgage loans (excluding those under the Government-sponsored Home Ownership Scheme) was up HK$9,720 million, or 9.1%, to HK$116,303 million. This was a result of the Group's effective marketing efforts and product innovation.

- Card advances surged by HK$792 million, or 13.7%, to HK$6,553 million, which was in line with the increase in cardholder spending.

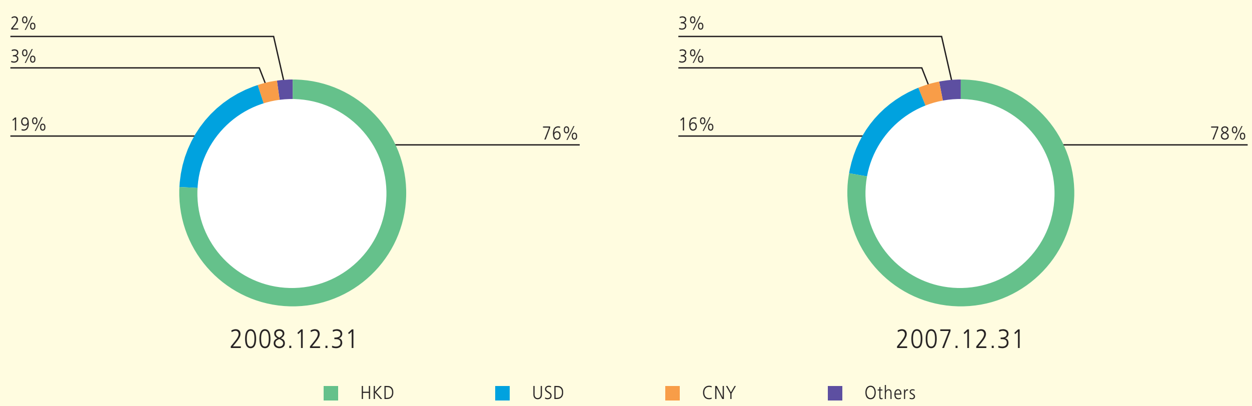
- Other individual lending increased by HK$782 million, or 7.3%, to HK$11,490 million mainly due to the growth in personal loans.

Trade finance recorded a mild increase of HK$280 million, or 1.2% against the decline in the import and export trade in Hong Kong in 2008. Meanwhile, loans for use outside Hong Kong grew strongly by HK$16,185 million or 19.5%.

Second Half Performance

Compared to the strong first half, the economic environment significantly deteriorated in the second half of the year and hence hindered further growth in advances to customers. At the same time, the Group took various strategic measures to contain its risk exposure amidst the global economic downturn. As a result, the Group's total advances to customers decreased by HK$15,140 million, or 3.2%, in the second half of the year.

Total Advances to Customers by Currency Mix (%)



In terms of currency mix, advances to customers in HKD and USD accounted for 75.5% and 19.0% respectively of the total at the end of 2008 while advances to customers in RMB and other currencies accounted for 3.3% and 2.2% respectively. The proportion of advances to customers in USD rose by 3.4% while advances to customers in HKD declined by 2.9%.

Deposits from Customers

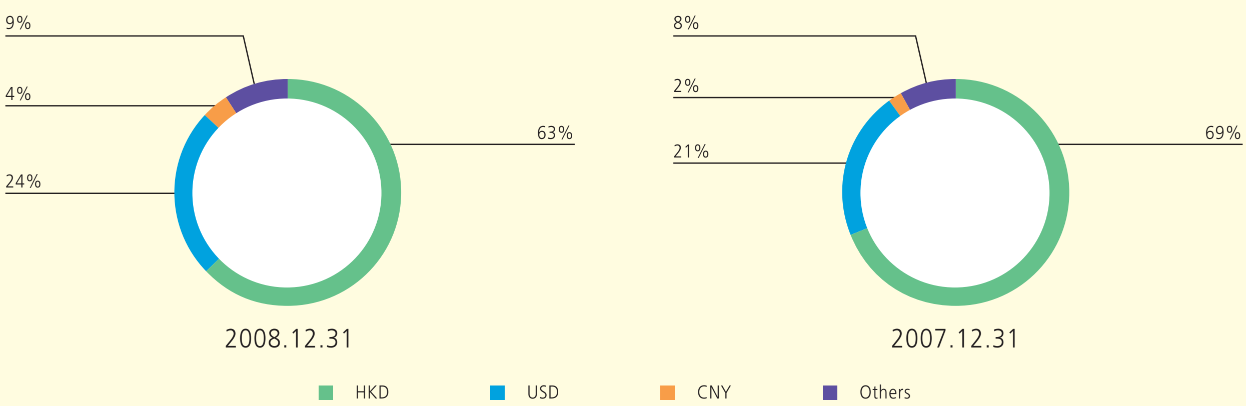
HK$'m, except percentage amounts	**At 31 December 2008**	**%**	At 31 December 2007	%
Demand deposits and current accounts	**46,042**	**5.7**	40,499	5.1
Savings deposits	**377,273**	**46.5**	286,653	35.9
Time, call and notice deposits	**379,262**	**46.7**	466,454	58.3
Total deposits from customers	**802,577**	**98.9**	793,606	99.3
Structured deposits	**8,939**	**1.1**	5,959	0.7
Adjusted total deposits from customers	**811,516**	**100.0**	799,565	100.0

Total deposits from customers increased by HK$8,971 million, or 1.1%, to HK$802,577 million, with improved deposit mix. Demand deposits and current accounts increased by HK$5,543 million or 13.7%. Savings deposits rose by HK$90,620 million or 31.6%. Time, call and notice deposits were down HK$87,192 million or 18.7% as customers sought liquidity under the low interest rate environment and switched their funds to savings deposits. Structured deposits, a hybrid of retail deposit and derivatives offering a higher nominal interest rate, increased by HK$2,980 million, or 50.0%. The Group's loan-to-deposit ratio was up 5.08 percentage points to 56.74% at the end of 2008 as total loan growth outpaced deposits growth.

Second Half Performance

Total deposits from customers dropped by HK$16,533 million, or 2.0% in the second half of 2008. Demand deposits and current accounts increased by HK$5,135 million or 12.6% while savings deposits rose by HK$81,771 million or 27.7%. However, time, call and notice deposits dropped by HK$103,439 million or 21.4%. Structured deposits, on the other hand, rose significantly by HK$5,338 million or 148.2% in the low interest rate environment.

Adjusted Total Deposits from Customers by Currency Mix (%)



In terms of currency mix, HKD and USD deposits accounted for 62.8% and 24.1% respectively at the end of 2008, while deposits in RMB and other currencies accounted for 3.7% and 9.4% respectively. The proportion of HKD deposits dropped by 6.3 percentage points while that of RMB and other currencies rose by 1.5 percentage points and 1.7 percentage points respectively from the end of 2007, reflecting customers' preference for shifting their funds into RMB deposits in anticipation of the appreciation of RMB and into other foreign currency deposits for higher returns. The proportion of USD deposits also rose by 3.1%. The Group's HKD loan-to-deposit ratio was 68.3%, up from 58.7% at end-2007 as HKD loans increased while HKD deposits decreased.

Loan Quality

HK$'m, except percentage amounts	**At 31 December 2008**	At 31 December 2007
Advances to customers	**460,447**	413,062
Classified or impaired loan ratio[1]	**0.46%**	0.44%
Impairment allowances	**2,301**	1,385
Regulatory reserve for general banking risks	**4,503**	4,130
Total allowances and regulatory reserve	**6,804**	5,515
Total allowances as a percentage of advances to customers	**0.50%**	0.34%
Total allowances and regulatory reserve as a percentage of advances to customers	**1.48%**	1.34%
Impairment allowances on classified or impaired loan ratio[2]	**38.96%**	22.52%
Residential mortgage loans[3] – delinquency and rescheduled loan ratio[4]	**0.05%**	0.15%
Card advances – delinquency ratio[4,5]	**0.29%**	0.28%

	2008	2007
Card advances – charge-off ratio[5]	**2.22%**	2.40%

(1) Classified or impaired loans represent advances which have been classified as "substandard", "doubtful" or "loss" under the Group's classification of loan quality, or individually assessed to be impaired. Repossessed assets are initially recognised at the lower of their fair value less costs to sell or the amortised cost of the related outstanding loans on the date of repossession. The related loans and advances are deducted from loans and advances.

(2) Including impairment allowances on loans classified as "substandard", "doubtful" or "loss" under the Group's classification of loan quality, or individually assessed to be impaired.

(3) Residential mortgage loans exclude those under the Home Ownership Scheme and other government-sponsored home purchasing schemes.

(4) Delinquency ratio is measured by a ratio of total amount of overdue loans (more than three months) to total outstanding loans.

(5) Excluding Great Wall cards and computed according to the HKMA's definition.

The Group's loan quality remained sound with its classified or impaired loan ratio increasing slightly by 0.02 percentage point to 0.46%, well below the market average. Classified loans increased by approximately HK$0.3 billion or 18.6% to HK$2.1 billion. New classified loans in 2008 represented approximately 0.4% of total loans outstanding.

Total impairment allowances, including both individual assessment and collective assessment, amounted to HK$2,301 million. Impairment allowances on classified or impaired loan ratio was 38.96%. The Group's regulatory reserve rose by HK$373 million to HK$4,503 million as advances to customers increased.

The quality of the Group's residential mortgage loans continued to improve with the combined delinquency and rescheduled loan ratio having fallen by 0.10 percentage point to 0.05% at end-2008. The quality of card advances remained strong, with the charge-off ratio declining from 2.40% in 2007 to 2.22% in 2008. Both ratios were well below the market average.

Capital and Liquidity Ratios

HK$'m, except percentage amounts	**At 31 December 2008**	At 31 December 2007
Core capital	**65,172**	67,145
Deductions	**(1,536)**	(483)
Core capital after deductions	**63,636**	66,662
Supplementary capital	**32,675**	5,161
Deductions	**(1,536)**	(483)
Supplementary capital after deductions	**31,139**	4,678
Total capital base after deductions	**94,775**	71,340
Risk-weighted assets		
Credit risk	**545,107**	510,970
Market risk	**9,097**	7,998
Operational risk	**44,144**	39,139
Deductions	**(12,273)**	(12,875)
Total risk-weighted assets	**586,075**	545,232
Capital adequacy ratios (consolidated basis)		
Core capital ratio	**10.86%**	12.23%
Capital adequacy ratio	**16.17%**	13.08%

	2008	2007
Average liquidity ratio	**41.74%**	50.92%

Consolidated capital adequacy ratio of the banking group at 31 December 2008 was 16.17%, up 3.09 percentage points from end-2007 due to the increase in total capital base. Total capital base rose by 32.8% to HK$94,775 million mainly due to two subordinated loans of EURO 660 million and USD2,500 million respectively from its parent bank, Bank of China Limited, on 27 June 2008 and 23 December 2008 respectively. These subordinated loans meet the conditions laid down in the Banking (Capital) Rules and have been included as supplementary capital for the purpose of determining the capital base of the banking group. The Group's capital structure was therefore further improved with a higher proportion of supplementary capital to total capital base at end-2008. Meanwhile, risk-weighted assets rose by 7.5% to HK$586,075 million, mainly due to the growth in advances to customers.

Average liquidity ratio remained strong at 41.74% in 2008.

BUSINESS REVIEW

This section covers the performance of the Group's business lines together with their respective financial results.

PERSONAL BANKING

HK$'m, except percentage amounts	**Full-year ended 31 December 2008**	Full-year ended 31 December 2007	Increase/ (decrease)
Net interest income	**6,511**	8,144	-20.1%
Other operating income	**4,179**	5,931	-29.5%
Operating income	**10,690**	14,075	-24.0%
Operating expenses	**(5,669)**	(5,829)	-2.7%
Operating profit before impairment allowances	**5,021**	8,246	-39.1%
Net charge of loan impairment allowances	**(120)**	(112)	+7.1%
Others	**(9)**	(5)	+80.0%
Profit before taxation	**4,892**	8,129	-39.8%

	At 31 December 2008	At 31 December 2007	Increase/ (decrease)
Segment assets	**165,148**	162,634	+1.5%
Segment liabilities	**523,682**	545,397	-4.0%

Note: For additional segmental information, see Note 49 to the Financial Statements.

Results

Personal Banking recorded a profit before taxation of HK$4,892 million in 2008. Low interest rates and a sluggish investment market had an adverse impact on both its net interest income and fees and commission income from investment-related agency businesses. As a result, operating profit before impairment allowances decreased by 39.1% to HK$5,021 million year-on year.

Net interest income decreased by 20.1% to HK$6,511 million primarily due to narrower deposits spread. Other operating income fell by 29.5% to HK$4,179 million, mainly caused by the decline in fees and commission income from stock broking and sales of open-end funds. A non-recurring gain arising from the initial recognition of shares received from Visa Inc. in 2007 also caused the decline in other operating income in 2008 on a comparable basis.

Operating expenses were down by 2.7% to HK$5,669 million, mainly due to the fall in staff costs as performance-related remuneration decreased. Lower promotional expenses also contributed to savings in operating expenses.

Net charge of loan impairment allowances rose by 7.1% to HK$120 million, mainly due to the deterioration of borrowers' debt servicing capability and lower collateral values as well as the reduction in recoveries.

Advances and other accounts, including mortgage loans and card advances, increased by 7.1% to HK$152,285 million. Customer deposits fell by 2.5% to HK$500,391 million.

Maintaining market leadership in residential property mortgage

The local property market turned sluggish in the second half of 2008 after recording a revival in late 2007. Both housing prices and transaction volume have declined notably since the third quarter of 2008. Nevertheless, the Group managed to achieve good results in its residential mortgage business through effective marketing and the introduction of a wider range of mortgage products. By the end of 2008, outstanding residential mortgage loans grew by 9.1%, outperforming the market growth of 5.1%. To commemorate the 2008 Beijing Olympics, a series of new mortgage plans were rolled out, such as the "8 Privilege Offers for the 2008 Olympics Mortgage Scheme" and "Olympic Decathlon Mortgage Scheme". In order to enhance its marketing capacity, the Group strengthened its strategic partnership and participated in joint promotion campaigns with major property developers. In March 2008, the Group also set up four Mortgage Advice Centres in selected areas to provide convenient and professional consultancy services to customers. All these initiatives sustained the Group's competitive edge in the residential mortgage market and ensured its leading position in the underwriting of new mortgages. In view of the economic downturn and turbulence in the financial market, the Group further strengthened its risk assessment and control on its mortgage business. Meanwhile, the credit quality of residential mortgages remained strong with the delinquency and rescheduled loan ratio falling further to 0.05%. For its outstanding service, the Group was awarded the "Sing Tao Excellent Services Brand Award 2008 – Mortgage and Loan Services" by *Sing Tao Daily* and the "Capital Weekly Service Awards 2008 – Mortgage" by *Capital Weekly*.

Maintaining competitive edge in investment and insurance business

In 2008, in the wake of the global financial crisis, stock markets throughout the world experienced a slump. The local equity market also plummeted and the collapse of Lehman Brothers further weakened investors' appetite for investment and wealth management products. This had an adverse impact on the Group's investment-related distribution business. Nevertheless, the Group strove to maintain its competitiveness and enhance its trading platforms to meet the diverse needs of customers. The "Online Securities Margin Trading" and "Closing Auction Session for Securities Trading" services were introduced during the year. The Group also launched the "Automated Stock Trading Hotline" service exclusively for its wealth management customers. At the same time, the Group continued its support for environmental protection by introducing the "Securities e-Statement" service. In anticipation of a volatile market in 2008, the Group launched the "Balanced Investment Fund Series" (the "Series") at the end of 2007 to raise customers' awareness of portfolio risk management while offering a wide array of investment products.

In respect of its Bancassurance business, the Group continued to improve its product offerings, strengthen its brand and develop its sales force.

During the year, a series of new insurance products were launched to satisfy both personal and corporate customers' needs in the area of protection and wealth accumulation. For wealth accumulation side, the "Fortuitous Saving Protection Plan" was launched in the first quarter of 2008, and the "5-Year Joyful Life Insurance Plan" in the fourth quarter of 2008, providing customers with guaranteed cash value and guaranteed cash coupon. For protection, the "BOC Family Comprehensive Protection Plan", a first-of-its-kind bundled insurance product in the market, was launched in May 2008 to offer extensive protection covering home content, annual travel, personal accident, golfers and domestic helpers. In September 2008, the "BOC Business Comprehensive Insurance Plan", a professional all-in-one insurance package, was introduced to corporate customers. The Group's insurance product suite was also substantially enriched after the introduction of the "Pleasure 5-year Saving Protection Plan", "Harvest Joy Protection Plan", and "China Express Accidental Emergency Medical Plan", thus enabling customers to decide their financial and protection needs at different stages of their lives.

In addition to product innovation, different promotional and marketing campaigns were rolled out in major media during the year to help reinforce the Group's brand image and to reward the Group's customers for their support for the Group's Bancassurance Services. Extensive training and reinforcement were provided to frontline sales teams to upgrade their product and service proficiency.

Expanding high net worth customer base and service foothold

Despite the general slowdown in the local economy in the second half of 2008, the Group made good progress in expanding its high net worth customer base and in reinforcing its strong position as a professional wealth management service provider. During the year, the Group launched the "Olympic Five Rings Rewards" which offered its customers exclusive privileges in foreign currency fixed deposits, RMB services, investment funds subscription and securities trading. To promote its expertise in wealth management services, the Group staged a number of wealth management expositions and investment seminars and sponsored market information and forecast in local newspapers. The Group also seized increasing opportunities in the Mainland China by working closely with BOC in launching the cross-border wealth management service. This service will be offered through designated branches of BOC in the Mainland and will further simplify the operation flow in the first half of 2009. Meanwhile, the Group enhanced the procedures and provided additional channels for account opening through call centre and internet banking for potential customers to access the wealth management services. At the end of 2008, the total number of wealth management customers* grew by 21.5% while assets of wealth management customers maintained with the Group declined by 12.7% because of the negative market conditions.

Developing the mass retail customer base

The Group continued to exploit the growth potential of mass retail customers for expanding its personal banking business. In 2008, the Group re-packaged the i-Free Integrated Account service ("i-Free") which provides customers with a hassle-free and multi-dimensional banking service covering different banking areas. The service was re-positioned to appeal to the younger clientele with a healthy and dynamic life style. Various acquisition campaigns bundled with MPF, RMB deposits, payroll and investment services were launched. Meanwhile, the Group rolled out the "Operational Customer Relationship Management" system to provide front-line staff with an integrated customer contact platform to conduct sale and service, thus enhancing customer experience and reinforcing the Group's marketing capabilities. As a result, the total number of i-Free customers and related assets maintained with the Group surged by 322.4% and 197.3% respectively in 2008.

Continuing to grow credit card business

The Group's card business sustained its growth momentum in card advances and customer base. Card advances and the number of cards in issue increased by 13.7% and 2.8% respectively from the end of last year. Cardholder spending volume and merchant acquiring volume grew by 12.7% and 19.9% respectively. At the same time, the Group continued its product innovation by offering a wide range of new products. To promote the Beijing 2008 Olympic Games, the Group introduced the "VISA BOC Olympic Games Platinum Card" in May 2008. In August 2008, the Group also launched the "BOC Elite Platinum Commercial Card" as a flexible financing solution for corporate customers. Two co-branded cards namely "BOC Esso MasterCard" and "SOGO VISA Platinum Card" were introduced in May and September respectively to provide customers with unsurpassed shopping experience and lifestyle privileges. In partnership with China UnionPay, the "BOC CUP Dual Currency Credit Card" was launched in December 2008. Acting as the event partner bank, the Group was authorized to provide acquiring services to merchants located at the Olympic Village, equestrian game venue and media hotels in Hong Kong. Meanwhile, the Group's card business in the Mainland continued to grow and the "EMV Titanium Card" was introduced during the year. Following the establishment of BOC Services Company, Limited, a joint venture between BOC Credit Card (International) Ltd. and BOC in late 2007, the Group has been benefiting from the strengthening of its bank card-related service and support in the rapidly growing market in the Mainland. Meanwhile, the charge-off ratio stood at 2.22%, well below the market average.

Leading RMB banking business in Hong Kong

The Group continued to lead the RMB banking business in Hong Kong. The Group secured the largest market share in the RMB deposits-taking business in Hong Kong with the amount of RMB deposits increasing by 58.5% in 2008. At the same time, the Group maintained its leading position in the RMB credit card business as the number of RMB credit cards issued increased by 24.6% while the RMB card acquiring volume and RMB cardholder spending volume increased by 60.5% and 49.8% respectively. To meet the huge demand for RMB deposits, the Group launched the "RMB Exchange Express" to provide customers with a more convenient RMB exchange service. At the same time, the Group also introduced the "RMB Remittance Express", providing customers with RMB remittance service to bank accounts of the Group's branches in the Mainland with preferential handling charges. During the year, the Group acted as the joint lead manager, bookrunner and placing bank for RMB bonds valued at a total of 9 billion yuan issued in Hong Kong by major Mainland banks.

* Including wealth management VIP and wealth management Prime customers

Channel rationalisation and e-channel development

The Group continued to optimise its distribution channels. During 2008, the Group added 14 wealth management centres and 4 Mortgage Advice Centres to its network in Hong Kong. At the end of 2008, the Group's service network in Hong Kong included a total of 286 branches (versus 288 at end-2007). Within this network, to provide exclusive financial services to selected customers, 108 Wealth Management Prime centres and 21 Wealth Management VIP centres have been in operation.

To strengthen its leading position in providing RMB services in Hong Kong, the Group extended its RMB ATM withdrawal services to all of its ATMs located in MTR stations. The number of ATMs with RMB withdrawal service reached 429 at the end of 2008 while the number of RMB withdrawals from the Group's ATM network in 2008 registered a significant increase against that of 2007. In view of the increasing demand of customers for RMB withdrawal and payment services, the Group collaborated with China UnionPay to enable the Group's new cardholders to enjoy RMB ATM services at China UnionPay's extensive ATM network and Point of Sale services in over one million shops all over China and around the world. Moreover, money exchange services were expanded to all branches.

The Group continued to enhance its internet banking platform to provide more efficient internet banking services to its customers. The number of personal e-banking customers increased by 12.2% while stock trading transactions through all e-channels accounted for 76.2% of total transactions. The Group also enhanced the Interactive Voice Response System to provide more user-friendly phone banking services and strengthened the telemarketing capability of call centres.

The staff of the Group won the "Outbound Contact Centre Agent of the Year" Silver Award and the "Inbound Contact Centre Agent of the Year" Bronze Award in the 9th Annual Contact Centre Awards 2008 competition organised by the Hong Kong Call Centre Association.

Launch of Beijing 2008 Olympic Games Hong Kong Dollar Commemorative Banknotes

In celebration of the Beijing 2008 Olympic Games, the Group as the sole banking sponsor launched the Beijing 2008 Olympic Games Hong Kong Dollar Commemorative Banknotes for public sale in July 2008 and received overwhelming response. This was the first time ever in the history of modern Olympic Games that commemorative banknotes were issued. Proceeds generated from the sale of the HKD Olympic Banknote were donated to charity.

CORPORATE BANKING

HK$'m, except percentage amounts	**Full-year ended 31 December 2008**	Full-year ended 31 December 2007	Increase/ (decrease)
Net interest income	**5,949**	5,739	+3.7%
Other operating income	**2,262**	1,930	+17.2%
Operating income	**8,211**	7,669	+7.1%
Operating expenses	**(2,143)**	(1,940)	+10.5%
Operating profit before impairment allowances	**6,068**	5,729	+5.9%
Net (charge)/release of loan impairment allowances	**(541)**	797	-167.9%
Others	**(3)**	–	N/A
Profit before taxation	**5,524**	6,526	-15.4%

	At 31 December 2008	At 31 December 2007	Increase/ (decrease)
Segment assets	**324,606**	281,680	+15.2%
Segment liabilities	**309,254**	284,353	+8.8%

Note: For additional segmental information, see Note 49 to the Financial Statements.

Results

Corporate Banking achieved good results in pre-provision profit and business development. Operating profit before impairment allowances rose by 5.9% to HK$6,068 million year-on-year. The increase was mainly driven by the growth of net interest income and other operating income. However, after accounting for the net charge of loan impairment allowances, profit before taxation declined by 15.4%.

Net interest income rose by 3.7% to HK$5,949 million, mainly due to the increase in average loans and advances, which was partly offset by narrowed deposit spread as market interest rates declined. Other operating income was up by 17.2%, primarily attributable to the growth in both fees income from loan and bills services.

Operating expenses increased by 10.5% to HK$2,143 million mainly because of higher staff cost after the headcount increase in the Mainland branches, higher business tax for Mainland business as well as increased depreciation charges on computer equipment.

Net charge of loan impairment allowances was HK$541 million, compared to the net release of loan impairment allowances of HK$797 million in 2007. The net charge reflected the reduction of loan recoveries and the increase in the loan impairment allowances made to cover the formation of new impaired loans and further deterioration of existing impaired accounts as the repayment capability of certain accounts deteriorated amid the economic downturn.

Advances and other accounts increased by 15.2% to HK$323,268 million. Customer deposits rose by 8.5% to HK$305,546 million.

Maintaining market leadership in loan syndication

The Group maintained its leading position in loan syndication. Not only did the Group remain the top mandated arranger in both the Hong Kong-Macau and the Mainland-Hong Kong-Macau syndicated loan markets in 2008, its market shares also rose significantly. Following its appointment as the "Asia-Pacific Syndicated Loan Centre" of the BOC Group in January 2008, the Group extended its strength in loan syndication business to the wider Asia-Pacific region. During the year, the Group successfully won the bid to become the sole arranger for the syndicated loan for two well-established enterprises in Australia, thus enhancing its market status in the region. As a result, the ranking of BOC Group in the Asia-Pacific region was considerably elevated in the year. The Group established the first phase of its "Loan Syndication Information Management System" in the first half of 2008. This new system links up similar networks of the BOC Group's major branches, thus optimising the sharing of supporting information among group members and enhancing overall operational efficiency.

Market recognition of SME business

The Group continued to expand and refine its product offerings to meet changing market needs. In early 2008, the Group and the Hong Kong Productivity Council jointly introduced the "Green Equipment Financing Scheme", a preferential lending package for corporate customers to acquire environment-friendly equipment. The Group also introduced the "Corporate Privilege" services at 74 selected branches to provide tailor-made services to targeted customers. At the same time, two Commercial Centres and an SME Centre were established to strengthen its service support to the SME business. In response to the HKSAR Government's initiatives of supporting SME businesses in the global financial crisis, the Group devoted more resources to promote the "SME Loan Guarantee Scheme", which helps enterprises secure loans from participating banks for meeting general business needs with the Government acting as the guarantor. In recognition of its success and innovative services provided to the SME business, the Group was given the "SME's Best Partner Award 2008" by the Hong Kong Chamber of Small and Medium Business Limited as well as the "*Capital Weekly* Service Awards 2008 – SME Banking" by *Capital Weekly*. In 2008, the Group recorded a steady year-on-year growth of SME loans.

Trade finance business adversely affected by contraction in global trade

During the year, the Group continued to actively develop its trade finance business by introducing a number of new factoring products with enhanced product features in order to enhance its competitiveness and market penetration. The "Trade Facilities Reform Programme" was launched to streamline the credit approval process and improve the credit utilisation rate. As a result, the trade finance business attained a strong growth in the first half of the year. However, it decelerated in the fourth quarter as the external economic environment deteriorated. Coupled with the risk management measures taken by the Group, the outstanding balance of trade finance slowed to a 1.2% increase over end-2007. The Group recorded a 32.0% increase in the volume of trade bills settlement compared to 2007, primarily driven by the strong import and export trade in the first three quarters of 2008.

Robust expansion of cash management

The Group made good progress in developing its cash management business. During the year, the Group continued to design and consolidate cross-border cash management projects for top-tier Mainland enterprises. Agreements on cash management services were concluded with several large Mainland corporates seeking overseas expansion. At the same time, the Group strove to enhance its competitive edge in the local cash management business. Refinement of existing products such as "Integrated Receivables and Payment Solutions" and continuous development of new products have been underway to meet the diverse needs of customers. In July 2008, the Group introduced the "Enterprise Resource Planning Integration" to make it easier for customers to handle various cash management transactions through their own financial systems. The remittance points of BOC Remittance Plus increased to over 2900. At the end of 2008, the number of CBS Online customers increased by 60.5% while that of BOC Wealth Master customers rose by 32.7%.

Forging ahead with the development of custody services

Following the establishment of a custody team in 2007, the Group's custody business continued to grow in 2008 with the number of clients recording satisfactory increase from end-2007. The Group has been the safe harbour for parking investment assets by institutional clients in the volatile market. During the year, the Group succeeded in becoming the custodian for a number of investment funds listed locally or incorporated offshore. In January 2008, the Group was appointed by a joint venture investment bank in the Mainland as the foreign custodian for its first QDII product, which was also the first broker-type QDII product ever approved in the Mainland. Through close collaboration with its parent, BOC, the Group successfully implemented several QDII mandates during the year. At the same time, the Group worked closely with BOC to conduct business reviews and explore new business opportunities. At end-2008, total assets under the Group's custody were valued at HK$200 billion.

Expansion of financial services to corporate customers

The Group is committed to offering a comprehensive range of financial services to meet customers' needs. In 2008, the Group established a specialised team for commercial wealth management to provide professional wealth management services for its corporate customers. The team formulates tailor-made financial management strategy and provides regular reviews to help customers in maximising their wealth potential while managing risks with the professional tools.

Proactive measures in risk management against global economic downturn

In response to the global economic downturn, the Group formulated a series of strategic measures to contain its risk exposure. These measures included stepping up the scrutiny of corporate risk and setting up a specialised working group on "crisis and risk management" for a full evaluation of the Group's risk exposure in its loan portfolio. Meanwhile, the Group conducted comprehensive re-assessments of credit risks and stress tests on customers from key business segments, especially those more adversely affected by the global economic downturn. Those customers identified with higher risk were closely monitored. Moreover, the Group lifted the average pricing of new corporate loan facilities granted during the year, in view of higher risk premium amidst the general tightening in liquidity.

MAINLAND BUSINESS

Making good progress in expanding Mainland business

Mainland business remains one of the Group's strategic focuses and continued to record satisfactory growth. With the local incorporation of NCB (China) since December 2007, the Group's Mainland operation has been making good progress in business development. In 2008, total advances to customers grew by 5.6%, with RMB loans surging by 12.6%. Customer deposits increased strongly by 72.5%. Total operating income recorded a growth of 15.9%, driven by the growth of both net interest income and net fees and commission income which was, however, partially offset by the foreign exchange loss arising from the revaluation of NCB (China)'s Hong Kong Dollar capital funds against the appreciated RMB. Operating profit before impairment allowances dropped by 3.1% year-on-year. Should the estimated impact of the exchange revaluation of the Mainland operation's capital funds be excluded**, operating profit before impairment allowances would have increased by 23.3%. Loan quality remained sound. The classified loan ratio stood at 0.88%, representing an increase of 0.20 percentage point from end-2007mainly due to the downgrade of several large accounts.

** The estimated impact of the exchange revaluation of the Mainland operation's capital funds included the exchange revaluation loss of NCB (China)'s HKD capital funds and the revaluation gain of the RMB operating funds of the Group's other mainland branches.

The Group continued to make good progress in expanding its cross-border financial services to better serve both personal and corporate customers. With the opening of its Guangzhou Panyu sub-branch and Hangzhou and Nanning branches, the Group's total number of branches and sub-branches in the Mainland increased to 18 by the end of 2008. Of these 18 branches and sub-branches, 6 had been approved to conduct full RMB businesses while 10 had been permitted to conduct RMB businesses except for Mainland residents. In addition, NCB (China)'s Shanghai Xuhui sub-branch already commenced business in January 2009 while the preparation for the opening of its Chengdu branch and Beijing Jianguomen sub-branch is underway following the approval granted by the China Banking Regulatory Commission ("CBRC"). The Group actively promoted its cross-border services, including RMB remittance and account opening services for non-domestic customers. With the expansion of domestic RMB businesses in the Mainland, the Group launched a wide range of deposits products such as "call deposits" and the "Smart Banking Account" as well as various mortgage products including the "All-You-Want Mortgage Scheme". In addition, new lending products had been introduced with good response from corporate customers.

TREASURY

HK$'m, except percentage amounts	**Full-year ended 31 December 2008**	Full-year ended 31 December 2007	Increase/ (decrease)
Net interest income	**7,178**	5,869	+22.3%
Other operating income	**879**	206	+326.7%
Operating income	**8,057**	6,075	+32.6%
Operating expenses	**(831)**	(627)	+32.5%
Operating profit before impairment allowances	**7,226**	5,448	+32.6%
Net charge of impairment allowances on securities investments	**(9,170)**	(2,133)	+329.9%
(Loss)/Profit before taxation	**(1,944)**	3,315	-158.6%

	At 31 December 2008	At 31 December 2007	Increase/ (decrease)
Segment assets	**603,965**	566,661	+6.6%
Segment liabilities	**203,481**	116,095	+75.3%

Note: For additional segmental information, see Note 49 to the Financial Statements.

Results

The Treasury segment registered a 32.6% growth in operating income in 2008, mainly driven by the increase in net interest income and other operating income. The increase was partially offset by the rise in operating expenses. Operating profit before impairment allowances grew by 32.6% to HK$7,226 million. However, the segment recorded a loss before taxation of HK$1,944 million mainly due to a net charge of impairment allowance of HK$9,170 million on the Group's portfolio of US non-agency RMBS and other debt securities.

Net interest income rose by 22.3% mainly due to higher interest spread on the debt securities portfolio with lower funding cost as market rates declined.

Other operating income surged by 326.7% mainly because of the improvement of net trading income from mark-to-market on foreign exchange swap contracts as well as higher income from other foreign exchange activities. During the year, the currency market was volatile and the anticipated appreciation of the RMB boosted the demand for currency-related products. As a result, the business volume of the foreign exchange businesses rose. Growth in income from commodities also contributed to the increase in operating income due to higher demand for bullion products amid the volatile commodity market.

Operating expenses increased by 32.5% to HK$831 million mainly due to the increase in depreciation charges on computer equipment and higher staff costs.

Safeguarding investment assets and enhancing portfolio management

The crash of the global stock markets, the virtual halt of inter-bank lending and diminished risk appetite of investors created a very challenging environment for the Group's investment portfolio management in the latter half of 2008. To ensure the liquidity and safety of surplus funds, the Group adjusted its asset allocation and increased its investments in short-term government bills. Meanwhile, by expanding its investments in high-quality fixed rate debt securities of high quality governments and government guaranteed agencies, the Group was able to generate a stable income stream despite a low interest rate environment. Moreover, the Group's investment decision-making process and portfolio risk management have been enhanced through the operation of three specialised investment teams focusing on different markets and with the Asset Liability Management System which was launched last year. Communication on the latest market developments between investment teams and the Group's subsidiaries was further strengthened.

In response to the financial crisis, the Group closely monitored the market movement, conducted detailed analysis of the underlying risks of its portfolio and managed its banking book investments proactively. The Group has established disposal and watch lists and has taken appropriate actions to safeguard its investments based on dynamic assessment of the market environment. The carrying value of the Group's exposure to US non-agency RMBS dropped by 51.3% to HK$19.3 billion at end-2008. In addition to the impairment allowances provided for the portfolio, the reduction in exposure was also attributable to repayment and disposal. Of the Group's total exposure to US non-agency RMBS, about 39.5% was originated* prior to 2006, 53.3% in 2006 and 7.2% in 2007 (Further analysis of the Group's US non-agency RMBS is available in Note 4.1 to the Financial Statements).

* The vintage analysis of US non-agency RMBS was based on their year of first issue.

In respect of the Group's total exposure in debt securities issued by banks and other financial institutions, the Group maintained a diversified portfolio in terms of names and geography. The following table presents an analysis of these securities as at 31 December 2008 by related issuers' country of residence and by credit rating and credit risk characteristic, based on Moody's ratings or their equivalent to the respective issues of the debt securities, in terms of the proportion to the total exposure:

%	United States	Australia	United Kingdom	European Union	Mainland China	Canada	Others	Total	Total**
Aaa	0.7	1.6	1.8	6.6	–	2.1	3.8	16.6	18.9
Aa1 to Aa3	6.9	12.0	7.3	11.1	–	3.0	8.2	48.5	60.1
A1 to A3	5.3	0.4	0.5	1.6	3.9	0.1	2.7	14.5	17.6
Lower than A3	–	–	0.2	0.5	0.3	–	0.1	1.1	1.1
Unrated	–	1.1	4.2	6.2	3.3	0.5	4.0	19.3	2.3
Total	12.9	15.1	14.0	26.0	7.5	5.7	18.8	100.0	100.0

** Including issuer rating distribution for debt securities with no issue rating.

Growing traditional businesses while improving product manufacturing capabilities

The fluctuation of the currency and precious metal markets and the anticipated appreciation of the RMB created business opportunities for traditional treasury products in 2008. The Group grasped the opportunities to promote its traditional products and recorded robust growth in foreign exchange as well as commodity-related income. Meanwhile, the Group continued to improve its product manufacturing capabilities and introduce new treasury products to meet the diverse needs of customers. During the year, the Group further expanded its product offerings by launching its first equity-linked investment products under its own brand and introducing a number of new equity-linked notes and equity warrants. In view of the global financial turmoil, the Group acted promptly by conducting a comprehensive evaluation of all products under distribution and reviewed its internal regulations, risk control measures and compliance procedures. The Group also provided customers with up-to-date market information in order to safeguard their investments and at the same time delivered thematic training and services to front-line staff to respond to customers' enquiries.

INSURANCE

HK$'m, except percentage amounts	**Full-year ended 31 December 2008**	Full-year ended 31 December 2007	Increase/ (decrease)
Net interest income	**1,122**	788	+42.4%
Other operating income	**5,503**	9,030	-39.1%
Operating income	**6,625**	9,818	-32.5%
Net insurance benefits and claims	**(7,709)**	(9,440)	-18.3%
Net operating income	**(1,084)**	378	-386.8%
Operating expenses	**(147)**	(117)	+25.6%
(Loss)/Profit before taxation	**(1,231)**	261	-571.6%

	At 31 December 2008	At 31 December 2007	Increase/ (decrease)
Segment assets	**31,703**	24,545	+29.2%
Segment liabilities	**30,977**	23,182	+33.6%

Note: For additional segmental information, see Note 49 to the Financial Statements.

Results

The Group's Insurance segment recorded a loss before taxation of HK$1,231 million in 2008 mainly due to the decline in other operating income caused by the weak performance of its investment assets and decrease in premium income. The decline was partly offset by the increase in net interest income and the fall in net insurance benefits and claims.

Net interest income rose by 42.4% mainly due to the growth of the investment in debt securities made by the premium income in 2008. Other operating income fell by 39.1% primarily due to the decline in net insurance premium income as sales contracted substantially and a net loss on its investment assets compared to a gain recorded in 2007. Net insurance benefits and claims were down 18.3% mainly due to the decline in net insurance premium income.

Operating expenses increased by 25.6% mainly because of higher staff costs after headcount increase.

Assets in the insurance segment grew by 29.2% because of the growth of debt securities investments and deposits with banks. Liabilities rose by 33.6% with increases in insurance contract liabilities and subordinated liabilities.

Expanding product offerings and enhancing brand awareness

The Group continued to broaden its product range and create new products to meet the emerging needs of customers. New single-premium products such as the "Fortuitous Saving Protection Plan", "Pleasure 5-year Saving Protection Plan" and "5-Year Joyful Life Insurance Plan" were launched with good response. To keep up with the ever-changing market, a new life product targeting the SME segment was launched in the first half of the year. In July, the Group introduced the "Harvest Joy Protection Plan", a unique back-end charged investment-linked insurance plan. In addition to product innovation, large-scale promotional and marketing activities were rolled out during the first half of the year to help reinforce the brand's image and boost the sales of various regular-pay products. The premium income of regular-pay products was up 40.1% year-on-year while the Group's market share and market ranking in terms of total individual new business standard premium in 2008 went up over the same period last year.

Focusing on further development of multi-channel platform

The development of a multi-channel platform remained the Group's focus in 2008. Following the establishment of BOC Life's telemarketing call centre in late 2007, a branch-based direct insurance specialist team was set up in the first half of 2008. The team specialised in analyzing the financial need of customers and in cross-selling life insurance products. A mobile sales team was launched in the fourth quarter to further expand the sales network. Contribution to new business sales from non-branch channels rose significantly in 2008.

REGULATORY DEVELOPMENT

Basel II Capital Accord

Basel II is an international capital adequacy framework introduced by the Basel Committee on Banking Supervision in 2004 to replace the 1988 Basel Accord. The new framework comprises 3 pillars which align regulatory capital requirements more closely with inherent risks and introduce new capital charge on operational risk. It also stipulates a framework for the supervisory review of capital adequacy by the regulatory authority and a greater scope of disclosure on capital adequacy and risk management. Since the introduction of Basel II by Hong Kong banks in 2007, the Group has adopted the Standardised Approach to calculate statutory minimum capital requirement on credit risk, market risk and operational risk under Pillar One. The Group intends to gradually adopt the Foundation Internal Ratings-Based ("FIRB") approach which is a more risk-sensitive approach on the calculation of the regulatory capital requirements. During 2008, the Group continues to devote substantial resources to the preparation for the implementation of Basel II. With the implementation of the Borrower Rating models and Facility Grading system for the Group's corporate banking business and Probability of Default, Exposure at Default and Loss Given Default models for the Group's personal banking business, together with their supporting system platforms, an electronic workflow system to support the automated credit application and approval process, and the Capital Adequacy Ratio calculation engine, the Group has established a solid foundation for the adoption of the FIRB approach. The core infrastructure required for the FIRB approach, including the related key models, system platforms, procedures and policies are all close to completion while the user acceptance test for the calculation of the regulatory capital requirement is in progress.

Under Pillar Two, the Group has implemented its internal capital adequacy assessment process ("ICAAP"). Using the statutory minimum capital adequacy ratio ("CAR") as a starting point, requirement for extra capital (capital add-on) needed to cover the risks not captured under Pillar One was assessed. Scorecard methodology has been used to evaluate the Group's risk profile in order to assess the capital add-on and determine the Group's minimum CAR. An Operating CAR Range has also been established which also considers the need for future business growth and efficiency of capital utilisation.

To comply with Pillar Three on the disclosure requirements prescribed by the Banking (Disclosure) Rules ("Disclosure Rules"), the Group has formulated its Financial Disclosure Policy, and the relevant disclosures made in 2008 were in accordance with the Disclosure Rules.

RELATIONSHIP-PRODUCT-CHANNEL ("RPC") MODEL

Following the implementation of the Relationship-Product-Channel ("RPC") Model in March 2007, the Group has continued to reinforce its capabilities in customer relationship management, product management and channel management by adopting a more focused customer segmentation model, putting in place professional product management and servicing teams, and optimising channels and workflows. During the year, the Group made further progress in strengthening the model and ensure its effectiveness. This includes the filling of some vacant key positions or hiring of senior executives from other market-leading institutions and realignment of product management teams, formulating new sales programmes to target on the Group's corporate customers, enhancing internal management information system and business intelligence capabilities for Relationship Managers or frontline sales staff to better understand customers' needs and identify cross-selling opportunities, and further streamlining operation and procedures in branches to improve sales and servicing ratios and to reinforce marketing efforts.

CORPORATE DEVELOPMENT, TECHNOLOGY AND OPERATIONS

Human Resources

Despite the difficult business environment brought about by the financial crisis, the Group has continued to invest in human resources development for long-term business growth and the realisation of its vision and strategic goals. During the year, the Group reviewed and put forward its mid-term human resources strategies for 2008-2012 which will form the blueprint for the Group's human resources development to improve manpower structure and staff quality in the next few years. At the same time, the Group also refined its staff performance management system. Taken as a whole, these measures were meant to enhance the Group's manpower structure, staff quality and productivity.

In 2008, the Group continued to provide comprehensive training programmes for all levels of staff. EMBA programmes and executive development programmes conducted jointly with reputable universities such as Harvard University and Oxford University were organised for the senior management and selected staff. During the year, 2,400 internal training courses were organised with over 134,000 attendees. Training programmes were offered to frontline staff to help them acquire professional qualifications. Meanwhile, an e-learning platform is available as a supplementary channel to provide an easy and convenient way of staff training. Moreover, a three-year Management Trainee Programme and a one-year Officer Trainee Programme have also been in place since 2006.

Technology and operations

In 2008, the Group continued to strengthen its information technology infrastructure under its 5-year IT development strategy. Several projects were completed during the year. The second phase of the new treasury platform revamp programme was implemented to support limit monitoring and strengthen position management. The Continuous Linked Settlement platform was established to enhance liquidity and risk management for foreign exchange transactions. The Credit and Facility Rating platform, an electronic credit workflow process, was launched to improve the credit approval efficiency. Both the cash management and custody platforms were enhanced to ensure higher operational efficiency and better service quality. Meanwhile, Phase 2 of the Operational Customer Relationship Management platform was launched to enhance overall customer relationship management. The new teller platform has been rolled out in most of the Group's local branches.

As part of the Group's long-term IT strategy, the Group initiated the Financial and Financial Risk Management System ("FRMS") in 2006 to revamp the existing computer systems for different finance functions, including financial accounting, management reporting, multi-dimension profitability analysis, capital management, and asset and liability management. Subsequent to the launch of the Asset Liability Management System in 2007, both the General Ledger and the Fund Transfer Pricing systems were successfully implemented in the fourth quarter of 2008.

CREDIT RATINGS

As at 31 December 2008	Long-term	Short-term
Fitch	A	F1
Moody's	Aa3	P-1
Standard & Poor's	A-	A-2

There has been no change in BOCHK's credit ratings since end-2007.

As at 31 December 2008, BOCHK's long-term and short-term foreign currency issuer default ratings assigned by Fitch Ratings were A and F1 respectively while the support rating was 2.

In respect of the ratings assigned by Moody's Investors Service, BOCHK's long-term and short-term local and foreign currency bank deposit ratings remained Aa3 and P-1 respectively. Financial Strength Rating was C+.

BOCHK's long-term and short-term counterparty credit ratings assigned by Standard & Poor's were A- and A-2 respectively. The Bank Fundamental Strength Rating was B.

RISK MANAGEMENT

Banking Group

Overview

The Group believes that sound risk management is crucial to the success of any organisation. In its daily operation, the Group attaches a high degree of importance to risk management and emphasises that a balance must be struck between risk control and business growth and development. The principal types of risk inherent in the Group's businesses are reputation risk, legal and compliance risk, strategic risk, credit risk, market risk, interest rate risk, liquidity risk and operational risk. The Group's risk management objective is to enhance shareholder value by maintaining risk exposures within acceptable limits.

Risk Management Governance Structure

The Group's risk management governance structure is designed to cover the whole process of all businesses and ensure that various risks are properly managed and controlled in the course of conducting business. The Group has a sound risk management organisational structure for implementing a comprehensive set of policies and procedures to identify, measure, monitor and control various risks that may arise. These risk management policies and procedures are regularly reviewed and modified to reflect changes in markets and business strategies. Various groups of risk takers assume their respective responsibilities for risk management.

The Board of Directors, representing the interests of shareholders, is the highest decision-making authority of the Group and has the ultimate responsibility for risk management. The Board, with the assistance of its committees, has the primary responsibility for formulating risk management strategies and ensuring that the Group has an effective risk management system to implement these strategies. The Risk Committee (RC), a standing committee established by the Board of Directors, is responsible for overseeing the Group's various types of risks, reviewing and approving high-level risk-related policies and overseeing their implementation, reviewing significant or high risk exposures or transactions and exercising its power of veto if it considers that any transaction should not proceed. The Audit Committee (AC) assists the Board in fulfilling its role in overseeing the internal control system.

The Chief Executive (CE) is responsible for managing the Group's various types of risks, approving detailed risk management policies, and approving material risk exposures or transactions within his authority delegated by the Board of Directors. The Chief Risk Officer (CRO) assists the CE in fulfilling his responsibilities in the day-to-day management of risks. The CRO is responsible for initiating new risk management strategies, projects and measures that will enable the Group to better monitor and manage new risk issues or areas that may arise from time to time from new businesses, products and changes in the operating environment. He may also take appropriate initiatives in response to regulatory changes. The CRO is also responsible for reviewing material risk exposures or transactions within his delegated authority and exercising his power of veto if he believes that any transaction should not proceed.

Various units of the Group have their respective risk management responsibilities. Business units act as the first line of defence while risk management units, which are independent from the business units, are responsible for the day-to-day management of different kinds of risks. Risk management units have the primary responsibilities for drafting, reviewing and updating various risk management policies and procedures.

The Group's principal banking subsidiaries, Nanyang, Nanyang (China) and Chiyu, are subject to risk policies that are consistent with those of the Group. These subsidiaries execute their risk management strategies independently and report to the Group's management on a regular basis.

Credit Risk Management

Credit risk is the risk that a customer or counterparty will be unable to or unwilling to meet its obligations under a contract. It arises principally from the lending, trade finance and treasury businesses, and covers inter-bank transactions as well as investments in bonds and securities. For details of the Group's Credit Risk Management, please refer to Note 4 to the Financial Statements in this Annual Report.

Interest Rate Risk Management

The Group's interest rate risk exposures are mainly structural. The major types of interest rate risk from structural positions are repricing risk, basis risk, yield curve risk and option risk. For details of the Group's Interest Rate Risk Management, please refer to Note 4 to the Financial Statements in this Annual Report.

Market Risk Management

Market risk is the risk of loss that results from movements in market rates and prices. The Group's market risk in the trading book arises from customer-related business and proprietary trading. Trading positions are subject to daily mark-to-market valuation. The risk includes potential losses arising from a change in foreign exchange and interest rates as well as the prices of equities and commodities. The major market risk in the banking book arises from the Group's investment portfolio. The risk includes potential losses arising from changes in market parameters such as credit, liquidity, and interest rate risk. These positions are subject to monthly mark-to-market valuation.

Market risk management framework

Market risk is managed within various major risk limits approved by the RC, including risk positions and/or risk factor sensitivities. Since April 2007, BOCHK has also formally applied Value-at-Risk (VAR) limit as a daily risk management tool. These overall risk limits are divided into sub-limits by reference to different risk products, including interest rates, foreign exchange rates, commodities and equities. Transactions are classified into different risk product categories according to the prominent type of risk inherent in the transactions.

Market risk arising from the banking book is managed within various risk limits such as P/L Management Alert Limit (P/L MAL) and P/L Management Alert Trigger (P/L MAT) which are approved by Asset and Liability Management Committee (ALCO). The mark-to-market result is reported to ALCO on a monthly basis.

As aforesaid, the Group's risk management objective is to enhance shareholder value by maintaining risk exposures within acceptable limits. The Group's market risk management framework comprises three levels. The Board of Directors and its Risk Committee are the ultimate decision-making authorities. The formulation of risk management procedures and the implementation mechanism, and the monitoring of compliance are mainly the responsibility of the Group's senior management (including CE and CRO). The Risk Management Department (RMD) is responsible for overseeing the Group's market risk to ensure that overall and individual market risks are within the Group's risk tolerance. Risk exposures are monitored on a day-to-day basis to ensure that they are within the established risk limits and are regularly reported to the senior management. Nanyang and Chiyu have their own independent risk monitoring units to monitor limit compliance on a daily basis.

The Group controls market risk by restricting individual operations to trade only a list of permissible instruments authorised by senior management and within various market risk limits approved by RC. The individual operations are also required to enforce rigorous new product approval procedures to ensure that all risks that may arise are thoroughly identified, properly measured and adequately controlled.

The Group also uses the VAR technique to measure potential losses and market risks of its trading book for reporting to the RC and senior management on a periodic basis. VAR is a statistical technique which estimates the potential losses that could occur on risk positions taken over a specified time horizon within a given level of confidence. BOCHK, being the banking entity within the Group with the major trading positions, which are mainly foreign currency positions in major currencies, uses VAR technique to monitor and control market risk on a daily basis.

The Group has changed its VAR calculation from a variance/co-variance basis to a historical simulation basis with effect from April 2007. The Group uses historical movements in market rates and prices, a 99% confidence level and a 1-day holding period to calculate portfolio and individual VAR. Movements in market prices are calculated by reference to market data from the last two years.

VAR

The following table sets out the VAR for all trading market risk exposure[1] of BOCHK.

HK$'m		At 31 December	Minimum for the year	Maximum for the year	Average for the year
VAR for all market risk	– 2008	12.6	3.0	13.5	6.5
	– 2007	3.2	1.4	10.4	4.1
VAR for foreign exchange risk products	– 2008	13.1	2.5	14.2	6.0
	– 2007	2.7	1.0	9.4	4.0
VAR for interest rate risk products	– 2008	4.2	1.0	5.9	2.9
	– 2007	1.5	0.5	3.9	1.6
VAR for equity risk products	– 2008	0.2	0.1	2.8	0.5
	– 2007	0.4	0.1	1.1	0.4
VAR for commodity risk products	– 2008	0.0	0.0	0.5	0.0
	– 2007	0.0	0.0	0.4	0.1

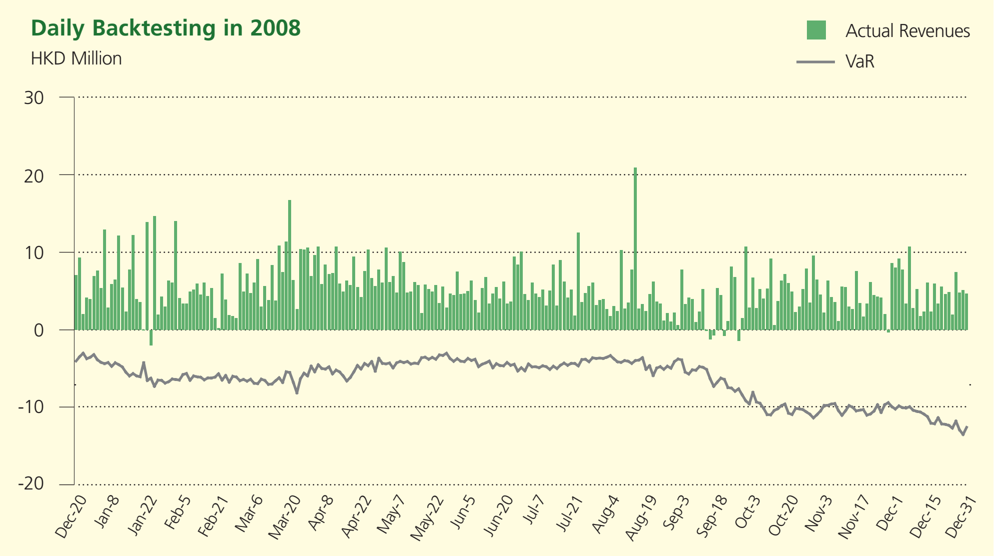
In 2008, the average daily revenue[2] of BOCHK earned from market risk-related trading activities was HK$5.35 million (2007: HK$3.06 million).

1 Structural FX positions have been excluded.

2 Revenues from structural FX positions and back-to-back transactions have been excluded.

The predictive power of the VAR measure is monitored by backtesting, which compares the calculated VAR figure of those trading positions of each business day with the actual revenues arising on those positions on the next business day. These actual revenues exclude non-trading income, including fees and commissions. If backtesting revenues are negative and exceeding the VAR, a "backtesting exception" is noted. Backtesting results are reported to the Group's senior management, including CE and CRO.

Generally speaking, the number of backtesting exceptions in a rolling 12-month period will not exceed four times, given a 99% confidence level. BOCHK conducts backtesting on a monthly basis and the graph below shows the backtesting result of the trading VAR of BOCHK.



There is no actual loss exceeding the VAR estimate for BOCHK in 2008.

Although a valuable guide to risk, VAR should always be viewed in the context of its limitations. For example:

- the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- the use of a one-day holding period assumes that all positions can be liquidated or hedged in one day. This may not fully reflect the market risk arising at times of severe illiquidity, when a one-day holding period may be insufficient to liquidate or hedge all positions fully;
- the use of a 99 per cent confidence level, by definition, does not take into account losses that might occur beyond this level of confidence; and
- VAR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures.

The Group recognises these limitations by augmenting its VAR limits with other position and sensitivity limit structures. Additionally, the Group applies a wide range of stress testing, both on individual portfolios and on the Group's consolidated positions. The stress testing programme of the trading book includes sensitivity testing on changes in risk factors with various degrees of severity, as well as scenario analysis on historical events including the 1987 Equity Market Crash, 1994 Bond Market Crash, the 1997 Asian Financial Crisis and the 11 September event in the United States in 2001. The Group also reassesses the stress testing programme to ensure its adequacy in view of the financial market crisis in 2008. The Group's stress-testing regime provides the senior management with an assessment of the financial impact of identified extreme events on the market risk exposures of the Group.

Liquidity Risk Management

The aim of liquidity management is to enable the Group to meet, even under adverse market conditions, all its maturing repayment obligations on time, and to fund all its asset growth and strategic opportunities without forced liquidation of its assets at short notice.

The Group funds its operations principally by accepting deposits from retail and corporate depositors. In addition, the Group may issue certificates of deposit to secure long-term funds. Funding may also be secured through adjusting the asset mix in the Group's investment portfolio. The Group uses the majority of funds raised to extend loans, to purchase debt securities or to conduct interbank placements.

The Group monitors the liquidity risks using cash flow analysis (under normal condition and stress conditions respectively) and by examining deposit stability, concentration risk, mismatch ratios, loan-to-deposit ratio and liquidity profile of the investment portfolio. The primary objective of the Group's asset and liability management strategy is to achieve optimal returns while ensuring adequate levels of liquidity and capital within an effective risk control framework and ALCO is responsible for establishing these policy directives (including the liquidity contingency plan), and RC sanctions the liquidity management policies. The Treasury Department (TD) manages the liquidity risk according to the established policies. The Finance Department (FD) monitors the Group's liquidity risks and reports to ALCO regularly. RMD reviews the policies, guidelines and limits proposed by TD.

In 2008, the Group further enhanced its liquidity risk management process by putting in place more stringent stress testing requirements in view of the then prevailing market situation.

Operational Risk Management

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.

The Group has put in place an effective internal control process which requires the establishment of detailed policies and control procedures for all the key activities. Proper segregation of duties and authorisation is the fundamental principle followed by the Group. RMD formulates corporate-level policies and procedures concerning operational risk management which are approved by RC. The management of respective business lines is responsible for managing and reporting operational risks specific to their business units by applying the respective tools such as key risk indicators, self assessment and operational risk events reporting mechanism to identify, assess and control the risks inherent in their business processes, activities and products. These are followed by periodic monitoring and ongoing review of changes by RMD. Besides the current operational risk status, trends derived from historical data are served as alert on potential risks. RMD evaluates the operational risk profile, records operational risk data and reports operational risk issues to RC and the senior management. The Group also takes out insurance to mitigate unforeseeable operational risks.

Business continuity plans are in place to support business operations in the event of emergency or disaster. Adequate backup facilities are maintained and periodic drills are conducted.

Reputation Risk Management

Reputation risk is the risk that negative publicity regarding the Group's business practices, whether genuine or not, will cause a potential decline in the customer base or lead to costly litigation or revenue erosion. Reputation risk is inherent in every aspect of business operation and covers a wide spectrum of issues.

In order to mitigate reputation risk, the Group has formulated and duly followed its Reputation Risk Management Policy. The policy aims to prevent and manage reputation risk proactively at an early stage when an incident occurs. The system entails continuous monitoring of external reputation risk incidents and published failures of risk incidents in the financial industry.

The recent Lehman Minibonds incident has had an adverse impact on the Group's reputation as there have been alleged cases of mis-selling. The Group is handling customer's complaints cautiously so as to minimise the reputation risk.

Legal and Compliance Risk Management

Legal risk is the risk that unenforceable contracts, lawsuits or adverse judgments may disrupt or otherwise negatively affect the operation or financial condition of the Group. Compliance risk is the risk of legal or regulatory sanctions, financial loss, or loss to reputation a bank may suffer as a result of its failure to comply with all applicable laws and regulations. Legal and compliance risks are managed by the Legal and Compliance Department headed by a General Manager who reports to the Chief Risk Officer.

Strategic Risk Management

Strategic risk generally refers to the risks that may induce immediate or future negative impact on the financial and market positions of the Group because of poor strategic decisions, improper implementation of strategies and lack of response to the market. The Board of Directors reviews and approves the policy for the management of strategic risks. Key strategic issues have to be fully evaluated and properly endorsed by the senior management and the Board.

The Group will regularly review its business strategies to cope with the latest market situation and developments.

Capital Management

The major objective of capital management is to maximise shareholders' total return while maintaining a capital adequacy position commensurate with the Group's overall risk profile. The Group periodically reviews its capital structure and adjusts the capital mix where appropriate to achieve the targeted weighted average cost of capital. ALCO monitors the Group's capital adequacy. The Group complied with all the statutory capital standards for all the periods in 2008.

To comply with HKMA's requirements as stated in the Supervisory Policy Manual "Supervisory Review Process", the Group has implemented its internal capital adequacy assessment process (ICAAP). Using the statutory minimum capital adequacy ratio (CAR), 8%, as a starting point, extra capital (capital add-on) needed to cover the risks not captured under Pillar I was assessed. Scorecard methodology has been used to evaluate the Group's risk profile in order to assess the capital add-on and determine the minimum CAR. An Operating CAR Range has also been established which incorporates the need for future business growth and efficiency of capital utilisation.

In 2008, the Group took further measures to strengthen its capital position, including the borrowing of subordinated loans from the parent bank.

Stress Testing

The Group supplements the analysis of various types of risks with stress testing. Stress testing is a risk management tool for estimating the Group's risk exposures under stressed conditions arising from extreme but plausible market or macroeconomic movements. These tests are conducted on a regular basis and ALCO monitors the results against limits approved by RC. Stress test results are also reported to the Board and RC regularly.

BOC Life Insurance

The principal activity of BOC Life's business is the underwriting of long-term insurance business in life and annuity, linked long-term business and retirement scheme management in Hong Kong. Major types of risks arising from the BOC Life's insurance business are insurance risk and market risk. BOC Life manages these risks independently and reports to RC on a regular basis. The key risks of its insurance business and related risk control process are as follows:

Insurance Risk Management

BOC Life is in the business of insuring against the risk of mortality, morbidity, disability, critical illness, accidents and related risks. BOC Life manages these risks through the application of its underwriting policies and reinsurance arrangement.

The underwriting strategy is intended to set premium pricing at an appropriate level that corresponds with the underlying exposure of the risks underwritten. Screening processes, such as the review of health condition and family medical history, are also included in BOC Life's underwriting procedures.

Within the insurance process, concentrations of risk may arise where a particular event or series of events could impact heavily upon BOC Life's liabilities. Such concentrations may arise from a single insurance contract or through a small number of related contracts, and relate to circumstances where significant liabilities could arise.

For the in-force insurance contracts, most of the underlying insurance liabilities are related to endowment and unit-linked insurance products. For most of the insurance policies issued by it, BOC Life has a retention limit on any single life insured. BOC Life reinsures the excess of the insured benefit over the limit for standard risks (from a medical point of view) under an excess of loss reinsurance arrangement. BOC Life does not have in place any reinsurance for contracts that insure against survival risk.

Uncertainty in the estimation of future benefit payments and premium receipts for long-term insurance contracts arises from the unpredictability of long-term changes in overall levels of mortality and persistency. In order to assess the uncertainty due to the mortality assumption and lapse assumption, BOC Life conducts mortality study and lapse study in order to determine the appropriate assumptions. In these studies, consistent results are reflected in both assumptions with appropriate margins.

Market Risk Management

(i) Interest Rate Risk Management

An increase in interest rates may result in the depreciation of the value of the bond portfolio. It may also result in customers accelerating surrenders. A decrease in interest rates may result in an inability to adequately match guarantees or lower returns leading to customer dissatisfaction. BOC Life manages the asset liability matching of its portfolios within an asset liability management (ALM) framework, that has been developed to achieve investment returns that match its obligations under insurance contracts.

(ii) Liquidity Risk Management

Liquidity risk is the risk of not being able to meet obligations as they fall due without incurring unacceptable loss. BOC Life's asset liability matching framework includes cashflow management in a bid to preserve liquidity to match policy payout from time to time. In the normal course of BOC Life's business, new business premiums generate constant cash inflows and as a result, the portfolios also grow gradually to meet future liquidity requirement.

(iii) Credit Risk Management

BOC Life has exposure to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due. Key areas to which BOC Life's insurance business is exposed include:

- Default risk of bond issuers or the counterparties of structured products
- Credit spread widening as a result of credit migration (downgrade)
- reinsurers' share of insurance unpaid liabilities
- amounts due from re-insurers in respect of claims already paid
- amount due from insurance contract holders
- amount due from insurance intermediaries

BOC Life manages credit risk by placing limits on its exposure to each investment counterparty or group of counterparties. Such limits are subject to annual or more frequent review by the management.

In order to enhance the credit risk management, BOC Life has strengthened its communication with the Treasury Department of the Group and closely monitors and updates the established Disposal and Watch Lists to ensure consistency with the Group's credit risk management and investment strategy.