





RIDING THE WAVES

DETERMINATION

MANAGEMENT DISCUSSION AND ANALYSIS

**BUSINESS IN
HONG KONG**

In 2011, our ingrained culture of customer service and time-to-market capabilities allowed us to react quickly to meet changing customer needs, especially amid the global economic uncertainties of the second half of the year.



We built on our large customer franchise, maintained prudent risk management and capitalised on new opportunities to achieve long-term growth.

Given the growing economic integration of Hong Kong and mainland China, we introduced more renminbi-related financial services for personal and business customers.

RETAIL BANKING AND WEALTH MANAGEMENT

Retail Banking and Wealth Management reported operating profit excluding loan impairment charges of HK\$6,441m, a decrease of 18.1% from 2010. Profit before tax fell by 15.9% to HK\$6,623m. Performance was affected by the drop in wealth management income in the second half of 2011.

Net interest income recorded a year-on-year decline of 3.9%. Intense market competition levied pressure on our deposit income, while unsecured lending and insurance were able to achieve moderate growth in their respective net interest income.

18.7 %

Market share of new mortgage
registrations in HK (Dec 2011)

2.23 MILLION

Credit cards issued



Our credit card business delivered a strong performance.

We leveraged our leading market position, convenient distribution network and personalised value-added solutions.

As part of our efforts to cater for the needs of e-savvy customers and improve operational efficiency, we continued to invest in technology. Our online and mobile banking capabilities were strengthened to improve the customer experience.

In September 2011, we launched a new generation of e-Banking services, providing a unified interface for different mobile devices accessing our Personal e-Banking. Other enhancements included the introduction of online account opening for integrated accounts and the provision of free basic real-time securities quotes.

At the end of 2011, the number of Personal e-Banking customers was up 11.7% to 1.2 million, compared with a year earlier.

CONSUMER FINANCE

Income from unsecured lending grew by 10.9% year-on-year. Personal loan balances were up 15.2%.

Our credit card business delivered a strong performance and we grew our market share in terms of card base. We remained the second and third largest issuer of VISA and MasterCard



1.2 MILLION
Personal e-Banking
customers

+34.2 %
Commercial Banking
profit before tax





We built on our wealth management strengths to help customers achieve their financial goals.

cards respectively. At the year-end, total cards issued had grown by 9.7% to 2.23 million. The Hang Seng Hong Kong dollar China UnionPay (CUP) credit card continued to generate strong interest, with the number of cards issued more than doubling to 206,000 during the year. Effective marketing efforts continued to boost card usage, with card spending and card receivables growing by 16.1% and 17.6% year-on-year respectively.

During the year, the Bank celebrated the 10th anniversary of its popular credit card Cash Dollars scheme.

Excluding Government Home Ownership Scheme mortgages, mortgage lending decreased by 2.0% to HK\$131.9bn as a result of the Bank's switch in focus to prime-based mortgage lending, intense market competition and government cooling measures. The Bank switched its focus from HIBOR-based lending to prime-based loans in early 2011. This affected our market share initially but as many competitors followed suit and rationalised their mortgage pricing, our market share in Hong Kong in terms of new registrations rebounded to reach 18.7% in December 2011.

To further strengthen our mortgage positioning, a dedicated 690-square-metre Mortgage Centre was established in Mongkok to provide customised one-stop financial planning solutions to home buyers.

WEALTH MANAGEMENT

We continued to build on our wealth management strengths to help customers achieve their financial goals in changing market conditions. However, as a result of the weakened investor sentiment in the second half of 2011, income from wealth management declined overall.

In our insurance business, we enhanced our comprehensive range of protection propositions and leveraged our effective distribution channels, including telemarketing. Life insurance annualised new premiums increased by 12.1% and total policies in force grew by 8.5%, compared with 2010. Despite the strong sales, income from insurance fell as market conditions led to lower investment returns on the life insurance fund portfolios.

Income from investment services fell by 10.6% year-on-year in the volatile market. The sales momentum of investment funds slowed down in the second half as global uncertainties intensified. As part of our efforts to widen our product range, we launched the Hang Seng Corporate Sustainability Index Fund, the first fund of its kind in Hong Kong in August 2011.

Income from securities broking decreased in the second half of the year, reflecting a decline in stock market trading turnover.

In order to cater for the increasing wealth management needs of individuals on the Mainland, we reached out to affluent Mainlanders looking for services in Hong Kong through our strong customer referral mechanisms.

We also continued to take advantage of the growing demand for investment exposure to the renminbi. During the year, we reopened the Hang Seng RMB Bond Fund for subscription after its debut launch in 2010. IPO subscription and trading services for renminbi-denominated securities were made available upon the listing of the first such stock outside the Mainland.





COMMERCIAL BANKING

Commercial Banking achieved an increase of 28.9% in operating profit excluding loan impairment charges to HK\$3,442m. Profit before tax grew by 34.2% to HK\$5,031m.

The growth was driven mainly by net interest income from advances and non-interest income. Net interest income from advances increased by 36.0%, whereas non-interest income grew by 13.0%.

Amid intense competition, growth of 5.1% was achieved in customer deposits during the year.

Net interest income from our trade finance business grew by 93.6% year-on-year. As a market leader in cross-border trade finance and supported by our strong balance sheet, we moved quickly to meet the increased demand in this area. Besides close collaboration between colleagues in Hong Kong and the Mainland, we also cooperate with strategic partners on the Mainland to enhance our cross-border trade proposition. This proved to be a valuable source of referral business.

In 2011, the number of our commercial renminbi accounts in Hong Kong grew by 20.1% to over 70,000 and the renminbi cross-border trade-related business routed through the Bank increased.

Initiatives to grow fee income from corporate wealth management sales achieved satisfactory results. Enhanced corporate investment, insurance and treasury products were marketed to customers through different platforms to capture the shift in investment sentiment. Income from corporate wealth management increased by 14.9% and contributed to 13.3% of Commercial Banking's total net operating income.

With the widening scope of the renminbi financial services market, we strengthened our suite of products and services for commercial and corporate banking customers to reinforce our leadership in this area. Our cash management and payment capabilities were further enhanced to offer greater convenience to business customers. Renminbi-related services launched included bill payment, inter-bank autopay and direct debit, cashier's order issuance and cheque deposits into HKD accounts. The renminbi MaxiInterest Investment Deposit and an online renminbi exchange service were also offered.

Three more Business Banking Centres were opened during the year to reach out to more customers, including SMEs, taking the total to seven. The Centres facilitated account acquisition and the Commercial Banking customer base increased by 13.4% over 2010.

With prudent risk management, a high quality portfolio was maintained and the loan impairment provision against Commercial Banking's total portfolio remained low at 0.77%.

Our efforts to help our customers grow won us industry recognition. We received an Achievement Award for Cash Management in Hong Kong from *The Asian Banker* for the second consecutive year and an SME's Best Partner Award from the Hong Kong General Chamber of Small and Medium Business for the sixth consecutive year.

Further enhancements to our online platform included the introduction of investment account activation and an e-Statement service on Business e-Banking services. The number of customers using Business e-Banking increased by 16.2% to over 74,000 while the number of online business transactions grew by 13.8%, compared with 2010.

Three more Business Banking Centres were opened in 2011 to reach out to more customers, taking the total to seven.





CORPORATE BANKING

Corporate Banking recorded growth of 41.9% in operating profit excluding loan impairment charges to HK\$1,794m. Profit before tax grew by 45.6% to HK\$1,843m.

Net interest income rose by 38.8%. Advances to customers rose by 10.2% as we selectively grew quality loans.

Against a backdrop of tightening market liquidity, we took the opportunity to improve our loan margins by repricing. We also proactively managed our loan book to capitalise on the increased cross-border loan demand.

Property-related financing remained a major component of Corporate Banking lending. However, given the tighter regulatory environment in Hong Kong and the Mainland, we

strengthened efforts to diversify our loan exposure and revenue base, leveraging strong customer relationships and good industry knowledge to capture new business opportunities. We focused on large corporates in Hong Kong with strong financial standing and well-established Mainland enterprises. We also targeted Mainland businesses with high growth potential in key industries, in particular those supported under China's 12th Five-Year Plan.

By delivering total cash management solutions to customers and capitalising on an efficient cross-border relationship management system, customer deposits increased by 29.0% despite intense competition.

Non-interest income rose by 14.3% as Corporate Banking offered a wide spectrum of tailor-made treasury, wealth management and insurance solutions to corporates.



We strengthened our suite of renminbi products for commercial and corporate banking customers to reinforce our leadership in this area.

TREASURY

Treasury recorded a 23.7% increase in operating profit to HK\$2,729m while profit before tax rose by 25.8% to HK\$4,227m. The growth in total operating income was mainly the result of an increase in net interest income which was partly offset by lower trading income.

In spite of persistently low interest rates and flat yield curves in various investment markets, net interest income rose by 50.2% to reach HK\$2,108m. The increase was attributed to a larger commercial surplus for investment as the Bank's balance sheet grew, more positioning taken in balance sheet management and better margins for inter-bank lending in both Hong Kong and the Mainland.

Leveraging opportunities in foreign exchange markets for funding swap activities also contributed to the increase in net interest income, although this was partly offset by the loss on foreign exchange arising from funding swap activities grouped under trading income.

Trading income fell by 13.9% to HK\$1,001m. Overall trading income was impacted by the decline in income from funding swap activities. However, foreign exchange trading income recorded encouraging growth, boosted in part by the increasing demand for renminbi-denominated products following the further liberalisation of the renminbi business in Hong Kong.

The customer referral mechanism with other business units was strengthened to encourage the cross-selling of treasury products.

HANG SENG INDEXES

Wholly owned subsidiary Hang Seng Indexes Company Limited (Hang Seng Indexes) continued to strengthen its position as a leading index compiler in the region through enriching its index profile and expanding its overseas exposure with the launch of new indexes and the listing of a new index-linked fund.

In January 2011, Hang Seng Indexes announced the launch of the HSI Volatility Index and the Hang Seng Risk Adjusted Index Series. The HSI Volatility Index is a useful indicator that reflects investor sentiment towards the stock market and facilitates the development of volatility products such as futures and options, allowing investors to diversify their portfolio and hedge against volatility exposure. The Hang Seng Risk Adjusted Index Series provides a tool for investors with a medium-to-long term perspective to gain exposure to the stock market while controlling the level of risk.

With the number of foreign companies listed in Hong Kong increasing rapidly in the past year, Hang Seng Indexes launched the Hang Seng Foreign Companies Composite Index and the

Hang Seng Global Composite Index in September 2011 to provide benchmarks to the market reflecting the overall performance of Hong Kong listed foreign companies and all Hong Kong listed companies (including foreign companies) respectively.

The Hang Seng Corporate Sustainability Index Series was expanded in August 2011 with the addition of two new benchmark indexes: the Hang Seng Corporate Sustainability Benchmark Index and the Hang Seng (China A) Corporate Sustainability Benchmark Index. The new benchmark indexes include more MidCap and SmallCap companies that have strong sustainability performance.

A new mutual fund tracking the Hang Seng Corporate Sustainability Index was launched in Hong Kong in August 2011 by Hang Seng Investment Management Limited (a wholly owned subsidiary of Hang Seng Bank Limited). In September 2011, Hang Seng Indexes increased its exposure in Europe with the listing of XACT China, an exchange-traded fund (ETF) tracking the Hang Seng China Enterprises Index (HSCEI), on NASDAQ OMX Stockholm, Sweden.

Hang Seng Indexes now compiles 302 publicly available indexes – 47 real-time price indexes and 255 daily indexes – of which 73 track the Mainland segment (including cross market indexes) of the market. In addition to its publicly available indexes, Hang Seng Indexes also compiles customised indexes to serve the specific indexing needs of various clients.

The total number of futures and options contracts traded on the Hang Seng Index and the Hang Seng China Enterprises Index in 2011 increased by 15.0% and 23.3% respectively, compared with 2010. At 31 December 2011, the total size of ETFs tracking all indexes in the Hang Seng Family of Indexes was over US\$13bn.





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