

REPORT OF THE DIRECTORS

The Directors have pleasure in presenting their report together with the audited accounts for the year ended 31 December 2005.

PRINCIPAL ACTIVITIES

The Bank and its subsidiaries 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 81 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 2005 are set out on page 139.

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\$11.4 million.

DIRECTORS

The Directors of the Bank who were in office at the end of the year were Mr Michael R P Smith, Mr Raymond C F Or, Mr John C C Chan, Mr Patrick K W Chan, Dr Y T Cheng, Dr Marvin K T Cheung, Mr S J Glass, Mr Jenkin Hui, Mr Peter T C Lee, Dr Eric K C Li, Dr Vincent H S Lo, Mr W K Mok, Mr Joseph C Y Poon, Dr David W K Sin, Mr Richard Y S Tang and Mr Peter T S Wong.

Mr D G Eldon retired as non-executive Chairman and Director of the Bank with effect from the conclusion of the Bank's Annual General Meeting held on 21 April 2005.

Mr Vincent H C Cheng resigned from the Board and from the position of Vice-Chairman and Chief Executive of the Bank with effect from 25 May 2005.

Mr W K Mok resigned from the Board with effect from 1 January 2006 and would retire on 1 April 2006 after 39 years of service with the Bank.

Mr Michael R P Smith, Mr Peter T S Wong and Mr Patrick K W Chan were appointed Directors of the Bank with effect from 22 April 2005, 25 May 2005 and 7 December 2005 respectively. All of them retire under the provisions of the Bank's Articles of Association and, being eligible, offer themselves for re-election.

The Directors retiring by rotation in accordance with the Bank's Articles of Association are Mr Raymond C F Or, Mr Jenkin Hui, Mr Peter T C Lee and Mr Richard Y S Tang, 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.

STATUS OF INDEPENDENT NON-EXECUTIVE DIRECTORS

The Bank has received from each independent non-executive Director an annual confirmation of his independence pursuant to Rule 3.13 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ("Stock Exchange") ("the Listing Rules") and the Bank still considers the independent non-executive Directors to be independent.

DIRECTORS' AND ALTERNATE CHIEF EXECUTIVES' INTERESTS

At the end of the financial year, the interests of the Directors and Alternate Chief Executives in the shares, underlying

shares of equity derivatives and debentures of the Bank and its associated corporations (all within the meaning of Part XV of the Securities and 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						
Directors:						
Mr John C C Chan	–	–	–	1,000 ⁽¹⁾	1,000	0.00
Mr Patrick K W Chan	–	1,000	–	–	1,000	0.00
Mr Joseph C Y Poon	5,000	–	–	–	5,000	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						
Directors:						
Mr Michael R P Smith	86,873 ⁽²⁾	–	–	348,538 ⁽⁸⁾	435,411	0.00
Mr Raymond C F Or	117,080	35,299	–	213,080 ⁽⁸⁾	365,459	0.00
Mr John C C Chan	14,283	–	–	3,000 ⁽¹⁾	17,283	0.00
Mr Patrick K W Chan	1,268	4,804	–	37,039 ⁽⁸⁾	43,111	0.00
Mr S J Glass	3,112	8,896	–	62,109 ⁽⁸⁾	74,117	0.00
Mr Jenkin Hui	10,148	24,342	1,124,457 ⁽³⁾	–	1,158,947	0.01
Dr Eric K C Li	–	18,132	79,622 ⁽⁴⁾	–	97,754	0.00
Mr Joseph C Y Poon	23,718 ⁽⁵⁾	57,263	–	50,743 ⁽⁸⁾	131,724	0.00
Mr Peter T S Wong	–	20,003	–	113,805 ⁽⁸⁾	133,808	0.00
Mr W K Mok	32,023 ⁽⁶⁾	–	–	68,797 ⁽⁸⁾	100,820	0.00
Alternate Chief Executives:						
Mr William W Leung	1,310	–	–	48,143 ⁽⁸⁾	49,453	0.00
Mrs Dorothy K Y P Sit	47,795 ⁽⁷⁾	1,000	–	40,907 ⁽⁸⁾	89,702	0.00

Notes:

- (1) 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.
- (2) 50,975 shares were jointly held by Mr and Mrs Michael R P Smith.
- (3) Mr Jenkin Hui was entitled to full 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.
- (4) Dr 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.
- (5) 22,599 shares were jointly held by Mr and Mrs Joseph C Y Poon.
- (6) 12,423 shares were jointly held by Mr and Mrs W K Mok.
- (7) 17,400 shares were jointly held by Mrs Dorothy K Y P Sit and her husband.



OUR
PEOPLE

REPORT OF THE DIRECTORS (continued)

(8) These represent interests in (i) options granted to Directors and Alternate Chief Executives under the HSBC share plans to acquire ordinary shares of US\$0.50 each in HSBC Holdings plc and (ii) conditional awards of shares under the HSBC Holdings plc Restricted Share Plan/HSBC Share Plans made in favour of Directors and Alternate Chief Executives and held by various trusts for ordinary shares of US\$0.50 each in HSBC Holdings plc, 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/HSBC Share Plans (please refer to the awards table below for further information)	Total
Directors:			
Mr Michael R P Smith	70,500	278,038	348,538
Mr Raymond C F Or	2,504	210,576	213,080
Mr Patrick K W Chan	27,059	9,980	37,039
Mr S J Glass	14,500	47,609	62,109
Mr Joseph C Y Poon	32,204	18,539	50,743
Mr Peter T S Wong	–	113,805	113,805
Mr W K Mok	2,526	66,271	68,797
Alternate Chief Executives:			
Mr William W Leung	28,141	20,002	48,143
Mrs Dorothy K Y P Sit	5,435	35,472	40,907

Options

At the end of the financial year, the undermentioned Directors and Alternate Chief Executives 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.

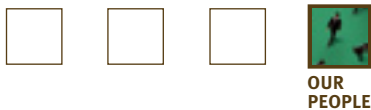
	Options held at 31 December 2005	Options exercised during the year (ordinary shares of US\$0.50 each)	Exercise price per share in pence	Date granted	Exercisable from	Exercisable until
Directors:						
Mr Michael R P Smith	–	2,798 ⁽²⁾	602.99	10 Apr 2000	1 Aug 2005	31 Jan 2006
	22,500	–	333.34	1 Apr 1996	1 Apr 1999	1 Apr 2006
	24,000	–	501.60	24 Mar 1997	24 Mar 2000	24 Mar 2007
	24,000	–	627.67	16 Mar 1998	16 Mar 2001	16 Mar 2008
	<u>70,500</u>					
Mr Raymond C F Or	–	1,119 ⁽²⁾	602.99	10 Apr 2000	1 Aug 2005	31 Jan 2006
	1,515	–	647.20	10 May 2004	1 Aug 2009	31 Jan 2010
	989	–	667.92	24 May 2005	1 Aug 2010	31 Jan 2011
	<u>2,504</u>					
Mr Patrick K W Chan	6,500	–	746.00	3 Apr 2000	3 Apr 2003	2 Apr 2010
	6,000	–	871.20	23 Apr 2001	23 Apr 2004	22 Apr 2011
	6,500	–	840.50	7 May 2002	7 May 2005	6 May 2012
	7,000	–	691.00	2 May 2003	2 May 2006	1 May 2013
	1,059	–	534.96	8 May 2003	1 Aug 2006	31 Jan 2007
	<u>27,059</u>					

	Options held at 31 December 2005	Options exercised during the year (ordinary shares of US\$0.50 each)	Exercise price per share in pence	Date granted	Exercisable from	Exercisable until
Directors:						
Mr S J Glass	–	17,550 ⁽¹⁾	637.54	29 Mar 1999	3 Apr 2002	29 Mar 2009
	–	6,500 ⁽¹⁾	746.00	3 Apr 2000	3 Apr 2003	3 Apr 2010
	–	2,798 ⁽²⁾	602.99	10 Apr 2000	1 Aug 2005	31 Jan 2006
	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
	<u>14,500</u>					
Mr Joseph C Y Poon	–	1,119 ⁽²⁾	602.99	10 Apr 2000	1 Aug 2005	31 Jan 2006
	3,750	–	501.60	24 Mar 1997	24 Mar 2000	24 Mar 2007
	9,000	–	637.54	29 Mar 1999	29 Mar 2002	29 Mar 2009
	4,750	–	746.00	3 Apr 2000	3 Apr 2003	3 Apr 2010
	2,750	–	871.20	23 Apr 2001	23 Apr 2004	23 Apr 2011
	4,400	–	840.50	7 May 2002	7 May 2005	7 May 2012
	5,050	–	691.00	2 May 2003	2 May 2006	2 May 2013
	1,515	–	647.20	10 May 2004	1 Aug 2009	31 Jan 2010
	989	–	667.92	24 May 2005	1 Aug 2010	31 Jan 2011
	<u>32,204</u>					
Mr W K Mok	2,526	–	647.20	10 May 2004	1 Aug 2009	31 Jan 2010
Alternate Chief Executives:						
Mr William W Leung	7,000	–	746.00	3 Apr 2000	3 Apr 2003	2 Apr 2010
	7,000	–	840.50	7 May 2002	7 May 2005	6 May 2012
	6,000	–	691.00	2 May 2003	2 May 2006	1 May 2013
	6,500	–	828.30	30 Apr 2004	30 Apr 2007	29 Apr 2014
	1,059	–	534.96	8 May 2003	1 Aug 2006	31 Jan 2007
	582	–	647.20	10 May 2004	1 Aug 2007	31 Jan 2008
	<u>28,141</u>					
Mrs Dorothy K Y P Sit	3,000	–	871.20	23 Apr 2001	23 Apr 2004	22 Apr 2011
	2,435	–	667.92	24 May 2005	1 Aug 2010	31 Jan 2011
	<u>5,435</u>					

Notes:

(1) At the date of exercise, 15 March 2005, the market value per share was 856.00p.

(2) At the date of exercise, 1 August 2005, the market value per share was 930.50p.



REPORT OF THE DIRECTORS (continued)

Conditional awards of shares

At the end of the financial year, the interests of the Directors and Alternate Chief Executives in the conditional awards of shares made in favour of them under the HSBC Holdings plc

Restricted Share Plan/HSBC Share Plans and held by various trusts for ordinary shares of US\$0.50 each in HSBC Holdings plc were as follows:

	Awards held at 1 January 2005	Awards made during the year	Shares awarded released during the year	Awards held at 31 December 2005 ⁽¹⁾
Directors:				
Mr Michael R P Smith	268,680 ⁽²⁾	–	–	278,038
Mr Raymond C F Or	161,789	61,768	20,270	210,576
Mr Patrick K W Chan	9,598 ⁽³⁾	–	–	9,980
Mr S J Glass	25,392	20,767	–	47,609
Mr Joseph C Y Poon	6,199	11,867	–	18,539
Mr Peter T S Wong	111,843 ⁽⁴⁾	–	–	113,805
Mr W K Mok	58,203	17,800	12,111	66,271
Alternate Chief Executives:				
Mr William W Leung	20,002 ⁽⁵⁾	–	–	20,002
Mrs Dorothy K Y P Sit	35,472 ⁽⁶⁾	–	–	35,472

Notes:

(1) This may include additional shares arising from scrip dividends.

(2) This represents the awards held by Mr Michael R P Smith on 22 April 2005 when he was appointed a Director of the Bank.

(3) This represents the awards held by Mr Patrick K W Chan on 22 August 2005 when he was appointed an Alternate Chief Executive of the Bank. Mr Chan was subsequently appointed as a Director of the Bank on 7 December 2005.

(4) This represents the awards held by Mr Peter T S Wong on 25 May 2005 when he was appointed a Director of the Bank.

(5) This represents the awards held by Mr William W Leung on 7 December 2005 when he was appointed an Alternate Chief Executive of the Bank.

(6) This represents the awards held by Mrs Dorothy K Y P Sit on 7 December 2005 when she was appointed an Alternate Chief Executive of the Bank.

All the interests stated above represent long positions. As at 31 December 2005, no short positions were recorded in the Register of Directors' and Alternate 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 2005.

DIRECTORS' INTEREST 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:

Mr Michael R P Smith is the President and Chief Executive Officer of The Hongkong and Shanghai Banking Corporation Limited. Mr Smith is also the Chairman of HSBC Bank Malaysia Berhad and a Director of HSBC Bank Australia Limited.

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

Corporation Limited for the period from 1 February 2000 to 1 April 2005. He was also a Director of Bank of Communications Co., Ltd., which conducts general banking business, for the period from 23 September 2004 to 1 August 2005.

Mr Patrick K W Chan is a Director of Industrial Bank Co., Ltd., in which the Bank holds a 15.98% stake. Industrial Bank Co., Ltd. conducts general banking business in mainland China.

Mr S J Glass is the Chief Financial Officer of The Hongkong and Shanghai Banking Corporation Limited. He is also a Director of HSBC Asia Holdings BV, the immediate holding company of The Hongkong and Shanghai Banking Corporation Limited, and certain of its subsidiaries. He was appointed the Chief Executive of Bank of Bermuda, Hong Kong Branch, which conducts general banking business, for the period from 31 January 2005 to 31 March 2005.

Mr W K Mok was 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 and has ceased to be a Director of both companies since 7 January 2005.

Mr Peter T S Wong is Group General Manager and Executive Director, Hong Kong and Mainland China of The Hongkong and Shanghai Banking Corporation Limited. Mr Wong is a Director of HSBC Insurance (Asia-Pacific) Holdings Limited, a subsidiary of The Hongkong and Shanghai Banking Corporation Limited. Mr Wong is also a Director of Ping An Bank Limited and Bank of Communications Co., Ltd., which conduct general banking business.

HSBC Holdings plc, through its subsidiaries and associated undertakings, including The Hongkong and Shanghai Banking Corporation Limited, the immediate holding company of the Bank, 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 eight independent non-executive Directors whose views carry significant weight in the Board's decisions. The Audit Committee of the Bank, which consists of three independent 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.

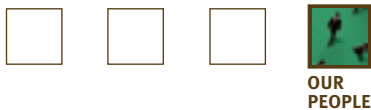
DIRECTORS' EMOLUMENTS

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 118 of the Bank's accounts for the year ended 31 December 2005.

SUBSTANTIAL INTERESTS IN SHARE CAPITAL

The register maintained by the Bank pursuant to the SFO recorded that, as at 31 December 2005, 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%)



REPORT OF THE DIRECTORS (continued)

The Hongkong and Shanghai Banking Corporation Limited is a 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 2005, 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.

CAPITAL

Subordinated notes of HK\$2,500 million with tenor of 10 years were issued and listed on the Stock Exchange in June 2005. During 2005, a subordinated loan of US\$260 million was obtained from The Hongkong and Shanghai Banking Corporation Limited, the immediate holding company of the Bank. The notes were issued and the loan was obtained to balance, and facilitate more efficient use of, the Bank's capital. The net proceeds will be used for general funding purposes and to support business growth.

PURCHASE, SALE OR REDEMPTION OF THE BANK'S LISTED SECURITIES

Save for the issuance of subordinated notes in June 2005, during the year, there was no purchase, sale or redemption by the Bank, or any of its subsidiaries, of the Bank's listed securities.

PUBLIC FLOAT

As at the date of this report, the Bank has maintained the prescribed public float under the Listing Rules, based on the information that is publicly available to the Bank and within the knowledge of the Directors of the Bank.

SUPERVISORY POLICY MANUALS ON FINANCIAL DISCLOSURE BY AND CORPORATE GOVERNANCE OF LOCALLY INCORPORATED AUTHORISED INSTITUTIONS

The accounts of the Bank for the year ended 31 December 2005 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 (HKMA) in November 2002. The Bank also follows the module on "Corporate Governance of Locally Incorporated Authorised Institutions" under the Supervisory Policy Manual issued by the HKMA in September 2001. Details of the Bank's corporate governance practices are set out in the "Corporate Governance and Other Information" section under its 2005 Annual Report.

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

Michael Smith

Chairman

Hong Kong, 6 March 2006