

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2007009471401**

TO: Department of Enforcement
Financial Industry Regulatory Authority ("FINRA")

RE: HSBC Securities (USA), Inc. (BD No. 19585), as successor-in-interest to HSBC Brokerage (USA) Inc.

Pursuant to NASD Rule 9216 of FINRA's Code of Procedure, HSBC Securities (USA), Inc., as successor-in-interest to HSBC Brokerage (USA) Inc. member organization ("HSBC Securities," "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 below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against Respondent alleging violations based on the same factual findings described herein.

I.

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 FINRA, or to which FINRA 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 FINRA:

BACKGROUND

Respondent is a registered broker-dealer of securities engaged in investment banking, underwriting, dealing and brokering of debt and equity securities and futures contracts, and is a primary dealer in United States Government and federal agency securities. Respondent has been a member of New York Stock Exchange since January 1996, and a member of the NASD since July 25, 1987.

In January 2005, Respondent merged with its broker-dealer affiliate, HSBC Brokerage (USA) Inc., to form a combined broker-dealer, which retained the name HSBC Securities (USA), Inc.

RELEVANT PRIOR DISCIPLINARY HISTORY

In Matter of HSBC Brokerage (USA), Inc., n/k/a HSBC Securities (USA), Inc., C200050023374 (AWC)(April 2007), Respondent entered into a Letter of

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Acceptance, Waiver and Consent ("AWC") and agreed to payment of a \$250,000 fine, based upon the failure of its predecessor firm, HSBC Brokerage (USA), Inc., to adequately supervise its retail fixed income trading desk with respect to compliance with best execution requirements in United States Government Agency and Treasury transactions during the period December 2003 through December 2004, in violation of NASD Rules 3010 and 2110. The Firm also agreed to a finding that it failed to provide best execution for certain customer trades, in violation of NASD Rules 2320 and 2110.

OVERVIEW

During the period from approximately January 2004 through June 2006 (the "Relevant Period"), certain customers who maintained escrow accounts with the Firm's bank affiliate, HSBC Bank USA, National Association ("HSBC Bank") were charged commissions for fixed income securities trades executed by the Firm on their behalf, which were higher than the commissions they were charged in the past, and, in certain instances, higher than the industry standard. The Firm, however, failed to take adequate steps to assess the fairness of these commissions. The higher commission charges were premised on the provision of additional services to the customers by former registered representative Robert Gatti ("Gatti"), when, in fact, Gatti did not provide such services. The Firm lacked adequate written guidelines for mark-ups and commissions on trades for fixed income products, and also failed to establish and maintain adequate procedures to monitor the appropriateness of commissions charged to these customers.

FACTS

In September 2001, HSBC Brokerage (USA) Inc. hired Gatti as a registered representative. After the merger of HSBC Brokerage with Respondent, Gatti continued his employment with Respondent as a registered representative in the Private Client Services group, until he resigned in August 2006.

Respondent is a separate, registered broker-dealer affiliate of HSBC Bank. HSBC Bank maintains nearly 450 bank branches in the United States and provides commercial banking products and services to individuals, corporations, institutions and governments. The Corporate Trust and Loan Agency is a division of HSBC Bank.

The CTLA Customers

In 2004, there were at least 66 customers who maintained escrow accounts with the Corporate Trust and Loan Agency division of HSBC Bank, including high net worth institutions (the "CTLA customers"). CTLA customers included commercial businesses, government agencies, public utilities and banks, among others.

Each CTLA customer was assigned to a Business Development Officer employed by HSBC Bank. Among other things, the Business Development Officer assisted the CTLA customers

with securities trades in fixed income products, which were executed by Respondent through an omnibus account maintained by HSBC Bank with Respondent.

Execution of Pre-2004 Trades on behalf of CTLA Customers

Prior to 2004, securities trades for CTLA customers were handled by a Business Development Officer who telephoned orders to the Firm's retail fixed income trading desk ("the Desk"). The Desk was responsible for executing the trade and reporting execution of the trade back to the Business Development Officer. All trades for the CTLA customers were unsolicited, and the Business Development Officer received no commissions. No registered representative was assigned to the CTLA customers for the purpose of providing trade recommendations or other assistance.

During the pre-2004 time period, the Desk trader determined what commission to charge the CTLA customers. At the end of the trading day, the Head of the Desk reviewed the commissions to ensure the reasonableness of the commissions.

In early 2004, Gatti, along with a Business Development Officer from HSBC Bank, who covered certain of the CTLA customers, proposed to Firm management a new procedure for handling trades on behalf of CTLA customers. This proposal designated Gatti as the registered representative responsible for handling trades for CTLA customers. Gatti claimed that he would provide additional services to the CTLA customers, including investment advice.

Beginning in approximately January 2004, after Firm management approved the proposed arrangement, orders from CTLA customers for fixed income trades were routed to Gatti, instead of being directly transmitted to the Desk. Upon receipt of these orders, Gatti transmitted the orders to the Desk, and informed the Desk trader how much to charge the CTLA customers for commission. The Desk no longer had a role in determining commissions for CTLA customers, and the Head of the Desk no longer had responsibility for reviewing these commissions.

Gatti was given broad discretion to determine commissions for the trades executed on behalf of the CTLA customers. He was not required to obtain supervisory approval for these commission charges.

When the Firm granted Gatti the authority to determine commissions for the CTLA customers, the Firm substituted the Desk's expertise on this matter for Gatti's judgment.

The securities trades which Gatti handled for the CTLA customers included United States Government Treasuries ("Treasuries"), federal agency bonds and corporate bonds.

Failure To Adequately Supervise Fixed Income Commissions

During the Relevant Period, Gatti charged commissions to the CTLA customers which were in some instances considerably higher than those previously charged by the Desk. Whereas the Desk had previously charged commissions in the range of three to eight basis points, Gatti

generally charged CTLA customers commissions in the range of 20 to 70 basis points.

Gatti justified charging higher commissions by representing to Firm management that he was providing additional services to CTLA customers. In fact, however, Gatti failed to provide trade recommendations or investment advice, and rarely spoke to the CTLA customers.

In March 2006, the Firm instituted a management change. Among other things, the head of the Firm's Private Client Services group ("PCS") was replaced, as was the PCS compliance manager. Shortly thereafter, in connection with a number of changes to the PCS program, the Firm investigated the commissions charged by Gatti to the CTLA customers.

The Firm's investigation concluded that the commissions Gatti charged to the CTLA customers were higher than what the Desk customarily charged.

In August 2007, the Firm self-reported the conclusions of its internal investigation to the Enforcement Division of NYSE Regulation, and also disclosed that it had voluntarily refunded a portion of the commissions paid by the CTLA customers totalling \$2,323,437. The Firm based these refunds on its calculation of what would have been charged prior to Gatti's involvement. In addition, the Firm terminated the individuals involved, including supervisory personnel.

Lack of Written Guidelines for Fixed Income Mark-ups and Commissions

During the Relevant Period, the Firm lacked adequate written guidelines for retail mark-ups and commissions on fixed income products. The Firm's General Compliance Policy Manual provided only general advice regarding the NASD guidelines for maximum markups/markdowns. No specific guidance was offered on how to determine fair mark-ups or commissions on Treasuries, which comprised most of the trades executed on behalf of the CTLA customers.

NASD Rule 2440 sets forth the general obligation of a member to charge fair commissions in connection with securities trades executed on an agency basis, stating, in relevant part:

In 'over-the-counter' transactions, whether in 'listed' or 'unlisted' securities, if a member . . . acts as agent for his customer in any such transaction, *he shall not charge his customer more than a fair commission or service charge*, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense of executing the order and the value of any service he may have rendered by reason of his experience in and knowledge of such security and the market therefor (emphasis added)."

NASD IM-2440 sets forth a detailed list of factors to be considered in determining the amount of mark-ups or commissions to charge for over-the-counter securities. Included in this list of factors are: the type of security involved; the availability of the security in the market; the price

of the security; the amount of money involved in a transaction; the disclosure of information regarding the amount of commission or markup; the pattern of mark-ups; and the nature of the member's business.

The Firm, however, failed to give specific guidance as to what factors should be considered in determining what is a fair mark-up or commission. The Firm also failed to establish any procedures reasonably designed to ensure that these factors were considered in determining the mark-ups or commissions for the CTLA customers.

Although NASD Rule 2440 does not apply to Treasuries, a member is also obligated to charge fair commissions for trades in Treasuries, pursuant to NASD Rule 2110, which requires a member to "observe high standards of commercial honor and just and equitable principles of trade". The factors enumerated in NASD IM-2440 are among those circumstances to be considered in determining what is a fair commission for a Treasury trade.

Inadequate Annual Compliance Audits

Firm procedures required the compliance department to conduct annual branch examinations. These branch examinations were intended to include a review of a sampling of all trades handled by registered representatives. In practice, however, CTLA trades were excluded from examination review.

The Firm's 2005 branch examination of Gatti's branch selected ten customer trades for review. One of these trades was a trade handled by Gatti for a CTLA customer. The compliance examiner, however, failed to review the commissions charged to this CTLA account, based on his belief that it was not his responsibility to do so.

Inadequate Monitoring of Fixed Income Mark-up and Commissions

During the Relevant Period, the Firm lacked adequate procedures for the review of fixed income security mark-ups and commissions which were reasonably designed to achieve compliance with applicable securities laws and regulations, such as NASD Rules 2110 and 2440.

The Firm's monitoring of fixed income markups and commissions during the period from January 2004 through approximately September 2005, was inadequate insofar as it consisted of a compliance officer conducting a "spot-check" of mark-ups and commissions. This review was a labor-intensive process which required collecting and comparing various sources of information. In addition, the Firm failed to provide adequate training to the compliance officer assigned to this task, who lacked sufficient knowledge regarding the appropriate factors to consider in assessing mark-ups or commissions on fixed income products.

After September 2005, no review of retail fixed income mark-ups/commissions was conducted of all relevant CTLA customer accounts until the Firm installed its current automated monitoring system in 2007.

VIOLATIVE CONDUCT BY RESPONDENT

NASD Rule 3010(a) provides, in relevant part, "[e]ach member shall establish and maintain a system to supervise the activities of each registered representative . . . that is reasonably designed to achieve compliance with applicable securities laws and regulations."

Based on the foregoing, from January 2004 through June 2006, Respondent violated NASD Rules 3010 and 2110 by failing to establish and maintain appropriate procedures for supervision and control of the charging of commissions on fixed income trades executed for CTLA customers, in that it:

- a) failed to establish adequate written guidelines for mark-ups and commissions on fixed income products;
- b) failed to give adequate guidance as to what factors should be considered in determining what is a fair mark-up or commission on fixed income products;
- c) failed to include trades executed for CTLA customers in branch examination reviews; and
- d) failed to establish reasonable procedures for monitoring fixed income security mark-ups and commissions.

B. Respondent also consents to the imposition of the following sanctions:

- 1. A censure;
- 2. A fine in the amount of \$200,000.

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

II.

WAIVER OF PROCEDURAL RIGHTS

Respondent specifically and voluntarily waives the following rights granted under FINRA'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 National Adjudicatory Council ("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 NASD Rule 9143 or the separation of functions prohibitions of NASD 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.

III.

OTHER MATTERS

Respondent understands that:

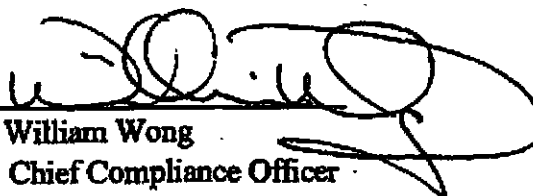
- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to NASD Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Respondent; and
- C. If accepted:
 - 1. this AWC will become part of Respondent's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against Respondent;
 - 2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about Respondent's disciplinary record;
 - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with NASD Rule 8310 and IM-8310-3; and
 - 4. 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. Respondent may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is

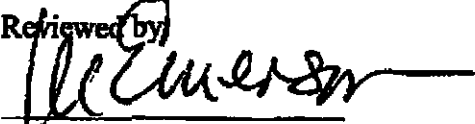
inconsistent with any part of this AWC. Nothing in this provision affects Respondent's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.

- D. Respondent 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 FINRA, nor does it reflect the views of FINRA or its staff.

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; that Respondent has agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce Respondent to submit it.

Date:

By: 
William Wong
Chief Compliance Officer

Reviewed by 
Michael Emerson
HSBC Securities (USA) Inc.
452 Fifth Avenue
New York, New York 10018

Accepted by FINRA:

5/14/08
Date

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


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