IN THE MATTER OF THE SECURITIES ACT,
R.S.O. 1990, c. S.5, as amended

- AND -

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

STATEMENT OF ALLEGATIONS OF STAFF OF THE ONTARIO SECURITIES COMMISSION

Staff of the Ontario Securities Commission ("Staff") make the following allegations:

PHOENIX RESEARCH AND TRADING CORPORATION

1. The respondent Phoenix Research and Trading Corporation ("Phoenix Canada") is a company incorporated pursuant to the laws of Ontario. During the material time, Phoenix Canada was registered with the Ontario Securities Commission (the "Commission") as an investment counsel and portfolio manager pursuant to the *Securities Act*, R.S.O. 1990, c. S.5 (the "Act"). Phoenix Canada's registration was suspended in May 2000 due to its difficulties in filing audited financial statements and maintaining insurance.

2. Phoenix Canada was a small company of approximately 14 employees. The respondent Ronald Mock ("Mock") was the CEO and President of Phoenix Canada. During the material time, Mock was registered with the Commission as an investment counsel and portfolio manager pursuant to the Act. Mock also was the company's registered supervisory procedures officer.

3. During the material time, the respondent Stephen Duthie ("Duthie") was a senior fixed income advisor and trader with Phoenix Canada. Duthie has never been registered with the Commission in any capacity.

4. (John) Blair Taylor ("Taylor") is a chartered accountant. From July 1997 to October 1999, Taylor was Phoenix Canada's Director of Operations and Finance. In November 1999, he was appointed the CFO. Taylor never was a registered officer of Phoenix Canada.

5. Mark Kassirer ("Kassirer") was the Chair of Phoenix Canada during the material time. Kassirer headed the equity arbitrage business of Phoenix Canada.

THE PHOENIX GROUP

6. Phoenix Canada formed part of the Phoenix Group of companies and limited partnerships. Unitholders invested in the Phoenix Fixed Income Arbitrage Fund Limited, the Phoenix Fund Limited, the Phoenix Equity Arbitrage Fund Limited and the Phoenix Alternative

Strategies Fund Limited (collectively, the "Feeder Funds"). The Feeder Funds (and other investors) purchased units of the Phoenix Fixed Income Arbitrage Limited Partnership ("PFIA LP") and the Phoenix Equity Arbitrage Limited Partnership ("PEA LP"). The Phoenix Hedge Fund Limited Partnership, a TSE-listed hedge fund, also held units of PFIA LP and PEA LP.

7. Pursuant to a services agreement with Phoenix Research and Trading (Bermuda) Limited ("Phoenix Bermuda"), Phoenix Canada provided investment advisory and portfolio management services to the Feeder Funds, PEA LP and PFIA LP.

PFIA LP

8. PFIA LP was a hedge fund managed by Phoenix Canada. 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.

9. Mock ran PFIA LP. In connection with this aspect of Phoenix Canada's fixed income arbitrage business, Mock's staff comprised 9 employees namely the Operations Group (Taylor, the Operations Manager and the Settlement Clerk), three fixed income advisors and traders, the Research and Risk Manager, the Systems Support Manager and an administrative assistant.

10. Taylor was the most senior person in the Operations Group. Taylor's duties included the direct supervision of the Operations Manager and the Settlement Clerk.

11. No one at Phoenix Canada involved in PFIA LP reported directly to Kassirer.

12. PFIA LP held investments in U.S. dollars, Canadian dollars and Euros. Commencing in the Fall of 1998, Duthie was responsible for PFIA LP's U.S. dollar portfolio under the direct supervision of Mock.

OVERVIEW OF PFIA LP'S COLLAPSE

13. In early January 2000, PFIA LP collapsed when it sustained a loss in excess of $120 million. By this time, Duthie had accumulated a $3.3 billion U.S. long position in 6% U.S. treasury notes due August 15, 2009 (the "UST Notes"). The UST Notes were not hedged. This unhedged position was contrary to PFIA LP's investment guidelines and had not been authorized by management. The UST Notes caused PFIA LP's collapse.

14. Duthie was authorized to engage in a matched book strategy of repurchase agreements ("repos") and open reverse repos. Phoenix Canada management operated on the basis that the UST Notes were the open reverse repo leg of the matched book and thus, fell within PFIA LP's investment parameters.

15. In reality, Duthie had engaged in a strategy of purchasing long bonds financed by repos. Ultimately, the UST Notes caused a significant overdraft position at the Bank of New York. As a result, Phoenix Canada was forced to liquidate all of PFIA LP's assets.

16. Duthie's accumulation of the UST Notes was contrary to the best interests of Phoenix Canada's and Duthie's clients. Further, Duthie engaged in registerable activity for which he was not registered with the Commission.

17. Mock failed to, among other things, keep the proper books and records, implement and monitor appropriate controls and procedures, and adequately supervise his staff. Absent these failures, the UST Notes would not have been accumulated or the true nature of the UST Notes would have been detected and the collapse of PFIA avoided.

THE ACQUISITION OF THE UST NOTES BY PFIA LP

18. Commencing in the fall of 1998, Duthie was authorized to engage in a market neutral strategy which included a low risk, matched book trading strategy of repos and open reverse repos in U.S. treasury benchmark issues. An open reverse repo is a type of reverse repo that has no termination date that is, terminable on demand by either party to the transaction.

19. The goal of a matched book trading strategy of repos and open reverse repos is to eliminate the risk of market fluctuations inherent in bond trading. In this type of strategy, the trader plays the interest rate spread between the borrowing rate (repo leg) and the lending rate (open reverse repo leg).

20. On the repo leg of the transaction, monies are borrowed on the collateral of bonds. On the termination of the repo, the borrowed monies plus interest are paid in exchange for the return of the bonds. Simultaneously, on the open reverse repo leg of the transaction, monies are lent on the collateral of bonds. On the termination of the open reverse repo, the lent monies are repaid with interest and the bonds are returned. Profits are earned on this type of matched book strategy when the interest earned on the open reverse repo leg exceeds the interest expense paid on the repo leg, net of transaction costs.

21. Duthie did not engage in the authorized trading strategy. Rather, Duthie accumulated the UST Notes (ie unhedged long bond positions). He financed the leveraged position using repos and satisfied transaction costs by accessing additional collateral. By trading the unhedged long bonds, PFIA LP was exposed to market risk which was magnified by the leverage of the UST Notes.

22. Approximately 80% of the total PFIA LP fund was in U.S. dollars. The UST Notes represented PFIA LP's entire U.S. dollar portfolio.

23. The UST Notes were not hedged. The concentration, size and length of time this unhedged position was in place contravened the investment guidelines and restrictions of PFIA LP.

24. On January 4, 2000, the Bank of New York informed Phoenix Canada that the latter was in an overdraft position in excess of $50 million U.S. The UST Notes caused the overdraft

position. To mitigate the loss exposure resulting from the UST Notes, Phoenix Canada liquidated all of PFIA LP's assets.

25. Phoenix Canada contacted Staff on January 5, 2000 respecting the UST Notes and the collapse of PFIA LP. As a condition of its registration, Phoenix Canada retained a forensic accounting firm to prepare a report.

MANAGEMENT'S FAILURE TO DETECT THE UST NOTES

26. Management relied principally on Duthie's representations that the UST Notes (and other long bonds reported by Duthie during the material time) were open reverse repos (the "purported open reverse repos") and thus, part of Duthie's authorized trading strategy (ie the open reverse repo leg of the matched book strategy).

27. Within one day of being informed by the Bank of New York of its overdraft position, however, Phoenix Canada was able to discern that the UST Notes were unhedged long bonds and not the purported open reverse repos.

28. The purported open reverse repo transactions fell outside the scope of controls and procedures then in place at Phoenix Canada. Phoenix Canada failed to:

(i) establish, implement and monitor appropriate controls and procedures respecting the purported open reverse repo transactions;

(ii) maintain the books, records and other documents necessary for the proper recording of the purported open reverse repo transactions; and

(iii) segregate duties relating to the purported open reverse repo transactions.

(a) Trade Capture of the Purported Open Reverse Repos

29. Phoenix Canada's method of capturing Duthie's trades in the purported open reverse repos was fundamentally flawed and thus, unreliable. Phoenix Canada's computer trading system ("Alydia") was not designed to capture open reverse repos. Thus, to Mock's knowledge, all trades by Duthie in the purported open reverse repos were entered into the bond module of Alydia as long bonds. These longs bonds were not distinguished from real bond inventory arising from authorized intra-day trading.

30. Knowing that the open reverse repos were entered into Alydia incorrectly, Phoenix Canada then made two manual adjustments namely:

(i) a manual adjustment to "correct" PFIA LP's value at risk ("VAR") report so that the VAR would be meaningful. This adjustment was approved by Mock. The adjustment was based only on Duthie's representations as to the existence of the purported open reverse repos and the length of time such repos would be held**;** and

(ii) a manual adjustment to "correct" income from the bond position which would be reflected in the general ledger and profit and loss statement. Duthie provided the information used to make this adjustment.

(b) Phoenix Canada's VAR Reports

31. The Risk Manager of Phoenix Canada, under Mock's supervision, prepared VAR reports on a daily basis. 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.

32. The information used to create the VAR report was pulled from the information inputted to Alydia. Since the purported open reverse repos had been entered incorrectly as long bonds in Alydia, Phoenix Canada adjusted the VAR report program so that the purported open reverse repos were treated as short term long bonds (which they were not) and their risk assessed accordingly. Mock knew that this adjustment was being made by the Risk Manager.

33. The adjustments to the VAR reports were unreliable because they were based solely on Duthie's representations as to the existence of the purported open reverse repos and the length of time such repos would be held. Phoenix Canada did not request nor maintain any documentation of the original trades of the purported open reverse repos to support or verify Duthie's representations.

34. A calculation of the VAR at December 31, 1999 for the UST Notes, without any adjustment, would have resulted in a VAR which was 7 times the allowable VAR permitted by PFIA LP's investment guidelines.

(c) Inappropriate Pricing of the Purported Open Reverse Repos

35. In the normal course, bond trades entered into the bond module of Alydia were priced by Phoenix Canada (using Bloomberg or another similar service) on a daily basis to generate a daily capital gain/loss. The daily capital gains/losses were reflected in the general ledger. The profit and loss statement reported a net income/loss figure for each strategy, including Duthie's market neutral strategy.

36. The purported open reverse repos were entered into the bond module of Alydia. Since there is no bond inventory associated with an open reverse repo, however, there is nothing to "price". Rather, the purported open reverse repos would earn interest income which ought to be recorded.

37. Phoenix Canada dealt with the purported open reverse repos based on Duthie's representations as follows: Duthie identified those bonds entered into the bond module which

were the purported open reverse repos. He assigned a “price” to the purported open reverse repos which would produce a capital gain figure on the general ledger equal to what he said was the interest earned on the purported open reverse repos. Phoenix Canada relied exclusively on Duthie to assign the “price” to the purported open reverse repos.

38. Phoenix Canada did not reallocate the “capital gain” figure to interest income. Thus, the purported interest earned on the purported open reverse repos appeared on the general ledger as a capital gain. This “capital gain” was then carried over to the profit and loss statement relating to Duthie’s market neutral strategy.

39. This method of dealing with the purported interest income earned on the purported open reverse repos was fundamentally flawed. Further, since Phoenix Canada did not maintain or retain any documentation respecting the existence of the purported open reverse repos or the basis for Duthie’s calculation of the adjusted “price”, there was nothing against which to check these transactions.

40. Moreover, management’s sole reliance on Duthie’s representations enabled Duthie to mask unrealized holding losses for the UST Notes and to smooth the income pattern.

41. Mock did not discuss with any member of the Operations Group how the purported open reverse repos would be recorded for the purpose of Phoenix Canada’s books and records and failed to make appropriate efforts to verify that they were being dealt with appropriately.

(d) Segregation of Duties

42. Phoenix Canada failed to segregate duties relating to the purported open reverse repo transactions by:

- (i) 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;
- (ii) permitting Duthie to execute trades on behalf of PFIA LP respecting the purported open reverse repos and make the “price” adjustment; and
- (iii) permitting Duthie to access collateral by virtue of his participation in cash management activities while engaged in his own profit and loss activities (enabling Duthie to satisfy transaction costs for the UST Notes).

(e) Books and Records

43. Phoenix Canada did not maintain books and records of the original trades of the purported open reverse repos, including the repo and open reverse repo contracts.

44. Internal reports generated from the inadequate trade capture and accounting of the purported open reverse repos such as daily trade blotters, collateral reports, settlement reports, general ledger and trial balances were flawed and unreliable.

45. For example, the settlement report used to confirm and settle trades listed trades in the UST Notes (ie long bonds). The collateral usage report did not reflect the purported open reverse repos. Further, the Operations Manager and Settlement Clerk who used these reports were unaware that the long bonds listed on the reports were a proxy for the purported open reverse repos.

INCORRECT REPORTING

46. PFIA LP had agreements with the Bank of Bermuda, including administration and custodial agreements.

47. Phoenix Canada reported incorrect information respecting the purported open reverse repos to the Bank of Bermuda, Phoenix Bermuda and the beneficial owners of PFIA LP. Phoenix Canada consistently reported the purported open reverse repos as long bonds.

48. Phoenix Canada submitted trade blotters, trial balances and net asset value calculations to the Bank of Bermuda which consistently reported the purported open reverse repos as long bonds and contained the income "correction" made by Duthie.

49. Phoenix Canada did not inform the Bank of Bermuda that it was engaged in a matched book trading strategy of repos and open reverse repos and that the long bond position was a proxy for the purported open reverse repos. Thus, the Bank was unable to fulfill properly its custodial and administrative roles for Phoenix Canada in connection with the purported open reverse repo transactions. Among other things, the Bank of Bermuda was able to agree the trades reflected on the trade blotters to third party trade confirms.

SUITABILITY

50. The accumulation of the UST Notes contravened PFIA LP's investment objectives and restrictions and thus, the Notes were not a suitable investment for PFIA LP. The collapse of PFIA LP resulted in a loss to the beneficial owners in excess of $120 million.

FAILURE TO BE REGISTERED

51. In the course of trading PFIA LP's U.S. dollar portfolio, Duthie had discretion as to the specific fixed income securities he bought and sold on behalf of PFIA LP. This discretion was subject to PFIA LP's investment guidelines and restrictions and Phoenix Canada's internal investment guidelines.

52. In exercising this discretion, Duthie advised the unitholders of the Feeder Funds, the TSE-listed hedge fund and PFIA LP as to the investing in and the buying or selling of securities

and thus, engaged in registerable activity under the Act. Contrary to section 25 of the Act, Duthie was not registered with the Commission.

LACK OF SUPERVISION

53. Mock failed to supervise adequately Duthie's activities. Duthie engaged in registerable activity without being registered. Further, over the course of 15 months, Duthie abused the discretion granted to him by Phoenix Canada without detection by Mock.

54. When Duthie assumed responsibility for PFIA LP's U.S. dollar portfolio, he had been a trader at Phoenix Canada for only 1 year. Among other things, Mock failed to establish a means of documenting the purported open reverse repo transactions for the purpose of supervising Duthie's trading.

55. Mock failed to supervise sufficiently Taylor and the Operations Group as it related to the purported open reverse repo transactions.

PHOENIX CANADA'S MISCONDUCT

56. As described above, Phoenix Canada engaged in conduct contrary to Ontario securities law and the public interest.

MOCK'S MISCONDUCT

57. As the President/CEO, supervisory procedures officer and officer responsible for PFIA LP, Mock failed to:

(i) ensure that the books, records and other documents necessary for the proper recording of the purported open reverse repo transactions were kept;

(ii) ensure that adequate controls and procedures respecting the purported open reverse repo transactions were established, implemented and maintained;

(iii) ensure that the appropriate segregation of duties relating to the purported open reverse repo transactions occurred;

(iv) adequately supervise Duthie and the Operations Group respecting the purported open reverse repo transactions;

(v) ensure that Duthie was registered with the Commission; and

(vi) ensure that Phoenix Canada dealt fairly with, and acted in the best interests of, its clients. In particular, that investments made on behalf of PFIA LP were suitable given the latter's investment objectives, guidelines and restrictions and that accurate information concerning PFIA LP was reported to the Bank of Bermuda, Phoenix Bermuda and the beneficial owners of PFIA LP.

58. Mock's conduct was contrary to Ontario securities law and the public interest.

DUTHIE'S MISCONDUCT

59. Duthie engaged in registerable activity without being registered contrary to section 25 of the Act.

60. In accumulating the UST Notes, Duthie acted in flagrant disregard for the investment objectives and restrictions and risk guidelines of PFIA LP. As such, Duthie failed to deal fairly, honestly and in good faith with Phoenix Canada's and his clients.

61. Further, Duthie made misrepresentations to Phoenix management designed to conceal the true nature of his activities and the UST Notes.

62. Duthie's conduct was contrary to Ontario securities law and the public interest.

63. Staff reserves the right to make such further and other allegations as Staff may submit and the Commission may allow.

DATE: Tuesday, June 11, 2002