

Bank On
Our Professionalism

理財創富 專注為你 *Managing wealth for you,*



The professional approach of our staff
is a key part of the

Hang Seng spirit,

helping our customers plan for the
future and achieve their financial goals

MANAGEMENT DISCUSSION AND ANALYSIS BUSINESS IN HONG KONG

In an unfavourable operating environment, particularly in the latter half of the year, Hang Seng's diverse portfolio of products and services helped us adapt to the changing market conditions. Our strong brand proved an important point of differentiation from our peers.

This helped sustain profits growth during the first half of the year and buffered our business against the effects of the financial storm during the second half.

Active management of our customer relationships and a comprehensive credit risk assessment system enabled us to identify good opportunities to expand quality lending during the year. Gross advances to customers increased by 7 per cent to HK\$331.2 billion.

Customer deposits, including certificates of deposit and other debt securities in issue, grew by 2.3 per cent to HK\$604.5 billion, due mainly to increases in Hong Kong dollar and US dollar savings accounts as customers took a more cautious approach to investment.



PERSONAL FINANCIAL SERVICES

Personal Financial Services' profit before tax fell by 29.4 per cent to HK\$8,410 million, due largely to the drop in wealth management income during the volatile market conditions of the second half. Operating profit excluding loan impairment charges was down 30.2 per cent at HK\$8,467 million.

Net interest income remained stable at HK\$8,700 million, with increases in credit card business and personal loans outweighing narrowing spreads on deposits and mortgage loans.

Non-interest income declined by 43.4 per cent, with negative investor sentiment resulting in a significant slowing of fee-earning investment business.

Our wealth management business maintained earnings growth during the first half of the year, recording a 2.2 per cent increase to reach HK\$3,518 million. Good growth in new life insurance business, a rapid shift in portfolio focus to more defensive investment products, and increased foreign exchange trading helped cushion the impact of economic conditions in the second

half, but wealth management income for the year fell by 37.6 per cent to HK\$5,389 million.

Investment services income was down 40.8 per cent, reflecting reduced investor activity and the downtrend in equities values. Our leadership position in the life insurance market supported a HK\$2,629 million increase in net earned insurance premiums. Strong management of the life insurance funds portfolio underpinned the 47.5 per cent increase in net interest income for the year and helped contain the loss on investment returns at HK\$35 million in the second half, compared with the HK\$1,030 million loss in the first half. Overall, insurance income fell by 29.4 per cent to HK\$1,697 million.

We launched a Green Banking account for students and a new credit card that are helping increase our appeal among key customer segments.

Investment Services

With the deterioration in equity markets during 2008, we leveraged our diverse wealth management portfolio and time-to-market

advantage to meet increased demand for more conservative investment instruments. We launched three new types of 100 per cent capital protected structured products and six new capital guaranteed funds.

Our trusted brand and reputation for the well-considered development and selection of products for customers emerged as important competitive advantages. We attracted new customers in the volatile market conditions, with the number of customer investment accounts increasing by 5 per cent year on year, placing us in a good position to capitalise on future investment activity once investor confidence returns.

As customers turned away from equities investments, a series of successful initiatives to promote foreign exchange and gold margin trading services resulted in a 4.4 per cent increase in related revenue and a 7.4 per cent rise in the number of margin trading accounts.

Hang Seng brand strength was further reinforced with performance awards for three of our retail investment funds at the Lipper Fund Awards 2008.

Active management
of our *customer*
relationships



We also competed on service delivery. We enhanced and expanded service channels, increased trading efficiency and streamlined subscription processes, making it easier for customers to grasp investment opportunities in a convenient and timely manner.

These developments helped support investment services earnings growth during the first half, but were outweighed by the sharp downturn in investment sentiment in the second half. Income from securities broking and related services fell by 31.5 per cent compared with 2007 to HK\$1,359 million. Revenue from investment funds dropped by 35.3 per cent to HK\$1,084 million and turnover was down 69.6 per cent. Income from structured products followed the same trend, declining by 40.9 per cent to HK\$882 million.

Funds under management (excluding private banking) dipped to HK\$51.5 billion – down 37.3 per cent compared with a year earlier – due mainly to a drop in the market value of the funds.

Private banking income fell by 75.4 per cent and assets under management declined by 42 per cent.

Insurance

Our comprehensive range of wealth and health insurance solutions for all life stages helped us remain Hong Kong's number one life insurance provider in terms of new annualised regular premiums for the first three quarters of the year and increase our market share.

We further refined our flagship insurance product – the Income Select Life Insurance Plan – to offer enhanced protection and increased income payment options. A market survey on financial preparation for retirement and a series of marketing campaigns increased customer awareness of our retirement planning proposition.

We took successful steps to improve our market penetration by positioning our whole-of-life insurance solutions as being for families as well as individuals, making better use of our multi-channel marketing and distribution network, and strengthening cross-referral mechanisms to reach new customers. As a result, net earned insurance premiums rose by 28 per cent to HK\$12,023 million.

Our website remained an important source of business for sales of enhanced personal insurance products, including those covering travel, home contents, personal accident and domestic helpers. New annualised insurance premiums from e-channels grew by 32 per cent compared with 2007.

Consumer Lending

Excluding the fall in Government Home Ownership Scheme mortgages, lending to individuals increased by 3.6 per cent.

A series of strategic card acquisition and utilisation campaigns helped us grow our market share for credit cards and underpinned the 13.4 per cent increase in the card base, 13.1 per cent rise in card advances and 15.9 per cent increase in card spending.

In personal loans, we achieved solid year-on-year growth of 18.9 per cent to HK\$3.3 billion and increased our market share to 8.2 per cent.

In a competitive operating environment, premium services such as our e-Mortgage proposition and dedicated mortgage consultants supported a 4.4 per cent increase in residential mortgage lending to individuals. Despite the slowdown in mortgage business during the second half, we maintained our market share.



With an eye on narrowing mortgage margins, we moved forward with diversifying our secured lending business, focusing on loan quality and profitability. Launched in October 2008, our Asset Link Secured Overdraft accepts a wide range of assets for pledge and has been well received.

COMMERCIAL BANKING

Against the backdrop of the challenging business environment, Commercial Banking performed well to achieve a 6.5 per cent increase in operating profit excluding loan impairment charges to reach HK\$2,354 million. Profit before tax fell by 8.6 per cent to HK\$2,470 million, affected by a HK\$688 million increase in loan impairment charges in the deteriorating economic conditions.

Net interest income rose by 2 per cent. Average customer advances grew by 14.5 per cent and the tighter credit environment underpinned an upward trend in pricing on new and renewed lending. Trade finance fell by 15.3 per cent on the back of declining export activity and commodities prices. Factoring advances were up 2.8 per cent. Lower interest rates narrowed spreads on deposits.

Supported by strong relationships with customers, we expanded our corporate wealth management business, which recorded a 4.5 per cent increase in income. Steps to expand and refine product offerings helped drive a 96.6 per cent rise in revenue from corporate life insurance.

We continued to promote our comprehensive financial solutions for retailers, achieving a 27.2 per cent rise in fee income from card-merchant acquiring business and helping us record a 5.5 per cent year-on-year increase in the number of new commercial customers.

We continued to enhance service delivery, extending the services of two Business Banking Centres to offer automated banking and counter services for commercial customers.

Utilising the extended network created by Hang Seng China and strategic alliances with Industrial Bank and Bank of Communications, we enjoyed success with our express China remittance service. Offering same-day remittances between Hong Kong and around 100 key cities in mainland China, this new service is helping to increase our outward remittance market share.

The close collaboration of our Commercial Banking teams in Hong Kong, the Mainland and Macau gave us a competitive advantage in capturing cross-market business flows. In September, a new branding programme was launched to establish us as a bank of choice for middle-market enterprises operating in Hong Kong and on the Mainland.

CORPORATE BANKING

Corporate Banking achieved a 36.3 per cent increase in operating profit excluding loan impairment charges.

Net interest income grew by 37.4 per cent. In the changing credit environment, we actively managed our loans portfolio to improve pricing. We identified new high-quality lending opportunities, leading to a 7.9 per cent increase in average customer advances. Narrower deposit spreads dampened the positive effects of the 5.4 per cent rise in average customer deposits.

Closer cross-group cooperation on corporate wealth management business supported efforts to further diversify revenue streams, with fee income up 16.5 per cent.

Hong Kong's *number one*
life insurance provider
in terms of new annualised
regular premiums



Profit before tax grew by HK\$170 million, or 35.8 per cent, to HK\$645 million.

TREASURY

Favourable interest rates led to improved margins on Treasury's balance sheet management portfolio, resulting in a 104.4 per cent increase in net interest income to reach HK\$2,682 million. Beginning in late 2007 as signs of the global financial crisis began to emerge, we took steps to reduce the credit risk of the balance sheet management portfolio. Throughout 2008, we enhanced the credit quality of the debt securities portfolio through the active disposal of some negotiable instruments. During the last quarter of 2008, we made selective investments in high-quality debt securities, most of which were triple-A rated papers.

With significantly reduced investor interest in equities investments, we explored new opportunities to promote foreign exchange-linked

and capital protected investment products. This underpinned growth in trading income to HK\$641 million and strengthened efforts to further diversify Treasury's income base.

The competitive operating environment saw customers focus on brand strength and service delivery as well as price. We stepped up collaboration with commercial and personal banking teams as well as IT to offer easier, more convenient trading across a wide network of channels, focusing particularly on online and mobile phone platforms.

Operating profit excluding credit risk provisions was up 98 per cent at HK\$3,037 million. Despite Treasury's prudent and proactive approach to balance sheet management, the growing credit crunch and declining economic conditions had a negative impact on certain investments under the balance sheet management portfolio, resulting in a HK\$1,375 million credit risk provision.

Treasury's profit before tax grew by 24.6 per cent to HK\$2,279 million.

TECHNOLOGY

Technology and e-channels continue to play a critical role in improving the convenience and efficiency of our service delivery. In December 2008, online and automated machine

channels accounted for 76.7 per cent of all customer transactions, up 1.5 percentage points compared with a year earlier.

At the end of 2008, we had over 870,000 Personal e-Banking customers, an increase of 14 per cent. Business e-Banking customers were up 26.5 per cent at nearly 65,000.

In rapidly changing market conditions, we used technology to offer personal customers greater flexibility over how and when they managed their finances. We improved the efficiency of our online securities trading service and streamlined processing for online securities and unit trust subscriptions under monthly investment plans. Online investment funds subscriptions as a percentage of total subscriptions was 63.1 per cent, compared with 38.4 per cent a year earlier.

With increased interest in foreign exchange and gold markets, we expanded related trading services to our mobile phone platform, helping us achieve record-high retail margin trading turnover in October.

We continued to extend our network of automated channels, implementing offsite deployment of more cash and cheque deposit machines at MTR stations and prime commercial locations.

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Specifically designed for tertiary students, our Green Banking account offers convenient and secure online banking and electronic payment services.

Value-added online services – such as our e-Priority booking service that offers a fast and secure way to buy tickets for Bank-sponsored concerts and other performances – are helping to increase our appeal among younger customer segments.

As part of our commitment to sustainability, we extended our e-InvestAdvice service – under which customers can save paper resources by opting to receive electronic versions of certain bank documents – to cover foreign exchange and gold margin trading advice. Our electronic document initiatives are now saving about 10 million sheets of paper a year.

Technological enhancements helped us support business customers in the difficult economic environment through improved customer relationship management and shorter processing times for remittances and applications. We offered advice to prospective owners of small and medium-sized enterprises under a new 'Business Start-up Corner' section on our website.

In August 2008, we strengthened our corporate wealth management proposition with the introduction of

online securities trading services. In December, this service accounted for 29 per cent of total securities trading turnover by business customers.

Year on year, the number of business banking transactions completed via the Internet increased by 27.8 per cent. Revenue generated from online sales and transactions by business customers increased by 28.9 per cent.

HANG SENG INDEXES

Wholly owned subsidiary Hang Seng Indexes Company Limited (Hang Seng Indexes) enhanced its indexing services in 2008 with the launch of new indexes to support continuing strong interest in China and further assist investors in changing market conditions.

To serve as a benchmark for comprehensive cross-market China investment, the Hang Seng China 50 Index that includes the 50 largest listed companies (in terms of market capitalisation) listed on Hong Kong and/or Mainland stock exchanges was launched in June 2008.

Launched in September, the Hang Seng Short and Leveraged Index Series

comprises six short and leveraged versions of the Hang Seng Index (HSI) and Hang Seng China Enterprises Index (HSCEI) and is designed to meet the demand for indexes with investment strategies.

In October, Hang Seng Indexes introduced the Hang Seng REIT Index to track the performance of real estate investment trusts in Hong Kong.

Hang Seng Indexes now compiles 86 publicly available indexes – 43 real-time price indexes and 43 daily indexes – of which 31 track the Mainland segment of the market. In addition to its publicly available indexes, Hang Seng Indexes also compiles customised indexes to serve the specific indexing needs of various clients.

The total number of futures and options contracts traded on the HSI in 2008 grew by 15.9 per cent compared with 2007, while the total number of futures and options contracts traded on the HSCEI was up 30.2 per cent. At the end of December 2008, the total size of exchange-traded funds tracking the two indexes was over HK\$60 billion.

