INVESTMENT DEALERS ASSOCIATION OF CANADA

bulletin

ASSOCIATION CANADIENNE DES COURTIERS EN VALEURS MOBILIÈRES

Contact: *For distribution to relevant parties within your firm*

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Discipline

Discipline Penalties Imposed on HSBC Securities (Canada) Inc.; Violations of Regulations 1300.1 (o) and 1300.2, and Policy 2

Person Disciplined

A Hearing Panel appointed pursuant to IDA By-law 20 has imposed discipline penalties on HSBC Securities (Canada) Inc., (HSBC), a Member of the Investment Dealers Association of Canada (Association).

By-laws, Regulations, Policies Violated

On August 31, 2005, a Hearing Panel considered, reviewed, and accepted a Settlement Agreement negotiated between Staff of the Enforcement Division of the Association, (Association Staff) and HSBC.

Pursuant to the Settlement Agreement, HSBC admitted that during the period from January 1st, 2002 to July 1st, 2002 it failed to implement supervisory systems to address red flags and thereby detect and prevent potentially harmful Market Timing practices. Specifically, HSBC failed to implement supervisory systems to:

(a) adequately supervise the activities of its employees in these circumstances;
(b) ensure appropriate review and approval of special arrangements' and thereby was in violation of Association Regulations 1300.2 and 1300.1 (o) and Policy 2.

Furthermore, HSBC, without sufficient diligence, under-reported its Market Timing activity conducted on behalf of clients, thereby failing to observe the high standard of business conduct required under Association By-law 29.1.

Penalty Assessed

The following penalties were assessed against HSBC:

- $506,596 for market-timing activity;
- $100,000 for under-reporting of market-timing activity;
- $506,596 disgorgement of Gross Market Timing Revenue
- $ 50,000 for Association Costs

Summary of Facts

Market-Timing Activity

From January 1st, 2002 to July 1, 2002 HSBC executed potentially harmful Market Timing activities on behalf of one client. HSBC's total gross revenues derived directly or indirectly from the Client's Market Timing activities during the Relevant Period was $506,596. The Client was an offshore entity that employed a Market Timing strategy.

Special arrangements, entered into between the Client and the mutual fund companies essentially allowed the Client to trade funds of the mutual fund company without a minimum hold period for a fee which was significantly less than the maximum fee which could have been charged by the mutual fund company pursuant to the funds' simplified prospectus. In turn, the Client had to comply with a limit on the number of monthly switches and keep a minimum amount of assets in the funds, otherwise an early redemption fee would apply.

HSBC received written warnings from mutual fund companies in respect of the Market Timing activities. The written warnings put HSBC on notice that Market Timing was potentially harmful to long term unit holders, was not welcome or permitted by the funds and/or that the mutual fund companies may impose a short term trading fee of up to 2% of the value of the mutual fund units that were held for fewer than 90 days, in accordance with the funds' simplified prospectuses.

Under –Reporting of Market Timing Activity

In January 2004, the IDA sent a market timing/late trading survey to all Member firms requesting information about any market timing trading done by the firm on behalf of clients. HSBC completed the survey and outlined the market timing trading activity done through it by the client. HSBC included in its response account statements relative to most of the client's market timing activity through HSBC. In July 2004, HSBC, on its own initiative, provided further disclosures relating to special arrangements between the client and certain fund companies. In February 2005, the IDA requested additional information from Members, including HSBC about market timing activity. In preparing its response to these new queries, HSBC realized that it had under-reported in its original response to the January 2004 survey. HSBC identified this under-reporting to the IDA in March 2005 on its own initiative (doing so was not required in order to respond to the February 2005 queries). HSBS's under-reporting of its market timing activity was a result of poor communication between relevant personnel at the firm and was not intentional. However, the under-reporting was not discovered until further inquiries were made by the IDA.

Kenneth A. Nason
Association Secretary