CHIEF EXECUTIVE'S REPORT

The Group achieved a set of respectable results in 2013, driven by solid growth of our core businesses. Our profit attributable to the equity holders reached a new high. This is a particularly remarkable achievement after taking into account the substantial drop in the property revaluation gain during the period. The satisfactory growth was fuelled by higher net interest income and fee income as well as effective cost control. The Group's financial position remained strong with healthy growth in loans and deposits. We continued to deliver on our strategic objectives and build our customer franchise.

Our performance was well recognised by various industry awards across our major businesses. We were also named as the Bank of the Year in Hong Kong 2013 by The Banker in recognition of our consistently sound performance and the continuous success in building our franchise, particularly in the development of offshore RMB business.

Operating Environment

In 2013, banks in Hong Kong faced a mixed operating environment as characterised by modest economic growth in Hong Kong, a sluggish property market and volatile financial markets. At the same time, banks needed to comply with more stringent regulatory requirements in running their businesses.

In terms of opportunities, the offshore RMB business in Hong Kong grew steadily with a number of new initiatives introduced to promote the use of RMB in trade and investment activities. The development of RMB business was further supported by HKMA's new measures to enhance the operation of the RMB liquidity facility. While competition remained keen, there continued to be good opportunities for lending business driven by strong demand from the Mainland.

Our Strategy and Achievements

Strive to enhance customer experience

The Group is committed to becoming customers' premier bank with comprehensive solutions and professional services. One of our key competitive advantages is a robust customer base. Our sophisticated customer segmentation strategy enables us to better cater for the diverse needs of our customers and to attract new customers.

During the year, we strengthened our wealth management platform with a three-tier structure, for more targeted sales and services. The Group re-packaged its i-Free Banking Service to meet the basic banking and financial planning needs of general customers, especially the younger segment. As part of our customer segmentation strategy, Enrich Banking Service was launched in late 2013 to the busy mid-segment working population, offering all-round financial management solutions. We continued to enhance our Wealth Management Service, targeting high-end customers with personalised services and professional financial solutions. Launched in late 2012, our Private Banking service provides affluent customers with a one-stop integrated service model encompassing investment management, liquidity management and estate planning. During the period, it worked closely with business units of the Group, BOC and our Mainland operation on a series of client acquisition and referral activities. Overall, our customer segmentation strategy made good progress for the period by growing the customer base and assets under management. It also enabled us to conduct more effective marketing and cross-selling activities.

For our corporate customers, we continued to deepen our industry expertise to better serve targeted customers of different industries. A Corporate Services Centre was set up to further improve service efficiency and quality. We also worked to enhance our service for SME customers. The corporate internet banking platform, CBS Online, was upgraded with a modern and user-friendly interface. In terms of products, we continued to broaden our offerings in areas such as trade finance, custody service and cash management service.

Extend our reach to drive growth

The Group is a leading banking group in Hong Kong with strong market positions in all major businesses. Over the past few years, we saw considerable opportunities arise from the development of the offshore RMB business and increasing demand for cross-border banking services, especially on the back of the international expansion of our major customers. Capitalising on these opportunities, we have successfully expanded our presence outside Hong Kong. This is also attributable to our close collaboration with BOC, our parent bank, which enhances our global service capabilities.

During the period, we continued to work in conjunction with BOC across a wide range of areas to explore business opportunities. We established a business referral channel with BOC's branches on the Mainland and overseas for both onshore and offshore businesses. BOCHK is not only the top mandated arranger in the Hong Kong-Macau syndicated loan market, but also acts as the Asia-Pacific Syndicated Loan Centre of BOC Group. In 2013, we successfully helped arrange a syndicated loan led by the BOC Group to finance a renowned acquisition. This enhanced the Group's reputation internationally as an arranger bank in both M&A finance and the syndicated loan market. Collaborating with BOC, we have also further strengthened our cross-border banking services for both personal and corporate customers.

As the Clearing Bank of the offshore RMB business in Hong Kong, we continued to enhance our clearing service platform to cater for the needs of both local and global participating banks. During the period, we extended the operating hours for cross-border RMB payments involving Mainland counterparts, introduced time deposit products, launched a tiered interest rate offering for participating banks' settlement accounts and adjusted RMB intra-day repo limits.

The offshore RMB business, as our key strategic focus, enables us to capture more business opportunities and enhance customer relationships. The Group maintains its leadership in this business, riding on its strong RMB franchise and experience. We have successfully secured new customer groups, including international companies, public organisations and global financial institutions. In 2013, BOCHK was also designated as a market maker for USD/CNH (offshore RMB) futures by the Chicago Mercantile Exchange Group, being the sole bank among the first group of market makers. BOCHK partnered with FTSE Group to develop the new FTSE-BOCHK Offshore RMB Bond Index Series. This landmark partnership combines BOCHK's unique position in the offshore RMB business with FTSE's leading index expertise. We launched concerted marketing campaigns globally with BOC to promote the RMB services of BOC Group. During the year, BOCHK was appointed by Clearstream Banking S.A. as its cash correspondent bank for offshore RMB in Hong Kong. This appointment reinforced the Group's leading position in the RMB business. All these developments have helped raise the international profile of the Group significantly and extend our reach outside Hong Kong, enabling us to capture more business opportunities.

Maintain a strong financial position for sustainable development

Our top priority continues to be to maintain a strong financial position, which gives us the flexibility to grow and manage our business amid fluctuating market conditions. During the period, the Group maintained its proactive yet prudent approach in managing its balance sheet and driving business development. All key financial ratios were maintained at healthy levels.

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Starting from 1 January 2013, the Basel III requirement came into effect. We continued to manage our capital and liquidity proactively. As at the end of 2013, the Group maintained its solid capital and liquidity position.

We continued to adopt stringent risk management and credit control to deliver quality growth. Overall loan quality remained healthy with our classified or impaired loan ratio staying at a low level. Our investment book was prudently managed to optimise risk and return.

Under the persistently low interest rate environment and intense competition, we took proactive measures to allocate our assets, enhance the deployment of offshore RMB funds, improve loan pricing and control deposit costs. In terms of asset allocation, we reduced securities investments in lower yielding government-related securities. New debt securities investments were made in high-quality financial institutions and corporations. Average yields for our interbank balances and placements, debt securities investments and customer loans all improved from last year's levels. As a result of these conscious efforts, the Group's net interest margin improved further both year-on-year and half-on-half.

While we remain focused on investing in our business platform, we believe that maintaining cost discipline is also critical to our long-term success. During the period, we judiciously managed expenditure to ensure cost efficiency while allowing sufficient resources to drive business growth. In addition, we took measures to improve operational efficiency by streamlining and centralising business processes. Our cost to income ratio further improved in 2013 on the back of our cost control measures and stronger income growth.

Financial Performance

For the period under review, the Group's net operating income before impairment allowances was HK$40,313 million, up by 13.2% as compared to 2012. The growth was mainly driven by the increase in net interest income and net fee and commission income. Operating expenses rose by 7.3% to HK$12,083 million due to business expansion. Cost to income ratio improved to 29.97% from 31.61%. The net gain from fair value adjustments on investment properties fell considerably by 86.0% or HK$1,621 million. Despite the drop in this non-operating income, profit attributable to the equity holders still reached a new high of HK$22,252 million, up 6.3% year-on-year. Return on average total assets and return on average shareholders' equity were 1.22% and 14.37% respectively compared to 1.24% and 14.91% in 2012.

Net interest income rose by 13.0% year-on-year to HK$27,916 million. The increase was driven by the growth in average interest-earning assets and the widening of net interest margin. Average interest-earning assets expanded by 7.4%, mainly supported by the increase in customer deposits, partly offset by the decrease in RMB funds from the clearing bank business. Net interest margin was 1.68%, up 8 basis points compared to 2012. The increase was mainly attributable to the widening of loan and deposit spread.

Net fee and commission income grew by 15.5% year-on-year to HK$8,965 million. The increase was broad-based, reflecting the Group's continuous efforts in expanding its service capabilities. Fee and commission income from funds distribution, insurance and securities brokerage increased substantially by 52.0%, 33.2% and 15.0% respectively.

Net trading gain decreased 5.5% year-on-year to HK$2,957 million. The decrease was mainly due to the mark-to-market changes of certain debt securities.

As at 31 December 2013, total assets increased by 11.8% to HK$2,046.9 billion compared with end-2012. The Group maintained a flexible deposit strategy to support business growth with cautious control of funding costs in response to market changes. Deposits from customers expanded by 8.0% to HK$1,328.0 billion. Advances to customers grew by 10.3% to a total of HK$858.3 billion. Loan to deposit ratio increased to 64.63%, up 1.31 percentage points from the end of 2012. Overall loan quality remained sound with the classified or impaired loan ratio at a low level of 0.28%.

Effective 1 January 2013, the calculation of the capital ratios was in compliance with the Basel III Accord. The total capital ratio as at 31 December 2013 was 15.80%. The average liquidity ratio for 2013 was 37.93%.

Business Review

Personal Banking business performed strongly in 2013 with broad-based income growth. Net operating income before impairment allowances and profit before taxation increased by 18.3% to HK$13,699 million and 25.6% to HK$6,926 million respectively.

Investment and insurance businesses saw an encouraging performance with strong growth of commission income from securities brokerage, funds distribution and insurance. Credit card business also made good progress with growth in related fee income. It maintained its leadership in the UnionPay International merchant acquiring business and card issuing business in Hong Kong. We also launched an innovative and convenient mobile payment service, BOCHK e-Wallet. Customers can make contactless credit card transactions with mobile phones equipped with BOC SD card and the BOCHK e-Wallet application.

The residential mortgage business was affected by the cooling down of the local residential property market. The market remained fairly upbeat at the beginning of the year but faced a slowdown following the introduction of further prudential measures by the government in February. Transaction volumes declined significantly from 2012. Competition was intense. The Group's residential mortgage loans grew by 1.8% while it maintained its market leadership in the underwriting of new mortgage loans during the year.

Corporate Banking business continued its growth momentum in 2013. Net operating income before impairment allowances increased by 16.7% to HK$15,842 million while profit before taxation increased by 21.8% to HK$11,844 million.

The strong performance was mainly led by higher net interest income. Corporate loan book grew 11.9% with sound loan quality. While growing our loan business, we continued to strengthen our know-your-customer process and close monitoring measures were put in place to ensure that timely precautionary measures can be taken to contain risks.

By stepping up business initiatives and cooperation with BOC, we captured more business opportunities and reinforced our competitive edge. In collaboration with BOC, the Group has increased its stature in the international syndicated loan market, while it has made good progress in the cross-border direct loan business. In the custody business, the Group continued to expand its client base in different geographical locations and successfully secured mandates to provide custody services for RQFII-ETFs and various types of RQFII and QDII products. The service capabilities of our cash management business were enhanced to reinforce its competitive position as the cross-border fund centre for customers in Hong Kong.

Treasury segment's performance was down slightly compared to 2012 although its second half performance showed a pick-up from the first half. Net operating income before impairment allowances decreased by 1.3% year-on-year to HK$9,497 million while profit before taxation decreased by 0.4% to HK$8,347 million.

The Group prudently managed its banking book investments. We shortened the average portfolio duration and selectively increased investments in high-quality financial institutions, corporate bonds and RMB-denominated bonds.

On the product development front, with timely response to market conditions, we promoted products suited to customer needs. We also made encouraging progress in underwriting bonds in different denominated currencies. The Group continued to pioneer the launch of RMB treasury products. We completed the first CNH/USD cross-currency swap transaction using CNH HIBOR as the pricing benchmark. The Group also successfully acted as the arranger for the issuance of the first certificate of deposit using CNH HIBOR as the benchmark rate, offering the market more choice of floating rate debt instruments.

Our **Mainland** business delivered a remarkable performance in a tough banking environment. Net operating income increased by 28.5% driven by higher net interest income and fee income. Deposits and loans recorded satisfactory growth of 16.0% and 12.8% respectively.

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Product offerings and distribution channels in our Mainland operation were further enhanced. A new series of wealth management products was introduced. During the period, NCB (China) commenced its credit card issuing business on the Mainland. The Group's SME business platform was reinforced by the development of tailor-made products to support targeted SME customers. With our branch network expanding to 41 and more features added to our personal and corporate e-Banking platform, the Group's distribution capabilities on the Mainland were strengthened.

Insurance business achieved a robust performance in 2013. Net operating income before impairment allowances grew by 66.5% year-on-year to HK$1,404 million. Profit before taxation jumped by 87.8% to HK$1,144 million.

The Group continued to broaden its product offerings to meet customers' diverse needs. It continued to do well, in particular, in RMB products and maintained its leading position in the Hong Kong RMB insurance market. The Group also actively developed new distribution channels and established partnerships with brokerage houses to promote insurance products. This enabled the Group to reach a wider range of customers.

Outlook

For 2014, we expect to see modest growth in major economies. While the US economy continues its gradual recovery, the Mainland economy is expected to slow down but in a managed manner. Hong Kong's economy is likely to be relatively stable and may expand moderately in 2014. However, uncertainties still exist in the macro environment that could lead to unexpected market volatility and need to be monitored closely. The US economic recovery and the tapering of the quantitative easing programme will have important implications for the global markets in relation to the normalisation of the interest rate trend.

On the positive side, acceleration in economic reform and the structural balancing process on the Mainland will provide Hong Kong with many opportunities. Exploring new patterns in cross-border cooperation and the continuous expansion of the offshore RMB markets will continue to provide banks with emerging business opportunities going forward. Nevertheless, banks in Hong Kong are also facing a tougher environment with regard to the tighter regulatory environment in terms of capital, liquidity and risk management. The Basel III regulatory regime has come into effect with more stringent capital and liquidity requirements. In addition, the supervisory requirements on the maintenance of liquidity cushions against a range of liquidity stress scenarios will become effective at the end of March 2014. Amid concerns over rising household leverage, HKMA has also set out requirements on the risk management of personal lending business. Banks, therefore, need to review prudently their business strategies and be prepared for a changing industry landscape.

The proactive strategies that we have implemented have put us in a strong position to continue our growth trajectory. We see considerable growth opportunities ahead for the Group, especially from the increasing use of RMB globally. This year is the tenth anniversary of BOCHK operating as the RMB Clearing Bank in Hong Kong. Over the past years, we witnessed the robust development of the offshore RMB markets with RMB transactions becoming more prevalent around the world. The Group has also made great strides in its business development and firmly established its market leadership in the offshore RMB business. Capitalising on our strong RMB franchise, we will continue to expand and deepen our customer base. We will also continue to drive product and service innovation to strengthen our market position.

In 2013, RMB cross-border trade settlement cleared via Hong Kong's clearing platform continued to see remarkable growth. As the Clearing Bank of the offshore RMB business in Hong Kong, we are committed to promoting the development of Hong Kong as a major offshore RMB hub. We endeavour to enhance our service capabilities and efficiency to cope with the growing clearing volume.

Our increasing collaboration with BOC has enabled us to strengthen our service capabilities, expand our customer base and extend our geographical reach. Over the past few years, the Group has substantially enhanced its product and service capabilities. This will enable us to better fulfil our role as the product manufacturing and service support centre for BOC Group. Major collaboration and business referral mechanisms have also been established. We are working closely together in a number of business areas, including RMB business, cash management, custody service, private banking and cross-border services to enhance BOC Group's total solution capabilities to cater for the international needs of our customers. This strategy has proved to be successful in capturing new business and securing quality customers. Our Chairman, Mr TIAN Guoli, who joined the Company in June 2013, is very supportive of this strategy. He has shared with the Management much insight on how to further enhance the synergies within BOC Group going forward. We see many areas where we could further deepen and expand our collaboration for mutual benefits.

Cross-border business and offshore RMB business are the two key strategic focuses of BOC Group and also where our strengths lie. Last year, a number of favourable market initiatives were introduced, covering the RQFII scheme, cross-border RMB business, the introduction of the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone and the China (Shanghai) Pilot Free Trade Zone. Leveraging BOC Group's overall service capabilities and strong franchise, we are strongly positioned to capture these opportunities.

To cater for the global needs of our leading corporate customers, we will continue to upgrade our global service platform in areas such as cross-regional cash management, custody, treasury products, and trade products and services. We also see great demand for cross-border wealth management solutions from our personal customers, not only in Hong Kong, but also from the Mainland and overseas. We will increase our collaboration in product innovation and distribution. The Group's asset management arm, though it was only set up in 2010, has already established a very strong market position and is well recognised by a number of industry awards. It will endeavour to offer personal and institutional investors with comprehensive investment solutions.

Maintaining a strong financial position will continue to be a key priority of the Group, especially in view of the considerable opportunities we have going forward. We will proactively manage our capital and liquidity. To support the Group's mid-to-long-term growth, we need to be more forward looking and take proactive measures to enhance our capital base and ensure the efficient use of our capital when implementing our business strategies. This also includes our strategy to invest in areas that boost the development of less capital-driven businesses. Riding on our customer segmentation strategy, we will continue to explore business opportunities with target customer groups. We will strive to develop primary banking relationships with our customers through product and service differentiation.

We will continue to focus our investments on areas that will enhance our total solution capabilities and drive future growth. We will also make use of fast-developing technology to drive efficiency and innovation, introducing new business capabilities to meet the evolving needs of our customers and enhancing the overall customer experience.

We are pleased with our progress to date. This achievement is attributable to the continuous support of customers and shareholders, the dedication of our staff, as well as the wisdom and counsel of the Board. Mr TUNG Chee Chen, who had been the Company's Independent Non-executive Director since 2002, retired last May. On behalf of the Group, I would like to take this opportunity to thank him for his valuable contributions to the Group during his tenure. Looking forward, I truly believe that the Group will continue to be well positioned to capture quality growth opportunities ahead. My colleagues and I are deeply committed to our vision to be our stakeholders' premier bank and to strive for continual improvement.

HE Guangbei
Vice Chairman & Chief Executive

Hong Kong, 26 March 2014