

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

Rule and Service Changes To Implement)
Functionally Equivalent Negotiated Service) Docket No. MC2005-2
Agreement with HSBC North America Holding Inc.)

**ANSWERS OF HSBC NORTH AMERICA HOLDINGS INC. TO
OFFICE OF CONSUMER ADVOCATE INTERROGATORIES
OCA/HSBC-T1-1-7
(March 25, 2005)**

HSBC North America Holdings Inc. ("HSBC") hereby provides the answers of witness John H. Harvey to the Office of Consumer Advocate Interrogatories OCS/HSBC-T1-1-7, filed March 18, 2005. Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

/s/

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March 25, 2005

**ANSWER OF HSBC WITNESS HARVEY
TO INTERROGATORY OCA/HSBC-T1-1**

OCA/HSBC-T1-1. Your testimony on page 7, beginning at line 9, makes reference to the factors driving volume forecasts.

(a) Please provide the methodology used to derive the “Before Rates” forecast. Please state all assumptions, exogenous data, and the modeling procedures, providing sufficient information for an analyst to evaluate the forecasts.

(b) Please provide the methodology used to derive the “After Rates” forecast. Please state all assumptions, exogenous data, and the modeling procedures, providing sufficient information for an analyst to evaluate the forecasts.

(c) One basis for differences between the two forecasts would be a change in the cost of mailing a piece resulting from the implementation of the NSA. Is this the only factor impacting the differences between the two forecasts, or are there other factors? Please explain all differences underlying the “Before Rates” and “After Rates” forecast assumptions.

ANSWER:

(a) Managers from each HSBC unit that was expected to generate First-Class Mail eligible for the NSA discounts were surveyed about the volume of First-Class Mail that the unit actually entered during 2000-03 and was projected to enter without the NSA during 2004 through 2007. The managers were asked to provide the same projections that the business units used for their own internal planning in the ordinary course of business. The precise methodologies and assumptions underlying the projections are proprietary, and disclosure would place HSBC at a competitive disadvantage. In general, however, HSBC derives mail volume projections of this kind as follows: First, for acquisition mail, the responsible HSBC analysts determine the target growth in the total portfolio in each year, and then add the projected rate of attrition of existing accounts. The sum equals the number of new accounts sought each year. Next, projections are made about (1) the share of solicitation activity by marketing

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channel, including First-Class Mail, (2) the projected response rate for each marketing channel, and (3) the cost effectiveness of each channel. Grossing up the desired growth in accounts by the projected response rate of each marketing channel, including First-Class Mail, and taking cost effectiveness into account, HSBC develops the projected volume of solicitations via each marketing channel. Portfolio mail follows a similar process except the targets are for convenience checks, balance consolidations, etc., and there is no attrition adjustment.

(b) Managers from each HSBC unit that was expected to generate First-Class Mail eligible for the NSA discounts were surveyed about the extent to which the proposed discounts would increase the projected "Before Rates" volume of First-Class Mail from the unit during each relevant period. The precise methodologies and assumptions underlying the responses rely on projected values for responses rates, "lift" (incremental response rates resulting from the use of First-Class Mail rather than Standard Mail), and lifetime account values that are highly proprietary, and cannot be disclosed without placing HSBC at a competitive disadvantage. A similar analysis based on publicly available data, however, was submitted by Bank One witness Lawrence G. Buc in Bank One NSA case (Docket No. MC2004-3).

(c) The After Rates forecasts were based on the assumption that HSBC would receive the rate discounts offered by the NSA; the Before Rates forecasts were based on the assumption of no NSA, and hence no NSA discounts. All other assumptions were held constant in the two scenarios.

**ANSWER OF HSBC WITNESS HARVEY
TO INTERROGATORY OCA/HSBC-T1-2**

OCA/HSBC-T1-2. Please turn to your testimony, page 4, lines 9 and 10, where you indicate that the attractiveness of alternative channels is likely to increase if the next postal rate case results in a substantial increase in postal rates.

(a) Please explain your concept of “substantial” and how this is related to elasticity of demand for First Class Mail. Please quantify your response.

(b) Is it essentially your testimony that the proposed NSA will result in no increase in volume in the event of a substantial increase in postal rates, the effects of the NSA being offset by the increased rates? Please explain.

(c) It is expected that the Postal Service will file a general rate case in the near future. How would a six percent increase in the cost of mail affect your projections in Tables 2 through 4? Please quantify your answer.

(d) If a second rate increase was subsequently to occur in the following year, how would the second increase in rates impact your projections? Please quantify your answer.

ANSWER:

(a) Alternative marketing channels are potential substitutes for First-Class Mail. An increase in the cost of First-Class Mail compared with alternative marketing channels, all other things being equal, will tend to cause the amount of First-Class Mail service demanded by HSBC to decrease, and the usage of alternative marketing channels by HSBC to increase. In economic terms, the cross-elasticity of demand for alternative marketing channels with respect to the price of First-Class Mail is positive. “Substantial,” in this context, is meant as synonymous with “large” or “significant,” and is a relative concept. The greater the increase in the cost of First-Class Mail vis-à-vis alternative marketing channels, the greater the substitution that is likely to occur.

(b) My testimony does not offer an answer to your question, which is beyond the scope of this case. The proposed NSA discounts, all other things being held

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constant, will decrease the net cost of First-Class Mail to HSBC, thereby encouraging HSBC to enter more First-Class Mail. A general increase in First-Class rates, all other things being equal, will tend to cause HSBC to reduce its use of First-Class Mail. If both the NSA and a general rate increase occur, the effects may tend to offset. We have not tried to quantify the relative significance of the two effects, however, since the relevant question before the Commission in *this* case is the volume effect of the NSA alone—i.e., the rate and classification proposal that the Commission is being asked to evaluate in this case.

(c) A six percent increase in the cost of postage would tend to decrease both Before Rates and After Rates volume by roughly the same amount, leaving the increment in First-Class Mail volume generated by the NSA roughly as projected in my testimony. The precise amount is dependant on a host of factors that enter our proprietary models. I have not been able to calculate a more precise answer to this question, however.

(d) A second increase in the cost of postage would tend to decrease both Before Rates and After Rates volume by roughly the same amount, leaving the increment in First-Class Mail volume generated by the NSA roughly as projected in my testimony. The precise amount is dependant on a host of factors that enter our proprietary models. I have not been able to calculate a more precise answer to this question, however.

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TO INTERROGATORY OCA/HSBC-T1-3**

OCA/HSBC-T1-3. Please turn to your testimony, page 4, lines 14 through 20, where you discuss the use of both First-Class and Standard Mail for solicitations. You subsequently indicate that the volume increase in First-Class Mail is due entirely to the conversion of Standard Mail to First-Class Mail. In Tables 1 through 4 on pages 6 and 7 of your testimony you provide historical and projected First-Class Mail volumes.

(a) Please provide the Table 1 data for the years 1995 through 2001; if data are not available for a specific year, please indicate the reason for data unavailability.

(b) Please also provide Standard Mail volumes for the years 1995 through 2004 as well as Standard Mail projections for the forecasted three years. In the case of the forecasted years, projections should be on the basis of “with NSA” and “without NSA.”

ANSWER:

(a) We do not have the requested information for the years 1995-1999, and many weeks of investigation and research among individual business units would be needed to determine whether the data exist elsewhere in HSBC. In all likelihood, the data would be grossly incomplete, because many of the relevant volume data (if they were ever compiled at all) were in the possession of third-party vendors whose contracts with HSBC have ended, or HSBC employees who are no longer employed by the company.

In the year 2000, HSBC entered 355,025,142 pieces of First-Class operational and solicitation mail. In the year 2001, the corresponding volume was 425,855,264 pieces. Although, the available HSBC records do not allow a precise disaggregation of these volumes between operational and solicitation mail, I do know that more than 70 percent of the mail in each year was operational.

(b) We do not have the requested information for the years 1995-1999, and many weeks of investigation and research among individual business units would be

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needed to determine whether the data exist elsewhere in HSBC. In all likelihood, the data would be grossly incomplete, because many of the relevant volume data (if they were ever compiled at all) were in the possession of third-party vendors whose contracts with HSBC have ended, or HSBC employees who are no longer employed by the company.

HSBC's Standard Mail volumes for 2000-2004 (historical) and 2005-2007 (projected Before Rates volume) are as follows:

Year	Std. Mail Volume
2000	52,957,483
2001	123,517,038
2002	222,549,993
2003	287,404,493
2004	336,299,264
2005	604,623,661
2006	596,187,001
2007	586,420,084

"After Rates" Standard volumes for 2005-2007 are 16 million pieces less for 2005 and 20 million pieces less for 2006 and 2007, because our "After Rates" volume for First-Class mail is predicated on a switch from Standard Mail.

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TO INTERROGATORY OCA/HSBC-T1-4**

OCA/HSBC-T1-4. Please turn to your testimony, page 4, lines 14 through 20. For Tables 1 through 4 in your testimony please indicate how much of the historical and projected solicitation mail is “to encourage existing customers to use their credit cards more often and to use other products and services,” and how much mail is for the acquisition of new accounts.

ANSWER:

The mix of HSBC solicitations between portfolio and acquisition solicitations is highly proprietary information. Disclosing it would place HSBC at a competitive disadvantage; we do not believe that the financial institutions in the previous NSA cases (Capital One, Discover, and Bank One) were required to disclose this information.

**ANSWER OF HSBC WITNESS HARVEY
TO INTERROGATORY OCA/HSBC-T1-5**

OCA/HSBC-T1-5. Please turn to page 9 of your testimony, lines 5 through 9. Please provide a quantitative methodology for projecting the tipping point, the potential level of mail at the tipping point, and any additional information developed subsequent to the filing of your testimony.

ANSWER:

Answering this question would require disclosure of internal HSBC data on the response rates of its mailings, the “lift” experienced between Standard and First-Class mailings of the same solicitations, and the expected lifetime present value of accounts thereby generated. This information is highly proprietary, and its disclosure would place HSBC at a competitive disadvantage. We do not believe that the financial institutions in the previous NSA cases (Capital One, Discover, and Bank One) were required to disclose this information.

**ANSWER OF HSBC WITNESS HARVEY
TO INTERROGATORY OCA/HSBC-T1-6**

OCA/HSBC-T1-6. Please turn to page 9 of your testimony, lines 18 through 21. If possible, please explain why HSBC-North America's 4.75-percent return rate is much lower than the return rates of other financial institutions. What practices does HSBC follow to minimize its return rate?

ANSWER:

I do not know whether the HSBC return rate on solicitation mail is lower than the return rates of most other financial institutions, although I do know that our return rate on solicitation mail is lower than the rates experienced by the three other financial institutions that are parties to NSAs. I do not know the reason for the differential because I am not privy to the marketing strategies of those companies. I do know that HSBC markets to existing portfolio customers and to address lists of existing customers of our marketing partners. These address lists tend to be more accurate and current than the address lists typically available from credit bureaus, address brokers, and other third-party sources of lists.

**ANSWER OF HSBC WITNESS HARVEY
TO INTERROGATORY OCA/HSBC-T1-7**

OCA/HSBC-T1-7. Please refer to your testimony at pages 5-8, concerning HSBC's First-Class volume history and First-Class before rates volume forecast. Also please refer to the Postal Service's final rule on Eligibility Requirements for Standard Mail, published in the *Federal Register* October 27, 2004. What role, if any, did the final rule have on the expected increase in the before rates solicitation volume forecast during the experiment, as compared to the historic solicitation volume during the period 2002 to 2004?

ANSWER:

None. HSBC does not believe that the final rule will require any significant migration of its solicitation volume from Standard to First-Class Mail.

CERTIFICATE OF SERVICE

I hereby certify that I have caused the foregoing document to be served in accordance with Section 12 of the Commission's Rules of Practice.

/s/

David M. Levy

March 25, 2005