Testimony

Of

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On behalf of

HSBC - North America

Presented to the

Senate Committee on Banking, Housing, and Urban Affairs

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HEARINGS ON "MORTGAGE MARKET TURMOIL: CAUSES AND CONSEQUENCES"

Mr. Chairman and Members of the Committee:

I am Brendan McDonagh, chief executive officer for HSBC Finance Corporation and chief operating officer for HSBC - North America, a wholly owned subsidiary of HSBC Holdings plc. I am responsible for HSBC's consumer finance businesses in the United States, including our consumer and mortgage lending business.

I would like to thank you for inviting me to testify today on behalf of HSBC - North America. I will structure my remarks today around three topics:

1) An overview of HSBC Finance with a focus on our mortgage operations

2) Our perspective on issues in the mortgage market

3) How HSBC Finance is addressing these issues, both on the originations and servicing aspects of the business

An Overview of HSBC

To share with you more about our global organization – HSBC is headquartered in London and provides worldwide a range of financial services including personal financial services; commercial banking; corporate, investment banking and markets; and private banking. I work alongside 300,000 colleagues in 10,000 offices in 82 countries, serving 125 million customers worldwide.

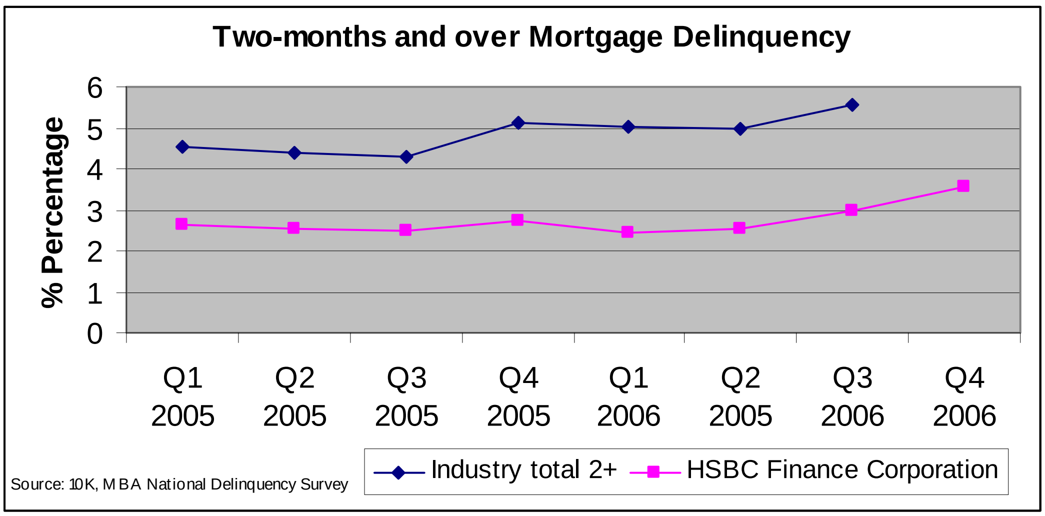
HSBC - North America is one of the ten largest banking organizations in the United States. HSBC - North America is the holding company for all of HSBC's U.S. and Canadian businesses, and our over 50,000 employees serve more than 60 million customers in the United States and Canada.

Specific to our consumer finance businesses -- these businesses operate under HSBC Finance Corporation, and serve consumers – with non-prime to prime credit characteristics -- with products including real estate secured loans, auto finance loans, MasterCard® and Visa® credit cards, and personal non-credit card loans. HSBC Finance Corporation is an SEC reporting entity.

In the area of real estate lending, HSBC Finance is a large player in the sub-prime mortgage market. HSBC Finance Corporation's consumer and mortgage lending business originates and services loans originated through retail (branch and direct) and wholesale (broker) channels, as well as portfolio acquisitions. We originate or purchase a variety of real estate secured and unsecured loans to primarily sub-prime customers. As one of the nation's largest consumer finance companies, we have more than 1,350 branches in 46 states and 11 servicing facilities across the US.

HSBC Finance has the second largest subprime servicing portfolio in the subprime industry (based off analysis of the National Mortgage News 4Q 2006 Quarterly Data Report [QDR]). Our portfolio is primarily fixed rate loans with documented income. Indeed adjustable rate loans are only 32% of HSBC Finance's subprime portfolio compared to over 70% for the industry as a whole. Stated income loans make up just 13% of the portfolio.

As a result of our origination and underwriting practices, we have seen relatively stronger credit performance compared to the industry. HSBC Finance mortgage delinquency levels are almost half of industry levels over the past two year period. The graph below depicts the percentage of mortgage loans that are two months or more past due for HSBC Finance and the subprime industry (as published in the Mortgage Bankers Association National Delinquency Survey).



Despite this more conservative makeup of HSBC Finance's mortgage portfolio, in the last year, we have faced a combination of challenges in certain portions of our portfolio. Like many of our peers in the sub-prime mortgage lending business, these challenges have been caused by a long run of rising interest rates and a slowing, and then declining, housing market. These factors have put pressure on consumers, and accordingly, on certain segments of our portfolio.

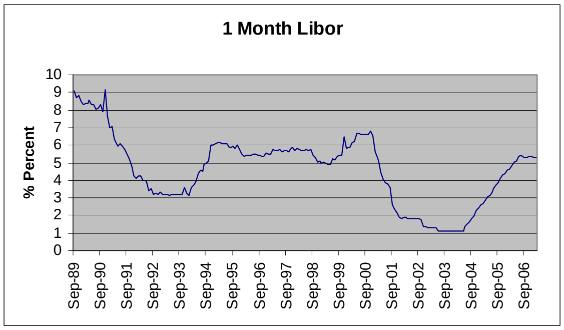
In one portion of our business, which buys loans that are already funded by other lenders, we've encountered higher than expected delinquency. These loans are primarily second lien loans, called piggy backs, because they are made in conjunction with a first lien used to buy a home. The second lien is used in lieu of a traditional down payment. We acquired a significant volume of these loans in the second half of 2005 and the first quarter of 2006. We are also experiencing higher than expected delinquency on some of our adjustable rate mortgages and stated income loans – again, acquired through one channel in our business.

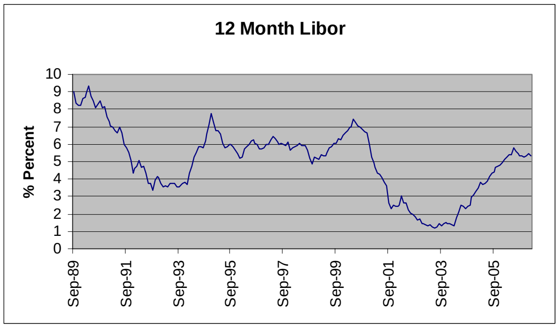
In retrospect, we don't believe we properly anticipated the future risk associated with these types of loans. Predicting the potential implications of 17 interest rate increases in a 21-month timeframe is just one example. Also, as it turned out, these types of higher risk loans purchased from other lenders during this time frame are performing much worse than loans purchased in this channel in earlier timeframes. These are the primary causes of the increased loss provision announced on February 7, 2007 in HSBC's trading statement and later confirmed on March 5th during HSBC's 2006 earnings announcement.

Our Perspective on the Issue

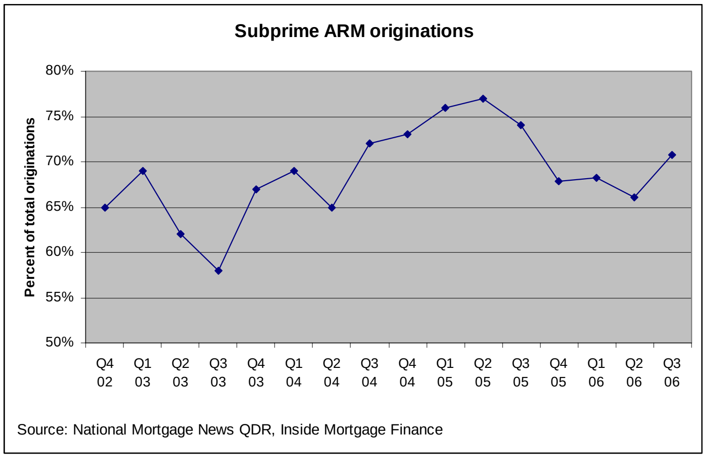
I'd like to offer some more general input and perspective on what is happening in the market, and also speak specifically to how HSBC is addressing these issues for our business and as importantly, for our customers.

As mentioned, we have had a long run of rising interest rates combined with a slowing housing market, which has put new pressures on consumers. In the past because of rising home prices, homeowners could more easily avoid foreclosure when they had interruptions in their income. They now have fewer options to use the equity in their homes for these purposes. ARM (adjustable rate mortgage) products were readily available before the historically low interest rates of 2001 to 2005 and were quite benign. It is the disparity between the all-time low rates recently experienced and the return to a more normalized interest rate environment that exacerbates the magnitude of the payment shock experienced by sub-prime customers. The products available in the sub-prime market, particularly the wholesale sub-prime market, are not well suited to this changing environment.





In addition to the interest rate impact, the wider application of products and the relaxation of industry underwriting standards (particularly around income) placed some customers into products they could not afford. As many markets appreciated, lenders focused on affordability products, even as home prices and mortgage payment growth outstripped personal income growth. The profile of subprime originations shifted dramatically towards ARM, Interest-only and stated income products. These products offered a lower starting payment to overcome the impact of a rising interest rate environment and affordability issues, but were inherently more risky. This environment also saw wider use of "teaser-rate" ARM products. While these types of products existed previously, they exacerbated the interest rate adjustment referenced above. The graph below depicts all types of subprime ARM originations (traditional, Interest-only, and teaser-rate ARM) as a percent of total subprime originations.



The demand for mortgage backed securities (MBS) also increased dramatically over the last several years. This trend was discussed in the recent Mortgage Banker's Association research paper: The Residential Mortgage Market and Its Economic Context in 2007 (January 30, 2007). Capital inflow to the US has increased dramatically over the past 20 years as the current account deficit has continued to grow. At the same time, there has been a dramatic increase in the percentage of foreign central banks approved to invest in MBS (2% in 1998 to 44% in 2006). In addition, the percentage of central banks investing in only US Treasuries has dropped (from 31% in 2002 to 3% in 2006). While adding excess demand for other fixed income securities, another impact of investors shifting out of Treasuries and into mortgage/debt securities is a compression of spreads across fixed-income markets. This increased liquidity drove the demand for higher risk products.

How HSBC Finance is addressing these issues - originations

HSBC Finance has been servicing customers for more than 125 years, through many credit cycles and a wide range of economic circumstances.   We take the current situation seriously and we are taking strong and proactive steps to minimize the impact of the current environment on our customers.

Our first step has been to do a significant amount of analytical work to understand precisely how much risk is present for our customers and what steps we must take to minimize that risk.

In our largest channel, the retail branch network, we have had policies in place for more than five years that largely parallel the new Interagency Guidance on Nontraditional Mortgage Products. As other lenders have adopted this guidance, it has brought about a leveling of the playing field in the mortgage industry. We believe this Guidance brings appropriate strengthening to the industry's underwriting standards. These rules currently apply only to federally regulated banks and bank holding companies; for them to fully impact consumers in a positive way, they need to apply to all lenders.

Long before the notion of "suitability" was central to the discussion of appropriate underwriting standards for subprime loans, HSBC Finance had implemented a comprehensive, self executing net tangible benefits test (NTB) in its retail subprime lending business. Requiring varying levels of benefits depending on the loan type, the NTB mandates that each loan passes a rigorous and systemically applied test that ensures the loans meet a minimum threshold of benefit and affordability for the customer. Failure to meet the standards of the test prevents the approval of the loan, regardless of credit, regardless of profitability. Versions of this NTB test have now been implemented in the wholesale channel as well.

To help ensure our programs and practices are effectively delivering the value our customers expect, in 2003 we installed a "Secret Shopper" program. This initiative uses an independent third party to monitor our retail branch origination channel and ensure all of our policies and procedures are effectively followed. "Secret Shopper" also provides almost real time feedback to management on the customer experience.

Further restrictions on underwriting have taken place as the slowing of housing appreciation and other economic factors have deteriorated performance. We also have largely eliminated the purchase of loans originated by other lenders and sold in the secondary market, giving us greater control over quality and underwriting, while building on our competitive strength of making mortgage loans in customer facing channels, such as our nationwide 1,350 branch retail network.

HSBC Finance also recognizes that the long term answer to this current market condition is not just tightening credit, but also introducing appropriate products that help the subprime customer solve their financial challenges and improve their circumstances.

An example of one such product is our "Pay Right Rewards" mortgage (PRR). This mortgage product rewards subprime customers who remain in good standing with automatic rate reductions with no risk that the customers' rate will ever go up. A very high percentage of customers who chose this product enjoy rate reductions without having to incur the cost of refinancing to get a lower rate.

This product has been very successful in the retail channel and we plan to expand to other areas of our mortgage business.

Finally, for our broker origination channel, your letter referenced media speculation regarding back-end yield spread premiums. Our broker management process begins with selecting only responsible brokers that comply with all state and federal laws. Our comprehensive broker approval process and broker monitoring process are independent of the sales organization. In addition, we have systemic controls in place to ensure we conduct business with brokers who are in good standing and meet HSBC's internal requirements. HSBC Finance has a comprehensive set of controls and monitoring in place regarding loan terms and broker fees. Our back-end premium spreads are capped at 200bps, though our average is ~60bps, which we believe is better than industry standards. It is worth noting that yield spread premiums paid by the lender provide the borrower the option of deferring borrower paid broker fees in the form of a reasonable and defined increase in the interest rate. Further, our broker management and fee structures are subject to review by numerous Federal and State regulatory entities.

How HSBC Finance is addressing these issues - servicing

The issues our existing customers face are being addressed in keeping with our approach and commitment to this business. We have reviewed our most “at risk” ARM customers and implemented a proactive program that will offer payment shock relief. This program was launched in mid-October 2006 with the objective of offering rate modification plans that will reduce the rates and payments our customers would be required to pay under their contract. In the program to date, we have assisted more than 2,200 customers and we estimate our assistance will reach more than 5,500 customers in 2007.

We truly believe that foreclosure is the worst alternative for all parties concerned and go to great lengths to avoid foreclosure. Financially, it is our worst alternative with the average loss on sale at foreclosure of 20-25% of loan value. In general, accounts are charged off by the end of the month in which they become eight months delinquent. This allows substantial time to contact customers and apply one of many workout programs and to assist their situation.

Our Foreclosure Avoidance Program (FAP) was developed in October 2003 and to date has provided over $100MM in financial relief to over 9,000 customers. The program was developed to provide temporary or permanent relief to customers whose ability to repay their loan has been reduced due to a change in circumstances. In most cases, the relief period is temporary as the customer loss is due to a layoff, loss of employment, reduction in wages and other similar circumstances. In some instances the relief may be permanent when the customer change is more catastrophic, such as a permanent disability or death. The overall intent of the program is to provide a means for the customer to repay their loan and avoid foreclosure where possible. The Foreclosure Avoidance Program helps HSBC customers with real estate loans by providing them with rate and payment relief to increase the customer's monthly disposable income.

In addition to direct assistance to our own customers, we help consumers at risk of foreclosure with other lenders. We have partnerships with a number of community groups to prevent foreclosure and rescue home owners in danger of foreclosure. For your information, we have enclosed an addendum to our testimony outlining all of our homeownership preservation programs.

Closing remarks

With the above initiatives in place, we believe HSBC’s efforts reflect positively on our performance in the industry. For HSBC Finance, the focus on growth will always be matched with our commitment to help our customers meet their financial goals in a sustainable manner.

Clearly, the mortgage industry is experiencing significant contraction. With just the lenders who have ceased operations, the sub-prime market has already lost 20+% of its origination capacity. This does not account for additional origination capacity reductions due to underwriting tightening. With that in mind we believe that any additional regulation needs to be carefully considered and weighed against the implications of credit availability.

Certainly we believe that uniform legislation could benefit the industry and consumers. There are numerous versions of Federal anti-predatory lending legislation that contain many of the key best practices our retail branch network has employed for several years. HSBC supports guidelines that put everyone in the industry on an even playing field.

I hope that my testimony today reflects for you that HSBC Finance’s lending and servicing practices do indeed demonstrate its desire to lead the industry in responsible lending, and responsible and fair servicing. But as important, we know there is always more work to be done. We are continually looking at our current and prospective products and services in this light. Fair business practices are core to our corporate values, and the best way to build the future for our employees, our customers and our shareholders.

Once again, thank you for inviting HSBC to share with you our experiences and recommendations. I am happy to answer any questions you may have..

HSBC – North America
Center for Consumer Advocacy
HOME PRESERVATION OFFICE

HSBC-North America funds a broad range of homeowner programs including pre-homeownership buyer education, down payment assistance, post-closing homeowner counseling and foreclosure intervention. HSBC's Home Preservation Office oversees all homeownership initiatives and creates a single source to manage program administration, monitor progress, and facilitate internal and external communication and learnings. The following is a description of the major home preservation initiatives supported by HSBC-North America.

NATIONAL

Consumer Rescue Loan Program- This program was established in 2002 in partnership with the National Community Reinvestment Coalition (NCRC): Initially designed as an Anti-Predatory Mortgage Loan Fund to rescue consumers who had been victimized by predatory lending practices, the program scope was later expanded to include any mortgage that had become unaffordable due to origination, servicing problems, or a significant change in the consumer's financial circumstances. The program, available to non-HSBC customers, provides a "fresh-start" refinance mortgage, originated by HFC. The rescue loan is underwritten using modified underwriting guidelines, there are no closing cost (points, processing fees or third-party fees) associated with the new loan and the new loan rate is subsidized. HSBC provides annual grants to support the administration of the program by NCRC and has allocated a reserve pool to fund the rescue loans.

Neighbor Works Center for Foreclosure Solutions- HSBC-North America joined this partnership in April of 2006. This national initiative, modeled after the very successful Chicago HOPI program, aims to provide solutions to foreclosures by raising consumer awareness of loss mitigation programs, provide 24/7 telephone counseling through a toll-free nationwide helpline (1-888-995-HOPE). The program provides in-person homeownership and budget counseling by Neighbor Works' (or other qualified non-profit group) local counseling agency. A national consumer awareness campaign, developed by Ad Council in support of this program, is scheduled to launch in 2007.

HSBC Early Intervention Program- HSBC is launching a signature initiative with a national non-profit partner that will provide bridge grants of up to $5,000 to homeowners who face a temporary financial hardship. The bridge grant may be used to cure mortgage delinquency and to pay down or eliminate delinquent balances on unsecured or credit card debt. Consumers participating in this program will receive budget and homeownership counseling.

Foreclosure Avoidance Program- Initiated in 2004, HSBC established this program in partnership with the Association of Community Organizations for Reform Now (ACORN) to provide special relief to HFC and Beneficial customers. Customers whose mortgage loans are delinquent are advised of the availability of budget counseling and loan modification relief and are encouraged to contact an ACORN housing counselor to receive counseling and to determine eligibility.

REGIONAL AND STATE

Chicago HOPI- Chicago Homeownership Preservation Initiative (HOPI) was launched in 2003 and includes a successful collaborative initiative between the City of Chicago, NHS of Chicago, and the telephone Hotline for Housing Counseling and lenders. This special initiative includes a city-sponsored consumer marketing campaign to reach Chicago residents who are at risk for foreclosure with budget and homeownership counseling, and referral to available city services. The program also facilitates discussions with lenders regarding workout options. The Chicago initiative, using the City's non-emergency "311" Hotline is the program on which national and most local programs are modeled. HSBC has been a participating sponsor since the program's inception.

New York PACE- New York's Preserve Assets and Community Equity (PACE) program was launched in 2005. The program is quite similar to the Chicago program and includes three community partner organizations and focuses its marketing outreach on NYC communities with the highest foreclosure rates. HSBC has been a participating sponsor since the program's inception.

Momentive- This program was established in 2004, to provide homeownership and budget counseling to Indiana residents. It has many of the same components as the Chicago and New York programs and is available to consumers state-wide. HSBC joined the initiative in 2006 and is one of the approximately 10 lenders who provide funding support.

Detroit HOPE- This program launched in 2005, HSBC joined the initiative in 2006. The program enjoys the support of the City of Detroit and over 45 lender partners who provide training and financial support. Detroit HOPE provides consumer budget and homeownership counseling support as the other local programs and, like Chicago, also sponsors weekend homeowner foreclosure prevention workshops. Lenders are invited to attend workshops and are able to provide confidential counseling to their own customers.

OTHER SIGNATURE INITIATIVES

YourMoneyCounts.com – HSBC's consumer education website provides information in a broad range of financial and money management topics. (There are more than 1,900 site visitors per month.)

Adult Financial Literacy Workshops – In partnership with the Center for Neighborhood Enterprise (CNE), HSBC provides financial education workshops at numerous community locations. More than 5,000 families were educated in 2006.

Financial Education Grant Program - Provides $1MM in grant funding to support consumer financial education, credit management, and home buyer counseling programs. These programs are provided by twelve organizations in nine states, and assisted more than 164,000 families in 2006.

Your Future Counts - In partnership with the Society for Financial Education and Professional Development (SFED), presents credit management and personal financial management seminars in Historically Black Colleges and Universities (HBCU) campuses nationwide. More than 11, 000 students have attended seminars since program inception in August 2005.