FINANCIAL PERFORMANCE

Income Statement

Summary of Financial Performance

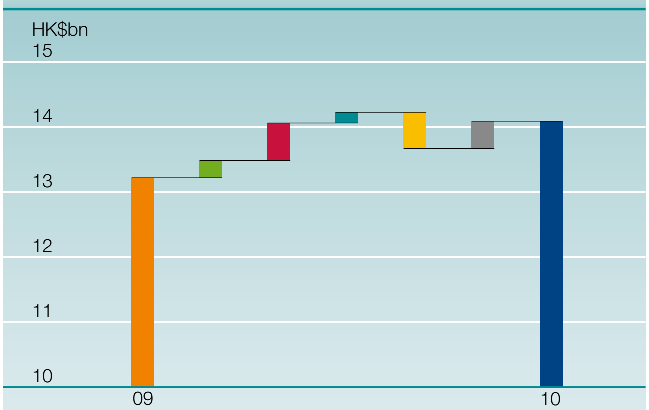
Figures in HK$m	**2010**	2009 (restated)
Total operating income	**34,417**	32,816
Total operating expenses	**7,355**	6,786
Operating profit after loan impairment charges and other credit risk provisions	**14,085**	13,214
Profit before tax	**17,345**	15,400
Profit attributable to shareholders	**14,917**	13,138
Earnings per share (in HK$)	**7.80**	6.87

Hang Seng Bank Limited ("the Bank") and its subsidiaries ("the Group") reported an audited profit attributable to shareholders of HK$14,917m for 2010, up 13.5% compared with 2009. Earnings per share were HK$7.80, up HK$0.93 from 2009. Profit attributable to shareholders for the second half of 2010 increased by HK$989m, or 14.2%, when compared with the first half.

Operating profit excluding loan impairment charges and other credit risk provisions grew by HK$449m, or 3.2%, to HK$14,475m.

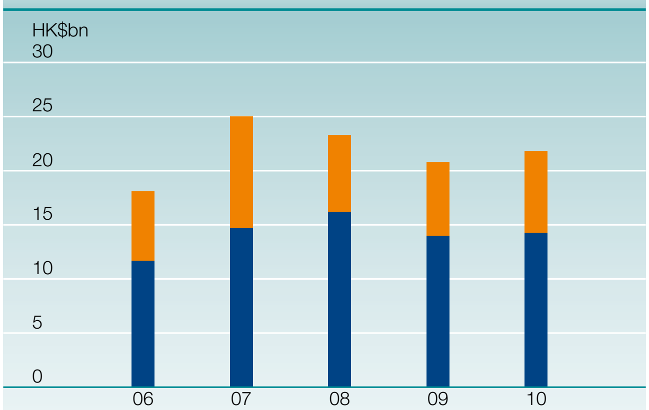
Although Hong Kong's economy improved solidly on the back of the strong rebound in exports, the operating environment for banks remained challenging with the persistence of low interest rates and intensifying market competition. Net interest income registered an increase of 2.0%, underpinned by strong loan growth. Supported by the improvement in investment sentiment, non-interest income grew by 10.9%. While continuing to carefully manage costs, investment for future growth led to an 8.4% rise in operating expenses compared with 2009. The Bank built encouraging business momentum, resulting in an 11.3% increase in operating profit excluding loan impairment charges and other credit risk provisions in the second half of the year compared with the first half.

Operating Profit Analysis



	HK$m
2009 Operating profit	13,214
Change due to:	
Net interest income	277
Net fee income	576
Other operating income	165
Operating expenses	(569)
Loan impairment charges and other credit risk provisions	422
2010 Operating profit	**14,085**

Net Operating Income
(Before loan impairment charges and other credit risk provisions)



Net operating income
Non-interest income
Net interest income

Net interest income rose by HK$277m, or 2.0%, with an 8.9% increase in average interest-earning assets.

Figures in HK$m	**2010**	2009
Net interest income/ (expense) arising from:		
– financial assets and liabilities that are not at fair value through profit and loss	**14,459**	14,151
– trading assets and liabilities	**(238)**	(234)
– financial instruments designated at fair value	**79**	106
	14,300	14,023
Average interest-earning assets	**802,464**	736,953
Net interest spread	**1.72%**	1.84%
Net interest margin	**1.78%**	1.90%

The increase in net interest income was largely contributed by strong growth in customer advances, which more than offset the adverse effects of the repricing of assets at lower market interest rates and the continuing compression of deposit spread.

Net interest margin narrowed by 12 basis points to 1.78% compared with 2009, and net interest spread fell by 12 basis points to 1.72%. Liability spread continued to be constrained by the low interest rate environment. Treasury's balance sheet management portfolio was negatively affected by the repricing of assets at lower interest rates and the flattening of yield curves, although increased contributions from the credit card business, personal loans and corporate lending provided a partial buffer. The Bank achieved volume growth in the average balance of mortgage lending, but intense market competition continued to drive down mortgage pricing. The contribution from debt securities under the life insurance funds investment portfolio grew, with a 17.7% rise in related net interest income. The contribution from net free funds remained the same as in 2009 at 6 basis points.

Net interest income in the second half of 2010 grew by HK$874m, or 13.0%, compared with the first half, due mainly to fewer days in the first half of the year and a 9.3% increase in average interest-earning assets. Net interest margin in the second half was 1.80% – up 3 basis points on the first half of the year.

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	**2010**	2009
Net interest income	**14,456**	14,137
Average interest-earning assets	**756,110**	670,321
Net interest spread	**1.86%**	2.06%
Net interest margin	**1.91%**	2.11%

Net fee income increased by HK$576m, or 13.3%, to HK$4,897m compared with 2009.

Leveraging its strong wealth management platform and improved investment market sentiment, income from retail investment funds rose by 72.0%. Income from stockbroking and related services fell by 6.3%, reflecting keen market pricing competition and a decline in stock market trading turnover. Insurance agency fee income rose by 34.7%, due mainly to strong sales of a life protection with return insurance product. In improved market conditions, private banking leveraged its core strengths of a diverse suite of investment products and client service excellence to grow private banking service fee income by 24.0%.

Card services income increased by 3.5%. The Bank grew the card base by 11.2% to over two million and gained market share in terms of card receivables and card spending, supporting a 13.9% increase in receivables and 18.4% rise in spending. Credit facilities fee income grew by 44.4%, due mainly to higher fees from increased corporate lending.

The upturn in trade activity together with the expansion of the cross-border renminbi trade settlement scheme boosted remittances and trade-related fee income by 19.4% and 19.3% respectively.

Compared with the first half of 2010, net fee income in the second half grew by HK$159m, or 6.7%, mainly reflecting increases in income from stockbroking and related services and the sales of retail investment funds. Fee income from private banking services, trade-related business and remittances also registered solid growth in the second half of the year.

Trading income rose by HK$136m, or 7.1%, to HK$2,059m.

Trading income rose by HK$136m, or 7.1%, to HK$2,059m. Foreign exchange income fell by HK$24m, or 1.3%, attributable partly to reduced net interest income from funding swaps* and lower customer demand for foreign exchange-linked structured products. The reduction was also affected by increased losses on the revaluation of certain US dollar capital funds – maintained in the Bank's mainland subsidiary bank and subject to regulatory controls – against the renminbi. Excluding the above items, foreign exchange trading grew by HK$72m, or 4.7%.

Income from securities, derivatives and other trading activities increased by HK$160m, or 122.1%, reflecting an improvement in derivatives trading.

* 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.

Net income from financial instruments designated at fair value reported a revaluation gain of HK$282m, compared with a revaluation loss of HK$75m in 2009.

This was mainly due to the improvement in financial markets in 2010. The gain is due mainly to changes in the fair value of assets supporting the linked insurance contracts and reported in "net income/(loss) from financial instruments designated at fair value" with offsetting movements in the value of these contracts reported under "net insurance claims incurred and movement in policyholders' liabilities".

Net earned insurance premiums fell by HK$212m, or 1.8%. Net insurance claims incurred and movement in policyholders' liabilities rose by HK$583m, or 4.9%.

Analysis of income from wealth management business

Figures in HK$m	**2010**	2009
Investment income:		
– retail investment funds	**1,039**	604
– structured investment products*	**448**	473
– private banking service fee**	**196**	158
– stockbroking and related services	**1,468**	1,566
– margin trading and others	**129**	141
	3,280	2,942
Insurance income:		
– life insurance	**2,282**	2,070
– general insurance and others	**342**	337
	2,624	2,407
Total	**5,904**	5,349

* 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 maintained good growth momentum in 2010, achieving a 10.4% increase in income compared with 2009. Investment and insurance income rose by 11.5% and 9.0% respectively.

Leveraging the open architecture of its wealth management platform, the Bank promoted a comprehensive range of yield enhancement investment products to suit the various risk appetites of customers in the low interest rate environment. Benefiting from the improvement in equity markets and investor sentiment, the Bank achieved strong growth of 72.0% in income from retail investment funds. Stockbroking and related services income fell by 6.3% as a result of lower stock market turnover activity recorded by the Bank and keen market pricing competition.

Private banking service income grew by 24.1%, supported by the improvement in investment sentiment.

The Bank continued to enhance its leading position in providing retirement savings and life insurance protection to customers. Total policies in-force increased by 8.6%. Net interest income and fee income from the life insurance funds investment portfolio rose by 18.4%, due mainly to growth in the size of the life insurance investment portfolio, which held bond investments as its major assets.

Investment return on life insurance investment funds improved by HK$270m. The gain mainly reflects changes in the fair value of assets supporting linked insurance contracts and reported under "net income/(loss) from financial instruments designated at fair value", with offsetting movements in policyholders' liabilities. Movement in the present value of in-force insurance business increased strongly, due mainly to the growth in volume and profitability of new business written during 2010.

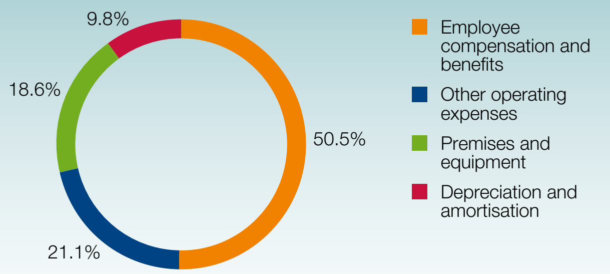
General insurance income increased by 1.5% to HK$342m.

Figures in HK$m	**2010**	2009
Life insurance:		
– net interest income and fee income	**2,382**	2,012
– investment returns on life insurance funds	**287**	17
– net earned insurance premiums	**10,966**	11,193
– net insurance claims incurred and movement in policyholders' liabilities*	**(12,479)**	(11,912)
– movement in present value of in-force long-term insurance business	**1,126**	760
	2,282	2,070
General insurance and others	**342**	337
Total	**2,624**	2,407

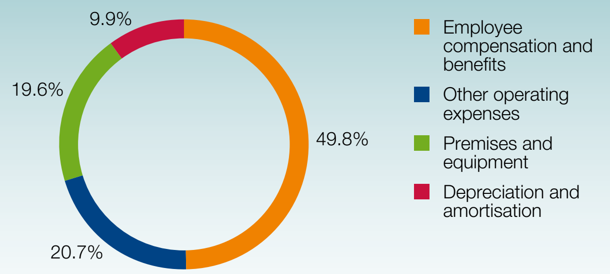
* Including premium and investment reserves

Operating expenses rose by HK$569m, or 8.4%, to HK$7,355m.

Operating Expenses for 2010



Operating Expenses for 2009



While carefully managing costs, the Bank continued to make investments in support of long-term business growth. Excluding mainland business, operating expenses rose by 7.1%.

Employee compensation and benefits increased by HK$339m, or 10.0%. Salaries and other related costs increased by 11.5%, reflecting the annual salary increment and higher average headcounts as well as an increase in performance-related pay expenses. General and administrative expenses were up 6.7%. Rental expenses rose as a result of increased rents for branches in Hong Kong and new branches on the Mainland. Depreciation charges rose by 4.7%, mainly reflecting increases in depreciation on the Bank's headquarters building in Hong Kong. Marketing and advertising expenses increased by 23.0% to support business growth.

Staff numbers by region*

	2010	2009
Hong Kong	**7,960**	7,834
Mainland	**1,623**	1,449
Others	**59**	59
Total	**9,642**	9,342

* Full-time equivalent

At 31 December 2010, the Group's number of full-time equivalent staff was up by 300 compared with the end of 2009.

With the increase in operating expenses outpacing the growth in net operating income before impairment charges and other credit risk provisions, the cost efficiency ratio rose by 1.1 percentage points compared with 2009 to 33.7%.

Loan impairment charges and other credit risk provisions fell by HK$422m, or 52.0%, to HK$390m compared with a year earlier, reflecting an overall improvement in the credit environment.

Figures in HK$m	**2010**	2009
Loan impairment charges:		
– individually assessed	**(186)**	(310)
– collectively assessed	**(204)**	(502)
	(390)	(812)
of which:		
– new and additional	**(609)**	(1,104)
– releases	**157**	230
– recoveries	**62**	62
	(390)	(812)
Other credit risk provisions	**–**	–
Loan impairment charges and other credit risk provisions	**(390)**	(812)

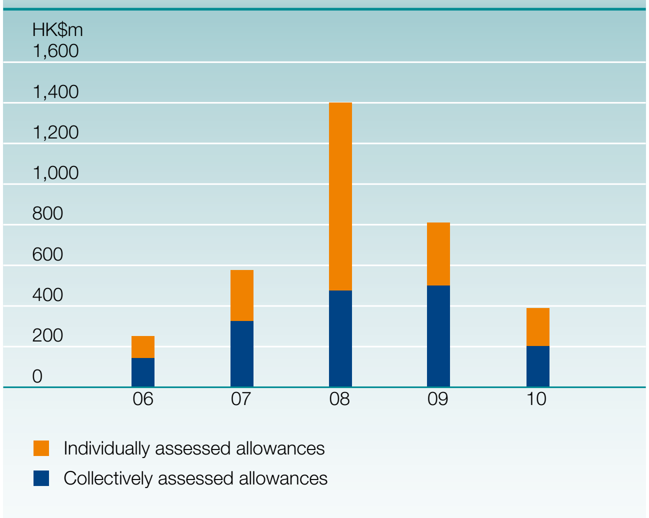
Individually assessed provisions were down HK$124m, with lower impairment charges made for Commercial Banking customers as economic conditions continued to improve.

Collectively assessed provisions were down HK$298m, attributable to lower charges on credit card and personal loans portfolios as a result of fewer delinquencies and the falling bankruptcy trend. Impairment allowances for loans not individually identified as impaired also fell due to lower historical loss rates with the improvement in global credit markets.

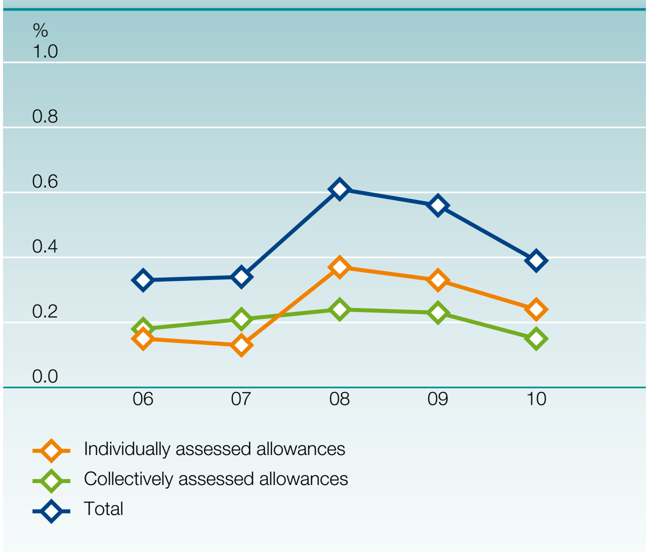
Total loan impairment allowances as a percentage of gross advances to customers are as follows:

	2010 %	2009 %
Loan impairment allowances:		
– individually assessed	**0.24**	0.33
– collectively assessed	**0.15**	0.23
Total loan impairment allowances	**0.39**	0.56

Net Charges for Loan Impairment Allowances



Loans Impairment Allowances as a Percentage of Gross Advances to Customers



Operating profit rose by HK$871m, or 6.6%, at HK$14,085m.

Profit before tax increased by 12.6% to HK$17,345m, after taking into account a 39.8% (or HK$74m) fall in **gains less losses from financial investments and fixed assets**; a 93.3% (or HK$235m) increase in **net surplus on property revaluation** and a 52.2% (or HK$913m) increase in **share of profits from associates**, mainly from Industrial Bank Co., Ltd. ("Industrial Bank").

Gains less losses from financial investments and fixed assets amounted to HK$112m, a decrease of 39.8% when compared with 2009.

Net gains from the disposal of available-for-sale equity securities fell by HK$151m, or 93.8%, attributable to the profit realised from the disposal of Visa Inc. shares in 2009. The Bank realised a HK$95m gain from the disposal of available-for-sale debt securities – reflecting profit realised primarily from the disposal of government-guaranteed debt securities – compared with a loss of HK$152m on the disposal of certain debt securities in the previous year. The net gain on the disposal of assets held for sale in 2010 was HK$12m, compared with HK$187m for 2009 which included a significant disposal profit from the sale of a property.

Net surplus on property revaluation rose by 93.3% to HK$487m.

Figures in HK$m	**2010**	2009 (restated)
Surplus of revaluation on investment properties	**474**	250
Surplus of revaluation on assets held for sale	**10**	–
Reversal of revaluation deficit on premises	**3**	2
	487	252

The Group's premises and investment properties were revalued at 30 November 2010 and updated for any material changes at 31 December 2010 by DTZ Debenham Tie Leung Limited. 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 net revaluation surplus for Group premises amounted to HK$2,105m of which HK$2,102m was credited to premises revaluation reserve and HK$3m was credited to the income statement. Revaluation gains of HK$474m on investment properties were recognised through the income statement. The related deferred tax provisions for Group premises and investment properties were HK$345m and HK$78m respectively.

The revaluation exercise also covered business premises/investment properties reclassified as properties held for sale. In accordance with HKFRS 5, the revaluation gain of HK$10m 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 reportable segments
Year ended 31 December 2010						
Profit before tax	**7,872**	**3,748**	**1,266**	**3,361**	**1,098**	**17,345**
Share of profit before tax	**45.4%**	**21.6%**	**7.3%**	**19.4%**	**6.3%**	**100.0%**
Year ended 31 December 2009 (restated)						
Profit before tax	7,258	2,637	915	3,393	1,197	15,400
Share of profit before tax	47.1%	17.1%	5.9%	22.0%	7.9%	100.0%

Personal Financial Services ("PFS") recorded a profit before tax of HK$7,872m for 2010, up 8.5% compared with 2009. Operating profit excluding loan impairment charges rose by 5.5% to HK$7,865m.

Net interest income grew by 3.5% over 2009, with the expansion in deposits and lending portfolios more than compensating for the squeeze on the net interest margin and severe price competition.

Unsecured lending grew strongly to achieve a 51.9% rise in profit before tax when compared with a year earlier, attributable to the impressive business momentum and improved loan quality. PFS took successful steps to increase the credit card base, which surpassed the two million mark, supporting year-on-year increases in card spending and receivables of 18.4% and 13.9% respectively. Personal loans grew by 29.1% to HK$4.6bn. Overall loan impairment charges dropped by 46.1% in 2010.

Against a backdrop of intense market competition and new government measures to cool property speculation, the residential mortgage business achieved good growth in 2010 to remain a top three mortgage lender and sustain its market share.

With new regulations governing investment business, PFS implemented the physical segregation of banking and investment services and reconfigured the investment sales process to maintain business momentum under the new operational structure. New products were launched to capture the shift in investor appetite in the changing market conditions. Wealth management income grew by 9.0% year-on-year and by 4.1% in the second half of the year compared with the first half.

Investment-related income increased by 9.8%, driven in part by an 85.1% rise in revenue from investment funds business. Timely new products, including the Hang Seng RMB Bond Fund, supported growth of 180.8% in retail investment fund sales as well as a significant increase in the Bank's investment fund market share. Stockbroking and related services fee income grew by 16.2% in the second half of 2010 compared with the first half.

New life insurance plans offering improved protection propositions proved effective in driving sales. Income from the life insurance business grew by 9.7% compared with 2009. Total life insurance policies in-force and annualised premiums rose by 8.6% and 13.3% respectively.

Hang Seng continued to be recognised as the leading wealth management bank in Hong Kong, receiving awards including "Best Domestic Bank in Hong Kong" from The Asset for the 11th consecutive year, "Company of the Year" in Benchmark's 2010 Wealth Management Awards and "Best Local Private Bank in Hong Kong" from *Euromoney* for the second year in a row.

Personal e-Banking grew its registered customer base by 10.2% compared with the end of 2009 to reach 1.1 million. PFS continued to implement service innovations, including the development and launch in August 2010 of a first-of-its-kind iPhone application to support foreign exchange margin trading. As of December over 435,000 customers had added their support to the Bank's environmental efforts by registering to receive electronic rather than paper statements through the e-Statement service – a 30.3% increase compared with a year earlier.

Commercial Banking ("CMB") achieved a 42.1% increase in profit before tax to HK$3,748m. CMB's contribution to the Bank's total profit before tax increased to 21.6%, up 4.5 percentage points from 2009. Operating profit excluding loan impairment charges was up by 34.3% to HK$2,671m, due mainly to increases in net interest income from advances and net fee income. With improving market conditions and a continuing emphasis on risk management, loan impairment charges fell by 36.0%.

Against a backdrop of economic recovery and the rebound in exports, CMB's swift response to the increase in demand for financing saw customer advances increase by 102.1%, underpinning a 57.8% rise in net interest income from lending. The influx of liquidity into the region drove a 14.5% rise in customer deposits. However, with continuing pressure on spreads, deposit-related net interest income fell by 19.0%.

Supported by a comprehensive business development plan and the Bank's strong internal infrastructure, CMB was quick to respond to the further relaxation of the scope of renminbi business in Hong Kong in early 2010, rolling out a comprehensive range of renminbi commercial banking services and establishing the Bank as a pioneer in this expanding area of business. Hang Seng was the first bank in Hong Kong to set up a renminbi prime rate and to sign a renminbi syndicated loan. CMB has developed a full suite of renminbi commercial banking products including, but not limited to, renminbi commercial finance, renminbi savings and current accounts, and renminbi factoring and solutions. 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.

To assist commercial customers in growing their cross-border business and to establish a dynamic customer referral channel, CMB closely collaborated with Hang Seng China and several strategic partners on the Mainland, including Industrial Bank and China Export and Credit Insurance Corporation (SINOSURE). This collaboration has enhanced CMB's ability to offer one-stop commercial banking solutions and capture an increasing share of cross-border business flows.

CMB worked to provide timely, competitive corporate wealth management products to its customers, focusing particularly on those in the top-end segment. Enhanced corporate insurance products were marketed on various platforms, including wealth management and yield enhancement. Underwriting procedures were streamlined to improve service efficiency.

Income from corporate wealth management business increased by 26.6% and contributed 13.4% to CMB's total net operating income before loan impairment charges in 2010.

With strong roots in its local communities, CMB continued to be an active player in government-backed schemes to support small and medium-sized enterprises. Since late 2008, the Bank has approved about 6,800 applications with a total loan amount of more than HK$18.4bn under the government-backed SME Loan Guarantee and Special Loan Guarantee schemes, with market shares of 25% and 15% respectively at the end of 2010.

CMB customers continued to migrate to online and automated banking channels. At 31 December 2010, over 92,000 customers had registered for the Bank's Business e-Banking service, up 19.3% compared with a year earlier. The number of online business transactions grew by 19.0%.

Corporate Banking ("CIB") experienced an intensification of market competition in 2010. With the uneven pace of global economic recovery, many banks turned their attention to Asia, leading to growing competition among lenders. Property-related financing has traditionally been an important element of CIB's business. With tighter government regulation in the property sector both in Hong Kong and on the Mainland, CIB took steps to diversify its revenue base, leveraging its strong customer relationships and good industry sector knowledge to capitalise on new business opportunities created by the growing demand for cross-border financial services.

CIB's advances to customers and customer deposits grew by 32.4% and 34.5% respectively compared with a year earlier.

Operating profit excluding loan impairment charges was HK$1,264m, an increase of HK$285m, or 29.1%. Operating profit was up 40.0% at HK$1,261m.

Treasury ("TRY") recorded a profit before tax of HK$3,361m, in line with 2009. With increased loan demand from business customers, a substantial proportion of the commercial surplus was redeployed to support commercial lending. Operating profit was down 24.3% at HK$2,207m.

Trading income increased 10.2% to HK$1,162m and disposal gains rose by 162.5% to HK$95m, but these increases were more than offset by the 35.1% decline in net interest income to HK$1,403m.

With abundant market liquidity and the fragile nature of the global economic recovery, interest rates remained at low levels. Yield curves were also relatively flat, particularly in the first half of the year. Net interest income fell to HK$609m in the first half of the year, but TRY's active management of the balance sheet management portfolio saw net interest income rebound by 30.4% to HK$794m in the second half of the year.

TRY placed more emphasis on high-quality debt securities, particularly government-guaranteed papers and high-quality corporate debt securities, and capitalised on market opportunities to dispose of selected securities. These actions helped improve the investment mix of the balance sheet management portfolio and generated a disposal gain of HK$95m, while remaining in line with the Bank's prudent risk management strategy.

Trading income increased by HK$108m, or 10.2%, to HK$1,162m, mainly contributed by the improvement in foreign exchange income and derivatives trading, boosted in part by strong demand for renminbi-denominated products and derivatives following the further liberalisation of renminbi business in Hong Kong.

Mainland Business

Hang Seng Bank (China) Limited ("Hang Seng China") opened two cross-location sub-branches under CEPA VI during the year, bringing its mainland network to 38 outlets across Beijing, Shanghai, Guangzhou, Dongguan, Shenzhen, Fuzhou, Nanjing, Hangzhou, Ningbo, Tianjin, Kunming, Foshan and Zhongshan. The Bank also has a branch in Shenzhen for foreign currency wholesale business and a representative office in Xiamen.

Hang Seng China continued to further enrich and diversify its wealth management product offerings and enhance its Commercial Banking capabilities to capture good growth opportunities. Close collaboration between Commercial Banking teams on the Mainland and in Hong Kong helped to support solid growth in both the personal and commercial customer bases – which increased by 15.3% and 14.4% respectively compared with a year earlier.

Customer advances recorded growth of 28.4% to HK$36.4bn compared with 2009 year-end. Customer deposits grew by 76.1%, underpinned by the increase in the mainland customer base.

Hang Seng China's profit before tax (excluding exchange losses on US dollar capital funds) recorded a growth of 139.8% compared with 2009, with growth in both net interest income and non-interest income offsetting increases in operating expenses and loan impairment charges.

The purchase of headquarters premises in Shanghai in 2010 demonstrated the Group's long-term commitment to the mainland market and is supporting the continued development of Hang Seng China.

The Bank's strategic alliance with Industrial Bank continued to generate good results. The Bank took up its full share entitlement under a rights issue by Industrial Bank and increased its equity interest in the mainland bank from 12.78% to 12.80% at 31 December 2010.

Economic Profit

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

For the year 2010, economic profit was HK$9,408m, an increase of HK$1,036m, or 12.4%, compared with 2009. Return on invested capital (post-tax profit, adjusted for the property revaluation surplus net of deferred tax, depreciation attributable to the revaluation and impairment of purchased goodwill), rose by HK$1,541m.

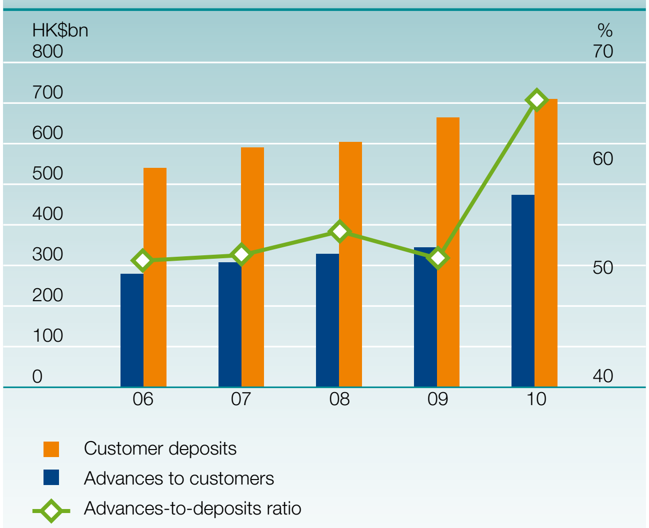
	2010		2009	
	HK$m	%	HK$m	%
Average invested capital	57,616		52,937	
Return on invested capital*	14,690	25.5	13,149	24.8
Cost of capital	(5,282)	(9.2)	(4,777)	(9.0)
Economic profit	9,408	16.3	8,372	15.8

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

Balance Sheet

Total assets rose by HK$86.2bn, or 10.4%, to HK$916.9bn. Customer advances increased by HK$128.0bn, or 37.1%, with strong growth in trade financing, corporate and retail lending and mainland loans. Despite the keen market competition, the Bank's residential mortgage business continued to record good growth and sustained its market share in terms of total mortgage lending. Customer deposits and certificates of deposit and other debt securities in issue increased by HK$46.7bn, or 7.0%, to HK$710.3bn, driven in part by strong growth in renminbi deposits. At 31 December 2010, the advances-to-deposits ratio was 66.5%, compared with 51.9% at 31 December 2009, reflecting the faster pace of loan growth in 2010. Financial investments and trading assets decreased by 17.5% and 60.9% respectively, attributable primarily to the redeployment of the commercial surplus to support loan growth.

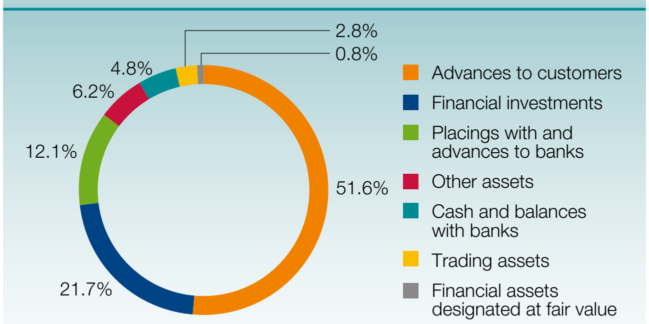
Advances to Customers and Customer Deposits



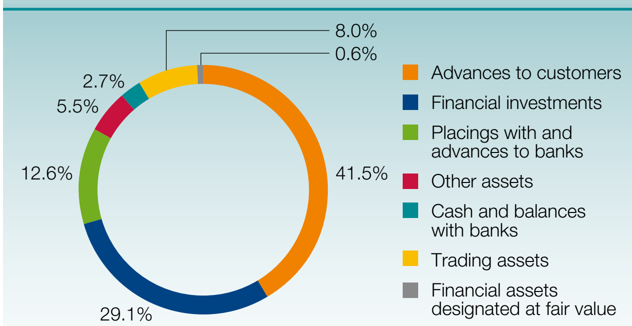
Assets Deployment

Figures in HK$m	2010	%	2009 (restated)	%
Cash and balances with banks and other financial institutions	**44,411**	**4.8**	22,086	2.7
Placings with and advances to banks and other financial institutions	**110,564**	**12.1**	104,551	12.6
Trading assets	**26,055**	**2.8**	66,597	8.0
Financial assets designated at fair value	**7,114**	**0.8**	5,450	0.6
Advances to customers	**472,637**	**51.6**	344,621	41.5
Financial investments	**199,359**	**21.7**	241,502	29.1
Other assets	**56,771**	**6.2**	45,861	5.5
Total assets	**916,911**	**100.0**	830,668	100.0

Assets Deployment for 2010



Assets Deployment for 2009



Advances to Customers

At 31 December 2010, gross advances to customers were up HK$127.9bn, or 36.9%, at HK$474.5bn compared with the previous year-end. Riding on the improved economic conditions and the increased scope of renminbi business in Hong Kong, the Bank leveraged its balance sheet strength to record encouraging lending growth in all core market sectors.

Loans for use in Hong Kong increased by HK$76.2bn, or 26.2%. Riding in part on the buoyancy of property and investment markets, the Bank achieved strong growth in lending to the property development and property investment sectors. The Bank continued to actively participate in the Hong Kong government's SME Loan Guarantee and Special Loan Guarantee schemes. Lending to customers in the manufacturing and wholesale and retail trade sectors grew by 40.6% and 46.4% respectively. The increase in lending to transport and transport equipment and information technology sectors was mainly due to new drawdowns by a number of large Commercial Banking customers. Growth in lending to "Other" was attributable to new working capital financing for several large corporations.

Lending to individuals rose by HK$19.7bn, or 14.3%. Residential mortgage lending to individuals grew by 16.3% and the Bank maintained its position as one of the leading providers of residential mortgages in Hong Kong amid intense market competition.

Against a backdrop of robust domestic consumption, card advances grew by 13.9%, supported by an 11.2% rise in the number of cards in issue and an 18.4% increase in cardholder spending. Lending to the "Other" sector, including mainly personal loans and overdrafts, rose by 15.2%, due in part to a series of successful promotional initiatives.

Commercial Banking strengthened its cross-border service proposition to offer a full range of renminbi commercial banking services and serve the growing demand from customers for renminbi-related financial solutions. This largely underpinned the 231.3% growth in trade financing.

Loans for use outside Hong Kong increased by 20.0%, due largely to the 28.4% expansion in the mainland loan portfolio, which stood at HK$36.4bn at 2010 year-end. The Group remained vigilant in assessing credit risk in increasing lending on the Mainland.

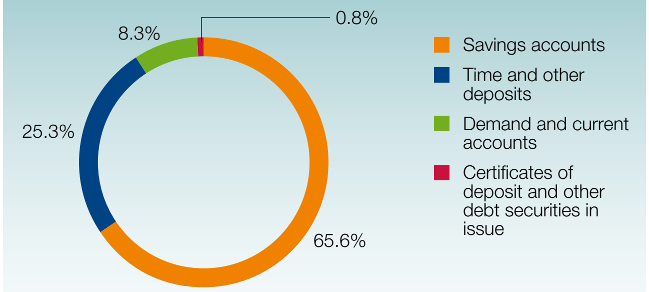
Customer Deposits

Customer deposits and certificates of deposit and other debt securities in issue stood at HK$710.3bn at 31 December 2010, an increase of 7.0% over the end of 2009. Growth was recorded in savings and current account balances. The increase in time and other deposits mainly reflects the 76.1% growth in customer deposits with Hang Seng China.

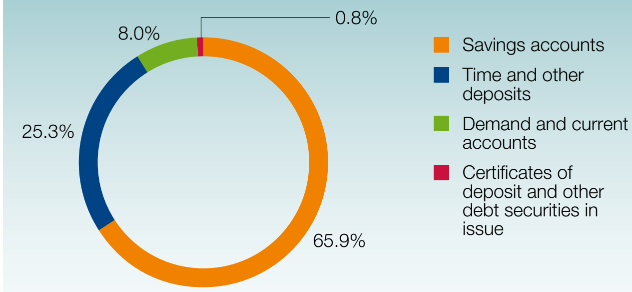
Subordinated Liabilities

The outstanding subordinated notes, which qualify as supplementary capital, serve to help the Bank maintain a more balanced capital structure and support business growth.

Customer Deposits for 2010



Customer Deposits for 2009



Shareholders' funds

Figures in HK$m	**2010**	2009 (restated)
Share capital	**9,559**	9,559
Retained profits	**42,966**	37,752
Premises revaluation reserve	**9,426**	7,885
Cash flow hedging reserve	**72**	174
Available-for-sale investment reserve		
– on debt securities	**(25)**	(496)
– on equity securities	**227**	239
Capital redemption reserve	**99**	99
Other reserves	**4,055**	3,303
Total reserves	**56,820**	48,956
	66,379	58,515
Proposed dividends	**3,633**	3,633
Shareholders' funds	**70,012**	62,148
Return on average shareholders' funds	**22.8%**	22.9%

Shareholders' funds (excluding proposed dividends) grew by HK$7,864m, or 13.4%, to HK$66,379m at 31 December 2010. Retained profits rose by HK$5,214m, mainly reflecting the growth in 2010 profit after the appropriation of interim dividends. The premises revaluation reserve increased by HK$1,541m, or 19.5%, compared with 2009, boosted by the robust property market. The premises revaluation reserve for 2010 and 2009 includes leasehold land held under a long lease for the Bank's headquarters building after adopting the amendments to HKAS 17 "Leases" in 2010.

The available-for-sale investment reserve for debt securities recorded a deficit of HK$25m compared with a deficit of HK$496m at 2009 year-end, reflecting the improvement in global credit markets and the disposal of high-risk assets under the Bank's prudent risk management strategy. The Group assessed that there were no impaired debt securities during the year, and accordingly, no impairment loss has been recognised.

The return on average shareholders' funds was 22.8%, compared with 22.9% for 2009.

Excluding the redemption of all the (1) Series A – HK$1,000m 4.125% subordinated notes due 2015 and (2) Series B – HK$1,500m floating rate subordinated notes due 2015, both at par on 24 June 2010, there was no purchase, sale or redemption by the Bank, or any of its subsidiaries, of the Bank's securities during 2010.

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, legal, operational, reputational and strategic. The Group has established policies and procedures to identify, measure, analyse and actively manage the risks and to set appropriate risk limits to control this broad spectrum of risks. In line with best practices, the Bank's Risk Management Committee exercises oversight of the risk management framework for the Bank. The Risk Management Committee is constituted by the Board and accountable to the Executive Committee. Its main functions are to review, analyse, evaluate, recognise and manage various risks of the Bank and is responsible for approval of all risk management related policies and major control limits. 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 and Asset and Liability Management Committee.

Note 61 "Financial risk management" to the financial statements provides a detailed discussion and analysis of the Group's credit risk, liquidity risk, market 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 fair and transparent dealings with customers, conflicts of interest, money laundering deterrence, environmental impact and anti-corruption measures. The reputational downside to the Group is fully appraised before any strategic decision is taken.

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