

# Chief Executive's Report



## YUE Yi

Vice Chairman & Chief Executive

2014 marked another year of success for the Group in terms of our business development and growth, with record high results achieved in revenue and profits. The overall operating conditions for banks in Hong Kong during the year remained challenging in a highly competitive environment with weaker demand. On the other hand, the offshore RMB markets continued to expand with the introduction of some important initiatives. We succeeded in capturing considerable business opportunities by leveraging our competitive edge in the RMB business and our close collaboration with our parent bank, Bank of China ("BOC"). In addition, we were proactive in managing our balance sheet to enhance returns and support our business development. All key financial ratios stayed sound with a solid capital and liquidity position, providing us with a strong foundation for further growth. In recognition of our solid financial position and ability to drive long-term profitability, we were named the Strongest Bank 2014 in Asia Pacific and Hong Kong by *The Asian Banker*.

The Group delivered a set of strong results, driven by the growth of its core businesses. Net operating income before impairment allowances increased by 9.8% year-on-year to HK\$44,282 million. Profit attributable to the equity holders increased by 10.4% year-on-year to HK\$24,577 million. Return on average total assets (ROA) and return on average shareholders' equity (ROE) were 1.19% and 14.65% respectively. Net interest income rose by 14.3% year-on-year to HK\$31,919 million, thanks to the expansion in both average interest-earning assets and net interest margin.

Net fee and commission income grew by 12.9% to HK\$10,122 million, mainly driven by commission income from loans, insurance, securities and funds distribution. As at 31 December 2014, total assets amounted to HK\$2,189.4 billion, up 7.0% compared with the end of 2013. Customer loans and deposits posted healthy growth of 12.0% and 11.7% respectively.

## Key Initiatives and Achievements

### Proactive management to enhance returns and support growth

**Capital strength reinforced.** In a tighter regulatory environment, we continued to deploy capital efficiently and optimise the management of risk-weighted assets when growing our business. The Group's capital adequacy level was further improved, with a total capital ratio of 17.51% and a Tier 1 capital ratio of 12.38%, both up 1.71 percentage points. Our liquidity position was also sound with the average liquidity ratio at 42.17%, up 4.24 percentage points.

**Net interest margin improved.** During the period, market interest rates were kept low and competition remained keen, making it difficult to improve margins. Nevertheless, our net interest margin improved by 4 basis points to 1.72%. This was attributable to our proactive balance sheet management, after taking into consideration market changes, risk exposure and capital deployment efficiency. We allocated our assets to maximise returns while controlling our deposit costs. Funds were allocated in advances to

customers, RMB bonds, balances and placements with banks, as well as high-quality corporate bonds.

**Overall loan quality remained benign.** In accordance with our approach of stringent risk management, we maintained our prudent credit policy and focus on customer selection. Overall loan quality remained sound, with the classified or impaired loan ratio staying at a low level of 0.31%, which was below the market average. We also closely monitored pre- and post-lending and carefully managed our exposure in the Mainland of China, where some industries were under pressure owing to slower economic growth. Certain loans by NCB (China), the Group's Mainland operation, were also affected. However, the impact was well contained as these loans only accounted for a small part of the Group's total book.

**Strategic investments with continued cost discipline.** Total operating expenses increased by 7.4% to HK\$12,972 million but at a slower rate than revenue growth, allowing us to achieve a cost-to-income ratio of 29.29%, down a 0.68 percentage point year-on-year. This was among the lowest in the industry. We maintained discipline in managing our expenses in order to balance profit growth and our long-term business needs. Our human resources continued to be a key area of our investment focus, as did enhancing efficiency and building new business capabilities.

### Strongly positioned to capture new business opportunities

**Reinforced leadership in the offshore RMB business.** Riding on the robust development of offshore RMB markets, we acted decisively to capture opportunities and expanded our business scope. In the ground-breaking Shanghai-Hong Kong Stock Connect programme launched in November 2014, BOCHK was appointed as a designated bank by China Securities Depository and Clearing Corporation Limited at the Hong Kong Securities Clearing Company Limited ("HKSCC"), as well as the designated settlement bank by HKSCC for Northbound Trading. BOCHK was also designated as a Primary Liquidity Provider by the Hong Kong Monetary Authority

for facilitating more efficient liquidity management in the offshore RMB ("CNH") market. In addition, we swiftly provided customers with a comprehensive range of services to equip them for the new investment opportunities through the Shanghai-Hong Kong Stock Connect programme. All these, once again, reflected our active and important role in supporting the development of the offshore RMB market.

Remarkable progress was made across our wide range of offshore RMB businesses, with both RMB deposits and loans recording encouraging growth. We significantly increased our market share in the underwriting of dim-sum bonds and launched a series of RMB investment products that was well received by the market. Following the further relaxation of personal RMB businesses in Hong Kong, the Group introduced services such as direct RMB exchange against other currencies, RMB Currency Linked Investment, A shares margin trading as well as RMB mortgage and personal loans.

Our strong RMB franchise enabled us to successfully establish relationships with central banks and major financial institutions in overseas countries and regions. This helped us secure new business while strengthening the BOC Group's global franchise. Through our new customer relationships, we extended our global banknote distribution network to new markets in Central America, and Central and Southeast Asia and were granted a franchise in managing the Extended Custodial Inventory of a major currency, making us the first Chinese bank to qualify for this role.

As the clearing bank for offshore RMB business in Hong Kong, we continued to enhance our clearing services to support the healthy development of the offshore RMB market. We extended our RMB clearing service hours to 20.5 hours per day, making us the world's first clearing system covering time zones in Europe, America and Asia with the longest operating hours. To improve our RMB clearing efficiency, we successfully migrated to the second generation of the China National Advanced Payment System. In recognition of our comprehensive and outstanding RMB clearing services, our RMB Clearing Centre received

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ISO 9001:2008 Certification – the first Clearing Bank for RMB business to achieve this certification globally.

**Strengthened cross-border business capabilities through our synergy with BOC.** With the increasing demand for cross-border banking services, we deepened our collaboration with BOC and its overseas branches in order to extend our service coverage. This has enabled us to better serve both Mainland enterprises going global and foreign enterprises expanding into the Mainland. In view of the huge potential of this business, we set up a regular cooperation mechanism with the Guangdong, Hong Kong and Macau operations of BOC for the express purpose of further enhancing the BOC Group's service capabilities in these three regions for both corporate and personal customers.

Riding on the opportunities that arose from the Shanghai Free Trade Zone, the Group successfully set up cash pooling services that facilitate two-way cash sweeping for several large corporates. We also provided cross-border RMB loans to corporates established in the zone. With our franchise in underwriting offshore RMB bonds, we supported BOC's London Branch to complete the first overseas dim-sum bond issuance by the Bank of England. Together with BOC, we continued to support the financing needs of Mainland enterprises expanding abroad. As the Asia-Pacific Syndicated Loan Centre of BOC Group, we participated in a number of significant syndicated loans for Mainland corporates in support of their overseas mergers and acquisitions. For our custody services, we expanded our customer base and established business relationships with a number of new RQFII applicants from the Mainland, Hong Kong, the Taiwan region and other countries.

Capitalising on our cooperation and referral mechanism with BOC, we continued to enhance our cross-border banking services for personal customers, especially the high-net-worth global customers. In collaboration with BOC's branches in the Mainland and overseas, we introduced a range of one-stop global cross-border banking services. In

2014, Private Banking business benefited from this effective cooperation platform to acquire customers.

## A comprehensive platform for providing professional and efficient services

### **We provided more efficient and convenient services.**

With the growth in mobile usage for accessing e-banking, we further enriched our mobile banking and payment services. During the period, we introduced applications such as an upgraded mobile banking app with a more user-friendly interface, a Mortgage Expert mobile app, and an e-Wallet for more convenient cross-border RMB/HKD mobile payments. Through our mobile apps, customers can enjoy a wide range of online banking services. These include Hong Kong's first location-based privileges service and BOC Express Cash Mobile Instant Approval service for personal loan applications. To engage with customers better, especially the younger generation, we made greater use of social media during the year. In recognition of our electronic banking platform and outstanding services, we received a number of industry awards in 2014, including Online Securities Platform of the Year – Hong Kong from *Asian Banking and Finance*, as well as other awards from local media.

Services were also improved for our corporate customers, from small businesses to large corporates. These included the continued enhancement of our Corporate Services Centre for our key customers and a streamlined application process, with a one-hour preliminary approval, to give small businesses more flexible financing solutions.

### **We offered more targeted wealth management services.**

Recognising the significant growth potential of wealth management and Private Banking, we made use of our sophisticated customer segmentation strategy to provide more targeted products and services. The launch of Enrich Banking at the end of 2013 and the enhancement of our Wealth Management services enabled us to successfully acquire new customers and increase product penetration

for the mid- and high-end segments. We made satisfactory progress in our Private Banking business during the year by enriching private banking products and services, optimising our business platform and raising brand awareness. In 2014, the Private Banking business recorded encouraging growth in both the number of clients and assets under management.

### Performance highlights by business segment

**Personal Banking** delivered solid growth in 2014. Net operating income before impairment allowances recorded broad-based growth with an increase of 11.0% to HK\$15,210 million. Profit before taxation recorded an increase of 15.8% to HK\$8,021 million. During the year, we maintained our leading position in new mortgage loans. We also provided a broader and timelier range of investment and insurance products and posted satisfactory growth in related fee and commission income. Our card business sustained its growth momentum, and we maintained our leadership in the UnionPay merchant acquiring business and card issuing business in Hong Kong. Wealth management and Private Banking continued to expand with satisfactory growth in customers.

**Corporate Banking** made encouraging progress in business expansion and recorded steady income growth. Net operating income before impairment allowances and profit before taxation grew by 2.8% to HK\$16,283 million and 0.7% to HK\$11,932 million, respectively. During the period, we successfully grew our Corporate Banking business in the local sector, captured new business opportunities and acquired new customers from financial institutions and central banks. We also continued to support the financing needs of Mainland enterprises expanding abroad through our collaboration with BOC and remained the top mandated arranger in the Hong Kong-Macau syndicated loan market. The corporate loan book grew by 12.1%, although the loan spread declined in the face of intense competition. With the

increase in cross-border activities, we provided a full range of innovative cross-border financial services to meet the diverse needs of our customers.

**Treasury** recorded strong growth in 2014, with net operating income before impairment allowances increasing by 27.1% to HK\$12,071 million. Profit before taxation rose by 29.7% to HK\$10,829 million. With new market opportunities created by interest rate movements, we selectively increased holdings in RMB-denominated bonds and balances and placements with banks. Average yield on the related assets rose with higher RMB market interest rates. Both of these resulted in higher net interest income, which grew by 46.7%. We also achieved solid progress in the bond underwriting business and significantly increased our market share in the underwriting of dim-sum bonds. In 2014, the Group took advantage of RMB exchange rate fluctuations and collaborated with the BOC Group, to provide value-preservation solutions to customers which led to significant growth in corporate and institution clients businesses.

**The Mainland** business registered solid growth in income, although profits were dragged down by higher net charge of loan impairment allowances in a challenging environment. Net operating income increased by 18.8%, driven by the growth in net interest income and net fee income. However, slower economic growth in the Mainland put further pressure on certain industries and new classified or impaired loans increased as a result. We remained focused on managing our asset quality through our prudent credit policy and close monitoring of the credit situation. During the year, we enriched our product and service offerings, such as the introduction of QDII-Overseas Fund Products, platinum credit cards, and Bancassurance business. With the start of business by NCB (China)'s Suzhou Branch and Shanghai Free Trade Zone Sub-branch in the second half of 2014, the Group's branches and sub-branches in the Mainland of China had reached a total of 42 by the end of 2014.

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**The Insurance** segment experienced a decline in net operating income before impairment allowances of 35.8% to HK\$902 million, and profit before taxation decreased by 46.4% to HK\$613 million. The drop was mainly due to a higher provision for insurance liabilities as a result of declining market interest rates and the decrease in return from the equity investments portfolio. Net insurance premium income decreased as demand for RMB insurance products weakened following the devaluation of the RMB. Nevertheless, BOCG Life maintained its leading position in the RMB insurance business in Hong Kong. We also stepped up our marketing efforts by diversifying our distribution channels and establishing partnerships with brokerage houses in order to reach a wider range of customers. Additionally, we introduced a new iPad Sales Kit to our sales team, which improved communication with customers and enhanced our sales performance.

## Outlook

Looking ahead, the operating environment for banks will remain challenging as the global recovery may be uncertain and divergent across different economies. On a positive note, we are encouraged by the business opportunities arising from the Mainland's deepening reform and a new round of opening up. We will be proactive in taking advantage of the opportunities associated with the One Belt, One Road initiative, the internationalisation of the RMB, Mainland enterprises going global, the development of Free Trade Zones and the enhancement of Hong Kong's status as a major hub for international financial services, trade, shipping, and the offshore RMB business. We will also deepen our collaboration with BOC to extend the geographical coverage of our business, drive innovation in financial products and services, and expand our customer base in order to sustain our business development and profit growth. In addition to this, we will remain focused on Serving Society, Delivering Excellence while making every effort to contribute to the enhancement of Hong Kong as an international financial hub and the long-term development of its economy.

Rooted in Hong Kong, we are committed to providing comprehensive financial and investment services to corporate customers, government and public institutions, with the aim of becoming the main bank for more local customers. In addition, the Group will continue its role of supporting the business development of BOC Group in Southeast Asia and will strengthen synergy in our cross-border business and other business areas in order to increase our global capabilities. We will also participate in building a financial artery for the One Belt, One Road strategy to support customer expansion in those markets. Additionally, we will leverage our core competitiveness in the offshore RMB business, cross-border business, trade services, overseas acquisition finance, syndicated loans, fund transaction business, bond issuance and underwriting business to further our global financing service capabilities. We are committed to providing quality cross-border banking services to Mainland enterprises going global as well as other regional and international enterprises.

The Group has the most extensive branch network in Hong Kong and a robust customer base. We will continue to optimise our branch network to enhance the coverage of our new concept branches and wealth management centres. We will continue to enrich our product and service portfolio to meet customers' personalised and diverse needs for financial services. To stay abreast of trends in technology and changes in the banking behaviours of our customers, we will develop our electronic channels and mobile banking in order to provide a better customer experience. Capitalising on the franchise of BOC Group's network in the Mainland of China, Hong Kong and overseas, we will enhance our service capabilities to provide integrated transaction, wealth management and investment services for personal banking customers, with the aim of building the global brand value of BOC Group.

We see emerging opportunities in the financial markets business, where the Group is also strong. To capture these opportunities, we will closely monitor market changes and new policies while staying ahead of economic trends and

changes in interest rates and exchange rates. To reinforce our competitive advantages and leading market position, we will continue to introduce new products in a timely manner and improve our innovation and trading capabilities in treasury products. As the RMB business is the Group's key strategic focus, we will capitalise on our franchise and extensive experience in this business and further develop our product and service portfolio in response to policy and market changes. We are committed to becoming the best choice for the RMB requirements of Mainland, local and overseas financial institutions, as well as corporate and personal customers.

We fully understand that we shall face challenges to our risk management in the complex external environment and meet stricter regulatory requirements. Prudent risk management will remain our primary consideration in pursuit of our business development. As a Domestic Systemically Important Authorised Institution in Hong Kong, we will diligently implement the Basel III guidelines and regulatory requirements, proactively manage capital and liquidity, and continually optimise our balance sheet mix. Our goal is to balance business growth with regulatory requirements and deliver stable shareholder returns. To ensure the healthy growth of our credit business and maintain benign asset quality better than industry average, we will strengthen our credit risk management and adhere closely to our prudent credit policy. We are also committed to strengthening our mechanisms and policies in managing the Group's market risk, operational risk and reputational risk, and will step up our efforts in anti-money laundering in accordance with the regulatory requirements. What's more, we will improve our risk management and internal controls in order to support the sustainable and healthy development of the Group.

Finally, I would like to take this opportunity to note some of the changes that have taken place in our senior management team. Mr HE Guangbei, after twelve years of service, resigned as the Vice Chairman and Chief Executive of the Group due to his age, with effect from 6 March 2015. During his years with us, he successfully led the Group in reinforcing its franchise and financial strength,

expanding its business scope and consistently delivering solid results in a fluctuating operating environment. On behalf of the Group, I would like to pay the highest tribute and express our deepest appreciation to Mr HE for his dedication and exceptional contributions. Due to other job engagements, Mr GAO Yingxin resigned as the Group's Deputy Chief Executive (Corporate Banking) this March, and Mr ZHUO Chengwen resigned as the Group's Chief Financial Officer last August. Mr YEUNG Jason Chi Wai also retired as the Group's Deputy Chief Executive (Personal Banking) this March. I would like to thank them all for their valuable contributions to the Group during their tenure with us.

I am greatly honoured to be appointed as the Vice Chairman and Chief Executive of the Group. Apart from myself, we also have two new senior management members, Madam SUI Yang, our Chief Financial Officer and Mrs KUNG YEUNG Ann Yun Chi, our Deputy Chief Executive (Personal Banking). The new management members will add new impetus to the team. The management team's extensive banking and management experience will help ensure the stability of the Group's management and drive business innovation to further our development. I would also like to take this opportunity to thank all members of the Group for their hard work and dedication, as well as our customers and shareholders for their continuous support and to our Board for their wisdom and counsel. All of their contributions have been key to the Group's success. Building on the Group's strong franchise and solid foundation of nearly 100 years in Hong Kong, my colleagues and I will remain committed to realising the Group's vision to become the Premier Bank for our stakeholders.

**YUE Yi**

*Vice Chairman & Chief Executive*

Hong Kong, 25 March 2015