

1

REMARKS BY

MARTIN J G GLYNN

PRESIDENT AND CHIEF EXECUTIVE OFFICER

HSBC BANK CANADA

THE NORTH AMERICAN ECONOMY:

FINANCIAL SERVICES SHOULD LEAD NOT FOLLOW

TO

THE CANADIAN CLUB

TORONTO

13 NOVEMBER 2002

It is my pleasure to be here before you at the Canadian Club to represent HSBC and to talk a little bit about current issues in the financial industry and specifically the need to emphasize North American financial delivery given the pressures in the marketplace.

My main theme today is to talk about banking in a North American context and put the position forward that the banking industry should lead not follow to make the North American economy and markets work. However, I hope you won't mind if I start with a brief commercial. I am pleased to see so many people here today, including representatives of the media, as we from time to time have felt that HSBC in Canada is the best kept secret in banking and we have not always had the chance to tell our story. Of course, we are part of a big international bank that is in 81 countries and territories and they often make the news. As well, while we are a public company in Canada as preferred shares and our "hats" (or asset trust securities) issue are listed on the Toronto stock exchange we do not have any common shares issued in Canada and therefore you cannot track the daily valuations of HSBC Bank Canada which may lose some people's interest. We have been in business since 1981 starting basically from scratch along with 60 or so other foreign banks. We started out in western Canada in a difficult environment with a very severe recession going on and 20% interest rates at that time. Nevertheless we came out of the gate fairly quickly and grew both organically and through acquisition and have now reached the point where we have roughly \$35 billion in assets, 6,000 employees and operate a full service financial services platform from coast to coast. We recently announced our third quarter 2002 results which were satisfactory and if you look back in time you would see that since 1985 we have made money every year and our earnings have grown every year consistently. How many other companies, let alone banks, can say that ?

The Wall Street Journal headlines about HSBC of several weeks ago said "HSBC shows why boring isn't bad" while initially I felt a little insulted it certainly illustrates the fact that we are conservative by nature, thrifty, quite focussed and believe we do a pretty good job in

the marketplace supporting and serving our customers. This certainly is verified in Canada by various customer service surveys that give us high marks in a number of key segments.

While we are proud of our domestic operations to illustrate the connection that we have with the global operations of HSBC, we are the largest issuer of letters of credit in Canada showing that we are committed and are a key part of the banking industry's financing of Canada's trade with the rest of the world. We are in places like St. John's, Saint John, Campbell River, Chicoutimi, Timmins, Lethbridge, so we are not just in big cities. As a truly multi international organization we are proud to also have big positions in segments of ethnic Canada and given the growing relevance of immigration and new Canadians to the demographics in Canada we consider ourselves very well placed to grow on all fronts.

We have a new brand "HSBC" that has been in place for several years which is building quickly in strength and our new tag line "the world's local bank" could not be more powerful.

Turning to the theme of North American banking, my thesis is that other than in select niches and one or two regions and in some of the corporate sector Canadian individuals and companies have had to struggle to make their North American activities work from a banking point of view. I would like to talk a little bit about where the market is and what the approaches are in the banking industry and what are some of the impediments to making it work better. In HSBC's case we have aggressive goals to compete to be the number one NAFTA bank, which not only includes being the number one cross-border bank between Canada and the US but also includes Mexico, as we have just announced recently the acquisition of a top five bank in Mexico called Bital.

But before I pursue that theme I would like to comment briefly on current events in Canadian banking and bank merger rumours. We are not totally unbiased as we do have a desire to grow in Canada and if mergers create opportunities or voids in the market we certainly are keen to pursue them if it makes sense for us. Acquiring branches, customer bases, more credit cards, groups of investment advisors, assets under management, bigger market share, really across the board is what we would consider. I believe there are relatively few players like us who are in this position so again I declare our interest. On the

other hand we can't participate by law in an acquisition or merger of the big players so there are no secret war rooms created at HSBC Bank Canada.

Also I should point out there is no pressure for us to merge as we have critical mass and global reach internationally now.

It is clear there is considerable pressure to consolidate around the world as banking markets are shrinking, capital becomes scarce and the pressures to spend money on it and grow outside one's traditional markets are huge. Equity valuations particularly without the presence of a takeover premium don't make life any easier to raise money for organic growth. The relatively small Canadian economy and its limited growth prospects, the weak Canadian dollar and finally the lack of breadth in financial services i.e.: the inability to sell insurance also provides limited maneuvering room. One thing in banks' favour though is that vis-a-vis other players in Canada, the Canadian banks are very successful so the trust industry has essentially disappeared and so have most of the foreign banks so the Canadian banks' position relatively speaking has actually strengthened. HSBC has emerged, in our minds at least, as the main alternative to the big five but we are pretty unique in making this claim.

In my view, the concept of merging is legitimate, legal and should not be looked at with a conspiracy theory perspective. It is quite helpful that the parliamentary committees will be meeting soon to clarify the criteria and hopefully provide more certainty of outcomes. I believe all options should be looked at in Ottawa including the possibility of linkages with insurance companies although if that were to happen I would hope the barriers to sell insurance in banking would be dropped. People should realize that these insurance barriers are a unique Canadian phenomenon and from an HSBC perspective, insurance is a key growth area around the world because it is linked to wealth management, consumer banking, retirement planning and it certainly brings down the cost of distribution to consumers particularly in the mass market. We proved that even in British Columbia and Alberta with our car and home insurance subsidiary, HSBC Canadian Direct Insurance,

that we could provide a high value, lower cost product even competing with a government owned car insurance agency, ICBC.

With respect to merger rumours this is of course quite negative to the Canadian banks as it creates anxiety among employees and the credibility of corporate messages being put in question. Customers are rattled and corporate treasurers have to be careful about having all their eggs in one basket. In banking we are told by our borrowing customers that a "slow no" is the worst outcome where credit decisions take forever and finally credits are declined.

I would say that is equally true in the merger discussion. The second worst outcome is a "fast no" !!!

One additional comment relating to competition is that a lot has happened in the last four years to develop alternate forms of distribution so that branches which typically were big barriers to entry and absolutely essential are slowly diminishing in value. The telephone, Internet and smart card options can attract competition in Canada and we may wish to get our heads around that being the basis for growth in competition in the future not a traditional branch based model. For these new competitive forces to emerge, ATMs may be more relevant than branches. Customers still need a place to deposit items and withdraw cash and when the Mackay Task Force was exploring options four years ago, we made a big deal about promoting the idea of full functionality of ATMs possibly through Interac where all customers of financial institutions and in fact retail stores etc, could deposit as well as withdraw cash at all ATMs across the country cheaply and easily, not just through their own institution. When the government set out to promote long distance telephone competition they didn't force new companies to put their own wires up but were permitted to use the infrastructure that existed. This point is still relevant today but the situation is actually worst because there is now surcharging going on whereby not only are there Interac charges for use of other people's ATMs but there are actual charges going

to the consumer so it becomes a very expensive process to make a simple withdrawal from another bank's ATM and, of course, you still can't make a deposit at another ATM other than a network that we are part of called the exchange network which includes national bank and the credit unions. If mergers occur and three banks own 90% of Canada's ATMs you can imagine the competitive barriers that are created by lack of full ATM functionality and by surcharging.

Moving to my main theme of North American banking if you read the annual reports of all the banks, their strategies wouldn't be very different from HSBC's i.e.: we want to build a North American platform. How you do it is of course more challenging as every option has been tried, like grocery store joint ventures using new brand concepts, promotion of discount brokerage, buying small regional banks, insurance ventures, private banking, making significant corporate loans south of the border, building investment banking platforms and on and on. Some of these strategies have not succeeded fully but I certainly recommend the Canadian banks keep trying.

So why the big deal about the US and Canada, well to quote the Conference Board in their Canada 2010 publication they say as follows:

"Looking to 2010, increased North American integration will remain Canada's dominant reality. As noted the impact of the border closing immediately after September 11, 2001 brought into sharp relief how dependent Canada has become on the American market. The risk for Canada lies in simply letting the process evolve without having a clear view of our interests and pursuing them proactively before decisions are made that hurt Canada's interest". They go on to conclude that, "ensuring access to the US market is arguably the single most important policy consideration facing Canada in the coming decade."

At HSBC we have never gone too far wrong doing what the client wants us to do. It's clear both the retail, mid market commercial and corporate client want us to provide as close to seamless banking services across the border as possible. Businesses do not want to start

from scratch with a new bank when they go south of the border. They don't want to reintroduce themselves and establish a credit reputation from scratch. They want easy access to currency hedging, collections, local security issues, us credit cards, withholding tax understanding, access to local professionals, credit information, obviously financing, lock boxes, mortgages, cash management, ideally accessible electronically. We found from a competitive point of view in banking that no one has jumped out in front on the most important issue facing Canadians and we are attempting to get out front. Of course, having over 400 branches in New York State and branches along the west coast as well as in Florida, gives us a bit of an advantage. It is conceivable this would grow, as I am sure the Canadian banks intend to grow too !!!

If you look at the subject of cross border banking in detail you run into a number of barriers which I don't think have been fully articulated. I have not mentioned the options of US banks expanding north into Canada but it is curious that reciprocity issues on ownership restrictions have not been raised. Capital taxes are another barrier as banks around the world can't understand why an industry so dependent on capital and safety of deposits would be taxed in this way in Canada but no where else. Currency harmonization has got most of the headlines but actually I think that is the least of our issues. People have gotten used to a weak Canadian dollar, it bounces around but it is not an inhibitor to business in my view. A number of areas require review by government and I'll only list a few. We operate with different accounting standards, which in banking can be quite difficult to deal with. For example the US rule "FAS 33" requires a different treatment of hedges on a market to market basis which makes it difficult for comparability purposes and creates more volatility of results. The US imposes withholding tax on mortgages to US residents in Canada and these kind of taxes on both sides of the border cause companies to have to incorporate subsidiaries on either side of the border when it may not be necessary to do that from a business point of view. Cross border reporting lines can cause tax treaty issues with head office functions in one city and operations on a North American basis.

There are additional US tax returns required particularly if one has a US holding company.

Related party transactions require arm's length pricing which sometimes inhibit achieving economies of scale across the border. Account opening requirements are considerably different with "kyc" or "know your customer", anti boycott rules, trading with the enemy act, the patriot act and so on being big issues. Sarbanes-oxley currently is an issue as US banks can lend to director's companies and Canadian banks can't. Border entry between Canada and the US as far as bank executives going back and forth can still be problematic and of course moving people with their spouses is not seamless. Tax treatments are different, compliance regimes and deductibility of interest on cross border funding can be problematic. Of course, we have different sets of bank regulators who have slightly different viewpoints on life, in the investment area a multiplicity of regulators exist and have different deposit insurance schemes.

So all in all, let's talk less about mergers and focus more on finding ways to encourage North American seamless cross border banking if the North American integration theme is our number one priority.