

Report of the Directors

The Directors have pleasure in presenting their report together with the audited accounts for the year ended 31 December 2003.

Principal activities

The Bank and its subsidiary and associated companies are engaged in the provision of banking and related financial services.

Profits

The consolidated profit of the Bank and its subsidiary and associated companies for the year is set out on page 103 together with particulars of dividends which have been paid or declared.

Major customers

The Directors believe that the five largest customers of the Bank accounted for less than 30% of the total of interest income and other operating income of the Bank in the year.

Subsidiaries

Particulars of the Bank's principal subsidiaries at 31 December 2003 are set out on page 149.

Share capital

No change in either the authorised or issued share capital took place during the year.

Donations

Charitable donations made by the Bank and its subsidiaries during the year amounted to HK\$12 million.

Directors

The Directors of the Bank who were in office at the end of the year were The Honourable Lee Quo-Wei, Mr D G Eldon, Mr Vincent H C Cheng, Mr John C C Chan, Dr Y T Cheng, Mr S J Glass, Dr Ho Tim, Mr Jenkin Hui, Mr Peter T C Lee, Dr the Hon Eric K C Li, Dr Vincent H S Lo, Mr Roger K H Luk, Mr W K Mok, Mr Raymond C F Or, Dr David W K Sin and Mr Richard Y S Tang.

Mr S C Penney resigned from the Board with effect from 23 April 2003 following his appointment as Senior Executive Vice President and Chief Financial Officer of HSBC North America.

Mr S J Glass was appointed a Director of the Bank with effect from 22 May 2003. He retires under the provisions of the Bank's Articles of Association and, being eligible, offers himself for re-election.

The Directors retiring by rotation in accordance with the Bank's Articles of Association are Mr Jenkin Hui, Dr the Hon Eric K C Li and Dr David W K Sin, who, being eligible, offer themselves for re-election.

No Director proposed for re-election at the forthcoming Annual General Meeting has a service contract with the Bank which is not determinable by the Bank within one year without payment of compensation (other than statutory compensation).

No contract of significance, to which the Bank or any of its holding companies or any of its subsidiaries or fellow subsidiaries was a party and in which a Director of the Bank had a material interest, subsisted at the end of the year or at any time during the year.

Board Committees

The Board has set up two committees, namely the Executive Committee and the Audit Committee.

Executive Committee

The Executive Committee meets regularly and operates as a general management committee under the direct authority of the Board. The members of the Executive Committee include Mr Vincent H C Cheng (Chairman), Mr Raymond C F Or, Mr Roger K H Luk and Mr W K Mok (Directors).

Audit Committee

The Audit Committee meets regularly with the senior financial, internal audit and compliance management and the external auditors to consider the Bank's financial reporting, the nature and scope of audit reviews and the

effectiveness of the systems of internal control and compliance. The members of the Audit Committee are Dr the Hon Eric K C Li (Chairman), Mr Richard Y S Tang and Mr S J Glass, all of whom are non-executive Directors of the Bank.

Code of Best Practice and Supervisory Policy Manual on Corporate Governance of Locally Incorporated Authorised Institutions

The Bank has complied throughout the year with the Code of Best Practice adopted by the Bank, which includes all the guidelines set out in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ("the Listing Rules"), and has followed the module on "Corporate Governance of Locally Incorporated Authorised Institutions" under the Supervisory Policy Manual issued by the Hong Kong Monetary Authority in September 2001. Information about the Bank's Corporate Governance is given on pages 94 to 96.

Directors' interests

(all within the meaning of Part XV of the Securities and

At the end of the financial year, the interests of the Directors in the shares, underlying shares of equity derivatives and debentures of the Bank and its associated corporations

Futures Ordinance "SFO") disclosed in accordance with the Listing Rules were detailed below.

| | Personal Interests (held as beneficial owner) | Family Interests (Interests of spouse or child under 18) | Corporate Interests (Interests of controlled corporation) | Other Interests | Total Interests | Total Interests as % of the relevant issued share capital |
|--|--|---|--|--------------------------|-----------------|---|
| Number of Ordinary Shares of HK\$5 each in the Bank | | | | | | |
| The Honourable Lee Quo-Wei | 1,091,516 | 1,184,783 | 350,990 ⁽¹⁾ | 158,152 ⁽²⁾ | 2,785,441 | 0.15 |
| Mr D G Eldon | 300 | – | – | – | 300 | 0.00 |
| Mr John C C Chan | – | – | – | 1,000 ⁽³⁾ | 1,000 | 0.00 |
| Dr Ho Tim | 3,480,252 | – | – | – | 3,480,252 | 0.18 |
| Mr Roger K H Luk | 1,983 | 2,500 | – | – | 4,483 | 0.00 |
| Mr W K Mok | 1,625 | – | – | – | 1,625 | 0.00 |
| Number of Ordinary Shares of US\$0.50 each in HSBC Holdings plc | | | | | | |
| The Honourable Lee Quo-Wei | 1,789,255 | 1,413,325 | 77,604 ⁽¹⁾ | 1,731,077 ⁽²⁾ | 5,011,261 | 0.05 |
| Mr D G Eldon | 46,189 ⁽⁴⁾ | 905 | – | 289,829 ⁽⁷⁾ | 336,923 | 0.00 |
| Mr Vincent H C Cheng | 35,533 | 50,559 | – | 158,249 ⁽⁷⁾ | 244,341 | 0.00 |
| Mr John C C Chan | 14,283 | – | – | 3,000 ⁽³⁾ | 17,283 | 0.00 |
| Mr S J Glass | 267 | 8,188 | – | 53,815 ⁽⁷⁾ | 62,270 | 0.00 |
| Dr Ho Tim | 102,687 | – | – | – | 102,687 | 0.00 |
| Mr Jenkin Hui | 9,487 | 24,342 | 1,051,176 ⁽⁵⁾ | – | 1,085,005 | 0.00 |
| Dr the Hon Eric K C Li | – | 18,132 | 79,622 ⁽⁶⁾ | – | 97,754 | 0.00 |
| Mr Roger K H Luk | 54,287 | 2,445 | – | 66,454 ⁽⁷⁾ | 123,186 | 0.00 |
| Mr W K Mok | – | – | – | 62,839 ⁽⁷⁾ | 62,839 | 0.00 |
| Mr Raymond C F Or | 63,744 | 32,481 | – | 135,030 ⁽⁷⁾ | 231,255 | 0.00 |

Notes:

- (1) The Honourable and Mrs Lee Quo-Wei together were entitled to control 33.33% of the voting power at general meetings of a private company which beneficially held all of those shares referred to above as his corporate interests.
- (2) 1,664,597 shares in HSBC Holdings plc were held by a charitable foundation which is exempt from tax under section 88 of the Inland Revenue Ordinance and of which The Honourable and Mrs Lee Quo-Wei were members of the Board of Trustees. 158,152 shares in the Bank and 66,480 shares in HSBC Holdings plc were held by two trusts of which Mrs Lee was one of the two trustees. Neither The Honourable Lee Quo-Wei nor Mrs Lee was a beneficiary of the shareholdings mentioned in this note.
- (3) 1,000 shares in the Bank and 3,000 shares in HSBC Holdings plc were held by a trust of which Mr and Mrs John C C Chan were beneficiaries.
- (4) These shares are jointly held by Mr and Mrs D G Eldon.
- (5) Mr Jenkin Hui was entitled to fully control the voting power at general meetings of Parc Palais Incorporated, a private company, which beneficially held all of those shares referred to above as his corporate interests.

- (6) Dr the Hon Eric K C Li was entitled to control no less than one-third of the voting power at general meetings of a private company which beneficially held all of those shares referred to above as his corporate interests.

- (7) These represent interests in (i) options granted to Directors under the HSBC share plans to acquire ordinary shares of US\$0.50 each in HSBC Holdings plc and (ii) conditional awards to Directors of ordinary shares of US\$0.50 each in HSBC Holdings plc under the HSBC Holdings plc Restricted Share Plan, as set against their respective names below:

| | Options (please refer to the options table below for details) | Conditional awards of shares under the HSBC Holdings plc Restricted Share Plan (please refer to the awards table below for further information) | Total |
|----------------------|--|---|---------|
| Mr D G Eldon | – | 289,829 | 289,829 |
| Mr Vincent H C Cheng | 3,070 | 155,179 | 158,249 |
| Mr S J Glass | 41,348 | 12,467 | 53,815 |
| Mr Roger K H Luk | 2,927 | 63,527 | 66,454 |
| Mr W K Mok | 3,126 | 59,713 | 62,839 |
| Mr Raymond C F Or | 2,994 | 132,036 | 135,030 |

At the end of the financial year, the undermentioned Directors held unlisted physically settled options to acquire the number of ordinary shares of US\$0.50 each in HSBC Holdings plc set against their respective names. These options were granted for nil consideration by HSBC Holdings plc.

| | Options held at 31 December 2003 | Options exercised during the year (ordinary shares of US\$0.50 each) | Exercise price per share in pence | Date granted | Exercisable from | Exercisable until |
|----------------------|-------------------------------------|---|---|-----------------|---------------------|----------------------|
| Mr D G Eldon | – | 36,000 ⁽¹⁾ | 217.27 | 7 Mar 1995 | 7 Mar 1998 | 7 Mar 2005 |
| | – | 40,500 ⁽¹⁾ | 333.34 | 1 Apr 1996 | 1 Apr 1999 | 1 Apr 2006 |
| Mr Vincent H C Cheng | 3,070 | – | 534.96 | 8 May 2003 | 1 Aug 2008 | 31 Jan 2009 |
| Mr S J Glass | 17,550 | – | 637.54 | 29 Mar 1999 | 3 Apr 2002 | 29 Mar 2009 |
| | 6,500 | – | 746.00 | 3 Apr 2000 | 3 Apr 2003 | 3 Apr 2010 |
| | 7,500 | – | 871.20 | 23 Apr 2001 | 23 Apr 2004 | 23 Apr 2011 |
| | 7,000 | – | 840.50 | 7 May 2002 | 7 May 2005 | 7 May 2012 |
| | 2,798 | – | 602.99 | 10 Apr 2000 | 1 Aug 2005 | 31 Jan 2006 |
| | <u>41,348</u> | | | | | |
| Mr Roger K H Luk | 1,248 | – | 539.80 | 1 Apr 1999 | 1 Aug 2004 | 31 Jan 2005 |
| | 1,679 | – | 602.99 | 10 Apr 2000 | 1 Aug 2005 | 31 Jan 2006 |
| | <u>2,927</u> | | | | | |
| Mr W K Mok | 3,126 | – | 539.80 | 1 Apr 1999 | 1 Aug 2004 | 31 Jan 2005 |
| Mr Raymond C F Or | – | 21,000 ⁽²⁾ | 627.67 | 16 Mar 1998 | 16 Mar 2001 | 16 Mar 2008 |
| | 1,875 | – | 539.80 | 1 Apr 1999 | 1 Aug 2004 | 31 Jan 2005 |
| | 1,119 | – | 602.99 | 10 Apr 2000 | 1 Aug 2005 | 31 Jan 2006 |
| | <u>2,994</u> | | | | | |

Notes:

(1) At the date of exercise, 27 May 2003, the highest price per share was 712p.

(2) At the date of exercise, 11 November 2003, the highest price per share was 900.5p.

At the end of the financial year, the interests of the Directors in the conditional awards of shares made in favour of them under the HSBC Holdings plc Restricted Share Plan and held by a trust for ordinary shares of US\$0.50 each in HSBC Holdings plc were as follows:

| | Awards held at 1 January 2003 | Awards made during the year | Shares awarded released and transferred to the Director during the year | Awards held at 31 December 2003 ⁽¹⁾ |
|----------------------|----------------------------------|--------------------------------------|---|---|
| Mr D G Eldon | 221,883 | 85,750 | 31,182 | 289,829 |
| Mr Vincent H C Cheng | 114,129 | 43,602 | 10,216 | 155,179 |
| Mr S J Glass | 12,235 ⁽²⁾ | – | – | 12,467 |
| Mr Roger K H Luk | 48,639 | 12,235 | – | 63,527 |
| Mr W K Mok | 45,005 | 12,235 | – | 59,713 |
| Mr Raymond C F Or | 81,553 | 44,450 | – | 132,036 |

Notes:

(1) This includes additional shares arising from scrip dividends.

(2) This represents the awards held by Mr S J Glass on 22 May 2003 when he was appointed a Director of the Bank.

All the interests stated above represent long positions.

As at 31 December 2003, no short positions were recorded in the Register of Directors' and Chief Executives' Interests and Short Positions required to be kept under section 352 of the SFO.

Save as disclosed in the preceding paragraphs, at no time during the year was the Bank or any of its holding companies or its subsidiaries or fellow subsidiaries a party to any arrangement to enable the Directors of the Bank to acquire benefits by means of the acquisition of shares in or debentures of the Bank or any other body corporate.

No right to subscribe for equity or debt securities of the Bank has been granted by the Bank to, nor have any such rights been exercised by, any person during the year ended 31 December 2003.

Directors' interests in competing businesses

Pursuant to Rule 8.10 of the Listing Rules, at the end of the year, the following Directors had declared interests in the following entities which compete or are likely to compete, either directly or indirectly, with the businesses of the Bank:

The Honourable Lee Quo-Wei is a Director of New World Finance Co. Ltd., which conducts money lending business.

Mr D G Eldon is a Director of HSBC Holdings plc, the ultimate holding company of the Bank, and certain of its subsidiaries, including The Hongkong and Shanghai Banking Corporation Limited, the immediate holding company of the Bank.

Mr Vincent H C Cheng is a Director of The Hongkong and Shanghai Banking Corporation Limited and HSBC Insurance (Asia-Pacific) Holdings Limited, a subsidiary of The Hongkong and Shanghai Banking Corporation Limited.

Mr S J Glass is a Director of HSBC Asia Holdings BV, the immediate holding company of The Hongkong and Shanghai Banking Corporation Limited, and certain of its subsidiaries.

Mr Roger K H Luk is a Director of AXA General Insurance Hong Kong Limited, which conducts general insurance business.

Mr W K Mok is a Director of HSBC Asset Management (Hong Kong) Limited and HSBC Investment Funds (Hong Kong) Limited, subsidiaries of The Hongkong and Shanghai Banking Corporation Limited.

Mr Raymond C F Or is a Director of HSBC Insurance (Asia-Pacific) Holdings Limited, a subsidiary of The Hongkong and Shanghai Banking Corporation Limited.

HSBC Holdings plc, through its subsidiaries and associated undertakings, is engaged in providing a comprehensive range of banking, insurance and related financial services.

The entities in which the Directors have declared interests are managed by separate Boards of Directors and management, which are accountable to their respective shareholders.

The Board of the Bank includes seven independent non-executive Directors whose views carry significant weight in the Board's decisions. The Audit Committee of the Bank, which consists of three non-executive Directors, meets regularly to assist the Board of Directors in reviewing the financial performance, internal control and compliance systems of the Bank and its subsidiaries. The Bank is, therefore, capable of carrying on its businesses independently of, and at arm's length from, the businesses in which Directors have declared interests.

Directors' emoluments

The emoluments of the Directors of the Bank (including executive Directors and independent non-executive Directors) on a named basis are set out on page 126 of the Bank's accounts for the year ended 31 December 2003.

Substantial interests in share capital

The register maintained by the Bank pursuant to the SFO recorded that, as at 31 December 2003, the following corporations had interests (as defined in that Ordinance) in the Bank set opposite their respective names:

| Name of Corporation | Number of Ordinary Shares of HK\$5 each in the Bank (Percentage of total) |
|--|---|
| The Hongkong and Shanghai Banking Corporation Limited | 1,188,057,371 (62.14%) |
| HSBC Asia Holdings BV | 1,188,057,371 (62.14%) |
| HSBC Asia Holdings (UK) | 1,188,057,371 (62.14%) |
| HSBC Holdings BV | 1,188,057,371 (62.14%) |
| HSBC Finance (Netherlands) | 1,188,057,371 (62.14%) |
| HSBC Holdings plc | 1,188,057,371 (62.14%) |

The Hongkong and Shanghai Banking Corporation Limited is a wholly-owned subsidiary of HSBC Asia Holdings BV, which is a wholly-owned subsidiary of HSBC Asia Holdings (UK), which in turn is a wholly-owned subsidiary of HSBC Holdings BV. HSBC Holdings BV is a wholly-owned subsidiary of HSBC Finance (Netherlands), which in turn is wholly-owned by HSBC Holdings plc. Accordingly, The Hongkong and Shanghai Banking Corporation Limited's interests are recorded as the interests of HSBC Asia Holdings BV, HSBC Asia Holdings (UK), HSBC Holdings BV, HSBC Finance (Netherlands) and HSBC Holdings plc.

The Directors regard HSBC Holdings plc to be the beneficial owner of 1,188,057,371 ordinary shares in the Bank (62.14%).

All the interests stated above represent long positions. As at 31 December 2003, no short positions were recorded in the Register of Interests in Shares and Short Positions required to be kept under section 336 of the SFO.

Purchase, sale or redemption of the Bank's listed securities

During the year, there was no purchase, sale or redemption by the Bank, or any of its subsidiaries, of the Bank's listed securities.

Supervisory Policy Manual on Financial Disclosure by Locally Incorporated Authorised Institutions

The accounts of the Bank for the year ended 31 December 2003 fully comply with the module on "Financial Disclosure

by Locally Incorporated Authorised Institutions" under the Supervisory Policy Manual issued by the Hong Kong Monetary Authority in November 2002.

Auditors

KPMG retire and, being eligible, offer themselves for re-appointment. A resolution for the re-appointment of KPMG as auditors of the Bank is to be proposed at the forthcoming Annual General Meeting.

On behalf of the Board

David Eldon

Chairman

Hong Kong, 1 March 2004