Innovative
RMB Service

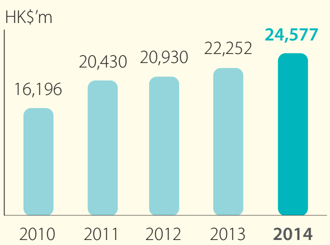
Management's Discussion and Analysis

Financial Performance and Conditions at a Glance

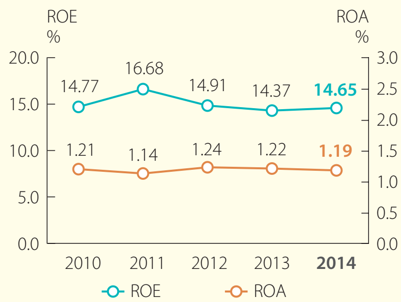
The Group achieved respectable financial results in 2014. Profit attributable to the equity holders reached a new high, driven by the satisfactory growth of its core businesses. Its financial position remained strong and key financial indicators were maintained at solid levels.

Key Performance Trends

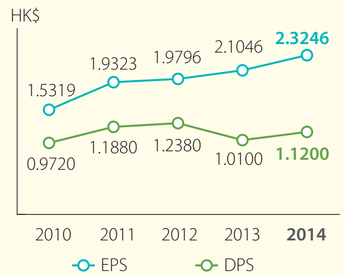
Profit Attributable to the Equity Holders



Return on Average Shareholders' Equity[1] ("ROE") and Return on Average Total Assets[2] ("ROA")



Earnings Per Share ("EPS") and Dividend Per Share ("DPS")



Profit attributable to the equity holders achieved a new high

- Profit attributable to the equity holders increased by 10.4% year-on-year to HK$24,577 million, a new high since listing. Income quality further improved with continuous growth recorded in core businesses.

Solid returns with sustainable growth in core businesses

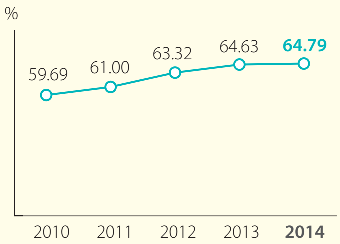
- ROE was 14.65%, up 0.28 percentage point year-on-year, as the increase in profit outpaced that of average equity.
- ROA was 1.19%.

Return to shareholders

- EPS was HK$2.3246. DPS was HK$1.12.

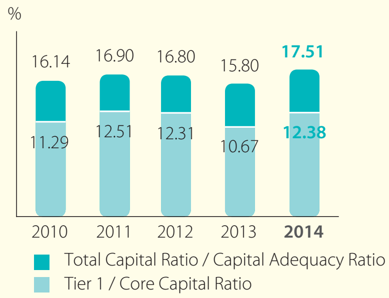
Financial Position

Loan to Deposit Ratio[3]



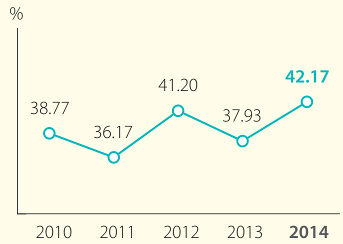
as at 31 December

Capital Ratio[4]



as at 31 December

Average Liquidity Ratio[5]



Balanced growth in advances to customers and deposits from customers

- Advances to customers increased by 12.0% while deposits from customers rose by 11.7%. The loan to deposit ratio was 64.79%.

Enhanced capital position to support business growth

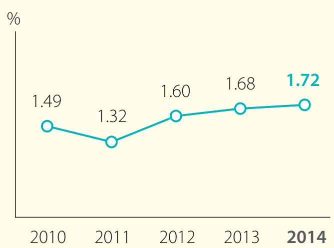
- The Group adopted proactive capital management to meet more stringent regulatory requirements and capture long-term business opportunities. The total capital ratio was 17.51% while the Tier 1 capital ratio was 12.38%.

Sound liquidity position

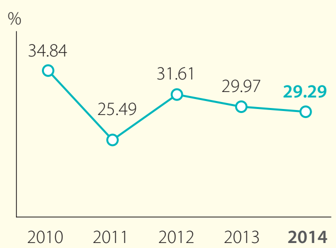
- The average liquidity ratio stood at a sound level of 42.17%.

Key Operating Ratios

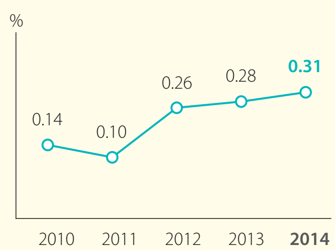
Net Interest Margin ("NIM")



Cost to Income Ratio



Classified or Impaired Loan Ratio[6]



as at 31 December

Improvement in NIM with optimised asset mix

- NIM was 1.72%, up 4 basis points year-on-year. The increase was mainly attributable to the growth in higher-yielding assets such as advances to customers, RMB bonds as well as balances and placements with banks.

Cautious cost control

- The cost to income ratio was 29.29%, down 0.68 percentage point year-on-year, which was still among the lowest in the industry.

Classified or impaired loan ratio at a low level

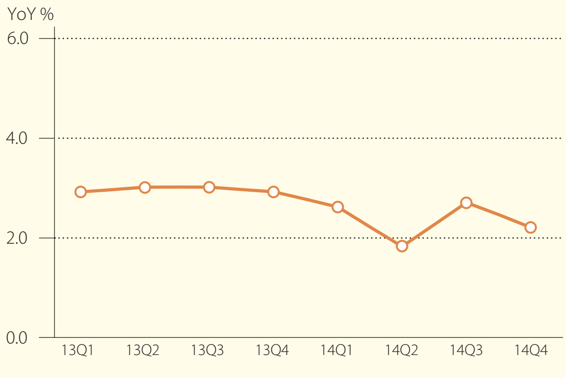
- The classified or impaired loan ratio stood at 0.31%, below the market average.

1. Return on Average Shareholders' Equity as defined in "Financial Highlights".
2. Return on Average Total Assets as defined in "Financial Highlights".
3. Loan represents gross advances to customers while deposits from customers include structured deposits reported as "Financial liabilities at fair value through profit or loss".
4. The capital ratios are computed on the consolidated basis that comprises the positions of BOCHK and certain subsidiaries specified by the HKMA for its regulatory purposes and in accordance with the Banking (Capital) Rules.
5. The average liquidity ratio is calculated as the simple average of each calendar month's average liquidity ratio of BOCHK for the year.
6. Classified or impaired loans represent advances which are either classified as "substandard", "doubtful" or "loss" under the Group's classification of loan quality, or individually assessed to be impaired.

Economic Background and Operating Environment

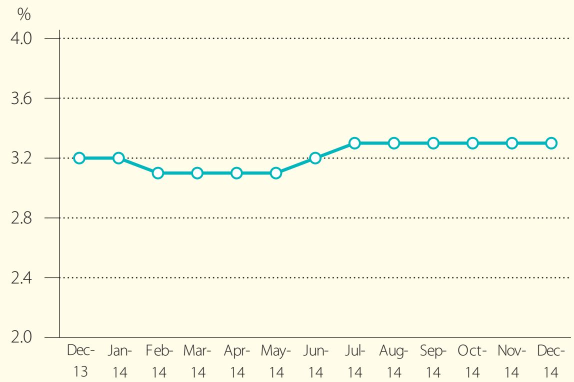
In 2014, the global economy experienced divergent growth. In the US, solid GDP growth and the improved labour market showed that the recovery was based on the economy's underlying strengths. Meanwhile, the sustainability of the growth momentum in the Eurozone remained in doubt amid growing disinflationary pressure. Divergent growth across the advanced economies resulted in different monetary policy paths being taken by the central banks. The Federal Reserve ("the Fed") in the US ended its bond purchase programme in contrast to the introduction of further monetary easing measures by the European Central Bank. In the Mainland of China, economic expansion slowed somewhat, and the Central Government introduced a series of stimulus measures to manage economic growth under the new normal.

Hong Kong Real GDP Growth Rate



Source: HKSAR Census and Statistics Department

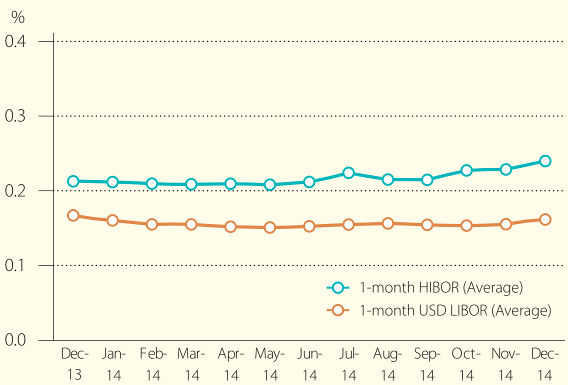
Hong Kong Unemployment Rate



Source: HKSAR Census and Statistics Department

In Hong Kong, the unemployment rate stayed at a low level. Inflationary pressure stayed moderate with the Composite CPI rising by 4.4% year-on-year in 2014. However, economic growth was sluggish owing to subdued external and domestic demand. GDP rose by 2.3% in 2014, underperforming the 2.9% rate of growth in 2013.

HIBOR and USD LIBOR



Source: Bloomberg

Overall liquidity remained strong in the Hong Kong banking sector, and market interest rates were kept at a low level. The average 1-month HIBOR rose slightly from 0.21% in 2013 to 0.22% in 2014, while average 1-month LIBOR fell from 0.19% to 0.16% over the same period. The average 10-year HKD swap rate and USD swap rate rose from 2.26% and 2.47% in 2013 to 2.53% and 2.65% respectively in 2014.

The Hong Kong stock market trended downwards in the first half of the year but rebounded in the second half on various positive factors, including indications by the Fed that it would keep interest rates low for the foreseeable future, a series of stimulus measures unveiled by Mainland Chinese authorities, and the launch of the Shanghai-Hong Kong Stock Connect. The Hang Seng Index reached the lowest point of the year at 21,182 in March and closed at 23,605 at the end of 2014, up 1.3% on a yearly basis.

The local residential property market remained static in the first quarter of the year but turned more active from the second quarter with transaction volume picking up and property prices resuming moderate growth. As a result, the level of transaction activity in 2014, in terms of the number of agreements for sale and purchase for residential building units, registered an increase over 2013. During the year, there was a year-on-year increase in the price of private domestic properties.

In 2014, the offshore RMB business in Hong Kong continued to grow at a robust pace. The total balance of RMB deposits in Hong Kong amounted to RMB1,003.6 billion at the end of 2014, representing an increase of 16.6% from 2013. The turnover of Hong Kong's RMB Real Time Gross Settlement system in 2014 also experienced substantial growth compared with 2013, reflecting a considerable rise in the use of RMB in trade, investment and financing activities. Meanwhile, a number of initiatives were introduced by regulatory authorities to promote the use of RMB globally and hasten the development of the offshore RMB business. These included the widening of the daily exchange rate trading band of onshore RMB; the release of detailed rules for the free trade account system in the China (Shanghai) Pilot Free Trade Zone ("Shanghai Free Trade Zone"); and the launch of Shanghai-Hong Kong Stock Connect. Furthermore, the HKMA announced enhancements to the operation of the RMB liquidity facility, including the extension of operating hours for the provision of overnight RMB funds and the offer of intraday RMB funds; the designation of seven banks as Primary Liquidity Providers with provision of a dedicated repo facility for each. The HKMA also removed the RMB currency conversion limit imposed on Hong Kong residents. All of these developments will help further strengthen Hong Kong's role as a premier offshore RMB centre.

The banking industry in Hong Kong continued to operate in a challenging environment in 2014. Weak external demand and keen market competition put pressure on banks' profitability, as did a number of new regulatory requirements placed on banks during the year. Nevertheless, opportunities arose for banks to expand their business and capture new customers with the introduction of new financial policies in the Mainland of China.

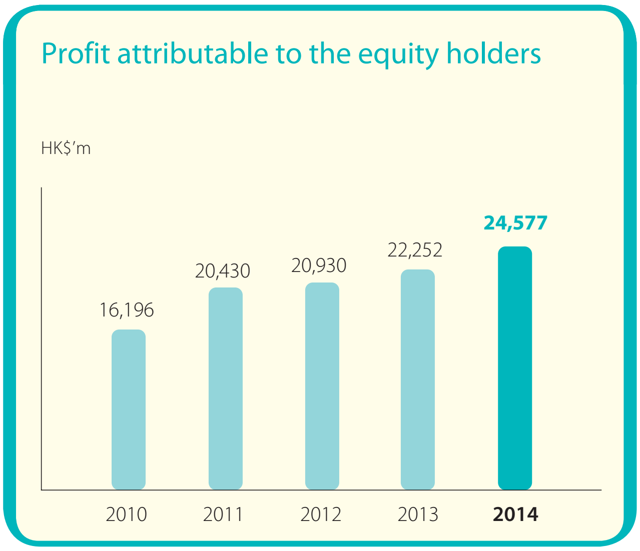
Outlook for 2015

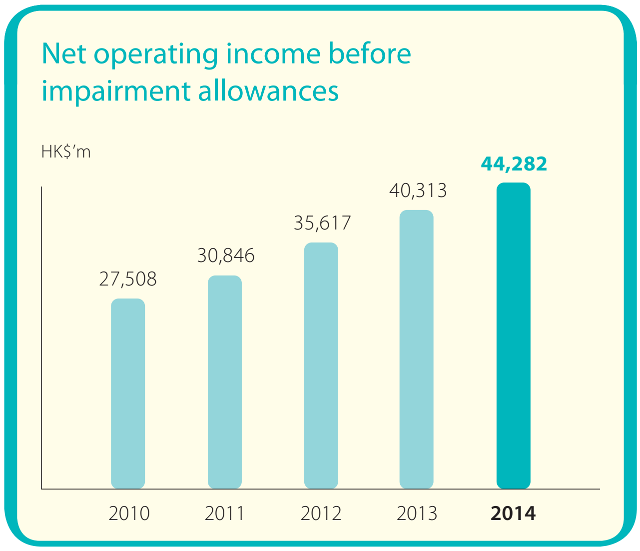
Heading into 2015, the overall operating environment for banks in Hong Kong is likely to be mixed. The diverging monetary policy paths taken in the advanced economies will pose considerable uncertainties in the global economic outlook. Multi-dimensional capital flows around the world and fluctuations caused by fund flows may result in greater challenges for banks in managing their liquidity. In the Mainland of China, the slower-than-expected growth and structural economic reform may have an adverse impact on the region's growth outlook and placed increased credit risk pressures on banks' Mainland exposures. It is also expected that the growth momentum of the Hong Kong economy will remain weak and personal consumption will slow down, both of which could hinder business growth of banks. In addition, banks will have to comply with more stringent regulatory requirements on liquidity risk management following the implementation of Liquidity Coverage Ratio which came into operation on 1 January 2015.

On a more positive note, the robust development of offshore RMB markets will continue. Hong Kong, as a major offshore RMB hub, has shown its first-mover advantage both in terms of breadth and depth of RMB services, which will lead to the further expansion of this business. The preferential policies that are being piloted in the Shanghai Free Trade Zone and the further expansion of these policies to different parts of the Mainland will enable Hong Kong banks to expand their cross-border business. In addition, the Central Government's strategic initiative of "One Belt, One Road" is expected to deepen and expand the cooperation between the Mainland of China and its neighbouring countries. This, together with the accelerated pace of RMB internationalisation and the economic and financial reform in the Mainland of China will provide banks with more business opportunities.

Consolidated Financial Review

Financial Highlights





HK$'m, except percentages	2014	2013	Change (%)
Net operating income before impairment allowances	**44,282**	40,313	9.8
Operating expenses	**(12,972)**	(12,083)	7.4
Operating profit before impairment allowances	**31,310**	28,230	10.9
Operating profit after impairment allowances	**30,260**	27,493	10.1
Profit before taxation	**30,663**	27,793	10.3
Profit attributable to the equity holders of the Company	**24,577**	22,252	10.4

In 2014, the Group achieved a new high in revenues and profits. This was a reflection of the Group's sustainable growth strategy and continuous efforts to build on its franchise in core businesses. It consolidated its strong franchise in the development of the RMB business and continued to collaborate closely with BOC to expand its business and customer base while maintaining stringent risk management and credit control to safeguard asset quality. The financial position of the Group remained solid during the year, with key financial ratios at healthy levels.

The Group's net operating income before impairment allowances increased by HK$3,969 million or 9.8% to HK$44,282 million. The increase was driven by the rise in net interest income and net fee and commission income which both registered double-digit growth. Net interest income was up by 14.3%, as a result of the growth in advances to customers and higher-yielding RMB assets such as bonds and balances and placements with banks. Net fee and commission income increased by 12.9%. The net gain from the disposal of certain equity instruments also contributed to the increase in net operating income. The increases were partially offset by the decline in net operating income of the Group's insurance segment and lower net trading gain. Operating expenses were higher in 2014, as the Group continued to invest in long-term growth. The net charge of loan impairment allowances increased year-on-year. As a result, profit attributable to the equity holders rose by HK$2,325 million, or 10.4%, compared with 2013.

As compared with the first half of 2014, net operating income before impairment allowances increased by HK$984 million or 4.5% in the second half. This growth in income was mainly driven by the increase in net interest income and net fee and commission income as well as the net gain from the disposal of certain equity instruments. The increases were partly offset by the lower net trading gain. Increases were registered in both operating expenses and the net charge of loan impairment allowances. As a result, profit attributable to the equity holders rose by HK$411 million or 3.4% on a half-on-half basis.

Factors Affecting the Group's Performance in 2014

Key factors contributing to the Group's financial performance in 2014 are outlined below:

- Maintained ***healthy growth in both advances to customers and deposits from customers*** with ***effective management of pricing under keen market competition***.
- Stepped up ***capital management*** initiatives, including adjustments to the target dividend payout range in order to ***strengthen capital base*** and the optimisation of ***risk-weighted asset management to improve capital efficiency***. Both of these initiatives enabled the Group to support long-term business growth under the Basel III capital regime.
- Enhancements of service capabilities and businesses which resulted in ***a broad-based growth in net fee and commission income***.
- Proactive in capturing business opportunities from the ***offshore RMB business*** and enhanced the income contribution from the RMB business. The better deployment of RMB funds is one of the key factors that contributed to the rise in income.
- Further improved ***operational efficiency*** and achieved a ***cost to income ratio that is among the lowest in the industry***.

The Group's financial performance in 2014 was also affected by the following key negative factors:

- The low market interest rates and intense market competition constrained the Group's ***interest spread***.
- Slower economic growth on the Mainland put pressure on certain industries, which resulted in a ***worsening of asset quality*** in the Group's Mainland business and hence a ***higher net charge of loan impairment allowances***.

Income Statement Analysis

Net Interest Income and Margin

HK$'m, except percentages	2014	2013	Change (%)
Interest income	**47,952**	39,379	21.8
Interest expense	**(16,033)**	(11,463)	39.9
Net interest income	**31,919**	27,916	14.3
Average interest-earning assets	**1,860,620**	1,657,215	12.3
Net interest spread	**1.59%**	1.58%	
Net interest margin*	**1.72%**	1.68%	

* Net interest margin is calculated by dividing net interest income by average interest-earning assets.

The Group's net interest income increased by HK$4,003 million or 14.3% year-on-year, driven by both the growth in average interest-earning assets and the widening of net interest margin. Average interest-earning assets expanded by HK$203,405 million or 12.3%, mainly supported by the increase in deposits from customers and an increase in RMB funds from the clearing bank business. Net interest margin was 1.72%, up 4 basis points compared with 2013, mainly attributable to the increase in higher-yielding assets such as advances to customers, RMB bonds and balances and placements with banks. The net interest margin was also enhanced by the increase in average yield of balances and placements with banks and RMB bonds. The positive impact was partly offset by the narrowing of the loan and deposit spread as deposit costs rose due to keen market competition.

The table below summarises the average balances and average interest rates of individual categories of assets and liabilities:

	Year ended 31 December 2014		Year ended 31 December 2013	
ASSETS	**Average balance HK$'m**	**Average yield %**	Average balance HK$'m	Average yield %
Balances and placements with banks and other financial institutions	**447,579**	**3.08**	330,475	2.60
Debt securities investments	**475,037**	**2.43**	498,493	2.15
Advances to customers	**922,492**	**2.43**	813,964	2.44
Other interest-earning assets	**15,512**	**1.41**	14,283	1.48
Total interest-earning assets	**1,860,620**	**2.58**	1,657,215	2.38
Non interest-earning assets	**252,002**	**–**	233,188	–
Total assets	**2,112,622**	**2.27**	1,890,403	2.08

LIABILITIES	**Average balance HK$'m**	**Average rate %**	Average balance HK$'m	Average rate %
Deposits and balances from banks and other financial institutions	**190,441**	**0.87**	155,896	0.67
Current, savings and time deposits	**1,361,986**	**0.99**	1,206,583	0.82
Certificates of deposit issued	**239**	**1.01**	–	–
Subordinated liabilities	**19,614**	**1.38**	24,150	0.49
Other interest-bearing liabilities	**51,794**	**1.18**	52,375	0.89
Total interest-bearing liabilities	**1,624,074**	**0.99**	1,439,004	0.80
Non interest-bearing deposits	**97,898**	**–**	86,504	–
Shareholders' funds* and other non interest-bearing liabilities	**390,650**	**–**	364,895	–
Total liabilities	**2,112,622**	**0.76**	1,890,403	0.61

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

Second Half Performance

Compared with the first half of the year, net interest income increased by HK$607 million, or 3.9%, to HK$16,263 million. The increase was mainly driven by the 5.0% growth in average interest-earning assets, supported by the increase in deposits from customers.

Net interest margin was 1.69%, narrowing by 5 basis points half-on-half, mainly due to the decrease in the average yield of RMB assets caused by drop in RMB market interest rates and the increase in lower-yielding assets in short-term debt securities investments. Nevertheless, the Group was proactive in managing its assets and liabilities and was effective in controlling its deposit pricing. It increased higher-yielding assets of RMB balances and placements with banks as well as bonds. The loan and deposit spread widened. All these partly offset the above negative impact.

Net Fee and Commission Income

HK$'m, except percentages	2014	2013	Change (%)
Credit cards business	**3,673**	3,516	4.5
Securities brokerage	**2,676**	2,432	10.0
Loan commissions	**2,185**	1,900	15.0
Insurance	**1,562**	1,285	21.6
Funds distribution	**1,035**	821	26.1
Bills commissions	**810**	819	(1.1)
Payment services	**604**	665	(9.2)
Trust and custody services	**450**	387	16.3
Safe deposit box	**264**	244	8.2
Currency exchange	**231**	197	17.3
Others	**515**	450	14.4
Fee and commission income	**14,005**	12,716	10.1
Fee and commission expenses	**(3,883)**	(3,751)	3.5
Net fee and commission income	**10,122**	8,965	12.9

Net fee and commission income grew by HK$1,157 million, or 12.9%, to HK$10,122 million in 2014. The increase was broad-based, reflecting the Group's efforts to broaden its fee income sources through diversified businesses. Loan commissions rose by 15.0%, due mainly to higher commission income from corporate loans. Income from insurance grew by 21.6%, owing to the rise in business volume that resulted from the Group's enriched product offerings from its insurance partner. The optimisation of wealth management solutions drove the growth by 26.1% in commission income from funds distribution while the favourable market sentiment in the second half of the year led to the 10.0% increase in commission income from securities brokerage. Commission income from credit cards, trust and custody services as well as currency exchange also recorded healthy growth. However, commission income from payment services and bills declined as affected by the volume of customer transactions. The increase in fee and commission expenses was mainly caused by higher insurance, credit cards and securities brokerage related expenses.

Second Half Performance

Compared with the first half of 2014, net fee and commission income was up by HK$492 million, or 10.2%, in the second half of the year. Market sentiment improved following the launch of Shanghai-Hong Kong Stock Connect, leading to an encouraging growth in commission income from securities brokerage. Commission income from insurance also recorded a strong growth, while income from credit cards, trust and custody services as well as currency exchange experienced continuous growth momentum from the first half. Loan and bills commissions, however, declined.

Net Trading Gain/(Loss)

HK$'m, except percentages	2014	2013	Change (%)
Foreign exchange and foreign exchange products	**1,404**	1,952	(28.1)
Interest rate instruments and items under fair value hedge	**727**	573	26.9
Commodities	**60**	91	(34.1)
Equity and credit derivative instruments	**(29)**	341	N/A
Net trading gain	**2,162**	2,957	(26.9)

Net trading gain was HK$2,162 million, down HK$795 million, or 26.9%, year-on-year. Net trading gain from foreign exchange and foreign exchange products dropped by HK$548 million, primarily due to the higher net trading loss from foreign exchange swap contracts*. Net trading gain from interest rate instruments and items under fair value hedge rose by HK$154 million, mainly attributable to the mark-to-market changes of certain debt securities caused by market interest rate movements. The decrease in net trading gain from commodities was due to the decline in bullion transactions. There was a net trading loss from equity and credit derivative instruments as opposed to a net gain in 2013, mainly due to the mark-to-market changes and the net trading loss from certain equity instruments.

Second Half Performance

Compared with the first half of 2014, net trading gain decreased by HK$496 million, or 37.3%. This was mainly due to the increase in net trading loss from foreign exchange swap contracts* and the decrease of the mark-to-market gain of certain debt securities.

* Foreign exchange swap contracts are usually used for the Group's liquidity management and funding activities. Under the foreign exchange swap contracts, the Group exchanges one currency (original currency) for another (swapped currency) at the spot exchange rate (spot transaction) and commits to reverse the spot transaction by exchanging the same currency pair at a future maturity at a predetermined rate (forward transaction). In this way, surplus funds in the original currency are swapped into another currency for liquidity and funding purposes with minimal foreign exchange risk. The exchange difference between the spot and forward contracts is recognised as a foreign exchange gain or loss (as included in "net trading gain/(loss)"), while the corresponding interest differential between the surplus funds in the original currency and swapped currency is reflected in net interest income.

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

HK$'m, except percentages	2014	2013	Change (%)
Net gain/(loss) on financial instruments designated at fair value through profit or loss	**25**	(159)	N/A

In 2014, the Group recorded a net gain of HK$25 million on financial instruments designated at FVTPL, compared with a net loss of HK$159 million in 2013. The change was mainly due to the mark-to-market changes of debt securities investments of BOCG Life, which was caused by market interest rate movements. The changes in market value of its securities portfolio were offset by the corresponding changes in policy reserves, as reflected in the changes in net insurance benefits and claims which were attributable to the movement of market interest rates.

Second Half Performance

A net gain of HK$7 million was recorded in the second half of the year, down HK$11 million as compared with a net gain of HK$18 million in the first half. The decrease in net gain was mainly attributable to the mark-to-market changes of certain debt securities investments.

Operating Expenses

HK$'m, except percentages	2014	2013	Change (%)
Staff costs	**7,268**	6,819	6.6
Premises and equipment expenses (excluding depreciation)	**1,679**	1,576	6.5
Depreciation on owned fixed assets	**1,829**	1,663	10.0
Other operating expenses	**2,196**	2,025	8.4
Total operating expenses	**12,972**	12,083	7.4

	At 31 December 2014	At 31 December 2013	Change (%)
Staff headcount measured in full-time equivalents	**14,926**	14,647	1.9

Total operating expenses increased by HK$889 million, or 7.4%, compared with 2013, reflecting the Group's continuous investments in service capabilities and new businesses. The Group remained focused on disciplined cost control while continuing to support long-term business growth.

Staff costs increased by 6.6%, mainly due to higher salaries as a result of the annual salary increment and increased headcount.

Premises and equipment expenses were up 6.5%, owing to higher rents for branches in Hong Kong and the Mainland of China, as well as higher IT costs.

Depreciation on owned fixed assets rose by 10.0% due to the larger depreciation charge on premises following the upward property revaluation in Hong Kong and on IT equipment as the Group continued to invest in IT infrastructure.

Other operating expenses were up 8.4% mainly due to higher expenses in connection with the increasing business volume and higher business taxes of NCB (China).

At the end of 2014, the total headcount measured in full-time equivalents rose by 1.9% to 14,926.

Second Half Performance

Compared with the first half of 2014, operating expenses rose by HK$540 million, or 8.7%. The increase was due to higher staff and advertising costs, as well as depreciation and maintenance expenses in the second half of the year.

Net Charge of Loan Impairment Allowances

HK$'m, except percentages	2014	2013	Change (%)
Net charge of allowances before recoveries			
– individual assessment	**(748)**	(313)	139.0
– collective assessment	**(485)**	(705)	(31.2)
Recoveries	**202**	288	(29.9)
Net charge of loan impairment allowances	**(1,031)**	(730)	41.2

Net charge of loan impairment allowances increased by HK$301 million, or 41.2% from 2013.

Net charge of individually assessed impairment allowances amounted to HK$748 million, up HK$435 million or 139.0%, mainly caused by the downgrade of a few corporate advances due to the worsening asset quality situation in the Mainland of China.

Net charge of collectively assessed impairment allowances amounted to HK$485 million, down HK$220 million or 31.2%. The lower net charge in 2014 was due to the periodic update of the parameter values in the assessment model.

Recoveries amounted to HK$202 million, down HK$86 million or 29.9% from 2013.

Second Half Performance

Net charge of loan impairment allowances rose by HK$277 million or 73.5% from the first half of the year. The increase was mainly caused by the downgrade of a few corporate advances extended by the Group's Mainland business.

Total loan impairment allowances as a percentage of gross advances to customers

	At 31 December 2014	At 31 December 2013
Loan impairment allowances		
– individual assessment	**0.11%**	0.10%
– collective assessment	**0.37%**	0.39%
Total loan impairment allowances	**0.48%**	0.49%

Balance Sheet Analysis

Asset Deployment

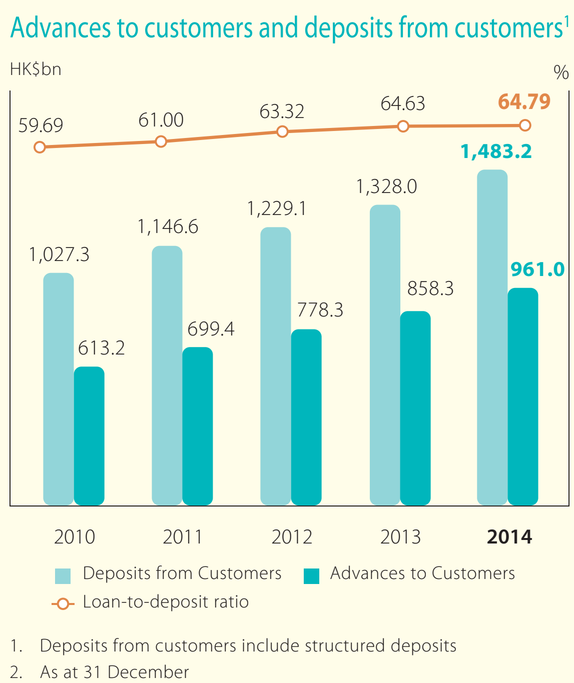
HK$'m, except percentages	At 31 December 2014 Amount	At 31 December 2014 % of total	At 31 December 2013 Amount	At 31 December 2013 % of total
Cash and balances with banks and other financial institutions	**398,673**	**18.2**	353,741	17.3
Placements with banks and other financial institutions maturing between one and twelve months	**37,436**	**1.7**	46,694	2.3
Hong Kong SAR Government certificates of indebtedness	**90,770**	**4.2**	99,190	4.8
Securities investments[1]	**492,820**	**22.5**	484,213	23.6
Advances and other accounts	**1,014,129**	**46.3**	924,943	45.2
Fixed assets and investment properties	**69,766**	**3.2**	66,955	3.3
Other assets[2]	**85,773**	**3.9**	71,200	3.5
Total assets	**2,189,367**	**100.0**	2,046,936	100.0

1. Securities investments comprise investment in securities and financial assets at fair value through profit or loss.
2. Interests in associates and a joint venture, deferred tax assets and derivative financial instruments are included in other assets.

As at 31 December 2014, total assets amounted to HK$2,189,367 million, increasing by HK$142,431 million or 7.0% from the end of 2013. The Group proactively managed its assets and liabilities and continued to optimise asset allocation in order to enhance returns.

Key changes in the Group's total assets include the following:

- Cash and balances with banks and other financial institutions increased by 12.7%, mainly due to the increase in balances and placements with banks relating to the Group's RMB business.
- Placements with banks and other financial institutions maturing between one and twelve months decreased by 19.8% as the Group redeployed its funds in higher-yielding assets such as advances to customers and securities investments.
- Securities investments increased by 1.8% as the Group increased its holdings in high-quality corporate bonds and RMB-denominated bonds.
- Advances and other accounts rose by 9.6%, with the growth in advances to customers by 12.0%.
- Other assets grew by 20.5%, which was led by the increase in reinsurance assets and derivative financial instruments.



Advances to Customers

HK$'m, except percentages	At 31 December 2014 Amount	At 31 December 2014 % of total	At 31 December 2013 Amount	At 31 December 2013 % of total
Loans for use in Hong Kong	**575,401**	**59.9**	507,971	59.2
Industrial, commercial and financial	**308,141**	**32.1**	267,632	31.2
Individuals	**267,260**	**27.8**	240,339	28.0
Trade finance	**86,316**	**9.0**	85,413	9.9
Loans for use outside Hong Kong	**299,272**	**31.1**	264,948	30.9
Total advances to customers	**960,989**	**100.0**	858,332	100.0

The Group continued to adopt stringent risk management and focus on customer selection to achieve quality growth. Advances to customers grew by HK$102,657 million or 12.0% to HK$960,989 million in 2014.

Loans for use in Hong Kong grew by HK$67,430 million or 13.3%.

- Lending to the industrial, commercial and financial sectors increased by HK$40,509 million, or 15.1%. Lending to the property development, transport and transport equipment, wholesale and retail, manufacturing and information technology sectors grew by 18.3%, 19.4%, 15.7%, 26.6% and 22.9% respectively.
- Lending to individuals increased by HK$26,921 million, or 11.2%. Residential mortgage loans (excluding those under the Government-sponsored home purchasing schemes) grew by 7.2%. Credit card advances rose by 6.5% while other individual loans increased by 45.3%.

Trade finance rose by HK$903 million, or 1.1%, while loans for use outside Hong Kong increased by HK$34,324 million, or 13.0%.

Second Half Performance

Advances to customers increased by HK$12,285 million, or 1.3%, amid slowing loan demand in the second half of the year. The growth in loans for use in and outside Hong Kong was partly offset by the decrease in trade finance.

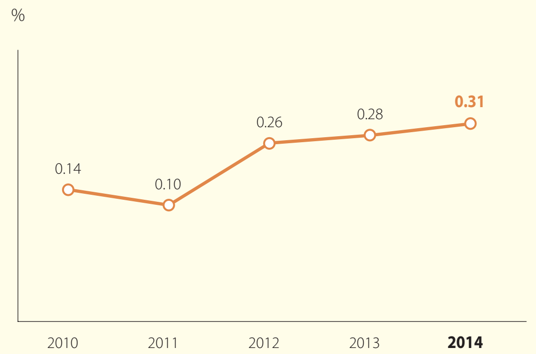
Loan Quality

HK$'m, except percentages	At 31 December 2014	At 31 December 2013
Advances to customers	**960,989**	858,332
Classified or impaired loan ratio	**0.31%**	0.28%
Impairment allowances	**4,616**	4,235
Regulatory reserve for general banking risks	**10,011**	8,994
Total allowances and regulatory reserve	**14,627**	13,229
Total allowances as a percentage of advances to customers	**0.48%**	0.49%
Impairment allowances[1] as a percentage of classified or impaired advances	**38.20%**	36.09%
Residential mortgage loans[2] – delinquency and rescheduled loan ratio[3]	**0.02%**	0.02%
Card advances – delinquency ratio[3]	**0.17%**	0.18%

	2014	2013
Card advances – charge-off ratio[4]	**1.42%**	1.43%

1. Referring to impairment allowances on advances classified as "substandard", "doubtful" or "loss" under the Group's classification of loan quality, or individually assessed to be impaired.
2. Residential mortgage loans exclude those under the Home Ownership Scheme and other government-sponsored home purchasing schemes.
3. The delinquency ratio is measured by the ratio of the total amount of overdue advances (more than three months) to total outstanding advances.
4. The charge-off ratio is measured by the ratio of total write-offs made during the year to average card receivables during the year.

Classified or impaired loan ratio



* as at 31 December

The classified or impaired loan ratio was 0.31%. Classified or impaired advances to customers rose by HK$575 million to HK$3,008 million, mainly due to the downgrade of a few corporate advances extended by the Group's Mainland business.

Total impairment allowances, including both individual assessment and collective assessment, amounted to HK$4,616 million. Total impairment allowances on classified or impaired advances as a percentage of total classified or impaired advances was 38.20%.

The credit quality of the Group's residential mortgage loans and card advances remained sound. The combined delinquency and rescheduled loan ratio stood at 0.02% at the end of 2014. As compared with 2013, the charge-off ratio of card advances decreased by a 0.01 percentage point to 1.42%.

Deposits from Customers*

HK$'m, except percentages	At 31 December 2014 Amount	At 31 December 2014 % of total	At 31 December 2013 Amount	At 31 December 2013 % of total
Demand deposits and current accounts	**116,361**	**7.8**	104,784	7.9
Savings deposits	**672,826**	**45.4**	636,137	47.9
Time, call and notice deposits	**690,922**	**46.6**	583,227	43.9
	1,480,109	**99.8**	1,324,148	99.7
Structured deposits	**3,115**	**0.2**	3,832	0.3
Deposits from customers	**1,483,224**	**100.0**	1,327,980	100.0

* Including structured deposits

The Group maintained a flexible deposit strategy to support business growth while proactively managing deposit pricing in response to market changes. Total deposits from customers amounted to HK$1,483,224 million at 31 December 2014, up HK$155,244 million, or 11.7%, from the end of 2013. Demand deposits and current accounts grew by 11.0%, while savings deposits increased by 5.8%. Time, call and notice deposits also increased by 18.5%. The loan to deposit ratio was 64.79% at the end of 2014, up 0.16 percentage point from the end of 2013.

Second Half Performance

Total deposits from customers increased by HK$42,848 million, or 3.0%, in the second half of 2014. Demand deposits and current accounts increased by 12.9%, while savings deposits went up by 8.3%. Time, call and notice deposits declined by 2.9%.

Capital and Reserves Attributable to the Equity Holders of the Company

HK$'m	At 31 December 2014	At 31 December 2013
Share capital	**52,864**	52,864
Premises revaluation reserve	**37,510**	34,682
Reserve for fair value changes of available-for-sale securities	**1,930**	488
Regulatory reserve	**10,011**	8,994
Translation reserve	**778**	1,051
Retained earnings	**73,621**	60,734
Reserves	**123,850**	105,949
Capital and reserves attributable to the equity holders of the Company	**176,714**	158,813

Capital and reserves attributable to the equity holders of the Company increased by HK$17,901 million, or 11.3%, to HK$176,714 million as at 31 December 2014. Retained earnings rose by 21.2%, reflecting the 2014 profit after the appropriation of dividends. The premises revaluation reserve increased by 8.2%, which was attributable to the increase in property prices in 2014. Regulatory reserve rose by 11.3%, mainly due to growth in advances to customers. Reserve for fair value changes of available-for-sale securities increased by 295.5%, due to lowering market interest rates.

Capital and Liquidity Ratio

HK$'m, except percentages	At 31 December 2014	At 31 December 2013
Consolidated capital after deductions		
Common Equity Tier 1 capital	**110,440**	92,112
Additional Tier 1 capital	**733**	894
Tier 1 capital	**111,173**	93,006
Tier 2 capital	**46,035**	44,683
Total capital	**157,208**	137,689
Total risk-weighted assets	**897,812**	871,618
Common Equity Tier 1 capital ratio	**12.30%**	10.57%
Tier 1 capital ratio	**12.38%**	10.67%
Total capital ratio	**17.51%**	15.80%

	2014	2013
Average liquidity ratio	**42.17%**	37.93%

The capital ratios are computed on a consolidated basis that comprises the positions of BOCHK and certain subsidiaries specified by the HKMA for its regulatory purposes and in accordance with the Banking (Capital) Rules.

In order to meet more stringent regulatory requirements and capture future business opportunities, the Group adopted proactive measures to manage its capital for sustainable growth. In 2013, the Group adjusted its target dividend payout range for the purpose of strengthening its capital base through internal retention. During the year, the Group continued to optimise the risk-weights of its assets. The Group's aim is to maintain a solid capital adequacy level to support an appropriate rate of growth.

The total capital ratio at 31 December 2014 was 17.51%, up 1.71 percentage points from that at the end of 2013. Total capital expanded by 14.2% to HK$157,208 million, mainly due to the increase in retained earnings, the reserve for fair value changes of available-for-sale securities and premises revaluation reserve. Total risk-weighted assets were up 3.0%, mainly from changes in credit risk-weighted assets due to growth in advances to customers in 2014.

The average liquidity ratio in 2014 remained sound at 42.17%.

Business Review

2014 Business Highlights

Personal Banking

- Maintained leading position in new residential mortgages and the UnionPay card business.
- The Group's refined customer segmentation strategy improved total relationship management. The enhanced service capability resulted in the satisfactory growth of the investment and insurance business.
- Launched comprehensive A shares investment services, and took the lead in the market with the launch of A shares margin services.
- Launched the BOCHK Credit Card WeChat official account.
- The Group received the Online Securities Platform of the Year – Hong Kong by Asian Banking and Finance and the Outstanding Retail Banking Business – Internet Banking award at the RMB Business Outstanding Awards 2014 organised by Metro Finance, Metro Finance Digital and Hong Kong Wen Wei Po for the second consecutive year.

Corporate Banking

- Remained the top mandated arranger in the Hong Kong-Macau syndicated loan market.
- Expanded the customer base and captured new business opportunities with leading enterprises from the Mainland, as well as financial institutions and central banks from overseas.
- Set up a regular co-operation mechanism among BOC Group's Guangdong, Hong Kong and Macau operations.
- Participated in a number of significant syndicated loans for Mainland enterprises in support of their overseas expansion.
- The Group received the Best SME's Partner Award for the seventh consecutive year.

Treasury

- Selectively increased investments in high-quality corporate bonds and RMB-denominated bonds.
- Launched a US commercial paper programme for enhancing liquidity management and diversifying its funding sources.
- The Group extended its global banknote distribution network to new market districts of Central America, Central and Southeast Asia and was granted a franchise in managing the Extended Custodial Inventory of a major currency.

RMB Business in Hong Kong

- Maintained leading position in cross-border trade settlement, RMB deposits, RMB insurance and currency exchange services.
- Helped corporates set up cross-border cash pooling services in RMB and underwrote cross-border RMB loans for corporates established in the Shanghai Free Trade Zone.
- Launched RMB settlement services for member institutions of UnionPay International Co. Ltd.
- Extended the RMB clearing service hours to 20.5 hours per day in order to cover time zones in Europe, America and Asia – the longest RMB clearing service hours globally.
- BOCHK was designated by the HKMA as the Primary Liquidity Provider to provide liquidity support to the market.
- BOCHK acted as a designated bank of China Securities Depository and Clearing Corporation Limited at the Hong Kong Securities Clearing Company Limited ("HKSCC"), as well as the designated settlement bank of HKSCC for northbound trading under the Shanghai-Hong Kong Stock Connect.
- Successfully migrated to the second generation of the China National Advanced Payment System in order to reinforce its RMB clearing efficiency and service capability.

Other new businesses

- The asset management business recorded encouraging growth in assets under management and expanded its geographical presence. Its BOCHK RMB High Yield Bond Fund was redomiciled to Luxemburg, allowing the fund to be distributed in Europe. The fund was awarded the Best RMB Bonds, Offshore, Three Years by Asia Asset Management for its 2014 Best of the Best Awards. Meanwhile, BOCHK AM was named the Best RMB Manager by Asia Asset Management under the same award. It also received the Best in Class RMB Fixed Income in the BENCHMARK Fund of the Year Award 2014.
- Further expanded the custody business and client base and remained one of the largest RQFII service providers in Hong Kong.
- Cash management services won the Achievement Award for Best Cash Management Bank in Hong Kong by The Asian Banker for two consecutive years in a row, as well as the Hong Kong Domestic Cash Management Bank of the Year in 2014 awarded by Asian Banking and Finance.
- The private banking business enriched its product and service offering and stepped up collaboration with BOC's branches in the Mainland and overseas to provide cross-border services.

Business Segment Performance

Profit before Taxation by Business Segments

HK$'m, except percentages	2014	% of total	2013	% of total
Personal Banking	**8,021**	**26.2**	6,926	24.9
Corporate Banking	**11,932**	**38.9**	11,844	42.6
Treasury	**10,829**	**35.3**	8,347	30.0
Insurance	**613**	**2.0**	1,144	4.1
Others	**(732)**	**(2.4)**	(468)	(1.6)
Total profit before taxation	**30,663**	**100.0**	27,793	100.0

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

Personal Banking

Financial Results

Personal Banking recorded an increase of HK$1,095 million, or 15.8%, in profit before taxation in 2014 compared with the previous year. The growth was mainly attributable to the increases in net interest income and net fee and commission income as well as the net gain from the disposal of certain equity instruments. The increase was, however, partly offset by the lower net trading gain and higher operating expenses.

Net interest income increased by 6.9%. This was mainly driven by the improvement in the deposit spread coupled with the increase in the average balance of deposits and loans.

Net fee and commission income rose by 13.5%. This robust growth was attributable to the higher income from insurance, securities brokerage, funds distribution and credit cards.

During the year, the Group captured market opportunities to dispose of certain equity instruments and realised a net gain.

Net trading gain declined by 31.6%, mainly caused by mark-to-market changes of equity instruments and a lower net gain from foreign exchange related products.

Business operations

The Group's Personal Banking business continued to achieve steady growth in 2014. It maintained its leading position in new mortgage loans and registered satisfactory growth in fee and commission income from funds distribution, insurance and securities brokerage. It also maintained its market leadership position in the UnionPay card business. During the year, the Group's refined customer segmentation strategy, including Wealth Management for customers with wealth management needs; Enrich Banking for mid-segment customers and i-Free Banking for the younger generation of clientele, resulted in the building of stronger relationships with customers. With its tailored sales and promotional campaigns targeted at different customer segments, the Group developed a competitive edge in cross-border services that resulted in the expansion of its client base and an improved customer mix.

Maintaining its market leadership in residential mortgages

In 2014, despite a slowdown in the first quarter, residential property market activities picked up from the second quarter of the year. By developing its strategic initiatives on market conditions and pricing, the Group maintained its leadership position in new residential mortgage loans. These included the launch of the Mortgage Expert mobile application, a one-stop mortgage service, including the first of its kind property valuation alert service that provides upside and downside triggers, mortgage application review and application appointment services. The Group also introduced new mortgage insurance business partners to strengthen its sales channel network. Meanwhile, it continued its mortgage top-up and re-financing promotions in order to provide an extensive range of products and services across all channels. In addition, with the launch of HKMA's new measures on the personal RMB business in Hong Kong, the Group rolled out the first of its kind RMB mortgage loan service to Hong Kong residents to reinforce the Group's RMB lending business.

Satisfactory growth in the investment and insurance businesses

Investment and insurance businesses registered encouraging performance with satisfactory growth in commission income from securities brokerage, funds distribution and insurance. Through the Group's Securities Club and promotion of Family Securities Accounts, it was able to increase the number of new accounts during the year. In order to strengthen investor education before the launch of Shanghai-Hong Kong Stock Connect, the Group took a leadership role in the market and launched an A Shares Information Web Page, providing free A share stock quotes and information. The Group also held customer seminars in Hong Kong and the Mainland of China to widen customers' understanding of these two stock markets. With the official launch made in November, the Group also became one of the first banks to provide A share-related services by enabling customers to trade in A shares and conduct RMB exchange transactions conveniently through multiple trading channels, including internet banking, a trading hotline and the Group's branches. In addition, the Group took the lead in the market to launch A shares margin services and various promotional campaigns were launched to acquire new customers and stimulate customer activity and securities turnover.

In the funds distribution business, the Group continued to broaden its product offerings. A number of currency-hedged funds including RMB and AUD were introduced to meet customers' investment needs. Based on customer research, the Group provided time-to-market products and launched themed marketing campaigns that led to an encouraging growth in commission income from funds distribution over the previous year.

In the Bancassurance business, the Group continued to maintain its leading position in the Hong Kong RMB insurance market and developed appropriate product bundles to meet customers' needs. The Group also ran a series of marketing campaigns to reinforce the Group's brand image. Insurance commission income grew satisfactorily, with increased contribution from whole-life insurance and annuity products.

A recognised leader in the UnionPay card business

With the Group's credit card business sustaining its growth momentum in 2014, it maintained its leadership in the UnionPay merchant acquiring business and card issuing business in Hong Kong. The BOCHK e-Wallet – Mobile Payment Services introduced in 2013 was further extended to support UnionPay QuickPass payment. This was the first such service in the market allowing customers to enjoy cross-border dual-currency mobile payment. The Group also introduced a mobile application to reach out to customers. Additionally, the Group launched BOCHK Credit Card WeChat official account and introduced the BOC Express Cash Mobile Instant Approval service, which allows customers to apply for personal loans and receive instant approvals. With UnionPay International Co. Ltd., the Group launched a new premium credit card, the BOC CUP Dual Currency Diamond Card, with enhanced services for affluent cardholders.

A growing customer base for its wealth management services

During the year, the Group continued to focus on customer segmentation in order to promote total relationship management and provide more targeted products and personalised services that meet customers' needs. Targeting potential customers for Wealth Management and Enrich Banking, the Group rolled out a large-scale marketing programme to strengthen brand awareness and create a better customer experience. Satisfactory growth was recorded in terms of number of customers and the related Total Relationship Balance.

The Group's Private Banking business continued to make good progress during the year by enriching designated private banking products and services, optimising its business platform and raising brand awareness. The Group also introduced designated share trading and estate planning services as well as treasury and RMB-related products. In addition, it offered portfolio lending and premium financing to provide additional liquidity for customers. In collaboration with BOC's branches in the Mainland and overseas, the Group introduced a range of one-stop global cross-border banking services. As a result, it achieved encouraging growth in both the number of Private Banking clients and their assets under management.

Improved electronic banking

In 2014, the Group continued to optimise its distribution channels to meet the needs of customers. At the end of 2014, the Group's service network in Hong Kong comprised 262 branches, including 134 wealth management centres. It added to this network by expanding the number of automated banking channels in terms of coverage points and facilities. Other service improvements included the launch of a brand new mobile application, upgraded mobile banking and 24-hour Online Chat service at its call centres for Wealth Management customers. In recognition of its well-received electronic platform and outstanding services, the Group received various industry awards during the year.

Corporate Banking

Financial Results

Corporate Banking recorded a growth of HK$88 million, or 0.7%, in profit before taxation. Both net interest income and net fee and commission income increased. The increase was, however, partly offset by the higher net charge of loan impairment allowances.

Net interest income rose by 1.6%, mainly driven by the improvement in deposit spread coupled with the increase in average balance of loans and deposits. The growth was partly offset by the decline in loan spread amid keen market competition.

Net fee and commission income increased by 7.2%, largely led by the growth in commission income from loans and trust services.

Net charge of loan impairment allowances was up 45.9%, mainly due to the higher net charge of individually assessed impairment allowances incurred by the Group's Mainland business.

Business operations

The Group's Corporate Banking business continued to grow in the local sector while its cohesive relationship with BOC enabled the Group to capture the increasing demand for cross-border banking services from BOC Group's customers around the globe. Together with BOC, the Group continued to support the financing needs of Mainland enterprises expanding abroad. It also extended its geographical presence by securing relationships with financial institutions and central banks in various overseas regions. In the cash management business, the Group further leveraged its competitive advantages and became the arranger for cross-border cash pooling services for various major corporates. In the custody business, the Group continued to expand its business coverage over different geographical locations.

Increasing its cooperation with BOC in corporate lending

In 2014, the Group deepened its collaboration with BOC and its overseas branches. With opportunities arising from Mainland enterprises going global and foreign enterprises expanding into the Mainland, it successfully expanded its customer base and captured new business opportunities with leading enterprises in Hong Kong, the Mainland and overseas. Riding on its strong franchise in the RMB business, the Group secured relationships with financial institutions and central banks in overseas regions. A two-way information exchange and business referral channel established with BOC continued to serve its major purpose. Its regular co-operation mechanism set up among BOC Group's Guangdong, Hong Kong and Macau operations raised the BOC Group's service capabilities in these three areas. Meanwhile, capitalising on its edge as the Asia-Pacific Syndicated Loan Centre of BOC Group, the Group participated in a number of significant syndicated loans for Mainland corporates in support of their overseas mergers and acquisitions. Through these activities, it remained the top mandated arranger in the Hong Kong-Macau syndicated loan market. At the same time, business opportunities were also made possible by the Shanghai Free Trade Zone. During the year, it helped corporates set up cross-border cash pooling services in RMB and other currencies, and underwrote cross-border RMB loans to corporates established in the Shanghai Free Trade Zone. At the end of 2014, the Group's balance of corporate advances grew by 12.1% from the end of 2013.

A full range of innovative cross-border financial services for SMEs

The Group constantly focused on ways to enhance the customer experience for SME customers. In 2014, the Group optimised its Business Integrated Account to provide SME customers with a variety of products and business privileges. This included its BOC Small Business Loan, which was enhanced with a streamlined application and approval service as part of a prompt and flexible financing solution for small businesses. With closer collaboration with BOC, the Group continued to provide a full range of innovative cross-border financial services to meet the diverse needs of customers. It also maintained contact with local trade associations and provided them with the latest market information at regular economics and business seminars, which reinforced its connections in the local business sector. In recognition of its long-standing support of SMEs in Hong Kong, the Group received the Best SME's Partner Award from the Hong Kong General Chamber of Small and Medium Business for the seventh consecutive year.

Growth in the customer base for custody services

During the year, the Group successfully expanded its customer base for custody services and established its business relationships with a number of new RQFII applicants from the Mainland of China, Hong Kong, Taiwan and other countries and regions. In 2014, it remained one of the largest RQFII service providers in Hong Kong. It also secured mandates from RQFII-ETFs and various types of RQFII and QDII products. In addition to this, the Group made closer collaboration with BOC and its branches to enhance their service capabilities. At the end of 2014, excluding the RMB fiduciary account for participating banks, total assets under the Group's custody were valued at HK$735.3 billion.

Expansion of cross-border cash management service capabilities

The Group continued to strengthen its cross-border cash management service capabilities during the year. To solidify its competitive edge in RMB business, the Group launched RMB settlement services for member institutions of UnionPay International Co. Ltd., making it the first bank to provide such services in Hong Kong. It also worked closely with BOC to successfully complete the implementation of cash pooling services that will facilitate two-way cash sweeping for several large corporates. With the launch of Shanghai-Hong Kong Stock Connect, BOCHK acts as a designated bank of the China Securities Depository and Clearing Corporation Limited at HKSCC, as well as the designated settlement bank of HKSCC for the northbound trading. In recognition of its outstanding cash management services, BOCHK was presented with the Achievement Award for Best Cash Management Bank in Hong Kong by The Asian Banker for the second consecutive year. It also received the Hong Kong Domestic Cash Management Bank of the Year award in 2014 by Asian Banking and Finance.

Proactive measures to contain risk

In 2014, the Group adhered to a prudent credit policy under the principle of Know Your Customers. It closely monitored the credit positions of customers and industries that could be adversely affected by the volatile economic environment, with an eye to a possible continuous slowdown of economic growth in the Mainland and withdrawal of stimulus measures in the US. The Group also stayed alert to its Mainland exposures and maintained vigilance in monitoring customers in certain vulnerable industries with overcapacity. Other measures included establishing a trigger point to manage the concentration risk of Mainland exposures and rigorous pre- and post-lending monitoring to track early negative signs, with timely ad hoc credit reviews and precautionary measures.

Mainland Business

Operating income maintained steady growth

The Group's Mainland business maintained steady growth during the year amid a challenging operating environment. Total operating income increased by 18.8% year-on-year, driven by the growth in net interest income and net fee income. Slower economic growth on the Mainland placed pressure on certain industries, resulting in an increase in new classified or impaired advances in 2014 and hence a higher net charge of loan impairment allowances. Deposits from customers and advances to customers dropped by 4.0% and 7.1% respectively from the end of last year.

Continuous enrichment of new products and services

The Group remained committed to enriching and diversifying its product and service offerings throughout 2014. These included a number of innovative products and business models to meet different customer needs. For example, Supply Chain Finance was launched to enhance its SME business, providing financing services to both upstream and downstream companies in the supply chain. Both the trade finance and treasury products businesses were also strengthened with the launch of new products. Additionally, the Group introduced QDII-Overseas Fund Products to allow Mainland customers to capture overseas investment opportunities by leveraging the cross-border synergy between Hong Kong and the Mainland of China. Beyond this, it introduced a China Securities Index 300 Index-linked product and launched a new series of structured wealth management products called Yiishun. What's more, the Group expanded its credit card business with the introduction of platinum credit cards. The Bancassurance business was also enhanced with improved sales management and the introduction of new business partners and insurance products.

New electronic platforms

The Group continued to enhance both its personal and corporate e-Banking platforms during the year. Several e-platforms were established to facilitate cross-border transactions as well as additional online services. During the year, NCB (China)'s Suzhou Branch and Shanghai Free Trade Zone Sub-branch commenced business. The Group's total number of branches and sub-branches in the Mainland of China reached 42 at the end of 2014.

Treasury

Financial Results

Treasury recorded a strong increase of 29.7% in profit before taxation from the previous year.

Net interest income increased by 46.7%, mainly due to the increases in RMB bonds and balances and placements with banks. Average yield on the related assets also rose with higher market interest rates.

Net trading gain was down 34.8%. The decrease was mainly caused by the net trading loss from foreign exchange swap contracts and the mark-to-market changes of certain interest rate instruments.

Business Operations

A proactive investment strategy and a diversified funding source

In 2014, the Group continued to take a proactive approach in managing its banking book investments. It closely monitored market changes and acted swiftly to adjust its investment portfolio to enhance returns while remaining alert to risks. The Group adjusted its investment portfolio in anticipation of the upcoming US interest rate hike cycle and selectively increased its holdings in high-quality corporate bonds to improve returns. The Group also increased its investments in RMB-denominated bonds. Meanwhile, BOCHK launched a US commercial paper programme for enhancing liquidity management and diversifying its funding sources.

Satisfactory growth recorded in RMB foreign exchange businesses

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. Leveraging its competitive edge in the RMB business, the Group launched a series of RMB investment products, including RMB Equity Linked Investment and the inclusion of bearish option in RMB Structured Deposits, which were well received by the market. Following the removal of the daily RMB exchange quota by Hong Kong residents, the Group launched various services including RMB exchange against other currencies and RMB Currency Linked Investment.

Strengthening intragroup cooperation in Debt Capital Markets business

The Group continued to achieve solid progress in the bond underwriting business during the year and significantly increased its market share in the underwriting of dim-sum bonds. It also strengthened cooperation with BOC's branches in the Debt Capital Markets business. It became the first Chinese bank to act as the joint lead manager and joint bookrunner for a major global USD bond issuance by a South American corporation. Other overseas activities included support for BOC's London Branch to complete the first overseas dim-sum bond issuance by the Bank of England and assisted BOC's other overseas branches in the issuance of overseas dim-sum bonds.

Global expansion of its banknote business

The Group made significant progress with the expansion of its global banknote business. It successfully became an international banknotes wholesale bank. In addition to major markets, the Group established banknotes business relationships with central banks and extended its global banknote distribution network to new market districts of Central America, Central and Southeast Asia. In addition, the Group was granted a franchise in managing the Extended Custodial Inventory of a major currency, making it the first Chinese bank to qualify for this role and fully recognising its expertise in banknotes management. Meanwhile, the Group continued to establish relationships with central banks, commercial banks and BOC's branches in other overseas countries and regions for its banknotes business.

Improved clearing support for the RMB business

In the year, the Group continued to develop better infrastructure to ensure the stable development and continuous improvement of RMB clearing services in both Hong Kong and overseas. It extended its RMB clearing service hours to 20.5 hours per day with effect from 1 October, which distinguished Hong Kong as the world's first clearing system to cover time zones in Europe, America and Asia with the longest operating hours globally. BOCHK also successfully migrated to the second generation of the China National Advanced Payment System ("CNAPS"), reinforcing its RMB clearing efficiency and service capability.

In addition, BOCHK was designated by the HKMA as the Primary Liquidity Provider to provide additional RMB liquidity support to the market. This designation reinforced the Group's leading position in the offshore RMB market.

Insurance

Financial Results

Profit before taxation in the Group's Insurance segment was HK$613 million in 2014, down 46.4% from 2013. The decline was mainly caused by a higher provision for insurance liabilities as a result of declining market interest rates, which outweighed the corresponding mark-to-market changes of debt securities. This, coupled with the decrease in return from its equity investments portfolio resulted in a decline in profits.

Net interest income grew by 13.0%, which was mainly driven by the expansion of securities investments acquired with the new premiums received.

Net gain on other financial assets amounted to HK$169 million which compared with a net loss of HK$63 million in 2013, owing to market opportunities for disposing of certain debt securities.

Business Operations

A focus on product enhancement and diversified distribution channels

During the year, the Group continued to broaden its product offerings, diversify its distribution channels and establish partnerships with insurance broker firms to reach out to a wider range of customers. New products launched in 2014 included Plenteous Life Coupon Plan which integrates both life insurance and savings elements; BestCare Critical Illness Plan which covers both critical illness and life protection; and Good Year Cash Coupon Insurance Plan which meets the life insurance and wealth management needs of customers through the telemarketing channel. These new products were well received by customers. The introduction of the new iPad Sales Kit to the Bank's sales team and the inbound sales model to the telemarketing channel improved its efficiency in both customer communications and sales performance. Continuous optimisation of the broker and tied agency channels provided customers with a broader spectrum of services. BOCG Life was honoured to receive a number of international and industry awards including the global award of Best Life Insurance Company 2014, Hong Kong presented by World Finance.

Leadership in RMB insurance products

The Group's leading position in Hong Kong RMB insurance market was consolidated through product optimisation and innovation in 2014. Popular RMB insurance products such as the IncomeGrowth Annuity Insurance Plan, Target 5 Years Insurance Plan Series and RMB Universal Life Insurance Plan continued to attract substantial new business. During the year, it launched whole life products, Plenteous Life Coupon Plan and Good Year Cash Coupon Insurance Plan, to customers, offering life protection and savings. BOCG Life maintained its leading position in the RMB insurance market. In recognition of its outstanding performance, BOCG Life received all three product awards in the RMB Business Outstanding Awards 2014 – Outstanding Insurance Business, organised by Metro Finance, Metro Finance Digital and Hong Kong Wen Wei Po.

Others

Asset management service reinforced local business and expanded geographical presence

BOCHK Asset Management Limited ("BOCHK AM") continued to make solid progress in 2014 with a satisfactory growth in asset under management compared with the end of 2013. The BOCHK All Weather HK & China Equity Fund, a retail fund launched in 2013, performed strongly in terms of asset growth, while the BOCHK RMB High Yield Bond Fund was redomiciled to Luxemburg in September 2014. This not only allowed the fund to be widely and effectively distributed in Europe but also established the Group's footprint in the continent while positioning BOCHK AM for distribution of its fund products in other Asian countries in the future. In addition, new distribution channels were developed and partnerships established with BOC's branches and other banks in Macau.

In recognition of its outstanding offshore RMB bond performance, BOCHK AM won the Best RMB Manager by Asia Asset Management for its 2014 Best of the Best Awards. The BOCHK RMB High Yield Bond Fund was awarded the Best RMB Bonds, Offshore, Three Years by Asia Asset Management under the same award. BOCHK AM was also granted the Best in Class RMB Fixed Income award in the BENCHMARK Fund of the Year Award 2014.

Business Focuses for 2015

The year 2015 will bring both opportunities and challenges to banks in Hong Kong. To capture new business opportunities, the Group will respond rapidly to market changes in order to achieve balanced growth in all areas of its business. At the same time, it will maintain its stringent risk management and controls to safeguard its financial strength and asset quality.

The Group will also develop its high-quality and professional wealth management services further to meet the growing demand for wealth management consultancy services. In addition, it will strengthen its dedicated professional service team and construct a more diversified sales and service system to improve its overall service capabilities. Elevate awareness of its brand will also be critical for improving customer perception and recognition.

With regards to its infrastructure, the Group will improve and integrate its multifunctional service chains and platforms. It will also extend its cash management services regionally to support customers expanding overseas. Other measures to be taken up in 2015 include enhancing its management capability of the custody business, strengthening its treasury products by serving central banks in other time zones and reaching out to other overseas markets with its asset management services.

The Group will also take advantage of opportunities in the offshore RMB business as this will promote its overseas development. It will focus on expanding its RMB-related products and services to markets worldwide with the aim of increasing the global service capabilities of the BOC Group. Cooperation with BOC's overseas branches to cultivate new customer groups in the Southeast Asia and other overseas markets will also be part of this initiative.

Finally, the Group will continue to strengthen its collaboration with BOC. It will leverage on its professional expertise and efficient business platforms to enhance cooperation and coordination with BOC in the development of products, customers and regions in order to raise the service coverage and overall synergy of the BOC Group.

Regulatory Developments

Implementation of Basel III Liquidity Coverage Ratio

Following the negative vetting of the Banking (Liquidity) Rules by the Legislative Council, the implementation of Basel III Liquidity Coverage Ratio ("LCR") came into operation on 1 January 2015. The implementation of the LCR seeks to promote banks' resilience to short-term liquidity risks by ensuring they have sufficient high quality liquid assets to meet their obligations for at least 30 calendar days under an acute stress scenario. The Group has completed all relevant preparatory work to ensure the efficient implementation of the LCR. These included the development of a system for calculation of the LCR for both regulatory reporting and internal risk management purposes; the formulation of a working manual and the introduction of training workshops to all business units to incorporate the LCR requirements into the daily business decision-making process; and the establishment of limit and risk appetite for setting the risk tolerance level and the inclusion of all requirements of LCR in the formulation of the Group's business plan.

Technology And Operations

The Group continued to upgrade its information technology and business operation infrastructure in 2014 to support its business growth and enhance operational efficiency. The revamp of the Group's data center was carried out as part of this exercise and the expansion phase was completed. The Group also launched a series of services to provide a better customer experience and support the growth of the Personal Banking, SME and Corporate Banking businesses. With the launch of Shanghai-Hong Kong Stock Connect, system enhancements were made to support cross-boundary clearing and settlement as well as the provision of counter and e-channel services. During the year, the Group Customer Services Centre for corporate customers was established to offer a new service model to selected customers with one-stop quality and professional after-sales services.

Credit Ratings

As at 31 December 2014	Long-term	Short-term
Standard & Poor's	A+	A-1
Moody's	Aa3	P-1
Fitch	A	F1

On 29 December 2014, Standard & Poor's affirmed the 'A+' long-term and 'A-1' short-term issuer credit ratings of BOCHK. The outlook is stable.

On 14 October 2014, Moody's Investors Service affirmed 'Aa3' long-term and 'P-1' short-term local and foreign currency bank deposit ratings; and the 'C+' bank financial strength rating on BOCHK. The outlook is stable.

On 21 October 2014, Fitch Ratings affirmed 'A' long-term and 'F1' short-term foreign currency issuer default ratings on BOCHK. The outlook is stable.

Risk Management

Banking Group

Overview

The Group believes that sound risk management is crucial to the success of any organisation. In its daily operation, the Group attaches a high degree of importance to risk management and emphasises that a balance must be struck between risk control and business development. The principal types of risk inherent in the Group's businesses are credit risk, interest rate risk, market risk, liquidity risk, operational risk, reputation risk, legal and compliance risk, and strategic risk. The Group's risk management objective is to enhance shareholder value by maintaining risk exposures within acceptable limits. The Group has a defined risk appetite statement approved by the Board, which is an expression of the types and level of risk that the Group is willing to take in a controllable way in order to achieve its business goals and to meet the expectations of its stakeholders. For details of the Group's risk management governance structure, please refer to Note 4 to the Financial Statements in this Annual Report.

Credit Risk Management

Credit risk is the risk of loss that a customer or counterparty is unable to or unwilling to meet its contractual obligations. Credit risk exists in the trading book and banking book, as well as from on- and off-balance sheet transactions of the Group. It arises principally from lending, trade finance and treasury businesses. For details of the Group's Credit Risk Management, please refer to Note 4.1 to the Financial Statements in this Annual Report.

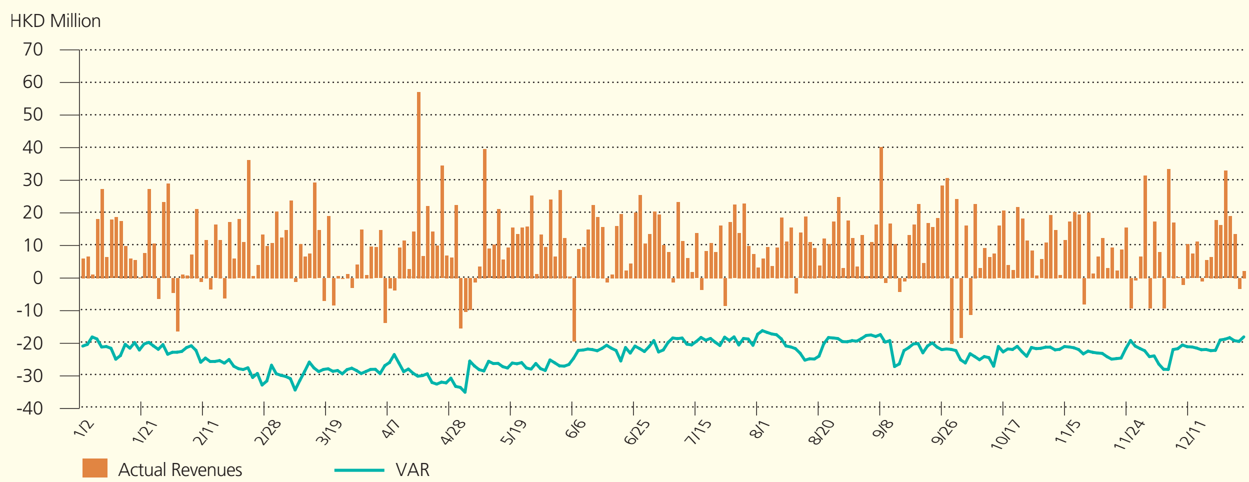
Market Risk Management

Market risk refers to the risk of loss arising from movements in the value of foreign exchange, interest rate, equity and commodity positions held by the Group due to the volatility of financial market price (foreign exchange rate, interest rate, equity price, commodity price). The Group adopts a moderate market risk appetite to achieve a balance between risk and return. For details of the Group's Market Risk Management, please refer to Note 4.2 to the Financial Statements in this Annual Report.

The Group uses the VAR to measure and report general market risks to the Risk Committee ("RC") and senior management on a periodic basis. The Group adopts a uniformed VAR calculation model, using a historical simulation approach and two years of historical market data, to calculate the VAR of the Group and subsidiaries over a 1-day holding period with a 99% confidence level, and sets up the VAR limit of the Group and subsidiaries.

The Group adopts back-testing to measure the accuracy of VAR model results. The back-testing compares the calculated VAR figure of market risk positions of each business day with the actual and hypothetical revenues arising from those positions on the next business day. Generally speaking, the number of back-testing exceptions in a rolling 12-month period will not exceed four times, given a 99% confidence level. The graph below shows the back-testing result of the VAR against actual revenues of the Group.

Daily Back-testing in 2014



There were no actual losses exceeding the VAR for the Group in 2014 as shown in the back-testing results.

Interest Rate Risk Management

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

Liquidity Risk Management

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

Operational Risk Management

Operational risk is the risk of loss resulting from inadequate or failed internal process, people and system, or from external events. The risk is inherent in every aspect of business operations and confronted by the Group in its day-to-day operational activities.

The Group has implemented the "Three Lines of Defence" for its operational risk management. All departments or functional units as the first line of defence are the first parties responsible for operational risk management, and carry out the duties and functions of self risk control in the process of business operation through self assessment and self enhancement. The Operational Risk and Compliance Department ("OR&CD"), together with certain specialist functional units in relation to operational risk management within the Group, including the Human Resources Department, Information Technology Department, Corporate Services Department, Financial Management Department and General Accounting & Accounting Policy Department (collectively known as "specialist functional units"), are the second line of defence. They are responsible for assessing and monitoring the operational risk conditions in the first line of defence, and providing them with guidance. The OR&CD, being independent from the business units, is responsible for assisting the Management in managing the Group's operational risk, including the establishment and review of the operational risk management policy and framework, designing the operational risk management tools and reporting mechanism, and assessing and reporting the overall operational risk position to the Management and RC. Specialist functional units are required to carry out their managerial duties of the second line of defence with respect to some specific aspects of operational risk and its related issues. Besides taking charge of operational risk management in their own units, these units are also required to provide other units with professional advice/training in respect of certain operational risk categories and to lead the group-wide operational risk management. Group Audit is the third line of defence which provides independent assessment to the effectiveness and adequacy of the operational risk management framework and is required to conduct periodic audit of the operational risk management activities of various departments or functional units within the Group regarding their compliance and effectiveness and to put forward recommendations for remedial actions.

The Group has put in place an effective internal control process which requires the establishment of policies and control procedures for all the key activities. The Group adheres to the fundamental principle of proper segregation of duties and authorisation. The Group adopts various operational risk management tools or methodologies such as key risk indicators, self-assessment, operational risk events reporting and review to identify, assess, monitor and control the risks inherent in business activities and products, as well as purchase of insurance to mitigate unforeseeable operational risks. Business continuity plans are established to support business operations in the event of an emergency or disaster. Adequate backup facilities are maintained and periodic drills are conducted.

Reputation Risk Management

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

In order to mitigate reputation risk, the Group has formulated and duly followed its Reputation Risk Management Policy. The policy aims to identify and prevent reputation risk proactively at an early stage when an incident occurs. Since reputation risk is often caused by various types of operational and strategic issues that negatively impact the trust and perception of the Group, all operational and key risks identified are assessed through the established Key Control Self-Assessment framework, including risk assessment tools, to evaluate the severity of their impact on the Group, including the damage to reputation.

In addition, the Group has put in place a comprehensive framework to continuously monitor reputation risk incidents in the financial industry. This continuous monitoring enables the Group to effectively manage, control and mitigate any potential adverse impact from an incident. The Group also adopts robust disclosure practices to keep our stakeholders informed at all times, which helps build confidence in the Group and establish a strong public image.

Legal and Compliance Risk Management

Legal risk is the risk that unenforceable contracts, lawsuits or adverse judgments may disrupt or otherwise negatively affect the operations or financial conditions of the Group. Compliance risk is the risk of legal or regulatory sanctions, financial losses or losses in reputation the Group may suffer as a result of its failure to comply with all applicable laws and regulations. Legal and compliance risks are managed by the OR&CD, which reports directly to the CRO. All legal matters are handled by the Legal Services Centre ("LSC"), which reports to the Chief Operating Officer. The OR&CD is responsible for legal risk management of the Group with support rendered by the LSC. As part of the Group's corporate governance framework, the policy for the management of legal and compliance risk is approved by the RC as delegated by the Board.

Strategic Risk Management

Strategic risk generally refers to the risks that may cause current or future negative impacts on the earnings, or capital or reputation or market position of the Group because of poor business decisions, improper implementation of strategies and inadequacies in the response to the changing market condition. The Board reviews and approves the strategic risk management policy. Key strategic issues have to be fully evaluated and properly endorsed by the senior management and the Board.

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

Capital Management

The major objective of the Group's capital management is to maximise total shareholders' return while maintaining a capital adequacy position in relation to the Group's overall risk profile. The Asset and Liability Management Committee ("ALCO") periodically reviews the Group's capital structure and adjusts the capital mix where appropriate to maintain an optimal balance among risk, return and capital adequacy.

To comply with the HKMA's requirements as stated in the Supervisory Policy Manual "Supervisory Review Process", the Group adopts the internal capital adequacy assessment process ("ICAAP") and reviews it annually. Based on the HKMA's guidelines on Pillar II, ICAAP has been initiated to assess the extra capital needed to cover the material risks not captured or not adequately captured under Pillar I, and therefore minimum Common Equity Tier 1 capital ratio, minimum Tier 1 capital ratio and minimum Total capital ratio are determined. Meanwhile, operating ranges for the aforementioned capital ratios have also been established which enable the flexibility for future business growth and efficiency of capital utilisation.

Stress Testing

The Group supplements the analysis of various types of risks with stress testing. Stress testing is a risk management tool for estimating risk exposures under stressed conditions arising from extreme but plausible market or macroeconomic movements. These tests are conducted on a regular basis by the Group's various risk management units in accordance with the principles stated in the Supervisory Policy Manual "Stress-testing" published by the HKMA. The ALCO monitors the results against the key risk limits approved by the RC. The Financial Management Department reports the combined stress test results of the Group to the Board and RC regularly.

BOCG Life

BOCG Life's principal business is the underwriting of long-term insurance business in life and annuity (Class A), linked long term business (Class C) and retirement scheme management category III (Class I) in Hong Kong. Major types of risk arising from BOCG Life's insurance business are insurance risk, interest rate risk, liquidity risk and credit risk. BOCG Life closely monitors these risks and reports to its Risk Management Committee on a regular basis. The key risks of its insurance business and related risk control process are as follows:

Insurance Risk Management

BOCG Life is in the business of insuring against the risk of mortality, morbidity, disability, critical illness, accidents and related risks. These risks are managed through the application of underwriting policies and reinsurance arrangements.

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

The reinsurance arrangement helps transfer the insurance risk associated with the insurance contracts to the third party. It does not, however, discharge BOCG Life's liability as the primary insurer. If a reinsurer fails to pay a claim for any reasons, BOCG Life remains liable for the payment to the policyholder. The creditworthiness of reinsurers is considered by reviewing the reinsurers' financial strength prior to finalisation of any reinsurance contract. BOCG Life directs its reinsurance placement policy and assesses the creditworthiness of all reinsurers and intermediaries by reviewing credit grades provided by rating agencies and other publicly available financial information. BOCG Life also monitors the recoverability of its reinsurance assets on an ongoing basis. It maintains records of the payment history for significant contract holders, with whom it conducts regular business.

For details of the Group's Insurance Risk Management, please refer to Note 4.4 to the Financial Statements in this Annual Report.

Interest Rate Risk Management

An increase in interest rates may result in the depreciation of the value of BOCG Life's bond portfolio. It might induce in customers surrender. A decrease in interest rates may result in an increase in insurance liability and an inability to adequately match guarantees or lower returns leading to customer dissatisfaction. BOCG Life manages the matching of assets and liabilities of its portfolios within an asset liability management framework that has been developed to achieve investment returns that match its obligations under insurance contracts; and to manage the adverse impact due to interest rate movement.

Liquidity Risk Management

Liquidity risk is the risk of not being able to meet obligations as they fall due without incurring unacceptable loss. BOCG Life's asset and liability management framework includes cash flow management to preserve liquidity to match policy payout from time to time.

Credit Risk Management

BOCG Life has exposure to credit risk that a customer or counterparty will be unable to or unwilling to meet a commitment that they have entered into. Key areas to which BOCG Life's insurance business is exposed include:

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

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

In order to enhance its credit risk management, BOCG Life has strengthened its communication with the Investment Management of the Group while closely monitoring and updating the established Bonds Issuers Disposal and Watch Lists to ensure consistency with the Group's credit risk management and investment strategy.