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PRESENTATION

Operator

Welcome to the HSBC Finance Corporation and HSBC USA third-quarter 2006 results conference call. Today's call is being hosted by Mr. Bobby Mehta, Chief Executive, HSBC North America Holdings, Inc., and Chairman and Chief Executive, HSBC Finance Corporation; Mr. Douglas Flint, Group Finance Director, HSBC Holdings plc; Mr. Simon Penney, Chief Financial Officer, HSBC North America Holdings, Inc.; and Mr. John McKenna, Chief Financial Officer of HSBC Bank USA.

Once the presentation has finished, there will be an opportunity for questions and answers. At this point, I would like to hand over to Mr. Douglas Flint to begin today's presentation. Mr. Flint.

Douglas Flint - ***HSBC Holdings plc - Group Finance Director***

Thank you very much and thank you to everyone who's on the call for participating. I'm here with Bobby Mehta. I'm going to hand over to him in a minute. And just for sake of clarification, the document that we're going to be referring to predominately throughout this call is the Form 8-K for HSBC Finance Corporation, which deals with the IFRS numbers, and the comments that we're going to make are going to be on a management basis under IFRS accounting. Bobby.

Bobby Mehta - ***HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive***

Thank you, Douglas, and again, let me add my thanks to everybody on the call. I know that the 8-K has been out for about a day, so I will walk through the qualitative sections of the 8-K. And if I could first also add some clarification to the point that Douglas made. We are going to be talking to the 8-K on an IFRS management basis. Just to remind everybody, what management basis means, particularly for the Finance Corporation, is that we look at the results of the Finance Corporation in totality, including the receivables that are managed by the Finance Corporation, but that are on the books of the Bank, which in particular and in large part include or encompass the private-label card receivables of the Finance Company.

So if I can direct you all to page 6, which really delves into the Finance Corporation, IFRS management basis. The third-quarter profit before tax increased 6% over the year-ago period, but decreased 43% from the prior quarter. If you look at it on an underlying basis, which excludes derivative and fair-value impacts and also the adjustments for the calculation of effective interest rate and credit card balances with low introductory rates, which is, again, something that an accounting convention under IFRS, where we, in essence, take -- or normalize the yields for credit card balances at low introductory rates.
And we took an adjustment in the half-year for that. So if you take those out, because they distort the underlying run rate (technical difficulty), our third-quarter profits increased 21% year-over-year, but declined 26% from the prior quarter. On the year-to-date basis, PBT increased 19% from the same period, and underlying PBT was up 30%.

I know a large part of the discussion today will be about the correspondent and wholesale mortgage business, but I also want to highlight the fact that third-quarter profit before tax reflects strong year-on-year profit growth in our retail branch channel and our credit card businesses. That includes the credit card business that we had originally, as well as the performance of the Metris portfolio, which we acquired about this time last year.

This growth in these businesses was primarily driven by higher yields due to repricing initiatives, higher fee income from the Metris portfolio and fee income from our underlying portfolio as well. And overall, I would say that we are pleased with the performance of the Metris portfolio, which was the deal that we closed in the fourth quarter of 2005.

Third quarter of last year, we also -- and the other piece obviously is also loan impairment charges -- lower loan impairment charges due to incremental charges recorded last year for both Hurricane Katrina and changes in U.S. bankruptcy legislations. If you recall, we took incremental provisions in the third-quarter last year for both Katrina and bankruptcy.

The favorable profit before tax of these goods businesses obviously was partially offset by higher operating expenses, to support receivable growth, lower Other income, including the fair value impacts, which I'll ask Douglas to comment on in a moment, and higher loan impairment charges, which we will talk about more as we go through this presentation.

Net interest income increased 6% year-over-year, but decreased 6% from the prior quarter. Underlying net interest income increased 6% year-over-year, but was broadly flat to the prior quarter. The adjustment between net interest income and underlying net interest income, once again, is the EIR adjustment I talked about earlier.

Net interest margin compression. We saw net interest margin compression, obviously, is consistent with the rising rate environment, the effects of which are partially offset by increasing yields, resulting from a continuation of our repricing efforts. Average customer loans grew 17% year-over-year due to the Metris acquisition, as well as organic growth. Annualized average growth of 12% from the prior quarter was driven by growth in our branch residential mortgage business and our MasterCard/Visa portfolios.

Our corresponding wholesale portfolio loan growth was held flat to the prior quarter and we saw growth in other parts of the business. Once again, we will talk more about that.

Fee income, once again a positive story, increased 21% over the year-ago period and 8% from prior quarter as a result of higher volumes in our credit card businesses, which includes Metris.

In the third-quarter, derivative and fair-value income declined, largely due to the impact of tightened credit spreads on the application of the fair value option to our own debt. Now this may be counterintuitive to many people, that we had an accounting period loss because our spreads were better. So Douglas, I'd maybe ask you to comment on that.

Douglas Flint *- HSBC Holdings plc - Group Finance Director*

As long as you are not going to ask me to justify the accounting under IFRS. Under IFRS, we've adopted the fair-value option for hedging. And the anomaly within that framework is that we fair value our own credit spread. So that you've got the interest rate hedged with our own debt and the instrument that is hedging it. To the extent that our own credit spread tightens, we end up booking losses; to the extent that it weakens, we end up booking gains.

Over the year as a whole, it hasn't been that significant, but it was a sizable charge in the third quarter as our credit spread tightened, and that is noise that simply amortizes over time over the debt. So it is a number that one has to normalize out. Bobby?

Bobby Mehta *- HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive*

Thank you. Moving on then to loan impairment charges, they decreased 4% year-over-year, but increased 16% from the second quarter. The year-ago quarter, as I said earlier, included charges for estimated incremental exposure associated with both Katrina and changes in U.S. bankruptcy legislation. The Katrina impact -- or the provision in the third quarter was about $200 million pretax and $138 million after-tax. That is shown on page 8. And the bankruptcy provision that is in the 10-Q was about $100 million. So if you normalize for that, our loan impairment charges increased by -- from about 1 billion 330 to 1 billion 597 in the third quarter.

Our correspondent and wholesale channel portfolio, as expected, experienced high delinquency and net charge-offs during the third quarter period. And this was really important to the portfolio acquired in 2005 and 2006. This is, as we said in the half-year, in the second lien and portions of the first lien portfolio. As a result, this portfolio has experienced higher loss estimates year-over-year, although third-quarter loan impairment charges were flat to the prior quarter. We'll discuss the mitigation efforts that are underway and really give you a better picture of what is in the portfolio and how that portfolio has grown over the past several quarters.

In our other portfolios, third quarter 2006 also experienced some higher loan impairment charges. But I would emphasize that this is really due to seasoning of the portfolio, which experienced strong growth in 2005, as well as normal seasonal impacts within certain portfolios, in particular the motor vehicle portfolio, which always has a seasonal uptick in the third quarter. Credit performance therefore, as measured by 2+and net charge-offs in most other portions of our domestic portfolio, including branch residential mortgages, is really consistent with the levels that we have seen in 2005.

Having said all of that, obviously we are monitoring credit very closely and we believe that the recent abnormally favorable credit performance is returning to a more normalized level. What we mean by this is obviously the first half of this year was abnormally low due to the sort of impacts of lower bankruptcy filings in the first half of the year. And the third quarter of last year obviously saw the spikes associated with the provisions of Katrina and bankruptcy. So we are seeing -- we saw in the third quarter some modest growth in bankruptcy filings, and we continue to monitor credit, and we don't believe we will see credit that we saw in the first half of 2006.

Operating expenses increased 17% year-over-year and were in line with the prior quarter. The 17% increase on the year-over-year basis is primarily driven by the taking on board the costs related to the Metris portfolio. And if you look at operating expenses quarter-over-quarter, they were relatively flat. And operating expenses as a percent of average customer loans were down against the prior quarter.

Last point on page 7 then is that in October of 2006, we entered into an agreement to sell our entire interest in Kanbay International to a third party. The transaction is expected to close in the fourth quarter of 2006, and will result in a pretax gain of approximately $123 million.

Moving over then, skipping over pages 8 and 9, which simply reflect the income statements for both -- for the sequential and linked quarters and the normal period, let me move on to page 10, which shows essentially the net interest margin risk-adjusted revenue and return on managed assets. These are on a management basis, but derived from the U.S. GAAP numbers, because that is where we have thetime series data; but they're broadly consistent with the IFRS figures as well.

Net interest margin, as I said earlier, declined from the prior year and prior quarter. The margin pressure obviously was due to higher cost of funds, consistent with the rising rate environment, and higher proportion of lower yielding residential mortgage portfolios. So some continued mix shift towards secured. This was partially offset by the yield's increases due to our repricing efforts and the bringing onboard of the Metris portfolio, which has yields obviously higher than the average yields in the portfolio as a whole.

Risk-adjusted revenues, down from the prior year and the prior quarter, in part driven by the lower net interest margin than the prior year, coupled with gains in 2005 from the loan and investment property sales, basically from the runoff Commercial portfolio that we have within the Finance Corporation, which were also partially offset by lower net charge-offs. The decline in risk-adjusted revenue compared to the prior quarter was due to lower net interest margin and higher net charge-offs, offset partially by increased fees.

On the return on managed assets basis, we are up in this quarter compared to Q3 '05 and down marginally from Q2 '06. Obviously, this is driven partly by the decline -- the comparison to the prior quarter is driven by the decline in NIM and RAR, but helped by increased cost efficiency as measured by expenses basically being flat.

Moving on to page 11, we have the same points on RAR. But looking at the risk-adjusted revenue compared to delinquency as well as charge-offs, the two-plus delinquency is up from the prior year and the prior quarter. Compared to the prior year, the increase was due to a deterioration in the correspondent and wholesale channel and the addition of the Metris portfolio, which credit cards in general have a higher 2+ rate compared to the portfolio average.

Compared to the prior quarter, the increase was largely due to the correspondent wholesale channel, and some expected seasonality, as I said earlier, in the credit card and motor vehicle finance portfolios, as well as seasoning in the unsecured personal lending portfolio. But where we are seeing -- and the highlighted credit deterioration is primarily in the correspondent and wholesale channel.

The charge-off ratio decreased from the prior year, but increased modestly from the prior quarter. The decrease from the prior year was due largely to personal lower personal bankruptcy charge-offs and filings following the U.S. bankruptcy legislations. This was offset by higher net charge-offs and seasoning in the correspondent and wholesale portfolio, which as we will see, has seen significant growth in the period up to June 30, as well as losses in portions of that business. The increase from the prior quarter was primarily from a seasonal increase in the motor vehicle finance portfolio and the seasoning of the overall portfolio.

So overall, I think the picture I would draw is of a business where we have a good businesses and good-performing businesses in the residential -- the branch-based business, the credit card business, stable credit really across our portfolios, and obviously increase in delinquency and charge-offs in our wholesale and correspondent channel.

If you turn then to page 12, which is a horizontal table, you can see the composition of the portfolio and the growth. You can see that from the June '06 quarter to the September '06 quarter, the portfolio grew 2% -- I'm sorry -- yes from the June '06 to the September '06 quarter, it grew 2%. So growth in the overall portfolio has slowed.

And the principal cause of this slowing growth is the correspondent real estate secured channel, where overall receivables were flat from the June '06 timeframe to the September '06 timeframe. We continue to see good growth in the branch real estate secured, the MasterCard/VISA business, more modest growth in our private label business and our other businesses, as indicated by this chart.

Moving on then to page 13, we are breaking out the correspondent (technical difficulty). On page 13, we are breaking out the correspondent real estate secured portfolio by lien position. So you can see on the top panel of this chart the composition of the portfolio from September '05 through September '06, you see about a 25% growth in that timeframe and you see an increasing proportion of second liens in that portfolio as well.

If you then look at the bottom part of this, you'll see, again, hinging off the September '06 number, what they're giving you here is the composition of the portfolio as of September '06 by period of purchase. Just to remind people, these are loans that we have purchased from the correspondent and wholesale, i.e. the broker channel. So 2004 and prior represents about 32% of the portfolio. And you can see the progression of the composition of the portfolio in that period, broken out between first and second.

A couple points I would make on this chart. As we have said to you earlier, we have seen high delinquencies in the second lien and portions of the first lien business, from both '05 and the early '06 vintages. And as a result of that, we've taken a whole series of actions, which I will talk about in a moment. But the result of that has really been a dramatic slowdown in the growth in the portfolio and also a slowdown in the amount in quantative lien, absolute terms, in the quantum of loans purchased.

So if you look at the period ending in the last quarter, we repurchased 3 billion roughly of residential firsts and about 400 million of second liens, down from 10 billion -- so 10 billion the first half and 3 billion in second liens in the first half. So significant slowdown in the rate of purchasing. And that is really by design.

Moving on then to page 14, give you a quick overview of all of our businesses. As I said earlier, in the retail branch channel, which is our HSBC Beneficial branded business, we see strong year-over-year profit growth, continued good loan growth, 14% up year-over-year, includes both the near-prime and non-prime segments. And really originations are driven by increased productivity and lower liquidations.

Ninety-four -- the vast majority, 94% to 95% of these loans are fixed rate loans, and so we are not seeing the kind of issues in the loans in this channel as we are seeing through the correspondent and wholesale channel.

Unsecured products were up year-over-year, driven by successful direct-mail campaigns and up-sell of the direct-mail unsecured product in the branches. And that is really the model of this business.

Broader cross-sell volume continues to expand. We've seen growth in motor vehicle loans and credit card sales in the branch offices as well. Credit performance as measured by 2+ and net charge-offs is really consistent with the 2005 levels.

In October 2006, we acquired Solstice Capital, which is a direct mortgage lender, which really augments our capability of originating mortgages (indiscernible) as opposed to originating non-real estate loans and upselling to real estate. So this is really an augmentation of our retail distribution strategy in the Finance company.

On the correspondent and wholesale channel, because of the increased loan impairment charges, the profits are down because of higher loan impairment charges, as well as the slowdown in growth, which obviously effects top line as well. As I said, we've seen deterioration in portions of the '05 and '06 vintages, and this is a similar to what we've seen in the industryperformance as well.

Some of the risk mitigation program efforts that are underway include really enhanced risk segmentation for collections. We've put a lot more effort into that, so that we are targeting the higher-risk segments, targeting them earlier, targeting them with greater focus as well.

On the front end, on the originations side, we've significantly enhanced and revamped our pricing models and repricing initiatives, which has in large part had the result of slowing down particularly the unprofitable volume that we believe that we originated in the '05 and early '06 vintages.

We are also proactively working with customers regarding their adjustable-rate mortgage resets, and we are calling these customers well in advance of their ARM resets to understand what their situation is, what their capacity is, and therefore, how we work with them. We've significantly increased collection capacity as well to enable all the other activity. We've tightened credit criteria, especially in second lien, low documentation, lower debt service capacity and lower credit scoring segments.

And if you look at the volume that we originated in the third quarter of '06, in large part, the slowdown in volume of originations was due to these changes in criteria. And you will see as we go forward the impact of these criteria in further slowing down of the volumes that we originate.

As you've seen, the portfolio is up 25% year-over-year, but flat to prior quarter. That is due to, as I said, the strategic decision to tighten the underwriting criteria, as well as reflective of the slowdown in market originations, but really more significantly due to the changes in the criteria. And as a result of these, second lien and low documentation volumes have been reduced significantly, and first lien loan purchases have also been reduced, as indicated by the chart on page 13.

I've talked at a high level about both the credit card and private-label businesses. Both of these businesses are performing well; we are seeing strong year-over-year growth, good fee income growth and good yields as a result of the repricing initiatives and continued stablecredit. Of course I won't talk on them a lot more, but obviously I'll be happy to take questions.

In the order business, profits are broadly flat year-over-year, as higher loan volumes are offset by higher cost of funds. We see good organic growth in both our dealer network and our consumer direct channel, and we are bullish on really growing the consumer direct channel as go forward, focusing on refinance volume. Again, credit quality in the business is stable.

In Canada, we see good growth and good potential and good opportunity. Once again, good year-over-year growth in the top line and stable credit. And the UK, we continue to see profit growth really hindered by a challenging credit environment and the business environment. We're focusing more on secured lending in this business, as well as really taking significant steps to improve the cost basis of the business. And we've also agreed to sell the central and eastern European operations of HFC Bank to an HSBC affiliate as part of a broader central and eastern European strategic expansion.

Moving on then to HSBC Bank USA [HSBC USA Inc.], third-quarter profits before tax decreased 11% over the year-ago period and 26% from the prior quarter. Once again, though, if you look at an underlying PBT, which excludes the derivative and fair-value impacts, PBT decreased 1% and 3%, respectively. On the year-to-date basis, PBT increased 2% from the same period and underlying PBT was up 5%.

In the third quarter, the PBT reflected volatility in our CIBM businesses due to the challenging interest rate environment affecting banks in general and weak U.S. global markets' trading volumes in the quarter. As we've talked again in previous calls, our balance sheet management income was lower due to a flat to inverted yield curve that has really persisted for most of this year. We have taken a new (indiscernible) stance toward the movement of interest rates, and the balance sheet management drag has really been stable for the last several months.

Creating incomes increased significantly and really reflects the buil-dout of the client-facing global markets businesses. The third quarter was slower, but really focused in the U.S. mortgage-backed securities and precious metals. However, the year-to-date contribution from both of these businesses has improved significantly. Global transaction banking continues to really operate on a very firm footing and continues to grow well.

Good progress has been made on strategic initiatives within both PFS and Commercial banking. We saw good growth in domestic deposits, and a large part of that story, but by no means the only part of it, was successful nationwide online savings product, branch expansion in new markets and really continued refined marketing and customer analytics for the Premier customer. Small business and middle market lending activities continue to grow.

And if you look at page 19 -- and I will fast forward through this -- you can see operating income increased. You can see some of the impacts in the third quarter due to some of the impacts that we saw in the slower third quarter. Credit performance has generally been sound and operating expenses really reflect the continuing spend on investment initiatives.

Moving on to page 22, the only thing I would highlight there is the fact that we continue to open branches. We've opened 11 this year and four in the third quarter. And we've rolled out our branding campaign, including the campaigns at both the air bridges at JFK and LaGuardia. We see good growth in the CMB business, including increased fee income in our commercial real estate business due to continued success in our syndication capability there.

Private Banking and CIBM. I think we've talked about CIBM. We saw good growth in BPrivate banking and continued good momentum in WTS businesses. So with that, why don't I stop, Douglas, turn it back to you, and obviously we are open to taking questions.

Douglas Flint - ***HSBC Holdings plc - Group Finance Director***

Bobby, thanks very much. I think at this stage, if we can ask if there are any questions, that you identify yourselves so that we know who you are, and we will do our best to respond to those questions. Thank you.

QUESTION AND ANSWER

Operator

(OPERATOR INSTRUCTIONS) Ian Smillie of ABN Amro in London.

Ian Smillie - ***ABN Amro - Analyst***

Two questions please. The first one on volume, the second one on margin. On volumes, clearly the slowdown in Q3 that you had signaled in the correspondent business. But I guess there's a slowdown coming across in every other product category as well. And if we can do our calculations correctly, it looks like that has brought to an end the period of time when you have been making quite significant market share gain.

I guess the question is, is that a signal of what we should be expecting going forward until you can see a better or a more stable outlook for credit quality? Or is that an unfair analysis from one quarter's performance?

Bobby Mehta - ***HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive***

Ian, I would say that we should expect to see continued slowdown in volume in the correspondent and wholesale channel. I think we should continue to see sort of historic levels of growth in the other businesses that we are in. Obviously, if we see irrational underwriting in those channels, we will be very mindful of that and slow the volume growth. So the objective is not volume growth for volume growth.

Douglas, would you add anything to that?

Douglas Flint - ***HSBC Holdings plc - Group Finance Director***

No, I think the thing to note also is that we're actually still originating in the mortgage correspondent channel. But the liquidations -- I mean, we originate and liquidate about $3 billion or so a month, and so there is a steady flow through the portfolio. So we are still originating and liquidating. And over the last couple of months, it has been by design that we've balanced the two, so the portfolio has been flat. I think we will continue that until there is more visibility in terms of the dynamics of the business.

I think the other thing to say too is that we have built a significant securitization capability in New York. And the whole mortgage value chain in the United States, we're able to join up in a way that we have not been able to do before. And I think you'll see us using that origination combined with the distribution capability in a more integrated way, because we now have that capability to offer.

Bobby Mehta - ***HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive***

I think that is right. And just to emphasize for the other businesses, unless we see a dramatic change in the credit environment, we will continue to grow that organically and prudently.

Ian Smillie - ***ABN Amro - Analyst***

Great. And the second question is on margin. If I can read the other 8-K correctly, it looks like the margin erosion has come from the rising funding costs more than offsetting the yield pickup that you've pushed through. So I guess the question is, firstly, can you give us any guidance as to when we will hit the top of the rising trend in this funding cost?

And then the second follow-on from that is, will the yield continue to rise after that? In other words, is there some sort of a lag built into the business model, or when your funding cost stops rising, will the yield stop rising at more or less the same time?

Bobby Mehta - ***HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive***

I think we should see essentially funding cost stabilizing, based on our view of where rates are going in 2007. And really, we continue to focus on management of yield. Whether we can push through yield increases or not obviously is a function of the competitive environment. But if you look at, particularly in our branch-based channel, we have been successful at pushing through yield increases. But as you point out rightly, Ian, there is a lag between the ability to push up yield and the rising cost of funds. So to the extent that the funding costs begin to stabilize, you should begin to see stabilization of the yield and margin.

Ian Smillie - ***ABN Amro - Analyst***

Great, thanks.

Operator

Jon Kirk of Redburn in London.

Jon Kirk - ***Redburn - Analyst***

Just to quickly follow on from Ian's question, actually. You sort of noted, I think, that in 2007 we would see stabilization of funding costs, and then with any luck, some feed through from the repricing initiatives. Should we expect that to significantly improve your overall revenue margin?

Because I think if you take the risk-adjusted revenue margins you've provided us with and remove the charge-off element from that, you see the overall revenue margin, which takes into account fees and so on. That did stabilize 2Q to 3Q. And I wonder whether it will stabilize -- carry on being stable in the fourth quarter and then perhaps through even '07.

Bobby Mehta - ***HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive***

Our objective obviously is to make sure that we earn the risk-adjusted margin. And a lot of the deterioration or this compression in risk-adjusted revenue, risk-adjusted margin has really been due to the compression of net interest margin. And we have been able to offset that, if you look at the historical figures, by an increase in the fee income that we have been able to generate through the sale of additional products and so on.

And you would expect to see the fee income trends be stable. And so to the extent that we will --just building off my response to Ian's question -- to the extent that we see cost of funds stabilizing, and therefore net interest margin stabilizing, we should expect to see, absent what might happen down the road from a credit perspective, risk-adjusted revenues stabilizing as well.

Jon Kirk - ***Redburn - Analyst***

Okay, great. And there was just one more question, on the loan impairment charge. Just taking that as a percentage of loans -- I know it has been a slightly strange few quarters, actually, with the various influences -- but we are now at about 3.6%, excluding Katrina, which is roughly where you were at the second half of 2005.

Is that, therefore -- is it reasonable to assume that that is a more normal level or that we have further to go from here?

Bobby Mehta - ***HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive***

I'm not sure we can make forward-looking statements with respect to what we expect loan charge-offs to be. I think we've given you guidance with respect to the fact that we see issues in wholesale and correspondent business and stable credit quality, really, in our other businesses.

The only other point, I think which is public publicly known that I would add to that, is that bankruptcy filings are, as measured by (technical difficulty), are anticipated to rise next year. So I think those are the factors that I would say should go into your --.

Douglas Flint - ***HSBC Holdings plc - Group Finance Director***

Having fallen significantly --

Bobby Mehta - ***HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive***

-- having fallen significantly this year, correct.

Jon Kirk - ***Redburn - Analyst***

Okay, thanks.

Operator

Simon Samuels, Citigroup in London.

Simon Samuels - ***Citigroup - Analyst***

Good morning or good afternoon. Sort of three questions regarding delinquency and charge-offs. In fact, the first one maybe is a nice way to think about answering that last question. So the first question is, in the past, you've sort of conditioned us to look for the delinquency trends as the lead indicator of the charge-offs. And so my first question is, is that still good and should we be looking at that big increase in delinquencies going into next year for the charge-off?

The second question is, you've given us in the other 8-K a lot of detail of the delinquencies by product. Can you give us some sense of how much of the $2.8 billion of delinquent real estate secured mortgages -- how much of that is in the second charge portfolio, to give us some sense?

And the third thing is, also in that same area, the big increase in the delinquent mortgages from $2.3 to $2.8 billion in the quarter has effectively not had any effect yet on the actual charge-off, which went up by $10 million from Q2 to Q3. So can you talk about the timing when we should expect the charge-offs in the mortgage portfolio to come through or would it stay disconnected?

Bobby Mehta - ***HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive***

Okay, I think the first point I would make is that in extrapolating -- first of all, I would say if we said to you in the past that delinquency trends are a good way of looking at future charge-offs, if it was true back then, it is certainly true today. So I think that is a fair statement.

Second, Simon, I would say is that there is a mix shift between secured and unsecured delinquencies that would factor into the charge-off estimations that you would want to do.

In terms of the further breakdown of delinquency by product, we certainly -- I don't have that detail and we've historically not disclosed that. So I think the second two questions, we should talk about the mix, how much of the change in the real estate secured delinquency second lien versus correspondent, etc., that is data that we have not historically disclosed. But at this stage, I don't think we can give you further detail on that.

Simon Samuels - ***Citigroup - Analyst***

What about the third part, which is in fact just from giving the numbers again? So in June of '06, you had 2.3 billion of delinquent mortgages; you've now got 2.8 billion. Yet your charge-offs just went 2.2 million to 2.3 today. Could you talk about the relationship between the delinquencies and the charge-offs within the real estate secured portfolio?

Douglas Flint - ***HSBC Holdings plc - Group Finance Director***

Let me try and help Bobby a little bit. Simon, if you remember at the end of the second quarter, we took an additional provision in the second quarter because the expected losses were rising. And effectively, part of the third quarter is the expected losses that were anticipated in the second-quarter judgment, the provision came through. So effectively, we had already reserved for some of what we saw coming through. And that sort of timing difference between the two quarters is a big part of the answer.

Simon Samuels - ***Citigroup - Analyst***

So while I've just got the line, as it were, I mean, again, is that relationships? At the moment, your charge-offs are running at about 8% of your delinquencies in the mortgage portfolio space. Can you give us some sense of history of that relationship? Is that usual, is that high, is that low?

Bobby Mehta - ***HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive***

Simon, I don't have that at the top of my head, as we speak. So that is probably something you could follow up on, potentially.

Simon Samuels - ***Citigroup - Analyst***

Okay, thank you.

Operator

John-Paul Crutchley of Merrill Lynch in New York.

John-Paul Crutchley - ***Merrill Lynch - Analyst***

Two questions, if I may, one on HSBC Finance and one on the USA numbers. I'd like to just take a step back, Bobby, if I can. You always talked about one of the great advantages of your model is being predictive in terms of bad debts and the bad debt charge always coming out fairly close to where you expect it at the beginning of the year. Given a lot of this correspondent mortgages being written in the last 12 months or so, it seems to have deteriorated more quickly than you expected.

I wonder if you could just revisit when you were writing that business back then, what your assumptions were for the business and what has changed relative to actually change the profitability of what has been written and what has been learned from that? Because it does seem a very sharp shift in a very short period of time.

Bobby Mehta - ***HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive***

Sure. Basically, I would say that the business was written -- there's a lot of disturbance on the line. But the business was written on the basis of what we had historically believed would be the loss experience in that business. I think as people can see from the '05 and '06 vintages from the NBS data of the sub-prime mortgage securizations, the '05 and '06 vintages are showing higher losses.

And so, our experience relative to delinquencies, etc., in the business that we wrote in '05 and '06 is really no different than what the industry as a whole is experiencing. However, we had rapid growth in that business and as soon as we identified it, we've made the changes. So to your point of what have we learned from it, we made significant cuts in terms of -- John, could you put your phone on mute?

John-Paul Crutchley - ***Merrill Lynch - Analyst***

Sorry. I will do that. Hang on.

Bobby Mehta - ***HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive***

Thank you. So what have we learned? We learned that we need to move very quickly to put greater focus on collections segmentation in terms of delinquent loans from a risk perspective, the changes in pricing and underwriting guidelines, all of which we did rapidly from the point in time where we identified the early vintages showing elevated early delinquency rates.

And we've moved, basically since we talked about the issue in the half-year, in the last three months to put a fence around this as quickly as we could, which is what we believe we have done.

John-Paul Crutchley - ***Merrill Lynch - Analyst***

Thank you. The second question is really more for Douglas, just on HSBC USA. And it's really just a question about the shape of the progression of the business, where -- at least three of the key business lines, PFS, Commercial Banking and CIBM, you saw faster cost growth than revenue growth. I just wanted to know, did you see this a bit of an aberration in the quarter or was there something more disturbing we should worry about here? I will put my phone back on mute again.

Douglas Flint - ***HSBC Holdings plc - Group Finance Director***

That would be kind. I don't think there's anything aberrational. I think that we have done a lot in 2006 organically to grow the business and PFS and CMB particularly, in relation to building out the branches in the U.S., building out the direct online savings deposit initiative and expanding the number of centers from which we do Commercial Banking business. So we have invested in the business at a time where we couldn't see any value in doing so anything other than organically; we'd much rather to go organically.

So what you see is us investing in our business. There is the lag end of the investment in the CIBM platform in New York and that is substantially done. So what you see is us investing in our business. And we will keep doing that, frankly. We have a program of continuing investments in branches, and we will continue to support the online savings channel as well, because that is going very well and much better than we had modeled. So it's not abnormal and it is not disturbing at all.

Bobby Mehta - ***HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive***

And the Commercial Banking centers that we put out, where you are basically co-locating Commercial Banking, Commercial Real Estate and Private Bankers, actually breaks even relatively quickly in the market. And we have a pretty unique service proposition because of the internationality of HSBC.

Douglas Flint - ***HSBC Holdings plc - Group Finance Director***

And the thing we would also say about CIBM is that the third quarter is always a slightly complicated one in relation to -- the majority of our business is flow business -- July and August are obviously seasonally weaker months. And the scale of that business is also reflective of its role as the U.S. piece of a global business, and you are only seeing a fraction of the business in the U.S. Bank [HSBC USA Inc.] results, as opposed to as just a part of a whole. So could put into context.

Bobby Mehta - ***HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive***

And I think a large part of the slowdown was due to lower activity in desks that are primarily U.S. oriented. So I would say that there's probably not a read across the other --

Douglas Flint - ***HSBC Holdings plc - Group Finance Director***

But the third quarter is always a slower month because of July -- here, because of July and August. Another question?

John-Paul Crutchley - ***Merrill Lynch - Analyst***

Thank you.

Operator

Tom Rayner of Citigroup in London.

Tom Rayner - ***Citigroup - Analyst***

Can I just follow on from JP asking about the wholesale and correspondent mortgages? Because it does seem that the whole sort of tone of the language has changed. I mean, you're now talking about putting a fence around it, trying to mitigate the issue. I'd just like to try to understand what has changed so radically that you were growing only 12 months ago considerably faster than your own branch-based, and now you have actually come to a complete stop in terms of growth and all the focus seems to be on mitigating the problem.

Can you give us any more detail on exactly what went wrong, if you like, or was there a particular geography or type of business that you have been purchasing which you are now having to do sort of deal with in these circumstances?

Bobby Mehta - ***HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive***

Yes, I think the point we are making is that we are seeing -- I think there's an echo on this line. Can you hear me?

Tom Rayner - ***Citigroup - Analyst***

I will try and mute mine. Hold on.

Bobby Mehta - ***HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive***

The response, I think to your question, would be that we have seen, again, as we said in the half-year, high delinquencies and potential loan impairment charges in the second lien portfolio and portions of the first lien portfolio, which are the low income documentation loans, which comprise a significant (technical difficulty) the wholesale channel as a whole originates it.

And what we are seeing is that the '05 and '06 vintages are performing differently from the prior vintages in those products. And as a result, we have changed our origination criteria to ensure that what we put on the books is product that we can price for the risk for that product. And as a result, a significant amount of the volume of second liens and low documentation loans basically no longer qualify for the kind of business that we would write.

That combined with slower mortgage originations through the wholesale channel in general has led to the slowdown in the growth that we indicated.

Tom Rayner - ***Citigroup - Analyst***

Was it higher U.S. interest rates or what has been the real driver for the unexpectedly poor credit performance, do you think?

Bobby Mehta - ***HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive***

I think the biggest driver of that has been a slowdown in real estate appreciation in the U.S.

Tom Rayner - ***Citigroup - Analyst***

Okay, thanks.

Douglas Flint - ***HSBC Holdings plc - Group Finance Director***

I think we're going to have time for probably only two more questions, given Bobby has to get a flight. So is there another question?

Operator

Robert Law of Lehman Brothers in London.

Robert Law - ***Lehman Brothers - Analyst***

Good afternoon, gentlemen. As you are cutting off the questions, can I have three, please? One on the margin, one on the credit and one on the expense side.

On the revenue side, can you talk us through --obviously there has been a big drop in the income relative to the run rate in the first half of the year. And you've pointed to some runoff items here. I think Bobby's presentation talked about the net interest income being down 6%, which sounds like it is about $180 million on an underlying basis.

Also, you've got non-interest income -- I'm looking at page 8 of the joint filing, where you have a number of the non-interest income what apparently are volatile items having negative swings in Q3 versus the first half. Can you give us some indication as to whether you view the Q3 level as a representative level of revenue, or whether the first half is a more representative level of revenue? That is the first question.

Bobby Mehta - ***HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive***

Okay.

Douglas Flint - ***HSBC Holdings plc - Group Finance Director***

I think the line where we did talk about it before, the financial instruments designated it at fair value. A large part of that is our own credit spread, and therefore it's a number that amortizes to nothing over the life of the loan. And perversely, gives us losses when the spreads improve and comes back the other way. So over the nine months, it comes to not very much. I mean, I would take that kind of line out from normalizing.

Robert Law - ***Lehman Brothers - Analyst***

(multiple speakers) $50 million, Douglas, isn't there. Otherwise, there is a $250 million reduction in the run rate in revenue in Q3 compared with the first-half quarterly rates.

Douglas Flint - ***HSBC Holdings plc - Group Finance Director***

You've also got -- in Q2, you've got the catch-up adjustments and the effect of interest rate. But, yes, there is a slowdown in revenue.

Simon Penney - ***HSBC North America Holdings, Inc. - CFO***

Doug, this is Simon Penney. If I could just remind Robert and others that we do have the seasonality in the first quarter as the [taxpayer] and actual services revenue come in. If you want to do a read across, you have to take that out of the run rate in the third half.

Robert Law - ***Lehman Brothers - Analyst***

Yes, but even so, there is still -- even if you allow for all of that, there is quite a significant reduction. What I am searching for is there anything else here that is unusually negative, apart from the own value debt, which is about $50 million by the look of it?

Bobby Mehta - ***HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive***

The other one, obviously, is in the June 30th period, the effect of interest rate adjustment, which was again a onetime. And Simon may have the exact figures for that.

Simon Penney - ***HSBC North America Holdings, Inc. - CFO***

It's shown on the page that Robert is looking at; after-tax, it was $91 million --.

Bobby Mehta - ***HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive***

So that inflates the June 30th number. So you need to make that adjustment as well for an underlying basis, Robert.

Robert Law - ***Lehman Brothers - Analyst***

Right. And alluding to credit, and obviously there has been a big deterioration in the delinquencies, and this hasn't been matched by the rise in the credit loss charge. And as a result, you've had a big reduction, certainly on a managed basis, of coverage of delinquencies. I mean, in a general way can you give us any further comfort as to why that won't lead to a rise in credit loss charges in the future. And in particular, as you've said in the past, delinquencies have led to charge-offs. Why don't the charge-offs lead to higher credit loss charges in the future?

Douglas Flint - ***HSBC Holdings plc - Group Finance Director***

It's a mixed point, Robert. The greater proportion of delinquency is secured, and therefore, you would expect if the higher proportion of the impaired debt is secured, the losses would be lower. And it is a mix impact that drags the coverage issue down predominately.

Robert Law - ***Lehman Brothers - Analyst***

But there's been, certainly on a managed basis -- the mortgage portfolio has risen in terms of delinquencies faster than the whole portfolio. But, on a managed basis, there has been a rise in delinquencies certainly on a sequential basis across the whole portfolio.

Bobby Mehta - ***HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive***

Yes, but the majority of that is really -- there's also underlying that is a mix shift in the delinquency ratio, which is why you reserve at a lower proportion for secured relative to unsecured.

Robert Law - ***Lehman Brothers - Analyst***

Okay. Do you expect further seasoning -- you talked about seasoning in the (indiscernible) with portfolios. Has that worked its way through yet or is that still fit to work its way through?

Bobby Mehta - ***HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive***

No, it hasn't worked its way through. It will work its way through as we move into 2007.

Robert Law - ***Lehman Brothers - Analyst***

Final question, just briefly, on the expense growth. And again, there's been a rise in expenses versus revenue. I know last Q3 was artificially lower, I think, but even so, there has been a rise in expenses versus revenue. Obviously, that is affected by margin, but it is still faster also than balance sheet growth. Can you talk through what are the factors behind that so we can think about when that might stop?

Bobby Mehta - ***HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive***

Yes, the big -- I think you can say that it will stop. The big increment was the bringing onboard of the expenses relative to Metris. And you see the much more representative trend, Robert, is the quarter-on-quarter progression in expenses, which are really flat in absolute dollars.

Robert Law - ***Lehman Brothers - Analyst***

Okay, thank you.

Douglas Flint - ***HSBC Holdings plc - Group Finance Director***

I think we will have to make the next question the last one. Otherwise -- well, we've taken the hour, but we've also got some people heading for airplanes. So if we could make this the last. Thank you.

Operator

Mamoun Tazi – *Man Group of London*

Mamoun Tazi – *Man Group of London*

Good afternoon. My question is about the slowdown in volume growth and the deteriorating environment in the U.S. What are you doing to prepare yourself for a potential slowdown or actually a decrease in volumes, both at the Finance Corp. and HSBC USA?

Bobby Mehta - ***HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive***

I think in general what we do is several things. One is we monitor where -- first of all, we don't believe that there is going to be a -- while there is slowdown in real estate appreciation, I think as we've said in the past, we don't anticipate a secular decline in real estate prices across the country. We will continue -- so as a result, we monitor market with at an NSA level to identify where the markets are undervalued, and as a result, where there is a prospect of further lack of appreciation or depreciation in value. And we manage and essentially adjust our underwriting criteria to match, number one.

Number two, if you look at the results of a lot of the sub-prime mortgage originated, particularly people who are in originate to sell (technical difficulty) originations through the wholesale channel, you've seen a weakness in their results. And as a result, we would expect to see some origination capacity go out of the market, which plays to the strength of our branch-based HFC and Beneficial channels, secondly.

Thirdly, we are going to be -- as you see quarter-on-quarter really flat costs, so we're going to be focusing and have been focusing on, in anticipation of this slowdown, making sure that we manage the cost line.

And lastly, I think what we would do in this kind of environment is, to the extent that there are portfolios that we believe we can identify from an acquisition perspective, where we can buy the assets, seasoned assets at a reasonable price, that would be a potential alternative to continued organic origination in this market.

Lastly, we are doing a lot of work as we speak on stress testing as well as identifying how a slowdown in the economy could affect credit and thereby taking a forward view -- we will take a forward view with respect to how we look at ongoing origination.

Mamoun Tazi - *Man Group of London*

If I may, a quick follow-up. You see excess capacity is being taken out. Could we see the following scenario, where there is excess capacity -- there is increased competition at the mortgage level and therefore margins could be under severe pressure?

Bobby Mehta - ***HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive***

No, I would not expect a further intensification of competition. Douglas --?

Douglas Flint - ***HSBC Holdings plc - Group Finance Director***

No. And it is just as likely that the other is the case. You've seen a number of players; particularly in the sub-prime space indicate that they are going to exit all or part of their business. And I think that takes capacity out of the marketplace, which is helpful.

I think the other comment, just to comment on the proposition you put forward in your question is, I think the issue of slowdown is simply in the area of the business where at the moment there is some uncertainty on the dynamics of the loss expectation. In the other parts of the business, credit cards and so on, we are very happy to grow that business, and indeed, the performance is extremely good. And in the Bank, we are in a growth strategy in PFS, the personal business, and in the Commercial business. And the business areas within the markets area that we have invested in have great potential. So there's a lot of areas in the U.S. where --

Bobby Mehta - ***HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive***

-- we continue to grow.

Douglas Flint - ***HSBC Holdings plc - Group Finance Director***

-- we continue to grow strongly. I think it is in some narrowly defined areas that we are making sure that any incremental business is based on better visibility than we've had over the last few months, clearly in relation to the expectation of performance.

Mamoun Tazi – *Man Group of London*

Great, thank you very much.

Douglas Flint - *HSBC Holdings plc - Group Finance Director*

I think at this point, we have to draw a halt. If there are further questions unanswered, I apologize. But if you can deal with them in the normal way through Danielle Neben in London, and she will make sure that our colleagues in the United States get back to you. But there is a volume of information within the four filings that have gone live yesterday, that went live yesterday.

So if I can thank you for your interest and we will pick up additional questions if you have them off line. But I think we have to draw this call to a halt. Thank you very much.

Bobby Mehta - *HSBC North America Holdings, Inc. - Chief Executive, HSBC Finance Corp.-Chairman, Chief Executive*

Thank you very much.

Operator

Thank you, ladies and gentlemen. That concludes the HSBC Finance Corporation and HSBC USA Inc. third-quarter 2006 results conference call. Thank you for participating.