CHIEF EXECUTIVE'S REPORT

In the year 2011 the Group recorded, once again, solid growth in its net operating income before impairment allowances, operating profit before impairment allowances and profit attributable to the equity holders, all of which reached record high levels. Notwithstanding the widespread volatility that plagued the global economy in the year, profit attributable to the equity holders surpassed the HK$20 billion mark for the first time in our history. By capitalising on our core competencies and implementing a balanced and sustainable growth strategy, we succeeded in expanding our core businesses, maintaining our leading market positions, capturing new business opportunities and achieving major breakthroughs, particularly in offshore RMB banking business.

Last year was a turbulent period in which the operating environment was affected by natural catastrophes, financial troubles and economic slowdown on a massive scale. The eruption and spreading of the sovereign debt crisis in the Eurozone seriously undermined the stability of the world economy which was still recuperating from the 2008 global financial crisis. The ramifications of the European debt crisis and the lingering weakness of the US economy hit Hong Kong as the demand for exports faltered and investment sentiment in stock and property markets deteriorated, especially in the second half of the year. Inflationary pressure was mounting, with upward pressure on costs on all fronts, while the persistently low interest rates continued to bring about pressure on margin, particularly in the first half of the year. In spite of this, with its solid economic fundamentals and strong support from the Mainland, Hong Kong was able to stay afloat and sustain a positive, albeit lower, GDP growth. For the banking and financial services sector as a whole, the steady and relatively fast development of the Mainland economy and the further relaxation of offshore RMB banking business have brought about inspiring new business opportunities.

Our robust performance in business development and financial results last year speaks for the effectiveness of the proactive strategies we have adopted over the past years, especially in the aftermath of the global financial crisis, in managing adversity in the external environment and maintaining our momentum for growth. We leveraged the increase in local business investment, private consumption, exports and re-exports as well as property transactions (mostly in the first half of 2011) to grow our loans and other services to customers by a healthy margin. Being the market leader in the fast-growing offshore RMB banking business, we have been playing a prominent role in developing RMB services and products, which have become increasingly important contributors to the Group's income and profit. On the other hand, in view of growing uncertainties in the financial markets, we took timely and effective measures in safeguarding the strength of our capital base and liquidity, enhancing the quality of our assets, and refining our lending and investment portfolios respectively. We continued to exercise high prudence in containing costs, including the costs of funding and operation. As a result, we kept our financial position strong. Our earnings and capital strength have enabled us to maintain a stable dividend policy.

Key Initiatives and Achievements

Our constant efforts in striking a right balance among growth, return and risks by pro-actively managing our assets and liabilities have been paying off well. We attained broad-based growth in income and profit. We succeeded in improving all of our major income streams, including net interest income, net fee and commission income as well as net trading gain from foreign exchange.

- Against the backdrop of a better market situation in the first half of the year, we effectively deployed our assets and adjusted these when the market evolved, thus optimising our yields and returns. We achieved a balanced growth in loans and deposits. Through a proactive yet prudent credit policy with emphasis on quality growth, we registered double-digit increases in loans and advances to both individual and corporate customers. Our customer base improved and the pricing of new loans was raised to increase yields. At the same time, in spite of severe competition for funds in the market, we adopted flexible deposit-taking strategies to attract deposits and optimise our deposit mix. The Group maintained its loan-to-deposit ratio at a healthy level, thus ensuring better utilisation of funds while keeping adequate liquidity.

- We made significant advancement in our RMB business. Conspicuous growth and development was recorded in 2011 in RMB deposit-taking, lending, trade settlement, credit card business, life insurance, treasury products and funds distribution. By enhancing our clearing bank function and network, including the introduction of the RMB Fiduciary Account Scheme and Intra-day Repo facilities, we have facilitated the Participating Banks in developing RMB business and hence the growth of the RMB market as a whole. We were re-appointed as the Clearing Bank of RMB business in Hong Kong.

- By collaborating more closely with our parent, BOC, and connecting the Group's service platforms with those of BOC, we succeeded in enhancing our servicing capability for cross-border customers and expanding our clientele, including corporate clients and wealth management customers. Among many other businesses in joint efforts with BOC, we have made very encouraging progress in extending RMB services to a wide spectrum of customers in Hong Kong, the Mainland and overseas.

- Faced with the strong headwinds in the global financial scene due to the sovereign debt crisis in Europe, we stayed highly alert all the time in monitoring and managing the Group's investment portfolio to minimise our exposure to various investment risks. By adjusting our portfolio mix to focus on high-quality and low-risk investments and acting promptly to dispose of investments in the Eurozone, we have ensured the good quality and positive yield of our investment portfolio as a whole.

- To get well-prepared for the uncertainties in the external environment, we believe that it is essential to keep a close watch on the Group's key financial ratios. Our capital adequacy ratio, cost-to-income ratio and classified or impaired loan ratio were among the best in the local industry, while our loan-to-deposit ratio and liquidity ratio remained solid. The Group's credit ratings were upgraded. Notwithstanding deterioration in the external operating environment and downgrades for most of the global and US banks, BOCHK's long-term credit rating was raised by Standard & Poor's by two notches (from "A-"to "A+") and short-term credit rating by one notch (from "A-2" to "A-1"), which clearly demonstrates the international recognition of the Group's strong fundamentals and core strengths in sustaining growth while fending off potential risks.

Financial Highlights

In 2011, the Group's profit attributable to the equity holders increased by 26.1% to HK$20,430 million, as a result of a broadly based growth in business and profitability, effective cost management as well as a net recovery from the underlying collateral of the Lehman Brothers Minibonds. The Group's net operating income before impairment allowances was HK$30,846 million, up 12.1% year-on-year. Operating profit before impairment allowances was HK$22,984 million, up 28.2% year-on-year. If the net recovery and the Lehman Brothers-related expenses were to be excluded, the Group's profit attributable to the equity holders would still have increased by 11.5%.

Return on average total assets (ROA) and return on average shareholders' equity (ROE) were 1.14% and 16.68%, versus 1.21% and 14.77% respectively for 2010.

Net interest income (NII) increased by 17.3% to HK$21,979 million with a surge of 32.4% in average interest-earning assets, which reached HK$1,662,201 million by 31 December 2011. The net interest margin (NIM) narrowed by 17 basis points to 1.32% for the full year, but improved by 23 basis points in the second half as compared with the first half of the year. This improvement was made as, firstly, we enhanced the pricing of new loans, especially in corporate lending, when market opportunities arose. Secondly, we accomplished better deployment of RMB funds in lending and investment. Thirdly, by introducing the RMB Fiduciary Account Scheme for RMB Participating Banks, we were able to mitigate the diluting effect of RMB funds on our NIM.

Net fee and commission income was up by 11.2% to HK$7,833 million, thanks mainly to the satisfactory performance of our core businesses. Fee income from the credit card business surged by 29.9% to HK$2,887 million. Commission income from insurance almost doubled to HK$1,097 million. Loan commissions and bills commissions increased by 20.7% and 13.7% to HK$1,160 million and HK$854 million respectively. Fee income from funds distribution, trust and custody, payment services and currency exchange, also saw good growth. Fee income from securities brokerage, however, declined by 16.7% to HK$2,782 million in the lethargic stock market.

CHIEF EXECUTIVE'S REPORT

A healthy increase of 24.9% was recorded in net trading gain, which amounted to HK$1,710 million in 2011, thanks to the significant growth in currency exchange activities and a reduction in foreign exchange loss on foreign exchange swap contracts.

There was a net loss of HK$340 million on financial instruments designated at fair value through profit or loss versus a net gain in 2010 due mainly to the loss from the investment portfolio of BOC Life amid the weak financial market.

On the expenditure side, we remained prudent in managing costs while continuing to invest in service infrastructure and human resources for future growth. Total operating expenses decreased by 18.0% to HK$7,862 million, largely due to the net recovery of HK$2,854 million from the underlying collateral of the Lehman Brothers Minibonds. After excluding this net recovery and related expenses, core operating expenses increased by 12.3% to HK$10,659 million due to the increases in staff numbers and performance-linked remuneration, rental for branches, IT-related expenses, other operation expenses related to increased business volume and the Group's expansion in the Mainland. Our cost-to-income ratio was low at 25.49% and the core ratio (excluding the Lehman effect) was 34.56%, ranking us the best in the market.

As at 31 December 2011, the Group's total assets stood at HK$1,738,510 million, representing an increase of 4.7% year-on-year. The quality of our assets remained excellent, with the classified or impaired loan ratio further improved to 0.10%, down 4 basis points versus 2010 and outperforming our peers.

Our lending policy last year, consistent with what we have been implementing over the past few years, aimed at growing our loans in a balanced and steady manner, with emphasis on credit quality and higher yield. Total loans and advances to customers grew by 14.1% to HK$699,379 million, of which corporate loans increased by 13.5% and personal loans, by 15.4%.

Amid keen competition for deposits in the market last year, we enlarged our deposit base to support loan growth through a flexible deposit policy with due regard for the cost involved. Deposits from customers increased by 11.6% to HK$1,146,590 million. There was significant growth in RMB deposits. The Group's loan-to-deposit ratio was 61.00% at the end of 2011, around the level of the two preceding years.

The Group was well capitalised, which was important to support our long-term development, to ensure a stable dividend policy and to provide a buffer for us to meet the changing regulatory requirements. To optimise our asset and liability management, we established a Medium Term Note Programme in September 2011 and made the first drawdown of US$750 million in November of the year. As at the end of 2011, the Group's consolidated capital adequacy ratio (CAR) was 16.90% while the core capital ratio was 12.51%. The average liquidity ratio stayed solid at 36.17%.

Business Review

Corporate Banking

In 2011 the Group's Corporate Banking business experienced strong performance by focusing on quality loan growth, customer base expansion, customer relationship management and service enhancement. We also made good progress in the development of cash management and custody business.

Robust financial results were recorded last year. Net operating income before impairment allowances rose by an impressive 27.6% to HK$11,943 million, of which net interest income, net fee and commission income and net trading gain increased by 30.5%, 17.4% and 82.8% respectively. Profit before taxation grew by 24.1% to HK$8,636 million.

The Group's corporate lending business maintained its strong growth momentum last year. Corporate loans increased by 13.5% while the pricing of new loans was improved to attain higher return. Our position as a leading corporate lender was further reinforced through better segmentation of both the local and cross-border clientele. We also maintained our position as the top mandated arranger in the Hong Kong-Macau syndicated loan market.

As cross-border trade settlement in RMB has been expanded to cover the entire nation since last August, we further advanced our trade finance business by exploiting our strong service capability. A number of new cross-border trade finance products were rolled out to serve the increased needs of corporate customers in both Hong Kong and the Mainland. The balance of the Group's trade finance increased by 11.4% year-on-year.

We enhanced our services for SMEs by offering total solutions and participating actively in the HKSAR Government's SME Financing Guarantee Scheme and the subsequently launched Bank Special Loan Guarantee Scheme. Last year we set up a new and comprehensive commercial centre specifically for serving the banking needs of corporate customers.

Our cash management service saw steady growth. We upgraded our service platform for both large corporate clients and SMEs. We also enriched our portfolio by launching a wide range of RMB payment and receivable products. In a breakthrough development, BOCHK acted as the RMB agent bank of the Stock Exchange of Hong Kong to facilitate the first RMB share listing in Hong Kong.

We successfully expanded the client base for our custody service. In addition to QDIIs and different types of fund clients, we were extending our service to RQFIIs. We are especially encouraged by the increase in the custody volume of RMB investment instruments.

Personal Banking

Our Personal Banking business focused on maintaining our lead in core segments, enhancing our business model to drive sales, upgrading our wealth management capability to expand our high-net worth customer base, fostering closer collaboration with BOC to facilitate the development of cross-border services, and enhancing our distribution channels for long-term growth. Profit before taxation reached HK$4,896 million.

In terms of business development, we continued to grow and maintain our market lead in customer deposits and residential mortgage business. By capturing the market's new demand arising from a bullish residential property market in the first half of 2011, our residential property mortgage loans grew by 15.2% year-on-year. To enhance the yield of mortgage lending, we adjusted upward the pricing of new mortgage loans. Different mortgage plans were offered to customers to meet their diverse needs. While driving business growth, we remained prudent to ensure high credit quality through stringent risk control. The combined delinquency and rescheduled loan ratio for mortgage stood at a low level of 0.01% at the end of 2011.

We recorded robust growth in both the funds distribution and life insurance businesses. Two BOCHK RMB bond funds were launched during the year for targeted investors. The Group's Investment Product Specialist Team has been providing professional advice to customers on investment products, including investment funds. As a result, commission income from funds distribution shot up by a staggering 110.6%. At the same time, commission income from insurance, including life insurance, general insurance and reinsurance, rose by 95.5%. By offering professional sales service and expanding our product spectrum, we have reinforced our position as a prominent life insurance provider and maintained our market lead in the RMB life insurance market.

Riding on the surge in consumer spending by both local residents and incoming tourists, we recorded solid growth in our credit card business in 2011. Through various incentives to attract new cardholders and encourage cardholder spending, the number of cards issued, cardholder spending and merchant acquiring volume increased by 12.4%, 20.6% and 34.1% respectively. Our RMB card business continued to flourish and outperform the market, especially in the RMB-HKD dual currency card business. We maintained our market lead in the China UnionPay merchant acquiring business and card issuance. Credit card advances rose strongly by 17.3%. The credit quality of card advances remained sound with the annualised charge-off ratio standing at 1.07%.

The personal stock brokerage segment experienced a setback amid subdued stock market volume. Fee income from securities brokerage declined by 16.7% to HK$2,782 million. Despite that, we continued to upgrade our service platform for stock trading, including the mobile trading channel, to reinforce our market position for long-term development. To equip ourselves for the future, we have enhanced our trading system during the year by launching a host of RMB-denominated securities trading services.

We made significant progress in expanding our wealth management segment in 2011. Through service enhancement, the enrichment of product offerings and closer cooperation with BOC branches and NCB (China), we boosted our wealth management customer base by 17.4%, which covers both Hong Kong and Mainland customers.

To cater to the needs of local and cross-border customers, we further upgraded and expanded our distribution channels, including the electronic banking platform, for which more than a dozen awards were bestowed on us last year. The functions of our e-banking platform have been expanded while the scope of our mobile banking services has also been enriched. These initiatives were obviously conducive to the increase in e-banking customers and usage.

Treasury

Our Treasury segment operated with a high degree of prudence last year amid rising fluctuations in global financial markets. We focused on proactively diversifying our investment portfolio, minimising the exposure to risks arising from the Eurozone, and optimising our asset allocation and portfolio deployment. Net operating income before impairment allowances surged by a robust 24.2%, of which net interest income was up 27.7% while net fee and commission income, up 345.7%. Profit before taxation increased by 19.3% versus 2010.

CHIEF EXECUTIVE'S REPORT

Highly alert to the adverse impact of the sovereign debt crisis in the Eurozone last year, we took a number of decisive and timely measures in risk management so as to safeguard our investment assets. We adjusted the duration of our portfolio when the market evolved to ensure better liquidity. We focused on government-related securities as well as bonds issued by high-quality financial institutions and corporations. We also refined our portfolio mix to reduce exposure to the European market and low-yielding securities. As a result, at the end of 2011, the Group had zero exposure to debt securities issued by GIIPS (Greece, Italy, Ireland, Portugal and Spain) governments, financial institutions or other private entities. The Group's exposure to the Europe region as a whole was also reduced as we attached importance to maintain a defensive portfolio position.

Our RMB-related business saw substantial progress last year. We acted as the major market maker in Hong Kong's CNH market. BOCHK became the first offshore institution with the "Delivery versus Payment" settlement arrangement in the onshore market. We were also a major player in the RMB bond underwriting business. By cooperating with BOC's overseas branches, we have been developing a global RMB banknote network. This has again underscored Hong Kong's importance as an offshore RMB business centre.

We were re-appointed as the Clearing Bank for RMB business in Hong Kong and as the only bank for providing RMB banknotes clearing services to Taiwanese banks. Last year, we launched the RMB Fiduciary Account Scheme Service to reduce the counterparty risk of Participating Banks to the Clearing Bank. We also initiated the intra-day Repo service to facilitate Participating Banks' intra-day liquidity management.

Mainland Business

In the Mainland, we focused on enlarging our deposit base to ensure that our loan-to-deposit ratio was in compliance with regulatory requirements. To better equip ourselves for future development, NCB (China) continued to build up its service capability and expand its branch network.

Total operating income increased by a solid 42.2% with the growth in net interest income as well as net fee and commission income. Our deposit base in the Mainland grew substantially by 52.7%. At the end of 2011, NCB (China)'s loan-to-deposit ratio stood at 70.2%.

In response to the rise in the reserve requirement ratio, we took prompt measures to improve our asset mix and loan pricing, thereby mitigating the pressure on net interest margin. Asset quality remained sound, with the classified loan ratio standing at 0.27%.

Meanwhile, we enhanced the linkage of our service platform with that of BOC to enable customers to enjoy better and more comprehensive services. Our branch network continued to expand with the number of branches/sub-branches increasing to 27 as at end of 2011.

Insurance

Last year our Insurance segment focused on enhancing its product offerings, upgrading its service capability and reinforcing its market position.

By enlarging our product range and taking a more aggressive approach in sales and marketing, we made significant progress in growing our gross regular premium income, which shot up strongly by 56.4% during the year. Meanwhile we launched more new RMB products to create demand and solidified our leading position in the RMB insurance market. Our improvement in service quality was duly recognised by the market, as evidenced by the industry awards we received last year.

Net interest income grew by 13.8%. Yet net operating income before impairment allowances and profit before taxation decreased by 47.0% and 93.5% respectively, due mainly to a higher provision for insurance liabilities as a result of declining market interest rates, and the investment loss incurred in the turbulent investment market.

Outlook

The outlook for the coming year is expected to be more challenging as the European sovereign debt crisis and the deep-rooted problems facing the US economy may still drag on. Trade prospects are turning bleak as demand continues to weaken. These conditions may imply that the operating environment for the banking sector is becoming even tougher than before and interest rates are staying at the current low level for a much longer period than originally envisaged. On top of that, business risks are to increase and competition may intensify. Yet we believe that positive prospects still exist in Asia. In particular, the further relaxation of offshore RMB business and the opening of the Mainland's financial market to external participants should create new business opportunities for banks with the right expertise and capabilities.

In view of the foreseeable uncertainties in the market, we shall adhere to our proactive management philosophy that has proven to be effective in delivering a sustainable and balanced growth of the Group. Our tremendous efforts over the past few years in asset and liability management has resulted in the Group's greater earning power and stronger foundations for long-term development, which will help tide us over the difficult and thorny time ahead.

For 2012, we will strive to maintain our consistent growth strategy, and put more emphasis on quality growth and profitability. We will exploit our core competencies to grow our traditional segments and maintain our leadership in the market with good prospects. By means of service upgrade, product/service innovation, expansion of customer base, strengthening of customer relationship, and the enlargement and optimisation of service channels and platforms, we will grow our core businesses, including corporate lending, loan syndication, residential mortgage, deposit taking, wealth management, credit card and insurance. To broaden our income and profit base, we will further enhance our service platforms for newly developed business arenas.

The development of the offshore RMB banking business has opened a new chapter for the banking industry in Hong Kong and beyond. It will definitely be a major focus for us in the coming years. Given our abundant expertise and strong track record as the local market leader, we will continue to play a leading role in driving the development of RMB-related services in Hong Kong. As China relaxes her offshore RMB banking policies, we will explore and develop more diverse RMB services and products to create and cater to new market demands. The recent relaxation by the HKMA of certain regulatory requirements of the RMB business provides banks in Hong Kong with greater flexibility in RMB asset management, thus giving us more leeway in the deployment of RMB funds. To meet the rapidly increasing interest in RMB worldwide and to strengthen Hong Kong's status as a global hub for offshore RMB business, we will seek to extend our RMB clearing and banking-related services to more overseas markets.

As we are taking an increasingly global perspective with regard to the development of the offshore RMB banking business, we will capitalise on our close connections with BOC and its overseas branches to extend our reach across continents. We will enhance the collaboration with BOC and strengthen the inter-linkage of our service platforms for further promoting cross-border services for customers from both banks. In particular, our experience and expertise in providing service support for the Mainland's corporate clients seeking to expand overseas will give us an edge in that regard.

While growing our core businesses and penetrating into new segments and markets, we will be highly vigilant over the management of our assets and liabilities to ensure that our financial position and key financial ratios remain strong. As global financial markets are still beleaguered with volatility, we will step up our risk management and internal control to safeguard our capital base, liquidity and asset quality. Despite persistent margin pressure resulting from low interest rates and keen market competition, we will make every endeavour to contain the cost of funding and increase the yields of lending and investment, with an aim to further improve our NIM. In the face of rising costs, we will exercise stringent cost control to attain higher cost-effectiveness while continuing to invest for the future.

This year we are celebrating the 100th anniversary of BOC. We take great pride in seeing that our parent is the only domestic bank that has been operating continuously for 100 years in the Mainland. Through a century of development, BOC has always been committed to the pursuit of excellence and has been growing into the most internationalised and most diversified commercial bank in China and earned high recognition in the world.

This year we are also entering the tenth year of BOCHK's public listing in Hong Kong. Through these years we have witnessed the Company's comprehensive transformation and advancement in such major areas as corporate governance, corporate development, income and profit performance, business diversification, asset quality, financial strength, human resources development, customer service capability, risk management and internal control, corporate social responsibility, credit ratings and so on.

While concluding the last year on a high note despite all the challenges, I must thank the Board of Directors, shareholders and customers for their wise counsel, trust and support. I must also thank my colleagues who have consistently contributed their best to enable the Group to perform well and attain new breakthroughs. Looking forward, we, as an integral part of the BOC Group, will further capitalise on BOC Group's strong franchise and extensive network to grow our business and deliver higher value for our shareholders, customers, staff and the community at large.

HE Guangbei
Vice Chairman & Chief Executive

Hong Kong, 29 March 2012