



Mutual Fund Dealers Association of Canada
Association canadienne des courtiers de fonds mutuels

**IN THE MATTER OF A SETTLEMENT HEARING
PURSUANT TO SECTION 24.4 OF BY-LAW NO. 1 OF
THE MUTUAL FUND DEALERS ASSOCIATION OF CANADA**

Re: W. H. Stuart Mutuals Ltd.

Heard: January 26, 2012 in Toronto, Ontario
Reasons for Decision: January 30, 2012

REASONS FOR DECISION

Hearing Panel of the Central Regional Council:

The Hon. Fred Kaufman, Q.C.
Cheryl Hamilton
Robert C. White

Chair
Industry Representative
Industry Representative

Appearances:

Shelly Feld)	For the Mutual Fund Dealers Association of
)	Canada
Dino De Rosa)	Chief Compliance Officer, W. H. Stuart Mutuals
)	Ltd.

Introduction

1. By Notice of Settlement Hearing dated December 16, 2011, the Mutual Fund Dealers Association of Canada (“MFDA”) advised W.H. Stuart Mutuals Ltd. (the “Respondent”) that the settlement reached by the parties would be submitted to a hearing panel of the Central Regional Council to determine whether or not it should be accepted pursuant to section 24.4 of MFDA By-law No. 1. The hearing took place on January 26, 2012, and after hearing from the parties the panel accepted the agreement and ordered that the terms of the agreement be carried out, reasons to follow. These, then, are the panel’s reasons.

The Facts

2. The facts, as agreed upon by the parties, are as follows

Registration History

3. The Respondent is registered as a mutual fund dealer in all Canadian provinces except for Quebec.

4. The Respondent has been a Member of the MFDA since March 4, 2003.

Corporate Structure

5. The Respondent’s head office is located in Unionville, Ontario (the “Head Office”). In 2009, the Respondent had one other branch office which was located in Burlington, Ontario. The Burlington branch is no longer open. As of September 30, 2011, the Respondent had 229 sub-branches located throughout Canada.

The 2009 Compliance Examination

6. Commencing on March 23, 2009, MFDA Compliance Staff conducted a compliance examination (the “2009 Examination”) in order to assess compliance by the Respondent with the By-laws, Rules and Policies of the MFDA during the period from October 1, 2006 to February

28, 2009. During the 2009 Examination, MFDA Compliance Staff conducted a review of the Respondent's operations at the Respondent's Head Office in Unionville, at a branch office located in Burlington, and at three sub-branch offices of the Respondent located in Orangeville, Markham and Toronto, Ontario.

7. The results of the 2009 Examination were summarized and delivered to the Respondent in a report dated August 21, 2009 (the "2009 Report").

8. The 2009 Report identified compliance deficiencies, including the fact that the Respondent failed to establish, implement and maintain adequate policies and procedures for conducting trade supervision including supervision of leveraged trading or to ensure the suitability of leveraging recommendations made by Approved Persons to clients.

Inadequate Trade Supervision

9. During the 2009 Examination, MFDA Compliance Staff identified deficiencies in the trade supervision conducted by the Respondent's branch managers and Head Office Compliance Staff insofar as they failed to maintain records of queries made, responses received from Approved Persons, and resolutions achieved as a result of any supervisory inquiries that were made.

10. As a result of deficiencies in the Respondent's trade supervision practices, there is no evidence that the Respondent was conducting adequate trade supervision to prevent the processing of trades which may have been unsuitable for clients.

Inadequate Supervision of Leveraged Trading and Leveraging Recommendations

11. During the 2009 Examination, MFDA Compliance Staff also identified deficiencies in the Respondent's internal controls and policies and procedures for the supervision of leveraged accounts and leveraging recommendations. In particular, the Respondent's branch managers and head office compliance staff failed to document evidence of supervisory reviews of leveraging recommendations including records of suitability queries made, responses received and resolutions achieved as a result of supervisory inquiries.

12. As a result, leveraging recommendations which may have been unsuitable were processed by the Respondent without being subjected to a full supervisory review in accordance with MFDA Rules and Policies.

Financial Compliance Deficiencies

13. By letter dated February 12, 2009, MFDA Financial Compliance Staff notified the Respondent that the Respondent had been designated in early warning pursuant to MFDA Rule 3.4.2(a)(iii) because the operating loss revealed by the Respondent's monthly financial statement filings for the quarter ending December 31, 2008 exceeded the Respondent's Risk Adjusted Capital ("RAC").

14. As a consequence of its designation in early warning, the early warning restrictions described in MFDA Rule 3.4.2(b) became applicable to the Respondent until MFDA Financial Compliance Staff determined that early warning restrictions were no longer required in accordance with MFDA Rule 3.4.4.

15. By letter dated February 18, 2009, senior officers of the Respondent acknowledged that the Respondent had been designated in early warning and was required to comply with the early warning restrictions set out in MFDA Rule 3.4.2(b)(iv).

Unauthorized Payments

16. When the Respondent submitted its monthly filings of Financial Questionnaires and Reports ("FQRs") in accordance with MFDA Rules 3.5.1(a) and 3.4.2(b)(ii)(B) for the months ended February 28, 2009 and July 31, 2009, desk reviews of the FQRs completed by MFDA Financial Compliance Staff revealed that:

- (a) in its February 2009 FQR, the Respondent reported that a discretionary bonus expense was incurred after the Respondent was designated in early warning. The bonus expense included 2 cash payments totaling \$5,500 that were made to or on behalf of an officer and shareholder of the Respondent; and

(b) in its July 2009 FQR, the Respondent reported a decrease of \$94,141 in accounts payable and accrued expenses that resulted from a payment to a related party called W.H. Stuart Insurance Agency.

17. The Respondent made the payments described in paragraph 19 above without the prior written consent of the MFDA, contrary to the early warning restrictions set out in MFDA Rule 3.4.2(b)(iv) which were applicable to the Respondent at the time.

18. On March 27, 2009, after becoming aware of the cash payments reported in the February 2009 FQR, Financial Compliance Staff informed the Respondent in writing that the February 2009 payments appeared to be in contravention of early warning conditions and that enforcement action might be warranted as a consequence.

19. Neither one of the payments described in paragraph 16 above resulted in a RAC deficiency.

20. By letter dated September 28, 2009, MFDA Financial Compliance Staff informed the Respondent that it was no longer designated in early warning.

The Contraventions

21. Arising from the facts set out above, the Respondent admitted that it had contravened certain MFDA Rules and Policies, as detailed below:

22. The Respondent admits that prior to February 28, 2009, it failed to establish, implement, maintain and adhere to adequate policies and procedures to ensure that branch managers and head office compliance staff maintained adequate records of trade supervision that was conducted including records of inquiries made, responses received and resolutions achieved and as a result, the Respondent was not able to demonstrate the suitability of all trades and leveraging strategies that were processed on behalf of its clients, contrary to MFDA Rules 2.2.1, 2.5 and 2.10 and MFDA Policy No. 2.

23. The Respondent admits that while it was designated in early warning from February 12,

2009 to September 28, 2009, the Respondent breached early warning restrictions that were applicable to it by paying a bonus to an officer of the Respondent in February 2009 and by making a direct or indirect payment to a related party in July 2009 without the prior written consent of MFDA Staff, contrary to MFDA Rule 3.4.2(b)(iv)(C).

24. As set out in the Settlement Agreement, the Respondent agreed to the following terms of settlement:

- (a) the Respondent shall pay a fine in the amount of \$45,000 upon the acceptance of this Settlement Agreement;
- (b) the Respondent shall pay the costs of this proceeding in the amount of \$2,500 upon the acceptance of this settlement;
- (c) The Respondent agrees that the fine and costs shall be payable as follows:
 - (i) \$20,000 of the fine and \$2,500 in costs shall be payable immediately upon acceptance of the Settlement Agreement; and
 - (ii) the remaining \$25,000 of the fine shall be paid by 10 monthly installments of \$2,500 per month payable on the last day of each month commencing on January 31, 2012;
- (d) the Respondent shall implement the revised policies and procedures and the Leverage Review Action Plan referenced in this Settlement Agreement;
- (e) the Respondent acknowledges that its obligations to handle complaints promptly and fairly in accordance with MFDA Rule 2.11 and MFDA Policy No. 3 are unaffected by this Settlement Agreement;
- (f) in accordance with s. 24.4.2 of the By-law, the Respondent agrees that in the future, it shall comply with all MFDA By-laws, Rules and Policies, and all applicable securities legislation and regulations made thereunder, including, MFDA Rules 2.2.1, 2.5, 2.10, 3.4.2(b)(iv) and MFDA Policy No. 2; and
- (g) a senior officer of the Respondent will attend the settlement hearing in person.

Staff Commitment

25. MFDA staff made the following commitment:

“If this Settlement Agreement is accepted by the Hearing Panel, Staff will not initiate any

proceeding under the By-laws of the MFDA against the Respondent or any of its officers or directors in respect of the contraventions described in Part V of this Settlement Agreement, subject to the provisions of Part IX below. Nothing in this Settlement Agreement precludes Staff from investigating or initiating proceedings in respect of any contraventions that are not set out in Part V of this Settlement Agreement including any possible contraventions associated with the Respondent's complaint handling obligations or in respect of conduct that occurred outside the specified date ranges of the contraventions set out in Part V, whether known or unknown at the time of settlement. Furthermore, nothing in this Settlement Agreement shall relieve the Respondent from fulfilling any continuing regulatory obligations."

Discussion

26. It is well accepted that the primary goal of securities legislation is the protection of the investor: see, for instance, *Pezim v. British Columbia (Superintendent of Brokers)*, [1994] 2 S.C.R. 557. MFDA rules, policies and regulations reflect this fact and are designed to ensure that Members handle their business in accordance with all relevant requirements.

27. Periodic compliance examinations are designed to assess the adequacy of the Member's establishment and implementation of policies and procedures to fulfil its obligations, and it was as a result of such an examination that the Respondent's deficiencies were first identified. Furthermore, the Respondent triggered an early warning test when it filed its Financial Questionnaire & Report for the quarter ending December 31, 2008, which showed, in the words of MFDA staff, "that the Member appeared to be treading towards a capital deficiency because its operating loss for the quarter exceeded its risk adjusted capital."

28. As a result of this early warning, the Respondent became subject to certain restrictions, and these were contravened when unauthorized payments were made to an officer, a shareholder or a related party. While these payments were clearly wrong, it was established in the course of the hearing that they were apparently made in ignorance of the prohibition, and while that is no excuse it does become a mitigating factor.

29. The MFDA Penalty Guidelines recommend, in cases such as these, the following

penalties (in abbreviated form):

- (a) Failure provide proper supervision, a minimum fine of \$25,000 and the possible appointment of a monitor;
- (b) Failure to assess suitability and non-observance of the Know Your Client rules, a minimum fine of \$10,000;
- (c) Failure to observe financial requirements, a minimum fine of \$25,000.

30. Previous cases reflect the guidelines, and the settlement reached by the parties is in line with penalties assessed under similar circumstances: see, for instance, *In re Sentinel Financial Management Corp.*, [2011] MFDA Prairie Regional Council, File No. 201034; *In re Financial Consulting Group*, [2011] MFDA Central Regional Council, File No. 201028; *In re Partners in Planning Financial Services Ltd.*, [2010] MFDA Prairie Regional Council, File No. 201032.

31. As set out in the guidelines, failure to provide proper supervision can lead to the appointment of a monitor. However, as Senior Enforcement Counsel told us at the hearing, this was considered unnecessary in the present case since remedial measures have already been taken. Furthermore, a Leverage Review Action Plan has been established, the terms of which were reviewed by the panel. Counsel also suggested that enforcement staff is more inclined than in the past, in appropriate case, to recommend a higher fine to reflect the seriousness of the deficiencies, but not ask for a monitor, whose employment often creates a major financial burden on the Member involved. The global fine imposed in this case reflects this new thinking.

32. It must also be noted that certain mitigating factors exist. One has already been pointed out above (the lack of wilfulness in making the two payments). Others are that this is a first offence, that the Respondent admitted its misconduct immediately, that it demonstrated remorse, and that by its actions it avoided the expenses of a potentially lengthy investigation and hearing.

33. In the result, the penalties set out in the Terms of Settlement are imposed.

34. The panel would like to thank Senior Enforcement Counsel for his clear and fair presentation of the case.

DATED this 30th day of January, 2012.

“Fred Kaufman”

The Hon. Fred Kaufman, Q.C.,
Chair

“Cheryl Hamilton”

Cheryl Hamilton,
Industry Representative

“Robert C. White”

Robert C. White,
Industry Representative

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