



Bank On
Our Strategy

We take a

broad outlook

on our markets while remaining focused on
our business objectives

MANAGEMENT DISCUSSION AND ANALYSIS[™] BUSINESS ON THE MAINLAND

In line with our strategy for long-term growth, we continued to expand the capabilities and reach of our mainland China business in 2008.

Our Mainland subsidiary bank, Hang Seng Bank (China) Limited, invested in new outlets and staff, further leveraged Hang Seng's trusted brand and business strengths, and enhanced product offerings and service delivery through new strategic collaborations.

These developments drove a solid rise in revenue and good increases in customer accounts and deposits that will help support continued growth. The focus of Hang Seng China's expansion sees us better positioned to take advantage of future business opportunities.



Hang Seng China's total operating income rose by 63.7 per cent. A 91.8 per cent increase in deposits and efforts to improve spreads on new and renewed credit facilities underpinned the 38.7 per cent growth in net interest income.

In the declining economic conditions, we took a conservative approach to lending, focusing on quality loans that offered good potential for generating additional streams of income through cross-selling or deposits business. Customer advances were up 3.7 per cent compared with a year earlier.

Excluding foreign exchange losses on the revaluation of US dollar capital funds against the renminbi, non-interest income increased by 105.9 per cent, in part reflecting the success of our growing range of wealth management products.

However, profit before tax fell, affected by investments in expanding Hang Seng China's network and headcount, currency revaluation losses, and increased loan impairment charges in the difficult economic environment.

Returns from our investment in Industrial Bank increased. In December, we completed a deal to acquire a 20 per cent shareholding in Yantai City Commercial Bank in Shandong province.

Including our share of profits from Industrial Bank, Mainland business contributed 11.9 per cent to total profit before tax, up from 6.5 per cent a year earlier.

NETWORK

Hang Seng China opened two branches and eight sub-branches in 2008, bringing its network to 33 outlets across 11 cities. Our focus remains the high-potential Pearl River Delta, Yangtze River Delta and Bohai Economic Rim regions, with increasing attention to strategic cities in other areas.

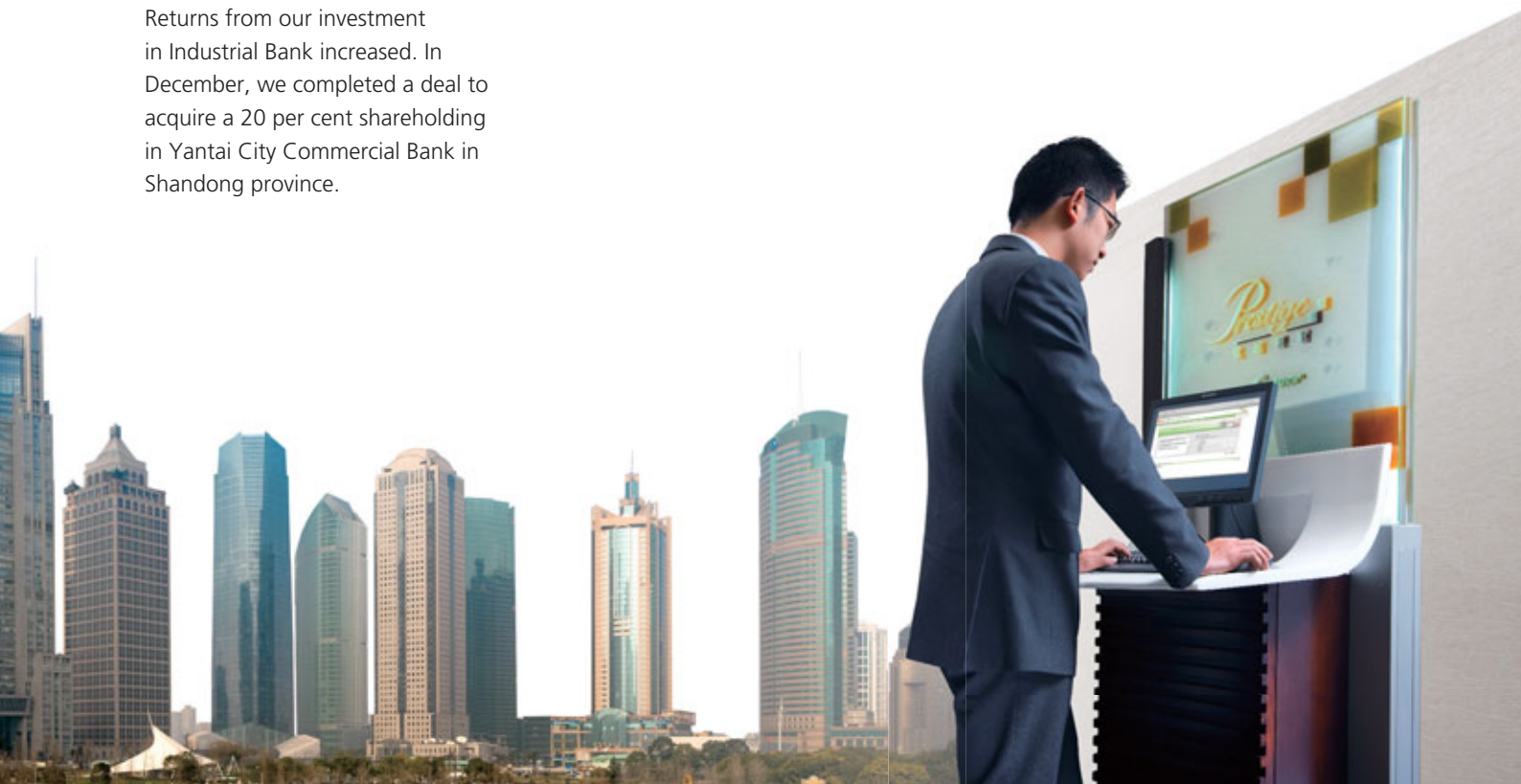
Our Shenzhen branch relocated to Futian district in April, with the vacated premises in Luohu district becoming a sub-branch. The establishment in May of our first commercial sub-branch – in Chang An county in Dongguan – helped us capture new Commercial Banking business. Along with our one-stop financial services and referrals from our well-established Hong Kong operation, this supported the 20 per cent year-on-year increase in the number of Mainland commercial customers.

In November, Hang Seng China became the first foreign subsidiary bank to have a branch in Yunnan province. Located in Kunming – a primary regional gateway – the new outlet gives us early-mover advantage in providing high-quality financial services to companies and individuals in western China.

We further strengthened our presence in the Bohai Economic Rim region during the year, opening a branch in Tianjin and another sub-branch in Beijing.

To support this growth and strengthen customer relationship management, our number of full-time equivalent staff rose by 32.2 per cent to 1,450.

At the end of 2008, Hang Seng China operated 64 ATMs. Customers can also access their accounts via the more than 140 HSBC China ATMs bearing our logo. In January 2009, we joined forces with China UnionPay (CUP) to enable Hang Seng China debit cards to be used on the CUP network at home and overseas and allow holders of other CUP-standard cards to complete transactions via Hang Seng China's ATM network.



SERVICES

We took steps to increase the efficiency and convenience of service delivery, including the further development of our call centre, phone banking and e-Banking services.

In Commercial Banking, we benefited from our strong relationships with customers in Hong Kong and close collaboration between Hang Seng teams across our markets of operation. We extended our commercial insurance agency service and launched forfaiting services.

We established a Mainland Trade Services Centre in Shenzhen. We will set up another centre in Shanghai later in 2009. These two centres will regionally centralise trade documents processing for our branches.

Leveraging partly on our wealth management experience and strength in Hong Kong, we launched new products to meet investor needs and risk appetite in the changing market environment, including a

partially capital protected structured product and a fund-linked investment instrument under our Qualified Domestic Institutional Investor licence. We further differentiated ourselves from our competitors through the introduction of an investment consultant team.

We extended our insurance offerings through strategic agreements with several Mainland insurance companies and cooperated with estate agents and a mortgage guarantee company to strengthen our mortgage loan business.

We took steps to further penetrate the burgeoning top mass-affluent customer segment, increasing brand recognition through a series of marketing and promotional events.

These initiatives helped drive the 154 per cent increase in the number of Prestige Banking customers, providing a strong base from which to deepen relationships through increased product penetration and cross-selling. This rise in customers was an important source of deposits business, with deposits from Prestige Banking customers up by 174.3 per cent.

Our efforts to provide premium financial services have been externally

recognised. Our 'Equity-Linked Partially Capital Protected Investment Product – Daily Chance' was named as one of the 10 best financial products in China by *Moneyweek* and *Shanghai Securities News*.

STRONG ALLIANCES

In addition to organic growth, we are firmly committed to building long-term strategic partnerships that augment and complement Hang Seng China's operations.

We continued to build competitive advantage through cooperation with Industrial Bank in areas such as service delivery networks, customer referrals and wealth management. Our dual logo credit card has become one of the most favoured on the Mainland on the back of strong customer segment management and attractive value-added privileges.

Towards the end of 2008, we became the largest shareholder in Yantai City Commercial Bank – a major city commercial bank in Shandong – following the completion of an RMB800 million deal to purchase 20 per cent of the bank's enlarged share capital. This acquisition significantly increases our interests in the Bohai Economic Rim region.

We became
the largest shareholder
in Yantai City Commercial Bank





Mr Johnson Fu, Chief Executive of Hang Seng Bank (China) Limited (third from right), with members of the Hang Seng China management team.

Our total investment on the Mainland is now over RMB7.4 billion.

LOOKING AHEAD

Moving forward, deposits acquisition, particularly renminbi deposits, will remain a central part of our strategy for long-term growth, helping to support balance sheet structure and providing liquidity for future lending once markets stabilise.

In personal banking, we will leverage our expanding Mainland wealth management capabilities and extended service networks to grow our customer base, focusing particularly on the affluent and mass affluent segments. In January 2009, we launched two debit cards – the Hang Seng Card and Hang Seng Prestige Banking Card – offering customers increased flexibility in managing their finances.

We will work to remain among the market leaders in offering customised advice and investment products that meet a wide range of customer needs. This will also support efforts to grow fee-based business and further diversify income.

Commercial customers will continue to benefit from our cross-market capabilities and comprehensive trade services.

In 2008, we reinforced risk control through training, enhanced credit policies and lending guidelines, and an improved operational risk management framework. We will remain vigilant in our assessment and management of all business risks.

We will further capitalise on the extended reach, capabilities and business opportunities created by our strategic partnerships.

New Outlet Openings in 2008

Kunming Branch

Tianjin Branch

Beijing Dongdan Sub-branch

Dongguan Chang An Sub-branch

Guangzhou Tianhe North Road Sub-branch

Guangzhou Wu Yang Xin Cheng Sub-branch

Nanjing Zhongshan East Road Sub-branch

Shanghai Zhaojiabang Road Sub-branch

Shenzhen Futian East Pacific Garden Sub-branch

Shenzhen Luohu Sub-branch