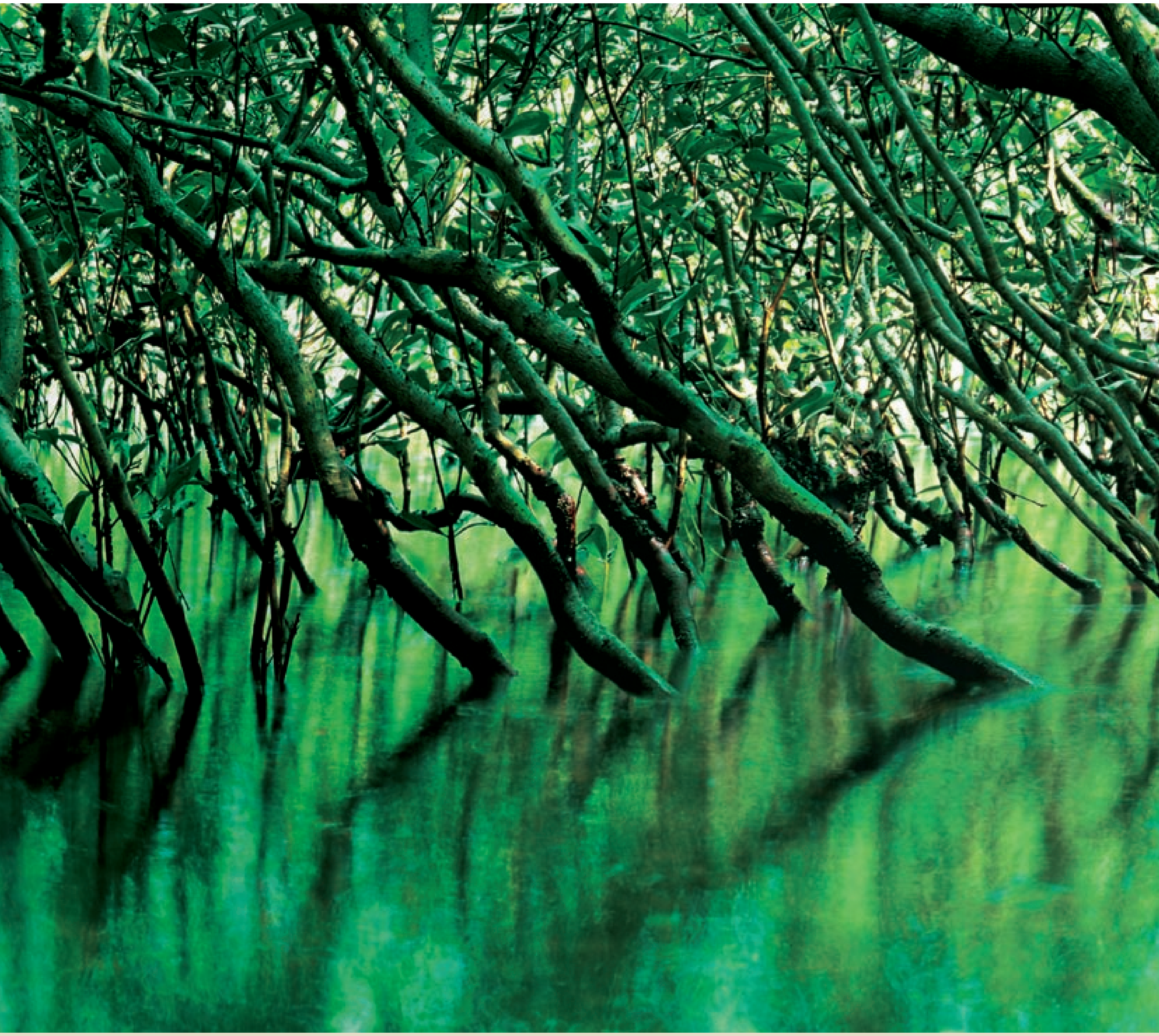
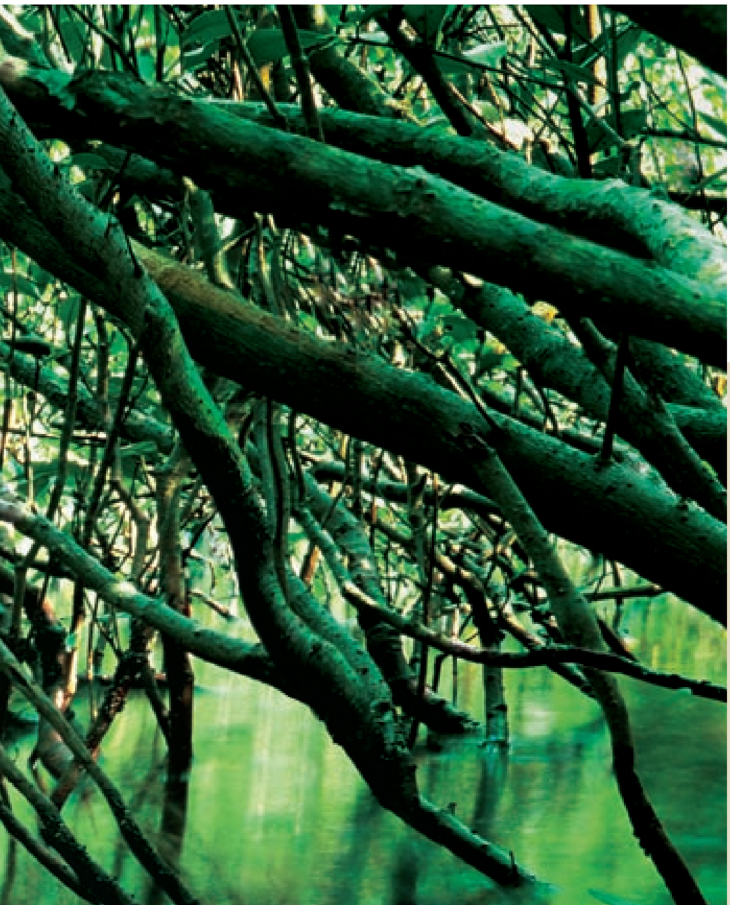


HK$90 million of the net proceeds generated from "Beijing 2008 Olympic Games Hong Kong Dollar Commemorative Banknote" was designated for the "Caring Hong Kong – A Heart Warming Campaign" by BOCHK to provide timely support to those in need.



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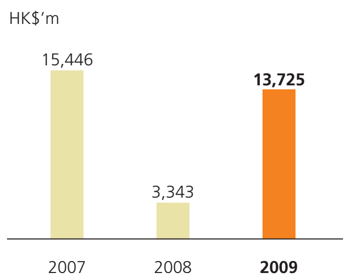
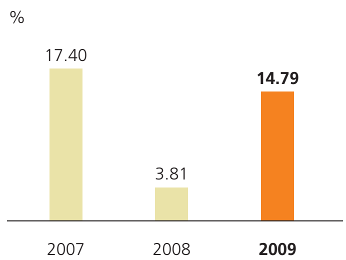
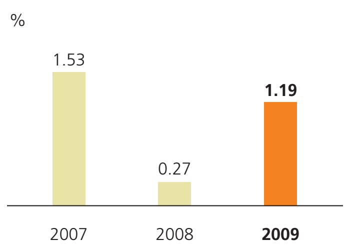
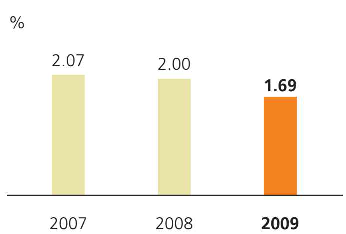
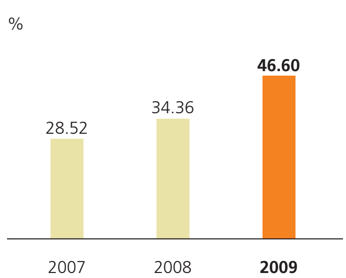
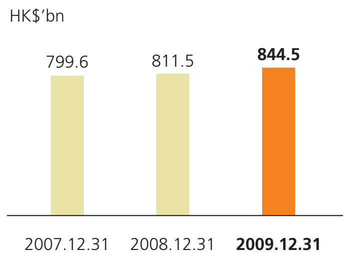
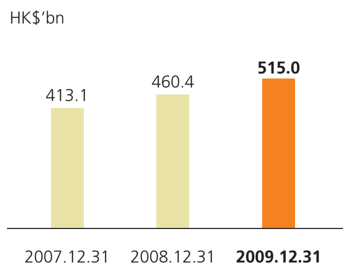
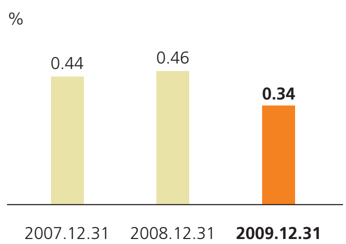
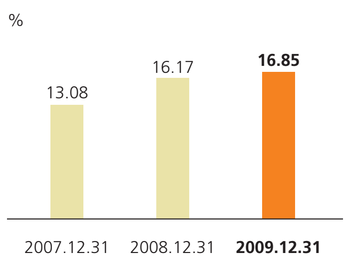
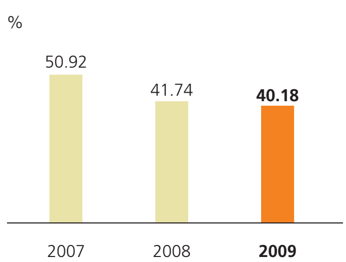
CONNECTED

The following sections provide metrics and analytics of the Group's performance, financial position, and risk management in the year 2009. These should be read in conjunction with the financial statements included in this Annual Report.

FINANCIAL PERFORMANCE AND CONDITION IN BRIEF

The following table is a summary of the Group's key financial results for the year 2009 with a comparison with the previous two financial periods.

Financial Indicators		2009 Performance
1. Profit Attributable to Shareholders		**Profit attributable to shareholders** • Profit attributable to shareholders was HK$13,725 million, up strongly from 2008. This demonstrated the Group's strengths in core banking businesses amid the challenging operating environment
2. Return on Average Capital and Reserves Attributable to the Equity Holders of the Company ("ROE")[1]		**ROE** • ROE was 14.79%, up 10.98 percentage points year-on-year, representing a strong rebound from 2008
3. Return on Average Total Assets ("ROA")[2]		**ROA** • ROA was 1.19%, up 0.92 percentage point year-on-year
4. Net Interest Margin ("NIM")		**NIM** • NIM was 1.69%, down 31 basis points year-on-year due to lower market interest rates in 2009
5. Cost-to-Income Ratio ("CIR")[3]		**CIR** • CIR was 46.60%, up 12.24 percentage points year-on-year as operating expenses increased by 38.4% due largely to the expenses incurred on Lehman Brothers related products[3]. Operating income increased by 2.1%

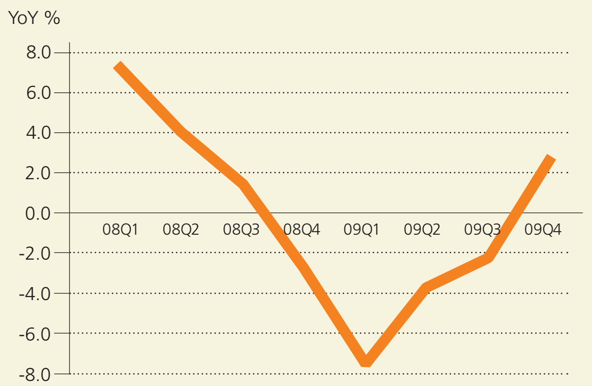
<table>
<tr><th>Financial Indicators</th><th></th><th>2009 Performance</th></tr>
<tr><td>6. Deposits from Customers (including structured deposits)</td><td>
</td><td>Deposits from Customers
• Total deposits increased by 4.1% from the end of 2008 to HK$844.5 billion, with continuous improvement in deposit mix</td></tr>
<tr><td>7. Advances to Customers</td><td>
</td><td>Advances to Customers
• The Group's advances to customers increased strongly by 11.8% year-on-year to HK$515.0 billion, outperforming the local loans market where loan growth remained lackluster in 2009</td></tr>
<tr><td>8. Classified or Impaired Loan Ratio[4]</td><td>
</td><td>Classified or Impaired Loan Ratio
• Classified or impaired loan ratio was 0.34%, down from 0.46% at the end of 2008
• Formation of new classified loans remained at a low level, representing approximately 0.3% of total loans</td></tr>
<tr><td>9. Capital Adequacy Ratio ("CAR")</td><td>
</td><td>CAR
• CAR maintained at a high level of 16.85% at the end of 2009
• Core capital ratio stood at 11.64%</td></tr>
<tr><td>10. Average Liquidity Ratio</td><td>
</td><td>Average Liquidity Ratio
• Average liquidity ratio remained healthy at 40.18% in 2009</td></tr>
</table>

1 Return on Average Capital and Reserves Attributable to the Equity Holders of the Company as defined in "Financial Highlights".
2 Return on Average Total Assets as defined in "Financial Highlights".
3 Expenses incurred on Lehman Brothers related products were primarily in relation to the Lehman Brothers minibonds ("Minibonds") repurchase arrangements announced on 22 July 2009. Excluding expenses incurred on Lehman Brothers related products, core cost-to-income ratio in 2009 and 2008 would have been 34.02% and 31.35% respectively.
4 Classified or impaired loans represent advances which have been classified as "substandard", "doubtful" or "loss" under the Group's classification of loan quality, or individually assessed to be impaired.

ECONOMIC BACKGROUND & OPERATING ENVIRONMENT

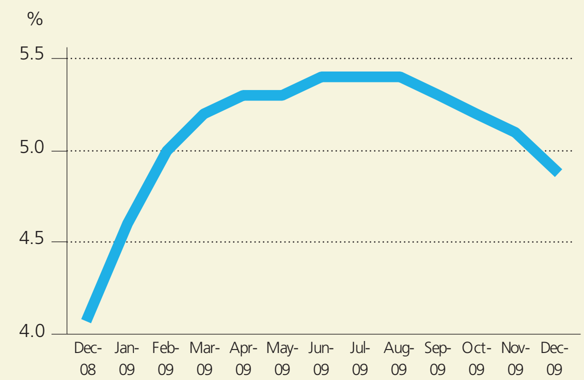
The global economic environment remained highly challenging in 2009 as the severe impact of the financial crisis from 2008 was still keenly felt. In the first half of the year, the global economy was undergoing a downturn. Most governments and central banks around the world had to resort to drastic measures to boost demand and stabilise the economy. The US Federal Reserve maintained its target interest rate at close to zero while other central banks also kept their benchmark rates low. In the second half of the year, these extraordinary fiscal and monetary policies were beginning to bear fruit. Some major economies, including the US and the Eurozone, showed signs of recovery. The momentum of economic recovery was stronger in Asia. The Mainland economy, in particular, resumed much faster growth that was spurred by public investment in infrastructure and a revival of the real estate sector. Other Asian economies also recovered, though to a lesser extent, driven by fiscal stimulus, rising confidence and the wealth effect of a rebound in the equity market.

Hong Kong Real GDP



Source: Bloomberg

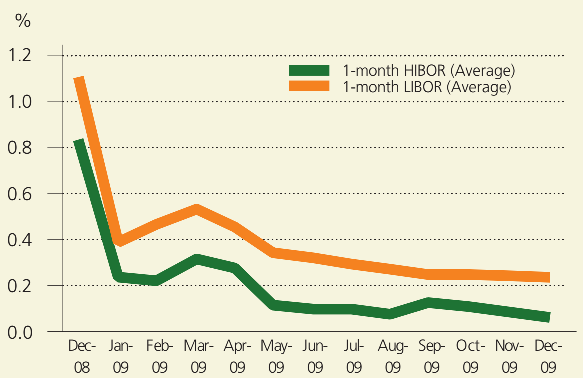
Hong Kong Unemployment Rate



Source: Bloomberg

The Hong Kong economy showed clearer signs of improvement in the fourth quarter of the year with the real GDP recording a year-on-year growth of 2.6%. This was mainly led by the rise in domestic demand and business investment. Consumer sentiments revived with the improvement in the labour market in the second half of the year when the unemployment rate fell to 5.3% in the third quarter before edging further down to 4.9% at the end of 2009. There was therefore a rebound in private consumption expenditure. At the same time, overall investment spending increased, which was largely attributable to public sector construction work. The property market recovered and investment in the stock market also rose strongly as the financial markets stabilised. Inflationary pressure in Hong Kong remained largely subdued with the composite consumer price index recording a modest year-on-year growth of 1.3% by the end of 2009.

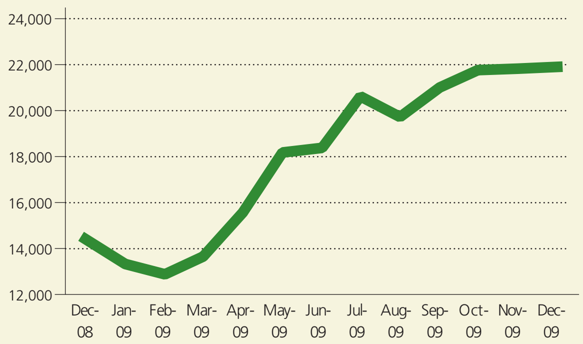
HIBOR and LIBOR



Source: Bloomberg

In the local money market, the Hong Kong Monetary Authority ("HKMA") introduced various accommodative measures in response to the global financial crisis. Interbank interest rates for the Hong Kong Dollar generally stayed at low levels in the first quarter and dropped further during the year with USD interest rates. Average 1-month HIBOR and LIBOR decreased from 0.23% and 0.38% respectively at the beginning of the year to 0.06% and 0.23% in December.

Hang Seng Index



Source: Bloomberg

With the improvement in market sentiments and inflow of funds, the local stock market rebounded and remained buoyant since the second quarter of the year. The Hang Seng Index ("HSI") closed at 21,873 points at the end of 2009, representing an increase of more than 50% versus 14,387 points at the end of 2008. IPO activities revived since September 2009 and recorded a total of HK$243.9 billion raised in 2009, up 269.6% year-on-year.

The local residential property market turned buoyant with both prices and transaction volume returning to the pre-crisis level. Property transaction regained its growth momentum from the second quarter onward when signs of economic recovery became more apparent. It cooled down somewhat in the last quarter with the anticipation of a possible rise of interest rates. Transaction volume, in terms of the number of sale and purchase agreements of all building units, in 2009 increased by 18.2% compared to 2008. Prices of private domestic properties in 2009 recorded a cumulative increase of 27.6% versus 2008.

While 2009 remained challenging for the local banking sector as competition remained acute and interest rates were low, the gradual stabilisation of the financial markets and improvement in investor and consumer sentiments helped improve the profitability of banks. Although interest income was further depleted by persistently low interest rates and intense price competition, buoyancy in the stock market generated higher non-interest income. Improvement in asset quality also led to lower provisions for loans and investment portfolios.

Outlook for 2010

Before reviewing the Group's 2009 financial performance in detail, here are certain factors that may affect the Group's financial outlook in 2010:

- Economic fundamentals remain fragile as the impetus for recovery primarily comes from fiscal and monetary easing policies adopted by individual governments. Governmental measures to stimulate the economy may result in inflationary and therefore asset bubbles. Faced with such a dilemma, major central banks might be forced to tighten the monetary policies. The subsequent withdrawal of liquidity could dampen economic activities.

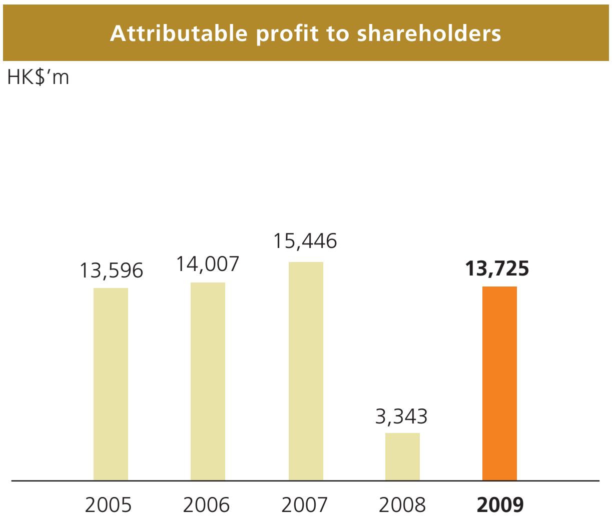
- In Hong Kong, a possible reversal of the trend of capital inflow might trigger changes in interest rates and asset values, thus resulting in uncertainties that may hinder the pace of the economic recovery.

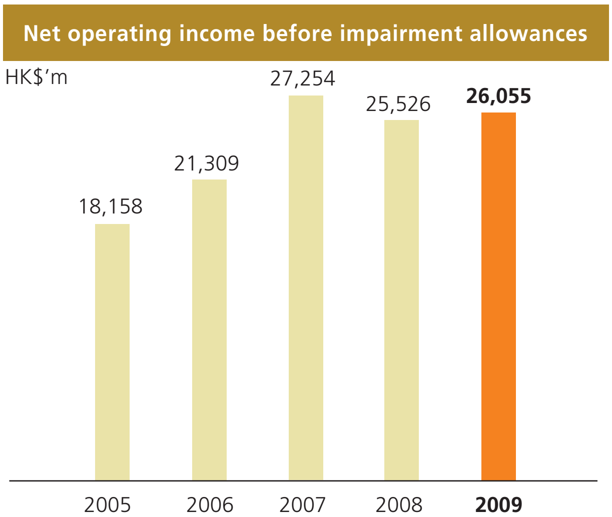
- Banks are faced with increasing regulatory pressure as regards the selling of products, customer service, liquidity and capital management, etc. Corresponding steps have to be taken to cope with the changes in regulatory requirements.

CONSOLIDATED FINANCIAL REVIEW

Financial Performance

Despite the challenging economic environment in 2009, the Group achieved encouraging financial results. By capitalising on its strengths in core businesses and seizing opportunities arising from the recovering economy, the Group quickly resumed growth in its earnings. It expanded its service scope in various business areas and captured bigger market shares. It also continued to strengthen its financial position and risk management in the uncertain market conditions.





In 2009, the Group's net operating income before impairment allowances increased by HK$529 million, or 2.1%, to HK$26,055 million, led by the improvement in net fees and commission income and the net operating income recorded by the Group's insurance segment. There was, however, a reduction in net interest income. Operating expenses increased mainly due to the expenses incurred on Lehman Brothers related products. The Group recorded a net write-back in impairment allowances on securities investments versus a net charge in 2008 while the net charge of impairment allowances on loans significantly decreased. Meanwhile, the Group's properties registered a revaluation gain versus a loss last year.

The Group's profit attributable to shareholders increased strongly by HK$10,382 million, or 310.6%, to HK$13,725 million. Earnings per share were HK$1.2981, up from HK$0.3162 in 2008. ROA was 1.19% while ROE was 14.79%.

Factors Affecting the Group's Performance in 2009

Amid uncertainties in the market resulting from the global financial crisis, the Group continued to enhance its franchise and strengthen its business capabilities. It refined its business strategies to drive the growth of its traditional core businesses and successfully captured new business opportunities.

- With ample liquidity and improved sentiments in the market, the local stock market rebounded strongly. The Group captured this business opportunity with its enhanced and reliable stock trading platform. It recorded a robust growth of 52.9% in stock broking fee income, outperforming the market. The fee income from core businesses also surged in the second half of the year.
- By reinforcing its services for local and Mainland enterprises as well as playing an active role as the BOC's "Asia-Pacific Syndicated Loan Centre", the Group grew its loan balance and remarkably expanded its market share. Loan commissions also rose strongly.
- With an enhanced service platform and the stabilisation of the capital markets, the Group's insurance segment improved its financial performance considerably with notable growth in its net operating income as well as market share.
- The Group proactively managed its US non-agency residential mortgage-backed securities ("RMBS") portfolio. As investment sentiments and market liquidity improved, the Group acted promptly by reducing to a large extent its exposure to US non-agency RMBS, thus generating a substantial write-back of impairment allowances.

The Group's financial performance in 2009 was also subject to the following negative factors:

- Exceptionally low interest rates coupled with the full-year impact of the two subordinated loans secured in 2008 adversely affected the Group's net interest income.
- Substantial expenses incurred on Lehman Brothers related products were recorded in 2009 (For details, please refer to Note 13 to the Financial Statements).

Financial Highlights

HK$'m, except percentage amounts	2009	2008
Net interest income	**17,932**	20,157
Other operating income	**8,123**	5,369
Operating income	**26,055**	25,526
Operating expenses	**(12,141)**	(8,771)
Operating profit before impairment allowances	**13,914**	16,755
Net reversal/(charge) of impairment allowances	**1,190**	(12,573)
Others	**1,620**	(104)
Profit before taxation	**16,724**	4,078
Profit attributable to the equity holders of the Company	**13,725**	3,343
Earnings per share (HK$)	**1.2981**	0.3162
Return on average total assets	**1.19%**	0.27%
Return on average capital and reserves attributable to the equity holders of the company	**14.79%**	3.81%
Net interest margin (NIM)	**1.69%**	2.00%
Non-interest income ratio	**31.18%**	21.03%
Cost-to-income ratio	**46.60%**	34.36%

Analyses of the Group's financial performance and business operations are set out in the following sections.

Net Interest Income and Margin

HK$'m, except percentage amounts	2009	2008
Interest income	**21,684**	35,281
Interest expense	**(3,752)**	(15,124)
Net interest income	**17,932**	20,157
Average interest-earning assets	**1,060,961**	1,006,440
Net interest spread	**1.62%**	1.78%
Net interest margin	**1.69%**	2.00%

With sizable capital inflows and ample liquidity in the interbank market, Hong Kong's short-term market interest rates in 2009 declined further and remained at an exceptionally low level. Average one-month HIBOR in 2009 fell by 185 basis points to 0.15% while average one-month LIBOR fell by 235 basis points to 0.33% compared to 2008. The Group's average HKD Prime rate decreased by 40 basis points to 5.00%, thus widening the HKD Prime-to-one-month HIBOR spread (hereafter called "Prime-HIBOR spread") by 145 basis points to 4.85%. Meanwhile, the yield curve steepened, as evidenced by the broader average interest spread of 164 basis points in 2009 between 2-year Exchange Fund notes and its 10-year counterparts, versus 111 basis points in 2008.

The Group's net interest income decreased by HK$2,225 million, or 11.0%, to HK$17,932 million in 2009. The decrease was mainly attributable to the drop in net interest margin, which was partially offset by the growth in average interest-earning assets. Net interest margin fell by 31 basis points to 1.69% as both net interest spread and contribution from net free fund declined by 16 basis points and 15 basis points respectively. Average interest-earning assets grew by HK$54,521 million, or 5.4%, to HK$1,060,961 million.

The summary below shows the average balances and average interest rates of individual categories of assets and liabilities:

ASSETS	Year ended 31 December 2009 Average balance HK$'m	Year ended 31 December 2009 Average yield %	Year ended 31 December 2008** Average balance HK$'m	Year ended 31 December 2008** Average yield %
Loans to banks	**241,683**	**1.21**	228,901	2.41
Debt securities investments	**332,865**	**2.44**	306,807	4.27
Loans and advances to customers	**473,888**	**2.22**	456,946	3.56
Other interest-earning assets	**12,525**	**1.16**	13,786	2.92
Total interest-earning assets	**1,060,961**	**2.04**	1,006,440	3.51
Non interest-earning assets	**117,552**	**–**	92,758	–
Total assets	**1,178,513**	**1.84**	1,099,198	3.21

LIABILITIES	Year ended 31 December 2009 Average balance HK$'m	Year ended 31 December 2009 Average rate %	Year ended 31 December 2008** Average balance HK$'m	Year ended 31 December 2008** Average rate %
Deposits and balances of banks and other financial institutions	**100,284**	**1.44**	79,969	1.91
Of which: subordinated loans	**27,092**	**3.40**	4,442	5.61
Current, savings and fixed deposits	**777,529**	**0.29**	767,006	1.65
Certificate of deposits issued	**519**	**4.06**	1,474	3.73
Other interest-bearing liabilities	**21,940**	**0.25**	27,597	3.08
Total interest-bearing liabilities	**900,272**	**0.42**	876,046	1.73
Non interest-bearing deposits	**73,376**	**–**	37,053	–
Shareholders' funds* and non interest-bearing liabilities	**204,865**	**–**	186,099	–
Total liabilities	**1,178,513**	**0.32**	1,099,198	1.38

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

** During the year, the Company has made certain enhancements on the compilation basis and the 2008 comparative figures of certain items have been adjusted.

Compared to 2008, the average yield of total interest-earning assets declined by 1.47 percentage points in 2009 while the average rate of total interest-bearing liabilities fell by 1.31 percentage points, thus narrowing the net interest spread by 16 basis points. The contribution from net free fund declined as a result of the decrease in market interest rates.

The average yield of total interest-earning assets dropped following their re-pricing at lower interest rates. The average rate of total interest-bearing liabilities fell by a lesser extent largely due to the full-year impact of the two subordinated loans* secured in June and December 2008 respectively as their costs were fully reflected in 2009. Further reduction in deposits costs was also limited as they were already at a very low level.

* Bank of China (Hong Kong) Limited ("BOCHK"), the principal operating subsidiary of the Group, secured two subordinated loans from BOC in June and December 2008 respectively. Subsequent to the balance sheet date, BOCHK issued fixed rate subordinated notes with the aggregate principal amount of US$1,600 million on 11 February 2010. BOCHK applied the proceeds from the issue of the subordinated notes to partly repay the subordinated loan secured from BOC in December 2008 (For details of this issue, please refer to Note 56 to the Financial Statements).

Nevertheless, the Group's deposit mix continued to improve with an increase in the proportion of average demand deposits and current accounts as well as savings deposits in average total deposits. This helped alleviate the negative impact of the above factors. Higher-yielding assets such as loans and advances to customers and securities investments also registered growth.

Second Half Performance

Compared to the first half of 2009, short-term market interest rates further decreased. Average one-month HIBOR dropped by 12 basis points while average one-month LIBOR dropped by 17 basis points. The Group's net interest income increased by HK$74 million, or 0.8%. Average interest-earning assets grew by HK$74,405 million, or 7.3%. Net interest margin and net interest spread fell by 13 basis points and 11 basis points respectively.

The increase in net interest income was mainly attributable to the increase in average interest-earning assets, which was mostly offset by the drop in net interest margin. Net interest spread narrowed as the decline in average yield of total interest-earning assets outpaced that of deposit costs which were already close to zero and further reduction was limited. The positive impact of the increase in the proportion of loans to customers in the average interest-earning assets as well as the improvement in deposit mix partially offset the decline in net interest spread.

Net Fees and Commission Income

HK$'m	**2009**	2008
Investment and insurance fee income	**3,886**	2,964
Securities brokerage		
– Stockbroking	**3,638**	2,380
– Bonds	**39**	259
Funds distribution	**97**	218
Life insurance*	**112**	107
Credit cards	**1,511**	1,417
Loan commissions	**922**	513
Bills commissions	**627**	683
Payment services	**495**	486
Account services	**276**	261
Currency exchange	**213**	204
Trust services	**178**	173
General insurance	**100**	102
Correspondent banking	**45**	44
Custody	**36**	45
IPO-related business	**41**	30
Others	**206**	292
Fees and commission income	**8,536**	7,214
Fees and commission expenses	**(2,028)**	(2,035)
Net fees and commission income	**6,508**	5,179

* Fee income from life insurance only included that from the Group's insurance business partner after group consolidation elimination.

Net fees and commission income increased by HK$1,329 million, or 25.7%, to HK$6,508 million, mainly driven by the strong growth in fee income from stock broking of HK$1,258 million, or 52.9%, which is discussed in the next section "Investment and Insurance Business". Loan commissions also recorded a significant growth of HK$409 million or 79.7% as a result of the expansion of the Group's loan portfolio and the increase in contribution from its role as the BOC Group's "Asia-Pacific Syndicated Loan Centre". Fees from the credit card business grew by HK$94 million or 6.6% with the increase in cardholder spending and merchant acquiring volume by 9.4% and 11.4% respectively. Fees income from IPO-related business increased by 36.7% as the Group successfully captured business opportunities arising from the upsurge of IPO activities since September 2009. Fees income from the Group's other traditional banking businesses such as payment services, account services and currency exchange also recorded a steady growth. However, bills commissions decreased by HK$56 million or 8.2%, which was in line with the drop in Hong Kong's external trade during the year. Meanwhile, fees and commission expenses decreased by HK$7 million or 0.3%.

Second Half Performance

Compared to the first half of 2009, net fees and commission income increased by HK$614 million, or 20.8%, in the second half largely because of the increase in fee income from stock broking by HK$388 million, or 23.9%. Loan commissions and fees from the credit card business went up by HK$126 million or 31.7% and HK$101 million or 14.3% respectively. IPO activities flourished since September 2009, driving up the Group's related fee income by HK$39 million. Meanwhile, fees and commission income from payment services, currency exchange, trust services, corresponding banking and custody in general registered double-digit growth over the first half of the year. Fees and commission expenses were up 16.4%, mainly because of higher credit card and stock broking business expenses.

Investment and Insurance Business

HK$'m	**2009**	2008
Investment and insurance fee income		
Securities brokerage		
– Stockbroking	**3,638**	2,380
– Bonds	**39**	259
Funds distribution	**97**	218
Life insurance*	**112**	107
	3,886	2,964
Net operating income/(loss) of BOC Life#		
Net insurance premium income	**7,744**	5,891
Interest income	**1,271**	1,122
Net loss on financial instruments designated at fair value through profit or loss	**(939)**	(136)
Others	**10**	17
Gross operating income of BOC Life#	**8,086**	6,894
Less: net insurance benefits and claims	**(7,286)**	(7,709)
	800	(815)
Total investment and insurance income	**4,686**	2,149
Of which: Life insurance fee income*	**112**	107
Net operating income/(loss) of BOC Life#	**800**	(815)
Total life insurance income/(loss)	**912**	(708)
Investment fee income	**3,774**	2,857
Total investment and insurance income	**4,686**	2,149

* Fee income from life insurance only included that from the Group's insurance business partner after group consolidation elimination.

Before commission expenses.

With the continuous influx of capital and the return of investors' confidence, the capital market began to stabilise and the local stock market turned buoyant since the second quarter of the year. Against this backdrop, the Group's total investment and insurance income increased strongly by HK$2,537 million, or 118.1%, to HK$4,686 million, driven by the increase in fee income from stock broking and the income from BOC Life. The Group continued to enhance its trading platform and seized opportunities arising from increased stock transactions, growing its stock broking income significantly by HK$1,258 million or 52.9%. As for BOC Life, it recorded a net operating income of HK$800 million, versus the loss of HK$815 million in 2008. The significant improvement in BOC Life's performance was mainly attributable to the improved underwriting results. Net insurance premium income increased significantly by HK$1,853 million, or 31.5%, as sales improved following the successful implementation of new product and distribution strategies. During the year, a financial planning team was established to provide professional insurance services for customers by means of in-depth analysis of their specific financial needs. The product mix continued to improve and contributed to the substantial increase of 142.4% in net insurance premium income from regular premium products.

As the demand for structured products and funds remained weak, the Group's fee income from the sales of bonds dropped by HK$220 million, or 84.9%. Commission from funds distribution decreased by HK$121 million, or 55.5%.

Second Half Performance

Compared to the first half of 2009, total investment and insurance income increased by HK$536 million, or 25.8%. Investment and insurance fee income grew by HK$404 million, or 23.2%, as market demand increased with the improvement of market sentiments in the second half of the year. Fee income from stock broking rose by HK$388 million or 23.9%. Benefiting from the Group's role as the joint lead manager and bookrunner as well as placing Bank for a number of RMB bond issues, fee income from the distribution of bonds increased. Fee income from the distribution of funds also rose, driven by the sales of open-ended funds. The net operating income of BOC Life increased by HK$132 million, or 39.5%. The increase was mainly attributable to the strong growth of net insurance premium income following the establishment of the financial planning team in April 2009 and the mark-to-market gain of certain debt securities caused by the narrowing of credit spread during the period.

Net Trading Income

HK$'m	**2009**	2008
Foreign exchange and foreign exchange products	**1,273**	1,809
Interest rate instruments	**62**	(127)
Equity instruments	**26**	119
Commodities	**124**	113
Net trading income	**1,485**	1,914

Net trading income was HK$1,485 million, down HK$429 million or 22.4% year-on-year, mainly due to the decrease of HK$536 million, or 29.6%, in the net trading income from foreign exchange and related products, but this was partially counterbalanced by the increase of HK$189 million in net trading income from interest rate instruments. The decrease in foreign exchange income was mainly attributable to the decline in RMB-related foreign currency transactions as the market's anticipation of the RMB's appreciation cooled off and the business volume of structured deposits also saw a reduction. Net trading income from interest rate instruments rose as a result of the mark-to-market gain of interest rate swap contracts versus the mark-to-market loss in 2008. Net trading income from equity instruments decreased by HK$93 million or 78.2% mainly as a result of the decline in income from equity-linked products as market demand for related products was weak.

Second Half Performance

Compared to the first half of 2009, net trading income declined by HK$293 million or 33.0% in the second half of the year. The decrease was mainly attributable to the loss from foreign exchange swap contracts*, compared to a gain recorded in the first half. Should the drop in income from foreign exchange swap contracts be excluded, the net trading income from foreign exchange and foreign exchange products would have increased by 10.5%.

* Foreign exchange swap contracts are usually used for the Group's liquidity management and funding activities. Under the foreign exchange swap contracts, the Group exchanges one currency (original currency) for another (swapped currency) at the spot exchange rate (spot transaction) and commits to reverse the spot transaction by exchanging the same currency pair at a future maturity at a predetermined rate (forward transaction). In this way, surplus funds in original currency are swapped into another currency for liquidity and funding purposes without any foreign exchange risk. The exchange difference between the spot and forward contracts is recognised as foreign exchange gain or loss (as included in "net trading income"), while the corresponding interest differential between the surplus funds in original currency and swapped currency is reflected in net interest income.

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

HK$'m	**2009**	2008
Banking business of the Group	**261**	(316)
BOC Life	**(939)**	(136)
Total net loss on financial instruments designated at FVTPL	**(678)**	(452)

Net loss on financial instruments designated at FVTPL increased by HK$226 million or 50.0%, mainly due to the mark-to-market loss of debt securities of BOC Life in 2009 caused by the rebound of long-term market interest rates from exceptional low level at the end of 2008. The loss was more than offset by the corresponding decrease in policy reserves, as reflected in the decrease in net insurance benefits and claims, attributable to market interest rate movement.

Second Half Performance

Compared to the net loss of HK$1,395 million recorded in the first half of 2009, the Group recorded a net gain of HK$717 million on financial instruments designated at FVTPL in the second half of 2009. This was mainly attributable to the mark-to-market gain of certain debt securities investments of BOC Life in the second half of 2009 caused by the rapid narrowing of credit spread versus a mark-to-market loss in the first half.

Operating Expenses

HK$'m, except percentage amounts	**2009**	2008
Staff costs	**5,091**	4,554
Premises and equipment expenses (excluding depreciation)	**1,160**	1,076
Depreciation on owned fixed assets	**1,018**	992
Other operating expenses	**1,594**	1,380
Core operating expenses	**8,863**	8,002
Expenses incurred on Lehman Brothers related products#	**3,278**	769
Total operating expenses	**12,141**	8,771
Cost-to-income ratio	**46.60%**	34.36%
Core cost-to-income ratio	**34.02%**	31.35%

\# including the related legal expenses

The Group's total operating expenses increased by HK$3,370 million, or 38.4%, to 12,141 million which included expenses incurred on Lehman Brothers related products totalling HK$3,278 million. An amount of HK$769 million was recorded in 2008 relating to the Lehman Brothers related products. Should such expenses be excluded for both 2009 and 2008, the Group's core operating expenses would have increased by HK$861 million or 10.8% while the core cost-to-income ratio would have risen by 2.67 percentage points to 34.02% in 2009.

The Group continued to streamline its costs in 2009 by implementing a number of cost containment measures. As the market environment showed clearer signs of improvement in the second half of the year, the Group invested and incurred additional business-related expenses, such as promotion and marketing, so that the Group would be in a better position to capture emerging business opportunities and drive business growth from the economic recovery.

Staff costs increased by HK$537 million, or 11.8%, primarily due to higher performance-related remuneration and more human resources inputs to its Mainland operation. Compared to the end of 2008, headcount measured in full-time equivalents fell by 219 to 13,244 at the end of 2009.

Premises and equipment expenses increased by HK$84 million or 7.8% mainly because of higher rental for branches in Hong Kong and new branches in the Mainland.

Depreciation on owned fixed assets rose by HK$26 million, or 2.6%, to HK$1,018 million due to the increase in computer equipment as the Group continued its infrastructure improvement.

Other operating expenses increased by HK$214 million or 15.5% to HK$1,594 million.

Second Half Performance

Compared to the first half of 2009, total operating expenses rose by HK$3,753 million, or 89.5%, primarily due to expenses incurred on Lehman Brothers related products. Should these expenses be excluded, operating expenses would have increased by HK$919 million or 23.1% due to higher staff costs and promotional expenses.

Net Charge of Loan Impairment Allowances

HK$'m	**2009**	2008
Net (charge)/reversal of loan impairment allowances		
Individual assessment		
– new allowances	**(391)**	(813)
– releases	**150**	83
– recoveries	**446**	722
Collective assessment		
– new allowances	**(358)**	(691)
– releases	**15**	10
– recoveries	**35**	28
Net charge to Income Statement	**(103)**	(661)

In 2009, the Group's loan quality continued to improve. The net charge of loan impairment allowances dropped significantly by HK$558 million or 84.4% to HK$103 million. New allowances from both individual and collective assessment declined but were partially offset by the decrease in loan recoveries.

New individual impairment allowances was HK$391 million, down HK$422 million from HK$813 million recorded in 2008.

New collective impairment allowances was HK$358 million, down HK$333 million from HK$691 million registered in 2008. The overall asset quality of loans and advances improved in 2009.

Recoveries in individual assessment amounted to HK$446 million, down HK$276 million from 2008.

Second Half Performance

The Group recorded a net charge of loan impairment allowances of HK$163 million in the second half of 2009 relative to a net reversal of HK$60 million in the first half of the year. Net charge of loan impairment allowances from collective assessment increased as a result of the expansion of the loan portfolio and refinement of the assessment methodology in the second half of the year. Meanwhile, higher net charge of loan impairment allowances from individual assessment was recorded in the second half of the year due to certain new impaired loans.

Net Reversal/(Charge) of Impairment Allowances on Securities Investments

HK$'m	**2009**	2008
Held-to-maturity securities	**690**	(4,061)
Available-for-sale securities	**612**	(7,839)
Net reversal/(charge) of impairment allowances on securities investments	**1,302**	(11,900)

The stabilisation of the capital markets since the second quarter of 2009 had a favourable impact on the Group's securities investments and hence the related provisions. The Group took active steps to reduce the overall credit risk of its investment portfolio by disposing of higher-risk securities, including impaired US non-agency RMBS, resulting in the write-back of impairment allowances. Meanwhile, an improved investing climate also led to fewer newly impaired securities and hence lower charge of impairment allowances. As a result, the Group recorded a net reversal of impairment allowances on securities investments of HK$1,302 million in 2009 versus a net charge of HK$11,900 million in 2008. The Group's total net charge of impairment allowances in 2008 included a charge of HK$2,730 million against its investments in Bank of East Asia, Limited ("BEA") for the depreciation of its share price. The share price of BEA rose subsequently and was higher at the end of 2009 relative to the end of 2008. However, according to accounting policies, the favourable change in fair value has been made through the reserve for fair value changes of available-for-sale securities within equity. The table below illustrates the breakdown of the Group's net reversal/(charge) of impairment allowances against its securities investments in 2009 and 2008.

HK$'m	2009	2008
US non-agency residential mortgage-backed securities		
Subprime	**30**	522
Alt-A	**16**	(1,734)
Prime	**1,140**	(7,041)
	1,186	(8,253)
Other debt securities	**116**	(917)
Sub-total	**1,302**	(9,170)
Investments in Bank of East Asia, Limited	**–**	(2,730)
Total net reversal/(charge) of impairment allowances on securities investments	**1,302**	(11,900)

For details about the composition of the Group's investment securities portfolio, and the impairment and provisioning policies on investments, please refer to Note 28, Note 2 and Note 3 to the Financial Statements.

Second Half Performance

In the second half of 2009, the Group recorded a net reversal of impairment allowances of HK$2,470 million versus a net charge of HK$1,168 million in the first half of the year. This was primarily attributable to the Group's disposal of US non-agency RMBS in the second half of the year as market sentiments improved.

Property Revaluation

HK$'m	2009	2008
Net gain/(loss) on fair value adjustments on investment properties	**1,554**	(132)
Deferred tax (charge)/credit	**(237)**	93
Net gain/(loss) on fair value adjustments on investment properties, after tax	**1,317**	(39)
Net gain/(loss) on revaluation of premises	**15**	(24)
Deferred tax (charge)/credit	**(2)**	4
Net gain/(loss) on revaluation of premises, after tax	**13**	(20)

The aggregate impact of property revaluation before tax on the income statement in 2009 was a gain of HK$1,569 million, which comprised a net gain of HK$1,554 million from the revaluation of investment properties and a net gain of HK$15 million from the revaluation of premises. The related deferred tax charge on revaluation of investment properties amounted to HK$237 million. As a result, the net impact of fair value adjustments on investment properties on the Group's profit attributable to the equity holders in 2009 was a gain of HK$1,317 million. The net gain on property revaluation was in line with the rebound of property prices in 2009.

Second Half Performance

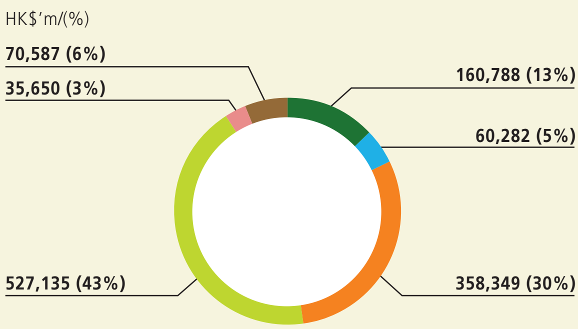
A net gain of HK$872 million from the revaluation of investment properties after tax was recorded, up HK$427 million from the first half of 2009.

Financial Position

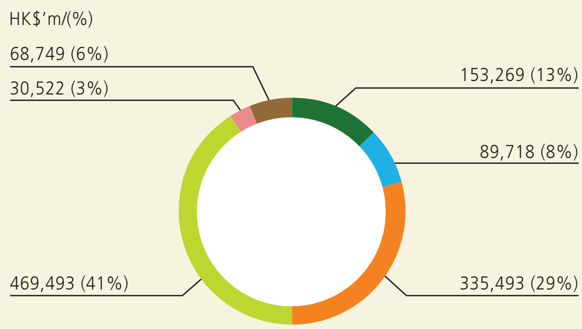
HK$'m, except percentage amounts	**At 31 December 2009**	At 31 December 2008
Cash and balances with banks and other financial institutions	**160,788**	153,269
Placements with banks and other financial institutions maturing between one and twelve months	**60,282**	89,718
Hong Kong SAR Government certificates of indebtedness	**38,310**	34,200
Securities investments[1]	**358,349**	335,493
Advances and other accounts	**527,135**	469,493
Fixed assets and investment properties	**35,650**	30,522
Other assets[2]	**32,277**	34,549
Total assets	**1,212,791**	1,147,244
Hong Kong SAR currency notes in circulation	**38,310**	34,200
Deposits and balances of banks and other financial institutions	**99,647**	88,779
Deposits from customers	**842,321**	802,577
Debt securities in issue at amortised cost[3]	**–**	1,042
Insurance contract liabilities	**33,408**	28,274
Other accounts and provisions[4]	**66,694**	80,501
Subordinated liabilities[5]	**26,776**	27,339
Total liabilities	**1,107,156**	1,062,712
Minority interests	**2,733**	1,813
Capital and reserves attributable to the equity holders of the Company	**102,902**	82,719
Total liabilities and equity	**1,212,791**	1,147,244
Loan-to-deposit ratio[6]	**60.98%**	56.74%

1 Securities investments comprise investment in securities and financial assets at fair value through profit or loss.
2 Interests in associates, deferred tax assets and derivative financial instruments are included in other assets.
3 Debt securities in issue at amortised cost represents the notes issued under the Group's notes programme.
4 Financial liabilities at fair value through profit or loss, derivative financial liabilities, current tax liabilities and deferred tax liabilities are included in other accounts and provisions.
5 Subordinated liabilities represent the subordinated loans granted by the Group's parent bank, Bank of China Limited.
6 Of which deposits from customers also include structured deposits reported as "Financial liabilities at fair value through profit or loss".

Balance Sheet Mix as at 31 December 2009



Balance Sheet Mix as at 31 December 2008



- Cash and balances with banks and other financial institutions
- Placements with banks and other financial institutions maturing between one and twelve months
- Securities investments
- Advances and other accounts
- Fixed assets and investment properties
- Other assets

The Group's total assets were HK$1,212,791 million as at 31 December 2009, up HK$65,547 million or 5.7% from the end of 2008. The overall assets structure of the Group further improved with growth in higher-yielding assets such as advances to customers as well as securities investments. Key changes include:

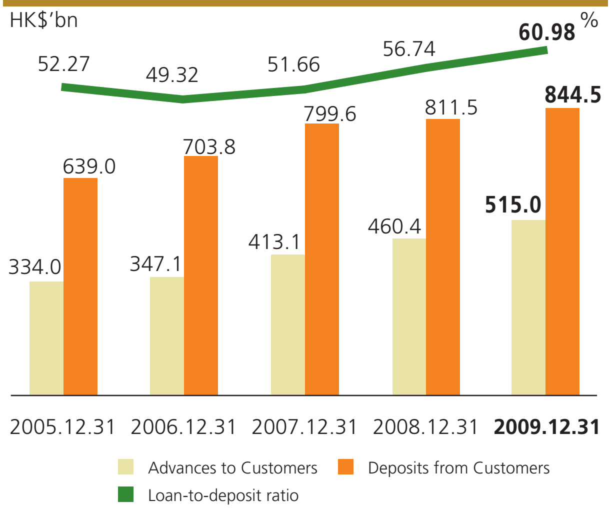
- Cash and balances with banks and other financial institutions increased by HK$7,519 million or 4.9% mainly due to the increase in balances with central banks including RMB deposits from participating banks placed with the PBOC.

- Placements with banks and other financial institutions maturing between one and twelve months decreased by HK$29,436 million, or 32.8%, as the Group redeployed its funds to advances to customers and debt securities investments.

- Advances and other accounts increased by HK$57,642 million, or 12.3%, mainly due to the growth of advances to customers by HK$54,525 million or 11.8%.

- Securities investments increased by HK$22,856 million or 6.8%. The Group actively disposed of higher-risk securities and expanded its investments in government-related and government-guaranteed securities. As at 31 December 2009, the carrying value of the Group's total exposure to US non-agency RMBS dropped significantly by 80.4% to HK$3.8 billion from HK$19.3 billion as at the end of 2008. The reduction in exposure was mainly attributable to active disposal and consistent repayment.

Advances to customers and deposits from customers*



* Deposits from customers including structured deposits

Advances to Customers

HK$'m, except percentage amounts	At 31 December 2009	%	At 31 December 2008	%
Loans for use in Hong Kong	**381,394**	**74.1**	336,597	73.1
Industrial, commercial and financial	**224,261**	**43.6**	188,774	41.0
Individuals	**157,133**	**30.5**	147,823	32.1
Trade finance	**29,321**	**5.7**	24,555	5.3
Loans for use outside Hong Kong	**104,257**	**20.2**	99,295	21.6
Total advances to customers	**514,972**	**100.0**	460,447	100.0

Notwithstanding a general sluggishness in loan demand in the Hong Kong market, the Group's total advances to customers rose strongly by HK$54,525 million or 11.8% to HK$514,972 million. This was attributable to the Group's proactive business strategies, effective marketing activities as well as the Bank's vital role as the "Asia-Pacific Syndicated Loan Centre" of the BOC Group.

Loans for use in Hong Kong grew by 13.3%.

- Lending to the industrial, commercial and financial sectors increased by HK$35,487 million, or 18.8%, to HK$224,261 million, covering a wide range of industries.
- Residential mortgage loans (excluding those under the Government-sponsored Home Ownership Scheme) were up HK$10,905 million, or 9.4%, to HK$127,208 million. This was the result of the Group's effective marketing efforts as well as greater demand in the property market in the second half of 2009.
- Card advances increased by HK$795 million, or 12.1%, to HK$7,348 million, which was in line with the increase in cardholder spending.

Trade finance recorded a robust growth of 19.4% or HK$4,766 million despite the decline in Hong Kong's merchandised trade in 2009. This outstanding performance was mainly attributable to the Group's enhanced service platform as well as the strong demand for commodities from the Mainland.

Loans for use outside Hong Kong increased by HK$4,962 million or 5.0% due mainly to the growth in the loan business of the Group's Mainland operation.

Second Half Performance

Compared to the first half of the year, the growth momentum of the Group's lending business was further strengthened in the second half of the year. By capturing the opportunities arising from the economic recovery, the Group's total advances to customers rose strongly by HK$39,408 million, or 8.3 %, in the second half of the year.

Deposits from Customers*

HK$'m, except percentage amounts	**At 31 December 2009**	**%**	At 31 December 2008	%
Demand deposits and current accounts	**65,440**	**7.7**	46,042	5.7
Savings deposits	**495,512**	**58.7**	377,273	46.5
Time, call and notice deposits	**281,369**	**33.3**	379,262	46.7
	842,321	**99.7**	802,577	98.9
Structured deposits	**2,132**	**0.3**	8,939	1.1
Deposits from customers	**844,453**	**100.0**	811,516	100.0

* including structured deposits

Deposits from customers increased by HK$32,937 million, or 4.1%, to HK$844,453 million, with an improved deposit mix. Demand deposits and current accounts increased significantly by HK$19,398 million, or 42.1%. Savings deposits rose by HK$118,239 million, or 31.3%. Time, call and notice deposits were down HK$97,893 million, or 25.8% as customers switched their funds to more liquid savings deposits as well as demand deposits and current accounts under the low interest rate environment. Structured deposits, a hybrid of retail deposit and derivatives offering a higher nominal interest rate, dropped by HK$6,807 million, or 76.1%. The Group's loan-to-deposit ratio was up 4.24 percentage points to 60.98% at the end of 2009 as total loan growth outpaced deposit growth.

Second Half Performance

Deposits from customers increased by HK$19,709 million, or 2.4% in the second half of 2009. The changes in the deposit mix were consistent with the full-year changes with increments in demand deposits and current accounts as well as savings deposits which increased by HK$5,920 million, or 9.9% and HK$45,452 million, or 10.1% respectively. Time, call and notice deposits decreased by HK$30,028 million, or 9.6% while structured deposits declined by HK$1,635 million, or 43.4% in the low interest rate environment.

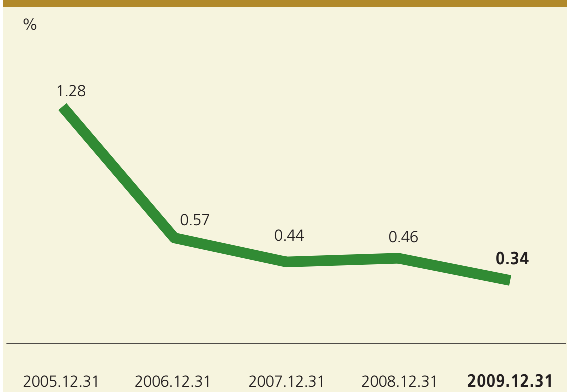
Loan Quality

HK$'m, except percentage amounts	At 31 December 2009	At 31 December 2008
Advances to customers	**514,972**	460,447
Classified or impaired loan ratio[1]	**0.34%**	0.46%
Impairment allowances	**2,269**	2,301
Regulatory reserve for general banking risks	**4,040**	4,503
Total allowances and regulatory reserve	**6,309**	6,804
Total allowances as a percentage of advances to customers	**0.44%**	0.50%
Total allowances and regulatory reserve as a percentage of advances to customers	**1.23%**	1.48%
Impairment allowances on classified or impaired loan ratio[2]	**39.57%**	38.96%
Residential mortgage loans[3] – delinquency and rescheduled loan ratio[4]	**0.04%**	0.05%
Card advances – delinquency ratio[4,5]	**0.23%**	0.29%

	2009	2008
Card advances – charge-off ratio[5,6]	**2.69%**	2.22%

1 Classified or impaired loans represent advances which have been classified as "substandard", "doubtful" or "loss" under the Group's classification of loan quality, or individually assessed to be impaired.
2 Including impairment allowances on loans classified as "substandard", "doubtful" or "loss" under the Group's classification of loan quality, or individually assessed to be impaired.
3 Residential mortgage loans exclude those under the Home Ownership Scheme and other government-sponsored home purchasing schemes.
4 Delinquency ratio is measured by a ratio of total amount of overdue loans (more than three months) to total outstanding loans.
5 Excluding Great Wall cards and computed according to the HKMA's definition.
6 Charge-off ratio is measured by a ratio of total write-offs made during the year to total card receivables as at the end of the year.

Classified or impaired loan ratio*



* Ratio as of 2005.12.31 being the classified loan ratio

The Group's loan quality further improved with its classified or impaired loan ratio falling by 0.12 percentage point to 0.34%. Classified or impaired loans decreased by approximately HK$369 million, or 17.3%, to HK$1,769 million mainly due to write-offs and collections. New classified loans in 2009 represented approximately 0.3% of total loans outstanding.

Total impairment allowances, including both individual assessment and collective assessment, amounted to HK$2,269 million. Total impairment allowances in respect of the classified or impaired loans as a percentage of total classified or impaired loans was 39.57%.

The quality of the Group's residential mortgage loans continued to improve with the combined delinquency and rescheduled loan ratio falling by 0.01 percentage point to 0.04% at the end of 2009. The charge-off ratio of card advances rose by 0.47 percentage point to 2.69% in 2009 mainly due to the general deterioration of cardholders' debt servicing capability in the overall economic downturn in the first half of the year.

Capital and Liquidity Ratios

HK$'m, except percentage amounts	**At 31 December 2009**	At 31 December 2008
Core capital	**72,465**	65,172
Deductions	**(334)**	(1,536)
Core capital after deductions	**72,131**	63,636
Supplementary capital	**32,638**	32,675
Deductions	**(334)**	(1,536)
Supplementary capital after deductions	**32,304**	31,139
Total capital base after deductions	**104,435**	94,775
Risk-weighted assets		
Credit risk	**578,374**	545,107
Market risk	**12,023**	9,097
Operational risk	**47,352**	44,144
Deductions	**(17,954)**	(12,273)
Total risk-weighted assets	**619,795**	586,075
Capital adequacy ratios (consolidated basis)		
Core capital ratio	**11.64%**	10.86%
Capital adequacy ratio	**16.85%**	16.17%

	2009	2008
Average liquidity ratio	**40.18%**	41.74%

The Group adopted the Standardised Approach in calculating capital adequacy ratios.

Consolidated capital adequacy ratio of the banking group at 31 December 2009 was 16.85%, up 0.68 percentage point from the end of 2008. Total capital base expanded by 10.2% to HK$104,435 million following the increase in retained earnings and decrease in the deficit value of reserve for fair value changes of available-for-sale securities. The increase in capital base was also attributable to the decrease in deductions as a result of the Group's active disposal of US non-agency RMBS during the year. Meanwhile, risk-weighted assets for credit risk increased by 6.1% to HK$578,374 million with the growth in advances to customers. Risk-weighted assets for market risk increased by 32.2% mainly due to increase in volume of the trading book business.

The average liquidity ratio in 2009 remained strong at 40.18%.

BUSINESS REVIEW

2009 Business Highlights

Business Focuses	2009 Highlights
Personal Banking • To grow on the Group's core strengths and fortify leading position in retail banking business • To review and adjust the Group's wealth management business strategy in response to the changing operating and regulatory environment • To extend wealth management and cross-border services to Mainland customers • To foster closer cooperation with BOC • To grow individual RMB businesses in Hong Kong by capitalising on the Group's market leadership	• Maintained leading position in residential mortgage with 9.4% growth in outstanding mortgage loans • Stock brokerage business grew strongly by 45.0% in transaction volume versus a decline registered in the market • Revamped wealth management model and sales culture, focusing on client needs and offering tailor-made wealth management products and professional financial planning services • Worked closely with BOC in providing Mainland customers with cross-border wealth management services and comprehensive banking services • Kick started various projects with BOC: "Asia-Pacific Personal Finance Product Centre"; "Overseas Banking Card Business" and "Customer Hotline Centre" • Led the Hong Kong market in issuing RMB and HKD dual currency credit cards with total reaching around 400,000 • Being the joint lead manager, bookrunner and placing bank for the issue of the first RMB sovereign bonds as well as the majority of other RMB bonds in Hong Kong
Corporate Banking • To deepen customer relationship and develop businesses with major enterprises and SMEs while exercising prudent risk management • To develop closer collaboration with BOC to better serve customers and extend the Group's presence outside Hong Kong • To enhance business capabilities to provide "Total Solution" services • To seize new opportunities from the expanding scope of the offshore RMB business	• A strong growth of 14.5% in corporate loans over the end of 2008, significantly outperforming the market • Actively promoted SME business and participated in the HKSAR Government's "Loan Guarantee Schemes" • Consolidated its top position in the Hong Kong-Macau syndicated loan market • Strengthened cash management service platform through expansion of direct network connection with BOC's platform • Being the "Asia-Pacific Syndicated Loan Centre" for BOC, the Group achieved significant business penetration in the Asia-Pacific region and contributed to the top position of BOC in the Asia-Pacific syndicated loan market • Provided one-stop services to BOC Group's major customers through "Global Relationship Manager Programme" and "Global Unified Facilities Arrangement" • Pioneered the first cross-border RMB trade settlement in Hong Kong, expanded the Group's service scope and product offerings and extended RMB trade settlement services to ASEAN countries

Business Focuses	2009 Highlights
Treasury • To maintain proactive management of the banking book and adjust the investment mix in response to market changes • To optimise risk-adjusted return in accordance with market trends • To focus on traditional investment products for personal customers and cross-border investments for corporate customers for hedging and investment purposes	• Increased investment in fixed-rate government-related securities with longer duration for yield enhancement • Selectively disposed of higher-risk US non-agency RMBS and credit securities. Significantly reduced exposure to US non-agency RMBS by 80.4% from the end of 2008 • Achieved promising results from offering traditional products in foreign exchange and precious metals to retail customers. Trading volume of RMB non-deliverable forward contracts from corporate customers reached a record high
Insurance • To implement a new life insurance business model with a greater focus on "need-based selling", serving customers' needs in different life stages, to be complemented by new product lines • To significantly improve sales of regular-premium products to secure stable return and enlarge revenue stream • To revise the risk management strategy with emphasis on risk diversification and proactive asset and liability management	• Implemented and expanded a new financial planning model with promising results • Net insurance premium income of regular premium products rose by 141.8 % over 2008 • Remarkable improvement in market share and market ranking in terms of total standard new business premium • Established the target solvency framework and refined the solvency at risk governance in accordance with the regulatory solvency margin requirement
Mainland Business • To ensure smooth integration of the Group's branches in the Mainland, establish NCB (China) as the primary brand and enlarge its business operation • To enhance the Group's business platform and expand product and service offerings to both corporate and personal customers	• Completed the restructuring of BOCHK's branches and sub-branches in the Mainland under NCB (China) • Expanded the network with 5 new branches and sub-branches • Accelerated personal banking development through enrichment of product range in debit cards, deposits, mortgages, wealth management services and cross-border attestation service • Total advances to customers recorded an encouraging growth

2010 Business Focuses

The Group will continue to safeguard its financial strength and upgrade its core competences in key business segments. In Personal Banking, the Group will continue to capitalise on its strong franchise and provide a wider range of mortgage products to solidify its market leadership. As for wealth management, the Group will continue to grow its stock broking business and revamp its business model for wealth management products to focus on customers' needs. The Group will also work closely with BOC to extend its banking services to Mainland customers.

For Corporate Banking, the Group will deepen its relationship with corporate customers to create more cross-selling opportunities. While further strengthening its leading position in the local corporate loans market, the Group will strive to grow its corporate lending prominently in the Mainland and the Asia-Pacific area through closer collaboration with BOC. It will further strengthen the "Global Relationship Manager" platform and maintain its market leadership in the syndicated loan business by consolidating its strategic position as BOC's "Asia-Pacific Syndicated Loan Centre". To capture opportunities arising from the expanding scope of offshore RMB business, the Group will focus on developing more featured and comprehensive RMB products and services in RMB trade settlement and financing services.

The Group will continue to adopt a prudent approach in managing its banking book investments. At the same time, it will establish a customer-oriented model in developing treasury products to cater for customers' needs. It will facilitate BOC in extending its treasury business to the Asia-Pacific region and overseas.

In respect of its insurance business, the Group aims to capture growth opportunities from its Bancassurance model. It will improve its product mix to meet the needs of customers and the new financial planning teams will operate at more branches.

In the Mainland, the Group will continue to expand its corporate banking business by acquiring deposits and placing advances. At the same time, it will continue to accelerate its retail banking business development by focusing on cross-border and local customers. It will actively promote its cross-border wealth management business and reinforce its marketing efforts in major cities.

The following section provides a review of the Group's business lines together with their respective financial results in 2009.

PERSONAL BANKING

HK$'m, except percentage amounts	**2009**	2008	Increase/ (decrease)
Net interest income	**5,795**	6,511	-11.0%
Other operating income	**4,853**	4,179	+16.1%
Operating income	**10,648**	10,690	-0.4%
Operating expenses	**(5,983)**	(5,669)	+5.5%
Operating profit before impairment allowances	**4,665**	5,021	-7.1%
Net charge of loan impairment allowances	**(150)**	(120)	+25.0%
Others	**(11)**	(9)	+22.2%
Profit before taxation	**4,504**	4,892	-7.9%

	At 31 December 2009	At 31 December 2008	Increase/ (decrease)
Segment assets	**178,026**	165,148	+7.8%
Segment liabilities	**570,566**	523,682	+9.0%

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

Financial Results

Personal Banking recorded a profit before taxation of HK$4,504 million in 2009. Despite the downward pressure on net interest income, operating income was maintained at the same level as the previous year as there was a strong growth in other operating income in 2009. Operating profit before impairment allowances declined by 7.1% to HK$4,665 million due to the increase in operating costs.

Net interest income decreased by 11.0% to HK$5,795 million, mainly due to narrower deposits spread in the low interest rate environment. Other operating income increased by 16.1% to HK$4,853 million, primarily driven by the strong growth in fee income from stock broking. This increase was partially offset by the decline in fee income from the distribution of funds and sales of bonds as well as the decrease in net trading income from foreign exchange activities as related business volumes were affected by weak demand.

Operating expenses were up 5.5% to HK$5,983 million, mainly due to increase in staff costs. Rental expenses for branches also increased.

Net charge of loan impairment allowances rose by 25.0% to HK$150 million, mainly due to the growth of credit card receivables and the general deterioration of cardholders' debt servicing capability in the overall economic downturn in the first half of the year.

Advances and other accounts, including mortgage loans and cards advances, increased by 6.7% to HK$162,422 million. Customer deposits rose by 8.4% to HK$542,652 million.

Business Operation

Personal Banking made good progress in business development and attained solid growth in the stock broking, residential property mortgage, credit card and RMB banking businesses in 2009. Despite very keen competition in the mortgage business, the Group grew its mortgage lending and maintained its leading market position. It also achieved impressive results in both stock broking and IPO activities. Not only did it maintain its leading position in the RMB banking business in Hong Kong, it also expanded its RMB-related business in the Asia-Pacific region by working closely with BOC.

Regaining growth momentum in residential property mortgage

With the revival of the local property market since the second quarter of 2009, the Group succeeded in capturing new business opportunities and achieving an increase in the underwriting of new residential mortgage loans through effective marketing and the offering of a wide array of mortgage products. During the year, the Group launched the "Fixed-Rate Mortgage Schemes" to meet the different financial needs of customers. In addition, the Group refined the HIBOR-based mortgage scheme by allowing customers to follow more closely movements in market interest rates. In response to the government's offer of unsold and returned Home Ownership Scheme ("HOS") flats in the last quarter of 2009, the Group tailored promotion plans with on-site sales promotion and advertising campaigns which were supported by various attractive offers. The Group also strengthened its co-operative relationship with major property developers by actively participating in the newly launched properties campaigns, and achieved satisfactory results in prime property development projects through joint promotions. Meanwhile, the Group enhanced its online service platform in the second half of 2009 by launching a number of new functions. These initiatives helped sustain the Group's leading position in the underwriting of new mortgages. By the end of 2009, the Group's outstanding residential mortgage loans grew by 9.4% year-on-year. During the year, the Group maintained its rigorous risk assessment and control over its mortgage business. The credit quality of residential mortgages remained sound with the delinquency and rescheduled loan ratio for 2009 falling further to 0.04% from 0.05% in 2008.

Robust expansion of investment and insurance business

Supported by its strong distribution network and trading platform as well as effective marketing strategies, the Group was able to capture business opportunities arising from the rebound of the local stock market. During the year, the Group launched a series of promotion and marketing campaigns including radio programme sponsorships and investment seminars. Various promotion programmes were offered to attract different targeted segments of stock-trading customers. The Group also bundled promotional offers with "Wealth Management" and "i-Free Integrated Account Service" to acquire new stock-trading customers. At the same time, the Group implemented the "Share Margin e-Approval Flow System" which helped shorten account opening time by simplifying the overall approval flow. As a result, the volume of the Group's stock broking business in 2009 surged by 45.0% with an encouraging increase in market share. In 2009, the Group also successfully acted as the major receiving bank for 22 IPOs in Hong Kong.

Regarding its Bancassurance business, the Group continued with a customer-oriented approach by upgrading its services and broadening its product spectrum by introducing core products with guaranteed value and protection element for customers. These products included the "5-Year Joyful Life Insurance Plan", "Target 5 Year Insurance Plan" and "Long Life and Harvest Year Plan". The Group also launched a new medical protection product, "BOC Medical Comprehensive Protection Plan". Meanwhile, the Group refined the "Universal Travel Insurance" plan by offering customers with better protection and pricing. The Group enhanced its brand image and market awareness by rolling out a series of marketing campaigns and rewarding customers with incentives, the response to which was overwhelming.

Expanding high net-worth customer base and entrenching service foothold in the Mainland

The Group continued with its customer segmentation strategy and further expanded its high net-worth customer base. During the year, the Group introduced the "New Customer Engagement Programme" and launched a series of "Wealth Management Acquisition Campaigns" to acquire new customers. At the same time, the Group developed an "Anti-attrition Model" for customer retention and provided tailor-made wealth management solutions to strengthen long-term customer relationship. In the Mainland, the Group worked closely with BOC in providing cross-border wealth management services. It expanded its high net-worth customer base in the Mainland by providing Mainland customers with professional service for better deployment and management of their assets across the border. In addition, the Group enhanced the operating procedures of the "Cross Border Attestation Service" with 187 BOC branches in 17 Mainland cities to raise the overall efficiency. The Group also seized rising opportunities by working closely with branches of BOC in providing comprehensive banking services to Mainland customers under the BOC Global Wealth Management Service and the Capital Investment Entrant Scheme launched by the HKSAR government. Meanwhile, a series of wealth management seminars were organised in 2009 to provide customers with the latest investment market information. By the end of 2009, the total number of wealth management customers* and their assets maintained with the Group grew by 11.9% and 31.2% respectively versus the end of 2008.

* Including Wealth Management VIP and Wealth Management Prime customers

Solid growth in credit card business

Despite the negative impact of the global financial crisis and the outburst of Influenza A (H1N1) in the first half of the year, the Group's credit card business sustained its growth momentum throughout 2009. Card advances and the total number of cards issued grew by 12.1% and 12.7% respectively while cardholder spending rose by 9.4%. The Group maintained its leadership in the acquiring business of the China UnionPay ("CUP") card, with merchant acquiring volume surging by 53.1%, which contributed significantly to the increase of 11.4% in total merchant acquiring volume. Meanwhile, the launch of the "BOC CUP Dual Currency Credit Card" in December 2008 received overwhelming response from customers and the number of new cards issued reached around 400,000 at the end of 2009. Riding on its strong competitive edge in the credit card market, the Group continued to extend appealing merchant offer programmes to customers through its comprehensive merchant network sprawling Hong Kong, Macau and the Mainland. At the same time, the Group introduced the "CUP-Secure Internet Payment Service" to allow merchants to offer secure Internet payment services to their customers particularly in the Mainland. In August 2009, the "CUP Instalment Payment Service" was launched for merchants targeting CUP cards issued in the Mainland. The credit quality of the Group's card advances remained sound with the charge-off ratio standing at 2.69% in 2009.

The Group's success in developing its credit card business in 2009 was widely recognised in the industry, as evidenced by a total of 28 awards received from VISA International, MasterCard and China UnionPay.

Consolidated leadership in providing comprehensive RMB banking business in Hong Kong

The Group remained the market leader in RMB banking business in Hong Kong. During 2009, the Group focused on two RMB integrated services – "RMB Remittance Express" and "RMB Exchange Express" – and launched promotional offers to further boost its RMB deposits. As a result, RMB deposits increased by 16.9% versus 2008. The launch of "BOC CUP Dual Currency Credit Card" in December 2008 to cater for the needs of Hong Kong-Mainland cross-border travelers was well received by customers. During the year, the Group was mandated by the Ministry of Finance of the People's Republic of China ("PRC") as the joint lead manager and bookrunner for its maiden issue of RMB sovereign bonds outside the Mainland. The Group also acted as the joint lead manager, bookrunner and placing bank for the majority of RMB bonds issued in Hong Kong. These achievements reinforced the Group's leading position in the RMB bonds market in Hong Kong.

Meanwhile, the Group continued to work closely with its parent, BOC, to extend its RMB-related business and began conducting RMB business with some BOC branches in the Asia-Pacific region. With BOC's support, the Group kick-started various projects, including the "Asia-Pacific Personal Finance Product Centre"; "Overseas Banking Card Business"; and "Customer Hotline Centre". The Group also set up a framework to deepen its cooperation with BOC in product development and expertise transfer, with the aim of establishing the Group's position as the BOC Group's major production platform and servicing support centre in the Asia-Pacific region.

Channel rationalisation and e-channel development

The optimisation of distribution channels continued to be a strategic focus for the Group in 2009. In response to the changing economic environment and new business opportunities, the Group revamped its branch network to meet the needs of different customer segments. At the end of 2009, the Group's service network in Hong Kong comprised of 272 branches.

To encourage more customers to use the e-platform for transactions and services, the Group launched a large-scale marketing campaign which effectively propelled the growth in Internet banking accounts and transactions. In 2009, the number of Internet banking customers increased by 10.1%. With the support of its efficient platform, stock trading transactions carried out through the e-channels accounted for 76.2% of total transactions. The Group also improved its phone banking services which helped to boost the subscription of the first RMB sovereign bonds in Hong Kong.

The Group continued to enhance its automated banking facilities by installing new ATMs at non-branch locations, as well as increasing the number of cheque deposit machines and cash deposit machines. It also launched the payment collection feature at its cheque deposit machines, which was the first of its kind in the market.

In response to regulatory requirements involving product sales and customer services, the Group enhanced its sale process and had undergone intensive reinforcement courses to its sales staff to ensure their knowledge adequacy and adherence to regulatory requirements. In the meantime, the Group strengthened its customer service training programmes for customer service staff with the aim of enhancing overall service quality and customer experience.

In recognition for its service excellence, the Group was awarded the "Best Internet Banking Award 2009" by Capital, a local financial magazine. The Group's call centre also won a number of awards in The 10th Anniversary of Hong Kong Call Centre Awards 2009 organised by Hong Kong Call Centre Association. These awards included the "Best Contact Centre in Corporate Social Responsibility" and "Outbound Contact Centre of the Year (Under 50 Seats)" gold awards, as well as six other individual awards.

CORPORATE BANKING

HK$'m, except percentage amounts	2009	2008	Increase/ (decrease)
Net interest income	**5,502**	5,949	-7.5%
Other operating income	**2,685**	2,262	+18.7%
Operating income	**8,187**	8,211	-0.3%
Operating expenses	**(2,321)**	(2,143)	+8.3%
Operating profit before impairment allowances	**5,866**	6,068	-3.3%
Net release/(charge) of loan impairment allowances	**47**	(541)	+108.7%
Others	**2**	(3)	+166.7%
Profit before taxation	**5,915**	5,524	+7.1%

	At 31 December 2009	At 31 December 2008	Increase/ (decrease)
Segment assets	**372,443**	324,606	+14.7%
Segment liabilities	**304,882**	309,254	-1.4%

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

Financial Results

Corporate Banking recorded satisfactory financial results in 2009. Profit before taxation grew by 7.1% to HK$5,915 million. The increase was mainly driven by higher other operating income and a decrease in new impairment allowances, though there was a reduction in net interest income and an increase in operating costs.

The decline of 7.5% in net interest income resulted mainly from narrower deposits spread in the low interest rate environment despite an increase in the average balance of loans and advances and improved pricing of new corporate loan facilities under the tightened credit environment. Other operating income rose strongly by 18.7% primarily due to the growth in fee income from the lending business.

Operating expenses increased by 8.3% to HK$2,321 million mainly due to increase in staff costs as well as expenses in relation to the expansion of the branch network in the Mainland.

Net release of loan impairment allowances was HK$47 million in 2009, compared to a net charge of HK$541 million in 2008. The net release in 2009 reflected the improved asset quality of the segment as new impairment allowances significantly declined. The net charge in 2008 was primarily due to the need to cover certain impaired loans amid the economic downturn.

Advances and other accounts increased by 14.6% to HK$370,523 million. Customer deposits fell by 1.4% to HK$301,363 million.

Business Operation

In 2009, Corporate Banking achieved strong business growth despite sluggish market demand. Loans to the industrial, commercial and financial sector in Hong Kong registered a remarkable growth over 2008. Apart from securing several large financing projects, it also grew its SME business by allocating additional resources to help its SMEs customers weather the adverse impact of the global financial crisis. As BOC's "Asia-Pacific Syndicated Loan Centre", it registered strong growth in syndicated loans. It pioneered the first cross-border RMB trade settlement in Hong Kong in early July, and made satisfactory progress in expanding its cash management and custody businesses. While focusing on business growth, the Group also exercised a high degree of prudence in risk management throughout the year to ensure sound asset quality.

Growth in corporate loans surpassing the market

The global economy exhibited the first signs of recovery in 2009 but overall loan demand began to pick up only towards the end of the year. With its strong capital strength and close collaboration made with BOC, the Group adjusted its business strategy to focus more on the financing needs of local and Mainland enterprises. This strategy was highly effective in driving loan growth. Overall corporate loans grew strongly by 14.5% over 2008, outperforming the market as a whole.

The Group not only remained the top mandated arranger in the Hong Kong-Macau syndicated loan market, but also captured a significantly larger market share. Being the "Asia-Pacific Syndicated Loan Centre" for BOC, the Group expanded its business penetration in the Asia-Pacific region and contributed to BOC's elevation to the position of top mandated arranger in the region in 2009. After the successful launch of the first phase in 2008, the second phase of the "Loan Syndication Information Management System" proceeded well in 2009. This new system links up similar networks of the BOC Group's major branches in the Asia-Pacific region, thus strengthening information management and enhancing overall operational efficiency in the region.

Market recognition of SME business

The Group devoted additional resources to promote the "SME Loan Guarantee Scheme" and "Special Loan Guarantee Scheme" launched by the HKSAR Government, helping enterprises to secure loans to weather the impact of the financial crisis. In May 2009, the Group launched the "BOC Octopus Merchant Services", providing merchants with a one-stop cash management solution for customer payment and transaction settlement. The new services were well received, with over 1,000 merchants already enrolled by the end of 2009. In recognition of its quality services and contribution to the SME business, the Group was awarded the "SME's Best Partner Award" for the second consecutive year by the Hong Kong Chamber of Small and Medium Business Limited.

Breakthrough in cross-border trade settlement and finance business

Following the announcement of the "Pilot Scheme for Settlement of Cross-Border Trade in RMB" by the PRC government, the Group pioneered the first of such transactions in Hong Kong through the clearing channel on 6 July 2009. Its expertise in trade services and trade finance in both Mainland and Hong Kong as well as its unique position as the sole RMB clearing bank in Hong Kong provided the Group with a distinctive edge in its launch of comprehensive services in cross-border RMB trade settlement. By the end of 2009, the Group opened over 5,000 RMB trade settlement accounts with corporate customers. The Group also launched RMB trade settlement services for the ASEAN countries during the year, signifying that the Group's RMB banking services are now extended beyond Hong Kong. The Group also launched a number of innovative RMB trade products and services with flexible pricing and business flows to complement its business strategy.

Despite the lacklustre external trade environment, the Group managed to grow its trade finance portfolio. The outstanding balance went up strongly by 19.4% versus 2008, again outperforming the market. During the year, the Group introduced several new trade products with cross-boundary features. Through the revamped Corporate Banking Services Online ("CBS Online") system, the Group provided more online trade services and enhanced credit card account management.

Significant progress in cash management

The Group made significant progress in its cash management business. During the year, the Group's e-banking platform was successfully connected with that of its parent, BOC, as well as its overseas branches so that customers can now conduct account balance enquiry and fund transfers between their accounts in Hong Kong, the Mainland and some countries in the Asia-Pacific region. At the same time, the Group enriched its product offering by introducing new account receivable, account payable and corporate deposit products. It also pioneered the bill payment feature of its Cheque Deposit Machines. In March 2009, the Group was designated as the USD settlement bank in Hong Kong for the Real Time Gross Settlement System linkage between Hong Kong and the Mainland. At the end of 2009, the remittance points of BOC Remittance Plus reached over 3,000 in the Mainland while the service has been extended to some countries in the Asia-Pacific region. The Group also enhanced its investment functions of the Internet banking platform for corporate customers. The number of CBS Online customers surged by 43.4%.

Expanding foothold in custody services

In the first half of the year, the Group actively strengthened its customer relationship and product diversifications to prepare for the economic recovery. With market sentiments becoming more positive in the second half, the Group's custodian business made successful breakthroughs in a number of areas. Firstly, it successfully secured custody business from various PRC Government entities and state-owned banks by processing their overseas investments. Secondly, it became the custodian for a securities broker of Taiwan origin, thus paving the way for more business opportunities from Taiwan. Thirdly, the Group has been accepted as the MPF scheme custodian by a MPF trustee company, only pending formality with the regulatory authority. This means that the Group's custody services now cover MPF assets as well. Lastly, in collaboration with BOC's Shanghai Branch, the Group achieved account opening in Hong Kong for a considerable number of high net-worth individual customers from the Mainland for providing escrow services. Based on the experience gained, this unique service model is likely to be replicated in other cities of the Mainland going forward. At the end of 2009, total assets under the Group's custody were valued at HK$392 billion, representing an increase of 95.9% from the end of 2008.

Closer business collaboration with Bank of China

The Group continued to strengthen the collaboration with its parent, BOC. With the latter's support, the Group implemented the "Global Relationship Manager Programme" and "Global Unified Facilities Arrangement". These schemes enable the Group to consolidate global credit facilities and enhance overall service capability for serving its high-end corporate customers. During the year, a number of enterprises have been selected as trial customers for promoting various trade products. In addition, a mechanism has been built up for enhancing the cooperation with BOC in product development and expertise transfer.

Greater efficiency in managing corporate credit and customer relationship

The Group continued to streamline the credit approval process during 2009 by setting up the "Corporate Credit Management Centre" to enhance the overall efficiency in credit vetting. Through the launch of "Total Solution" services, the Group aims to strengthen relationship with its key corporate customers on the one hand, and improve overall return from selling packaged products on the other. In addition, the Group provided tailor-made marketing strategies to targeted customers and successfully expanded the wealth management and payroll accounts, mortgage, investment and credit card businesses that cater to corporate customers.

Implementation of proactive measures in risk management throughout the credit cycle

In spite of improved market sentiments, the Group continued to exercise stringent risk management. The Group closely monitored corporate customers in various business segments, especially those severely affected by the global economic downturn. The Group strengthened the information sharing mechanism among the three sister banks to enhance overall risk monitoring capabilities. Coupled with enhanced management of credit risks before and after credit approval, the Group could formulate risk mitigation measures at an early stage. Marketing units also stepped up due diligence on potential customers, and enhanced product compliance and risk management.

MAINLAND BUSINESS

Integration and expansion of Mainland business operation

Having obtained the approval of China Banking Regulatory Commission ("CBRC") on 4 May 2009, BOCHK's Mainland branches and sub-branches were restructured under the brand of NCB (China), while the Shanghai Branch was renamed as Nanyang Commercial Bank, Limited's Shanghai Branch for conducting foreign currency wholesale banking business. This restructuring, which came into effect on 1 August 2009, not only enables the Group to fully explore the potential of its Mainland business and capitalise on the Group's unique strengths, but also signifies a major move by NCB (China) to expand its business network.

In 2009, the Group continued to expand its cross-border financial services to serve both personal and corporate customers. With the opening of NCB (China)'s branches and sub-branches in Shanghai Xuhui, Shanghai Lujiazui, Beijing Jianguomen and Chengdu respectively together with the opening of Xiamen Jimen Sub-branch of Chiyu Banking Corporation Limited, the Group's total number of branches and sub-branches in the Mainland reached 23 by the end of 2009. Of these, 18 have been approved to conduct the full range of RMB businesses, 4 can conduct RMB businesses for non-Mainland residents, and the remaining one operates foreign exchange businesses only. With the approval of the CBRC, the Group is in the process of establishing NCB (China)'s Wuxi Branch.

Development of retail banking business gaining momentum

The Group has established business cooperation with a number of insurance companies for cross-selling various general and life insurance products to customers. NCB (China) launched its debit card business in the last quarter of 2009 and by sharing the ATM network of China UnionPay, it has been able to expand its selling channels to retail customers. At the same time, NCB (China) launched a range of deposits products such as "club deposits", "premium product" and "non-standardised fixed deposits". NCB (China) also promoted diversified mortgage products, such as the "All-You-Want Mortgage Scheme", and "overseas studies loans" for retail customers as well as hypothecated loans for export tax rebate for corporate customers. Meanwhile, several newly-launched guaranteed wealth management products were well received by both corporate and retail customers.

Satisfactory growth of customer deposits and advances to customers

In terms of business performance, customer deposits grew by 48.8%, of which RMB deposits increased by 58.7% during 2009. Total advances to customers rose by 14.9%, reversing the decline recorded in the first half of the year, and RMB loans were up 5.1%. Total operating income dropped by 2.8% as improvements in net fees and commission income and other operating income were outweighed by the decline in net interest income. Loan quality remained solid, with the classified loan ratio at 0.44%, down significantly from 0.88% at the end of 2008.

TREASURY

HK$'m, except percentage amounts	**2009**	2008	Increase/ (decrease)
Net interest income	**5,422**	7,178	-24.5%
Other operating income	**982**	879	+11.7%
Operating income	**6,404**	8,057	-20.5%
Operating expenses	**(742)**	(831)	-10.7%
Operating profit before impairment allowances	**5,662**	7,226	-21.6%
Net release/(charge) of impairment allowances on securities investments	**1,302**	(9,170)	+114.2%
Profit/(Loss) before taxation	**6,964**	(1,944)	+458.2%

	At 31 December 2009	At 31 December 2008	Increase/ (decrease)
Segment assets	**593,807**	603,965	-1.7%
Segment liabilities	**195,956**	203,481	-3.7%

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

Financial Results

Treasury's profit before taxation amounted to HK$6,964 million, compared to a loss of HK$1,944 million in 2008. This turnaround was mainly driven by the net release of impairment allowances on securities investments in 2009 versus the substantial net charge in 2008. Operating profit before impairment allowances decreased by 21.6% to HK$5,662 million as a result of the decline in net interest income.

Net interest income fell by 24.5% to HK$5,422 million with the reduction in the contribution of net free fund under the low interest rate environment.

Other operating income increased by 11.7%, primarily attributable to the mark-to-market gain on certain debt securities. This gain was partially offset by the mark-to-market loss on foreign exchange swap contracts and decrease in income from structured deposits.

Operating expenses decreased by 10.7% to HK$742 million because of a decrease in both computer-related expenses and the depreciation charge on computer equipment.

Net release of impairment allowances on securities investment was HK$1,302 million in 2009, versus the net charge of HK$9,170 million in 2008. The net release was mainly due to the write-back of impairment allowances from the disposal of US non-agency RMBS as the Group took advantage of improved market sentiments in 2009 to dispose of higher-risk securities. Meanwhile, improved market sentiments also led to fewer newly impaired securities and hence lower charge of impairment allowances.

Business Operation

Maintaining proactive investment strategy and prudently securing risk-adjusted return

In view of the uncertainty of market conditions and prospects, the Group adopted a more prudent approach in asset and liability management and proactively managed its banking book investments. Taking advantage of the steepening yield curve, the Group expanded its investments in high-quality fixed rate debt securities of government-related and government-guaranteed securities, leading to a stable return amid the low interest rates environment while bearing relatively lower credit and interest rate risk. Meanwhile, as market sentiments improved after the US Government's Public-Private Investment Plan came on stream, the Group reduced the overall credit risk of its investment portfolio by disposing of higher-risk US non-agency RMBS and credit securities. The carrying value of the Group's exposure to US non-agency RMBS dropped drastically by HK$15.5 billion, or 80.4% from the end of 2008 to HK$3.8 billion at the end of 2009. The reduction in exposure was mainly attributable to active disposal and consistent repayment. (Further analysis of the Group's US non-agency RMBS is available in Note 4.1 to the Financial Statements). In addition, the Group increased investments in short-term government securities so as to minimise the credit risk of residual funds and enhance liquidity against contingencies.

From late 2009, the credit crisis in certain European countries resulted in growing concerns over debt securities issued by Portugal, Ireland, Italy, Greece and Spain. Among these countries, the Group only had exposure to debt securities issued by financial institutions of Ireland and Italy amounting to a total of HK$3,217 million as at 31 December 2009. There were no signs of impairment on these debt securities. The Group will continue to monitor the developments of the issues.

More focus on traditional businesses and internal control

While the currency, precious metal and stock markets remained volatile, customers' confidence returned as market sentiments improved, especially in the second half of 2009. Against this backdrop, the Group's strategy of promoting traditional products related to foreign exchange and precious metals received promising results. The Group focused on providing its corporate customers with hedging products linked to foreign exchange and interest rate amid the low interest rate environment. Through BOC, the Group offered its self-developed gold-linked investment products for selling to customers in the Mainland. With the credit support of BOC, the Group provided offshore hedging products to corporate customers with Mainland background. As a result, the trading volume of RMB non-deliverable forward contracts reached a record high during the year. Meanwhile, the Group thoroughly reviewed and updated the relevant internal regulations, selling process and risk disclosure policies for structured treasury products to better safeguard investors' interests. The Treasury Product Committee (the "Committee"), which was set up at the end of 2008, started its operation in 2009. The Committee is responsible for overseeing and strengthening the management of all treasury products offered by the Group. During the year, a series of business strategies and product management guidelines were discussed and approved by the Committee to ensure the Group's business development would be in line with the latest supervisory requirements, best market practices and customer expectation.

INSURANCE

HK$'m, except percentage amounts	**2009**	2008	Increase/ (decrease)
Net interest income	**1,271**	1,122	+13.3%
Other operating income	**6,486**	5,503	+17.9%
Operating income	**7,757**	6,625	+17.1%
Net insurance benefits and claims	**(7,286)**	(7,709)	-5.5%
Net operating income	**471**	(1,084)	+143.5%
Operating expenses	**(176)**	(147)	+19.7%
Profit/(Loss) before taxation	**295**	(1,231)	+124.0%

	At 31 December 2009	At 31 December 2008	Increase/ (decrease)
Segment assets	**37,963**	31,703	+19.7%
Segment liabilities	**35,355**	30,977	+14.1%

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

Financial Results

The Group's Insurance segment recorded a major turnaround in 2009 with a profit before taxation of HK$295 million, versus a loss of HK$1,231 million in 2008. The recovery of the financial markets together with BOC Life's success in service platform enhancement, product development and distribution led to the substantial improvement in BOC Life's business performance in 2009. Net operating income grew strongly to HK$471 million.

Net interest income rose by 13.3%, which was largely driven by the growth of securities investments. Other operating income increased by 17.9% to HK$6,486 million primarily due to the growth of net insurance premium income by 31.5%. Majority of the sales were achieved in the second half of the year following the launch of the financial planning model in April 2009. Rise in long-term market interest rates had an overall positive impact on the profit of the segment. Net loss on financial instruments designated at fair value through profit or loss increased as the market values of debt securities reduced, caused by the rebound of long-term market interest rates from exceptional low level at end of 2008. Nevertheless, the increase in market interest rates has given rise in a corresponding decrease in policy reserve, and hence a decline in net insurance benefits and claims which has offset the negative impact of the market price movement of debt securities.

Operating expenses increased by 19.7%. The increase was due to higher staff costs for the establishment of the financial planning team and higher rental expenses.

Assets in the Insurance segment grew by 19.7% because of the increase in both debt and equity securities which was made possible by the strong growth in premium income. Liabilities rose by 14.1% with the increase in insurance contract liabilities.

Business Operation

Enlargement of product range and significant sales improvement of regular-premium products

In 2009, the Group continued to expand its range of insurance products and services to meet the diverse needs of customers. During the year, a total of 23 new products were launched, primarily focused on retirement and wealth management needs of clients. The continuous product rationalisation reinforced the emphasis on sales of regular-premium products. Net insurance premium income from regular premium products was up 141.8% year-on-year.

Implementation of new Life Insurance business model to focus on "need-based selling"

Following the pilot launch of the new financial planning model at selected branches in April 2009, the Group extended this new model across all branches in different districts, thus enhancing the penetration of the life insurance business among bank customers. While developing the new financial planning model, the Group continued to strengthen its telemarketing sales. A more diversified product portfolio was developed to meet the different needs of various customer segments. All these initiatives contributed to the hefty growth of 31.5 % in premium income.

Improvement of market image and ranking

With the aim of further reinforcing the Group's corporate image in the market, the Group launched large-scale advertising and promotional campaigns with the theme of "Endless Caring" in the second half of 2009 which resulted in overwhelming market response. The TV advertisements played an important part in enhancing the brand awareness of the Group in the insurance segment. The successful performance of the Group in 2009 was reflected in the remarkable improvement in market share and market ranking in terms of standard new business premium.

Capital injection into BOC Life

In July 2009, BOC Hong Kong (Holdings) Limited ("the Company") injected a capital of HK$765 million into BOC Life. The previous capital injection involving HK$255 million was made in June 2008. Both capital injections were financed by the Company's internal resources and paid in cash. After the capital injections, BOC Life remains 51% held by the Company and 49% by Bank of China Group Insurance Co. Ltd.. The strengthened capital base will support BOC Life future growth and development.

REGULATORY DEVELOPMENT

Basel II Capital Accord

Since the introduction of Basel II regulatory framework for compliance by Hong Kong banks in 2007, the Group has adopted the Standardised Approach to calculate statutory minimum capital requirement on credit risk, market risk and operational risk under Pillar One. The Group intends to gradually upgrade to the Foundation Internal Ratings-Based approach to calculate non-retail credit exposures and Advanced Internal Ratings-Based approach to calculate retail credit exposures. Both are more risk-sensitive approaches for the calculation of the regulatory capital requirements. During 2009, the Group completed the development of most of the Internal Ratings-Based ("IRB") regulatory requirement and the implementation of IRB approach with regard to its credit businesses. The Group now adopts a two-dimensional internal rating system with 27 obligor rating grades (consisting of 26 performing grades and 1 default grade) and 21 facility rating grades for its corporate and bank customers. The rating system has been integrated in the Group's credit process in credit approval, credit monitoring and credit reporting to the Management and future public disclosure. Going forward, these internal rating-based systems will serve as key input in the calculation of regulatory capital for credit risk and form the key foundation for decision-making on credit, thereby further advancing the Group's risk management practices.

Under Pillar Two of the Basel II Capital Accord, the Group has implemented and reviewed its internal capital adequacy assessment process ("ICAAP") and continued to make improvements to better align the Group's business strategies with regulatory requirements. While the widening of the risk coverage as well as improvement of risk measuring methodologies have been made, forward looking factors have been incorporated to provide a more comprehensive and precise assessment of risk profile to reflect the Group's risk appetite and capital needs in the future.

To comply with Pillar Three on the disclosure requirements prescribed by the Banking (Disclosure) Rules ("Disclosure Rules"), the Group has formulated its Financial Disclosure Policy, and the relevant disclosures made in 2009 were in compliance with the requirements set out in the Disclosure Rules.

HUMAN RESOURCES, TECHNOLOGY AND OPERATIONS

Human Resources

The Group values human resources development as a crucial factor for long-term business growth and the realisation of its strategic goals. The Group introduced a corporate culture programme – "Corporate Culture Starts with Me" – to boost staff morale and enhance their sense of belonging. The Group has been implementing the mid-term human resources strategies for 2008-2012 since 2008 and made further progress in enhancing corporate culture, improving manpower structure and staff quality as well as optimising the human resources mechanism in 2009. Meanwhile, refinement to the staff performance management system continued with the inclusion of "core values" as one of the performance measurement parameters.

In 2009, the Group continued to provide comprehensive training programmes for all levels of staff. A total of some 2,900 courses were organised with over 210,000 attendees. Executive development programmes conducted jointly with reputable universities were organised for the senior management and selected staff. Major training activities included a series of workshops and seminars covering risk management, legal and compliance topics, corporate governance, corporate culture, sales and services, skills development and leadership development. They were offered to both frontline and back-office staff to equip them with the knowledge needed to face the economic turmoil, to meet and comply with new selling regulatory requirements as well as to enhance self development. An e-learning platform is available as a supplementary channel for staff training.

Technology and operations

In 2009, the Group continued to strengthen its information technology infrastructure under its 5-year IT development strategy. Several major projects were completed during the year. With the rollout of the new teller platform, frontline branches are better equipped to meet customers' needs. The Fixed Deposit System was revamped to facilitate the launch of new products. A new feature was introduced to enable the setting of securities margin limit based on asset value of wealth management customers while the workflow process for setting securities margin was streamlined. In late 2009, the Group kicked off the project on "Mobile Banking", which provides banking services via mobile phones, aiming to enrich its service capability via e-channels and broaden its customer base from the Mainland as well as overseas. The cash management platform was enhanced to ensure higher operational efficiency and better service quality. With the implementation of the Basel II Capital Accord, the establishment of the capital adequacy ratio calculation engine was completed. It serves to strengthen the Group's credit risk management capability and facilitate better utilisation of the Group's capital. At the same time, the Group continued to streamline and centralise workflows to improve overall operational efficiency. These included physical and geographical relocation of job duties and operations from frontline to back-office units as well as from Hong Kong to the Mainland. The Group also participated in various projects with BOC in order to enhance synergies within the BOC Group. These included the "Continuous Linked Settlement System" which enhances liquidity and risk management for foreign exchange transactions; "China Link", a foreign currency real-time gross settlement system between Hong Kong and the Mainland; and "Cash Management System Linkage" which links up the Group's cash management service platform with that of BOC to provide cross-border cash management services to customers.

As part of the Group's long-term IT strategy, the Group initiated the Financial Risk Management System ("FRMS") in 2006 to enhance the existing computer systems for different finance functions, including financial accounting, management reporting, multi-dimension profitability analysis, capital management, and asset and liability management. Subsequent to the launch of the Asset Liability Management System in 2007, the General Ledger and the Fund Transfer Pricing systems in the fourth quarter of 2008, both the Accounts Payable System and the Fixed Asset Module were implemented in November 2009. The Profitability Analysis project and Capital Management Module were also kicked off during the year.

CREDIT RATINGS

As at 31 December 2009	Long-term	Short-term
Fitch	A	F1
Moody's	Aa3	P-1
Standard & Poor's	A-	A-2

There has been no change in BOCHK's credit ratings since the end of 2007.

As at 31 December 2009, BOCHK's long-term and short-term foreign currency issuer default ratings assigned by Fitch Ratings were A and F1 respectively while the support rating was 2.

In respect of the ratings assigned by Moody's Investors Service, BOCHK's long-term and short-term local and foreign currency bank deposit ratings remained Aa3 and P-1 respectively. Financial Strength Rating was C+.

BOCHK's long-term and short-term counterparty credit ratings assigned by Standard & Poor's were A- and A-2 respectively. The Bank Fundamental Strength Rating was B.

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 growth and development. The principal types of risks 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.

Risk Management Governance Structure

The Group's risk management governance structure is designed to cover the whole process of all businesses and ensure various risks are properly managed and controlled in the course of conducting business. The Group has a sound risk management organisational structure. It implements a comprehensive set of policies and procedures to identify, measure, monitor and control various risks that may arise. These risk management policies and procedures are regularly reviewed and modified to reflect changes in markets and business strategies. Various groups of risk takers assume their respective responsibilities for risk management.

The Board of Directors, representing the interests of shareholders, is the highest decision-making authority of the Group and has the ultimate responsibility for risk management. The Board, with the assistance of its committees, has the primary responsibility for formulating risk management strategies and ensuring that the Group has an effective risk management system to implement these strategies. The Risk Committee ("RC"), a standing committee established by the Board of Directors, is responsible for overseeing the Group's various types of risks, reviewing and approving high-level risk-related policies and overseeing their implementation, reviewing significant or high risk exposures or transactions and exercising its power of veto if it considers that any transaction should not proceed. The Audit Committee assists the Board in fulfilling its role in overseeing the internal control system.

The Chief Executive ("CE") is responsible for managing the Group's various types of risks, approving detailed risk management policies, and approving material risk exposures or transactions within his authority delegated by the Board of Directors. The Chief Risk Officer ("CRO") assists the CE in fulfilling his responsibilities for the day-to-day management of risks. The CRO is responsible for initiating new risk management strategies, projects and measures that will enable the Group to better monitor and manage new risk issues or areas that may arise from time to time from new businesses, products and changes in the operating environment. He may also take appropriate initiatives in response to regulatory changes. The CRO is also responsible for reviewing material risk exposures or transactions within his delegated authority and exercising his power of veto if he believes that any transaction should not proceed.

Various units of the Group have their respective risk management responsibilities. Business units act as the first line of defence while risk management units, which are independent from the business units, are responsible for the day-to-day management of different kinds of risks. Risk management units have the primary responsibilities for drafting, reviewing and updating various risk management policies and procedures.

The Group's principal banking subsidiaries, Nanyang, NCB (China) and Chiyu, are subject to risk policies that are consistent with those of the Group. These subsidiaries execute their risk management strategies independently and report to the Group's management on a regular basis.

Credit Risk Management

Credit risk is the risk that a customer or counterparty will be unable to or unwilling to meet its obligations under a contract. It arises principally from lending, trade finance and treasury businesses, and covers inter-bank transactions, foreign exchange and derivative transactions as well as investments in bonds and securities. For details of the Group's Credit Risk Management, please refer to Note 4 to the Financial Statements in this Annual Report.

Interest Rate Risk Management

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 to the Financial Statements in this Annual Report.

Market Risk Management

Market risk is the risk of loss that results from movements in market rates and prices of both the trading book and banking book. The Group's market risk in the trading book arises from customer-related business and proprietary trading. Trading positions are subject to daily mark-to-market valuation. The risk includes potential losses arising from a change in foreign exchange and interest rates as well as the prices of equities and commodities. Banking book positions are subject to interest rate risk and liquidity risk. In particular, the Group's bond investment portfolio is exposed to the potential losses arising from changes in market price of the debt securities as these positions are subject to monthly mark-to-market valuation.

Market risk management framework

Market risk is managed within various major risk limits approved by the RC, including risk positions and/or risk factor sensitivities. Since April 2007, BOCHK has also formally applied Value-at-Risk (VAR) limit as a daily risk management tool. These overall risk limits are divided into sub-limits by reference to different risk products, including interest rates, foreign exchange rates, commodities and equities. Transactions are classified into different risk product categories according to the prominent type of risk inherent in the transactions.

For BOCHK, banking book market risk is managed within various risk limits such as sensitivity limits like Present Value per Basis Point (PVBP) limits and Greek limits, and the AFS Economic Value Impact limit (which is aimed at controlling the price risk impact of the available-for-sale debt securities portfolio on the Bank's capital base). In addition, Profit-and-loss Management Alert Limit (P/L MAL) is set up to control the earnings impact arising from the banking book's financial instruments. These limits are approved by the Asset and Liability Management Committee ("ALCO") and the results are reported to ALCO on a monthly basis.

As aforesaid, the Group's risk management objective is to enhance shareholder value by maintaining risk exposures within acceptable limits. The Group's market risk management framework comprises three levels. The Board of Directors is the ultimate decision-making authority. The formulation of risk management procedures and the implementation mechanism as well as the monitoring of compliance are mainly the responsibility of the Group's senior management (including CE and CRO). The Risk Management Department (RMD) is responsible for overseeing the Group's market risk to ensure that overall and individual market risks are within the Group's risk tolerance. Risk exposures are monitored on a day-to-day basis to ensure that they are within the established risk limits and are regularly reported to the senior management. Nanyang, NCB (China), Chiyu and BOC Life have their own independent risk monitoring units to monitor limit compliance on a daily basis.

The Group controls market risk by restricting individual operations to trade only a list of permissible instruments authorised by the senior management and within various market risk limits approved by RC. The individual operations are also required to enforce rigorous new product approval procedures to ensure that all risks that may arise are thoroughly identified, properly measured and adequately controlled.

The Group also uses the VAR technique to measure potential losses and market risks of its trading book for reporting to the RC and senior management on a periodic basis. VAR is a statistical technique to estimate the potential losses that could occur on risk positions taken over a specified time horizon within a given level of confidence. BOCHK, being the banking entity within the Group with the major trading positions, which are mainly foreign currency positions in major currencies, uses VAR technique to monitor and control market risk on a daily basis.

The Group uses historical simulation approaches to calculate portfolio and individual VAR by historical movements in market rates and prices, given a 99% confidence level and a 1-day holding period. Movements in market prices are calculated by reference to market data from the last two years.

VAR

The following table sets out the VAR for all trading market risk exposure[1] of BOCHK.

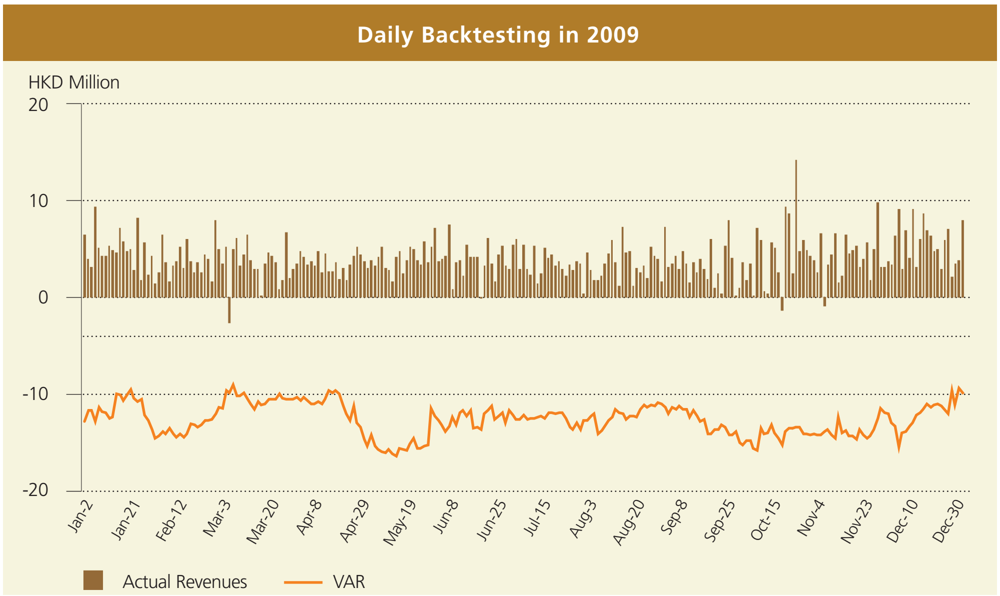
HK$'m		At 31 December	Minimum for the year	Maximum for the year	Average for the year
VAR for all market risk	– 2009	9.8	9.0	16.3	12.6
	– 2008	12.6	3.0	13.5	6.5
VAR for foreign exchange risk products	– 2009	7.7	7.4	15.8	11.3
	– 2008	13.1	2.5	14.2	6.0
VAR for interest rate risk products	– 2009	6.4	2.1	12.8	5.7
	– 2008	4.2	1.0	5.9	2.9
VAR for equity risk products	– 2009	0.1	0.1	2.5	0.3
	– 2008	0.2	0.1	2.8	0.5
VAR for commodity risk products	– 2009	0.0	0.0	0.1	0.0
	– 2008	0.0	0.0	0.5	0.0

In 2009, the average daily revenue[2] of BOCHK earned from market risk-related trading activities was HK$3.88 million (2008: HK$5.35 million).

1 Structural FX positions have been excluded.
2 Revenues from structural FX positions and back-to-back transactions have been excluded.

The predictive power of the VAR measure is monitored by back-testing, which compares the calculated VAR figure of those trading positions of each business day with the actual revenues arising on those positions on the next business day. These actual revenues exclude non-trading income, including fees and commissions. If back-testing revenues are negative and exceeding the VAR, a "back-testing exception" is noted. Back-testing results are reported to the Group's senior management, including CE and CRO.

Generally speaking, the number of back-testing exceptions in a rolling 12-month period will not exceed four times, given a 99% confidence level. BOCHK conducts back-testing on a monthly basis and the graph below shows the back-testing result of the trading VAR of BOCHK.



There is no actual loss exceeding the VAR estimate for BOCHK in 2009.

Although a valuable guide to risk, VAR should always be viewed in the context of its limitations. For example:

- the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- the use of a one-day holding period assumes that all positions can be liquidated or hedged in one day. This may not fully reflect the market risk arising at times of severe illiquidity, when a one-day holding period may be insufficient to liquidate or hedge all positions fully;
- the use of a 99 per cent confidence level, by definition, does not take into account losses that might occur beyond this level of confidence; and
- VAR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures.

The Group recognises these limitations by augmenting its VAR limits with other position and sensitivity limit structures. Additionally, the Group applies a wide range of stress testing, both on individual portfolios and on the Group's consolidated positions. The stress testing programme of the trading book includes sensitivity testing on changes in risk factors with various degrees of severity, as well as scenario analysis on historical events including the 1987 Equity Market Crash, 1994 Bond Market Crash, the 1997 Asian Financial Crisis and the 11 September event in the United States in 2001. The Group has been constantly reassessing the stress testing programme to ensure its adequacy after the global financial crisis in 2008. The Group's stress-testing regime provides the senior management with an assessment of the financial impact of identified extreme events on the market risk exposures of the Group.

Liquidity Risk Management

The aim of liquidity management is to enable the Group to meet, even under adverse market conditions, all its maturing repayment obligations on time, and to fund all its asset growth and strategic opportunities with reasonable costs.

Liquidity management is carried out at both the Group and subsidiary level. BOCHK and its subsidiaries are required to maintain a strong daily liquidity position and a healthy cash flow aligning risk-taking incentives with liquidity exposures and to make sure that all funding obligations are met when due. The subsidiaries are required to report their respective liquidity positions to BOCHK on a regular basis. In 2009, the Group conducted more stress testing under different stress conditions to ensure that risks were managed within the Group's tolerance level.

The risk measurement and monitoring process is set in accordance with the requirements and guidelines issued by the regulatory authorities and is stated in the policies and procedures endorsed by RC and ALCO. The primary objective of the Group's asset and liability management strategy is to achieve optimal returns while ensuring adequate levels of liquidity and capital within an effective risk control framework. ALCO is responsible for establishing these policy directives (including the liquidity contingency plan), and RC sanctions the liquidity management policies. The Asset and Liability Management Department ("ALMD") manages the liquidity risk according to the established policies and reports to ALCO regularly. RMD reviews the policies, guidelines and limits proposed by ALMD. Liquidity risk measurements include cash flow analysis (under normal and stress conditions respectively), deposits maturity structure, concentration risk, mismatch ratios, loan-to-deposit ratio and liquidity profile of the investment portfolio.

The Group funds its operations principally by accepting deposits from retail and corporate depositors. In addition, the Group may issue certificates of deposit to secure long-term funds. Funding may also be secured through adjusting the asset mix in the Group's investment portfolio. The Group uses the majority of funds raised to extend loans, to purchase debt securities or to conduct interbank placements.

Operational Risk Management

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

The Group has put in place an effective internal control process which requires the establishment of detailed policies and control procedures for all the key activities. Proper segregation of duties and authorisation is the fundamental principle followed by the Group. Corporate-level policy and procedure on operational risk management are formulated by the Operational Risk & Compliance Department ("OR&CD") and approved by RC.

The Group has adopted the "Three Lines of Defence" model for its operational risk management framework. All departments and business units are the first line of defence, responsible for managing and reporting operational risks specific to their business/functional areas by applying the respective tools such as key risk indicators, self assessment and operational risk events reporting mechanism to identify, assess and control the risks inherent in their business/functional processes, activities and products. OR&CD together with certain operational risk-related functional departments within the Group are the second line of defence. In addition to formulating the operational risk management policy and procedure, OR&CD is also responsible for developing and introducing operational risk management tools, monitoring the performance and result of operational risk management in various units, assessing operational risk profile, recording operational risk data and reporting operational risk events to RC and the senior management in order to assist the overall management of the Group's operational risk. Certain functional departments, including Human Resources Department, Information Technology Department, Corporate Services Department, Financial Management Department, General Accounting & Accounting Policy Department and OR&CD, are required to carry out the corporate-level operational risk management for the risk areas that are under their functional responsibilities and to provide other units with professional advice/training in respect of certain operational risk categories. The Audit Department is the third line of defence, responsible for conducting independent audit of the operational risk management activities to evaluate their compliance and effectiveness.

The Group also takes out insurance to mitigate unforeseeable operational risks. Business continuity plans are in place 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 regarding 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 erosion. Reputation risk is inherent in 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 prevent and manage reputation risk proactively at an early stage when an incident occurs. The system entails continuous monitoring of external reputation risk incidents and published failures of risk incidents in the financial industry.

In the Lehman Brothers minibonds incident, the Group has handled customer complaints in accordance with regulatory guidelines to minimise the reputation risk and repurchased most of the outstanding Minibonds under the Repurchase Scheme and its complaint handling process.

Legal and Compliance Risk Management

Legal risk is the risk that unenforceable contracts, lawsuits or adverse judgments may disrupt or otherwise negatively affect the operation or financial condition of the Group. Compliance risk is the risk of legal or regulatory sanctions, financial loss, or loss to reputation a bank may suffer as a result of its failure to comply with all applicable laws and regulations. Legal and compliance risks are managed by OR&CD headed by a General Manager who reports to CRO.

Strategic Risk Management

Strategic risk generally refers to the risks that may induce immediate or future negative impact on the financial and market positions of the Group because of poor strategic decisions, improper implementation of strategies and lack of response to the market. The Board of Directors reviews and approves the policy for the management of strategic risks. Key strategic issues have to be fully evaluated and properly endorsed by the senior management and the Board.

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

Capital Management

The major objective of capital management is to maximise shareholders' total return while maintaining a capital adequacy position commensurate with the Group's overall risk profile. The Group periodically reviews its capital structure and adjusts its capital mix where appropriate. ALCO monitors the Group's capital adequacy position. The Group has complied with all the statutory capital standards for all the periods in 2009.

To comply with HKMA's requirements as stated in the Supervisory Policy Manual "Supervisory Review Process", the Group has implemented its internal capital adequacy assessment process (ICAAP). Using the statutory minimum capital adequacy ratio (CAR), 8%, as a starting point, extra capital (capital add-on) needed to cover the risks not captured under Pillar I is assessed. Scorecard methodology has been used to evaluate the Group's risk profile in order to assess the capital add-on and determine the minimum CAR. An Operating CAR Range has also been established which incorporates the need 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 the Group's risk exposures under stressed conditions arising from extreme but plausible market or macroeconomic movements. These tests are conducted on a regular basis by various risk management units and ALCO monitors the results against limits approved by RC. The Financial Management Department reports the combined stress test results to the Board and RC regularly.

BOC Life Insurance

The principal activity of BOC Life's business is the underwriting of long-term insurance business in life and annuity, unit-linked long-term business and retirement scheme management in Hong Kong. Major types of risk arising from the BOC Life's insurance business are insurance risk, interest rate risk, liquidity risk and credit risk. BOC Life closely monitors these risks and reports to its RC 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. BOC Life manages these risks through the application of its underwriting policies and reinsurance arrangement.

The underwriting strategy is intended to set premium pricing at an appropriate level that corresponds to 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.

Within the insurance process, concentrations of risk may arise where a particular event or series of events could impact heavily upon BOC Life's liabilities. Such concentrations may arise from a single insurance contract or through a small number of related contracts, and relate to circumstances where significant liabilities could arise.

For in-force insurance contracts, most of the underlying insurance liabilities are related to endowment and unit-linked insurance products. For most of the insurance policies issued, BOC Life has a retention limit on any single life insured. BOC Life cedes the excess of the insured benefit over the limit for standard risks (from a medical point of view) to reinsurer under an excess of loss reinsurance arrangement.

Uncertainty in the estimation of future benefit payments and premium receipts for long-term insurance contracts arises from the unpredictability of long-term changes in overall levels of mortality and persistency. In order to assess the uncertainty due to the mortality assumption and lapse assumption, BOC Life conducts mortality study and lapse study in order to determine the appropriate assumptions. In these studies, consistent results are reflected in both assumptions with appropriate margins.

Interest Rate Risk Management

An increase in interest rates may result in the depreciation of the value of the bond portfolio. It may also result in customers accelerating surrenders. A decrease in interest rates may result in an inability to adequately match guarantees or lower returns leading to customer dissatisfaction. BOC Life manages the asset liability matching of its portfolios within an asset liability management (ALM) framework that has been developed to achieve investment returns that match its obligations under insurance contracts.

Liquidity Risk Management

Liquidity risk is the risk of not being able to fund increases in assets or meet obligations as they fall due without incurring unacceptable loss. BOC Life's asset liability matching framework includes cash flow management to preserve liquidity to match policy payout from time to time. In the normal course of BOC Life's business, new business premiums generate constant cash inflows and as a result, the portfolios also grow gradually to meet future liquidity requirement.

Credit Risk Management

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

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

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

In order to enhance the credit risk management, BOC Life has strengthened its communication with the Investment Management of the Group and closely monitors and updates the established Disposal and Watch Lists to ensure consistency with the Group's credit risk management and investment strategy.