

TAKING THE LEAD

DRIVE



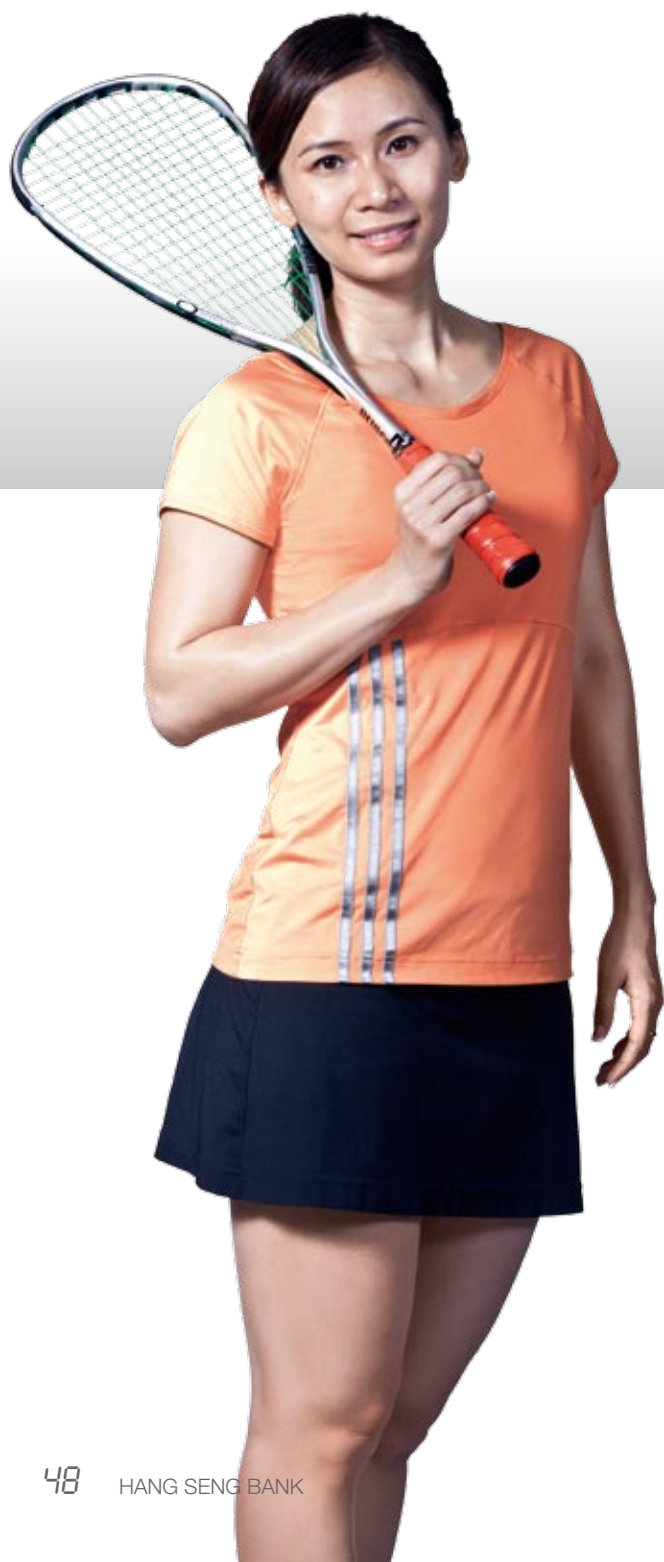


2010 Asian Games –  
Squash, Silver Medal

**Rebecca Chiu**

## MANAGEMENT DISCUSSION AND ANALYSIS

### BUSINESS IN HONG KONG



Hang Seng's trusted brand, diverse portfolio of financial products and extensive network of service channels reinforced our leading position in key areas of banking during 2010.

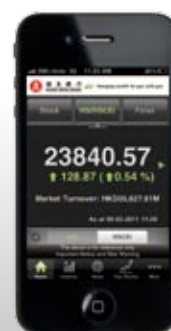
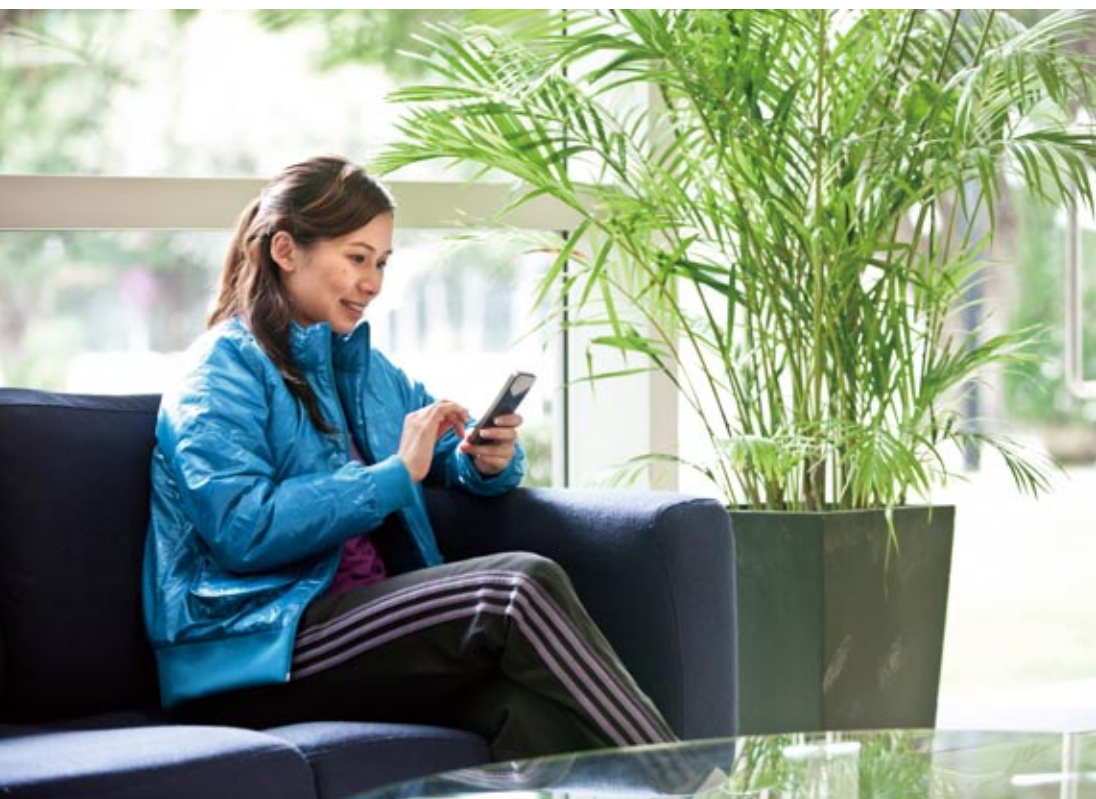
Our swift response to the opening up of new avenues of business strengthened our foothold in sectors with good potential for future growth.

With increased demand for loans, we leveraged our balance sheet strength to achieve a 36.9% increase in gross advances to customers to HK\$474.5bn. Customer deposits, including certificates of deposit and other debt securities in issue, rose by HK\$46.7bn, or 7.0%, to HK\$710.3bn, driven in part by good growth in renminbi deposits.

#### **PERSONAL FINANCIAL SERVICES**

Personal Financial Services' operating profit excluding loan impairment charges rose by 5.5% to HK\$7,865m, reflecting increases in lending and fee-related business. Operating profit was up 9.3% at HK\$7,656m, driven by a 54% improvement in loan impairment charges. Profit before tax grew by 8.5% to HK\$7,872m.





We launched a first-of-its-kind foreign exchange margin trading iPhone application.

Net interest income increased by 3.5% to HK\$8,485m, with good growth in credit card business and personal loans more than offsetting the adverse effects of downward pressure on deposit spreads and mortgage loan pricing.

Net fee income rose by 14.1%. We used our wealth management strength to help customers pursue their financial goals against a backdrop of changing market conditions – recording significant increases in investment fund and insurance agency fees. The upturn in investment sentiment and our emphasis on personalised service supported a 24.9% rise in service fee income from private banking.

We continued to invest in technology to provide our customers with fast, convenient and secure access to financial services. Personal e-Banking passed two major milestones in 2010 – registering its 1 millionth customer in the first half of the year and celebrating its 10th anniversary in August.



We made good use of the popular mobile platform, reaching out to younger and tech-savvy customers with the launch of two iPhone applications. Our first application, which provides on-the-move access to securities and foreign exchange investment information, recorded about 40,000 registrations in its first month. In August, we built on this success with the launch of a first-of-its-kind foreign exchange margin trading application, helping drive growth in the retail margin trading account base.

At the end of 2010, the number of Personal e-Banking customers was up 10.2% at 1.1 million compared with a year earlier. The percentage of total personal banking transactions conducted via Personal e-Banking was up 0.7 percentage points at 52.2%.

#### **Wealth Management**

Wealth management income rose by 9% to HK\$5,092m. We maintained a steady growth trend during the year to record a 4.1% increase in revenue in the second half of 2010 compared with the first half.

Against the backdrop of a tighter regulatory environment, we achieved a 9.8% rise in investment services income to HK\$2,786m – driven largely by the 85.1% growth in fee revenue from investment fund business. Enhancements to our life insurance proposition and increased returns from the life insurance investment funds portfolio generated a 9.7% rise in life insurance income to HK\$2,121m.

# +180.8%

## retail investment funds sales

Improving economic conditions and continuing low interest rates generated renewed customer interest in investment opportunities offering enhanced yields. Our trusted reputation for wealth management services and time-to-market competitive strength helped us capitalise on the increase in investor activity. We also established a new customer referral mechanism to capture more business from affluent mainland Chinese individuals looking for wealth management services in Hong Kong.

Riding on the robust Mainland economy and growing demand for investment exposure to the renminbi, we developed new China-related funds. In November, we became the first non-Mainland fund manager to offer a renminbi bond investment fund in Hong Kong with the launch of the Hang Seng RMB Bond Fund – which was fully subscribed in four days. Our Hang Seng A Share Focus Fund that was authorised earlier in the year also enjoyed a good response from customers. These new products helped drive strong growth of 180.8% in retail investment fund sales and we increased our investment fund market share – further reinforcing our reputation for Hong Kong and Mainland-focused product development expertise.

Our innovative foreign exchange margin trading iPhone application was a primary driver of the 54.5% increase in new margin trading accounts in the second half of the year compared with the first half. The margin trading account base increased by 3.8% year on year.

We worked to establish ourselves as a market leader in providing renminbi-related retail investment opportunities. In addition to our RMB Bond Fund, we offered a renminbi-denominated floating rate bond and equity-linked note. We were also the first bank in Hong Kong to launch renminbi certificates of deposit for retail investors.

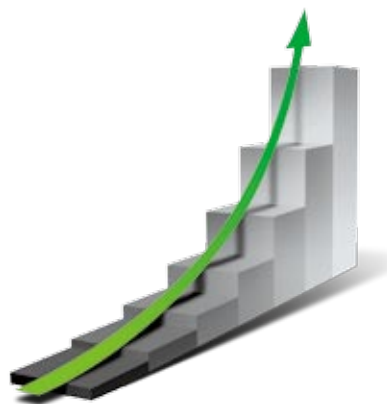
With strong market competition in securities services, we launched customer acquisition and service utilisation promotions, and enhanced our Internet-based securities platform with convenient new functions such as online submission of corporate events instructions, supporting a 16.2% increase in income from stockbroking and related services in the second half of 2010 compared with the first half.



We worked to establish ourselves as a market leader for renminbi-related retail investment opportunities.

## MANAGEMENT DISCUSSION AND ANALYSIS

### BUSINESS IN HONG KONG



Our credit card base passed the 2 million cards in circulation milestone.

We continued to strengthen our position as a prominent provider of retirement planning and life insurance solutions. We further diversified our insurance offerings with new products and improved protection under existing plans to meet the needs of customers at different life stages. We enhanced the capacity of our telemarketing channel to increase our market penetration of the younger customer segment. We also launched strategic promotional offers to expand relationships with existing insurance customers. This proved effective in driving sales, with life insurance policies in-force and annualised premiums growing by 8.6% and 13.3% respectively. Insurance agency fee income rose by 34.7%.

Effective management of the life insurance funds investment portfolio generated a HK\$270m increase in investment gains and an 18.4% rise in related net interest income and fee income for the year.

#### Consumer Finance

Lending to individuals grew by 8.8% to HK\$185.3bn.

We capitalised on the positive outlook of consumers and robust domestic demand with card utilisation incentive offers. In June, we launched the Hang Seng Hong Kong dollar China UnionPay (CUP) credit card which offers cardholders access to the extensive CUP merchant network in Hong Kong and on the Mainland, as well as in many countries overseas. This new card enjoyed strong uptake, with over 100,000 issued by the end of 2010, helping to drive the 11.2% rise in the card base to over 2 million cards in circulation. We gained market share and maintained our number two ranking for card advances and cardholder spending, which grew by 13.9% and 18.4% respectively.

Excluding Government Home Ownership Scheme mortgages, residential mortgage lending to individuals increased by 11.1% to HK\$134.7bn. Amid intense market competition and government measures to cool speculation in the property sector, our multi-platform mortgage services helped us outperform the market in terms of new mortgage registrations and grow our overall market share.

+224.8%

Commercial Banking trade finance





## COMMERCIAL BANKING

Commercial Banking leveraged its competitive strengths to capitalise on improved commercial and trade activity in 2010, recording a 34.3% increase in operating profit excluding loan impairment charges to HK\$2,671m. Operating profit rose by 45.7% to HK\$2,493m, reflecting the positive impact of the economic recovery and effective credit risk management on loan impairment charges, which fell by 36%. Profit before tax was up 42.1% at HK\$3,748m.

Net interest income rose by 34.7% to HK\$2,709m. Benefitting from our close customer relationships and good understanding of market trends, we moved quickly to meet the growing demand for financing, achieving a 102.1% increase in customer advances to HK\$167.5bn, with a 57.8% rise in related net interest income.

As a well-established supporter of local business, we remained an active participant in government-initiated loan schemes for SMEs, with total lending under these programmes reaching more than HK\$18.4bn by the end of 2010.

We helped customers manage risk while taking advantage of the improving economic conditions, resulting in a 224.8% increase in trade finance to HK\$62.5bn.

We took steps to enhance service access and efficiency at Business Banking Centres and strengthened customer referral mechanisms, supporting a 35.2% rise in the number of new account openings compared with 2009.

**Business  
Banking**  
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Commercial Banking  
achieved a 35.2%  
year-on-year increase  
new account openings.



## MANAGEMENT DISCUSSION AND ANALYSIS

### BUSINESS IN HONG KONG



The increase in the customer base helped drive a 14.5% increase in deposits, which partly offset the adverse effects of the continuing compression of spreads. Net interest income from deposits fell by 19%.

With the widening scope of renminbi financial services in Hong Kong, we leveraged our strong internal infrastructure to establish ourselves as a market leader. We were the first bank in Hong Kong to launch a renminbi prime rate and to lead-arrange a renminbi syndicated loan, placing us in a good position to capture a growing share of business in this important new market sector. At the end of 2010, we had more than 58,000 renminbi commercial accounts and had helped settle more than RMB35bn in renminbi cross-border trade-related business.

Net fee income increased by 8.5% to HK\$1,209m, supported in part by good growth in corporate insurance business.

Trade-related fee income was up 16.1%. In addition to our comprehensive suite of renminbi products and services, our close collaboration with Hang Seng China and strategic alliances with Mainland partners reinforced the competitive strength of our cross-border capabilities and proved a valuable source of top-end customer referrals.

Our extensive Mainland correspondent bank network facilitated efficient cross-border transactions, resulting in a 22.1% increase in fee income from remittances.



Our service excellence was recognised with an 'Achievement Award for Cash Management in Hong Kong'.

We used platforms including cash management and yield enhancement to market our growing portfolio of corporate wealth management offerings. We worked to streamline insurance underwriting processes and extended the reach of our 'premium financing' programme to provide customers with a faster service and more flexibility in obtaining insurance coverage, helping us achieve good growth in sales of universal life insurance products and our Executive Retention Insurance Plan.

In the low interest rate environment, we offered customers improved-yield investment opportunities serving a variety of risk appetites, recording increases in sales of structured products and treasury instruments. Income from investment and treasury business rose by 80.6%.

Overall, income from corporate wealth management increased by 26.6%, representing 13.4% of Commercial Banking's net operating income before loan impairment charges.

Our efforts to assist customers brought us industry recognition, with an 'Achievement Award for Cash Management in Hong Kong' at *The Asian Banker* Transaction Banking Awards 2010. We received an 'SME's Best Partner Award' from the Hong Kong Chamber of Small and Medium Business for the fifth consecutive year.

## MANAGEMENT DISCUSSION AND ANALYSIS

### BUSINESS IN HONG KONG



Our renminbi cross-border trade settlement business topped RMB35bn.



We made further enhancements to our online channel, providing a wider range of investment services and support for renminbi account services. At 31 December 2010, the number of Business e-Banking customers had risen by 19.3% compared with a year earlier to more than 92,000. The number of online business customer transactions was up 19%, with online securities transactions reaching 51.4% of total securities transactions.

### CORPORATE BANKING

Corporate Banking recorded a 29.1% increase in operating profit excluding loan impairment charges to HK\$1,264m.

Net operating income before loan impairment charges was up HK\$332m, or 25.3%, at HK\$1,643m, due mainly to the 24.4% rise in net interest income to HK\$1,440m.

In a competitive operating environment, we achieved a 32.4% increase in customer advances. With property-related financing traditionally a key element of Corporate Banking lending, the tightening of property sector regulations in Hong Kong and on the Mainland during 2010 created new challenges. We leveraged our in-depth understanding of local markets to capture more business in other industry sectors. Our cross-border capabilities proved a useful tool in expanding lending to the Hong Kong-based operations of well-established large Mainland enterprises and in growing trade finance. Net interest income from advances rose by 27.5%.

+19.3%

## Business e-Banking customers

Customer deposits increased by 34.5%, but the effects of continuing low interest rates saw net interest income from deposits fall by 29.4%.

We leveraged our strong customer relationships and market leadership for renminbi financial services to explore new opportunities for growing fee-based business and further diversifying income. We capitalised on rising demand for renminbi investment products to open more client investment accounts and increased corporate wealth management sales turnover. Fee income for the year grew by 29.7% to HK\$188m.

With loan impairment charges improving by 96.2%, Corporate Banking recorded an operating profit of HK\$1,261m – up 40% compared with a year earlier. Profit before tax rose by 38.4% to HK\$1,266m.

## TREASURY

Treasury's operating profit fell by 24.3% to HK\$2,207m, with growth in trading income outweighed by the decline in net interest income in difficult market conditions. A 68.4% increase in the share of profits from associates and a disposal gain helped support profit before tax, which was down just 0.9% at HK\$3,361m.

Net interest income dropped by 35.1% to HK\$1,403m. Excess market liquidity and continuing uncertainty over the outlook for sustained global economic recovery kept downward pressure on interest rates, serving to limit good investment opportunities under the balance sheet management portfolio. Yield curves remained relatively flat, particularly in the first half of the year. With increased loan demand from business customers, a substantial proportion of the commercial surplus was redeployed to support commercial lending.

We continued to emphasise prudent risk management while taking steps to defend the interest margin. As market conditions changed, we disposed of selected instruments and invested in high-quality enhanced-yield assets, generating a HK\$95m disposal gain. We took advantage of gapping opportunities to capitalise on yield differentials. This effective management of the balance sheet management portfolio underpinned the 30.4% increase in net interest income to HK\$794m in the second half of the year compared with the first half.



## MANAGEMENT DISCUSSION AND ANALYSIS

### BUSINESS IN HONG KONG



We took steps to enhance service access and efficiency for customers.



With the further liberalisation of the renminbi financial services sector in Hong Kong, we actively sourced and developed renminbi-denominated products to meet growing demand from customers, and strengthened cross-selling and customer referral mechanisms with corporate and commercial banking business units, supporting a 10.2% increase in trading income to HK\$1,162m.

### HANG SENG INDEXES

Wholly owned subsidiary Hang Seng Indexes Company Limited (Hang Seng Indexes), strengthened its indexing services and expanded its global exposure in 2010 with the launch of new indexes and the overseas listing of new index-linked funds.

In March, Hang Seng Indexes restructured the Hang Seng Family of Indexes based on the findings of an extensive market consultation exercise undertaken in 2009 and, in July, deepened its coverage of the Hong Kong and Mainland markets with the launch of two new index series.

The Hang Seng Corporate Sustainability Index Series serves the increasing market interest in the development of socially responsible investment products and also aims to raise awareness about corporate sustainability issues among listed companies and the financial communities

in Hong Kong and on the Mainland. Comprised of the Hang Seng Corporate Sustainability Index, the Hang Seng (China A) Corporate Sustainability Index and the Hang Seng (Mainland and HK) Corporate Sustainability Index, the series is the first of its kind to focus exclusively on Hong Kong and the Mainland.

The Hang Seng Dividend Point Index Series – consisting of the Hang Seng Index Dividend Point Index and the Hang Seng China Enterprises Index Dividend Point Index – provides the market with indicators to track cash dividends from Hang Seng Index (HSI) constituents and Hang Seng China Enterprise Index (HSCEI) constituents respectively. In November, Hong Kong Exchanges and Clearing Limited launched dividend futures based on the index series, reflecting its value in providing benchmarks for investment products hedging dividend risks.

Hang Seng Indexes increased its profile in both Asia and Europe during 2010. In July, the exchange-traded funds (ETFs) of ComStage HSI and ComStage HSCEI were listed on the SIX Swiss Exchange. Later in the year, new funds tracking the HSCEI were listed in the Mainland and Japan – an open-ended fund on the Shenzhen Stock Exchange and an ETF on the Tokyo Stock Exchange.

Hang Seng Indexes now compiles 88 publicly available indexes – 46 real-time price indexes and 42 daily indexes – of which 34 track the Mainland segment of the market. In addition to its publicly available indexes, Hang Seng Indexes also compiles customised indexes to serve the specific indexing needs of various clients.

The total number of futures and options contracts traded on the HSI and the HSCEI in 2010 increased by 11.8% and 7.1% respectively compared with 2009. At 31 December 2010, the total size of ETFs tracking all indexes in the Hang Seng Family of Indexes was over US\$12bn.



Backed by our trusted brand, we reinforced our leading position in key areas of financial services.

88

publicly available indexes compiled by  
Hang Seng Indexes Company Limited