

CORPORATE GOVERNANCE

The Bank is committed to high standards of corporate governance 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. The Bank has also complied 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 Stock Exchange”) (“the Listing Rules”) throughout the year ended 31 December 2004. In November 2004, the Stock Exchange introduced the Code on Corporate Governance Practices (“the Code”) in replacement and enhancement of the Code of Best Practice. The Code has become effective from 1 January 2005. The Bank will follow the Code provisions in the year 2005.

BOARD OF DIRECTORS

The Board consists of 15 Directors with a variety of different experience, whose brief biographical particulars are set out on pages 52 to 54. Among them, three are executive Directors, while the remaining 12 are non-executive Directors. Of the 12 non-executive Directors, eight are independent non-executive Directors. All Directors have full and timely access to all relevant information. There are established procedures for Directors to seek independent professional advice where appropriate at the Bank’s expense.

Induction programmes are arranged for newly appointed Directors and opportunities to update and develop skills and knowledge are provided to them.



The roles of the Chairman, who is a non-executive Director, and the Chief Executive of the Bank are segregated with a clear division of responsibilities. While the Board of Directors is led by the non-executive Chairman, the Chief Executive exercises all the powers, authorities and discretions of the Executive Committee as may be delegated to him in respect of the Bank and its subsidiaries.

The Board of Directors is committed to the Bank's objectives of consistent growth and development, increase in shareholder value and provision of superior services. It sets strategies and monitors the executive management. It meets regularly and had seven meetings in 2004.

The Board has set up three committees, namely, the Executive Committee, Audit Committee and Remuneration Committee. Details of these three committees are set out in the Report of the Directors on page 57.

The Executive Committee meets each month and exercises the powers, authorities and discretions of the Board in so far as they concern the management and day-to-day running of the Bank in accordance with its terms of reference and such other policies and directions as the Board may determine from time to time. There are certain matters reserved for approval by the Board, including annual plans and performance targets, specified senior appointments, acquisitions and disposals above predetermined thresholds and any substantial change in balance sheet management policy. The Executive Committee also sub-delegates credit, investment and capital expenditure authorities to its members.

The Audit Committee, which consists of three independent non-executive Directors, meets regularly, normally four times a year. The Audit Committee is accountable to the Board and assists the Board in meeting its responsibilities in ensuring an effective system of internal control and compliance and for meeting its external financial reporting obligations. It is also responsible for the selection, oversight and remuneration of external auditors. The Committee reports to the Board following each Committee meeting,

drawing the attention of the Board to salient points of which the Board should be aware, identifying any matters in respect of which it considers that action or improvement is needed and making relevant recommendations.

In addition, in the light of the Code provisions, the Board has recently set up a Remuneration Committee consisting of three independent non-executive Directors to consider human resource issues and to make recommendations to the Board on the Bank's policy and structure for all remuneration of Directors and senior management in order to attract, motivate and retain Directors and senior management. It will meet at least two times a year.

INTERNAL CONTROL

The Directors are responsible for internal control in the Bank and its subsidiaries and for reviewing its effectiveness.

The internal control system of the Bank comprises a well-established organisational structure and comprehensive policies and standards. Areas of responsibility of each business and operational unit are clearly defined to ensure effective checks and balances.

Procedures have been designed for safeguarding assets against unauthorised use or disposition; for maintaining proper accounting records; and for the reliability of financial information used within the business or for publication. The procedures provide reasonable but not absolute assurance against material errors, losses or fraud. Procedures have also been designed for compliance of applicable laws, rules and regulations.

Systems and procedures are in place in the Bank to identify, control and report on the types of risks. These risks are monitored by means of reliable and up-to-date management information. Risk management policies and major risk control limits are approved by the Board. The business and functional units are responsible for the assessment of individual types of risk arising under their areas of responsibility and the management of such risk in accordance with the risk

management procedures. The relevant risk management reports are submitted to the Credit Committee, Asset and Liability Management Committee, Executive Committee and Audit Committee and subsequently to the Board for monitoring of the respective types of risk.

A more detailed discussion of the policies and procedures for management of each of the major types of risk the Bank is facing, including credit, market, liquidity and operational, is included in the Financial Review – Risk management section on pages 38 to 45.

In addition, the Bank has developed procedures (ranging from the money laundering deterrence programme to health and safety rules) to manage reputational risks which may arise as a consequence of its daily operations.

An annual operating plan is reviewed and approved by the Board. Reports on monthly financial results, business performance and variances against the approved annual operating plan are submitted to the Executive Committee and the Board of Directors for regular monitoring. A strategy is prepared every three to five years. The HSBC Group Strategic Plan for 2004 to 2008 entitled “Managing for Growth” was adopted by the Board in January 2004.

Internal audit plays an important role in the Bank’s internal control framework. It monitors the effectiveness of internal control procedures and compliance with policies and standards across all business and operational units. All management letters of external auditors and reports from regulatory authorities will be reviewed by Audit Committee and all recommendations will be implemented. Management has to confirm in writing each year to internal audit that all recommendations made by the external auditors and by regulatory authorities have been complied with. Internal audit also advises management on operational efficiency and other risk management issues. The work of the internal audit function is focused on areas of greatest risk to the Bank as determined by a risk assessment approach. The head of internal audit of the Bank reports to the Chairman and the Audit Committee.

A review of the effectiveness of the Bank’s internal control system covering all controls, including financial, operational and compliance and risk management, is conducted annually. The review at the end of 2004 was conducted by reference to the COSO (The Committee of Sponsoring Organization) internal control framework, which assesses the Bank’s internal control system against the five elements of control environment, risk assessment, control activities, communication and monitoring. The result has been reported to the Audit Committee and the Board. Areas for improvement have been identified and measures put in place to manage them.

HUMAN RESOURCES

The human resources policies of the Bank are designed to attract people of the highest calibre and to motivate them to excel in their career, as well as uphold the Bank’s culture of service quality.

Employee Remuneration

Compensation packages take into account levels and composition of pay and the market in which the Bank operates. Salaries are reviewed annually in the context of individual and business performance, market practice, internal relativities and competitive market conditions.

Under appropriate circumstances, performance-related variable pay is provided as an incentive for staff. On 1 January 2004, the Bank introduced a 12-month Pay Scheme with variable bonus as part of the Bank’s performance-based remuneration strategy for new staff. Staff who joined the Bank before then had the option of choosing to join the new scheme or remain in the old 13-month Pay Scheme without a variable bonus.

Since 1999 the Bank has participated in the HSBC Holdings Savings-related Share Option Plan (Sharesave), in which staff members make monthly savings for the purchase of HSBC Group shares after a specified period. The savings contracts of the 1999 Plan and the 3-year 2001 Plan matured on

(Left) In addition to face-to-face training, the Hang Seng Learning Resource Centre offers a wide range of educational materials.

(Middle) Training programmes from professional skills development to awareness of occupational health and safety are provided to staff.

(Right) The Board of Hang Seng Bank and Mr Vincent Cheng (third right) receive Directors of the Year Awards from the Hong Kong Institute of Directors.

2 August 2004. A total of 2,679 staff members under these two plans exercised their share options at that time. The Sharesave 2004 Plan was launched during the year, and 1,994 staff members subscribed to the new plan.

Subject to the attainment of predetermined targets, awards are also made to staff under the relevant HSBC Group share plans as long-term incentives. In April 2004 1,657 staff members with outstanding performance were also given share option awards under the 2004 HSBC Holdings Group Share Option Plan.

Employee Involvement

The Bank's staff have a valuable role to play in its direction and policies. Through a variety of communication channels, two-way information exchanges are held between the Bank and its staff. Employees are further encouraged to bring up their ideas in work improvement programmes, cross-team projects and suggestion schemes.

Other channels for communicating management-related matters, such as the Bank's business direction, strategies and performance, include internal business seminars, in-house magazines, morning broadcasts, management communication sessions and training programmes.

To offer staff the opportunity to express their views on a variety of issues relating to their work and the organisation, a staff opinion survey was conducted in September 2004 to gauge staff opinion on a number of topics. In response to the feedback from the survey, a steering committee chaired by the Deputy Chief Executive was established to address staff comments and suggestions.

Staff Development

In order to develop staff members, the Bank offers a wide range of training programmes that help them fulfil their personal career goals or professional training requirements, including those for the regulated businesses/activities, while equipping them to meet future challenges.

New staff joining the Bank attend an induction programme for a better understanding of the history, culture and values of the Bank. In addition, they receive training in their respective areas so they can carry out their duties professionally and effectively. They are also encouraged to take refresher courses to update their knowledge and skills so that they can perform to the highest standards.

The Bank provides continuous educational development through a variety of channels, including traditional classroom settings at the Bank's Learning Resource Centre, multi-media programmes, the Intranet and video. Staff members are also encouraged to pursue professional or academic qualifications through the Bank's Education and Professional Qualification Award System.

In 2004, a training video entitled "The Black Hole – Money Laundering" and an Anti-Money Laundering Interactive Multimedia Training Programme were developed to help staff identify and report suspicious terrorist financing and money laundering activities. In addition, in-branch coaching materials were produced to provide staff with information on the latest anti-money laundering cases regarding securities, credit cards and insurance. Updated messages on codes of banking practice, the Hong Kong Employment Ordinance, discrimination policy and data privacy were also reinforced through in-branch coaching newsletters and the training section of the Hang Seng Intranet for staff.

Various training materials were also provided to staff in relation to the Supplement to the Guideline on Prevention of Money Laundering issued by the Hong Kong Monetary Authority in June 2004. The Supplement introduced a new set of requirements on customer acceptance policy and customer due diligence which were required to be implemented by 31 December 2004.

To raise the awareness of compliance among staff further, a campaign was launched in 2004 with a new section added to the Hang Seng Intranet.



To support the career aspirations of its employees, the Bank has set up a designated team of human resource professionals. High calibre staff are given career development opportunities in the form of experience sharing with senior staff, overseas training and job rotations, as well as local and overseas cross-postings within the HSBC Group.

In addition to the Hong Kong Management trainee programme, a Mainland programme has been established to groom Mainland university graduates into banking professionals. The programme, which takes place in Hong Kong as well as the Mainland, provides trainees with valuable opportunities to gain exposure in an international banking and financial system.

In 2004 permanent training sites were established in Shenzhen and Shanghai to provide regular training for staff members in Mainland branches. A Mainland training intranet was also launched to provide more than 40 e-learning modules and news updates. To instil a service mindset in the Bank's Mainland branch staff, the Bank organised "Service Boot Camps" in Shenzhen, Shanghai and Fuzhou.

The average number of training days per staff in 2004 was about 7 days.

2004 Recruitment

The economic recovery created a surge in demand for frontline sales staff in 2004. Large-scale recruitment programmes were conducted during the year to meet the need for frontline staff, as well as Business Banking, Commercial Banking and Information Technology personnel.

The Bank's recruitment drive included advertisements in major newspapers, advertorials, participation in a government sponsored Career Expo, and a Hang Seng recruitment day.

The Bank's total headcount was 7,604 as at 31 December 2004, an increase of 280 or 3.94% over last year.

To meet the staffing requirements for its fast-growing business in the Mainland, the Bank carried out intensive recruitment activities for local staff throughout the year. The majority of the new recruits were for Personal Financial Services business, which included customer service as well as direct sales staff, and credit and marketing staff. As at 31 December 2004, the number of local staff was 258, an increase of 100 or 63% over 2003.

Code of Conduct

To ensure the Bank operates according to the highest standards of ethical conduct and professional competence, all staff are required to follow strictly the Code of Conduct contained in the Staff Handbook. The Code, which is in line with the relevant regulatory guidelines and other best industry practices, sets out ethical standards and values to which staff are required to adhere and covers various legal, regulatory and ethical issues. These include topics such as prevention of bribery, dealing in securities, personal benefits and outside employment.

Staff are also reminded from time to time of the requirements of the Code, which is reviewed and updated periodically.

Health and Safety

The Bank recognises the need for effective management of health and safety in order to provide a safe working environment. The Bank's objectives are to identify health, safety and fire risks in advance, assess the attendant risks and effect any necessary measures to remove, reduce or control material risks of fires and of accidents or injuries to employees and visitors.

Following the SARS outbreak in 2003, a Communicable Diseases Plan was prepared setting out the key issues to be addressed and the responses to be taken should there be a recurrence of a serious communicable disease.

Staff were also made aware through various channels of the importance of personal hygiene and health.

COMMUNICATION WITH SHAREHOLDERS

The Bank attaches great importance to communications with shareholders and a number of means are used to promote greater understanding and dialogue with investment audiences. The Bank's annual and interim results announcements are webcast live. The Annual and Interim Reports contain comprehensive information on business strategies and developments. The Annual General Meeting is an opportunity for communicating with shareholders. The Chairman, Executive Directors, Chairman of Audit Committee and non-executive Directors are available at the Annual General Meeting to answer questions from shareholders on the business.

Designated senior executives maintain regular dialogue with institutional investors and analysts to keep them abreast of the Bank's development. The website www.hangseng.com offers an investor relations section and timely access to the Bank's press releases and other business information.