



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

**IN THE MATTER OF A DISCIPLINARY HEARING
PURSUANT TO SECTIONS 20 AND 24 OF BY-LAW NO. 1 OF
THE MUTUAL FUND DEALERS ASSOCIATION OF CANADA**

**Re: W. H. Stuart Mutuals Ltd., Marilyn Dianne Stuart and
Walter Howard Stuart**

NOTICE OF HEARING

NOTICE is hereby given that a first appearance will take place by teleconference before a hearing panel of the Central Regional Council (the “Hearing Panel”) of the Mutual Fund Dealers Association of Canada (the “MFDA”) in the hearing room located at 121 King Street West, Suite 1000, Toronto, Ontario on January 6, 2015 at 10:00 a.m. (Eastern), or as soon thereafter as the appearance can be held, concerning a disciplinary proceeding commenced by the MFDA against W. H. Stuart Mutuals Ltd. (“W. H. Stuart” or the “Member”), Marilyn Dianne Stuart (“Dianne Stuart”) and Walter Howard Stuart (“Howard Stuart”) (collectively, the "Respondents").

DATED this 27th day of November, 2014.

“Paige L. Ward”

Paige L. Ward
Corporate Secretary

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NOTICE is further given that the MFDA alleges the following violations of the By-laws, Rules or Policies of the MFDA:

Allegation #1: Between March 26, 2003¹ and March 2013, Dianne Stuart and W. H. Stuart solicited and accepted approximately \$6 million from more than 180 clients purportedly to be invested on their behalf (the “Note Program”), which monies they used for the benefit of Dianne Stuart, W. H. Stuart and companies that they controlled and failed to repay or otherwise account for, thereby:

- (a) failing to deal fairly, honestly and in good faith with the clients and engaging in conduct unbecoming a Member and Approved Person, contrary to MFDA Rule 2.1.1; and
- (b) engaging in personal financial dealings with the clients which gave rise to a conflict or potential conflict of interest between the interests of Dianne Stuart and W. H. Stuart and the interests of the clients, which Dianne Stuart and W. H. Stuart failed to ensure was addressed by the exercise of responsible business judgment influenced only by the best interests of the clients, contrary to MFDA Rules 2.1.4 and 2.1.1.

Allegation #2: Between March 26, 2003 and May 2013, Dianne Stuart and W. H. Stuart actively concealed the activity in Allegations #1 and #3 from others at W. H. Stuart, external auditors, the MFDA and other regulators by:

- (a) deliberately not recording transactions and other information about the Note Program in the books and records of W. H. Stuart;
- (b) preparing records of the Note Program that were maintained separately from the records of W. H. Stuart (the “Note Program Records”) and actively concealed; and
- (c) falsifying, altering, concealing and withholding documents, information and records on the W. H. Stuart back office system;

contrary to MFDA Rule 5, MFDA Policy No. 4 and MFDA Rule 2.1.1.

¹This is the date when W. H. Stuart became of a Member of the MFDA and therefore subject to its jurisdiction.

Allegation #3: Between March 26, 2003 and May 2013, in addition to failing to repay or otherwise account for the monies invested in the Note Program described in Allegation #1, Dianne Stuart and W. H. Stuart misappropriated or have otherwise failed to account for more than \$800,000 of investments and monies from over 30 clients, those monies consisting of:

- (a) cash balances in client accounts at W. H. Stuart that were not returned to the clients;
- (b) the proceeds of authorized redemptions that were not deposited in client accounts or paid to clients;
- (c) the proceeds of unauthorized redemptions that were not deposited in client accounts or paid to clients;
- (d) monies that clients directed W. H. Stuart to transfer to other mutual fund dealers or financial institutions that W. H. Stuart did not transfer; and
- (e) amounts withheld from redemptions in client accounts to pay taxes owing in respect of the redemptions that were not remitted to the Canada Revenue Agency;

contrary to MFDA Rules 2.1.1 and 2.3.1.

Allegation #4: Dianne Stuart and W. H. Stuart failed to comply with interim orders of a Hearing Panel of the MFDA with respect to the matters in Allegations #1 and #3 above, contrary to section 22.1 of MFDA By-law No.1 and MFDA Rule 2.1.1.

Allegation #5: Between March 26, 2003 and May, 2013, in the course of sustaining the Note Program described in Allegation #1, Dianne Stuart and W. H. Stuart failed to:

- (a) file accurate and complete monthly Form 1's and annual audited Form 1's for W. H. Stuart with the MFDA, contrary to MFDA Rules 3.5.1 and 2.1.1 and MFDA Policy No. 4;
- (b) ensure that W. H. Stuart maintained the minimum capital required of a Level 4 dealer, contrary to MFDA Rule 3.1.1;
- (c) segregate cash and other property of W. H. Stuart's clients from W. H. Stuart's own property, contrary to MFDA Rules 3.3 and 2.1.1 and MFDA Policy No. 4;

- (d) implement adequate internal controls, contrary to MFDA Rule 2.9; and
- (e) ensure accurate financial records were maintained by W. H. Stuart, contrary to MFDA Rule 5, MFDA Policy No. 4 and MFDA Rule 2.1.1.

Allegation #6: Commencing November 21, 2012, Howard Stuart failed to cooperate during the course of an investigation by failing to attend an interview requested by Staff to provide a statement and give information about the matters under investigation, contrary to section 22.1 of MFDA By-law No. 1 and MFDA Rule 2.1.1.

PARTICULARS

NOTICE is further given that the following is a summary of the facts alleged and intended to be relied upon by the MFDA at the hearing:

Registration Histories

W. H. Stuart

1. From 1986 until May 2013, W. H. Stuart was registered and carried on business as a mutual fund dealer in all Canadian provinces except Quebec. Between November 26, 1993 and August 15, 2000, W. H. Stuart was also registered in Ontario as a limited market dealer.
2. On March 26, 2003, W. H. Stuart became a Member of the MFDA.
3. On January 2, 2013, W. H. Stuart gave notice of its intention to resign from membership in the MFDA in connection with a proposed transaction for its acquisition.
4. On May 10, 2013, after a Hearing Panel made orders against W. H. Stuart and Dianne Stuart pursuant to s. 24.3 of MFDA By-law No. 1, an asset purchase agreement was signed with the approval of the MFDA and the applicable provincial securities commissions that resulted in

the transfer of W. H. Stuart's client accounts and Approved Persons to Keybase Financial Group Inc., another Member of the MFDA.

5. On May 31, 2013, on the basis of some of the allegations described in greater detail herein, a Hearing Panel of the MFDA made an order pursuant to s. 24.3 of MFDA By-law No. 1 suspending W. H. Stuart from membership in the MFDA and requiring W. H. Stuart and Dianne Stuart to, among other things, preserve and produce certain documents and information relevant to the allegations described in this proceeding.

6. At the time that W. H. Stuart was suspended, W. H. Stuart had approximately 18,800 client accounts and client assets under administration totaling \$583 million. During the period of its membership in the MFDA, W. H. Stuart had between 200 and 400 Approved Persons providing services to its clients.

Dianne Stuart

7. From July 10, 1986 to May 9, 2013, Dianne Stuart was registered as an officer of W. H. Stuart in all Canadian provinces except Quebec and Alberta.

8. On March 26, 2003, W. H. Stuart became a Member of the MFDA. As a consequence, Dianne Stuart became an Approved Person of W. H. Stuart subject to the jurisdiction of the MFDA. While an Approved Person of W. H. Stuart, Dianne Stuart was registered in the following categories:

- (a) from November 20, 2009 to May 9, 2013: in Ontario and Manitoba, as the Ultimate Designated Person ("UDP");
- (b) from September 28, 2009 to May 9, 2013: in Ontario, as a dealing representative; and
- (c) from March 4, 2003 to May 9, 2013: in Ontario, as a director;
- (d) from March 4, 2003 to May 9, 2013: in all provinces except Quebec and Alberta, as an officer;
- (e) on May 9, 2013, the above registrations were suspended.

9. At all material times, Dianne Stuart was the primary person who directed and controlled all of W. H. Stuart's operations and was the only Approved Person of W. H. Stuart with meaningful knowledge of, responsibility for, and final control over, W. H. Stuart's financial affairs and financial reporting. In addition to being the UDP, her most recent title at W. H. Stuart was "Officer Responsible for Operations".

10. As described in greater detail below, it is alleged that Dianne Stuart was the primary person responsible for the design, operation and control of the Note Program referenced in Allegation #1 of this Notice of Hearing.²

11. On May 9, 2013, after an MFDA Hearing Panel issued an interim order against Dianne Stuart and W. H. Stuart pursuant to s. 24.3 of MFDA By-law No. 1 that prohibited Dianne Stuart from dealing with the public, W. H. Stuart submitted a notice of termination on behalf of Dianne Stuart to the National Registration Database stating that Dianne Stuart was resigning as a dealing representative and as the UDP of W. H. Stuart. In response, the Ontario Securities Commission suspended Dianne Stuart as a registrant and she continues to be a suspended registrant under provincial securities legislation.

Howard Stuart

12. From July 10, 1986 to May 15, 2013, Howard Stuart was registered in Ontario as an officer and director of W. H. Stuart.

13. Commencing March 26, 2003 (the date of W. H. Stuart's membership in the MFDA), Howard Stuart became an Approved Person of W. H. Stuart subject to the jurisdiction of the MFDA and was registered in the following categories:

(a) from March 4, 2003 to May 15, 2013: in Ontario, as an officer and director; and

² The nature and extent of Howard Stuart's knowledge of, participation in, and control over the business and affairs of W. H. Stuart and, in particular, the Note Program could not be determined by MFDA Staff due, in part, to Howard Stuart's failure or refusal to cooperate with MFDA Staff's investigation, as set out in Allegation #6.

(b) from September 28, 2009 to May 15, 2013: in Ontario, as a dealing representative.

14. From September 2009 to May 2013, Howard Stuart held the title of President and Chief Executive Officer of W. H. Stuart.

15. Prior to May 15, 2013, Howard Stuart was also registered as an officer and director of W. H. Stuart in Alberta, British Columbia and Manitoba.

16. Since approximately 2006, Howard Stuart appears to have had limited involvement in the day-to-day management and operations of W. H. Stuart. Nonetheless, he remained a director and held the positions of President and Chief Executive Officer of W. H. Stuart and received substantial monthly payments from W. H. Stuart or related companies.³

17. Howard Stuart presently resides in California, U.S.A.

Other Companies

18. In addition to operating W. H. Stuart, Dianne Stuart and Howard Stuart set up and supported the operations of several other companies in Canada and the United States, including a Canadian insurance brokerage called W. H. Stuart Insurance Agency Ltd. (“Stuart Insurance”) and a computer software company called S21C Technologies (“S21C”). S21C developed a proprietary back office system used by W. H. Stuart and Stuart Insurance to record client information and transactions. Dianne Stuart, W. H. Stuart and Howard Stuart used the trade name “W. H. Stuart and Associates” on letterhead and documents from time to time. “W. H. Stuart and Associates” was a registered trade name of W. H. Stuart.

19. Since 1999, Dianne Stuart and Howard Stuart also financed the start-up of the family’s American companies, including Stuart Securities Corp., Stuart Mutuals, Stuart Financial Corporation and W. H. Stuart Insurance Agencies Inc. These companies were all incorporated in

³ Due to Howard Stuart’s failure to cooperate with Staff’s investigation, Staff was unable to determine the full particulars of the remuneration, payments or other benefits he may have received from W. H. Stuart or related companies.

the state of Georgia and may have been financed in part using money solicited by means of the Note Program described in Allegation #1 and the monies misappropriated (or unaccounted for) from clients' accounts, as described in Allegation #3.

20. In or around 2007, Dianne Stuart assumed primary responsibility for the operation of the Stuart family companies.

Allegation #1: The Note Program

21. Prior to working in the securities industry, Dianne Stuart and Howard Stuart were employed as high school teachers in Ontario. As former teachers, Dianne Stuart and Howard Stuart had established strong relationships with individuals who worked in the education sector and they targeted these individuals to become clients and Approved Persons of W. H. Stuart. Some of the senior compliance staff hired by Dianne Stuart and Howard Stuart were former teachers and principals and, in one case, a former Board of Education Superintendent.

22. Relying on advice received from Dianne Stuart, Howard Stuart and other Approved Persons of W. H. Stuart who were former educators, many retired educators elected to become clients of W. H. Stuart and to commute their pensions and transfer the proceeds to W. H. Stuart to be invested in mutual funds. These clients placed a high degree of trust and confidence in the Respondents and believed that the Respondents understood their personal circumstances and were committed to furthering their best interests.

23. Following the market downturn after September 11, 2001 and the beginning of a period of low interest rates, Dianne Stuart and W. H. Stuart began offering clients the opportunity to invest with "W. H. Stuart and Associates"⁴ in a "guaranteed investment" that purportedly guaranteed the principal amount invested and purportedly paid investors interest (usually 7% per year) (the "Note Program"). The Respondents did not disclose to investors how the money was to be used, why it was being solicited or constraints on their ability to repay investors.

⁴ As set out in paragraph 18 above, "W. H. Stuart and Associates" was a registered trade name of W. H. Stuart which was used on letterhead and documents from time to time.

24. In total, Dianne Stuart and W. H. Stuart solicited and obtained approximately \$6 million from more than 180 clients for investment in the Note Program. Investors in the Note Program understood, assumed or were led to believe by Dianne Stuart that the Note Program was a legitimate investment that W. H. Stuart was permitted to sell.

25. There is no evidence of any collateral or security of any kind supporting the investments in the Note Program in spite of the representations that it was a “guaranteed” investment.

26. The monies that Dianne Stuart and W. H. Stuart solicited and obtained from investors in the Note Program should have been deposited in the trust account of W. H. Stuart (if the Note Program had been a legitimate investment, which it was not). Dianne Stuart deposited the investors’ monies in other bank accounts that she controlled including, in particular, bank accounts of related companies.

27. All or substantially all of the monies remained within the possession and control of Dianne Stuart or companies that Dianne Stuart controlled and were used to sustain the operations of W. H. Stuart and related companies, or for the direct or indirect benefit of Dianne Stuart.

28. There is no evidence that any of the monies solicited from clients who participated in the Note Program were invested on their behalf. Dianne Stuart and W. H. Stuart have not repaid any of the monies to investors, except to the extent that they may have used some investors’ monies to purportedly make interest payments to other investors or they repaid a few clients who chose to redeem their investments. All of the monies otherwise remain unaccounted for.

29. Some investors who participated in the Note Program received a document entitled “Investment Agreement” that was usually signed by Dianne Stuart and which purported to set out the terms of their investment, including the following:

- (a) the principal amount invested;
- (b) a representation that the principal amount was guaranteed;
- (c) the annual interest rate (usually 7%);
- (d) the term of the investment, which was a minimum period of 1 year renewable at maturity; and

- (e) a statement to the effect that investors were required to provide advance written notice of a request to redeem their investment (usually specified in the agreement as between 60 days and 3 months).

30. Other investors in the Note Program did not receive documents evidencing the terms of their investments but were either verbally promised, or were led to believe, that they would receive interest payments at the rate of 7% to 10% per annum on monies that they held in cash in their investment accounts at W. H. Stuart. These investors were led to believe that their purported interest payments would be credited to their investment accounts on a regular basis.

31. Diane Stuart and W. H. Stuart have failed to repay or otherwise account for all or substantially all of the monies (approximately \$6 million) that they are known to have solicited from more than 180 clients who invested in the Note Program and have thereby:

- (a) failed to deal fairly, honestly and in good faith with the clients and engaged in conduct unbecoming a Member and Approved Person, contrary to MFDA Rule 2.1.1; and
- (b) engaged in personal financial dealings with the clients which gave rise to a conflict or potential conflict of interest between the interests of Diane Stuart and W. H. Stuart and the interests of the clients, which they failed to ensure was addressed by the exercise of responsible business judgment influenced only by the best interests of the clients, contrary to MFDA Rules 2.1.4 and 2.1.1.

Allegation #2: Concealment

32. Dianne Stuart created or facilitated the creation of the Note Program Records outside of W. H. Stuart which purported to record and report on the performance of the Note Program. She provided investors in the Note Program with electronic access to the Note Program Records for the purpose of allowing them to view the purported performance of their own investments. Some investors were provided with paper copies of these same records.

33. The Note Program Records that Dianne Stuart made available to investors falsely showed that their money was securely invested and held for their benefit by W. H. Stuart and that their investment was performing well.

34. For those investors who were led to believe that their interest payments would be credited to their investment accounts at W. H. Stuart, Dianne Stuart arranged for the Note Program Records to falsely show increases in the value of their investment each month to reflect the accumulation of interest to which they were purportedly entitled.

35. Some investors requested and received payments purporting to be the interest owing on their investment in the Note Program, rather than leaving the purported interest to accumulate in their investment account. In these cases, some or all of the interest payments were reflected, similar to the interest credits, in the Note Program Records made available to these investors.

36. The Note Program was not disclosed in the books and records that W. H. Stuart was required to maintain under MFDA By-laws, Rules and Policies, thus concealing information from the MFDA, securities regulators, and other parties such as W. H. Stuart's auditors. In fact, as set out in greater detail below, Dianne Stuart and W. H. Stuart went to great lengths to conceal the Note Program from MFDA Staff and other securities regulators and denied its existence in response to questioning by MFDA Staff.

37. Dianne Stuart maintained the electronic portion of the Note Program Records in an area of the S21C back office system that was separate and distinct from the books and records of W. H. Stuart. The existence of the Note Program Records was concealed from, and access to the area of the S21C back office system in which they were stored was not available to, the individuals who would ordinarily be entitled to access and review records for clients of W. H. Stuart, such as W. H. Stuart's dealing representatives, trade processing staff and compliance staff, and MFDA Staff and other regulators.

38. The Note Program was conceived of, operated and controlled primarily by Dianne Stuart. The existence of the Note Program was only known to those who invested in it and to a small number of Approved Persons, some of whom participated in it themselves and in some cases, often based upon direction or encouragement from Dianne Stuart, recommended it to clients.

39. Dianne Stuart used her ability to add, delete, manipulate and alter records maintained on the S21C back office system to create, maintain and conceal the Note Program Records, all of which enabled her to sustain the operation of the Note Program and report on its purported performance to investors while concealing its existence from W. H. Stuart staff and regulators.

40. No advertising, promotional or offering material about the Note Program was prepared or distributed and it was not referenced on W. H. Stuart's website or in other public sources of information.

41. Commencing in August 2008, Dianne Stuart hired an individual named DH, who was not an Approved Person, to contact clients of W. H. Stuart to solicit investments by them in the Note Program. Dianne Stuart provided DH with the contact details of clients for this purpose. Dianne Stuart targeted clients who did not have an Approved Person assigned to service their accounts for participation in the Note Program, thereby minimizing the likelihood that an Approved Person would question the propriety of the investment, raise concerns with W. H. Stuart compliance staff, or report the activity to regulators. Many of the investors in the Note Program were unsophisticated investors.

42. DH frequently attended at W. H. Stuart in the evening after normal business hours. Although individuals who worked at W. H. Stuart were aware that DH attended at the office and made phone calls from there, the nature of his activities and the reasons for his presence were not explained by Dianne Stuart to W. H. Stuart staff.

43. From time to time, Dianne Stuart also arranged for NS, who was also not an Approved Person, to contact current or prospective investors in the Note Program to discuss the Note Program with them and solicit investments. As with DH, Dianne Stuart provided NS with contact details of clients for this purpose. NS sometimes worked from an office at W. H. Stuart but his activities in connection with the Note Program were not disclosed by Dianne Stuart to W. H. Stuart staff.

44. In March and April, 2013 during the course of MFDA Staff's investigation of the matters described in Allegations #1 and #3, and at other times, Dianne Stuart:

- (a) refused to provide some of the information and documentation that MFDA Staff requested; and
- (b) directed computer technology staff responsible for the operation of the S21C System to, among other things:
 - i. alter files and records; and
 - ii. restrict access of Approved Persons and MFDA Staff to client records.

45. By engaging in the conduct described above, Dianne Stuart and W. H. Stuart actively concealed the activity regarding the Note Program from others at W. H. Stuart, external auditors, the MFDA and other regulators by:

- (a) deliberately not recording transactions and other information about the Note Program in the books and records of W. H. Stuart;
- (b) preparing records of the Note Program that were maintained separately from the records of W. H. Stuart (the Note Program Records) and actively concealed; and
- (c) falsifying, altering, concealing and withholding documents, information and records on the W. H. Stuart back office system;

contrary to MFDA Rule 5, MFDA Policy No. 4 and MFDA Rule 2.1.1.

Allegation #3: Misappropriation and failure to account for client investments and monies

46. In addition to failing to repay or account for the monies that were invested in the Note Program as described in Allegation #1 above, Dianne Stuart and W. H. Stuart also misappropriated or have otherwise failed to account for approximately \$800,000 of investments and monies from over 30 clients, those monies consisting of:

- (a) cash balances in client accounts at W. H. Stuart that were not returned to the clients;
- (b) proceeds of authorized redemptions that were not deposited in client accounts or paid to clients;

- (c) proceeds of unauthorized redemptions that were not deposited in client accounts or paid to clients;
- (d) monies that clients directed W. H. Stuart to transfer to other mutual fund dealers or financial institutions that W. H. Stuart did not transfer; and
- (e) amounts withheld from redemptions in client accounts to pay taxes owing in respect of the redemptions that were not remitted to the Canada Revenue Agency.

47. None of the over 30 clients whose accounts were affected by the actions described above authorized or approved of the transactions or activities that gave rise to the disappearance of the investments or monies from their accounts at W. H. Stuart. In the cases where a client's signature was required in order for Dianne Stuart to process unauthorized transactions in a client's account, Dianne Stuart used falsified signatures. She also used house account representative codes on transaction documents and never used her own name, signature or representative code on such documentation as a means of hiding or obfuscating her involvement.

48. In a few cases in which unauthorized transactions in client accounts came to the attention of clients or Approved Persons of W. H. Stuart and were questioned by them, Dianne Stuart directed all head office staff to refer such inquiries to her personally to be dealt with. In such cases, Dianne Stuart personally responded to the inquiries by contacting the individuals who reported the unauthorized transactions. She told such individuals that the unauthorized transactions had been processed in error and would be corrected. Dianne Stuart then took steps to restore the investment holdings of the affected clients.

49. Dianne Stuart and W. H. Stuart did not report the unauthorized transactions that were the subject of inquiries to W. H. Stuart's head office to the MFDA. Dianne Stuart did not inform the Chief Compliance Officer of W. H. Stuart or the compliance and trade processing staff of W. H. Stuart of the unauthorized transactions. Dianne Stuart and W. H. Stuart also did not treat the inquiries from the affected clients about the unauthorized transactions in their accounts as client complaints, contrary to the requirements of MFDA Policy No. 6. As a consequence, there was no written record of the unauthorized transactions created by W. H. Stuart for review by either W. H. Stuart compliance staff or by MFDA Staff.

50. By engaging in the conduct described above, Dianne Stuart and W. H. Stuart misappropriated or have otherwise failed to account for approximately \$800,000 of client investments and monies from over 30 clients, contrary to MFDA Rules 2.1.1 and 2.3.1.

Client losses relating to Allegations #1 and #3

51. Persons claiming to be clients have submitted claims to the MFDA Investor Protection Corporation seeking compensation for monies they invested in the Note Program (Allegation #1) or for investments and monies held in their accounts at W. H. Stuart which Dianne Stuart and W. H. Stuart misappropriated or have failed to account for (Allegation #3).

52. As of November 27, 2014, the MFDA Investor Protection Corporation has paid out approximately \$6.8 million to more than 200 clients in respect of those claims.

Allegation #4: Failure to Comply with Order (Dianne Stuart)

53. On April 29, 2013, MFDA Staff commenced an application pursuant to s.24.3 of MFDA By-Law No. 1 on an ex parte basis to obtain interim orders against Dianne Stuart and W. H. Stuart for the purpose of, among other things, suspending the authority of Dianne Stuart to have dealings with the public, engage in complaint handling or play an active role in the banking and financial operations of W. H. Stuart and to avoid further deterioration of W. H. Stuart's financial position and preserve certain documents and records relevant to the matters under investigation. Subsequent appearances before the Hearing Panel took place on notice to Dianne Stuart and W. H. Stuart on May 10, 2013, May 22, 2013 and May 31, 2013.

54. During attendances before the Hearing Panel in April and May 2013, MFDA Staff sought orders to prevent further non-compliance with regulatory requirements by Dianne Stuart and W. H. Stuart that could result in further client harm.

55. On May 6, 2013, during an interview with MFDA Staff that was conducted pursuant to the April 29, 2013 Order of the Hearing Panel, Dianne Stuart downplayed the nature, extent and

scope of the Note Program, falsely asserting that it had not been offered to very many clients and had been discontinued “some time ago”.

56. During the May 6, 2013 interview, Dianne Stuart also provided false and misleading answers to questions about the unauthorized redemptions that had been processed in client accounts and had come to the attention of MFDA Staff by the time of that interview.

57. Contrary to the terms of the Orders made by the Hearing Panel between April 29, 2013 and May 31, 2013:

- (a) Dianne Stuart and W. H. Stuart continued to transfer money between bank accounts of W. H. Stuart and bank accounts of related companies like Stuart Insurance, without the prior written consent of MFDA Staff;
- (b) Dianne Stuart and W. H. Stuart failed to produce a complete list of the bank accounts belonging to related companies and also failed to produce a complete set of deposit books for Stuart Insurance;
- (c) Dianne Stuart continued to access the S21C back office system;
- (d) Dianne Stuart maintained her signing authority over the bank accounts of W. H. Stuart and did not discontinue her role in the banking transactions of W. H. Stuart;
- (e) Dianne Stuart continued to process transactions in the bank accounts of Stuart Insurance;
- (f) Dianne Stuart did not provide MFDA Staff with the authorization or electronic passwords required to obtain access to the on-line banking records of W. H. Stuart and Stuart Insurance;
- (g) Dianne Stuart did not provide MFDA Staff with a list of all amounts deposited into a bank account of Stuart Insurance after January 2009 that constituted proceeds from investments held by clients or former clients of W. H. Stuart; and
- (h) Dianne Stuart failed to provide complete answers to undertakings that she gave during her interview with Staff on May 6, 2013.

58. Some of Dianne Stuart’s contraventions of the orders of the Hearing Panel came to MFDA Staff’s attention after W. H. Stuart was suspended on May 31, 2013.

59. By engaging in the conduct described above, Dianne Stuart and W. H. Stuart failed to comply with interim orders made by a Hearing Panel of the MFDA with respect to the preservation and production of documents and information relevant to the matters under investigation, contrary to section 22.1 of MFDA By-law No. 1 and MFDA Rule 2.1.1.

Allegation #5: Financial compliance deficiencies

60. W. H. Stuart, as a Level 4 Dealer, was required to have and maintain at all times risk adjusted capital (“RAC”) greater than zero and minimum capital in the amount of at least \$200,000 calculated in accordance with Form 1, pursuant to MFDA Rule 3.1.1.

61. Pursuant to MFDA Rule 3.5.1, W. H. Stuart was also required to file with the MFDA:

- (a) financial reports (the “Form 1”) on a monthly basis; and
- (b) two copies of its audited Form 1 on an annual basis.

62. Between 2004 and 2013, W. H. Stuart failed to disclose any of the liabilities associated with the Note Program on the Form 1’s and annual audited Form 1’s that it filed with the MFDA pursuant to MFDA Rule 3.5.1. Furthermore, the liability owed to investors as a result of the Note Program was not shown on any financial records that were available to regulators or auditors of W. H. Stuart and information about the scope and terms of the Note Program was not disclosed to regulators or auditors of W. H. Stuart.

63. As stated in paragraph 9 above, at all material times, Dianne Stuart directed and controlled all of W. H. Stuart’s operations and was the only Approved Person of W. H. Stuart with meaningful knowledge of, responsibility for, and final control over, W. H. Stuart’s financial affairs and financial reporting.

64. The Certificates relating to the more recent monthly Form 1’s filed by W. H. Stuart were signed by Dianne Stuart and the Chief Compliance Officer of W. H. Stuart. They also signed the Certificate which accompanied the last audited Form 1 filed by W. H. Stuart with the MFDA for its year ended October 31, 2012.

65. Certificates relating to earlier monthly Form 1's and earlier annual audited Form 1's filed by W. H. Stuart with the MFDA were signed by Dianne Stuart and Howard Stuart.

66. Dianne Stuart knew or ought to have known that if the liabilities associated with the Note Program were taken into account when calculating W. H. Stuart's financial position, it would have been apparent that W. H. Stuart was not maintaining the minimum capital required of a Level 4 dealer. In fact, if the liabilities associated with the Note Program had been reported to the MFDA, W. H. Stuart would have been substantially capital deficient on a consistent basis.

67. Dianne Stuart also concealed the existence of the liabilities associated with the Note Program from W. H. Stuart's auditors. As a consequence, the liabilities were not disclosed on the audited Form 1's that W. H. Stuart filed annually with the MFDA.

68. At all material times, MFDA Rule 3.1.2 provided that if, at any time, the RAC of a Member is, to the knowledge of the Member, less than zero, the Member shall immediately notify the MFDA. Dianne Stuart and W. H. Stuart deliberately concealed the liabilities associated with the Note Program and failed to report W. H. Stuart's capital deficiency to the MFDA contrary to Rule 3.1.2, in order to avoid:

- (a) at a minimum, the requirements and restrictions that would have been imposed on W. H. Stuart by MFDA Staff pursuant to MFDA Rule 3.4.2(b) and potentially also restrictions imposed pursuant to MFDA Rule 3.4.3 as a result of being designated in early warning;
- (b) any additional measures that MFDA Staff would have taken to reduce the risk of an insolvency and protect the interests of clients and other creditors of the Member; and
- (c) other possible regulatory measures, such as the suspension or termination of W. H. Stuart's membership and/or the appointment of a Monitor, that would have resulted from the disclosure of its precarious financial position.

69. Even while it was not reporting the liabilities associated with the Note Program, W. H. Stuart was still designated in early warning from time to time by MFDA Staff in recent

years and still rarely maintained RAC that significantly exceeded its minimum capital requirements.

70. Dianne Stuart and W. H. Stuart also failed to take any steps to segregate the client monies received in respect of the Note Program, deliberately commingled those monies with monies in the accounts of related companies, like Stuart Insurance, and allowed Dianne Stuart to use the monies and transfer the monies to bank accounts under her control, contrary to MFDA Rule 3.3.2.

71. As described above, Dianne Stuart and W. H. Stuart engaged in conduct to conceal their activity from other W. H. Stuart staff, external auditors, the MFDA and other regulators, such that MFDA Staff was unable to determine the true state of W. H. Stuart's financial position and assess its compliance with MFDA requirements during the period 2004 to 2013.

72. By engaging in the conduct described above, Dianne Stuart and W. H. Stuart failed to:

- (a) file accurate and complete monthly Form 1's and annual audited Form 1's for W. H. Stuart with the MFDA, contrary to MFDA Rules 3.5.1 and 2.1.1 and MFDA Policy No. 4;
- (b) ensure that W. H. Stuart maintained the minimum capital required of a Level 4 dealer, contrary to MFDA Rule 3.1.1;
- (c) segregate cash and other property of W. H. Stuart's clients from W. H. Stuart's own property, contrary to MFDA Rules 3.3 and 2.1.1 and MFDA Policy No. 4;
- (d) implement adequate internal controls, contrary to MFDA Rule 2.9; and
- (e) ensure accurate financial records were maintained by W. H. Stuart, contrary to MFDA Rule 5, MFDA Policy No. 4 and MFDA Rule 2.1.1.

Allegation #6: Failure to Cooperate (Howard Stuart)

73. Prior to May 15, 2013, Howard Stuart held the title of President and Chief Executive Officer of W. H. Stuart and remained registered as an officer and director of W. H. Stuart. He also received substantial monthly payments from W. H. Stuart or related companies.

74. On February 6, 2012, MFDA Staff received a written statement purportedly signed by Howard Stuart denying that W. H. Stuart, its related or affiliated entities or principals had entered into investment or lending arrangements with any clients of W. H. Stuart or other individuals whether by promissory note, investment certificate, loan arrangement or other type of transaction.

75. On November 21, 2012, Staff sent a letter to counsel for W. H. Stuart requesting among other things that by Wednesday, November 28, 2012, Howard Stuart agree to attend an interview with MFDA Enforcement Staff on or before December 12, 2012.

76. By letter dated November 27, 2012, counsel for W. H. Stuart informed MFDA Staff that Howard Stuart had suffered a heart attack and had withdrawn from full time employment. Counsel indicated that Howard Stuart was travelling out of the country and was not expected to return to Toronto for some time. Counsel offered to inform MFDA Staff when he was next expected in Toronto.

77. Subsequently, MFDA Staff learned that Howard Stuart had not resided in Toronto for several years and presently resides in California.

78. On November 7, 2013, MFDA Staff sent a letter to Howard Stuart at his residential address in California requesting his attendance at an interview with Staff to answer questions in connection with the investigation of W. H. Stuart.

79. On November 26, 2013, MFDA Staff received a responding letter from Howard Stuart in which he asserted that he would be unable to attend an interview with Staff.

80. By letter dated December 11, 2013, MFDA Staff offered to conduct an electronic interview with Howard Stuart so that he would not have to travel to Toronto to attend in person.

81. On December 31, 2013, MFDA Staff received a second letter from Howard Stuart in which he agreed to participate in an interview provided MFDA Staff first disclosed to him certain information that had been gathered during the investigation.

82. By letter dated January 6, 2014, MFDA Staff reiterated its request to Howard Stuart for a date when he would participate in an electronic interview with Staff.

83. On January 15, 2014, MFDA Staff received another letter from Howard Stuart in which he expressed his willingness to co-operate with the investigation but he did not provide a date on which he agreed to be interviewed.

84. On January 17, 2014, MFDA Staff informed Howard Stuart that MFDA Staff intended to interview him on February 7, 2014.

85. Howard Stuart did not respond to MFDA Staff's January 17, 2014 letter and did not participate in an interview with MFDA Staff on February 7, 2014.

86. Although he has acknowledged MFDA Staff's attempts to contact him during the course of its investigation, Howard Stuart has not attended an interview or facilitated his participation in an interview to provide a statement and give information about the matters under investigation.

87. By reason of Howard Stuart not cooperating with MFDA Staff's investigation, MFDA Staff was unable to determine if Howard Stuart, identified as the President and Chief Executive Officer and as a director of W. H. Stuart, knowingly participated in or benefited from the Note Program and the other alleged misconduct, allowed such misconduct to proceed or was indifferent to it proceeding, failed to fulfill his duties as a senior officer and director through incompetence or neglect, or simply abdicated his duties entirely.

88. By failing to attend an interview to provide a statement and give information respecting the matters under investigation, Howard Stuart failed to cooperate with an investigation, contrary to section 22.1 of MFDA By-law No. 1 and MFDA Rule 2.1.1.

NOTICE is further given that the Respondent shall be entitled to appear and be heard and be represented by counsel or agent at the hearing and to make submissions, present evidence and call, examine and cross-examine witnesses.

NOTICE is further given that MFDA By-laws provide that if, in the opinion of the Hearing Panel, the Respondent:

- has failed to carry out any agreement with the MFDA;
- has failed to comply with or carry out the provisions of any federal or provincial statute relating to the business of the Member or of any regulation or policy made pursuant thereto;
- has failed to comply with the provisions of any By-law, Rule or Policy of the MFDA;
- has engaged in any business conduct or practice which such Regional Council in its discretion considers unbecoming or not in the public interest; or
- is otherwise not qualified whether by integrity, solvency, training or experience,

the Hearing Panel has the power to impose any one or more of the following penalties:

- (a) a reprimand;
- (b) a fine not exceeding the greater of:
 - (i) \$5,000,000.00 per offence; and
 - (ii) an amount equal to three times the profit obtained or loss avoided by such person as a result of committing the violation;
- (c) suspension of the authority of the person to conduct securities related business for such specified period and upon such terms as the Hearing Panel may determine;
- (d) revocation of the authority of such person to conduct securities related business;

- (e) prohibition of the authority of the person to conduct securities related business in any capacity for any period of time;
- (f) such conditions of authority to conduct securities related business as may be considered appropriate by the Hearing Panel;

NOTICE is further given that the Hearing Panel may, in its discretion, require that the Respondent pay the whole or any portion of the costs of the proceedings before the Hearing Panel and any investigation relating thereto.

NOTICE is further given that the Respondent must **serve a Reply** on Enforcement Counsel and **file a Reply** with the Office of the Corporate Secretary within twenty (20) days from the date of service of this Notice of Hearing.

A **Reply** shall be **served** upon Enforcement Counsel at:

Mutual Fund Dealers Association of Canada
121 King Street West, Suite 1000
Toronto, Ontario
M5H 3T9
Attention: Shelly Feld
Fax: 416-361-9073
Email: sfeld@mfd.ca

A **Reply** shall be **filed** by:

- (a) providing 4 copies of the **Reply** to the Office of the Corporate Secretary by personal delivery, mail or courier to:

The Mutual Fund Dealers Association of Canada
121 King Street West, Suite 1000
Toronto, Ontario
M5H 3T9
Attention: Office of the Corporate Secretary; or

- (b) transmitting 1 copy of the **Reply** to the Office of the Corporate Secretary by fax to fax number 416-361-9781, provided that the Reply does not exceed 16 pages, inclusive of the covering page, unless the Office of the Corporate Secretary permits otherwise; or

- (c) transmitting 1 electronic copy of the **Reply** to the Corporate Secretary by e-mail at corporatesecretary@mfd.ca.

A **Reply** may either:

- (i) specifically deny (with a summary of the facts alleged and intended to be relied upon by the Respondent, and the conclusions drawn by the Respondent based on the alleged facts) any or all of the facts alleged or the conclusions drawn by the MFDA in the Notice of Hearing; or
- (ii) admit the facts alleged and conclusions drawn by the MFDA in the Notice of Hearing and plead circumstances in mitigation of any penalty to be assessed.

NOTICE is further given that the Hearing Panel may accept as having been proven any facts alleged or conclusions drawn by the MFDA in the Notice of Hearing that are not specifically denied in the **Reply**.

NOTICE is further given that if the Respondent fails:

- (a) to **serve** and **file** a **Reply**; or
- (b) attend at the hearing specified in the Notice of Hearing, notwithstanding that a **Reply** may have been served,

the Hearing Panel may proceed with the hearing of the matter on the date and the time and place set out in the Notice of Hearing (or on any subsequent date, at any time and place), without any further notice to and in the absence of the Respondent, and the Hearing Panel may accept the facts alleged or the conclusions drawn by the MFDA in the Notice of Hearing as having been proven and may impose any of the penalties described in the By-laws.

END.

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