

HSBC Holdings plc's Plans to Ensure
Fair Lending Practices at
Household International, Inc.

HSBC Holdings also brings to this transaction two of its most valuable assets: its global reputation for integrity and fair dealing and its recognized commitment to serving the communities in which it operates, as is evidenced in the United States by HSBC Bank's "Outstanding" Community Reinvestment Act ("CRA") rating. HSBC Holdings has every intention of preserving and enhancing the value of these assets through its new affiliation with Household. In this regard, HSBC Holdings is aware of allegations that have been made against Household about certain of its lending practices and the pending lawsuits against lending subsidiaries of Household by various consumer groups based on these allegations. It has also examined carefully the terms of the preliminary agreement for settlement that Household reached in October of this year with a multi-state group of attorneys general and banking regulators and the individual settlements that its lending subsidiaries reached with the states of New York, California and Illinois (the "Settlement"). HSBC Holdings fully supports the efforts that Household has made to arrive at the Settlement and its efforts to improve its compliance record with consumers and its regulators.

HSBC Holdings plans to demonstrate this support in four ways: (i) by ensuring that Household fulfills the specific commitments that it made in the Settlement, (ii) by monitoring the fulfillment of the commitments through an independent monitor, a "secret shopper" program and the planned integration of HSBC Holdings' Group audit and compliance functions with those of Household, (iii) by affirming the current and projected resources that Household will dedicate to its overall compliance effort, and (iv) by working with Household to expand the range of products available to its customers, including the development of a "referral-up" program designed to increase the products and services available to Household's customers.

A. HSBC Holdings' and Household's History of Commitment to Service to the Community and to Consumer Protection

HSBC Holdings and Household bring to the transaction a history of leadership in efforts to serve the communities in which they operate.

1. HSBC Holdings' Service to its Communities

HSBC Holdings operates throughout the world in accordance with certain key business values. The values include:

- the highest personal standards of integrity at all levels,
- a commitment to truth and fair dealing,

- a commitment to complying with the spirit and letter of all laws and regulations wherever HSBC conducts its business, and
- a commitment to the welfare and development of each local community.

Consistent with these values, HSBC Holdings has a proud record of support for the communities it serves.

In the United States, through its principal U.S. operating subsidiary, HSBC Bank, HSBC Holdings has shown an exemplary commitment to serving responsibly the credit and financial services needs of all segments of the communities in which HSBC Bank is located. This dedication is reflected in the broad range of community-oriented lending and investment programs that it has undertaken. These programs are described in more detail in the Public Summaries of its Community Reinvestment Act ("CRA") Performance Evaluations prepared by the Federal Reserve Bank of New York and the New York State Banking Department and available upon request from HSBC Bank. They include loan programs for individuals that historically have had difficulty obtaining credit, investments in community development credit organizations, partnerships with non-profit and non-governmental organizations to increase development and credit opportunities in areas with critical needs, small business lending, and sponsoring workshops, seminars and other educational initiatives for those who have experienced credit-related problems. In addition, HSBC Bank clearly and unequivocally opposes predatory lending and its pernicious effects on the community. HSBC Bank's commitment to eliminating predatory lending practices is exemplified by the attached brochure developed by HSBC Bank with the Better Business Bureau of New York.

As of September 30, 2000, HSBC Bank was examined by the Federal Reserve Bank of New York and New York State Banking Department for performance under the CRA. Both agencies gave HSBC Bank an "Outstanding" rating for CRA performance. HSBC Bank, together with its subsidiary, HSBC Mortgage Corporation (USA), ranks within the top ten of peer-group lenders in New York for making loans to low- and moderate-income census tracts and low- and moderate-income individuals. It ranks in the top five of peer-group lenders in New York for small-business lending in low- and moderate-census tracts. It has an excellent level of qualified community development investments and grants with investments of \$130 million. It provides an excellent level of community development services, including job training, career development workshops, mentoring, internships, summer employment and mortgage and small business seminars. These activities complement the Bank's lending and investment initiatives, reflecting a multi-faceted approach to community development that is highly responsive to the needs of its community.

Household has demonstrated its own commitment to the prevention of predatory lending practices by introducing its own initiatives during the past several years. Even before the Settlement, Household had adopted numerous changes to its lending practices concerning product, pricing and disclosures. These enhancements relate, among other things, to:

- ability to pay,
- risk-based pricing,
- refinancing fee limitations,
- a three-tiered tangible benefit requirement,
- clear disclosures,
- credit insurance products,
- zero- or special-interest mortgages,
- prepayment fees,
- 100 percent-satisfaction guarantee,
- reducing interest rates for responsible borrowers,
- fair debt collection practices,
- loan proceeds to pay home improvement contractors,
- balloon loans,
- call provisions,
- default advice,
- advance payments,
- negative amortization,
- servicing standards,
- employee training and education,
- an employee code of ethics,
- a consumer advisory board,
- consumer financial education, and
- financial literacy and community outreach.

Further details on these enhancements to its practices can be found on Household's website located at www.household.com. All of these items were implemented with the input of various consumer groups, legislators, and customers. Some specific changes included:

- a reduction in the prepayment penalty term from five to three years,
- new disclosures to ensure that customers understood that insurance is optional,
- an extension of the period from 30 to 60 days during which a customer may cancel credit insurance and obtain a full refund,
- an improvement to its "PayRight Reward Product" to double the potential total rate reduction from 150 to 300 basis points and to offer the first rate cut within 12 rather than 36 months of origination,
- the establishment of an 800 number for consumers to call to obtain a review of the terms and features of direct mail loans, and

- funding for a partnership with the National Community Reinvestment Corp for a consumer financial education curriculum and a consumer loan rescue program designed to educate consumers in financial management and to rescue consumers who are at risk of foreclosure from a predatory loan.

Household regularly reviews its practices to ensure that they are responding to the needs of its customer base.

B. Household's Best Practices Announced on October 11

In October 2002, Household entered into a landmark preliminary agreement for settlement with a multi-state group of attorneys general and regulators in which Household agreed to adopt numerous additional consumer protection measures applicable to its retail branch-based real estate-secured consumer lending business. In so doing, according to one of the attorneys general, "Household set an example for the entire non-prime lending industry." [The Settlement will become effective upon the decision to participate of states in which Household makes at least 80 percent of the dollar volume of its loans.] The effective date for the implementation of the Settlement is expected to be December 16, 2002.

HSBC Holdings commits, as Household's new parent, to monitor the consumer lending business of Household to ensure that Household follows through in implementing each of the following measures to which it agreed in the Settlement:

1. Loan origination fees and points will be capped at five percent. Household may charge other lender fixed fees at origination; however, they will be reasonable, related to the origination of the loan and only those that are allowed by state law. Household will comply with the definition, if any, of bona fide discount points in the relevant state's law. Whenever Household offers discount points in connection with a real estate-secured loan, it will provide a written disclosure to borrowers at the earliest possible date of the interest rate available to the borrower and the corresponding discount points available to buy down the interest rate.
2. Loan products will be offered and disclosed with and without prepayment penalties and never with a prepayment penalty term greater than 24 months from origination. Prepayment penalties will be set in accordance with state law or, where there is no state law, calculated on the amount outstanding at the time of prepayment.
3. Household will notify current borrowers -- those who were extended real estate-secured loans between January 1, 1999 and September 30, 2002 and who are still on Household's books -- within 60 days of the effective date of the Settlement that prepayment penalties are no longer payable after 24 months after origination.

4. Prepayment penalty disclosures will now include the cost of the prepayment penalty if the loan is paid off immediately.
5. All Good Faith Estimates will bear a reasonable relationship to the charge the borrower is likely to pay at settlement. Fee variances of 10 percent or more will require Household to repeat a Good Faith Estimate, provided the increase in fees is not due to an increase in the amount originally applied for.
6. A new loan disclosure form will more clearly inform borrowers of the circumstances in which making minimum payments will result in a "balloon" payment at the end of the term, including the full amount of the balloon payment and the monthly payment required to pay off the loan by the end of the term.
7. Except in those states in which it does not charge fees and in those states whose laws require other disclosure, "live checks" issued by Household will carry the following disclaimer on the face and back, in twelve point, bold face type: "SIGNING THIS CHECK WILL RESULT IN A LOAN TO YOU THAT MUST BE REPAID WITH INTEREST AND FEES (as applicable, unless other required by state law)." No prepayment penalties will be charged on such loans.
8. Disclosed via customer billing statement, "interest short" amounts will be placed in a deferred status and will not incur interest. Full disclosure and consent is required to change a customers' payment date.
9. Disclosures will be simplified and improved, and accuracy will be ensured. Household will work with the multi-state group to more fully develop other timely loan disclosures, including a one-page summary of key loan terms and features.
10. Non-certified Spanish language branches will provide information about certified Spanish branch offices within 50 miles and/or addresses and phone numbers of Spanish certified loan offices. Household will continue to work with the multi-state group to more fully develop assistance to Spanish-speaking borrowers.
11. Spanish-certified branches will provide Spanish-language loan documents. Employees and independent loan closers in certified branches will be certified to conduct Spanish language transactions. Non-certified employees will not speak Spanish in connection with loan transactions.
12. Borrowers will be provided with payoff information on all underlying liens held by Household within five business days of a borrower's written request, or as specifically permitted by state or federal law. Household will inform customers that requests by mortgage brokers or other agents

must be authorized in writing by the customer. Payoff information requested in person at a branch shall be provided as promptly as practicable.

13. Employees will be trained on the terms of, and compliance with, the consent decree. Employee manuals will be made consistent with the consent decree terms.
14. Household branch offices will have an "independent closer," or other type of control mechanism, to manage the loan closing process. The independent closer may be an employee of Household so long as the employee does not report to sales management and the employee's compensation is not based on loan production. Spanish certified branches will also have Spanish language independent closers.
15. Rates and points options will be clearly and properly disclosed.
16. No single-premium credit insurance will be offered on mortgage loans. Household will fully disclose the availability of other insurance products, the optional nature of credit insurance and the effect of such insurance on projected loan payments. Household's operational systems, training, and scripts will direct its account executives to disclose monthly loan payments without the monthly cost of insurance before disclosing the monthly loan payment with the cost of insurance. On each monthly account statement provided to a borrower for a real estate secured loan, Household will separately identify the amount of the monthly insurance premium that the borrower is paying.
17. All real estate-secured loans must provide a net tangible benefit to the borrower. Household will not enter into any real estate-secured loan that does not provide such a tangible benefit to the borrower, *i.e.*, a loan that does not result in a monetary benefit to the borrower, taking into consideration the totality of the circumstances, including, but not limited to, the loan product and the borrower's stated loan objectives, repayment ability, current and expected income and current obligations.
18. Written loan representations will be accurate and not deceptive.
19. Borrowers may cancel a real estate-secured open-end line of credit at any time. Household will adequately disclose to borrowers the procedure it requires to cancel and terminate any real estate-secured open-end credit.
20. If a prepayment penalty is charged on a real estate-secured loan, it will be disclosed in writing and include a dated signature of the borrower.
21. Systems and reasonable safeguards will ensure HOEPA disclosures are provided on all HOEPA loans, including notice of a right to rescind.

22. Household will provide borrowers with the lowest rate applicable to a Household real estate-secured product for which the borrower's credit qualifies.
23. If a Household real estate-secured loan is refinanced within 12 months of the date of the original loan, points will not be charged on the original loan amount or will be refunded on the original loan amount before being charged on the full new loan amount.
24. No subordinated real estate loan to the same borrower secured by the same property will be allowed within 90 days of making the first real estate loan unless the loan is a purchase-money transaction.
25. Household will continue to make unsecured second loans. However, the unsecured loan may not pay for the origination fees and costs on a first real estate-secured loan to the same borrower. The unsecured second loan must provide a benefit to the borrower, and Household must ensure and confirm the borrower's understanding that two separate loans with separate and distinct loan terms and features are being transacted.

These measures set a nationwide framework for best practices in the subprime lending business and have been endorsed by the state attorneys general and the state banking regulators who participated in the negotiation of the Settlement.

C. Monitoring Compliance with Settlement Commitments

HSBC Holdings plans to monitor Household's compliance with the terms of the Settlement in three ways.

1. The Independent Monitor

HSBC Holdings will have the benefit of the reports that will be filed by an independent third party that Household will retain under the terms of the Settlement to monitor compliance with the Settlement. The reports will also be provided to the states, which will thus provide an additional layer of assurance that Household will comply with the Settlement. Household and the states will agree on the procedures to be employed by the monitor, and the states must approve the monitor recommended by Household. Household will pay the full cost of the monitor, and must provide the monitor access to any and all documents that it requests. The monitor will review Household's compliance for the six-month period beginning on the effective date of the Settlement (expected to be December 16, 2002), for the subsequent six-month period, and for the four subsequent annual periods, for a total monitoring period of five years. The monitoring requirement has been designed by Household and the states to provide an effective and independent means of measuring compliance by Household with the Settlement.

2. The Secret Shopper Program

Household is planning to institute before the end of this year a unique and unprecedented Secret Shopper Program. The Secret Shopper Program is unlike other "mystery shopper" programs which simply verify customer-service standards at the beginning of a transaction with a consumer. Rather, this program will involve a secret shopper from the first interaction with an account representative all the way through the loan application process to the funding and closing of the loan. As a result, each phase of Household's loan process will be assessed. Both its oral and written practices and procedures will be evaluated and tracked through this program. The Secret Shopper program is critical to Household's overall commitment to responsible lending practices. Household is committed, first, to make meaningful changes in its pricing, products, fees and disclosures, and, second, to back up those changes with confirmation that its oral communications and branch processes reflect those commitments. As far as Household is aware, there is no other program in the industry that is comparable in breadth and depth to the one that Household is initiating in that it traces every step in the process from initial contact through closing of a loan.

Shoppers will be employed from an external agency as recommended by an independent firm that will manage the Secret Shopper Program.

3. The Planned Integration of HSBC Holdings' Group Audit and Compliance Functions

HSBC Holdings plans, as in the case of all of its acquisitions, to integrate Household into its Group audit and compliance functions and culture, bringing Household's lending subsidiaries under the reporting systems and audit regimes that it applies to all of its worldwide subsidiaries.

a. Group Compliance Function

HSBC Holdings' compliance function reports to a Head of Group Compliance who reports both to the Group General Manager, Legal and Compliance and to the HSBC Holdings Group Audit Committee. The role of the Group's Compliance Department is (i) to set policies and standards on compliance issues for the Group; (ii) through the Group Compliance function, to support line management in managing and containing compliance risk by identifying and evaluating the risks, by helping to design and monitor procedures for the management of these risks, by assisting in the resolution of compliance issues, by providing an independent reporting line for compliance issues, and by managing relationships with regulators; and (iii) to manage and review the Group compliance function.

The Group compliance function is performed through a network of Regional Compliance Officers ("RCOs"), Area Compliance Officers ("ACOs") and Local Compliance Officers ("LCOs") operating on a territorial basis and Global Compliance Officers ("GCOs") operating on a global basis for the subsidiary or business grouping that they serve.

Management at all levels are required to ensure that they, or their executives with delegated managerial responsibilities, are fully acquainted with the rules and regulations applying to the operations for which they have responsibility and that arrangements for ensuring compliance with legal and regulatory requirements are an integral part of the operational procedures of the business. When managers become aware of breaches of laws or regulations, they are required to advise their LCO.

The CEO of each business unit and the board of each Group Company is required to establish policies, practices and programs to ensure compliance with all relevant laws, codes, rules, regulations and standards of good market practice. CEOs are required to include a reference to these responsibilities in their job descriptions and also in the job description of all executives with delegated managerial responsibilities. CEOs are further charged with ensuring that Compliance Officers have unfettered access to line management and also to their functional compliance superiors and that Area, Global and Regional Compliance Officers always have a direct management reporting line into the CEO of the business which they support, or a Senior Legal Adviser who in turn reports to the CEO. All actual or potential breaches of regulation are required to be referred immediately to the LCO. The LCO, in turn, is required to meet his own reporting obligations through periodic updates and semi-annual compliance certificates as provided in the Compliance Officer Handbook.

b. Group Audit Function

Internal audit throughout the Group is the responsibility of the General Manager and Group Audit controller who is based in Group Head Office and reports directly to the Group Chairman and the Group Audit Committee. Group Internal Audit is responsible for formulating and communicating Internal Audit policy as well as ensuring the maintenance of high-quality standards in Internal Audit throughout the Group. All Internal Audit units throughout the Group report to the General Manager and Group Audit Controller either directly or through the head of one of the main audit units. Each unit also has an administrative reporting line to the local chief executive officer for cost allocation and personnel management purposes.

The Group's policy is that all of its business units and support functions are required to be audited by the Group's Internal Audit units. Internal Audit is an integral part of the control environment of the Group. It provides management, and, through the Group Audit Committee, the Board with an independent and objective review of the business activities and support functions of the Group. Internal audit has access to all operations, records, property and staff at each Group location. All Group employees are required to cooperate fully with and provide full and complete information to the Group's internal auditors in the performance of their assigned duties. Internal Audit is required to be independent of the operations that it audits and objective in carrying out its duties. The objectives of the Internal Audit function are to assess and report on (i) the appropriateness, efficiency and effectiveness of the internal control environment; (ii) the reliability and integrity of financial and other operating information; (iii) the appropriateness and adequacy of procedures in place to ensure compliance with local,

national and international laws and regulations; (iv) compliance with Group and local policies and procedures; and (v) the evaluation and protection of assets.

Some audit cycles are predetermined by regulatory or similar requirements. In general, however, audits throughout the Group are carried out on a frequency determined primarily by the risk-grading allocated to the business unit at the time of the previous audit with units considered to represent greater risks being audited at more frequent intervals. Internal Audit reports are issued to that member of senior management who has functional or regional authority for overseeing the activities of the unit being audited. That manager has the responsibility of ensuring that the recommendations made by Internal Audit are implemented. Confirmation to this effect must be sent to the relevant internal audit unit within an agreed time frame. In order to preclude any negotiation of audit findings, Group policy is not to issue internal audit reports on a draft basis. Management, in its response, has the opportunity to raise matters on which it disagrees with the findings.

Local business units are required to advise the local Internal Audit unit before the introduction of all new or enhanced products or systems to enable them to comment on risks and controls. Senior management are required to confirm in writing each year to either Group Internal Audit or the appropriate local Internal Audit unit that offices under their control have complied with all recommendations made by the external auditors in their management letters and by the local regulatory authorities if they have carried out any inspections during the previous 12 months. Reasons for non-compliance must also be reported in detail.

Group Audit USA, based in Buffalo and with staff in New York City, has responsibility for internal audits of HSBC Group entities in the United States (primarily HSBC Bank USA). Group Financial Services Audit, based in London, has Group-wide responsibility for internal audits of treasury, investment banking and insurance activities, including entities in the United States.

Audits are conducted using established and updated detailed audit programs. The principal objectives of each audit are to evaluate the system of internal controls and assess compliance with applicable policies, procedures, laws and regulations. In addition, the objectives of credit audits include an evaluation of the quality of loan portfolios, the accuracy of reporting, the effectiveness of management of the loan portfolio, and the adequacy of loan loss reserves.

D. Support for Household's Increase in Compliance Resources

In the course of reaching the Settlement, Household has recognized that the resources that it applies to its overall compliance function should be increased dramatically. HSBC Holdings strongly supports this effort. As demonstrated by the following table, the principal business functions within Household have significantly increased their compliance budget for 2003 over 2002, most particularly in the branch-based consumer lending business, which has attracted the greatest number of consumer complaints:

Household International, Inc.
Compliance Budget
2002-2003

<u>Lines of Business</u>	<u>2002</u>	<u>2003</u>	<u>Percentage Increase</u>
Corporate		\$21,300,000.00*	N/A
Consumer Lending (HFC/Beneficial)	\$12,974,000.00	\$17,123,000.00	31.98
Auto	\$1,712,970.00	\$2,000,000.00	16.76
Credit Card (including Retail Services)	\$10,455,510.00	\$10,661,334.00	1.97
Insurance	\$2,303,017.00	\$4,956,807.00	115.23
Decision One	\$577,694.00	\$819,869.00	41.92
Mortgage Services	\$858,013.00	\$1,098,569.00	28.03
Direct Lending	\$427,314.00	\$442,270.00	3.5
Total	\$29,308,518.00	\$59,901,849.00	104.38

* Represents a newly established corporate compliance office and includes \$10MM allocated to the Secret Shopper Program and \$10MM allocated to compliance with the Settlement.

This budget growth was accompanied by a company-wide increase in compliance positions from 325 in 2002 to a projected 475 in 2003, a 46-percent increase. This growth in budget and personnel compares with an actual and projected growth in Household's total assets over these years of approximately 10 percent from 2001 to 2002 and approximately 10 percent from 2002 to 2003.

In May 2002, Household hired James B. Kauffman, the former Secretary of Banking of the Commonwealth of Pennsylvania, to serve in a newly created position of Senior Vice President of Compliance and Policy. Mr. Kauffman, who reports directly to the chairman and chief executive officer of Household, has impeccable credentials, financial services expertise and firsthand knowledge of compliance requirements. Since arriving at Household, Mr. Kauffman has been an integral part of negotiating the Settlement, has strengthened Household's policy and compliance functions, secured the necessary budgetary resources to implement Household's new consumer protection measures and hired the additional compliance personnel who will be necessary to implement the enhanced compliance function.

In September 2002, Household hired as Vice President of Consumer Lending Policy and Compliance Frances A. Bedekovic, the former Acting Secretary of Banking for the Commonwealth of Pennsylvania and former Deputy Secretary of Banking responsible for Supervision and Enforcement of Depository Institutions. Before joining Pennsylvania's banking department, Ms. Bedekovic held a variety of risk management positions in the banking industry.

HSBC Holdings has examined these efforts carefully and has discussed them with Household's senior management. It is convinced that these measures are desirable and necessary if Household is going to bring its practices up to the standard required by the Settlement and by HSBC Holdings. HSBC Holdings commits to support Household's continuing expansion of its compliance efforts.

E. Expanded Products and Services

HSBC Holdings is committed to working closely with Household to ensure all consumers, at all credit levels, have fair access to credit with terms and pricing that accurately reflect their credit profile. One of the principal benefits of the acquisition will be the availability of an expanded product base, including prime products from HSBC Holdings. This product base will include a "referral-up" program.

HSBC Holdings and Household intend to develop a "referral-up" program to identify and notify customers of Household who qualify for prime loans and to review their options with them. As an initial matter, the focus will be on mortgage products. HSBC Holdings' mortgage lending subsidiary, HSBC Mortgage Corporation (USA), is already licensed to lend in 48 states; Household's subsidiaries are licensed to lend in 46 states. HSBC Holdings and Household intend to investigate the technical feasibility of establishing compatible computer systems which, subject to any additional state requirements, would allow a customer of Household who qualifies for a prime product to have access in a Household office to an HSBC Bank prime mortgage product. HSBC Mortgage Corporation (USA) and Household would establish selection criteria based on the amount of the loan, the borrower's bankruptcy history, FICO scores, and loan-to-value and ability-to-pay ratios. Personnel within the two organizations would be appointed as managers of the program. HSBC Holdings and Household also intend to develop a range of other prime products that can be made available to Household's customers through Household's branches.