**MARGARET LEUNG**
Vice-Chairman and Chief Executive

# Chief Executive's Report

> "The economic environment in 2009 created both challenges and opportunities for Hang Seng."

Despite difficult operating conditions, our long-term goals continued to guide our strategy. We made good use of our competitive strengths to serve the different financial needs of our customers, maintain momentum in core areas of business and strengthen our platform for future growth.

Competitive pressures grew during the year as banks sought to capture business flows in recovering market segments. New rules on the physical segregation of investment and banking services in Hong Kong necessitated the reorganisation of wealth management services during the second half of the year. Assisted by our strong brand, we emphasised service excellence in differentiating ourselves from our peers.

With continued financial market uncertainty in the first half of the year, we provided enhanced insurance protection offerings and defensive investment opportunities. As the outlook of investors improved during the second half, we capitalised on our time-to-market advantage to launch products in line with changing trends and tap new areas of business with good growth potential.

Leveraging our strong balance sheet and credit risk management capabilities, we assisted customers through the prudent expansion of our lending portfolios. Deposits also increased but low interest rates put significant downward pressure on spreads.

Our early actions to tackle the challenges created by the global financial crisis as well as the improving economic conditions resulted in better performances by our core business drivers in the second half of 2009 compared with the first half.

We further enhanced our service delivery channels – particularly our online and mobile phone platforms – to provide greater choice over when and where customers manage their finances. The number of Personal e-Banking and Business e-Banking customers grew by 12.8 per cent and 19 per cent respectively.

Our mainland China subsidiary bank, Hang Seng Bank (China) Limited, extended its service reach by adding outlets and building new business alliances. Close collaboration between colleagues on the Mainland and in Hong Kong led to new wealth management products and the strengthening of cross-border capabilities – supporting good growth in the Mainland customer base.

## CUSTOMER GROUP HIGHLIGHTS

Personal Financial Services recorded an 11.9 per cent drop in operating profit excluding loan impairment charges to HK$7,457 million and a 13.7 per cent fall in profit before tax to HK$7,258 million.

Operating profit excluding loan impairment charges and profit before tax for the second half of 2009 were up 8.4 per cent and 9.3 per cent respectively compared with the first half.

Although advances to individuals increased, interest margins on deposits and the mortgage portfolio fell, resulting in a 5.8 per cent reduction in net interest income.

Despite subdued investor sentiment, we maintained wealth management business flows, recording a 2.4 per cent decline in income. Revenue from wealth management in the second half of 2009 increased by 14.7 per cent compared with the first half.

With continuing economic uncertainty, particularly in the first half of the year, we provided life insurance protection and investment solutions that emphasised financial security.

As market conditions began to stabilise, we used our Securities Select Customer Trading Centre and attractive IPO investment services to capitalise on renewed interest in securities trading, promoted lower-risk yield-enhancement investment products and launched new Hang Seng-branded investment funds that received a good response from customers. These actions helped drive a 36.8 per cent rise in investment income in the second half of the year compared with the first half, with increases across all major revenue streams.

In August, we became the first Hong Kong financial institution to achieve a dual listing of exchange-traded funds (ETFs) in Taiwan.

Overall, investment income dropped by 23.2 per cent for 2009. The growth in revenue from stockbroking and related services was outweighed by declines in income from investment funds and structured investment products. Private Banking service fee income also fell, reflecting the reduced level of investment activity.

Life insurance income rose by 46.8 per cent, due mainly to our proactive management of the life insurance funds investment portfolio – which resulted in a HK$17 million investment gain in 2009 compared with a HK$1,063 million loss in 2008 – as well as the increase in net interest income arising from the growth in the portfolio and asset reallocation.

Commercial Banking's profit before tax was up 6.8 per cent at HK$2,637 million. Operating profit excluding loan impairment charges fell by 15.5 per cent, due mainly to the 16.6 per cent drop in net interest income. Operating profit increased by 14 per cent, with good management of credit risk and improvements in the economic environment underpinning a 67.4 per cent reduction in loan impairment charges.

Operating profit excluding loan impairment charges and profit before tax for the second half of 2009 rose by 9.1 per cent and 44.2 per cent respectively compared with the first half.

Strong customer relationships, active participation in Hong Kong Government-led small and medium-sized enterprise loan schemes, and enhanced service capabilities drove good increases in both customer advances and deposits – which rose by 12.1 per cent and 26 per cent respectively. Net interest income from lending was up 15.4 per cent, but the low interest rate environment saw net interest income from deposits drop by 47.7 per cent.

Success with new corporate life insurance products helped sustain corporate wealth management income – which fell by just 1.8 per cent despite the less favourable environment for investment business.

Corporate Banking achieved a 20.1 per cent increase in operating profit excluding loan impairment charges to HK$979 million. A significant improvement in loan impairment charges saw operating profit grow by 46.7 per cent to HK$901 million. Profit before tax was HK$915 million – an increase of 41.9 per cent.

Total operating income grew by 15.4 per cent, supported mainly by the 17.2 per cent rise in net interest income. We capitalised on our balance sheet strength and good understanding of local markets to assist corporate customers with new and renewed facilities while adjusting pricing in line with the credit environment, resulting in a 41.5 per cent increase in net interest income from advances. Net interest income from deposits fell by 36.4 per cent.

Treasury's operating profit excluding credit risk provisions declined by 3.9 per cent to HK$2,918 million.

We continued with our prudent risk management strategy, working to enhance the portfolio mix through investment in high-quality debt securities and selectively disposing of negotiable instruments as market conditions changed.

Net interest income fell by 19.4 per cent, with low interest rates keeping the cost of funds down but limiting yields on new deployments of funds and balance sheet management portfolio investments. Net trading income grew by 64.4 per cent. With weak investor demand for equity and interest rate-linked products, we successfully maintained momentum in Treasury's customer-driven business by enhancing the features of our foreign exchange-linked investment offerings.

Treasury's profit before tax increased by 48.9 per cent, due mainly to a HK$1,375 million credit risk provision booked in 2008.

## MAINLAND BUSINESS

Including a sub-branch opened in January 2010 under CEPA VI, Hang Seng China now operates 37 outlets across 12 cities.

Hang Seng China's profit before tax achieved steady growth, reflecting an increase in total operating income as well as reductions in both operating expenses and loan impairment charges.

Hang Seng China's operating income grew by 3.9 per cent, underpinned by a 1.3 per cent rise in net interest income. Further expansion of our cross-border Commercial Banking capabilities and range of wealth management products drove an 18.3 per cent year-on-year increase in the Mainland customer base and a 35.9 per cent rise in deposits. Advances to customers rose by 5.2 per cent as we continued to focus on the quality rather than the size of the loans portfolio. With deposits growth significantly outpacing the expansion in lending, balance sheet strength improved.

Collaborative initiatives with strategic partners Industrial Bank and Yantai Bank provided synergy in key areas of business and extended our reach in regions with strong economic growth potential.

Including the share of profits from Mainland associates, our Mainland business contributed 13.3 per cent to total profit before tax, compared with 11.9 per cent a year earlier.

## FINANCIAL HIGHLIGHTS

Total assets increased by HK$63.8 billion, or 8.4 per cent, to HK$826 billion. Surplus funds from maturing trading assets were redeployed to interbank placements and high-quality available-for-sale debt securities, resulting in a 33.3 per cent rise in financial investments. Advances to customers grew by 4.7 per cent. Customer deposits increased by 9.8 per cent, reflecting a marked preference for liquidity in the uncertain economic environment.

# Chief Executive's Report

Despite a 7.1 per cent rise in average interest-earning assets, net interest income fell by 13.6 per cent to HK$14,023 million. Increased contributions from our lending business and investments under the life insurance funds investment portfolio were more than offset by the adverse impact of low interest rates on contributions from deposits and net free funds. Net interest margin was down 0.46 percentage points at 1.90 per cent.

Net fee income dropped by 13 per cent to HK$4,321 million, due mainly to reduced fee income from structured investment products issued by third parties, investment funds and private banking, which fell by 91.8 per cent, 44.3 per cent and 44.9 per cent respectively. Card services fee income rose by 8.4 per cent on the back of good increases in the card base, spending and receivables. Insurance-related fee income grew by 93.9 per cent. Fee income from stockbroking and related services increased by 15.2 per cent due to the recovery in the stock market and our market positioning. Effective actions to capitalise on improving investor sentiment and continuing growth in our credit cards business helped support a 24.4 per cent rise in fee income in the second half of the year compared with the first half.

Trading income rose by 32.2 per cent to HK$1,923 million. Foreign exchange income grew by 29.5 per cent, due mainly to the increase in net interest income from funding swaps and reduced losses on the revaluation of Hang Seng China's US dollar capital funds against the renminbi.

Lower employee-related expenses and good cost control led to reductions in operating expenses in both Hong Kong and the Mainland to record a total decline of 1.8 per cent. However, with net operating income before loan impairment charges and other credit risk provisions down 10.7 per cent at HK$20,812 million, our cost efficiency ratio rose to 32.1 per cent – up 2.9 percentage points compared with 2008.

With greater stability in the economic environment and effective actions to enhance the quality of the lending and investment portfolios, loan impairment charges and other credit risk provisions fell by HK$1,964 million, or 70.7 per cent, to HK$812 million.

At 31 December 2009, total loan impairment allowances as a percentage of gross advances to customers was 0.56 per cent and gross impaired advances as a percentage of gross advances to customers was 0.7 per cent – improvements of 5 and 30 basis points respectively compared with the end of 2008. Impairment charges as a percentage of average advances to customers improved by 18 basis points to 0.25 per cent.

## MOVING AHEAD

In a year marked by economic uncertainty, Hang Seng remained committed to a forward-looking strategy that focuses on the long term. We have continued to support customers, sustain the momentum of growth drivers and establish new avenues of revenue generation.

Investors are placing greater emphasis on personalised financial services and the timely provision of information. Businesses facing difficult operating conditions are demanding one-stop financial assistance with fast and efficient delivery channels that can give them an edge over their competitors. Good anticipation of customer needs in rapidly changing markets is a vital tool in achieving and maintaining leadership. Financial institutions that fail to think ahead will be left behind.

Hang Seng's strengths – including service excellence, time-to-market capabilities and a strong distribution network – will continue to serve us well, helping us deepen existing customer relationships and acquire new ones.

Our diverse portfolio of investment and insurance products enables us to provide tailored wealth management solutions for a wide range of market conditions and financial needs. Our wealth management business – particularly sales of investment funds – has gained strong momentum during the first two months of 2010 and we will build on this with new products and services.

With deep roots in our communities, our local knowledge allows us to identify emerging trends ahead of the curve to the mutual benefit of our customers and our business. Following on from our ground-breaking dual listing of ETFs in Taiwan last year, we will take more steps to develop new revenue streams that support our core business lines.

Commercial Banking's growing range of cross-border services and corporate wealth management offerings will help us strengthen ties with commercial customers and attract new business. We will further enhance cross-selling and leverage our multi-channel platforms and payment and cash management capabilities in Hong Kong and on the Mainland as part of our new customer acquisition strategy.

Our support of Corporate Banking clients in challenging economic times puts us in a good position to deepen these partnerships as market conditions improve.

We will take advantage of opportunities to expand our renminbi services for commercial and corporate customers in Hong Kong following new measures announced by the Hong Kong Monetary Authority last month that widen the scope of renminbi business.

Treasury will continue to prudently manage its investment portfolio to strike a good balance between risk and return. We will further enhance Treasury's service infrastructure and product development capabilities to strengthen fee-earning potential.

We will upgrade and expand our service delivery channels to provide customers with greater efficiency and convenience in managing their financial needs. We will maintain a high level of vigilance in the management of our loans portfolios and other credit risks.

Hang Seng China will further grow its brand on the Mainland, make good use of its strategic alliances and extend its business reach in high-potential locations – including Guangdong under the favourable policies of CEPA VI.

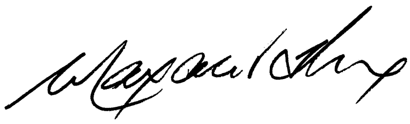
Supported by Hang Seng's strong capabilities in Hong Kong, we will expand our wealth management offerings on the Mainland to attract more customers in target segments. We will promote our comprehensive cross-border services to increase the Mainland commercial customer base. These initiatives will help drive deposits growth, providing important support for business expansion.

On top of our investments in Industrial Bank and Yantai Bank, we are actively looking for strategic partners in wealth management industries on the Mainland.

We will continue to invest in staff capabilities, technology and initiatives that enhance our reputation as a leading provider of Greater China financial expertise.

The past year has been a challenging one but we are looking ahead – to identify new opportunities and ensure our strategic decisions best serve our long-term goals.

Supported by our trusted brand and solid financial fundamentals, we will reinforce our leadership in traditional lines, build momentum in areas with good potential for further business expansion, and explore new markets and customer segments in order to deliver sustainable growth.



**Margaret Leung**
Vice-Chairman and Chief Executive
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