

REPORT OF THE DIRECTORS

The Directors have pleasure in presenting their report together with the audited financial statements for the year ended 31 December 2011.

PRINCIPAL ACTIVITIES

The Bank and its subsidiaries and associates are engaged in the provision of banking and related financial services.

PROFITS

The consolidated profit of the Bank and its subsidiaries and associates for the year and the particulars of dividends which have been paid or declared are set out on pages 97 and 133 of this Annual Report respectively.

MAJOR CUSTOMERS

The Directors believe that the five largest customers of the Bank accounted for less than 30% of the total interest income and other operating income of the Bank for the year.

SUBSIDIARIES

Particulars of the Bank's principal subsidiaries as at 31 December 2011 are set out in note 37 to the financial statements for the year ended 31 December 2011.

SHARE CAPITAL

No change in either the authorised or issued share capital took place during the year.

DONATIONS

Charitable donations made by the Bank and its subsidiaries during the year amounted to HK\$7.0m. For further details of the Bank's corporate social responsibility activities and expenditures, please refer to the section "Corporate Responsibility" of this Annual Report.

RESERVES

Profit attributable to shareholders, before dividends, of HK\$16,680m (2010: HK\$14,917m) have been transferred to reserves. Distributable reserve of the Bank as at 31 December 2011 amounted to HK\$20,642m (2010: HK\$20,556m). Other movements in reserves are set out in the consolidated statement of changes in equity.

DIRECTORS

The Directors of the Bank who were in office as at the end of the year were Dr Raymond K F Ch'ien, Mrs Margaret Leung, Dr John C C Chan, Dr Marvin K T Cheung, Ms L Y Chiang, Mr Andrew H C Fung, Ms Anita Y M Fung, Dr Fred Zulu Hu, Mr Jenkin Hui, Ms Sarah C Legg, Dr Eric K C Li, Dr Vincent

H S Lo, Mrs Dorothy K Y P Sit, Mr Richard Y S Tang, Mr Peter T S Wong and Mr Michael W K Wu.

After appointment as Directors of the Bank with effect from 14 February 2011, Mr Mark S McCombe and Ms Sarah C Legg were elected Directors at the Bank's 2011 Annual General Meeting ("AGM") held on 13 May 2011. Subsequently, Mr McCombe resigned from the Board with effect from 9 September 2011.

Mr William W Leung resigned from the Board with effect from 20 August 2011.

Dr Fred Zulu Hu, Mr Andrew H C Fung and Ms Anita Y M Fung were appointed Directors of the Bank with effect from 30 May 2011, 10 October 2011 and 1 November 2011, respectively. They will retire under the provisions of the Bank's Articles of Association and, being eligible, offer themselves for election at the Bank's forthcoming AGM to be held on 11 May 2012 ("2012 AGM").

The Directors retiring by rotation in accordance with the Bank's Articles of Association are Mrs Margaret Leung, Mrs Dorothy K Y P Sit, Mr Richard Y S Tang and Mr Peter T S Wong. Mrs Margaret Leung has informed the Board of her intention of not seeking re-election at the 2012 AGM for the reason set out below. All the other above-mentioned Directors will offer themselves for re-election at the 2012 AGM.

Mrs Margaret Leung will retire as Vice-Chairman and Chief Executive of the Bank and from the Board with effect from the conclusion of the 2012 AGM. Ms Rose W M Lee will be appointed a Non-executive Director and Chief Executive Designate of the Bank with effect from the date of receipt of the approval of Hong Kong Monetary Authority of her appointment until the conclusion of the 2012 AGM and being eligible, will offer herself for election by shareholders at the 2012 AGM. Subject to being elected by the shareholders, Ms Lee will become Vice-Chairman and Chief Executive of the Bank with effect from the conclusion of the 2012 AGM.

The Board announces the above changes to the Board composition on 27 February 2012. For further details of the above changes to the Board composition, shareholders may refer to the announcement issued by the Bank and uploaded on the Bank's website at www.hangseng.com.

No Director proposed for re-election or election, as the case may be, at the forthcoming AGM has a service contract with the Bank which is not determinable by the Bank within one year without payment of compensation (other than statutory compensation).

The biographical details of the Directors of the Bank are set out in the section "Biographical Details of Directors" of this Annual Report.

STATUS OF INDEPENDENT NON-EXECUTIVE DIRECTORS

The Bank has received from each Independent Non-executive Director an annual confirmation of his/her independence pursuant to Rule 3.13 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") (the "Listing Rules") and the Bank still considers the Independent Non-executive Directors to be independent.

DIRECTORS' AND ALTERNATE CHIEF EXECUTIVES' INTERESTS

INTERESTS IN SHARES

As at 31 December 2011, the interests of the Directors and Alternate Chief Executives in the shares, underlying shares of equity derivatives and debentures of the Bank and its associated corporations (all within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) disclosed in accordance with the Listing Rules were detailed below.

	Personal Interests (held as beneficial owner)	Family Interests (interests of spouse or child under 18)	Corporate Interests (interests of controlled corporation)	Other Interests	Total Interests	Total Interests as % of the relevant issued share capital
Number of Ordinary Shares of HK\$5 each in the Bank						
Directors:						
Mrs Margaret Leung	21,000	–	–	–	21,000	0.00
Dr John C C Chan	–	–	–	1,000 ⁽¹⁾	1,000	0.00
Number of Ordinary Shares of US\$0.50 each in HSBC Holdings plc						
Directors:						
Dr Raymond K F Ch'ien	57,237	–	–	–	57,237	0.00
Mrs Margaret Leung	243,889	–	–	375,502 ⁽⁵⁾	619,391	0.00
Dr John C C Chan	20,234	–	–	4,371 ⁽¹⁾	24,605	0.00
Ms L Y Chiang	12,000	–	6,000 ⁽²⁾	–	18,000	0.00
Mr Andrew H C Fung	20,585	–	–	41,668 ⁽⁵⁾	62,253	0.00
Ms Anita Y M Fung	–	–	–	1,299,729 ⁽⁵⁾	1,299,729	0.00
Mr Jenkin Hui	17,915	–	1,985,170 ⁽³⁾	–	2,003,085	0.01
Ms Sarah C Legg	37,270	2,008	–	57,359 ⁽⁵⁾	96,637	0.00
Dr Eric K C Li	–	41,040	–	–	41,040	0.00
Mrs Dorothy K Y P Sit	57,343 ⁽⁴⁾	1,031	–	37,143 ⁽⁵⁾	95,517	0.00
Mr Peter T S Wong	410,767	17,599	–	406,683 ⁽⁵⁾	835,049	0.00
Alternate Chief Executives:						
Mr Nixon L S Chan	16,816	–	–	32,007 ⁽⁵⁾	48,823	0.00
Mr Christopher H N Ho	79,457	44,324	–	15,075 ⁽⁵⁾	138,856	0.00
Mr Donald Y S Lam	22,699	–	–	20,804 ⁽⁵⁾	43,503	0.00
Mr Andrew W L Leung	4,710	–	–	1,668 ⁽⁵⁾	6,378	0.00
Mr David W H Tam	22,171	9,014	–	14,928 ⁽⁵⁾	46,113	0.00

Notes:

- (1) 1,000 shares in the Bank and 4,371 shares in HSBC Holdings plc were held by a trust of which Dr John C C Chan and his wife were beneficiaries.
- (2) Ms L Y Chiang was entitled to fully control the voting power at general meetings of Happy Boom Enterprises Limited, a private company, which beneficially held all of those shares referred to above as her corporate interests.
- (3) Mr Jenkin Hui was entitled to fully control the voting power at general meetings of Parc Palais Incorporated, a private company, which beneficially held all of those shares referred to above as his corporate interests.
- (4) 8,046 shares were jointly held by Mrs Dorothy K Y P Sit and her husband.
- (5) These represented interests in (i) options granted to Directors and Alternate Chief Executives under the HSBC Share Option Plans to acquire ordinary shares of US\$0.50 each in HSBC Holdings plc and (ii) conditional awards of ordinary shares of US\$0.50 each in HSBC Holdings plc under the HSBC Share Plans made in favour of Directors and Alternate Chief Executives, as set against their respective names below:

	Options (please refer to the options table below for details)	Conditional awards of shares under the HSBC Share Plans (please refer to the awards table below for further information)	Total
Directors:			
Mrs Margaret Leung	4,197	371,305	375,502
Mr Andrew H C Fung	4,197	37,471	41,668
Ms Anita Y M Fung	4,197	1,295,532	1,299,729
Ms Sarah C Legg	20,021	37,338	57,359
Mrs Dorothy K Y P Sit	2,375	34,768	37,143
Mr Peter T S Wong	–	406,683	406,683
Alternate Chief Executives:			
Mr Nixon L S Chan	11,476	20,531	32,007
Mr Christopher H N Ho	5,961	9,114	15,075
Mr Donald Y S Lam	11,082	9,722	20,804
Mr Andrew W L Leung	–	1,668	1,668
Mr David W H Tam	13,770	1,158	14,928

OPTIONS

As at 31 December 2011, the Directors and Alternate Chief Executives mentioned below held unlisted physically settled options to acquire the number of ordinary shares of US\$0.50 each in HSBC Holdings plc set against their respective names. These options were granted for nil consideration by HSBC Holdings plc.

	Options held as at 31 December 2011	Options exercised/ cancelled during the Director's/ Alternate Chief Executive's term of office in 2011	Exercise price per share	Date granted	Exercisable from	Exercisable until
Directors:						
Mrs Margaret Leung	4,197	–	HK\$37.8797	29 Apr 2009	1 Aug 2014	31 Jan 2015
Mr Andrew H C Fung	4,197	–	HK\$37.8797	29 Apr 2009	1 Aug 2014	31 Jan 2015
Ms Anita Y M Fung	4,197	–	HK\$37.8797	29 Apr 2009	1 Aug 2014	31 Jan 2015
Ms Sarah C Legg	–	5,738	£7.5919	23 Apr 2001	23 Apr 2004	22 Apr 2011
	3,656	–	£7.3244	7 May 2002	7 May 2005	7 May 2012
	3,803	–	£7.3244	7 May 2002	7 May 2005	7 May 2012
	2,295	–	£6.0216	2 May 2003	2 May 2006	2 May 2013
	5,738	–	£7.2181	30 Apr 2004	30 Apr 2009	30 Apr 2014
	4,529	–	£3.6361	29 Apr 2009	1 Aug 2014	31 Jan 2015
	20,021					

	Options held as at 31 December 2011	Options exercised/ cancelled during the Director's/ Alternate Chief Executive's term of office in 2011	Exercise price per share	Date granted	Exercisable from	Exercisable until
Directors:						
Mrs Dorothy K Y P Sit	–	3,443	£7.5919	23 Apr 2001	23 Apr 2004	22 Apr 2011
	2,375	–	HK\$37.8797	29 Apr 2009	1 Aug 2012	31 Jan 2013
	<u>2,375</u>					
Alternate Chief Executives:						
Mr Nixon L S Chan	–	4,820	£7.5919	23 Apr 2001	23 Apr 2004	22 Apr 2011
	3,328	–	£7.3244	7 May 2002	7 May 2005	6 May 2012
	3,615	–	£6.0216	2 May 2003	2 May 2006	1 May 2013
	4,533	–	£7.2181	30 Apr 2004	30 Apr 2009	29 Apr 2014
	–	592 ⁽¹⁾	HK\$62.9770	21 Apr 2010	1 Aug 2011	31 Oct 2011
	<u>11,476</u>					
Mr Christopher H N Ho	3,443	–	£7.2181	30 Apr 2004	30 Apr 2009	29 Apr 2014
	2,518	–	HK\$37.8797	29 Apr 2009	1 Aug 2012	31 Jan 2013
	<u>5,961</u>					
Mr Donald Y S Lam	6,885	–	£7.2181	30 Apr 2004	30 Apr 2009	30 Apr 2014
	4,197	–	HK\$37.8797	29 Apr 2009	1 Aug 2014	31 Jan 2015
	<u>11,082</u>					
Mr David W H Tam	–	5,738	£7.5919	23 Apr 2001	23 Apr 2004	22 Apr 2011
	6,311	–	£7.3244	7 May 2002	7 May 2005	6 May 2012
	7,459	–	£7.2181	30 Apr 2004	30 Apr 2009	29 Apr 2014
	<u>13,770</u>					

Note:

[1] At the date of exercise, 1 August 2011, the market value per share was £6.0750.

CONDITIONAL AWARDS OF SHARES

As at 31 December 2011, the interests of the Directors and Alternate Chief Executives in the conditional awards of ordinary shares of US\$0.50 each in HSBC Holdings plc made in favour of them under the HSBC Share Plans were as follows:

	Awards held as at 1 January 2011	Awards made during the Director's/Alternate Chief Executive's term of office in 2011	Awards released during the Director's/Alternate Chief Executive's term of office in 2011	Awards held as at 31 December 2011
Directors:				
Mrs Margaret Leung	396,274	110,657	150,534	371,305 ⁽¹⁾
Mr Andrew H C Fung	38,776	13,665	16,521	37,471 ⁽¹⁾
Ms Anita Y M Fung	1,295,532 ⁽²⁾	–	–	1,295,532
Ms Sarah C Legg	36,889 ⁽³⁾	12,557	13,351	37,338 ⁽¹⁾
Mrs Dorothy K Y P Sit	42,602	11,819	21,217	34,768 ⁽¹⁾
Mr Peter T S Wong	308,025	241,631	156,545	406,683 ⁽¹⁾
Alternate Chief Executives:				
Mr Nixon L S Chan	20,055	4,924	5,263	20,531 ⁽¹⁾
Mr Christopher H N Ho	8,153	1,723	1,101	9,114 ⁽¹⁾
Mr Donald Y S Lam	9,722 ⁽⁴⁾	–	–	9,722
Mr Andrew W L Leung	848	1,046	282	1,668 ⁽¹⁾
Mr David W H Tam	1,663	–	553	1,158 ⁽¹⁾

Notes:

(1) This includes additional shares arising from scrip dividends.

(2) This represented the awards held by Ms Anita Y M Fung on 1 November 2011 when she was appointed a Director of the Bank.

(3) This represented the awards held by Ms Sarah C Legg on 14 February 2011 when she was appointed a Director of the Bank.

(4) This represented the awards held by Mr Donald Y S Lam on 18 October 2011 when he was appointed an Alternate Chief Executive of the Bank.

All the interests stated above represent long positions. As at 31 December 2011, no short positions were recorded in the Register of Directors' and Alternate Chief Executives' Interests and Short Positions required to be kept under section 352 of the SFO.

Save as disclosed in the preceding paragraphs, at no time during the year was the Bank or any of its holding companies or its subsidiaries or fellow subsidiaries a party to any arrangement to enable the Directors of the Bank to acquire benefits by means of the acquisition of shares in or debentures of the Bank or any other body corporate.

No right to subscribe for equity or debt securities of the Bank has been granted by the Bank to, nor have any such rights been exercised by, any person during the year ended 31 December 2011.

DIRECTORS' INTERESTS IN CONTRACTS

No contract of significance, to which the Bank or any of its holding companies or any of its subsidiaries or fellow subsidiaries was a party and in which a Director of the Bank had a material interest, subsisted as at the end of the year or at any time during the year.

DIRECTORS' INTERESTS IN COMPETING BUSINESSES

Pursuant to Rule 8.10 of the Listing Rules, as at the date of this report, the following Directors had declared interests in the following entities which compete or are likely to compete, either directly or indirectly, with the businesses of the Bank:

Mr Andrew H C Fung is Director, a member of Executive Committee and a member of Remuneration and Examination Committee of Industrial Bank Co., Ltd. ("Industrial Bank"), in which the Bank holds a 12.8% stake. Industrial Bank conducts general banking business in mainland China.

Ms Anita Y M Fung is a Group General Manager of HSBC Holdings plc and the Chief Executive Officer, Hong Kong of The Hongkong and Shanghai Banking Corporation Limited. She is also the Deputy Chairman of HSBC Bank (China) Company Limited and the Chairman and Director of HSBC Global Asset Management (Hong Kong) Limited, subsidiaries of The Hongkong and Shanghai Banking Corporation Limited, and a Director of various HSBC Group subsidiaries.

Ms Sarah C Legg is the Chief Financial Officer of The Hongkong and Shanghai Banking Corporation Limited and a Director of various HSBC Group subsidiaries.

Mrs Margaret Leung is a Group General Manager of HSBC Holdings plc and a Director of The Hongkong and Shanghai Banking Corporation Limited.

Mr Peter T S Wong is a Group Managing Director of HSBC Holdings plc. He is also the Chief Executive and Executive Director of The Hongkong and Shanghai Banking Corporation Limited; and Chairman and Non-executive Director of HSBC Bank Malaysia Berhad and HSBC Bank (China) Company Limited. He is a Non-executive Director of Bank of Communications Co., Ltd., which conducts general banking business. He is also a Non-executive Director of Ping An Insurance (Group) Company of China, Ltd., which conducts life insurance, property and casualty insurance and other financial services.

HSBC Holdings plc, through its subsidiaries and associated undertakings, including The Hongkong and Shanghai Banking Corporation Limited, the immediate holding company of the Bank, is engaged in providing a comprehensive range of banking, insurance and related financial services.

The entities in which the Directors have declared interests are managed by separate Boards of Directors and management, which are accountable to their respective shareholders.

Further, Industrial Bank has an Audit and Related Party Transaction Control Committee which is responsible for considering all matters concerning audit as well as connected party transactions to be entered into by Industrial Bank as required by the laws of mainland China. The majority of members of Industrial Bank's Audit and Related Party Transaction Control Committee are independent Directors.

The Board of the Bank includes nine Independent Non-executive Directors whose views carry significant weight in the Board's decisions. The Audit Committee of the Bank, which consists of three Independent Non-executive Directors, meets regularly to assist the Board of Directors in reviewing the financial performance, internal control and compliance systems of the Bank and its subsidiaries. The Bank is, therefore, capable of carrying on its businesses independently of, and at arm's length from, the businesses in which Directors have declared interests.

DIRECTORS' EMOLUMENTS

The emoluments of the Directors of the Bank (including Executive Directors and Independent Non-executive Directors) on a named basis are set out in note 19 to the financial statements for the year ended 31 December 2011.

SUBSTANTIAL INTERESTS IN SHARE CAPITAL

The register maintained by the Bank pursuant to the SFO recorded that, as at 31 December 2011, the following corporations had interests or short positions in the shares or underlying shares (as defined in the SFO) in the Bank set opposite their respective names:

Name of Corporation	Number of Ordinary Shares of HK\$5 each in the Bank (Percentage of total)
The Hongkong and Shanghai Banking Corporation Limited	1,188,057,371 (62.14%)
HSBC Asia Holdings BV	1,188,057,371 (62.14%)
HSBC Asia Holdings (UK) Limited	1,188,057,371 (62.14%)
HSBC Holdings BV	1,188,057,371 (62.14%)
HSBC Finance (Netherlands)	1,188,057,371 (62.14%)
HSBC Holdings plc	1,188,057,371 (62.14%)

The Hongkong and Shanghai Banking Corporation Limited is a wholly-owned subsidiary of HSBC Asia Holdings BV, which is a wholly-owned subsidiary of HSBC Asia Holdings (UK) Limited, which in turn is a wholly-owned subsidiary of HSBC Holdings BV. HSBC Holdings BV is a wholly-owned subsidiary of HSBC Finance (Netherlands), which in turn is a wholly-owned subsidiary of HSBC Holdings plc. Accordingly, The Hongkong and Shanghai Banking Corporation Limited's interests are recorded as the interests of HSBC Asia Holdings BV, HSBC Asia Holdings (UK) Limited, HSBC Holdings BV, HSBC Finance (Netherlands) and HSBC Holdings plc.

The Directors regard HSBC Holdings plc to be the beneficial owner of 1,188,057,371 ordinary shares in the Bank (62.14%).

All the interests stated above represent long positions. As at 31 December 2011, no short positions were recorded in the Register of Interests in Shares and Short Positions required to be kept under section 336 of the SFO.

PURCHASE, SALE OR REDEMPTION OF THE BANK'S LISTED SECURITIES

Save for the redemption of all the US\$450,000,000 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 listed securities during the year.

PUBLIC FLOAT

As at the date of this report, the Bank has maintained the prescribed public float under the Listing Rules, based on the information that is publicly available to the Bank and within the knowledge of the Directors of the Bank.

CODE ON CORPORATE GOVERNANCE PRACTICES

Details of the Bank's corporate governance practices are set out in the "Corporate Governance and Other Information" section in this Annual Report.

AUDITOR

KPMG retire and, being eligible, offer themselves for re-appointment. A resolution for the re-appointment of KPMG as auditor of the Bank will be proposed at the forthcoming Annual General Meeting.

On behalf of the Board

Raymond Ch'ien

Chairman

Hong Kong, 27 February 2012