OFFERING
INNOVATIVE SERVICES
TO YOU

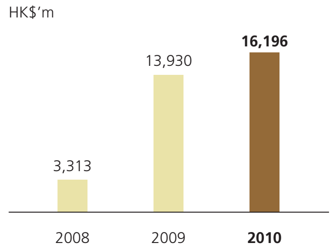
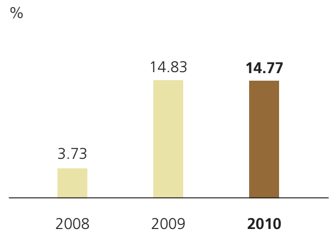
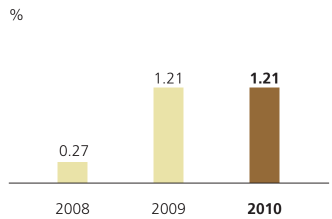
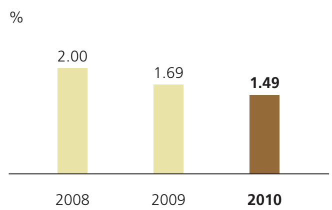
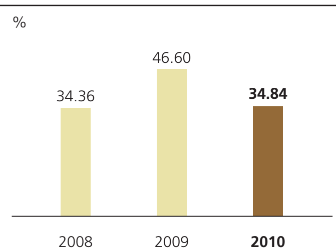

上午10:25
94%
中国銀行(香港)
BANK OF CHINA
HSI
22880.52
465.36
(1.99%)
Market Turnover: HKD14,542.68M
As at: 2011-03-15 10:10:04 +08:00
Mobile Banking
Forex Rates
Latest Promotion
Credit Card
Personal Loan
ATM/Branches
Setting
CSR
Terms and Conditions & Important Notice

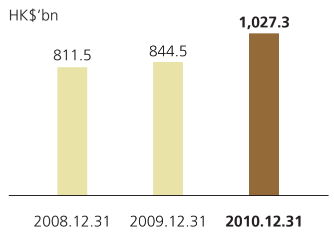
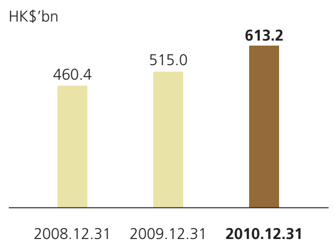
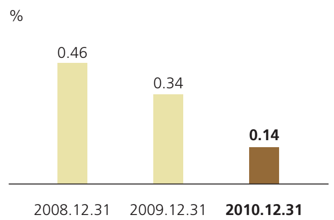
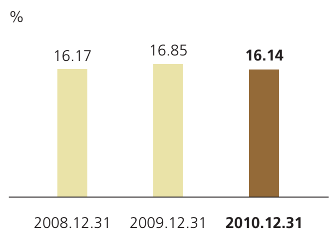
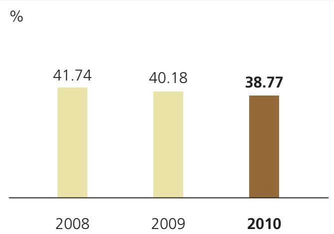
MANAGEMENT'S DISCUSSION & ANALYSIS

The following sections provide metrics and analytics of the Group's performance, financial position, and risk management in the year 2010. These should be read in conjunction with the financial statements included in this Annual Report.

FINANCIAL PERFORMANCE AND CONDITION IN BRIEF

The following table is a summary of the Group's key financial results for the year 2010 with a comparison with the previous two financial periods.

Financial Indicators		2010 Performance
1. Profit Attributable to Shareholders		**Profit attributable to shareholders** • Profit attributable to shareholders was HK$16,196 million, up HK$2,266 million or 16.3% year-on-year and a record high since listing.
2. Return on Average Capital and Reserves Attributable to the Equity Holders of the Company ("ROE")[1]		**ROE** • ROE was 14.77%, down 0.06 percentage point as the increase in equity outpaced that of the profit. Higher equity was mainly caused by additions of retained earnings, premises revaluation reserve and reserve for fair value changes of available-for-sale securities.
3. Return on Average Total Assets ("ROA")[2]		**ROA** • ROA stayed at 1.21%. While the Group's profit rose by 17.1%, its average asset base also increased with the growth of advances to customers, securities investments and the RMB business.
4. Net Interest Margin ("NIM")		**NIM** • NIM was 1.49%, down 20 basis points year-on-year because of low market interest rates, the increase in HIBOR-based loans and the diluting effect of the local RMB business in Hong Kong. • Net interest income grew by HK$802 million or 4.5%.
5. Cost-to-Income Ratio ("CIR")		**CIR** • CIR was 34.84%, down 11.76 percentage points. Operating expenses dropped by 21.1%, largely due to the significant decline in expenses incurred for Lehman Brothers-related products. Operating income increased by 5.6%.

<table>
<tr><th>Financial Indicators</th><th></th><th>2010 Performance</th></tr>
<tr><td>6. Deposits from Customers (including structured deposits)</td><td>
</td><td>Deposits from Customers
• Total deposits increased by 21.6% to HK$1,027.3 billion. The Group adopted proactive deposit strategy to support business growth. RMB deposits also grew strongly.</td></tr>
<tr><td>7. Advances to Customers</td><td>
</td><td>Advances to Customers
• The Group's advances to customers increased by 19.1% to HK$613.2 billion, which was underpinned by the growth of all major loan segments.</td></tr>
<tr><td>8. Classified or Impaired Loan Ratio[3]</td><td>
</td><td>Classified or Impaired Loan Ratio
• Classified or impaired loan ratio was 0.14%, down from 0.34% at the end of 2009.
• Formation of new classified loans remained at a low level, representing approximately 0.1% of total loans.</td></tr>
<tr><td>9. Capital Adequacy Ratio ("CAR")</td><td>
</td><td>CAR
• CAR was at a solid level of 16.14% at the end of 2010.
• Core capital ratio stood at 11.29%.</td></tr>
<tr><td>10. Average Liquidity Ratio</td><td>
</td><td>Average Liquidity Ratio
• Average liquidity ratio remained healthy at 38.77% in 2010.</td></tr>
</table>

1 Return on Average Capital and Reserves Attributable to the Equity Holders of the Company as defined in "Financial Highlights".

2 Return on Average Total Assets as defined in "Financial Highlights".

3 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.

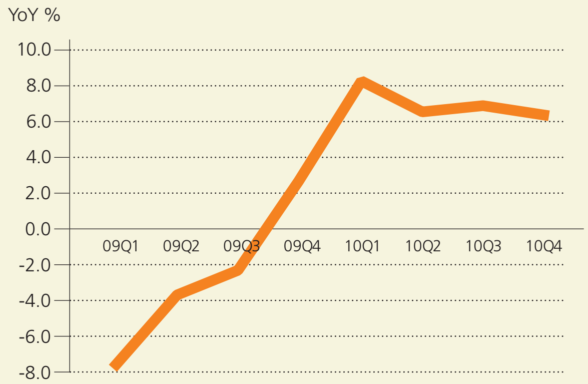
MANAGEMENT'S DISCUSSION & ANALYSIS

ECONOMIC BACKGROUND & OPERATING ENVIRONMENT

The global economy continued to recover in 2010. The pace of recovery was particularly strong in Asia. However, growth in certain major economies decelerated. As the impact of the first round of quantitative easing measures (QE I) waned, economic growth in the US slowed down and unemployment rose again after the first quarter. The US Federal Reserve launched the second round of quantitative easing measures (QE II) in November 2010 in an attempt to boost the economy and employment, and bring inflation up to normal levels.

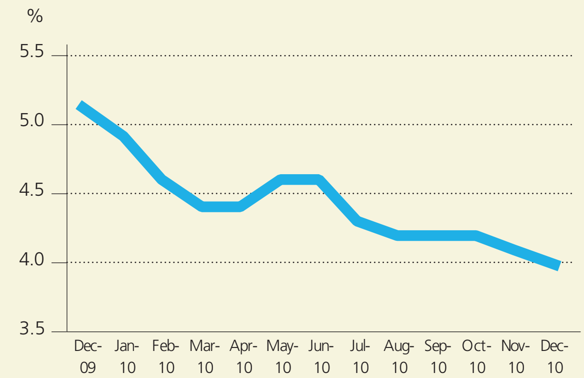
GDP growth in the Mainland China reached 10.3% in 2010. The Consumer Price Index ("CPI") in the Mainland rose by 3.3%, caused mainly by surging food prices. To curb the inflationary pressure, the Mainland raised interest rates and the reserve requirement ratio several times.

Hong Kong Real GDP



Source: Bloomberg

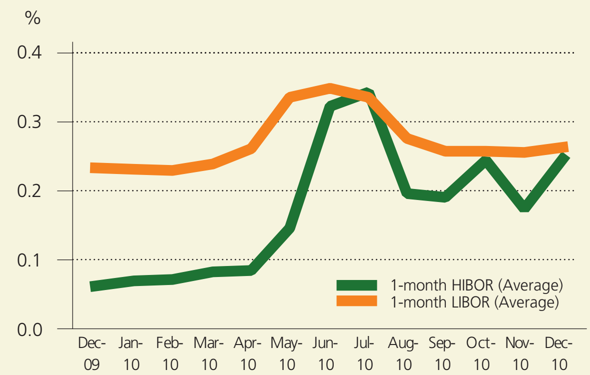
Hong Kong Unemployment Rate



Source: Bloomberg

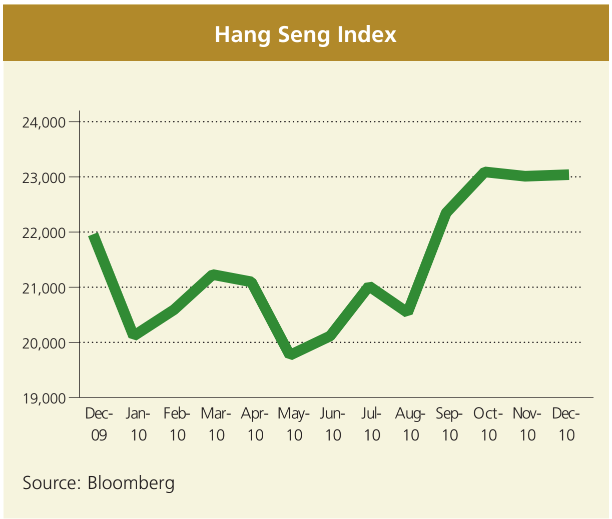
After resuming growth in the fourth quarter of 2009, the Hong Kong economy sustained its growth momentum in 2010. GDP grew by 6.8%, supported by the rise in private consumption and the revival of world trade. Domestic demand picked up, with both consumption and fixed investment growing at a pace. At the same time, net exports also made significant contribution to the GDP growth. The unemployment rate dropped to 4.0% in the last quarter of the year. Inflationary pressure in Hong Kong was mounting amid rising food prices and rent, with the Composite CPI rising by 3.1% year-on-year in December 2010.

HIBOR and LIBOR



Source: Bloomberg

The US Federal Reserve maintained its target interest rate at close to zero during the year. The QE II as well as the fiscal and monetary policies adopted by central governments around the world also led to ample liquidity in the market. Despite some slight increases, market interest rates remained at a very low level throughout the year. Average 1-month HIBOR and LIBOR increased from 0.06% and 0.23% respectively in December 2009 to 0.24% and 0.26% respectively in December 2010.



Investors in the Hong Kong stock market turned cautious in the first half of 2010 in view of the worsening of the European debt crisis and the tightening of the Mainland's fiscal policy. In the second half, stock transactions increased with the soaring of the Mainland stock market and the release of QE II in the US. The Hang Seng Index reached 24,964 points in November, the highest since June 2008, and closed at 23,035 points at the end of 2010.

The local residential property market remained buoyant in 2010, with both the property prices and transaction volume continuing to mount. The surge in the property market prompted the government to launch several measures, including additional stamp duty and the further tightening of mortgage criteria to curb speculation. The number of sales and purchase agreements of all building units registered a 21.5% increase versus 2009, while the average price of private domestic properties showed an increase of 20.1% since of the end of 2009. Meanwhile, HIBOR-based mortgage became the norm in the market as dictated by customers' preference.

During the year, Hong Kong achieved several major breakthroughs in the RMB banking business. On 11 February 2010, the Hong Kong Monetary Authority announced the "Elucidation of Supervisory Principles and Operational Arrangements Regarding Renminbi Business in Hong Kong" ("Elucidation"), to facilitate the development of diversified RMB-denominated financial services. On 19 July 2010, the People's Bank of China ("PBOC") and BOCHK signed the revised "Settlement Agreement on the Clearing of Renminbi Businesses" ("Settlement Agreement"), which expanded the scope of offshore RMB banking business and enhanced the flexibility for Hong Kong and overseas banks to conduct such business. Both the Elucidation and the revised Settlement Agreement led to greater flexibility and offered more favourable development prospects for the RMB business. New RMB products were subsequently launched by banks and insurance companies.

As interest rates remained low and competition for both loans and deposits intensified, banks in Hong Kong continued to face a narrowing net interest margin. Greater inflationary pressure on operating costs was also affecting banks' profitability. Nevertheless, as the economy further recovered, coupled with keen demand from the Mainland, loan growth in Hong Kong was made possible. The rebound of the stock market in the second half of the year also gave rise to opportunities for banks to increase non-interest income. As asset quality improved with the economic recovery, there was less need for provisioning.

Outlook for 2011

The Group takes a cautiously optimistic view on Hong Kong's economic outlook in 2011. The Hong Kong economy recorded steady growth in 2010 with the gradual stabilisation of the global economy and financial markets. While there are potential challenges and uncertainties, including mounting inflationary pressure in emerging markets, political unrest in certain countries and fluctuations in fund flow, the Group believes that the trend of global economic recovery would continue and enable Hong Kong economy to sustain decent growth in 2011.

Given the accommodative policies adopted by central governments and the quantitative easing measures by the US and other economies, Hong Kong's banking sector encountered ample liquidity. Market interest rates are expected to remain low for some time. Intense competition on pricing will also exert pressure on banks' net interest margin.

MANAGEMENT'S DISCUSSION & ANALYSIS

While the market's general concern for the European sovereign debt issue has not dissipated, political unrest in Middle East and North Africa has fueled the rise in oil price and market volatility. The potential impact on Hong Kong's banking sector and the financial markets in case of any sovereign default cannot be ignored.

With increasing cross-border economic activities, Hong Kong's economy is increasingly linked with the Mainland. In view of mounting inflationary pressure, the PBOC had raised interest rates and the reserve requirement ratio several times in 2010. It is possible that the Central Government may introduce more controlling policies, which could create uncertainties in Hong Kong's operating environment.

Apart from market risks, banks might also face more stringent regulatory requirements on product sales and customer service, liquidity management and capital management.

Looking forward, the Group believes that the Mainland's robust economic growth will continue to support Hong Kong's long-term economic development. The expansion of the offshore RMB business and the increasing use of RMB in the global economy will also facilitate the growth of RMB banking business in Hong Kong. In addition, China's twelfth five-year plan, which focuses on accelerating the transformation of its economic development pattern, may create new business opportunities for banks in Hong Kong.

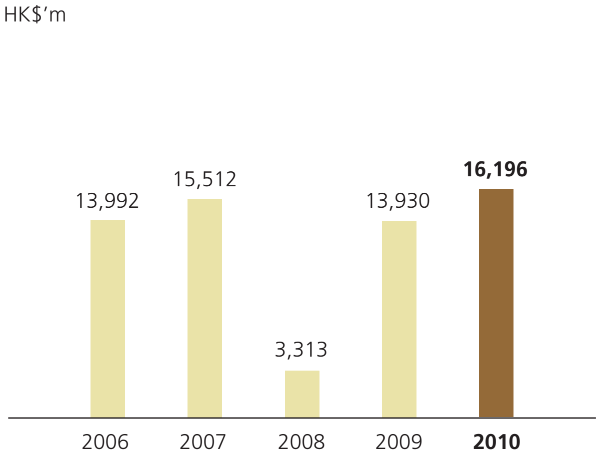
The Group's 2011 business focuses are set out in the Business Review section.

CONSOLIDATED FINANCIAL REVIEW

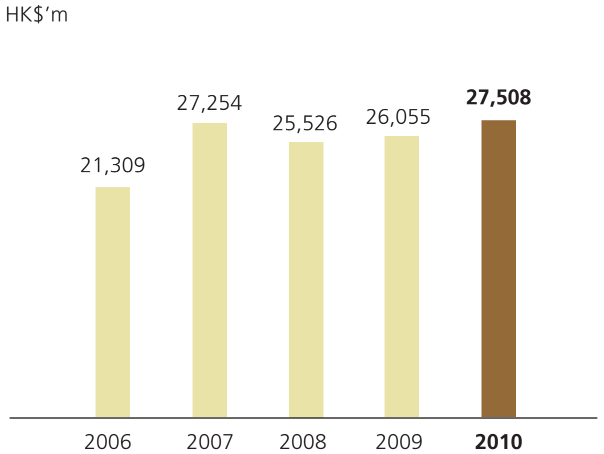
Financial Performance

In spite of the still challenging operating environment, the Group achieved encouraging results in both its financial performance and business development in 2010. By seizing opportunities arising from the reviving economy and capitalising on its core competencies, both the Group's net operating income before impairment allowances and profit attributable to shareholders reached record highs in 2010. The Group expanded its traditional businesses proactively and took key steps in growing its RMB business. As a result, the Group's asset base and RMB business in Hong Kong recorded satisfactory growth. Meanwhile, the Group continued to exercise rigorous risk management in view of the economic uncertainties arising from the debt crisis in Europe as well as the risks of overheating in the property market. The capital adequacy ratio of the banking group remained at a solid level.

Profit attributable to shareholders



Net operating income before impairment allowances



The Group's profit attributable to shareholders increased by HK$2,266 million, or 16.3%, to HK$16,196 million. Earnings per share were HK$1.5319, up from HK$1.3175 in 2009. ROA and ROE were 1.21% and 14.77% respectively.

Factors Affecting the Group's Performance in 2010

Below are the key positive factors that contributed to the Group's 2010 financial performance:

- With an improving economic environment and increasing loan demand, the Group registered a ***broad-based loan growth*** of 19.1%. The increase in corporate loans was particularly strong. The growth in trade finance was outstanding. The Group also maintained its leadership in the local residential mortgage market and the Hong Kong-Macau syndicated loan market.
- To support the Group's asset growth and business development, the Group implemented a strategic plan to attract deposits and proactively managed its funding costs. As a result, the Group's ***deposit base increased*** by 21.6%. During the year, as part of its strategy to manage capital and funding costs, the Group issued ***subordinated notes*** to repay the US Dollar subordinated loan granted by BOC.
- The Group actively promoted its ***traditional banking businesses*** and recorded a double-digit growth in the related net fee and commission income. Satisfactory growth was recorded across all major items with higher growth in currency exchange, trade settlement and payment services.
- ***The Group made encouraging progress in its RMB business in Hong Kong***. With the further expansion of the offshore RMB market, the Group actively developed and promoted its cross-border RMB business. The Group launched a number of RMB trade settlement, treasury and insurance products, and acted as the lead manager for several RMB bonds issued in Hong Kong. The business volume of RMB cross-border settlement, exchange transactions and remittance transactions recorded satisfactory growth. The issuance of dual currency China UnionPay ("CUP") credit cards continued to rise while the Group's RMB deposits saw significant growth. The growth of RMB assets also contributed to the increase in net interest income despite the diluting effect of local RMB deposits on the Group's net interest margin.
- Contribution from the Group's ***insurance business*** increased strongly. Thanks to the successful implementation of the financial planning team and "need-based selling" approach as well as the new business opportunities in the local RMB market and the recovery of the financial markets, BOC Life recorded a substantial growth in its profit. It improved its market share and market ranking in terms of total standard new business premium. At the same time, commission income from the Group's life insurance agency business doubled year-on-year.

The Group's financial performance in 2010 was also subject to the following key negative factors:

- Exceptionally low market interest rates further compressed the Group's net interest margin.
- Despite higher demand for mortgage loans, customers would generally opt for HIBOR-based lending to take advantage of the low interbank rates, which bore a lower gross yield compared to prime-based mortgages.
- Intense market competition in loan and deposit businesses resulted in pressure on loan pricing and funding costs.
- The Group's Mainland operation also faced intense competition in the loan and deposit market. It also focused on growing deposits in order to improve the loan to deposit ratio, resulting in higher funding costs. These all weighed down the profitability of the Group's Mainland operation.

Financial Highlights

HK$'m, except percentage amounts	2010	(Restated) 2009
Net interest income	**18,734**	17,932
Other operating income	**8,774**	8,123
Net operating income before impairment allowances	**27,508**	26,055
Operating expenses	**(9,584)**	(12,141)
Operating profit before impairment allowances	**17,924**	13,914
Net reversal of impairment allowances	**315**	1,190
Others	**1,503**	1,620
Profit before taxation	**19,742**	16,724
Profit attributable to the equity holders of the Company	**16,196**	13,930
Earnings per share (HK$)	**1.5319**	1.3175
Return on average total assets	**1.21%**	1.21%
Return on average capital and reserves attributable to the equity holders of the Company	**14.77%**	14.83%
Net interest margin	**1.49%**	1.69%
Non-interest income ratio	**31.90%**	31.18%
Cost-to-income ratio	**34.84%**	46.60%

In 2010, the Group's net operating income before impairment allowances increased by HK$1,453 million or 5.6% year-on-year to HK$27,508 million, driven by the improvement in net interest income, net fee and commission income, income from foreign exchange activities arising from customer-related activities as well as net operating income of the Group's insurance segment. Increase in net gain on investment in securities also contributed to the growth in the Group's net operating income. There was, however, a reduction in net trading gain mainly caused by a foreign exchange loss from foreign exchange swap contracts*. Operating expenses declined by 21.1% due to the significant decline in expenses incurred for Lehman Brothers-related products. The Group recorded a modest amount of net reversal of impairment allowances on securities investments and loans.

* Foreign exchange swap contracts are usually used for the Group's liquidity management and funding activities in its daily operation.

Income growth accelerated in the second half of the year, backed by the continuous recovery of the local economy, revival of the equity market and development of the RMB business in Hong Kong. Compared to the first half of the year, the Group's net operating income before impairment allowances increased by HK$2,426 million or 19.3% in the second half. Profit attributable to shareholders rose by HK$1,816 million or 25.3%.

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	2010	2009
Interest income	**23,449**	21,684
Interest expense	**(4,715)**	(3,752)
Net interest income	**18,734**	17,932
Average interest-earning assets	**1,255,879**	1,058,765
Net interest spread	**1.43%**	1.64%
Net interest margin	**1.49%**	1.69%
Adjusted net interest margin* (adjusted for clearing bank function)	**1.59%**	1.74%

* The adjusted net interest margin excludes the estimated impact of RMB clearing services performed by the Group. Since December 2003, the Bank has been appointed as the clearing bank to provide RMB clearing services in Hong Kong.

Net interest income increased by HK$802 million or 4.5%, which was primarily attributable to the growth in average interest-earning assets. Net interest margin was 1.49%, down 20 basis points year-on-year. Should the estimated impact of BOCHK's RMB clearing function in Hong Kong be excluded, the adjusted net interest margin would have been 1.59%, down 15 basis points year-on-year.

Average interest-earning assets increased by HK$197,114 million or 18.6%, mainly supported by the Group's customer deposits and the increases in RMB funds from the clearing bank business.

Average yield of interest-earning assets fell by 18 basis points while the average rate of interest-bearing liabilities increased by 3 basis points. As a result, the net interest spread decreased by 21 basis points. Contribution from net free fund increased by 1 basis point.

The decline in the average yield of interest-earning assets was primarily due to three factors. The first one was the repricing of the Group's assets, namely, debt securities investments as well as loans and advances to customers, at a lower rate under the low interest rate environment. Secondly, the proportion of loans and advances with pricing based on interbank market rates (hereafter called "market rate-based loans") became larger. The last factor was the increase in local RMB deposits (including those arising from the clearing bank business and the Group's customers), the use of which was limited at the early stage of development of the offshore RMB business.

The adverse impact from the above-mentioned factors was moderated by the Group's proactive approach in managing its assets and liabilities through an increase in higher-yielding assets such as loans and advances to customers as well as debt securities investments.

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

	Year ended 31 December 2010		Year ended 31 December 2009	
ASSETS	Average balance HK$'m	Average yield %	Average balance HK$'m	Average yield %
Cash, Balances and placements with banks and other financial institutions	276,827	1.07	241,931	1.21
Debt securities investments	393,865	2.24	330,196	2.46
Loans and advances to customers	570,697	2.01	473,890	2.22
Other interest-earning assets	14,490	1.37	12,748	1.14
Total interest-earning assets	1,255,879	1.87	1,058,765	2.05
Non interest-earning assets	126,242	–	118,529	–
Total assets	1,382,121	1.70	1,177,294	1.84

	Year ended 31 December 2010		Year ended 31 December 2009	
LIABILITIES	Average balance HK$'m	Average rate %	Average balance HK$'m	Average rate %
Deposits and balances of banks and other financial institutions	142,969	0.76	74,734	0.70
Current, savings and fixed deposits	859,366	0.34	792,744	0.28
Certificate of deposits issued	–	–	519	4.06
Subordinated liabilities*	27,113	1.88	27,092	3.40
Other interest-bearing liabilities	53,949	0.33	29,829	0.19
Total interest-bearing liabilities	1,083,397	0.44	924,918	0.41
Non interest-bearing deposits	67,037	–	56,601	–
Shareholders' funds# and non interest-bearing liabilities	231,687	–	195,775	–
Total liabilities	1,382,121	0.34	1,177,294	0.32

* Bank of China (Hong Kong) Limited ("BOCHK"), the principal operating subsidiary of the Group, secured two subordinated loans from BOC in June and December 2008 respectively. Subsequently, BOCHK issued fixed rate subordinated notes in February and April 2010 and applied the proceeds to repay the US Dollar subordinated loan secured from BOC

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

Second Half Performance

Net interest income increased by HK$806 million or 9.0% compared to the first half of 2010 primarily due to the growth in average interest-earning assets. Net interest margin was 1.42%, down 16 basis points. Should the estimated impact of BOCHK's RMB clearing function in Hong Kong be excluded, the adjusted net interest margin would have been 1.55%, down by 9 basis points as compared to the first half of 2010.

Average interest-earning assets increased by HK$225,141 million, or 19.7% compared to the first half of 2010. It was mainly supported by the Group's customer deposits and the increase in RMB funds from the clearing bank business.

The average market interest rates in the second half was slightly higher than that in the first half, with average 1-month HIBOR rate rising by 10 basis points while average 1-month LIBOR rate remained at the same level. However, the increase in deposit costs, higher proportion of market rate-based loans and growth in local RMB assets continued to put pressure on the Group's net interest margin. These negative effects were partly offset by the growth in loans and advances to customers and debt securities investments, which bore higher yield.

Net Fee and Commission Income

HK$'m	**2010**	2009
Investment and life insurance fee income	**3,736**	3,886
Credit cards	**2,003**	1,511
Loan commissions	**961**	922
Bills commissions	**751**	627
Payment services	**568**	495
Currency exchange	**332**	213
Other insurance	**323**	100
Trust services	**206**	178
Safe deposit box	**200**	191
Others	**399**	413
Fee and commission income	**9,479**	8,536
Fee and commission expenses	**(2,435)**	(2,028)
Net fee and commission income	**7,044**	6,508

Net fee and commission income increased by HK$536 million, or 8.2%, to HK$7,044 million. The increase was broad-based, of which bills commissions increased by HK$124 million or 19.8% and fee income from credit card business grew by HK$492 million or 32.6%. The growth in bills commission was in line with the robust performance of Hong Kong's external trade while the increase in fee income from credit card business was driven by the rise in cardholder spending and merchant acquiring volume by 22.7% and 41.0% respectively. Fee income from currency exchange and payment services rose by HK$119 million or 55.9% and HK$73 million or 14.7% respectively. Loan commissions and trust services also recorded satisfactory growth. Investment and life insurance fee income declined by HK$150 million or 3.9%, which is discussed in the next section "Investment and Life Insurance Business". Fee and commission expenses increased by HK$407 million or 20.1%, which was mainly due to the growth of the credit card business.

Second Half Performance

Compared to the first half of 2010, net fee and commission income increased by HK$250 million or 7.4% in the second half. Total fee and commission income rose by HK$517 million or 11.5%, mainly resulting from the increases in investment and life insurance fee income, fee income from the credit card business as well as currency exchange, but this increase was partially offset by the decrease in loan commissions. Meanwhile, fee and commission expenses were also up HK$267 million, or 24.6%, mainly because of higher expenses incurred by the credit card and stock broking businesses.

Investment and Life Insurance Business

HK$'m	2010	2009
Investment and life insurance fee income		
Securities brokerage		
– Stockbroking	**3,279**	3,638
– Bonds	**59**	39
Funds distribution	**160**	97
Life insurance[1]	**238**	112
	3,736	3,886
Net operating income/(loss) of BOC Life[2]		
Gross earned premiums	**8,650**	7,762
Less: gross earned premiums ceded to reinsurers	**(2,166)**	(18)
Others[3]	**2,716**	342
Less: net insurance benefits and claims	**(7,988)**	(7,286)
	1,212	800
Total income from investment and life insurance business	**4,948**	4,686
Of which:		
Life insurance fee income[1]	**238**	112
Net operating income of BOC Life[2]	**1,212**	800
Total life insurance income	**1,450**	912
Investment fee income	**3,498**	3,774
Total income from investment and life insurance business	**4,948**	4,686

1 Fee income from life insurance only includes that from the Group's insurance business partner after group consolidation elimination.
2 Before commission expenses.
3 Comprises net interest income, net trading gain/(loss), net gain/(loss) on financial instruments designated at fair value through profit or loss, net gain on investment in securities, commission income and other operating income of BOC Life.

The Group's income from the investment and life insurance business increased by HK$262 million, or 5.6%, to HK$4,948 million. The increase was mainly contributed by the growth in income from the life insurance business and fee income from fund distribution.

Fee income from funds and bonds distribution went up by HK$63 million or 64.9%, and HK$20 million or 51.3% respectively. Meanwhile, fee income from stock broking declined by HK$359 million or 9.9%, as local stock investors' sentiments were negatively affected by the European debt crisis and the tightening measures taken by the Mainland government, in particular in the first half of the year.

Net operating income from BOC Life rose by HK$412 million or 51.5%, to HK$1,212 million. It was mainly attributable to improved underwriting results, the continuous optimisation of product mix and better investment performance. Gross insurance premium income rose by 11.4% with gross regular premium increasing by 185.2% year-on-year. Net insurance benefits and claims rose by HK$702 million or 9.6%. The increase was also a reflection of the movement in policy reserves caused by the drop of long-term interest rates, which was offset by a corresponding increase in net gain on financial instruments designated at fair value through profit or loss.

Second Half Performance

Compared to the first half of 2010, income from the investment and life insurance business increased by HK$732 million or 34.7% in the second half. The growth was mainly driven by the increase in fee income from stock broking by HK$267 million or 17.7%, as the stock investors' sentiments improved in the second half of 2010. Net operating income from BOC Life increased by HK$492 million or 136.7% because of the improved underwriting results and investment performance, as well as higher interest income.

Net Trading Gain/(Loss)

HK$'m	**2010**	2009
Foreign exchange and foreign exchange products	**999**	1,273
Interest rate instruments and items under fair value hedge	**262**	62
Equity instruments	**(8)**	26
Commodities	**116**	124
Net trading gain	**1,369**	1,485

Net trading gain was HK$1,369 million, down HK$116 million or 7.8%, which was mainly caused by the decrease of HK$274 million or 21.5% in the net trading gain from foreign exchange and related products. The decrease was primarily caused by higher foreign exchange loss on foreign exchange swap contracts*. These foreign exchange swap contracts were used for the Group's liquidity and funding activities. Should the impact of the loss on foreign exchange swap contracts be excluded, the gain from other foreign exchange activities would have increased by HK$343 million, or 26.4%. Net trading gain from interest rate instruments and items under fair value hedge also rose by HK$200 million or 322.6% as a result of the rise in mark-to-market gain of certain interest rate instruments.

* Foreign exchange swap contracts are usually used for the Group's liquidity management and funding activities. Under the 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. The exchange difference between the spot and forward contracts is recognised as foreign exchange gain or loss (as included in "net trading gain/(loss)"), 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 net trading loss of HK$36 million in the first half of 2010, the Group registered a net trading gain of HK$1,405 million in the second half of the year. The gain was largely contributed by the mark-to-market gain on certain interest rate instruments in the second half of the year, as opposed to a loss in the first half. Net trading gain from foreign exchange and foreign exchange products also increased by HK$299 million or 85.4%.

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

HK$'m	**2010**	2009
Banking business of the Group	**44**	261
BOC Life	**698**	(939)
Net gain/(loss) on financial instruments designated at FVTPL	**742**	(678)

Compared to the net loss of HK$678 million in 2009, the Group recorded a net gain of HK$742 million on financial instruments designated at FVTPL in 2010. This was mainly due to the mark-to-market gain on certain debt securities investments of BOC Life, which was caused by the drop in market interest rates. Meanwhile, net gain on financial instruments designated at FVTPL from the banking business dropped by HK$217 million, or 83.1%, mainly due to the decline in the mark-to-market gain on certain debt securities investments.

Second Half Performance

Net gain on financial instruments designated at FVTPL in the second half of 2010 was HK$102 million, down HK$538 million or 84.1% from the first half. This was mainly caused by the mark-to-market loss of certain debt securities investments of BOC Life caused by the increase in market interest rates.

Operating Expenses

HK$'m, except percentage amounts	2010	2009
Staff costs	**5,357**	5,091
Premises and equipment expenses (excluding depreciation)	**1,201**	1,160
Depreciation on owned fixed assets	**1,131**	1,018
Other operating expenses	**1,806**	1,594
Core operating expenses	**9,495**	8,863
Expenses incurred on Lehman Brothers-related products*	**89**	3,278
Total operating expenses	**9,584**	12,141
Cost-to-income ratio	**34.84%**	46.60%
Core cost-to-income ratio	**34.52%**	34.02%

* Includes the related legal expenses.

The Group's total operating expenses decreased by HK$2,557 million or 21.1% to HK$9,584 million. This was largely due to the significant decline in expenses incurred for Lehman Brothers-related products. In 2010, the Group focused on operational efficiency and cost control while deploying relevant financial resources for business development. Additional expenses were incurred for marketing and promotion as well as business expansion in strategic focus areas such as the Mainland market and RMB business. Operating expenses also increased with the growth of transaction volume.

Staff costs increased by HK$266 million or 5.2%, primarily due to more human resources input for business growth and higher performance-related incentives. Compared to the end of 2009, headcount measured in full-time equivalents rise by 562 to 13,806 at the end of 2010.

Premises and equipment expenses increased by HK$41 million or 3.5% as a result of higher IT costs and higher rental for branches in Hong Kong and new branches in the Mainland. Depreciation on owned fixed assets rose by HK$113 million, or 11.1%, to HK$1,131 million, which was attributable to larger depreciation charge on premises following the upward revaluation. Other operating expenses increased by HK$212 million or 13.3% to HK$1,806 million, mainly due to higher marketing and promotion expenses as well as expenses connected with the increasing business volume.

Second Half Performance

Compared to the first half of 2010, total operating expenses rose by HK$516 million, or 11.4%, mainly due to the increase in staff costs, business promotion and IT expenses. Compared to 30 Jun 2010, headcount measured in full-time equivalents rose by 377.

Net Reversal/(Charge) of Loan Impairment Allowances

HK$'m	2010	2009
Net reversal/(charge) of allowances before recoveries		
– individual assessment	**149**	(241)
– collective assessment	**(528)**	(343)
Recoveries	**449**	481
Net reversal/(charge) of loan impairment allowance	**70**	(103)

The Group's loan quality remained sound in 2010. It recorded a net reversal of loan impairment allowances of HK$70 million versus a HK$103 million net charge in 2009.

A net reversal of HK$149 million of individual allowance was registered in 2010 under an improved economic environment. Higher net charge of collective allowance was primarily due to the expansion of the loan portfolio and the re-estimation of parameter values in the assessment model in the second half of the year. Meanwhile, recoveries during the year totaled HK$449 million.

Second Half Performance

The Group recorded a net charge of loan impairment allowances of HK$24 million in the second half of 2010 relative to a net reversal of HK$94 million in the first half. The net charge of loan impairment allowances was primarily caused by the higher net charge from collective assessment as a result of the expansion of the loan portfolio and the re-estimation of parameter values in the assessment model in the second half of the year.

Net Reversal/(Charge) of Impairment Allowances on Securities Investments

HK$'m	2010	2009
Held-to-maturity securities	**46**	690
Available-for-sale securities	**208**	612
Net reversal of impairment allowances on securities investments	**254**	1,302

Following the Group's continuing effort to reduce the overall credit risk of its investment portfolio by disposing of higher-risk securities since 2009, it recorded a net reversal of impairment allowances on securities investments of HK$254 million in 2010.

The table below illustrates the breakdown of the Group's net reversal or charge of impairment allowances against its securities investments in 2010 and 2009.

HK$'m	2010	2009
US non-agency residential mortgage-backed securities		
Subprime	**17**	30
Alt-A	**26**	16
Prime	**238**	1,140
	281	1,186
Other debt securities	**(27)**	116
Net reversal of impairment allowances on securities investments	**254**	1,302

For details about the composition of the Group's investment securities portfolio, and the impairment and provisioning policies on investments, please refer to Note 27, Note 2 and Note 3 to the Financial Statements.

Second Half Performance

In the second half of 2010, the Group recorded a net reversal of impairment allowances on securities investments of HK$182 million. This was primarily attributable to the Group's further disposal of US non-agency residential mortgage-backed securities ("RMBS") in the second half of the year. The reversal was partially offset by a charge of impairment allowance on European bonds of HK$56 million. For further details on the Group's exposure to European countries, please refer to the Business Review of the Treasury Segment below.

Property Revaluation

HK$'m	2010	(Restated) 2009
Net gain on fair value adjustments on investment properties	**1,511**	1,554
Net gain on revaluation of premises	**4**	15
Deferred tax charge	**(1)**	(2)
Net gain on revaluation of premises, after tax	**3**	13

The net impact of fair value adjustments on properties on the Group's profit attributable to equity holders in 2010 was a gain of HK$1,514 million, which comprised a gain of HK$1,511 million from the revaluation of investment properties and a net gain of HK$3 million from the revaluation of premises. The net gain on property revaluation was in line with the increase in property prices in 2010.

Second Half Performance

A net gain of HK$910 million from the revaluation of investment properties was recorded, up HK$309 million from the first half of 2010.

Financial Position

HK$'m, except percentage amounts	At 31 December 2010	(Restated) At 31 December 2009
Cash and balances with banks and other financial institutions	**415,812**	160,788
Placements with banks and other financial institutions maturing between one and twelve months	**39,499**	60,282
Hong Kong SAR Government certificates of indebtedness	**46,990**	38,310
Securities investments[1]	**430,060**	358,349
Advances and other accounts	**645,424**	527,135
Fixed assets and investment properties	**41,391**	35,650
Other assets[2]	**41,864**	32,280
Total assets	**1,661,040**	1,212,794
Hong Kong SAR currency notes in circulation	**46,990**	38,310
Deposits and balances of banks and other financial institutions	**313,784**	99,647
Deposits from customers	**1,027,033**	842,321
Insurance contract liabilities	**39,807**	33,408
Other accounts and provisions[3]	**88,260**	65,417
Subordinated liabilities[4]	**26,877**	26,776
Total liabilities	**1,542,751**	1,105,879
Non-controlling interests	**3,108**	2,736
Capital and reserves attributable to the equity holders of the Company	**115,181**	104,179
Total liabilities and equity	**1,661,040**	1,212,794
Loan-to-deposit ratio[5]	**59.69%**	60.98%

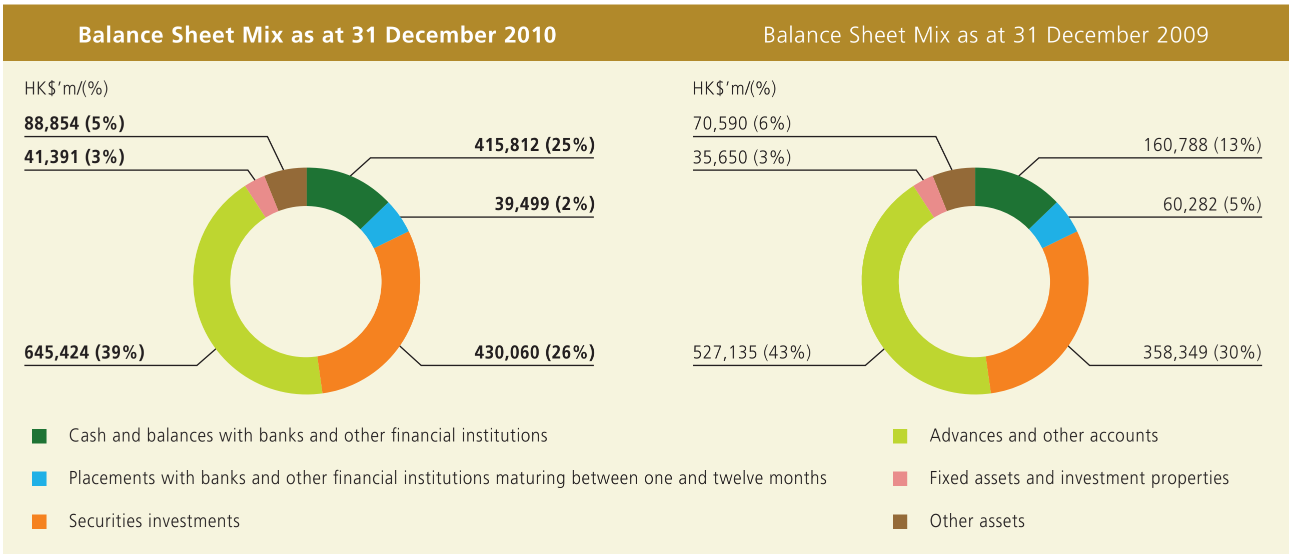
1 Securities investments comprise investment in securities and financial assets at fair value through profit or loss.

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

3 Financial liabilities at fair value through profit or loss, derivative financial liabilities, current tax liabilities and deferred tax liabilities are included in other accounts and provisions.

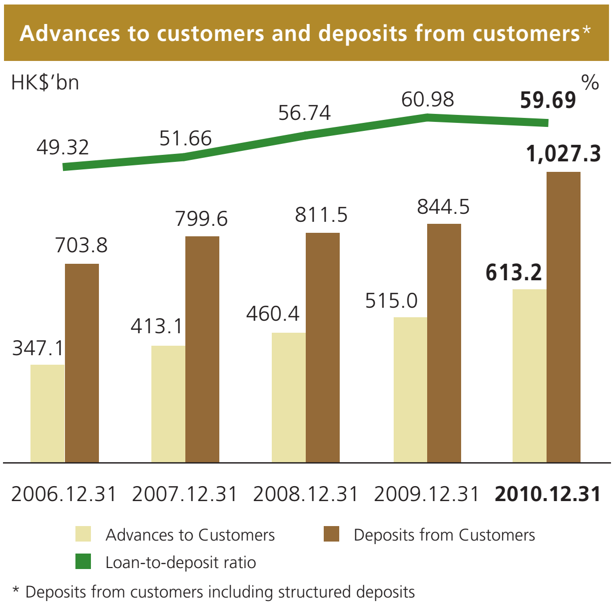
4 Subordinated liabilities as at 31 December 2009 represented USD and EUR subordinated loans granted by BOC (the "Loans"). During the year, the Group issued USD subordinated notes (the "Notes"), the proceeds of which were applied to repay the USD Loan. Accordingly, subordinated liabilities as at 31 December 2010 comprised the Notes and the EUR Loans.

5 The deposit base also includes structured deposits reported as "Financial liabilities at fair value through profit or loss".



As at 31 December 2010, the Group's total assets amounted to HK$1,661,040 million, up HK$448,246 million or 37.0% from the end of 2009. The overall asset growth was primarily driven by the development of the Group's core banking businesses and the expansion of its RMB business in Hong Kong. Key changes include:

- Cash and balances with banks and other financial institutions rose by HK$255,024 million or 158.6% mainly due to the strong growth in RMB deposits placed with the PBOC by BOCHK's clearing business.
- Placements with banks and other financial institutions maturing between one and twelve months decreased by HK$20,783 million, or 34.5%, as the Group redeployed its funds for advances to customers and debt securities investments.
- Securities investments increased by HK$71,711 million or 20.0%. The Group expanded its investments in government-related and high-quality financial institution bonds and corporate bonds.
- Advances and other accounts rose by HK$118,289 million or 22.4%, which was mainly attributable to the growth in advances to customers by HK$98,247 million or 19.1% and trade bills by HK$22,505 million or 247.3%.
- Deposits and balances of banks and other financial institutions increased by HK$214,137 million or 214.9%, led by the growth in RMB deposits arising from the clearing bank business.



In February and April 2010, the Group successfully completed the issue of Subordinated Notes (the "Notes") of US$1,600 million and US$900 million respectively to global debt investors. The proceeds of the Notes were used to repay the USD subordinated credit facility provided by BOC in December 2008. Pursuant to the regulatory requirements of the HKMA, the Notes qualify as Tier 2 Capital. The issue of the Notes broadened the Group's investor base and established a market benchmark for the Group to tap the debt market as an alternative source of future funding for its growth and development. The bond issue received The Asset magazine's Triple A 2010 Best Bank Capital Bond Award.

Advances to Customers

HK$'m, except percentage amounts	**At 31 December 2010**	**%**	(Restated) At 31 December 2009	%
Loans for use in Hong Kong	**387,087**	**63.1**	352,210	68.4
Industrial, commercial and financial	**206,947**	**33.7**	195,520	38.0
Individuals	**180,140**	**29.4**	156,690	30.4
Trade finance	**53,396**	**8.7**	29,321	5.7
Loans for use outside Hong Kong	**172,736**	**28.2**	133,441	25.9
Total advances to customers	**613,219**	**100.0**	514,972	100.0

In view of strong market demand for loans in 2010, the Group implemented proactive business strategies to grow its loan book. It strengthened collaboration with BOC to capture new business opportunities in corporate banking and at the same time focused on enhancing the loan pricing. Advances to customers rose strongly by HK$98,247 million or 19.1% to HK$613,219 million. Growth was seen in all major sectors. Average loan pricing on corporate loans also improved year-on-year.

Loans for use in Hong Kong grew by 9.9%.

- Lending to the industrial, commercial and financial sectors increased by HK$11,427 million, or 5.8%, to HK$206,947 million, covering a wide range of industries. Loans to wholesale and retail trade, property development, financial concerns and manufacturing recorded impressive growth.

- Residential mortgage loans (excluding those under the Government-sponsored Home Ownership Scheme) were up HK$20,211 million or 15.9%, to HK$147,424 million, as a result of the Group's effective marketing effort as well as an active property market in 2010. The proportion of new drawdown in HIBOR-based residential mortgage loans showed significant increase as customers were more inclined to take advantage of low interbank rates.

- Card advances rose by HK$882 million or 12.0% to HK$8,230 million.

Trade finance recorded a strong growth of HK$24,075 million or 82.1%, thanks to the enhanced relationship between the Group and its large corporate customers as well as the increased demand for trade financing spurred by the robust growth of global trade.

Loans for use outside Hong Kong increased by HK$39,295 million or 29.4%, driven mainly by the growth in the loan business of the Group's Mainland operation, and other loans used outside Hong Kong.

Second Half Performance

The Group maintained the growth momentum of its lending business in the second half of the year and expanded its total advances to customers by HK$41,733 million or 7.3%, with notable growth in loans used outside Hong Kong, residential mortgage and trade finance.

Deposits from Customers*

HK$'m, except percentage amounts	**At 31 December 2010**	**%**	At 31 December 2009	%
Demand deposits and current accounts	**70,453**	**6.9**	65,440	7.7
Savings deposits	**528,035**	**51.4**	495,512	58.7
Time, call and notice deposits	**428,545**	**41.7**	281,369	33.3
	1,027,033	**100.0**	842,321	99.7
Structured deposits	**234**	**0.0**	2,132	0.3
Deposits from customers	**1,027,267**	**100.0**	844,453	100.0

* Includes structured deposits.

Deposits from customers increased by HK$182,814 million, or 21.6%, to HK$1,027,267 million, as the Group proactively grew its deposit base to support its lending business and other business growth. Demand deposits and current accounts increased by HK$5,013 million, or 7.7%. Savings deposits rose by HK$32,523 million, or 6.6%. Time, call and notice deposits went up significantly by HK$147,176 million, or 52.3%. Meanwhile, structured deposits dropped by HK$1,898 million, or 89.0%. The Group's loan-to-deposit ratio was down 1.29 percentage points to 59.69% at the end of 2010 as growth in deposits outpaced that in loans.

Second Half Performance

Deposits from customers increased by HK$134,530 million or 15.1% in the second half of 2010. The changes in the deposit mix were similar to the full-year changes with increments in demand deposits and current accounts by HK$3,331 million, or 5.0% and savings deposits by HK$54,543 million, or 11.5%. Time, call and notice deposits rose by HK$76,948 million or 21.9% while structured deposits declined by HK$292 million or 55.5%.

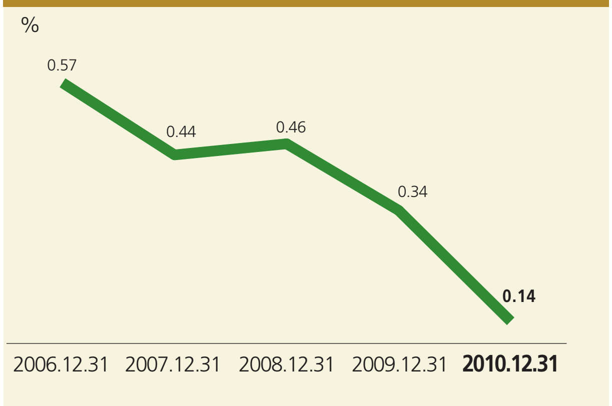
Loan Quality

HK$'m, except percentage amounts	**At 31 December 2010**	At 31 December 2009
Advances to customers	**613,219**	514,972
Classified or impaired loan ratio[1]	**0.14%**	0.34%
Impairment allowances	**2,311**	2,269
Regulatory reserve for general banking risks	**5,076**	4,040
Total allowances and regulatory reserve	**7,387**	6,309
Total allowances as a percentage of advances to customers	**0.38%**	0.44%
Total allowances and regulatory reserve as a percentage of advances to customers	**1.20%**	1.23%
Impairment allowances[2] on classified or impaired loan ratio	**40.02%**	39.57%
Residential mortgage loans[3] – delinquency and rescheduled loan ratio[4]	**0.02%**	0.04%
Card advances – delinquency ratio[4,5]	**0.15%**	0.23%

	2010	2009
Card advances – charge-off ratio[5,6]	**1.36%**	2.69%

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.
2 Referring to 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.
6 Charge-off ratio is measured by a ratio of total write-offs made during the year to total card receivables as at the end of the year.

Classified or impaired loan ratio



The Group's loan quality further improved with its classified or impaired loan ratio falling by 0.20 percentage point to 0.14%. Classified or impaired loans decreased by HK$902 million, or 51.0%, to HK$867 million mainly due to collections and fewer new classified loans. New classified loans in 2010 represented approximately 0.1% of total loans outstanding. Regulatory reserve for general banking risks increased by HK$1,036 million or 25.6% mainly due to loan growth.

Total impairment allowances, including both individual assessment and collective assessment, amounted to HK$2,311 million. Total impairment allowances in respect of the classified or impaired loans as a percentage of total classified or impaired loans was 40.02%.

The quality of the Group's residential mortgage loans continued to improve with the combined delinquency and rescheduled loan ratio falling by 0.02 percentage point to 0.02% at the end of 2010. The charge-off ratio of card advances dropped by 1.33 percentage point to 1.36% in 2010 mainly due to cardholders' improved debt servicing capability as economic conditions improved.

Capital and Liquidity Ratios

HK$'m, except percentage amounts	**At 31 December 2010**	At 31 December 2009
Core capital	**78,275**	72,465
Deductions	**(332)**	(334)
Core capital after deductions	**77,943**	72,131
Supplementary capital	**33,876**	32,638
Deductions	**(332)**	(334)
Supplementary capital after deductions	**33,544**	32,304
Total capital base after deductions	**111,487**	104,435
Risk-weighted assets		
Credit risk	**648,236**	578,374
Market risk	**18,328**	12,023
Operational risk	**47,895**	47,352
Deductions	**(23,862)**	(17,954)
Total risk-weighted assets	**690,597**	619,795
Capital adequacy ratios (consolidated basis)		
Core capital ratio	**11.29%**	11.64%
Capital adequacy ratio	**16.14%**	16.85%

	2010	2009
Average liquidity ratio	**38.77%**	40.18%

The Group adopted the Standardised Approach in calculating its capital adequacy ratio.

Consolidated capital adequacy ratio of the banking group at 31 December 2010 was 16.14%, 0.71 percentage point lower than that at the end of 2009. The Group's total capital base expanded by 6.8% to HK$111,487 million mainly due to the increase in retained earnings. Meanwhile, risk-weighted assets for credit risk increased by 12.1% to HK$648,236 million, as a result of the growth in advances to customers.

The average liquidity ratio of the Group in 2010 remained strong at 38.77%, down slightly from the end of 2009 due to the increase in deposits maturing within 1 month.

BUSINESS REVIEW

2010 Business Highlights

Business Focuses	2010 Highlights
Personal Banking • To leverage the Group's competitive advantages and reinforce its leading position in core businesses • To enlarge customer base with high potential for long-term growth • To take advantage of closer collaboration with BOC in developing cross-border service • To optimise distribution channels and enhance customers' banking experiences	• Maintained leading positions in deposits and residential mortgage. Achieved satisfactory growth in credit card business • Broadened the customer base for wealth management and Mainland business • Provided attestation, cross-border financial services, "Dual Relationship Manager" and other differentiated services by working closely with BOC • Launched mobile banking services and improved the e-banking platform
Corporate Banking • To capitalise on the Group's competitive advantage in corporate banking businesses in Hong Kong • To provide comprehensive cross-border financial services for the Mainland's large corporate entities seeking global expansion • To grow loan book with focus on good credit quality • To strengthen collaboration with BOC in providing cross-border financial services	• Registered a growth of 20.6% in corporate loans and maintained sound loan quality • Trade finance increased by 82.1% • Improved the average pricing of its corporate loans • Maintained the Group's leading position as the mandated arranger in the Hong Kong-Macau syndicated loan market • Reinforced the implementation of "Global Relationship Manager" and "Global Unified Facilities Agreement" with BOC
Treasury • To maintain proactive management of the Group's banking book and optimise the investment portfolio to guard against risks while maximising return • To adopt a dynamic yet prudent approach in asset and liability management	• Increased investment in fixed-rate government-related securities, financial institution bonds and corporate bonds with robust fundamentals • Balanced the growth of loans and deposits and optimised the asset-liability structure
Insurance • To deepen the Bancassurance platform and increase market share • To improve sales of regular-premium products to secure stable return and enlarge revenue stream • To reinforce BOC Life's corporate image and uplift the marketing forces	• In terms of new business standard premium, BOC Life uplifted its market ranking from No. 4 in 2009 to No. 2 in 2010 • Gross regular premium income rose by 184.1% over 2009 • Expanded the financial planning team in the distribution network
Mainland Business • To maintain well-balanced growth in loans and deposits for sustainable development • To enhance the business platform by further extending branch network and enriching product and service spectrum	• Registered growth in loans and deposits of 26.2% and 133.1% respectively with improved loan-to-deposit ratio • Expanded the network to 25 branches and sub-branches at end-2010 • Rolled out a series of wealth management services and received positive feedback from the market. Debit card business also saw substantial growth

Business Focuses	2010 Highlights
RMB Business in Hong Kong • To consolidate the Group's market leadership in offshore RMB business • To expand the range of RMB products and services and capture emerging opportunities in Hong Kong • To work closely with BOC to enhance the Group's overall RMB service capability globally	• Appointed by the PBOC as the RMB clearing bank of RMB banknotes business for Taiwan • Maintained leading position in RMB banking business in Hong Kong including deposits, remittance, trade settlement, credit cards, bond underwriting and insurance • Offered comprehensive products in various areas of individual RMB banking businesses such as deposits, credit cards, bonds and funds • Rolled out a series of new RMB insurance products including the first RMB insurance products with settlement being made in RMB • Introduced RMB deliverable forwards and conducted the first RMB Overseas Direct Investment (ODI) remittance into Hong Kong and the first Foreign Direct Investment (FDI) remittance into the Mainland • Underwrote and distributed the majority of RMB bonds issued in Hong Kong, and pioneered the distribution of RMB funds in Hong Kong • Published the "BOCHK Offshore RMB Bond Index", the first offshore RMB bond index of its kind in Hong Kong

2011 Business Focuses

The strengthening of traditional banking businesses and the RMB business will continue to be the Group's main business focus in the coming year.

With regard to Personal Banking, the Group will proactively target high net-worth customers and Mainland customers, in particular those with cross-border financial needs. It will strengthen its collaboration with BOC and implement the "Dual Relationship Manager" initiative to enhance customer relationship and business referrals. A wider range of products will be designed to better serve the needs of residential mortgage and stock trading customers. The Group will further consolidate its leading position in individual RMB business with innovative products and enlarge its customer base. The Group will continue to optimise the service channels, including phone, internet and mobile banking, with a view to further improving efficiency and customer experience.

For Corporate Banking, the Group will continue to speed up the development of offshore RMB trade finance products and services. It will also focus on the business opportunities arising from the various financing needs of Mainland corporate entities seeking global expansion. The Group will strengthen its cooperation with BOC and continue to implement the "Global Relationship Manager" and "Global Unified Facilities Agreement" to enhance cross-border services. It will strive to enrich its range of cash management products and expand its customer base for custody services.

In managing its banking book investments, the Group will remain proactive and vigilant in order to safeguard its asset quality while maximising return. The Group will develop new treasury products, especially RMB-denominated products, to cater for customers' needs. Through the newly-formed BOCHK Asset Management Limited ("AML"), the Group will launch RMB investment products and introduce discretionary portfolio management services to high net-worth customers.

In respect of its insurance business, the Group aims to achieve sustainable growth by implementing the "Needs-based Selling" approach and optimising its product mix. It will launch a wider range of RMB insurance products to secure its leadership in the market.

In the Mainland, the Group will focus on growing its deposit base to support lending growth and to improve the loan-to-deposit ratio of NCB (China). It will also enhance its e-banking platform to improve service quality and customer experience.

PERSONAL BANKING

HK$'m	2010	2009
Net interest income	**5,985**	5,795
Other operating income	**5,156**	4,853
Operating income	**11,141**	10,648
Operating expenses	**(6,369)**	(5,983)
Operating profit before impairment allowances	**4,772**	4,665
Net charge of loan impairment allowances	**(99)**	(150)
Others	**(17)**	(11)
Profit before taxation	**4,656**	4,504

	At 31 December 2010	At 31 December 2009
Segment assets	**210,978**	178,026
Segment liabilities	**657,605**	570,566

Note: For additional segmental information, see Note 48 to the Financial Statements.

Financial Results

Personal Banking recorded satisfactory results in 2010. Operating income grew by 4.6% to HK$11,141 million, driven by the increase in both net interest income and other operating income. Operating profit before impairment allowances increased by 2.3% to HK$4,772 million. Profit before taxation reached HK$4,656 million in 2010, up 3.4% year-on-year.

Net interest income increased by 3.3% mainly due to the growth in average loans and deposits. The increase was partly offset by narrower loan and deposit spread amid keen market competition.

Other operating income rose by 6.2%, driven by the growth of fee and commission income from funds distribution and life insurance. Other core businesses including loans, payment services and credit card business also posted satisfactory growth. Fee income from stock broking, however, dropped.

Operating expenses were up 6.5% mainly due to increases in business expenses and staff costs. Rental expenses for branches and computer-related expenses also increased.

Net charge of loan impairment allowances decreased year-on-year, which was mainly attributable to cardholders' better debt servicing capability as the Hong Kong economy further improved in 2010.

Advances and other accounts, including mortgage loans and card advances, increased by 21.0% to HK$196,484 million. Customer deposits rose by 15.8% to HK$628,238 million.

Business operation

The Group made good progress in developing its Personal Banking business in 2010. It effectively expanded its high-potential customer base and broadened its product and service spectrum to better serve customers' needs. By collaborating with BOC, the Group further expanded its cross-border wealth management services and provided tailor-made services to customers in the Mainland and Hong Kong. It also enhanced its e-platform and optimised its distribution channels. Meanwhile, it continued to grow its residential mortgage and credit card businesses despite intensified market competition. Stock broking business also recorded a strong rebound in the second half of 2010. In view of the surging demand for RMB banking services, the Group rolled out various new RMB-related products and services, thus solidifying its leadership in individual RMB businesses in Hong Kong.

Expanding customer base with high potential

The Group focused on acquiring, growing and retaining its high-potential customers, namely, wealth management and Mainland customers. It took a series of initiatives, such as the "Grow Your Wealth with Every Opportunity" campaign and "Wealth Management Customer Referral Programme", to expand its target customer base. It also launched the "Health & Spiritualised Well-being" campaign to strengthen its relationship with prestigious customers. Meanwhile, the Group launched the Capital Investment Entrant Scheme ("CIES") Services promotion campaign to provide a wide range of banking services to CIES customers. In view of the surging demand for cross-border investment services, the Group continued to provide quality cross-border wealth management services. A mobile service team was established during the year to enhance the collaboration with BOC branches and strengthen the business development of NCB (China). In addition, it worked with BOC's Shenzhen branch to introduce the "BOC Wealth Express Card" to acquire high net-worth customers in Hong Kong and the Mainland. The "Dual Relationship Manager" service was launched as an initiative to expand its cross-border services for customers who were served by the relationship managers of both BOC and the Group. At the end of 2010, the total number of wealth management customers and their assets maintained with the Group grew by 15.9% and 14.3% respectively from the end of 2009.

Robust growth in residential mortgages

With the revival of the local property market, the Group further grew its mortgage lending business. In response to the launch of the "Sandwich Class Housing Scheme" by the Hong Kong Housing Society and "Sale of Surplus HOS Flats Phase 6" by the Hong Kong Housing Authority, the Group offered tailor-made mortgage plans to meet customers' needs. It also strengthened its strategic partnership with major property developers and participated in joint promotions in most of the prime property development projects. These initiatives reinforced the Group's prominent position in the residential mortgage market. By the end of 2010, the Group's outstanding residential mortgage loans grew by 15.9% from the end of 2009. In recognition of its outstanding performance in the mortgage business, the Group received the "Sing Tao Excellent Services Brand Award 2010 – Mortgage Services" from Sing Tao Daily. Meanwhile, under rigorous risk assessment and control, the quality of mortgage loans remained sound.

Robust growth in credit card business

The Group's card business experienced strong growth in 2010. The total number of cards issued increased by 17.5% while cardholder spending and merchant acquiring volume rose by 22.7% and 41.0% respectively. The Group maintained its leadership in the China UnionPay ("CUP") merchant acquiring business and CUP card issuing business, with merchant acquiring and cardholder spending volume surging by 57.3% and 115.5% respectively. Meanwhile, the Shenzhen-Hong Kong Cross-Border Autopay Services were introduced to provide a reliable and convenient cross-border payment service to the holders of the CUP Dual Currency credit card. Credit card advances rose by 12.0% compared to end-2009 and the credit quality remained sound with the charge-off ratio for 2010 standing at 1.36%.

The Group's success in growing its credit card business gained extensive market recognition, as evidenced by a total of 28 awards received from VISA International, MasterCard and CUP respectively.

Maintaining the growth of investment and insurance business

In 2010, sentiments in the local stock market were adversely affected by the external environment, including the European debt crisis and the Mainland's tightening policy. This had a negative impact on the Group's stock brokerage business. Nonetheless, the Group continued to grow its customer base by enhancing its products and services and acquiring new customers. During the year, the Group launched a series of promotion and marketing campaigns, including preferential brokerage fee for selected customers, promotion on warrants and Callable Bull/Bear Contracts businesses and investment seminars. An investment product specialist team was established to provide investment information and support to the frontline staff on the sales of investment products. In addition, the launch of mobile banking service provided a convenient way for customers to manage their investment anytime, anywhere. Meanwhile, the Group embarked on a number of acquisition campaigns to attract new customers, such as the "Corporate Securities Services Promotion" targeting corporate customers. To capture business opportunities arising from the increase in the number of Mainland customers, new initiatives, including brokerage fee waiver for online securities trading, were taken during the year with positive response. The Group's stock broking business recorded a strong rebound in the second half of 2010. Encouraging growth in funds distribution business was recorded during 2010, with related commission income surging by 64.9%. The Group also distributed the first RMB-denominated fund in Hong Kong.

Regarding its Bancassurance business, the Group achieved strong sales growth by expanding its product spectrum, launching extensive marketing campaigns and implementing multi-channel distribution. The Group was the first in Hong Kong to launch RMB insurance products with settlement being made in either Hong Kong Dollars or RMB, including the "Target 8 Years Insurance Plan Series", "Target 5 Years Insurance Plan Series", "Hundred Life Insurance Plan" and "Multi-Plus Savings Insurance Plan". Meanwhile, a life insurance savings plan, the "Glorious Life Savings Insurance Plan", was launched. The Group also expanded its financial planning team and rolled out large-scale marketing campaigns. These initiatives enabled the Group to further expand its foothold in the market.

Reinforcing market leadership in RMB banking business in Hong Kong

The Group maintained its leading position in the RMB banking business in Hong Kong by offering comprehensive RMB products covering deposits, credit card, bonds, funds and insurance. In 2010, it focused on RMB integrated services, "RMB Remittance Express" and "RMB Exchange Express". At the same time, it introduced "RMB Triple Jump Time Deposit", "RMB Club Deposit" and "RMB Flexi Time Deposit" with promotional offers and successfully grew its RMB deposits. Meanwhile, the Group remained its market lead in the RMB credit card business with the number of CUP Dual Currency Credit Card issued by the Group growing by 73.2%. In addition, the Group introduced RMB life insurance product in Hong Kong with settlement being made in RMB, which was well-received by customers. RMB bond brokerage and funds distribution businesses also flourished. The Group underwrote and distributed the majority of RMB bonds issued in Hong Kong during the year, and pioneered the distribution of RMB funds in Hong Kong, thus consolidating its leading position in the RMB market. It also made significant progress in the RMB corporate banking business. For details, please refer to Corporate Banking section below.

Optimising distribution channels and strengthening e-platform and services

The Group continued to optimise its distribution channels. At the end of 2010, the Group's service network in Hong Kong comprised 268 branches. Customers can obtain specialised investment advice as well as comprehensive traditional banking services at designated branches.

The Group strengthened its e-platform by launching "Mobile Banking", which allows customers to gain access to the latest market information and manage their finance and investment using their mobile phones. The quality of services delivered by the e-banking platform was further enhanced. New features include the 24-hour scheduled electronic transfer, 24-hour automated securities trading channel and enhanced capacity of automated stock trading services. The number of Internet Banking customers increased by 12.3%, while stock trading transactions through e-channels accounted for 76.8% of total transactions. The Group also enhanced the quality of telephone banking services by consolidating its services into four specialised hotline numbers with the aim of providing one-stop and more user-friendly phone banking services to customers. It also opened a call centre in Shenzhen to provide cross-border service support for Hong Kong as well as Mainland customers. As an initiative to optimise its automated banking facilities, the Group added new ATMs and extended the coverage of the dual currency cash withdrawal services in its ATM network for providing convenient RMB cash withdrawal services.

In recognition of its excellence in customer service, the Group won the gold prize in the "Award for Excellence in Training and Development 2010" organised by Hong Kong Management Association, and was awarded the "Best Internet Wealth Management Award 2010" by Capital Weekly, a local finance magazine. Moreover, the Group was granted a total of 13 awards by the Hong Kong Call Centre Association in 2010, including the "Inbound Contact Centre of the Year (Under 50 Seats) – Gold Award".

CORPORATE BANKING

HK$'m	**2010**	2009
Net interest income	**6,634**	5,502
Other operating income	**2,726**	2,685
Operating income	**9,360**	8,187
Operating expenses	**(2,568)**	(2,321)
Operating profit before impairment allowances	**6,792**	5,866
Net reversal of loan impairment allowances	**169**	47
Others	**–**	2
Profit before taxation	**6,961**	5,915

	At 31 December 2010	At 31 December 2009
Segment assets	**458,928**	372,443
Segment liabilities	**407,328**	304,882

Note: For additional segmental information, see Note 48 to the Financial Statements.

Financial Results

Corporate Banking registered strong growth in 2010. Profit before taxation grew by 17.7% to HK$6,961 million. The increase was mainly attributable to higher net interest income and the increase in net reversal of loan impairment allowances.

Net interest income increased by 20.6% as a result of the growth in loans and advances. The loan and deposit spread continued to narrow in the low interest rate environment. However, the Group focused on yield enhancement and managed to increase the pricing of new corporate loan facilities.

Other operating income increased by 1.5%, primarily due to the growth in bills commission income and fee income from trust services.

Operating expenses increased by 10.6%, mainly because of higher staff costs and rental expenses.

Net reversal of loan impairment allowances for 2010 was higher, mainly as a result of the higher net reversal of individual allowance as the economic environment improved. This was partly offset by the increase in net charge of collective allowance due to the expansion of the loan portfolio and the re-estimation of parameter values in the assessment model during the year.

Advances and other accounts increased by 23.2% to HK$456,511 million. Customer deposits grew by 33.2% to HK$401,384 million.

Business operation

In 2010, the Group provided comprehensive cross-border financial services to large corporate entities in the Mainland seeking overseas expansion. With the gradual recovery of the global economy, the Group's corporate loan business recorded strong growth. The growth of trade finance outpaced the market as a whole while the syndicated loan business maintained its leadership in the Hong Kong-Macau market. The Group continued to actively support the local SMEs and was honoured the "SME's Best Partner Award" for the third consecutive year. In 2010, the Group achieved various milestones in the RMB banking business and consolidated its leadership in Hong Kong.

Solid growth in corporate loans

Against the backdrop of an improving economic environment and the credit tightening policy in the Mainland, there was a strong demand for cross-border financial services and lending in Hong Kong. The Group offered customised services and "Total Solution" to its core corporate clients. The "Global Relationship Manager Programme" and "Global Unified Facilities Agreement" were expanded to better serve the Group's major Hong Kong and Mainland corporate customers. Through closer collaboration with BOC, the Group strengthened its long-term relationship with corporate customers in the Mainland. It continued to offer "Consolidated Group Credit Facilities", which allows its clients to manage credit facilities with greater flexibility. As a result, the Group's corporate loans grew strongly by 20.6% while asset quality remained sound. As regards the syndicated loan business, the Group maintained its position as the top mandated arranger in the Hong Kong-Macau syndicated loan market. During the year, the Group also expanded its IPO financing business, providing financing to corporate and retail customers in connection with the IPO of 32 companies in Hong Kong.

Strong growth in trade finance

The Group's trade finance business registered solid growth in 2010, benefiting from the rapid recovery in global trade. The Group's enhanced relationship with large corporate customers and closer business cooperation with BOC were also instrumental to the growth. Various innovative cross-border products were introduced during the year, such as the "Outward Documentary Bill and Non-Deliverable Forward", "Overseas Loan under Domestic Guarantee" and "Overseas Loan Guaranteed by Non-Resident Account Deposit". The outstanding balance of trade finance surged by 82.1%. During the year, BOCHK received "The Asian Banker Achievement Award for Trade Finance in Hong Kong" from The Asian Banker magazine in recognition of its outstanding performance and contribution in trade finance.

Breakthroughs in offshore RMB business

Leveraging its unique position and competitive advantages, the Group achieved a number of milestones in its RMB business. Following the announcement of the "Elucidation of Supervisory Principles and Operational Arrangements Regarding Renminbi Business in Hong Kong" by the Hong Kong Monetary Authority on 11 February, the Group pioneered a number of transactions in RMB business in Hong Kong, such as the granting of the first RMB export invoice finance, the first RMB import invoice finance, the first RMB working capital loan and the first RMB remittance service for dividend payout. It also underwrote the first RMB corporate bond in Hong Kong as the sole bookrunner and lead manager. In addition, the Group secured a mandate to provide custody, trustee and fund administration services to the first offshore RMB-denominated public bond fund raised in Hong Kong from retail investors.

In respect of its clearing business, the PBOC and BOCHK signed the revised "Settlement Agreement on the Clearing of Renminbi Businesses" in July, which expanded the scope of offshore RMB business and enhanced the banking flexibility in conducting offshore RMB business. In September, the Group was appointed as the RMB Agent Bank of the Hong Kong Securities Clearing Company Limited for the purposes of conducting RMB money settlement operations relating to the Central Clearing and Settlement System. Under the "Agreement on Provision of Clearing Service for RMB Banknotes Business for Taiwan" signed by the PBOC and BOCHK, the Group has provided RMB Banknotes Clearing Service to two Taiwanese banks since October 2010.

Steady development of SME business

The Group's SME business developed steadily in 2010, which was to some extent facilitated by enhanced cooperation with major industry associations to explore new targeted customers. Further support was given to local enterprises under the "SME Loan Guarantee Scheme" and "Special Loan Guarantee Scheme" launched by the Hong Kong Government. The Group launched the "Cross-boundary Usage of Credit Limit" during the year, allowing SME customers to use the same credit facilities in both the Mainland and Hong Kong. The Group signed "The Mutual Cooperation Memorandum of SME" with the SME Bureau of Guangdong Province in order to promote the development of SMEs in both the Mainland and Hong Kong. In recognition of its quality services and contribution to the SME business, the Group was honoured with the "2010 SME's Best Partner Award" for the third consecutive year by the Hong Kong Chamber of Small and Medium Business Limited.

Cash management making solid progress

The Group made solid progress in its cash management business in 2010. It enriched its products by launching a remittance service via credit card, which enables customers to send remittance overseas with their BOCHK Credit Cards and was the first of its kind in the market. A new Premium Savings Account product was also launched during the year which, by providing competitive product features to corporate customers, helped attract new savings deposits. In view of soaring demand for cross-border transactions, the Group launched the Shenzhen-Hong Kong cross-border autopay service, thus allowing customers to pay Mainland suppliers with their HKD accounts in Hong Kong. During the year, it also conducted the first RMB Overseas Direct Investment (ODI) remittance into Hong Kong and the first Foreign Direct Investment (FDI) remittance into the Mainland. Meanwhile, the Group continued to strengthen the linkage of its cash management service platform with those of BOC and its overseas branches. It expanded the remittance points of BOC Remittance Plus to about 4,000 in the Mainland and Macau. With effective marketing, the number of remittance transactions increased by 13.9% year-on-year, while the number of CBS Online customers increased by 24.4% in 2010.

Expanding foothold in custody services

Riding on its growth momentum in 2009, the Group's custody business continued to flourish in 2010. The Group successfully expanded its institutional client base and secured mandates to provide global custody services to various Qualified Domestic Institutional Investors, including major banks, fund houses and securities companies in the Mainland. The Group also promoted escrow services to personal and corporate customers. As one of the key custodians of Exchange Traded Fund ("ETF") in Hong Kong, it provided custody services for several ETFs managed by fund houses of Mainland origin. With continuous communication and sales effort, coupled with an outstanding service track record, the Group's strengths and capabilities in the global custody area became increasingly well-known among Mainland institutions seeking overseas expansion. The Group also continued to work closely with BOC to expand its customer base. At the end of 2010, total assets under the Group's custody increased by 17.5% to HK$460.1 billion versus end-2009.

Proactive measures in risk management

The Group remained highly vigilant in risk management and regarded the safeguarding of asset quality as its top priority. It closely monitored the business performance of corporate customers which were adversely affected by rising production costs in the Mainland, RMB appreciation, recent upsurge in commodity prices, emerging sovereign risks in the Euro area, etc. The forward-looking credit control system enabled the Group to exercise stringent credit control in those segments with higher risks.

MAINLAND BUSINESS

Satisfactory growth of loan and deposit businesses

The Group's Mainland business recorded satisfactory growth in 2010. Total operating income rose by 10.1% while operating expenses increased by 18.0% upon further investment in the Mainland. Total customer deposits leaped by 133.1% during 2010 while advances to customers grew by 26.2%, resulting in further improvement in the loan-to-deposit ratio. Asset quality in the Mainland remained sound, with the classified loan ratio dropping to 0.23%. During the year, a steering committee led by a Deputy Chief Executive of the Group was established to monitor the implementation of the Group's strategies for its Mainland business.

Enhancement of product spectrum and service platform in the Mainland

The Group continued to enrich its investment and wealth management product offerings in the Mainland. It partnered with a number of insurance companies to provide a comprehensive range of insurance products to personal and corporate customers. It also launched various wealth management products such as the "Floating Yield Product with Flexible Maturity", "Yi An Investment-Supported Products" and "Structured Deposits Linked with Exchange Rate", which received positive feedback. The card business also saw satisfactory development, with solid growth in the number of debit card issued since the launch of the debit card service at the end of 2009. NCB (China) further strengthened its collaboration with BOC and the Group. It proactively followed up with BOC's customers and business referrals and developed linkage with BOC's and the Group's service platforms. It also promoted different cross-border financial services, such as cross-border RMB trade settlement and financing guarantee for overseas investments, to acquire new customers with cross-border banking needs.

Further expansion of Mainland branch network

The Group further expanded its branch network in the Mainland. During the year, the Wuxi branch and Shanghai Hongqiao sub-branch of NCB (China) commenced business, bringing the Group's total number of branches and sub-branches in the Mainland to 25. Besides, with the approval of the China Banking Regulatory Commission ("CBRC"), the Group is actively preparing for the opening of the Beijing Zhongguancun sub-branch.

TREASURY

HK$'m	2010	2009
Net interest income	**4,707**	5,422
Other operating income	**1,234**	982
Operating income	**5,941**	6,404
Operating expenses	**(785)**	(742)
Operating profit before impairment allowances	**5,156**	5,662
Net reversal of impairment allowances on securities investments	**307**	1,302
Profit before taxation	**5,463**	6,964

	At 31 December 2010	At 31 December 2009
Segment assets	**910,772**	593,807
Segment liabilities	**437,174**	195,956

Note: For additional segmental information, see Note 48 to the Financial Statements.

Financial Results

Treasury segment recorded a profit before taxation of HK$5,463 million, down 21.6% year-on-year. Operating profit before impairment allowances decreased by 8.9% mainly due to the 13.2% decline in net interest income despite the increase of 25.7% in other operating income.

Net interest income fell by 13.2%, which was mainly caused by the decline in net yield of debt securities following their repricing at lower interest rates. The decrease in the segment's average balance of residual funds also led to drop in interest income as funds were redeployed to advances to customers under the Group's other segments.

Other operating income increased by 25.7%, primarily driven by the increase in net trading gain from foreign exchange activities arising from customer-related activities as well as the net gain on disposals of investment in securities. This was partially offset by the foreign exchange loss on foreign exchange swap contracts and the decline in the mark-to-market gain on certain debt securities investments.

Operating expenses went up by 5.8% as a result of higher rental costs and promotional expenses related to investment products.

Net reversal of impairment allowances on securities investment decreased by 76.4% to HK$307 million. This was because in 2009, the Group focused on reducing the overall credit risk of its investment portfolio by disposing of higher-risk securities, which led to a substantially higher reversal of impairment allowances than in 2010. Besides, improved market sentiments in 2010 also led to fewer newly-impaired securities and lower charge of impairment allowances.

Business Operation

Pursuing proactive investment strategy

The Group continued with a proactive approach in managing its banking book investments and adopted a dynamic yet prudent approach in asset and liability management. During the year, global market environment remained challenging. Market sentiments weakened and credit spread widened as a result of the European sovereignty debt crisis. In this environment, the Group's investment strategy remained focused on maintaining safety while maximising return. Taking into account the trend of market interest rates and credit spreads, investments were made in high-quality fixed-rate government-related bonds, financial institution and corporate bonds with robust fundamentals. It also controlled the overall duration of its investment portfolio to manage interest rate risks and liquidity.

As at the end of 2010, the carrying value of the Group's exposure to US non-agency RMBS was HK$1.2 billion (2009: HK$3.8 billion). In respect of the exposure to the European countries which were affected by the debt crisis, namely Portugal, Ireland, Italy, Greece and Spain, the Group only had exposure to debt securities issued by financial institutions of Ireland and Italy amounting to a total of HK$1,238 million as at the end of 2010 (2009: HK$3,217 million), and made impairment allowances of HK$56 million on those debt securities in 2010.

Focusing on traditional businesses and grasping new RMB-related business opportunities

In response to changes in the operating environment, the Group adopted a proactive approach in growing its traditional businesses related to foreign exchange and precious metals respectively and achieved satisfactory results in both areas. Meanwhile, the Group provided offshore customers with hedging products linked to foreign exchange and interest rate to meet their hedging needs. The trading volumes of RMB foreign exchange derivatives and interest rate swaps registered promising growth. To further capture RMB opportunities, the Group introduced the first offshore RMB deliverable forwards in Hong Kong.

Establishment of an asset management company

In October 2010, the Group formed BOCHK Asset Management Limited ("AML"), a wholly owned subsidiary of BOC Hong Kong (Holdings) Limited, with the aim to provide tailor-made investment solutions to customers and enhance the Group's retail sales capability. On 31 December 2010, the Group published the "BOCHK Offshore RMB Bond Index" set up by AML. This is the first offshore RMB bond index of its kind in Hong Kong that provides a reference for the performance of the offshore RMB bond market.

INSURANCE

HK$'m	2010	2009
Net interest income	**1,491**	1,271
Other operating income	**7,268**	6,486
Operating income	**8,759**	7,757
Net insurance benefits and claims	**(7,988)**	(7,286)
Net operating income	**771**	471
Operating expenses	**(213)**	(176)
Operating profit before impairment allowances	**558**	295
Net charge of impairment allowances on securities investment	**(53)**	–
Profit before taxation	**505**	295

	At 31 December 2010	At 31 December 2009
Segment assets	**48,195**	37,963
Segment liabilities	**45,149**	35,355

Note: For additional segmental information, see Note 48 to the Financial Statements.

Financial Results

The Group's Insurance segment recorded strong financial results in 2010. Profit before taxation grew by 71.2% to HK$505 million. Operating profit before impairment allowances increased by 89.2% to HK$558 million, which was mainly attributable to improved underwriting results, continued optimisation of product mix and better investment performance.

Net interest income rose by 17.3%, the bulk of which was contributed by the growth of securities investments made for the new premiums received. Other operating income grew by 12.1%, which was mainly attributable to the gain from the investment portfolio. Meanwhile, the Group's insurance product mix continued to improve with gross regular premium income increasing by 184.1% year-on-year.

Net insurance benefits and claims increased by 9.6%. The increase was mainly due to the decline in market interest rates, which also led to a corresponding increase of the mark-to-market gain of debt securities as reflected in other operating income.

A net charge of impairment allowances on securities investment of HK$53 million was made for BOC Life's debt securities investments in Ireland.

Operating expenses grew by 21.0% mainly because of the increase in staff costs, IT cost and promotional expenses.

Assets in the insurance segment grew by 27.0% with the increase in securities investments. Liabilities rose by 27.7% with the increase in insurance contractual liabilities.

Business Operation

Maintaining growth in market share and stepping up marketing effort

In 2010, the Group succeeded in maintaining the growth momentum of its insurance business and achieving good results in business development. Following the introduction of the "Need-based Selling" approach in 2009, the Group further expanded its financial planning team and enhanced its multi-channel distribution strategy. It continued with product innovation and product mix optimisation, leading to the substantial increase in gross regular premium income. In order to reinforce its corporate image, the Group launched extensive marketing initiatives, including large-scale marketing campaigns, to promote its customer-oriented services, the response to which was encouraging. The satisfactory performance of the Group's insurance business was reflected in the growth of market share and ranking. In terms of new business standard premium, BOC Life uplifted its market ranking from No. 4 in 2009 to No. 2 in 2010.

Introducing new RMB insurance products

The Group continued to offer a comprehensive range of insurance products to meet customers' diverse needs. In view of the soaring demand for RMB insurance products, the Group introduced RMB life insurance products with settlement being made in RMB, such as the "Target 8 Years Insurance Plan Series" and "Target 5 Years Insurance Plan Series". The response to these products was encouraging. Besides, a new endowment product with high flexibility, the "Multi-Plus Savings Insurance Plan", was introduced to help customers better meet their financial goals. In addition, the "Hundred Life Insurance Plan" was launched to provide comprehensive life protection coverage.

In recognition of its outstanding standard of service quality management, BOC Life was given the Silver Award under the Hong Kong Management Association's Quality Award scheme during the year.

REGULATORY DEVELOPMENT

Basel II Capital Accord

In 2007, the Group adopted the Basel II Standardised Approach to calculate statutory minimum capital requirement under Pillar One. Following the official approval by HKMA at the end of 2010, the Group has adopted the Foundation Internal Ratings-Based ("FIRB") approach to calculate its credit risk exposures from 2011 onwards. The Group's FIRB approach consists of the FIRB approach to calculate corporate and financial institutions ("FI") credit exposures as well as the Retail Internal Ratings-Based ("RIRB") approach to calculate retail credit exposures which include the Retail Small and Medium-sized ("SME") business. Both are more risk-sensitive approaches for calculating the regulatory capital requirements. During the past three years, the Group completed the implementation of the internal rating systems for all its significant credit exposures, and successfully integrated them into the Group's credit business process and credit risk management practices. The estimates of risk components generated by the two-dimensional internal rating system, i.e., the Probability of Default ("PD") and the Loss Given Default ("LGD") and hence the Expected Loss ("EL"), are playing a major role in credit approval, credit monitoring and credit reporting to the Group's management. The Group plans to develop the AIRB approach for its corporate and FI credit exposures in 2011 and gradually upgrade its current FIRB approach to the AIRB approach in its risk management system in 2012 and the subsequent years. Going forward, these internal rating-based systems will serve as key inputs to the calculation of regulatory capital for credit risk and form the key foundation for decision-making, monitoring and reporting on credit, thereby further advancing the Group's risk management practices.

Under Pillar Two of the Basel II Capital Accord, the Group has implemented and reviewed its internal capital adequacy assessment process ("ICAAP") to better align the Group's business strategies with regulatory requirements. While the scope of risk measurement was widened and calculation methodologies were refined, forward looking factors were also incorporated to provide a more comprehensive and precise assessment of risk profile to reflect the Group's risk appetite and capital needs in the future.

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 2010 were in compliance with the requirements set out in the Disclosure Rules.

With the issuance of Basel III rules by the Basel Committee on Banking Supervision, the Group has established a task force for complying with the new Basel III requirements.

HUMAN RESOURCES, TECHNOLOGY AND OPERATIONS

Human Resources

The Group values human resources as its most important assets. It consistently enforces a well-structured human resources system in order to achieve long-term business growth and realise its strategic goals. During the year, the Group focused on the all-round talent management strategy, namely, "Selection, Deployment, Development and Retention". It put forward various measures to enhance the Group's overall staff quality. The Group also continued to refine its staff performance measurement system to enhance its performance-driven corporate culture. At the same time, the Group put forward its mid-term human resources strategies for 2010-2014 which will form the blueprint for human resources development to improve manpower structure, staff quality, efficiency and productivity.

In 2010, the Group performed an in-depth review on its remuneration and incentive mechanism, which covers variable remuneration mechanism, performance management mechanism and incentive schemes. A steering committee led by the Chief Executive of the Group was established to monitor the revamp of the remuneration and incentive mechanism. This review helped reinforce the Group's risk management by integrating risk factors into the remuneration and incentive mechanism. The Group continued to provide comprehensive training programmes for all levels of staff. Executive development programmes conducted jointly with reputable universities were organised for the senior management and selected staff to enhance their leadership skills and strategic mindset. Major training activities included a series of workshops and seminars covering risk management, legal and compliance topics, corporate governance, corporate culture, sales and services, skills development and leadership development. At the same time, the Group continued to optimise the training and development framework for the frontline staff to upgrade their sales techniques and capability to comply with new selling regulatory requirements. An e-learning platform is available as a supplementary channel for staff training.

Technology and operations

In 2010, the Group continued to strengthen its information technology infrastructure to support business growth and enhance risk management. Several major projects were completed during the year. With the launch of "Mobile Banking", a new electronic service platform is made available to facilitate fund transfer, bill payment and investment transactions. The Sales Management Platform was launched to automate the sales process for investment products, enable the mitigation of operational risk via reduced human errors, and provide stringent control over the sales process for meeting compliance requirements. The Cash Management platform was further strengthened with enhanced corporate deposit products, liquidity management and RMB services. With the implementation of the Basel II Capital Accord, the analytical capability and the application level for the performance rating model was enhanced, and the functionalities of the Capital Adequacy Ratio calculation engine were also optimised. The brand new automated underwriting system also helped BOC Life improve risk assessment and uplift operation efficiency. The Group also participated in various projects to enhance synergies within the BOC Group, such as the "BOC Wealth Express Card".

CREDIT RATINGS

As at 31 December 2010	Long-term	Short-term
Fitch	A	F1
Moody's	Aa3	P-1
Standard & Poor's	A-	A-2

As at 31 December 2010, 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 upgraded to '1' from '2' on May 5, 2010.

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. The Bank 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 risks inherent in the Group's businesses are credit risk, interest rate risk, market risk, liquidity risk, operational risk, reputation risk, legal and compliance risk, and strategic 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 all business processes and ensure various risks are properly managed and controlled in the course of conducting business. The Group has a robust risk management organisational structure with 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 the formulation of risk management strategies and for 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 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 for 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, NCB (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

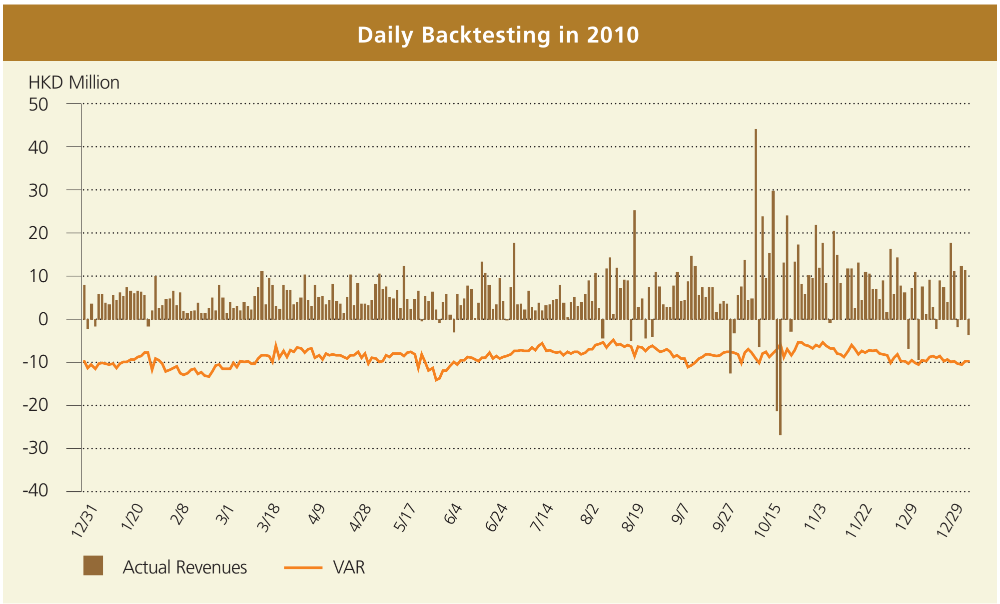
Credit risk is the risk that a customer or counterparty will be unable to or unwilling to meet their obligations under a contract. It arises principally from lending, trade finance and treasury businesses, and covers inter-bank transactions, foreign exchange and derivative transactions as well as investments in bonds and securities. For details of the Group's Credit Risk Management, please refer to Note 4.1 to the Financial Statements in this Annual Report.

Market Risk Management

Market risk refers to the risk of losses arising from adverse movements in the value of foreign exchange and commodity positions and the trading book interest rate and equity positions held by the Group due to the volatility of financial market price (debt security price/interest rate, foreign exchange rate, equity price, commodity price). The Group adopts robust market risk appetite to achieve balance between risk and return.

The Group 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. The Group adopts a uniform VAR calculation model, using historical simulation approach and 2-year historical data, to calculate VAR of the Group and subsidiaries over 1-day holding period with 99% confidence level, and set up VAR limit of the Group and subsidiaries.

The predictive power of the VAR measure is monitored by back-testing, 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. Generally speaking, the number of back-testing exceptions in a rolling 12-month period will not exceed four times, given a 99% confidence level. BOCHK conducts back-testing on a monthly basis and the graph below shows the back-testing result of the trading VAR of BOCHK.



There are 3 actual losses exceeding the VAR estimate for BOCHK in 2010. The exceptions of the back-testing mainly resulted from intra-day trading loss of RMB spot position.

For details of the Group's Market Risk Management, please refer to Note 4.2 to the Financial Statements in this Annual Report.

Interest Rate Risk Management

Interest rate risk is the risk to a bank's earnings and economic value arising from adverse movements in interest rate and term structures of the bank's asset and liability positions. The Group's interest rate risk exposures are mainly structural. The major types of interest rate risk from structural positions are re-pricing risk, basis risk, yield curve risk and option risk. For details of the Group's Interest Rate Risk Management, please refer to Note 4.2 to the Financial Statements in this Annual Report.

Liquidity Risk Management

Liquidity risk is the risk that banks fail to provide sufficient funds to grow assets or pay the due obligations, and need to bear an unacceptable loss. The Group follows the sound liquidity risk appetite to provide stable, reliable and adequate sources of cash to meet liquidity needs under both normal circumstances and stressed scenarios; and survive with net positive cumulative cash flow in extreme scenarios, without requesting HKMA to act as the lender of last resort. For details about Liquidity Risk Management, please refer to the Note 4.3 to the Financial Statements in this Annual Report.

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 risk is inherent in every aspect of business operations and confronted by the Bank in its day to day operational activities.

The Group has put in place an effective internal control process which requires the establishment of policies and control procedures for all the key activities. Proper segregation of duties and authorisation is the fundamental principle followed by the Group. Corporate-level policy and procedure on operational risk management are formulated by Operational Risk & Compliance Department ("OR&CD") and approved by RC.

The Group has adopted the "Three Lines of Defence" model for its operational risk management governance structure: all departments as the first line of defence are the owner of operational risk and are responsible for carrying out the duties and functions of self risk control in the process of business operation through self assessment, self checking and self correction. OR&CD together with certain specialist functional units in relation to operational risk management within the Group are the second line of defence, which is responsible for assessing and monitoring the operational risk condition of the first line of defence, and providing them with guidance. In addition to formulating the operational risk management policy and procedure, OR&CD, being independent from business units, is the central management unit of the Group's operational risk management and also responsible for designing the operational risk assessment methodologies, tools and the reporting mechanism (including the capturing of data on operational risk events loss), monitoring the implementation status of policies and operational procedures in the departments of the first line of defence through operational risk management tools, and assessing and reporting the overall operational risk position to Management and RC. Certain specialist functional units, including the Human Resources Department, Information Technology Department, Corporate Services Department, OR&CD, Financial Management Department and General Accounting & Accounting Policy Department, are required to carry out their managerial duties of the second line of defence with respect to some specific aspects of operational risk. Besides taking charge of operational risk management in their own units, these units are also required to provide other units with professional advice/training in respect of certain operational risk categories and to lead the corporate-level operational risk management. Audit Department is the third line of defence which provides independent assessment with respect to the operational risk management framework and is required to conduct periodic audit of the operational risk management activities of various departments/business units within the Group regarding their compliance and effectiveness and to put forward recommendations for corrective actions.

The Group adopts the tools or methodologies such as key risk indicators, self-assessment, operational risk events reporting and review to identify, assess, monitor and control the risks inherent in business activities and products, as well as takes out insurance to mitigate unforeseeable operational risks. Business continuity plans are in place to support business operations in the event of an 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.

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 OR&CD headed by a General Manager who reports to CRO.

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 the Group's capital management is to maximise total shareholders' return while maintaining a capital adequacy position in relation to the Group's overall risk profile. The Group periodically reviews its capital structure and adjusts the capital mix where appropriate. ALCO monitors the Group's capital adequacy. The Group has complied with all the statutory capital standards for the reported periods.

To comply with HKMA's requirements as stated in the Supervisory Policy Manual "Supervisory Review Process", the Group has established the Internal Capital Adequacy Assessment Process (ICAAP) and reviews it annually. Using the statutory minimum CAR, 8%, as a starting point, extra capital (capital add-on) needed to cover the risks not captured under Pillar I is assessed. A Scorecard approach based on HKMA's compliance guidance on Pillar II has been used to evaluate the Group's risk profile in order to assess the add-on capital in Pillar II to the minimum regulatory capital calculated under Pillar I to 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 view of the envisaged adoption of Foundation Internal Ratings-Based approach ("FIRB"), the minimum CAR and the Operating CAR Range for 2010 are determined based on both Standardised approach and FIRB approach with the consideration of the possible impact of Basel III.

Taking advantage of market conditions, the Group had successfully issued subordinated notes in 2010 to repay the US Dollar Subordinated Credit Facility granted by Bank of China.

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 by various risk management units and the ALCO monitors the results against limits approved by RC. The Financial Management Department reports the combined stress test results to the Board and RC regularly.

BOC Life Insurance

BOC Life's principal business activity is the underwriting of long-term insurance business in life and annuity, unit-linked long-term business and retirement scheme management in Hong Kong. Major types of risk arising from the BOC Life's insurance business are insurance risk, interest rate risk, liquidity risk and credit risk. BOC Life closely monitors these risks and reports to its 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 to 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 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, BOC Life has a retention limit on any single life insured. BOC Life cedes the excess of the insured benefit over the limit for standard risks (from a medical point of view) to reinsurer under an excess of loss reinsurance arrangement.

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.

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.

Liquidity Risk Management

Liquidity risk is the risk of not being able to fund increases in assets or meet obligations as they fall due without incurring unacceptable loss. BOC Life's asset liability matching framework includes cash flow management 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.

Credit Risk Management

BOC Life has exposure to credit risk, which is the risk that a customer or counterparty will be unable to or unwilling to meet a commitment that they have entered into. 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)
- Re-insurers' 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 Investment Management 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.