

**BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001**

**RATE AND SERVICE CHANGES TO
IMPLEMENT FUNCTIONALLY EQUIVALENT
NEGOTIATED SERVICE AGREEMENT WITH
HSBC NORTH AMERICA HOLDINGS INC.**

Docket No. MC2005-2

**DIRECT TESTIMONY
OF
JOHN H. HARVEY
ON BEHALF OF
HSBC NORTH AMERICA HOLDINGS INC.**

TABLE OF CONTENTS

	<u>Page</u>
AUTOBIOGRAPHICAL SKETCH.....	1
I. PURPOSE OF TESTIMONY.....	2
II. HSBC GROUP.....	2
III. MAIL PROFILE OF HSBC-NORTH AMERICA	4
A. Solicitation Mail.....	4
B. Operational Mail	5
IV. FIRST-CLASS MAIL VOLUME HISTORY.....	5
V. FIRST-CLASS MAIL VOLUME FORECASTS.....	6
A. Before Rates Volumes.....	7
B. After Rates Volumes.....	8
VI. ADDRESS HYGIENE.....	9
CONCLUSION.....	10
APPENDIX A.....	11

AUTOBIOGRAPHICAL SKETCH

1
2 My name is John H. Harvey. I am Managing Director of Marketing of HSBC
3 Card Services (“HCS”), a credit card business conducted by several subsidiaries of
4 HSBC North America Holdings Inc., with offices at 1441 Schilling Place, Salinas,
5 California 93901. (For convenience, I refer to the subsidiaries of HSBC North
6 America Holdings Inc. that are operating in the United States as “HSBC-North
7 America.”) In this position, I am responsible for, among other things, managing our
8 relationships with the AFL-CIO and its affiliates and with General Motors Corporation.
9 I am also responsible for all aspects of marketing in connection with HCS’s two
10 largest credit card portfolios and certain other loan products, and for managing HCS’s
11 business unit that markets third party and internal non-credit products to credit card
12 and other loan customers.

13 I attended Kings College in Wimbledon, United Kingdom, and the University of
14 New Brunswick in Canada. In 1978, I joined Household International, Inc. in the
15 Canadian operations group, where I managed various branch offices and then held
16 several positions at the Canadian corporate office. From 1988 to 1991, I was
17 promoted to various positions including division operations manager, director of sales
18 for the retail services group in Canada, director of General Motors Card marketing,
19 group director for partnership marketing, and managing director for the Union
20 Privilege program and Enhancement Services. I assumed my current position in
21 2004.

1 **I. PURPOSE OF TESTIMONY**

2 HSBC North America Holdings Inc. and the United States Postal Service have
3 entered into a mutually-beneficial arrangement for a Negotiated Service Agreement
4 (“NSA”). This NSA is similar to the Capital One NSA, the Discover Financial Services
5 (“DFS”) NSA, and the Bank One Corporation (“Bank One”) NSA, all previously
6 approved by the Postal Rate Commission. Like these earlier NSAs, this NSA will
7 reduce the Postal Service’s costs of handling undeliverable mail and will encourage
8 HSBC-North America to send more solicitations using First-Class Mail.

9 My testimony describes HSBC-North America and its solicitation mail and
10 operational mail practices. I also provide HSBC-North America’s forecasts of
11 First-Class Mail volumes without the NSA (“Before Rates” volumes) and with the NSA
12 (“After Rates” volumes) for calendar years 2005, 2006, and 2007, referred to here as
13 Year 1, Year 2, and Year 3, respectively, of the NSA. Finally, I discuss HSBC-North
14 America’s return rates for First-Class Mail.

15 In discussing our marketing practices, I am unable to reveal proprietary
16 information that might disclose competitively sensitive information about our
17 marketing strategies to our competitors. I will discuss, to the greatest extent
18 possible, our marketing practices as they relate to our mail operations.

19 **II. THE HSBC GROUP**

20 Headquartered in London, HSBC Holdings plc (“HSBC Holdings” and together
21 with its subsidiaries, “HSBC Group”) is one of the largest banking and financial
22 holding companies in the world. HSBC Holdings' subsidiaries and affiliates have

1 over 10,000 offices and over 220,000 employees in 76 countries and territories in
2 Europe, the Asia-Pacific region, the Americas, the Middle East and Africa.

3 HSBC Holdings' banks have won numerous awards, including Best Consumer
4 Bank in Global Finance's World's Best Banks in 2004, and World's Best Bank in the
5 2004 Euromoney Awards for Excellence. A partial listing of HSBC Group's awards
6 and rankings is attached as Appendix A. HSBC Group also believes that it can make
7 a real difference in people's lives by supporting educational, environmental, and
8 community projects. In 2003, HSBC Group's charitable contributions exceeded \$47
9 million worldwide (including over \$20 million of donations in North America).
10 Thousands of HSBC-North America employees also donated their time and
11 experience to projects such as Junior Achievement, Project JumpStart, the United
12 Negro College Fund, and the Hispanic Scholarship Fund.

13 HSBC Group developed its presence in the United States in recent years by
14 acquiring Marine Midland Banks, Inc., and Household International, Inc. HSBC North
15 America Holdings Inc. comprises all of the businesses of HSBC Group in the United
16 States and Canada, including the businesses formerly owned by Household
17 International, Inc. Through an international network linked by advanced technology,
18 including a rapidly growing e-commerce capability, HSBC-North America now
19 provides a comprehensive range of financial services in the United States to over 60
20 million customers. These services include personal financial services; commercial
21 banking; corporate, investment banking and markets; private banking; and other
22 financial activities. As a lender and credit card issuer, HSBC Card Services is a
23 direct competitor of Capital One, DFS, and Bank One.

1 **III. MAIL PROFILE OF HSBC-NORTH AMERICA**

2 HSBC-North America sends two main types of mail: solicitation mail, which is
3 sent by either First-Class Mail or Standard Mail, and operational mail, which is sent
4 by First-Class Mail.

5 **A. Solicitation Mail**

6 Mail is one of several channels available for marketing financial services, and
7 faces increasing competition from alternatives, such as E-mail and the Internet, event
8 marketing, merchant marketing, telemarketing, print, television, radio, and outdoor
9 advertising. The attractiveness of these alternative channels is likely to increase if
10 the next postal rate case results in a substantial increase in postal rates.

11 Nonetheless, HSBC-North America continues to view direct mail as an integral part of
12 its marketing efforts and, as discussed below, plans to increase significantly its
13 volume of solicitation mail in the next few years.

14 HSBC-North America mails solicitations to encourage existing customers to
15 use their credit cards more often and to use other products and services. HSBC-
16 North America also sends solicitations designed to acquire new customers. HSBC-
17 North America uses Standard Mail for most of its solicitation mail. Although we
18 project our use of First-Class Mail for solicitations to steadily increase in the future,
19 even by 2007, First-Class Mail will likely account for only about one third of HSBC-
20 North America's 886 million solicitations projected for that year.

21 Compared to Standard Mail, First-Class Mail is generally of greater value to
22 HSBC-North America because of the forwarding and return service provided at no

1 additional charge, the certainty of in-home delivery dates, and the higher response
2 rates from customers. In the past, however, the difference in value usually has not
3 been large enough to justify reliance on First-Class Mail for most solicitations. To
4 determine whether to mail a solicitation as First-Class Mail or Standard Mail, HSBC-
5 North America tests whether the incremental response (referred to as “lift” in the
6 industry) from sending solicitations as First-Class Mail rather than Standard Mail
7 justifies paying the approximately ten cents differential in rates. HSBC-North
8 America has found that the lift generally does not justify this differential. NSA
9 discounts that reduce the cost premium for First-Class Mail would cause HSBC-North
10 America to shift a certain amount of solicitations from Standard Mail to First-Class
11 Mail.

12 **B. Operational Mail**

13 Like other financial institutions, HSBC-North America uses First-Class Mail to
14 communicate with existing customers. These communications include, among other
15 things, bills for credit card accounts, statements for bank accounts, letters responding
16 to customer inquiries, and mailings of new and replacement credit cards. HSBC-
17 North America has much less choice in the class of mail used for operational mail
18 than for solicitation mail, and the class of mail for operational mail is generally
19 determined by the requirements of postal regulations rather than by economics.

20 **IV. FIRST-CLASS MAIL VOLUME HISTORY**

21 HSBC-North America’s mail volumes have grown over the last three years:
22 Operational mail grew from 408 million pieces for the combined entities that
23 constitute HSBC-North America in 2002 to 440 million pieces in 2004. Operational

1 mail in 2004 was 7.8 percent higher than in 2002. Solicitation First-Class Mail
 2 volume declined from 108 million pieces in 2002 to 89 million pieces in 2003, but
 3 then increased to 96 million pieces in 2004. Table 1 summarizes HSBC-North
 4 America’s historical First-Class Mail volumes for operational mail and solicitation
 5 mail, based on Postal Service fiscal year and HSBC records.

Table 1: Historical First-Class Mail Volumes

Mail Type	2002	2003	2004
Solicitation	107,741,060	89,141,274	95,685,915
Operational	407,693,861	409,784,484	439,597,836
Total	515,434,921	498,925,758	535,283,751

3 **V. FIRST-CLASS MAIL VOLUME FORECASTS**

4 Tables 2, 3, and 4 compare HSBC-North America’s Before and After Rates
 5 forecasts for Year 1, Year 2, and Year 3 of the Agreement:

Table 2: Year 1 Before and After Rates First-Class Mail Volume

Mail Type	Before Rates	After Rates
Solicitation	158,232,348	174,232,348
Operational	483,021,271	483,021,271
Total	641,253,619	657,253,619

Table 3: Year 2 Before and After Rates First-Class Mail Volume

Mail Type	Before Rates	After Rates
Solicitation	245,191,188	265,191,188
Operational	518,407,521	518,407,521
Total	763,598,709	783,598,709

Table 4: Year 3 Before and After Rates First-Class Mail Volume

Mail Type	Before Rates	After Rates
Solicitation	299,268,268	319,268,268
Operational	556,469,938	556,469,938
Total	855,738,206	875,738,206

1 **A. Before Rates Volumes**

2 As the tables above indicate, HSBC-North America intends to grow the scale
3 of its business in the United States significantly over the next few years. To achieve
4 this goal, HSBC-North America plans significant growth in its volume of First-Class
5 Mail solicitations. The Before Rates forecasts are based on HSBC-North America's
6 business plan developed by our business managers and used in the ordinary course
7 of business for HSBC-North America's planning. Our annual budget process begins
8 with a strategic plan that provides direction for the following year, including a new
9 account goal forecast. Economic factors, current market conditions, and other
10 business trends and developments are considered, as well as recent run rates and

1 historical performance data, testing results, and common industry trends.

2 Based on HSBC-North America's budget and growth plans and my business
3 judgment, I expect Year 1 Before Rates volumes to reflect substantial growth in
4 solicitations. In the absence of the proposed NSA, HSBC-North America would mail
5 approximately 641 million pieces of First-Class Mail in 2005, consisting of 483 million
6 pieces of operational mail and 158 million solicitations.

7 As to the Year 2 and Year 3 Before Rates volumes, I project continued growth.
8 For Year 2, in the absence of the proposed NSA, HSBC-North America would mail
9 approximately 764 million pieces of First-Class Mail, consisting of 518 million pieces
10 of operational mail and 245 million solicitations. For Year 3, in the absence of the
11 proposed NSA, HSBC-North America would mail approximately 856 million pieces of
12 First-Class Mail, consisting of 556 million pieces of operational mail and 299 million
13 solicitations.

14 **B. After Rates Volumes**

15 Based on historical volumes, discussions with senior marketing managers on
16 the potential effect of the NSA discounts, and my business judgment, I forecast an
17 After Rates volume increase for Year 1 of 16 million pieces. As our marketing
18 managers have more time to adjust to the NSA's incentives, the After Rates volume
19 increase for Year 2 would be 20 million pieces, and for Year 3 would be 20 million
20 pieces. These volume increases would consist entirely of solicitation mail. There
21 may also be significant organic growth in our First-Class Mail use for new solicitation
22 campaigns as a result of the NSA incentives, but I have not relied on such "new"

1 First-Class Mail in developing these forecasts. Because it is difficult to quantify the
2 volume of “new” First-Class Mail that will be sent due to the NSA discounts, my
3 projections conservatively assume that all new First-Class Mail would be “switched”
4 from Standard Mail.

5 My After Rates estimates are conservative. It is quite possible that without a
6 cap the NSA discounts, especially in the higher volume tiers, may reach the tipping
7 point where a very significant volume of mail would switch to First-Class Mail. HSBC-
8 North America is continuing to conduct testing to determine more precisely the point
9 at which the shift would likely occur.

10 **VI. ADDRESS HYGIENE**

11 Under the NSA, HSBC-North America will meet or exceed the postal
12 requirements for address hygiene. HSBC-North America will perform National
13 Change of Address (“NCOA”) processing on existing operational files and on
14 solicitation files every 90 days.

15 Our business records indicate that HSBC-North America’s historical return
16 rates have been as follows: for non-solicitation First-Class Mail, including statements
17 and letters, 0.3 percent were returned; for First-Class Mail letter solicitations,
18 approximately 4.75 percent were returned. I conservatively estimate similar return
19 rates for 2005, 2006, and 2007. HSBC-North America’s 4.75 percent return rate is
20 much lower than the return rates of other financial institutions which have signed
21 NSAs, as shown in Table 5, below.

Table 5: Return Rates in NSAs of Other Financial Institutions

(Percents)

	HSBC-North America	Bank One	Discover	Capital One
Operational Mail	0.3	0.3	0.3	1.2
Solicitation Letters	4.8	9	9.3	9.6
Solicitation Flats	N/A	11	N/A	N/A

Sources: Bank One: MC2004-3, USPS-T-1 Appendix A.xls; Discover: MC2004-4, USPS-T-1-AppA.xls; Capital One: MC2002-2, T3 Atta2.xls.

1

CONCLUSION

2

HSBC-North America believes that this NSA provides cost-savings to the

3

Postal Service through electronic Address Correction Service and incentives to

4

HSBC-North America to switch solicitations from Standard Mail to First-Class Mail,

5

thus increasing the contribution that HSBC-North America makes to the Postal

6

Service's institutional costs. This NSA also contains a negotiated cap on total

7

discounts available to HSBC-North America. HSBC-North America respectfully

8

requests that the Commission handle its NSA application with expedition under the

9

rules for functionally equivalent NSAs and that the Commission recommend approval

10

of this NSA, as proposed, without modification.

APPENDIX A

Awards and Rankings of HSBC, the World's Local Bank

Month	Award	Company/ Entity	Body / Publication
Nov. 2004	Best Consumer Bank	HSBC Holdings plc	Global Finance, World's Best Banks 2004
Jul 2004	World's Best Bank	HSBC Holdings plc	Euromoney Awards for Excellence 2004
June 2004	Europe's 50 Best Performing Companies, ranked 5 th	HSBC Holdings plc	The European Business Week 50, Business Week
May 2004	World's 2,000 Biggest Companies, ranked 7 th	HSBC Holdings plc	World's Largest Companies, Forbes
April 2004	Ranked 7 th of world's leading 2,000 companies	HSBC Holdings plc	Forbes
January 2004	Ranked 41 st Most Respected Company in the World	HSBC Holdings plc	FT/Price Waterhouse Coopers
January 2004	Ranked 25 th Most Respected Company in the World for creating Shareholder Value	HSBC Holdings plc	FT/Price Waterhouse Coopers
November 2003	Retail Bank of the Year 2003	HSBC	Lafferty Retail Banking Awards
November 2003	Ranked 2 nd best Cash Management bank globally	HSBC Holdings plc	Euromoney's Annual Cash Management Poll 2003
September 2003	Best Global Bank	HSBC Holdings plc	The World's Best Banks, The Banker Magazine
July 2003	Ranked 14 th in the World, third largest in Britain	HSBC Holdings plc	The Business Week Global 1000, Business Week
July 2003	Ranked 9 th in the World	HSBC Holdings plc	The Forbes Global 2000, Forbes Magazine

July 2003	Ranked 2 nd by market capitalization	HSBC Holdings plc	Top 1000 world banks, The Banker
July 2003	Ranked 37 th most valuable brand	HSBC Holdings plc	Interbrand's World's Most Valuable Brands, Business Week Magazine
March 2003	Ranked 50 th most admired company in the World	HSBC Holdings plc	The World's Most Admired Companies, Fortune Magazine
March 2003	Ranked 2 nd most admired company in the world by industry – Megabanks	HSBC Holdings plc	The World's Most Admired Companies, Fortune Magazine
January 2003	Ranked 5 th for Financial Services in 2002	HSBC Holdings plc	World's Most Respected Companies, Financial Times

CERTIFICATE OF SERVICE

I hereby certify that I have this 23rd day of February caused to be served the foregoing document and testimony in accordance with Section 12 of the Commission's Rules of Practice.

/s

Joy M. Leong