A Century of Services, Always with You

2017 marked the 20th anniversary of Hong Kong's return to the motherland and the centenary of BOC's service to Hong Kong. On 24 September 1917, BOC set up a sub-branch in Hong Kong, which was also its first institution outside the Chinese mainland. Through a century of continuous effort, BOCHK has transformed from a small sub-branch with fewer than 10 staff members into a leading commercial banking group. It is also one of Hong Kong's three note-issuing banks, one of the city's largest listed companies and the sole clearing bank for RMB business in Hong Kong. Nowadays, BOCHK not only plays a significant role in Hong Kong's economic development, but also makes important contributions to the prosperity and stability of Hong Kong society. To mark this special occasion, BOCHK organised a series of events to celebrate Hong Kong's return to the motherland and our centenary with Hong Kong citizens. At the same time, we actively fulfilled our corporate social responsibility by inviting underprivileged communities and grassroots families to join in with some of the events and share the joy with us.

In June, BOCHK organised the "A Century of Services, Always with You - Exhibition of Bank of China's Centenary of Service to Hong Kong". At the same time, we joined hands with Hong Kong Chinese Enterprises Association to hold the "Exhibition of Chinese Enterprises' Services to Hong Kong". More than 50 major Chinese enterprises participated in this exhibition. Through pictures and text, the exhibition showcased the continuous effort and contributions made by Chinese enterprises in terms of promoting Hong Kong's economic development, securing people's livelihood and supporting philanthropy.

"A Century of Services, Always with You - Exhibition of Bank of China's Centenary of Service to Hong Kong" reviewed the century-long history of BOCHK's service to the city through a wide variety of pictures and text, exhibits and videos. It also highlighted the bright prospects of BOCHK, which has continuously deepened its local market penetration, driven forward regional development and created greater value for stakeholders.

A Glorious Century

In July, we held a grand event to celebrate the centenary of BOC's service to Hong Kong at the Hong Kong Convention and Exhibition Centre, which was attended by more than 3,000 guests. These included Mr Tung Chee-hwa, Vice Chairman of the National Committee of the Chinese People's Political Consultative Conference; Mr Leung Chun-ying, Vice Chairman of the National Committee of the Chinese People's Political Consultative Conference; Mrs Carrie Lam Cheng Yuet-ngor, Chief Executive of HKSAR, heads of the central authorities based in Hong Kong, renowned representatives from different local sectors, senior management of our parent bank, BOCHK's honorary retirees and staff representatives.

The grand celebration reviewed our centenary of progress and glorious achievements, while unveiling a new chapter of our development. The wonderful performance of our staff during this special occasion demonstrated the quality of employee and corporate culture of BOCHK, further strengthening the theme of "A Century of Services, Always with You".


中國銀行(香港)
BANK OF CHINA (HONG KONG)
百年中銀　與您同行
A CENTURY OF SERVICES, ALWAYS WITH YOU
2016年度中銀之星

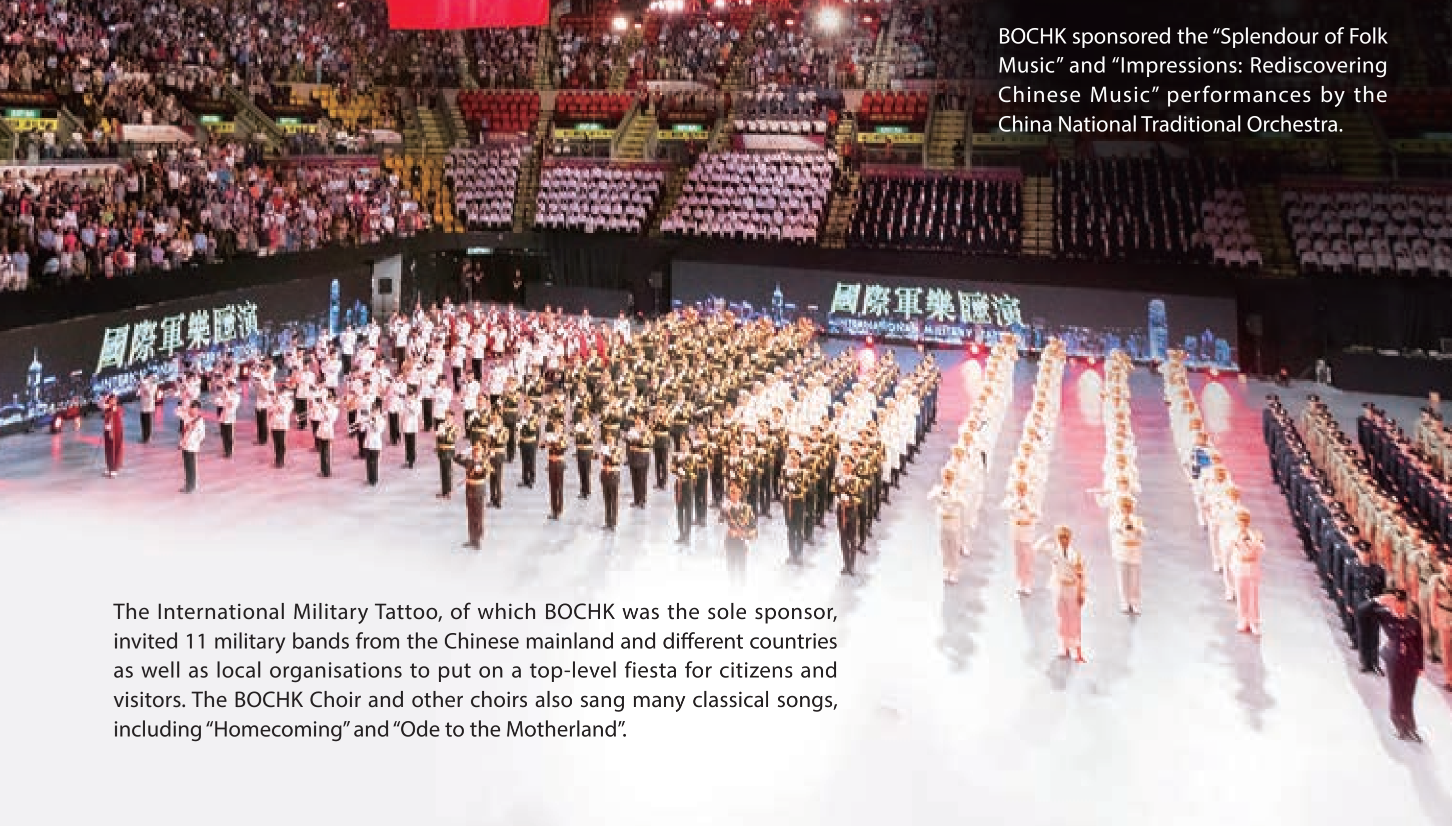
In 2017, BOCHK issued the "Bank of China (Hong Kong) Centenary Commemorative Banknote" in celebration of the 100th anniversary of BOC's presence in Hong Kong. The front side of the Banknote features a famous local landmark, Bank of China Tower, superimposed on an image of the Bank of China Building, with the old Bank of China Hong Kong Branch and Bank of China Head Office in Beijing pictured on the side. These buildings symbolise the glorious history of BOC's centenary of service to Hong Kong. The reverse side of the Commemorative Banknote features an image of a newspaper advertisement for the grand opening of Bank of China Hong Kong Branch, which was upgraded from sub-branch status in 1919, and the logos of the 12 member banks of Bank of China Group in Hong Kong in 1983. There is also an image of the first HKD banknote issued by BOC in 1994, superimposed on the centre of the Commemorative Banknote. This special design tells the long and illustrious history of BOC's Hong Kong presence and its service to the city over the past century.

In special honour of the centenary of BOCHK, net proceeds generated from the sale of the Commemorative Banknote, after deducting all relevant costs, will be used for local community projects and charitable causes.

Joint Celebration

BOCHK was the title sponsor of the "BOCHK 2017 Hong Kong New Year Countdown", which attracted over 330,000 citizens and visitors to enjoy a pyro-musical show together at Victoria Harbour. This event also unveiled the start of the celebrations of our centenary of service to Hong Kong.

BOCHK sponsored the "Splendour of Folk Music" and "Impressions: Rediscovering Chinese Music" performances by the China National Traditional Orchestra.



The International Military Tattoo, of which BOCHK was the sole sponsor, invited 11 military bands from the Chinese mainland and different countries as well as local organisations to put on a top-level fiesta for citizens and visitors. The BOCHK Choir and other choirs also sang many classical songs, including "Homecoming" and "Ode to the Motherland".

BOCHK joined hands with Hong Kong Chinese Enterprises Association to hold a forum on "China's Outward Investment Trends and Hong Kong's Role", to celebrate the 20th anniversary of Hong Kong's return to the motherland. The forum aimed to facilitate the exchanges on strengthening Hong Kong's position as a "super-connector" and capitalising on national strategies such as the Belt and Road Initiative. Over 2,000 guests from the mainland, Hong Kong, Southeast Asia and other countries and regions attended the forum.

In celebration of BOC's centenary of service to Hong Kong, a book titled *The Era of RMB SDR and the Offshore RMB Centre in Hong Kong* was published by BOCHK in June. The book analyses the development and prospects of offshore RMB business. BOCHK has been Hong Kong's sole RMB clearing bank since 2003, proactively developed various RMB businesses and made contributions to RMB internationalisation and promoting the development of Hong Kong as an offshore RMB centre.

A Century-long Branding

BOCHK produced a TV commercial, "A Century of Services, Always with You", which tells the history of BOCHK's development into an internationalised regional bank over the past century. It also reflects on the precious moments that BOCHK has shared together with the country and Hong Kong in both hard times and prosperity.

BOCHK joined hands with various organisations to hold the "New Era - Chinese Paintings 2017 Hong Kong Exhibition". The exhibition, which featured more than 100 ink paintings by contemporary artists active in the mainland, Hong Kong and Taiwan, aimed to pass on the inheritance and promote the excellence of Chinese traditional culture.

Caring for Employees

BOCHK held a "Staff and Family Members Carnival" at Hong Kong Disneyland Resort to celebrate its centenary of service to Hong Kong. The Carnival attracted more than 28,000 people, including BOC staff and their family members, BOC retirees, families and seniors from grassroots communities. This demonstrated BOCHK's fulfilment of corporate social responsibility for employee care and its dedication to charitable activities.

Innovation

Management Discussion and Analysis

As a result of the disposal of Chiyu, the financial results of Chiyu are reported as profit from discontinued operations in the Group's consolidated income statement, with comparative information restated. Meanwhile, the assets and liabilities of Chiyu are presented separately as assets held for sale and liabilities associated with assets held for sale in the consolidated balance sheet as at 31 December 2016. Certain comparative figures in this Management Discussion and Analysis have been restated to conform to the current year's presentation.

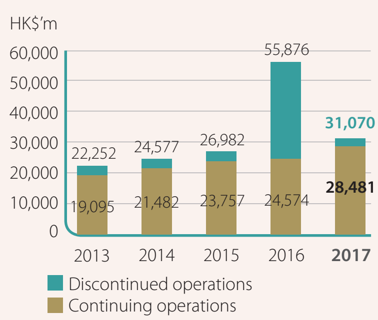
Following the completion of the share acquisition of Bank of China (Malaysia) Berhad ("BOC Malaysia") and Bank of China (Thai) Public Company Limited ("BOC Thailand") on 17 October 2016 and 9 January 2017 respectively, and the completion of the acquisition of the Indonesia Business and Cambodia Business of BOC on 10 July 2017 and 6 November 2017 respectively, the Group has applied the merger accounting method in the preparation of financial statements for the combination of entities under common control. The comparative information for 2016 has been restated accordingly.

The above transactions are collectively referred as the "disposal and acquisitions" in this Management Discussion and Analysis.

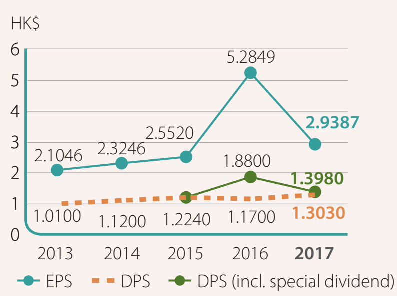
Financial Performance and Conditions at a Glance

The following table is a summary of the Group's key financial results for 2017 in comparison with the previous four years. The average value of liquidity coverage ratio is reported on a quarterly basis.

Profit Attributable to Equity Holders[1]



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



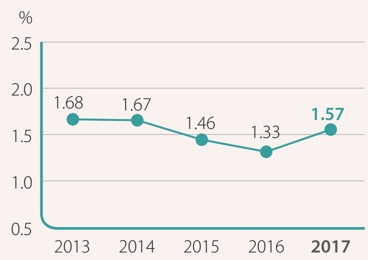
Profit attributable to equity holders

- Profit attributable to equity holders amounted to HK$31,070 million. Profit attributable to equity holders from continuing operations increased by 15.9% year-on-year to HK$28,481 million. Profit attributable to equity holders from discontinued operations was HK$2,589 million, accounted for mainly by the gain on the disposal of Chiyu. ROE was 13.18%. ROE on continuing operations[2] was 13.49%, up 1.30 percentage points year-on-year. ROA was 1.24%. ROA on continuing operations[3] was 1.14%, up 0.01 percentage point year-on-year.

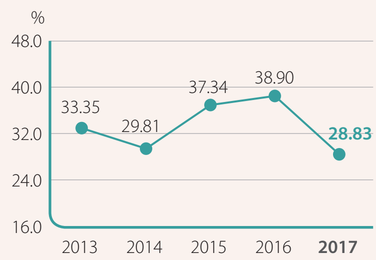
Solid returns to shareholders

- EPS was HK$2.9387. Dividend per share was HK$1.303 and the special dividend was HK$0.095 per share.

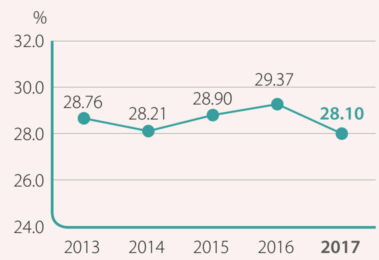
Net Interest Margin ("NIM")[1,4]



Non-interest Income Ratio[1,4]



Cost to Income Ratio[1,4]



Improvement in net interest margin ("NIM"), along with expanded asset size

- NIM was 1.57%, up 24 basis points year-on-year. The Group continued to be proactive in managing its assets and liabilities, recording both an increased average balance and an enhanced average yield of advances to customers and debt securities investments. The Group also captured opportunities from the interbank market to improve the average yield of balances and placements with banks. If the funding income or cost of foreign currency swap contracts[5] were included, NIM would have been 1.44%, up 5 basis points.

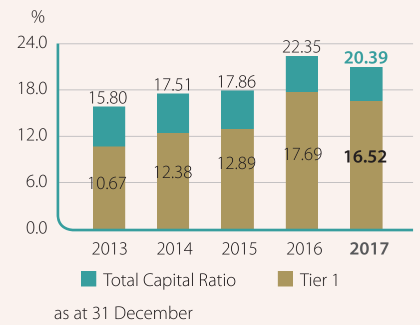
Fall in non-interest income ratio

- Non-interest income ratio was 28.83%, down 10.07 percentage points year-on-year. If the funding income or cost of foreign currency swap contracts were excluded, non-interest income ratio would have been 34.45%, down 1.99 percentage points.

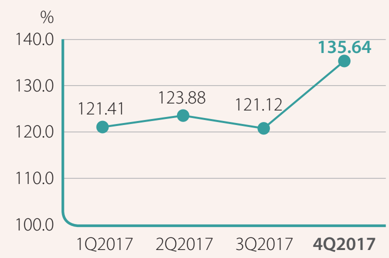
Cautious cost control with high operational efficiency

- The Group's cost to income ratio was 28.10% in 2017, down 1.27 percentage points year-on-year, putting cost efficiency at a solid level relative to the industry peers.

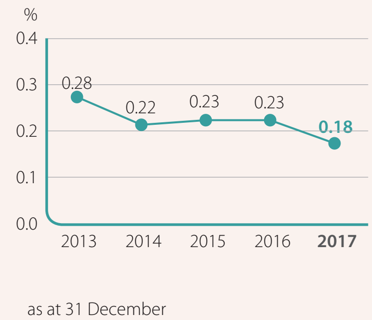
Capital Ratio



Average Value of Liquidity Coverage Ratio



Classified or Impaired Loan Ratio[1,4,6]



Strong capital position to support business growth

- Total capital ratio was 20.39%. Tier 1 capital ratio was 16.52%, down 1.17 percentage points from that at the end of 2016.

Sound liquidity position

- The average value of liquidity coverage ratio was above the regulatory requirement throughout the four quarters of 2017.

Stable asset quality with classified or impaired loan ratio well below market average

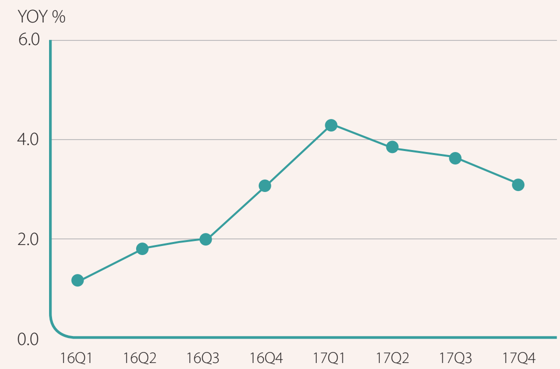
- The classified or impaired loan ratio was 0.18%, well below the market average.

1. The Group has applied the merger accounting method in the preparation of financial statements for the combination of entities under common control in 2017. The comparative information for 2016 has been restated accordingly. However, financial information prior to 2016 has not been restated as the difference before and after restatement is insignificant.
2. ROE on continuing operations is calculated by dividing profit attributable to equity holders from continuing operations by the average of the beginning and ending balance of capital and reserves attributable to equity holders, excluding the impact of profit attributable to equity holders from discontinued operations and special dividend paid.
3. ROA on continuing operations is calculated by dividing profit for the year from continuing operations by the daily average balance of total assets excluding those of discontinued operations.
4. The financial information is from continuing operations and excludes assets held for sale and liabilities associated with assets held for sale.
5. Foreign exchange swap contracts are normally used for the Group's liquidity management and funding activities. In foreign exchange swap contracts, the Group exchanges one currency (original currency) for another (swapped currency) at the spot exchange rate (spot transaction) and commits to reverse the spot transaction by exchanging the same currency pair at a future maturity date at a predetermined rate (forward transaction). In this way, surplus funds in the original currency are swapped into another currency for liquidity and funding purposes with minimal foreign exchange risk. The exchange difference (funding income or cost) between the spot and forward contracts is recognised as a foreign exchange gain or loss (as included in "net trading gain"), while the corresponding interest differential between the surplus funds in the original currency and swapped currency is reflected in net interest income.
6. Classified or impaired loans represent advances that are either classified as "substandard", "doubtful" or "loss" under the Group's classification of loan quality, or individually assessed to be impaired.

Economic Background and Operating Environment

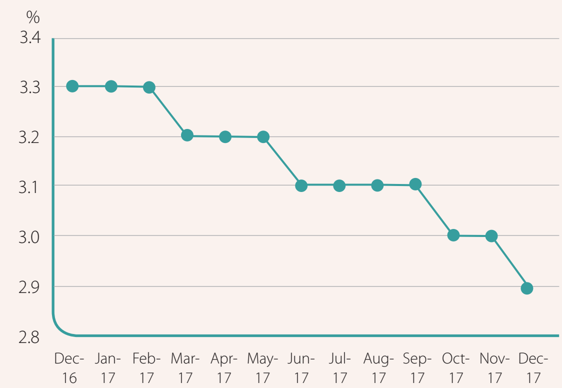
In 2017, the global economy continued to recover. The US economy maintained stable growth with improving financial and labour markets and stable property market performance, despite the combination of the Federal Reserve's balance sheet normalisation programme and three interest rate hikes. The Eurozone economy continued to improve amid the European Central Bank's highly accommodative monetary policy and a continuous improvement in global economic conditions. The ASEAN region's solid economic growth remained on track, supported by accelerated global economic growth, stable commodity prices and increased infrastructure investments by some ASEAN countries. Growth in the mainland of China continued to stabilise and China's economic structure further improved with the high-tech and equipment manufacturing sector, and the service sector both gathering pace and emerging as significant new economic growth drivers.

Hong Kong Real GDP Growth Rate



Source: HKSAR Census and Statistics Department

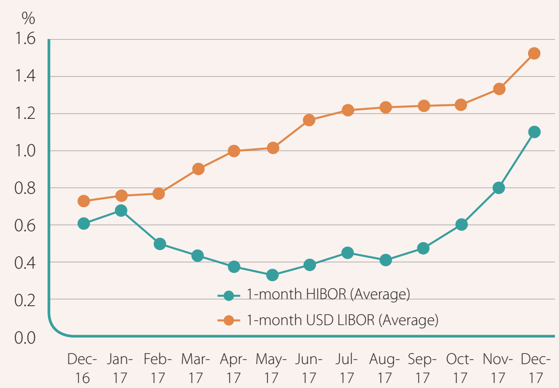
Hong Kong Unemployment Rate



Source: HKSAR Census and Statistics Department

In Hong Kong, real GDP growth in 2017 was 3.8% over the previous year, the highest since 2011. The synchronous recovery of the world's major economies helped to boost Hong Kong's trade performance, while tourism and retail sales also gradually improved. Stock and property markets remained buoyant amid prevailing low interest rates, leading to higher demand for financial and related services. These factors, coupled with positive consumer confidence driven by a consistently low unemployment rate, supported the overall economic performance of Hong Kong.

HIBOR and USD LIBOR



Source: Bloomberg

The liquidity of the Hong Kong banking sector remained ample in 2017, although market interest rates rose in line with US interest rate hikes. The average 1-month HIBOR and 1-month LIBOR rose from 0.30% and 0.50% respectively in 2016 to 0.55% and 1.11% respectively in 2017.

Hong Kong's stock market staged a strong rally, underpinned by improved macroeconomic conditions, strong corporate earnings and capital inflows from the mainland into Hong Kong's stock market. The Hang Seng Index surged by 36.0% over the year, recording its highest growth since 2009 and outpacing major international markets. Transaction volumes picked up significantly, with those on the Shenzhen-Hong Kong Stock Connect and Shanghai-Hong Kong Stock Connect registering substantial increases.

Management Discussion and Analysis

During the year, local private residential property prices hit new highs and the number of residential property transactions increased from that of 2016. The Government continued to implement demand management measures and announced a new round of measures for residential mortgage loans in order to strengthen banks' risk management on mortgage business.

The offshore RMB business in Hong Kong continued to grow steadily in 2017. A number of initiatives were introduced to promote capital account convertibility and the internationalisation of the RMB. These included expanding the free trade zones ("FTZs") in seven provinces of the mainland, including Henan, Hubei, Sichuan, Zhejiang, Liaoning, Shaanxi and Chongqing, and allowing offshore institutional investors to engage with eligible onshore financial institutions to undertake derivative business in RMB against foreign currencies. Also, Bond Connect was successfully launched and become an important channel for offshore institutions to invest in bonds in the mainland market, thus achieving breakthroughs in the establishment of mutual capital market access between Hong Kong and the mainland. As a result of these initiatives, development opportunities opened up for the financial industry in Hong Kong, further promoting the healthy development of the offshore RMB market.

In 2017, banks in Hong Kong operated in a highly challenging environment. These challenges included changes in global monetary policies, heightened geopolitical risks, rising trade protectionism and intensified market competition. Nevertheless, new growth drivers for banks in Hong Kong included the enormous demand for financial services arising from steady progress in the implementation of the Belt and Road Initiative, the launch of a development framework for the Guangdong-Hong Kong-Macao Greater Bay Area and the further implementation of mutual capital market access between Hong Kong and the mainland.

Consolidated Financial Review

The comparative information for 2016 has been restated as a result of the Group's disposal and acquisitions.

Financial Highlights

HK$'m, except percentages	2017	(Restated) 2016	Change (%)
FROM CONTINUING OPERATIONS			
Net operating income before impairment allowances	**48,769**	42,595	14.5
Operating expenses	**(13,703)**	(12,512)	9.5
Operating profit before impairment allowances	**35,066**	30,083	16.6
Operating profit after impairment allowances	**33,990**	29,482	15.3
Profit before taxation	**35,262**	29,971	17.7
Profit attributable to equity holders of the Company	**31,070**	55,876	(44.4)
– from continuing operations	**28,481**	24,574	15.9
– from discontinued operations	**2,589**	31,302	(91.7)

In 2017, the Group seized market opportunities for development, leveraged its competitive advantages and responded positively to a complex and uncertain operating environment. As a result, the Group's core businesses realised satisfactory growth. Key business areas achieved good results, with key financial indicators remaining at solid levels. During the year, the Group proactively pushed forward business restructuring in Southeast Asia and further optimised its regional operations. Regional synergies began to emerge as the Group made notable progress towards its building into an internationalised regional bank. The Group continued to develop the local market in Hong Kong, enhanced market penetration among local customers and continued to refine its business structure to become more customer-centric. It deepened collaboration with BOC to expand its cross-border business development. The development of its diversified business platforms gathered pace and it achieved solid growth in income from its diversified business operations. At the same time, it strengthened innovation in financial technology ("Fintech") so as to upgrade the smart service levels of its products and services as well as its overall service capabilities. It also reinforced its strong RMB clearing business franchise by broadening its scope of services and enhancing its trading capabilities so as to consolidate its leading market position. To ensure its sustainable and healthy development, the Group further strengthened its risk management, internal controls and compliance management.

In 2017, profit attributable to equity holders of the Group amounted to HK$31,070 million. Profit attributable to equity holders from continuing operations amounted to HK$28,481 million, an increase of HK$3,907 million, or 15.9%, year-on-year. Net operating income before impairment allowances was HK$48,769 million, an increase of HK$6,174 million, or 14.5%, year-on-year. Net interest income increased, due to the growth of the Group's average interest-earning assets and a rise in net interest margin. The Group captured opportunities arising from improved investor sentiment in the market and focused on providing diversified investment services. As a result, net fee and commission income rose year-on-year. During the year, the funding cost of foreign currency swap contracts resulted in a decrease in the net trading gain of the banking business, which partially offset the above-mentioned income growth. Operating expenses rose to support the Group's long-term business expansion. Meanwhile, the net charge of loan impairment allowances increased year-on-year. A higher net gain from fair-value adjustments on investment properties was recorded. Profit attributable to equity holders from discontinued operations amounted to HK$2,589 million, which included a gain on the disposal of Chiyu of HK$2,504 million. This represented a drop of HK$28,713 million from the previous year's figure, which had included a gain on the disposal of NCB of HK$29,956 million.

Second Half Performance

As compared with the first half of 2017, the Group's net operating income before impairment allowances increased by HK$1,415 million, or 6.0% half-on-half. This was mainly attributable to an increase in net interest income arising from the continuous expansion in the Group's average interest-earning assets. The banking business recorded an increase in net trading gain, arising from a half-on-half decrease in the funding cost of foreign currency swap contracts. Operating expenses increased by HK$1,343 million, or 21.7% from the first half of the year, while the net charge of loan impairment allowances rose by HK$373 million, or 107.5%. Meanwhile, the net gain from fair-value adjustments on investment properties decreased notably by HK$577 million, or 65.1%. As a result, profit attributable to equity holders from continuing operations decreased by HK$1,185 million or 8.0%, on a half-on-half basis.

Income Statement Analysis

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

Net Interest Income and Net Interest Margin

HK$'m, except percentages	2017	(Restated) 2016	Change (%)
Interest income	**48,951**	36,776	33.1
Interest expense	**(14,243)**	(10,752)	32.5
Net interest income	**34,708**	26,024	33.4
Average interest-earning assets	**2,216,623**	1,946,172	13.9
Net interest spread	**1.44%**	1.23%	
Net interest margin*	**1.57%**	1.33%	

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

The Group's net interest income increased by HK$8,684 million, or 33.4%, year-on-year. The increase was driven by growth in average interest-earning assets and an increase in net interest margin.

Average interest-earning assets expanded by HK$270,451 million, or 13.9%. The increase in deposits from customers led to an increase in advances to customers, balances and placements with banks as well as debt securities investments.

Net interest margin was 1.57%, up 24 basis points. The Group continued to proactively manage its assets and liabilities, enhancing the average yield of advances to customers and debt securities investments. In addition, the Group captured opportunities from the interbank market to improve the average yield of balances and placements with banks, which also resulted in a rise in net interest margin. If the funding income or cost of foreign currency swap contracts* were included, net interest margin would have been 1.44%, up 5 basis points.

* Foreign exchange swap contracts are normally used for the Group's liquidity management and funding activities. In foreign exchange swap contracts, the Group exchanges one currency (original currency) for another (swapped currency) at the spot exchange rate (spot transaction) and commits to reverse the spot transaction by exchanging the same currency pair at a future maturity date at a predetermined rate (forward transaction). In this way, surplus funds in the original currency are swapped into another currency for liquidity and funding purposes with minimal foreign exchange risk. The exchange difference (funding income or cost) between the spot and forward contracts is recognised as a foreign exchange gain or loss (as included in "net trading gain"), while the corresponding interest differential between the surplus funds in the original currency and swapped currency is reflected in net interest income.

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

	2017		(Restated) 2016	
ASSETS	**Average balance HK$'m**	**Average yield %**	Average balance HK$'m	Average yield %
Balances and placements with banks and other financial institutions	**438,113**	**2.18**	332,802	1.36
Debt securities investments	**670,159**	**1.98**	634,504	1.62
Advances to customers	**1,091,645**	**2.38**	956,915	2.26
Other interest-earning assets	**16,706**	**1.29**	21,951	0.89
Total interest-earning assets	**2,216,623**	**2.21**	1,946,172	1.88
Non interest-earning assets[1]	**348,939**	**–**	452,146	–
Total assets	**2,565,562**	**1.91**	2,398,318	1.53

LIABILITIES	**Average balance HK$'m**	**Average rate %**	Average balance HK$'m	Average rate %
Deposits and balances from banks and other financial institutions	**226,074**	**0.92**	233,899	0.79
Current, savings and time deposits	**1,558,918**	**0.68**	1,348,081	0.57
Subordinated liabilities	**19,312**	**4.82**	19,513	3.04
Other interest-bearing liabilities	**47,705**	**1.41**	36,012	1.51
Total interest-bearing liabilities	**1,852,009**	**0.77**	1,637,505	0.65
Shareholders' funds[2] and other non interest-bearing deposits and liabilities[1]	**713,553**	**–**	760,813	–
Total liabilities	**2,565,562**	**0.56**	2,398,318	0.45

1. Including assets held for sale and liabilities associated with assets held for sale respectively.
2. Shareholders' funds represent capital and reserves attributable to equity holders of the Company.

Second Half Performance

In the second half of the year, net interest income recorded a half-on-half increase of HK$466 million, or 2.7%, to reach HK$17,587 million. This was due to growth in average interest-earning assets, and was partially offset by a decrease in net interest margin. Average interest-earning assets grew by HK$192,405 million, or 9.1%, which was supported by an increase in deposits from customers. Net interest margin was 1.51%, down 12 basis points, as loan pricing and deposit costs came under pressure from intensified market competition. In addition, a drop in RMB market interest rates lowered the average yield of RMB assets. Nevertheless, an increase in advances to customers and a rise in the average yield of debt securities investments partially offset this negative impact. If the funding cost of foreign currency swap contracts were included, net interest margin would have been 1.43%, down 3 basis points.

Net Fee and Commission Income

HK$'m, except percentages	2017	(Restated) 2016	Change (%)
Loan commissions	**3,559**	3,522	1.1
Credit card business	**3,202**	3,703	(13.5)
Securities brokerage	**2,624**	1,954	34.3
Insurance	**1,326**	1,630	(18.7)
Funds distribution	**985**	735	34.0
Bills commissions	**802**	724	10.8
Payment services	**629**	631	(0.3)
Trust and custody services	**555**	470	18.1
Currency exchange	**433**	336	28.9
Safe deposit box	**291**	277	5.1
Others	**999**	950	5.2
Fee and commission income	**15,405**	14,932	3.2
Fee and commission expense	**(3,889)**	(4,248)	(8.5)
Net fee and commission income	**11,516**	10,684	7.8

In 2017, net fee and commission income amounted to HK$11,516 million in 2017, up HK$832 million or 7.8% year-on-year. The Group captured opportunities arising from improved investor sentiment in the market and focused on delivering promotional campaigns to mid- to high-end and cross-border customers. As a result, commission income from securities brokerage and funds distribution grew 34.3% and 34.0% year-on-year, respectively. The Group also leveraged its diversified business platforms to record healthy growth in a number of areas. Income from currency exchange rose by 28.9% year-on-year, as the Group captured market opportunities to achieve satisfactory growth of its banknote business in Asia. The Group was effective in expanding its trust and custody services, resulting in a year-on-year increase of 18.1% in related income. Bills and loan commissions also recorded solid growth. Income from its credit card business dropped 13.5% year-on-year, as the 10.5% growth in commission income from credit card business in Hong Kong was more than offset by the drop in fee income from merchant acquiring business in Hong Kong, which was affected by cardholder spending from mainland visitors to Hong Kong. In addition, commission income from insurance and payment services also dropped. The decrease in fee and commission expense was mainly due to lower credit card related expenses.

Second Half Performance

Net fee and commission income in the second half of the year increased by HK$36 million, or 0.6%, compared to the previous half-year. Commission income from securities brokerage and funds distribution increased significantly. Commission income from credit cards, insurance, trust and custody services, currency exchange and payment services also increased. However, a drop in loan commissions largely offset the aforesaid increases. Fee and commission expense rose from the first half of the year, mainly attributable to higher credit card and securities brokerage related expenses.

Net Trading Gain

HK$'m, except percentages	2017	(Restated) 2016	Change (%)
Foreign exchange and foreign exchange products	**157**	3,719	(95.8)
Interest rate instruments and items under fair value hedge	**739**	867	(14.8)
Commodities	**205**	32	540.6
Equity and credit derivative instruments	**225**	88	155.7
Net trading gain	**1,326**	4,706	(71.8)

Net trading gain decreased by HK$3,380 million, or 71.8% year-on-year, to HK$1,326 million. If the funding income or cost of foreign currency swap contracts were excluded, net trading gain would have risen by 11.2%, primarily due to higher gains from foreign exchange and bullion transactions and an increase in income from equity-linked products. These gains were partially offset by lower mark-to-market gains of certain debt securities investments and interest rate instruments, caused by interest rate movements.

Second Half Performance

Compared with the first half of 2017, net trading gain decreased by HK$18 million or 2.7%. If the funding cost of foreign currency swap contracts were excluded, net trading gain would have decreased by 34.3%, primarily due to the decrease in mark-to-market gain on certain foreign exchange products.

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

HK$'m, except percentages	2017	(Restated) 2016	Change (%)
Net gain on financial instruments designated at fair value through profit or loss	**2,181**	101	2059.4

The Group recorded a net gain of HK$2,181 million on financial instruments designated at FVTPL in 2017, compared with a net gain of HK$101 million in 2016. The change was mainly attributable to an increased gain arising from the equity securities and bond fund investments of BOC Life, as well as an increase in the mark-to-market gain of its debt securities investments, caused by market interest rate movements. Changes in BOC Life's policy reserves, as reflected in changes in net insurance benefits and claims and movement in liabilities, were also attributable to the movement of market interest rates.

Second Half Performance

A net gain of HK$993 million was recorded in the second half of the year, down HK$195 million or 16.4% compared with the first half of the year. The change was mainly attributable to a half-on-half decrease in the mark-to-market gain of BOC Life's debt securities investments. This decrease was partially offset by an increased gain from its equity securities investments.

Operating Expenses

HK$'m, except percentages	2017	(Restated) 2016	Change (%)
Staff costs	**7,813**	6,939	12.6
Premises and equipment expenses (excluding depreciation)	**1,704**	1,591	7.1
Depreciation	**1,949**	1,805	8.0
Other operating expenses	**2,237**	2,177	2.8
Total operating expenses	**13,703**	12,512	9.5

	At 31 December 2017	(Restated) At 31 December 2016	Change (%)
Staff headcount measured in full-time equivalents*	**13,049**	12,738	2.4

* The comparative information of staff headcounts measured in full-time equivalents at 31 December 2016 has been restated to enable analysis on a comparable basis.

Total operating expenses increased by HK$1,191 million, or 9.5% year-on-year, as a result of the Group's ongoing investment in the service capabilities, business systems and platforms needed to support long-term business growth. The Group remained focused on disciplined cost control, its cost to income ratio remained low at 28.10%, with cost efficiency at a solid level relative to the wider industry.

Staff costs increased by 12.6% year-on-year, mainly due to annual salary increment, increased headcount, and an increase in performance-related remuneration.

Premises and equipment expenses were up 7.1%, reflecting higher expenses related to the enhancement of business systems and platforms, and an increase in rental costs.

Depreciation rose by 8.0%, largely due to a larger depreciation charge on information technology ("IT") infrastructure. The depreciation charge on the fixtures and fittings of rented premises also increased.

Other operating expenses increased by 2.8%, mainly due to higher business promotional and advertising expenses.

Second Half Performance
Compared with the first half of 2017, total operating expenses increased by HK$1,343 million, or 21.7%. The increase was due to higher staff costs and business promotional and advertising expenses.

Net Charge of Loan Impairment Allowances

HK$'m, except percentages	2017	(Restated) 2016	Change (%)
Net charge of allowances before recoveries			
– individually assessed	**(2)**	(84)	(97.6)
– collectively assessed	**(1,196)**	(667)	79.3
Recoveries	**131**	137	(4.4)
Net charge of loan impairment allowances	**(1,067)**	(614)	73.8

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

	At 31 December 2017	(Restated) At 31 December 2016
Loan impairment allowances		
– individually assessed	**0.04%**	0.07%
– collectively assessed	**0.32%**	0.28%
Total loan impairment allowances	**0.36%**	0.35%

The net charge of loan impairment allowances in 2017 was HK$1,067 million, an increase of HK$453 million, or 73.8%, from 2016. Net charge of collectively assessed impairment allowances increased by HK$529 million, or 79.3%, attributable to growth in advances to customers and the Group has taken a prudent and stable approach to increase impairment allowances for a certain loan portfolio.

As at 31 December 2017, total loan impairment allowances as a percentage of gross advances to customers was 0.36%, up slightly from the end of 2016.

Second Half Performance

Compared with the first half of 2017, the net charge of loan impairment allowances increased by HK$373 million, or 107.5%. The Group recorded a net charge of individually assessed impairment allowances in the second half of 2017. Meanwhile, there was a net reversal in the first half, mainly due to loan repayments by certain corporate customers. Net charge of collectively assessed impairment allowances increased, as the Group has taken a prudent and stable approach to increase impairment allowances for a certain loan portfolio. This increase was partly offset by the lower net charge owing to lower loan growth in the second half of the year.

Balance Sheet Analysis

The comparative figures as of 31 December 2016 have been restated to conform to the current year's presentation.

Asset Composition

	At 31 December 2017		(Restated) At 31 December 2016		
HK$'m, except percentages	Amount	% of total	Amount	% of total	Change (%)
Cash and balances with banks and other financial institutions	**364,205**	**13.8**	236,306	10.0	54.1
Placements with banks and other financial institutions maturing between one and twelve months	**59,056**	**2.2**	72,610	3.1	(18.7)
Hong Kong SAR Government certificates of indebtedness	**146,200**	**5.5**	123,390	5.3	18.5
Securities investments[1]	**704,507**	**26.6**	655,231	27.8	7.5
Advances and other accounts	**1,189,609**	**45.0**	1,008,025	42.8	18.0
Fixed assets and investment properties	**66,930**	**2.5**	64,039	2.7	4.5
Other assets[2]	**115,246**	**4.4**	141,846	6.0	(18.8)
Assets held for sale	**–**	**–**	53,293	2.3	(100.0)
Total assets	**2,645,753**	**100.0**	2,354,740	100.0	12.4

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

As at 31 December 2017, total assets of the Group amounted to HK$2,645,753 million, an increase of HK$291,013 million, or 12.4%, from the end of 2016. The Group continued to enhance the management of its assets and liabilities in order to ensure sustainable growth in business and profitability.

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

- Cash and balances with banks and other financial institutions increased by HK$127,899 million, or 54.1%, mainly due to an increase in balances with banks and central banks;
- Advances and other accounts rose by HK$181,584 million, or 18.0%, with growth in advances to customers rising by HK$156,266 million, or 15.8%;
- Other assets decreased by HK$26,600 million, or 18.8%, mainly due to a decrease in derivative financial instruments;
- Assets held for sale dropped to zero as the Group completed the disposal of Chiyu.

Advances to Customers

HK$'m, except percentages	At 31 December 2017 Amount	At 31 December 2017 % of total	(Restated) At 31 December 2016 Amount	(Restated) At 31 December 2016 % of total	Change (%)
Loans for use in Hong Kong	**759,038**	**66.3**	664,030	67.2	14.3
Industrial, commercial and financial	**436,754**	**38.2**	375,506	38.0	16.3
Individuals	**322,284**	**28.1**	288,524	29.2	11.7
Trade finance	**78,182**	**6.8**	72,210	7.3	8.3
Loans for use outside Hong Kong	**307,239**	**26.9**	251,953	25.5	21.9
Total advances to customers	**1,144,459**	**100.0**	988,193	100.0	15.8

In 2017, the Group captured opportunities arising from national strategies including the Belt and Road Initiative, the Going Global strategy, the development of the Guangdong-Hong Kong-Macao Greater Bay Area and Southeast Asia. It strengthened its collaboration with the BOC Group in order to provide a diversified range of financial services to mainland enterprises going global as well as corporates in Southeast Asia. The Group also continued to develop the local market in Hong Kong with a focus on family-owned businesses, chambers of commerce and listed companies, along with business development related to government and public sector entities. In addition, it enhanced its services to customers in the SME, residential mortgage and other retail loan businesses by leveraging the competitive edge arising from its branch transformation and its diversified business platforms. Advances to customers grew by HK$156,266 million, or 15.8%, to HK$1,144,459 million in 2017.

Loans for use in Hong Kong grew by HK$95,008 million or 14.3%:

- Lending to the industrial, commercial and financial sectors increased by HK$61,248 million or 16.3%, reflecting growth in the property development, manufacturing, transport and transport equipment, financial concerns and information technology industries;

- Lending to individuals increased by HK$33,760 million or 11.7%. Residential mortgage loans (excluding those under Government-sponsored home purchasing schemes) grew by 7.3% while other individual loans increased by 32.8%, mainly driven by the increase in property refinancing.

Trade finance rose by HK$5,972 million or 8.3%. Loans for use outside Hong Kong grew by HK$55,286 million or 21.9%, mainly driven by growth in loans for use in the Asia-Pacific region.

Loan Quality

HK$'m, except percentages	At 31 December 2017	(Restated) At 31 December 2016
Advances to customers	**1,144,459**	988,193
Classified or impaired loan ratio	**0.18%**	0.23%
Total impairment allowances	**4,084**	3,429
Total impairment allowances as a percentage of advances to customers	**0.36%**	0.35%
Residential mortgage loans[1] – delinquency and rescheduled loan ratio[2]	**0.01%**	0.02%
Card advances – delinquency ratio[2]	**0.21%**	0.24%

	2017	2016
Card advances – charge-off ratio[3]	**1.51%**	1.51%

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

To maintain stable asset quality, the Group adhered to a prudent credit strategy for the year. The classified or impaired loan ratio was 0.18% as at 31 December 2017, down 0.05 percentage point from the end of last year. Classified or impaired advances to customers decreased by HK$203 million, or 8.9%, to HK$2,079 million.

The credit quality of the Group's residential mortgage loans and card advances remained sound. The combined delinquency and rescheduled loan ratio of residential mortgage loans was 0.01% as at 31 December 2017. The charge-off ratio of card advances was 1.51%, unchanged from that of 2016.

Deposits from Customers*

HK$'m, except percentages	At 31 December 2017 Amount	At 31 December 2017 % of total	(Restated) At 31 December 2016 Amount	(Restated) At 31 December 2016 % of total	Change (%)
Demand deposits and current accounts	**203,831**	**11.5**	173,988	11.4	17.2
Savings deposits	**910,184**	**51.3**	805,831	52.9	12.9
Time, call and notice deposits	**657,498**	**37.0**	540,048	35.5	21.7
	1,771,513	**99.8**	1,519,867	99.8	16.6
Structured deposits	**2,784**	**0.2**	3,425	0.2	(18.7)
Deposits from customers	**1,774,297**	**100.0**	1,523,292	100.0	16.5

* Including structured deposits.

The Group implemented a number of strategic initiatives in its deposits business in 2017, including the development of payroll account services, receiving bank business for IPOs, cash management, settlement and custody business, with the aim of retaining deposits from customers. As at 31 December 2017, total deposits from customers amounted to HK$1,774,297 million, up HK$251,005 million, or 16.5%, from the end of last year. Demand deposits and current accounts grew by 17.2%, saving deposits increased by 12.9%, and time, call and notice deposits were up 21.7%.

Capital and Reserves Attributable to Equity Holders of the Company

HK$'m, except percentages	At 31 December 2017	(Restated) At 31 December 2016	Change (%)
Share capital	**52,864**	52,864	–
Premises revaluation reserve	**36,689**	35,608	3.0
Reserve for fair value changes of available-for-sale securities	**42**	(592)	N/A
Regulatory reserve	**10,224**	9,227	10.8
Translation reserve	**(669)**	(1,217)	(45.0)
Merger reserve	**–**	3,455	(100.0)
Retained earnings	**143,589**	129,302	11.0
Reserves	**189,875**	175,783	8.0
Capital and reserves attributable to equity holders of the Company	**242,739**	228,647	6.2

Capital and reserves attributable to equity holders of the Company amounted to HK$242,739 million as at 31 December 2017, an increase of HK$14,092 million, or 6.2%, from the end of 2016. Retained earnings rose by 11.0%, mainly reflecting the profit for 2017 after the distribution of dividends. The premises revaluation reserve increased by 3.0%, which was attributable to an increase in the valuation of premises in 2017. The reserve for fair value changes of available-for-sale securities moved from a deficit to a surplus, driven by market interest rate movements. The regulatory reserve rose by 10.8%, mainly driven by growth in advances to customers. The merger reserve arose from the Group's application of the merger accounting method in relation to its combination with BOC Thailand and BOC's Indonesia Business and Cambodia Business.

Capital Ratio and Liquidity Coverage Ratio

HK$'m, except percentages	At 31 December 2017	At 31 December 2016
Consolidated capital after deductions		
Common Equity Tier 1 capital	**170,012**	158,828
Additional Tier 1 capital	**–**	458
Tier 1 capital	**170,012**	159,286
Tier 2 capital	**39,816**	41,926
Total capital	**209,828**	201,212
Total risk-weighted assets	**1,029,152**	900,288
Common Equity Tier 1 capital ratio	**16.52%**	17.64%
Tier 1 capital ratio	**16.52%**	17.69%
Total capital ratio	**20.39%**	22.35%

	2017	2016
Average value of liquidity coverage ratio		
First quarter	**121.41%**	112.92%
Second quarter	**123.88%**	109.70%
Third quarter	**121.12%**	118.69%
Fourth quarter	**135.64%**	107.02%

The minimum capital requirements under the Basel III phase-in arrangements came into effect on 1 January 2013 and will become fully effective on 1 January 2019. The Group's capital level was further enhanced by the gain from the disposal of Chiyu. In the course of formulating its internal capital management targets, the Group took into consideration not only the regulatory requirements but also its rapid business development and short- and long-term capital requirements, including support from capital replenishment solutions, with the ultimate aim of ensuring the long-term stability of its capital level. The Group also continued to refine measures for monitoring changes in the risk-weight of its assets. At the same time, the Group made use of stringent and forward-looking stress testing to assess the demand and supply of capital under different stress scenarios, examined management targets for capital adequacy and formulated a capital adjustment solution to ensure the Group's ability to comply with capital requirements under stressed conditions.

At 31 December 2017, both the common equity tier 1 ("CET1") capital ratio and tier 1 capital ratio were 16.52%, down 1.12 and 1.17 percentage points respectively from the end of 2016. Profits net of dividends for 2017 drove up CET1 capital and tier 1 capital by 7.0% and 6.7% respectively. Total risk-weighted assets ("RWAs") were up 14.3%, driven by an increase in credit RWAs due to growth in advances to customers in 2017, which was partially offset by a reduction in RWAs following the disposal of Chiyu. The total capital ratio of the Group was 20.39%.

The Group's liquidity position remained sound with the average value of liquidity coverage ratio for all four quarters of 2017 above the regulatory requirement.

Business Review

Business Segment Performance

Profit/(loss) before Taxation by Business Segments

HK$'m, except percentages	2017	% of total	2016	(Restated) % of total	Change (%)
CONTINUING OPERATIONS					
Personal Banking	**8,055**	**22.8**	7,486	25.0	7.6
Corporate Banking	**14,813**	**42.0**	13,238	44.1	11.9
Treasury	**10,227**	**29.0**	8,625	28.8	18.6
Insurance	**1,401**	**4.0**	1,230	4.1	13.9
Others	**766**	**2.2**	(608)	(2.0)	N/A
Total profit before taxation	**35,262**	**100.0**	29,971	100.0	17.7

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

Personal Banking

Financial Results

Personal Banking achieved a profit before tax of HK$8,055 million in 2017, an increase of HK$569 million, or 7.6% year-on-year, mainly driven by an increase in net interest income and non-interest income.

Net interest income increased by 14.3%. This was mainly driven by an improvement in the deposit spread along with an increase in the average balance of deposits and loans. Net fee and commission income increased by 11.9% as the Group achieved satisfactory performance in its securities brokerage and funds distribution business with encouraging year-on-year growth in commission income. Net trading gain rose by 31.1%, owing to growth in income from the bond business and equity-linked structured products. Operating expenses were up 18.2%, mainly due to an increase in staff costs and business-related expenses. Net charge of impairment allowances increased by 77.6%, as the Group has taken a prudent and stable approach to increase impairment allowances for a certain loan portfolio.

Business Operations

Optimising wealth management services

The Group seized market opportunities and actively deepened its business relationships with customers. It continued to refine its wealth management system and widen the range of upgraded wealth management services. The Group offered exclusive private banking products, including bonds and equity-linked notes, to enrich the privileged product spectrum for high-end customers, and redesigned its Wealth Management Centre to strengthen its professional brand image. It organised the Worldwide Wealth Management Expo 2017, hosted investment strategy seminars and sponsored a series of Hong Kong Jockey Club Cup activities, so as to provide more value-added services for mid- to high-end customers. The total number of mid- to high-end customers increased by 24% year-on-year.

Private Banking business maintained satisfactory growth and acquired high net-worth clients from local, mainland and overseas. In line with its people-oriented culture, the Group strengthened its private banking team and accelerated development in cross-border business. It optimised the private banking open platform and launched a brand new and exclusive internet banking service so as to enhance customer experience. It actively participated in the development of the private banking industry by supporting The Pilot Apprenticeship Programme for Private Wealth Management, which is jointly organised by the HKMA and the Private Wealth Management Association, to provide training to wealth management talent. In September 2017, BOCHK's Private Banking Headquarter was established at the Bank of China Building, a Grade 1 historic building in Hong Kong, to signify its status as the Overseas Private Banking Centre of BOC Group and to enhance its brand reputation. Both the total number of private banking clients and related assets under management grew satisfactorily from the end of last year.

Faster growth in deposit and loan business

The Group achieved promising growth in its deposit business by pursuing a targeted strategy for different customer segments, providing differentiated pricing to customer groups, driving customer upgrades and strengthening cross-selling. The Group also made a concerted effort to acquire employee payroll business from government entities and large corporates so as to grow current and savings deposits and continuously optimise its deposit structure. In its loan business, the Group integrated its internal resources to enhance the mortgage approval process and introduced digital sales to enhance customer experience. It developed partnerships with property agencies and law firms with a view to deepening cooperative relationships through joint sales activities. At the same time, the Group strengthened its product innovation and integrated service capabilities to boost loan growth. In 2017, both the balance of deposits and the amount of new loan drawdown of the personal banking reached record highs, with customer deposits increasing by 21% from the prior year-end and the number of new residential mortgage loan transactions rising by 43% year-on-year.

Enhancing cross-border service capabilities

Capturing the opportunities arising from the development of the Guangdong-Hong Kong-Macao Greater Bay Area, the Group cooperated with BOC to drive forward the implementation of major cross-border projects, with the aim of achieving mutual brand recognition for personal customers and promoting service sharing and joint sales in the area. Both the total number of cross-border customers and related total relationship balance recorded satisfactory growth from the end of last year. The Group established additional cross-border financial services centres and introduced the BOCHK WeChat cross-border official account so as to enhance its integrated cross-border service capabilities through online and offline collaboration. In addition, the Group coordinated with a number of BOC branches to launch joint marketing activities promoting account opening attestation and employee payroll services to well-known large and medium-sized Chinese enterprises, which helped to boost the number of potential high-end customers and establish the Group as the first-choice bank for cross-border customers. During the year, the total number of cross-border customers grew 24% year-on-year.

Deepening branch transformation

During the year, the Group completed the optimisation of its personal banking business structure. This included refining frontline unit management and strengthening professional support from the headquarters to the frontlines. This was effective in boosting the productivity of its branches. The Group also completed the design of a new branch model and further optimised its branch network by setting up large-scale integrated branches. Leveraging its extensive branch network, the Group transformed its retail-focused branch service coverage to a more comprehensive service model. This shift was integrated with the implementation of the Group's SME "personal + business" all-in-one model, with the overall aim of becoming customers' primary bank. The Group actively participated in the SME Financing Guarantee Scheme launched by the government to facilitate the growth of the real economy and to contribute to the development of SMEs. In line with the HKMA's call to encourage overseas enterprises to conduct business in Hong Kong, the Group launched a series of seminars and exhibitions to enhance the integrated servicing capabilities of small enterprises. During the year, the total number of business integrated accounts increased by 15%.

Stepping up the smart service development

The Group bolstered its omni-channel infrastructure by promoting full-function enhancement projects, including Smart Counter and iService. Together with innovative projects including mobile banking, biometric identification and a customer labelling database, the Group broadened its online payment channels by promoting the Small Value Transfer service in mobile banking, Smart Account and blockchain cross-border e-wallet. The Group also strived to become a smart green bank by enhancing paperless operations and digitising customer information, so as to promote the centralisation and reconstruction of the digital processes of its core businesses and to accelerate the shift from counter transactions to e-channel transactions.

Innovation in credit card business

Retail consumption in Hong Kong was stagnant in the first half of 2017 but regained momentum in the second half. The Group capitalised on such market conditions and changes in customer consumption patterns by launching a series of promotions in order to maintain continuous growth in cardholder spending volume. During the year, the Group actively promoted e-payment services to provide customers with convenient day-to-day payments. Following the launch of Apple Pay with VISA and MasterCard last year, the Group pioneered the launch of Apple Pay with UnionPay credit card and debit card, as well as introducing Samsung Pay and Android Pay with VISA and MasterCard. In addition, the Group cooperated with WeChat Pay Hong Kong and Alipay Hong Kong to introduce a binding local wallet service, thus creating a differentiated competitive edge and successfully achieving growth in online cardholder spending volume. It also issued several co-branded cards, including the BOC CMHK Dual Currency Diamond Card with China Mobile Hong Kong and UnionPay International, to target cross-border customers and to enhance the competitive advantages of all parties. During the year, the Group maintained its leadership in the UnionPay merchant acquiring and card issuing business in Hong Kong.

Corporate Banking

Financial Results

Corporate Banking achieved a profit before tax of HK$14,813 million, an increase of HK$1,575 million, or 11.9%, year-on-year. The growth was mainly driven by an increase in net interest income and net fee and commission income.

Net interest income increased by 15.7%, owing to the increase in the average balance of loans and deposits, coupled with improvement in the deposit spread. Net fee and commission income rose by 3.8%, mainly driven by commission income from the trust, insurance, securities brokerage and bills services. Operating expenses were up 12.1%, owing to an increase in staff costs and business-related expenses. Net charge of impairment allowances increased by 60.7%, due to the higher net charge of collectively assessed impairment allowances, attributable to growth in advances to customers.

Business Operations

Continuous expansion of customer base

Amid intense market competition, the Group strengthened its business contacts with existing customers while actively acquiring new customers. Faced with increased market uncertainty and fierce competition, the Group made a concerted effort to expand its syndicated loan business, arranging a number of syndicated loans with significant market influence during the year. The Group's total loan arrangement volume amounted to US$15 billion for the year, making it the top mandated arranger in the Hong Kong and Macao syndicated loan market for the 13th consecutive year. The total amount of funds raised from IPOs in which the Group served as the main receiving bank reached HK$79.2 billion, representing a market share of 64.9%. The Group obtained several major service tenders from the HKSAR government and related entities, which effectively strengthened its business relationships with the government. It successfully established business relationships with a number of major central banks, national treasuries and sovereign wealth funds. Deposits growth from institutions was satisfactory, providing a stable funding source for the Group's USD loans. The Group grasped opportunities arising from policies such as the establishment of treasury centres in Hong Kong and mainland corporates going global to expedite the development of its cash pooling and treasury centre businesses, with the aim of becoming the first-choice bank for cross-border pooling services. The Group also made breakthroughs in regionalisation and globalisation by providing support to mainland corporates going global, and helping leading enterprises in Hong Kong and Southeast Asia to manage their local, regional and global funding activities.

Proactive development in local commercial SME business

The Group continued to improve its services to local commercial customers by deepening business relationships with local family-owned businesses, chambers of commerce and listed companies in Hong Kong, helping them by establishing a convenient and effective financial service platform so as to mutually enhance market competitiveness and growth. The Group helped customers to access business opportunities in the mainland and overseas countries by inviting them to participate in the Cross-border Investment Matching Service held by BOC branches around the world. In addition, by leveraging the competitive advantages arising from its branch network, the Group continued to enhance its service capabilities to local corporate customers. BOCHK won the Best SME's Partner Gold Award 2017 from the Hong Kong General Chamber of Small and Medium Business in recognition of its acquisition of the Best SME's Partner Award for ten consecutive years.

Solid progress of business development in Southeast Asia

The corporate banking business collaborated with the Group's Southeast Asian institutions to acquire major projects and customers, with the aim of advancing those institutions' business development. It focused on cultivating the Southeast Asian institutions' marketing capabilities and stimulating their internal growth drivers through full product and service coverage. Guided by its long-term strategic vision, the Group made a concerted effort to develop business opportunities with leading Southeast Asian enterprises. The Group also expedited the establishment of a regional management mechanism and expanded its regional businesses with these institutions to create an effective, integrated system for sales, products and management. Capturing opportunities arising from the Guangdong-Hong Kong-Macao Greater Bay Area and FTZs in the mainland, the Group expanded its business model by continuously strengthening regional collaboration, optimising its service model for cross-border products and enriching the variety of its bilateral trading products. The Group also met regulatory requirements by setting up a cross-border financial infrastructure for mutual access.

Enhancing competitiveness of transaction banking products

The Group accelerated business transformation and product innovation in its corporate banking business by capturing opportunities in Hong Kong, the mainland and Southeast Asia. It continued to improve its competitive advantages in products and services, which was in turn effective in supporting the expansion of its customer segments. This attracted lower-cost funding, enhanced customer retention within the Group and drove profitability. It also strengthened the innovation and integration of its transaction banking products, so as to provide customers with a one-stop, scenario-based and comprehensive product solution that can be applied across different industry segments, including the real estate and aviation industry. Moreover, it introduced the new "1+N" supply chain service model. The Group led the market in terms of technological innovation. It completed the first application using blockchain technology for trade finance in Hong Kong and continued to improve the level of its e-banking services. Through the establishment of ASEAN regional product centres, the Group was able to seize business opportunities within the region, upgrade its service systems and enrich its products, thereby uplifting its regional service capabilities in transaction banking. BOCHK received the Achievement Award for Best Trade Finance Bank in Hong Kong and Best Corporate Trade Finance Deal in Thailand from *The Asian Banker*. Furthermore, BOCHK was named Hong Kong Domestic Cash Management Bank of the Year for the fourth consecutive year by *Asian Banking and Finance*.

Proactive credit risk management

In 2017, the Group continued to adhere to a prudent credit policy. In view of the uncertain economic environment, the Group adopted close credit monitoring on a more frequent and proactive basis. This included enhancing the analysis of industries and countries that could be negatively affected by market volatility, so as to identify risks and weaknesses. Moreover, it closely monitored emerging risks in the mainland and any related impacts on customers, reinforced its supervision of customers in segments under threat of overcapacity and in highly concerned industries, and put prompt precautionary measures in place. The Group also formulated risk control guidelines for its business strategies relating to the Belt and Road Initiative and mainland enterprises going global, thus supporting the healthy development of its credit business.

Treasury

Financial Results

Treasury recorded a profit before tax of HK$10,227 million, an increase of HK$1,602 million, or 18.6%, year-on-year. The growth was driven by an increase in net interest income, which was partially offset by the funding cost of foreign currency swap contracts recorded in 2017.

Net interest income surged by 119.5%, mainly attributable to an increase in the average balance of debt securities investments and balances and placements with banks, and an increase in the average yield of related assets caused by a rise in market interest rates. Net trading gain decreased by 98.5%, owing to the funding cost of foreign currency swap contracts, which was partially offset by an increased gain from currency exchange business and commodities trading. Operating expenses were up 24.9%, owing to higher staff costs.

Business Operations

Enhancing trading and service capabilities

During the year, the Group responded to a number of market changes and enhanced its capability in G10 currency trading. By applying in-depth fundamental research and capturing market opportunities, while at the same time cautiously controlling its risk exposure, the Group achieved notable growth in its trading business. It offered professional services and a diversified range of innovative products to meet customer needs. The Group also launched a series of structured derivatives products and strengthened the price quotation function of its electronic trading platforms. In celebration of the centenary of BOC's service to Hong Kong, the Group introduced the limited edition 9999 Commemorative Gold Plate, which was well received by customers. In recognition of its treasury business performance, BOCHK received the Hong Kong Domestic Foreign Exchange Bank of the Year award from *Asian Banking and Finance* and the Outstanding Treasury Business – Dim Sum Bond Market Maker award at the 2017 RMB Business Outstanding Awards, jointly organised by Metro Finance and Hong Kong Ta Kung Wen Wei Media Group. BOCHK also won the Key Business Partner in FIC Market award in the 4th Annual RMB Fixed Income and Currency Conference 2017, organised by HKEX.

Proactive expansion in banknote business

In 2017, the Group became the first bank in Hong Kong to provide Brunei dollar and South African rand banknote withdrawal and deposit services. This took the total number of listed currencies available for note exchange at the Group's retail counters to 24, further reinforcing its market leadership in local retail note exchange. In the wholesale banknote business, the Group established a more flexible and efficient operating framework to enhance its service capabilities in the mainland of China. It supported BOC Guangxi Branch's establishment as the ASEAN Banknote Centre in order to improve its service capabilities to customers. Moreover, the Group achieved further milestones in the internationalisation of its banknote business. Drawing on its expertise in supporting the Southeast Asia banknote business, BOCHK became the world's sole overseas operating bank of EURO Extended Custodial Inventory.

Consolidating competitive advantages in RMB clearing business

The Group further consolidated its competitive edge in offshore RMB business. Following the launch of Bond Connect in July 2017, BOCHK has acted as the sole designated bank for the Hong Kong Central Moneymarkets Unit and Bond Connect Company Limited for providing cross-border fund settlement services for institutions in both Hong Kong and the mainland, thus providing institutions with comprehensive services related to Bond Connect. In October, the Group successfully connected with the bilateral transformation function of the securities settlement system of China's Cross-border Interbank Payment System ("CIPS"), thus joining the first batch of direct participating banks to support bilateral business and provide delivery versus payment settlement for Bond Connect, and reinforcing its unique position as Bond Connect's sole overseas CIPS direct participating bank.

A proactive but risk-aware investment strategy

The Group continued to take a cautious approach in managing its banking book investments by closely monitoring market changes and seeking investment opportunities to enhance return, while remaining alert to risk. During the year, the Group adjusted its investment portfolio to respond to changes in interest rates and to enhance its returns from the allocation of funds.

Insurance

Financial Results

In 2017, profit before tax in the Group's Insurance segment was HK$1,401 million, up 13.9% year-on-year. The growth was mainly attributable to the improved performance of its equity securities and bond fund investments, as well as a rise of 37.9% in net insurance premium income, which was mainly attributable to the increase in renewal premium income. Operating expenses were up 16.3%, mainly due to higher staff costs.

Business Operations

Product innovation and channel expansion

The Group capitalised on its diversified distribution channels. In its bancassurance channels, it focused on developing its commercial, high-net-worth and private banking customer segments, in addition to the retail market. In terms of non-banking channels, it served non-bank customers through tied agency, brokerage, and third party affiliates. Cross-channel synergy enhanced business momentum. The Group remained committed to developing the local market and maintained its leading positions in the Hong Kong life insurance market and RMB insurance market. The Group also actively enriched its product range and supported the development of each distribution channel. Innovative products and value-added services were introduced to meet the differentiated needs of high-net-worth customers and visitors to Hong Kong. The Group's newly-launched and innovative annuity product, SmartRetire Annuity Insurance Plan, attracted the younger customer segment and captured extensive attention from the market, owing to its unique and flexible features, including the Retirement Fund Payout Option and Premium Payment Term Options. In order to support cross-border business, BOC Life deepened collaboration within the Group's business units, promoted the BOC Life brand to enhance awareness in overseas markets, and improved operational support and facilities to offshore customers.

Providing one-stop life insurance services

During the year, the Group established customer service centres providing both life insurance and diversified wealth management services in order to offer one-stop professional life insurance services to visitors to Hong Kong and high-net-worth customers. These centres are equipped with special features, including the first-of-its-kind Predictive-underwriting Engine, so as to provide services such as instant underwriting approval, mobile verification and medical examination. Service ambassadors with underwriting and claims authority are also stationed at the centres to provide customers with meticulous and efficient one-stop services and solutions. In recognition of its outstanding claims services, BOC Life received the Claims Innovation of the Year award at the Claims Awards Asia-Pacific 2017, organised by the Claims Club Asia-Pacific of *Insurance Post*.

Proactive application of innovative technology

The Group launched a number of InsurTech services, the first of their kind in the market, to enhance operational efficiency and customer experience. These included Easy Claims, the first online hospital cash claims platform to provide real-time approval in Hong Kong; the Electronic Bill Presentment and Payment service for premium payment; Apple Pay and Android Pay payment gateways; ecConnect for customers to store policies of other insurance companies and enjoy superior claim services, and e-signature, all of which offer new experiences to customers.

Recognition of outstanding services

BOC Life's outstanding services and professional reputation were recognised by the industry. During the year, it received a number of awards locally and internationally, including the Brand of the Year and Cross Border Insurance Service Excellence awards from *Bloomberg Businessweek*; the 2017 RMB Business Outstanding Awards, jointly organised by Metro Finance and Hong Kong Ta Kung Wen Wei Media Group; and the High Net Worth Team of the Year, Client Engagement – Best-In-Class and Outstanding Customer Support Team awards from *Benchmark*. In terms of credit rating, BOC Life's solid financial strength was affirmed by a financial strength rating from Moody's Investors Service of A2, with its outlook revised from stable to positive, reflecting BOC Life's excellent asset and liability management and solvency.

Diversified Business Platforms

In keeping with its goal of business diversification, the Group achieved satisfactory performance in enhancing its diversified business platforms. Business related to credit cards, private banking, cash management and life insurance are discussed under the Personal Banking, Corporate Banking and Insurance segments above. The Group's asset management, custody, trust and securities and futures businesses are discussed below.

A wider range of asset management products

In 2017, BOCHK Asset Management Limited ("BOCHK AM") rapidly developed its business. Its assets under management ("AUM") grew by over 25% from the end of 2016. During the year, its investment performance outperformed the market, with both bond and equity investment portfolios outperforming their corresponding benchmark indices. Products and services were further enriched, thus expanding the coverage of underlying assets. A total of two new public funds and five new private funds were launched during the year. Apart from traditional bond funds and equity funds, newly-launched funds included a fixed-maturity bond fund, a commercial real estate fund and a multi-asset strategy fund. The number and diversity of institutional clients further expanded, gradually transforming BOCHK AM's client structure from serving mainly local institutional clients to also serving mainland financial institutions and state-owned enterprises. BOCHK AM also expanded its client base among large-scale institutional clients in Europe and the US. By strengthening its collaboration with BOC and Bank of China Investment Management Co., Ltd., it boosted sales of its northbound fund (BOCHK All Weather China High Yield Bond Fund), with strong growth in related AUM from the end of 2016. Moreover, BOCHK AM successfully transferred its undertakings for collective investment in transferable securities ("UCITS") fund to BOC Luxembourg's new fund platform, also recording notable growth in related AUM.

Rapid expansion in custody business

In 2017, the Group's custody business achieved rapid growth in all major aspects. Its consistent focus on the insurance and pension sectors yielded outstanding results, as these client segments delivered remarkable growth amid robust equity and bond markets. During the year, the Group established a business relationship with a major insurance-type QDII client and successfully implemented large-scale custody asset transfers. The Group further attended to the needs of institutional clients going out of and coming into the mainland, focused on product diversification and nurtured local and overseas clients of different types in order to achieve a record high in new mandate numbers and a further enhancement in client diversity. The Group captured opportunities arising from various mergers and acquisitions ("M&A"), listed company activities, financing arrangements and the Belt and Road Initiative to proactively offer escrow services. At the same time, the Group leveraged its market expertise in RMB to promote active sales for Bond Connect and maintain its leading market position. At the end of 2017, total assets under custody reached HK$1,162.4 billion, reflecting a substantial rise in custody business volume and support to low- to non-interest customer deposits.

Trustee business recording remarkable growth

The Group provides trustee and fund administration services for occupational retirement schemes and mandatory provident fund ("MPF") schemes as well as trustee and custodian services for unit trusts through its subsidiary company, BOCI-Prudential Trustee Limited ("BOCI-Prudential Trustee"). BOCI-Prudential Trustee strives to deliver a holistic retirement planning solution by generating corporate synergy, actively broadening diversified distribution channels, optimising referral and incentive mechanisms, and promoting technological innovations and system function upgrades. In 2017, it continued to acquire large institutional clients and increase new business volume. During the year, BOCI-Prudential Trustee secured a further tenure of an MPF administration service contract from a governmental institution and was successfully awarded with new tenders from several large corporates. As of the end of 2017, the MPF asset size of BOCI-Prudential Trustee reached a record high, representing an increase of over 28% from the end of 2016. In respect of unit trust funds, BOCI-Prudential Trustee acted as the Transfer Agency for the approved northbound fund (BOCHK All Weather China High Yield Bond Fund) managed by BOCHK AM, processing daily cross-border transactions. In addition, it added two renowned asset management companies to the client base of its trustee services; a subsidiary of a time-honoured insurance brand in the mainland, and an institution with excellent financial strength in an ASEAN country.

BOCI-Prudential Trustee received a total of 29 awards from independent rating agencies, the market, the industry and the innovation and technology sector in recognition of its outstanding performance and strength. BOCI-Prudential Trustee's My Choice MPF Scheme and BOC-Prudential Easy-Choice MPF Scheme received multiple accolades at the MPF Awards 2017, organised by MPF Ratings. It was awarded the Excellent Brand of MPF Online Platform award for the second consecutive year in the Hong Kong Leaders' Choice Brand Awards 2017, organised by Metro Finance; and the Best of MPF App Service Provider award for the third consecutive year at e-Brand Awards 2017, organised by *e-zone* of *Hong Kong Economic Times*. Furthermore, it also received a number of fund awards at the 2017 Lipper Hong Kong Fund Awards, organised by Lipper, and the Top Fund Awards 2017, organised by *Bloomberg Businessweek*.

Steady growth in securities and futures brokerage services

The Group engages in the provision of brokerage services for futures and options trading through its subsidiary company, Po Sang Securities and Futures Limited ("Po Sang Securities and Futures"). In 2017, Po Sang Securities and Futures reached a new milestone following the completed restructuring of its organisational structure and business model. In addition to existing futures and options contract trading services, it introduced a range of market-oriented investment services, including securities trading services and securities financing services for individual and corporate clients. It also established its first account executive team and developed its institutional sales services. With a new securities trading platform in operation, Po Sang Securities and Futures also introduced a number of core services including securities margin trading, IPO subscription and IPO financing services. It now has a total of five branches, located in Central, Mongkok, Mei Foo, Tai Po and Yuen Long, thus strengthening its marketing capabilities in those respective Hong Kong regions.

Southeast Asia Business

BOCHK's overall development strategy in Southeast Asia

Southeast Asia has remarkable development potential, both as a core focus of China's Belt and Road Initiative, a key market for RMB internationalisation and as a target region for Chinese enterprises going global. Hong Kong, serving as a testing ground for China's new opening-up initiatives, is an essential conduit connecting the mainland and Southeast Asia. It also assumes the role of a super-connector between China and countries along the Belt and Road. BOCHK has actively pushed forward the restructuring of its assets in Southeast Asia. This move is important not only in terms of supporting China's Belt and Road Initiative and consolidating Hong Kong's status as an international financial centre, but also in terms of strategically aligning with BOC Group's efforts to build a financial artery along the Belt and Road and accelerating the Group's own development to build a top-class, full-service and internationalised regional bank. Aiming to achieving mainstream bank status in local Southeast Asia areas, the Group's Southeast Asian institutions made a concerted effort to integrate into local society and serve mainstream clients, including Chinese enterprises operating in Belt and Road areas, mainland enterprises going global and leading local corporates, overseas Chinese and high-net-worth customers. They also focused on local mainstream projects and business areas such as RMB business, commodities and supply chain financing, as well as high-end private banking services.

Accelerating business development in Southeast Asia and promoting its regional transformation strategy

In 2017, the Group's asset integration in Southeast Asia was conducted in an orderly manner. Synergies began to emerge, facilitating a leap forward in the Group's building into an internationalised regional bank. Following the acquisition of BOC Thailand on 9 January 2017, the Group completed the acquisition of the Indonesia Business and Cambodia Business of BOC on 10 July 2017 and 6 November 2017 respectively. The acquisition of the Vietnam Business and Philippines Business of BOC was completed on 29 January 2018. As a result, the Jakarta Branch, Phnom Penh Branch, Ho Chi Minh City Branch and Manila Branch became branches of BOCHK. For further information on these acquisitions, please refer to the announcements issued by the Group on 28 February, 6 July, 3 November, 6 November and 29 December 2017. During 2017, the Group also completed the preparation work for the opening of BOC Malaysia's Melaka Branch.

Strengthening regional business collaboration and developing local mainstream markets

Since 2017, the Group's Hong Kong operations have proactively supported business development in Southeast Asia and recorded great achievements through cooperation with its Southeast Asian institutions. In corporate banking business, the Group achieved regional synergy through internal collaboration, expanding business cooperation with leading enterprises in Southeast Asia and participating in major infrastructure projects related to the construction of railway and communication equipment, oil and optical cables. In addition, BOCHK's competitive edge was extended to its Southeast Asian institutions through enriched product offerings such as cash management, structured financing, syndicated loan arrangement and customised trade products tailored to clients' needs, providing more comprehensive services for local customers. BOCHK collaborated with its Southeast Asian institutions in jointly undertaking cross-border loans for Hong Kong enterprises while actively expanding its institutional and RMB banknote businesses.

In personal banking business, the Group reinforced local sales teams to better serve personal customers by stationing account executives at its Southeast Asian institutions and conducting team building and staff training. BOC Malaysia launched its medical insurance plan in 2017 and received positive feedback, and introduced eight products from four fund houses after obtaining a licence for funds distribution from the local regulatory authority. With respect to bancassurance business, BOCHK Jakarta Branch worked closely with life insurance companies on product referral.

Maintaining prudent risk management policies and achieving sustainable and healthy development

The Group adhered to a prudent credit strategy in order to achieve sustainable and healthy development in its credit business. It formulated guidelines to facilitate risk control and sustainable expansion in its credit business with regard to business strategies relating to Chinese enterprises going global and the Belt and Road initiative.

In order to refine its regional management system and mechanism, the Group gave guidance to its Southeast Asian institutions regarding management structure, internal control, policies and procedures, as well as approval authority and limits pertaining to credit risk, thus ensuring that they act in accordance with BOCHK's credit risk management principles and standards as well as related regulatory requirements. Moreover, the Group extended its credit risk management system and standards to its Southeast Asian institutions as part of its compliance supervision, and focused on enhancing Southeast Asian institutions' management of credit and anti-money laundering risk.

The Group is committed to adopting consistent and prudent risk management policies, and as such all Southeast Asian institutions must comply with its risk appetite and credit risk policies. It has established a regional credit risk management system that provides full guidance and support to its Southeast Asian institutions in terms of their organisational structure, policies and procedures, approval processes and staff allocation and system techniques, in order to ensure that they operate in accordance with the Group's standards and the requirements of the HKMA and local regulators in Southeast Asia.

Technology and Operations

The Group attached a high level of importance to Fintech innovation. It proactively introduced customer-oriented Fintech services and continuously enhanced its competitive edge in e-Finance, driving business development forward in a number of domains. During the year, the Group achieved breakthroughs in the application of technological innovation, including blockchain, biometric authentication and big data. Development of blockchain technology applications for property valuation made good progress, with more than 80% of the Group's valuation cases conducted using this technology. The application was also extended to trade finance services, enhancing transaction efficiency. The use of biometric authentication technology was expanded to different business scenarios. The Group became the first bank in Hong Kong to introduce finger vein authentication on ATMs. It also adopted fingerprint and voiceprint authentication for mobile banking and call centres respectively, providing customers with safer and more convenient authentication options. It continued to develop its big data platform, enhancing insight analysis on individual customers and customer segmentation for more effective marketing. Meanwhile, the Group strived to promote the development of e-channel facilities. BOCHK iService, a 24-hour video banking service, was optimised and the brand new BOCHK WeChat account and BOC Life mobile application were launched. Payment services including Apple Pay, Samsung Pay, Android Pay and WeChat Pay were introduced to improve customer experience. As a result of the initiatives mentioned above, the total number of customers using e-channels including internet and mobile banking services continued to rise during the year, together with a year-on-year increase in the total number of related transactions.

As part of its commitment to driving innovation and promoting Fintech development in Hong Kong, the Group signed a strategic cooperation agreement with China Mobile International and China Mobile Hong Kong. The partnership enables all parties to develop diversified service platforms, create a core customer base, accelerate regional development and jointly develop business in Southeast Asia. In addition, the Group strived to strengthen its strategic cooperation with several large internet companies in order to expand its cross-border business and improve overall competitiveness. During the year, the Group set up the Innovation Laboratory and Innovation Workshop as a platform to strengthen cooperation and idea exchanges with industry regarding innovation.

The Group continued to strengthen development in its IT infrastructure in order to maintain stable business growth. During the year, the Group proactively pushed forward information systems integration as part of the deployment of BOC Group's global IT strategy. The relocation of the Group's disaster recovery centre was completed in order to improve the operational efficiency and stability of its application systems during disaster recovery. In line with its regional development strategy, the Group expedited regional system architecture planning and implementation, and established regional IT governance and procedures. With respect to technology risk management and other security issues, the Group has adopted international best practices and launched a series of cyber security awareness programmes to increase the sophistication of technology risk management.

In recognition of its innovations in technology and IT development, BOCHK was recognised as Excellent Brand of Fintech-Banking in the Hong Kong Leaders' Choice Brand Award 2017, hosted by Metro Finance and Metro Finance Digital. In recognition of its efforts to develop and apply blockchain technology in the local banking and finance industry, BOCHK won the Best FinTech (Emerging Solutions/Payment Innovation) Gold Award at the Hong Kong ICT Awards 2017. Its finger vein authentication function also won the Best Smart Hong Kong (Digital Inclusion Application) Certificate of Merit in the same awards. In the 12th Retail Banking Awards, organised by *Asian Banking and Finance*, BOCHK received the Mobile Banking Initiative of the Year – Hong Kong award for the third consecutive year, the Digital Banking Initiative of the Year – Hong Kong award for the second consecutive year, and the Online Securities Platform of the Year – Hong Kong award, reflecting BOCHK's outstanding performance in e-banking services. As a commendation to BOCHK's IT governance, it was awarded a Gold Medal in the IT Governance Achievement Award in Private Sector presented by the ISACA China Hong Kong Chapter.

Disposal of Chiyu Banking Corporation Limited

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

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

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

Profit attributable to equity holders from discontinued operations amounted to HK$2,589 million, including a gain on the disposal of Chiyu of HK$2,504 million. This represented a decrease of HK$28,713 million from the previous year's figure, which included a gain on the disposal of NCB of HK$29,956 million.

HK$'m	**2017**	2016
Profit of discontinued operations	**85**	1,346
Gain on disposal of discontinued operations	**2,504**	29,956
Profit attributable to equity holders of the Company from discontinued operations	**2,589**	31,302

Outlook and Business Focus for 2018

The global economy will continue to recover in 2018. The International Monetary Fund expects global output to grow by 3.9% in 2018, slightly faster than the previous year's 3.7%. The US economy will maintain stable growth as it benefits from tax reform implementation. The Chinese economy is expected to realise mid- to high-speed growth, having entered a stage of high-quality development rather than high-speed expansion. The Hong Kong economy is expected to maintain a positive outlook and satisfactory performance in 2018 amid an improved external environment, full employment and the policies of the new Government administration. The ASEAN region will continue to experience solid economic growth, supported by accelerated infrastructure development, an improving business environment and a rise in foreign investment.

2018 will be a year of both opportunities and challenges. More opportunities will be created for Hong Kong banks by major national strategic initiatives and policies (such as the Belt and Road Initiative and the Guangdong-Hong Kong-Macao Greater Bay Area Plan), strengthened connections between financial markets in Hong Kong and the mainland, a bullish outlook for Hong Kong's capital markets, robust investment and M&A flows in Southeast Asia and the drawing of the RMB internationalisation 2.0 era. At the same time, uncertainties in the global political and economic environment, intensifying market competition and a more stringent regulatory environment for business development will continue to create challenges for the operation and development of banks. The Group will aim to "Build a Top-class, Full-service and Internationalised Regional Bank", proactively respond to market changes and reinforce the development of its core businesses. It will accelerate regional expansion and business transformation, enhance its product innovation and service capabilities while remaining committed to prudent risk management, so as to achieve sustainable development in all areas.

The Group will accelerate the integration of its Southeast Asian institutions in order to push forward its regional development. It will further refine its regional management mechanism, reinforce support to its Southeast Asian institutions, tailor their business development to local conditions and enrich its product offering, with the aim of achieving sustainable and balanced development and establishing itself as a mainstream bank in local Southeast Asia markets, as well as a major bank for enterprises along the Belt and Road and enterprises going global. The Group will focus on RMB business and step up the development of the RMB market in local Southeast Asia. For corporate banking business, the Group will develop relationships with mainstream clients and industries in Southeast Asia areas, focusing on Chinese family-owned businesses to establish a target client base. For personal banking business, it will focus on credit cards, mobile banking and payroll account services, striving to become the main bank for mid- to high-end and cross-border Chinese clients and clients of payroll account services. It will also optimise the risk management system of its Southeast Asian institutions, cultivate a solid compliance culture and optimise the "Three Lines of Defence" mechanism in order to meet both Group and local regulatory requirements.

The Group will accelerate technological innovation and product R&D in order to achieve digital development. It will apply internet thinking and digital technology to its business model restructuring and product upgrading and development, and refine its innovation mechanism in order to become a leading digitalised bank. Aiming at enhancing customer experience and enlarging its customer base in local areas, the Guangdong-Hong Kong-Macao Greater Bay Area and Southeast Asia, the Group will innovate a diversified range of featured services, integrate its online and offline channels and provide systematic, automatic, intelligent and timely one-stop services.

In pursuit of full-function development, the Group will speed up the construction of its diversified business platforms and the integration of its commercial banking and investment banking businesses. Focusing on clients' varied financial needs, the Group will accelerate the integration of its investment banking, diversified businesses and traditional commercial banking businesses, leverage the competitive advantages arising from its distribution channels and customer segments and enhance its overall service capabilities, in order to expand its customer base and business coverage.

The Group will remain committed to developing the local market and further enhancing its competitive edge. It will lend its weight to Hong Kong's economic development, support major projects, acquire more customers from local market SMEs, listed companies and family-owned businesses, and deepen business cooperation with the Government and public sector entities. It will also step up innovations in livelihood finance in order to serve customers more comprehensively and efficiently. In addition, it will actively expand its RMB business and strengthen its trading capacity, thus supporting Hong Kong in consolidating and enhancing its role as a hub for global offshore RMB business.

The Group will proactively expand its cross-border business with a focus on the regional integration of Guangdong, Hong Kong and Macao. Leveraging opportunities arising from the Belt and Road Initiative, the regional integration of Guangdong, Hong Kong and Macao and the relaxation of China's FTZ policies, the Group will work more closely with BOC institutions in the mainland and overseas countries, provide support to key industrial sectors and major projects and upgrade its one-stop products and services, thus enhancing its regional competitiveness. It will also strengthen innovation in its cross-border RMB business in order to become the first-choice bank for cross-border personal banking clients.

The Group will reinforce general management and team building in order to enhance its corporate governance. It will accelerate the establishment of intensified, intelligent and regionalised operations and leverage economies of scale so as to further enhance operational efficiency. The Group's asset yield and net interest margin will improve due to strengthened asset and liability management. Moreover, with the aim of establishing the BOC Group training centre for international professional talent, the Group will step up staff allocation and training for key business areas and set up an education and training system tailored to its development needs.

Credit Ratings

As at 31 December 2017	Long-term	Short-term
Standard & Poor's	A+	A-1
Moody's	Aa3	P-1
Fitch	A	F1

RISK MANAGEMENT

Banking Group

Overview

The Group believes that sound risk management is crucial to the success of any organisation. In its daily operation, the Group attaches a high degree of importance to risk management and emphasises that a balance must be struck between risk control and business development. The principal types of risk inherent in the Group's businesses are credit risk, interest rate risk, market risk, liquidity risk, operational risk, reputation risk, legal and compliance risk, and strategic risk. The Group's risk management objective is to enhance shareholder value by maintaining risk exposures within acceptable limits. The Group has a defined risk appetite statement approved by the Board, which is an expression of the types and level of risk that the Group is willing to take in a controllable way in order to achieve its business goals and to meet the expectations of its stakeholders. For details of the Group's risk management governance structure, please refer to Note 4 to the Financial Statements.

Credit risk management

Credit risk is the risk of loss that a customer or counterparty is unable to or unwilling to meet its contractual obligations. Credit risk exists in the trading book and banking book, as well as from on- and off-balance sheet transactions of the Group. It arises principally from lending, trade finance and treasury businesses. For details of the Group's Credit Risk Management, please refer to Note 4.1 to the Financial Statements.

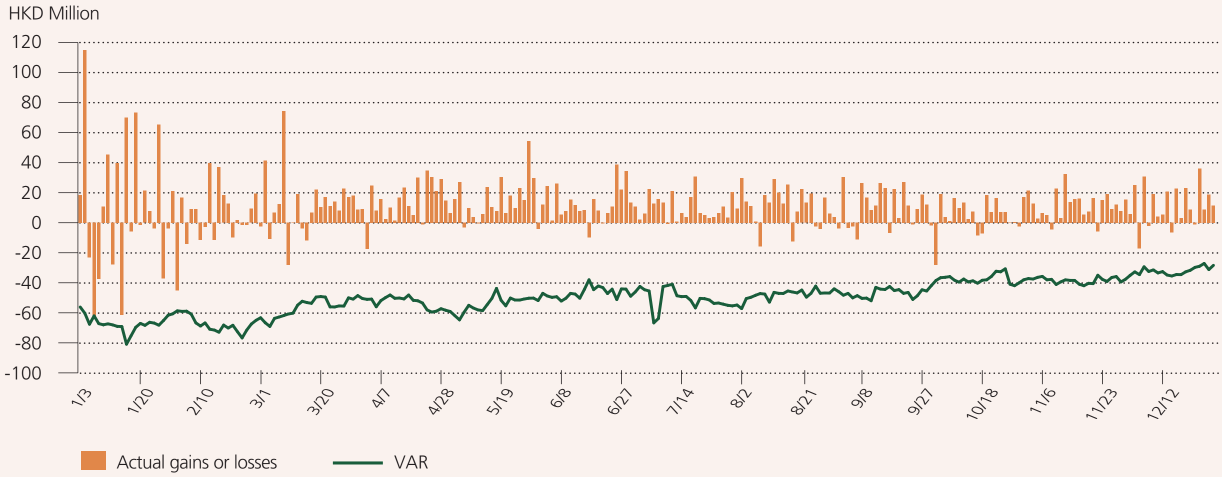
Market risk management

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

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

The Group adopts back-testing to measure the accuracy of VAR model results. The back-testing compares the calculated VAR figure of market risk positions of each business day with the actual and hypothetical gains or losses 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 gains or losses of the Group.

Daily Back-testing in 2017



There was one actual loss exceeding the VAR for the Group in 2017 as shown in the back-testing results.

Interest rate risk management

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

Liquidity risk management

Liquidity risk is the risk that banks may not be able to obtain sufficient and timely funding at reasonable cost to meet their obligations as they fall due. The Group maintains sound liquidity risk appetite to provide stable, reliable and adequate sources of cash to meet liquidity needs under normal circumstances or stressed scenarios; and to survive with net positive cumulative cash flow in extreme scenarios, without requesting the HKMA to act as the lender of last resort. For details of the Group's Liquidity Risk Management, please refer to Note 4.3 to the Financial Statements.

Operational risk management

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

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

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

Reputation risk management

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

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

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

Legal and compliance risk management

Legal risk is the risk that unenforceable contracts, lawsuits or adverse judgments may disrupt or otherwise negatively affect the operations or financial conditions of the Group. Compliance risk is the risk of legal or regulatory sanctions, financial losses or losses in reputation the Group may suffer as a result of its failure to comply with applicable laws and regulations. Legal and compliance risks are managed by the LCO, while the risks related to money laundering, terrorist financing and financial crime are independently managed and controlled by the Financial Crime Compliance Department ("FCC"). Both LCO and FCC report directly to the CRO. As part of the Group's corporate governance framework, the policies for the management of legal and compliance risks, and money laundering, terrorist financing and financial crime compliance risks are approved by the RMC as delegated by the Board.

Strategic risk management

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

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

Capital management

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

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

Stress testing

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

BOC Life

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

Insurance risk management

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

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

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

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

Interest rate risk management

An increase in interest rates may result in the depreciation of the value of BOC Life's investment assets. It might induce customers to surrender their insurance policies/contracts. A decrease in interest rates may result in an increase in insurance liability and an inability to adequately match guarantees or lower returns leading to customer dissatisfaction. BOC Life manages the matching of assets and liabilities of its portfolios within an asset liability management framework that has been developed to achieve investment returns that match its obligations under insurance contracts; and to manage the adverse impact due to interest rate movement.

Liquidity risk management

BOC Life's liquidity risk is the risk of not being able to meet obligations as they fall due without incurring unacceptable loss. BOC Life's asset and liability management framework includes cash flow management to preserve liquidity to match policy payout from time to time.

Credit risk management

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

- Default risk associated with bonds, notes and counterparties
- Credit spread widening as a result of credit migration (downgrade)
- Reinsurers' share of insurance unpaid liabilities
- Amounts due from reinsurers in respect of claims already paid
- Amounts due from insurance contract holders
- Amounts due from insurance intermediaries

BOC Life manages credit risk by placing limits on its exposure to each investment counterparty and issuer. Such limits are subject to review by the Management at least once a year.

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

Equity price risk management

BOC Life's equity price risk refers to the risk of loss due to volatility of market price in equity securities, equity funds, private equity and real asset. BOC Life's asset and liability framework includes managing the adverse impact due to equity price movement through stress test and exposure limit.

Currency risk management

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