

NASD
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO.2005002337401

TO: Department of Enforcement
NASD

RE: HSBC Brokerage (USA), Inc. (BD No. 6956) now known as
HSBC Securities (USA), Inc. (BD No. 19585)

Pursuant to Rule 9216 of NASD Code of Procedure, HSBC Brokerage (HBI, Respondent or the Firm) submits this Letter of Acceptance, Waiver and Consent (AWC) for the purpose of proposing a settlement of the alleged rule violations described in Part II below. This AWC is submitted on the condition that, if accepted, NASD will not bring any future actions against Respondent alleging violations based on the same factual findings.

Respondent understands that:

1. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by NASD's Department of Enforcement and National Adjudicatory Council (NAC) Review Subcommittee or Office of Disciplinary Affairs (ODA), pursuant to NASD Rule 9216;
2. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Respondent; and
3. If accepted:
 - a. this AWC will become part of Respondent's permanent disciplinary record and may be considered in any future actions brought by NASD or any other regulator against Respondent;
 - b. this AWC will be made available through NASD's public disclosure program in response to public inquiries about Respondent's disciplinary record;
 - c. NASD may make a public announcement concerning this agreement and the subject matter thereof in accordance with NASD Rule 8310 and IM-8310-2; and
 - d. Respondent may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. Nothing in this provision affects Respondent's testimonial obligations or right to take legal or factual positions in litigation or

other legal proceedings in which NASD is not a party.

Respondent also understands that its experience in the securities industry and disciplinary history may be factors that will be considered in deciding whether to accept this AWC. That experience and history are as follows:

HBI has been a NASD member firm since January 2, 1976. The firm's NASD membership was terminated effective April 21, 2005, due to its merger with HSBC Securities (HSD). HBI operated a general retail securities business. HBI has no relevant formal disciplinary history with NASD, the Securities and Exchange Commission, any self-regulatory organization or any state securities regulator.

I.

WAIVER OF PROCEDURAL RIGHTS

Respondent specifically and voluntarily waives the following rights granted under NASD's Code of Procedure:

- A. To have a Formal Complaint issued specifying the allegations against it;
- B. To be notified of the Formal Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and
- D. To appeal any such decision to the NAC and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Respondent specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

Respondent further specifically and voluntarily waives any right to claim that a person violated the *ex parte* prohibitions of Rule 9143 or the separation of functions prohibitions of Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

II.

ACCEPTANCE AND CONSENT

- A. Respondent hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of NASD, or to which NASD is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by NASD:

1. Failure To Provide Reasonable Supervision For Best Execution of Government Securities Transactions From December 2003 through December 2004.

HBI conducted a retail brokerage business which was largely located in HSBC bank branches. To support the retail business, HBI operated a trading desk to handle orders that were placed by brokers who had direct contact with HBI's clients. One desk was devoted to filling orders for fixed income products. When a client order was placed, HBI required traders on the Fixed Income Desk to call several broker-dealers on the "street" in an effort to get the best price for a client's transaction. During the periods discussed below, the Firm failed to adequately supervise United States Government Agency and Treasury (collectively Government Securities) transactions for best execution.

Towards the end of 2003, there were discussions between HBI and HSI about increasing business between the two, affiliated firms. Effort was undertaken by HBI to increase its order flow to its institutional affiliate, and HBI began to track, on a monthly basis, the percentage of its orders that it executed with HSI and other firms.

After several months of internal discussions, and an increase in the order flow from HBI to HSI, on May 12, 2004, an HBI manager told traders on its Fixed Income Desk to direct all Government Securities business to HSI, its affiliated institutional broker-dealer. The directive stated that if HSI did not match the best available price, the traders should ask HSI to honor a better external price, or take the HSI price and ask the HBI retail broker to adjust the mark-up/mark-down so that the customer would not be adversely impacted.

The change in order flow in Government Securities from HBI to HSI is evident from the increase in dollar volume of transactions between the two firms. The monthly percentage of total dollar volume of Treasury transactions at HBI that were routed to HSI rose from about 25 percent in October 2003 to close to 100 percent by June 2004 and remained at that level throughout the review period. Similarly, the dollar volume of Government Agency Securities that HBI sent to HSI had increased by more than ten fold in June 2004 from the level eight months earlier.

a. December 1, 2003, to May 11, 2004

During the period prior to the explicit directive to route orders to HSI, the Firm produced reports that reflected, for certain transactions, the process followed by traders on its desk in "shopping

around” fixed income orders, the best execution procedure required by the Firm’s written procedures. The Firm failed to review these reports to supervise for best execution.

The sampling reflected on those reports suggests that certain Government Securities transactions with two or more bids/offers were not effected at the best available price. There was no supervisory or compliance follow-up on the trades that appeared to have violated the Firm’s best execution obligations.

The Firm was asked to provide evidence of its reasonable diligence to ascertain the best price for a sampling of Government Security transactions. The Firm was unable to provide any such evidence.

NASD member firms are required to tailor their supervisory procedures to the structure of their business. HBI was aware that the plan to route Government Securities transactions to HSI created a risk of best execution violations, and accordingly, impacted the reasonable supervision of this business for best execution. In November and December 2003, in high level internal discussions at and between both firms, the compliance director for HBI, the compliance director for HSI, and HBI’s Fixed Income Manager all stated that such order routing raised concerns about HBI’s best execution obligations. In response to the May 12, 2004, directive to route all HBI Government Securities transactions to HSI, the HSI compliance director reiterated to the HBI Chief Trading Officer and the head of the Fixed Income Desk: “I hope you guys have thought through your best execution issues.” The Firm had not.

While the Firm recognized the increased risk associated with directing all Government Securities transactions to a single, affiliated broker-dealer, HBI failed to put reasonable policies and procedures in place to ensure that clients received best execution for such orders. The Firm had minimal systems in place to supervise for best execution prior to May 2004. No additional supervisory systems or procedures were put in place to monitor for best execution after the Firm directed order flow of Government Securities transactions to a corporate affiliate.

b. May 12, 2004 through December 31, 2004

During the examination, the Firm was asked to provide evidence of its reasonable diligence to ascertain the best price for a sampling of Government Security transactions during the period after the May 12, 2004 directive. The Firm did not provide any documentary evidence. The Firm was unable to provide any documentary evidence of supervisory review for best execution for these or any other transactions during this period.

In light of its new business model, HBI did not have a reasonable supervisory system or procedures in place for monitoring Government Securities transactions for best execution.

* * *

The Firm was unable to provide any documentary evidence of supervisory review for best execution during the entire review period. The Firm had no written supervisory procedures that instructed a supervisor how to monitor for best execution.

From December 1, 2003, to December 31, 2004, the Firm failed to establish and maintain a system to supervise the activities of each registered representative and associated person on the HBI Fixed Income Desk that was reasonably designed to achieve compliance with the obligation to use reasonable diligence to ascertain the best price for Government Securities, and thus, comply with applicable securities laws and regulations, and with the Rules of this Association. Based on this conduct, the Firm violated NASD Conduct Rules 3010(a) and 2110.

From December 1, 2003, to December 31, 2004, the Firm failed to establish and maintain and enforce written procedures to supervise the activities of each registered representative and associated person on the HBI Fixed Income Desk that was reasonably designed to achieve compliance with the obligation to use reasonable diligence to ascertain the best price for Government Securities, and thus, comply with applicable securities laws and regulations, and with the Rules of this Association. Based on this conduct, the Firm violated NASD Conduct Rules 3010(b) and 2110.

2. Failure To Provide Best Execution for Specified Transactions.

During the review period, the Firm engaged in approximately 8,200 Government Securities transactions. The Firm was asked to provide evidence of reasonable diligence to ascertain the best price for a sampling of 100 transactions identified by NASD staff. The Firm was unable to provide documentary evidence for any of the 100 requested transactions.

The Firm's lack of records needed for a best execution review severely limited the staff's ability to review transactions for best execution. Based on the limited information that was available through the few reports reflecting the traders' shopping of certain orders, the staff identified five transactions between December 2003 and June 2004, in which the Firm failed to provide its customers with best execution. In those transactions, the Firm failed to buy or sell a Government Security so that the price received by the customer was as favorable as possible under prevailing market conditions. Those transactions are reflected on Exhibit A, which is attached and incorporated here by reference.¹ Through this conduct, HBI violated NASD Conduct Rules 2320 and 2110.

B. Respondent also consents to the imposition, at a maximum, of the following sanctions:

1. A censure;
2. A fine in the amount of \$250,000.

The sanctions imposed herein shall be effective on a date set by NASD staff.

¹ There is no restitution to clients as part of the sanction in this AWC because the clients in the identified transactions are institutional affiliates of the Firm.

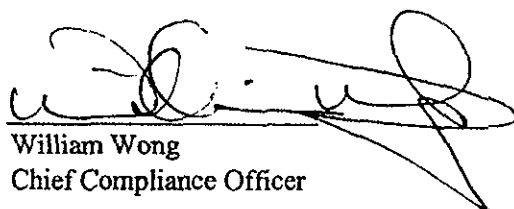
III.

OTHER MATTERS

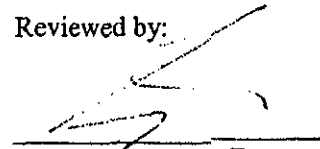
- A. Respondent understands that it may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by NASD, nor does it reflect the views of NASD or its staff.
- B. Respondent agrees to pay any monetary sanctions imposed upon notice that this AWC has been accepted and that such payments are due and payable and have attached an Election of Payment form showing the method by which Respondent proposes to pay any fine imposed. Respondent specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, any monetary sanction imposed in this matter.

Respondent certifies that it has read and understood all of the provisions of this AWC and has been given a full opportunity to ask questions about it, and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein, has been made to induce Respondent to submit it.

04/04/07
Date

By: 
William Wong
Chief Compliance Officer

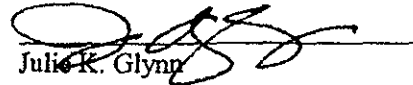
Reviewed by:


Lawrence Portnoy, Esq.
Davis Polk & Wardwell
450 Lexington Avenue
New York, NY 10017

Accepted by NASD:

April 20, 2007
Date

Signed on behalf of the
Director of ODA, by delegated authority


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Trade Date	Buy/Sell	Cusip	Description	Number of Bonds	Best Price	Price to customer (excluding mark-up)	Difference	Customer Disadvantage
12/4/2003	Buy	912828AP5	US Treasury Note 11/15/2012	100	98.0200	98.0469	0.0269	\$26.90
12/8/2003	Buy	912828BS8	US Treasury Note 11/30/2005	250	99.9370	99.9450	0.0080	\$20.00
4/26/2004	Buy	912828BY5	US Treasury Note 2/15/2007	315	98.8125	98.8438	0.0313	\$98.44
4/26/2004	Buy	912828CD0	US Treasury Note 3/31/2006	315	98.6250	98.6563	0.0313	\$98.44
6/30/2004	Sell	912795QS3	US Treasury Bill 7/8/2004	28500	99.9766	99.9764	0.0001	\$31.67
						Total Disadvantage		\$275.44