CHIEF EXECUTIVE'S REPORT

Margaret Leung
Vice-Chairman and Chief Executive

The operating environment was very competitive in 2010 as banks sought to capitalise on improved investment sentiment and the upturn in economic activity.

TAKING THE LEAD

UNRIVALLED PASSION

Backed by our trusted brand and strong financial fundamentals, our timely actions to meet changing customer needs reinforced our leadership in traditional bank services and strengthened our position in new areas of business – supporting good growth in the customer bases, revenue and profit of our core business lines.

Low interest rates had an adverse effect on deposit spreads and returns from Treasury's balance sheet management portfolio. While remaining vigilant in managing credit risk, we redeployed the commercial surplus to expand lending, outperforming the market for growth in customer advances and increasing our share in the competitive credit card and residential mortgage sectors.

We achieved year-on-year growth in net interest income, building good momentum during the year to record increases in net interest income and net interest margin in the second half compared with the first half.

With our strong wealth management and cross-border trade-related capabilities, we also achieved a second-half growth trend in net fee income – supporting a solid rise in fee-related revenue for the year.

We launched new mainland China-focused investment products and increased our retail investment fund market share, reaffirming our reputation as a leading fund manager and distributor in Hong Kong.

Innovative initiatives to support business customers with operations in Hong Kong and on the Mainland established us as a market leader for renminbi financial services. We are now well positioned to capture a growing share of this rapidly expanding sector.

A new iPhone application for foreign exchange margin trading and the expansion of services on our online banking platforms helped customers take timely advantage of investment opportunities. At 31 December 2010, our Personal e-Banking and Business e-Banking customer bases were up 10% and 19% respectively compared with a year earlier.

CUSTOMER GROUPS

Personal Financial Services recorded an 8% increase in profit before tax to HK$7,872m. Operating profit excluding loan impairment charges grew by 5% to HK$7,865m. Operating profit was up 9%.

Despite downward pressure on mortgage pricing and deposit spreads, we achieved a 4% rise in net interest income to HK$8,485m by expanding our loan portfolios.

Unsecured lending recorded a 52% rise in profit before tax compared with 2009, attributable to good business momentum and improved loan quality. Our new Hong Kong dollar China UnionPay credit card helped support an 11% increase in the card base, which passed the major milestone of 2 million cards in circulation. Card spending and receivables rose by 18% and 14% respectively. Personal loans grew by 29%. Impairment charges for unsecured lending fell by 46%.

We reinforced our strong position in the residential mortgage sector. We outperformed the market in terms of the number of new mortgage registrations and increased our share of mortgage business.

We used our time-to-market strength and extensive distribution network to capitalise on the improvement in investor outlook during the year, achieving a 9% increase in wealth management income. Wealth management revenue in the second half of 2010 rose by 4% compared with the first half.

Investment income was up 10%. Timely new products, including the Hang Seng RMB Bond Fund, supported a 181% increase in retail investment fund sales and an 85% rise in investment fund fee revenue. Funds under management (including private banking) exceeded HK$150bn for the first time. With a diverse investment product suite and an emphasis on customised wealth management solutions, private banking achieved a 25% increase in service fee income.

Our enhanced online securities services and innovative iPhone application for foreign exchange margin trading drove increases in the number of securities and margin trading accounts.

We strengthened our position as a prominent provider of retirement planning solutions and insurance coverage for different life stages by launching new products and enhancing protection under existing plans. Life insurance income rose by 10%. Total life insurance policies in-force and annualised premiums grew by 9% and 13% respectively.

We were named 'Company of the Year' in *Benchmark*'s Wealth Management Awards 2010 and 'Best Local Private Bank in Hong Kong' by *Euromoney* for the second consecutive year.

Commercial Banking took good advantage of the global economic recovery and the further opening up of renminbi financial services in Hong Kong. Profit before tax rose by 42% to HK$3,748m, reflecting broad-based income growth as well as a 36% improvement in loan impairment charges. Operating profit excluding loan impairment charges was up 34% at HK$2,671m. Operating profit rose by 46%.

We took steps to facilitate commercial activity. Our cross-border and renminbi offerings helped companies capitalise on new business opportunities while managing risk, driving a 225% increase in trade finance. Our financial support for SMEs through government-initiated lending schemes topped HK$18.4bn by the end of 2010. We used technology to reduce turnaround times for new and renewed lending and credit facility decisions. These efforts helped drive a 102% increase in customer advances, with a 58% rise in related net interest income.

Customer deposits rose by 14%, but pressure on spreads resulted in a 19% fall in deposit net interest income.

We established a leadership position for renminbi commercial banking services that will provide an excellent springboard for future growth. Among other initiatives, we became the first bank in Hong Kong to establish a prime rate and lead-arrange a syndicated loan denominated in renminbi.

Close collaboration between commercial banking teams in Hong Kong and on the Mainland and new strategic alliances with Mainland partners enhanced our cross-border service proposition and proved a valuable source of referral business. At the end of 2010, we had over 58,000 renminbi commercial accounts and our renminbi cross-border trade-related business exceeded RMB35bn.

Net fee income rose by 9%, supported in part by an enriched portfolio of corporate wealth management products and enhanced online investment services.

Corporate wealth management income rose by 27%, representing 13% of Commercial Banking's net operating income before loan impairment charges.

Stronger Internet-based business banking platforms helped drive continued customer migration to online channels. At 31 December 2010, the number of Business e-Banking customers had reached over 92,000. The number of online business transactions in 2010 grew by 19% compared with 2009.

Corporate Banking recorded a 38% increase in profit before tax to HK$1,266m. Operating profit excluding loan impairment charges was up 29% at HK$1,264m. Operating profit rose by 40%.

Total operating income rose by 25% on the back of a 24% increase in net interest income.

> “We reaffirmed our reputation as a leading fund manager and distributor in Hong Kong.”

Tighter regulations in the Hong Kong and Mainland property markets and intensifying competition among lenders created new challenges for traditional drivers of Corporate Banking growth. We took steps to further diversify the revenue base, leveraging our strong customer relationships and good market knowledge to capture business in a broader range of industry sectors and explore opportunities created by the growing demand for cross-border financial services. Customer advances and deposits grew by 32% and 34% respectively.

Treasury's profit before tax fell by HK$32m, or 1%, to HK$3,361m. With increased loan demand from business customers, a substantial proportion of the commercial surplus was redeployed to support commercial lending. Good growth in trading income, a disposal gain and an increase in share of profits from associates was more than offset by the effects of continuing low global interest rates on net interest income, which dropped by 35%. Operating profit fell by 24%.

We made prudent use of gapping opportunities and took steps to enhance the investment mix under the balance sheet management portfolio by disposing of selected instruments and investing in high-quality debt securities, resulting in a HK$95m disposal gain. These actions led to a 30% increase in net interest income in the second half of 2010 compared with the first half despite the challenging market conditions.

Closer collaboration with business banking colleagues and efforts to meet the growing demand for renminbi-denominated products drove the 10% increase in trading income.

"We became the first bank in Hong Kong to establish a prime rate and lead-arrange a syndicated loan denominated in renminbi."

MAINLAND BUSINESS

Hang Seng Bank (China) Limited moved forward with its strategy for long-term development with the RMB510m purchase of headquarters premises in Shanghai. With the opening of two cross-location sub-branches under CEPA VI in 2010, Hang Seng China now has 38 outlets across 13 Mainland cities.

An enhanced customer referral mechanism, good cross-border commercial banking capabilities and a diverse portfolio of products proved valuable in attracting new business and building a broader platform to sustain growth in deposits. The Mainland personal and commercial banking customer bases increased by 15% and 14% respectively year on year.

The expansion of wealth management offerings to better meet the needs of customers at different life stages underpinned a 17% rise in the number of Prestige Banking accounts. Along with enhancements to services for commercial customers, this rise helped drive a 76% year-on-year increase in deposits – improving balance sheet strength. With continuing emphasis on credit quality over portfolio size, advances to customers increased by 28%.

Hang Seng China's profit before tax recorded solid growth, with the 24% rise in total operating income outweighing increases in loan impairment charges and operating expenses.

Collaboration with Hang Seng's strategic Mainland partners, Industrial Bank and Yantai Bank, continued to extend our reach in regions with good economic growth potential.

FINANCIAL HIGHLIGHTS

Total assets rose by HK$86.2bn, or 10%, to HK$916.9bn. Our efforts to facilitate the upswing in commercial trade and capitalise on robust consumer demand underpinned the 37% increase in customer advances. Customer deposits, including certificates of deposit and other debt securities in issue, were up 7%, driven partly by good growth in renminbi deposits. With the emphasis on using surplus funds to support loan growth, financial investments and trading assets were down 17% and 61% respectively.

Net interest income rose by 2% to HK$14,300m. The 9% increase in average interest-earning assets, improved loan spreads and returns from the life insurance funds investment portfolio outweighed reduced contributions from deposits and the Treasury balance sheet management portfolio. In challenging operating conditions, we achieved a 13% rise in net interest income and a 3 basis points improvement in net interest margin in the second half of 2010 compared with the first half. Net interest margin for the year was down 12 basis points on 2009 at 1.78%.

We recorded a 13% increase in net fee income to HK$4,897m, largely reflecting the 72% rise in investment fund fee income. Fees from trade services, remittances and credit facilities grew by 19%, 19% and 44% respectively. Successful credit card customer acquisition and card utilisation campaigns supported a 3% rise in fee income from card services. As investor confidence improved, our diverse range of wealth management products and service excellence supported a 35% increase in insurance agency fees and a 24% rise in private banking service fee income. Net fee income in the second half of 2010 was up 7% compared with the first half.

Trading income grew by 7% to HK$2,059m. Income from securities, derivatives and other trading activities rose by HK$160m, or 122%, reflecting an improvement in derivatives trading. Foreign exchange income fell by HK$24m, or 1%, due mainly to a fall in net interest income from funding swaps and increased losses on the revaluation of Hang Seng China's US dollar capital against the renminbi.

While continuing to carefully monitor costs, we invested in staff and marketing to recognise good performance and support future growth. Rental expenses increased with higher rents in Hong Kong and new outlets on the Mainland.

Our cost efficiency ratio for 2010 was 33.7%.

> "Our long-term goals are to be the leading personal and private bank for affluent and middle-class customers in Hong Kong and on the Mainland, and the leading trade bank in Greater China."

The combined impact of the improved economic climate and our effective actions to manage credit risk saw loan impairment charges and other credit risk provisions fall by HK$422m, or 52%, to HK$390m.

Total loan impairment allowances as a percentage of gross advances to customers was 0.39% compared with 0.56% a year earlier. Gross impaired advances as a percentage of gross advances to customers improved by 30 basis points to 0.40%.

A WINNING STRATEGY

The economic rebound boosted international trade and investment markets in 2010, but the outlook for 2011 remains uncertain. With stimulus initiatives winding down, many of the world's advanced economies are still grappling with major monetary and fiscal issues, which may subdue export demand.

Although upbeat consumer and business sentiment should continue to support domestic demand, a slowdown in the external sector would create new challenges for Hong Kong. Despite recent measures to curb economic overheating, domestic consumption on the Mainland looks set to remain robust, underpinning continued growth – albeit at a more moderate pace.

Our long-term goals are to be the leading personal and private bank for affluent and middle-class customers in Hong Kong and on the Mainland, and the leading trade bank in Greater China.

To achieve these objectives, we have identified business priorities that capitalise on our competitive strengths and support sustainable growth.

Hang Seng's strengths are its unique market positioning, comprehensive wealth management capabilities and extensive business referral network.

The rapidly growing middle and affluent classes on the Mainland are seeking new investment opportunities at home and in Hong Kong. With our good cross-border reach and trusted brand, we are strongly positioned to meet their needs.

In support of achieving our goals, we will maintain our excellent service level. We will make further investments in technology and launch service innovations to facilitate transactions and capture more business, particularly in the Prestige Banking segment and among young people. We will develop new applications for personal mobile devices to provide convenient access to account and market information. We will work to drive continuing good growth in deposits in Hong Kong and on the Mainland, providing a solid foundation for business expansion.

We have placed ourselves at the leading edge of the wealth management and offshore renminbi financial services markets. We will continue to make good use of our product development strength and well-established service platforms to become the preferred bank in these rapidly growing sectors.

Our strong cross-border banking proposition is proving an important tool as we work to become the leading trade bank in Greater China.

Treasury will continue to develop effective hedging solutions and new renminbi-related products, and Commercial Banking has enhanced online banking services to support renminbi account enquiries and transaction instructions. We will remain close to customers and to Mainland regulators to ensure we stay ahead of the game.

Enduring characteristics of Hang Seng's success are a willingness to aim high in setting our business objectives and our focus on serving customers well by providing financial solutions that are tailored to their needs. We have a winning strategy for maintaining a strong position in traditional business lines and for taking the lead in key areas of new banking business to deliver long-term growth.

Margaret Leung
Vice-Chairman and Chief Executive
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