
TRUST

SOLID
PERFORMANCE

MANAGEMENT DISCUSSION AND ANALYSIS
FINANCIAL REVIEW

FINANCIAL PERFORMANCE

INCOME STATEMENT

Summary of Financial Performance

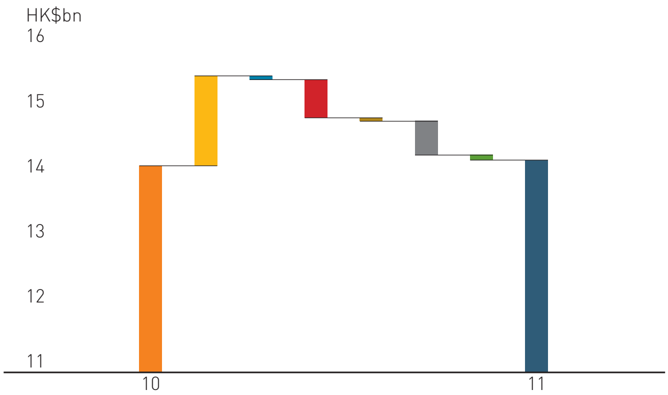
Figures in HK$m	2011	2010
Total operating income	**34,207**	34,417
Operating expenses	**7,898**	7,355
Operating profit after loan impairment charges	**14,181**	14,085
Profit before tax	**19,213**	17,345
Profit attributable to shareholders	**16,680**	14,917
Earnings per share (in HK$)	**8.72**	7.80

Hang Seng Bank Limited ("the Bank") and its subsidiaries ("the Group") reported an audited profit attributable to shareholders of HK$16,680m for 2011, up 11.8% compared with 2010. Earnings per share were HK$8.72, up HK$0.92 from 2010. Profit attributable to shareholders for the second half of 2011 increased by HK$566m, or 7.0%, compared with the first half.

Operating profit excluding loan impairment charges grew by HK$146m, or 1.0%, to HK$14,621m.

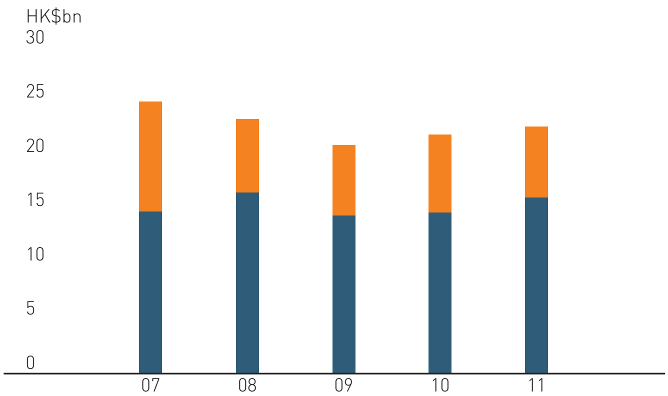
The Bank continues to navigate a challenging environment and delivered a solid operating result. Net interest income grew by 10.0%, primarily due to average loan growth coupled with higher loan spreads and increased balance sheet management income. The increasingly uncertain and volatile market as a result of the evolving eurozone sovereign debt concerns and slow recovery of the US economy led to an unfavourable investment climate which did not favour the wealth management business. Non-interest income declined by 8.9% compared with last year. While the Bank remains prudent in managing costs, investment for future growth, in particular business expansion in mainland China, led to a 7.4% rise in operating expenses compared with 2010. Riding on the Bank's business momentum and leveraging its core strengths, the Bank registered a 0.6% increase in operating profit excluding loan impairment charges in the second half of the year compared with the first half.

OPERATING PROFIT ANALYSIS



	HK$m
2010 Operating profit	14,085
Changes due to:	
Net interest income	1,436
Net fee income	(61)
Other operating income	(608)
Loan impairment charges	(50)
Operating expenses	(543)
Impairment loss on intangible assets	(78)
2011 Operating profit	14,181

NET OPERATING INCOME
(Before loan impairment charges)



Net operating income
Non-interest income
Net interest income

Net interest income rose by HK$1,436m, or 10.0%, with a 10.4% increase in average interest-earning assets.

Figures in HK$m	2011	2010
Net interest income/ (expense) arising from:		
– financial assets and liabilities that are not at fair value through profit and loss	**16,525**	14,459
– trading assets and liabilities	**(848)**	(238)
– financial instruments designated at fair value	**59**	79
	15,736	14,300
Average interest-earning assets	**886,156**	802,464
Net interest spread	**1.68%**	1.72%
Net interest margin	**1.78%**	1.78%

The increase in net interest income was primarily due to the growth in average customer advances with strong loan growth from the latter part of 2010, improved balance sheet management income and loan spreads. This was partly offset by the narrowed deposit spreads under keen market competition on deposit acquisition and the persistently low interest rate environment.

Net interest margin remained intact at 1.78% for 2011, and net interest spread fell by four basis points to 1.68%. The reduction in net interest spread was driven by the combination of the low interest rate environment and narrowing deposit spreads, resulting from keen market competition. There was an improvement in balance sheet management portfolio income as Treasury grasped opportunities in the interbank market and successfully enhanced the portfolio yield on new and existing assets with a larger commercial surplus for investment. The average volume growth in corporate and commercial lending and credit cards also helped to support net interest income revenue streams. The Group also grew its life insurance funds investment portfolio and increased its interest income by 10.0% compared with last year. Despite the growth in renminbi business, the dilutive effect of the increase in lower yielding renminbi funds placed with the local clearing bank adversely affected the net interest spread. The contribution from net free funds grew by four basis points to 0.10%.

Net interest income in the second half of 2011 grew by HK$462m, or 6.0%, compared with the first half, due mainly to fewer days in the first half of the year and a 1.7% increase in average interest-earning assets. Net interest margin in the second half was 1.80%, up five basis points compared with the first half.

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	2011	2010
Net interest income	**16,525**	14,456
Average interest-earning assets	**840,064**	756,110
Net interest spread	**1.89%**	1.86%
Net interest margin	**1.97%**	1.91%

Net fee income decreased slightly by HK$61m, or 1.2%, to HK$4,836m compared with 2010.

With the weak investment sentiment in Hong Kong in the second half of the year, income from stockbroking and related services decreased by 12.5%, reflecting the decline in stock market trading turnover. Income from retail investment funds fell by 12.9%, as the demand for wealth management products decreased in the second half. The increasingly uncertain and volatile equities market and an unfavourable investment sentiment led to a decline in retail investment funds sales. As a result, subscription fees and commissions decreased. Insurance agency fee income and private banking service fee income fell by 5.5% and 19.4% respectively.

Card services income increased by 14.6%, which was in line with the growth in average credit card balances. The 9.8% growth in the card base resulted in rising merchant and interchange fee income. Credit facilities fee income rose by 29.7%, due mainly to higher fees from increased corporate lending.

On the back of increased trade activity and the expansion of renminbi cross-border trade settlement volumes, remittances and trade-related fee income grew by 5.4% and 2.0% respectively.

Compared with the first half of 2011, net fee income in the second half fell by HK$236m, or 9.3%, mainly reflecting decreases in income from stockbroking and related services, the sales of retail investment funds and private banking services. Fee income from credit facilities and card services registered growth in the second half of the year.

Trading income fell by HK$263m, or 12.8%, to HK$1,796m.

Foreign exchange income rose by HK$75m, or 4.2%, contributed by higher customer demand for foreign exchange-linked structured products and the Bank's efforts to meet the growing demand for renminbi-denominated products. The Bank was also successful in capturing higher customer driven activity and achieving wider spreads as volatility increased. This was offset partly by reduced net interest income from funding swap* activities and increased losses on the revaluation of certain US dollar capital funds – maintained in Hang Seng China and subject to regulatory controls – against the renminbi. Excluding the above offsetting items, foreign exchange trading income grew by HK$285m, or 17.8%.

Income from securities, derivatives and other trading activities fell by HK$338m. This was primarily related to the losses on equity options backing a life endowment product due to unfavourable movements in the underlying equity indices, which resulted in a corresponding decrease in "Net insurance claims incurred and movement in policyholder liabilities".

* 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 a foreign exchange gain/loss, while the corresponding interest differential between the original and swap funding is reflected in net interest income.

Net income/(loss) from financial instruments designated at fair value reported a revaluation loss of HK$160m, compared with a revaluation gain of HK$282m in 2010.

This was mainly due to the fair value changes of assets supporting the linked insurance contracts with offsetting movements in the value of those contracts reported under "net insurance claims incurred and movement in policyholders' liabilities".

Net earned insurance premiums fell by HK$246m, or 2.2%. Net insurance claims incurred and movement in policyholders' liabilities fell by HK$977m, or 7.8%.

Analysis of income from wealth management business

Figures in HK$m	2011	2010
Investment income:		
– retail investment funds	**905**	1,039
– structured investment products*	**661**	448
– private banking service fee**	**172**	196
– stockbroking and related services	**1,285**	1,468
– margin trading and others	**134**	129
	3,157	3,280
Insurance income:		
– life insurance	**2,018**	2,282
– general insurance and others	**364**	342
	2,382	2,624
Total	**5,539**	5,904

* 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.

Eurozone sovereign debt concerns affected the stock market in general and weakened investment sentiment in the second half of 2011. Against this backdrop, wealth management business income decreased by 6.2% compared with 2010. Investment and insurance income fell by 3.8% and 9.2% respectively.

The volatility in the stock market and unfavourable investment sentiment led to a 12.9% decline in income from sales of retail investment funds. Stockbroking and related services income fell by 12.5% as a result of lower stock market turnover recorded by the Bank.

The Bank continued to make good progress in distributing competitive structured products to customers, primarily related to renminbi-denominated products, and recorded a 47.5% growth in structured investment products income. Private banking service income fell by 12.2%, reflecting weaker investment sentiment.

Life insurance income decreased by HK$264m, or 11.6%, to HK$2,018m. Hang Seng continued to launch new products catering for customers' investment and protection needs. This included the launch of the "RewardYou Life Insurance Plan" and "3-Year Target Life Insurance Plan" which were well received. Total policies in-force at 31 December 2011 rose by 8.5% year-on-year.

Net interest income and fee income from the life insurance funds investment portfolio rose by 8.1%, due mainly to growth in the size of the life insurance investment portfolio, which held bond investments as its major assets.

The investment return on life insurance investment funds reported a loss of HK$361m, compared with a gain of HK$287m in 2010, reflecting changes in the fair value of assets supporting insurance contracts and reported under "trading income" and "net income/(loss) from financial instruments designated at fair value", with offsetting movements in policyholders' liabilities. The movement in PVIF decreased by 47.2%, representing the net effect of the unfavourable experience variance of the investment return assumption, offset by a refinement of the calculation of the PVIF asset to bring greater comparability and consistency across the Group's insurance operations and higher sales in 2011 compared with last year.

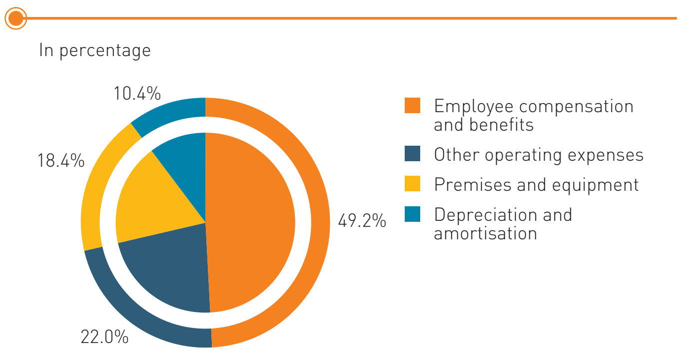
General insurance income increased by 6.4% to HK$364m.

Figures in HK$m	2011	2010
Life insurance:		
– net interest income and fee income	**2,576**	2,382
– investment returns on life insurance funds	**(361)**	287
– net earned insurance premiums	**10,723**	10,966
– net insurance claims incurred and movement in policyholders' liabilities*	**(11,515)**	(12,479)
– movement in present value of in-force long-term insurance business	**595**	1,126
	2,018	2,282
General insurance and others	**364**	342
Total	**2,382**	2,624

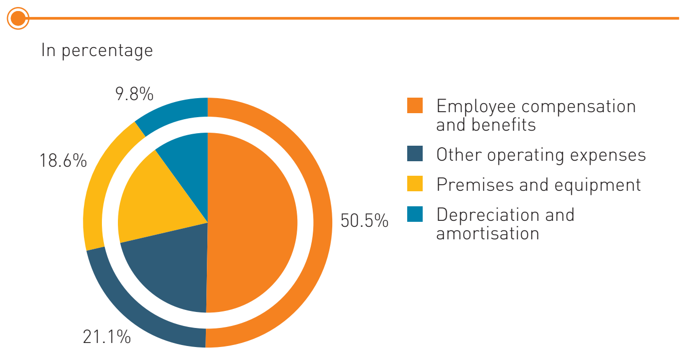
* Including premium and investment reserves

Operating expenses rose by HK$543m, or 7.4%, to HK$7,898m.

OPERATING EXPENSES FOR 2011



OPERATING EXPENSES FOR 2010



While carefully managing costs, the Bank continued to make investments in support of long-term business growth. Operating expenses of our Hong Kong operations rose by 5.2%.

Employee compensation and benefits increased by HK$171m, or 4.6%. Salaries and other related costs increased by 3.4%, reflecting the annual salary increment and higher average headcount. General and administrative expenses were up 9.4%, mainly due to the increase in processing charges and marketing expenditure as more branding and promotional activities were conducted during the year to support business growth. Rental expenses rose as a result of increased rents for branches in Hong Kong and new branches on the Mainland. Depreciation charges rose by 13.1%, mainly reflecting higher depreciation charges on business premises following upward property revaluation in Hong Kong.

Full time equivalent staff numbers by region

	2011	2010
Hong Kong	**7,993**	7,960
Mainland	**1,784**	1,623
Others	**57**	59
Total	**9,834**	9,642

At 31 December 2011, the Group's staff numbers had increased by 192 compared with the end of 2010.

With the increase in operating expenses outpacing the growth in net operating income before impairment charges, the cost efficiency ratio rose by 1.3 percentage points, compared with 2010, to 35.0%. The Bank continues to focus on improving operational efficiency while maintaining growth momentum and market leadership.

Impairment loss on intangible assets of HK$78m related to certain IT projects.

Operating profit rose slightly by HK$96m, or 0.7%, to HK$14,181m after accounting for the increase in *loan impairment charges.*

Loan impairment charges increased by HK$50m, or 12.8%, to HK$440m compared with a year earlier.

Figures in HK$m	2011	2010
Loan impairment charges:		
– individually assessed	**(103)**	(186)
– collectively assessed	**(337)**	(204)
	(440)	(390)
of which:		
– new and additional	**(740)**	(609)
– releases	**222**	157
– recoveries	**78**	62
	(440)	(390)

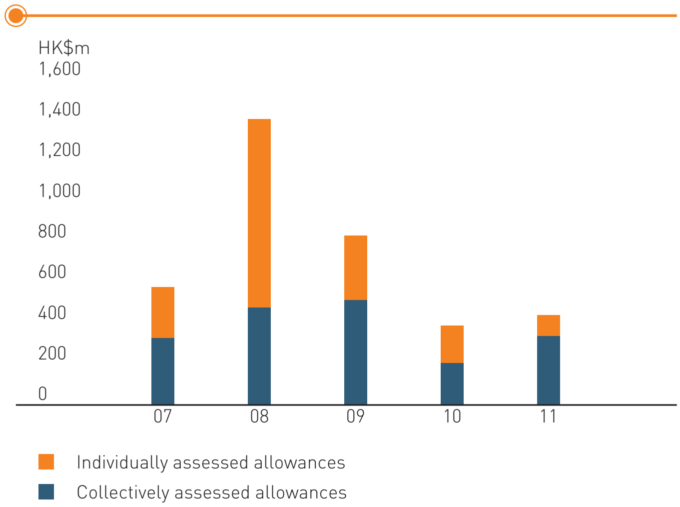
Individually assessed impairment charges fell by HK$83m, or 44.6%, mainly due to higher releases and recoveries from commercial and corporate banking customers which offset the increase in new impairment. The increase in new impairment charges was primarily due to a specific impairment charge provided in 2011.

Collectively assessed impairment charges rose by HK$133m, due largely to the rise in impairment allowances for loans not individually identified as impaired. Impairment allowances for credit card and personal loans portfolios were also higher as a result of portfolio growth.

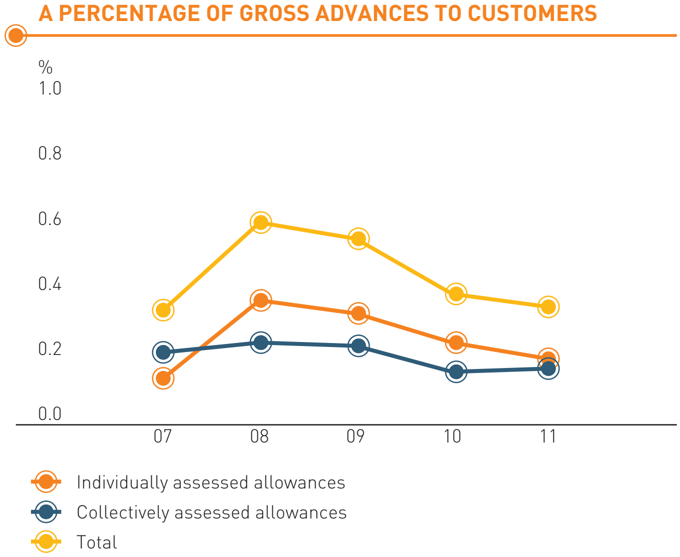
Total loan impairment allowances as a percentage of gross advances to customers are as follows:

	2011 %	2010 %
Loan impairment allowances:		
– individually assessed	**0.19**	0.24
– collectively assessed	**0.16**	0.15
Total loan impairment allowances	**0.35**	0.39

NET CHARGES FOR LOAN IMPAIRMENT ALLOWANCES



LOAN IMPAIRMENT ALLOWANCES AS A PERCENTAGE OF GROSS ADVANCES TO CUSTOMERS



Profit before tax increased by 10.8% to HK$19,213m after taking into account a 55.4% (or HK$62m) fall in **gains less losses from financial investments and fixed assets;** a 103.7% (or HK$505m) increase in **net surplus on property revaluation;** and a 49.9% (or HK$1,329m) increase in **share of profits from associates**, mainly from Industrial Bank and a property investment company.

Gains less losses from financial investments and fixed assets fell by HK$62m, or 55.4%, compared with 2010.

Net gains from the disposal of available-for-sale equity securities rose by HK$32m while net gains from the disposal of available-for-sale debt securities fell by HK$84m compared with 2010.

Net surplus on property revaluation rose by 103.7% to HK$992m.

Figures in HK$m	2011	2010
Surplus of revaluation on investment properties	**982**	474
Surplus of revaluation on assets held for sale	**8**	10
Reversal of revaluation deficit on premises	**2**	3
	992	487

The Group's premises and investment properties were revalued at 30 November 2011 and updated for any material changes at 31 December 2011 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$3,731m, of which HK$3,729m was credited to premises revaluation reserve and HK$2m was credited to the income statement. Revaluation gains of HK$982m on investment properties were recognised through the income statement. The related deferred tax provisions for Group premises and investment properties were HK$610m and HK$162m respectively.

The revaluation exercise also covered business premises/ investment properties reclassified as properties held for sale. The revaluation gain of HK$8m 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	Retail Banking and Wealth Management	Commercial Banking	Corporate Banking	Treasury	Other	Total reportable segments
Year ended 31 December 2011						
Profit before tax	**6,623**	**5,031**	**1,843**	**4,227**	**1,489**	**19,213**
Share of profit before tax	**34.5%**	**26.2%**	**9.6%**	**22.0%**	**7.7%**	**100.0%**
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%

Retail Banking and Wealth Management ("RBWM") reported a profit before tax of HK$6,623m in 2011, down 15.9% from 2010. Operating profit excluding loan impairment charges reached HK$6,441m, representing a drop of 18.1% compared with 2010.

Net interest income recorded a year-on-year decline. Intense market competition levied pressure on RBWM's deposit income, while unsecured lending and insurance were able to achieve moderate growth in their respective net interest income. Intense market competition and the resulting high cost of funds hit deposit income. To grow the Bank's deposit base, increased interest rates were offered to customers. As a result, net interest income from deposits dropped by 15.8% compared with the same period in 2010.

The Bank switched its focus from HIBOR-based lending to Prime-based loans in early 2011 in its mortgage business. The Bank's mortgage market share dropped initially, but as many competitors followed suit and rationalised their mortgage pricing, our market share in terms of new registrations rebounded to reach 18.7% in December 2011. Net interest income from our Hong Kong mortgage business improved in the second half of the year over the first half.

With a quality credit card customer base, total operating income from unsecured lending remained a key income driver and grew by 10.9% year-on-year. The Bank grew its market share in terms of card base and remained the second and third largest issuer of VISA and MasterCard cards respectively. As of 31 December 2011, total cards in issue reached 2.23 million and over 342,000 new cards were acquired during the year. 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 since the end of 2010. 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. Personal loan balances were up by 15.2% year-on-year to HK$5.3bn.

Income from investments declined by 10.6% year-on-year as the investment business experienced volatile markets in 2011. Investment fund subscriptions deteriorated in the second half due to the economic uncertainties around the globe. As a result, the income from both retail investment funds and securities broking declined compared with the previous year.

The diversification strategy of offering new life insurance plans with improved protection propositions proved to be effective in driving sales momentum later in the year. Annualised new premiums grew by 12.1% compared with 2010 while total policies in force also grew steadily. However, net insurance premium income fell by 2.2% compared to 2010. Income from non-linked insurance business fell as unfavourable market conditions led to lower investment returns. Insurance income was also affected by the decline in the present value of in-force long-term insurance business, representing the net effect of the unfavourable experience variance of the investment return assumption, offset by a refinement of the calculation of the PVIF asset to bring greater comparability and consistency across the Group's insurance operation and higher sales in 2011 compared with 2010.

Service quality was never compromised and Hang Seng Bank continued to receive recognition in the banking industry. The Bank was named "Best Local Private Bank in Hong Kong" in the *Euromoney* Private Banking Survey 2011 based on the assessment of business performance and peer nominations. *Asiamoney* also named Hang Seng Bank the "Best Domestic Bank in Hong Kong" again in 2011.

Commercial Banking ("CMB") achieved a 34.2% increase in profit before tax to HK$5,031m, contributing to more than a quarter of the Bank's total. Operating profit excluding loan impairment charges was up 28.9% to HK$3,442m.

Against a backdrop of buoyant consumer demand, CMB achieved encouraging growth driven mainly by net interest income from advances and non-interest income. With a strong asset base and strategic re-pricing, net interest income from advances increased by 36.0%, whereas non-interest income grew by 13.0%. Amidst intense competition, healthy growth was achieved in customer deposits of 5.1% compared with 31 December 2010.

Various initiatives to grow fee income achieved satisfactory results, notably from loan-related fees and remittances. CMB also provided timely and competitive corporate wealth management products for its customers, focusing particularly on those in the top-end segment. A wide range of products including corporate investment, insurance and treasury products were marketed to customers through different platforms to capture the shift in investment sentiment as well as to meet customers' expectations on yield enhancement or hedging needs. Income from the corporate wealth management business increased by 14.9% and contributed to 13.3% of CMB's net operating income.

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 strategic partners on the Mainland. This collaboration has enhanced the Bank's cross-border service proposition and has proven to be a valuable source of referral business.

At 31 December 2011, the number of commercial renminbi accounts in Hong Kong exceeded 70,000 and the renminbi cross-border trade-related business routed through the Bank had increased. As Hong Kong develops into an important renminbi offshore centre, the Bank will capitalise on its growth capabilities by further enhancing renminbi services, especially through the provision of customised renminbi trade solutions and wealth management services as well as capturing the potential of renminbi lending in Hong Kong.

Cash management capabilities were further enhanced to offer speedy China remittance services to customers. The Express China remittance service was enhanced to provide "within 3 hours credit" for remittances to beneficiary accounts of Hang Seng China. Hang Seng was one of the pioneer banks to offer a renminbi bill payment service providing a one-stop solution to merchants for collecting renminbi payments from their customers via the Bank's automated channels.

Seven Business Banking Centres located in areas of high commercial traffic are in operation, enhancing the network and providing high quality and convenient services to customers and referral partners. Those Centres facilitated account acquisition and Commercial Banking customer numbers increased by 13.4% over 2010.

There were also continuous efforts to encourage customers to use online and automated banking channels. The activation of online investment accounts and e-Statement services were launched on the Business e-Banking platform in July 2011. An online renminbi exchange service was launched in August 2011. As a result, the number of customers using Business e-Banking services increased by 16.2% while the number of online business transactions grew by 13.8%.

With prudent risk management, a high quality asset portfolio was maintained and loan impairment allowances against CMB's total portfolio remained at a low level of 0.77%.

Corporate Banking ("CIB") achieved a 45.6% growth in profit before tax to HK$1,843m compared with 2010. Operating profit excluding loan impairment charges was HK$1,794m, up 41.9%. The strong profit growth was mainly attributable to a rise in net interest income and non-interest income which increased by 38.8% and 14.3% respectively.

CIB encountered a challenging operating environment in 2011. On the Mainland, market liquidity tightened significantly following a series of increases in interest rates and the required deposit reserve ratio. Strong loan demand prompted an increasing number of Mainland enterprises to come to Hong Kong for bank financing. To meet the loan demand, competition for customer deposits intensified and hence raised funding costs.

Against a backdrop of tightening market liquidity, CIB leveraged its strong industry knowledge, effective risk management as well as dedicated business teams in Hong Kong and on the Mainland to achieve strong financial results through selective growth in customer advances, which increased by 10.2% compared with the end of 2010. By offering total cash management solutions to customers and capitalising on an efficient cross-border relationship management system, CIB's customer deposits grew by 29.0% amid intense competition.

The return on renminbi deposits and lending also showed positive growth as we took advantage of the increase in cross-border loan demand and the relaxation of foreign direct investment restrictions.

Leveraging its well-established business infrastructure, CIB also stepped up efforts to grow non-interest income, offering a wide spectrum of services encompassing treasury, hedging, trade services, cash management, wealth management and insurance.

Treasury ("TRY") recorded a 25.8% increase in profit before tax to HK$4,227m, while operating profit increased by 23.7% to HK$2,729m. The growth was mainly driven by increases in net interest income and TRY's share of profits from associates.

In spite of persistently low interest rates, net interest income surged by 50.2% to reach HK$2,108m. The increase was attributed to a number of factors including more commercial surplus for investment as the Bank's balance sheet grew, more positioning taken in balance sheet management and more opportunities and better margins for inter-bank lending in both Hong Kong and mainland China. Leveraging opportunities in foreign exchange markets for funding swap activities also contributed to the increase though this was partly offset by the loss on foreign exchange arising from funding swap activities grouped under trading income.

Trading income fell by HK$161m, or 13.9%, to HK$1,001m. Foreign exchange trading income recorded encouraging growth, boosted in part by rising demand for renminbi-denominated products following further liberalisation of renminbi business in Hong Kong. However, overall trading income was impacted by the decline in income from funding swap activities.

MAINLAND BUSINESS

With the opening of the third cross-city sub-branch in Huizhou under CEPA VI in August 2011, Hang Seng China currently operates a network of 11 branches and 28 sub-branches, covering 14 cities in mainland China. The Bank maintains a wholesale branch in Shenzhen for foreign currency business. Applications to establish a new branch in Xiamen, a sub-branch each in Beijing and Tianjin, and a cross-city sub-branch each in Guangdong's Shunde, Zhuhai and Jiangmen respectively have been approved. The establishment of the new outlets will further strengthen Hang Seng's strategic presence in focused areas on the Mainland.

Since late 2010, inflationary pressure became the government's major concern and a series of tightening measures was adopted in the first half of 2011. This was followed by transitions in macro-economic policies from credit tightening to selective monetary easing after the consumer price index ("CPI") peaked and worries over international economic conditions that weakened domestic growth surfaced in the latter half of 2011. In the banking sector, competition for deposits remained intense among all banks and costs to attract and retain talent with local experience stayed high.

Against such a challenging and highly competitive environment, Hang Seng China continued to target corporate customers with renminbi cross-border trade-related business needs and align credit policies with China's 12th Five-Year Plan. On the retail front, Hang Seng China's leading position in the wealth management business was boosted with the launch of the VIP Prestige Centre in Shanghai to provide tailor-made services for high net worth individuals.

Hang Seng China's strategy has been to grow in both scale and value and this has delivered encouraging results. In 2011, the total number of Corporate and Commercial Banking customers increased by 8.3% while the total number of Retail Banking and Wealth Management customers grew by 21.1% (the number of Prestige Banking customers increased by 25.6%) over December 2010.

Driven by the expanded customer base, gross advances to customers rose by 23.0% whereas total deposits increased by 34.1% over the end of 2010. Total operating income was 45.7% higher than 2010, underpinned by strong growth in net interest income and other operating income. Profit before tax recorded an increase of 821.8% compared with 2010.

	2011 compared with 2010	
	As reported	**Constant currency***
Total operating income	**45.7%**	**38.8%**
Profit before tax	**821.8%**	**778.2%**
Gross advances to customers	**23.0%**	**17.6%**
Customer deposits	**34.1%**	**28.3%**

The partnership with Industrial Bank continued to support the Bank's long-term growth on the Mainland. In March 2011, the Bank signed a memorandum of understanding with Industrial Bank to further strengthen bilateral cooperation in various business areas. Moreover, more branch-level cooperation initiatives have been launched between Hang Seng and Industrial Bank.

In October 2011, Hang Seng Securities Limited ("Hang Seng Securities"), a wholly owned subsidiary of the Bank, signed a memorandum of understanding with Guangzhou Securities Company Limited ("Guangzhou Securities") to take an important step in their application to set up Guangzhou GuangZheng Hang Seng Securities Investment Advisory Company Limited. This is the first ever application to set up a joint venture securities investment advisory company in Guangdong province under CEPA VI. Subject to regulatory approval for its establishment, the joint venture aims to become a showcase for cross-border securities investment advisory co-operation under CEPA by combining the strengths of both partners, paving the way for Hang Seng to expand its business on the Mainland.

* When reference is made to "constant currency" in commentaries, comparative data reported in the functional currency of Hang Seng's operations on the Mainland have been translated at the appropriate exchange rates applied in the current year in respect of the income statement or balance sheet. Constant currency comparatives in respect of 2010 and 2009 used in the 2011 and 2010 commentaries respectively are computed by translating into HK Dollars:

- the income statement for 2010 and 2009 of renminbi at the average rates of exchange for 2011 and 2010 respectively; and
- the balance sheet at 31 December 2010 and 2009 for renminbi at the prevailing rates of exchange on 31 December 2011 and 2010 respectively.

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 2011, economic profit was HK$10,312m, an increase of HK$904m, or 9.6%, compared with 2010. 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$1,318m.

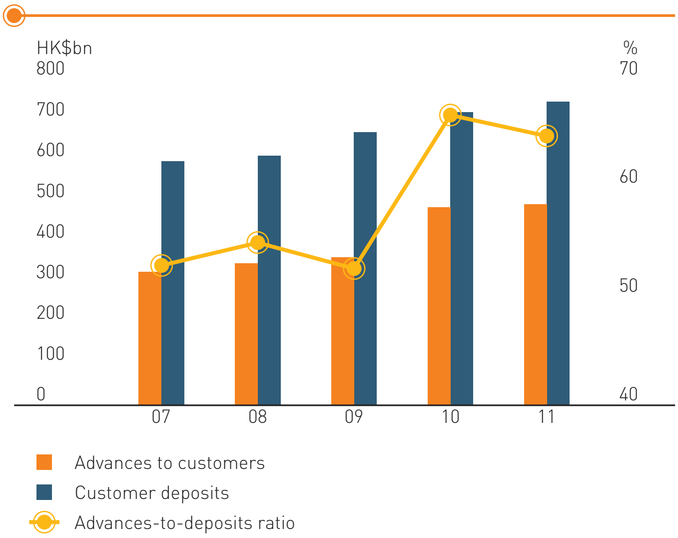
	2011		2010	
	HK$m	%	HK$m	%
Average invested capital	**62,837**		57,616	
Return on invested capital*	**16,008**	**25.5**	14,690	25.5
Cost of capital	**(5,696)**	**(9.1)**	(5,282)	(9.2)
Economic profit	**10,312**	**16.4**	9,408	16.3

* 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$58.5bn, or 6.4%, to HK$975.4bn. Customer advances increased by HK$7.9bn, or 1.7%, with growth in the commercial and corporate lending businesses, largely in mainland China. The trade finance business declined as certain trade finance loans matured in the second half of the year. The Bank was strongly positioned to capture cross-border opportunities and prudently grew its Mainland lending during the year while maintaining sound loan quality. Under the vigorous deposit acquisition strategy in both Hong Kong and the Mainland during the year, customer deposits, including certificates of deposit and other debt securities in issue, increased by HK$32.9bn, or 4.6%, to HK$743.2bn, driven in part by strong growth in renminbi deposits. At 31 December 2011, the advances-to-deposits ratio was 64.7%, compared with 66.5% at 31 December 2010. Financial investments and trading assets increased by 4.9% and 146.3% respectively, reflecting the deployment of the commercial surplus to high-quality treasury bills and debt securities.

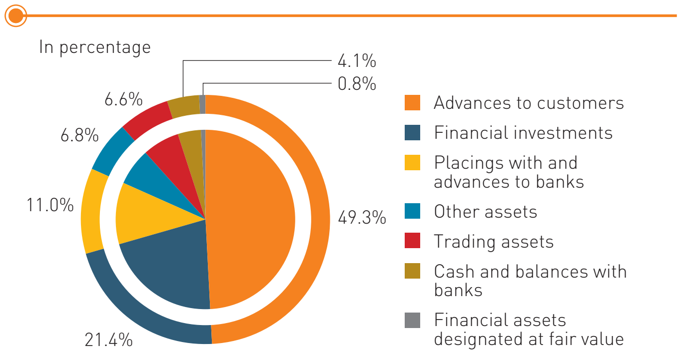
ADVANCES TO CUSTOMERS AND CUSTOMER DEPOSITS



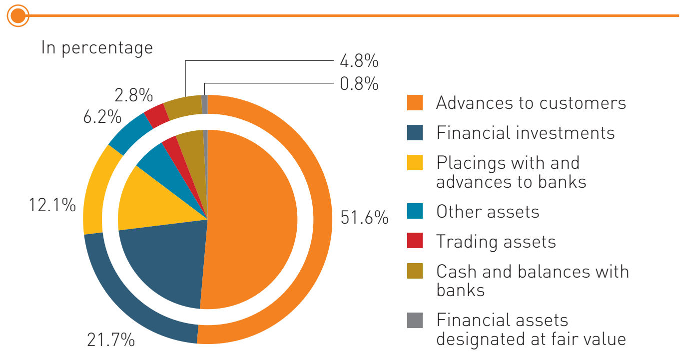
Assets Deployment

Figures in HK$m	2011	%	2010	%
Cash and balances with banks and other financial institutions	**39,533**	**4.1**	44,411	4.8
Placings with and advances to banks and other financial institutions	**107,742**	**11.0**	110,564	12.1
Trading assets	**64,171**	**6.6**	26,055	2.8
Financial assets designated at fair value	**8,096**	**0.8**	7,114	0.8
Advances to customers	**480,574**	**49.3**	472,637	51.6
Financial investments	**209,190**	**21.4**	199,359	21.7
Other assets	**66,139**	**6.8**	56,771	6.2
Total assets	**975,445**	**100.0**	916,911	100.0

ASSETS DEPLOYMENT FOR 2011



ASSETS DEPLOYMENT FOR 2010



Advances to Customers

At 31 December 2011, gross advances to customers were up HK$7.8bn, or 1.6%, at HK$482.2bn compared with the end of 2010.

Loans for use in Hong Kong decreased by HK$4.1bn, or 1.2%. Lending to industrial, commercial and financial sectors declined marginally by 0.9%. New financing to corporate customers remained active, reflecting strong growth in property investment lending against the backdrop of the buoyant commercial property market during the year. Stronger partnerships with Commercial Banking customers helped grow lending to the manufacturing industry by 11.3%. Advances to the information technology sector fell by 54.1% mainly due to loan repayments.

Trade finance declined substantially as certain trade finance loans matured during the second half of the year.

Lending to individuals fell by HK$2.3bn, or 1.5%. Residential mortgage lending to individuals declined by 4.3%, as a result of the Bank's focus towards Prime-based mortgage lending. The decrease was also affected by the intense market competition and new government measures to cool the residential property market. The uncertain economic conditions also led to a decline in residential property market activity towards the latter part of the year.

The credit card business registered strong growth, with card advances growing by 17.9%. This was supported by a rise of 9.8% in the number of cards in issue and a 16.5% increase in card spending, mainly due to successful card customer acquisition and card utilisation campaigns.

Loans for use outside Hong Kong increased strongly by HK$26.0bn, or 41.6%, compared with the end of 2010. This was due largely to the 23.0% expansion of Mainland loan portfolios, which reached HK$44.7bn at 31 December 2011. Strong growth was recorded in corporate lending, driven mainly by renminbi loans. The Group remained vigilant in assessing credit risk in increasing lending on the Mainland.

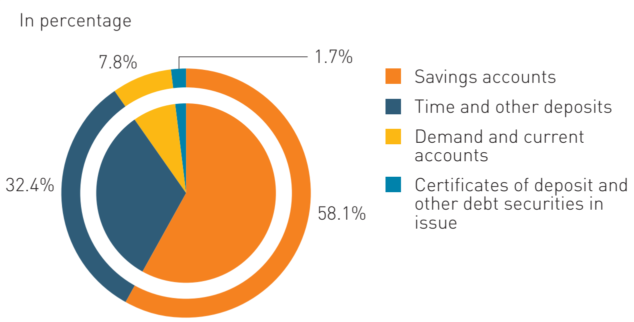
Customer Deposits

Customer deposits, including current, savings and other deposit accounts and certificates of deposit and other debt securities in issue, stood at HK$743.2bn at 31 December 2011, an increase of 4.6% over the end of 2010. In the low interest rate environment with keen market competition, most customers shifted deposits from savings accounts to time deposits. Certificates of deposit and structured deposit instruments with yield enhancement features also gained popularity. Hang Seng China achieved deposit growth of 34.1%, mainly in renminbi deposits.

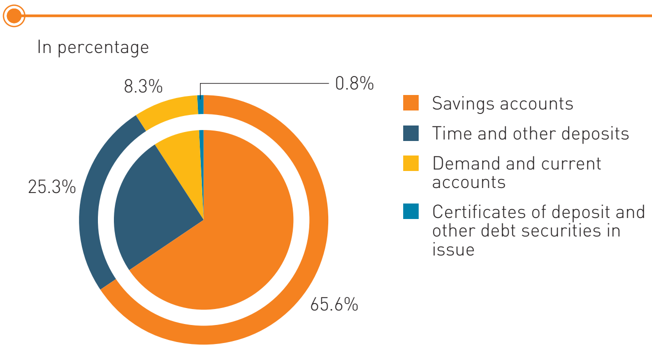
Subordinated Liabilities

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

CUSTOMER DEPOSITS FOR 2011



CUSTOMER DEPOSITS FOR 2010



Shareholders' funds

Figures in HK$m	2011	2010
Share capital	**9,559**	9,559
Retained profits	**48,640**	42,966
Premises revaluation reserve	**12,280**	9,426
Cash flow hedging reserve	**6**	72
Available-for-sale investment reserve		
– on debt securities	**(756)**	(25)
– on equity securities	**195**	227
Capital redemption reserve	**99**	99
Other reserves	**5,099**	4,055
Total reserves	**65,563**	56,820
	75,122	66,379
Proposed dividends	**3,633**	3,633
Shareholders' funds	**78,755**	70,012
Return on average shareholders' funds	**22.6%**	22.8%

Shareholders' funds (excluding proposed dividends) grew by HK$8,743m, or 13.2%, to HK$75,122m at 31 December 2011. Retained profits rose by HK$5,674m, mainly reflecting growth as a result of the 2011 profit after the appropriation of interim dividends. The premises revaluation reserve increased by HK$2,854m, or 30.3%, attributable to the buoyant commercial property market.

The available-for-sale investment reserve for debt securities recorded a deficit of HK$756m compared with a deficit of HK$25m at the end of 2010, reflecting the general widening of the credit spread. 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 22.6%, compared with 22.8% for 2010.

Excluding the redemption of all the US$450m floating rate subordinated notes due 2016 at par on 6 July 2011, there was no purchase, sale or redemption by the Bank, or any of its subsidiaries, of the Bank's securities during 2011.

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.