

**IN THE MATTER OF THE SECURITIES ACT,
R.S.O. 1990, c. S.5, as amended and THE COMMODITY FUTURES ACT,
R.S.O. 1990, c. C.20, as amended**

-AND-

**IN THE MATTER OF PHOENIX RESEARCH AND TRADING CORPORATION,
RONALD MOCK AND STEPHEN DUTHIE**

**SETTLEMENT AGREEMENT BETWEEN
STAFF OF THE ONTARIO SECURITIES COMMISSION AND
PHOENIX RESEARCH AND TRADING CORPORATION**

I. INTRODUCTION

1. By Amended Amended Notice of Hearing dated March 11, 2003 (the "Notice of Hearing"), the Ontario Securities Commission (the "Commission") announced that it proposed to hold a hearing against Phoenix Research and Trading Corporation ("Phoenix Canada") to consider, among other things:

- (a) whether pursuant to sections 127 and 127.1 of the *Securities Act*, R.S.O. 1990, c. S.5 (the "Act"), it is in the public interest for the Commission to make an Order:
 - (i) that the registration of Phoenix Canada be terminated or restricted or that terms and conditions be imposed on its registration;
 - (ii) reprimanding Phoenix Canada;
 - (iii) requiring Phoenix Canada to pay the costs of the Commission's investigation and the hearing; and
 - (iv) encompassing such other terms and conditions as the Commission may deem appropriate; and
- (b) whether, pursuant to sections 60 and 60.1 of the *Commodity Futures Act*, R.S.O. 1990, c. C.20 it is in the public interest for the Commission to make an order:
 - (i) that Phoenix Canada's registration be terminated or restricted or that terms and conditions be imposed on its registration;

- (ii) reprimanding Phoenix Canada;
- (iii) requiring Phoenix Canada to pay the costs of the Commission's investigation and the hearing; and
- (iv) encompassing such other terms and conditions as the Commission may deem appropriate.

II. JOINT SETTLEMENT RECOMMENDATION

2. Staff of the Commission ("Staff") agrees to recommend settlement of the proceeding respecting Phoenix Canada initiated by the Notice of Hearing in accordance with the terms and conditions set out below. Phoenix Canada consents to the making of an order against it in the form attached as Schedule "A" based on the facts set out in Part III of this Settlement Agreement.

III. STATEMENT OF FACTS

ACKNOWLEDGEMENT

3. Solely for the purposes of this proceeding, and of any other proceeding commenced by a securities regulatory agency, Staff and Phoenix Canada agree with the facts set out in paragraphs 4 through 56.

FACTS

(i) The Phoenix Group

4. The Phoenix Group was a hedge fund management group. It was structured as a master/feeder fund arrangement. The Phoenix Group's "feeder" funds were established to raise cash from investors. Its "master" funds were pooled investment vehicles that developed and implemented trading strategies.

5. The Phoenix Group feeder funds were the Phoenix Fixed Income Arbitrage Fund Limited, the Phoenix Fund Limited, the Phoenix Equity Arbitrage Fund Limited and the Phoenix Alternative Strategies Fund Limited.

6. The Phoenix Fixed Income Arbitrage Limited Partnership ("PFIA LP") and the Phoenix Equity Arbitrage Limited Partnership ("PEA LP") were the Phoenix Group's master funds.

7. Unitholders invested in the feeder funds. In turn, the feeder funds (and other investors) purchased units in the master funds. Of the Phoenix Group's feeder funds, the

Phoenix Fixed Income Arbitrage Fund Limited and the Phoenix Fund Limited purchased units in PFIA LP.

8. The Phoenix Hedge Fund Limited Partnership was a hedge fund listed on the TSE in or about July 1997 (the “Phoenix TSE fund”). Phoenix Canada provided portfolio management services to the Phoenix TSE fund. The Phoenix TSE fund purchased, among other things, units of PFIA LP.

(ii) Phoenix Canada

9. Phoenix Canada was incorporated in 1994 pursuant to the laws of Ontario. It began operating in early 1995. Phoenix Canada was established as a speciality hedge fund asset manager investing money for sophisticated international clients.

10. During the material time, Phoenix Canada was registered with the Commission as an investment counsel and portfolio manager pursuant to the Act. It was also registered pursuant to the *Commodity Futures Act* as an adviser in the category of commodity trading manager. Phoenix Canada’s registrations were suspended voluntarily in May 2000 due to its inability to meet the conditions for registration renewal namely to file audited financial statements and maintain insurance.

11. Phoenix Research and Trading (Bermuda) Limited (“Phoenix Bermuda”) is a wholly-owned subsidiary of Phoenix Canada. Commencing in or about late 1995, and pursuant to an agreement between Phoenix Bermuda and Phoenix Canada which ultimately was formalized in a Services Agreement dated June 15, 1999 (the “Services Agreement”), Phoenix Canada provided investment advisory and portfolio management services to the feeder funds, PFIA LP and PEA LP.

12. Among other things, the Services Agreement included Schedules which enumerated PFIA LP’s approved fixed income trades, investment guidelines and risk control guidelines.

13. During the material time, Phoenix Canada had approximately 14 employees. Ronald Mock (“Mock”) was Phoenix Canada’s CEO and President. Mock was registered with the Commission pursuant to the Act as an investment counsel and portfolio manager. He also was the company’s registered supervisory procedures officer for the fixed income arbitrage activity.

14. Mock was responsible for all Phoenix Canada’s fixed income arbitrage business, including PFIA LP. In connection with such business, Mock managed the Operations Group, comprising the CFO (Blair Taylor), the Operations Manager and the Settlement Clerk. The fixed income traders, including Stephen Duthie (“Duthie”), and the Research and Risk Manager reported to Mock.

15. Mark Kassirer (“Kassirer”) was the Chair of Phoenix Canada. Kassirer managed Phoenix Canada’s equity arbitrage business.

(iii) Duthie's PFIA LP Trading

16. PFIA LP was a hedge fund. Its investment objective was to maximize returns by pursuing professionally-managed fixed income market neutral and arbitrage investment trading strategies. Such trading strategies are designed to reduce exposure to market direction. Commencing in late January 1999, PFIA LP held investments primarily in U.S. dollars, Canadian dollars and Euros.

17. In the spring of 1998, Duthie became the trader for PFIA LP's U.S. portfolio. At this time, Duthie had less than one year's experience as a fixed income arbitrage trader.

18. Commencing in January 1999, Phoenix Canada management and certain personnel operated on the basis that Duthie was engaged in a matched book trading strategy of repurchase agreements ("repos") and open reverse repos. Phoenix Canada had never before engaged in such a matched book strategy.

19. In a matched book trading strategy of repos and open reverse repos, the trader plays the interest rate spread between the borrowing rate (repo leg) and the lending rate (open reverse repo leg). This is a low risk strategy with only interest rate and counterparty risks. Profits can be generated where the interest earned on the lending leg exceeds the interest expense paid on the borrowing leg, net of transaction costs.

20. Duthie never engaged in a matched book trading strategy of repos and open reverse repos. Rather, he engaged in unhedged long bond trading of various U.S. benchmark treasuries, financed largely by overnight repos.

21. As of January 4, 2000, PFIA LP held a US\$3.3 billion long position in 6% U.S. treasury notes due August 15, 2009 (the "UST Notes"). The UST Notes represented PFIA LP's entire U.S. portfolio. The U.S. portfolio constituted 80% of PFIA LP's total assets.

22. Duthie's trading was directional, unhedged and not approved (in concentration, size or length of time held) under the Services Agreement. The Notes were not a suitable investment for PFIA LP and certain other Phoenix Canada clients.

23. The Bank of New York informed Phoenix Canada on January 4, 2000 that the latter was in an overdraft position in excess of US\$50 million. The UST Notes caused the overdraft. Phoenix Canada liquidated all of PFIA LP's assets. PFIA LP collapsed when it sustained a loss in excess of US\$125 million.

24. All Phoenix unitholders who had a direct investment in PFIA LP, and the TSE Phoenix fund shareholders, were detrimentally impacted by PFIA LP's collapse.

25. After being informed of the overdraft position, it took Phoenix Canada little time to determine that the UST Notes were a long bond position and not a reversed in bond position.

26. Duthie received an annual salary and was eligible for a bonus. Based on the Phoenix Canada November 1999 profit and loss statement, management had discussed with Duthie the possibility of a bonus in the neighbourhood of \$1 million for his 1999 trading activity.

(iv) Phoenix Canada's Conduct

27. Notwithstanding any misconduct by Duthie, the accumulation of an unhedged, long position and the collapse of PFIA LP could have been avoided if, in connection with Duthie's trading activity, Phoenix Canada:

- (a) had supervised sufficiently Duthie and the operations group;
- (b) had not established and implemented systems which generated inaccurate books and records;
- (c) had not implemented and relied on flawed controls and procedures; and
- (d) had properly segregated duties.

(a) Books and Records

28. Phoenix Canada inaccurately recorded and/or reported Duthie's purported open reverse repos as outright bond purchases in its:

- (a) internal trade capture and accounting computer system (Alydia);
- (b) trade blotters;
- (c) settlement reports;
- (d) VAR reports;
- (e) collateral reports;
- (f) profit and loss statements;
- (g) general ledger accounts; and
- (h) net asset value reports.

29. Phoenix Canada's profit and loss statements, and related general ledger accounts, misstated Duthie's position and the related income.

30. Phoenix Canada reported inaccurate information to Phoenix Bermuda, the Bank of Bermuda and unitholders by reporting a large holding of a long position in the UST Notes and not open reverse repos.

31. Since Phoenix Canada did not inform the Bank of Bermuda that the reported long bond position was open reverse repo transactions, the Bank was unable to fulfill properly its administrative role for Phoenix Canada in connection with Duthie's PFIA LP trading.

(b) Controls and Procedures

(i) Trade Capture

32. Duthie's purported open reverse repo transactions were booked in Alydia's bond module even though, in connection with another fixed income strategy, open repo contracts were booked in Alydia's repo module (by creating an artificial termination date and rolling it forward on a daily basis until the contract terminated).

33. Phoenix Canada knew that Duthie's purported open reverse repo transactions fell outside its controls and procedures. The alternative controls and procedures Phoenix Canada implemented, however, were flawed and relied solely on Duthie's oral representations respecting the nature of his trading activity.

34. Phoenix Canada did not request or retain a "Bloomberg" or any other third party source document for any of Duthie's purported open reverse repo transactions. Phoenix Canada neither created a ledger or document to keep track manually of Duthie's purported open reverse repos nor booked Duthie's purported matched book trading in a separate strategy. If Phoenix Canada had done so, the true nature of Duthie's activities could have been readily detected.

(ii) Risk Assessment

35. Value at Risk ("VAR") attempts to determine at a high probability the loss that could occur over a specified period due to changes in the market prices of securities in the portfolio. The biggest risk for Phoenix Canada was the market risk associated with VAR.

36. The VAR Reports were Phoenix Canada's primary risk monitoring and management tool to ensure that investments were within the limits prescribed by PFIA LP. Commencing in November 1998, Phoenix Canada implemented a system to assess PFIA LP's risk which was flawed and unreliable since it was based solely on Duthie's word.

37. Phoenix Canada's VAR Reports were generated from information pulled from Alydia. The Research and Risk Manager manually adjusted the information inputted by Duthie to Alydia's bond module and the corresponding VAR based only on Duthie's oral representations as to the existence of the purported open reverse repo transactions and their maturity dates.

38. In connection with this manual "adjustment" to the VAR Reports, Phoenix Canada did not maintain any third party source documentation to support Duthie's oral representations. If Phoenix Canada had done so, the true nature of Duthie's activities could have been readily detected.

39. On the face of the unadjusted VAR reports, Duthie's trading exceeded greatly PFIA LP's permitted VAR. A calculation of the VAR at December 31, 1999 for the UST Notes was seven times the allowable VAR permitted by PFIA LP's investment guidelines.

(iii) Net Asset Value

40. Commencing in November 1998, Phoenix Canada implemented a revision to its system to estimate that part of PFIA LP's net asset value relating to Duthie's trading. This system relied only on the truth of Duthie's representations and thus, was flawed and unreliable.

41. There is no need to price a repo or an open reverse repo "trade" because it isn't a market position in a normal sense. Each purported open reverse repo transaction, however, would earn interest income which should be recorded in Phoenix Canada's books.

42. Notwithstanding that there is no need to price an open reverse repo on a monthly basis, Duthie orally identified those positions inputted to the Alydia bond module which he claimed were the purported open reverse repos and assigned a price to such repos. This price was supposed to produce a capital gain figure on the general ledger equal to what Duthie said was the interest earned on the purported open reverse repo transactions.

43. Phoenix Canada did not request or maintain any third party source documents or anything else against which it could check the existence of the purported open reverse repos, the repo rate, corresponding interest income accrual and Duthie's calculation of the adjusted "price".

44. By failing to institute a reliable means to determine that Duthie's positions were as he represented and thus, consistent with the risk parameters of PFIA LP, Phoenix Canada compromised the interests of PFIA LP and other Phoenix Canada clients.

45. Further, Phoenix Canada's reliance on Duthie's representations concerning the purported open reverse repo transactions enabled Duthie to mask unrealized holding losses for the UST Notes and to smooth the income pattern of his trading.

(c) Inadequate Supervision of the Operations Group

46. Since all of Duthie's purported open reverse repos were booked as outright bond purchases, Phoenix Canada's settlement clerk and the Bank of Bermuda were able to confirm and settle all of the UST Notes trades.

47. Neither the operations manager, nor the settlement clerk, was told that Duthie was engaged in a repo/open reverse repo strategy and that Duthie should be booking, and the operations group confirming, open reverse repo transactions. If they had been so told, the true nature of Duthie's trading activities could have been readily detected.

(d) Inadequate Supervision of Duthie

48. On the face of Duthie's on-line trading and Phoenix Canada's trade blotters relating to Duthie's activity, Duthie was engaged in directional and unauthorized trading. Further, there were no "Bloombergs" or other third party source documents which supported or corroborated Duthie's oral representations concerning the purported open reverse repo transactions. Thus, there was no way for Phoenix Canada to supervise meaningfully Duthie's trading.

49. Further, because the controls and procedures in place concerning the trade capture, risk assessment and pricing of Duthie's securities were flawed, Phoenix Canada should not have relied upon the trade blotters, VAR reports or the profit and loss statements to supervise Duthie's trading.

50. By late fall 1999, the size and concentration of Duthie's portfolio militated against continuing to rely only on Duthie's oral representations concerning the purported open reverse repo transactions.

51. Further, Phoenix Canada did nothing to corroborate Duthie's oral representations concerning his open reverse repo activities notwithstanding that there appeared to be an inconsistency between his representations and the information contained in Phoenix Canada's November 1999 Collateral Report.

52. In connection with his PFIA LP responsibilities, Duthie engaged in registrable activity by providing advisory services. Duthie was never registered with the Commission, although Phoenix Canada made efforts to have him so registered.

(e) Segregation of Duties

53. Phoenix Canada failed to segregate duties relating to Duthie's purported open reverse repo transactions by:

- (a) relying solely on the representations of Duthie to allocate PFIA LP's U.S. bond inventory between long bonds and the purported open reverse repos;
- (b) permitting Duthie to execute trades on behalf of PFIA LP respecting the purported open reverse repos and make the "pricing" adjustment relating to interest earned on the purported open reverse repos; and
- (c) permitting Duthie to access collateral by virtue of his participation in cash management activities while engaged in his own profit and loss activities.

(f) Phoenix Canada's Co-Operation

54. On January 5, 2000, Phoenix Canada contacted Staff respecting the problem with the UST Notes. Phoenix Canada promptly retained a forensic accounting firm to prepare a report.

55. Phoenix Canada co-operated throughout the Commission's investigation concerning the UST Notes.

56. Phoenix Canada's conduct was contrary to Ontario securities law and the public interest.

IV. TERMS OF SETTLEMENT

57. Phoenix Canada agrees to the following terms of settlement:

- (a) The making of an Order:
 - (i) approving this Settlement Agreement;
 - (ii) terminating its registrations under the Act and the *Commodity Futures Act*;
 - (iii) reprimanding it; and
 - (iv) requiring it to pay costs to the Commission in the amount of \$50,000.

V. STAFF COMMITMENT

58. If this settlement is approved by the Commission, Staff will not initiate any complaint to the Commission or any other proceeding under the Act against Phoenix Canada respecting the facts set out in Part III of this Settlement Agreement.

VI. APPROVAL OF SETTLEMENT

59. Approval of the settlement set out in this Settlement Agreement shall be sought at the public hearing of the Commission scheduled for March 13, 2003 or such other date as may be agreed to by Staff and Phoenix Canada (the "Settlement Hearing").

60. Counsel for Staff or for Phoenix Canada may refer to any part, or all, of this Settlement Agreement at the Settlement Hearing. Staff and Phoenix Canada agree that this Settlement Agreement will constitute the entirety of the evidence to be submitted at the Settlement Hearing.

61. If this settlement is approved by the Commission, Phoenix Canada agrees to waive its rights to a full hearing, judicial review or appeal of the matter under the Act.

62. Staff and Phoenix Canada agree that if this settlement is approved by the Commission, they will not make any public statement inconsistent with this Settlement Agreement.

63. If, for any reason whatsoever, this settlement is not approved by the Commission, or an order in the form attached as Schedule “A” is not made by the Commission:

- (a) this Settlement Agreement and its terms, including all discussions and negotiations between Staff and Phoenix Canada leading up to its presentation at the Settlement Hearing, shall be without prejudice to Staff and Phoenix Canada;
- (b) Staff and Phoenix Canada shall be entitled to all available proceedings, remedies and challenges, including proceeding to a hearing of the allegations in the Notice of Hearing and Statement of Allegations of Staff, unaffected by this Settlement Agreement or the settlement discussions/negotiations;
- (c) the terms of this Settlement Agreement will not be referred to in any subsequent proceeding, or disclosed to any person except with the written consent of Staff and Phoenix Canada, or as may be required by law; and
- (d) Phoenix Canada agrees that it will not, in any proceeding, refer to or rely upon this Settlement Agreement, the settlement discussions/negotiations or the process of approval of this Settlement Agreement as the basis of any attack on the Commission’s jurisdiction, alleged bias or appearance of bias, alleged unfairness or any other remedies or challenges that may otherwise be available.

VII. DISCLOSURE OF SETTLEMENT AGREEMENT

64. Subject to paragraph 60 above, this Settlement Agreement and its terms will be treated as confidential by Staff and Phoenix Canada until approved by the Commission, and forever if, for any reason whatsoever, this settlement is not approved by the Commission, except with the written consent of Staff and Phoenix Canada, or as may be required by law.

65. Any obligations of confidentiality shall terminate upon approval of this settlement by the Commission.

VIII. EXECUTION OF SETTLEMENT AGREEMENT

66. This Settlement Agreement may be signed in one or more counterparts which together shall constitute a binding agreement.

67. A facsimile copy of any signature shall be as effective as an original signature.

DATED this 12th day of March 2003

**PHOENIX RESEARCH AND TRADING
CORPORATION**

_____c/s
per Mark Kassirer

DATED this 12th day of March 2003

**STAFF OF THE
ONTARIO SECURITIES COMMISSION**

(Per) “Michael Hubley”
Michael Watson
Director, Enforcement Branch