BANK OF CHINA (CANADA)

BASEL PILLAR III DISCLOSURES

AS AT DECEMBER 31, 2014

Bank of China (Canada)

Basel Pillar III Disclosures

December 31, 2014

(All figures are in thousands of Canadian dollar, unless otherwise stated)

Table of Contents

1. Scope of Application 5
2. Capital Management 3
   - (a) Capital structure 3
   - (b) Capital adequacy ratio 4
   - (c) Assets to capital multiple[1] 4
   - (d) Minimum capital requirement for principal risks 4
3. Risk Management Framework 5
   - (a) Credit risk 5
   - (b) Market risk 8
   - (c) Operational risk 10
   - (d) Liquidity and funding risk 10
   - (e) Counterparty credit risk 10
4. Remuneration Policy 12

Bank of China (Canada)

Basel Pillar III Disclosures

December 31, 2014
(All figures are in thousands of Canadian dollar, unless otherwise stated)

1. Scope of Application

In this document, the Bank of China (Canada) (the "Bank") provides its Basel Pillar III disclosures, as required by the Office of the Superintendent of Financial Institutions Canada (OSFI).

The Bank, through its 10 branches in Toronto, Montreal, Calgary and Vancouver, is licensed to operate in Canada as a foreign bank subsidiary with full banking powers under the Bank Act. The Bank is a wholly owned subsidiary of Bank of China Limited (the "parent bank"). The Bank is domiciled in Canada and its registered office is located at 50 Minthorn Boulevard, Suite 600, Markham, Ontario, L3T 7X8, Canada. It has established a number of retail branches in Vancouver, Calgary and Montreal.

2. Capital Management

The Bank's objectives when managing capital are:

- to comply with the capital requirements of the Office of the Superintendent of Financial Institutions Canada (OSFI),
- to safeguard the Bank's ability to continue as a going concern so that it can continue to provide reasonable returns to the sole shareholder, and
- to maintain a strong capital base to support future business development.

The Bank has established a policy on capital management. The Board of Directors along with the Management review the Bank's capital structure on a regular basis and in light of its capital adequacy ratio. The process of allocating capital to specific operations and activities is undertaken by the Bank's Assets and Liabilities Management Committee.

The capital adequacy of the Bank is measured pursuant to the guidelines issued by OSFI which are based on the standards established by the Bank for International Settlements. OSFI has established risk based capital targets for financial institutions. These targets are currently a tier 1 capital ratio of 7% and a total capital ratio of 10.5%. In addition, financial institutions are required to ensure that their assets to capital multiple (ACM), which is calculated by dividing gross adjusted assets by total capital, does not exceed a maximum level (20 times) prescribed by OSFI.

(a) Capital structure

The Bank's capital base is comprised of tier 1 capital and tier 2 Capital.

Tier 1 capital represents the permanent form of capital and primarily includes common shares and retained earnings of the Bank. Tier 2 capital is primarily comprised of subordinated debt. Total regulatory capital is the total of tier 1 capital and tier 2 Capital, net of certain deductions.

	December 31, 2014	December 31, 2013
	$	$
Paid up common share capital	**115,230**	115,230
Retained earnings	**47,403**	34,433
Accumulated other comprehensive income	**18**	14
Tier 1 Capital	**162,651**	149,677
Subordinated debt	**40,000**	40,000
Tier 2 Capital	**40,000**	40,000
Total Regulatory Capital	**202,651**	189,677

(b) Capital adequacy ratio

	December 31, 2014	December 31, 2013
	%	%
Tier 1 Capital adequacy ratio	**12.35**	14.33
Tier 2 Capital adequacy ratio	**3.03**	3.06
Total Capital adequacy ratio	**15.38**	17.39

Capital adequacy ratios are compiled in accordance with the guideline titled *Capital Adequacy Requirements – Simpler Approaches* issued by OSFI in December 2014. The Bank has adopted the Standardized Approach for the calculation of risk weighted assets for credit risk and the Basic Indicator Approach for the calculation of operational risk.

(c) Assets to capital multiple[1]

	December 31, 2014	December 31, 2013
	$	$
Total adjusted assets (on and off balance sheet)	**2,083,129**	1,648,644
Total capital	**202,651**	181,677
Asset to capital multiple	**10.28x**	9.07x

1. Based on revised OSFI Capital Adequacy Requirements in December 2014, effective January 1, 2015 the assets to capital multiple (ACM) measure is no longer required by OSFI. This is the last time we will be disclosing this measure. Also effective January 1, 2015 we will start disclosing two new OSFI capital adequacy (leverage ratio (LRR)) and liquidity coverage ratio (LCR) measures.

(d) Minimum capital requirement for principal risks

	December 31, 2014	December 31, 2013
	$	$
Credit Risk		
- Bank	**13,289**	11,697
- Corporate	**103,045**	80,752
- Residential Mortgages	**5,857**	4,003
- Other Retail	**897**	603
Operational Risk	**6,920**	5,698

3. Risk Management Framework

The Bank has established a risk management system and policies to identify, analyze, monitor and control various types of risks that the Bank faces in its operations. The risk management policies covering credit risk, market risk, operational risk, and liquidity and funding risk of the Bank are reviewed regularly by the Risk Management Committee, the Assets and Liabilities Management Committee, the Risk Policy Committee and the Audit Committee of the Board.

(a) Credit risk

Credit risk arises from the possibility that a customer or counterparty in a transaction may default. Such risk may arise from customer risks from loan and advances, issuer risks from securities purchased and counterparty risks from inter-bank transactions such as deposit placement, foreign exchange, etc.

The Risk Policy Committee reviews and the Board of Directors approves credit risk management policy to establish delegated lending authorities, portfolio quality, credit extension criteria, credit monitoring process, concentration limit, risk rating system, credit recovery and provisioning, and account officer responsibilities. Management ensures that credit risk is managed and controlled within the policy to permit a sound and prudent management and control of existing and potential credit risk exposure. The policy is reviewed and enhanced on an ongoing basis to cater for market changes, statutory requirements and best practices in credit risk management.

In evaluating the credit risk associated with an individual customer or counterparty, financial strength and repayment ability are always the primary considerations. Credit risk may be mitigated by obtaining collateral, such as cash deposits, properties and guarantees, from the customers or counterparties. During the years ended December 31, 2014, the Bank had not used any credit derivatives to mitigate credit or concentration risks.

The Bank undertakes ongoing credit analysis and monitoring at several levels and establishes a system to promote early detection of customer, industry, or product exposures that require special monitoring. The overall portfolio risk, individual impaired loans and potential impaired loans are monitored on a regular basis.

The Risk Policy Committee of the Board of Directors and Management meet regularly to review and deal with significant issues relating to credit risk exposures.

Based on the Bank's internal risk rating system, the credit exposure can be classified as "Pass", "Special Mention" or "Impaired". "Pass" means the borrowers can honor the terms of the credit agreements; and, there is no reason to doubt their ability to repay principal and interest on loans in full and as scheduled. "Special Mention" means the borrowers are still able to service the loans currently, although the repayment of loans might be adversely affected by some factors. "Impaired" means the borrowers cannot repay loan principal and interest in full and significant losses will incur.

The Bank classifies loans as impaired when, in the opinion of management, the Bank no longer has reasonable assurance of timely collection of the full amount of principal and interest. Loans where principal or interest is contractually past due 90 days are automatically classified as impaired, unless the Bank determines that they are fully secured, in the process of collection, and the collection efforts are reasonably expected to result in either full repayment of the loan or restoring it to a performing status within 180 days from the date the payment has become in arrears.

When a loan is classified as impaired, its carrying amount is reduced to its present value of estimated future cash flows discounted at the original effective interest rate inherent in the loan. If

the original interest rate is contracted at a variable interest rate, the discount rate for measuring the present value of estimated future cash flows will be the current effective interest rate determined under the loan agreement. The reduction in carrying amount of the impaired loan is recognized as a change in the impairment allowances and will be charged to the statement of income and comprehensive income in the period in which impairment is identified.

Any subsequent changes to the amounts and timing of the expected future cash flows compared to the prior estimates will result in a change in the impairment allowances and will be charged or credited to the statement of income and comprehensive income. A reversal of impairment losses is limited to the loan carrying amount that would have been determined had no impairment loss been recognized in prior years.

Where there is no reasonable prospect of recovery, the loan and the related interest receivables are written off through the impairment allowance account.

As of the following reporting dates, the Bank's exposure to credit risk is presented below:

	December 31, 2014	December 31, 2013
	$	$
Commercial Loans		
Neither past due nor impaired	**785,341**	725,449
Past due but not impaired	**-**	-
Impaired	**-**	-
	785,341	725,449
Mortgages		
Neither past due nor impaired	**351,165**	253,617
Past due but not impaired	**-**	-
Impaired	**-**	-
	351,165	253,617
Other Loans		
Neither past due nor impaired	**8,417**	6,007
Past due but not impaired	**4**	-
Impaired	**-**	-
	8,421	6,007

Of which the credit exposure of neither past due nor impaired as of the following reporting dates is presented below:

			December 31, 2014	December 31, 2013
	Pass	Special Mention	Total	Total
	$	$	$	$
Commercial Loans	**785,341**	**-**	**785,341**	725,449
Mortgages	**350,880**	**285**	**350,165**	253,617
Other Loans	**8,417**	**-**	**8,417**	6,007
	1,144,638	**285**	**1,143,923**	985,073

The credit quality of the portfolio of loans and advances that were neither past due nor impaired was assessed by reference to the Bank's internal credit risk rating system.

The Bank had past due credit card overdraft of $4 as at December 31, 2014. The credit card overdraft had passed the due date for over 90 days but within 120 days as at December 31, 2014. The Bank had Special Mention commercial mortgage of $285 from one customer. This commercial mortgage is current and properly servicing by the borrower. The adjustment to the credit exposure is mainly due to the borrower's instable repayment source. The fair value of collaterals held as at December 31, 2014 against loans and advances was $739,285 (December 31, 2013 - $544,701).

As of the following reporting dates, the Bank's exposure to credit risk broken down by industries is presented below:

	December 31, 2014	December 31, 2013
	$	$
Commercial and other loans		
Financial institutions	**206,192**	211,931
Mining	**165,528**	94,806
Manufacturing	**75,816**	126,705
Service	**9,471**	2,684
Transportation	**19,819**	56,241
Trading	**31,896**	64,823
Logging and forestry	**-**	1,755
Real estate	**133,954**	27,189
Energy	**142,047**	149,068
Agriculture	**86**	93
Other	**8,953**	6,161
	793,762	741,456
Mortgages	**351,166**	253,617
	1,144,928	995,073
Less: General allowance for impairment	**(7,567)**	(5,509)
Total, net of allowance for loan impairment	**1,137,361**	989,564

As of December 31, 2014, the Bank's exposure to credit risk broken down by geographic location is presented below:

						December 31, 2014
	Gross portfolio	Net portfolio (1)	Gross impaired loans	Specific allowance	General allowance	Total allowance
	$	$	$	$	$	$
Canada						
Commercial loans	**231,555**	**230,712**	-	-	**(843)**	**(843)**
Commercial mortgages	**139,483**	**137,341**	-	-	**(2142)**	**(2142)**
Residential mortgages	**114,134**	**112,738**	-	-	**(1396)**	**(1396)**
Other loans	**16,007**	**15,952**	-	-	**(55)**	**(55)**
	501,179	**496,743**	-	-	**(4436)**	**(4436)**
International						
Commercial loans	**493,894**	**492,821**	-	-	**(1073)**	**(1073)**
	995,073	**989,564**	-	-	**(5509)**	**(5509)**

(b) Market risk

Market risk is the potential for adverse changes in the value of the Bank's assets and liabilities resulting from changes in market variables such as interest rates, foreign exchange rates, equity and commodity prices, and their implied volatilities. The two primary types of market risk applicable to the Bank are: (a) interest rate risk; and (b) foreign exchange risk.

The Risk Policy Committee reviews and the Board of Directors approves policy on market risk management to monitor and control its market risk exposures within acceptable parameters, while optimizing the return on risk. The Assets and Liabilities Management Committee, which is responsible for the ongoing general market risk management, meets regularly to review and deal with issues in response to the changing market conditions.

(i) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Bank is exposed to interest rate risk when asset and liability principals and interest cash flows have different interest payment or maturity dates. These are called "mismatched positions." An interest sensitive asset or liability is re-priced when interest rate changes or when there is cash flow from final maturity, normal amortization and when customers exercise prepayment. The Bank's exposure to interest rate risk depends on the size and direction of the interest rate change and on the size and maturity of the mismatched positions.

Interest rate risk is measured using various interest rate "shock" scenarios to estimate the impact of changes in interest rates on the Bank's annual Earnings at Risk (EaR). EaR is defined as the change in the Bank's annual net interest income from 200-basis-point unfavorable interest rate shock due to mismatched cash flows. The Bank has established a risk acceptance level in terms of a percentage to EaR to monitor this exposure and adjust any mismatched position whenever the policy limit is exceeded.

As of the following reporting dates, the before tax impact on net interest income due to the change of interest rate over the next 12 months is presented below:

	December 31, 2014	December 31, 2013
200 basis points increase in interest rates:	**2,583**	2,167
200 basis points decrease in interest rates:	**(2,583)**	(2,167)

As at December 31, 2014, the financial assets and liabilities of the Bank based on the earlier of their contractual re-pricing or maturity date are presented below.

	Floating rate	Within 3 months	Over 3 months to 1 year	Over 1 year to 5 years	Over 5 years Total	Non-rate sensitive	Total
	$	$	$	$	$	$	$
ASSETS							
Cash and cash equivalents	17,760	428,885	-	-	-	64,603	511,248
Securities	-	49,963	258,176	-	-	24	308,163
Loans and Advances	375,454	504,600	156,453	107,773	-	648	1,144,928
Allowance for impairment	-	-	-	-	-	(7,567)	(7,567)
Other assets (1)	139	-	-	311	-	28,634	29,084
Total assets	393,353	983,448	414,629	108,084	-	86,342	1,985,856
LIABILITIES & SHAREHOLDER'S EQUITY							
Deposits							
Demand and notice	676,119	-	-	-	-	64	676,183
Fixed term	-	417,905	590,452	58,200	-	-	1,066,557
Call loan from other bank	-	8,121	-	-	-	-	8,121
Other liabilities (2)	492	-	-	-	-	31,852	32,344
Subordinated debt	-	40,000	-	-	-	-	40,000
Shareholder's Equity	-	-	-	-	-	162,651	162,651
Total liabilities and equity	676,611	466,026	590,452	58,200	-	194,567	1,985,856
Total gap - 2013	(283,258)	517,422	(175,823)	49,884	-	(108,225)	-
Total gap - 2012	(197,435)	250,657	70,428	21,736	346	(145,732)	-

(1) Other assets include customer liabilities under acceptances, property and equipment, deferred tax assets and other assets.

(2) Other liabilities include bank's liabilities under acceptances, cheques and other items in transit, income taxes payable and other liabilities.

(ii) Foreign exchange risk

Foreign exchange risk is the risk of loss due to changes in foreign currency exchange rates. The Bank's foreign exchange market activities are primarily to cover customers' needs and foreign currency positions in the non-trading books. During the years ended December 31, 2014, the Bank did not speculate on foreign exchange movements or maintain large open positions in foreign currencies.

The Bank does not have any significant risk in foreign exchange as it is not involved in speculative trading activities. The Bank covers or hedges its foreign currency exposures using foreign currency forward contracts. There is no significant foreign exchange exposure incurred in foreign currency deposit and loan transactions.

(c) Operational risk

Operational risk is the potential for loss resulting from inadequate or failed internal control processes or systems, human interactions or external events.

The Audit Committee reviews and the Board of Directors approves the policy for operational risk management. Management has established various operational and control procedures to identify, manage and monitor inherent control weaknesses. The Audit Committee has oversight responsibility for operational risk strategy and governance. The Bank's Operational Risk Management Committee provides advice and guidance to the business units on operational risk assessments, measurement, mitigation and monitoring initiatives. A report on the status of operational risk management is submitted to the Audit Committee quarterly. The Bank adopts the basic indicator approach to calculate the capital requirement for operational risk.

(d) Liquidity and funding risk

Liquidity and funding risk arises when the Bank encounters difficulty in meeting obligations from its financial liabilities.

The Risk Policy Committee reviews and the Board of Directors approves the policies for liquidity and funding risk management. The Asset and Liability Management Committee of the Bank meets regularly to review and deal with liquidity management issues in response to changing market conditions.

The Bank's liquidity risk management policy and control procedures are designed to ensure that an effective liquidity contingency planning and liquefiable assets exist at all times to permit uninterrupted daily operations. The Bank's liquidity position is monitored daily and liquidity stress testing is conducted regularly under a variety of scenarios covering both normal and more severe market conditions.

The key measure used by the Bank for managing liquidity risk is the percentage of liquid assets to its deposit liabilities. Liquid assets include cash and cash equivalents, and deposit placements with other financial institutions maturing within one month. The Bank's policy is that it shall maintain an adequate percentage in order to cover a minimum survival period of thirty days.

(e) Counterparty credit risk

Counterparty credit risk is the risk that the counterparty to a derivative transaction could default before the final settlement of the transaction's cash flows. An economic loss would occur if the transactions or portfolio of transactions with the counterparty has a positive economic value to the Bank at the time of default. In the normal course of business, the Bank has foreign exchange transactions with positive values and there is a risk that the counterparties might default. The Bank has established limits governing its foreign exchange activities with banks and customers; and, most importantly, it does not speculate on foreign exchange trading. To quantify settlement and counterparty risk, the Bank has adopted the 'current exposure method' to measure it and calculate the capital requirement for it.

As at December 31, 2014, the capital requirement for counterparty credit risk calculated by using the current exposure method is presented in the table following:

					December 31, 2014
	Notional amounts	Positive (Negative) Replacement Cost		Credit Equivalent Amount	Risk Weighted Balance
	$	$	$	$	$
Foreign exchange contracts					
Forward contracts	**420,445**	**2,118**	**(2,427)**	**6,323**	**2,422**
	420,445	**2,118**	**(2,427)**	**6,323**	**2,422**

4. Remuneration Policy

The Bank's remuneration policy applies to all its employees in Canada. The primary objectives of the Bank's remuneration policy are to compensate its employees in such a manner that it can attract, retain and motivate them, while at the same time enable the Bank implement and achieve its business targets and strategies.

The Bank has implemented a fair and balanced remuneration package that reflects the values of the business units and each individual employee. The package is comprised of the following components:

- Base salary
- Incentive pay
- Other benefits
- Severance payment

The base salary, which is a fixed remuneration, represents 80% to 90% of the total remuneration. The Bank aims at being competitive in determining the base salary of different positions.

The incentive pay is applied to motivate employees and increase their productivity. Employees with satisfactory performance are generally eligible. The amount of incentive pay is determined according to the performance of each individual employee measured by a number of criteria that are communicated to the employees in advance. The Bank has established certain risk control measures to prevent employees from taking excessive risks in attempting to achieve targets; and, the Bank can at its sole discretion adjust the incentive pay structure from time to time in order to minimize risk taking.

Other benefits are non-cash rewards to employees and include some special awards to employees who have demonstrated outstanding performance either at work or in internal competitions organized by the Bank.

The Bank may provide severance payment to terminate the employment relationship with unsatisfactory employees after all efforts to help them are unsuccessful.

The Bank conducts annual review on the remuneration package to ensure its competitiveness and that it matches with the Bank's overall business strategy.

Key Management Compensation

Key management refers to the members of the Board of Directors and General Management Office of the Bank. Their compensation is determined and overseen by the parent bank in accordance with the Bank of China Group remuneration policy. For the year 2014, their remuneration was $1,628 (2013 - $1,600), all amounts in thousands CAD $.