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

- AND -

IN THE MATTER OF (JOHN) BLAIR TAYLOR

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. 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 voluntarily 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. 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. The respondent (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.

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

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.

OVERVIEW

8. In early January 2000, PFIA LP collapsed when it sustained a loss in excess of US$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 represented PFIA LP's entire U.S. dollar portfolio.

9. 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.

10. 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. In reality, Duthie engaged in a strategy of purchasing long bonds financed by repos. Phoenix Canada management failed to detect the true nature of the UST Notes and Duthie's activities.

11. Ultimately, the UST Notes caused a significant overdraft position (in excess of US$50 million) at the Bank of New York. As a result, Phoenix Canada was forced to liquidate PFIA LP's assets. PFIA LP collapsed as it sustained a loss in excess of US$120 million.

12. Taylor, as the CFO and a senior member of Phoenix Canada's management, failed to, among other things, keep the proper books and records, implement appropriate controls and procedures, and adequately supervise his staff.

PFIA LP

13. 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.

14. 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.

15. Taylor was Phoenix Canada's Director of Operations and Finance and then CFO. He was the most senior person in the Operations Group. Taylor's duties included the direct supervision of the Operations Manager and the Settlement Clerk.

PFIA LP'S ACQUISITION OF THE UST NOTES

16. PFIA LP held investments in U.S. dollars, Canadian dollars and Euros. From the fall of 1998 through January 2000, Duthie was responsible for PFIA LP's U.S. dollar portfolio under the direct supervision of Mock.

17. 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.

18. 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).

19. 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 incurred 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.

20. Duthie did not engage in the authorized trading strategy. Rather, Duthie accumulated the UST Notes, financing the leveraged position using repos.

MANAGEMENT'S FAILURE TO DETECT THE TRUE NATURE OF THE UST NOTES

21. 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).

22. 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.

23. 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 alternative 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.

As a result of these failures, the true nature of the UST Notes was not detected by management.

(a) Trade Capture of the Purported Open Reverse Repos

24. Phoenix Canada's method of capturing Duthie's trades in the purported open reverse repos was flawed and thus, unreliable. Phoenix Canada's computer trading system ("Alydia") was not designed to capture open repos or open reverse repos. All trades by Duthie in the purported open reverse repos, therefore, were entered into the bond module of Alydia as long bonds.

25. 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. 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 statements. Duthie provided the information used to make this adjustment.

(b) Phoenix Canada's VAR Reports

26. Phoenix Canada 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.

27. 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.

28. 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.

(c) "Pricing" of the Purported Open Reverse Repos

29. Since there is no bond inventory associated with an open reverse repo, there is nothing to "price". Rather, the purported open reverse repos would earn interest income which ought to be recorded.

30. Taylor 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 then 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. Taylor relied exclusively on Duthie to assign a "price" to the purported open reverse repos.

31. Taylor never reallocated 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.

32. 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.

(d) Segregation of Duties

33. 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 "pricing" adjustment relating to interest earned on the purported open reverse repos; 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.

(e) Books and Records

34. Phoenix Canada did not maintain any books and records of the original trades of the purported open reverse repos. Taylor did not request or obtain any open reverse repo contracts. Further, there was no manual blotter or spreadsheet maintained for the purported open reverse repos.

35. 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.

36. 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. 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

37. 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 and the interest income as capital gains.

38. At no time did Taylor inform the Bank of Bermuda, Phoenix Canada's custodian, that Phoenix Canada was engaged in a trading strategy of repos and open reverse repos. 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.

39. Because Phoenix Canada did not notify the Bank of Bermuda that the long bond position was a proxy for the purported open reverse repos, the Bank was able to agree the trades reflected on the trade blotters to third party trade confirms.

SUITABILITY

40. 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.

LACK OF SUPERVISION

41. Taylor failed to provide his staff with sufficient information to carry out their responsibilities as it related to the purported open reverse repo transactions. Among other things, because Taylor did not inform the Settlement Clerk that the long bond position was a proxy for the purported open reverse repos, she was able to agree the trades reflected on the trade blotters to trade confirms.

TAYLOR'S MISCONDUCT

42. As the Director of Operations and then CFO of Phoenix Canada, Taylor failed to:

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

(ii) establish and implement appropriate controls and procedures for the accurate capturing, recording, accounting and reporting of Phoenix Canada's purported open reverse repo transactions; and

(iii) adequately supervise Phoenix Canada's accounting and operations staff.

43. Taylor's conduct was contrary to the public interest.

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

DATE: July 16, 2002