

**IN THE MATTER OF AN APPEAL TO THE APPEAL COMMITTEE
OF THE CANADIAN INVESTOR PROTECTION FUND**

RE: [REDACTED], [REDACTED] and [REDACTED]

Heard: November 13, 2015

HEARD BEFORE:

BRIGITTE GEISLER

Appeal Committee Member

APPEARANCES:

Nicolas Businger

) Counsel for Canadian Investor
) Protection Fund Staff

[REDACTED]

) On his own behalf, on behalf of [REDACTED]
) and on behalf of [REDACTED]

DECISION AND REASONS

Introduction and Overview

1. [REDACTED] (“[REDACTED]”), [REDACTED] and [REDACTED] (“[REDACTED]”), (collectively, the “Appellants”) were clients of First Leaside Securities Inc. (“FLSI”), an investment dealer through which over 1,200 customers made investments in various affiliated companies, trusts and limited partnerships (collectively the “First Leaside Group”). FLSI was registered with the Ontario Securities Commission (“OSC”) and was a member of the Investment Industry Regulatory

Organization of Canada (“IIROC”). It was also a member of the Canadian Investor Protection Fund (“CIPF” or the “Fund”) until its suspension by IIROC on February 24, 2012, being the same date that FLSI was declared to be insolvent and the day after FLSI sought protection under the *Companies’ Creditors Arrangement Act*. The relevant history leading up to these events and the role of CIPF with respect to claims to the Fund are set out in detail in the Appeal Committee’s decision in relation to an appeal heard on October 27, 2014.¹

2. The Appellants sought recovery from CIPF on the basis that FLSI was a Member of CIPF and as such the Appellants were entitled to protection through the Fund which was established to provide coverage in the event of insolvency. CIPF Staff made a decision denying compensation to the Appellants on the basis that the Appellants’ losses did not arise as a result of the insolvency of FLSI and thus were not covered under the CIPF Coverage Policy dated September 30, 2010.

3. On November 13, 2015, an Appeal Committee Member of CIPF’s Board heard an appeal to determine whether to depart from the decision of CIPF Staff. The hearing was held at Neeson Arbitration Chambers in Toronto, Ontario. [REDACTED] was in attendance representing himself and his brother [REDACTED], and as the sole shareholder of [REDACTED].

Chronology of Events Relevant to the Appellants’ Claim

(i) The Appellants’ Investments and Claim

4. The claim arises from the Appellants’ purchases of various First Leaside Group products for a total net claim by [REDACTED] of \$537,496.44; by [REDACTED] of \$147,744.60; and by [REDACTED] of \$818,974.50. The claims by [REDACTED] include reductions for distributions received from the insolvency trustee.

5. The securities representing the Appellants’ purchases were transferred to accounts in the names of the Appellants at Fidelity Clearing Canada ULC, or were delivered into the possession of the Appellants.

¹ This decision is available on the CIPF website and will be referenced throughout as the “October 27, 2014 decision”.

(ii) *The Appellants' Application for Compensation*

6. The Appellants applied to CIPF for compensation for their losses in investments made through FLSI. By separate letters dated November 12, 2014, the Appellants were advised that CIPF Staff were unable to recommend payment of their claims. The relevant parts of the letters read as follows:

....losses caused by dealer misconduct, compliance failures or breaches of securities regulatory requirements in respect of the distribution of securities are not covered by CIPF. The securities that you purchased were subject to the disclosure of an offering memorandum or other offering documentation which, among other things, disclosed the risks relevant to the purchase and the investment. These investments, like any securities, were subject to market forces and, unfortunately, your loss appears to have been a loss caused by a change in the market value of your investments and not a loss resulting from the insolvency of FLSI.

Analysis

7. At the hearing, [REDACTED] submitted a copy of the Appellant brief in the October 27, 2014 decision and the submission of another CIPF Appellant ([REDACTED]), along with a written summary of his presentation. He made reference to the [REDACTED] submissions in his presentation.

8. [REDACTED] submitted that the policies of CIPF are ambiguous and therefore should be construed against CIPF in favour of the investors. He did not elaborate upon the specifics of these alleged ambiguities. At the October 27, 2014 hearing, a similar argument with respect to ambiguity was presented with reference to the interpretation of the phrase "including property unlawfully converted". That decision determined that there was no ambiguity in that phrase. [REDACTED] submitted that his investment funds had been unlawfully converted and offered an example that a particular investment had been converted to another investment without his authorization and consent. [REDACTED]'s example refers to possible improper conduct on the part of FLSI, which is not covered under the Coverage Policy.

9. The written submission that [REDACTED] presented made reference to prior CIPF decisions in which CIPF paid compensation in circumstances of fraud and argued that a similar approach should be taken in the FLSI appeals. The Appeal Committee's October 27, 2014 decision, in paragraph 32, stated that fraud was not covered:

After careful consideration, we conclude that fraud, material non-disclosure and/or misrepresentation, as alleged in this case, are not covered by the words "including property unlawfully converted" under CIPF's Coverage Policy. The Appeal Committee does not find the phrase to be ambiguous. It is clear that the intent of the Coverage Policy is to return property in the Customer's account to the Customer in the event of the insolvency of the Member. The inclusion of the phrase simply recognizes that circumstances may arise where the Customer has provided investment funds or other property to the Member for deposit to their account, but the funds were not posted to the Customer's account; in other words, the property has been "unlawfully converted".

10. The written submission referenced the insolvency of Essex Capital Management Limited ("Essex"), wherein compensation was paid to customers in circumstances of fraud. Those circumstances differ not only for these Appellants but for other FLSI Appellants. In the Essex matter, customers' funds were misappropriated and removed from their accounts without authorization; this is a fraud. CIPF coverage was applicable, not because it was a fraud *per se*, but because the customers' property was unavailable. In the case of FLSI, customers purchased specific investments relating to specific First Leaside Group entities and received certificates representing their investments. There may have been misconduct by agents of FLSI with respect to representations regarding the suitability of the investment in a particular First Leaside Group entity and CIPF coverage, but CIPF specifically does not provide coverage in instances of broker misconduct.

11. I understand that this may be a fine distinction, not appreciated by FLSI investors. The First Leaside Group involved a very large number of separate entities, many of them having "First Leaside" as part of their name. This naming protocol, along with the fact that many of these entities entered into insolvency at about the same time as FLSI, has created confusion for FLSI customers. While investors have suffered losses because of insolvency, it has been the insolvency of the First Leaside Group entities that generated the loss, not the insolvency of FLSI. Only FLSI is a member

of CIPF and only claims resulting from FLSI's insolvency and not its related entities are eligible for compensation.

12. The kind of claim that is eligible for compensation from CIPF is one that arises from circumstances described in the Essex matter; that is, where customer funds have been diverted from their intended objective. CIPF's mandate and its coverage is custodial in nature; in other words, to ensure that the clients of an insolvent member have received their property. The Appellants have received their property; accordingly this is not an issue of CIPF coverage. It is most unfortunate that the property has lost almost all of its value; however, the Coverage Policy clearly states that CIPF does not cover "changing market values of securities, unsuitable investments, or the default of an issuer of securities".

13. [REDACTED] queried whether it would have made any difference if the securities which had been delivered to the Appellants had been re-deposited into the respective accounts. Counsel for CIPF Staff confirmed that there would be no difference with respect to the claims as the issue was whether the securities had all been accounted for, which they had.²

14. [REDACTED] noted that he had been an investor since 1992. In fact, the majority of investments noted in the claims by the [REDACTED] brothers were undocumented, relating to investments made prior to FLSI becoming an IIROC member, with another good portion of these investments made prior to 2009 when the OSC began its investigation into the First Leaside Group. These investments have been acknowledged by the insolvency trustee.³

15. [REDACTED] also queried about the role of CIPF vis-à-vis its Members - whether there was any specific oversight by CIPF. Counsel for CIPF Staff advised that CIPF was not a regulator and that its only relationship with its Members is the collection of fees. These fees are calculated on the basis of the amount of equity in customer accounts on the books and records of the Members.

² The exception is a large number of securities for which records were not available, as these were purchased prior to FLSI becoming an IIROC member.

³ The claims by [REDACTED] relate to investments in 2010 for which the insolvency trustee has made a payment.

Some oversight of the audit and supervisory function of IIROC is performed; however, the responsibility for enforcement of compliance with industry rules lies primarily with IIROC, and in the case of the First Leaside Group entities, also with the OSC.

16. [REDACTED] observed that the payouts from the insolvency were generally minimal. He felt that this was the result of excessive fees paid to process the insolvency, which he also felt was processed at “fire-sale” prices for the properties that were disposed of by the trustee. He suggested that the appeals process be discontinued as it was a waste of time and money and that CIPF should negotiate a compromise with investors.

17. Reference was also made to the Appeal Committee’s decision in relation to an appeal heard on April 7, 2015 in which it was suggested that if claims were to be paid it would be an assault of \$200,000,000 on the CIPF Fund. It was suggested that this decision states, in effect, that the reason for not acknowledging any of the FLSI claims to date is the large impact it would have upon the CIPF Fund. This is not correct. A proper reading of that decision explains that the claimant was arguing that the Appeal Committee should exercise its discretion and acknowledge his claim. The Appeal Committee’s response was that “‘discretion’ cannot be stretched to allow a whole new classification of coverage that is clearly not included in existing coverage”.

18. I have a certain amount of sympathy for the Appellants. I do note, however, that most of the investments for the [REDACTED] brothers were of a very long standing nature and presumably paid appropriate returns during that period of time. If the claim were to be successful, then all of the returns made on the investments would have to be accounted for.

19. I conclude that the Appellants’ submissions in this appeal are not persuasive and do not give rise to a successful claim for compensation from CIPF.

Disposition

20. The appeals are dismissed. The decisions of CIPF Staff are upheld.

Dated at Toronto, this 23rd day of November, 2015.

Brigitte Geisler