

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

RE: [REDACTED] and [REDACTED]

Heard: December 2, 2015

HEARD BEFORE:

BRIGITTE GEISLER

Appeal Committee Member

APPEARANCES:

Graeme Hamilton
Nicolas Businger

)
)

Counsel for Canadian Investor
Protection Fund Staff

[REDACTED]

)
)

On his own behalf and representing

[REDACTED]

DECISION AND REASONS

Introduction and Overview

1. [REDACTED] and [REDACTED] (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 December 2, 2015, 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 at Neeson Arbitration Chambers in Toronto. [REDACTED] was in attendance representing himself and [REDACTED].

Chronology of Events Relevant to the Appellants’ Claim

(i) The Appellants’ Investments and Claim

4. The claim arises from the Appellants’ investments in various First Leaside Group products for a total net claim of \$149,019.73 by [REDACTED]; \$112,713.53 for [REDACTED]; and \$671,777.63 for the joint account of [REDACTED]. These claims include claims for stock dividends and undocumented claims that could not be verified by CIPF Staff. As well, the net claim for the joint account reflects a deduction of \$24,151.37 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 delivered to their possession.

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 March 5, 2015, the Appellants were advised that CIPF Staff were unable to recommend payment of their claims. The relevant parts of the letters read as follows:

██████████: Regarding your claim for unlawful conversion, it does not appear to us that any property held by FLSI for you was converted or otherwise misappropriated. 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 or the conversion of your property. 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 joint account*: Regarding your claim for unlawful conversion, it does not appear to us that any property held by FLSI for you was converted or otherwise misappropriated....

.... 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. ██████████ expressed his disappointment that no appeals regarding FLSI had been allowed to date. He expressed the view that CIPF is hiding behind the Coverage Policy because it is unwilling to make any payments out of the fund. In response to those comments, I would note that

neither I nor my other Appeal Committee Members are motivated by any desire to protect the Fund. The Appeal Committee is charged with the responsibility of applying the provisions of the Coverage Policy, and should that result in payments, whatever the amount might be, the Appeal Committee would make such a finding. Regretfully, for the appeal hearings to date, the Appeal Committee has been unable to make those findings.

8. [REDACTED] also commented on the CIPF mission statement, which can be found at www.cipf.ca and reads as follows: “To contribute to the security and confidence of customers of IIROC Dealer Members by maintaining adequate sources of funds to return assets to eligible customers in cases where a Member becomes insolvent”. It was his opinion that CIPF was not interested in helping investors, but rather, was spending its resources to fight investors. He urged CIPF to “do what is right, not what is easy or popular”.

9. In contrast to [REDACTED] comments, in denying claims to FLSI Appellants, I do not believe the Appeal Committee is doing what is easy or popular. In fact, the opposite is true. The Appeal Committee Members have seen many Appellants with substantial losses in First Leaside come before them. We have heard many compelling stories of hardship. We have denied claims because the claims do not fall within the Coverage Policy and it is the Appeal Committee’s function to interpret and apply the Coverage Policy as it is set out.

10. 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 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”.

11. [REDACTED] also referred to the fact that payments had been made by CIPF in circumstances of fraud in the insolvency of Essex Capital Management Limited (“Essex”). 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, the powers of the First Leaside Group entity to loan monies to other First Leaside Group entities, and the extent of CIPF coverage, but CIPF specifically does not provide coverage in instances of broker misconduct.

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.

13. [REDACTED] also commented that it was repeatedly confirmed to him that his investments were safe because of CIPF coverage. He noted that the CIPF logo "was everywhere". He advised that he had surveyed six dealers asking them of the nature of CIPF coverage and that not one of them understood the limitations of the coverage. He chided CIPF for not ensuring that investment advisors were properly trained with respect to the nature of CIPF coverage.

14. It is of great concern and disappointment to the CIPF Board of Directors that its coverage has been misrepresented to investors by FLSI. Efforts have been, and continue to be undertaken to promote a proper understanding of CIPF coverage within the investment industry. A review of CIPF's communication with investors through its website and brochures is also being undertaken.

15. [REDACTED] also suggested that the delivery of securities to customers was an unlawful act by FLSI because the off-book status of these securities was an unlawful conversion. This is not an argument that can be sustained. Firstly, it is not improper or contrary to IIROC rules to deliver securities to customers when the customer has so requested, as was the case with the Appellants. IIROC's rules require that transactions be noted on the books and records of the member, but there

is no prohibition to delivering the security thereafter. Secondly, there has been no conversion when the securities were delivered as no one else has gained any benefit from such a delivery.

16. [REDACTED] also expressed his disappointment with the OSC in not advising investors of their investigation of the First Leaside Group, which investigation started in the fall of 2009 and came to a head nearly 2 years later. He stated that both IIROC and the OSC had failed to do their jobs properly. He felt that CIPF's refusal to live up to its mandate left a black mark on investment dealers in Canada. In short, he stated that an insolvency had occurred, unlawful conversion had occurred and fraud had occurred, all of which, combined, should result in payment of his claim.

17. [REDACTED] is correct that all of these events had occurred; however, it does not follow that these events are within the Coverage Policy. The insolvency that he is primarily concerned with is that of the issuer of the securities that he purchased. Issuer insolvency is not part of the Coverage Policy. The full discussion of the meaning of 'property unlawfully converted' can be found in the October 27, 2014 decision; it is not applicable in these circumstances. The kind of fraud that occurred is not covered by CIPF as was discussed above with reference to the Essex matter.

18. Although the CIPF logo appears on FLSI documentation, as required by IIROC rules, it does not follow that CIPF represents or has a relationship with member firms in the same way as a regulator. CIPF is not a regulatory body; it has no powers to investigate or to discipline member firms. That authority lies within IIROC or the OSC.

19. The October 27, 2014 decision deals extensively with the Appellants' written submissions and the reasoning in the October 27, 2014 decision is adopted by this Appeal Committee. As in the October 27, 2014 decision, while expressing considerable sympathy for the position of the Appellants, 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 12th day of December, 2015.

Brigitte Geisler