

Report of the Directors

The Directors have pleasure in presenting their report together with the audited financial statements for the year ended 31 December 2009.

PRINCIPAL ACTIVITIES

The Bank and its subsidiaries and associates are engaged in the provision of banking and related financial services.

PROFITS

The consolidated profit of the Bank and its subsidiaries and associates for the year and the particulars of dividends which have been paid or declared are set out on pages 90 and 127 of the Annual Report respectively.

MAJOR CUSTOMERS

The Directors believe that the five largest customers of the Bank accounted for less than 30% of the total interest income and other operating income of the Bank for the year.

SUBSIDIARIES

Particulars of the Bank's principal subsidiaries as at 31 December 2009 are set out in note 37 to the financial statements for the year ended 31 December 2009.

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\$11.6 million.

RESERVES

Profit attributable to shareholders, before dividends, of HK\$13,221 million (2008: HK\$14,099 million) have been transferred to reserves. Other movements in reserves are set out in the consolidated statement of changes in equity.

DIRECTORS

The Directors of the Bank who were in office as at the end of the year were Dr Raymond K F Ch'ien, Mrs Margaret Leung, Dr John C C Chan, Dr Marvin K T Cheung, Mr Alexander A Flockhart,

Mr Jenkin Hui, Mr William W Leung, Dr Eric K C Li, Dr Vincent H S Lo, Mr Iain J Mackay, Mrs Dorothy K Y P Sit, Mr Richard Y S Tang and Mr Peter T S Wong.

Mr Raymond C F Or and Mr Patrick K W Chan retired from the Board, and Dr Y T Cheng and Dr David W K Sin resigned from the Board with effect from the conclusion of the Bank's 2009 Annual General Meeting ("AGM") held on 6 May 2009. Mr Edgar D Ancona and Mr Joseph C Y Poon resigned from the Board with effect from 1 September 2009 and the close of business on 30 September 2009 respectively.

It is with regret that the Directors report the loss of Mr Peter T C Lee, who passed away on 17 October 2009. He had been a Director of the Bank since August 2002 and made invaluable contributions and offered his wise counsel and guidance to the Bank during his tenure of office.

Mrs Margaret Leung was appointed a Non-executive Director of the Bank with effect from 1 April 2009. After the election of Mrs Leung as a Director of the Bank by shareholders at the 2009 AGM, she was re-designated Vice-Chairman and Chief Executive of the Bank with effect from the conclusion of the 2009 AGM.

Mrs Dorothy K Y P Sit and Mr William W Leung were appointed Directors of the Bank with effect from 7 August 2009. Mr Iain J Mackay was appointed a Director of the Bank with effect from 1 September 2009. They will retire under the provisions of the Bank's Articles of Association and, being eligible, offer themselves for election at the forthcoming AGM.

The Directors retiring by rotation in accordance with the Bank's Articles of Association are Dr John C C Chan, Dr Eric K C Li and Dr Vincent H S Lo, who, being eligible, offer themselves for re-election at the forthcoming AGM.

No Director proposed for re-election or election, as the case may be, at the forthcoming AGM 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).

The biographical details of the Directors of the Bank are set out in the section "Biographical Details of Directors" of this Annual Report.

Report of the Directors

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

Interests in shares

As at 31 December 2009, 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:						
Mrs Margaret Leung	21,000	–	–	–	21,000	0.00
Dr John C C Chan	–	–	–	1,000 ⁽¹⁾	1,000	0.00
Number of Ordinary Shares of US\$0.50 each in HSBC Holdings plc						
Directors:						
Dr Raymond K F Ch'ien	54,689	–	–	–	54,689	0.00
Mrs Margaret Leung	75,218	–	–	307,666 ⁽⁶⁾	382,884	0.00
Dr John C C Chan	20,234	–	–	4,371 ⁽¹⁾	24,605	0.00
Mr Alexander A Flockhart	269,008	–	–	882,803 ⁽⁶⁾	1,151,811	0.00
Mr Jenkin Hui	17,111	–	1,895,991 ⁽²⁾	–	1,913,102	0.01
Mr William W Leung	27,088	–	–	46,375 ⁽⁶⁾	73,463	0.00
Dr Eric K C Li	–	38,199	–	–	38,199	0.00
Mr Iain J Mackay	–	–	–	235,155 ⁽⁶⁾	235,155	0.00
Mrs Dorothy K Y P Sit	29,412 ⁽³⁾	1,031	–	43,125 ⁽⁶⁾	73,568	0.00
Mr Peter T S Wong	210,331	17,163	–	240,639 ⁽⁶⁾	468,133	0.00
Alternate Chief Executives:						
Mr Nixon L S Chan	5,729	–	–	41,010 ⁽⁶⁾	46,739	0.00
Mr Andrew H C Fung	–	–	–	26,477 ⁽⁶⁾	26,477	0.00
Mr Christopher H N Ho	74,436 ⁽⁴⁾	41,529 ⁽⁵⁾	–	10,643 ⁽⁶⁾	126,608	0.00
Mr Andrew W L Leung	4,428	–	–	–	4,428	0.00
Mr David W H Tam	21,404	9,014	–	27,129 ⁽⁶⁾	57,547	0.00

Notes:

- (1) 1,000 shares in the Bank and 4,371 shares in HSBC Holdings plc were held by a trust of which Dr John C C Chan and his wife were beneficiaries.
- (2) Mr Jenkin Hui was entitled to fully 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.
- (3) 8,046 shares were jointly held by Mrs Dorothy K Y P Sit and her husband.
- (4) 40,000 shares were the underlying shares of the Equity-linked Notes ("ELN") due August 2010 held by Mr Christopher H N Ho.
- (5) 10,800 shares were the underlying shares of the ELN due August 2010 held by Mr Christopher H N Ho's wife.
- (6) These represented interests in (i) options granted to Directors and Alternate Chief Executives under the HSBC Share Option Plans to acquire ordinary shares of US\$0.50 each in HSBC Holdings plc and (ii) conditional awards of ordinary shares of US\$0.50 each in HSBC Holdings plc under the HSBC Share Plans made in favour of Directors and Alternate Chief Executives, as set against their respective names below:

	Options (please refer to the options table below for details)	Conditional awards of shares under the HSBC Share Plans (please refer to the awards table below for further information)	Total
Directors:			
Mrs Margaret Leung	4,197	303,469	307,666
Mr Alexander A Flockhart	4,529	878,274	882,803
Mr William W Leung	15,183	31,192	46,375
Mr Iain J Mackay	1,531	233,624	235,155
Mrs Dorothy K Y P Sit	5,818	37,307	43,125
Mr Peter T S Wong	–	240,639	240,639
Alternate Chief Executives:			
Mr Nixon L S Chan	22,034	18,976	41,010
Mr Andrew H C Fung	4,197	22,280	26,477
Mr Christopher H N Ho	5,961	4,682	10,643
Mr David W H Tam	19,508	7,621	27,129

Options

As at 31 December 2009, the Directors and Alternate Chief Executives mentioned below 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 as at 31 December 2009	Options exercised/ cancelled during the Director's/ Alternate Chief Executive's term of office in 2009	Exercise price per share	Date granted	Exercisable from	Exercisable until
Directors:						
Mrs Margaret Leung	–	1,738 ⁽¹⁾	£5.6399 ⁽²⁾	10 May 2004	1 Aug 2009	31 Jan 2010
	4,197 ⁽³⁾	–	HK\$37.8797	29 Apr 2009	1 Aug 2014	31 Jan 2015
	4,197					
Mr Alexander A Flockhart	–	1,528	£6.1760 ⁽²⁾	25 Apr 2007	1 Aug 2010	31 Jan 2011
	4,529	–	£3.3116	29 Apr 2009	1 Aug 2014	31 Jan 2015
	4,529					

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	Options held as at 31 December 2009	Options exercised/ cancelled during the Director's/ Alternate Chief Executive's term of office in 2009	Exercise price per share	Date granted	Exercisable from	Exercisable until
Directors:						
Mr William W Leung	6,885	–	£6.0216 ⁽²⁾	2 May 2003	2 May 2006	1 May 2013
	7,459	–	£7.2181 ⁽²⁾	30 Apr 2004	30 Apr 2007	29 Apr 2014
	839 ⁽³⁾	–	HK\$37.8797	29 Apr 2009	1 Aug 2010	31 Oct 2010
	15,183					
Mr Iain J Mackay	1,531	–	US\$11.8824 ⁽²⁾	30 Apr 2008	1 Aug 2011	31 Jan 2012
Mrs Dorothy K Y P Sit	–	2,435	£6.6792	24 May 2005	1 Aug 2010	31 Jan 2011
	3,443	–	£7.5919 ⁽²⁾	23 Apr 2001	23 Apr 2004	22 Apr 2011
	2,375	–	HK\$37.8797	29 Apr 2009	1 Aug 2012	31 Jan 2013
	5,818					
Alternate Chief Executives:						
Mr Nixon L S Chan	5,738	–	£6.5009 ⁽²⁾	3 Apr 2000	3 Apr 2003	2 Apr 2010
	4,820	–	£7.5919 ⁽²⁾	23 Apr 2001	23 Apr 2004	22 Apr 2011
	3,328	–	£7.3244 ⁽²⁾	7 May 2002	7 May 2005	6 May 2012
	3,615	–	£6.0216 ⁽²⁾	2 May 2003	2 May 2006	1 May 2013
	4,533	–	£7.2181 ⁽²⁾	30 Apr 2004	30 Apr 2009	29 Apr 2014
	22,034					
Mr Andrew H C Fung	4,197 ⁽³⁾	–	HK\$37.8797	29 Apr 2009	1 Aug 2014	31 Jan 2015
Mr Christopher H N Ho	3,443	–	£7.2181 ⁽²⁾	30 Apr 2004	30 Apr 2009	29 Apr 2014
	2,518	–	HK\$37.8797	29 Apr 2009	1 Aug 2012	31 Jan 2013
	5,961					
Mr David W H Tam	–	6,885 ⁽⁴⁾	£6.0216 ⁽²⁾	2 May 2003	2 May 2006	1 May 2013
	–	5,738 ⁽⁵⁾	£6.5009 ⁽²⁾	3 Apr 2000	3 Apr 2003	2 Apr 2010
	5,738	–	£7.5919 ⁽²⁾	23 Apr 2001	23 Apr 2004	22 Apr 2011
	6,311	–	£7.3244 ⁽²⁾	7 May 2002	7 May 2005	6 May 2012
	7,459	–	£7.2181 ⁽²⁾	30 Apr 2004	30 Apr 2009	29 Apr 2014
	19,508					

Notes:

(1) At the date of exercise, 8 October 2009, the market value per share was £7.1210.

(2) Due to HSBC Rights Issue completed in April 2009, the exercise price per share has been adjusted.

(3) Notifications that Mrs Margaret Leung, Mr William W Leung and Mr Andrew H C Fung held these unlisted physically settled options to acquire shares of US\$0.50 each in HSBC Holdings plc were given by them in January 2010 on their becoming aware of the same.

(4) At the dates of exercise, 21 and 22 September 2009, the market values per share were £7.2160 and £7.1330 respectively.

(5) At the date of exercise, 16 November 2009, the market value per share was £7.6120.

Conditional Awards of Shares

As at 31 December 2009, the interests of the Directors and Alternate Chief Executives in the conditional awards of ordinary shares of US\$0.50 each in HSBC Holdings plc made in favour of them under the HSBC Share Plans were as follows:

	Awards held as at 1 January 2009	Awards made during the Director's/Alternate Chief Executive's term of office in 2009	Awards released during the Director's/Alternate Chief Executive's term of office in 2009	Awards held as at 31 December 2009
Directors:				
Mrs Margaret Leung	331,233 ⁽¹⁾	–	7,467	303,469 ^{(2)&(3)}
Mr Alexander A Flockhart	384,644	420,528	16,291	878,274 ^{(2)&(3)}
Mr William W Leung	35,173	5,354	3,415	31,192 ^{(2)&(3)}
Mr Iain J Mackay	231,901 ⁽⁴⁾	–	–	233,624 ⁽²⁾
Mrs Dorothy K Y P Sit	33,983	8,761	2,732	37,307 ^{(2)&(3)}
Mr Peter T S Wong	142,171	120,902	14,390	240,639 ^{(2)&(3)}
Alternate Chief Executives:				
Mr Nixon L S Chan	18,976 ⁽⁵⁾	–	–	18,976
Mr Andrew H C Fung	21,916 ⁽⁶⁾	–	–	22,280 ⁽²⁾
Mr Christopher H N Ho	4,606 ⁽⁷⁾	–	–	4,682 ⁽²⁾
Mr David W H Tam	7,565 ⁽⁸⁾	–	–	7,621 ⁽²⁾

Notes:

- (1) This represented the awards held by Mrs Margaret Leung on 1 April 2009 when she was appointed a Director of the Bank.
- (2) This includes additional shares arising from scrip dividends.
- (3) This takes into account the forfeiture of shares under the relevant Share Plan(s).
- (4) This represented the awards held by Mr Iain J Mackay on 1 September 2009 when he was appointed a Director of the Bank.
- (5) This represented the awards held by Mr Nixon L S Chan on 19 October 2009 when he was appointed an Alternate Chief Executive of the Bank.
- (6) This represented the awards held by Mr Andrew H C Fung on 3 June 2009 when he was appointed an Alternate Chief Executive of the Bank.
- (7) This represented the awards held by Mr Christopher H N Ho on 27 August 2009 when he was appointed an Alternate Chief Executive of the Bank.
- (8) This represented the awards held by Mr David W H Tam on 17 September 2009 when he was appointed an Alternate Chief Executive of the Bank.

All the interests stated above represent long positions. As at 31 December 2009, 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 2009.

DIRECTORS' INTERESTS IN CONTRACTS

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 as at the end of the year or at any time during the year.

Report of the Directors

DIRECTORS' INTERESTS IN COMPETING BUSINESSES

Pursuant to Rule 8.10 of the Listing Rules, as at the date of this report, 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 Alexander A Flockhart is a member of HSBC Group Management Board and the Chairman, Personal and Commercial Banking and Insurance, and an Executive Director of HSBC Holdings plc. He is an Executive Director of The Hongkong and Shanghai Banking Corporation Limited and a Director of various HSBC Group subsidiaries.

Mrs Margaret Leung is a Group General Manager of HSBC Holdings plc and a Director of The Hongkong and Shanghai Banking Corporation Limited.

Mr William W Leung is a Director of Yantai Bank Co., Ltd. ("Yantai Bank"), in which the Bank holds a 20.0% stake, and HSBC Global Asset Management (Hong Kong) Limited, a subsidiary of The Hongkong and Shanghai Banking Corporation Limited. Yantai Bank conducts general banking business in mainland China.

Mr Iain J Mackay is the Chief Financial Officer of The Hongkong and Shanghai Banking Corporation Limited and Director of various HSBC Group subsidiaries.

Mr Peter T S Wong is a Group Managing Director of HSBC Holdings plc. He is also the Chief Executive Officer and Executive Director of The Hongkong and Shanghai Banking Corporation Limited; and acts as Chairman and/or Director of its subsidiaries, including Chairman of various rural banks incorporated in mainland China and a Non-executive Director of HSBC Bank Australia Limited. He is a Non-executive Director of Bank of Communications Co., Ltd., which conducts general banking business. He is also a Non-executive Director of Ping An Insurance (Group) Company of China, Ltd., which conducts life insurance, property and casualty insurance and other financial services.

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.

Further, Yantai Bank has an Audit and Related Party Transactions Control Committee which is responsible for considering all matters concerning connected party transactions to be entered into by Yantai Bank as required by the laws of mainland China. The majority of members of Yantai Bank's Audit and Related Party Transactions Control Committee are Non-executive Directors.

The Board of the Bank includes six 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 in note 19 to the financial statements for the year ended 31 December 2009.

SUBSTANTIAL INTERESTS IN SHARE CAPITAL

The register maintained by the Bank pursuant to the SFO recorded that, as at 31 December 2009, the following corporations had interests or short positions in the shares or underlying shares (as defined in the SFO) 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) Limited	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%)

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) Limited, 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 a wholly-owned subsidiary of 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) Limited, 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 2009, 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.

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

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.

CODE ON CORPORATE GOVERNANCE PRACTICES

Details of the Bank's corporate governance practices are set out in the "Corporate Governance and Other Information" section in this 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 will be proposed at the forthcoming Annual General Meeting.

On behalf of the Board

Raymond Ch'ien

Chairman

Hong Kong, 1 March 2010