

Report of the Directors

The Directors have pleasure in presenting their report together with the audited financial statements for the year ended 31 December 2012.

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 78 and 112 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 2012 are set out in note 38 to the financial statements for the year ended 31 December 2012.

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\$10m. 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\$19,426m (2011 restated: HK\$16,885m) have been transferred to reserves. Distributable reserve of the Bank as at 31 December 2012 amounted to HK\$24,773m (2011 restated: HK\$20,630m). 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, Ms Rose W M Lee, 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.

Mrs Margaret Leung retired from the Board with effect from the conclusion of the Bank's 2012 Annual General Meeting ("AGM") held on 11 May 2012.

Ms Rose W M Lee was appointed a Non-executive Director and Chief Executive Designate of the Bank with effect from 22 March 2012. After the election of Ms Lee as a Director of the Bank by shareholders at the Bank's 2012 AGM, she was re-designated Vice-Chairman and Chief Executive of the Bank with effect from the conclusion of the 2012 AGM.

The Directors retiring by rotation in accordance with the Bank's Articles of Association are Dr John C C Chan, Dr Marvin K T Cheung, Mr Jenkin Hui, Dr Eric K C Li and Dr Vincent H S Lo. Mr Jenkin Hui has informed the Board of his intention of not seeking re-election at the 2013 AGM to be held on 16 May 2013. All the other above-mentioned Directors will offer themselves for re-election at the 2013 AGM.

No Director proposed for re-election 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"). The Bank still considers all the Independent Non-executive Directors to be independent.

Directors' And Alternate Chief Executives' Interests

As at 31 December 2012, 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.

Interests in shares

	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						
Director:						
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	57,814	–	–	–	57,814	0.00
Ms Rose W M Lee	146,940	1,397	–	7,988 ⁽⁵⁾	156,325	0.00
Dr John C C Chan	24,605 ⁽¹⁾	–	–	–	24,605	0.00
Mr Andrew H C Fung	41,943	–	–	38,531 ⁽⁵⁾	80,474	0.00
Ms Anita Y M Fung	101,313	–	–	459,381 ⁽⁵⁾	560,694	0.00
Mr Jenkin Hui	18,685	–	2,070,581 ⁽²⁾	–	2,089,266	0.01
Ms Sarah C Legg	60,845	2,008	–	68,001 ⁽⁵⁾	130,854	0.00
Dr Eric K C Li	–	43,463	–	–	43,463	0.00
Mrs Dorothy K Y P Sit	80,853 ⁽³⁾	1,031	–	32,568 ⁽⁵⁾	114,452	0.00
Mr Peter T S Wong	712,463	18,413	–	547,165 ⁽⁵⁾	1,278,041	0.00
Alternate Chief Executives:						
Mr Nixon L S Chan	32,712	–	–	21,839 ⁽⁵⁾	54,551	0.00
Mr Christopher H N Ho	93,856	46,938	–	8,070 ⁽⁵⁾	148,864	0.00
Mr Donald Y S Lam	30,504	–	–	18,110 ⁽⁵⁾	48,614	0.00
Mr Andrew W L Leung	5,369	–	–	2,993 ⁽⁵⁾	8,362	0.00
Number of perpetual non-cumulative preference shares of US\$0.01 each in HSBC Holdings plc						
Director:						
Ms Rose W M Lee	–	–	–	306,075 ⁽⁴⁾	306,075	0.20

Interests in debentures of associated corporations of the Bank

Name of debenture	Name of Director	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
8.00% perpetual subordinated capital securities, series 2 issued by HSBC Holdings plc	Ms Rose W M Lee	–	–	–	US\$7,651,875 ⁽⁴⁾	US\$7,651,875
4.75% senior notes, due on 15 July 2013 and issued by HSBC Finance Corporation	Ms Anita Y M Fung	US\$1 million	–	–	–	US\$1 million
5% senior notes, due on 30 June 2015 and issued by HSBC Finance Corporation	Ms Anita Y M Fung	US\$3 million	–	–	–	US\$3 million

Notes:

- (1) 1,000 shares in the Bank and 4,371 shares in HSBC Holdings plc were jointly held by Dr John C C Chan and his wife.
- (2) 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.
- (3) 8,046 shares were jointly held by Mrs Dorothy K Y P Sit and her husband.
- (4) Ms Rose W M Lee was a beneficiary of a trust, which had interests in the total principal amount of US\$7,651,875 of the 8.00% perpetual subordinated capital securities, series 2. These perpetual subordinated capital securities were exchangeable at the option of HSBC Holdings plc into 306,075 perpetual non-cumulative preference shares of US\$0.01 each in HSBC Holdings plc. Ms Lee's interests set out in the table under "Interests in shares" and the table under "Interests in debentures of associated corporations of the Bank" represented the same interests.
- (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:			
Ms Rose W M Lee	–	7,988	7,988
Mr Andrew H C Fung	4,197	34,334	38,531
Ms Anita Y M Fung	4,197	455,184	459,381
Ms Sarah C Legg	12,562	55,439	68,001
Mrs Dorothy K Y P Sit	–	32,568	32,568
Mr Peter T S Wong	–	547,165	547,165
Alternate Chief Executives:			
Mr Nixon L S Chan	8,148	13,691	21,839
Mr Christopher H N Ho	3,443	4,627	8,070
Mr Donald Y S Lam	11,082	7,028	18,110
Mr Andrew W L Leung	–	2,993	2,993

Options

As at 31 December 2012, 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 2012	Options exercised/ cancelled during the Director's/ Alternate Chief Executive's term of office in 2012	Exercise price per share	Date granted	Exercisable from	Exercisable until
Directors:						
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	–	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	–	£3.3116	29 Apr 2009	1 Aug 2014	31 Jan 2015
	<u>12,562</u>					
Mrs Dorothy K Y P Sit	–	2,375 ⁽¹⁾	HK\$37.8797	29 Apr 2009	1 Aug 2012	31 Jan 2013
Alternate Chief Executives:						
Mr Nixon L S Chan	–	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
	–	590 ⁽²⁾	HK\$63.9864	20 Apr 2011	1 Aug 2012	31 Oct 2012
	<u>8,148</u>					
Mr Christopher H N Ho	3,443	–	£7.2181	30 Apr 2004	30 Apr 2009	29 Apr 2014
	–	2,518 ⁽³⁾	HK\$37.8797	29 Apr 2009	1 Aug 2012	31 Jan 2013
	<u>3,443</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>					

Notes:

(1) As at the date of exercise, 12 September 2012, the market value per share was £5.6910.

(2) As at the date of exercise, 11 October 2012, the market value per share was £5.9720.

(3) As at the date of exercise, 16 October 2012, the market value per share was £6.1100.

Conditional Awards of Shares

As at 31 December 2012, 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 2012	Awards made during the Director's/Alternate Chief Executive's term of office in 2012	Awards released/lapsed during the Director's/Alternate Chief Executive's term of office in 2012	Awards held as at 31 December 2012
Directors:				
Ms Rose W M Lee	7,752 ⁽¹⁾	–	–	7,988 ⁽²⁾
Mr Andrew H C Fung	37,471	16,247	21,358	34,334 ⁽²⁾
Ms Anita Y M Fung	1,295,532	215,147	1,097,491	455,184 ⁽²⁾
Ms Sarah C Legg	37,338	38,770	23,575	55,439 ⁽²⁾
Mrs Dorothy K Y P Sit	34,768	17,069	21,135	32,568 ⁽²⁾
Mr Peter T S Wong	406,683	398,753	287,444	547,165 ⁽²⁾
Alternate Chief Executives:				
Mr Nixon L S Chan	20,531	7,611	15,306	13,691 ⁽²⁾
Mr Christopher H N Ho	9,114	2,049	6,852	4,627 ⁽²⁾
Mr Donald Y S Lam	9,722	4,683	7,805	7,028 ⁽²⁾
Mr Andrew W L Leung	1,668	1,829	659	2,993 ⁽²⁾

Notes:

(1) This represented the awards held by Ms Rose W M Lee on 22 March 2012 when she was appointed a Director of the Bank.

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

All the interests stated above represent long positions. As at 31 December 2012, 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 2012.

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 a 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 10.9% stake after its completion of a private placement of additional share capital to a number of third parties in January 2013. 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 Chairman and Director of HSBC Global Asset Management (Hong Kong) Limited, subsidiary of The Hongkong and Shanghai Banking Corporation Limited, and a Director of various HSBC Group subsidiaries. She is also a Non-executive Director of Bank of Communications Co., Ltd. and a member of its Personnel and Compensation Committee. Bank of Communications Co., Ltd. conducts general banking business.

Ms Rose W M Lee is a Group General Manager of HSBC Holdings plc and a Director of The Hongkong and Shanghai Banking Corporation Limited.

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.

Mr Peter T S Wong is a Group Managing Director and a member of Group Management Board 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 which are the wholly-owned subsidiaries of The Hongkong and Shanghai Banking Corporation Limited. He is a Non-executive Director of Bank of Communications Co., Ltd.

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 2012.

Substantial Interests In Share Capital

The register maintained by the Bank pursuant to the SFO recorded that, as at 31 December 2012, 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 2012, 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\$300,000,000 floating rate subordinated notes due 2017 at par on 6 July 2012, 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, 4 March 2013