Re HSBC Securities

IN THE MATTER OF:

The Investment Dealer and Partially Consolidated Rules

and

HSBC Securities (Canada) Inc.

2024 CIRO 01

Canadian Investment Regulatory Organization
Hearing Panel (Ontario District)

Heard: December 15, 2023, in Toronto, Ontario
Decision: December 15, 2023
Reasons for Decision: January 2, 2024

Hearing Panel:
Barry Bresner, Chair, Debbie Archer and Zahra Bhutani

Appearances:
Michael Mantle, Enforcement Counsel
John Fabelo, for HSBC Securities
Sarah Shody, for HSBC Securities

REASONS FOR DECISION

INTRODUCTION

¶ 1 This hearing was held pursuant to Sections 8215 (Settlements and Settlement Hearings) and 8428 (Settlement Hearings) of the Investment Dealer and Partially Consolidated Rules (the "IDPC Rules") to consider whether to accept a Settlement Agreement dated November 29, 2023 (the 'Settlement Agreement") negotiated between Enforcement Staff and HSBC Securities (Canada) Inc. ("HSBC Securities").

¶ 2 A copy of the Settlement Agreement is attached as Appendix A to these Reasons. Part III of the Settlement Agreement recites the facts agreed to by the parties. Pursuant to Section 8428(6) of the IDPC Rules, the agreed facts in the Settlement Agreement were the only facts considered by the Hearing Panel.

¶ 3 In the Settlement Agreement, HSBC Securities admitted that, between October 2018 and December 2022, it failed to establish and maintain a system of controls and supervision to ensure client fee agreements were accurately recorded in its fee management systems and that clients were charged appropriately, contrary to Dealer Member Rules 38.1 and 2500.

¶ 4 The Settlement Agreement provides for an agreed fine of $52,500 and costs of $5,000, to be paid by HSBC Securities within 30 days of December 15, 2023.

¶ 5 At the close of the hearing, the Panel advised the parties that it accepted the Settlement Agreement, with reasons for that acceptance to follow. These are those reasons.

ANALYSIS

¶ 6 The underlying facts are set out in detail in the Settlement Agreement. For present purposes, the salient facts are summarized as follows:

- Between October 2018 and December 2022, HSBC Securities charged excess fees to approximately 1,234 clients as a result of inadvertent errors in the classification of clients between different business unit record systems.
- The total of the excess fees was approximately $198,674.
- The discrepancies were detected in an internal audit in December 2022.
- After an internal investigation to identify the scope of the discrepancies, in March 2023, HSBC Securities voluntarily reported the issue to CIRO. In April 2023, HSBC Securities provided CIRO with a formal letter with particulars of the issue.
- HSBC Securities promptly and in a detailed manner self-identified the issues, volunteered substantial assistance to CIRO staff and voluntarily developed and implemented an appropriate remediation plan.
- HSBC Securities remediated the discrepancies by promptly compensating the clients who were charged excess fees and by implementing new business controls to minimize the possibility of a recurrence of the issue. In addition, HSBC Securities decided not to charge additional fees to clients who were inadvertently undercharged fees as a result of the misclassification.
- HSBC Securities has received no profit or benefit from its inadvertent control deficiency.
- Enforcement Staff agreed to a 30% reduction in the fine it would have otherwise sought in recognition of "the proactive and exceptional cooperation" by HSBC Securities, the remedial measures implemented, and HSBC Securities' willingness to resolve the matter in a timely manner, all of which led to an early resolution of the matter.

¶ 7 In determining whether to accept the Settlement Agreement, the Hearing Panel considered the agreed facts, the IIROC Sanction Guidelines (the "Guidelines") and prior decisions which addressed similar contraventions.

¶ 8 The Guidelines set out general principles to be considered in assessing the reasonableness of the Settlement Agreement, including the requirement that the sanction be significant enough to discourage future misconduct by the respondent (specific deterrence) and to deter others from engaging in similar misconduct (general deterrence). In the present matter, HSBC Securities acted appropriately to rectify the situation it had self-identified and specific deterrence is not a particularly significant factor. As regards general deterrence, the Guidelines provide that the goal of general deterrence can be satisfied if the sanction strikes an appropriate balance by addressing the specific misconduct but is also in line with industry expectations.

¶ 9 The Guidelines also list a number of factors to be considered in assessing the proposed sanction. Those factors include the number, size and character of the transactions, the duration of the misconduct, whether there was a pattern of misconduct, whether the conduct was intentional or reckless, the harm to clients or financial benefit to the respondent, the remedial steps taken and the degree of cooperation with CIRO.

¶ 10 While the excess fees were charged over a period of over 4 years and involved a significant number of clients, the overcharging resulted from a single inadvertent error in failing to implement an adequate system to reconcile the client classifications between business units. As noted above, HSBC Securities' conduct after self-identifying the errors has been above reproach.

¶ 11 As noted above, the principle of general deterrence requires a consideration of industry expectations. While each case turns on its unique facts, prior decisions on the sanctions for similar misconduct can be instructive and shape industry expectations. Two of those prior decisions are particularly relevant: *Re Peak Securities* 2020 IIROC 36 and *Re Worldsource Securities* 2018 IIROC 48.

¶ 12 In the *Peak Securities* matter, one of the allegations involved the charging of excess fees totaling

roughly $191,500 to almost 500 clients over an extended period due to a lack of adequate controls. The respondent voluntarily reported the issue to IIROC, compensated its clients and did not benefit financially. The approved sanction was a fine of $50,000. The hearing panel concluded that the fine was sufficiently harsh to meet the need for specific and general deterrence.

¶ 13 Similarly, in the *Worldsource Securities* matter, one of the contraventions involved the charging of excess fees totalling approximately $148,904 over a period of 7 years to 236 clients. The issue arose because the respondent relied on a manual, rather than an automated, system for advisors communicating fee information to the respondent. While the respondent developed a plan to fix the manual process and to compensate the clients, it was noted that the problem was only identified by IIROC'S Business Conduct Compliance department. In the result, the hearing panel concluded that a fine of $50,000 was appropriate for the excess fee issue.

CONCLUSION

¶ 14 Section 8215(5) of IDPC Rules provides that a hearing panel may accept or reject a settlement agreement. It is well-established that a hearing panel should not substitute its opinion of an appropriate sanction for that negotiated by the parties and should accept the settlement agreement unless it clearly falls outside of a reasonable range of appropriateness. Having considered the agreed facts, the Guidelines and the prior decisions, the Hearing Panel had no difficulty in concluding that the Settlement Agreement falls comfortably within a reasonable range of appropriateness and that acceptance of the Settlement Agreement is in the public interest.

¶ 15 Accordingly, for the reasons stated above, the Hearing Panel accepted the Settlement Agreement.

Dated at Toronto, Ontario this 2 day of January 2024.

"Barry Bresner"

Barry Bresner, Chair

"Debbie Archer"

Debbie Archer

"Zahra Bhutani"

Zahra Bhutani

Appendix "A"
Settlement Agreement

IN THE MATTER OF
THE INVESTMENT DEALER AND PARTIALLY CONSOLIDATED RULES
AND THE DEALER MEMBER RULES
AND
HSBC SECURITIES (CANADA) INC.

SETTLEMENT AGREEMENT

PART I – INTRODUCTION

¶ 1 The Canadian Investment Regulatory Organization ("CIRO")[i] will issue a Notice of Application to announce a settlement hearing pursuant to sections 8215 and 8428 of the Investment Dealer and Partially Consolidated Rules (the "Investment Dealer Rules") to consider whether a hearing panel should accept this Settlement Agreement between Enforcement Staff and HSBC Securities (Canada) Inc. (the "Respondent").

PART II – JOINT SETTLEMENT RECOMMENDATION

¶ 2 Enforcement Staff and the Respondent jointly recommend that the hearing panel accept this Settlement Agreement in accordance with the terms and conditions set out below.

PART III – AGREED FACTS

¶ 3 For the purposes of this Settlement Agreement, the Respondent agrees with the facts as set out in Part III of this Settlement Agreement.

Registration History

¶ 4 HSBC Securities (Canada) Inc. is a Dealer Member of CIRO with its head office located in Toronto, Ontario.

Overview

¶ 5 In March 2023, the Respondent self-reported to CIRO that HSBC InvestDirect ("HIDC"), the order-execution-only division of HSBC Securities (Canada) Inc. ("HSBC"), had charged incorrect fees in certain client accounts due to inadvertent discrepancies in the classification of clients between different business unit record systems.

¶ 6 It was later determined by the Respondent that between October 2018 and December 2022, it charged approximately 1,234 clients excess fees for a total of roughly $198,674.

¶ 7 The Respondent voluntarily reported the incorrect fees issue to CIRO and has made diligent efforts to remediate the issue by compensating clients and implementing additional internal protocols to ensure that the appropriate fees are charged on a going forward basis.

Identification of the Fee Issue and the Internal Discrepancies

¶ 8 One type of client classification offered by the Respondent is called "Premier." This unique customer tier designation enabled clients, who qualified, to receive certain advantages including the waiver of inactivity fees, account maintenance fees, and annual administration fees in their brokerage accounts. Other benefits of the "Premier" client classification included favourable margin debit interest rates and lower trading commissions.

¶ 9 An internal audit of HIDC in December 2022 revealed that discrepancies existed between HIDC's Information Systems Management ("ISM"), and HSBC Bank's Core Banking System ("CBS") regarding the "Premier" classification of clients. Certain clients that qualified as "Premier" were not correctly coded as such in HIDC's ISM system. This inconsistency resulted in some clients paying excess fees to the benefit of the Respondent.

¶ 10 At all material times, the Respondent had relied on manual updates between HIDC's ISM and HSBC Bank's CBS. A regularly scheduled reconciliation process had not been implemented which led to the incorrect charging of client fees.

¶ 11 In total, between October 2018 and December 2022, approximately 1,234 clients, in around 1,252 client accounts, paid excess fees totaling roughly $198,674.

Self-Reporting Process

¶ 12 In approximately December 2022, as a result of the aforementioned internal audit process, the Respondent discovered potential inconsistencies in the systems outlined above.

¶ 13 After an investigation to determine the scope of the matter, in March 2023, HIDC's Chief Compliance

Officer (CCO) initiated a meeting with CIRO's Business Conduct Compliance relationship manager to self-report this matter.

¶ 14 In April 2023, the Respondent provided CIRO with a formal letter outlining the particulars of the incorrect charging of fees in client accounts issue.

Remedial Steps Taken By the Respondent

¶ 15 The Respondent has remediated the incorrect charging of fees in client accounts by compensating clients who were erroneously overcharged fees and by implementing new business controls to address the underlying issue. Furthermore, the Respondent has chosen not to charge additional fees to clients who were inadvertently undercharged.

(i) Client Remediation

¶ 16 The Respondent communicated the incorrect charging of fees issue to clients. For existing HIDC clients, the Respondent communicated with them by sending a direct secured message on the HIDC online platform. Where an individual was no longer an HIDC client, letters were mailed to clients.

¶ 17 Between June 13 and 14, 2023, the Respondent processed client rebates totaling approximately $198,674. For existing clients of HIDC, direct credit was paid to their account. Direct credit was also paid to clients who no longer had an HIDC account, but still maintained their HSBC bank account. Finally, where individuals no longer held a HIDC or HSBC Bank account, the Respondent mailed cheques to the address listed on file.

¶ 18 On June 16, 2023, the HIDC Risk Control team completed the review of accounts that received the rebate to ensure that the rebate amount and the description of the rebate were correct.

¶ 19 No subsequent issues have been reported.

(ii) Fees Issue Remediation

¶ 20 In January 2023, the Respondent implemented an interim manual solution to enhance the reconciliation of the ISM and CBS systems, in order to ensure that the issue did not continue. Specifically, the Respondent implemented an additional quarterly reconciliation of client classifications on HIDC's ISM and HSBC Bank's CBS profiles. This reconciliation process was undertaken prior to any fees being charged to ensure that client classification records are consistent on both internal systems and to ensure that correct fees are charged.

¶ 21 The Respondent has now implemented an automated solution to identify any client classification changes. A new automated report will identify any client classification changes and then notify the HIDC operations team who will accordingly update the proper client classification status on ISM.

Additional Factors

¶ 22 The Respondent promptly and in a detailed manner self-identified the issues, volunteered substantial assistance to Staff by promptly sharing the results and details of its internal investigation, and voluntarily developed and implemented a remediation plan, as outlined above.

¶ 23 The Respondent's control deficiency was inadvertent. There is no suggestion that the Respondent deliberately charged clients incorrect fees.

¶ 24 The Respondent has compensated clients and has made necessary payments to ensure that it receives no profit or benefit from its inadvertent control deficiency.

¶ 25 The Respondent discovered its control deficiency as a result of its own audit processes and self-reported it to CIRO promptly.

¶ 26 Enforcement Staff has agreed to a 30% reduction of the fine it would otherwise have agreed to based on the proactive and exceptional cooperation by the Respondent, the remediation measures implemented, the compensation paid to clients, and the Respondent's willingness to resolve this matter in a timely manner. These factors led to an early resolution of this matter.

PART IV – CONTRAVENTIONS

¶ 27 By engaging in the conduct described above, the Respondent committed the following contravention of CIRO requirements:

> Between October 2018 and December 2022, the Respondent failed to establish and maintain a system of controls and supervision to ensure client fee agreements were accurately recorded in its fee management systems and that clients were charged appropriately, contrary to Dealer Member Rules 38.1 and 2500.

PART V – TERMS OF SETTLEMENT

¶ 28 The Respondent agrees to the following sanctions and costs:

(i) A fine in the amount of $52,500; and

(ii) Costs in the amount of $5,000.

¶ 29 If this Settlement Agreement is accepted by the hearing panel, the Respondent agrees to pay the amounts referred to above within 30 days of such acceptance unless otherwise agreed between Enforcement Staff and the Respondent.

PART VI – STAFF COMMITMENT

¶ 30 If the hearing panel accepts this Settlement Agreement, Enforcement Staff will not initiate any further action against the Respondent in relation to the facts set out in Part III and the contraventions in Part IV of this Settlement Agreement, subject to the provisions of the paragraph below.

¶ 31 If the hearing panel accepts this Settlement Agreement and the Respondent fails to comply with any of the terms of this Settlement Agreement, Enforcement Staff may bring proceedings under Investment Dealer Rule 8200 against the Respondent. These proceedings may be based on, but are not limited to, the facts set out in Part III of this Settlement Agreement.

PART VII – PROCEDURE FOR ACCEPTANCE OF SETTLEMENT

¶ 32 This Settlement Agreement is conditional on acceptance by the hearing panel.

¶ 33 This Settlement Agreement shall be presented to a hearing panel at a settlement hearing in accordance with sections 8215 and 8428 of the Investment Dealer Rules, in addition to any other procedures that may be agreed upon between the parties.

¶ 34 Enforcement Staff and the Respondent agree that this Settlement Agreement will form all the agreed facts that will be submitted at the settlement hearing, unless the parties agree that additional facts should be submitted at the settlement hearing. If the Respondent does not appear at the settlement hearing, Staff may disclose additional relevant facts, if requested by the hearing panel.

¶ 35 If the hearing panel accepts this Settlement Agreement, the Respondent agrees to waive all rights under the Rules of CIRO and any applicable legislation to any further hearing, appeal and review.

¶ 36 If the hearing panel rejects this Settlement Agreement, Enforcement Staff and the Respondent may enter into another settlement agreement or Enforcement Staff may proceed to a disciplinary hearing based on the same or related allegations.

¶ 37 The terms of this Settlement Agreement are confidential unless and until this Settlement Agreement has been accepted by the hearing panel.

¶ 38 This Settlement Agreement will become available to the public upon its acceptance by the hearing panel and CIRO will post a copy of this Settlement Agreement on the CIRO website. CIRO will publish a notice and news release of the facts, contraventions, and the sanctions agreed upon in this Settlement Agreement and the hearing panel's written reasons for its decision to accept this Settlement Agreement.

¶ 39 If this Settlement Agreement is accepted, the Respondent agrees that neither they nor anyone on their behalf, will make a public statement inconsistent with this Settlement Agreement.

¶ 40 This Settlement Agreement is effective and binding upon the Respondent and Enforcement Staff as of the date of its acceptance by the hearing panel.

PART VIII – EXECUTION OF SETTLEMENT AGREEMENT

¶ 41 This Settlement Agreement may be signed in one or more counterparts which together will constitute a binding agreement.

¶ 42 An electronic copy of any signature will be treated as an original signature.

DATED this "29th" day of "November", 2023.

"Sarah Shody"
Witness

"Jeff Brown"
Respondent

"Michael Mantle"
Michael A. M. Mantle
Enforcement Counsel on behalf of Enforcement Staff of the Canadian Investment Regulatory Organization

The Settlement Agreement is hereby accepted this "15" day of "December", 2023 by the following Hearing panel:

Per: "Barry Bresner"
Chair

Per: "Debbie Archer"
Industry Member

Per: "Zahra Bhutani"
Industry Member

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[i] The Canadian Investment Regulatory Organization ("CIRO") has adopted interim rules that incorporate the pre-amalgamation regulatory requirements contained in the rules and policies of IIROC and the by-law, rules and policies of the MFDA (the "Interim Rules"). The Interim Rules include (i) the Investment Dealer and Partially Consolidated Rules, (ii) the UMIR and (iii) the Mutual Fund Dealer Rules. These rules are largely based on the rules of IIROC and the rules and certain by-laws and policies of the MFDA that were in force immediately prior to amalgamation. Where the rules of IIROC and the rules and by-laws and policies of the MFDA that were in force immediately prior to amalgamation have been incorporated into the Interim Rules, Enforcement Staff have referenced the relevant section of the Interim Rules.
Section 1105 (Transitional provision) of the Investment Dealer and Partially Consolidated Rules sets out CIRO's continuing jurisdiction, including that CIRO shall continue the regulation of any person subject to the jurisdiction of the Investment Industry Regulatory Organization of Canada that was formerly conducted by the Investment Industry Regulatory Organization of Canada.