

## CORPORATE GOVERNANCE AND OTHER INFORMATION

Hang Seng Bank Limited (the “Bank”) is committed to high standards of corporate governance with a view to safeguarding the interests of shareholders, customers, staff and other stakeholders. The Bank has followed the module on “Corporate Governance of Locally Incorporated Authorised Institutions” under the Supervisory Policy Manual (“SPM”) issued by the Hong Kong Monetary Authority (“HKMA”) and has fully complied with all the code provisions and most of the recommended best practices as set out in the Code on Corporate Governance Practices contained in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the “Listing Rules”) throughout the year. The Bank also constantly reviews and enhances its corporate governance framework to ensure that it is in line with international and local best practices.

### BOARD OF DIRECTORS

The Board has collective responsibilities for leadership and control of, and for promoting the long-term sustainability and success of, the Bank by directing and supervising the Bank’s affairs; and for performing its corporate governance duties to ensure the Bank’s economic efficiency.

The types of decisions which are to be taken by the Board include those relating to:

- strategic plan and objectives;
- annual operating plans and performance targets;
- annual and interim results;
- capital plans and management;
- risk appetite and profile;
- internal control and risk management governance;
- significant policies such as large credit exposure policy, liquidity management policy and remuneration policy;
- specified senior appointments;
- acquisitions and disposals above predetermined thresholds; and
- significant changes to balance sheet management policies.

### CHAIRMAN AND CHIEF EXECUTIVE

The roles of Chairman of the Board and Chief Executive of the Bank are separate, with a clear division of responsibilities. The Chairman of the Board is an Independent Non-executive Director who is responsible for the leadership and effective running of the Board. The Chief Executive is an Executive Director who exercises all the powers, authorities and discretions of the Executive Committee as may be delegated to her in respect of the Bank and its subsidiaries.

### BOARD COMPOSITION

As at the date of this Annual Report, the Board comprises 16 Directors, of whom two are Executive Directors and 14 are Non-executive Directors. Of the 14 Non-executive Directors, nine are Independent Non-executive Directors. There is a strong independent element on the Board, to ensure the independence and objectivity of the Board’s decision-making process as well as the thoroughness and impartiality of the Board’s oversight of the Management.

All the Independent Non-executive Directors meet the guidelines for assessment of independence as set out in Rule 3.13 of the Listing Rules. The Bank has also received from each of the Independent Non-executive Directors an annual confirmation of his/her independence.

Members of the Board, who come from a variety of different backgrounds, have a diverse range of business, banking and professional expertise. Brief biographical particulars of all the Directors, together with information relating to the relationship among them, are set out in the section “Biographical Details of Directors” in this Annual Report.

### BOARD PROCESS

Regular Board/Board Committee meeting schedules for each year are made available to all Directors/Board Committee members before the end of the preceding year. In addition, notice of meetings will be given to all Directors at least 14 days before each Board meeting.

Other than regular Board meetings, the Chairman also met with Non-executive Directors, including Independent Non-executive Directors, without the presence of Executive Directors, to facilitate an open and frank discussion among the Non-executive Directors on issues relating to the Bank.

Meeting agendas for regular Board meetings are set after consultation with the Chairman and the Chief Executive. All Directors are given an opportunity to include matters in the agenda. Regular reports include the Bank's financial performance, strategic plan, risk appetite and profile, review of internal control and risk management framework, results of stress testings, as well as large credit exposures and connected lendings of the Bank and its subsidiaries.

Minutes of Board/Board Committee meetings with details of the matters discussed by the Board/Board Committee and decisions made, including any concerns or views of the Directors/Board Committee members, are kept by the Company Secretary and are open for inspection by Directors/Board Committee members.

During 2011, the important matters discussed at Board meetings included:

- financial and business performance;
- strategic plan for the period from 2012 to 2014;
- risk appetite statement and profile;
- capital plan and management, and internal capital adequacy assessment process;
- results of stress testings on the Bank's rolling operating plan;
- significant policies such as large credit exposure policy and strategic risk management policy;
- liquidity contingency plan;
- corporate values implementation;
- appointments of Directors and senior executives; and
- pay review for 2011 and variable pay for 2010.

The Board reviews and evaluates its work process and effectiveness annually, with a view to identifying areas for improvement and further enhancement.

All Directors have access to the Executive Directors as and when they consider necessary. They also have access to the Company Secretary who is responsible for ensuring that the Board procedures, and related rules and regulations, are followed.

Under the Articles of Association of the Bank, a Director shall not vote or be counted in the quorum in respect of any contract, arrangement, transaction or other proposal in which he/she or his/her associate(s), is/are materially interested.

### APPOINTMENT, RE-ELECTION AND REMOVAL

The Bank's Articles of Association provide that each Director is required to retire by rotation once every three years and that one-third (or the number nearest to one-third) of the Directors shall retire from office every year at the Bank's Annual General Meeting. A Director's specific term of appointment, therefore, cannot exceed three years. Retiring Directors are eligible for re-election at Annual General Meetings of the Bank.

The Bank uses a formal, considered and transparent procedure for the appointment of new Directors. Before a prospective Director's name is formally proposed, opinions of the existing Directors (including the Independent Non-executive Directors) will be solicited. The appointment will be considered and if thought fit, approved by the Board after due deliberation. In accordance with the requirement under the Banking Ordinance, approval from HKMA will also be obtained. All new Directors are subject to election by shareholders of the Bank at the next Annual General Meeting after their appointments have become effective.

Three new Directors have been appointed since 2011 Annual General Meeting, namely, Mr Andrew H C Fung, Ms Anita Y M Fung and Dr Fred Zulu Hu. The aforesaid Directors will all stand for election by the Bank's shareholders at the Bank's Annual General Meeting to be held on 11 May 2012.

### RESPONSIBILITIES OF DIRECTORS

The Bank regularly reminds all Directors of their role and responsibilities. Through regular Board meetings, all Directors are kept abreast of the conduct, business activities and development of the Bank.

Induction programmes on the following key areas are arranged for newly appointed Directors:

- the Bank's business operations in Hong Kong, including retail banking and wealth management, corporate and commercial banking, treasury and investment services;
- the Bank's business operations on the Mainland; and

- the Bank's financial control, risk management, internal audit, compliance, information technology and support, and human resources.

All Directors are given opportunities to update and develop their skills and knowledge.

All Directors have full and timely access to all relevant information about the Bank so that they can discharge their duties and responsibilities as Directors. There are established procedures for Directors to seek independent professional advice on matters relating to the Bank where appropriate. All costs associated with obtaining such advice will be borne by the Bank. In addition, each Director has separate and independent access to the Bank's senior management.

The Bank has adopted a Code for Securities Transactions by Directors on terms no less exacting than the required standards as set out in the Model Code for Securities Transactions by Directors of Listed Issuers (as set out in Appendix 10 to the Listing Rules). Specific enquiries have been made with all Directors who have confirmed that they have complied with the Bank's Code for Securities Transactions by Directors throughout the year of 2011.

Appropriate Directors' liability insurance cover has also been arranged to indemnify the Directors for liabilities arising out of corporate activities. The coverage and the sum insured under the policy are reviewed annually.

The interests in Group securities, including securities relating to HSBC Holdings plc and the Bank, held by the Directors as at 31 December 2011 are disclosed in the Report of the Directors as set out in this Annual Report.

## DELEGATION BY THE BOARD

### BOARD COMMITTEES

The Board has set up three committees, namely, the Executive Committee, the Audit Committee and the Remuneration Committee, to assist it in carrying out its responsibilities.

Each of these committees has specific written terms of reference which set out in detail their respective authorities and responsibilities. All committees, except the Executive Committee, comprise solely of Independent Non-executive Directors. All committees report back to the Board on their decisions or recommendations on a regular basis.

BOARD		
Executive Committee	Audit Committee	Remuneration Committee
Members: Mrs Margaret Leung (Chairman)	Members: Dr Eric K C Li* (Chairman)	Members: Dr John C C Chan* (Chairman)
Mr Andrew H C Fung	Mr Richard Y S Tang*	Mr Jenkin Hui*
Mr Nixon L S Chan	Dr Marvin K T Cheung*	Dr Raymond K F Ch'ien*
Mr Andrew W L Leung		
Mr Christopher H N Ho		
Mr Donald Y S Lam		
Mr Nai Pan Tang		

\* Independent Non-executive Directors

## EXECUTIVE COMMITTEE

The Executive Committee meets at least once each month and operates as a general management committee under the direct authority of the Board. It exercises the powers, authorities and discretions as delegated by the Board in so far as they concern the management and day-to-day running of the Bank in accordance with its terms of reference and such other policies and directives as the Board may determine from time to time. The Executive Committee also sub-delegates credit, investment and capital expenditure authorities to its members and senior executives.

To further enhance the Bank's risk management framework and in line with best practices, the Bank has set up a Risk Management Committee to centralise the risk management oversight function of the Bank and its subsidiaries. The Risk Management Committee reports directly to the Executive Committee. Its main functions are to review, analyse, evaluate, recognise and manage various risks of the Bank, including all the eight types of risks stipulated in the SPM of HKMA, namely, credit risk, market risk, liquidity risk, interest rate risk, operational risk, legal and compliance risk, reputation risk and strategic risk. In addition, the Risk Management Committee also covers insurance risk, pension risk and sustainability risk, and is responsible for approval of all risk management related policies.

## AUDIT COMMITTEE

The Audit Committee meets at least four times a year, with the Bank's executives including, but not limited to, the Chief Financial Officer, the Chief Risk Officer, the Chief Compliance Officer and the Head of Audit, and representatives of the external auditor, to consider, among other things, the Bank's financial reporting, the nature and scope of audit reviews, the effectiveness of the systems of internal control and compliance, and high level risk related matters and risk governance (including, but not limited to, current and forward-looking risk exposures, the Group's risk appetite and future risk strategy; and management of risk within the Group). It is also responsible for making recommendations to the Board on the appointment, re-appointment, removal and remuneration of the Bank's external auditor. In addition, the Audit Committee has also established a "Policy for the Reporting of Improprieties" to provide a secured and confidential channel through which all staff members may report incidents of improprieties to the Chief Executive of the Bank so that appropriate actions can be taken promptly.

The Audit Committee reports to the Board following each Audit Committee meeting, drawing the Board's attention to salient points that the Board should be aware of, identifying any matters in respect of which it considers that action or improvement is needed and making relevant recommendations.

The Audit Committee held five meetings in 2011. The major work performed by the Committee during 2011 included:

- reviewing the Bank's financial statements for the year ended 31 December 2010 and the related documents, and the management letter and audit issues noted by the Bank's external auditor;
- reviewing the Bank's interim financial statements for the six months ended 30 June 2011 and the related documents, and the issues noted by the Bank's external auditor;
- reviewing essential matters or reports relating to financial control, internal audit, compliance and internal control, and discussing the same with the Management;
- reviewing risk-related matters (including, but not limited to, the Bank's risk management framework, risk appetite statement, enterprise stress testing analysis, risk dashboards, risk maps, top and emerging risks, and balance sheet management position), and the adequacy of resources of the risk management function of the Bank;
- reviewing regulatory review reports and internal audit reports, and discussing the same with the Management and Head of Audit;
- reviewing the revised accounting standards and prospective changes to accounting standards, and the impact on the Bank's financial reporting;
- reviewing the internal audit plan for 2012;
- reviewing the remuneration and engagement letters of the Bank's external auditor, and its objectivity and independence;
- reviewing the adequacy of resources, qualifications and experience of the staff of the accounting and financial reporting function of the Bank, and their training programme and budget, and succession planning for key roles of the function;

- reviewing the implementation progress of Sarbanes-Oxley Act;
- reviewing the Bank's capital plan, capital management and internal capital adequacy assessment process;
- reviewing the Bank's progress in implementing Basel III;
- reviewing the effectiveness of the Policy for the Reporting of Improperities and the incidents reported through such channel; and
- exercising oversight over the audit committees and, where applicable, risk committee of the Bank's principal subsidiaries.

The Audit Committee meets with the representatives of the Bank's external auditor and Head of Audit on a regular basis and also meets with them without the presence of the Management at least once a year. Further, the Committee meets with the representatives of HKMA to maintain a regular dialogue with the regulator and to share HKMA's general views on their supervisory focus.

In order to identify areas for further enhancements, the Audit Committee conducts an annual gap analysis as regards the effective discharge of its role and responsibilities pursuant to its terms of reference.

### REMUNERATION COMMITTEE

The Remuneration Committee meets at least twice a year to consider human resources issues and make recommendations to the Board on the Bank's policy and structure for all remuneration and fees of Directors, senior management and key personnel in order to attract, motivate and retain quality personnel. The Committee also determines the remuneration policy of the Bank and its subsidiaries, and the specific remuneration packages of all Executive Directors, senior management and key personnel. In addition, the Committee also reviews annually and independently of the Management, the adequacy and effectiveness of the Bank's remuneration policy and its implementation to ensure that the Bank's remuneration policy is consistent with regulatory requirements and promote effective risk management.

In determining the bank-wide remuneration policy, the Remuneration Committee will take into account the Bank's business objective, people strategy, short-term and long-term performance, business and economic environment conditions, market practices and risk management needs, in order to ensure the remuneration aligns with business and individual performances, promotes effective risk management, facilitates retention of quality personnel and is competitive in the market. The Committee may invite any Director, executive, consultant or other relevant party to provide advice in this respect.

The Remuneration Committee held two meetings in 2011. The major work performed by the Committee during 2011 included:

- reviewing the fees payable to the Directors and Board Committee Chairmen/members of the Bank and its subsidiaries and recommending the same to the Board for approval;
- determining the remuneration packages of the Executive Directors, senior management and key personnel of the Bank; and the Vice Chairman and Chief Executive of Hang Seng Bank (China) Limited;
- reviewing the proposed variable pay for 2010 and recommending the same to the Board for approval; and
- reviewing the pay review proposal for 2011 and recommending the same to the Board for approval.

At the Remuneration Committee meeting held in February 2012, the Committee also reviewed the outcome of a review conducted by the Bank's internal audit function on the Bank's remuneration policy and remuneration system, and the adequacy and effectiveness of its implementation.

In order to identify areas for further enhancements, the Remuneration Committee conducts an annual gap analysis as regards the effective discharge of its role and responsibilities pursuant to its terms of reference.

## ATTENDANCE RECORDS

The attendance records of Board and Board Committee meetings held in 2011 are set out in the following table:

	Meetings held in 2011				
	2011 AGM	Board	Executive Committee	Audit Committee	Remuneration Committee
Number of Meetings	1	9 <sup>Note 1</sup>	16	6	2
<b>Directors</b>					
Dr Raymond K F Ch'ien* ( <i>Chairman</i> )	1/1	9/9	–	–	2/2
Mrs Margaret Leung ( <i>Vice-Chairman and Chief Executive</i> )	1/1	9/9	16/16	–	–
Dr John C C Chan*	1/1	9/9	–	–	2/2
Dr Marvin K T Cheung*	1/1	7/9	–	6/6	–
Ms L Y Chiang*	1/1	9/9	–	–	–
Mr Andrew H C Fung <sup>Note 2</sup>	–	2/2	13/16	–	–
Ms Anita Y M Fung <sup># Note 3</sup>	–	1/2	–	–	–
Dr Fred Zulu Hu* <sup>Note 4</sup>	–	5/5	–	–	–
Mr Jenkin Hui*	1/1	7/9	–	–	2/2
Ms Sarah C Legg <sup># Note 5</sup>	1/1	6/8	–	–	–
Mr William W Leung <sup>Note 6</sup>	1/1	5/5	10/11	–	–
Dr Eric K C Li*	1/1	8/9	–	6/6	–
Dr Vincent H S Lo <sup>#</sup>	1/1	6/9	–	–	–
Mr Mark S McCombe <sup># Note 7</sup>	1/1	4/5	–	–	–
Mrs Dorothy K Y P Sit <sup>#</sup>	1/1	9/9	–	–	–
Mr Richard Y S Tang*	1/1	9/9	–	6/6	–
Mr Peter T S Wong <sup>#</sup>	1/1	6/9	–	–	–
Mr Michael W K Wu*	1/1	9/9	–	–	–
<b>Senior Executives</b>					
Mr Nixon L S Chan	–	–	16/16	–	–
Mr Christopher H N Ho	–	–	14/16	–	–
Mr Donald Y S Lam <sup>Note 8</sup>	–	–	4/4	–	–
Mr Andrew W L Leung	–	–	14/16	–	–
Mr David W H Tam <sup>Note 9</sup>	–	–	13/16	–	–
<b>Average Attendance Rate</b>	100%	88%	91%	100%	100%

\* Independent Non-executive Directors

# Non-executive Directors

<sup>Note 1</sup> The Board held seven regular meetings, one special meeting and one strategic session in year 2011.

<sup>Note 2</sup> Mr Andrew H C Fung was appointed as Executive Director with effect from 10 October 2011.

<sup>Note 3</sup> Ms Anita Y M Fung was appointed as Non-executive Director with effect from 1 November 2011. She attended the Board's strategic session held in October 2011 in Shanghai as a Director Designate.

<sup>Note 4</sup> Dr Fred Zulu Hu was appointed as Independent Non-executive Director with effect from 30 May 2011.

<sup>Note 5</sup> Ms Sarah C Legg was appointed as Non-executive Director with effect from 14 February 2011.

<sup>Note 6</sup> Mr William W Leung resigned from the Board with effect from 20 August 2011.

<sup>Note 7</sup> Mr Mark S McCombe resigned from the Board with effect from 9 September 2011.

<sup>Note 8</sup> Mr Donald Y S Lam was appointed as a member of the Executive Committee with effect from 7 September 2011.

<sup>Note 9</sup> Mr David W H Tam retired and ceased to be a member of the Executive Committee with effect from 28 January 2012.

## REMUNERATION OF DIRECTORS, SENIOR MANAGEMENT AND KEY PERSONNEL

The Bank's policy on remuneration is to maintain fair and competitive packages based on business needs and industry practice.

### REMUNERATION OF DIRECTORS

The level of fees paid to Non-executive Directors is determined by reference to factors including fees paid by comparable institutions, and Directors' workload and commitments.

The following factors are considered when determining the remuneration packages of Executive Directors:

- business needs;
- general economic situation;
- changes in appropriate markets such as supply/demand fluctuations and changes in competitive conditions;
- individual contributions to results as confirmed in the performance appraisal process; and
- retention consideration and individual potential.

No individual Director will be involved in decisions relating to his/her own remuneration.

The current scales of Director's fees, and additional fees for Chairmen and members of the Audit Committee and Remuneration Committee are set out below:

	Fees (HK\$)
<b>Board of Directors</b>	
Chairman	440,000
Vice-Chairman	Nil <sup>Note 10</sup>
Other Directors	340,000 <sup>Note 10</sup>
<b>Audit Committee</b>	
Chairman	260,000
Members	160,000
<b>Remuneration Committee</b>	
Chairman	90,000
Members	60,000

<sup>Note 10</sup> In line with the remuneration policy of HSBC Group, no Directors' fees are paid to those Directors who are full time employees of the Bank or its subsidiaries.

Information relating to the remuneration of each Director for the year ended 31 December 2011 is set out in Note 19 to the Bank's 2011 Financial Statements.

### REMUNERATION OF SENIOR MANAGEMENT AND KEY PERSONNEL

There were 11 and two employees being classified as Senior Management and Key Personnel respectively during the financial year 2011.

Aggregate amount of remuneration of Senior Management<sup>Note 11</sup> and Key Personnel<sup>Note 12</sup> during the financial year 2011, split into fixed and variable remuneration, is set out below:

Amount of remuneration for the financial year 2011* (HK\$)	Non-deferred	Deferred
<b>Fixed remuneration</b>		
Cash	39,004,000	–
<b>Variable remuneration</b>		
Cash	14,158,000	4,672,000
Shares	3,115,000	7,029,000

\* Remuneration refers to all remuneration payments payable to employees during the period between 1 January 2011 and 31 December 2011. For those employees who left the Bank during the financial year 2011, termination payments calculated up to their last employment date are also included.

<sup>Note 11</sup> Senior Management refers to those executives who are the heads of major business lines and functions.

<sup>Note 12</sup> Key Personnel refers to those executives other than Senior Management who are engaged in trading and dealing activities which involve the assumption of material risk or the taking on of material exposures on behalf of the Bank.

Aggregate amount of deferred variable remuneration, split into (i) vested and paid during the financial year 2011 and (ii) outstanding and unvested as at 31 December 2011 is set out below:

Amount (HK\$)	Awarded for Performance Year 2011	Awarded for Prior Performance Years
<b>Vested and paid during 2011</b>		
Cash	–	–
Shares	–	14,770,000
<b>Outstanding and unvested as at 31 December 2011</b>		
Cash	4,672,000	4,767,000
Shares	7,029,000	29,156,000

There was no deferred variable remuneration being reduced through performance adjustments in 2011.

Quantitative information on employees' exposure to implicit (e.g. fluctuations in the value of shares or performance units) and explicit adjustments (e.g. malus, clawbacks or similar reversals or downward revaluations of awards) of deferred remuneration and retained remuneration is set out below:

	Amount (HK\$)
Total amount of outstanding deferred remuneration and retained remuneration exposed to ex post explicit/implicit adjustments	45,624,000
Total amount of reductions during the financial year 2011 due to:	
– Ex post explicit adjustments	–
– Ex post implicit adjustments	(1,924,000)

No Senior Management and Key Personnel has been awarded or paid guaranteed bonus, new sign-on or severance payment during the financial year 2011.

## ACCOUNTABILITY AND AUDIT FINANCIAL REPORTING

The Board aims at making a balanced, clear and comprehensive assessment of the Bank's performance, position and prospects. An annual operating plan is reviewed and approved by the Board on a yearly basis. Reports on financial results, business performance and variances against the approved annual operating plan are submitted to the Board for regular discussion and monitoring at Board meetings.

Strategic planning cycles are generally from three to five years. The Bank's strategic plan for 2012 to 2014 was reviewed by the Board in October 2011. Progress on the implementation of the key initiatives in the strategic plan will be reported to and reviewed by the Board on a regular basis.

The annual and interim results of the Bank are announced in a timely manner within the limits of three months and two months respectively after the end of the relevant year or period.

The Directors acknowledge their responsibilities for preparing the accounts of the Bank. As at 31 December 2011, the Directors were not aware of any material uncertainties relating to events or conditions which may cast significant doubt upon the Bank's ability to continue as a going concern. Accordingly, the Directors have prepared the financial statements of the Bank on a going-concern basis.

The responsibilities of the external auditor with respect to financial reporting are set out in the Independent Auditor's Report attached to the Bank's 2011 Financial Statements.



## INTERNAL CONTROLS

### System and Procedures

The Board is responsible for internal control at the Bank and its subsidiaries and for reviewing its effectiveness.

The Bank's internal control system comprises a well-established organisational structure and comprehensive policies and standards. Areas of responsibilities for each business and functional unit are clearly defined to ensure effective checks and balances.

Procedures have been designed for safeguarding assets against unauthorised use or disposition; for maintaining proper accounting records; and for ensuring the reliability of financial information used within the business or for publication. The procedures provide reasonable but not absolute assurance against material errors, losses or fraud. Procedures have also been designed to ensure compliance with applicable laws, rules and regulations.

Systems and procedures are in place in the Bank to identify, control and report on the major types of risks the Bank faces. Business and functional units are responsible for the assessment of individual types of risk arising under their areas of responsibilities, the management of the risks in accordance with risk management procedures and reporting on risk management. The Board maintains an effective risk management framework through the Risk Management Committee which reports to the Executive Committee by setting up of specialised management committees for supervision of major risk areas and the establishment of risk management departments for relevant functions of the Bank. The scope of responsibilities of the Audit Committee has also been expanded to cover risk management oversight. The relevant risk management reports are submitted to Asset and Liability Management Committee, Risk Management Committee, Executive Committee and Audit Committee, and ultimately to the Board for monitoring the respective types of risk. The Bank's risk management policies and major control limits are approved by the Board or its delegated committees, and are monitored and reviewed regularly according to established procedures of the Bank.

More detailed discussions on the policies and procedures for management of each of the major types of risk the Bank faces, including credit, liquidity, market, insurance, operational and reputational risks, are included in the risk management section of the "Financial Review" under the Bank's 2011 Annual Report, and in Note 61 to the Bank's 2011 Financial Statements.

### Annual Assessment

A review of the effectiveness of the Bank's internal control system covering all material controls, including financial, operational, compliance, and risk management controls, is conducted annually. The review at the end of 2011 was conducted with reference to the COSO (The Committee of Sponsoring Organisations of the Treadway Commission) internal control framework, which assesses the Bank's internal control system against the five elements of control environment, risk assessment, control activities, information and communication, and monitoring. The Bank has also conducted an annual review to assess the adequacy of resources, qualifications and experience of staff of the Bank's accounting and financial reporting function, and their training programmes and budget, and succession planning for key roles of the function. The approach, findings, analysis and results of these annual reviews have been reported to the Audit Committee and the Board.

## FRAMEWORK FOR DISCLOSURE OF PRICE-SENSITIVE INFORMATION

The Bank has put in place a robust framework for the disclosure of price-sensitive information in compliance with the Listing Rules and other regulatory requirements in this respect. The framework sets out the procedures and internal controls for the handling and dissemination of price-sensitive information in a timely manner so as to allow the shareholders, customers, staff and other stakeholders to apprehend the latest position of the Bank and its subsidiaries. The framework and its effectiveness are subject to review on a regular basis according to established procedures.

### INTERNAL AUDIT

The internal audit function plays an important role in the Bank's risk management and internal control framework. It provides independent and objective assurance to the Management and the Audit Committee in this respect with a view to adding value and enhancing the Bank's operations. It also facilitates the Management accomplish its objectives through a systematic and disciplined approach to the evaluation and strengthening of the effectiveness of risk management, control, and governance processes. The scope of work of the internal audit function is to determine whether the framework of risk management, control, and governance processes, as designed and represented by the Management, is adequate and effective. Opportunities for reinforcing management control, profitability, best practice and the Bank's corporate image may be identified during audits and will be communicated to the appropriate level of the Management. The Bank's Head of Audit reports to the Chairman and the Audit Committee.

## EXTERNAL AUDITOR

KPMG is the Bank's external auditor. The Audit Committee is responsible for making recommendations to the Board on the appointment, re-appointment, removal and remuneration of the external auditor. The external auditor's independence and objectivity are also reviewed and monitored by the Audit Committee on a regular basis.

During 2011, fees paid to the Bank's external auditor for audit services amounted to HK\$13.3m, same as in 2010. For non-audit services, the fees paid to the Bank's external auditor amounted to HK\$6.7m, compared with HK\$5.8m in 2010. In 2011, the significant non-audit service assignments covered by these fees include the following:

Nature of service	Fees paid (HK\$m)
Other assurance services	6.5
Tax services	0.2
	<u>6.7</u>

## AUDIT COMMITTEE

The Audit Committee assists the Board in meeting its responsibilities for ensuring effective systems of risk management, internal control and compliance, and in meeting its financial reporting obligations.

## COMMUNICATION WITH SHAREHOLDERS

### EFFECTIVE COMMUNICATION

The Bank attaches great importance to communication with shareholders. To this end, a number of means are used to promote greater understanding and dialogue with the investment community. The Bank holds group meetings with analysts in connection with the Bank's annual and interim results. The results announcements are also broadcast live via webcast. Apart from the above, designated senior executives maintain regular dialogue with institutional investors and analysts to keep them abreast of the Bank's development, subject to compliance with the applicable laws and regulations. Including the two results announcements, over a hundred meetings with analysts and fund managers were held in 2011. In addition, the Bank's Vice-Chairman and Chief Executive; and Chief Financial Officer also made presentations and held group meetings with investors at investor forums in Hong Kong and overseas.

Further, the Bank's website ([www.hangseng.com](http://www.hangseng.com)) contains an investor relations section which offers timely access to the Bank's press releases, other business information and information on the Bank's corporate governance structure and practices. For efficient communication with shareholders and in the interest of environmental preservation, shareholders are encouraged to browse the Bank's corporate communications on the Bank's website, in the place of receiving printed copies of the same.

The Annual General Meeting provides a useful forum for shareholders to exchange views with the Board. The Bank's Chairman, Executive Directors, Chairmen of the Board Committees and Non-executive Directors are available at the Annual General Meeting to answer questions from shareholders about the business and performance of the Bank. In addition, the Bank's external auditor is also invited to attend the Annual General Meeting to answer questions about the conduct of the audit, and the preparation and contents of the auditor's report. Separate resolutions are proposed at general meetings for each substantial issue, including the re-election and election (as the case may be) of individual Directors. An explanation of the detailed procedures of conducting a poll will be provided to shareholders at the Annual General Meeting, to ensure that shareholders are familiar with such procedures.

The Bank's last Annual General Meeting was held on Friday, 13 May 2011 at Hang Seng Bank Headquarters, 83 Des Voeux Road Central, Hong Kong. All the resolutions proposed at that meeting were approved by the shareholders by poll voting. Details of the poll results are available under the investor relations section of the Bank's website at [www.hangseng.com](http://www.hangseng.com).

The next Annual General Meeting will be held on Friday, 11 May 2012, the notice of which will be sent to shareholders at least 20 clear business days before the said meeting. Shareholders may refer to the section "Corporate Information and Calendar" in this Annual Report for information on other important dates for shareholders in year 2012.

### CALLING AN EXTRAORDINARY GENERAL MEETING

Shareholder(s) holding not less than 5 percent of the paid-up capital of the Bank may requisition an Extraordinary General Meeting of the Bank.

The requisition must (i) state the objects of the meeting, (ii) be signed by the requisitionist(s) and (iii) be deposited at the Bank's registered office at 83 Des Voeux Road Central, Hong Kong. It may also consist of several documents in like form, each signed by one or more requisitionist(s).

The requisition must also (i) state the name(s) of the requisitionist(s), (ii) the contact details of the requisitionist(s) and (iii) the number of ordinary shares of the Bank held by the requisitionist(s).

The Directors must proceed to convene an Extraordinary General Meeting within 21 days from the date of the deposit of the requisition. Such meeting should be held on a day not more than 28 days after the date on which the notice convening the meeting is given.

If the Directors fail to convene the Extraordinary General Meeting as aforesaid, the requisitionist(s), or any of them representing more than one-half of the total voting rights of all of them, may themselves convene the meeting. Any meeting so convened shall not be held after the expiration of three months from the date of the deposit of the requisition.

A meeting so convened by the requisitionist(s) shall be convened in the same manner, as nearly as possible, as that in which meetings are to be convened by the Directors.

Any reasonable expenses incurred by the requisitionist(s) by reason of the failure of the Directors duly to convene a meeting shall be repaid to the requisitionist(s) by the Bank.

#### **PUTTING FORWARD PROPOSALS AT GENERAL MEETINGS**

Shareholders holding not less than 2.5 percent of the paid-up capital of the Bank, or, not less than 50 shareholders each holding specified number of shares in the Bank, may :

- put forward proposal at general meeting;
- circulate to other shareholders written statement with respect to matter to be dealt with at general meeting.

For further details on the shareholder qualifications, and the procedures and timeline, in connection with the above, shareholders are kindly requested to refer to Section 115A of the Companies Ordinance (Chapter 32 of the Laws of Hong Kong).

Further, a shareholder may propose a person other than a retiring Director of the Bank for election as a Director of the Bank at a general meeting. For such purpose, the shareholder must send to the Bank's registered address (for the attention of the Bank's Company Secretary) a written notice which identifies the candidate and includes a notice in writing by that candidate of his/her willingness to be so elected. Such notice must be sent within a period of not less than seven days commencing no earlier than the day after the despatch of the notice of the meeting appointed for such election and ending no later than seven days prior to the date of such meeting.

#### **PUTTING ENQUIRIES TO THE BOARD**

Shareholders may send their enquiries requiring the Board's attention to the Bank's Company Secretary at the Bank's registered address. Questions about the procedures for convening or putting forward proposals at an Annual General Meeting or Extraordinary General Meeting may also be put to the Company Secretary by the same means.

#### **SHAREHOLDERS COMMUNICATION POLICY**

The Bank has established a Shareholders Communication Policy to set out the Bank's processes to provide shareholders and the investment community with ready, equal and timely information on the Bank for them to make informed assessments of the Bank's strategy, operations and financial performance, and to encourage them to take active interest in the Bank.

#### **MATERIAL RELATED PARTY TRANSACTIONS AND CONNECTED TRANSACTIONS**

##### **MATERIAL RELATED PARTY TRANSACTIONS AND CONTRACTS OF SIGNIFICANCE**

The Bank's material related party transactions are set out in Note 60 to the 2011 Financial Statements. These transactions include those that the Bank has entered into with its immediate holding company and fellow subsidiary companies in the ordinary course of its interbank activities, including the acceptance and placement of interbank deposits, corresponding banking transactions, off-balance sheet transactions, and the provision of other banking and financial services.

The Bank uses the information technology services of, and shares an automated teller machine network with, The Hongkong and Shanghai Banking Corporation Limited, its immediate holding company. The Bank also shares information technology and certain processing services with fellow subsidiaries on a cost recovery basis. In 2011, the Bank's share of the costs included HK\$231m for system development, HK\$240m for data processing, and HK\$165m for administrative services.

The Bank maintains a staff retirement benefit scheme for which a fellow subsidiary company acts as insurer and administrator. As part of its ordinary course of business with other financial institutions, the Bank also markets Mandatory Provident Fund products and distributes retail investment funds for fellow subsidiaries, with a fee income of HK\$194m and HK\$53m respectively in 2011. Hang Seng Investment Management Limited, a wholly owned subsidiary of the Bank, manages in the ordinary course of its business a fund administered by a fellow subsidiary, to which management fee rebates were made. The rebate for 2011 amounted to HK\$70m.

These transactions were entered into by the Bank in the ordinary and usual course of business on normal commercial terms, and in relation to those which constituted connected transactions under the Listing Rules, they also complied with applicable requirements under the Listing Rules. The Bank regards its usage of the information technology services of The Hongkong and Shanghai Banking Corporation Limited (amount of information technology services cost incurred for 2011: HK\$473m) as contracts of significance for 2011.

### CONTINUING CONNECTED TRANSACTIONS

On 22 June 2010, Hang Seng Insurance Company Limited ("HSIC"), a wholly-owned subsidiary of the Bank, entered into the following agreements :

- (i) a management services agreement ("Management Services Agreement") with HSBC Life (International) Limited ("INHK") for a term of three years commencing from 22 June 2010, pursuant to which INHK, directly or through one or more of its affiliates, would provide to HSIC certain management services.

INHK would charge HSIC for the provision of the services on a fully absorbed cost basis plus a mark-up of 5%. These charges have been determined following negotiation on an arm's length basis and in accordance with the policy of the HSBC Group, which has taken into account the transfer pricing guidelines of UK and the Organisation for Economic Co-operation and Development.

- (ii) an investment management agreement ("Investment Management Agreement") with HSBC Global Asset Management (Hong Kong) Limited ("AMHK") for a term of three years commencing from 22 June 2010, pursuant to which AMHK would act as investment manager in respect of certain of HSIC's assets held from time to time.

HSIC would pay, on a quarterly basis, to AMHK a fee of between 0.17% and 0.375% per annum of the mean value of the assets under management, which has been determined on an arm's length basis.

Details of the terms of and the caps under the Management Services Agreement and the Investment Management Agreement for the period from 22 June to 31 December 2010, and for the years ending 31 December 2011 and 2012, and for the period from 1 January to 21 June 2013, were announced by the Bank on 22 June 2010.

The Directors believed that the Management Services Agreement would enable HSIC to run at a reasonably low cost structure by leveraging the shared infrastructure and expertise

of INHK. The resulting cost efficiency has contributed to increased competitiveness of HSIC's manufactured products in the market, which the Directors considered to be essential to the future business growth of HSIC.

The Investment Management Agreement was based on the commercial terms set out in the previous investment management agreement which expired on 21 June 2010 and the Directors (including the Independent Non-executive Directors) believed that these terms should remain in place.

INHK and AMHK are both indirect wholly-owned subsidiaries of HSBC Holdings plc, the ultimate controlling shareholder of the Bank and therefore are connected persons of the Bank. Accordingly, the Management Services Agreement and the Investment Management Agreement constituted continuing connected transactions of the Bank. The Bank has complied with the disclosure requirements in accordance with Chapter 14A of the Listing Rules.

For the year ended 31 December 2011, the aggregate amount paid under the Management Services Agreement was HK\$83m, whereas the aggregate amount paid under the Investment Management Agreement was HK\$61m.

In respect of the Management Services Agreement and the Investment Management Agreement which constituted the Bank's continuing connected transactions, all the Independent Non-executive Directors of the Bank have reviewed the said transactions and confirmed that the said transactions have been entered into:

- (i) in the ordinary and usual course of business of the Group;
- (ii) on normal commercial terms; and
- (iii) in accordance with the relevant agreements governing them on terms that are fair and reasonable and in the interests of the Bank and its shareholders as a whole.

Further, the Bank has engaged its external auditor to report on the Group's continuing connected transactions in accordance with Hong Kong Standard on Assurance Engagements 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" and with reference to Practice Note 740 "Auditor's Letter on Continuing Connected Transactions under the Hong Kong Listing Rules" issued by the Hong Kong Institute of Certified Public Accountants. The auditor has issued an unqualified letter containing their findings and conclusions in respect of the continuing connected transactions set out in the preceding paragraphs in accordance with Listing Rule 14A.38. A copy of the auditor's letter has been provided by the Bank to The Stock Exchange of Hong Kong Limited.

## HUMAN RESOURCES

The human resources policies of the Bank are designed to attract people of the highest calibre and to motivate them to excel in their careers, as well as uphold the Bank's brand equity and culture of quality service.

### EMPLOYEE STATISTICS

As at 31 December 2011, the Bank's total headcount was 9,834, representing an increase by 192, or 2.0%, compared with a year earlier. The total headcount comprised 1,407 executives, 4,048 officers and 4,379 clerical and non-clerical staff.

### EMPLOYEE REMUNERATION

The Remuneration Committee oversees the Bank's overall reward strategy and ensures all the reward policies are carefully considered in the context of business objective, people strategy, commercial competitiveness and regulatory guidance during their formulation. The Committee may invite any Director, executive, consultant or other relevant party to provide advice in this respect. The fundamental principles, philosophies and processes are documented in the Bank's remuneration policy.

The Bank adopts a Total Reward Approach. In determining the total remuneration for employees, the Bank will make reference to individual's responsibility, capability and risk profile of the job to ensure an appropriate balance between the fixed pay and variable pay.

Fixed pay is determined by taking into account relevant level and composition of pay in the markets in which the Bank operates. Salaries are reviewed in the context of business performance, individual performance and potential, market practice, internal relativities, risk management requirements and competitiveness compared to peers.

Bank-wide variable remuneration budgets are formulated in consideration of the Bank's business performance, people strategy and the relevant operational and financial risks; and is subject to a periodic review and adjustment by the Bank's Asset and Liability Management Committee against the Bank's latest business performance, financial position and risk appetite profile.

Variable pay is determined with respect to individual's performance against respective financial and non-financial goals and measures, and the relevant governance criteria. This consists of deferred and non-deferred components in the forms of cash and share award. Deferred awards will be granted if the total variable remuneration amount of the relevant employee exceeds the

prescribed thresholds. The deferred award has a vesting period of three years and is subject to adjustment or clawback under certain specific circumstances with respect to the awardee's individual performance or the Bank's overall performance.

The principles of the remuneration policy are applicable to the Bank and its subsidiaries, subject to the local legislative requirements and market practices and proportional to the scope and complexity of the local business.

### EMPLOYEE ENGAGEMENT

The Bank continues to build a best place to work by promoting employee engagement and by driving a diversity and inclusive culture.

The Global People Survey 2011 was completed and follow up actions were taken as a continuous effort to gauge and improve staff engagement. The results showed that our staff's engagement was sustained at a level well above the Best in Class. To foster an engaging, inclusive environment for employees, the Bank advocates appreciation and inclusion across all levels of staff through mass communication and training initiatives.

### GROWTH AND DEVELOPMENT

The Bank is committed to sustain a culture of competence and ethical behaviour with due regard to the principles set out in the SPM CG-6 "Competence and Ethical Behaviour" module issued by HKMA. The Bank has established policies and procedures for monitoring, developing and maintaining the competence levels and ethical behaviour of staff members. These include clear competence criteria for staff members and strong commitment to staff training and development.

In order to fully develop staff competence and potential, the Bank has a comprehensive induction programme that provides new staff with an understanding of the Bank's history, culture, values and corporate governance. To equip staff members to meet future challenges and professional requirements, including those for regulated businesses and activities, the Bank offers a wide range of training and development programmes in the areas of sales and relationship management, product, operations, compliance, credit and risk. The Bank also offers Professional Qualifications and Education Award Scheme to support staff members to pursue professional or academic qualifications. On average, our staff members received six days of training in 2011.

To strengthen the leadership pipeline and help staff members fulfill their personal career goals, the Bank has developed a Leadership and Management Development framework which offers a broad range of leadership and management skills training. To ensure sustainability, the Bank has strategy, measures and metrics to plan and manage succession to critical roles, and to facilitate talent feed to the succession pipeline. Line businesses and the HR function are connected to accelerate the development of talents and high potential staff through a mix of on-the-job training, coaching and learning interventions.

### RECRUITMENT AND RETENTION

Vigorous recruitment activities continued in the first half of year 2011, especially for front-line sales positions, experienced professionals and specialists to meet business needs and for replacement of staff turnover. In view of the uncertain economic outlook since the second half of year 2011, headcount has been closely monitored and external recruitment was restricted only to cases justified by business needs.

Young talents are constantly recruited and groomed through well-structured, intensive development programmes. Further, trainee programmes have been provided for jobs in selected functional areas in order to build pipeline for succession. There were also conscious efforts on retention of talents and key staff through review of career advancement opportunities and remuneration package to ensure market competitiveness.

## OTHER INFORMATION

### BUSINESS PRINCIPLES AND VALUES

The Bank has a set of well-founded business principles and corporate values guiding staff to keep the highest personal standards of integrity as well as to comply with the spirit and letter of all laws and regulations when conducting business. "Courageous Integrity" is the guiding principle whereby every employee has the courage to do the right thing without compromising the ethical standards and integrity, and behaves in a dependable, open and connected way in everyday work. The Bank advocates the living of values by all staff, promotes their awareness and commitment, and empowers leaders and managers to drive values behaviour in the workplace.

### CODE OF CONDUCT

To ensure the Bank operates according to the highest standards of ethical conduct and professional competence, all staff are required to strictly follow the Code of Conduct contained in the Bank's Staff Handbook. With reference to the applicable regulatory guidelines and other industry best practices, the

Code sets out ethical standards and values to which all the Bank's staff are required to adhere and covers various legal, regulatory and ethical issues. These include topics such as prevention of bribery, dealing in securities, personal benefits, outside employment and anti-discrimination policies.

The Bank uses various communication channels to periodically remind staff of the requirement to adhere to the rules and ethical standards set out in the Code of Conduct.

### HEALTH AND SAFETY

The Bank acknowledges and accepts its responsibilities for securing safety and health of its employees, of contractors working at premises over which it has control, and of visiting members of the public. By successfully implementing the certified BS OHSAS 18001:2007-compliant Safety Management System, the Bank marks its achievement to be the first bank world-wide to conform to this internationally acclaimed best practice aiming at reducing the exposure of the Bank's staff, contractors and customers to occupational safety and health risks associated with its business activities.

The Bank provides a range of training and activities to enhance the knowledge of its staff in occupational safety and health, fire safety, manual handling, and office safety. A number of staff have acquired Qualified First Aider status so as to offer prompt assistance to their colleagues and customers in the event of a medical emergency or accident whilst awaiting the arrival of the ambulance.

The Bank implements a Contingency Plan for Communicable Disease, which sets out the key issues to be addressed and the actions to be taken by various units in response to the occurrence of a serious communicable disease, and the keeping of adequate stock of Face Masks and Tamiflu to cater for the needs of its staff in case of an outbreak of influenza pandemic. Staff have been made aware through various communication channels of the importance of personal hygiene and health, and the contingency measures to be adopted, to enable the Bank to continue with its services to the community during an outbreak of a serious communicable disease.

The Bank operates a Staff Recreation Centre at Kowloon Bay with various facilities for health enhancement and leisure activities to foster work life balance among its staff and their family members.