

October 17, 2018

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Dear Sirs and Madam,

RE: Client Focused Reforms Proposed Amendments to National Instrument 31- 103 and Companion Policy 31-103CP (the “Paper”)

Worldsource Wealth Management Inc. (Worldsource) thanks the CSA for the opportunity to provide comments on this Paper and commends the CSA for the thought process undertaken specifically with respect to Know Your Product (KYP), Suitability and Know Your Client (KYC) requirements.

While there is much to comment on we will focus on the proposals as they relate to:

1. Know Your Product (KYP);
2. Suitability;
3. Know Your Client (KYC); and
4. Referral Arrangements.

We agree with the CSA that it is essential to implement policies that protect investors and ensure that investor’s interests are aligned with those of the Investment Firms and Advisors with whom they invest; we begin our comment by writing about the value that investors currently receive from Financial Advisors and Investment Dealers as they go hand-in-hand. While this topic is not specifically addressed in this paper it has been addressed as a Key Concern in CP 33-404 and is referenced on page four of this paper which we encapsulate here:

Key Concerns

We have identified the following key investor protection concerns with respect to the client-registrant relationship, as discussed in more detail in CP 33-404:

- Clients are not getting the value or returns they could reasonably expect from investing: in their suitability analysis, some registrants fail to consider all of the factors relevant to helping clients meet their investing goals.

While we have commented on the value of Advice in the past with respect to how it related to the CSA's statement on page 14 of Consultation Paper 81-408 which stated that "embedded commissions paid generally do not align with the services provided to investors, we continue to believe that the Advisor Client relationship model is complex and extends beyond the recommendation of securities and the rate of return that those securities may generate. It encompasses activities such as:

- The initial and ongoing assessment of investors risk tolerance, investment objectives and time horizon;
- An assessment of their immediate and future income requirements;
- Advice and implications on withdrawal strategies and their income tax implications;
- Advice on asset location (the use of different investment account types);
- Immediate and ongoing assessments of the progress made towards their financial goals;
- Implementing savings strategies;
- Recommending and implementing investment strategies and rebalancing on an ongoing basis; and
- Behavioral coaching and helping investors navigate difficult personal circumstances such as job loss or divorce as well as difficult investment environments.
- In addition, the Dealer's role in the client relationship model is also important as they provide among other things:
 - Access to online information;
 - Transaction confirmations;
 - Quarterly reporting;
 - Annual Tax reporting;
 - Performance reporting;
 - Compensation reporting;
 - Two Tiers of Compliance Oversight; and
 - Access to financial markets and investment products.

While studies have been conducted that suggest Advisors add approximately 3% of Alpha ¹ (additional Return) to the client relationship, the best source of investor satisfaction (i.e. value) with Advisors' services needs to be gleaned from their clients. To this end, time and time again investor surveys express client satisfaction with their Advisors. However, a recent survey conducted by the Gandalf Group between April 7th and May 5th 2017 is perhaps one of the most telling as this survey was conducted after investors had a chance to review their first Dealer Compensation and Performance Reports. This report concluded that: "there is little dissatisfaction with the current system of financial advice in Canada and the way advisor compensation is calculated. While there may be some

¹ Vanguard March 2014: Putting a value on your value: Quantifying Vanguard Advisor's Alpha

dissatisfaction about fees, generally, there is relatively higher satisfaction when it comes to advisors transparency around fees.”²

The value of advice provided by Advisors is not easily quantified. For instance, each of the Advisor activities (and more) listed above as well as the services provided by Dealers must be included as part of the value that clients receive from Advisors throughout the engagement and relationship process.

The value of advice that Advisors and Investment Dealers bring to client relationships begins with the Know Your Product, Suitability and Know Your Client processes. We agree with the CSA that KYP, Suitability and KYC obligations are among the most fundamental obligations owed by registrants to their clients, and are cornerstones of our investor protection regime.

1. Know Your Product (KYP)

We agree that a formal product approval and monitoring requirement for firms should be codified such as in the MFDA’s MSN-0048. However, some of the language and points surrounding the KYP proposals require additional thought, starting with when a Product Review is warranted. According to Subsection 13.2.1(1) a registered firm may not make a “security available to clients unless the firm has first taken reasonable steps to understand the security, including the structure, features, returns and risks, as well as the initial and ongoing costs of the security and the impact of those costs. In our opinion a registered firm makes a security available to clients by:

- purchasing or selling it for a client,
- recommending it to a client,
- placing the security on the firm’s “shelf”, product or watch list, or
- advertising or promoting the security in any medium, including distributing marketing material about the security to a client.”

We fully agree that a formal product review should occur prior to any of these four activities.

However, other transactions such as the sale of the security or transfer-in from another Investment Dealer of an unapproved security should not require a formal product review or form part of the above definition. For example, an Advisor may transfer in an unapproved security for one client with the intention of selling it (perhaps for a lower commission than the previous Dealer) while at the same time not making it available for distribution. An Advisor often consolidates an investor’s assets as a result of the client becoming disgruntled with their previous Advisor and or Firm and in the absence of a less restrictive definition than 13.2.1 investors may be forced to:

- maintain accounts at firms where they have become disgruntled;
- realize needless capital gains/losses on assets that they could only transfer in cash to their new Investment Firm; and
- incur additional account costs associated with maintaining an account at their old Investment Firm.

² The Gandalf Group, May 30, 2017: The Canadian Investor’s Survey: An Opinion Research Study in Fees & Advisory Services

As a result, we recommend that the first bullet point in the above definition be altered to not include the words “or selling it for a client”. To this point the proposals also lay out extensive requirements for the ongoing monitoring of securities “that have been made available to clients “ and also notes that “ firms are expected to maintain reasonably up to date analyses of securities held in their client accounts even if they no longer continue to make those securities available to clients.” While we agree that the ongoing monitoring of securities that are made available for sale is of the utmost importance, we believe that securities that are not available for sale yet continue to be held in client accounts should not be subject to the same robust KYP requirements of securities that continue to be made available for sale.

We also firmly agree that the same KYP process should apply equally to all approved products including those of related or connected issuers. However, we’d like to point out that while the proposals detail that where “firms offer securities of related or connected issuers as well as other securities, we expect that the performance of related and connected issuers will be subject to the same scrutiny as the performance of other issuers”; the KYP process is not solely focused on performance, but amongst other things takes into account the products structure, risk profile, liquidity, manager experience and track record, costs, third party providers, associated conflicts of interest etc.. As a result, we do not believe that when looking at reviewing the products of connected issuers we can focus solely on performance as all other factors associated with the KYP process need to be evaluated when reviewing all products and securities regardless of the relationship to the issuer.

Worldsource is a firm that currently has a robust product review process that follows much of the same product review processes outlined in these proposals. As a result, we can say that the KYP processes that we have implemented have resulted in a better client experience with clients exposed to less structural risk in the products that we have made available for sale. This is a slight contrast to what the anticipated expectations of these processes seem to be where the CSA indicates that we anticipate that these new requirements will result in improvements including a higher provision of lower cost, better performing securities to clients.” It is important to note that performance and cost are not the only measurements that an effective product review process can have at both the firm and client level.

2. Suitability

Worldsource fully supports and understands the need for robust suitability determinations.

Currently suitability modules are designed to view and compare each individual security to the clients KYC in isolation. The proposals convey to change the current suitability approach to a portfolio approach where registrants “will need to consider the impact to the overall portfolio attributes (including the risk and return) which will necessitate the consideration of interactions between the securities in the portfolio”. **This is a significant system change that needs to be fully explored to ensure it will result in a client benefit.**

This change from the “prudent man” to “prudent investor” suitability approach is significant and will result in the introduction of subjectivity to compliance reviews and may result in the introduction of bespoke suitability approvals especially in situations where clients assets that are held outside of the

Dealer are considered. While we agree that the portfolio approach to suitability has its merits its introduction and approach to suitability determinations needs to be fully defined and explored well in advance of the overture of the current suitability assessment process.

In addition to commenting on the portfolio approach to suitability we'd also like to take this opportunity to comment on what seems to be an over emphasis being placed on the cost of a security in the suitability determination process. Specifically, the proposals state that “unless a registrant has a reasonable basis for determining that a higher cost security will be better for a client, we expect the registrant to trade, or recommend, the lowest cost security available to the client.” The proposals do “recognize that there may be reasons why a specific higher cost security available at the firm may be better for a client than other suitable securities available at the firm. We expect registrants to include an assessment of the relative costs of, including the relative compensation associated with, various options available when documenting the reasonable basis for their suitability determinations.”

While we recognize that costs have a significant impact on a client’s return over time, it is not the only measure that needs to be looked at in the suitability determination process; in fact, it can be argued that cost is not the most important data point when assessing the quality of a recommended security. If we had only one metric or data point to choose from in the evaluation and comparison of securities such as mutual funds, we would likely choose to look at the Funds Information Ratio which “shows the consistency of the fund manager in generating superior risk adjusted performance. A higher Information Ratio shows that the fund manager has outshined other fund managers and has delivered consistent returns over a specified period”³ as opposed to the cost of the securities.

As an example, below is a quick analysis of the 10 most expensive and the 10 least expensive Canadian Equity Funds (both passive and active) over the past 5 years.

5 Year Analysis by Cost (Data supplied by Morningstar)

	Average Annual 5 Year Return	Average MER	Average Sharpe Ratio	Average Information Ratio
Most Expensive 10 Funds	6.28	2.69	0.91	-0.37
Least Expensive 10 Funds	6.60	0.85	0.91	-5.85

While the least expensive funds (on a gross return basis) outperformed the most expensive funds, it is important to note that the least expensive funds did not provide the performance consistency of the most expensive funds.

Additionally, we'd like to point out the need for consistency in the proposals as they currently state the desire to move to a portfolio suitability determination process yet also call for the cost of each individual security to be evaluated against a “reasonable” choice of alternative products. In

³ Financial Times <https://economictimes.indiatimes.com/definition/information-ratio>

addition, the proposals also call for the justification of a recommend security (as opposed to the cost of the portfolio) if the cost of the recommended security is higher than an alternative. While we are confident that Advisors could point to higher Information and Sharpe Ratios as the rationale for the recommendation of a higher cost product, we do not think that it is efficient, practical or prudent to justify the rational for recommendations solely on the basis of cost.

Finally, on this Suitability subject, the Paper includes an imposed onus on a registrant to conduct a suitability assessment prior to transferring in securities. We recommend that this be amended to align with the existing MFDA requirements for the transfer of assets whereby the suitability assessment must be performed within a reasonable time, but in any event no later than the time of the next trade.

3. Know Your Client (KYC)

We applaud the CSA for recognizing the importance of the KYC process and the need to accurately collect and assess the client's personal financial and non-financial circumstances as well as providing clarification on how to assess a client's risk profile. While we feel that much of the KYC processes that are outlined in the proposals are already being used today we appreciate the structure that the proposals present to the KYC process.

The only comment that we have on the KYC proposals relates to new subsection 13.2(4.1) that specifies "the circumstances when a client's KYC information must be reviewed and updated, including when the registrant knows or reasonably **ought to know** of a significant change in a client's KYC information" . We feel that the term "ought" is perhaps not the right word to be used in this subsection as it can be ambiguous and open for debate. We recommend that an alternate phrase such as "becomes aware of" be used in lieu of the term "ought".

4. Referral Arrangements

Referral Arrangements, such as those to a private client portfolio manager (portfolio manager), have long formed part of an effective wealth management platform. In these instances, the referring Advisor works in concert with the portfolio manager by providing complimentary services such as financial and estate planning to the client in return for an ongoing referral fee.

We have found that referral arrangements such as those to a portfolio manager have proven beneficial to the formation of long lasting client relationships and our research also indicates that the end cost to the clients on average decreases as a result of the referral. While the proposals convey limiting the amount of the referral fee as well as the length of time (36 months) that a referral fee may be paid to a referring Advisor, we feel that referral arrangements for product referrals (such as those for an exempt market product) and portfolio service related referrals such as those to a portfolio manager should not be viewed and regulated under the same brush.

We believe that portfolio service related referrals result, more often than not, in long lasting, profitable client relationships. Furthermore, the client receives more cost effective services from a team of wealth advisors which includes the referring Advisor. As a result, we do not believe that in this instance a defined time frame for the continued payment of the referral fee is in the best interest of a client.

Worldsource is a firm that believes in providing both Advisors and Investors with a wide range of product choices and Advisors with the freedom to provide unbiased advice. While we welcome change we feel that change should be measured and well contemplated before it is implemented and we look forward to continuing to work with all participants in the pursuit of well contemplated change.

In conclusion we urge the CSA to consider the far reaching ramifications that the Paper contemplates. On the face of it some of them appear only to affect Investment Firms and Advisors but ultimately, they may have a downstream negative effect on investor's interests.

Thank you for your consideration and the opportunity to comment on the Paper.

Sincerely,

WORLDSOURCE WEALTH MANAGEMENT INC.

Richard Rizi
Sr. Director, Investment Services