Re Worldsource Securities

IN THE MATTER OF:

The Rules of the Investment Industry Regulatory Organization of Canada

and

Worldsource Securities Inc.

2018 IIROC 48

Investment Industry Regulatory Organization of Canada
Hearing Panel (Ontario District)

Heard: December 19, 2018 in Toronto, Ontario
Decision: December 19, 2018
Reasons: December 27, 2018

Hearing Panel:
Paul M. Moore Q.C., Chair, Peter Gribbin, and Jane Waechter
Appearance:
Robert DelFrate, Enforcement Counsel
David Di Paolo and Veronica Sajolin for Worldsource Securities Inc.
Worldsource Securities Inc.

ACCEPTANCE OF SETTLEMENT AGREEMENT

Settlement Agreement

¶ 1 The panel accepted a Settlement Agreement dated November 23, 2018 between Staff of IIROC and Worldsource Securities Inc. (the "Respondent").

¶ 2 The Settlement Agreement is attached to these reasons.

Facts

¶ 3 The agreed facts are set out in Part III of the Settlement Agreement.

¶ 4 The salient facts relate to two separate contraventions and may be summarized as follows.

¶ 5 First, 236 clients of the Respondent were charged excess fees of $148,904.40 when they should not have been. This was a result of the Respondent relying on a manual process, which failed to achieve its objective, requiring advisors to inform the Respondent if certain funds were to be excluded from annual fee charges and related matters.

¶ 6 Secondly, the disclosure of an actual or potential conflict of interest arising out of the compensation structure of a new mutual fund-like exempt fund was inadequate. The conflict of interest related to a Registered Representative (who was the innovator, fund advisor, and/or portfolio manager of the fund) offered to clients on a prospectus-exempt basis. Although the various fees and potential economic benefit to the Registered Representative were disclosed in various documents such as the term sheet, and/or a fee-based account agreement, the cumulative impact of a management fee, performance fee, and annual fee may not have been

clearly understood by investors.

Contraventions

¶ 7 The Respondent admitted in the Settlement Agreement to two contravention of IIROC's Rules:

i) between January 2010 and January 2017, it failed to establish and maintain a system of internal controls and supervision reasonably designed to achieve compliance with IIROC requirements, including the requirement to deal fairly with clients with regard to fees, contrary to Dealer Member Rules 38.1 and 2500; and

ii) between April 2013 and November 2015, it failed to take reasonable steps to identify and address an existing and potential material conflict of interest, contrary to Dealer Member Rule 42.

Agreed Penalty

¶ 8 The agreed penalty and costs set out in the Settlement Agreement are:

i) a fine of $100,000 broken down as follows:

a) $50,000 for contravention (i); and

b) $50,000 for contravention (ii): and

ii) Costs of $5,000.

Three Considerations

¶ 9 The panel determined that before it could accept the Settlement Agreement it had to be satisfied regarding three key considerations. First, the agreed penalty had to strike a reasonable balance between fairness to the Respondent in the circumstances and the need to protect the investing public, industry membership, the integrity of the disciplinary process, and the integrity of the securities markets. Secondly, the agreed penalty had to provide an adequate deterrent against future violations by the Respondent and by others in the industry in similar circumstances. Thirdly, and closely connected to the first two considerations, the agreed penalty had to fall within a reasonable range of appropriateness when compared to penalties in similar cases in comparable circumstances.

Decision

¶ 10 The panel concluded that the agreed penalty met all three considerations and, therefore, the panel accepted the Settlement Agreement.

¶ 11 The panel also concluded that the costs were within the range of reasonableness when compared to similar cases.

Analysis

¶ 12 The panel concluded that the admitted conduct did constitute violations of the referenced Rules.

¶ 13 The panel heard Staff's oral argument as to why it should accept the Settlement Agreement, and reviewed and agreed with Staff's written submission. We reviewed the IIROC Sanction Guidelines referred to by Staff. We also reviewed the precedent cases submitted to us by Staff.

¶ 14 We noted in particular the number of clients affected and the dollar amounts in the Settlement Agreement and in the precedent cases.

¶ 15 We also noted several mitigating factors mentioned in the Settlement Agreement, including the fact that the Respondent voluntarily developed and implemented a remedial plan relating to the first violation which will make the clients whole and which should prevent a recurrence of the violation.

¶ 16 Also, the deficient disclosure of the conflict of interest relating to the second violation was rectified, as

particularized in the Settlement Agreement, in November 2015. Furthermore, in November 2016, the Registered Representative ceased to be sponsored by the Respondent and the Respondent ceased to be the fund manager of the fund. No clients of the Respondent currently hold units of the fund.

Conclusion

¶ 17 The agreed penalty was consistent with the suggestions in the IIROC Sanction Guidelines and the precedent cases submitted to us by Staff.

¶ 18 It was in the public interest to accept the Settlement Agreement.

Dated at Toronto, Ontario this 27th day of December, 2018.

Paul Moore

Peter Gribbin

Jane Waechter

SETTLEMENT AGREEMENT

PART I – INTRODUCTION

1. The Investment Industry Regulatory Organization of Canada ("IIROC") will issue a Notice of Application to announce that it will hold a settlement hearing to consider whether, pursuant to Section 8215 of the Consolidated Enforcement, Examination and Approval Rules of IIROC, a hearing panel ("Hearing Panel") should accept the settlement agreement ("Settlement Agreement") entered into between the staff of IIROC ("Staff") and Worldsource Securities Inc. ("Respondent").

PART II – JOINT SETTLEMENT RECOMMENDATION

2. Staff and the Respondent jointly recommend that the Hearing Panel accept this Settlement Agreement in accordance with the terms and conditions set out below.

PART III – AGREED FACTS

3. For the purposes of this Settlement Agreement, the Respondent agrees with the facts as set out in Part III of this Settlement Agreement

Overview

4. The Respondent is a Dealer Member of IIROC with its head office located in Markham Ontario.

5. Between January 2010 and December 2016, certain clients of the Respondent (the "Clients") who were enrolled in a fee based program with the Respondent either purchased new mutual funds or continued to hold mutual funds which had additional fees paid to the Respondent. As a result, the Clients paid higher fees than they should have (the "Excess Fees"). In total, 236 Client accounts were charged $148,904.40 in Excess Fees.

6. In addition, beginning in 2012, the Respondent offered a proprietary fund to clients without ensuring that the disclosure to clients of an existing and potential material conflict of interest between the interests of the Respondent and one of its Approved Persons and the interests of clients was adequate. The conflict was ultimately addressed appropriately by way of enhanced disclosure to clients in November 2015.

Control and Supervision Failures

(i) The Fee-Based Accounts

7. The Respondent offered fee-based accounts (the "Fee-Based Accounts") to its clients.

8. The Respondent relied on a manual process requiring advisors to inform the Respondent if certain funds were to be excluded from the annual fee (the "Annual Fee") calculation. In order to begin the exclusion process, advisors were required to inform the Respondent of a mutual fund with an embedded compensation.

9. In several instances, funds with embedded compensation were not excluded from the Annual Fee calculation, resulting in clients paying excess fees to the benefit of the Respondent and its advisors.

10. In total, between January 2010 and December 2016, Clients in 236 Fee-Based Accounts paid Excess Fees of $148,904.40 to the Respondent.

(ii) Remedial Steps Taken by the Respondent

11. In 2015, IIROC's Business Conduct Compliance department conducted an examination of the Respondent (the "BCC Examination") and identified instances in which funds with embedded compensation were not excluded from the Annual Fee calculation.

12. As a result of the issues identified by the BCC Examination, the Respondent undertook to identify the full extent of the issue and number of clients affected.

13. In or around June 2018, the Respondent voluntarily developed and implemented a compensation plan satisfactory to IIROC Staff to address the Excess Fees charged. Specifically, the Respondent has undertaken to:

    a) Advise all Clients in writing of Excess Fees charged to and paid by them;

    b) Reimburse all Clients with an amount owing greater than $10.00 via a transfer to each client's bank account;

    c) For amounts owing that are less than $10.00 and for any Clients whom the Respondent is unable to locate, the Respondent will make a donation of the aggregate amount to a local charity. As at November 2, 2018, that amount was $72.76; and

    d) The Respondent will provide regular reports to IIROC Staff detailing the progress with respect to the implementation of the compensation plan and notifying Staff once the compensation plan is complete.

14. The compensation plan is anticipated to be complete by December 15, 2018. The Respondent began paying compensation to the Clients beginning the week of September 24, 2018 and as at November 2, 2018, $126,556.70 has been deposited into Clients' bank accounts or investment accounts; $22,247.70 is outstanding.

15. In addition, in January 2017, the Respondent implemented revised internal policies to ensure similar issues do not arise for clients invested in Fee-Based Accounts. These revised policies include a monthly review of products held in Fee-Based Accounts to ensure that these are properly excluded from the Annual Fee calculation.

The Conflict of Interest

(i) The Launch of the Entrepreneur's Fund

16. In or around late 2012, a registered representative (the "RR") of the Respondent proposed establishing a new mutual fund-like product for which he would be the fund advisor and/or portfolio manager.

17. In or around April 2013, the Respondent launched the Entrepreneur's Fund, an open ended trust with a mandate to "invest directly in securities of small, medium and large companies, both public and private, as well as alternative investments [such as hedge funds and private equity vehicles], exchange-traded funds ("ETFs"), and mutual funds. It is anticipated that the Fund will generally invest 10% in private equity and up to 40% of its assets in alternative investments such as hedge funds."

18. Units of the Entrepreneur's Fund were only available to accredited investors, as defined in National Instrument 45-106 or to non-accredited investors who were prepared to invest a minimum of $150,000.

19. In total, accredited or otherwise eligible clients invested approximately $20 Million in units of the Entrepreneur's Fund. At the time of investment, clients were provided a two page confidential term sheet (the "Term Sheet") and a Subscription Agreement outlining key features of the units of the Entrepreneur's Fund, including the fund's investment objective and strategy. The Term Sheet also listed some of the fees associated with an investment in units of the Entrepreneur's Fund.

(ii) The Fees

20. The Entrepreneur's Fund paid to the Respondent, as Fund Manager, an annual management fee (the "Management Fee") equal to 60 basis points of the net asset value ("NAV") of the fund, of which 50 basis points was paid to the RR as the Fund Advisor. In addition, as the Fund Advisor, the RR was entitled to a performance fee (the "Performance Fee") of 10% of the annual increase in the NAV of the fund, subject to a high water mark. The Respondent received 15% of all fees paid to the RR.

21. Clients who invested in the Entrepreneur's Fund did so primarily in their Fee-Based Accounts. As is typical in fee-based account arrangements, investors in the Fee-Based Accounts pay an annual account fee as well as bear the indirect costs of the investment funds in which they invest. As such, clients who invested in the Entrepreneur's Fund indirectly bore the expense of the Management Fee and Performance Fee, and also paid the Annual Fee.

22. The roles and responsibilities of the Respondent, as Fund Manager, and the RR, as Fund Advisor, were described in the Term Sheet. Further, the Management Fee and the Performance Fee were disclosed in the Term Sheet. Although the Management and Performance Fees were disclosed in the Term Sheet, the Annual Fee was only disclosed to clients in their Fee-Based Account agreement completed at the time their accounts were initially opened or updated. As such, the cumulative impact of the Management Fee, Performance Fee and Annual Fee may not have been clearly understood by clients who invested in the Entrepreneur's Fund.

23. The compensation structure of the Entrepreneur's Fund created an actual or potential conflict of interest in that the Respondent and the RR might receive economic benefits by recommending the fund which paid the Management Fee and Performance Fee in lieu of other equally suitable investment products. The Annual Fee did not create a conflict of interest.

24. Although this actual or potential conflict of interest was identified by the Respondent prior to the Entrepreneur's Fund being offered to clients, and although the compensation arrangement forming the subject matter of the conflict of interest was disclosed in the Term Sheet, the disclosure to clients of this actual or potential conflict of interest was not sufficient until such disclosure was rectified in November 2015, as particularized below.

25. In total, between January 2014 and November 2015, the Respondent and the RR received total Management Fees of $219,960 and total Performance Fees of $359,125, in addition to the Annual Fees. The Respondent's portion of the Management and Performance Fees totaled approximately $87,000.

(iii) Disclosure of Conflict of Interest to Unitholders

26. In November 2015, the Respondent issued a notice to unitholders of the Entrepreneur's Fund advising of amendments to the trust agreement and term sheet. Specifically, changes were made to reflect:

    a) A change in the investment strategy;

    b) A change to the investment restrictions;

    c) A decrease in the Management Fee; and

    d) The inclusion of a conflict of interest disclosure statement (the "Conflict Disclosure

Statement").

27. The decrease in the Management Fee eliminated the 50 basis point payment that was being made to the RR in his role as Fund Advisor.

28. The Conflict Disclosure Statement clarified the fees being paid by unitholders of the Entrepreneur's Fund, and included a more detailed explanation of the Management Fee, Performance Fee and Annual Fee.

29. The Conflict Disclosure Statement noted that the "compensation structure of the Fund reflects a perceived conflict of interest, in that [the RR] may receive economic benefits by recommending the Fund to you in lieu of other equally suitable investment products."

30. This was the first clear disclosure to unitholders of the existence of a conflict or potential conflict of interest between the Respondent, the RR and the unitholders of the Entrepreneur's Fund.

31. In November 2016, the RR ceased to be sponsored by the Respondent and the Respondent ceased to be the Fund Manager at that time. No clients of the Respondent currently hold units of the Entrepreneur's Fund.

32. Investments in the Entrepreneur's Fund were profitable and no client complaints were received by the Respondent. No investors in the Entrepreneur's Fund were subject to Excess Fees as outlined in paragraphs 5-10 above.

33. All investments in the Entrepreneur's Fund were also suitable for the clients based on their stated investment objectives and risk tolerances.

Mitigating and Other Factors

34. The Respondent has voluntarily developed and is implementing a remediation plan, the terms of which include:

    a) compensation paid to clients as particularized in paragraphs 12 to 15 above;

    b) for those clients who have left the Respondent, the Respondent will work with the advisor in order to locate the client, and will use other means such as Internet searches and the employment of third party tracers for any client who is owed more than $200;

    c) for those clients who are deceased, the Respondent will make best efforts to locate the estate of the representative in order to ensure that the appropriate amount is reimbursed to the estate of the deceased client; and

    d) for amounts owing that are less than $10 in total, and for any clients who cannot be located, the aggregate amount will be donated to a local charity.

35. The Respondent has also implemented a new procedure, effective as of January 1, 2017, to ensure that Fee-Based Accounts exclude products with embedded fees, trailers or commissions.

36. The Respondent has spent a significant amount of time and effort to develop a remediation plan and new procedures for Fee-Based Accounts. Further, there is no ongoing harm to investors.

PART IV – CONTRAVENTIONS

37. By engaging in the conduct described above, the Respondent committed the following contraventions of IIROC's Rules:

    (i) Between January 2010 and January 2017, the Respondent failed to establish and maintain a system of internal controls and supervision reasonably designed to achieve compliance with IIROC requirements, including the requirement to deal fairly with clients with regard to fees, contrary to Dealer Member Rules 38.1 and 2500.

    (ii) Between April 2013 and November 2015, the Respondent failed to take reasonable steps to identify

and address an existing and potential material conflict of interest, contrary to Dealer Member Rule 42.

PART V – TERMS OF SETTLEMENT

38. The Respondent agrees to the following sanctions and costs:

    a) A fine in the amount of $100,000, broken down as follows:

        i. $50,000 with respect to contravention (i); and

        ii. $50,000 with respect to contravention (ii).

    b) Costs in the amount of $5,000.

39. If this Settlement Agreement is accepted by the Hearing Panel, the Respondent agrees to pay the amounts referred to above within 30 days of such acceptance unless otherwise agreed between Staff and the Respondent.

PART VI – STAFF COMMITMENT

40. If the Hearing Panel accepts this Settlement Agreement, Staff will not initiate any further action against the Respondent in relation to the facts set out in Part III and the contraventions in Part IV of this Settlement Agreement, subject to the provisions of the paragraph below.

41. If the Hearing Panel accepts this Settlement Agreement and the Respondent fails to comply with any of the terms of the Settlement Agreement, Staff may bring proceedings under Rule 8200 against the Respondent. These proceedings may be based on, but are not limited to, the facts set out Part III of this Settlement Agreement.

PART VII – PROCEDURE FOR ACCEPTANCE OF SETTLEMENT

42. This Settlement Agreement is conditional on acceptance by the Hearing Panel.

43. This Settlement Agreement shall be presented to a Hearing Panel at a settlement hearing in accordance with the procedures described in Sections 8215 and 8428, in addition to any other procedures that may be agreed upon between the parties.

44. Staff and the Respondent agree that this Settlement Agreement will form all of the agreed facts that will be submitted at the settlement hearing, unless the parties agree that additional facts should be submitted at the settlement hearing. If the Respondent does not appear at the settlement hearing, Staff may disclose additional relevant facts, if requested by the Hearing Panel.

45. If the Hearing Panel accepts the Settlement Agreement, the Respondent agrees to waive all rights under the IIROC Rules and any applicable legislation to any further hearing, appeal and review.

46. If the Hearing Panel rejects the Settlement Agreement, Staff and the Respondent may enter into another settlement agreement or Staff may proceed to a disciplinary hearing based on the same or related allegations.

47. The terms of this Settlement Agreement are confidential unless and until this Settlement Agreement has been accepted by the Hearing Panel.

48. The Settlement Agreement will become available to the public upon its acceptance by the Hearing Panel and IIROC will post a full of copy of this Settlement Agreement on the IIROC website. IIROC will also publish a summary of the facts, contraventions, and the sanctions agreed upon in this Settlement Agreement.

49. If this Settlement Agreement is accepted, the Respondent agrees that neither it nor anyone on its behalf, will make a public statement inconsistent with this Settlement Agreement.

50. The Settlement Agreement is effective and binding upon the Respondent and Staff as of the date of its

acceptance by the Hearing Panel.

PART VIII – EXECUTION OF SETTLEMENT AGREEMENT

51. This Settlement Agreement may be signed in one or more counterparts which together will constitute a binding agreement.

52. A fax or electronic copy of any signature will be treated as an original signature.

DATED this "23rd" day of "November", 20"18".

"Witness"	"Worldsource Securities Inc."
Witness	Respondent
"Avinash Joshi"	"Rob DelFrate"
Witness	[EC Name] Enforcement Counsel on behalf of Enforcement Staff of the Investment Industry Regulatory Organization of Canada

The Settlement Agreement is hereby accepted this "19th" day of "December", 20"18" by the following Hearing Panel:

Per: "Paul Moore"
Panel Chair

Per: "Peter Gribbin"
Panel Member

Per: "Jane Waechter"
Panel Member