

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2007010582702**

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

RE: HSBC Securities (USA) Inc.
CRD No. 19585

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent, HSBC Securities (USA) Inc. ("HSI" 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 the Firm alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. HSI 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

HSI is a registered broker-dealer and is a wholly-owned subsidiary of HSBC Markets (USA) Inc. The Firm's principal offices are located in New York, New York. HSI engages in a full range of primary and secondary securities activities in the U.S. and international markets. The Firm currently has 495 branch offices and approximately 2,780 registered persons, about 250 of whom are working as Series 7 licensed retail representatives in the Firm's 495 branch offices. Most of HSI's retail brokerage business is conducted from branch offices that are located inside the branches of HSBC Bank USA, N.A.

RELEVANT DISCIPLINARY HISTORY

HSI's relevant disciplinary history includes the following:

On September 13, 2007, NYSE issued a Hearing Panel Decision in which HSI, without admitting or denying guilt, consented to findings that it: (1) violated NYSE Rule 476(a)(6) for engaging in conduct inconsistent with just and equitable principles of trade

by: (a) recommending and selling LIBOR CDs to customers for whom such products were unsuitable; (b) failing to accurately advise customers about the risks associated with the LIBOR CDs; and/or (c) making misrepresentations regarding certain material features of the LIBOR CDs and/or the manner in which the products were likely to perform; (2) violated NYSE Rule 401(a) by failing to adhere to principles of good business practice by recommending and selling the LIBOR CD products to clients for whom they were not suitable; and (3) violated NYSE Rule 342(a) and (b) by: (a) failing to establish and maintain appropriate procedures to reasonably supervise whether the sale of callable LIBOR CDs was suitable for its customers, and (b) failing to adequately supervise its personnel in order to reasonably detect and prevent misrepresentations regarding material features of the LIBOR CDs, and/or the manner in which they were likely to perform. HSI consented to the imposition by the Exchange of the sanction of a censure and a \$500,000 fine and an undertaking requiring the Firm to review the purchases of the outstanding LIBOR CDs (that existed as of June 1, 2007) and offer a remediation plan reviewed and approved by NYSE Enforcement.

OVERVIEW

HSI began offering collateralized mortgage obligation securities (“CMOs”) to its retail customers in or around late 2003. Between January 1, 2004 and June 7, 2007 (the “Relevant Period”), HSI registered representatives sold in excess of 250 CMOs to retail customers. Included among these CMO sales were the sales of approximately 50 inverse floating rate CMOs (“Inverse Floaters”), a riskier type of CMO, which FINRA has advised are suitable only for sophisticated investors with a high risk profile.

During the Relevant Period, HSI violated NASD Conduct Rules 3010(a) and (b) and 2110 by failing to establish and maintain a supervisory system and written procedures regarding the sale of CMOs to customers that were reasonably designed to achieve compliance with applicable securities laws and regulations and with FINRA rules. HSI did not establish and maintain a system and written procedures reasonably designed to supervise whether the sales of CMOs were suitable for its customers and the attendant risks of the products were fully explained whenever a registered representative recommended an Inverse Floater or other risky CMO investment. Moreover, the Firm did not provide registered representatives who sold CMO products to their customers with sufficient guidance or training relating to CMOs.

HSI also did not comply with NASD IM-2210-8, which requires firms to offer certain educational materials “[b]efore the sale of a CMO to any person other than an institutional investor.” The educational materials are required to include, among other things, the characteristics and risks of CMOs, in general, and the specific characteristics and risks associated with the different tranches of a CMO. While the Firm’s registered representatives were provided with a brochure relating to CMOs, the brochure was not consistently offered to retail customers before they purchased CMOs and, even to the extent the brochures were provided, the brochures did not fully comply with the content standards of NASD Conduct Rule 2210(d)(1) and IM-2210-8. HSI also violated NASD

Conduct Rule 2110 by failing to adequately disclose to customers material facts regarding the risks and characteristics of Inverse Floaters.

In Notice to Members (“NTM”) 93-73, FINRA informed members that Inverse Floaters “are only suitable for sophisticated investors with a high risk profile.” During the Relevant Period, six HSI registered representatives made 43 unsuitable recommendations of Inverse Floaters to retail customers that did not have a high risk profile.¹ Twenty-five of these Inverse Floaters were for sums exceeding \$100,000, which required pre-approval from the registered representative’s supervisor. HSI supervisors pre-approved each of these transactions. Five of the customers lost money in their investments.² By virtue of the unsuitable sales, HSI violated NASD Conduct Rules 2310 and 2110.

FACTS AND VIOLATIVE CONDUCT

Background on Inverse Floater CMOs

A CMO is a fixed income security that pools together mortgages and issues tranches, with various characteristics and risks. Unlike typical fixed income products like certificates of deposits and corporate bonds that provide for the return of the face value of the security on the maturity date, CMOs make principal payments throughout the life of the security with the maturity date being the last date by which all of the principal must be returned. The timing of the return of principal payments can vary depending on interest rate changes.

One of the more risky CMO tranches is the Inverse Floater, a type of tranche that pays an adjustable rate of interest that moves in the opposite direction from movements of an interest rate index, such as the LIBOR. In Notice to Members (“NTM”) 93-73, FINRA informed members that Inverse Floaters “are only suitable for sophisticated investors with a high-risk profile.”³

HSI’s Sale of CMO Products

HSI began offering CMO products to its retail customers in or around late 2003. One of the Firm’s Fixed Income traders determined which CMOs would be made available to HSI’s customers. The trader found available products by searching the Bloomberg system each morning for available CMO inventory – that is, CMOs that had been structured by third parties and were available to be sold to investors.

The trader sent emails to HSI’s registered representatives regarding the availability of particular CMOs, including Inverse Floaters. His emails included a brief description of

¹ One registered representative made 32 of the unsuitable recommendations.

² The five customers have received full restitution from the Firm, totaling approximately \$320,000.

³ NTM 93-73, Members' Obligations to Customers When Selling Collateralized Mortgage Obligations (CMOs).

the CMO and various statistics about the CMO, like its average life,⁴ the prepayment speed assumptions, the price of the CMO, and the suggested sales price. When HSI's registered representatives became interested in selling a particular Inverse Floater, they were able to sell the product to customers based on the information in the email, or they called the trader to get additional information.

HSI's System and Procedures Related to CMOs

During the Relevant Period, HSI violated NASD Conduct Rules 3010(a) and (b) and 2110 by failing to establish and maintain a supervisory system and written procedures regarding the sale of CMOs to customers that were reasonably designed to achieve compliance with applicable securities laws and regulations and with FINRA rules. HSI failed to establish and maintain a system and written procedures reasonably designed to supervise whether the sales of CMOs were suitable for its customers and the attendant risks of the products were fully explained. HSI had limited procedures specific to CMOs.

Moreover, HSI did not provide its registered representatives who sold CMOs with sufficient training on CMOs. Nor did the Firm offer sufficient written guidance relating to the sale or suitability of CMOs. In its Written Supervisory Procedures, the Firm warned representatives that, among other things, clients who invested in mortgage-based securities should be advised that the stated yield of the securities is not guaranteed and may not apply for the entire term of the investment. But the Firm failed to provide its registered representatives with the information that Inverse Floaters were "only suitable for sophisticated investors with a high risk profile." In addition, the Firm did not provide the registered representatives with information regarding the risks associated with the specific Inverse Floaters that were available to be sold.

The Firm also did not comply with the requirements of NASD IM-2210-8, which FINRA had adopted in November 2003. NASD IM-2210-8 requires firms to offer certain educational materials "[b]efore the sale of a CMO to any person other than an institutional investor." The educational materials must include, among other things, the characteristics and risks of CMOs, in general, and the specific characteristics and risks associated with the different tranches of a CMO.

During the Relevant Period, HSI did not issue any procedures or compliance memos to advise its registered representatives that they were required to offer written educational materials to their customers before they sold them CMOs. The only materials relating to CMOs that HSI's registered representatives could give to their customers was a brochure entitled, "CMOs: A Guide to Agency & Whole Loan CMOs." The seven-page brochure provided information about, among other things, the evolution of CMOs, who issues the products, how CMOs are structured, credit ratings, questions a customer should ask when buying a CMO, how the structure works, and a glossary of terms. The brochure informed

⁴ "[T]he average life is the average time that each principal dollar in the pool is expected to be outstanding, based on certain assumptions about prepayment speeds. If prepayment speeds are faster than expected, the average life of the CMO will be shorter than the original estimate; if prepayment speeds are slower, the CMO's average life will be extended." An Investor's Guide to CMOs, SIFMA brochure (Copyright 1999-2007).

readers that CMOs “offer a unique opportunity for monthly income, relative safety, and attractive yield advantages compared to other similar quality investments.” The brochure did not comply with the content standards of NASD Conduct Rule 2210(d)(1). In particular, the brochure failed to discuss Inverse Floaters and failed to include a section on risks associated with purchasing CMOs. While the brochure stated that “CMOs are available in a variety of average lives and with varying sensitivity to changes in prepayment speeds,” it did not inform readers on how changes in the market could impact average lives and prepayment speeds.

The registered representatives frequently included the CMO brochure in a display of brochures outside their offices. But the registered representatives did not offer the brochure to every CMO investor, nor did they know that they were required to give the materials to all potential CMO investors before selling them a CMO.

HSI's Unsuitable Sales of Inverse Floaters

As a result of HSI not implementing an adequate supervisory system and procedures relating to the sale of Inverse Floaters, six HSI registered representatives made 43 unsuitable sales of Inverse Floaters to retail customers in violation of NASD Conduct Rules 2310 and 2110. Many of these customers were unsophisticated investors and none of them had a high risk profile. Of the 43 transactions in Inverse Floaters, 32 were placed by one registered representative.

HSI's supervisory system and procedures required that all investments of \$100,000 or more be pre-approved by the registered representative's supervisor. Twenty-five of the 43 unsuitable Inverse Floater recommendations were for sums exceeding \$100,000. HSI supervisors pre-approved each of those transactions. Five of the customers lost money in their investments.⁵

In addition, in connection with the sale of the Inverse Floaters to many of these customers, at least some registered representatives violated NASD Conduct Rule 2110 by not fully disclosing material facts regarding the risks and characteristics of Inverse Floaters.

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

1. A censure; and
2. A fine of \$375,000.

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

HSI agrees to pay the monetary sanction(s) upon notice that this AWC has been accepted and that such payment(s) are due and payable. HSI has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

⁵ The five customers have all received full restitution from the Firm, totaling approximately \$320,000.

HSI specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanction(s) imposed in this matter.

II.

WAIVER OF PROCEDURAL RIGHTS

HSI specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against the Firm;
- B. To be notified of the 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, HSI specifically and voluntarily waives any right to claim bias or prejudice 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.

HSI further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA 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

HSI 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 FINRA Rule 9216;

- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against me; and
- C. If accepted:
1. this AWC will become part of HSI's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against the Firm;
 2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about HSI's disciplinary record;
 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
 4. HSI 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. The Firm 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 HSI's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. HSI may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The Firm 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.


The undersigned, on behalf of the Firm, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that the undersigned 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 the Firm to submit it.

5/19/10
Date

HSBC Securities (USA) Inc.
Respondent

By: Christopher R. Donald

Reviewed by:

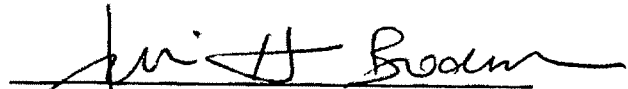
 5/19/10

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Accepted by FINRA:

6/10/10
Date

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



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