

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

RE: [REDACTED] and [REDACTED]

Heard: February 18, 2016, by teleconference

HEARD BEFORE:

BRIGITTE GEISLER

Appeal Committee Member

APPEARANCES:

Nicolas Businger

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)

Counsel for Canadian Investor
Protection Fund Staff

[REDACTED]

)

On his own behalf, and on behalf of
[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 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. [REDACTED] was in attendance and made submissions on behalf of both Appellants.

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 net claim by [REDACTED] of \$755,991.71 and by [REDACTED] for \$67,361.29. These claims have been reduced by receipts from the insolvency trustee and also include claims for undocumented amounts. [REDACTED] was unable to confirm the date of a substantial purchase of Wimberly Apartments Limited Partnership units for [REDACTED], but stated that no purchases were made prior to 2006. Although CIPF Staff was unable to access records for this purchase, it has been acknowledged by the insolvency trustee.²

5. Certificates representing the Appellants' purchase were transferred to an account in the names of the Appellants at Fidelity Clearing Canada ULC or were delivered to their possession.

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

² See Appeal Record Volume 1, Tab A-21, p. 133. It may be that these units of Wimberly Apartments were acquired in an exchange for units of First Leaside Advantage PLU and First Leaside Property LPU which were purchased in December, 2006. See Appeal Record Volume 1, Tab A-2, p.2

(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 2, 2015 and April 13, 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:

..... 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. [REDACTED] advised that he was relying upon the arguments prepared by Cassels, Brock and not the additional arguments which the Appellants had included with their claim to CIPF. These are arguments similar to those advanced at the October 27, 2014 appeal hearing. This included interpretation of the phrase “including property unlawfully converted” in the Coverage Policy, with particular application to investments made after the OSC began investigating the First Leaside Group in 2009. The Appellants submitted that they intended the funds they invested be applied to proprietary First Leaside products for the primary purpose of funding the acquisition and/or development of various real estate projects; instead, these funds were unlawfully converted by FLSI for its own use.

8. The written arguments are focused on the investments made during the time period following the commencement of the OSC investigation into the First Leaside Group (although the Appellants have included all of the investments that they have made within this argument).

However, as was fully discussed in the October 27, 2014 decision, the reasons for which are adopted by this Appeal Committee, the Appellants' arguments regarding possible misuse of investors' funds 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, an issue which has not been raised in this Appeal. 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. ██████████ submitted that the receipt by FLSI of funds which were then applied in ways other than intended by the investor was a fraudulent misrepresentation, which was an unlawful conversion and should vitiate the original purchase instructions. Counsel for CIPF Staff noted that prior decisions of the Appeal Committee did not extend the concept of unlawful conversion as suggested by ██████████. He noted that the purchases by the Appellants were authorized and that they had received certificates representing those purchases and monthly statements from FLSI which also detailed the purchases. The Appellants' real complaint is that the securities issuers that received their funds did not apply them as they had wished; however, the issuers had the authority in their offering documents to transfer funds to related entities.³ Regardless, it is not within the jurisdiction or purpose of CIPF to delve into the operations of issuers to determine the nature of their business decisions.

10. ██████████ submitted that the fact that the First Leaside entities shared similar management should result in all of the entities being treated as one entity. While this may seem an attractive suggestion, it does not comport with the vertical nature of Canadian securities regulation. CIPF has a limited mandate with respect to its member firms, in this case, FLSI. It has no relationship with the other First Leaside entities which were issuers under the regulatory authority of the OSC. The nature of that regulation is to encourage and enforce adherence to *The Securities Act*. CIPF's

³ See Appeal Record Volume 2, pgs. 3, 15, 21 and 29.

interest in its member firms is to ensure that in the event of insolvency, the property that is being held for customers on member firms' books and records is returned to them. It does not extend its involvement in member firms to issues of misconduct or regulatory compliance.

11. CIPF is not a regulatory body; it has no powers to investigate or to discipline member firms. That authority lies within IIROC and/or the OSC. IIROC's regulatory function relates to the business and operations of FLSI. It does not have jurisdiction over the various proprietary products that were marketed by FLSI to various investors. As stated above, those products, or issuers, are under the jurisdiction of the OSC, which, having concerns over those operations, began an investigation into the First Leaside Group in the fall of 2009. The jurisdiction of IIROC, and by extension, CIPF, within the limits of its mandate, is confined to FLSI only.

12. CIPF's 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 books and records of the members. 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.

13. Counsel for CIPF Staff described the origins of CIPF and the restrictive nature of CIPF coverage. CIPF's mandate is to provide coverage that 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".

14. As stated above, CIPF does not guarantee the value of an investment. We have heard from many appellants who have stated that they were told that their investments were safe because there was CIPF coverage. It is correct that they were safe, in that they would be returned to the investors in the event of an insolvency, but it seems that it was implied and believed by many investors that

the coverage extended far beyond a return of property and included a “guarantee” of the principal of their investment. It does not.

15. [REDACTED] submitted that all of the marketing documentation for the First Leaside Group had included CIPF logos, which led the Appellants to believe that they had insurance coverage. I assured them that the Board of Directors of CIPF is examining the nature and content of the disclosure of CIPF coverage and appreciates the insight of investors such as the Appellants.

16. I have considerable sympathy for the Appellants; however, 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

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

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

Brigitte Geisler