INNOVATIVE RMB SERVICE

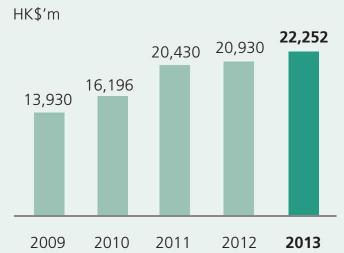
MANAGEMENT'S DISCUSSION AND ANALYSIS

FINANCIAL PERFORMANCE AND CONDITION AT A GLANCE

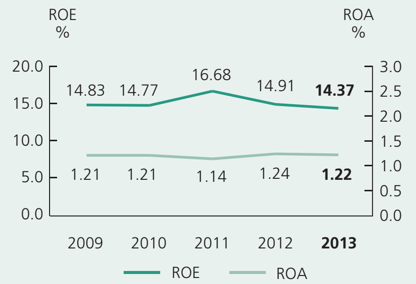
The Group delivered once again a set of satisfactory financial results in 2013. Both net operating income before impairment allowances and profit attributable to the equity holders achieved a record high since listing while the Group's financial position remained solid.

Key Performance Trends

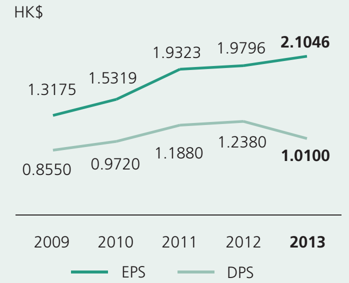
Profit Attributable to the Equity Holders



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



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



Profit attributable to the equity holders

- Profit attributable to the equity holders increased by 6.3% year-on-year to HK$22,252 million, a record high since listing. The increase was driven by the 17.0% growth of operating profit after impairment allowances, partly offset by a drop in net gain from fair value adjustments on investment properties.

Solid return with sustainable growth in core income

- ROE was 14.37%, down 0.54 percentage point year-on-year, as the increase in average equity outpaced that of the profit. Higher average equity was mainly caused by additions of retained earnings and the higher average premises revaluation reserve.
- ROA was 1.22%.

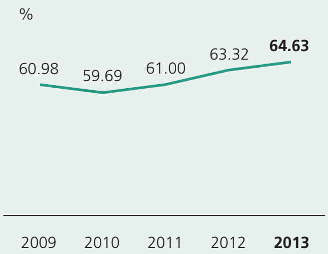
Return to shareholders

- EPS was HK$2.1046. DPS was HK$1.01.

MANAGEMENT'S DISCUSSION AND ANALYSIS

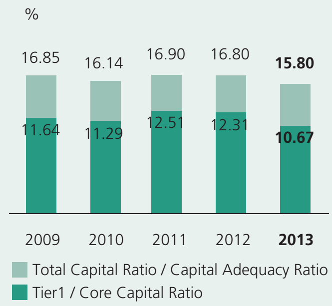
Financial Position

Loan to Deposit Ratio[3]



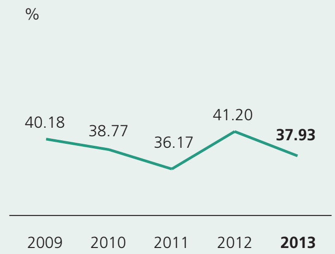
as at 31 December

Capital Ratio[4]



as at 31 December

Average Liquidity Ratio[5]



Loan and deposit growth at a steady pace

- Advances to customers increased by 10.3% while deposits from customers rose by 8.0%. Loan to deposit ratio was 64.63%.

Solid capital position to support business growth

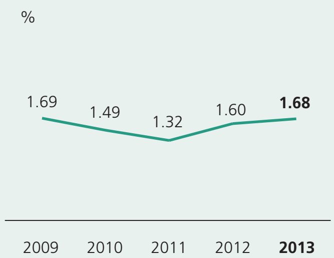
- Total capital ratio was 15.80% while Tier 1 capital ratio was 10.67%. Starting from 1 January 2013, the calculation of the capital ratios was in compliance with the Basel III Accord.

Sound liquidity position

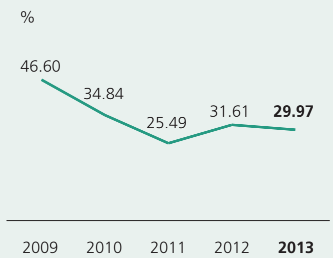
- Average liquidity ratio stood at a sound level of 37.93%.

Key Operating Ratios

Net Interest Margin ("NIM")



Cost to Income Ratio[6]



Classified or Impaired Loan Ratio[7]

as at 31 December

Solid improvement in NIM

- NIM was 1.68%, up 8 basis points year-on-year, mainly attributable to the improvement in loan and deposit spread.

Cautious cost control

- Cost to income ratio was 29.97%, down 1.64 percentage points year-on-year, among the lowest in the industry.

Classified or impaired loan ratio at a low level

- Classified or impaired loan ratio stood at a sound level of 0.28%, below the market average.

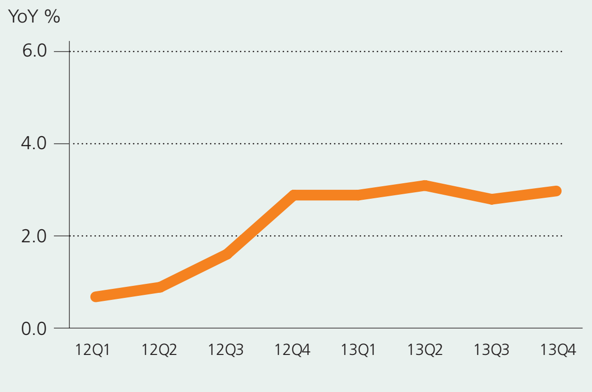
1. Return on Average Shareholders' Equity as defined in "Financial Highlights".
2. Return on Average Total Assets as defined in "Financial Highlights".
3. The deposit base also includes structured deposits reported as "Financial liabilities at fair value through profit or loss".
4. The capital ratios are computed on the consolidated basis that comprises the positions of BOCHK and certain subsidiaries specified by the HKMA for its regulatory purposes and in accordance with the Banking (Capital) Rules. The Banking (Capital) (Amendment) Rules 2012 and the Banking (Capital) (Amendment) Rules 2013 came into operation on 1 January 2013 and 30 June 2013 respectively. The bases of regulatory capital calculation for credit risk, market risk and operational risk are described in Note 4.5 to the Financial Statements in this Annual Report.
5. The average liquidity ratio is calculated as the simple average of each calendar month's average liquidity ratio of BOCHK for the year.
6. Certain comparative amounts in 2012 have been reclassified to conform with the current year's presentation.
7. Classified or impaired loans represent advances which are either classified as "substandard", "doubtful" or "loss" under the Group's classification of loan quality, or individually assessed to be impaired.

MANAGEMENT'S DISCUSSION AND ANALYSIS

ECONOMIC BACKGROUND AND OPERATING ENVIRONMENT

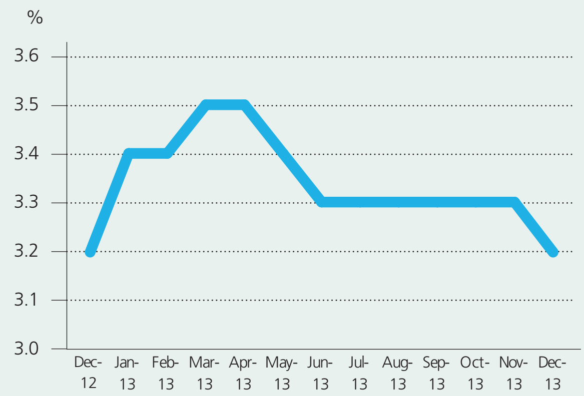
In 2013, the global economic recovery continued on a modest growth trajectory. In the US, with the unemployment rate trending downward and property prices climbing steadily, the prospects for economic growth look brighter relative to other developed economies although momentum remains mild. The economy in the Eurozone emerged from an 18-month recession with modest GDP growth rates. However, elevated unemployment rates and fiscal tightening continued to hinder economic recovery. In the Mainland, economic growth slowed owing to sluggish external demand but the introduction of a series of micro stimulus measures by the Central Government helped the economy regain momentum in the second half of the year. Meanwhile, financial markets were susceptible to volatility since May as there were uncertainties regarding the timing and the pace of tapering of the bond purchase programme by the Federal Reserve ("the Fed").

Hong Kong Real GDP Growth Rate



Source: HKSAR Census and Statistics Department

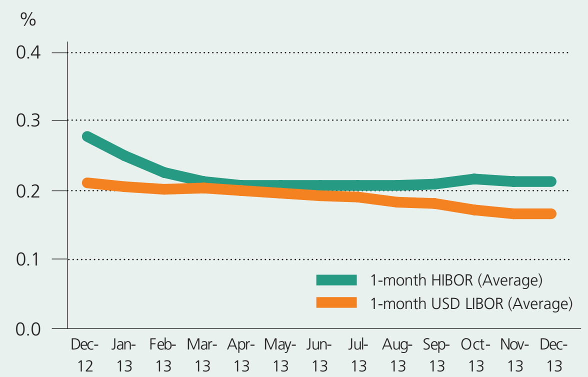
Hong Kong Unemployment Rate



Source: HKSAR Census and Statistics Department

Notwithstanding sluggish external demand, the Hong Kong economy continued to grow at a moderate pace as private consumption remained buoyant. Domestic demand continued to be the major driver of Hong Kong's economic growth. GDP rose by 2.9% in 2013. The unemployment rate stayed at a low level. Inflationary pressure softened with the Composite CPI rising by 4.3% year-on-year in 2013.

HIBOR and USD LIBOR



Source: Bloomberg

The low interest rate environment continued to prevail in Hong Kong. Average 1-month HIBOR and USD LIBOR fell from 0.28% and 0.21% in December 2012 to 0.21% and 0.17% respectively in December 2013. Meanwhile, long-term interest rates rose. The average 10-year HKD Swap rate and USD Swap rate rose from 1.38% and 1.76% in December 2012 to 2.79% and 2.96% respectively in December 2013, with concerns of the Fed's tapering.

The Hong Kong stock market saw increased volatility during the year. In the first half, market sentiment weakened with uncertainty about the Fed's exit strategy for monetary stimulus and the slowdown of economic growth in the Mainland, resulting in the sharp sell-off in June. Nevertheless, stock prices rebounded in the second half with improvement in the Mainland economy and the Fed's decision to start tapering, which was greeted by markets as a sign of improvement in the US economy. The Hang Seng Index reached the lowest point of the year at 19,814 in June and closed at 23,306 at the end of 2013, up 2.9% on a yearly basis.

The local residential property market remained fairly upbeat in early 2013 but cooled following the introduction of further prudential measures by the government in February. As a result, transaction volumes in 2013 plunged compared to 2012. Meanwhile, there was a year-on-year increase in the prices of private domestic properties.

In 2013, the offshore RMB business in Hong Kong grew steadily in terms of market depth and breadth. The total balance of RMB deposits in Hong Kong reached a record high at the end of 2013, representing an increase of 42.7% from 2012. A number of initiatives were introduced to promote the global use of RMB in trade and investment activities. These included the further relaxation of investment restrictions relating to the RQFII scheme, the simplification of operating procedures for cross-border RMB business, and the introduction of the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone and the China (Shanghai) Pilot Free Trade Zone. Furthermore, the HKMA announced two enhancements to the operation of the RMB liquidity facility to provide additional short-term liquidity to support the offshore RMB market. It also removed the RMB net open position limits and the requirement on the RMB liquidity ratio. All these initiatives helped boost the further development of offshore and cross-border RMB business and gave banks more flexibility to conduct RMB business.

With respect to the regulatory environment, the HKMA issued a guidance paper in December 2013 on sound practices for transaction screening, transaction monitoring and suspicious transaction reporting. Banks are expected to give due consideration to the adoption of the recommended practices set out in the paper, where appropriate, or otherwise adopt control measures that are equally effective. The HKMA also set out requirements in January 2014 on the risk management of personal lending business by banks in Hong Kong amid concerns over rising household leverage. With regard to liquidity management, the supervisory requirements on the maintenance of liquidity cushions against a range of liquidity stress scenarios will become effective by the end of March 2014.

Overall, the operating environment for the banking industry remained challenging in 2013. While the offshore RMB market continued to provide the banking sector with more business opportunities, the low interest rate environment, weak external demand and keen market competition hindered banks' profitability.

Outlook for 2014

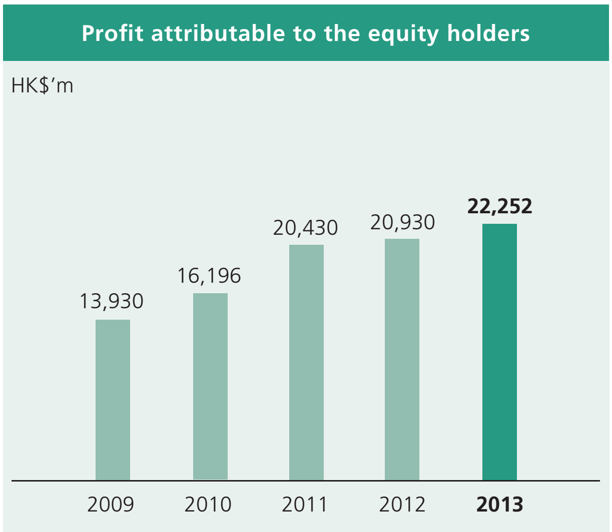
Going into 2014, the overall operating environment for banks in Hong Kong looks mixed as both opportunities and challenges coexist. Global economic recovery is expected to gain strength and provide a stable environment and stronger demand for financial services from the banking sector. With the gradual internationalisation of RMB and wider acceptance of RMB as the transaction currency, banks will have more opportunities to develop RMB-related products and services. The implementation of economic and financial reform measures in the Mainland will provide banks in Hong Kong, in particular, with more business opportunities.

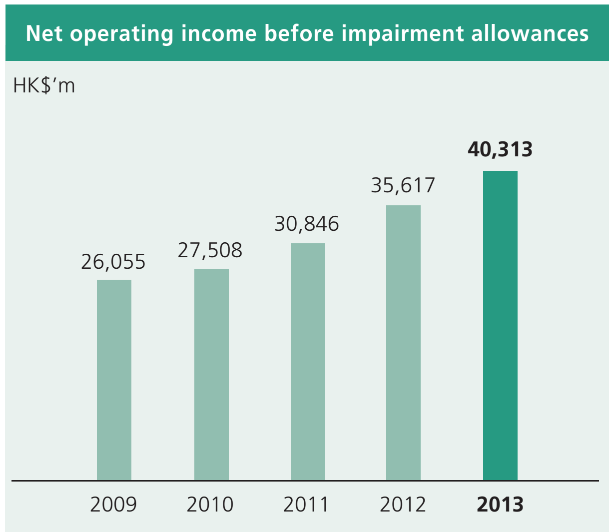
However, the Fed's tapering of stimulus measures, which started in early 2014, and tightened liquidity in the Mainland may lead to increasing volatility in financial markets and risk of capital outflows in emerging markets. With the loan to deposit ratio of the Hong Kong banking sector reaching a relatively high level, banks may face greater challenges in deposit taking and liquidity management. While the asset quality of local banks remained benign in 2013, the upward trend in the volume of non-performing loans in the Mainland may put pressure on Mainland-related exposures of Hong Kong banks.

MANAGEMENT'S DISCUSSION AND ANALYSIS

CONSOLIDATED FINANCIAL REVIEW

Financial Highlights





HK$'m, except percentages	**2013**	2012	Change (%)
Net operating income before impairment allowances	**40,313**	35,617	13.2
Operating expenses	**(12,083)**	(11,259)	7.3
Operating profit before impairment allowances	**28,230**	24,358	15.9
Operating profit after impairment allowances	**27,493**	23,499	17.0
Profit before taxation	**27,793**	25,521	8.9
Profit attributable to the equity holders of the Company	**22,252**	20,930	6.3

Note: Certain comparative amounts in 2012 have been reclassified to conform with the current year's presentation.

Against the backdrop of a challenging operating environment, the Group closely monitored market changes and proactively managed its assets and liabilities. It continued to adopt stringent risk management principles and policies to safeguard its asset quality. In 2013, the Group achieved encouraging financial results with solid growth in core businesses. Key financial ratios stayed at healthy levels.

The Group's net operating income before impairment allowances increased by HK$4,696 million or 13.2% to HK$40,313 million. This was underpinned by the growth in net interest income and net fee and commission income. The Group's insurance business saw improved income growth. The increase was partially offset by the lower net gain on other financial assets. Operating expenses rose by 7.3%, as a result of the business expansion. Net charge of loan impairment allowances decreased. Operating profit after impairment allowances grew by HK$3,994 million or 17.0%. Meanwhile, the net gain from fair value adjustments on investment properties fell considerably by HK$1,621 million year-on-year. As a result, profit attributable to the equity holders rose by HK$1,322 million or 6.3% compared to 2012.

As compared to the first half of 2013, the Group's net operating income before impairment allowances increased by HK$731 million or 3.7% in the second half. The increase in net interest income was partly offset by the decrease in net fee and commission income. The Group recorded a lower net gain from fair value adjustments on investment properties in the second half of the year. As a result, profit attributable to the equity holders decreased by HK$252 million or 2.2% on a half-on-half basis.

Factors Affecting the Group's Performance in 2013

The key positive factors that contributed to the Group's 2013 financial performance are outlined below:

- The Group's proactive asset and liability management achieved a ***healthy growth in both loans and deposits*** with ***effective control of deposit costs and improved loan pricing***.
- The Group's ongoing efforts to enhance its service platform and broaden its product offerings have resulted in an encouraging growth of fee and commission income. Fee income from ***funds distribution***, ***insurance*** and ***securities brokerage*** performed strongly with double-digit growth.
- The Group further expanded its ***offshore RMB business*** and enhanced the income contribution from its RMB business as a ***participating bank***. The better deployment of RMB funds is one of the key factors contributing to the rise in profit.
- The Group further improved its ***operational efficiency*** with the ***cost to income ratio among the lowest in the industry***.
- Contribution from the ***Mainland business*** increased strongly with optimisation of its asset and liability structure.

The Group's financial performance in 2013 was also subject to the following key negative factors:

- The low market interest rates and intense market competition constrained enhancement of the Group's ***asset yield***.
- In contrast to the strong uptrend in 2012, commercial property prices in Hong Kong only rose mildly in 2013. This has resulted in a lower ***net gain from fair value adjustments on investment properties*** in 2013.
- The sluggish ***residential property market*** constrained the growth of the Group's mortgage business.

INCOME STATEMENT ANALYSIS

Net Interest Income and Margin

HK$'m, except percentages	**2013**	2012	Change (%)
Interest income	**39,379**	35,413	11.2
Interest expense	**(11,463)**	(10,705)	7.1
Net interest income	**27,916**	24,708	13.0
Average interest-earning assets	**1,657,215**	1,542,565	7.4
Net interest spread	**1.58%**	1.49%	
Net interest margin*	**1.68%**	1.60%	

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

The Group's net interest income increased by HK$3,208 million or 13.0% year-on-year, driven by both the growth in average interest-earning assets and the widening of net interest margin. Average interest-earning assets expanded by HK$114,650 million or 7.4%, mainly supported by the increase in deposits from customers, partly offset by the decrease in RMB funds from the clearing bank business. Net interest margin was 1.68%, up 8 basis points compared to 2012, mainly attributed to the widening of loan and deposit spread. The average yield of corporate loans improved, while deposit costs were stable through cautious pricing control. Average asset yield was also enhanced with the increase in higher-yielding assets such as loans to customers, RMB bonds as well as balances and placements with banks.

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

ASSETS	Year ended 31 December 2013 Average balance HK$'m	Year ended 31 December 2013 Average yield %	Year ended 31 December 2012 Average balance HK$'m	Year ended 31 December 2012 Average yield %
Balances and placements with banks and other financial institutions	**330,475**	**2.60**	335,842	2.43
Debt securities investments	**498,493**	**2.15**	471,662	2.07
Loans and advances to customers	**813,964**	**2.44**	720,488	2.38
Other interest-earning assets	**14,283**	**1.48**	14,573	1.71
Total interest-earning assets	**1,657,215**	**2.38**	1,542,565	2.29
Non interest-earning assets	**233,188**	**–**	191,823	–
Total assets	**1,890,403**	**2.08**	1,734,388	2.04

LIABILITIES	Average balance HK$'m	Average rate %	Average balance HK$'m	Average rate %
Deposits and balances from banks and other financial institutions	**155,896**	**0.67**	143,219	0.68
Current, savings and time deposits	**1,206,583**	**0.82**	1,112,820	0.81
Subordinated liabilities	**24,150**	**0.49**	28,678	1.09
Other interest-bearing liabilities	**52,375**	**0.89**	44,012	0.92
Total interest-bearing liabilities	**1,439,004**	**0.80**	1,328,729	0.80
Non interest-bearing deposits	**86,504**	**–**	83,588	–
Shareholders' funds* and non interest-bearing liabilities	**364,895**	**–**	322,071	–
Total liabilities	**1,890,403**	**0.61**	1,734,388	0.62

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

Second Half Performance

Compared to the first half of the year, net interest income increased by HK$1,254 million, or 9.4%, to HK$14,585 million. The increase was mainly driven by the 6.2% growth in average interest-earning assets, supported by the increase in deposits from customers and RMB funds from the clearing bank business.

Net interest margin was 1.70%, widening by 3 basis points half-on-half. Net interest spread and contribution from net free fund rose by 1 basis point and 2 basis points respectively. Average yield of balances and placements with banks rose with the rising RMB market interest rates. Increase in higher-yielding assets such as RMB bonds as well as balances and placements with banks also contributed to the widening of net interest margin. Meanwhile, the positive impact was partly offset by the narrowing of loan and deposit spread as the average yield of corporate loans lowered while deposit costs rose, both of which were affected by keen market competition.

Net Fee and Commission Income

HK$'m, except percentages	2013	2012	Change (%)
Credit card business	**3,516**	3,161	11.2
Securities brokerage	**2,432**	2,114	15.0
Loan commissions	**1,900**	1,774	7.1
Insurance	**1,285**	965	33.2
Funds distribution	**821**	540	52.0
Bills commissions	**819**	736	11.3
Payment services	**665**	667	(0.3)
Trust and custody services	**387**	360	7.5
Safe deposit box	**244**	228	7.0
Currency exchange	**197**	156	26.3
Others	**450**	409	10.0
Fee and commission income	**12,716**	11,110	14.5
Fee and commission expenses	**(3,751)**	(3,347)	12.1
Net fee and commission income	**8,965**	7,763	15.5

Note: Certain comparative amounts of fee and commission income, fee and commission expense and operating expenses have been reclassified to conform with the current year's presentation.

Net fee and commission income grew by HK$1,202 million, or 15.5%, to HK$8,965 million in 2013. The increase was broad-based, reflecting the results of the Group's continuous effort in building up its service capabilities. Strong growth of fee and commission income was recorded from funds distribution, insurance and securities brokerage. Income from funds distribution rose substantially by 52.0% as the Group rolled out a range of products and effective segmentation to meet targeted customers' needs. Income from insurance grew by 33.2%, with the rise in business volume. Securities brokerage income increased by 15.0%, supported by the Group's effort in enhancing its business platform and the increased volume of transactions in the stock market. Fee income from the credit card business also grew by 11.2%, driven by the growth in cardholder spending and merchant acquiring volume. Commission income from bills and currency exchange recorded solid growth. The increase in fee and commission expenses was mainly caused by higher credit card and insurance related expenses.

Second half performance
Compared to the first half of 2013, net fee and commission income decreased by HK$397 million or 8.5% in the second half. Fee and commission income from currency exchange, trust and custody services as well as bills saw continued growth momentum from the first half. Income from payment services registered a satisfactory growth. However, commission income from loans and insurance dropped from the high level in the first half.

Net Trading Gain

HK$'m, except percentages	2013	2012	Change (%)
Foreign exchange and foreign exchange products	**1,952**	1,988	(1.8)
Interest rate instruments and items under fair value hedge	**573**	900	(36.3)
Equity instruments	**341**	120	184.2
Commodities	**91**	121	(24.8)
Net trading gain	**2,957**	3,129	(5.5)

Net trading gain was HK$2,957 million, down HK$172 million or 5.5% year-on-year, mainly due to the mark-to-market changes of certain debt securities. During the year, income from currency exchange transactions increased, but was offset by net trading loss from foreign exchange swap contracts*. The growth in net trading gain from equity instruments was mainly attributable to the higher mark-to-market gain on certain equity securities and the increased gain from equity-linked products, which were well received by customers. The decrease in net trading gain from commodities was due to the decline in bullion transactions.

Second Half Performance

Compared to the first half of 2013, net trading gain was up HK$75 million or 5.2%. This was mainly due to the mark-to-market gain of certain debt securities caused by market interest rate movements, compared to a mark-to-market loss in the first half.

* 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 with minimal 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 gain/(loss)"), while the corresponding interest differential between the surplus funds in original currency and swapped currency is reflected in net interest income.

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

HK$'m, except percentages	**2013**	2012	Change (%)
Net (loss)/gain on financial instruments designated at fair value through profit or loss	**(159)**	747	N/A

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

Second Half Performance

A net gain of HK$361 million was recorded in the second half of the year, compared to a net loss in the first half. The net gain was mainly attributable to the mark-to-market changes of BOCG Life's debt securities investments.

Net Charge of Loan Impairment Allowances

HK$'m, except percentages	**2013**	2012	Change (%)
Net charge of allowances before recoveries			
– individual assessment	**(313)**	(512)	(38.9)
– collective assessment	**(705)**	(606)	16.3
Recoveries	**288**	264	9.1
Net charge of loan impairment allowances	**(730)**	(854)	(14.5)

The net charge of loan impairment allowances decreased by HK$124 million, or 14.5% from the previous year, owing to the decrease in the net charge of individually assessed impairment allowances.

Net charge of individually assessed impairment allowances amounted to HK$313 million, down HK$199 million or 38.9%, mainly due to the decrease in the amount of new classified or impaired loans in 2013.

Net charge of collectively assessed impairment allowances amounted to HK$705 million, up HK$99 million or 16.3%, primarily due to the loan growth and the periodic update of the parameter values in the assessment model.

Recoveries amounted to HK$288 million, up HK$24 million or 9.1% from 2012.

Second Half Performance

Net charge of loan impairment allowances decreased mildly by HK$6 million or 1.6% from the first half. The higher net charge of individually assessed impairment allowances was offset by the lower net charge of collectively assessed impairment allowances. Recoveries also reduced.

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

	At 31 December 2013	At 31 December 2012
Loan impairment allowances		
– individual assessment	**0.10%**	0.10%
– collective assessment	**0.39%**	0.38%
Total loan impairment allowances	**0.49%**	0.48%

Operating Expenses

HK$'m, except percentages	**2013**	2012	Change (%)
Staff costs	**6,819**	6,406	6.4
Premises and equipment expenses (excluding depreciation)	**1,576**	1,456	8.2
Depreciation on owned fixed assets	**1,663**	1,493	11.4
Other operating expenses	**2,025**	1,904	6.4
Total operating expenses	**12,083**	11,259	7.3

	At 31 December 2013	At 31 December 2012	Change (%)
Staff headcount measured in full-time equivalents	**14,647**	14,638	0.1

Note: Certain comparative amounts of operating expenses have been reclassified to fee and commission expense to conform with the current year's presentation.

Total operating expenses increased by HK$824 million, or 7.3%, to HK$12,083 million, as a result of the Group's business expansion. The Group continued to invest in new business platforms and the Mainland business to support long-term business growth. At the same time, it adhered to conscious cost control to enhance operational efficiency.

Staff costs increased by 6.4%, reflecting higher salaries following the annual salary increment and the increase in headcount in the Mainland business. Performance-related remuneration also increased.

Premises and equipment expenses rose by 8.2% with higher rental for branches in Hong Kong and new branches in the Mainland.

Depreciation on owned fixed assets rose by 11.4% due to larger depreciation charge on premises following the upward property revaluation in Hong Kong.

Other operating expenses were up 6.4%, mainly due to higher business expenses incurred by NCB (China) and the Group's credit card business.

At the end of 2013, the total headcount measured in full-time equivalents rose slightly to 14,647.

Second Half Performance
Compared to the first half of 2013, operating expenses rose by HK$699 million. The increase was due to higher staff costs, depreciation, IT, maintenance and rental expenses in the second half of the year.

BALANCE SHEET ANALYSIS

Asset Deployment

	At 31 December 2013		At 31 December 2012	
HK$'m, except percentages	**Amount**	**% of total**	Amount	% of total
Cash and balances with banks and other financial institutions	**353,741**	**17.3**	198,748	10.9
Placements with banks and other financial institutions maturing between one and twelve months	**46,694**	**2.3**	66,025	3.6
Hong Kong SAR Government certificates of indebtedness	**99,190**	**4.8**	82,930	4.5
Securities investments[1]	**484,213**	**23.6**	531,696	29.0
Advances and other accounts	**924,943**	**45.2**	819,739	44.8
Fixed assets and investment properties	**66,955**	**3.3**	63,107	3.4
Other assets[2]	**71,200**	**3.5**	68,518	3.8
Total assets	**2,046,936**	**100.0**	1,830,763	100.0

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

As at 31 December 2013, the Group's total assets amounted to HK$2,046,936 million, increasing by HK$216,173 million or 11.8% from the end of 2012. The Group maintained its proactive asset and liability management for sustainable growth and enhanced profitability. It focused on optimising asset allocation, enhancing loan pricing and funding cost management.

Key changes in the Group's total assets include:

- Cash and balances with banks and other financial institutions increased by 78.0%, mainly due to the increase in RMB funds placed with the People's Bank of China by BOCHK's clearing business as participating banks increased their RMB deposits with the clearing bank. Balances and placements with banks relating to the RMB business in Hong Kong also increased.

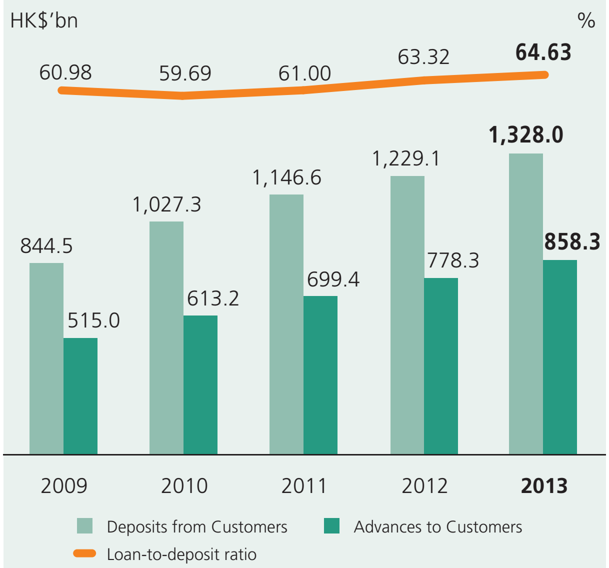
- Placements with banks and other financial institutions maturing between one and twelve months decreased by 29.3% as the Group redeployed its funds in higher-yielding assets such as advances to customers.

- Securities investments decreased by 8.9% with the reduction mainly in lower yielding government-related securities. Meanwhile, new investments were made in high-quality financial institutions and corporate bonds.

- Advances and other accounts rose by 12.8%, mainly attributable to the growth in advances to customers by 10.3% and trade bills by 56.8%.

- Other assets grew by 3.9%, which was led by the increase in reinsurance assets.

Advances to customers and deposits from customers[1]



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

Advances to Customers

HK$'m, except percentages	At 31 December 2013 Amount	At 31 December 2013 % of total	At 31 December 2012 Amount	At 31 December 2012 % of total
Loans for use in Hong Kong	**507,971**	**59.2**	480,753	61.8
Industrial, commercial and financial	**267,632**	**31.2**	252,877	32.5
Individuals	**240,339**	**28.0**	227,876	29.3
Trade finance	**85,413**	**9.9**	67,137	8.6
Loans for use outside Hong Kong	**264,948**	**30.9**	230,374	29.6
Total advances to customers	**858,332**	**100.0**	778,264	100.0

The Group continued to focus on customer selection to achieve quality and sustainable growth. Advances to customers grew by HK$80,068 million or 10.3% to HK$858,332 million in 2013.

Loans for use in Hong Kong grew by HK$27,218 million or 5.7%.

- Lending to the industrial, commercial and financial sectors increased by HK$14,755 million, or 5.8%. Lending to the property development, transport and transport equipment sectors as well as stockbrokers grew by 29.3%, 26.0% and 267.8% respectively.

- Lending to individuals increased by HK$12,463 million, or 5.5%. Residential mortgage loans (excluding those under the Government-sponsored home purchasing schemes) grew by 1.8%. Credit card advances rose by 6.0%.

Trade finance rose significantly by HK$18,276 million, or 27.2%. Meanwhile, loans for use outside Hong Kong grew by HK$34,574 million or 15.0%.

Second Half Performance

The Group's advances to customers increased by HK$27,589 million or 3.3%, mainly driven by growth in loans for use outside Hong Kong and trade finance.

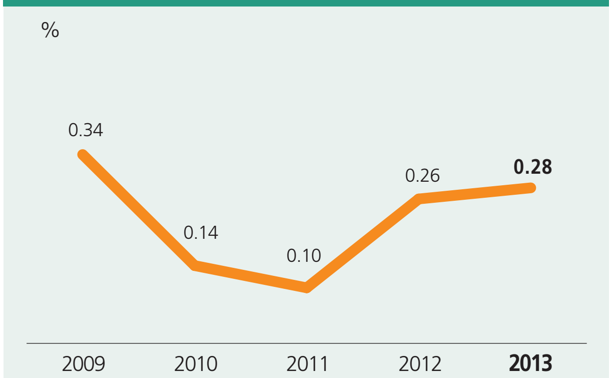
Loan Quality

HK$'m, except percentages	**At 31 December 2013**	At 31 December 2012
Advances to customers	**858,332**	778,264
Classified or impaired loan ratio	**0.28%**	0.26%
Impairment allowances	**4,235**	3,705
Regulatory reserve for general banking risks	**8,994**	7,754
Total allowances and regulatory reserve	**13,229**	11,459
Total allowances as a percentage of advances to customers	**0.49%**	0.48%
Impairment allowances[1] on classified or impaired loan ratio	**36.09%**	37.44%
Residential mortgage loans[2] – delinquency and rescheduled loan ratio[3]	**0.02%**	0.02%
Card advances – delinquency ratio[3]	**0.18%**	0.17%

	2013	2012
Card advances – charge-off ratio[4]	**1.43%**	1.24%

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

Classified or impaired loan ratio



as at 31 December

The Group's credit quality remained solid. The classified or impaired loan ratio was at 0.28%. Classified or impaired loans rose by HK$379 million, or 18.5% to HK$2,433 million, due to the downgrade of a few corporate loans. Formation of new classified or impaired loans in 2013 represented approximately 0.15% of total loans outstanding.

Total impairment allowances, including both individual assessment and collective assessment, amounted to HK$4,235 million. Total impairment allowances on classified or impaired loans as a percentage of total classified or impaired loans was at 36.09%.

The credit quality of the Group's residential mortgage loans and credit cards remained sound. The combined delinquency and rescheduled loan ratio of residential mortgage loans stood at 0.02% at the end of 2013. The charge-off ratio of card advances remained low at 1.43%, amid an upward trend in the market.

Deposits from Customers*

HK$'m, except percentages	At 31 December 2013 Amount	At 31 December 2013 % of total	At 31 December 2012 Amount	At 31 December 2012 % of total
Demand deposits and current accounts	**104,784**	**7.9**	97,295	7.9
Savings deposits	**636,137**	**47.9**	603,565	49.1
Time, call and notice deposits	**583,227**	**43.9**	525,430	42.8
	1,324,148	**99.7**	1,226,290	99.8
Structured deposits	**3,832**	**0.3**	2,841	0.2
Deposits from customers	**1,327,980**	**100.0**	1,229,131	100.0

* Including structured deposits

The Group maintained a flexible deposit strategy to support its business growth with cautious control of funding costs in response to market changes. Its deposit base was up HK$98,849 million, or 8.0%, to HK$1,327,980 million in 2013. Demand deposits and current accounts grew by 7.7% while savings deposits increased by 5.4%. Time, call and notice deposits also increased by 11.0%. The Group's loan to deposit ratio was 64.63% at the end of 2013, up 1.31 percentage points from the end of last year.

Second Half Performance
Total deposits from customers increased by HK$63,690 million or 5.0% in the second half of 2013. Demand deposits and current accounts increased by 5.1% while savings deposits went up by 12.7%. Time, call and notice deposits declined by 2.1%.

Capital and Reserves Attributable to the Equity Holders of the Company

HK$'m	At 31 December 2013	At 31 December 2012
Share capital	**52,864**	52,864
Premises revaluation reserve	**34,682**	31,259
Reserve for fair value changes of available-for-sale securities	**488**	5,510
Regulatory reserve	**8,994**	7,754
Translation reserve	**1,051**	771
Retained earnings	**60,734**	52,811
Reserves	**105,949**	98,105
Capital and reserves attributable to the Equity Holders of the Company	**158,813**	150,969

Capital and reserves attributable to the equity holders increased by HK$7,844 million, or 5.2% to HK$158,813 million at 31 December 2013. Retained earnings rose by 15.0%, reflecting the 2013 profit after the appropriation of dividends. Premises revaluation reserve increased by 11.0%, which was attributable to the increase in property prices in 2013. Regulatory reserve rose by 16.0%, mainly due to loan growth. Reserve for fair value changes of available-for-sale securities decreased to HK$488 million, due to rising market interest rates.

Capital and Liquidity Ratio

HK$'m, except percentages	At 31 December 2013
Capital ratios under Basel III	
Consolidated capital after deductions	
Common Equity Tier 1 capital	**92,112**
Additional Tier 1 capital	**894**
Tier 1 capital	**93,006**
Tier 2 capital	**44,683**
Total capital	**137,689**
Total risk-weighted assets	**871,618**
Common Equity Tier 1 capital ratio	**10.57%**
Tier 1 capital ratio	**10.67%**
Total capital ratio	**15.80%**

	At 31 December 2012
Capital ratios under Basel II	
Consolidated capital base after deductions	
Core capital	89,096
Supplementary capital	32,452
Total capital base	121,548
Total risk-weighted assets	723,699
Core capital ratio	12.31%
Capital adequacy ratio	16.80%

	2013	2012
Average liquidity ratio	**37.93%**	41.20%

The Banking (Capital) (Amendment) Rules 2012 and the Banking (Capital) (Amendment) Rules 2013 ("the rules") came into operation on 1 January 2013 and 30 June 2013 respectively. The rules mainly addressed the revision to both the minimum capital ratio requirement and the definition of regulatory capital. The rules also included enhancements to the counterparty credit risk framework and amendments on the capital treatment for certain trade financing activities and securities financing transactions. For information on the components of total capital and type of capital instruments used, please refer to Note 4.5 and Note 41 to the Financial Statements in this Annual Report. As a result of the adoption of the rules, the capital ratios shown above are not directly comparable.

Total capital ratio at 31 December 2013 was 15.80%.

Risk-weighted assets increased by 20.4%, mainly from changes in risk-weighted assets for credit risk as a result of loan growth and increase in interbank exposures. The increase in risk-weighted assets was also attributable to changes introduced by Basel III.

The average liquidity ratio in 2013 remained solid at 37.93%.

MANAGEMENT'S DISCUSSION AND ANALYSIS

BUSINESS REVIEW

2013 Business Highlights

Personal Banking
- Maintained leading position in residential mortgages and the UnionPay card business
- Strengthened the wealth management platform with introduction of the brand new Enrich Banking Service
- Launched Virtual Securities Investment Platform and various marketing campaigns to appeal to younger clientele
- Good progress seen in Private Banking service with increased number of customers and assets under management
- Received the "Outstanding Retail Banking Business – Internet Banking Business" award of the "RMB Business Outstanding Awards 2013"

Corporate Banking
- Remained the top mandated arranger in the Hong Kong-Macau syndicated loan market
- Set up the Corporate Services Centre to further improve service efficiencies
- Notable performance in cross-border direct loan business and introduced offshore import finance service
- Received "Best SME's Partner Award" for the sixth consecutive year
- Further expanded client base for custody services and awarded "Best QFII Custodian" by The Asset Magazine
- Cash management services was presented with the "Achievement Award for Best Cash Management Bank in Hong Kong" in the "Asian Banker Transaction Banking Awards 2013"

Treasury
- Proactively adjusted portfolio mix to enhance return and shortened portfolio duration while staying attuned to risk
- Increased investments in high-quality financial institutions and corporate bonds as well as RMB-denominated bonds
- Timely response to market conditions and successful launch of treasury products

Insurance
- Maintained leading position in Hong Kong RMB insurance market
- Enriched product offerings to meet customers' needs and enhanced distribution channels to recruit new customers
- Recognised as "Best Life Insurance Company, Hong Kong" in the "Insurance Award 2013" by World Finance, a UK finance magazine

Mainland Business
- Achieved encouraging profit growth with satisfactory increases in loans and deposits
- Expanded product and service offerings with launch of credit card issuing business
- Further expanded branch network to 41 branches and sub-branches

RMB Business in Hong Kong
- Completed the Group's first RMB cross-border loan in Qianhai
- Collaborated with BOC to promote RMB business and establish closer relationship with overseas customers
- BOCHK appointed by Clearstream Banking S.A. as its cash correspondent bank for offshore RMB in Hong Kong
- Completed the first CNH/USD cross-currency swap transaction using the CNH HIBOR as the pricing benchmark
- Acted as the arranger for the issuance of the first RMB certificate of deposit with the CNH HIBOR as the benchmark rate
- Designated as the market maker of the USD/CNH futures for the Chicago Mercantile Exchange Group and Hong Kong Futures Exchange
- Introduced RMB time deposit service and tiered interest rates scheme and adjusted RMB intra-day Repo limits for participating banks to better manage their RMB funds
- Extended operating hours of RMB cross-border payments to better serve participating banks in different time zones
- Jointly launched the FTSE-BOCHK Offshore RMB Bond Index Series with FTSE Group

Others – BOCHK Asset Management Limited
- Launched two retails funds, both of which received overwhelming response from customers
- Granted an RQFII status and received an investment quota to invest in onshore equity securities
- Named the "Best Offshore RMB Manager" by Asia Asset Management for its "Best of the Best Awards" in two consecutive years since 2012
- Launched in 2012, the BOCHK-World Bank Emerging Markets Bond Fund was awarded the "Best-in-Class for Technology and Innovation" in the BENCHMARK Fund of the Year Award 2013

Business Segment Performance

Profit before Taxation by Business Segments

	2013		2012	
HK$'m, except percentages	**Amount**	**% of total**	Amount	% of total
Personal Banking	**6,926**	**24.9**	5,513	21.6
Corporate Banking	**11,844**	**42.6**	9,725	38.1
Treasury	**8,347**	**30.0**	8,382	32.8
Insurance	**1,144**	**4.1**	609	2.4
Others	**(468)**	**(1.6)**	1,292	5.1
Total profit before taxation	**27,793**	**100.0**	25,521	100.0

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

PERSONAL BANKING

Financial Results

Personal Banking achieved a strong increase of HK$1,413 million, or 25.6%, in profit before taxation in 2013 compared with the previous year. The growth was mainly attributable to the increase in net interest income and net fee and commission income.

Net interest income increased by 14.1%. This was mainly driven by the growth in average balance of loans and deposits coupled with the improvement in loan spread. Personal loans and deposits grew by 6.6% and 3.2% respectively compared with the end of 2012.

Net fee and commission income rose by 23.4%. The notable growth was attributable to the higher income from securities brokerage, funds distribution, insurance and credit cards.

Net trading gain increased by 31.3%, due to higher gains from equity instruments and foreign exchange related products.

Business operation

The Group's personal lending business continued its steady growth in 2013. It remained the market leader in new mortgage loans and the UnionPay card business. The Group's investment and insurance businesses registered broad-based growth with strong performance in fee and commission income from funds distribution, insurance and securities brokerage. The wealth management platform was further strengthened by the launch of the Enrich Banking Service while the Private Banking service showed encouraging results. Distribution channels were further optimised to enhance customer experience.

Residential mortgages – reinforcing market leadership

The Group continued to innovate to provide customers with the widest range of mortgage products and services across all channels. New products and services such as the Fixed-Rate Mortgage Scheme, Portable Fixed-Rate Mortgage Scheme, Instant Mortgage Assessment Service and Premium Mortgage Service were launched. The Group also partnered with the Hong Kong Mortgage Corporation Limited to actively promote reverse mortgages. During the year, it worked in close partnership with major property developers and participated in joint promotions of prime property development projects. The extensive range of products and services enabled the Group to remain as the market leader of new mortgage loans underwritten during the year.

Investment and insurance businesses – registering broad-based growth

Investment and insurance businesses registered encouraging performance with strong growth of commission income from securities brokerage, funds distribution and insurance. IPO shares placement services, traditionally offered to Private Banking customers only, were introduced to selected personal banking customers. The new educational Virtual Securities Investment Platform and the revamped Warrants/Callable Bull/Bear Contracts Information Webpage were rolled out to serve the needs of young investors as well as sophisticated traders respectively. Meanwhile, the innovative Family Securities Accounts service provides a brand new platform for parents to manage their various securities portfolios. The new Securities Club provides preferential services suited to customers of various membership tiers.

In the funds distribution business, the Group continued to broaden its product offerings. Two retail funds, the BOCHK All Weather RMB High Yield Bond Fund and the BOCHK All Weather HK & China Equity Fund, were launched and well received by customers. The Group continued to deepen relationships with existing customers and actively pursued new customers. Themed marketing campaigns and investment seminars were conducted to help customers further diversify their investment portfolios. The online fund webpage was enhanced with integrated information such as the latest market trends and fund information. As a result, commission income from funds distribution surged by 52.0% over last year. For bonds distribution, the Group continued to leverage its competitive edge and became one of the largest placing banks of the third iBond issuance and the RMB Sovereign Bonds issuance during the year.

With regards to the Bancassurance business, the Group maintained its leading position in the Hong Kong RMB insurance market. During the year, the direct sales team was centralised to enhance overall sales capabilities.

Credit card business – recognised leader in UnionPay card business

The Group's credit card business achieved success on a number of fronts in 2013. It maintained its leadership in the UnionPay International ("UPI") merchant acquiring business and card issuing business in Hong Kong. During the year, the Group partnered with UPI to pioneer the RMB settlement service of UnionPay card for merchants in Hong Kong. The launch of BOCHK e-Wallet – Mobile Payment Services brought an innovative and convenient mobile payment experience to customers. Through mobile phones equipped with BOC SD card and BOCHK e-Wallet application, customers can make credit card contactless transactions.

Wealth management service – one-stop wealth management solutions

Following the consolidation of its Wealth Management Service platform in 2012, the Group continued to provide personalised services and professional financial solutions to meet the banking and investment needs of high-end customers locally and across the border. A series of marketing programmes were launched to enhance brand image and to increase penetration with targeted customers. The Group also introduced its brand new Enrich Banking Service, to fulfil the lifestyle needs of the busy mid-segment working population with all-round financial management solutions, including the first-ever 24-hour Online Chat service in banking industry and a suite of electronic alerts.

The Group's Private Banking business made good progress after its launch in late 2012. In collaboration with business units of the Group as well as BOC, it expanded its customer base through a series of client acquisition and referral activities. Based on the one-stop, holistic service model, a wide range of tailor-made products and services in the area of investment management, liquidity management and estate planning were offered to meet the needs of Private Banking clients. Consequently, the business recorded encouraging results in terms of both the number of Private Banking customers and the assets under management.

Mass retail customers – appealing to younger clientele

The Group continued to implement its customer segmentation strategy to provide customers with the appropriate sales and service models. The Group re-packaged its i-Free Banking Service to cater for the basic banking and financial planning needs of general customers. In addition, a selection of savings plans together with lower-risk savings and investment products were launched to appeal to mass clientele. To target the youth segment, the Group used social media as the main channel to promote BOCHK's new investment learning platform.

Cross-border business – full coverage of attestation service in the Mainland

As the leading cross-border service provider in the market, the Group provides comprehensive and seamless solutions to customers in both Hong Kong and in the Mainland with banking needs across the border. The Group extended attestation account opening services at BOC's branches in all major cities and all branches of NCB (China). Referral services were enhanced with the support of a new dedicated team.

Distribution channels – strengthening automated banking channels

The Group continued to optimise its distribution channels to meet the needs of customers. At the end of 2013, the Group's service network in Hong Kong comprised 266 branches, including 133 wealth management centres. The continuous introduction of new concept branches was intended to enhance the customer experience and the Group's brand image. Automated banking channels were upgraded to provide customers with a comprehensive range of self-service banking services. Voice navigation ATM machines were also introduced to aid visually impaired customers with automated banking services. Furthermore, the Group launched the first HKD/RMB Cash Deposit Machine in Hong Kong, giving customers added convenience with the cash deposit functions in both currencies.

In recognition of its well-received electronic platform and outstanding services, the Group received the "Outstanding Retail Banking Business – Internet Banking" award of the "RMB Business Outstanding Awards 2013" organised by Metro Finance, Metro Finance Digital and Hong Kong Wen Wei Po. The Group was also recognised for "Best Personal Internet Banking" and the "Best Mobile Banking" under the e-brand Awards 2013 organised by the e-Zone Magazine. Financial planners of the Group won the Gold Award and the Best Performance Award in the "7th HKIB Outstanding Financial Management Planner Awards" presented by The Hong Kong Institute of Bankers.

CORPORATE BANKING

Financial Results

Corporate Banking recorded an encouraging growth of HK$2,119 million, or 21.8%, in profit before taxation in 2013.

Net interest income rose by 20.6%, mainly driven by the increase in average balance of loans and deposits coupled with the increase in loan spread. The growth was partly offset by the decrease in deposit spread. Corporate loans and deposits grew by 11.9% and 13.5% respectively compared with the end of 2012.

Net fee and commission income increased by 7.1%, largely led by the growth of loans and bills commissions. The increase was, however, partly offset by the decline in commissions from payment services.

Business operation

The Group's Corporate Banking business made important headway with business development in 2013. It continued to provide comprehensive banking services to better serve customers' needs and strengthen customer relationships. It stepped up initiatives and collaboration with BOC in various business areas to enhance its competitive advantages and the overall synergy of the BOC Group. In collaboration with BOC, the Group's status in the international syndicated loan market has been elevated, while it registered a notable performance in the cross-border direct loan business. In the custody business, the Group further expanded its client base from different geographical locations. Service capabilities of the cash management business were enhanced to reinforce its competitive edge as the cross-border fund centre for customers.

Corporate lending business – Top mandated arranger in the Hong Kong-Macau syndicated loan market

The Group continued to work closely with BOC to provide a distinctive service offering. A two-way information exchange and business referral channel was established with BOC's branches in the Mainland and overseas for both onshore and offshore business. In cooperation with BOC, the Group successfully conducted conference presentations in various overseas countries, promoting its RMB business and establishing relationships with overseas customers. The Group strives to enhance service quality through continuous improvement of expertise in different industries. The Corporate Services Centre was set up to further improve service efficiencies. In 2013, the Group successfully completed its first RMB cross-border loan to an enterprise in Qianhai. It also made significant progress in the cross-border direct loan business and remained the top mandated arranger in the Hong Kong-Macau syndicated loan market. Acting as the Asia-Pacific Syndicated Loan Centre of BOC Group, the Group successfully helped arrange a syndicated loan led by the BOC Group to finance a renowned acquisition, enhancing the Group's reputation as an arranger bank in both M&A finance and syndicated loan market in the international arena. The Group also worked closely with BOC to explore new business opportunities from the China (Shanghai) Pilot Free Trade Zone.

SME business – “Best SME’s Partner Award” for the sixth consecutive year

The Group strives to enhance customer experience for SME customers. Further to the launch of the Integrated Branches for Commercial Business and Business Integrated Account in 2012, the Group optimised the corporate internet banking platform CBS Online, featuring a modern and user-friendly interface which encourages transaction flow to consolidate customer relationships and attract new customers. The Group also launched a privileged guarantee fee subsidy to support the Special Concessionary Measures of the SME Financing Guarantee Scheme of the Hong Kong Mortgage Corporation Limited. Furthermore, the BOC Small Business Loan was launched to offer the vast majority of small businesses in the market a prompt and flexible financing solution to facilitate their business growth. In recognition of its long-standing support of SMEs in Hong Kong, the Group received for the sixth consecutive year the “Best SME’s Partner Award” from the Hong Kong General Chamber of Small and Medium Business.

Trade finance – enhanced product features

The Group continued to enhance product features to meet customer needs in a changing business environment. During the year, the Group launched the offshore import finance service. Meanwhile, there was considerable growth in the offshore export finance business. The Group focused on doing business that have a genuine trade background, arranging services in forfeiting, risk participation and offshore import finance. At the end of 2013, the Group’s balance of trade finance had grown by 27.2% from the end of 2012.

Custody service – further expansion of customer base

The Group continued to expand its custody services in 2013. In addition to those institutions with Mainland background, the Group established business relationships with a number of new RQFII applicants from Hong Kong, Taiwan and other overseas countries or regions. It continued to expand its client base and successfully secured mandates to provide custody services for RQFII-ETFs and various types of RQFII and QDIIs products. Continuous and closer cooperation have been fostered with BOC branches to enhance the overall service capacity. In recognition of its outstanding QFII-related performance, BOCHK was awarded the “Best QFII Custodian” under Regional Specialist in the Asset Servicing Awards 2013 by The Asset Magazine. At the end of 2013, excluding the RMB fiduciary account for participating banks, total assets under the Group’s custody were valued at HK$690 billion.

Cash management service – further strengthening of service capabilities

The Group continued to strengthen its cross-border cash management service capabilities. The remittance points of BOC Remittance Plus have been extended to cover all BOC’s branches in the Mainland and its Taipei Branch, providing customers with greater convenience. In addition, the Group successfully completed the linkage of domestic liquidity management functions with the cross-border liquidity management services of BOC to strengthen its competitive edge as a cross-border fund centre for customers in Hong Kong. The new Electronic Bill Presentment and Payment service was launched to provide one-stop bill collection and payment services to customers. During the year, BOCHK was appointed by Clearstream Banking S.A. as its cash correspondent bank for offshore RMB in Hong Kong. This appointment reinforced the Group’s leading position in the offshore RMB business. In recognition of its outstanding cash management services, BOCHK was presented the “Achievement Award for Best Cash Management Bank in Hong Kong” in the “Asian Banker Transaction Banking Awards 2013”.

Risk management – proactive measures to contain risks

The Group remained focused on managing its asset quality through strict adherence to prudent credit policy. It continued to strengthen its know-your-customer process and closely monitored customers and industries that could be adversely affected by the volatile economic environment, including the possible slowdown of economic growth in the Mainland and the withdrawal of stimulus in the US. Mainland customers in certain vulnerable industries with over-capacities have been closely monitored. Rigorous pre- and post-lending monitoring measures were put in place to track early negative signs, with ad hoc credit review and precautionary measures taken in a timely manner. In view of the rapid growth in the offshore RMB business, the Group also enhanced risk measurements and control standards of RMB exposure to support the healthy growth of RMB businesses.

MANAGEMENT'S DISCUSSION AND ANALYSIS

MAINLAND BUSINESS

Financial performance – encouraging growth

The Group's Mainland business recorded encouraging growth with optimisation of assets and liabilities to improve return. Net operating income increased by 28.5% while operating expenses rose by 28.4% with further investment in the Mainland. Deposits from customers and loans registered satisfactory growth of 16.0% and 12.8% respectively from the end of last year. Loan quality remained sound.

Product and service offerings – continuous enhancement in capabilities

The Group continued to enrich its product and service offerings. During the year, the Group launched a series of structured wealth management products, including the equity-linked Preferred Equity and the crude oil-linked Global Energy. Another series of wealth management products, Yixiang II, was also launched and well received by customers, making significant contribution to commission income. During the year, NCB (China) commenced its credit card issuing business in the Mainland. The SME business platform was further enhanced with the launch of the Small Micro-Enterprises Loan Programme as well as financing programmes that were tailor-made to support SMEs in certain industries. In close collaboration with BOC's branches in the Mainland and overseas, NCB (China) reinforced its competitiveness in the trade finance business.

Distribution channels – further expansion of branch network and enhanced e-Banking function

The Group further expanded its branch network in the Mainland with the opening of one main branch and four sub-branches of NCB (China) in the year. The Group's total number of branches and sub-branches in the Mainland increased to 41 by the end of 2013. Meanwhile, the Group continued to enhance both its personal and corporate e-Banking platforms with the introduction of new services, extension of service hours and sharing of the payment platform of BOC. The Group also conducted several projects to streamline business processes, in order to shorten turnaround time and enhance customer experience.

TREASURY

Financial Results

Treasury recorded a mild decrease of 0.4% in profit before taxation from the previous year.

Net interest income increased by 0.8%. This was mainly due to the increase in the average balance of debt securities investments coupled with the improved yield on interbank placements. The increase was, however, partly offset by the decrease in the average balance of interbank placements and the lower spread on debt securities investments.

Net trading gain was up 17.5%. The increase was mainly attributable to the income from currency exchange transactions and the mark-to-market gain of certain interest rate instruments.

Net gain on other financial assets was down 71.3%. This was mainly due to the higher gain recorded in 2012 as the Group captured market opportunities to realise gain on certain debt securities investments.

Business Operation

Proactive investment strategy – staying attuned to risk

The Group continued to take a proactive yet prudent approach in managing its banking book investments. It closely monitored market changes and adjusted its investment portfolio to enhance return while staying vigilant of risks. In 2013, the Group shortened portfolio duration and selectively increased its investments in high-quality financial institutions and corporate bonds. The Group also increased its holdings in RMB-denominated bonds issued by policy banks and high-quality Mainland corporates.

Product sales – responding to market demand

In line with its customer-centric approach, the Group continued to focus on its strengths in deal origination, client marketing and product management. During the year, the Group was an active participant in the market, providing timely response to customer demand. It focused on promoting products and services, including structured deposit, equity-linked investment and foreign exchange margin trading, which were well-received by customers. In the bond underwriting business, the Group achieved success in business diversification with underwriting of bond issuance in different denominated currencies.

RMB-related business – the leading CNH (offshore RMB) market player

As the leading market player in the offshore RMB treasury business in Hong Kong, the Group completed the first CNH/USD cross-currency swap transaction using the CNH HIBOR as the pricing benchmark. This transaction served as a tool to hedge against interest rate risks and marked a new milestone in the development of the offshore RMB business. The Group also successfully acted as the arranger for the issuance of the first RMB certificate of deposit with the CNH HIBOR as the benchmark rate, offering the market a wider choice of floating rate debt instruments. BOCHK has been designated as the market maker of the USD/CNH futures for the Chicago Mercantile Exchange Group and Hong Kong Futures Exchange, becoming the only bank to play such a role in both exchanges.

RMB clearing service – continuous service enhancement

The Group continued to develop better infrastructure to ensure the stable operation and continuous improvement of RMB clearing services in Hong Kong. A number of measures, including the introduction of RMB time deposit service, tiered interest rates scheme and the adjustment of RMB intra-day Repo limits, have been introduced for participating banks to better manage their RMB funds. The extension of operating hours for RMB cross-border payments allows participating banks in different time zones to enjoy the convenience of the Group's settlement service.

INSURANCE

Financial Results

The Group's Insurance segment registered a strong growth of 87.8% in its profit before taxation to HK$1,144 million in 2013.

Net insurance premium income grew robustly by 42.1%, as a result of the Group's continuous efforts in product enhancement as well as marketing and promotional campaigns. Policy reserves were lower, as reflected in the changes in net insurance benefits and claims on the back of higher long-term interest rates. This outweighed the mark-to-market changes of debt securities, which were affected by market interest rate movements.

Business Operation

Driving growth through product enhancement and diversified distribution channels

The Group continued to broaden its product offerings to meet the diverse needs of customers. The UltiChoice Universal Life Insurance Plan was launched to help customers with financial planning and provide whole life protection. The Group also actively developed new distribution channels and established partnerships with brokerage houses to promote insurance products. The optimisation of distribution channels enabled the Group to reach a wider range of customers.

In recognition of its distinctive achievements in the year, BOCG Life was awarded the"Best Life Insurance Company, Hong Kong" in the "Insurance Award 2013" by World Finance, a UK finance magazine, and the "Outstanding Brand Award 2013 – Life Insurance Category" by Economic Digest.

RMB insurance products – a prominent provider

The Group continued to maintain its leading position in the Hong Kong RMB insurance market. Products such as IncomeGrowth Annuity Insurance Plan, Target 5 Years Insurance Plan Series, and RMB Universal Life Insurance Plan were well received by customers. Two new products Wealth Conquer Universal Life Insurance Plan and Forever Glorious Universal Life Insurance Plan were launched and tailored for distribution through brokerage houses.

In recognition of its outstanding performance in RMB services, BOCG Life was granted for two consecutive years the award of "RMB Business Outstanding Awards – Outstanding Insurance Business" organised by Metro Finance, Metro Finance Digital and Hong Kong Wen Wei Po.

OTHERS

Asset management service – making solid progress

BOCHK Asset Management Limited ("BOCHK AM") saw solid progression in its business in 2013. With strong impetus to focus on developing RMB products and being a competent equity fund house, it launched two retail funds BOCHK All Weather RMB High Yield Bond Fund and BOCHK All Weather HK & China Equity Fund. Both of these funds received an overwhelming response from customers. BOCHK AM was granted an RQFII status by the China Securities Regulatory Commission in July and received an RQFII equity quota from the State Administration of Foreign Exchange in August. It plans to launch an RQFII fund investing in onshore equity securities in 2014.

With respect to its investment advisory services, BOCHK AM continued to expand its geographical foothold by offering its advisory services to overseas financial institutions. This includes acting as the investment advisor for two RMB bond funds launched in Taiwan by a local asset management company. BOCHK AM also acts as the advisor for the new FTSE-BOCHK Offshore RMB Bond Index Series (the "Index Series") launched in partnership with BOCHK and FTSE Group in October. The Index Series combines BOCHK's unique positioning in offshore RMB business and FTSE's global innovative expertise in index benchmarks, allowing investors to benchmark offshore RMB bond market performance and supports market demand for related fixed income investment products.

In recognition of its outstanding offshore RMB bond performance, BOCHK AM has been named the Best Offshore RMB Manager by Asia Asset Management for its Best of the Best Awards in two consecutive years since 2012. In addition, the BOCHK-World Bank Emerging Markets Bond Fund was awarded for "Best-in-Class for Technology and Innovation" in the BENCHMARK Fund of the Year Award 2013. These awards demonstrate BOCHK AM's strengths and capabilities in RMB related investment product innovation and leadership.

2014 Business Focuses

In 2014, there will be opportunities and challenges in the operating environment for banks in Hong Kong. The Group will continue to ensure the efficient use of its capital to support growth and drive sustainable return, while adhering to rigorous risk management to safeguard its financial strength and asset quality.

The Group will further explore potential business opportunities with existing customers and expand its market penetration as customers' main bank. It will capitalise on its personal customer segmentation strategy and produce differentiated product propositions to strengthen customer relationships and increase loyalty among different customer segments. The advisory service capability of frontline staff will be further enhanced to encourage cross-selling.

With regards to infrastructure, the Group will further optimise its service platforms to appeal to key targeted customers. It will emphasise product innovation and channel establishment as well as integrate innovative technology with customer experience to pave the way for the Group's future developments.

Leveraging on opportunities from continuing economic reform of the Mainland economy and its strength in the offshore RMB business, the Group will focus on expanding its customer base and enhancing its product development capabilities to optimise its customer and business mix. At the same time, it will continue to improve products and services of the RMB clearing bank with the aim to expand the clearing network globally and consolidate the clearing bank's strong market position in both offshore and cross-border RMB clearing services.

The Group will pursue a strategy of seamless service delivery within the BOC Group. Through closer collaboration with BOC, it will capitalise on its RMB clearing network and competitive advantages to expand beyond Hong Kong. At the same time, it will increase cooperation with BOC to enhance the service coverage and overall synergy of the BOC Group.

TECHNOLOGY AND OPERATIONS

In 2013, the Group continued to strengthen its information technology and business operation infrastructure to support business growth and operational efficiency. The revamp and expansion of the Group's data centre have been carried out to cater for the business expansion of the Group. Some of the major operations of the Group's subsidiary companies were centralised to enhance both operational synergies and risk management. Meanwhile, a series of services was introduced to enhance customer relationships and support the growth of Personal Banking business. The BOCHK e-Wallet – Mobile Payment Services was launched to provide customers with a new way of conducting payments. The first-ever 24-hour Online Chat Platform was established to provide customers of Enrich Banking service with immediate feedback and assistance. HKD/RMB Cash Deposit machines, the first of their kind in Hong Kong, were made available to provide customers with added convenience in performing cash deposit functions in both currencies. In addition, the paperless branch teller model and electronic account opening platform have been implemented in over 80 local branches.

CREDIT RATINGS

As at 31 December 2013	Long-term	Short-term
Standard & Poor's	A+	A-1
Moody's	Aa3	P-1
Fitch	A	F1

On 28 October 2013, Standard & Poor's affirmed the 'A+' long-term and 'A-1' short-term issuer credit ratings for BOCHK. The outlook is stable.

On 7 May 2013, Moody's Investors Service affirmed 'Aa3' long-term and 'P-1' short-term local and foreign currency bank deposit ratings; and 'C+' bank financial strength rating for BOCHK. The outlook is stable.

On 30 October 2013, Fitch Ratings affirmed 'A' long-term and 'F1' short-term foreign currency issuer default ratings for BOCHK. The outlook is stable.

RISK MANAGEMENT

Banking Group

Overview

The Group believes that sound risk management is crucial to the success of any organisation. In its daily operation, the Group attaches a high degree of importance to risk management and emphasises that a balance must be struck between risk control and business development. The principal types of 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. The Group has a defined risk appetite statement approved by the Board, which is an expression of the types and level of risk that the Group is willing to take in a controllable way in order to achieve its business goals and to meet the expectations of its stakeholders. For details of the Group's risk management governance structure, please refer to Note 4 to the Financial Statements in this Annual Report.

Credit Risk Management

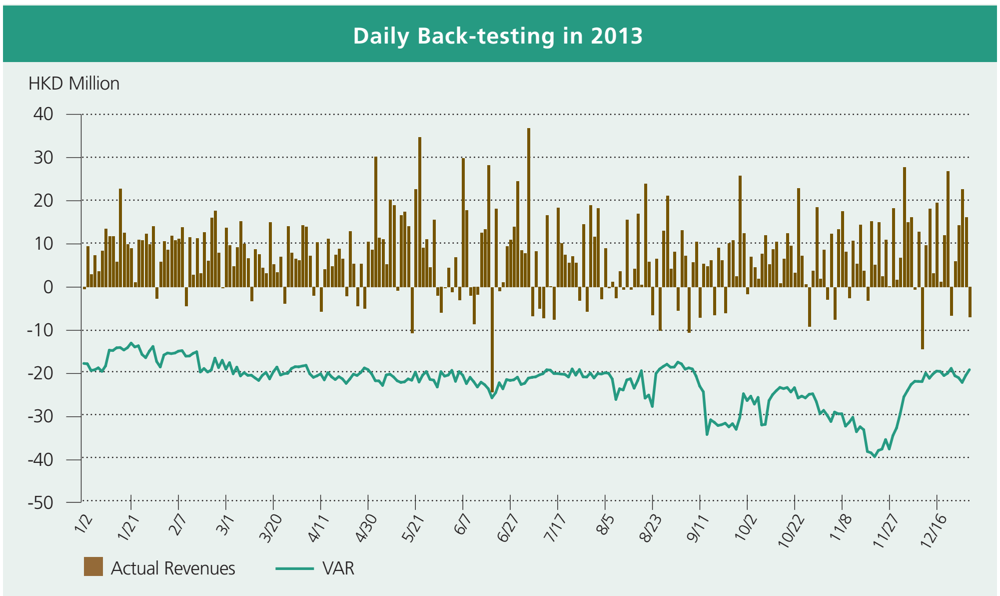
Credit risk is the risk of loss arising from a customer or counterparty that will be unable to or unwilling to meet its contractual obligations. Credit risk exists in the trading book and banking book, on- and off-balance sheet exposures of a bank. It arises principally from the lending, trade finance 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 4.1 to the Financial Statements in this Annual Report.

Market Risk Management

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

The Group uses the VAR to measure and report general market risks to the Risk Committee ("RC") and senior management on a periodic basis. The Group adopts a uniformed VAR calculation model, using historical simulation approach and 2-year historical market data, to calculate VAR of the Group and subsidiaries over a 1-day holding period with 99% confidence level, and sets up the VAR limit of the Group and subsidiaries.

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



There were no actual losses exceeding the VAR for the Group in 2013 as shown in the back-testing results.

Interest Rate Risk Management

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

Liquidity Risk Management

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

Operational Risk Management

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

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

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

Reputation Risk Management

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

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

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

Legal and Compliance Risk Management

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

Strategic Risk Management

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

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

Capital Management

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

The Banking (Capital) (Amendment) Rules 2012 and the Banking (Capital) (Amendment) Rules 2013 came into operation on 1 January 2013 and 30 June 2013 respectively. The rules mainly addressed the revision to both the minimum capital ratio requirement (in terms of expanding the existing capital adequacy ratio into three ratios, namely, a Common Equity Tier 1 capital ratio, a Tier 1 capital ratio and a Total capital ratio) and the definition of regulatory capital. In addition, the rules included the enhancements to the counterparty credit risk framework and amendments on the capital treatment for certain trade financing activities and securities financing transactions. The Group's capital position remains strong after the implementation of the rules.

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

Stress Testing

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

BOCG Life

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

Insurance Risk Management

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

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

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

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

Interest Rate Risk Management

An increase in interest rates may result in the depreciation of the value of BOCG Life's bond portfolio. It may also result in customers accelerating surrenders. A decrease in interest rates may result in an increase in insurance liability and an inability to adequately match guarantees or lower returns leading to customer dissatisfaction. BOCG Life manages the matching of assets and liabilities of its portfolios within an asset liability management (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. BOCG Life's asset and liability management framework includes cash flow management to preserve liquidity to match policy payout from time to time. In the normal course of BOCG Life's business, new business and in-force policies premiums generate constant cash inflows and, as a result, the portfolios also grow gradually to meet future liquidity requirements.

Credit Risk Management

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

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

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

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