FinTech Innovation

Management’s Discussion and Analysis

As a result of the disposal of NCB and proposed disposal of Chiyu, the Group reported the financial results and positions of NCB and Chiyu in 2016 as discontinued operations, assets held for sale and liabilities associated with assets held for sale in the consolidated financial statements. The comparative amounts of consolidated income statement have been restated as if the discontinued operations had been discontinued at the beginning of year 2015. To facilitate a year-on-year comparison, comparative amounts of the consolidated balance sheet as well as certain financial ratios in this Management’s Discussion and Analysis have been restated to enable analysis on a comparable basis.

Following the completion of the share acquisition of Bank of China (Malaysia) Berhad (“BOC Malaysia”) on 17 October 2016, the Group has applied the merger accounting method in the preparation of financial statements for the combination with entity under common control. The comparative information for year 2015 has been restated accordingly.

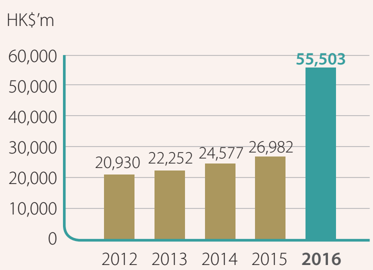
The above transactions are collectively referred as the “disposals and acquisition” in this Management’s Discussion and Analysis.

Financial Performance and Conditions at a Glance

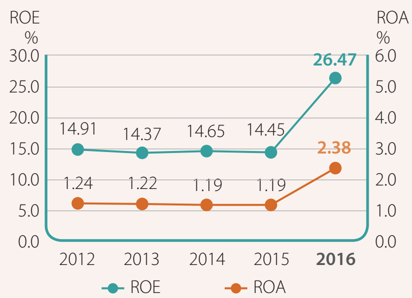
The following table is a summary of the Group’s key financial results for the year 2016 in comparison with the previous four years. The average value of liquidity coverage ratio is reported on a quarterly basis.

Key Performance Trends

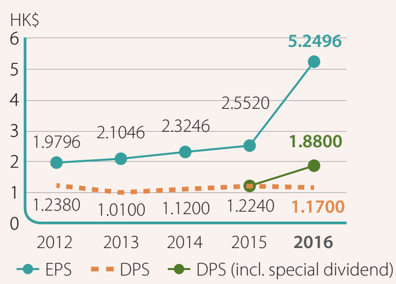
Profit Attributable to the Equity Holders



Return on Average Shareholders’ Equity (“ROE”) and Return on Average Total Assets (“ROA”)



Earnings Per Share (“EPS”) and Dividend Per Share (“DPS”)



Profit attributable to the equity holders achieved a new high

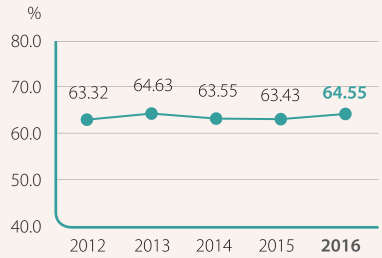
- Profit attributable to the equity holders increased by 105.7% year-on-year to HK$55,503 million.

Solid returns to shareholders

- ROE was 26.47%. ROE on continuing operations[1] was 12.23%.
- ROA was 2.38%. ROA on continuing operations[2] was 1.13%.
- EPS was HK$5.2496. Excluding the gain from the disposal of NCB, EPS would have been HK$2.4163. Dividend per share was HK$1.88, including the special dividend of HK$0.71 per share resulting from the gain on the disposal of all the issued shares of NCB.

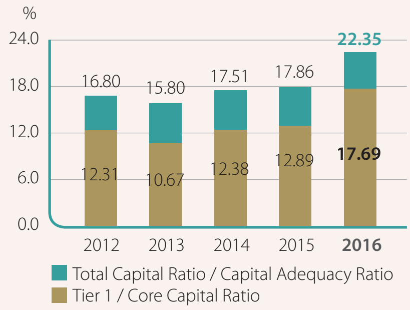
Financial Position

Loan to Deposit Ratio



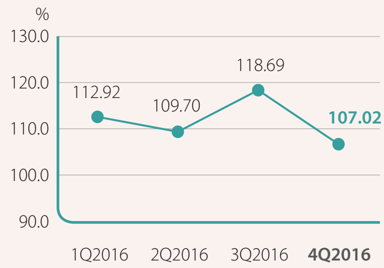
as at 31 December

Capital Ratio



as at 31 December

Average value of Liquidity Coverage Ratio



Loan to deposit ratio at a healthy level

- Advances to customers and deposits from customers grew by 11.7% and 9.8% respectively from the end of 2015. The loan to deposit ratio was 64.55%, up 1.12 percentage points from 63.43% at the end of 2015.

Enhanced capital position to support business growth

- The total capital ratio was 22.35% while the Tier 1 capital ratio was 17.69%, up 4.49 and 4.80 percentage points from that at the end of 2015.

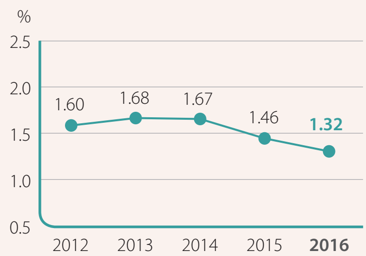
Sound liquidity position

- Average value of liquidity coverage ratio was well above the regulatory requirement throughout the four quarters of 2016.

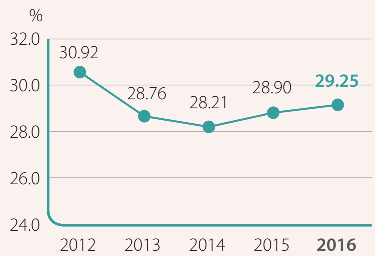
Management's Discussion and Analysis

Key Operating Ratios

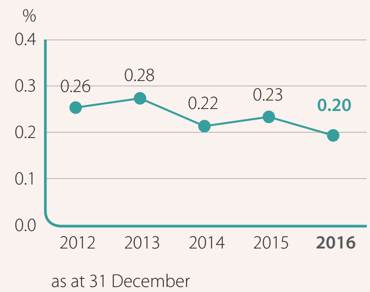
Net Interest Margin ("NIM")[3]



Cost to Income Ratio[3]



Classified or Impaired Loan Ratio[4]



Narrowing NIM with expanded asset size

- NIM was 1.32%, down 14 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 of RMB funds from the clearing bank business. The decrease in net interest margin was also due to the increase in short-term debt securities investments. NIM for the second half of 2016 improved half-on-half, up 6 basis points, which was attributable to lower deposit costs, an improved deposit mix and increased advances to customers.

Cautious cost control with better operational efficiency

- The cost to income ratio was 29.25%, up only 0.35 percentage point year-on-year, cost efficiency at a relatively good level in the industry.

Asset quality remained benign with classified or impaired loan ratio below market average

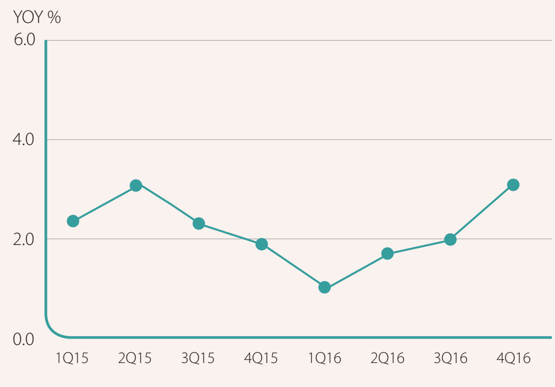
- The classified or impaired loan ratio was 0.20%, well below the market average.

1. ROE on continuing operations is calculated by dividing profit attributable to the equity holders from continuing operations by the average of the beginning and ending balance of capital and reserves attributable to the equity holders that excludes the impact of profit attributable to the equity holders from discontinued operations and special dividend paid.
2. ROA on continuing operations is calculated by dividing profit for the year from continuing operations by daily average balance of total assets excluding those of discontinued operations.
3. The financial information for the year 2016 is from continuing operations, and the comparative information has been restated accordingly. The Group has applied the merger accounting method in the preparation of financial statements for the combination with entity under common control in 2016. The comparative information for the year 2015 has been restated accordingly. However, the financial information prior to 2015 had not been restated as the difference before and after restatement is insignificant.
4. 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

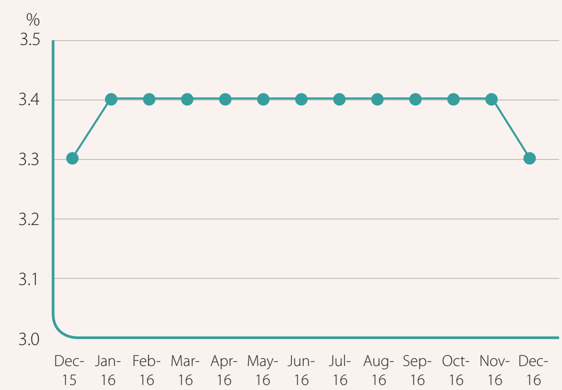
In 2016, global economic growth continued to be at a low level. In the US, the economy maintained a moderate growth trend in an improving employment market and with rising inflation. The US Federal Reserve raised the federal funds target rate in December, which was the second time in twelve months. In Europe, the Eurozone economy remained stable owing to the European Central Bank's ultra-loose monetary stance and despite fears that the Brexit referendum in June would significantly affect economic fundamentals. In ASEAN, the economy remained on track and outperformed global growth, supported by growing private and public consumption, robust infrastructure development and accommodative fiscal policy. In the Mainland of China, with accelerated restructuring and upgrading of traditional industries, as well as structural reform, economic growth remained stable despite headwinds from lacklustre international trade and weak private fixed asset investment.

Hong Kong Real GDP Growth Rate



Source: HKSAR Census and Statistics Department

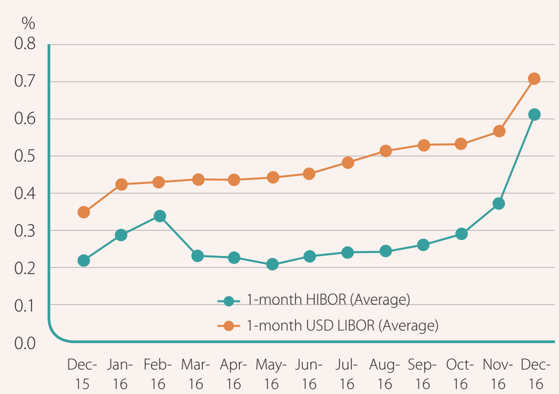
Hong Kong Unemployment Rate



Source: HKSAR Census and Statistics Department

In Hong Kong, the real GDP growth in 2016 was only 1.9% over the previous year. Sluggish international trade amid weakened global economic growth, and the structural adjustments in inbound tourism and retail sales hindered economic growth. The real GDP growth in the first quarter slowed to 1.0% over a year earlier. It gradually stablised and improved to 3.1% increase in the fourth quarter.

HIBOR and USD LIBOR



Source: Bloomberg

In 2016, there was abundant liquidity in the Hong Kong banking sector overall, and market interest rates continued at relatively low levels but there was increased volatility compared with 2015. In anticipation of a US interest rate hike, the average 1-month HIBOR and 1-month LIBOR rose from 0.23% and 0.20% respectively in 2015 to 0.30% and 0.50% respectively in 2016.

In 2016, the Hong Kong stock market came under pressure at the beginning of the year, but resumed momentum during the second and third quarters, supported by factors including the smaller-than-expected contagion effect of Brexit, delay in US interest rate hikes and the approval of Shenzhen-Hong Kong Stock Connect implementation plan. The Hang Seng Index again experienced correction towards the end of the year, amid market concerns over imminent US interest rate hikes, finishing the year almost flat from the end of 2015. Transaction volumes decreased significantly from the high level in 2015.

During the year, local private domestic property price illustrated a V-shaped rebound, prompting the Government to raise the stamp duty in November 2016 as a corrective measure. The overall level of transaction activity in the local residential property market, in terms of the number of agreements for sale and purchase of residential building units, was lower than in 2015.

In 2016, the Mainland of China continued to introduce a number of initiatives to promote capital account convertibility and the internationalisation of the RMB. These included the relaxation of policies on Free Trade Zones ("FTZs"), allowing foreign entities to issue Panda bonds and participate in the Mainland's interbank bond market as well as the interbank foreign exchange market, and allowing overseas banks to join China's Cross-border Interbank Payment System ("CIPS"). RMB's inclusion in the Special Drawing Rights ("SDR") basket of currencies in October 2016 facilitated and encouraged offshore governments, central banks and institutions to invest in RMB assets. All of these initiatives encouraged the healthy development of the offshore RMB market and opened up new business opportunities to banks.

Banks in Hong Kong operated in a highly challenging environment in 2016. The global economic slowdown, destocking in the Mainland and increasing finance costs for Mainland corporates in Hong Kong continued to hinder loan demand. As low interest rates prevailed and market competition intensified, banks' profitability remained under pressure. Furthermore, the contraction of the local RMB funding pool intensified competition for offshore RMB deposits in Hong Kong and hence created upward pressure on deposit costs. Nevertheless, banks also had new opportunities to expand their business from the implementation of China's important strategies, such as the Belt and Road Initiative, Going Global Strategy and the inclusion of the RMB into the SDR basket.

Outlook for 2017

Heading into 2017, the overall operating environment for banks in Hong Kong will remain challenging. The trend of subdued economic growth will continue globally amid elevated political, economic and financial uncertainties. In the US, the labour market continues to improve and economic activities resume at a moderate pace. These, coupled with the support of low oil prices and accommodative monetary policy, economic growth is expected to improve somewhat. In some of the Eurozone member states, the prospect of elections in 2017 is creating new uncertainties. In the Mainland of China, the economic restructuring will continue to exert downward pressure on industrial production and investment, although economic growth is expected to continue at a steady rate supported by a proactive fiscal policy and stable monetary policy. In Hong Kong, the subdued global environment will probably maintain growth at a low level. External trade is unlikely to improve in the short-term amid the uncertainties arising from the strong US dollar, protective new trade policies that the US might initiate, the outcome of the Brexit trade negotiations, and the continuous restructuring and relocation of manufacturing in the Mainland. Further development of the RMB business in Hong Kong will require additional impetus across all channels amid the downward pressure on RMB exchange rates and the narrowing of onshore and offshore RMB interest rate differentials.

On a more positive note, domestic demand in Hong Kong, including private consumption and investment, is likely to be supported by a resilient labour market, the low interest rate environment, some consolidation in the property market and the benefits that accrue from the Mainland's financial reforms. What's more, the Mainland's important strategies, such as the Belt and Road Initiative and Going Global Strategy, and the deepening of RMB internationalisation will help to propel the growth of the offshore RMB market. In addition, growth trends are expected to be divergent in ASEAN member countries. However, as a key region for the Belt and Road Initiative and a market with significant potential, the ASEAN economy will see ample opportunities, including those from a number of new infrastructure projects, rising demand for financial services and a broader use of RMB in the region, and provide more business opportunities for banks in Hong Kong.

Consolidated financial review

The comparative information for the year 2015 has been restated as a result of the Group's disposals and acquisition.

Financial Highlights

HK$'m, except percentages	2016	(Restated) 2015	Change (%)
CONTINUING OPERATIONS			
Net operating income before impairment allowances	**41,754**	40,181	3.9
Operating expenses	**(12,213)**	(11,611)	5.2
Operating profit before impairment allowances	**29,541**	28,570	3.4
Operating profit after impairment allowances	**28,963**	27,815	4.1
Profit before taxation	**29,452**	28,575	3.1
Profit attributable to the equity holders of the Company	**55,503**	26,982	105.7

In 2016, the Group's profit attributable to the equity holders increased to HK$55,503 million, up 105.7% year-on-year, a new high since its listing. The Group proactively implemented Bank of China Group's strategies and captured market opportunities. It actively explored business opportunities in the ASEAN and expedited the development of business transformation and technological innovation, and continued to refine its business structure to become more customer-centric. It optimised its distribution channels and Internet finance capabilities in order to enhance its overall service capabilities. The Group also reinforced its strong franchise in RMB clearing business and stepped up its efforts in building key business platforms. It leveraged its competitive edge to achieve satisfactory performance in its core business areas. Key financial indicators remained at solid levels.

During the year, the Group's regional development plans gathered pace with synergies beginning to emerge. It successfully completed the sale of NCB and steadily pushed forward its proposed sale of shares in Chiyu. Meanwhile, it restructured its business in the ASEAN region in an orderly manner and completed the share acquisition of Bank of China (Malaysia) Berhad and Bank of China (Thai) Public Company Limited ("BOC Thailand") on 17 October 2016 and 9 January 2017 respectively. On 20 December 2016, BOCHK's first overseas institution in Brunei Darussalam ("Brunei") – the Brunei Branch formally commenced business, further optimising its business network.

The Group further improved its risk management, internal controls and compliance to safeguard its healthy and sustainable development. During the year, it further optimised its asset and liability structure. Total deposits and loans grew rapidly and ahead of the market with a higher market share. The proportion of current and savings deposits continued to rise, with asset quality outperforming the market.

Profits of 2016 and 2015 included factors such as profit from discontinued operations and gain from disposal of certain equity instruments. Without taking into consideration these factors, the Group's profit attributable to the equity holders in 2016 increased by 6.8% from 2015.

Profit attributable to the equity holders from continuing operations increased by HK$444 million, or 1.9%, year-on-year to HK$24,201 million, which was attributable to the higher net operating income before impairment allowances. The increase in net operating income was driven by the strong growth in net trading gain of the banking business, mainly contributed by the net gain from foreign exchange swap contracts in 2016. Net interest income was higher due to the expansion in average interest-earning assets, but the increase was partially offset by the lower net interest margin. Also contributing to the increase in net operating income was the improved performance of the Group's insurance segment. The increase was, however, partially offset by the decline in net fee and commission income. Meanwhile, operating expenses rose, reflecting the Group's efforts to strengthen resource allocation and continuous investment in human resources and infrastructure enhancements to support its long-term growth. The net charge of loan impairment allowances dropped, due to the lower net charge of individually assessed impairment allowances. As a result, profit increased year-on-year.

Second Half Performance

As compared with the first half of 2016, net operating income before impairment allowances of continuing operations increased by HK$888 million, or 4.3% half-on-half. This growth in net operating income was attributable to higher net interest income from the rebound in net interest margin and the expansion in average interest-earning assets. Net operating income of the Group's insurance segment also rose. The increase was partially offset by the decline in net fee and commission income. Operating expenses increased by HK$765 million, or 13.4%, while the net charge of loan impairment allowances decreased by HK$479 million, or 89.7%. As a result, profit rose by HK$715 million, or 6.1%, on a half-on-half basis, to HK$12,458 million.

Income Statement Analysis

The following income statement analysis is based on the Group's continuing operations, and the comparative information has been restated as a result of the Group's disposals and acquisition.

Net Interest Income and Net Interest Margin

HK$'m, except percentages	2016	(Restated) 2015	Change (%)
Interest income	**35,890**	37,492	(4.3)
Interest expense	**(10,462)**	(12,316)	(15.1)
Net interest income	**25,428**	25,176	1.0
Average interest-earning assets	**1,918,837**	1,729,850	10.9
Net interest spread	**1.22%**	1.36%	
Net interest margin*	**1.32%**	1.46%	

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

The Group's net interest income increased by HK$252 million, or 1.0%, year-on-year. The increase was attributable to the growth in average interest-earning assets, partially offset by the lower net interest margin.

Average interest-earning assets expanded by HK$188,987 million, or 10.9%. The increase in the average balances of deposits from customers as well as deposits from banks led to the increase in the average balances of both advances to customers and debt securities investments.

Net interest margin was 1.32%, down 14 basis points. In view of the challenging operating environment, the Group continued to manage its deposit pricing and deposit mix and at the same time grew its loan portfolio, which led to the positive impact to net interest margin. However, the lower average interest spread of the RMB business, which was caused by the drop in RMB market interest rates and the increase of RMB funds from the clearing bank business, offset the positive impact described above. The narrowing of net interest margin was also due to the increase in lower-yielding short-term debt securities investments.

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

ASSETS	2016 Average balance HK$'m	2016 Average yield %	(Restated) 2015 Average balance HK$'m	(Restated) 2015 Average yield %
Balances and placements with banks and other financial institutions	**325,274**	**1.37**	346,278	2.36
Debt securities investments	**632,911**	**1.62**	547,447	1.93
Advances to customers	**938,700**	**2.23**	821,139	2.26
Other interest-earning assets	**21,952**	**0.89**	14,986	1.40
Total interest-earning assets	**1,918,837**	**1.87**	1,729,850	2.17
Non interest-earning assets[1]	**450,263**	**–**	597,586	–
Total assets	**2,369,100**	**1.51**	2,327,436	1.61

LIABILITIES	2016 Average balance HK$'m	2016 Average rate %	(Restated) 2015 Average balance HK$'m	(Restated) 2015 Average rate %
Deposits and balances from banks and other financial institutions	**227,237**	**0.75**	209,497	0.91
Current, savings and time deposits	**1,331,609**	**0.57**	1,244,154	0.75
Subordinated liabilities	**19,435**	**3.05**	19,560	2.25
Other interest-bearing liabilities	**35,917**	**1.51**	38,724	1.76
Total interest-bearing liabilities	**1,614,198**	**0.65**	1,511,935	0.81
Shareholders' funds[2] and other non interest-bearing deposits and liabilities[1]	**754,902**	**–**	815,501	–
Total liabilities	**2,369,100**	**0.44**	2,327,436	0.53

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 increased by HK$1,580 million, or 13.3%, to HK$13,504 million, due to the growth in average interest-earning assets and the rebound in net interest margin. Average interest-earning assets were up HK$122,001 million, or 6.6%, which was supported by the increase in deposits from customers. Net interest margin was 1.35%, a rise of 6 basis points half-on-half. The widening of net interest margin was attributable to lower deposit costs through effective pricing control, an improved deposit mix and increased advances to customers. The increase was partially offset by the increase in lower-yielding short-term debt securities investments.

Net Fee and Commission Income

HK$'m, except percentages	2016	(Restated) 2015	Change (%)
Credit card business	**3,702**	3,726	(0.6)
Loan commissions	**3,500**	3,239	8.1
Securities brokerage	**1,954**	3,255	(40.0)
Insurance	**1,630**	1,467	11.1
Funds distribution	**735**	901	(18.4)
Bills commissions	**631**	561	12.5
Payment services	**593**	561	5.7
Trust and custody services	**470**	473	(0.6)
Currency exchange	**336**	302	11.3
Safe deposit box	**277**	248	11.7
Others	**944**	839	12.5
Fee and commission income	**14,772**	15,572	(5.1)
Fee and commission expense	**(4,231)**	(4,299)	(1.6)
Net fee and commission income	**10,541**	11,273	(6.5)

Net fee and commission income decreased by HK$732 million, or 6.5%, to HK$10,541 million in 2016. The decrease was mainly attributable to the stock market turnover in 2016 amid the weakened investment sentiment, which resulted in the decline of 40.0% and 18.4% respectively in fee and commission income from securities brokerage and funds distribution from 2015. However, income from other businesses recorded satisfactory growth year-on-year as the Group leveraged its diversified business platforms to record healthy growth in a number of areas. Loan commissions rose by 8.1%, due to the growth of commission income from corporate loans. During the year, the Group captured opportunities from the Belt and Road Initiative and in the Southeast Asia, actively explored financing needs of Mainland corporates seeking global expansion and also cultivated the Hong Kong market. These resulted in satisfactory growth in new loan drawdowns and loan commissions. With the rise in business volumes, income from insurance and bills commissions increased by 11.1% and 12.5% respectively. Income from currency exchange rose 11.3%, driven by the higher demand for foreign currency banknotes. Commission income from payment services and safe deposit box also recorded healthy growth.

Second Half Performance

Compared with the first half of 2016, net fee and commission income dropped by HK$671 million, or 12.0%, in the second half. On one hand, the Group was able to achieve strong growth of 29.1% in commission income from securities brokerage. Income from funds distribution, trust and custody services along with payment services also grew. On the other hand, loan commissions dropped from the high level in the first half, as did bills commissions. Fee and commission expense rose, which was mainly attributable to higher insurance and securities brokerage related expenses.

Net Trading Gain

HK$'m, except percentages	2016	(Restated) 2015	Change (%)
Foreign exchange and foreign exchange products	**3,618**	2,051	76.4
Interest rate instruments and items under fair value hedge	**867**	295	193.9
Equity and credit derivative instruments	**88**	194	(54.6)
Commodities	**32**	57	(43.9)
Net trading gain	**4,605**	2,597	77.3

Net trading gain increased by HK$2,008 million, or 77.3% year-on-year, to HK$4,605 million. Net trading gain from foreign exchange and foreign exchange products increased by HK$1,567 million, primarily due to the net gain from foreign exchange swap contracts*, as well as the increase in currency exchange income from customer transactions. Net trading gain from interest rate instruments and items under fair value hedge increased by HK$572 million, which was mainly attributable to the mark-to-market changes of certain debt securities and interest rate instruments, caused by interest rate movements. The decrease in net trading gain from equity and credit derivative instruments was mainly due to the decreased income from equity-linked products. The decrease in net trading gain from commodities was mainly due to the lower gain in bullion transactions.

Second Half Performance

Compared with the first half of 2016, net trading gain decreased slightly by HK$25 million, or 1.1%. The decrease was mainly attributable to the mark-to-market changes of certain debt securities.

* Foreign exchange swap contracts are normally used for the Group's liquidity management and funding activities. In 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 date 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"), while the corresponding interest differential between the surplus funds in the original currency and swapped currency is reflected in net interest income.

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

HK$'m, except percentages	2016	(Restated) 2015	Change (%)
Net gain/(loss) on financial instruments designated at fair value through profit or loss	**101**	(751)	N/A

The Group recorded a net gain of HK$101 million on financial instruments designated at FVTPL in 2016, compared with a net loss of HK$751 million in 2015. The change was mainly attributable to the mark-to-market gains of debt securities and bond fund investments of BOC Life in 2016, as opposed to the mark-to-market losses in 2015, with the former being caused by market interest rates movements. 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$933 million was recorded in the second half of the year, as opposed to a net gain of HK$1,034 million in the first half. The change was mainly attributable to the mark-to-market loss of debt securities investments of BOC Life, compared with the mark-to-market gain in the first half.

Operating Expenses

HK$'m, except percentages	2016	(Restated) 2015	Change (%)
Staff costs	**6,787**	6,420	5.7
Premises and equipment expenses (excluding depreciation)	**1,557**	1,412	10.3
Depreciation on owned fixed assets	**1,788**	1,713	4.4
Other operating expenses	**2,081**	2,066	0.7
Total operating expenses	**12,213**	11,611	5.2

	At 31 December 2016	(Restated) At 31 December 2015	Change (%)
Staff headcount measured in full-time equivalents	**12,154**	12,236	(0.7)

Total operating expenses increased by HK$602 million, or 5.2%, from 2015, as a result of the Group's ongoing investment in human resources and projects, including enhancements in business systems and platforms as well as Internet finance services, to support long-term business growth. The Group remained focused on disciplined cost control, however, and the cost to income ratio was below the industry average at 29.25%.

Staff costs increased by 5.7% year-on-year, mainly due to higher salaries following the annual salary increment.

Premises and equipment expenses were up 10.3%, reflecting higher rental costs and IT-related expenses associated with the Group's strategic initiatives.

Depreciation on owned fixed assets rose by 4.4%, largely due to a larger depreciation charge on premises following the upward property revaluation in Hong Kong in 2015 and on IT infrastructure.

Second Half Performance

Compared with the first half of 2016, operating expenses rose by HK$765 million, or 13.4%, in the second half of the year. The increase was due to higher staff costs and IT-related expenses, as well as an increase in advertising and business promotional expenses.

Net Charge of Loan Impairment Allowances

HK$'m, except percentages	2016	(Restated) 2015	Change (%)
Net (charge)/reversal of allowances before recoveries			
– individually assessed	**(31)**	(412)	(92.5)
– collectively assessed	**(694)**	(537)	29.2
Recoveries	**136**	143	(4.9)
Net charge of loan impairment allowances	**(589)**	(806)	(26.9)

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

	At 31 December 2016	(Restated) At 31 December 2015
Loan impairment allowances		
– individually assessed	**0.05%**	0.06%
– collectively assessed	**0.27%**	0.27%
Total loan impairment allowances	**0.32%**	0.33%

The net charge of loan impairment allowances was HK$589 million in 2016, a decrease of HK$217 million from 2015. Net charge of individually assessed impairment allowances fell by 92.5%, mainly caused by the reversal of impairment allowances for a few corporate advances. Net charge of collectively assessed impairment allowances amounted to HK$694 million, up 29.2%, mainly attributable to the higher growth rate of advances to customers in 2016.

Total loan impairment allowances as a percentage of gross advances to customers was 0.32%, which was relatively unchanged from 2015.

Second Half Performance

Net charge of loan impairment allowances decreased by HK$479 million, or 89.7%, from the first half of the year. The decrease was due to the net reversal of individually assessed impairment allowances in the second half of the year as opposed to the net charge in the first half. Meanwhile, there was a lower net charge of collectively assessed impairment allowances owing to lower loan growth in the second half of the year.

Balance Sheet Analysis

The comparative information at 31 December 2015 has been realigned to enable analysis on a comparable basis.

Asset Deployment

	At 31 December 2016		(Restated) At 31 December 2015		
HK$'m, except percentages	**Amount**	**% of total**	Amount	% of total	Change (%)
Cash and balances with banks and other financial institutions	**229,073**	**9.9**	225,985	9.5	1.4
Placements with banks and other financial institutions maturing between one and twelve months	**70,392**	**3.0**	62,661	2.6	12.3
Hong Kong SAR Government certificates of indebtedness	**123,390**	**5.3**	101,950	4.3	21.0
Securities investments[1]	**659,523**	**28.3**	564,075	23.7	16.9
Advances and other accounts	**992,137**	**42.6**	901,082	37.8	10.1
Fixed assets and investment properties	**63,959**	**2.8**	63,998	2.7	(0.1)
Other assets[2]	**136,014**	**5.8**	109,350	4.6	24.4
Assets held for sale	**53,293**	**2.3**	353,714	14.8	(84.9)
Total assets	**2,327,781**	**100.0**	2,382,815	100.0	(2.3)

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 2016, total assets of the Group amounted to HK$2,327,781 million, a decrease of HK$55,034 million, or 2.3%, from the end of 2015. The decrease in total assets was attributable to the decrease in assets held for sale following the Group's disposal of NCB in 2016. The Group continued to enhance its management of assets and liabilities and successfully expanded its businesses amid challenges in the operating environment.

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

- Securities investments increased by HK$95,448 million, or 16.9%, with increases mainly in government-related and high-quality banks and financial institutions bonds.
- Advances and other accounts rose by HK$91,055 million, or 10.1%, with the growth in advances to customers by HK$101,945 million, or 11.7%.
- Other assets grew by HK$26,664 million, or 24.4%, mainly due to the increases in derivative financial instruments, and accounts receivable and prepayments.
- Assets held for sale decreased by HK$300,421 million, or 84.9% as the Group completed the disposal of NCB on 30 May 2016. As a result of the Group's proposed disposal of Chiyu, assets of Chiyu as at 31 December 2016 are presented separately as assets held for sale.

Advances to Customers

HK$'m, except percentages	At 31 December 2016 Amount	At 31 December 2016 % of total	(Restated) At 31 December 2015 Amount	(Restated) At 31 December 2015 % of total	Change (%)
Loans for use in Hong Kong	**663,415**	**68.2**	550,713	63.2	20.5
Industrial, commercial and financial	**374,891**	**38.5**	284,241	32.6	31.9
Individuals	**288,524**	**29.7**	266,472	30.6	8.3
Trade finance	**72,121**	**7.4**	78,593	9.0	(8.2)
Loans for use outside Hong Kong	**237,535**	**24.4**	241,820	27.8	(1.8)
Total advances to customers	**973,071**	**100.0**	871,126	100.0	11.7

In 2016, the Group succeeded in capturing opportunities arising from national strategies and growth opportunities in the ASEAN region. It continued to leverage its strong customer base and strengthened collaboration with BOC to reinforce financial services offered to corporates, in particular, for Mainland enterprises going global and leading corporates in the ASEAN region. The Group remained the top mandated arranger in the Hong Kong-Macau syndicated loan market for the twelfth consecutive year. It also strongly supported leading corporates and SMEs in the local market. The Group adhered to a prudent credit strategy and focused on customer selection to achieve quality growth. Advances to customers grew by HK$101,945 million, or 11.7%, to HK$973,071 million in 2016.

Loans for use in Hong Kong grew by HK$112,702 million or 20.5%.

- Lending to the industrial, commercial and financial sectors increased by HK$90,650 million, or 31.9%, representing a broad-based growth in various industry sectors including property development, transport and transport equipment, wholesale and retail trade, manufacturing, information technology and recreational activities.

- Lending to individuals increased by HK$22,052 million, or 8.3%. Residential mortgage loans (excluding those under government-sponsored home purchasing schemes) grew by 5.4% while other individual loans increased by 29.0%.

Trade finance decreased by HK$6,472 million, or 8.2%, while loans for use outside Hong Kong decreased by HK$4,285 million, or 1.8%.

Loan Quality

HK$'m, except percentages	At 31 December 2016	(Restated) At 31 December 2015
Advances to customers	**973,071**	871,126
Classified or impaired loan ratio	**0.20%**	0.23%
Total impairment allowances	**3,124**	2,906
Total impairment allowances as a percentage of advances to customers	**0.32%**	0.33%
Residential mortgage loans[1] – delinquency and rescheduled loan ratio[2]	**0.02%**	0.02%
Card advances – delinquency ratio[2]	**0.24%**	0.20%

	2016	2015
Card advances – charge-off ratio[3]	**1.51%**	1.39%

1. Residential mortgage loans exclude those under the Home Ownership Scheme and other government-sponsored home purchasing schemes.
2. The delinquency ratio is measured by the ratio of the total amount of overdue advances (more than three months) to total outstanding advances.
3. The charge-off ratio is measured by the ratio of total write-offs made during the year to average card receivables during the year.

The Group maintained benign asset quality during the year. The classified or impaired loan ratio was 0.20% as at 31 December 2016. Classified or impaired advances to customers decreased by HK$39 million, or 2.0%, to HK$1,955 million.

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 2016. The charge-off ratio of card advances was 1.51%.

Deposits from Customers*

HK$'m, except percentages	At 31 December 2016 Amount	At 31 December 2016 % of total	(Restated) At 31 December 2015 Amount	(Restated) At 31 December 2015 % of total	Change (%)
Demand deposits and current accounts	**172,427**	**11.5**	130,958	9.5	31.7
Savings deposits	**796,571**	**52.8**	701,304	51.1	13.6
Time, call and notice deposits	**535,078**	**35.5**	538,478	39.2	(0.6)
	1,504,076	**99.8**	1,370,740	99.8	9.7
Structured deposits	**3,425**	**0.2**	2,571	0.2	33.2
Total Deposits from customers	**1,507,501**	**100.0**	1,373,311	100.0	9.8

* Including structured deposits

In 2016, the Group implemented a number of deposit strategies and flexibly responded to market changes, achieving good progress in deposit taking, improvement in deposit mix and lowering of deposit costs. The measures included expansion of wealth management business for the mid- to high-end customer segment, development of payroll account services, expansion of central bank and supranational clients, and development of receiving bank business for IPOs. Consequently, total deposits from customers rose by HK$134,190 million, or 9.8%, to HK$1,507,501 million at the end of 2016. The proportion of current and savings deposits increased to 64.3%, up 3.7 percentage points from the end of 2015. Time, call and notice deposits fell by 0.6%. Savings deposits increased by 13.6% while demand deposits and current accounts grew strongly by 31.7%.

Capital and Reserves Attributable to the Equity Holders of the Company

HK$'m, except percentages	At 31 December 2016	(Restated) At 31 December 2015	Change (%)
Share capital	**52,864**	52,864	–
Premises revaluation reserve	**35,608**	40,278	(11.6)
Reserve for fair value changes of available-for-sale securities	**(592)**	294	N/A
Regulatory reserve	**9,227**	10,928	(15.6)
Translation reserve	**(722)**	(346)	108.7
Merger reserve	**–**	1,789	(100.0)
Retained earnings	**128,268**	88,943	44.2
Reserves	**171,789**	141,886	21.1
Capital and reserves attributable to the equity holders of the Company	**224,653**	194,750	15.4

Capital and reserves attributable to the equity holders of the Company amounted to HK$224,653 million as at 31 December 2016, an increase of HK$29,903 million, or 15.4%, from the end of 2015. Retained earnings rose by 44.2%, mainly reflecting the profit for 2016 after the appropriation of dividends. The premises revaluation reserve decreased by 11.6%, which was attributable to the corresponding amount released to retained earnings upon disposal of discontinued operations and the decline in the valuation of premises in 2016. Reserve for fair value changes of available-for-sale securities turned from a surplus into a deficit, mainly reflecting market interest rate movements. The regulatory reserve fell by 15.6%, as the growth in advances to customers was more than offset by the corresponding regulatory reserve released to retained earnings upon the disposal of discontinued operations. Merger reserve was arising on the Group's application of merger accounting method in relation to the combination with BOC Malaysia.

Capital Ratio and Liquidity Coverage Ratio

HK$'m, except percentages	At 31 December 2016	At 31 December 2015
Consolidated capital after deductions		
Common Equity Tier 1 capital	**158,828**	121,089
Additional Tier 1 capital	**458**	561
Tier 1 capital	**159,286**	121,650
Tier 2 capital	**41,926**	46,886
Total capital	**201,212**	168,536
Total risk-weighted assets	**900,288**	943,802
Common Equity Tier 1 capital ratio	**17.64%**	12.83%
Tier 1 capital ratio	**17.69%**	12.89%
Total capital ratio	**22.35%**	17.86%

	2016	2015
Average value of liquidity coverage ratio		
First quarter	**112.92%**	101.90%
Second quarter	**109.70%**	109.89%
Third quarter	**118.69%**	104.00%
Fourth quarter	**107.02%**	106.52%

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

The Banking (Capital) (Amendment) Rules 2014 came into effect on 1 January 2015 as a means of implementing the Basel III capital buffer requirements arising from the operation of the Capital Conservation Buffer ("CCB") and Countercyclical Capital Buffer ("CCyB"), as well as the Higher Loss Absorbency ("HLA") requirement for domestic systemically important authorised institutions ("D-SIBs") that came into effect on 1 January 2016. The CCB is designed to ensure that banks build up capital outside periods of stress, which can be drawn down when losses are incurred. The CCyB is set on a individual country basis and is built up during periods of excessive credit growth for absorbing future losses, and the HLA is an additional capital requirement for D-SIBs. These three requirements are expressed as a percentage of the Common Equity Tier 1 ("CET1") capital to the risk-weighted assets ("RWAs") of an authorised institution ("AI") and under the phase-in arrangements from 2016 to 2019. The CCB begins with a rate of 0.625% of RWAs in 2016 and will increase each subsequent year by an additional 0.625% to reach its final of 2.5% of RWAs on 1 January 2019. On 27 January 2015 and 14 January 2016, the HKMA announced a CCyB for Hong Kong of 0.625% and 1.25% of RWAs from 1 January 2016 and 1 January 2017 respectively, equivalent to 2.5% once fully implementation of Basel III. On 16 March 2015 and 31 December 2015, the HKMA announced the designation of BOCHK as one of the D-SIBs in Hong Kong, requiring BOCHK to establish 0.375% and 0.75% of RWAs for HLA from 1 January 2016 and 1 January 2017 respectively, equivalent to 1.5% on full implementation of Basel III.

The Group's capital level was significantly enhanced by the gain from the disposal of NCB. With the phase-in arrangements of the Basel III capital buffer requirements that came into effect from 2016, the Group responded to this higher regulatory requirement by opting to comply with the 2019 Basel III capital buffer requirements in one go during the course of formulating its internal capital management targets. In addition to this regulatory requirement, the Group took into consideration its strategic initiatives and risk appetite as well as its short- and long-term capital requirement, with the support of capital replenishment solutions, to ensure the long-term stability of its capital level. The Group attached a high degree of importance to the need for capital accumulation and focused on internal growth to ensure its sustainable business development. To meet these requirements, the Group continued to refine its measures to monitor changes in the risk-weights of its assets. At the same time, the Group made use of stringent and forward-looking stress testing to assess the demand and supply of capital under different stress scenarios, examine management targets for capital adequacy and formulate a capital adjustment solution to ensure the Group's ability to comply with the capital requirement under stress conditions.

During the year, the Group complied with all capital requirements of the HKMA. At 31 December 2016, the CET1 capital ratio was 17.64% and Tier 1 capital ratio was 17.69%, up 4.81 and 4.80 percentage points respectively from the end of 2015. Profits net of dividends for the year 2016 drove up CET1 capital and Tier 1 capital by 31.2% and 30.9% respectively. Total RWAs were down 4.6%, as the increase in credit RWAs due to the growth in advances to customers in 2016 was more than offset by the reduction in RWAs following the disposal of NCB. The total capital ratio was 22.35%.

The average value of the liquidity coverage ratio ("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 2016. The average value of LCR for all four quarters of 2016 are as above, which were higher than the regulatory minimum.

Management's Discussion and Analysis

Business Review

2016 Business Highlights

Personal Banking

- Completed implementation of the branch transformation project, with upgrade of the branch network and optimisation of business workflows, to provide a more comprehensive range of services for both personal and corporate customers in Hong Kong. Operating efficiency was significantly enhanced, and a number of businesses achieved satisfactory growth.
- Built an omni-channel banking service and launched a series of new functions, including the 24-hour video banking iService.
- Committed to the development of the cross-border business to meet the increasing demand for overseas asset deployment by Mainland customers. Continuously refined the customer mix and introduced a new service model for the wealth management business, which successfully expanded the mid- to high-end customer segment in Hong Kong and Mainland of China.
- Named Best Retail Bank in Hong Kong for two consecutive years; awarded Wealth Management Business of the Year 2016 by *The Asian Banker*.

Corporate Banking

- Succeeded in capturing opportunities from major national strategic initiatives, including the Belt and Road. Provided a comprehensive range of financial services in support of Mainland enterprises' overseas expansion. Completed financing projects for a number of cross-border merger and acquisition ("M&A") transactions and major projects for leading local enterprises in the ASEAN region.
- Leveraged the synergy arising from collaboration within the Group and its platform for cross-border business development in FTZs and enhanced market influence.
- Cultivated the local market by expanding its customer base in the commercial sector and institutional business. Continued to establish business relationships with overseas central banks and financial institutions and, in a major breakthrough for the Group, a relationship with a large overseas sovereign wealth fund.
- Through the branch transformation project integrating commercial centres and branches, the Group reinforced its service and sales capabilities for local SME customers.
- Arranged a number of significant syndicated loans and remained the top mandated arranger in the Hong Kong-Macau syndicated loan market for the twelfth consecutive year.
- Acted as the receiving bank for a number of major IPOs in Hong Kong, including one of the year's largest IPOs, which consolidated its leading position in the market.
- Named the Best Transaction Bank in Hong Kong for 2016 by *The Asian Banker*; a trade finance project received the Best Corporate Trade Finance Deal in Hong Kong for 2016. Received the Best SME's Partner Award for the ninth year in a row.

Treasury

- Focused on customer needs and captured market opportunities with introduction of innovative time-to-market products.
- Expanded treasury products and services to markets in the ASEAN region and along the Belt and Road to drive further growth of ASEAN entities' treasury business.
- Achieved encouraging growth in the bond underwriting business. Assisted in the underwriting of the first Silver Bond issued by the HKSAR Government and the first Chinese Green Covered Bond issued by BOC's London Branch.
- Strategically increased investments in high-quality bonds to enhance returns, while remaining alert to risk.
- Received the Hong Kong Domestic Foreign Exchange Bank of the Year award by *Asian Banking and Finance* for the second consecutive year.

RMB Business in Hong Kong

- Maintained its status as the clearing bank and Primary Liquidity Provider for offshore RMB business in Hong Kong.
- Obtained all business qualifications for Shenzhen-Hong Kong Stock Connect.
- Joined CIPS – the first overseas bank to join this system as a direct participant and became the only clearing bank with both CIPS and CNAPS as its clearing channels.
- Reinforced its leading position in the Hong Kong RMB insurance market.

ASEAN Business

- Completed the acquisition of the share capital of BOC Malaysia and BOC Thailand on 17 October 2016 and 9 January 2017 respectively.
- Brunei Branch commenced operation on 20 December 2016, becoming the first Chinese financial institution to establish a presence in the country.
- Adopted a matrix management structure for its ASEAN entities, met regulatory requirements and established a control mechanism. Set up a business supervisory committee and a business integration team to provide various support resources.
- Provided support to enterprises going global and made inroads with enterprises in regional mainstream businesses, achieving rapid growth in financing scale and business cooperation.
- Collaborated in marketing activities and assisted in the business development of its ASEAN entities, with significant progress made on major financing projects.
- Received My Favourite "Belt and Road" Banking Service Award from *Sky Post*.

Eight key business platforms

- Credit card business maintained its market leadership in the UnionPay card business.
- Private Banking business continued to optimise products and its service platform, achieved encouraging growth in both the number of clients and assets under management.
- BOC Life continued to enhance product and service innovation, launched featured products and diversified its distribution channels. Received Insurance Company of the Year – Outstanding Performance and Saving Plan – Excellence awards in the 2016 Financial Institution Awards by *Bloomberg Businessweek*.
- BOCHK AM continued to enrich its product range and explored new business opportunities, with assets under management growing significantly by 1.7 times. Three funds issued under the BOCHK All Weather Creation Series received awards in the CAMAHK – Bloomberg Offshore China Fund Awards 2016.
- Cash management business continued with product innovation and feature enhancements, pioneered the launch of payment by e-Cheque services to enhance its competitive edge. Won the Achievement Award for the Best Cash Management Bank in Hong Kong by *The Asian Banker* for the fourth consecutive year.
- Custody business diversified its client mix and enlarged its client base, with rapid growth in assets under custody. Won the Best Custody Specialist – China award from *The Asset* magazine.
- BOCI-Prudential Trustee enhanced its sales, referrals and cross-selling capabilities; the My Choice MPF Scheme received a number of industry awards.
- Po Sang Securities and Futures made steady progress and continued to widen its product range.

Technology and operations

- Launched a series of FinTech products and services, including several innovative applications that were first to market, enhancing operating efficiency and the customer experience. The total number of customers using e-channels increased notably. Also set up a Smart Flagship Branch with new technology applications.
- Established the BOCHK-ASTRI FinTech Collaboration Centre to develop new financial technologies for the banking sector.
- Received Technology Innovation Awards – Best Mobile Social Media Engagement Project by *The Asian Banker* and awarded The Best Consumer Digital Bank in Hong Kong by *Global Finance* magazine.

Business Segment Performance

Profit before Taxation by Business Segments

HK$'m, except percentages	2016	% of total	2015	(Restated) % of total	Change (%)
CONTINUING OPERATIONS					
Personal Banking	**7,538**	**25.6**	9,070	31.7	(16.9)
Corporate Banking	**12,614**	**42.8**	10,752	37.6	17.3
Treasury	**8,552**	**29.0**	7,846	27.5	9.0
Insurance	**1,230**	**4.2**	932	3.3	32.0
Others	**(482)**	**(1.6)**	(25)	(0.1)	N/A
Total profit before taxation	**29,452**	**100.0**	28,575	100.0	3.1

Note: For additional segmental information, see Note 47 to the Financial Statements.

Personal Banking

Financial Results

Personal Banking's profit before taxation was HK$7,538 million in 2016, a decrease of HK$1,532 million, or 16.9%, year-on-year. The decrease was mainly caused by the drop in net fee and commission income, as a result of the decrease in income from securities brokerage and funds distribution.

Net interest income increased by 6.4%. This was mainly driven by the increase in the average balance of deposits and loans. Net fee and commission income decreased by 15.1%. The decrease was mainly attributable to the exceptionally high stock market turnover in 2015, and the weakening investment sentiment in 2016 which resulted in the sharp decline of income from securities brokerage and funds distribution from the high level in 2015. Fee and commission income from insurance and safe deposit box grew healthily. Net gain on other financial assets dropped year-on-year as the Group captured market opportunities to dispose of certain equity instruments and realised a net gain in 2015.

Business Operations

Implementation of the branch transformation project and omni-channel

In 2016, the Group completed its branch transformation project to transform its single brand retail branches into multi brand branches for serving personal and corporate customers. This project enabled the Group to continuously improve its customer mix, increase two-way referrals and provide better service to SME customers. Consequently, encouraging results were achieved in operating efficiency across various business areas, including satisfactory growth in deposits from customers, remittance, merchant acquiring services and commercial cards. As part of its initiative to build an omni-channel banking service, the Group launched its 24-hour video banking iService to address customers' banking needs beyond the opening hours of branches, and expanded the number of coverage points in its automated banking network.

New service model for cross-border services and new management model for ASEAN

With better planning and a new management model in place, the Group was better able to serve cross-border customers from the Mainland during the year. At the same time, the Group deepened its collaboration with various BOC entities, stepped up staff training, offered referral incentives, and launched a series of promotional campaigns in order to acquire new cross-border customers. Meanwhile, with good progress made in respect of the regional transformation, the Group also developed a new management structure and established a matrix-style management mechanism for cross-region services and referrals to help accelerate business expansion in the ASEAN region. It fully leveraged its expertise by introducing its products and services to ASEAN entities to broaden their product offerings and strengthen cross-region sales support.

Recognised wealth management services

During the year, the Group deepened relationships with existing wealth management customers and made a concerted effort to acquire new customers in the mid- to high-end market. It also introduced a new service model for top-tier Wealth Management customers by providing customised products and streamlined services. This was accompanied by a series of marketing programmes designed to raise the Group's image in wealth management and by the optimisation of its team of relationship managers. As a result, the Group recorded satisfactory growth in the total number of Wealth Management customers as well as their total relationship balances. In recognition of its outstanding performance in retail banking, BOCHK received the Best Retail Bank in Hong Kong award for the second consecutive year and the Wealth Management Business of the Year 2016 award, both from *The Asian Banker*.

The Group's Private Banking business continued to provide customer-centric financial solutions that cater for the personal, family and business needs of its high net-worth customers. In 2016, the Group further upgraded the private banking team, optimised business workflows and expanded its product and service offerings on its enhanced open platform. In addition to serving the local market, the Group looked for opportunities to expand its customer base through closer cooperation with different units of the Group and BOC's Mainland and overseas entities, including a series of customer events in Hong Kong, the Mainland of China and Southeast Asia, to establish stronger customer relationships and raised awareness of its brand. As a result, the Group achieved encouraging growth in both the number of Private Banking clients and their assets under management.

Improvements in the residential mortgage and other retail loan services

The local residential property market was relatively quiet in the first half of 2016 with the slowdown in transaction volume. To acquire new business, the Group focused on enhancing the service capabilities of its front-line staff and optimising the sales team for the launch of the branch transformation project. The Group also expanded its mortgage service into the luxury property market, acquired customers in the mid- to high-end market and shortened the credit assessment approval process. Additionally, the Group launched blockchain technology application for property valuation and completed the first case with its surveyor partner. Furthermore, the Group continued to refine the personal lending business model by expanding eligible collateral types for secured lending business, and enhanced the servicing flow.

A wider range of investment and insurance products

Heightened volatility in the global financial market and a generally weak global recovery dampened market sentiments, resulting in a notable year-on-year decline in stock market transactions. Correspondingly, the Group's investment business was adversely affected with lower commission income from securities brokerage and funds distribution. In line with the launch of Shenzhen-Hong Kong Stock Connect, the Group provided customers with a comprehensive range of China A shares trading services for investing in Hong Kong and China. Also during the period, the Group succeeded in acquiring new securities customers through a new promotional campaign.

With regard to the bancassurance business, the Group always strived for excellence by offering a wider range of products, enhancing cross-selling activities and providing customised services to meet customers' needs at different life stages with the aim of penetrating the high-end customer segment and Mainland customers. With the completion of the branch transformation project, the Group strategically extended the scope of insurance services to company customers to meet their protection needs and to make insurance services as one of their key financial solutions.

Continuous enhancement in credit card service

The Group's credit cardholders' spending in 2016 registered a lower volume from 2015, mainly due to the contraction in total retail sales in Hong Kong. Nonetheless, the Group recorded a growth in the volume of merchant acquiring business over the previous year, supported by a number of new major merchants acquired in Hong Kong during the year. It also maintained its leadership in the UnionPay merchant acquiring and card issuing business in Hong Kong. In 2016, the Group focused on acquiring mid- to high-end personal customers and high-quality corporate customers, with satisfactory growth recorded in each segment. The business integration achieved through the branch transformation project allowed for closer collaboration within different business units and increased cross-selling and credit card promotions. The Group also introduced a number of new credit cards and launched targeted promotional programmes to bolster cardholder spending on daily necessities, online shopping and overseas purchases. In keeping with its commitment to develop e-Channels and mobile payment solutions to cater for the different financial needs and lifestyles of customers, the Group launched Apple Pay as a fast, convenient and secure payment for its credit cardholders.

Corporate Banking

Financial Results

Corporate Banking's profit before taxation was HK$12,614 million, a growth of HK$1,862 million, or 17.3%, 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 16.3%, mainly driven by the increase in the average balance of loans, together with the increase in the average balance of deposits and the improvement in deposit spread. Net fee and commission income grew by 8.2%, led by the increase in loan commissions. Operating expenses were up 10.1%, mainly due to the increase in staff costs and rental expenses. Net charge of impairment allowances decreased by 64.5%, mainly caused by the reversal of individually assessed impairment allowances for a few corporate advances.

Business Operations

Cross-border business and expansion in ASEAN

In 2016, the Group captured the opportunities arising out of major national strategic initiatives and expanded its customer base. Business development along the Belt and Road and in the ASEAN region paved the way for the transformation of BOCHK into a regional bank. The Group also strengthened its collaboration with BOC's branches and provided leading Mainland enterprises with funding solutions in support of their development along the Belt and Road and in ASEAN where it assisted non-Chinese and leading local enterprises on several major projects. Moreover, the Group coordinated with BOC entities in ASEAN to enable them to increase their competitive edge and market influence in the region. At the same time, the Group focused on product and service innovations to better meet the needs of customers and successfully broadened its customer base by exploring both upstream and downstream companies in the supply chain of existing customers as well as new customers from emerging industries.

In collaboration with BOC entities in the Mainland and overseas, the Group completed financing projects for a number of cross-border M&A transactions in support of Mainland enterprises' overseas expansions, making successful inroads in the business development of merger financing. Business development in Free Trade Zones in Shanghai, Tianjin, Fujian and Guangdong and further cooperation among BOC's Guangdong, Hong Kong and Macau operations added to BOC Group's market influence in these areas. Acting as BOC's Asia-Pacific Syndicated Loan Centre, the Group worked closely with BOC's overseas branches on a number of significant syndicated loans. The Group remained the top mandated arranger in the Hong Kong-Macau syndicated loan market for a twelfth consecutive year.

A growing base of commercial customers

In 2016, the Group further expanded its customer base of leading enterprises. In the local market, it strengthened its relationships with trade associations, family-owned businesses and second- and third-tier listed companies. Based on BOC Group's global network coverage, the Group was able to take advantage of business opportunities with leading overseas enterprises and, through closer collaboration with BOC, acquire cross-border businesses in the ASEAN region. Through its branch transformation project integrating commercial centres and branches, the Group reinforced its service and sales capabilities for local SME customers. 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 ninth year in a row.

Working with institutional businesses

During the year, the Group continued to form new relationships with overseas central banks and corresponding banks. In collaboration with BOC, the Group also established business relationships with overseas regional development banks and, in a major breakthrough for the Group, a relationship with a large overseas sovereign wealth fund. In Hong Kong, the Group expanded cooperation with government and public sector entities by offering differentiated services and business solutions. Moreover, it acted as the receiving bank for a number of major IPOs in Hong Kong, including one of the year's largest, which consolidated its leading position in the market.

Product innovation in transaction banking

The Group reinforced its competitive advantage in the trade finance and cash management business through continuous product innovation and feature enhancements. During the year, the Group launched a USD Trade Finance Incentive programme and the new concept of Trade Buffet programme, both of which have strong customer potential. It also pioneered the launch of ePresentation under Letter of Credit, further increasing its competitive edge in trade finance. Additionally, the Group continued to enhance its service capabilities in cross-border cash management and assisted a number of large corporate clients in maximising their cash liquidity through onshore and offshore two-way cash sweeping. Following its pioneer launch of payment by e-Cheque services, the Group introduced solutions that support corporates issuing e-Cheques via ERP Integration and Corporate File Transfer Service. It also introduced 29 non-major currencies as supporting currencies for its remittance service to cover majority of countries along the Belt and Road. In recognition of its outstanding transaction banking services, BOCHK was named Best Cash Management Bank in Hong Kong for the fourth consecutive year and the Best Transaction Bank in Hong Kong for 2016 by *The Asian Banker*. A trade finance project undertaken by BOCHK was also named the Best Corporate Trade Finance Deal in Hong Kong for 2016. In addition to these accolades, BOCHK was named Hong Kong Domestic Cash Management Bank of the Year for the third consecutive year by *Asian Banking and Finance*.

New client segments for custody services

In 2016, the large number of M&A and corporate activities in the market created robust demand for escrow deals. Of the investor segments, segregated mandates and proprietary accounts generally fared better than funds. Although other client segments were affected to various degrees by market volatility and subdued turnover volumes, active portfolio building by new clients enabled the Group to capture business opportunities. During the year, it made solid progress in the Qualified Domestic Institutional Investors ("QDII") business, as a result of active market sentiment and the increasing demand from Mainland institutions for QDII products. Business relationships were also established with new client segments from the Mainland of China, Hong Kong and overseas. Moreover, the Group collaborated more closely with BOC and its overseas entities to enhance service in areas such as the Mainland-Hong Kong Mutual Recognition of Funds scheme which was well received by its partners. In recognition of its outstanding custody services, the Group won the Best Custody Specialist – China award from *The Asset magazine*. At the end of 2016, excluding the RMB fiduciary accounts for participating banks, total assets under the Group's custody were valued at HK$856.0 billion.

Proactive measures to contain risk

In 2016, the Group continued to adhere to a prudent credit strategy and made further refinements to its Know Your Customers and risk management policies. In view of the uncertain economic environment, the Group carried out close credit monitoring on a more frequent and proactive basis. This included monitoring the credit positions of customers in vulnerable industries and countries that could be negatively affected by uncertainties in the global economic environment. More pre-lending monitoring measures were adopted, including the continuous optimisation of the industry mix and closer management of the clustering limit to meet the more stringent regulatory requirements. Additionally, the Group remained alert to emerging risks in the Mainland market and closely monitored customers in segments under threat of overcapacity. It also established a trigger point to review and manage the concentration risk of Mainland exposures. With regard to the Belt and Road Initiative, Mainland enterprises going global and the acquisition of BOC's assets in ASEAN, the Group adopted underwriting standards and credit risk management to monitor the risks associated with the local political and economic environment, tax issues and legal risks. The Group has also been raising related underwriting standards in its credit policies and procedures so that it has more efficient and sound risk control measures governing the Group's business development in new markets.

Treasury

Financial Results

Treasury's profit before taxation was HK$8,552 million, an increase of HK$706 million, or 9.0%, from the previous year. The growth was driven by the increase in net trading gain.

Net interest income decreased by 27.0%, mainly due to the decline in the average yield of debt securities investments, coupled with the decrease in the average balance of RMB balances and placements with banks and the decline in the average yield of related assets caused by the drop in market interest rates. The decrease was, however, partially offset by the higher average balance of debt securities investments. Net trading gain was up strongly, primarily due to the net gain from foreign exchange swap contracts, the increase in currency exchange income from customer transactions as well as the mark-to-market changes of certain debt securities and interest rate instruments.

Business Operations

Acclaim for the Group's treasury business

In response to the complex economic environment and volatile global financial markets, the Group broadened its product and service offerings to meet the diverse needs of customers. It also focused on increasing customer transactions and advancing its strategy of diversification in trading currencies, trading mix, customer segments and business model. As a result, foreign exchange trading volume and related revenue for customer transactions grew satisfactorily during the year. In the banknotes business, it developed relationships with central banks and financial institutions, particularly in countries in the ASEAN region and along the Belt and Road. During the review period, the Group underwrote the first Silver Bond issued by the HKSAR Government and the first Chinese Green Covered Bond issued by BOC's London Branch. In recognition of its outstanding performance in the treasury business, BOCHK received the Hong Kong Domestic Foreign Exchange Bank of the Year award by *Asian Banking and Finance* for the second consecutive year. BOCHK also won the Excellence Brand of Foreign Exchange award in The Hong Kong Leaders' Choice Award 2016 organised by Metro Finance, and received the Outstanding Treasury Business – Dim Sum Bond Market Maker, the Outstanding Retail Banking – Diversified Investment Business, and the Outstanding Treasury Product – (Foreign Exchange) Derivative Trading at the RMB Business Outstanding Awards 2016, organised by Metro Finance, Metro Finance Digital and Hong Kong *Wen Wei Po*.

Business expansion in ASEAN

In line with its ASEAN development strategy, the Group set up mechanisms for closer cooperation with BOC Malaysia, BOC Thailand and BOC's entities in the ASEAN region to promote further growth in their treasury businesses and provide support for their funding needs. Along with the opportunities arising from the internationalisation of the RMB and the Belt and Road Initiative, the Group publicised its treasury products and services by consolidating its relationships with central banks, sovereign wealth funds and financial institutions in several overseas markets and the Mainland of China.

Further enhancement in BOCHK's strong franchise as the RMB clearing Bank

The Group continued to ensure the stable development and continuous improvement of its RMB clearing services in Hong Kong and overseas in 2016. During the year, BOCHK obtained approval from the PBOC to join the CIPS and became the first offshore bank to join the system as a direct participant, and the only clearing bank with both CIPS and China National Advanced Payment System ("CNAPS") as its clearing channels. This not only enhanced the Group's clearing capabilities but also expanded its coverage of Hong Kong's RMB clearing network, making it easier to use RMB in both cross-border payments and overseas settlements, while reinforcing Hong Kong's position as the major offshore RMB centre. In addition, the Group continued to function as an active Primary Liquidity Provider with RMB liquidity to stabilise the market. BOCHK also obtained all qualifications for Shenzhen-Hong Kong Stock Connect, including that of sole Settlement Bank for Northbound Trading and the provision of cross-border fund settlement services for Southbound Trading.

A proactive but risk aware investment strategy

The Group continued to be prudent in managing its banking book investments. It closely monitored changes in the market and sought investment opportunities to enhance returns while remaining attuned to risk. During the year, the Group adjusted its investment portfolio in response to changes in interest rates and increased its investments in high-quality bonds.

Insurance

Financial Results

Profit before taxation in the Group's Insurance segment was HK$1,230 million in 2016, up 32.0% year-on-year. The growth was mainly attributable to the improved performance of its bond fund investments which recorded a net trading gain in 2016 versus a net trading loss in 2015. Net gain on other financial assets increased strongly as the Group recorded a higher gain from the disposal of certain debt securities investments in 2016. The growth was partially offset by the decrease in reinsurance income due to the decline in new RMB businesses amid the slowdown of the RMB insurance market. Net insurance premium income dropped by 14.5% as the Group adjusted its product mix by reducing its single premium business and enlarging its regular premium business in order to ensure a stable stream of renewal premium income for continuous growth.

Business Operations

Product innovation and distribution channel diversification

In 2016, the Group continued to broaden its product offerings and optimise features through its insurance arm in order to provide customers with a more comprehensive product selection. New products launched during the year included the MaxiWealth ULife Insurance Plan for customers who want flexibility in financial planning and whole life protection, the UltraReach Insurance Plan for customers with insurance and savings needs, and Cancer Rider to supplement additional benefits. Other products introduced in 2016 were the GoSports Accident Insurance Plan, Target 5 Years Plus Insurance Plan and SmartUp Wholelife Insurance Plan. To secure new business from non-bank sources, the Group diversified its distribution channels by expanding the tied agency channel, broker channel, telemarketing and e-channels. The Group also reinforced its high-net-worth customer business by strengthening collaboration within the Group and enhancing cross-selling opportunities. Additionally, it set up a new Customer Service Centre and supporting team to provide a better experience for cross-border customers.

Leadership in RMB insurance products and strengthening market recognition

The Group maintained its leading position in the Hong Kong RMB insurance market during the year through a diversified and comprehensive range of products. It also launched a variety of promotions, including programmes for an enhanced returns policy and premium discounts, as well as acting as the title sponsor for an RMB currency exchange rates programme on a TV news channel, reinforcing its image as a provider of RMB insurance. In recognition of its performance in the insurance sector, BOC Life was named Insurance Company of the Year – Outstanding Performance and Saving Plan – Excellence awards in the 2016 Financial Institution Awards by *Bloomberg Businessweek*. It also received the Best Life Insurance Award in the 2016 Metro Awards for Banking and Finance Corporation by *Metro Daily* and *Metro Prosperity*. In the RMB Business Outstanding Awards – Outstanding Insurance Business organised by Metro Finance, Metro Finance Digital and Hong Kong *Wen Wei Po*, BOC Life won all the awards for a fifth consecutive year. In addition, BOC Life took four awards in the insurance sector of *Benchmark*'s 2016 Wealth Management Awards, including the Customer Insight Award – Best-in-Class and Innovation Award – Best-in-Class.

Eight Key Business Platforms

In pursuit of business diversification, the Group enhanced its eight key business platforms with satisfactory performance. Business operations of credit cards, private banking, cash management, custody and life insurance have been discussed under Personal Banking, Corporate Banking and Insurance segment respectively. Business operations of asset management, trust as well as securities and futures are discussed below.

A greater choice of asset management products

BOCHK Asset Management Limited ("BOCHK AM") enriched its product range in 2016 as part of its ongoing business development. The BOCHK All Weather China High Yield Bond Fund, as a northbound fund under the Mainland-Hong Kong Mutual Recognition of Funds scheme, was launched for distribution in the Mainland. A new retail fund, the BOCHK All Weather Asian Bond Fund, was launched, which aims to achieve medium- to long-term income growth and capital appreciation through investment in Asian bonds. Both of these funds were well received by customers. BOCHK AM also expanded its distribution channels to enhance sales capabilities to retail and high-end customers. In addition, new business opportunities were explored through collaboration with BOC's overseas branches and participation in the Group's ASEAN expansion. As a result of BOCHK AM's progress in new businesses, the assets under management at the end of 2016 grew by 1.7 times from the end of 2015. In recognition of its outstanding performance, BOCHK AM won the Outstanding Achiever – High Yield Fixed Income and Best-In-Class, Manager of the Year Award – High Yield Fixed Income in the Fund of the Year Awards 2016 by *Benchmark*. BOCHK AM also won the Best for Retail Focused Investment Solutions – Hong Kong in the 2016 Wealth & Money Management Awards by *Wealth & Finance International*. In addition, three funds issued under the BOCHK All Weather Creation Series received three awards in the CAMAHK – Bloomberg Offshore China Fund Awards 2016. Also, in the Best of the Best Awards announced by *Asia Asset Management* in January 2017, BOCHK AM was named the Best China Fund House and the Best RMB Manager in Hong Kong, as well as the Best Offshore RMB Bond Performance (5 years).

Development of the trustee services business

The Group provides trustee, provident fund, retirement fund and unit trust administration services through its subsidiary company, BOCI-Prudential Trustee Limited ("BOCI-Prudential Trustee"). During the year, BOCI-Prudential Trustee improved its sales, referrals and cross-selling capabilities by collaborating with various units of the Group. It also made a number of functional enhancements to its online MPF administration platform and mobile application for an enhanced customer experience. Moreover, the launch of a Hotline Referral Service saw encouraging results in converting service calls into MPF account consolidation opportunities and creating MPF transfer-in of assets. In recognition of its performance in trustee services, BOCI-Prudential Trustee was awarded the Excellent Brand of MPF Online Platform in The Hong Kong Leaders' Choice Brand Award 2016 organised by Metro Finance. It was also named Best of MPF App Service Provider in the e-Brand Awards 2016 organised by *e-zone* magazine of *Hong Kong Economic Times*. Additionally, a number of industry awards went to BOCI-Prudential Trustee's My Choice MPF Scheme.

Expansion of securities and futures brokerage services

The Group engages in the provision of brokerage services for futures and options trading through its subsidiary company, Po Sang Securities and Futures Limited ("Po Sang Securities and Futures"). During the year, Po Sang Securities and Futures broadened the range of products it offers to include trading services for Sector Index Futures Contracts, RMB Currency Futures Contracts and those under Shenzhen-Hong Kong Stock Connect. It also upgraded its trading system and strengthened its brand image through the launch of a number of promotional campaigns.

Disposal of Nanyang Commercial Bank, Limited

On 18 December 2015, the Group entered into a 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 total consideration for the 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 NCB (China); and (iv) potential synergies between NCB and China Cinda Asset Management Co., Ltd. and its subsidiaries.

The disposal was completed on 30 May 2016 (the "Completion Date") in accordance with the terms and conditions of the Sale and Purchase Agreement. Upon completion, NCB ceased to be a subsidiary of both BOC and the Group. BOCHK, NCB and Cinda Financial entered into a Transitional Services Agreement on the Completion Date, pursuant to which BOCHK provides certain transitional support services to NCB and NCB (China) at service charges mutually agreed upon by the parties for an initial term of three years from the Completion Date (which may be extended for a further 12-month period at the election of NCB and further extended if and as mutually agreed by the parties) to facilitate the transition.

For further information on the disposal, please refer to the joint announcements made by BOC and the Group on 18 December 2015 and 27 May 2016.

The operating results of NCB, which are reported as discontinued operations, for the period up to the date of the disposal and the year of 2015 and the gain on disposal of NCB were as follows:

HK$'m	**2016**	2015
Profit of discontinued operations	**961**	2,827
Gain on disposal of discontinued operations	**29,956**	–

Disposal of Chiyu Banking Corporation Limited

On 22 December 2016, the Group entered into a Sale and Purchase Agreement with Xiamen International Investment Limited ("XIL") and the Committee of Jimei Schools ("CB") and jointly made an announcement with BOC in relation to the Group's disposal of a total of 2,114,773 ordinary shares of Chiyu (representing approximately 70.49%) of the total issued shares of Chiyu (the "Disposal") by BOCHK.

The total consideration for the Disposal is HK$7.685 billion, of which (i) XIL has agreed to purchase, or procure the purchase through its three wholly-owned subsidiaries of, 1,929,373 ordinary shares of Chiyu (representing approximately 64.31% of the total issued shares of Chiyu); and (ii) CB has agreed to purchase, or procure the purchase through Chip Bee Private Institution of, 185,400 ordinary shares of Chiyu (representing approximately 6.18% of the total issued shares of Chiyu). Chip Bee Private Institution is an existing registered shareholder of Chiyu prior to the Disposal holding 416,407 ordinary shares of Chiyu (representing approximately 13.88% of the total issued shares of Chiyu).

The Disposal was completed on 27 March 2017 (the "Completion Date") in accordance with the terms and conditions of the Sale and Purchase Agreement. Upon completion, Chiyu ceased to be a subsidiary of both BOC and the Group. BOCHK, Chiyu and XIL entered into a Transitional Services Agreement on 22 December 2016, which takes effect from the Completion Date, pursuant to which BOCHK provides certain transitional support, information technology and other assistance to Chiyu at service charges mutually agreed for a term of four years from the Completion Date (with an option for Chiyu to extend this term for two consecutive periods of one year each) to facilitate the transition.

For further information on the Disposal, please refer to the joint announcements made by BOC and the Group on 22 December 2016 and 24 March 2017.

ASEAN strategy: transforming into a regional bank

The Group made significant progress in developing its ASEAN business during the year. On 30 June 2016, BOCHK entered into Share Purchase Agreements with BOC in relation to the acquisitions of the entire issued share capital of BOC Thailand and the entire issued share capital of BOC Malaysia, respectively, as part of the restructuring exercise of the BOC Group in the ASEAN region. The share acquisition of BOC Malaysia and BOC Thailand was subsequently completed on 17 October 2016 and 9 January 2017 respectively. On 20 December 2016, the Group's Brunei Branch celebrated its grand opening which made it the first Chinese financial institution to establish a presence in the country.

On 28 February 2017, BOCHK entered into Asset Purchase Agreements with BOC in relation to the acquisition of the Indonesia Business and the Cambodia Business, respectively. The completion of each proposed acquisition is subject to the satisfaction of the conditions precedent stated in the respective Asset Purchase Agreement. Upon completion, all the assets and liabilities arising in connection with the Indonesia Business and Cambodia Business will be transferred to and assumed by BOCHK. For further information on the acquisitions, please refer to the announcement made by the Group on 28 February 2017.

ASEAN is a high growth market that has been one of the core regions for the BOC Group's overseas business development over the years. ASEAN is also a key region for both the Belt and Road Initiative and RMB internationalisation. The acquisition of certain ASEAN assets from BOC signified the start of the transformation of BOCHK from a local bank into a regional bank, in line with the Group's integration strategy for BOC Group's domestic and overseas operations. With the acquisition of BOC Thailand, BOC Malaysia, BOC Jakarta Branch and BOC Phnom Penh Branch as well as the establishment of the Brunei Branch, together with its competitive advantages in services, products and resources, the Group is in an excellent position as the largest offshore RMB clearing bank to further develop its business in the region. To achieve this objective, the Group will adopt a matrix management structure. It has also set up a business supervisory committee and a business integration team to coordinate and manage the integration work, ensuring a smooth transition of business operations and management of the ASEAN institutions.

Technology and Operations

In 2016, in view of the complex operating environment and market trend, the Group remained committed to the strategy of innovative development. It captured market opportunities with latest trend in innovation and technology, and proactively pushed forward its business development, achieving new breakthroughs in a number of areas. Innovation and technology became the new growth driver for business development.

The Group continued to strengthen its information technology and business operation infrastructure in order to support its business growth and increase operational efficiency during the year. New initiatives in 2016 included the launch of a series of FinTech products and services that integrate Internet technology with traditional banking to provide better customer experience and support for the growth of the Personal Banking, SME and Corporate Banking businesses. Most of these products and services are leveraged on the mobile platform, including e-Cheque Services, P2P Small Value Transfers, BOC Loan mobile app, QR code payment pilot and Apple Pay and some of these were new to the market.

In 2016, the Group established a Big Data platform in order to improve its information management and target marketing capabilities, and brought in blockchain technology application to expedite property valuations. It also set up a Smart Flagship Branch with new technology applications such as the use of finger-vein to authenticate customer identity, an interactive robot (named RoBOC) to interact with customers, and an online appointment and smart queuing service. Also introduced was the new BOCHK iService, a 24-hour video banking service that addresses customers' banking needs beyond the opening hours of branches. All of these innovations helped to raise the Group's overall service capabilities and increased the total number of customers using e-channels such as Internet and Mobile Banking services from the end of 2015.

As part of its commitment to FinTech in Hong Kong, the Group signed a Memorandum of Understanding with the Hong Kong Applied Science and Technology Research Institute ("ASTRI") to establish the BOCHK-ASTRI FinTech Collaboration Centre. Under this agreement, both parties will develop new financial technologies for the banking sector and promote FinTech in Hong Kong. One of the projects jointly launched was the use of Artificial Intelligence stock trading model in the Smart Investment Contest, enabling the contestants to experience the use of FinTech in investment services.

In recognition of the Group's innovations in technology, BOCHK received a number of local and international awards, including the Technology Innovation Awards – Best Mobile Social Media Engagement Project award by *The Asian Banker* and The Best Consumer Digital Bank in Hong Kong by *Global Finance* magazine. BOCHK also received the Digital Banking Initiative of the Year – Hong Kong, Mobile Banking Initiative of the Year – Hong Kong, and Social Media Initiative of the Year – Hong Kong in the Retail Banking Awards 2016 by *Asian Banking and Finance*.

Business Focus for 2017

The year 2017 will be one of both opportunities and challenges for banks in Hong Kong. The international political and economic environment will be complex and fast-changing. The trend of subdued economic growth will continue globally. This, coupled with intensifying market competitions and challenges from FinTech development, will make the operation and development of banks more difficult. Nevertheless, major national strategic initiatives, RMB's inclusion in the SDR basket of currencies and ASEAN economic development will provide banks with more room for growth. The Group will respond swiftly to changes in the market, capture business opportunities and implement BOC's strategic goal of Serving Society, Delivering Excellence. It will strengthen resources allocation and accelerate business transformation and innovation to achieve sustainable development in all areas.

The Group will continue to develop its local business while exploring opportunities in Southeast Asian markets, particularly for its corporate banking business. Leveraging opportunities from the Belt and Road Initiative, ASEAN business development as well as the regional integration of Guangdong, Hong Kong and Macau, it will deepen collaboration with BOC's entities in the Mainland and overseas to acquire customers among large corporates, enterprises going global and financial institutions. In Hong Kong, the Group will strengthen business cooperation with local commercial, government and financial institution sectors. It will establish an integrated business model to serve customers more comprehensively and efficiently.

The Group will capitalise on its strong franchise and expand cross-border business. Its corporate banking, personal banking and financial market businesses will focus on cross-border services and exert its strong supporting role in Bank of China Group's cross-border business. It will deepen collaboration with BOC's entities in the Mainland and overseas to uplift the overall contribution of cross-border business.

The Group will step up its regional expansion, including the combination and consolidation of its ASEAN entities. Aiming at a smooth transition of business operations and becoming a mainstream bank in the local area, it will adopt an integrated management model and reinforce its support to ASEAN entities. It will also refine the risk management system of ASEAN entities to meet the Group's and local regulatory requirements.

In pursuit of business diversification, the Group will expedite the development of its eight key business platforms, including credit cards, private banking, life insurance, asset management, cash management, custody, trust as well as securities and futures. It will fully leverage the competitive advantages of each business platform to enlarge customer base and meet their changing demand with an enriched product portfolio.

The Group will elevate its professional standards and competitive edge in the financial markets. It will take advantage of market changes to increase trading and investment profitability. It will seize opportunities from RMB's inclusion in the SDR basket of currencies and expand its institutional business. In addition, it will develop a diversified business platform and establish a collaborative business model of commercial and investment banking.

The Group will remain focused on solidifying its deposit business, prudent management of its assets and liabilities as well as disciplined cost control. It will continue to optimise its asset and liability structure, adopt a flexible strategy to expand its deposit base and refine its management of deposit costs. It will better allocate resources with enhanced cost control.

The Group will optimise its business processes for a better customer experience. It will remain customer-centric, improve service model and business processes to increase customer satisfaction. It will deepen the branch transformation and enhance the efficacy of distribution channels, which can contribute to the operational efficiency and overall service capabilities of its branch network.

In view of the potential of Internet finance to improve its competitiveness and productivity, the Group will continue to accelerate technological innovation. It will step up its efforts in technological innovation to drive faster business growth. Together with branch transformation, it will raise the intelligent service levels of its branches to upgrade production efficiency and service capabilities. In line with its strategy in the Southeast Asia, the Group will plan the integration of overseas systems with its own and the application framework to improve the overall operational capabilities. At the same time, the Group will consolidate its intelligent infrastructure for safe and efficient business operation.

The Group will strengthen its risk management and internal control to ensure compliance with various regulatory requirements. It will continue to enhance overall risk management to safeguard the sustainable and healthy development. It will refine its credit approval management and risk management in the Southeast Asia to maintain solid asset quality and control credit costs. It will also strengthen compliance control and upgrade its anti-money laundering measures.

Credit Ratings

As at 31 December 2016	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

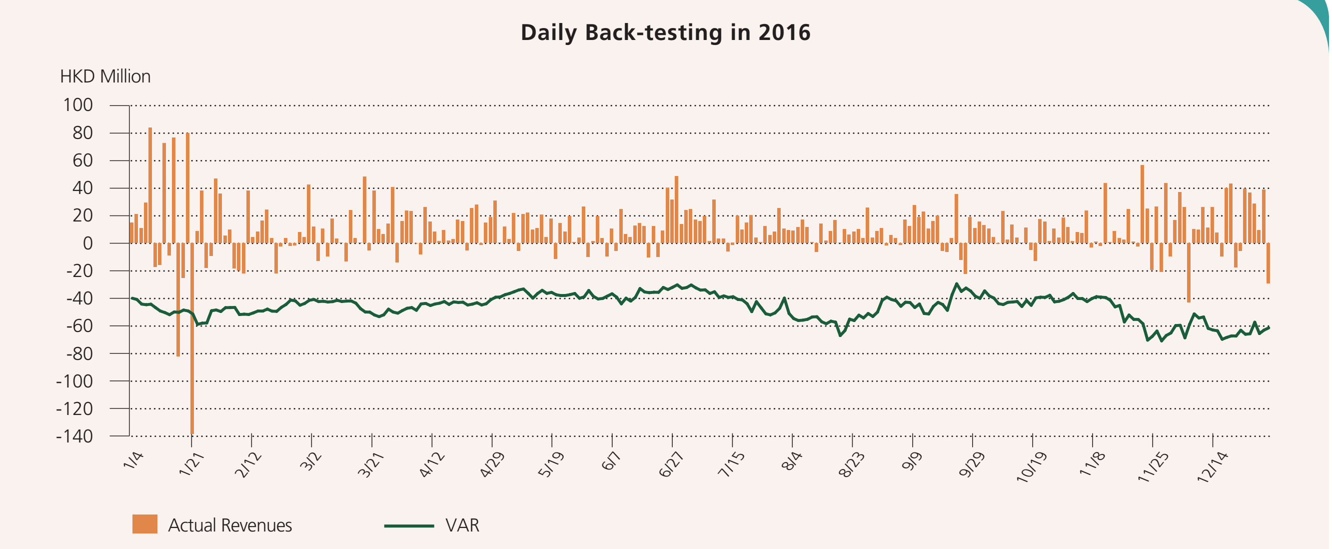
Credit risk is the risk of loss that a customer or counterparty is unable to or unwilling to meet its contractual obligations. Credit risk exists in the trading book and banking book, as well as from on- and off-balance sheet transactions of the Group. It arises principally from lending, trade finance 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.



There were two actual losses exceeding the VAR for the Group in 2016 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 Crime Compliance 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 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.

BOC Life

BOC 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 BOC Life's insurance business are insurance risk, interest rate risk, liquidity risk, credit risk, equity price risk and currency risk. BOC 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

BOC 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 BOC 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 BOC Life's liability as the primary insurer. If a reinsurer fails to pay a claim for any reasons, BOC 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. BOC 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. BOC 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 BOC Life's investment assets. It might induce customers to surrender their insurance policies/contracts. 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. BOC 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. BOC 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

BOC 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 BOC 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

BOC 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, BOC Life has strengthened its communication with the Group while closely monitoring and updating internal controls 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. BOC Life's asset and liability framework includes managing the adverse impact due to equity price movement through stress test and exposure limit.

Currency risk management

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