

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

RE: [REDACTED]

Heard: February 18, 2016

HEARD BEFORE:

BRIGITTE GEISLER

Appeal Committee Member

APPEARANCES:

[REDACTED]

) On his own behalf

Nicolas Businger

) Counsel for Canadian Investor
) Protection Fund Staff

DECISION AND REASONS

Introduction and Overview

1. [REDACTED] (the “Appellant”) was a client 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 Appellant sought recovery from CIPF on the basis that FLSI was a Member of CIPF and as such the Appellant was 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 Appellant on the basis that the Appellant's 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 February 18, 2016, an Appeal Committee Member of CIPF's Board heard an appeal to determine whether to depart from the decision of CIPF Staff. The appeal hearing was held by teleconference. The Appellant was in attendance and made submissions.

Chronology of Events Relevant to the Appellant's Claim

(i) The Appellant's Investments and Claim

4. The Appellant claims the net amount of \$51,481.01 with respect to his purchases of Wimberly Fund (Class B) Series 7% Designation 2010 and FLEX Fund (Class B) in February and August, 2011, respectively. Although the records indicate that the Appellant invested \$4,169 in FLEX Fund (Class B), he has only claimed the amount of \$1,481.01, resulting in the net claim above.²

5. Certificates representing the Appellant's purchases were transferred to an account in his name at Fidelity Clearing Canada ULC ("Fidelity").

(ii) The Appellant's Application for Compensation

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

² The purchase of \$4,169 is confirmed in various documents: Appeal Record Volume 1, Tab 3 p. 5 and Tab 4, p. 7. The Appellant's claim indicates the amount of \$1,481.01: Appeal Record Volume 1, Tab 9, p. 199.

6. The Appellant applied to CIPF for compensation for his losses in investments made through FLSI. By letter dated December 10, 2014, the Appellant was advised that CIPF Staff were unable to recommend payment of his claim. The relevant parts of the letter 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. The Appellant included various documents with his claim, including the claim against David Phillips, Margaret Davis and their limited company brought by the insolvency trustee; the IIROC disciplinary decision against David Phillips and John Wilson; the submissions made by Cassels, Brock as representative counsel for the First Leaside investors; and a further document which is a variation on the submissions made by another Appellant, [REDACTED]. The Appellant addressed some of the issues which were raised in those documents.

8. The Cassels, Brock submissions included with this appeal are essentially the submissions put forth at the October 27, 2014 appeal hearing and are focused on investments made during the time period following the commencement of the OSC investigation. However, as was fully discussed in the October 27, 2014 decision, the reasons for which are adopted by this Appeal Committee, the Appellant's arguments regarding possible misuse of investors' fund do not lead to the conclusion that what happened in this case falls within the meaning of the phrase "including property unlawfully converted" as set out in the Coverage Policy. That phrase is intended to address the situation where there is a failure to return property to the customer because it has been improperly confiscated by the broker. The Appellant has acknowledged that the securities in which he had purchased were transferred to an account in his name at Fidelity. To apply the interpretation

suggested by these written submissions would, in effect, create a new head of coverage relating to fraud, material non-disclosure and misrepresentation.

9. The Appellant submitted that the CIPF Fund was huge (he attributed an unrealistic size to the Fund), and that losses due to fraud should be compensated. He stated that claimants were not being treated fairly as individual appeals were being held, rather than a joint appeal by all investors. I am not aware of why CIPF Staff determined that appeals should proceed individually; however, I would suspect that it arises from the fact that there has not been an issue of missing property in any of the claims which I have seen to date. CIPF's mandate is to ensure that a customer's property has been returned to the customer. Since that has been the case, the appeals would need to be individually considered as the submissions would be particular to that Appellant.

10. The Appellant addressed the comments made by another Appeal Committee Member with respect to the limitations of the exercise of discretion.³ He suggested that the comments are indicative of a bias towards the denial of claims because of the potentially large impact on the CIPF Fund. The Appellant is incorrect in two aspects. Firstly, the comments were made only to illustrate that discretion must be exercised within the bounds of the Coverage Policy, as noted in paragraph 8 above. Secondly, the Appellant suggested that Appeal Committee Members see their role as protecting the Fund, which, I can assure him, is not the case.

11. The Appellant submitted that the funds that he invested were invested in properties in the United States and consequently, were not under the control of anyone in Canada. He stated that he had no input into the transfer of money from the investments he made to other First Leaside entities; however, the Offering Documents for the Appellant's investments indicate that there was authority within those funds to make such transfers.⁴

12. The Appellant made numerous comments with respect to what he felt was improper conduct by the principals of First Leaside. He stated that the properties were not being properly maintained,

³ Appeal Committee Decision dated June 19, 2015.

⁴ See Appeal Record Volume 2, Tab 1, p. 2 and Tab 2, p. 10

and that the money to be used for the properties was being diverted to the personal use of the principals. He stated that the principals had been defrauding the public for years and were criminally convicted of fraud.⁵ No evidence was offered by the Appellant to substantiate these statements.

13. The Appellant submits that because fees were paid by brokers to IIROC for the benefit of the CIPF, this made all brokers employees of IIROC and CIPF and as such, IIROC and CIPF were responsible and accountable for their conduct. This is not only impractical, but incorrect. CIPF is not a regulator. Its relationship to its members is the collection of fees, which are calculated on the basis of the amount of equity in customer accounts on the members' books and records. 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.

14. The Appellant submitted that FLSI should have been monitored as its actions were "one step ahead of the law". As stated above, IIROC does have the responsibility to monitor and discipline members and their employees for violations of their rules; however, the expectation that this involves a complete oversight as to all actions, including sales presentations by the broker's representatives, is unrealistic.

15. In many of the appeal hearings, Appellants have failed to make a distinction among the various First Leaside Group entities. CIPF coverage is applicable to FLSI only; it is a member of IIROC. The other First Leaside Group entities are issuers of securities and are regulated by the OSC. For many, confusion arises because FLSI and many of the First Leaside Group entities not only had similar names, but also entered into insolvency at approximately the same time; however, the losses experienced by investors arise from the insolvency of the issuers. The loss is from a decrease in the value of the investments made in the various First Leaside Group products, and not from the insolvency of FLSI. FLSI acted as an agent for the issuers and recorded customers'

⁵ This information is incorrect. The proceedings brought by the OSC against Phillips and Wilson were under *The Securities Act*, Ontario.

investments in the issuers on FLSI's books and records. Although there was an overlap in the roles of the principals of FLSI and the First Leaside Group, the entities were separate and were separately regulated.

16. The Appellant also asserted that everyone involved with the hearing process was an employee of CIPF and as such, the hearing would be biased in favour of CIPF. The process for review of Staff's original decisions with respect to customer claims is provided for in CIPF's Claims Procedures. CIPF is subject to the oversight of the Canadian Securities Administrators which reviews CIPF on a regular basis. The CIPF Board of Directors has acknowledged the possible issues of bias and has taken steps to ensure that any discussions of substance relating to the FLSI appeals be held in the absence of the Appeal Committee Members. The Appeal Committee Members see their role as fair adjudication of appeals brought before them, having consideration for the terms of CIPF's Coverage Policy and Mandate. The Appeal Committee Members address the issues and arguments before them according to their merits, without regard to the potential impact upon the Fund. They have no interest or role to protect the Fund from payouts to eligible customers.

17. The Appellant urged the Appeal Committee to consider that CIPF is an insurance organization designed to protect investors from unscrupulous activities within the financial world. The customers' investments are protected in that they would be returned to the customer in the event of insolvency. Unfortunately, it appears that many Appellants believed that the coverage extended far beyond that to include a "guarantee" of the principal of their investments. It does not. As stated above, CIPF coverage is to ensure that property is returned to Members' customers. It is not an insurance scheme to cover fraud, like the one that can be found in Quebec. In fact, the existence of the Quebec fund confirms the narrowness of CIPF coverage in that the Quebec government realized that there was a gap in coverage for investor losses as a result of fraud and has provided limited coverage.

18. CIPF's mandate and its coverage is custodial in nature; in other words, to ensure that the customers of an insolvent member have received their property. The Appellant has received his

property; accordingly the issue of CIPF coverage is not applicable. It is most unfortunate that the value of the property is uncertain, 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”.

19. I have sympathy for the losses suffered by the Appellant; however, I conclude that the Appellant’s submissions in this appeal are not persuasive and do not give rise to a successful claim.

Disposition

20. The appeal is dismissed. The decision of CIPF Staff is upheld.

Dated at Toronto, this 26th day of February, 2016

Brigitte Geisler