

CORPORATE GOVERNANCE

The Company is **committed to maintaining and upholding good corporate governance** in order to protect the interests of shareholders, customers and staff. The Company abides strictly by the laws and regulations of the jurisdiction where it operates, and observes the guidelines and rules issued by regulatory authorities such as the Hong Kong Monetary Authority, the Hong Kong Securities and Futures Commission and The Stock Exchange of Hong Kong. The Company also keeps its corporate governance system under constant review to ensure that it is in line with international and local best practices.

The Company is **in full compliance with all the provisions of the Code on Corporate Governance Practices** (the “Code”) as appended to the Listing Rules of Hong Kong. It also **complies with nearly all the recommended best practices** set out in the Code. In particular, the Company **publishes quarterly financial and business reviews** so that shareholders can be better updated of the performance, financial position and prospects of the Company. BOCHK, the Company’s wholly-owned and principal operating subsidiary, is in full compliance with the guideline in the Supervisory Policy Manual module CG-1 issued by the Hong Kong Monetary Authority and entitled “Corporate Governance of Locally Incorporated Authorised Institutions”.

Corporate Governance Framework

The **Board is at the core of the Company’s corporate governance framework**, and there is **clear division of responsibilities between the Board and the Management**. The Board is responsible for providing high-level guidance and effective oversight of the Management. Generally, the Board is responsible for:

- formulating the Group’s mid and long-term strategy and monitoring the implementation thereof;
- reviewing and approving the annual business plan and financial budget;
- approving the annual, interim and quarterly reports;
- reviewing and monitoring risk management and internal control;
- ensuring good corporate governance and effective compliance; and
- monitoring the performance of the Management.

The Board authorises the Management to execute strategies that have been approved. The Management reports to the Board and is responsible for the day-to-day operation of the Group. **The Board has formulated clear written guidelines, which stipulate the circumstances under which the Management should report to and obtain prior approval from the Board** before making decisions or entering into any commitments on behalf of the Group. The Board will regularly review these guidelines.

To avoid the concentration of power in any single individual, the **positions of the Chairman and the Chief Executive are held by two different individuals. Their roles are distinct and are clearly established and stipulated in the Board’s Mandate**. In short, the Chairman is responsible for ensuring that the Board properly discharges its responsibilities and conforms to good corporate governance practices and procedures. As the Chairman of the Board, he is also responsible for making sure that all Directors are properly briefed on

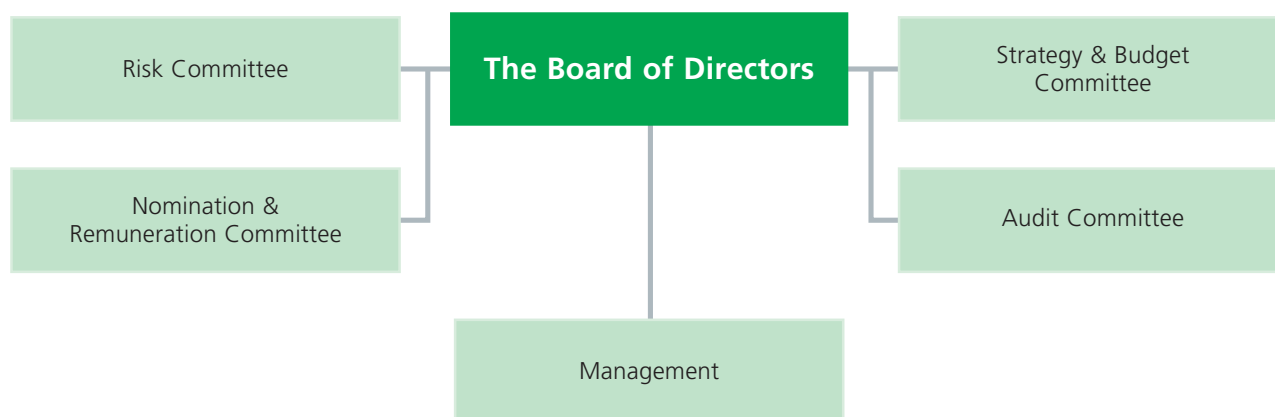
issues arising at the board meetings, and that all Directors receive accurate, timely and clear information. The Chief Executive is responsible for providing leadership for the whole Management and implementing the important policies and development strategies approved by the Board.

Taking into consideration market practices and international best practices in corporate governance, **the Board has established four standing Board Committees** to assist it in carrying out its responsibilities. They are the Audit Committee, Nomination and Remuneration Committee, Risk Committee, and Strategy and Budget Committee. Should the need arise, the Board will authorise an independent board committee comprising all the independent non-executive Directors to review, approve and monitor connected transactions (including the continuing connected transactions) that should be approved by the Board.

Each of the Board Committees has a well-defined mandate. They make recommendations to the Board on relevant matters within their terms of reference, or make decisions under appropriate circumstances in accordance with the power delegated by the Board. **A secretarial department is assigned to provide support services to each Board Committee so that it can discharge its responsibilities properly and effectively**. The Board and Board Committees will participate in the annual performance appraisal of the secretarial departments to ensure the support services provided by these departments are adequate and of good quality. According to their mandates, **the Board and the Board Committees will review and evaluate their respective work process and effectiveness annually, with a view to identifying areas for improvement**.

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The following chart sets out the Company's corporate governance framework.



The Company's corporate website (www.bochk.com) contains detailed information on the Company's corporate governance principles and framework, the compositions of the Board and Board Committees and a summary of their respective terms of reference, shareholders' rights and the Company's Fair Disclosure Policy.

Board of Directors

Non-executive Directors and independent non-executive Directors form the majority of the Board. This structure ensures the independence and objectivity of the Board's decision-making process as well as the thoroughness and impartiality of the Board's oversight of the Management. The Board acts honestly and in good faith in order to maximise long-term shareholder value and fulfill its corporate responsibility to other stakeholders of the Group. Its decisions are made objectively and in the best interests of the Group.

The Board currently has 12 members, comprising five independent non-executive Directors, five Non-executive Directors and two Executive Directors. Mdm. Yang Linda Tsao retired as an independent non-executive Director of the Company with effect from 21 May 2010. Save as disclosed above,

there was no other change to the composition of the Board in 2010 and up to the date of this report.

All Directors possess extensive experience in banking and management, and over one third of them are independent non-executive Directors, of whom several are experts in financial and/or risk management. The Board has adopted the "Policy on Independence of Directors" (the "Independence Policy") which stipulates the criteria on independence of independent non-executive Directors. The Company has received from each of the independent non-executive Directors an annual confirmation of his/her independence by reference to the Independence Policy. In particular, two of the independent non-executive Directors, namely, Dr. Fung Victor Kwok King and Mr. Shan Weijian, who were appointed in 2002, will retire by rotation at the forthcoming annual general meeting and, being eligible, offer themselves for re-election pursuant to the Articles of Association. Their term of office will be more than 9 years if they are re-elected at the forthcoming annual general meeting for a further term of approximately 3 years. On the basis of the information available to it, the Company considers all of the

Independent Non-executive Directors to be independent. Biographical details of the Directors are set out in the "Board of Directors and Senior Management" section of this Annual Report and the Company's website at www.bochk.com.

All the existing **Non-executive Directors and independent non-executive Directors** of the Company have been **appointed for a fixed term, with formal letters of appointment** setting out the key terms and conditions of their appointment. Pursuant to the Articles of Association, all Directors, including the Chairman, Vice Chairmen and Chief Executive, shall retire by rotation at least once every three years at annual general meetings and be eligible for re-election. Accordingly, Mr. He Guangbei, Mr Li Zaohang, Dr. Fung Victor Kwok King and Mr. Shan Weijian will retire by rotation at the forthcoming annual general meeting and, being eligible, offer themselves for re-election. Further details regarding proposed re-election of Directors are set out in the section headed "Report of the Directors" of this Annual Report. The Nomination and Remuneration Committee has also established a **written and formal process for the appointment of independent**

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non-executive Directors to ensure that the appointment procedures are standardised, thorough and transparent.

There is **no relationship (including financial, business, family or other material/relevant relationship(s)) among the Board members.** Messrs. Xiao Gang, Li Lihui, Li Zaohang and Zhou Zaiqun are Executive directors of BOC. Mdm. Zhang Yanling is a former executive vice-president of BOC (she ceased to be an executive vice-president of BOC on 23 July 2010). It is expressly provided in the Board's Mandate that, unless permissible under applicable laws or regulations, if a substantial shareholder or Director has a conflict of interest in the matter to be considered by the Board, a Board meeting attended by independent non-executive Directors who have no material interest in the matter shall be held to deliberate on the same.

The Company has arranged for **appropriate Directors' Liability Insurance Policy to indemnify the Directors for liabilities arising out of corporate activities.** The coverage and the sum insured under the policy are reviewed annually.

To ensure that newly appointed Directors have adequate understanding of the Company's business and operation, and to enable current Directors to constantly update their skills and knowledge so that they can continue to offer informed advice and contribute to the Board, the Board enforces a **formal system for the initial induction and ongoing professional development of the Directors.** In 2010, the Board invited Mr. Koh Beng Seng, the Chairman of the Risk Committee of the Company with extensive experiences in supervision of financial sector, to share with members of the Board and senior management the risk appetite setting of the banks.

Seven Board meetings were held during the year with an average attendance rate of 95%. The meeting schedule was prepared and approved by the Board in the preceding year. In general, Board agenda and meeting materials are despatched to all Board members for review at least seven days before the meetings. Board agenda is approved by the Chairman following consultation with other Board members and the Management. As a general practice, the Chairman will meet all Non-executive Directors (including independent non-executive Directors) in the absence of Executive Directors and the Management at the beginning of each Board meeting, in order to facilitate an open and frank discussion among the Non-executive Directors. This practice has been incorporated in the Working Rules of the Board. Individual attendance records of the Directors in 2010 are set out as follows:

Director	Number of Board meetings attended	Attendance rate
<i>Non-executive Directors</i>		
Mr. XIAO Gang (<i>Chairman</i>)	6 out of 7	86%
Mr. LI Lihui (<i>Vice Chairman</i>)	7 out of 7	100%
Mr. LI Zaohang	6 out of 7	86%
Mr. ZHOU Zaiqun	7 out of 7	100%
Mdm. ZHANG Yanling	7 out of 7	100%
<i>Independent Non-executive Directors</i>		
Dr. FUNG Victor Kwok King	6 out of 7	86%
Mr. KOH Beng Seng	7 out of 7	100%
Mr. SHAN Weijian	7 out of 7	100%
Mr. TUNG Chee Chen	6 out of 7	86%
Mr. TUNG Savio Wai-Hok	7 out of 7	100%
Mdm. YANG Linda Tsao (<i>Note</i>)	4 out of 4	100%
<i>Executive Directors</i>		
Mr. HE Guangbei (<i>Vice Chairman and Chief Executive</i>)	7 out of 7	100%
Mr. GAO Yingxin	6 out of 7	86%

Note: Mdm. Yang Linda Tsao retired as an Independent Non-executive Director with effect from 21 May 2010.

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Apart from formal Board meetings and general meetings, there are opportunities for the Board and the Management to interact and communicate on relatively less formal occasions. For example, **Board members have been invited to give a talk to the Company's middle to senior management on diverse subjects leveraging on their respective background and expertise.** Further, **off-site events have been held to enhance communication among Board members, and between the Board and the Management.**

Audit Committee

The Audit Committee currently has six members (with Mdm. Yang Linda Tsao retired in May 2010), comprising one Non-executive Director and all the five independent non-executive Directors. Independent non-executive Directors make up 83% of the Committee members. The Committee is chaired by Mr. Shan Weijian, an independent non-executive Director.

The Committee assists the Board in fulfilling its oversight role over the Company and its subsidiaries in, among others, the following areas:

- integrity of financial statements and financial reporting process;
- internal control systems;
- effectiveness of internal audit function and performance appraisal of the Head of Internal Audit;
- appointment of external auditor and assessment of their qualifications, independence and performance

and, with authorisation of the Board, determination of their remuneration;

- periodic review and annual audit of the Company's and the Group's financial statements, and financial and business review;
- compliance with applicable accounting standards as well as legal and regulatory requirements on financial disclosures; and
- corporate governance framework of the Group and implementation thereof.

The work performed by the Audit Committee in 2010 included the review and, where applicable, approval of:

- the Company's Directors' Report and financial statements for the year ended 31 December 2009 and the annual results announcement that were recommended to the Board for approval;
- the Company's interim financial statements for the six months ended 30 June 2010 and the interim results announcement that were recommended to the Board for approval;
- the Company's announcement on quarterly financial and business review for the period ended 31 March 2010 and 30 September 2010 that were recommended to the Board for approval;
- the audit reports and report on internal control recommendations

submitted by the external auditor, and the on-site examination reports issued by regulators;

- the re-appointment of external auditor, the fees payable to external auditor for the annual audit, interim review and other non-audit services;
- the Group's internal audit plan for 2010 and key issues identified;
- the deployment of human resources and pay level of the Internal Audit, and the department's budget for 2010; and
- the 2010 key performance indicators for and 2009 performance appraisal of the Head of Internal Audit and the Internal Audit Department.

The "Policy on Staff Reporting of Irregularities" adopted by the Board has proved to be effective. Last year, reports on a number of cases were received and handled satisfactorily through the channels and procedures set out in the said Policy.

Pursuant to paragraph C.2 of the Code, the Audit Committee conducted an annual review of the effectiveness of the internal control systems of the Group in 2010. This review covered all material controls, including financial, operational and compliance controls as well as risk management. The review also considers the adequacy of resources, staff qualifications and experience and training of the Group's accounting and financial reporting functions. For detailed information on this topic, please refer to the "Internal Control" section below.

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Six Audit Committee meetings were held during the year with an average attendance rate of 90%. Individual attendance records of the relevant Directors are set out as follows:

Director	Number of committee meetings attended	Attendance rate
Mr. SHAN Weijian (<i>Chairman</i>)	6 out of 6	100%
Mr. ZHOU Zaiqun	5 out of 6	83%
Dr. FUNG Victor Kwok King	5 out of 6	83%
Mr. KOH Beng Seng	5 out of 6	83%
Mr. TUNG Chee Chen	5 out of 6	83%
Mr. TUNG Savio Wai-Hok	6 out of 6	100%
Mdm. YANG Linda Tsao (<i>Note</i>)	4 out of 4	100%

Note: Mdm. Yang Linda Tsao retired and resigned as an Independent Non-executive Director and a member of the Audit Committee with effect from 21 May 2010. The Independent Non-executive Directors nevertheless make up the majority of the Committee members, and the independence of the Committee is not affected by the relevant change.

Nomination and Remuneration Committee

The Nomination and Remuneration Committee currently has five members (with Mdm. Yang Linda Tsao retired in May 2010) comprising two Non-executive Directors and three independent non-executive Directors. The independent non-executive Directors represent 60% of the Committee members. The Committee is chaired by Mr. Li Lihui, Vice-chairman of the Board.

The Committee assists the Board in fulfilling its oversight role over the Company and its subsidiaries in, among others, the following areas:

- overall human resources, remuneration strategy and incentive framework of the Group;
- selection and nomination of Directors, Board Committee members and certain senior executives as designated by the Board from time to time;
- structure, size and composition (including skills, experience and knowledge) of Directors and Board Committee members;

- remuneration of Directors, Board Committee members, designated senior management and key personnel, and
- effectiveness of the Board and Board Committees.

The work performed by the Committee in 2010 included the review and where applicable, approval of:

- performance appraisal of the Executive Director and designated senior executives for year 2009;
- proposal on staff bonus for year 2009 and salary adjustment for year 2010 for the Group, including the designated senior executives;
- key performance indicators of the Group and the designated senior executives for year 2010;
- proposal on human resources budget of the Group for year 2011;
- reform proposals related to the implementation of HKMA's "Guideline on a Sound Remuneration System";
- implementation progress of the Group's medium-term human

resources strategies and other major human resources policies;

- reports on self-evaluation of the Board and Board Committees, which were analysed by the Committee. The Committee also made recommendations to the Board regarding the results of the self-evaluation, with a view to further enhancing the role and effectiveness of the Board and Board Committees;
- formulation, review and amendment on major HR and compensation policies; and
- matters relating to the appointment of directors to the boards of certain major subsidiaries of the Group.

Pursuant to the "Policy on Directors' Remuneration" adopted by the Company, in recommending the remuneration of Directors, the Committee makes reference to companies of comparable business type or scale, and the nature and quantity of work at both Board and Board Committee levels (including frequency of meetings and nature of agenda items) in order to compensate

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Directors reasonably for their time and efforts spent. **No individual Director is allowed to participate in the procedures for deciding his/her individual remuneration package.** Information relating to

the remuneration of each Director for 2010 is set out in Note 21 of the financial statement of the 2010 Annual Report. The present scale of Director's fees, including additional fees for membership of Board Committees, is given below:

Board of Directors:		
All Directors		HK\$200,000 p.a.
Board Committees:		
Chairman		HK\$100,000 p.a.
Other Committee members		HK\$50,000 p.a.

Note: For the year ended 31 December 2010, all five Non-executive Directors waived their Director's fee mentioned above.

The **Nomination and Remuneration Committee** also has the delegated responsibility to **determine the specific remuneration packages of the Executive Directors and designated senior executives and review the remuneration and incentive mechanism of the Group.** Please refer to the section headed "Remuneration and Incentive Mechanism" in this Corporate Governance Report for further details.

Six Nomination and Remuneration Committee meetings were held during the year with an average attendance rate of 86%. Individual attendance records of the relevant Directors are set out as follows:

Director	Number of committee meetings attended	Attendance rate
Mr. LI Lihui (<i>Chairman</i>)	6 out of 6	100%
Mr. LI Zaohang	5 out of 6	83%
Dr. FUNG Victor Kwok King	4 out of 6	67%
Mr. SHAN Weijian	5 out of 6	83%
Mr. TUNG Chee Chen	5 out of 6	83%
Mdm. YANG Linda Tsao (<i>Note</i>)	3 out of 3	100%

Note: Mdm. Yang Linda Tsao retired as a member of Nomination and Remuneration Committee with effect from 21 May 2010.

Risk Committee

The Risk Committee has four members in 2010. Two of them are independent non-executive Directors and two are Non-executive Directors. The Committee is chaired by Mr. Koh Beng Seng, an independent non-executive Director.

The Committee assists the Board in fulfilling its oversight role over the Company and its subsidiaries in, among others, the following areas:

- formulation of the risk appetite and risk management strategy of the

Group, and determination of the Group's risk profile;

- identification, assessment and management of material risks faced by the various business units of the Group;
- review and assessment of the adequacy of the Group's risk management policies, system and internal control;
- review and monitoring of the Group's capital management;

- review of the Group's target balance sheet;

- review and monitoring of the Group's compliance with the risk management policies, system and internal control, including the Group's compliance with prudential, legal and regulatory requirements governing the business of the Group;
- review and approval of high-level risk-related policies of the Group;

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- review of significant or high risk exposures and transactions; and
- review of key reports, including risk exposure reports, model development and validation reports, and credit risk model performance reports.

The work performed by the Committee in 2010 included the following:

- review/approval of policies, including the “Group’s Operating Principles”, the “Risk Management Policy Statement”, the “Requirements Relating to the Approval, Formulation, Review and Revision of Risk Management Policies and Procedures”, the “Capital Management Policy of BOCHK”,

the “Staff Code of Conduct”, the “Policy for Validating Internal Rating Systems”, the “Connected Transactions Management Policy”, and a range of risk management policies covering strategic risk, credit risk, market risk, interest rate risk, operational risk, legal, compliance and reputation risk and stress testing;

- review/approval of the risk adjustment method for group bonus funding mechanics;
- review of the Group’s operating plan, including the Group’s target balance sheet, the Bank’s banking book investment plan and portfolio key risk indicators, as well as risk management limits;

- review and monitoring of Basel II implementation, including approval of FIRB models, review of model validation reports, receiving the implementation progress reports of FIRB, IMA and ICAAP, as well as the status reports of the allocation of risk-weighted assets;

- review of various periodic risk management reports; and

- review of significant high risk exposures and transactions.

Seven Risk Committee meetings were held during the year with an average attendance rate of 96%.

Individual attendance records of the relevant Directors are set out as follows:

Director	Number of committee meetings attended	Attendance rate
Mr. KOH Beng Seng (<i>Chairman</i>)	7 out of 7	100%
Mr. TUNG Savio Wai-Hok	7 out of 7	100%
Mdm. ZHANG Yanling	7 out of 7	100%
Mr. LI Zaohang	6 out of 7	86%

Strategy and Budget Committee

The Strategy and Budget Committee currently comprised four members: one independent non-executive Director, two Non-executive Directors, and the Chief Executive, who is an Executive Director. The Committee was chaired by Mdm. Yang Linda Tsao, an independent non-executive Director who retired with effect from 21 May 2010. Thereafter the number of members of the Strategy and Budget Committee was reduced from five to four and the Committee is then chaired by Mr. Zhou Zaiqun, a Non-executive Director.

The Committee assists the Board in fulfilling its oversight role over the Company and its subsidiaries in, among others, the following areas:

- draft, review, motion, and monitor the Group’s medium to long-term strategy;
- draft and review the process for formulating the Group’s medium to long-term strategy to ensure that they are sufficiently robust to take into account a range of alternatives;
- monitor implementation of the Group’s medium to long-term strategy through pre-determined metrics and provide guidance to Management;
- review and monitor the Group’s regular/periodic (including annual) business plan and financial budget; and
- make recommendations to the Board on major capital expenditures, merger & acquisition and strategic commitments of the Group and monitor implementation of the same.

During the year, the Strategy and Budget Committee guided and monitored the Management’s implementation of the Group’s annual business strategy. The Committee also played a prominent role in driving the formulation and implementation of the Group’s key business strategies, including those for the development of China business, RMB business, etc. In particular, the Committee guided the Management to consummate the medium to long-term rolling

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strategic plan of the Group as it faced new opportunities and threats arising from the new operating environment. Furthermore, the Committee monitored the implementation of the Group's

budget and business plan for 2010. In planning for 2011, the Committee reviewed and endorsed the Group's financial budget and business plan, and recommended to the Board for approval.

Seven Strategy and Budget Committee meetings were held during the year with an average attendance rate of 100%. Individual attendance records of the relevant Directors are set out as follows:

Director	Number of committee meetings attended	Attendance rate
Mdm. YANG Linda Tsao (<i>Former Chairlady</i>) (Note 1)	4 out of 4	100%
Mr. ZHOU Zaiqun (<i>Chairman</i>) (Note 2)	7 out of 7	100%
Mr. HE Guangbei	7 out of 7	100%
Mdm. ZHANG Yanling	7 out of 7	100%
Mr. TUNG Savio Wai-Hok	7 out of 7	100%

Note 1: Mdm. Yang Linda Tsao retired as Chairlady of Strategy and Budget Committee with effect from 21 May 2010

Note 2: Mr. Zhou Zaiqun was appointed as Chairman of Strategy and Budget Committee with effect from 21 May 2010

Ad Hoc Committee

The Board established ad hoc Independent Board Committee during the year with details as follow:

Independent Board Committee

An Independent Board Committee was set up in January 2010 to review and approve the terms and conditions of the appointment of BOCI, an associate of BOC, as one of the joint lead managers in relation to issue of subordinated notes by BOCHK in February and April 2010 to qualified institutional buyers in reliance on certain exemption from the registration requirements of the U.S. Securities Act of 1933. The Committee comprised all the independent non-executive Directors of the Company at the material time and was chaired by Mr. Tung Chee Chen. The appointment was exempted from compliance with relevant requirements under the Listing Rules but the Independent Board Committee was still set up for good corporate governance. As the terms and conditions for BOCI's appointment are consistent with those for the appointment of other two joint lead managers who are independent third parties, the Independent Board Committee considered that the appointment was fair and reasonable,

on normal commercial terms and was in the interests of the Company and its shareholders taken as a whole.

An Independent Board Committee was set up in May 2010 to review and approve the continuing connected transactions between the Group on the one hand and BOC and its associates on the other hand, for the three financial years ending 31 December 2013. The Committee comprised all the independent non-executive Directors and was chaired by Mr. Tung Chee Chen. The Committee has engaged KBC Bank N.V. as the independent financial adviser for the purpose of reviewing the continuing connected transactions. On the basis of KBC Bank N.V.'s advice, the Committee has been satisfied that the continuing connected transactions were conducted in the ordinary and usual course of business of the Group and the continuing connected transactions and the annual caps imposed on such transactions for the three years 2011-2013 are in the interests of the Company and its shareholders as a whole and are fair and reasonable so far as the independent shareholders are concerned. As the annual caps for certain categories of continuing connected transactions represent more

than 5% of the applicable percentage ratios as defined in the Listing Rules, such transactions are subject to the approval of the independent shareholders of the Company. For such purpose, an extraordinary general meeting is scheduled to be held immediately after the annual general meeting of the Company on 25 May 2011. Shareholders please refer to the circular issued by the Company dated 20 January 2011 and notice of the extraordinary general meeting issued by the Company in April 2011 for details on the continuing connected transactions and the extraordinary general meeting. Shareholders can also view and download the aforesaid documents from the Company's website at www.bochk.com.

Directors' Securities Transactions

The Company has adopted the "Code for Securities Transactions by Directors" to govern securities transactions by Directors. The terms of the said Code are more stringent than the mandatory standards set out in the "Model Code for Securities Transactions by Directors of Listed Issuers" contained in Appendix 10 of the Listing Rules. Apart from the securities of the Company, the

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Code applies equally to the Director's dealings in the securities of BOC which was listed on the Stock Exchange of Hong Kong in June 2006. In this connection, the Company had made specific enquiry of all Directors, who confirmed that they had complied with the standards set out in both the Company's Code and the said Model Code throughout year 2010, with the following exception. On 25 June 2010, without the knowledge of Mr. Zhou Zaiqun who was on a business trip, or any prior consultation with him, his wife caused 500 shares in the Company held by him in an account jointly controlled by him and her to be sold. The number of shares sold represented only 0.05% of his interests in shares/underlying shares of the Company and only 0.000005% of the issued share capital of the Company. The sale did not take place during the "black out" period for Directors' dealing in securities in the Company. At the time Mr. Zhou did not have any material non-public price-sensitive information relating to securities in the Company. As Mr. Zhou was unaware of the sale of the 500 shares, he could not, and did not, seek any approval for the sale and did not disclose it pursuant to the requirements set out in the Company's Code (and the Model Code). Mr. Zhou only learnt for the first time about the sale of the shares on 26 July 2010, whereupon he immediately brought the matter to the attention of the Management of the Company.

Remuneration and Incentive Mechanism

The Remuneration and Incentive Mechanism of the Group is based on the principles of "effective motivation" and "sound remuneration management". It links remuneration, performance and risk management tightly, and encourages staff to enhance their performance and at the same time strengthen their mindset of risk management so as to achieve sound remuneration management.

- **The Determination of the Remuneration Policy**

To fulfill the above-mentioned principles and to facilitate effective

risk management within the framework of the Remuneration Policy of the Group, the Remuneration Policy of the Group is initiated by Human Resources Department with consultation of the risk control units including Risk Management, Financial Management and Compliance in order to balance the needs for staff motivations, sound remuneration and prudent risk management. After the proposed Remuneration Policy is cleared with the Management Committee, it will be submitted to the Nomination and Remuneration Committee for review and thereafter to the Board of Directors for approval. Nomination and Remuneration Committee and the Board of Directors will seek opinions of other Board committees (e.g. Risk Committee, Audit Committee, etc.) where they consider necessary under the circumstances.

- **The Key Features of the Remuneration and Incentive Mechanism**

1. *Performance Management Mechanism*

To reflect the corporate culture of "Achieving Performance and Effectiveness", the Group has put in place a performance management mechanism to formalise the performance management at the levels of the Group, units and individuals. The annual targets of the Group will be cascaded down under the framework of balanced scorecard whereby the performance of the senior management and different units (including business units, risk control units and other units) would be assessed from the perspectives of financial, customer, building block/key tasks, human capital, risk management and compliance. As to the performance management of individual staff at different levels, the annual targets of the Group will be tied to the job requirements of different posts at different levels through the model of level-based performance management. Performance of individuals will be appraised with

reference to their accomplishment of work targets, contribution towards overall performance of their corresponding units and compliance of risk management and internal control policies. Under this mechanism, not only the target accomplishment has been taken into account, the risk exposure involved during the course of work of a staff member could also be evaluated and managed so as to provide safeguards to the Group against the risk and ensure normal operations. The mechanism is also coupled with the assessment on system of values, thereby facilitating the attainment of the core values of the Group.

2. *Risk Modification of Remuneration*

To implement the principle of aligning the performance and remuneration with the risk, the Group has introduced "The Risk Adjustment Method" under which the key risk modifiers of the bank have been incorporated into the performance management mechanism of the Group and the size of the Variable Remuneration Pool of the Group, which is the total amount to be paid to the staff as variable compensation, would be determined on the basis of the risk-adjusted performance results. This method enables the Group to fix the Group's Variable Remuneration Pool after considering risk exposures and changes and to maintain effective risk management through the remuneration mechanism.

3. *Performance-based Remuneration Management*

The remuneration of staff is composed of "fixed remuneration" and "variable remuneration", the proportion of one to the other for individual staff members depends on job grades, roles, responsibilities and functions of the staff with the prerequisite that balance has to be struck between the fixed and variable portion. Generally speaking, the higher the job grades and/or the greater the responsibilities, the higher will be the proportion

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of variable remuneration so as to encourage the staff to follow the philosophy of prudent risk management and sound long-term financial stability.

Every year, the Group will conduct periodic review on the fixed remuneration of the staff with reference to various factors like remuneration strategy, market pay trend and staff salary level; and to determine the remuneration based on the affordability of the Group as well as the performance of the Group, units and individuals. As mentioned above, performance assessment criteria include quantitative and qualitative factors, as well as financial and non-financial indicators.

The size of the Variable Remuneration Pool of the Group is determined by the Board on the basis of the financial performance of the Group and the achievement of non-financial strategic business targets under the long-term development of the Group. Thorough consideration is also made to the risk factors in the determination process. The size of the Pool is reached based on formulaic calculations but the Board can make discretionary adjustment to it if deemed appropriate under prevailing circumstances. As far as individual units and individual staff are concerned, allocation of the variable remuneration is closely linked to the performance of the units, and that of each individual staff as well as the unit he/she is attaching to, the assessment of which should include risk modifiers. Within the acceptable risk level of the Group, the better the performance of the unit and the individual staff, the higher will be the variable remuneration for the individual staff.

4. *Linking the payout of the variable remuneration with the time horizon of the risk to reflect the long-term value creation of the Group*
To work out the principle of aligning

remuneration with the risk and to ensure that sufficient time is allowed to ascertain the associated risk and its impact before the actual payout, payout of the variable remuneration of staff is required to be deferred if such amount reaches certain prescribed threshold. The Group adopts a progressive approach towards deferral. The longer the time horizon of risk in the activities conducted by the staff, the higher the job grade or the higher amount of the variable remuneration, the higher will be the proportion of deferral. Deferral lasts for 3 years.

The vesting of the deferred variable remuneration is linked with the long term value creation of the Group. The vesting conditions are linked to the yearly performance (financial and non-financial) of the Group in the next 3 years to the effect that the variable remuneration could only be vested to such extent as set for the relevant year in that 3-year period subject to the condition that the Group's performance has met the threshold requirement in the corresponding year. In case of material revision of the original estimates of the performance of the Group or individual units, or if a staff is found to commit fraud, or found to be of malfeasance or in violation of internal control policies, the unvested portion of the deferred variable remuneration of the relevant staff will be clawed back.

External Auditor

Pursuant to the "Policy on External Auditors" adopted by the Board, the **Audit Committee** reviewed and monitored and **was satisfied with the independence and objectivity of PricewaterhouseCoopers**, the Group's external auditor, **and the effectiveness of their audit procedures**, based on the principles and standards set out in the policy that were in line with international best practices. Upon the recommendation of the Audit Committee, the Board will propose that PricewaterhouseCoopers be re-appointed as auditor of the Group

at the Company's 2011 annual general meeting. Subject to authorisation by the shareholders, the Board will authorise the Audit Committee to determine the remuneration of PricewaterhouseCoopers. For 2010, the fee charged by PricewaterhouseCoopers was HK\$39 million, of which HK\$31 million was for audit services and HK\$8 million related to other services. Among the said HK\$8 million, HK\$4 million of which was the fee charged by PricewaterhouseCoopers in relation to issue of subordinated notes by the Bank. For 2009, the fee charged by PricewaterhouseCoopers was HK\$35 million, of which HK\$29 million was for audit services and HK\$6 million related to other services.

The Audit Committee was satisfied that the non-audit services did not affect the independence of PricewaterhouseCoopers. The amount paid to PricewaterhouseCoopers for non-audit services in 2010 comprised mainly the tax-related services fee of HK\$2 million, the fee incurred incidental to the issue of subordinated notes by the Bank of HK\$4 million and miscellaneous non-audit services fee of HK\$2 million.

Internal Control

The Board has the responsibility to ensure that the Group maintains sound and effective internal controls to safeguard the Group's assets. According to the Board's delegation, the Management is responsible for the day-to-day operations and risk management.

The internal control system is designed to provide appropriate assurance against material misstatement or loss; to manage the risk of system failure; and to assist in the achievement of the Group's objectives. In addition to safeguarding the Group's assets, it also ensures the maintenance of proper accounting records and compliance with relevant laws and regulations.

The Group conducts an annual review of the effectiveness of its internal control systems covering all material controls, including financial,

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operational and compliance controls as well as risk management. The review is conducted by making reference to the guidelines and definitions given by the regulatory and professional bodies for the purpose of assessing five different internal control elements, namely, the control environment, risk assessment, control activities, information and communication, and monitoring. The assessment covers all the major internal controls and measures, including financial, operational and compliance controls as well as risk management functions. The review also considers the adequacy of resources, staff qualifications and experience and training of the Group's accounting and financial reporting functions. The annual review is coordinated by the Group's Internal Audit which, after the Management and various business departments have performed their self-assessment, then carries out an independent examination and other post-assessment work on the review process and results. The results of the 2010 review have been reported to the Audit Committee and the Board.

The key procedures that the Group has essentially established and implemented to provide internal controls are summarised as follows:

- with a Management that functions under a rational organisational structure and whose authority, responsibility and accountability are clearly delineated, the Group has formulated policies and procedures to ensure reasonable checks and balances for all the operating units, reasonable safeguard for the Group's assets, the implementation of internal controls and adherence to relevant laws and regulations and risk management in its operations;
- the Management draws up and continuously monitors the implementation of the Group's strategies, business plans and financial budgets. The accounting and management systems that are in place provide the basis for

evaluating financial and operational performance;

- the Group has various risk management and human resources policies. There are specific units and personnel that are responsible for identifying, assessing and managing all the major risks. These include reputation, strategic, legal, compliance, credit, market, operational, liquidity and interest rate risks (The Group's risk management governance structure is given on page 49 to page 53 in this Annual Report);
- the Group has established an information technology governance structure that produces a range of reports on information systems and management, including information on the monitoring of various business units, financial information and operating performance. Such information facilitates the Management, business units and the regulatory bodies in assessing and monitoring the Group's operation and performance. Proper communication channels and reporting mechanisms are in place at various business units and levels to facilitate exchange of information;
- pursuant to a risk-based approach and in accordance with the internal audit plan approved by the Audit Committee, the Group's Internal Audit conducts independent reviews on such aspects as financial activities, various business areas, various kinds of risks, operations and activities. Audit reports are submitted directly to the Audit Committee. Internal Audit closely follows up on the items that require attention in a systematic way and reports to the Audit Committee and the Management in a timely manner; and
- the Audit Committee reviews the reports submitted by external auditor to the Group's Management

in connection with the annual audit as well as the recommendations made by regulatory bodies on internal control. Internal Audit follows up on the same to ensure timely implementation of the recommendations, and also periodically reports the status of the implementation to the Management and the Audit Committee.

The Group is committed to maintaining and upholding good corporate governance practices and internal control system of all subsidiaries are reviewed regularly. During the year of 2010, continuous improvement on the organisation structure and segregation of duty, the risk management policy and procedure, and the enhancement of disclosure transparency have been undertaken. In response to the volatility in global financial markets and unstable momentum of economic recovery, the Group has implemented a series of measures and undertaken an on-going review on the effectiveness of the internal control mechanism. In 2010, areas for improvement have been identified and appropriate measures have been implemented.

Communication with Shareholders and Shareholders' Rights

The Board attaches a high degree of importance to continuous communication with shareholders, especially direct dialogue with them at the Company's annual general meetings. Shareholders are therefore encouraged to actively participate at such meetings.

The Chairman of the Board, the Chairmen and members of Board Committees, and representatives of PricewaterhouseCoopers were present at the Company's 2010 annual general meeting held on 20 May 2010 at the Grand Ballroom, Lower Lobby, Conrad Hong Kong, Pacific Place to respond to questions and comments raised by shareholders. Resolutions passed at the Company's 2010 annual general meeting included: adoption of the

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Company's and the Group's 2009 financial statements, re-election of Directors, re-appointment of auditor and grant of general mandates to the Board to issue and repurchase shares of the Company.

As disclosed in the Annual Report for 2009 of the Company, in view of the investors' concern regarding the potential dilution of the shareholders' value arising from the exercise of power pursuant to the grant of a general mandate to issue shares to the Board, the Board has voluntarily reduced the general mandate to issue shares of up to 5% of the issued share capital as compared to the 20% limit permitted under the Listing Rules in the event that the issue of shares is for cash and not related to any acquisition of assets for approval by the shareholders at the 2010 annual general meeting. The Board would also recommend the said 5% threshold at the forthcoming 2011 annual general meeting for approval by shareholders. Further, given its commitment to high standards of corporate governance, the Board also adopted certain **internal policies for the exercise of the powers granted to the Board under the general mandates to issue shares solely for cash and repurchase shares**. Those policies are summarised as follows:

- the Board will not exercise the mandate at a discount that will result in significant dilution of shareholders' value. In the exercise of such power to issue shares for cash, the Board will have regard to factors such as the Group's capital adequacy ratio, and in particular, its Tier 1 capital, cost and benefit of raising Tier 2 capital, need for cash for the Group's business development, the principle that shareholders should be treated equally and the alternative of conducting a rights issue; and
- the Board has set the triggering events for the exercise of the power to repurchase shares, which include: market price of the Company's shares is lower than the fair value

of the shares; the Group has surplus funds which is in excess of its short to mid term development requirements; and the Board considers it proper and appropriate to exercise the general mandate for enhancing the return on equity or net assets or earnings per share of the Company. In general, such purchases will be made on the Stock Exchange. However, if it is expected that the size of the purchases may lead to a disorderly market for the Company's shares, then the Board will consider making the purchases through a general offer, i.e. offer to all existing shareholders in proportion to their respective shareholdings. The price at which shares are repurchased will not be higher than the fair value of the shares of the Company.

All the resolutions proposed at the Company's 2011 annual general meeting will be voted on by poll. The Company has engaged Computershare Hong Kong Investor Services Limited, the Company's Share Registrar, to act as the scrutineer for such purpose. The results of the poll voting will be posted on the Company's website at www.bochk.com and the Stock Exchange's website at www.hkexnews.hk as soon as practicable following conclusion of the vote-counting.

In order that shareholders can have a better understanding of the agenda items to be discussed at the 2011 annual general meeting and to encourage their active participation so that exchange of views and communication can be further enhanced, **the Company has provided detailed information on the 2011 annual general meeting in a circular** which is despatched together with this Annual Report to the shareholders. This includes background information to the proposed resolutions, information on the retiring Directors and information on voting and other issues relating to the 2011 annual general meeting in the form of "Frequently Asked Questions" (including how to convene an extraordinary general meeting and how to put forward a proposal for

consideration by shareholders at a general meeting).

Further shareholder information is set out in the "Investor Relations" section of this Annual Report. Shareholders who wish to raise any queries with the Board may write to the Company Secretary at 52nd Floor, Bank of China Tower, 1 Garden Road, Central, Hong Kong.

Directors' Responsibility Statement in relation to Financial Statements

The following statement should be read in conjunction with the auditor's statement of their responsibilities as set out in the auditor's report contained in this Annual Report. The statement is made with a view to distinguishing for shareholders the respective responsibilities of the Directors and of the auditor in relation to the financial statements.

The Directors are required by the Hong Kong Companies Ordinance to prepare financial statements, which give a true and fair view of the state of affairs of the Company. The financial statements should be prepared on a going concern basis unless it is not appropriate to do so. The Directors have responsibility for ensuring that the Company keeps accounting records which disclose with reasonable accuracy at any time the financial position of the Company and which enable them to ensure that the financial statements comply with the requirements of the Hong Kong Companies Ordinance. The Directors also have general responsibilities for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The Directors consider that in preparing the financial statements contained in this Annual Report, the Company has adopted appropriate accounting policies which have been consistently applied and supported by reasonable judgements and estimates, and that all accounting standards which they consider to be applicable have been followed.