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Management's Discussion and Analysis

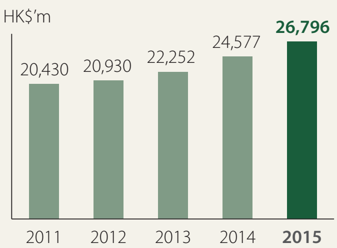
Financial Performance and Conditions at a Glance

The following table is a summary of the Group's key financial results for the year 2015 in comparison with the previous four years. The average value of liquidity coverage ratio is reported for the four quarters of 2015.

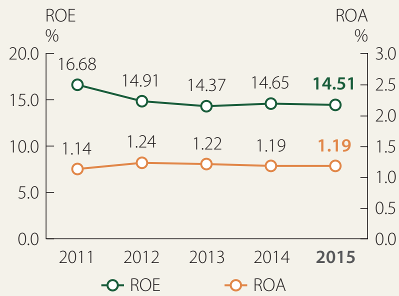
As a result of the Group's proposed disposal of NCB, the Group reported the operating results of NCB in 2015 separately as discontinued operations in the consolidated income statement with comparative information restated. Assets and liabilities of NCB as at 31 December 2015 are presented separately as assets held for sale and liabilities associated with assets held for sale in the consolidated balance sheet. Restatement of assets and liabilities as at 31 December 2014 is not required and a direct comparison between the two years may not be appropriate. As a result, to facilitate year-on-year comparison, selected balance sheet items and related ratios of 2014 are restated and analysed in this Management's Discussion and Analysis while those of 2011-2013 are not restated.

Key Performance Trends

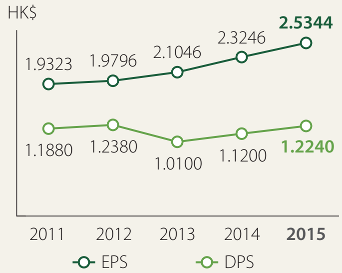
Profit Attributable to the Equity Holders



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 another record high

- The Group's profit attributable to the equity holders increased by 9.0% year-on-year to HK$26,796 million, another record high since listing, with strong growth in non-interest income. Profit attributable to the equity holders from continuing operations increased by 9.3% to HK$23,969 million.

Solid returns with sustainable growth

- ROE was 14.51%, down 0.14 percentage point year-on-year, as the increase in average equity outpaced that of profit. Higher average equity was mainly caused by additions of retained earnings and the higher average premises revaluation reserve.

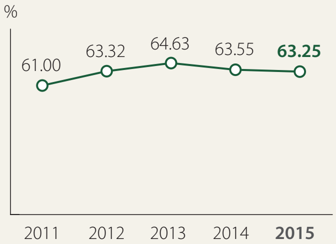
- ROA was 1.19%.

Return to shareholders

- EPS was HK$2.5344. EPS from continuing operations was HK$2.2670. DPS was HK$1.224.

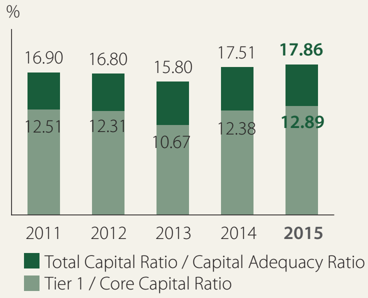
Financial Position

Loan to Deposit Ratio[3]



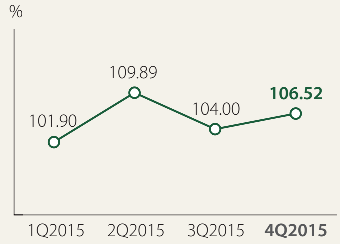
as at 31 December

Capital Ratio[4]



as at 31 December

Average value of Liquidity Coverage Ratio[5]



Loan to deposit ratio at a healthy level

- For the Group's continuing operations, the loan to deposit ratio was 63.25%, down 0.30 percentage point from 63.55% at the end of 2014 on a comparable basis. Advances to customers and deposits from customers increased by 9.7% and 10.2% respectively.

Solid capital position to support business growth

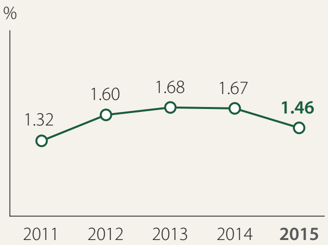
- The Group continued to strengthen its capital and risk-weighted asset management to meet more stringent regulatory requirements and capture long-term business opportunities. The total capital ratio was 17.86% while the Tier 1 capital ratio was 12.89%, up 0.35 and 0.51 percentage point respectively from that at the end of 2014.

Stable liquidity position

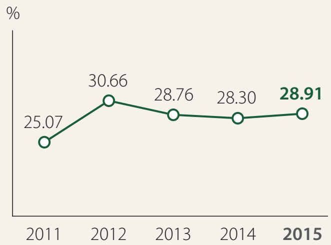
- Average value of liquidity coverage ratio was stable throughout the four quarters of 2015, well above the regulatory requirement.

Key Operating Ratios

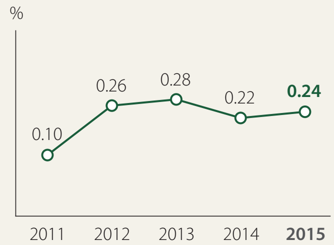
Net Interest Margin ("NIM")



Cost to Income Ratio[6]



Classified or Impaired Loan Ratio[7]



as at 31 December

Narrowing NIM with expanded asset size

- NIM for continuing operations in 2015 was 1.46%, down 21 basis points year-on-year. The decrease was mainly due to the decrease in the average interest spread of RMB assets, caused by the drop in RMB market interest rates and the increase in deposit costs. The decrease in net interest margin was also due to the increase in short-term debt securities investments.

Cautious cost control

- The cost to income ratio for continuing operations in 2015 was 28.91%, up 0.61 percentage point year-on-year, which was at a relatively low level in the industry.

Classified or impaired loan ratio stayed at a low level

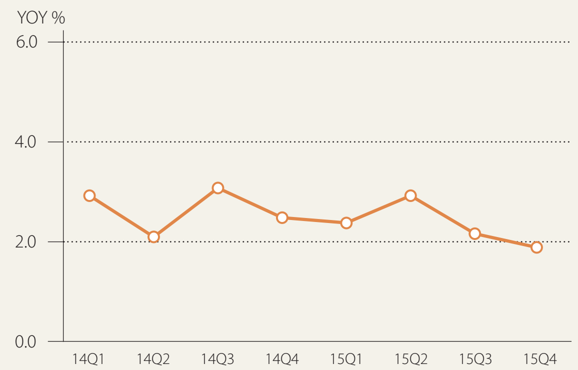
- At the end of 2015, the classified or impaired loan ratio of continuing operations was 0.24%, below the market average.

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 for regulatory purposes that comprises the positions of BOCHK and certain subsidiaries specified by the HKMA in accordance with the Banking (Capital) Rules.
5. The implementation of the Basel III liquidity coverage ratio came into effect on 1 January 2015. The average value of liquidity coverage ratio is calculated based on the arithmetic mean of the liquidity coverage ratio as at the end of each working day in the quarter and is computed on a consolidated basis, which comprises the positions of BOCHK and certain subsidiaries specified by the HKMA in accordance with the Banking (Liquidity) Rules.
6. The financial information for the year 2015 is from continuing operations and the comparative information has been restated accordingly.
7. 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

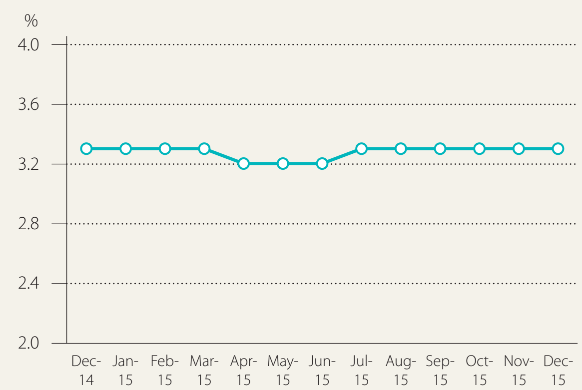
In 2015, the global recovery remained divergent across major advanced economies. In the US, underlying domestic demand stayed solid, and employment continued to grow steadily. The strengthening recovery finally persuaded the US Federal Reserve to raise the federal funds target rate for the first time in almost a decade. By contrast, growth momentum in the Eurozone remained sluggish. This, together with subdued inflation, prompted the European Central Bank to ease monetary policy further. In the Mainland of China, strong headwinds remained amid weakened external demand and overcapacity. The Central Government introduced supportive measures in response to the slowdown in economic expansion.

Hong Kong Real GDP Growth Rate



Source: HKSAR Census and Statistics Department

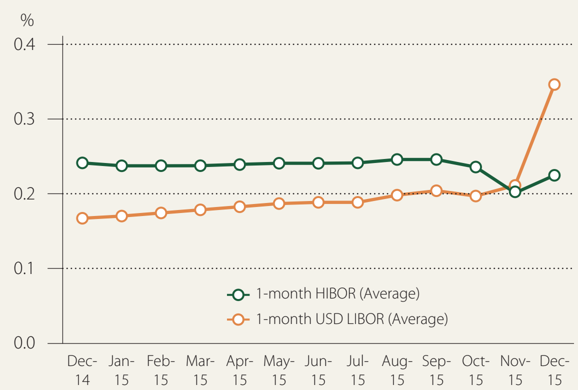
Hong Kong Unemployment Rate



Source: HKSAR Census and Statistics Department

The Hong Kong economy continued to grow moderately, supported by domestic demand and solid labour market conditions. However, the underlying growth momentum declined amid lacklustre export performance and continued weakness in inbound tourism. GDP rose by 2.4% in 2015, the unemployment rate stayed at a low level, and inflationary pressure was moderate with the Composite CPI rising by 3.0% year-on-year in 2015.

HIBOR and USD LIBOR



Source: Bloomberg

Overall liquidity in the Hong Kong banking sector remained abundant, and market interest rates continued at low levels in 2015, despite the notable rise in December. The average 1-month HIBOR and 1-month LIBOR rose slightly from 0.22% and 0.16% respectively in 2014 to 0.23% and 0.20% respectively in 2015. During this period, the average 10-year HKD swap rate and USD swap rate fell from 2.53% and 2.65% respectively in 2014 to 1.99% and 2.18% respectively in 2015. In the Mainland of China, the People's Bank of China ("PBOC") cut its benchmark interest rates for five times in 2015 and also lowered the reserve requirement ratio for five times.

Triggered by the announcement for the launch of the Mainland-Hong Kong Mutual Recognition of Funds scheme, the Hong Kong stock market turned buoyant in the second quarter of the year with transaction volumes increasing significantly. The Hang Seng Index reached the highest point of the year at 28,443 in April. It was then hit by a number of negative financial market events in the third quarter, including the sell-off in the Mainland stock market, volatility in the global foreign exchange market and the plunge in global commodity prices. The Hang Seng Index closed at 21,914 at the end of 2015, down 7.2% on a yearly basis.

The local residential property market showed some signs of consolidation following the introduction of further prudential measures for property mortgage loans by the HKMA and softened local economic growth. As a result, the level of transaction activity in 2015, in terms of the number of agreements for sale and purchase of residential building units, registered a decrease over 2014. Despite the downtrend adjustments in property price towards the end of the year, there was a modest year-on-year increase in the price of private domestic properties in 2015.

In 2015, the offshore RMB business in Hong Kong continued to grow steadily. A number of initiatives were introduced to promote capital account convertibility and the global use of RMB. These included the further expansion of the Free Trade Zones ("FTZs") in Guangdong, Tianjin and Fujian; a relaxation of the policy to allow offshore RMB clearing banks and participating banks to conduct repos in the onshore interbank bond market; the decision to give foreign central banks, sovereign wealth funds and supranational organisations access to the onshore interbank bond market without investment quotas and the onshore foreign exchange market; and the launch of the Mainland-Hong Kong Mutual Recognition of Funds. Furthermore, the International Monetary Fund ("IMF") announced in November 2015 that it will include the RMB in its Special Drawing Rights ("SDR") basket effective 1st October 2016 – a milestone in the development of the RMB. This will promote further confidence in the use of the RMB for international trade and financial transactions, giving more impetus to the internationalisation of the RMB.

The operating environment for banks in Hong Kong remained highly challenging in 2015. Interest rate cuts in the Mainland of China put pressure on offshore loan pricing, while slower economic growth in the Mainland further dampened already-softened loan demand and negatively affected certain industries, which put pressure on asset quality. Additionally, the depreciation of the RMB resulted in a decrease in offshore RMB deposits in Hong Kong and deterred the demand for RMB-denominated trade finance and investment products. Nevertheless, the Mainland's strategic initiatives and deepening economic reform continued to present banks with business opportunities for acquiring new customers and expanding their business coverage.

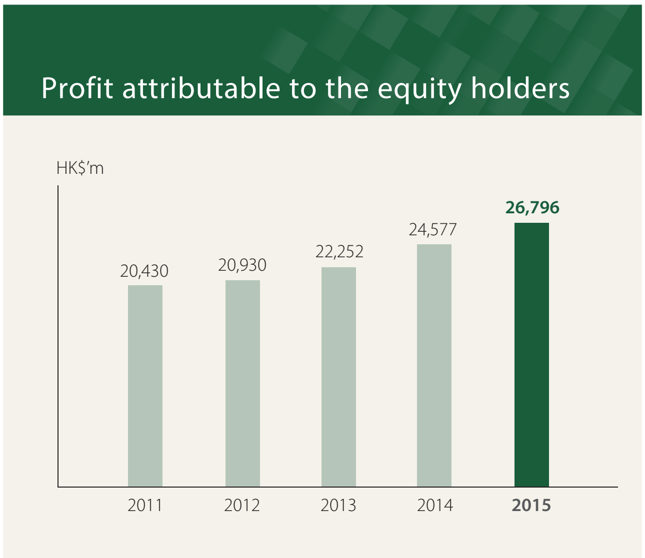
Outlook for 2016

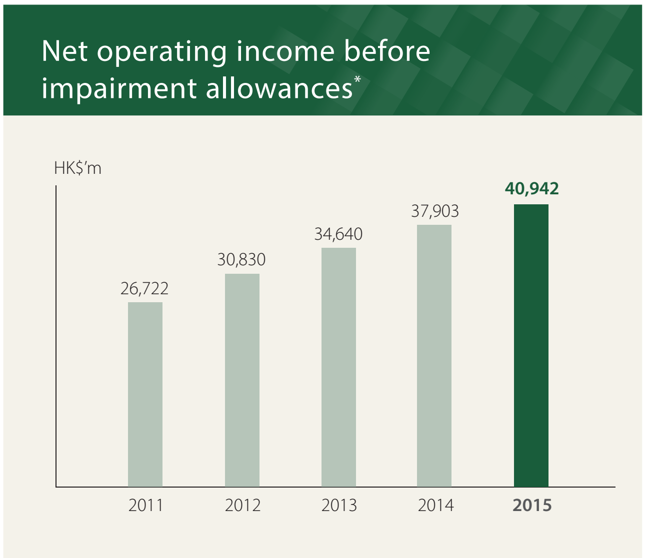
The year 2016 will bring both opportunities and challenges to banks in Hong Kong. The Mainland's Belt and Road initiative will continue to expand the cooperation between the Mainland of China and its neighbouring countries, bringing in new demand for financing and market opportunities. Moreover, the Mainland-Hong Kong Mutual Recognition of Funds and the coming Shenzhen-Hong Kong Stock Connect schemes will build momentum in capital markets and stimulate additional market activities. The accelerated pace of RMB internationalisation and economic reform in the Mainland of China will provide banks with new business opportunities.

However, there are also challenges ahead. The macroeconomic outlook is subject to downside risks, including weaker-than-expected global growth prospects and unexpected shocks from US interest rate normalisation. Challenges in the operating environment of the Mainland will continue to put pressure on certain industries which may lead to further deterioration in asset quality. In Hong Kong, growth momentum is expected to stay moderate as Hong Kong's external trade performance is unlikely to improve in the short-term amid the sluggish global trade flows and domestic demand remains the driver for local economic growth. Development of the RMB business will require growth drivers from a wider range of areas amid the increasing volatility in RMB exchange rates and the narrowing of the onshore and offshore RMB interest rate differential. Banks will also face intensifying competition and comply with more stringent regulatory requirements. Additional resources will be made to cater for compliance, anti-money laundering and financial crime.

Consolidated Financial Review

Financial Highlights





* Net operating income before impairment allowances for the year 2015 is from continuing operations and the comparative information has been restated accordingly.

HK$'m, except percentages	2015	(Restated) 2014	Change (%)
CONTINUING OPERATIONS			
Net operating income before impairment allowances	**40,942**	37,903	8.0
Operating expenses	**(11,836)**	(10,728)	10.3
Operating profit before impairment allowances	**29,106**	27,175	7.1
Operating profit after impairment allowances	**28,175**	27,029	4.2
Profit before taxation	**28,952**	27,398	5.7
Profit attributable to the equity holders of the Company	**26,796**	24,577	9.0
– from continuing operations	**23,969**	21,927	9.3
– from discontinued operations	**2,827**	2,650	6.7

In 2015, the Group leveraged on its diversified business platforms and responded swiftly to market changes to capture business opportunities in various areas. It remained proactive in managing its balance sheet and continued to deepen collaboration with BOC to extend its customer base. Meanwhile, it maintained prudent risk management to safeguard asset quality. As a result, the Group achieved a new high in profit attributable to the equity holders with key financial ratios staying at healthy levels. For the year 2015, the Group's profit attributable to the equity holders reached HK$26,796 million, representing an increase of 9.0% year-on-year. Profit attributable to the equity holders from continuing operations amounted to HK$23,969 million while that from discontinued operations amounted to HK$2,827 million, representing an increase of 9.3% and 6.7% respectively year-on-year.

For the Group's continuing operations, net operating income before impairment allowances increased by HK$3,039 million, or 8.0%, year-on-year to HK$40,942 million. The increase was driven by the strong growth in net fee and commission income, the increased net gain from the disposal of certain financial assets and the higher net trading gain of the banking business, coupled with higher net operating income of the Group's insurance segment. Net interest income decreased with the lowering of net interest margin, partially offset by the growth in average interest-earning assets. Operating expenses were higher to support the Group's long-term business expansion. The net charge of loan impairment allowances rose as did the net gain from fair value adjustments on investment properties. Meanwhile, the Group recognised deferred tax assets in the second half of the year in respect of the temporary differences arising from taxation incurred by the Group's cross-border businesses, resulting in lower net tax expenses in the year. Profit attributable to the equity holders from continuing operations grew by HK$2,042 million, or 9.3%, compared with 2014.

As compared with the first half of 2015, net operating income before impairment allowances for the Group's continuing operations decreased by HK$518 million, or 2.5% in the second half. Net trading gain of the banking business improved notably, mainly contributed by the net gain on foreign exchange swap contracts and the growth in income from currency exchange transactions. The increase was, however, offset by the decline in net interest income, resulting from the narrowing of net interest margin. Net fee and commission income stayed broadly unchanged. Operating expenses rose. Meanwhile, the Group recognised deferred tax assets in the second half of the year in respect of the temporary differences arising from taxation incurred by the Group's cross-border businesses, resulting in lower net tax expenses in the second half of the year. As a result, profit attributable to the equity holders from continuing operations reduced by HK$203 million, or 1.7%, on a half-on-half basis.

Income Statement Analysis

The following income statement analysis is based on the Group's continuing operations and the comparative information for the year 2014 has been restated accordingly.

Net Interest Income and Margin

HK$'m, except percentages	2015	(Restated) 2014	Change (%)
Interest income	**38,074**	38,693	(1.6)
Interest expense	**(12,335)**	(11,965)	3.1
Net interest income	**25,739**	26,728	(3.7)
Average interest-earning assets	**1,766,079**	1,598,555	10.5
Net interest spread	**1.36%**	1.56%	
Net interest margin*	**1.46%**	1.67%	

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

The Group's net interest income decreased by HK$989 million, or 3.7%, year-on-year. The decrease was due to the lower net interest margin, partially offset by the growth in average interest-earning assets.

Average interest-earning assets expanded by HK$167,524 million, or 10.5%, mainly supported by the increase in deposits from customers. Average balance of both advances to customers and debt securities investments increased.

Net interest margin was 1.46%, down 21 basis points compared with 2014. The decline was mainly due to the decrease in average interest spread of RMB assets, caused by the drop in RMB market interest rates and increase in RMB deposit costs. The decrease in net interest margin was also due to the increase in short-term debt securities investments. Nevertheless, the Group proactively managed its assets and liabilities and was effective in controlling its deposit pricing and improving its loan yield. The widened loan and deposit spread and the increase in advances to customers partially offset the above negative impact.

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

ASSETS	Year ended 31 December 2015 Average balance HK$'m	Year ended 31 December 2015 Average yield %	(Restated) Year ended 31 December 2014 Average balance HK$'m	(Restated) Year ended 31 December 2014 Average yield %
Balances and placements with banks and other financial institutions	**353,345**	**2.31**	386,571	3.00
Debt securities investments	**558,292**	**1.94**	423,446	2.39
Advances to customers	**839,001**	**2.25**	774,300	2.17
Other interest-earning assets	**15,441**	**1.39**	14,238	1.29
Total interest-earning assets	**1,766,079**	**2.16**	1,598,555	2.42
Non interest-earning assets[1]	**545,481**	**–**	514,067	–
Total assets	**2,311,560**	**1.65**	2,112,622	1.83

LIABILITIES	Average balance HK$'m	Average rate %	Average balance HK$'m	Average rate %
Deposits and balances from banks and other financial institutions	**207,438**	**0.87**	176,622	0.79
Current, savings and time deposits	**1,277,429**	**0.74**	1,166,816	0.85
Certificates of deposit issued	**–**	**–**	239	1.01
Subordinated liabilities	**19,560**	**2.25**	19,614	1.38
Other interest-bearing liabilities	**39,214**	**1.76**	35,198	0.91
Total interest-bearing liabilities	**1,543,641**	**0.80**	1,398,489	0.86
Shareholders' funds[2] and other non interest-bearing deposits and liabilities[1]	**767,919**	**–**	714,133	–
Total liabilities	**2,311,560**	**0.53**	2,112,622	0.57

1. Including assets held for sale and liabilities associated with assets held for sale respectively.
2. 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 decreased by HK$845 million, or 6.4%, to HK$12,447 million, due to the lower net interest margin. Average interest-earning assets registered a growth of 5.2% as supported by the increase in deposits from customers. Net interest margin was 1.36%, falling by 20 basis points half-on-half. The drop in RMB interest rates affected the yield of the Group's RMB assets. The decrease in net interest margin was also due to the increase in short-term debt securities investments. The above negative impact was partially offset by lower deposit costs and increase in advances to customers.

Net Fee and Commission Income

HK$'m, except percentages	2015	(Restated) 2014	Change (%)
Credit card business	**3,727**	3,610	3.2
Securities brokerage	**3,397**	2,471	37.5
Loan commissions	**3,286**	1,890	73.9
Insurance	**1,551**	1,447	7.2
Funds distribution	**913**	877	4.1
Payment services	**563**	534	5.4
Bills commissions	**543**	574	(5.4)
Trust and custody services	**473**	442	7.0
Currency exchange	**302**	231	30.7
Safe deposit box	**264**	241	9.5
Others	**722**	630	14.6
Fee and commission income	**15,741**	12,947	21.6
Fee and commission expenses	**(4,276)**	(3,856)	10.9
Net fee and commission income	**11,465**	9,091	26.1

Net fee and commission income reached a new high and grew by HK$2,374 million, or 26.1%, to HK$11,465 million in 2015. The increase was broad-based, reflecting the Group's efforts to leverage on its diversified business platforms. Fee and commission income from loans, securities brokerage, insurance and currency exchange grew strongly. Loan commissions rose by 73.9%, due mainly to strong growth of commission income from corporate loans. Income from securities brokerage grew by 37.5%, as the Group successfully captured opportunities from increased transactions in the local stock market. Income from insurance increased by 7.2% with the rise in business volume. Income from currency exchange rose 30.7%, driven by the higher demand for foreign currency banknotes by customers. Commission income from credit cards, funds distribution as well as trust and custody services also recorded healthy growth. However, commission income from bills decreased, reflecting the subdued trade-related activities. The increase in fee and commission expenses was mainly caused by higher credit card and securities brokerage related expenses.

Second Half Performance

Compared with the first half of 2015, net fee and commission income was broadly unchanged. Commission income from securities brokerage and funds distribution decreased as investment sentiment weakened in the second half of the year. However, loan commissions grew strongly as did income from credit cards, insurance, bills and payment services. Fee and commission expenses were broadly unchanged.

Net Trading Gain/(Loss)

HK$'m, except percentages	2015	(Restated) 2014	Change (%)
Foreign exchange and foreign exchange products	**2,055**	1,461	40.7
Interest rate instruments and items under fair value hedge	**293**	663	(55.8)
Commodities	**57**	62	(8.1)
Equity and credit derivative instruments	**194**	(29)	N/A
Net trading gain	**2,599**	2,157	20.5

Net trading gain was HK$2,599 million, up HK$442 million, or 20.5%, year-on-year. Net trading gain from foreign exchange and foreign exchange products increased by HK$594 million, primarily due to the increase in currency exchange income from customers' transactions and lower net loss on foreign exchange swap contracts*. Net trading gain from interest rate instruments and items under fair value hedge decreased by HK$370 million, mainly attributable to the lower mark-to-market gain 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 gain from equity and credit derivative instruments as opposed to a net loss in 2014, mainly due to the increased income from equity-linked products and the lower net trading loss from certain equity instruments in 2015.

Second Half Performance

Compared with the first half of 2015, net trading gain increased strongly by HK$1,189 million, or 168.7%. The Group proactively managed its asset allocation and captured the market opportunities among different currencies and markets, there was a net gain on foreign exchange swap contracts* in the second half as opposed to a net loss in the first half. Meanwhile, currency exchange income from customers' transactions also grew satisfactorily. The increases were partly offset by the mark-to-market loss of certain debt securities and the decreased income from equity-linked products.

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

HK$'m, except percentages	2015	(Restated) 2014	Change (%)
Net (loss)/gain on financial instruments designated at fair value through profit or loss	**(767)**	33	N/A

In 2015, the Group recorded a net loss of HK$767 million on financial instruments designated at FVTPL, compared with a net gain of HK$33 million in 2014. The change was mainly due to the mark-to-market loss of debt securities investments of BOCG Life, which was caused by market interest rate movements, and the net trading loss from equity securities investments under a challenging market environment. The changes in market value of its debt securities portfolio were offset by the corresponding changes in policy reserves, as reflected in the changes in net insurance benefits and claims attributable to the movement of market interest rates.

Second Half Performance

A net loss of HK$600 million was recorded in the second half of the year, up HK$433 million from a net loss of HK$167 million in the first half. The increased net loss was mainly attributable to the net trading loss of equity securities investments of BOCG Life in the second half as opposed to a net trading gain in the first half, partially offset by the mark-to-market changes of its debt securities investments.

Operating Expenses

HK$'m, except percentages	2015	(Restated) 2014	Change (%)
Staff costs	**6,568**	6,033	8.9
Premises and equipment expenses (excluding depreciation)	**1,436**	1,371	4.7
Depreciation on owned fixed assets	**1,732**	1,604	8.0
Other operating expenses	**2,100**	1,720	22.1
Total operating expenses	**11,836**	10,728	10.3

	At 31 December 2015	(Restated) At 31 December 2014	Change (%)
Staff headcount measured in full-time equivalents	**12,576**	12,105	3.9

Total operating expenses increased by HK$1,108 million, or 10.3%, from 2014, as the Group continued to invest in its service capabilities and IT infrastructure to support its long-term business growth. The Group remained focused on disciplined cost control. The cost to income ratio was kept at a low level of 28.91%, below the industry average.

Staff costs increased by 8.9%, mainly due to higher salaries as a result of the annual salary increment and increased headcount, and the increase in performance-related remunerations.

Premises and equipment expenses were up 4.7%, reflecting higher rental and IT costs.

Depreciation on owned fixed assets rose by 8.0%, due to a larger depreciation charge on premises following the upward property revaluation in Hong Kong and on IT equipment as the Group continued to improve its IT infrastructure.

Other operating expenses grew by 22.1%, mainly due to higher promotional expenses and business tax.

Second Half Performance

Compared with the first half of 2015, operating expenses rose by HK$830 million, or 15.1%. The increase was due to higher staff costs and business promotion expenses, as well as depreciation and IT-related expenses in the second half of the year.

Net Charge of Loan Impairment Allowances

HK$'m, except percentages	2015	(Restated) 2014	Change (%)
Net (charge)/reversal of allowances before recoveries			
– individually assessed	**(590)**	77	N/A
– collectively assessed	**(548)**	(399)	37.3
Recoveries	**156**	195	(20.0)
Net charge of loan impairment allowances	**(982)**	(127)	673.2

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

	At 31 December 2015	(Restated) At 31 December 2014
Loan impairment allowances		
– individually assessed	**0.06%**	0.05%
– collectively assessed	**0.28%**	0.28%
Total loan impairment allowances	**0.34%**	0.33%

The net charge of loan impairment allowances was HK$982 million in 2015, an increase of HK$855 million from 2014. Net charge of individually assessed impairment allowances amounted to HK$590 million, mainly caused by the downgrade of a few corporate advances. Net charge of collectively assessed impairment allowances amounted to HK$548 million, mainly due to the increase in advances to customers.

Total loan impairment allowances as a percentage of gross advances to customers was 0.34%, relatively unchanged from 2014.

Second Half Performance

Net charge of loan impairment allowances increased by HK$52 million, or 11.2%, from the first half of the year. The increase was mainly due to the higher net charge of individually assessed impairment allowances and the lower recoveries, partially offset by the relatively lower net charge of collectively assessed impairment allowances owing to the lower loan growth.

Balance Sheet Analysis

Comparative information of certain balance sheet items at 31 December 2014 are restated to enable analyses on a comparable basis. Related items and ratios for 2011-2013 are not restated.

Asset Deployment

	At 31 December 2015		(Restated) At 31 December 2014		
HK$'m, except percentages	**Amount**	**% of total**	Amount	% of total	Change (%)
Cash and balances with banks and other financial institutions	**230,730**	**9.7**	342,242	15.6	(32.6)
Placements with banks and other financial institutions maturing between one and twelve months	**64,208**	**2.7**	19,256	0.9	233.4
Hong Kong SAR Government certificates of indebtedness	**101,950**	**4.3**	90,770	4.1	12.3
Securities investments[1]	**574,998**	**24.3**	439,568	20.1	30.8
Advances and other accounts	**920,214**	**38.9**	850,225	38.8	8.2
Fixed assets and investment properties	**65,695**	**2.8**	62,579	2.9	5.0
Other assets[2]	**109,596**	**4.6**	84,300	3.9	30.0
Assets held for sale	**300,473**	**12.7**	300,427	13.7	–
Total assets	**2,367,864**	**100.0**	2,189,367	100.0	8.2

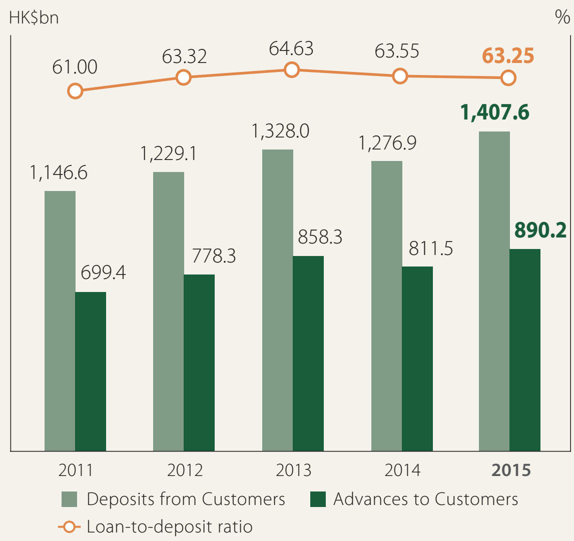
1. Securities investments comprise investment in securities and financial assets at fair value through profit or loss.
2. Interests in associates and a joint venture, deferred tax assets and derivative financial instruments are included in other assets.

As at 31 December 2015, total assets amounted to HK$2,367,864 million, an increase of HK$178,497 million, or 8.2%, from the end of 2014. The Group continued to proactively manage its assets and liabilities to enhance profitability and maintained a balanced growth in both advances to customers and deposits from customers.

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

- Cash and balances with banks and other financial institutions decreased by 32.6%, as funds were redeployed to securities investments and advances to customers.
- Placements with banks and other financial institutions maturing between one and twelve months rose by 233.4%. The Group lengthened the maturity of its interbank placements to gain a higher return.
- Securities investments increased by 30.8%, with increases mainly in government-related and high-quality corporate bonds.
- Advances and other accounts increased by 8.2%, with the growth in advances to customers by 9.7%.
- Other assets grew by 30.0%, which was led by the increase in account receivables, derivative financial instruments and reinsurance assets.
- Assets held for sale represented assets of NCB following the Group's undertaking of the disposal of all the issued shares of NCB.

Advances to customers and deposits from customers[1]



1. Deposits from customers include structured deposits
2. As at 31 December

Advances to Customers

HK$'m, except percentages	At 31 December 2015 Amount	At 31 December 2015 % of total	(Restated) At 31 December 2014 Amount	(Restated) At 31 December 2014 % of total	Change (%)
Loans for use in Hong Kong	**571,487**	**64.2**	502,536	61.9	13.7
Industrial, commercial and financial	**300,766**	**33.8**	252,844	31.2	19.0
Individuals	**270,721**	**30.4**	249,692	30.7	8.4
Trade finance	**79,108**	**8.9**	78,674	9.7	0.6
Loans for use outside Hong Kong	**239,648**	**26.9**	230,276	28.4	4.1
Total advances to customers	**890,243**	**100.0**	811,486	100.0	9.7

The Group leveraged its strong customer base and optimised its customer segments. With the enriched product spectrum, it also fully capitalised on its close collaboration with BOC and the Asia-Pacific Syndicated Loan Centre. It continued to focus on customer selection to achieve quality and sustainable loan growth. Advances to customers grew by 9.7% to HK$890,243 million in 2015.

Loans for use in Hong Kong grew by HK$68,951 million or 13.7%.

- Lending to the industrial, commercial and financial sectors increased by HK$47,922 million, or 19.0%. Lending to the property development, financial concerns, transport and transport equipment and manufacturing sectors grew by 45.0%, 315.4%, 23.5% and 22.5% respectively.
- Lending to individuals increased by HK$21,029 million, or 8.4%. Residential mortgage loans (excluding those under the Government-sponsored home purchasing schemes) grew by 8.5%. Credit card advances rose by 6.4% while other individual loans increased by 12.3%.

Trade finance rose by HK$434 million, or 0.6%, while loans for use outside Hong Kong increased by HK$9,372 million, or 4.1%.

Second Half Performance
With the comparative information at 30 June 2015 restated, advances to customers increased by HK$19,266 million, or 2.2%, amid slowing loan demand in the second half of the year. The growth in loans for use in Hong Kong was partly offset by the decrease in trade finance. Loans for use outside Hong Kong stayed broadly unchanged.

Loan Quality

HK$'m, except percentages	At 31 December 2015	(Restated) At 31 December 2014
Advances to customers	**890,243**	811,486
Classified or impaired loan ratio	**0.24%**	0.22%
Total impairment allowances	**3,009**	2,645
Total impairment allowances as a percentage of advances to customers	**0.34%**	0.33%
Impairment allowances[1] as a percentage of classified or impaired advances	**29.20%**	23.50%

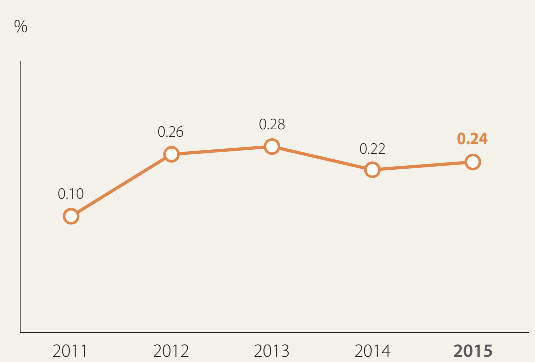
Table below shows the credit quality of the Group's residential mortgage loans and card advances in accordance with the HKMA's reporting requirement.

	At 31 December 2015	At 31 December 2014
Residential mortgage loans[2] – delinquency and rescheduled loan ratio[3]	**0.02%**	0.02%
Card advances – delinquency ratio[3]	**0.20%**	0.17%

	2015	2014
Card advances – charge-off ratio[4]	**1.39%**	1.42%

1. Referring to impairment allowances on advances to customers 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 Group's loan quality remained solid. Excluding assets held for sale, the classified or impaired loan ratio was 0.24% as at 31 December 2015. Classified or impaired advances to customers increased by HK$343 million, or 19.6%, to HK$2,096 million on a comparable basis, due to the downgrade of a few corporate loans.

As at 31 December 2015, total impairment allowances, including both individual assessment and collective assessment, amounted to HK$3,009 million. Impairment allowances as a percentage of classified or impaired advances was 29.20%.

The credit quality of the Group's residential mortgage loans and card advances remained sound. The combined delinquency and rescheduled loan ratio of residential mortgage loans was 0.02% at the end of 2015. As compared with 2014, the charge-off ratio of card advances decreased by 0.03 percentage point to 1.39%.

Deposits from Customers*

HK$'m, except percentages	At 31 December 2015 Amount	At 31 December 2015 % of total	(Restated) At 31 December 2014 Amount	(Restated) At 31 December 2014 % of total	Change (%)
Demand deposits and current accounts	**134,069**	**9.5**	96,672	7.6	38.7
Savings deposits	**717,747**	**51.0**	621,944	48.7	15.4
Time, call and notice deposits	**553,173**	**39.3**	555,156	43.5	(0.4)
	1,404,989	**99.8**	1,273,772	99.8	10.3
Structured deposits	**2,571**	**0.2**	3,115	0.2	(17.5)
Total deposits from customers	**1,407,560**	**100.0**	1,276,887	100.0	10.2

* Including structured deposits

The Group maintained a flexible deposit strategy to support business growth while proactively managing deposit pricing. Total deposits from customers rose by 10.2% to HK$1,407,560 million in 2015. Demand deposits and current accounts rose strongly by 38.7% while savings deposits were up 15.4%. Time, call and notice deposits decreased slightly by 0.4%. The proportion of current and savings deposits improved notably. The loan to deposit ratio was 63.25% at the end of 2015, down 0.30 percentage point from the end of 2014.

Second Half Performance

With the comparative information at 30 June 2015 restated, total deposits from customers increased by HK$13,553 million, or 1.0%, in the second half of 2015. Demand deposits and current accounts decreased by 8.7%, while savings deposits went up 12.8%. Time, call and notice deposits declined by 9.0%.

Capital and Reserves Attributable to the Equity Holders of the Company

HK$'m	At 31 December 2015	At 31 December 2014
Share capital	**52,864**	52,864
Premises revaluation reserve	**40,278**	37,510
Reserve for fair value changes of available-for-sale securities	**294**	1,930
Regulatory reserve	**10,879**	10,011
Translation reserve	**191**	778
Retained earnings	**88,072**	73,621
Reserves	**139,714**	123,850
Capital and reserves attributable to the equity holders of the Company	**192,578**	176,714

Capital and reserves attributable to the equity holders of the Company amounted to HK$192,578 million as at 31 December 2015, increasing by HK$15,864 million, or 9.0% from the end of 2014. Retained earnings rose by 19.6%, reflecting the 2015 profit after the appropriation of dividends. The premises revaluation reserve increased by 7.4%, which was attributable to the increase in property prices in 2015. Regulatory reserve rose by 8.7%, mainly due to growth in advances to customers.

Capital Ratio and Liquidity Coverage Ratio

HK$'m, except percentages	At 31 December 2015	At 31 December 2014
Consolidated capital after deductions		
Common Equity Tier 1 capital	**121,089**	110,440
Additional Tier 1 capital	**561**	733
Tier 1 capital	**121,650**	111,173
Tier 2 capital	**46,886**	46,035
Total capital	**168,536**	157,208
Total risk-weighted assets	**943,802**	897,812
Common Equity Tier 1 capital ratio	**12.83%**	12.30%
Tier 1 capital ratio	**12.89%**	12.38%
Total capital ratio	**17.86%**	17.51%

	2015	2014
Average value of liquidity coverage ratio		
First quarter	**101.90%**	–
Second quarter	**109.89%**	–
Third quarter	**104.00%**	–
Fourth quarter	**106.52%**	–
Average liquidity ratio	**–**	42.17%

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

In order to meet higher capital requirement following the Group's designation as one of the domestic systemically important banks in Hong Kong and to capture future business opportunities, the Group continued to adopt proactive measures to manage its capital and optimise the risk-weights of its assets during the year. The Group's aim is to maintain a solid capital adequacy level to support its sustainable growth strategy.

The Group's capital position stayed solid to support its business growth. At 31 December 2015, the Common Equity Tier 1 ("CET1") capital ratio was 12.83% and the Tier 1 capital ratio was 12.89%, up 0.53 and 0.51 percentage point respectively from that at the end of 2014. Profits net of dividends for the year 2015 drove up CET1 capital and Tier 1 capital by 9.6% and 9.4% respectively. Total risk-weighted assets ("RWA") were up 5.1%, mainly from an increase in credit RWA due to the growth in advances to customers in 2015. The ratio of total RWA for credit risk to Exposure at Default dropped from the end of 2014 as a result of the Group's optimisation of asset mix. Total capital ratio was 17.86%.

The Banking (Liquidity) Rules became effective on 1 January 2015, signifying the implementation of Basel III Liquidity Coverage Ratio ("LCR") in Hong Kong. The liquidity information disclosures reported for the four quarters in 2015 under Basel III are therefore not directly comparable with the disclosure reported for the year 2014.

The average value of LCR is calculated based on the arithmetic mean of the LCR as at the end of each working day in the quarter and the calculation methodology and instructions set out in the HKMA return of liquidity position. The LCR is computed on a consolidated basis, which comprises the positions of BOCHK and certain subsidiaries specified by the HKMA in accordance with the Banking (Liquidity) Rules.

The Group's liquidity position stayed at a solid level in 2015. The average values of LCR for all four quarters of 2015 were above the regulatory minimum. For details on the LCR, please refer to Note 4.3(A) to the Financial Statements.

Business Review

2015 Business Highlights

Personal Banking

- Customer base of wealth management services expanded. The number of new securities accounts opened doubled from 2014.
- Maintained its market leadership in new residential mortgages and the UnionPay card business. Pioneered the distribution of the first recognised Mainland fund under the Mainland-Hong Kong Mutual Recognition of Funds scheme.
- Enhanced the service capabilities of electronic banking. Launched e-Cheques Services and the first-ever Online Loan 360 Service in Hong Kong. Upgraded the WeChat official account with improved functions.
- Named the Best Retail Bank 2015 in Hong Kong by *The Asian Banker* in its International Excellence in Retail Financial Services Programme. Received the Best Multi-channel Project Award in the Technology Implementation Awards 2015 by *The Asian Banker* and the Mobile Banking Initiative of the Year – Hong Kong award in the *Asian Banking and Finance* Retail Banking Awards 2015.

Corporate Banking

- Captured opportunities made possible by major national strategic initiatives including the Belt and Road and FTZs. Optimised its customer segments and actively developed institutional business by strengthening relationships with overseas central banks, supranational organisations and non-governmental entities. Customer base further expanded.
- Participated in a number of significant syndicated loans for corporates in support of their global financing activities and remained the top mandated arranger in the Hong Kong-Macau syndicated loan market.
- Acted as the receiving bank for a number of major IPOs in Hong Kong, which consolidated its leading position in the market.
- Received the Best SME's Partner Award for the eighth year in a row.

Treasury

- Strategically increased investments in government-related and high-quality corporate bonds.
- First international commercial bank to issue RMB financial bonds (Panda bonds) in the Mainland's domestic interbank bond market.
- Successfully expanded its banknote business to other overseas markets.
- Received the Hong Kong Domestic Foreign Exchange Bank of the Year award in the *Asian Banking and Finance* Wholesale Banking Awards 2015.

RMB Business in Hong Kong

- Maintained its status as the clearing bank and the Primary Liquidity Provider of RMB business in Hong Kong.
- Appointed as the sole settlement bank for Shanghai-Hong Kong Gold Connect.
- Maintained its market position in RMB business. Both the transaction amount and the number of transactions of RMB clearing services grew satisfactorily year-on-year. Reinforced its leading position in the Hong Kong RMB insurance market.
- Launched the RMB Extended Clearing Service.
- Received the Best Onshore Interest Rate Hedging in the Stars of China Awards 2015 by *Global Finance* Magazine and the Best offshore RMB Bond Lead Manager in Hong Kong 2015 in the Global RMB Asset Ranking 2015 award by *The Asian Banker*.

Other new business platforms

- Private Banking business achieved encouraging growth in both the number of clients and their assets under management.
- Enlarged the client base of the custody business and maintained its status as one of the largest RQFII service providers in Hong Kong.
- Cash management services won the Achievement Award for the Best Cash Management Bank in Hong Kong by *The Asian Banker* for the third consecutive year, as well as the Hong Kong Domestic Cash Management Bank of the Year award by the *Asian Banking and Finance* for the second consecutive year.
- BOCG Life received all four awards in the RMB Business Outstanding Awards 2015 – Outstanding Insurance Business, organised by Metro Finance, Metro Finance Digital and Hong Kong *Wen Wei Po*.
- BOCHK AM's BOCHK All Weather CNY Equity Fund was awarded the Most Innovative Product by *Asia Asset Management*.

Business Segment Performance

Profit before Taxation by Business Segments

HK$'m, except percentages	2015	% of total	(Restated) 2014	% of total
CONTINUING OPERATIONS				
Personal Banking	**9,285**	**32.1**	7,352	26.8
Corporate Banking	**10,975**	**37.9**	10,655	38.9
Treasury	**7,801**	**26.9**	9,411	34.4
Insurance	**932**	**3.2**	613	2.2
Others	**(41)**	**(0.1)**	(633)	(2.3)
Total profit before taxation	**28,952**	**100.0**	27,398	100.0

Note: For additional segmental information, see Note 46 to the Financial Statements.

Personal Banking

Financial Results

Personal Banking's profit before taxation was HK$9,285 million in 2015, a growth of HK$1,933 million, or 26.3%, year-on-year. The growth was mainly driven by the increase in net interest income and net fee and commission income.

Net interest income increased by 13.0%. This was mainly driven by the improvement in the loan spread along with the increase in the average balance of deposits and loans. The growth was partially offset by the decrease in the deposit spread. Net fee and commission income grew strongly by 22.8%. This growth was broad-based and mainly attributable to the higher income from securities brokerage, insurance and credit cards. Net trading gain increased by 46.0%, mainly attributable to the increased income from currency exchange transactions and equity-linked products. Net gain on other financial assets increased by 27.1% as the Group captured market opportunities to dispose of certain equity instruments and realised a higher net gain.

Business Operations

The Group's Personal Banking business achieved solid growth in 2015. It maintained its leading position in new mortgage loans and the UnionPay card business, continuously expanded its product and service offerings and recorded satisfactory growth in commission income from the investment and insurance businesses. The Group also provided targeted sales and promotions to different customer segments and registered significant growth in quality customers from the Mainland. What's more, it set up a Cross-border Financial Service Centre, increasing the Group's capabilities in cross-border banking services to personal clients. Meanwhile, the Group continued to optimise its distribution channels to meet the needs of customers. In recognition of its outstanding performance in retail banking, BOCHK was named the Best Retail Bank 2015 in Hong Kong by *The Asian Banker* in its International Excellence in Retail Financial Services Programme.

Maintaining market leadership in residential mortgages

In 2015, market activities in the local residential property market slowed down following further prudential measures introduced by the HKMA, and competition in the local residential mortgage market intensified. To capture business opportunities, the Group focused on enriching its mortgage service portfolio and providing innovative products across all channels. During the year, the Group offered a new fixed-rate mortgage scheme that allows customers to lock in interest expenses ahead of interest rate hikes. It supported The Hong Kong Mortgage Corporation Limited by launching the new Premium Loan Insurance Scheme to expand the Group's subsidised housing business and enhanced the features of Home Ownership Scheme mortgage plans to offer greater product flexibility. The Group also strengthened its relationships with property agents. In addition, the Mortgage Expert mobile application was enhanced with a Mortgage eAssessment function allowing home buyers to obtain a preliminary approval amount for their mortgage loan applications within one minute.

Satisfactory growth in the investment and insurance businesses

The investment and insurance businesses recorded satisfactory growth in commission income from securities brokerage, funds distribution and insurance. During the year, the Group captured market opportunities and stepped up its marketing efforts in view of the volatile market. It strengthened its cross-selling activities to new customers to raise the penetration rate of investment products and provided family securities services to acquire more family customers. As a result, the Group doubled the number of new securities accounts opened from 2014. In addition, the Group provided customers with comprehensive stock quote services and market information relating to shares from both the Mainland and Hong Kong stock market and maintained its market leadership position. As a result, commission income from securities brokerage grew strongly in 2015.

In the funds distribution business, the Group continued to broaden its product offerings to satisfy the diverse needs of its customers. In support of capital market access between the Mainland of China and Hong Kong and following the announcement of the launch of the Mainland-Hong Kong Mutual Recognition of Funds, the Group worked closely with BOC and pioneered the distribution of the first recognised Mainland fund in December. The Group also produced an education video, webpage and series of customer seminars with the aim of helping customers learn about the investment opportunities of Mutual Recognition of Funds.

With regards to the Bancassurance business, the Group maintained its leading position in the Hong Kong RMB insurance market. During the year, the Group continued to provide a diversified range of life insurance and property insurance products and optimised its sales distribution channels. It also held a series of marketing campaigns. Insurance commission income grew satisfactorily.

A recognised leader in the UnionPay card business

Despite weak retail sales in the market, the Group's credit card business delivered a year-on-year growth in both cardholder spending and merchant acquiring volume. It also maintained its leading position in the UnionPay merchant acquiring business and card issuing business in Hong Kong. During the year, a number of new credit cards were launched to meet the needs of different customer segments, and a series of marketing campaigns were conducted to encourage the use of e-Channels. Additionally, the "BOCHK Credit Card" WeChat official account was upgraded to include new services such as account and bonus points balance enquiries; and transaction alert service to further improve the overall customer experience and convenience. These helped maintain the Group's leadership position in terms of the number of WeChat fans under the financial institution official account category.

A growing customer base for wealth management services

The Group made a stronger effort to deepen its existing customer relationships and acquire new customers. During the year, it continued to provide tailored financial solutions to Wealth Management, Enrich Banking and i-Free Banking customers, and deepened customer relationships. It also launched large-scale marketing programmes, including Family Banking-themed promotions and those targeted to university students and youth customers. At the same time, via the multi-dimensional development of employee payroll service, the Group encouraged customers to use its banking services with the aim of becoming their main bank. Through deepening collaboration with BOC and establishment of an effective cross-border sales and service model, the Group recorded a significant growth in quality customers from the Mainland. Furthermore, it set up a Cross-border Financial Service Centre with a dedicated team of Relationship Managers to serve customers across the border, increasing the Group's capabilities in cross-border banking services to personal clients.

In collaboration with business units of the Group as well as BOC's other entities, the Group's Private Banking business further expanded its customer base through a series of client acquisition and referral activities. During the year, it broadened its range of tailored products and services and optimised its business platform to raise brand awareness. The Group worked more closely with BOC's branches in the ASEAN region, to be in line with its regional transformation. Both the number of Private Banking clients and their assets under management achieved an encouraging growth.

Optimising banking channels

In 2015, the Group strived to optimise its distribution channels to meet the needs of customers. At the end of 2015, the Group's (including NCB) service network in Hong Kong comprised 262 branches, including 135 wealth management centres. During the year, the Group continued to roll out new concept branches in strategic areas of Hong Kong to enhance its brand image and appeal to new customers. Automated banking channels were further enhanced in terms of coverage points and facilities.

In response to the rapid development of Internet finance, the Group enhanced the use of new media for sales promotions. It pioneered the launch of customer enquiries function in the WeChat official account and the first-ever Online Loan 360 Service in Hong Kong, which is an Online-to-Offline (O2O) platform to provide online loan services for enhanced protection of customers' data. As initiated by the HKMA, the Group launched e-Cheques Services and was among the first batch of banks to introduce this brand new platform. Other service improvements included functional enhancements to Internet banking, mobile banking and its call centre. In recognition of its well-received electronic platform and outstanding services, BOCHK received the Best Multi-channel Project Award in the Technology Implementation Awards 2015 by *The Asian Banker*, the Mobile Banking Initiative of the Year – Hong Kong award in the *Asian Banking and Finance* Retail Banking Awards 2015 as well as a number of other industry awards during the year.

Corporate Banking

Financial Results

Corporate Banking's profit before taxation was HK$10,975 million, a growth of HK$320 million, or 3.0%, year-on-year. Net fee and commission income grew strongly, partially offset by the net charge of loan impairment allowances.

Net interest income decreased slightly by 0.6%. The positive impact on net interest income with the increase in the average balance of loans and deposits and the improvement in loan spread was offset by the narrowed deposit spread. Net fee and commission income increased strongly by 41.8%, largely led by the growth in loan commissions. There was a net charge of loan impairment allowances as compared with a net reversal last year, mainly due to the net charge of individually assessed impairment allowances caused by the downgrade of a few corporate advances.

Business Operations

In 2015, the Group continued to make good progress in becoming a bridgehead for the internationalisation and diversification of the BOC and provided comprehensive financial support to clients across different regions. Its Corporate Banking business continued to grow in the local sector and made important headway in capturing the increasing demand for cross-border banking services from customers expanding into countries along the Belt and Road. The Group also captured opportunities arising from the development of FTZs and extended its geographical presence by securing relationships with overseas financial institutions and central banks. In the custody business, the Group successfully enlarged its customer base and captured opportunities in new client segments. The Group also enhanced its service capabilities in the cash management business, which was well recognised by the industry.

Capturing opportunities from major national strategic initiatives

In 2015, the Group was active in capturing opportunities from major national strategic initiatives. It succeeded in expanding its customer base with leading enterprises in Hong Kong, the Mainland and overseas. It formulated differentiated strategies that brought tailored services to customers and provided them with funding solutions that support their expansion into countries along the Belt and Road and in the ASEAN region. To capture opportunities made possible by the development of the FTZ policy, the Group took the lead in signing strategic cooperation agreements or loan contracts with a number of enterprises in new FTZs in Guangdong, Fujian and Tianjin and successfully provided cross-border direct loans to these enterprises.

The Group also further deepened its collaboration with BOC. During the year, the co-operation mechanism set up among BOC's Guangdong, Hong Kong and Macau operations in 2014 was optimised and helped complete several significant cross-border loan projects, raising BOC's service capabilities in these three areas. In line with its strategic development, the Group also set up closer cooperation mechanisms with BOC's entities in the ASEAN region, strengthening its comprehensive cooperation in banking products and services and raising BOC's service coverage and overall synergy in the region.

Meanwhile, acting as BOC's Asia-Pacific Syndicated Loan Centre, the Group worked closely with BOC's overseas branches and participated in a number of significant syndicated loans for corporates in support of their global financing activities. Through these activities, it remained the top mandated arranger in the Hong Kong-Macau syndicated loan market. In recognition of its outstanding services in cross-border financing, BOCHK received the Outstanding Corporate/Commercial Banking – Cross-border All-round Services Award at the RMB Business Outstanding Awards 2015 organised by Metro Finance, Metro Finance Digital and Hong Kong *Wen Wei Po* and the Commercial Banking – Excellence Award, Corporate Finance – Excellence Award in the *Bloomberg Businessweek* Financial Institution Awards 2015.

Enhancing business development in the commercial sector

In 2015, the Group improved the management model of SME service, which not only further enhanced its service and sales capabilities but also helped expand its customer base. The Group supported BOC's effective cross-border business platform for business matching and collaboration between the Mainland, local and overseas SMEs to achieve mutual benefits. The Group added a streamlined application and One-hour Preliminary Approval Service to its BOC Small Business Loan service that improved operational efficiency and the customer experience. It also maintained its close contacts with local trade associations by co-organising and sponsoring various business activities and providing the latest market information to reinforce its connections in the local business sector. In recognition of its long-standing support of SMEs in Hong Kong, BOCHK received the Best SME's Partner Award from the Hong Kong General Chamber of Small and Medium Business for the eighth year in a row.

Development of institutional businesses

The Group expanded its institutional businesses in 2015. To carry out its long-term strategies for expanding business in countries along the Belt and Road and in the ASEAN region, the Group strengthened its network of corresponding banks and created extensive cooperation with central banks in these countries. Leveraging BOC's competitive edge in RMB business and global service capabilities, the Group actively developed relationships with overseas central banks and supranational organisations. Locally, the Group expanded cooperation with and offered tailor-made services to non-governmental organisations and entities. During the year, the Group acted as the receiving bank for a number of major IPOs in Hong Kong, which consolidated its leading position in the market. Under the Mainland-Hong Kong Mutual Recognition of Funds scheme, the Group captured opportunities to open southbound settlement accounts for Hong Kong agents of various Mainland asset management companies and strengthened business relationships with foreign asset management companies in the northbound fund business. BOCHK was appointed the sole settlement bank for Shanghai-Hong Kong Gold Connect by Shanghai International Gold Exchange Co. Ltd. ("SGEI"), a wholly-owned subsidiary of Shanghai Gold Exchange.

Enlarging the customer base for custody services

In 2015, the Group strived to enlarge its institutional customer base and capture growing opportunities from new client segments for custody services. It successfully established business relationships with new applicants from overseas and maintained its status as one of the largest Renminbi Qualified Foreign Institutional Investors ("RQFII") service providers in Hong Kong. It made solid progress in Qualified Domestic Institutional Investor ("QDII") by securing its first trust-QDII mandates and also Qualified Domestic Limited Partner deals. In addition, the Group collaborated more closely with BOC and its branches to enhance its service capabilities. At the end of 2015, excluding the RMB fiduciary account for participating banks, total assets under the Group's (including NCB) custody were valued at HK$776.6 billion.

Further expansion of cross-border cash management services

The Group further enhanced its cross-border cash management service capabilities. It worked closely with BOC and completed the implementation of cross-border cash pooling services for a number of large corporate clients and helped them maximise their cash liquidity through onshore and offshore two-way cash sweeping. Following BOCHK's appointment as the sole settlement bank for Shanghai-Hong Kong Gold Connect by SGEI, the Group provides SGEI with funds settlement and cross-border payment services for cross-border gold trading related transactions. In recognition of its outstanding cash management services, BOCHK received the Achievement Award for the Best Cash Management Bank in Hong Kong by *The Asian Banker* for the third consecutive year. It also received the Hong Kong Domestic Cash Management Bank of the Year award in the *Asian Banking and Finance* Wholesale Banking Awards for the second consecutive year. In addition, BOCHK was recognised in the corporate customer poll held by *Asia Money* as the Best Overall Domestic Cash Management Services for Large Sized Corporates and Best Overall Cross-Border Cash Management Services for Large Sized Corporates.

Proactive measures to contain risks

In 2015, the Group adhered to a prudent credit policy with further refinement of Know Your Customers and risk management on key industries. In view of the uncertain economic environment, credit monitoring has been performed on a more frequent and proactive basis. The Group put in place more stringent pre- and post-lending monitoring measures to track early negative signs. Additionally, it stayed alert to its Mainland exposures and remained vigilant in monitoring customers in certain vulnerable industries with the threat of overcapacity. It also established a trigger point to review and manage the concentration risk of Mainland exposures. Finally, to accommodate the Group's business strategy associated with Mainland enterprises going global and in line with the Belt and Road initiative, the Group has been raising related underwriting standards in its credit policies and procedures with the aim of putting in place more efficient and sound risk control measures for the Group's business development in new markets.

Treasury

Financial Results

Treasury's profit before taxation was HK$7,801 million, a decrease of 17.1% from the previous year.

Net interest income decreased by 24.2%, mainly due to the decrease in the average balance of RMB balances and placements with banks, coupled with the decline in the average yield on related assets caused by the drop in market interest rates. The average yield of debt securities investments also declined. The decrease was, however, partially offset by the increase in the average balance of debt securities investments. Net gain on other financial assets increased strongly by HK$455 million or 928.6% as the Group recorded a gain from the disposal of certain debt securities investments in 2015.

Business Operations

In 2015, the Group's Treasury business captured market opportunities and offered time-to-market products to customers with satisfactory growth in customer transactions. The Group reinforced its market leadership in the RMB treasury business and was the first international commercial bank to issue RMB financial bonds (Panda bonds) in the Mainland's domestic interbank bond market. In addition, the Group continued to optimise its RMB clearing service and actively supported the liquidity of the RMB market in Hong Kong.

An active response to customer demand

In line with its customer-centric approach, the Group studied customers' product preferences and requirements to enhance its product distribution capabilities. It offered time-to-market products, launched themed and bundling marketing programmes, revamped the distribution channel for traditional investment products, and strengthened the sales support of the Investment Product Specialist team. During the year, currency exchange, FX Margin and equity-linked investment products were well-received by customers and the related transactions registered a satisfactory growth. In the bond underwriting business, the Group explored diversified business opportunities from the underwriting of dim sum bonds as well as USD and EUR-denominated bonds. The Group also successfully expanded its banknote business to overseas markets. In recognition of its outstanding service in treasury products, BOCHK received the Hong Kong Domestic Foreign Exchange Bank of the Year award in the *Asian Banking and Finance* Wholesale Banking Awards 2015.

Reinforcing market leadership in the RMB treasury business

The Group remained committed to strengthening Hong Kong's position as a major offshore RMB hub and promoted the continuous development of RMB internationalisation. In 2015, in view of changes in RMB interest rates and exchange rates, the Group fully leveraged its competitive edge in RMB business by providing value-preservation solutions and instant market pricing information to customers, resulting in significant growth in corporate and institutional clients businesses. In recognition of its outstanding RMB treasury business, BOCHK received the Best Onshore Interest Rate Hedging in the Stars of China Awards 2015 by *Global Finance* Magazine and the Best offshore RMB Bond Lead Manager in Hong Kong 2015 in the Global RMB Asset Ranking 2015 by *The Asian Banker*.

Optimising RMB clearing service

The Group continued to strengthen its clearing capabilities to ensure the stable development and continuous improvement of its RMB clearing services in Hong Kong and overseas. During the year, the Group extended the clearing service hours of its RMB Real Time Gross Settlement ("RTGS") System to 20.5 hours per day to further enhance the real-time RMB clearing services for participating banks and RMB clearing banks in Europe and the Americas. The Group also launched the innovative Extended Clearing Service in the RMB RTGS System by enhancing the system architecture and adding a new tier of participant called Global Users. This new function provided convenience to participating banks' provision of real-time RMB clearing services to their corresponding banks. In addition, the Group continued to act as an active Primary Liquidity Provider with additional RMB liquidity to stabilise the market. In June, the PBOC enacted a policy that allows offshore RMB clearing and participating banks to take part in the onshore bond repo market, following which the Group completed the first repo transaction as an offshore participating bank.

Maintaining a prudent investment strategy

The Group continued to exercise prudence in managing its banking book investments, while closely monitoring market changes and adjusting its investment portfolio in order to enhance returns, while remaining alert to risks. During the year, the Group adjusted its investment portfolio in response to fluctuations in RMB interest rates and the normalisation of US interest rates. It increased its investments in government-related and high-quality corporate bonds to optimise its investment portfolio. In September, the Group successfully issued RMB1 billion financial bonds (Panda bonds), making it the first international commercial bank to do so in the domestic interbank bond market of the Mainland of China. This landmark transaction not only opened up a new source of funding for the Group, but also set a precedent for other foreign institutions that plan to tap the onshore capital market.

Insurance

Financial Results

Profit before taxation in the Group's Insurance segment was HK$932 million in 2015, up 52.0% from 2014. The growth was mainly driven by improved underwriting income, derived from larger scale of in-force insurance business, and reinsurance profit. Net interest income grew by 3.4%, which was mainly driven by larger scale of securities investments due to net premium income received. During the year, net insurance premium grew robustly by 62.5%.

Business Operations

In 2015, the Group continued to optimise its insurance products and enhanced its marketing and promotional campaigns to increase the sales volume. It reinforced its leading position in the Hong Kong RMB insurance market and remained focused on diversifying its distribution channels to acquire customers from different segments, in particular those with wealth management needs and younger customers.

Continued distribution channel diversification and product enhancement

The Group continued to broaden its product offerings to meet the various needs of customers and diversify its distribution channels to reach different customers segments. During the year, the Group launched a variety of innovative products, including the IncomeRich Annuity Insurance Plan for senior customers, the IncomeShine Whole Life Coupon Plan and the StepUp Whole Life Insurance Plan for customers with savings and wealth management needs, and the Forever Glorious ULife plan for high-net worth customers. By expanding the broker and tied agency channels and launching a new e-Channel, the Group was able to explore different customer segments, especially the younger clientele.

Reinforced leadership in RMB insurance products

The Group reinforced its leading position in the Hong Kong RMB insurance market through product optimisation and innovation amid a slowdown in the RMB insurance market. The Group launched a series of revamped products and products with new features, such as the Target 5 Years Insurance Plan Series, IncomeRich Annuity Insurance Plan, IncomeShine Whole Life Coupon Plan, StepUp Whole Life Insurance Plan, and Forever Glorious ULife Plan, to sustain the growth in the RMB insurance business. In recognition of its outstanding performance, BOCG Life received all four awards in the RMB Business Outstanding Awards 2015 – Outstanding Insurance Business, organised by Metro Finance, Metro Finance Digital and Hong Kong *Wen Wei Po*.

Others

Improving product diversification in asset management

In 2015, BOCHK Asset Management Limited ("BOCHK AM") continued to enhance its product offerings and expand its footprint in other regions. During the year, the Group launched a new retail fund, the BOCHK All Weather CNY Equity Fund, which was well received by customers. This fund aims to achieve long-term capital growth by investing primarily in China A-shares in the Shenzhen stock market through RQFII. With the strong impetus for developing RMB products, the business performance of BOCHK AM was adversely affected by the economic slowdown in the Mainland and the depreciation of the RMB. During the year, BOCHK AM established relationships with other business partners in order to diversify its product offerings and widen its distribution channels. It also established partnerships with BOC's branches in the ASEAN region for customer referrals as well as the promotion of BOCHK AM's services.

In recognition of its outstanding performance, BOCHK AM won the Best RMB Bonds, Offshore, Three Years in its Best of the Best Performance Awards by *Asia Asset Management* in its 2015 Best of the Best Awards. The BOCHK All Weather CNY Equity Fund was awarded the Most Innovative Product under the Best of the Best Country Awards – Hong Kong in the same award. BOCHK AM was also granted the Best-in-Class, High Yield Fixed Income award and the Outstanding Achiever, RMB Fixed Income award in the House Awards of the *BENCHMARK* Fund of the Year Award 2015.

Disposal of Nanyang Commercial Bank, Limited

On 18 December 2015, the Group entered into the Sale and Purchase Agreement with Cinda Financial Holdings Co., Limited ("Cinda Financial") and jointly made an announcement with BOC in relation to the Group's disposal of all the issued shares of NCB (the "Proposed Disposal"). Cinda Financial had been confirmed by Beijing Financial Assets Exchange ("CFAE") as the only qualified bidder in the bidding process and was invited to enter into negotiations with BOCHK on the terms of the Proposed Disposal.

The total consideration for the Proposed Disposal is HK$68 billion, which was determined with reference to various factors, including (i) the net asset value of NCB and the price-to-book multiples achieved in similar transactions in the Hong Kong banking sector; (ii) scarcity value of banking licences in Hong Kong and China; (iii) future development prospects of NCB and Nanyang Commercial Bank (China) Limited ("NCB China"); and (iv) potential synergies between NCB and China Cinda Asset Management Co., Ltd. and its subsidiaries.

Completion of the Proposed Disposal depends upon the satisfaction of certain conditions set out in the Sale and Purchase Agreement. The Group expects to derive a gain before taxation of approximately HK$34,027 million as a result of the Proposed Disposal, which is calculated based on the surplus of the Consideration over the net asset value of NCB as at 31 December 2014, together with the reclassification of the related cumulative translation exchange and revaluation reserve.

However, the actual gain to be recognised could be different from the estimated gain disclosed above owing to (i) the taxes to be incurred on the Proposed Disposal; (ii) change in the net asset value of NCB from 31 December 2014 to the Completion Date; (iii) changes in the cumulative translation exchange and revaluation reserve from 31 December 2014 to the Completion Date; and (iv) the professional charges and expenses arising from the Proposed Disposal for engaging, amongst others, financial, legal and accounting advisors.

For further information on the Proposed Disposal, please refer to the joint announcement made by BOC and the Group on 18 December 2015.

Discontinued operations

Profit from discontinued operations reflected the operating results of NCB after consolidation. Discontinued operations recorded an after-tax profit of HK$2,827 million, representing a year-on-year increase of 6.7%. The increase was attributable to the 21.0% growth of non-interest income, of which net fee and commission income increased by 8.2% and net gain on other financial assets rose by 116.4%. Net interest income was down 9.1% year-on-year. Net interest margin was 1.65%, down 18 basis points from 2014. Classified or impaired loan ratio was 0.44%, a decline of 0.40 percentage point from the end of last year.

Business Focus for 2016

The year 2016 will bring both opportunities and challenges to banks in Hong Kong. The Group will focus on consolidating its leading market position and core businesses in Hong Kong, offering a diverse range of products and services and promoting its strategic transformation and regional development. At the same time, it will adhere to its stringent risk management and controls to safeguard its financial strength and asset quality.

With regards to its customer base, the Group will optimise the mix and boost the business development of its corporate customers. It will also enhance the acquisition of mid- and high-end personal customers. It will seize opportunities from the Mainland's strategic initiatives and policy changes to enhance business penetration of large corporates and to become a more competitive cross-border wealth management platform for mid- and high-net-worth customers. It will further deepen business relationships with the government, public entities, commercial and SME customers in various banking businesses. The Group will continue to enhance its service capabilities to customers and strengthen its business collaboration with BOC's worldwide entities, in particular those in Guangdong, Hong Kong and Macau, to expand areas for business development.

The Group will expand its product offerings and strive to be the premier bank of offshore RMB business. It will capture market opportunities and meet the diverse needs of targeted customers through product innovation, reinforcing the Group's leading position in the offshore RMB business.

To capture opportunities from the new era in asset management, the Group will speed up the development of the eight key business platforms in credit cards, private banking, life insurance, asset management, cash management, custody, trustee and futures. It will leverage the competitive edge of each strategic business platform to deepen product and service penetration to targeted customers and markets to provide support for other business units and for regional expansion.

As regards to its infrastructure, the Group will focus on the branch network transformation to establish an integrated network model to serve retail and commercial customer segments. It will identify targeted customer and service positioning for branches and enrich branch network functions to increase the overall service capabilities and fully enhance the productivity of its branch network. The Group will sharpen its competitive edge in Internet finance by enhancing product and service innovation through the effective use of information technology. It will continue to develop new Internet finance initiatives, push forward various forms of mobile banking service and utilise various mobile application platforms to link the Group's banking services into customers' daily lives. It will also capitalise on BOC's strong competitive edge in cross-border services to develop cross-border e-commerce business.

On 21 May 2015, the Group announced its proposed acquisition from BOC of its banking assets in certain ASEAN countries, and the acquisition work has been progressing smoothly. Expanding into the ASEAN market will transform the Group from a local bank in Hong Kong into a regional bank with cross-border operations. It has put in place a comprehensive matrix-style mechanism for management, cross-region service and referral in the ASEAN region. The Group aims to enhance service capabilities of entities in the ASEAN region and hence become the prevailing bank for banking business domestically.

Regulatory Developments

Designation of Domestic Systemically Important Authorised Institutions ("D-SIBs")

In March 2015, the HKMA designated BOCHK as one of the D-SIBs, which will be required to include a Higher Loss Absorbency (HLA) requirement into the calculation of regulatory capital buffers. In line with the phase-in arrangement in the frameworks issued by the Basel Committee on Banking Supervision, the full amount of HLA requirement will be phased in from 2016-2019 in parallel with the Capital Conservation Buffer and Countercyclical Capital Buffer. In response to the higher regulatory requirement, the Group enhanced its profitability to strengthen its capital base and continued to optimise its management of risk-weighted assets in 2015, resulting in increases in all capital ratios compared with those at the end of 2014. The Group will implement various capital-saving mechanisms and strengthening business units' awareness of capital management to enhance the Group's overall capital position. Additionally, considering the Group's proposed disposal of NCB and the proposed acquisition of BOC's banking assets in certain ASEAN countries, it is expected that the Group will meet all regulatory capital buffer requirements early and maintain its capital position at a solid level.

Growing Importance of Cyber Security Risk Management

The HKMA issued to all authorised institutions a general guidance highlighting the growing importance of proper cyber security risk management given the rise of cyber attacks globally. This guidance provides a detail description of areas for an effective cyber security risk management that authorised institutions are expected to have in place. The Group also pays serious attention to cyber security. It enhanced its technology risk management framework and related policies to strengthen its cyber security and technology risk management. It also introduced best practices in the industry and conducted independent risk assessments on a regular basis. In addition, it promoted respective culture and awareness to all units within the Group.

Technology and Operations

In 2015, the Group continued to upgrade its information technology and business operation infrastructure to support its business growth and improve operational efficiency. It completed the revamp and expansion of its data centre which serves to further improve the information technology production capabilities for supporting the Group's long-term business growth. It launched and enhanced a series of services to strengthen its service capabilities and provide a better customer experience. These included the launch of the AppsDollar platform and e-Cheques services, the kick-off of the Virtual Teller Machine Project, and the enhancement to Electronic Bill Presentment and Payment services. With regards to its operation infrastructure, a new data-processing platform and operation model were deployed to centralise data processing of customer applications at frontline branches.

The Group continued to enhance its infrastructure and reinforce its position as the global hub for RMB settlements. The extension of clearing service hours and the launch of Extended Clearing Service of the RMB RTGS System greatly improved the breadth and depth of the Hong Kong RMB clearing model, with a sharp increase in the clearing volume from Europe and the Americas as well as the increased number of different participants such as overseas central banks and sovereign institutions.

In recognition of the Group's efforts in technological innovation and operational efficiency, BOCG Life's e-Sales & e-Services System won the Digital Transformation Award of the 5th Asia Insurance Technology Award. BOCHK's Trade Services Centre was awarded ISO 9001:2015 Certification as the Group became one of the first financial institutions in Hong Kong to receive this certification in recognition of its consistent products and services for customers. BOCHK also won the Best Champion in Implementing Continual Improvement in Organization and the Best Practice in Process Improvement with Lean in the Asia Quality Best Practice Award.

Credit Ratings

As at 31 December 2015	Long-term	Short-term
Standard & Poor's	A+	A-1
Moody's	Aa3	P-1
Fitch	A	F1

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.

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.

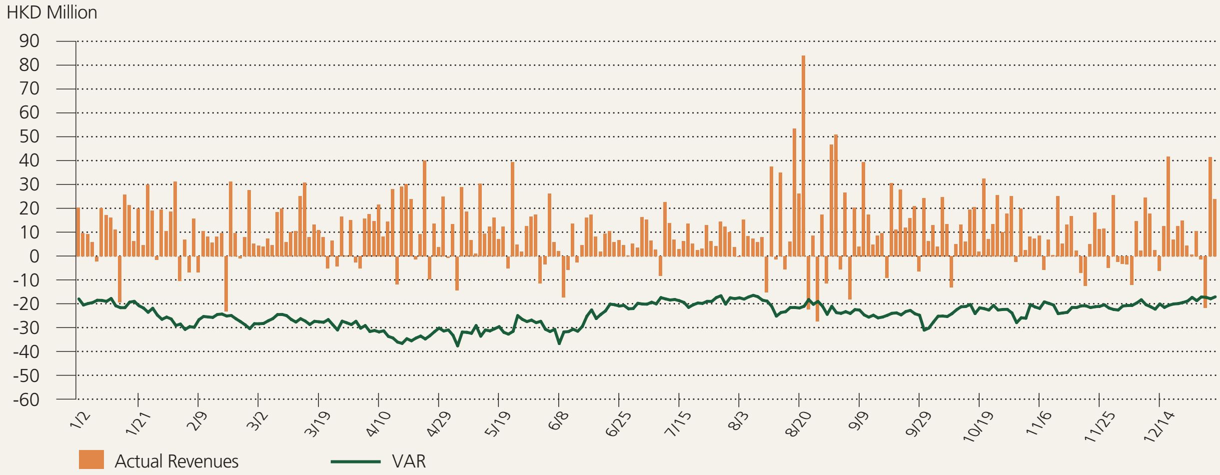
Market risk management

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.

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 one-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 2015



There were three actual losses exceeding the VAR for the Group in 2015 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.

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.

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 Legal & Compliance and Operational Risk Management Department ("LCO"), 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 LCO, 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 LCO, which reports directly to the CRO. As part of the Group's corporate governance framework, the policy for the management of legal and compliance risks 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), permanent health (Class D), retirement scheme management category I (Class G) 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, credit risk, equity price risk and currency 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 reinsurance counterparty risk exposure 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.

Interest rate risk management

An increase in interest rates may result in the depreciation of the value of BOCG Life's investment assets. 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, debtor 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 associated with bonds, notes and counterparties
– 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 and issuer. Such limits are subject to review by the Management at least once a year.

In order to enhance its credit risk management, BOCG Life has strengthened its communication with the Group while closely monitoring and updating internal control to ensure consistency with the Group's credit risk management and investment strategy.

Equity price risk management

Equity price risk refers to the risk of loss due to volatility of market price in listed equity securities and equity funds. BOCG Life's asset and liability framework includes managing the adverse impact due to equity price movement though stress test and exposure limit.

Currency risk management

Currency risk refers to the risk of loss due to volatility of exchange rate. BOCG Life's asset and liability framework includes managing the adverse impact due to exchange rate movement though stress test, exposure limit and risk limit.