BUSINESS OPERATIONS

BUSINESS IN HONG KONG

The progress made by Hang Seng's Hong Kong operations in 2005 reflects the combined strength of our brand, superior personalised services and customer group segmentation strategy in a highly competitive environment.

Personal Financial Services and Commercial Banking both recorded good growth in operating profit excluding loan impairment charges and other credit risk provisions, underpinned by the further development of our insurance business and the expansion of our consumer and commercial loan portfolios.

Despite rising interest rates, the stronger local economy and improvements in the employment and property markets served to sustain borrower demand, helping us grow advances to customers by 3.6 per cent to HK$260.7 billion.

Customer deposits, including certificates of deposit and other debt securities in issue, rose by 3.4 per cent to HK$479.1 billion. With the upward trend in interest rates, customers shifted their deposits from current and savings accounts to time deposits, structured investment deposits and other instruments. Certificates of deposit and other debt securities in issue (including those reported as trading liabilities) grew by HK$7.6 billion, or 47.2 per cent, to HK$23.6 billion.

PERSONAL FINANCIAL SERVICES

Personal Financial Services' pre-tax profit increased 13.4 per cent and accounted for 57.5 per cent of our total pre-tax profit. Net interest income grew by 18 per cent, benefiting from the increase in customer deposits and a widening of deposit spreads, as well as the expansion of our wealth management business.

Wealth management-related income rose by HK$16 million, with the 17.9 per cent growth in insurance-related income compensating for the 10.1 per cent reduction in income from investment services.

Insurance

The introduction of several new life insurance products, together with greater investment in marketing campaigns, increases in cross-selling and more effective use of delivery channels saw insurance income rise by HK$235 million to HK$1,545 million.

Net earned insurance premiums were up HK$3,445 million, or 77.9 per cent, reflecting significant growth in premiums earned from life insurance policies. Life insurance gained market share and achieved an increase of 66.4 per cent in annualised premiums.

Hang Seng Insurance Company Limited and Hang Seng Life Limited marked their 40th and 10th anniversaries respectively with a host of initiatives, including a new brand-building TV advertising campaign, which won Silver Prizes at both the 2005 EFFIE Awards and 4As Creative Awards.

Increased growth momentum was achieved with the launch of products such as the 3-Year Express Wealth Life Insurance Plan, which provides life cover and a favourable savings return in eight years with the added benefit of a short payment term.

Hang Seng Life Limited is among the local front-runners in the launch of annuity products designed to tap the large retirement planning market.

New annuity products include the Hang Seng Monthly Income Retirement Plan, which provides policyholders with a guaranteed retirement bonus upon reaching their preferred retirement age followed by a monthly retirement income for 10, 15 or 20 years.

Investment Services

Income from investment services fell by HK$219 million to HK$1,943 million in 2005. Under the rising interest rate environment, capital-guaranteed fund sales slowed significantly compared with 2004, leading to a 34 per cent fall in related fee income. However, this was partly compensated for by trading income generated through sales of market-linked products. Increased investor demand for shorter-tenor instruments with potentially higher yields saw income from structured product services rise significantly.

The local securities and stockbroking sector grew increasingly competitive in 2005. We enhanced our securities services with the introduction of an online stagging finance application service and straight-through processing for IPO applications, a real-time stock alert service and new stock order types.

Securities-related income fell by 12 per cent to HK$493 million, in line with less stockmarket activity by retail investors.

We launched a total of 28 new funds in 2005, bringing the Hang Seng Investment Fund Series, including exchange-traded funds (ETFs), to 130.

With the Mainland's economy continuing to provide good investment potential, we introduced several new China-related funds. In June 2005, the Hang Seng FTSE / Xinhua China 25 Index ETF was listed on the Stock Exchange of Hong Kong and we launched two new capital-guaranteed China equity funds. All three funds focus on potential growth by H-share and Red-chip companies, collectively offering a range of risk and return profiles.

Our longer established China funds performed well in 2005. At 31 December 2005, our Hang Seng China H-share Index Fund had achieved growth of over 80 per cent since its launch in July 2003. Funds under management in the Hang Seng H-share Index ETF reached HK$1,282.8 million.

In September, our investment quota under our Mainland QFII securities investment business permit was doubled to US$100 million. This will allow us to expand our Mainland securities investment business, which includes offering A-share-related products to Hong Kong and overseas customers.

Our Private Banking business grew significantly, with rises in both customer number and funds under management, and a 52.8 per cent increase in income from investment services and advisory fees.

Total funds under management, including discretionary and advisory, grew by 18.1 per cent to HK$106.2 billion.

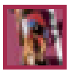
Consumer Lending

Sustained economic growth and the improving employment market helped underpin consumer loan demand in 2005. Personal loans registered strong growth of 51.8 per cent.

Card advances rose by 18.4 per cent, reflecting a 19.7 per cent increase in card spending and a 10.2 per cent rise in the card base, which reached 1.27 million. Our annualised credit card charge-off ratio improved by 1.33 percentage points to 1.88 per cent.

Overall lending to individuals, excluding mortgages suspended under the Government Home Ownership Scheme, rose by 3.2 per cent.

In the highly competitive residential mortgage sector, lending grew by 1.7



BUSINESS IN HONG KONG (continued)

per cent. This was achieved through a number of initiatives that included increasing the combined age of the property and mortgage loan tenor from 40 to 60 years for certain key estates and extending our 95% "Top Up" Mortgage Plan from primary to secondary properties.

Also important was our Mortgage-Link Account, which offers homebuyers an interest rate equal to the mortgage rate on savings linked to their mortgage account. Other developments included our strategic alliance with a major local real estate agent, which is providing additional retail channels to offer mortgage sales and consultation advice.

The average yield on our residential mortgage portfolio was on a downward trend in the first half of 2005 but stabilised in the second half, supported by gradual rises in Best Lending Rate and mortgage pricing.

RMB Business

We continued to make progress with our Hong Kong RMB services. To attract new customers, we implemented a series of RMB cash rebate and other incentive offers. Following the introduction of further liberalisation measures by Mainland authorities, we launched several new service enhancements, including increases in the daily limits on RMB exchange and remittances to the Mainland, as well as the removal of the credit limit cap on RMB credit cards.

By 31 December 2005, our share of the RMB deposit market in Hong Kong was 11.6 per cent, up 3.1 percentage points on a year earlier.

In November, we were among the first banks in Hong Kong to offer non-deliverable forward contracts in RMB to individual customers and small and medium-sized enterprises (SMEs).

COMMERCIAL BANKING

Commercial Banking contributed 8.1 per cent to our total pre-tax profit in 2005. Operating profit excluding loan impairment charges rose by 11.3 per cent, due primarily to growth in trade services volume and customer advances, which increased by 6.8 per cent and 15.5 per cent respectively.

Net interest income increased by 19.1 per cent, underpinned by the growth in customer advances and deposits as well as widening deposit spreads.

However, due to a small number of large loan impairment charges, and the significant reduction in releases compared with 2004, pre-tax profit fell 49.2 per cent to HK$1,078 million.

Refining customer group segmentation continued to form an important part of our Commercial Banking business strategy.

We appointed dedicated customer relationship managers to better serve the needs of key middle-market enterprises. We better aligned our insurance sales teams and trade services teams with our customer relationship teams to improve customer focus and service.

We continued to invest in human resources and business banking outlets to enable us to broaden and deepen our relationships with SMEs. Four area sales management offices, fielding a total of 60 staff, were established in late 2005 to focus on the banking needs of our top non-borrowing SME customers and to actively acquire new business. We also expanded our direct marketing team to serve the rest of the SME customer base.

We made good progress with building an infrastructure for increasing insurance and investment product sales to customers. We also enhanced cross-division collaboration with Personal Financial Services and Treasury which will result in better cross-selling.

In December 2005, we introduced RMB deposit accounts for business customers and expanded our RMB to Hong Kong dollar exchange service to a broader range of merchants.

The Bank's Macau branch recorded strong growth in business, including a near doubling of its loan balance.

CORPORATE AND INSTITUTIONAL BANKING

Corporate and Institutional Banking reported a pre-tax profit of HK$507 million, 37.8 per cent lower than in 2004, due primarily to a net collectively assessed loan impairment charge of HK$54 million, compared with a net release of HK$112 million in general provisions in the previous year. Operating profit excluding loan impairment charges fell 19.1 per cent.

Market liquidity together with limited corporate demand for loans continued to squeeze corporate lending margins in 2005, leading us to focus more on higher-yielding assets and non-interest income opportunities. Corporate and Institutional Banking's contribution to our total profit was 3.8 per cent.

TREASURY

Rising interest rates created a difficult operating environment for Treasury in 2005, with the sustained rise in funding costs and the lack of opportunities for yield enhancement in the flat yield curve environment negatively affecting income.

Pre-tax profit fell by 55.2 per cent to HK$1,072 million, contributing 8 per cent to our total pre-tax profit. Net interest income was down 53.7 per cent. Trading income declined by 28.8 per cent, due largely to reduced foreign exchange trading activity by customers and certain revaluation losses on forward foreign exchange contracts linked to money market transactions reportable under Hong Kong Accounting Standard 39.

In the rising interest rate environment, we sought to further diversify Treasury income to reflect a better balance between net interest income and income derived from proprietary trading and customer-driven business.

In early 2005, Treasury launched retail structured certificates of deposit and other retail capital-protected products. These investment instruments enjoyed a positive market response with a corresponding rise in revenue from structured product sales.

The rollout of retail RMB non-deliverable forward contracts to personal and small company customers which began in November 2005 is also showing some promising early results.

Given the challenging operating conditions, Treasury's main focus with respect to balance sheet management was to lower risk exposure through measures such as shortening investment tenor and reducing interest rate mismatch positions.

E-BANKING

We are committed to using technology to improve and expand our banking services.

We continued to encourage customers to switch to online and automated channels, which will enable us to make more efficient use of our branches as sales and advisory centres.

By the end of 2005, we had over 520,000 Personal e-Banking customers, up 21 per cent on a year earlier.

In December 2005, 32.9 per cent of all personal customer transactions were conducted online, up from 28.6 per cent at the same time in 2004.

Online securities transactions accounted for 63 per cent of all securities transactions in 2005, up from 60.8 per cent in 2004. Online foreign exchange margin trading reached 77 per cent of all such trading, compared with 65.5 per cent a year earlier.

Following the launch of an e-Loan Centre in June, personal banking customers can now enjoy the convenience of being able to apply and obtain preliminary approval for a wide range of personal loans online.

We are stepping up efforts to incentivise our corporate customers to make increased use of our online services. At 31 December 2005, over 29,000 companies had registered for Business e-Banking services, an increase of 26 per cent from the end of 2004. The number of business banking transactions undertaken online also grew by 26 per cent. Letters of credit (LCs) issued online represented 15 per cent of all issued LCs in 2005, up from 10.8 per cent a year earlier.

We are also using technology to save costs and reduce our negative impact on the environment. Launched in February 2005, our e-Statement service allows customers to opt for electronic rather than paper statements. Over 70,000 people have already signed up for the service, which saved over two million sheets of A4 paper in its first year of operation.

MAINLAND OPERATIONS

WANG XI

Responsible for a busy car dealership in southern China, Director-President Wang Xi has limited time for shopping and other leisure pursuits. But thanks to Hang Seng and its strategic mainland China partner Industrial Bank, she enjoys the convenience of purchasing by credit card.

"My credit card frees me from the need to carry large sums of cash and allows me to shop around my work schedule. I also benefit from the flexibility it offers in managing my personal finances and from the security these two well-established banks provide."

This joint initiative is just one way in which Hang Seng serves the growing Mainland consumer market. In addition to co-operating with Industrial Bank, Hang Seng's expanding Mainland network offers a wide range of RMB and foreign currency products and services.

ENTERED CAR SALES BUSINESS IN 1998 ▶

HONED PROFESSIONAL SKILLS ▶

JUGGLING BUSINESS AND PERSONAL SCHEDULES ▶

ENJOYS CONVENIENCE OF FLEXIBLE BANKING SERVICES ▶


“The combined strengths of two trusted banks offer me purchasing privileges and convenience.”
VISA

BUSINESS OPERATIONS

BUSINESS ON THE MAINLAND

Hang Seng's mainland China business forms an increasingly important part of our long-term growth strategy. Accelerating liberalisation in the financial sector, strong economic growth trends and the Mainland's close relationship with Hong Kong are providing us with increasing opportunities for new business.

NETWORK GROWTH

We continued to develop our Mainland network in 2005. In January, we opened a sub-branch in Shenzhen and relocated our Fuzhou branch to accommodate its business expansion. During the third quarter of the year we opened a new representative office in Dongguan and a third sub-branch in Shanghai, and upgraded our Beijing representative office to a branch.

We now operate 12 outlets on the Mainland: six branches (in Beijing, Shanghai, Guangzhou, Shenzhen, Fuzhou and Nanjing), four sub-branches (three in Shanghai and one in Shenzhen) and two representative offices (in Xiamen and Dongguan).

In late December 2005, we obtained approval to establish offsite ATMs in Shanghai and Beijing.

With the Mainland's financial sector scheduled for full liberalisation by the end of 2006, competition among banking service providers is likely to increase significantly. Our strategy is to strengthen our presence in key cities in the Pearl River Delta and Yangtze River Delta regions. We will focus primarily on building our wealth management, mortgage finance and commercial banking services, which all offer good growth potential.

During the next three years, we plan to invest over HK$1 billion to expand our service scope and our number of outlets to more than 30. Shanghai remains an important strategic location. We are moving ahead with plans to have two new sub-branches in the city by the end of 2006. We have also applied for permission to upgrade our Dongguan representative office to a branch.

Our strategic 15.98 per cent stake in Industrial Bank returned strong results in 2005, contributing HK$358 million to bottom-line profits.

BUSINESS GROWTH

We achieved steady increases in personal and commercial customer numbers. Customer deposits grew by 79.6 per cent. Encouraging expansions in commercial lending and home mortgages helped our Mainland loan portfolio rise by 41.9 per cent to HK$10.5 billion.

We recruited new staff to expand our service capabilities and capture more business. By 31 December 2005, our total number of full-time equivalent employees had reached 377, a 32.7 per cent increase over a year earlier.

In Personal Financial Services, we stepped up efforts to attract customers in the mass affluent segment by expanding incentive offers for using Prestige Banking services. We strengthened our direct sales force and responded to market demand with the launch of products such as capital-protected investment deposits.

In Commercial Banking, we capitalised on our corporate customer base in Hong Kong, providing deposit and loan services to companies with business interests on the Mainland. We also undertook strategic marketing to grow our Mainland corporate client base, with particular success in expanding loan and trade services to companies in the manufacturing and trading sectors.

> “Accelerating liberalisation in the financial sector, strong economic growth trends and the Mainland’s close relationship with Hong Kong are providing us with increasing opportunities for new business.”

SERVICES GROWTH

We continued to strengthen our business co-operation with Industrial Bank. In April 2005, we established a joint credit card centre. When regulations permit, we will take an equity interest in this centre. We are also exploring other potential areas of co-operation that offer good future growth prospects.

In September, we began offering an RMB forward foreign exchange contracts service to corporate customers at our Shanghai, Guangzhou, Shenzhen and Fuzhou branches.

In the fourth quarter of 2005, we launched trade-related insurance agency services in Shanghai and Shenzhen. We intend to extend the availability of these services to other Mainland branches in 2006.

In December, our Fuzhou branch received approval to extend its RMB services to Mainland enterprises and its foreign currency services to both Mainland enterprises and individuals. This brings to four the number of Hang Seng branches offering RMB services to foreign-invested enterprises, Mainland enterprises and expatriates.