MANAGEMENT DISCUSSION AND ANALYSIS
FINANCIAL REVIEW

FINANCIAL PERFORMANCE

Income Statement

Summary of financial performance

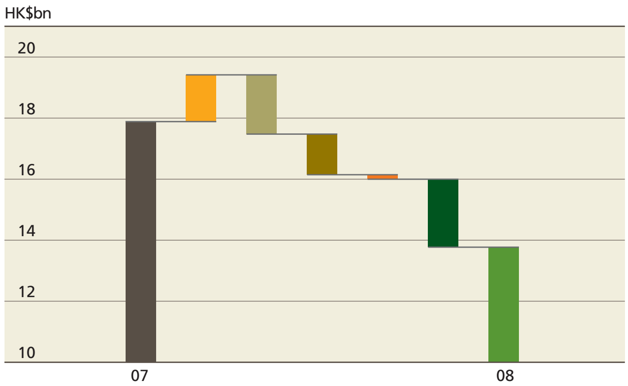
Figures in HK$m	**2008**	2007
Total operating income	**34,759**	35,692
Total operating expenses	**6,795**	6,650
Operating profit after loan impairment charges and other credit risk provisions	**13,725**	17,789
Profit before tax	**15,878**	21,471
Profit attributable to shareholders	**14,099**	18,242
Earnings per share (in HK$)	**7.37**	9.54

Hang Seng Bank Limited ("the Bank") and its subsidiaries and associates ("the Group") reported an audited profit attributable to shareholders of HK$14,099 million for 2008, down by 22.7 per cent compared with 2007. Earnings per share were HK$7.37, down HK$2.17 from 2007. Excluding the dilution gain arising from the Bank's strategic investment in Industrial Bank Co., Ltd. ("Industrial Bank") in 2007, profit attributable to shareholders fell by 16.0 per cent. Attributable profit to shareholders for the second half of 2008 decreased by HK$4,029 million, or 44.5 per cent, when compared with the first half, adversely affected by lower wealth management income and higher loan impairment charges following the deepening of the global credit crisis and liquidity crunch.

Operating profit excluding loan impairment charges and other credit risk provisions declined by HK$1,864 million, or 10.1 per cent, to HK$16,501 million.

Although net interest income grew by 10.3 per cent as a result of asset and liability growth and improved net interest margin, this was more than offset by declining non-interest income in the second half of the year resulting from the worldwide economic downturn and deteriorating operating conditions.

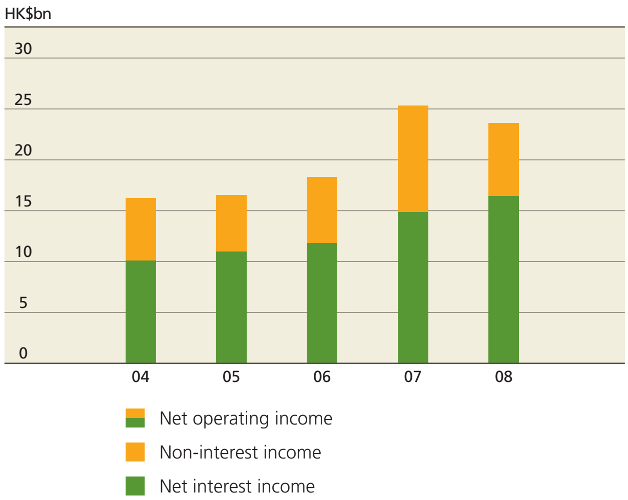
Operating Profit Analysis



	HK$m
2007 Operating profit	17,789
Changes due to:	
Net interest income	1,513
Net fee income	(1,917)
Other operating income	(1,315)
Operating expenses	(145)
Loan impairment charges and other credit risk provisions	(2,200)
2008 Operating profit	13,725

Net Operating Income

(Before loan impairment charges and other credit risk provisions)



Net interest income rose by HK$1,513 million, or 10.3 per cent, to HK$16,232 million with a 4.0 per cent increase in average interest-earning assets.

Figures in HK$m	2008	2007
Net interest income/ (expense) arising from:		
– financial assets and liabilities that are not at fair value through profit and loss	17,277	16,404
– trading assets and liabilities	(1,211)	(1,753)
– financial instruments designated at fair value	166	68
	16,232	14,719
Average interest-earning assets	688,252	661,469
Net interest spread	2.15%	1.84%
Net interest margin	2.36%	2.23%

Average customer advances rose 11.6 per cent, with notable increases in higher yielding personal loans, card advances, trade finance and Mainland loans. The active property market in first half of 2008 drove strong growth in average mortgage lending, but this was partly offset by compressed mortgage pricing in the intensely competitive and low interest rate environment. Overall, the total loan portfolio contributed HK$846 million to the growth in net interest income.

Benefiting from low market interest rates, Treasury balance sheet management income registered strong growth, contributing HK$1,370 million to the increase in net interest income. The interest earned from the life insurance funds investment portfolio also recorded encouraging growth of HK$473 million, reflecting the increase in the size of the portfolio.

Average customer deposits grew by 6.8 per cent, mainly reflecting increases in savings and foreign currency time deposits. However, the favourable impact of the growth in deposits and low-cost savings balances were more than offset by narrower time deposit spreads with little room to reduce customer rates under the low interest rate environment. Net interest income from deposit products fell by HK$270 million.

The contribution from net free funds fell by HK$906 million due to the decrease in market interest rates, but this was partly offset by the increase in level of net free funds (including non-interest-bearing account balances and net shareholders' funds).

Net interest margin rose by 13 basis points to 2.36 per cent. Net interest spread increased by 31 basis points to 2.15 per cent, benefiting from growth in low cost customer deposits, better yields on the Treasury balance sheet management portfolios and the lagged effect of asset re-pricing following several prime interest rate cuts in 2008. Contribution from net free funds, however, fell by 18 basis points to 0.21 per cent as a result of the fall in market interest rates. Including the net decrease of HK$305 million in funding swap costs – which were recognised as foreign exchange losses under trading income – net interest income increased by HK$1,818 million, or 12.8 per cent, and net interest margin improved by 18 basis points to 2.34 per cent.

The HSBC Group reports interest income and interest expense arising from financial assets and financial liabilities held for trading as "Net trading income". Income arising from financial instruments designated at fair value through profit and loss is reported as "Net income from financial instruments designated at fair value" (other than for debt securities in issue and subordinated liabilities, together with derivatives managed in conjunction with them).

The table below presents the net interest income of Hang Seng, as included within the HSBC Group accounts:

Figures in HK$m	2008	2007
Net interest income	17,233	16,358
Average interest-earning assets	664,750	643,655
Net interest spread	2.34%	1.98%
Net interest margin	2.59%	2.54%

Net fee income fell by HK$1,917 million, or 27.8 per cent, to HK$4,969 million, compared with 2007.

Hang Seng achieved good growth in stockbroking and related services, retail investment funds and sales of structured investment products in the first half of 2008.

However, the worldwide economic downturn drove a sharp deterioration in the operating environment in the second half of 2008, adversely affecting many business activities that generate fee-based income. Revenue from stockbroking and related services, retail investment funds and sales of structured investment products fell by 31.5 per cent, 35.3 per cent and 48.4 per cent respectively for the full year. Private banking investment services fee income dropped by 76.6 per cent as customers become more conservative towards investment.

Card services income sustained good growth momentum, rising by 24.4 per cent on the back of the increase in number of cards in circulation as well as the 15.9 per cent rise in card spending and the 38.6 per cent growth in merchant sales. The launch of the Hang Seng enJoy card, which employs contactless payment technology, was well received by the market and helped to boost the number of cards in issue by about 13.4 per cent.

Remittances and credit facilities rose by 9.8 per cent and 20.0 per cent respectively.

Compared with the first half of 2008, net fee income in the second half fell by HK$1,085 million, or 35.8 per cent, due mainly to declines in income from stockbroking and related services, retail investment funds and private banking.

Trading income dropped by HK$224 million, or 13.3 per cent, to HK$1,455 million, compared with 2007.

The HK$523 million increase in foreign exchange income takes into account two specific items not related to normal foreign exchange trading. First, an exchange loss of HK$156 million was incurred in 2008 (HK$461 million in 2007) on forward contracts employing "funding swap" activities* in the balance sheet management portfolios. Also, the revaluation loss on the US dollars capital funds of Hang Seng China amounted to HK$194 million in 2008 (HK$171 million in 2007). The capital funds were injected in US dollars and pending regulatory approval for conversion into Chinese renminbi, and the revaluation against Chinese renminbi was recognised as a foreign exchange loss. Excluding these two unfavourable items, normal foreign exchange trading registered encouraging growth of HK$241 million, or 16.1 per cent, reflecting the Bank's ability to capture good opportunities to sustain its income from proprietary trading and customer-driven business (particularly foreign exchange-linked products) in volatile financial market conditions. The Bank will work to further develop sustainable competitive advantages in this area by enhancing product pricing, sales synergy and system support when launching innovative products in both Hong Kong and the Mainland.

Income from securities, derivatives and other trading activities fell by HK$747 million, or 91.3 per cent, due to lower demand for equity-linked structured products and unfavourable trading results.

* Treasury from time to time employs foreign exchange swaps for its funding activities, which in essence involve swapping a currency ("original currency") into another currency ("swap currency") at the spot exchange rate for short-term placement and simultaneously entering into a forward exchange contract to convert the funds back to the original currency on maturity of the placement. In accordance with HKAS 39, the exchange difference of the spot and forward contracts is required to be recognised as foreign exchange gain/loss, while the corresponding interest differential between the original and swap funding is reflected in net interest income.

Financial instruments designated at fair value reported a net loss of HK$1,031 million, compared with a HK$1,907 million gain in 2007.

This was mainly reflecting the weak performance of the investment assets of the life insurance portfolio in the turbulent market conditions of 2008. In response to the volatile global stock market, the equity component of the investment portfolios has been replaced substantially by high quality debt securities. As a result, the investment loss was contained at a relatively low level of HK$15 million in the second half of 2008 when compared with a loss of HK$1,030 million in the first half.

Net earned insurance premiums rose by HK$2,649 million, or 27.3 per cent. Net insurance claims incurred and movement in policyholders' liabilities rose by HK$786 million, or 7.4 per cent.

The Bank's life insurance business continued to gain market share and was ranked first in Hong Kong in terms of new annualized regular life insurance premiums in the first nine months of 2008. The increase in movement in policyholders' liabilities is largely in line with the increase in premium income.

Analysis of income from wealth management business

Figures in HK$m	2008	2007
Investment income:		
– retail investment funds	1,084	1,676
– structured investment products*	882	1,492
– private banking**	248	1,009
– securities broking and related services	1,359	1,985
– margin trading and others	119	78
	3,692	6,240
Insurance income:		
– life insurance	1,383	2,055
– general insurance and others	314	348
	1,697	2,403
Total	5,389	8,643

* Income from structured investment products includes income reported under net fee income on the sales of third-party structured investment products. It also includes profit generated from the selling of structured investment products in issue, reported under trading income.

** Income from private banking includes income reported under net fee income on investment services and profit generated from selling of structured investment products in issue, reported under trading income.

Wealth management business remained strong and maintained balanced growth in the first half of 2008, but was subsequently affected by the global economic turmoil and deteriorating economic environment in the second half of the year. Investment income and insurance income for 2008 fell by 40.8 per cent and 29.4 per cent respectively when compared with a year earlier.

While the operating environment deteriorated rapidly and many financial institutions were impacted in the second half of 2008, the Bank's adaptable wealth management strategy proved successful in maintaining its leadership position in the market by providing diversified income streams from a wide product range. To offer greater peace of mind to customers amid the financial market turmoil, the focus of wealth management sales was shifted to highly defensive products, such as capital-protected investments and life insurance. The Bank's reputation for stringent risk control in the development and selection of the suitable products for customers proved an important competitive advantage and further strengthened the Bank's position as one of the most preferred financial institutions in Hong Kong.

The worldwide economic downturn that took hold in the second half of 2008 adversely affected financial markets-related income. Although the Bank offers a wide variety of investment funds to meet the changing risk appetites of investors, investment fund income (including sales commissions and management fees) fell by 35.3 per cent to HK$1,084 million with turnover down by 69.6 per cent. Funds under management (excluding private banking) declined by 37.3 per cent to HK$51.5 billion compared with the end of 2007, due mostly to a decline in the market value of the funds resulting from declining financial market values.

Throughout the year, equity markets remained difficult and market values trended sharply downward. The Bank continued to distribute a wide range of structured products offering flexibility of investment options and potential returns, but with increasing investor caution, income from structured investment products declined by 40.9 per cent. The sluggish equity markets also affected securities broking and related services income, which fell by 31.5 per cent to HK$1,359 million.

Following strong growth in 2007, Private Banking was adversely affected by weak investment sentiment. This led to lower customer transactions and a 75.4 per cent decrease in wealth management income for 2008. Private banking's customer base maintained stable growth, which will help support a solid recovery in income growth once financial markets stabilise and investor confidence returns. Assets under management dropped by 42.0 per cent, due largely to the fall in the market value of assets under the volatile financial conditions.

Life insurance income declined by HK$672 million, or 32.7 per cent, to HK$1,383 million (analysed in the table below). Despite poor investment sentiment, the Bank was able to sustain its robust growth in life insurance, topping the league in terms of new annualised regular life insurance premiums for the first three quarters of the year and gaining market share. The Bank continued to enhance its strong position in providing retirement savings and protection products to its banking customers. New features were added to the Bank's flagship life insurance product – the Income Select Life Insurance Plan. Net earned insurance premiums were up by HK$2,629 million, or 28.0 per cent. In response to the volatile global stock markets, the equity component of the life insurance funds investment portfolio has been replaced substantially by debt securities. As a result, net interest income from life insurance business rose significantly by 47.5 per cent due to the growth in investment portfolio size. In addition, the loss on investment returns on life insurance funds was significantly contained at a low level of HK$35 million in second half when compared with the loss of HK$1,030 million in the first half of the year.

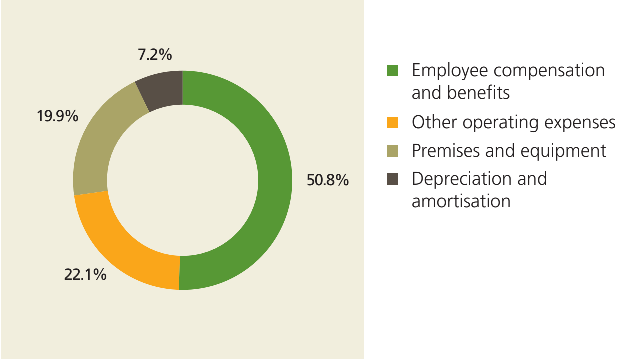
General insurance income dropped by 9.8 per cent to HK$314 million.

Figures in HK$m	**2008**	2007
Life insurance:		
– net interest income and fee income	**1,400**	943
– investment returns on life insurance funds	**(1,065)**	1,903
– net earned insurance premiums	**12,023**	9,394
– claims, benefits and surrenders paid	**(676)**	(609)
– movement in policyholders' liabilities*	**(10,703)**	(9,991)
– reinsurers' share of claims incurred and movement in policyholders' liabilities	**22**	18
– movement in present value of in-force long-term insurance business	**382**	397
	1,383	2,055
General insurance and others	**314**	348
Total	**1,697**	2,403

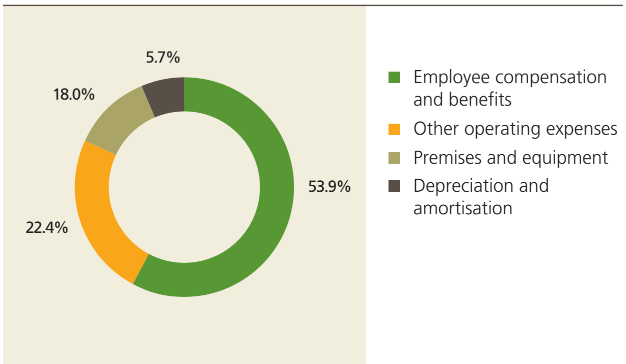
* Including premium and investment reserves

Operating expenses rose by HK$145 million, or 2.2 per cent, to HK$6,795 million.

Operating Expenses for 2008



Operating Expenses for 2007



Operating expenses rose slightly by HK$145 million, reflecting the Bank's traditional cost discipline in the difficult economic environment. Excluding Mainland operations, operating expenses fell slightly by 2.7 per cent.

Employee compensation and benefits declined by HK$133 million. Salaries and other costs increased by 15.3 per cent, reflecting the annual salary increment and an increase in the number of full-time equivalent staff. Performance-related pay expenses were down 57.8 per cent while retirement benefit costs increased due to the change in actuarial assumptions made on the expected rate of salary increases at the end of 2007. General and administrative expenses rose by 6.2 per cent. Increasing rental costs for branches in Hong Kong, new branches in the Mainland and the Bank's large office premises in Kowloon Bay resulted in higher rental costs. IT costs also rose. These expenses were partly offset by controlled spending in marketing and advertising. Depreciation was up by HK$84 million due to the acquisition of equipment, fixtures and fittings for the Bank's Kowloon Bay office and Headquarters building in Central.

Staff numbers by region*

	2008	2007
Hong Kong	**8,256**	8,033
Mainland	**1,450**	1,097
Others	**58**	60
Total	**9,764**	9,190

* Full-time equivalent

The number of full-time equivalent staff rose by 574 compared with 2007 year-end. New hires to support Hang Seng China's Mainland expansion accounted for 61.5 per cent of the total rise. The remaining increase was due to investment in the expansion of CMB's relationship management and wealth management teams as well as IT systems development needs.

The cost efficiency ratio for 2008 was 29.2 per cent, compared with 26.6 per cent in 2007.

Operating profit was down by HK$4,064 million, or 22.8 per cent, to HK$13,725 million, after accounting for the HK$2,200 million increase in **loan impairment charges and other credit risk provisions** in the deteriorating economic conditions.

Loan impairment charges and other credit risk provisions significantly increased by HK$2,200 million, or 381.9 per cent, to HK$2,776 million.

Figures in HK$m	**2008**	2007
Loan impairment charges		
– individually assessed	**(925)**	(250)
– collectively assessed	**(476)**	(326)
	(1,401)	(576)
of which:		
– new and additional	**(1,505)**	(702)
– releases	**48**	64
– recoveries	**56**	62
	(1,401)	(576)
Other provision	**(1,375)**	–
Loan impairment charges and other credit risk provisions	**(2,776)**	(576)

The charge for individually assessed impairment provisions increased by HK$675 million, or 270.0 per cent, due mainly to the downgrading of certain corporate and commercial banking customers in the weakening credit environment. However, these provisions were partly offset by a net release on the mortgage portfolio.

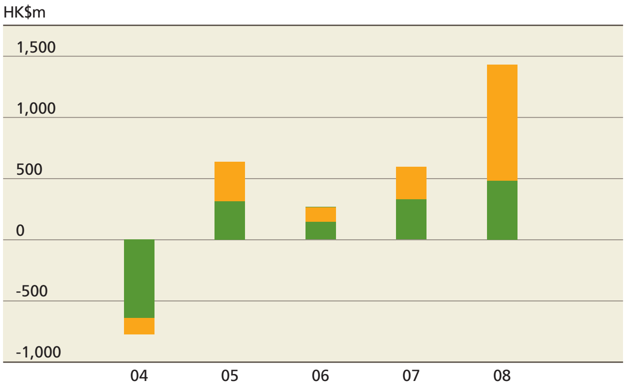
Collectively assessed provisions rose by HK$150 million, or 46.0 per cent, reflecting the combined effect of the HK$81 million rise in allowances on card and personal loan portfolios and the HK$69 million increase in allowances for loans not individually identified as impaired as a result of the periodical update of historical loss rates to reflect the turbulence of the global credit markets.

Other credit risk provisions registered an impairment charge of HK$1,375 million in 2008. During the third quarter, growing volatility in major financial markets had an adverse impact on Hang Seng's investment securities. The Bank wrote down the carrying value of certain available-for-sale debt securities and made an impairment charge of HK$1,375 million.

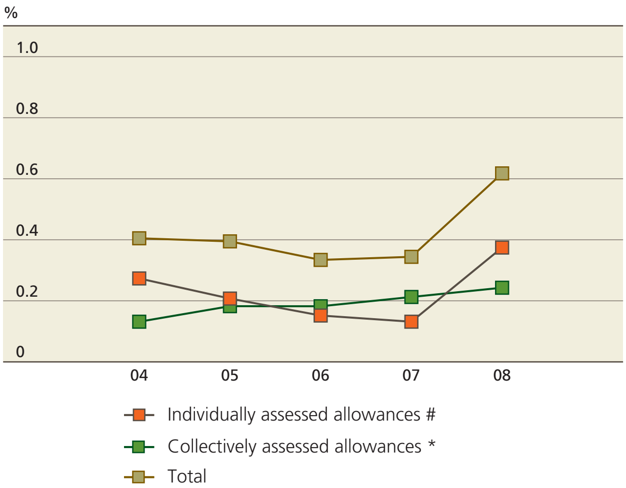
Total loan impairment allowances as a percentage of gross advances to customers are as follows:

	2008	2007
	%	%
Loan impairment allowances:		
– individually assessed	**0.37**	0.13
– collectively assessed	**0.24**	0.21
Total loan impairment allowances	**0.61**	0.34

Net Charges/(Releases) for Loan Impairment Allowances



Loan Impairment Allowances as a Percentage of Gross Advances to Customers



\# For 2004, individually assessed allowances merely include the specific provision assessed on individual basis.

* For 2004, collectively assessed allowances include the specific provision assessed on portfolio basis plus general provision.

Attributable profit

Profit before tax was down HK$5,593 million, or 26.0 per cent, to HK$15,878 million, in part reflecting a HK$1,465 million **gain on dilution of investment in an associate** related to the listing of Industrial Bank in 2007 and an increase of HK$685 million in **share of profits from associates**, mainly contributed by Industrial Bank. These were partly offset by a decrease of HK$300 million in **net surplus on property revaluation** and a decrease of HK$449 million in **gains less losses from financial investments and fixed assets**.

Gains less losses from financial investments and fixed assets amounted to HK$267 million, a decrease of 62.7 per cent compared with 2007.

Net gains from the disposal of available-for-sale equity securities rose by HK$197 million, or 43.9 per cent, to HK$646 million, and comprised primarily profit realised from the partial disposal of shares held in MasterCard Inc. and the redemption of shares in Visa Inc. following its IPO early in 2008. In accordance with Hong Kong accounting standards, an impairment charge of HK$284 million was made for certain available-for-sale equity securities. Gains less losses on disposal of investment properties was lower due to fewer property disposals.

Net surplus on property revaluation fell by 79.2 per cent to HK$79 million.

Figures in HK$m	**2008**	2007
Net surplus on property revaluation:		
– investment properties	**8**	250
– assets held for sale	**–**	95
Reversal of revaluation deficit on premises	**71**	34
	79	379

On 30 September 2008, the Group's premises and investment properties were revalued by DTZ Debenham Tie Leung Limited and were adjusted for material change in the valuation as at 31 December 2008. The valuation was carried out by qualified persons who are members of the Hong Kong Institute of Surveyors. The basis of the valuation of premises was open market value for existing use and the basis of valuation for investment properties was open market value. The revaluation surplus for Group premises amounted to HK$242 million of which HK$71 million was a reversal of revaluation deficits

previously charged to the income statement. The balance of HK$171 million was credited to the premises revaluation reserve. Revaluation gains of HK$8 million on investment properties were recognised through the income statement. The related deferred tax provisions for Group premises and investment properties were HK$40 million and HK$1 million respectively.

The revaluation exercise also covered investment properties reclassified as properties held for sale. In accordance with HKFRS 5, the revaluation deficit of HK$8 million was recognised through the income statement.

Customer Group Performance

The table below sets out the profit before tax contributed by the customer groups for the years stated.

Figures in HK$m	Personal Financial Services	Commercial Banking	Corporate Banking	Treasury	Other	Total
Year ended 31 December 2008						
Profit before tax	8,410	2,470	645	2,279	2,074	15,878
Share of profit before tax	52.9%	15.6%	4.1%	14.4%	13.0%	100.0%
Year ended 31 December 2007						
Profit before tax	11,918	2,701	475	1,829	4,548	21,471
Share of profit before tax	55.5%	12.6%	2.2%	8.5%	21.2%	100.0%

Personal Financial Services ("PFS") reported a profit before tax of HK$8,410 million for 2008, 29.4 per cent lower than last year, due largely to the adverse impact of the global economic downturn on wealth management business in the second half of the year. Operating profit excluding loan impairment charges was down 30.2 per cent at HK$8,467 million.

Net interest income remained at the same level as last year, supported mainly by the strong performance of unsecured lending, which offset narrowing margins on deposits and secured lending caused by falling interest rates.

Unsecured lending business recorded a significant year-on-year growth of 31.5 per cent in total operating income, underpinned by the satisfactory growth of credit cards-in-force as well as cards spending and receivables. The launch of a new credit card employing contactless payment technology and a series of promotional campaigns helped increase the number of cards in issue to 1.73 million, representing year-on-year growth of 13.4 per cent. Card receivables rose by 13.1 per cent year-on-year to reach HK$12.8 billion, attributable mainly to successful card utilisation campaigns. Personal lending also registered impressive growth with an 18.9 per cent year-on-year increase in loan balances to HK$3.3 billion.

Residential mortgage business paralleled the property market slow down in the second half of the year, but the Bank maintained its market share in terms of total mortgage loans, which stood at 15.3 per cent as of 31 December 2008.

Non-interest income fell by 43.4 per cent. With increasingly negative investor sentiment, fee income from the selling of investment products, securities trading and private banking declined significantly. Investment returns on life insurance business were badly hit by the troubled financial markets. Nevertheless, sales of life insurance broke new record of over HK$3 billion in new annualised premiums – representing year-on-year growth of 45.0 per cent and resulting in a number one ranking in Hong Kong in terms of new business for the first three quarters of the year with a market share of 13.4 per cent.

PFS continued to strengthen its positioning in young customer segments and promote self-directed banking behaviours with the launch of a Green Banking account, a new account for tertiary students that offers secure online banking services and Hong Kong's first virtual identity bank card to facilitate secured online payment using digital certificate.

Personal e-banking continued its steady growth in 2008 with over 870,000 registered customers. The Internet channel was further developed in line with its position as a major transaction media and accounted for 75 per cent of total securities trading transactions.

Commercial Banking ("CMB") reported year-on-year increases in every major income category despite the challenging market conditions, with operating profit excluding loan impairment charges rising by 6.5 per cent to HK$2,354 million. However, with increased loan impairment charges in the deteriorating business environment, profit before tax dropped by 8.6 per cent to HK$2,470 million. CMB contributed 15.6 per cent to the Bank's total profit before tax in 2008, up 3.0 percentage points on a year earlier.

Average customer advances rose by 14.5 per cent. Falling commodity prices and international trade caused a 15.3 per cent year-on-year decline in trade finance, while factoring advances grew by 2.8 per cent. The overall reduction in interest rates dragged down deposit spreads, offsetting a strong 14.7 per cent increase in net interest income from advances to result in a 2.0 per cent overall increase in net interest income.

Other operating income achieved year-on-year growth of 11.8 per cent with increases seen in all major non-interest income categories. Despite challenging market conditions, Corporate Wealth Management income achieved a 4.5 per cent increase and contributed 10.4 per cent of CMB's total operating income. Following good growth in the first half of 2008, investment and treasury business was affected by weak investment sentiment and volatile market conditions in the second half, leading to a moderate income growth of 2.7 per cent for the year. Corporate life insurance business benefited from improved product offerings and sales training, leading to a 96.6 per cent increase in income.

The successful launch of express China remittance services in cooperation with Hang Seng Bank (China) Limited, Industrial Bank and Bank of Communications underpinned encouraging improvements in our outward remittance market share. Through these strengthened services, our customers can now make same-day remittances to about 100 key cities on the Mainland.

Alongside increased collaboration among the Hong Kong, Mainland and Macau teams, a branding programme was rolled out in September 2008 to establish the Bank as the financial institution of choice for middle-market enterprises ("MMEs") which are in need of one-stop cross-border financial services.

CMB continued to improve its position in the merchant-acquiring business by offering total banking solutions to retailers. Fee income from card merchant-acquiring saw good growth of 27.2 per cent. Octopus card merchant services remained an important source of new customer acquisitions, with around 70 per cent of Octopus card merchants acquired in 2008 being new customers for the Bank. The overall number of new commercial customers acquired in 2008 rose by 5.5 per cent.

As of 31 December 2008, more than 64,000 customers had registered for Business e-Banking services, a year-on-year increase of 26.5 per cent. Business e-Banking securities trading services were introduced in August 2008 to provide commercial customers with an efficient and convenient trading platform. The number of online business banking transactions grew by 27.8 per cent compared with 2007. To further expand service channels, the services of two Business Banking Centres were extended to offer automated banking and counter services for commercial customers.

Corporate Banking ("CIB") achieved an increase of 36.3 per cent in operating profit excluding loan impairment charges, driven largely by satisfactory growth of 37.4 per cent in net interest income. Average customer deposits rose by 5.4 per cent. Average customer advances were up 7.9 per cent, due mainly to increased lending to property development and building & construction companies. Profit before tax rose strongly by HK$170 million, or 35.8 per cent, to HK$645 million.

Our restraint in asset growth leading up to 2008 has served us well. Throughout 2008, CIB has been able to support its customers with new or renewed facilities at good risk-adjusted returns. Net interest income from advances grew by 45.3 per cent.

CIB remained active in financing Mainland projects of Hong Kong-based corporations during 2008 and continued to expand its Mainland customer base. Average customer deposits on the Mainland recorded encouraging growth of 50.9 per cent while loan balances remained flat due to macro-economic control and repayments.

Treasury ("TRY") reported a strong growth of 87.0 per cent in operating income, due mainly to improved interest margins on the balance sheet management portfolio under low global interest rates.

In the face of slowing economic activity and the growing credit crisis, Treasury further strengthened its prudent risk management strategy. By rebalancing its investment portfolio with a particular focus on investing in high quality papers, Treasury achieved an impressive HK$1,370 million, or 104.4 per cent, increase in net interest income from balance sheet management portfolios.

Net trading income also recorded encouraging growth of 37.0 per cent, or HK$173 million. Income from foreign exchange spot and derivative trading remained the central pillar of trading income. In the uncertain market conditions, sales of capital-protected investment instruments and other foreign exchange linked products enjoyed strong growth.

The financial turmoil that took hold of markets in the second half of the year affected the credit quality of some investments under the balance sheet management portfolio, resulting in an impairment provision of HK$1,375 million, which partly offset the growth in operating income.

Despite the credit challenges, profit before tax taking into account the increase in share of profits from associates grew by 24.6 per cent to HK$2,279 million, contributing 14.4 per cent to the Group's total profit before tax.

Mainland Business

Headquartered in Shanghai, the Bank's Mainland subsidiary, Hang Seng Bank (China) Limited ("Hang Seng China"), marked its first anniversary in May 2008. At the end of 2008, Hang Seng China operated a network of 33 outlets in Beijing, Shanghai, Guangzhou, Dongguan, Shenzhen, Fuzhou, Nanjing, Hangzhou, Ningbo, Tianjin and Kunming. The Bank has a branch in Shenzhen for foreign currency wholesale business and a representative office in Xiamen.

To strengthen its foothold in the rapidly developing Bohai Economic Rim region, in January 2008 the Bank signed an agreement to subscribe for 20 per cent of the enlarged share capital of Yantai City Commercial Bank ("YTCCB") – one of the largest city commercial banks in Shandong Province – for a consideration of RMB800 million. The Bank obtained formal approval for the deal from the China Banking Regulatory Commission on 5 December 2008 and paid the purchase consideration to YTCCB on 31 December 2008.

Hang Seng China set up strategic business collaborations during 2008, working with various insurance companies to enrich its insurance product offerings, expanding its mortgage loan business by cooperating with a guarantee company and property agencies, providing additional Chinese renminbi depository channels and express China remittance services through partnering with Mainland banks, and preparing for the issuance of a debit card and expanding its service channel coverage by joining China UnionPay.

These developments helped solidify relationships with existing customers and reach out to new ones, with the number of Prestige Banking customers and corporate customers up by 154 per cent and 20 per cent respectively. Under the current economic turmoil, balance sheet structure was further improved by successful efforts to build a stronger deposit base. Total operating income rose by 63.7 per cent, benefiting from impressive increases in both non-interest income and net interest income, supported by a 3.7 per cent increase in customer advances and a strong 91.8 per cent growth in customer deposits. Profit before tax fell substantially, affected by the cost of investments in human resources and branch network, an exchange loss on US dollar capital funds upon revaluation against the Chinese renminbi, and an increase in loan impairment charges.

Including the Bank's share of profit from Industrial Bank, Mainland business contributed 11.9 per cent of total profit before tax, compared with 6.5 per cent in 2007.

Economic Profit

Economic profit is calculated from post-tax profit, adjusted for any surplus/deficit arising from property revaluation and depreciation attributable to the revaluation surplus, and takes into account the cost of capital invested by the Bank's shareholders.

For the year 2008, economic profit was HK$8,804 million, a decrease of HK$3,893 million, or 30.7 per cent, compared with 2007. Post-tax profit, adjusted for the property revaluation surplus net of deferred tax and depreciation attributable to the revaluation, fell by HK$3,879 million. Cost of capital rose by HK$14 million, in line with the growth in invested capital with the accumulation of retained profits.

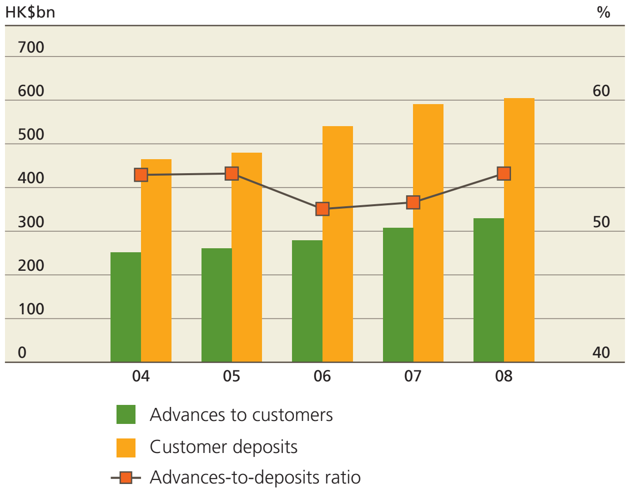
	2008		2007	
	HK$m	%	HK$m	%
Average invested capital	53,866		46,051	
Return on invested capital*	14,120	26.2	17,999	39.1
Cost of capital	(5,316)	(9.9)	(5,302)	(11.5)
Economic profit	8,804	16.3	12,697	27.6

* Return on invested capital is based on post-tax profit excluding any surplus/deficit arising from property revaluation and depreciation attributable to the revaluation surplus.

Balance Sheet

Total assets increased by HK$16.2 billion, or 2.2 per cent, to HK$762.2 billion. Customer advances rose by 6.7 per cent. In line with the Bank's strategy to diversify its loan portfolio, encouraging growth was recorded in Mainland lending, commercial lending, cards and personal loans. The Bank took good advantage of opportunities to grow its residential mortgage lending in the active property market during the first half of 2008. In light of the unprecedented turbulence in the financial market and the interventions by the government and central bank to stabilise the financial system, the Bank has continued reducing its available-for-sale debt securities holdings and shifted to debt securities issued or guaranteed by the government and central bank. Customer deposits increased by HK$13.9 billion, or 2.3 per cent, to HK$604.5 billion. At 31 December 2008, the advances-to-deposits ratio was 54.4 per cent, compared with 52.2 per cent at the end of 2007.

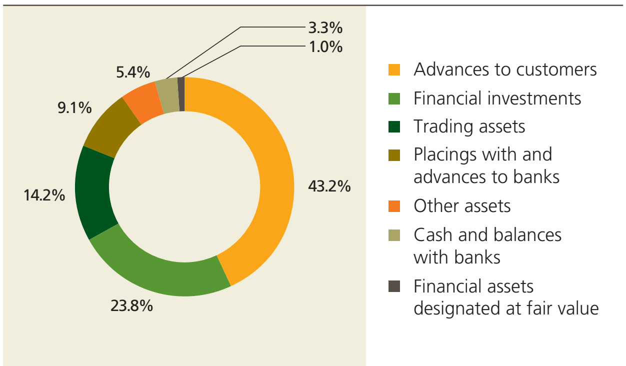
Advances to Customers and Customer Deposits



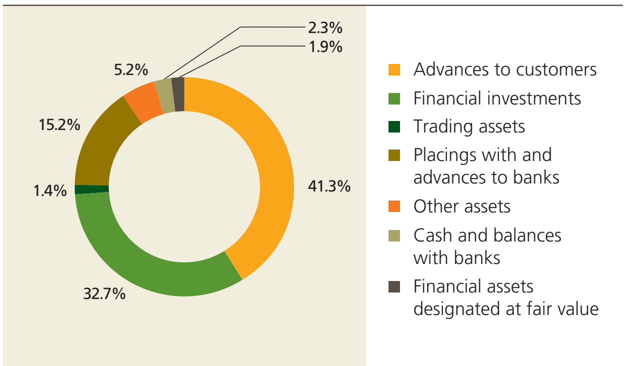
Assets deployment

Figures in HK$m	2008	%	2007	%
Cash and balances with banks and other financial institutions	24,822	3.3	16,864	2.3
Placings with and advances to banks and other financial institutions	69,579	9.1	113,029	15.2
Trading assets	108,389	14.2	10,390	1.4
Financial assets designated at fair value	7,798	1.0	13,892	1.9
Advances to customers	329,121	43.2	308,356	41.3
Financial investments	181,159	23.8	244,294	32.7
Other assets	41,300	5.4	39,174	5.2
Total assets	762,168	100.0	745,999	100.0

Assets Deployment for 2008



Assets Deployment for 2007



Advances to customers

Gross advances to customers rose by HK$21.8 billion, or 7.0 per cent, to HK$331.2 billion compared with the previous year-end.

The Bank proactively managed its loan book amid the changing credit environment, enabling it to capture good business opportunities in the first half of 2008 and record encouraging growth in industrial, commercial and financial sectors during the year. Lending to property development and property investment increased satisfactorily by 23.9 per cent and 21.0 per cent respectively against the backdrop of the buoyant property market in the first half of 2008. Lending to manufacturing sectors grew by 54.3 per cent while lending to transport and transport equipment fell by 10.3 per cent, mainly due to loan repayments.

Trade finance dropped by 17.2 per cent, reflecting the sustained contraction of exports to the US, the Mainland and major Asian markets.

Lending to individuals recorded a rise of 1.8 per cent despite the economic downturn. Excluding the fall in Government Home Ownership Scheme ("GHOS") mortgages, lending to individuals grew by 3.6 per cent. Residential mortgages to individuals rose by 4.4 per cent as the Bank was able to capture business opportunities arising from the booming property market in the first half of 2008 by leveraging its e-Mortgage service and mortgage consultants to offer a premium mortgage solution. Although economic conditions led to a decline in property market activity during the second half, the Bank was able to maintain its position as one of the market leaders amid intense market competition.

Credit card business registered strong growth, with card advances growing by 13.1 per cent. This was supported by a rise of 13.4 per cent in the number of cards in issue and a 15.9 per cent increase in card spending, mainly due to successful card customer acquisition and card utilisation campaigns.

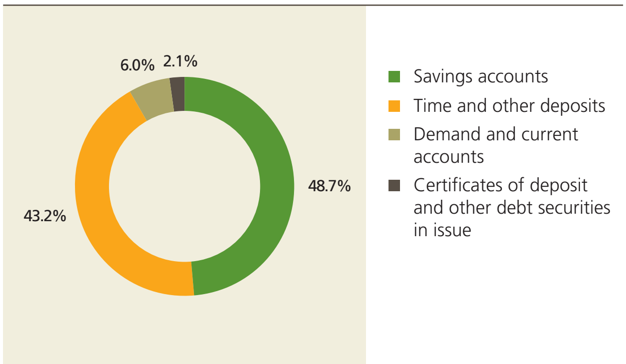
Loans for use outside Hong Kong increased by HK$3,312 million, or 10.2 per cent, compared with the end of 2007. This was due largely to the 3.7 per cent growth in the mainland loan portfolio, which had reached HK$26.9 billion at 31 December 2008. The Bank employed a cautious approach to lending on the Mainland and will continue to strengthen its prudent credit risk policies in light of the more difficult operating conditions for businesses.

Customer deposits

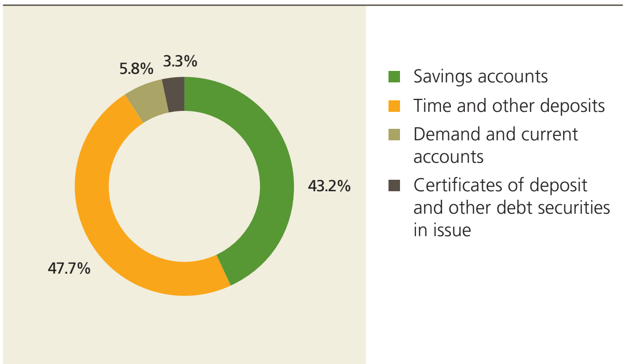
Customer deposits, certificates of deposit and other debt securities in issue rose by HK$13.9 billion, or 2.3 per cent, to HK$604.5 billion, largely due to increases in Hong Kong dollar and United States dollar savings accounts and mainland deposits.

In tandem with the expanding scope of Chinese renminbi banking services offered by Hang Seng China, deposits from mainland branches registered impressive growth of 91.8 per cent. Hang Seng China will continue building an integrated network via its expanding outlet presence in key cities and provide premium services to grow its customer base.

Customer Deposits for 2008



Customer Deposits for 2007



Subordinated liabilities

There was no subordinated debt issued during 2008. The outstanding subordinated notes, which qualify as supplementary capital, serve to help the Bank maintain a more balanced capital structure and support business growth.

Shareholders' funds

Figures in HK$m	**2008**	2007
Share capital	**9,559**	9,559
Retained profits	**32,518**	32,873
Premises revaluation reserve	**3,711**	3,639
Cash flow hedges reserve	**562**	144
Available-for-sale investments reserve		
– on debt securities	**(4,137)**	(841)
– on equity securities	**314**	2,733
Capital redemption reserve	**99**	99
Other reserves	**3,264**	2,514
Total reserves	**36,331**	41,161
	45,890	50,720
Proposed dividends	**5,736**	5,736
Shareholders' funds	**51,626**	56,456
Return on average shareholders' funds	**26.0%**	35.4%

Shareholders' funds (excluding proposed dividends) decreased by HK$4,830 million, or 9.5 per cent, to HK$45,890 million at 31 December 2008. Retained profits were down by HK$355 million, reflecting the increase in actuarial loss on the defined benefit scheme during the year. The available-for-sale investments reserve (including debt and equity securities) showed a deficit of HK$3,823 million compared with a surplus of HK$1,892 million in 2007.

In accordance with accounting standards, available-for-sale debt and equity securities should be measured at fair value. The carrying amounts of the various debt and equity securities are reviewed at the balance sheet date to determine whether there is any objective evidence of impairment. If evidence exists, the relevant carrying amount is reduced to the estimated recoverable amount by means of an impairment charge to the income statement.

The available-for-sale investments reserve for debt securities showed a deficit of HK$4,137 million compared with a deficit of HK$841 million at the end of 2007, reflecting the mark down of debt securities, predominantly through reserves as credit spreads widened after the outbreak of global credit crisis and the liquidity crunch. The Group has assessed that the impairment provision on debt securities at 31 December 2008 was adequate and sufficient.

The available-for-sale investments reserve for equity securities fell by HK$2,419 million to HK$314 million compared with 2007 year-end, due mainly to the decrease in the fair value of certain equity securities which were adversely affected by the slowdown of the equities markets and the release of reserves upon the disposal of equity securities during the year.

The return on average shareholders' funds was 26.0 per cent, compared with 35.4 per cent for 2007.

There was no purchase, sale or redemption by the Bank, or any of its subsidiaries, of the Bank's securities in 2008.

RISK MANAGEMENT

The effectiveness of the Group's risk management policies and strategies is a key success factor. Operating in the financial services industry, the most important types of risks the Group is exposed to are credit, liquidity, market, insurance, operational and reputational risks. The Group has established policies and procedures to identify and analyse risks and to set appropriate risk limits to control this broad spectrum of risks. The risk management policies and major control limits are approved by the Board of Directors. Risk limits are monitored and controlled continually by dedicated departments by means of reliable and up-to-date management information systems. The management of various types of risks is well coordinated at the level of the Bank's Board and various Management committees, such as, the Executive Committee, Risk Management Committee, Asset and Liability Management Committee and Credit Committee.

Note 62 "Financial risk management" to the financial statements provides a detailed discussion and analysis of the Group's credit risk, liquidity risk, market and interest rate risk, insurance risk, operational risk and capital management. The management of reputational risk is set out as follows:

Reputational risks can arise from social, ethical or environmental issues, or as a consequence of operational risk events. Standards are set and policies and procedures are established in all areas of reputational risk and are communicated to staff at all levels. These include treating customers fairly, conflicts of interest, money laundering deterrence, environmental impact and anti-corruption measures. The reputation downside to the Group is fully appraised before any strategic decision is taken.

The Group is a socially and environmental responsible organization. Its corporate social responsibility policies and practices are discussed in the corporate responsibility section of this annual report.