

We anticipate and satisfy
changing customer needs
in our efforts to exceed, excel. By providing
greater choice, maximum convenience
and value-added solutions, we help enhance
the lifestyle of our diverse customers.



Hang Seng Bank leveraged on its large customer franchise, grew strong-earning businesses and built on its financial prudence to maintain market leadership in 2001. Our results in the difficult operating conditions reflect our sound fundamentals and value-creating strategies.

We deepened customer relationships by strengthening segmentation and widening our one-stop solutions. We provided more convenient customer access by applying information technology more extensively. We encouraged customers to look to Hang Seng for all their banking needs and rewarded them for total banking relationships.

Good progress was recorded in our areas of focus: wealth management and commercial banking. The groundwork was also laid for our future expansion in mainland China.

Financial Highlights

Operating profit before provisions decreased marginally by 0.3% to HK\$11,503 million compared with 2000. Profit before tax amounted to HK\$11,514 million, a reduction of 1.4%.

Net interest income fell by 0.3% to HK\$11,660 million, although average interest-earning assets grew by 4.4%. Net interest spread improved by 9 basis points to 2.28%, but this was offset by a reduction of 21 basis points in the contribution from net free funds to 0.28%. As a result, there was a 12 basis point compression in net interest margin to 2.56%.

The improvement in net interest spread was helped by the growth in low cost savings deposits and a wider gap between the best

lending rate and HIBOR. The positioning of the treasury portfolios and holding of fixed rate securities also benefited significantly from falling interest rates. These were partly offset by a further decline in the average yield of the mortgage portfolio. Time deposits also earned narrower spreads.

A Strong Customer Focus

The launch of Prestige Banking has enabled the Bank to strengthen relationships with customers and expand personal wealth management. Customers can enjoy a wider range of personalised and value-added services in an enhanced banking environment with a minimum account opening amount of HK\$500,000. A designated Customer Relationship Manager looks after each customer's asset portfolio as well as takes care of their banking and investment needs. A total of **58 PRESTIGE BANKING CENTRES** have been set up so far. Dedicated Prestige Banking counters are also available at all the Bank's ground-level branches.

Other operating income rose by 10.4% to HK\$3.9 billion, with net fees and commissions growing by 16.2% to HK\$2.4 billion. With successful initiatives to increase non-interest income, the ratio of other operating income to total operating income rose by 1.9 percentage points to 25.3%, compared with 22.4% five years ago.

The 10.2% increase in operating expenses was largely due to a special contribution of HK\$213 million to maintain the staff retirement benefit scheme at a fully funded position.

Premises and equipment expenses rose by HK\$101 million, or 13.2%, reflecting our continued investment in e-Banking initiatives to strengthen our role as a major e-force.

Although the cost:income ratio grew by 1.9 percentage points to 26.3%, it remained low within the banking sector, reflecting the Bank's strict expense discipline. Excluding the special contribution to the staff retirement benefit scheme, the cost:income ratio would have grown by 0.5 percentage point to 24.9%.

During the year, business processes were further streamlined to achieve productivity gains. Attributable profit per employee was a record HK\$1.35 million, up from HK\$1.34 million a year earlier.

In the weakening economy, the net charge for bad and doubtful debts amounted to HK\$424 million, an increase of 116.3% compared with the previous year.

New specific provisions for doubtful accounts rose by 14.9% to HK\$1,135 million, mainly in residential mortgages and card advances. Recoveries and releases, mainly in corporate accounts, decreased by 9.9% to HK\$711 million. As the balance of HK\$125 million of the additional general provision made in 1997 was transferred to augment general provisions at the end of 2000, no charge for general provisions was made against loan growth during 2001.

The ratio of total provisions to gross advances to customers fell to 1.55% at 31 December 2001, compared with 2.01% a year earlier. Specific provisions decreased by 0.45 percentage point to 0.91%, reflecting the write-off of the irrecoverable portion of large corporate accounts and residential mortgages upon repossession, as well as the upgrading of rescheduled advances and doubtful accounts to performing status. General provisions, at 0.64% of gross advances to customers, were maintained at a level consistent with the underlying risk portfolio of the loan book.

Gross non-performing advances (after

deduction of interest in suspense) fell by HK\$1,260 million, or 16.9%, to HK\$6,174 million. The ratio of gross non-performing advances to gross advances to customers also improved to 2.7% from 3.3% at the end of the previous year. Specific provisions plus collateral that is conservatively valued amounted to almost 100% of non-performing advances.

We continued to maintain strong liquidity. The average liquidity ratio for 2001 increased to 45.6% from 43.3% in 2000. The total capital ratio was maintained at 15.3% at 31 December 2001, the same level as a year earlier. The tier one capital ratio rose to 12.3%, compared with 11.9%.

Business Operations

Our businesses are divided into five lines that aim at long-term higher-value creation for both customers and the Bank.

Personal financial services remained the major profit contributor, providing 45.2% of the profit before tax. Commercial banking contributed 10.4%, corporate and institutional banking 8.6% and treasury 16.8%. Other businesses, which mainly cover the management of shareholders' funds, investment properties and long-term equity investments, provided 19.0%.

The final phase of interest rate deregulation on 3 July 2001, which involved Hong Kong dollar savings and current deposits, had minimal impact in view of the low interest rate environment and abundant market liquidity. Reflecting customers' preference for liquidity, savings and current account deposits grew but time and other deposits fell. Overall, deposits dropped by 4.6% to HK\$395.8 billion at 31 December 2001, compared with the previous year-end.

Despite weak loan demand, advances to customers (after deduction of interest in suspense and provisions) grew by 2.3% to HK\$222.4 billion.



Hang Seng has a strong customer franchise and serves **all strata** of Hong Kong people. The Bank's segmentation strategy enables it to **customise solutions** for each group and deepen relationships with them.

The advances to deposits ratio was 53.7% at 31 December 2001, compared with 50.6% a year earlier.

In our mortgage business, Government Home Ownership Scheme (GHOS) mortgages continued to grow due to the draw-down of commitments made before the imposition of the moratorium of GHOS sales between September 2001 and

June 2002, but residential mortgages fell slightly as a result of intense market competition. Due to the further reduction in the pricing of new mortgages and the re-pricing of existing loans, the average yield of the residential mortgage portfolio, excluding GHOS mortgages and staff loans, fell to 134 basis points below BLR at the end



We understand the requirements of **growing businesses** and manage the financial needs of commercial customers. Our support and expertise help them build a **strong foundation** for the future.

Secure and reliable e-Banking services offer customers the advantage of 'any time, any place' banking. Our rapidly expanding e-initiatives have become an important part of our multi-channel delivery network.



A Winning e-Image

Hang Seng's e-image campaign has helped build up a modern and progressive image for the Bank as well as its standing as a major e-player. The campaign won an Award for Excellence in the **GOLD QUILL AWARDS 2001**, organised by the International Association of Business Communicators. It highlights how the Bank is using leading edge technology and innovating to satisfy evolving customer needs. The launch of the campaign in July 2000 coincided with the introduction of the Hang Seng e-Banking brand name and the corporate tagline 'Hang Seng Bank. Exceed. Excel.' e-Banking services were introduced the following month.

of 2001 from 80 basis points below BLR a year earlier. This excluded the effect of cash incentive payments for new mortgages, which were charged to interest expenses as incurred.

CUSTOMER RELATIONSHIP MANAGEMENT

The Hang Seng brand and its reputation for service excellence offer us a strong advantage in the intensely competitive market. Our one-stop financial solutions and efficient distribution network enable us to enhance customer relationships.

Our integrated accounts have become a major platform to strengthen total customer relationships

customers and helping them develop good banking habits. Besides encouraging children to save, it provides a wide range of educational and recreational programmes helpful to their development, including an 'infotainment' website (www.hangseng.com/mikid). It also helps parents plan for the future of their children.

In April, we announced measures that encourage customers to consolidate their accounts with us and reward loyal customers. This followed a review of the price structure of our savings deposits in the face of full interest rate deregulation.

We believe that social responsibility and customer loyalty should balance purely commercial considerations. On this basis, more than two million Hong Kong dollar savings accounts have been exempted from a new minimum balance requirement introduced in July. New accounts opened by some groups of customers, including

senior citizens and minors, are also not subject to the new requirement.

A new ATM Savings Account, introduced to encourage customers to migrate to cost-efficient automated channels, has no minimum balance requirement.

Our customer relationship management also entails analysis of existing customer information in a bid to anticipate customer needs and maximise cross-selling efficiency.

MAJOR BUSINESSES

Personal financial services recorded a marked growth in income from the wealth management business. However, profit before tax fell by 7.3% compared with the previous year, because of the decline in the mortgage portfolio yield and higher

Protecting and Growing Assets

In the volatile investment environment, Hang Seng Bank's capital guaranteed funds aim to provide security to investors by minimising investment risk while offering growth opportunities. The Bank has introduced **15 HIGHLY POPULAR CAPITAL GUARANTEED FUNDS** since 2001 – the largest series of similar funds in Hong Kong – investing in the technology, financial services and bio-sciences sectors as well as the Hong Kong equity market. Total subscription of the Bank's capital guaranteed funds and other guaranteed funds distributed by the Bank reached **HK\$12.6 billion** in 2001.

and expand wealth management services.

During the year, a number of integrated accounts were launched. Prestige Banking was introduced in March 2001 for affluent customers. A total of 58 Prestige Banking Centres have been set up.

Femina Banking, Hong Kong's first integrated account targeting women, was launched in November. Aside from comprehensive financial services, it offers a wide variety of lifestyle and shopping privileges.

ezLink Financial Services, an integrated account for customers commuting between Hong Kong and the Mainland, was introduced in February 2002.

The M.I. Kid Account was successfully launched in October as a means of reaching out to young





As a one-stop bank, our financial solutions keep pace with the increasingly complex needs of customers in the marketplace. We offer easy access, comprehensive products and a rewarding experience.

bad debt charges for residential mortgages and card advances.

Income from wealth management, which comprises investment and insurance services, grew by 27.1%. With increased referrals between business units, the Bank improved its cross-selling ratio.

Investment fund subscription rose impressively by 128%. Funds managed under the Hang Seng Investment Series had grown by 204% to HK\$12.1 billion at the year-end. Since 2001, 17 investment funds have been launched under the Investment

Series, bringing the total to 34. This includes 15 highly popular capital guaranteed funds – the largest series of similar funds in Hong Kong. More than 360 funds from leading fund management companies are also offered to customers.

Hang Seng Life recorded good progress, with annualised new premiums for life insurance growing by 96.6%. Our Mandatory Provident Fund (MPF) business began to generate income, with the number of enrolled individuals increasing to more than 214,300 during the year.



We reach out to customers at an early age. Specially designed services encourage children to learn the importance of **saving and planning** for their future.

Credit card advances grew by 10.9% to HK\$5.3 billion as the card base increased to more than 930,000. Other lending to individuals, mainly tax and personal loans, rose by 24.1% to HK\$6.1 billion. Securities broking and related income fell because of the depressed stock market.

Our e-Banking services have become a convenient and cost-efficient channel to market and deliver wealth management products to customers. During the year, our online investment services were enhanced. A new look was introduced

for www.hangseng.com with dedicated e-Banking screen menus for different customer segments.

At the end of 2001, the number of customers registered for e-Banking had increased to more than 173,000. Internet transactions had grown to account for about 9% of total transactions and online share trading for about 50% of total securities transactions.

As we encourage customers to switch to cost-efficient automated channels, our branches are focusing more on sales and advisory services. At



Our scope of services in **mainland China** is growing as we build up our network of branches and offices there. The Mainland's financial liberalisation is an important driver for our **business expansion.**

present, we operate 155 branches and automated banking centres in Hong Kong.

Commercial banking, which manages middle market and small corporate relationships, recorded an increase in commercial lending. Trade finance grew by 4.7%, which saw the Bank gain market share despite dampened export trade. Commercial banking, however, showed a decrease of 1.9% in profit before tax, affected by a lower level of bad debt recoveries.

The Bank was ranked second in the list of

most preferred banking partners by small and medium-sized companies in a study conducted by the Hong Kong Productivity Council.

We continued to expand in mainland China. Fuzhou Branch, opened in February 2001, joined our network of branches in Guangzhou, Shanghai and Shenzhen and representative offices in Beijing and Xiamen. Hang Seng Insurance Company Limited opened a representative office in Shenzhen in April.

Our lending portfolio to Mainland-related

entities was HK\$9.5 billion and amounted to 4.2% of total advances at the year-end.

In Taiwan, we opened our first representative office in Taipei in January 2002.

Corporate and institutional banking achieved growth of 2.9% in profit before tax, benefiting mainly from the substantial recovery of bad and doubtful debts.

Treasury recorded encouraging growth of 60.6% in profit before tax, as the fixed rate debt securities portfolio and the assets and liabilities re-pricing gap benefited significantly in the falling interest rate environment. Increased profit on disposal of debt securities also contributed to the growth. The Bank was bookrunner for 94 Hong Kong-dollar capital markets issues totalling HK\$17.8 billion and was ranked the No. 2 bookrunner for such issues by *basis point*.

Staff Values

In order to reinforce the Managing for Value strategy and service excellence, staff communication and training programmes promoted the Bank's service and sales culture, entrepreneurship and innovation.

During the year, the 'Service from the Heart' campaign for staff reinforced our strong service orientation and our strategy of deepening customer relationships.

Staff were encouraged to be more entrepreneurial and help identify new business opportunities across the Bank. As part of this, the Bank's culture of innovation was intensified. A staff intranet website was launched to enhance communication and cultivate a Bank-wide innovation mindset.

During the year, about 850 ideas to improve services and capture business opportunities were received from staff. Operational savings and revenue generation from the implementation of

ideas in 2001 reached HK\$50.7 million, taking the total since 1992 to HK\$114.2 million on an annual recurring basis.

We continued to invest in people. Training initiatives helped staff meet new regulatory requirements and business demands, and to achieve their individual potential. The average number of training days per staff member was 7.5 days. The quality of the Bank's training was recognised when it won a Gold Prize in the Award for Excellence in Training 2001 from the Hong Kong Management Association.

Community Service

As a good corporate citizen, we are active in community service. Our philanthropic and sponsorship activities are focused primarily on education, community service and sports.

The Bank has committed over HK\$24 million to its scholarship schemes since 1995, benefiting about 400 students.

The Bank's charitable donations since 1990 exceed HK\$129 million, including about HK\$16 million to the Community Chest.

Under the Hang Seng Athlete Incentive Awards Scheme, the Bank and the Hong Kong Sports Development Board jointly presented cash totalling HK\$1.1 million to nine medal-winners at the 9th National Games. The awards have taken the total number of benefiting athletes to 34 and the sponsorship amount to over HK\$3 million since the Scheme's launch in 1996.

The Hang Seng Table Tennis Academy was established as the first academy for a single sport in Hong Kong and is expected to benefit about 30,000 participants from 2001-2003. The Bank's sponsorship of the Academy will take its total sponsorship amount for the promotion of the sport to over HK\$15 million since 1991.

Hang Seng's enormous contribution to



We share our success with the communities we serve through philanthropic and sponsorship activities. Our focus areas of education, community service and sports development highlight our commitment to help shape a better future.

A Good Corporate Citizen

Our scholarship schemes and education programmes are aimed at grooming young people for a dynamic, knowledge-based society. A total of 22 students have benefited since the 1996 launch of **THE HANG SENG BANK OVERSEAS SCHOLARSHIP SCHEME**. Four students from Hong Kong and mainland China were sent abroad to study from September under the Scheme. A further 102 scholarships were awarded to students in Hong Kong and mainland China in 2001. We have also sponsored the Hang Seng Bank Blossom with Music programme since 1998 and the Inter Post-Secondary College Debate Competition since 1995.

the promotion of sports won the Bank the 'Outstanding Marketing Contributor to Sport Award' in the 4th Excellence in Sports Marketing Awards presented by the Hong Kong Sports Development Board. This prestigious Award has only been presented twice in the last four years and to Hang Seng on both occasions.

HSI Services Limited, a wholly owned subsidiary, launched the Hang Seng Composite Index Series, continuing its efforts to provide comprehensive index services to meet different investor needs.

Future Prospects

The outlook for the banking sector in 2002 remains difficult, with continued intense competition, high liquidity, sluggish credit demand and narrowing margins.

Hang Seng will strengthen its focus on financial prudence, customer relationships and value-creating businesses to further enhance its competitive edge and maximise shareholder value.

In order to build more profitable customer relationships, we shall further strengthen segmentation and cross-selling. Lifestyle banking services will become more important in our efforts to offer added value to different groups of customers.

In our wealth management business, we shall target both the affluent and mass customer markets, and widen our already extensive product range to increase non-interest income. Consumer financing will be prudently expanded.

We shall further increase our customer base of small and medium-sized businesses in commercial banking.

Our e-Banking services will be further enhanced for service differentiation. Online investment services will be expanded, with retail margin services planned. Business internet banking will be available to all commercial

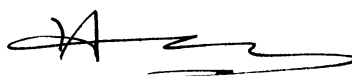
customers in the middle of the year. e-Treasury services will also be introduced for corporate customers.

Following China's accession to the World Trade Organization in December 2001, financial liberalisation and attraction of foreign direct investment will offer greater opportunities to the banking sector. In preparation, Hang Seng is strengthening its presence and range of services in the Mainland. We aim to be an important player in the Mainland, providing corporate, commercial and personal financial services.

Applications to open a branch in Nanjing and to upgrade the Beijing representative office to a branch have been submitted. Hang Seng Securities Limited has submitted applications for the purpose of obtaining B share trading seats on the Shanghai and Shenzhen stock exchanges and setting up a representative office in Shanghai. An application to operate internet banking services in the Mainland is planned.

Our branch in Shanghai is expected to receive a licence for renminbi banking services. We are ready to take advantage of the initial liberalisation of banking regulations which will allow foreign banks to provide foreign currency services to mainland Chinese companies and individuals.

Amid economic uncertainty, we shall redouble our efforts to exceed, excel, and to meet customer and shareholder expectations. Given the strength of our franchise, and our commitment to constant improvement, we are determined to ensure stable future earnings.



Vincent H C Cheng
Vice-Chairman and Chief Executive
Hong Kong, 4 March 2002