



NEW YORK STATE DEPARTMENT OF FINANCIAL SERVICES  
REPORT ON MARKET CONDUCT EXAMINATION  
OF THE  
HSBC INSURANCE AGENCY (USA) INC.  
AND  
HSBC SECURITIES (USA) INC.

CONDITION:

DECEMBER 31, 2010

DATE OF REPORT:

JUNE 30, 2011

NEW YORK STATE DEPARTMENT OF FINANCIAL SERVICES

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OF THE

HSBC INSURANCE AGENCY (USA) INC.

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EXAMINER:

S'EL REY N. DAVID

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NEW YORK STATE  
DEPARTMENT *of*  
FINANCIAL SERVICES

Andrew M. Cuomo  
Governor

Benjamin M. Lawsky  
Superintendent

January 18, 2012

Honorable Benjamin M. Lawsky  
Superintendent of Financial Services  
New York, New York 10004

Sir:

In accordance with instructions contained in Appointment No. 30635, dated January 6, 2011 and annexed hereto, an examination has been made into the condition and affairs of HSBC Insurance Agency (USA) Inc. and HSBC Securities (USA) Inc., hereinafter referred to as "the Agencies," at their home office located at 452 5th Avenue, New York, New York 10018.

Wherever "Department" appears in this report, it refers to the New York State Department of Financial Services.

On October 3, 2011, the Insurance Department merged with the Banking Department to create the New York State Department of Financial Services.

The report indicating the results of this examination is respectfully submitted.

## 1. EXECUTIVE SUMMARY

The recommendations contained in this report are summarized below.

- The examiner recommends that the Agencies, (1) prepare a list of all New York consumer complaints pertaining to the sale of life insurance policies or annuity contracts that the Agencies received, whether written or oral, during the period January 1, 2005 to December 31, 2010, (2) advise the insurer that issued the product of each such complaint and provide the insurer with a summary of the complaint and the manner in which it was resolved by the Agencies. (See Section 4A1)
- The examiner also recommends that all current and future complaints and their disposition be reported to the insurance carriers. (See Section 4A1)

## 2. SCOPE OF EXAMINATION

The examiner conducted a target examination of the Agencies' policies and procedures with respect to the handling of complaints and the solicitation of life and annuity contracts, including replacements, during the period from January 1, 2005 through December 31, 2010.

The examination comprised a review of market conduct activities and utilized the National Association of Insurance Commissioners' Market Regulations Handbook or such other examination procedures, as deemed appropriate, in such review.

The objective of the examination was to determine whether the Agencies satisfied and complied with applicable New York Insurance Law and Department regulations and circular letters, the rules and guidelines set forth in sales and servicing agreements with licensed insurers, the operating rules and guidelines of the Agencies, and internal control standards. In connection with the examination of the Agencies, information was also requested from the licensed insurers who had appointed the Agencies to solicit their products.

This report on examination is confined to comments on those matters which involve departure from laws, regulations or rules, or which require explanation or description.

### 3. DESCRIPTION OF AGENCIES

HSBC Securities (USA) Inc. (“HSI”) is a Delaware corporation headquartered in New York City and is a wholly-owned subsidiary of HSBC Markets USA Inc. (“HMUS”). HSBC Insurance Agency (USA) Inc. (“HIA”) is a New York domiciled insurance agency and is a wholly-owned subsidiary of HSBC Bank USA, N.A. (“HBUS”). Both entities are wholly-owned indirect subsidiaries of HSBC North American Holdings Inc. (“HNAH”), which is a wholly owned indirect subsidiary of HSBC Holdings plc, the ultimate holding company in the HSBC group of companies.

HSI is registered as a broker-dealer with the Securities and Exchange Commission and is a member of the Financial Industry Regulatory Authority (“FINRA”). HSI is registered as an Agency for distribution of annuity and insurance products and currently has 481 retail registered branch offices throughout the US, the majority of which are in New York. HSI operates under a Networking Agreement, conducting business on the premises of HBUS.

HIA has 1,262 licensed agents, primarily located in New York, and offers a broad range of insurance products – Term, Whole Life, Universal and Variable Life, as well as Long Term Care Insurance, Disability Insurance, and Property & Casualty Products, through third party carriers to customers of HBUS.

HSI and HIA were appointed to sell annuities and life insurance products by 23 and 55 New York licensed life insurers, respectively.

HSI averages annual sales of approximately 10,000 contracts, with fixed annuities accounting for 70% of them. Whole life policies represent the greatest percentage of HIA’s business. As a standard business practice, HSI signs off on all variable life contract sales.

The two entities share in most respects agents and branch locations, and are supported by their respective legal, compliance, and sales infrastructure personnel.

#### 4. MARKET CONDUCT ACTIVITIES

The examiner reviewed various elements of the Agencies' market conduct activities affecting policyholders, applicants and complainants to determine compliance with applicable statutes and regulations and the operating rules of the Agencies.

##### A. Complaints

The examiner reviewed various elements of the Agencies complaint handling processes to determine compliance with applicable statutes and regulations, the rules and guidelines set forth in sales and servicing agreements with licensed insurers, the operating rules and guidelines of the Agencies, and internal control standards.

HIA defines a complaint as, "an expressing by or on behalf of a client of dissatisfaction with a service provided". A complaint may be oral or written, delivered by telephone or in person. A written record is required to be made of all oral complaints. All complaints received by an Agent are time stamped and logged by the Agent. The responsibility for reviewing and providing a prompt response to all complaints has been delegated to the Insurance Compliance Department ("ICD"). Regardless of how a complaint is received, the type of complaint, or the source of the complaint, client, regulator, attorney, etc, ICD sends an Acknowledgment Letter to the client before forwarding the complaint to the proper party for resolution. In the case of an oral complaint, the specific nature of the complaint will be recorded in the Acknowledgment Letter. Once the complaint has been fully investigated and a determination made, a letter is sent to the client detailing the reason for denial or the nature of the settlement.

HSI defines a customer complaint as, "any grievance, verbal or written, regarding HSI or a HSI Registered Representative, whether initiated by a customer or someone acting on behalf of the customer". All complaints must be reported to the Compliance Department ("Compliance") to ensure accurate and timely reporting and tracking by the Agency. When a written complaint is received, a copy is forwarded immediately to Compliance for follow-up. Verbal complaints are handled by the Regional Sales Manager or their qualified designee unless deemed otherwise and reported to Compliance via the Lotus Notes based Verbal Customer Complaint System. All customer complaints that are subject to FINRA reporting requirements must be acknowledged within 15 business days of receipt. The acknowledgment may be by letter or in the same format

that the complaint was received in. Responses to customers regarding the resolution of a complaint are sent promptly, based on the nature of the complaint and the time necessary to investigate the issues raised in the complaint.

The Agencies provided a data file of 314 complaints, 45 insurance policy related complaints and 269 annuity contract related complaints, received during the period under examination. Of the complaints reviewed, 13 were received from the Department's Consumer Services Bureau.

The examiner selected a sample of 78 complaint files, 14 of which were received by HIA and 64 by HSI. The sample was selected with an emphasis on complaints regarding misrepresentation or suitability.

### 1. Complaint Reporting

The sales and services agreements between the Agencies and the licensed insurers call for the Agencies, to promptly notify the insurers of any complaint, oral or written, or to notify the insurers of written complaints only.

In 29 of the 78 complaint files reviewed, the complaint was forwarded to the Agencies by the insurance carrier. In the 49 complaint files where the complaint was received directly by the Agencies, the examiner's review revealed 42 instances that should have been reported to the insurance carriers in accordance with the selling agreement.

In 39 (92.9%) of the 42 instances, the examiner found no evidence in the complaint file that the Agencies notified the insurance carrier of the complaint. The Agencies failed to comply with its selling agreement with the insurance carriers.

The examiner recommends that the Agencies, (1) prepare a list of all New York consumer complaints pertaining to the sale of life insurance policies or annuity contracts that the Agencies received, whether written or oral, during the period January 1, 2005 to December 31, 2010, (2) advise the insurer that issued the product of each such complaint and provide the insurer with a summary of the complaint and the manner in which it was resolved by the Agencies.

The examiner also recommends that all current and future complaints and their disposition be reported to the insurance carriers.

In response to the examiner's finding, the Agencies agreed that it will promptly report all customer complaints to all insurance carriers, whether required in the selling agreements or not. The Agencies also stated that all customer complaints received in 2011 have been reported to the relevant insurance carrier(s).

## 2. Complaint Handling

Following are summaries of the complaints reviewed where the examiner noted the Agencies lack of adequate procedures along with the examiner's recommendations:

In 3 instances the clients complained that they did not understand the products sold to them due to difficulty understanding the English language. The examiner's review revealed that the Agencies do not have a procedure in place to ensure that clients for whom English is not a primary language, have an understanding of both the product and the documents that are presented to them.

The examiner recommends that the Agencies implement a procedure to ensure that clients for whom English is not the primary language, have an understanding of the product proposed to them, prior to completing the transaction.

In one instance a sub-agent of the Agencies was fined by the Department for not providing Department Regulation No. 60 disclosures on a replacement policy. The examiner's review revealed that the Agencies failed to notify the insurance carrier that issued the life insurance policy, of the disciplinary action involving the sub-agent.

The examiner recommends that the Agencies report Department disciplinary actions/fines to the issuing insurance carrier(s).

## B. New Business and Surrenders

The examiner reviewed various elements of the Agencies new business files and surrender files to determine compliance with applicable statutes and regulations, compliance with the operating rules and guidelines of the Agencies, and compliance with internal control standards.

The Agencies provided a data file of 9,208 life insurance (including universal life and variable life) policies, 39,580 fixed annuities and 13,281 variable annuities.

### 1. New Life Policy Business Files

The examiner reviewed a sample of 47 new life business files processed by HIA and HSI. Based upon the sample reviewed, no significant findings were noted.

## 2. New Annuity Contract Business Files

The Agencies utilize a structure and system of supervision on new business sales to ensure that it is in compliance with Agencies' policies and procedures. The Regional Sales Managers are responsible for overseeing the Registered Representatives/Agents and others under their supervision; as well as enforcing policies and procedures in their respective regions. The Middle Office Group in Buffalo, which is responsible for reviewing insurance and annuity submissions, provides an independent review of all applications and ensures that any required pre-sale approvals are documented. The Middle Office also validates the reviews and approvals made by the Regional Sales Managers and ensures that all customer information is provided and is compliant with the Agencies' suitability guidelines. Trades identified as "Not in Good Order" are rejected by the Middle Office and returned to the Registered Representative/Agent for correction.

The examiner reviewed a sample of 65 new business files, 48 fixed annuities and 17 variable annuities, processed by HSI.

HSI procedures require supervisory pre-sale approval for certain transactions. A Registered Representative is required to obtain pre-approval from their Regional Sales Manager or their qualified designee, or their Sales Director for transactions such as sales involving new fixed or variable annuity contract into a tax qualified plan, sales of variable/fixed annuity or a variable life insurance policy to a customer over 65 years old, sales where the ratio of scheduled/target premium to income exceeds 60%, etc. The examiner's review of HSI's new business files revealed instances where HSI failed to adhere to its procedures regarding supervisory approval and/or documentation.

In 10 out of 65 (15.4%) new business files reviewed, HSI failed to provide evidence that all required supervisory pre-sale approvals and/or waivers were obtained.

The examiner recommends that HSI enhance its training and supervisory activities to ensure that all required supervisory pre-sale approvals and waivers are obtained prior to documentation being forwarded to the insurance carrier, in accordance with its policies and procedures.

HSI ensures compliance with its policies and procedures by maintaining standardized forms such as annuity disclosure and investment acknowledgement forms, switch authorization forms, supervisory trade approval forms, etc. The Registered Representatives/Agents are required to use the standardized forms in all transactions, and therefore have limited ability to make sales over prescribed limits. The client's financial information, investment objective, time horizon and risk tolerance are recorded on multiple forms and form the basis for the analysis of the product's suitability. The examiner's review revealed inconsistencies in the information recorded in the standardized forms. In addition, documents were sometimes not dated correctly or changes therein were not evidenced by the applicant's initial.

In 20 out of 65 (30.8%) new business files reviewed, the HSI's internal documentation was incomplete or inconsistent and was not returned as "Not in Good Order" by the Middle Office.

The examiner recommends that HSI enhance its training and supervisory activities to ensure that all required internal documentation are completed fully and correctly, and that all internal documentation and documents forwarded to the insurance carrier are consistent.

In particular the examiner recommends that:

- all documents required to be signed by the client are fully completed at the time of signature
- all documents are dated to accurately reflect when the client's signature was obtained
- all changes to documentation are initialed by the client
- the amounts entered on to the Account Application for Estimated Net Worth and Liquid Assets, are stated at the amount available before deducting the amount necessary to purchase the policy or contract

### 3. Cancelled and Surrendered Files

The examiner selected a sample of 50 contracts issued to clients 65 years and above, and cancelled or surrendered during the examination period, from an inventory of 2,191 cancelled or surrendered contracts provided by the Agencies' top eight insurance carriers, based on number of contracts sold by the Agencies. Included in the 50, were 8 single premium universal life policies, 24 fixed annuity contracts, and 18 variable annuity contracts. The sample was selected

to verify that seniors were not being targeted by agents and sold products that were not appropriate for their investment objectives.

Of the 50 files reviewed, 25 (50.0%) were surrendered within one year of issue and 40 (80.0%) were surrendered within the surrender charge period.

In 2008, the Group Financial Services and European Audit issued a report on HSBC Insurance North America, encompassing the work of HBUS. The report focused on ensuring that the key risks arising from the activities of the entity were being managed in an appropriate manner and in accordance with expected Group standards. In the Section on Insurance Distribution, under Sales Compliance Monitoring, the report contained the following relating to the Insurance Compliance Function:

"...do not monitor risk factors such as early cancellations or whether any branches/agents are unusually successful in order to enable them to assess where there are increased risks of compliance failures nor have they revisited any branches that have previously failed a review although they do ask management to certify that any issues have been addressed."

The examiner's review revealed that the Agencies have no procedure in place to monitor early cancelations for evidence of compliance failures, including potential suitability issues.

The examiner recommends that the Agencies review all contracts surrendered or otherwise terminated within one year of the issue date for compliance failures, as well as potential suitability issues.

The examiner's review also noted the following:

- 19 (38.0%) of the cancelled and surrendered files reviewed did not contain the required supervisory approval, and/or documentation at the time of issue.
- 5 (10.0%) of the cancelled and surrendered files reviewed did not contain evidence that all required supervisory pre-approvals were obtained.
- 17 (34.0%) of the cancelled and surrendered files reviewed contain documentation that was incomplete or inconsistent.

### C. Replacements

The examiner reviewed the Agencies replacement handling process to determine compliance with Department Regulation No. 60 and the operating rules and guidelines of the Agencies.

In response to the examiner's request for an inventory of policies and contracts replaced by the Agencies during the period under examination, the Agencies provided data files of 422 life policies, 6,809 fixed annuities and 2,367 variable annuities.

The examiner reviewed a sample of 50 replacement files, 16 processed by HIA and 34 processed by HSI.

The examiner's review revealed that, although the Agencies made reasonable attempts to comply with Department Regulation No. 60, there were deviations from technical aspects of the regulation. For example, the agent failed to answer the question regarding the use of sales materials on the Disclosure Statement, or the agent failed to provide evidence that a copy of any proposal, including the sales material used in the sale of the proposed life insurance policy or annuity contract was provided to the insurer.

In response to the examiners findings, the Agencies stated that it has distributed Department Regulation No. 60 Compliance Procedures to all its agents. In addition, the Agencies stated that it has incorporated this training into its Financial Advisor New Hire Training program, which became effective in June 2011. The Agencies anticipate that this training, in addition to enhanced diligence by the Agencies' Middle Office to the proper completion of documentation, will address the Department Regulation No. 60 issues noted by the examiners during the audit.

## 5. SUMMARY AND CONCLUSIONS

Following are the recommendations contained in this report:

<u>Item</u>	<u>Description</u>	<u>Page No(s).</u>
A	The examiner recommends that the Agencies, (1) prepare a list of all New York consumer complaints pertaining to the sale of life insurance policies or annuity contracts that the Agencies received, whether written or oral, during the period January 1, 2005 to December 31, 2010, (2) advise the insurer that issued the product of each such complaint and provide the insurer with a summary of the complaint and the manner in which it was resolved by the Agencies.	6
B	The examiner also recommends that all current and future complaints and their disposition be reported to the insurance carriers.	6
C	The examiner recommends that the Agencies implement a procedure to ensure that clients for whom English is not the primary language, have an understanding of the product proposed to them, prior to completing the transaction.	7
D	The examiner recommends that the Agencies report Department disciplinary actions/fines to the issuing insurance carrier(s).	7
E	The examiner recommends that HSI enhance its training and supervisory activities to ensure that all required supervisory pre-sale approvals and waivers are obtained prior to documentation being forwarded to the insurance carrier, in accordance with its policies and procedures.	8
F	The examiner recommends that HSI enhance its training and supervisory activities to ensure that all required internal documentation are completed fully and correctly, and that all internal documentation and documents forwarded to the insurance carrier are consistent.	9
G	The examiner recommends that the Agencies review all contracts surrendered or otherwise terminated within one year of the issue date for compliance failures, as well as potential suitability issues.	10

Respectfully submitted,

S'el Rey N. David  
S'el Rey N. David  
Senior Insurance Examiner

STATE OF NEW YORK     )  
  )SS:  
COUNTY OF NEW YORK    )

S'el Rey N. David, being duly sworn, deposes and says that the foregoing report, subscribed by him, is true to the best of his knowledge and belief.

S'el Rey N. David  
S'el Rey N. David

Subscribed and sworn to before me

this 18<sup>th</sup> day of JANUARY, 2012

Charles T. Lovejoy

**Charles T. Lovejoy**  
Notary Public, State of New York  
No. 31-4798952  
Qualified in New York County  
Commission Expires 1-26-14

APPOINTMENT NO. 30635

STATE OF NEW YORK  
**INSURANCE DEPARTMENT**

I, JAMES J. WRYNN, Superintendent of Insurance of the State of New York,  
pursuant to the provisions of the Insurance Law, do hereby appoint:

**S'ELREY DAVID**

*as a proper person to examine into the affairs of the*

**HSBC INSURANCE AGENCY (USA), INC. AND HSBC SECURITIES (USA), INC.**

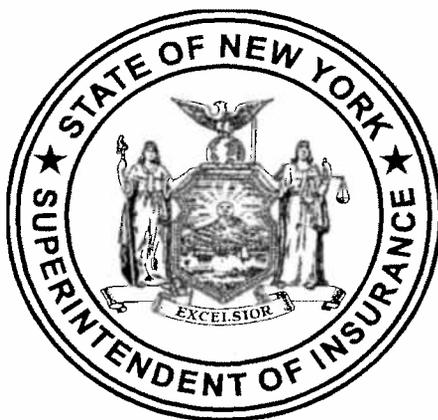
*and to make a report to me in writing of the condition of the said*

**AGENCIES**

*with such other information as he shall deem requisite.*

*In Witness Whereof, I have hereunto subscribed by name  
and affixed the official Seal of the Department  
at the City of New York*

*this 6th day of January, 2011*



JAMES J. WRYNN  
Superintendent of Insurance

*James J. Wrynn*  
Superintendent