Chief Executive's Report

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> I would like to thank and acknowledge my colleagues for their commitment and perseverance amid working in a demanding environment. The pursuit of excellence and ever-growing success is engrained in the company's DNA and will continue to be the driving force behind our brand, now and into the future.

2021: A Year of Continuity and Change

Few would dispute that the operating environment continued to be challenging in 2021. Nevertheless, we have bright spots to report in our performance last year. We enjoyed solid balance sheet growth, healthy increases in non-interest income and strong momentum in building up our mortgage, trade and green loans portfolios. Digital developments advanced at speed and environmental, social and governance ('ESG') issues were an important focus as we made efforts to support the transition to a low-carbon economy. We were also delighted to celebrate with our Hang Seng Table Tennis Academy graduates who brought home a bronze medal from the Olympic Games.

Our financial performance was a tale of two halves.

In the first half, there was cautious optimism that we were turning the corner on COVID-19. An improved economic outlook buoyed sentiments and drove activity in global financial and commercial markets. We benefitted from strong business momentum, especially in wealth management. The second half, however, was more challenging as investor and business sentiment dampened with the emergence of Omicron which brought back disruptions to trade and global supply chains, slowing economic recovery.

In addition, due to tightening liquidity and increased refinancing risk in the mainland commercial real estate sector, we built in a material adjustment to our expected credit losses ('ECL') to reflect the higher risk level. We will continue to closely monitor the market situation and mitigate potential risks through robust reviews of credit portfolios. That said, our overall lending portfolio remains stable.

The underlying performance of our business was resilient. However, enhancing the ECL provisions has impacted our full-year results. Also, low interest rates continued to affect net interest income across all of our businesses. As a result, our attributable profit for 2021 fell by 16% to HK$13,960m.

Wealth and Personal Banking

Our Wealth and Personal Banking business recorded an 11% year-on-year increase in wealth management income. This is the result of stronger data analytics capabilities and the uplifting of digital banking capabilities to deliver better customer solutions and more diversified investment and insurance products. We have particularly focused on the mid-market segments. Amongst other achievements, we were the first bank in Hong Kong to extend equity-linked investment product subscription services to US securities for retail investors. As demand for ESG investment products accelerates around the world, we are pleased to be launching the first ESG ETF based on the Hang Seng Index. We will also be introducing green mortgage and electrical vehicle loans in the first half.

Hang Seng was one of the first banks to launch cross-boundary investment services under the Wealth Management Connect ('WMC') Scheme. We have set up a designated WMC team in Hong Kong which will work closely with our colleagues in the mainland to provide seamless support to customers for their northbound and southbound investment in the Greater Bay Area ('GBA').

Insurance business income rose by 17% as we launched new products to meet growing customer needs in areas such as lifetime protection, legacy planning and long-term asset growth.

Strong momentum in the local property market and improved retail consumption sentiment boosted by the Government's Consumer Voucher Scheme propelled strong growth in our mortgage and credit card businesses. New mortgage drawdowns outpaced the market, increasing by 34% year-on-year. Card spending was up 10%.

Investing in digital infrastructure remains a priority. Last year, we rolled out 415 digital innovations and enhancements for personal banking, including the introduction of the 'Pay with Hang Seng' online payment channel. Our digital efforts have been well received. Year-on-year, the number of users of our award-winning mobile banking app was up by 12%, log-ons increased 26% and the total number of online transactions jumped 44%.

The enhanced digital experience extends seamlessly into our physical branches and outlets. We continued to invest in our 'Future Branch' concept to deliver more customer-centric services. Our new landmark Central Branch is the latest showcase of our digital servicing model.

Commercial Banking, Global Banking and Global Markets

On the commercial side, we continued to focus on supporting our customers. The pace of new lending grew as export demand and international economic activity revived. In particular, Commercial Banking's trade finance lending was up 41%. Overall, the renewed activity helped Commercial Banking grow customer advances by 2%, with customer deposits rising by 8%. We stayed active in the syndicated loan market, recording a 10% increase in credit facilities fees. We also captured opportunities to grow our foreign exchange and trade fee incomes.

ESG is fast becoming a prerequisite for doing business and we are proactive in supporting clients to transition. We introduced sustainability-linked loans and enhanced existing trade finance products with green and sustainable features. We also stepped up our collaboration with Hong Kong Quality Assurance Agency to help green financing customers capitalise on opportunities in the GBA. In total, we approved HK$7.3bn in green loans, 15 times more than the amount in 2020. Global Markets grew its green bond investment portfolio by 83% year-on-year, and the Repo Trading business began accepting green bonds as collateral to support market growth in sustainable financing activity.

As we continue to explore new business segments and opportunities in green finance, our efforts will also help to further diversify our revenue base.

Fintech provided customers with remote account opening services and shorter turnaround and processing times while making the management of cash flow and payments collection faster and easier. We introduced over 250 digital innovations and enhancements. Corporate clients now enjoy more timely collection and reconciliation processes with our new Virtual Account tool and we deployed the use of blockchain technology to support digital trade documentation and finance activities. Innovation supported a more than doubling in average monthly customer acquisitions compared with the previous year.

We are continuing to collaborate with external partners to facilitate the advancement of fintech development. In addition to our strategic alliances with Hong Kong Cyberport and Hong Kong Science and Technology Parks, we started working with the Hong Kong Trade Development Council last year to co-create 'InnoClub', a one-stop platform to help SMEs go digital in their operations.

We offered tailor-made, industry-specific cash management solutions to Global Banking clients across different business sectors. This led to a 21% growth in current and savings deposits and an 11% growth in the loan balance. Global Banking customers are also discovering the benefits of going digital as we saw 22% of total transactions switching from in-branch counters to online channels.

We expanded our Global Markets Repo Trading business, maintained our market-making role for Hong Kong government bills and bonds, and actively participated in the issuance of the Hong Kong Monetary Authority's first one-year HONIA-indexed Floating Rate Note. We also supported the regulatory transition of LIBOR by launching replacement financial products referencing new risk-free rates.

Hang Seng China

Challenging operating environment aside, our wholly-owned subsidiary Hang Seng China leveraged its close connectivity with our Hong Kong operations to maintain strong growth momentum. Profit before tax increased 23%. The personal banking business increased by 268%, while commercial and global banking business were up 29% and 10% respectively. In particular, our deep understanding of local market and industry trends supported a solid increase in lending. Wholesale trade loans reached a record high and we continue to be one of the most active foreign banks in the syndication segment, maintaining a top ranking in the industry.

All in all, the Bank's underlying fundamentals are strong and we are gaining momentum in key strategic areas to make our business more resilient and drive sustainable future growth.

Financial Overview

The Bank's financial position was strengthened as we recorded good growth in non-interest income business lines, which benefitted from improved economic and investment sentiments in the first half as well as initiatives to further diversify our revenue base. While there were increased market uncertainties in the second half, due in part to new developments in the pandemic situation, overall, non-interest income grew by 2% year-on-year to HK$9,360m.

Income from interest-earning activities came under growing pressure during the year. Despite solid balance sheet growth and a 2.7% increase in average interest-earning assets, net interest income fell by 11% to HK$23,822m, reflecting the unfavourable effects of the interest rate environment. Year-on-year, the net interest margin was down by 24 basis points at 1.49%, which remains above market average levels.

Net operating income before change in expected credit losses and other credit impairment charges fell by 8% compared with 2020 to HK$33,182m.

We continued to invest in technology, brand presence and people to strengthen our strategic positioning and facilitate future growth, which contributed to a 7% rise in operating expenses to HK$14,134m. Together with the decline in net operating income, the increase in expenses pushed our cost efficiency ratio to 42.6%. However, on the back of these investments into our business, we are now more strongly positioned to capture a greater share of new market opportunities and realise improved operational efficiencies over the longer term.

As previously mentioned, we increased ECL provisions on a few currently unimpaired credit exposures to clients in the mainland real estate sector. However, our overall credit quality remained robust and with the release of similar provisions across a broad range of other sectors and a reduction in stage-3 ECL charges, change in ECL only increased slightly by 3% to HK$2,807m.

The overall impact of all these factors was a 19% decline in operating profit to HK$16,231m. Operating profit excluding the change in ECL was down by 17% at HK$19,038m.

Recovery in the commercial property market in Hong Kong resulted in a net surplus of HK$82m on property revaluation, compared with a net deficit of HK$636m in the same period in 2020.

Profit before tax fell by 16% to HK$16,385m. Attributable profit was also down by 16% at HK$13,960m. Earnings per share were down by 17% at HK$6.93 per share. For our individual business segments, profit before tax for Wealth and Personal Banking, Commercial Banking, and Global Banking and Markets, fell by 8%, 18% and 40% respectively, affected mainly by a drop in net interest income.

Return on average ordinary shareholders' equity was 7.7%, compared with 9.6% for 2020. Return on average total assets was 0.8%, compared with 1.0% in 2020.

Our capital base remains strong. At 31 December 2021, our common equity tier 1 capital ratio was 15.9%, our tier 1 capital ratio was 17.5%, and our total capital ratio was 18.9%. We continued to maintain healthy liquidity that was well above the statutory requirement throughout the year. At 2021 year-end, our liquidity coverage ratio was 192.7%.

Gross advances to customers were HK$1,004bn, up 6% compared with 2020 year-end, driven mainly by residential mortgages, trade finance lending and loans for use outside Hong Kong.

Customer deposits, including certificates of deposit and other debt securities in issue, increased by HK$35bn, or 3%, to HK$1,339bn against the end of 2020. To diversify its funding sources, the Bank issued more certificates of deposit in 2021.

2022 Outlook

It is clear that recovery cannot be taken for granted and uncertainty will continue to be a factor. In order to operate in this environment, we must always remain vigilant and agile, and be quick to respond to any sudden changes.

It is vital that we have clear strategies and a direction forward. In 2022, we will focus on growing our business and capturing new opportunities in strategic customer segments and in the GBA by leveraging cross-business revenue synergies and boosting contribution from non-fund income and digital channels.

Markets are expecting an increase in interest rates this year, which should provide some medium-term relief on the net interest margin and net interest income. As we look to grow our loan book, we will continue to adopt a prudent risk management approach. Innovation is essential and will remain a top priority. We will invest in equipping our colleagues with future skills to support their career ambitions within the Bank.

The future is 'Beyond Banking'. We will embrace fintech to integrate banking services more seamlessly into people's business and everyday lives. In the future, customers will not need to seek us out, we will already be there when needed.

We are well-positioned to provide our customers with seamless support to take advantage of new business and investment opportunities in the GBA. This will further strengthen our own franchise and be an important contributor for long-term profit growth.

Focusing attention and driving action on the ESG agenda will remain a core value. We will expand our green loans and sustainability-linked investment products. We will also enhance the ESG performance of our own operations. We are on track to meet our target of being carbon neutral by 2030.

Our community investment programmes will support the sustainable, long-term development of Hong Kong.

With the COVID-19 situation recently becoming more serious, we have announced a HK$10m initiative to provide support for the elderly and grassroots families that includes donating rapid antigen tests, surgical masks and other supplies, and the setting up of an Emotional Well-being Hotline. Our staff volunteers will also participate in telephone outreach activities to offer care and general support to the elderly and others in need.

And finally, I would like to thank and acknowledge my colleagues for their commitment and perseverance. Maintaining uninterrupted services for customers in a demanding environment required working as a team and putting in long hours. I am delighted that last month, Hang Seng was again named the Best Domestic Bank in Hong Kong by *The Asset* magazine, a recognition we have maintained for 22 consecutive years. The pursuit of excellence and ever-growing success is engrained in the company's DNA and will continue to be the driving force behind our brand, now and into the future.

Diana Cesar
Executive Director and Chief Executive
22 February 2022