

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

RE: [REDACTED] AND [REDACTED]

Considered: April 28, 2016, in writing

CONSIDERED BY:

ANNE W. LA FOREST

Appeal Committee Member

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 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. FLSI was declared to be insolvent on February 24, 2012. The Appellants sought recovery from CIPF on the basis that FLSI was a Member of CIPF and as such the Appellants were entitled

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

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. The Appellants requested that their appeals be considered on the basis of written materials that they provided, including additional written submissions dated April 21, 2016.

Chronology of Events Relevant to the Appellants' Claim

(i) The Appellants' Investments and Claim

4. The Appellant, [REDACTED], claims the amount of \$463,846.26 with respect to her purchases of various First Leaside Group products purchased between October 30, 2008 and June 16, 2011. The total amount purchased was \$503,128 plus a claim for \$1,471.83 for stock received and \$147.24 for an undocumented investment less \$40,900.81 from Grant Thornton in the insolvency proceedings. The Appellant, [REDACTED], claims the amount of \$167,171 with respect to two purchases of First Leaside Wealth Management Fund on June 15, 2011, one in the amount of 40,001 units and the other in the amount of 127,170 units. Many of the products invested in by the Appellants were purchased during the period after the OSC began investigating FLSI in the fall of 2009.

5. Certificates representing the Appellant, [REDACTED], purchases were either delivered to her possession or the units were transferred to an account in her name at Fidelity Clearing Canada ULC ("Fidelity") in December 2012. A Certificate representing the Appellant, [REDACTED], purchase of 40,001 units was delivered to his possession and 127,170 units were transferred to an account in his name at Fidelity in December 2012.

(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 14, 2014, the Appellants were advised that CIPF Staff were unable to recommend payment of their claims. The relevant parts of the letter to the Appellant, [REDACTED], read as follows:

As a basis for explaining your claim to CIPF, you stated:

“Unlawful conversion of property in a Ponzi manner (OSC & GT findings on use of new investor capital)

The losses were directly caused by insolvency and the abrupt cessation of FL as a going concern with no opportunity for even partial restructuring

The losses are not due to changing markets values of FL securities, nor unsuitable investments, nor default of an issuer

The losses occurred because of unacceptable custodial practices and reporting/accounting by Penson and FL (FL management charged with fraud by IIROC + OSC)

Marketing of CIPF coverage on the part of both Penson and FL to induce investment in private securities where FL management always had complete control of the assets/securities, including valuation

Failure of the regulatory system for private securities”

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. In addition, while you have not provided evidence of the truth of all of the assertions in support of your claim, 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.

With respect to the securities that you purchased [which were held on book], they were properly recorded in the books and records of FLSI at the date of insolvency.

Those securities were transferred to accounts in your name at another IIROC Dealer Member subsequent to February 24, 2012.

In addition, at the date of insolvency, the security [which was held off book] was not held by, or in the control of, FLSI. Therefore, the loss is not one that is eligible for CIPF coverage, as indicated above.

The letter to the Appellant [REDACTED] was substantially the same.

Analysis

7. The Appellants provided lengthy submissions in writing that were developed by a number of investors but primarily another CIPF Appellant ([REDACTED]). These submissions have been relied upon in other appeal hearings and in an appeal heard before me on February 8, 2016.² In the February 8, 2016 appeal hearing, I addressed these arguments in detail and rely upon my decision in that case as a basis for their dismissal. In this decision, I will briefly respond to those arguments that were specifically made or raised by these Appellants.

8. In the materials that were provided to the CIPF explaining their claim, the Appellants argued that there had been an unlawful conversion of property in the manner of a Ponzi scheme and in this regard, they relied upon the findings of the OSC and the Grant Thornton Report to the effect that the continuing viability of the First Leaside Group was contingent on the infusion of new investor capital. The Appellants also argued that their losses were caused by insolvency and not, as CIPF Staff contends, a loss caused by a change in the market value of the First Leaside Group securities, not unsuitable investments, nor default of an issuer. The Appellants argue that the actions of FLSI's principals were fraudulent. The Appellants provided me with a number of documents supporting these claims, including an OSC amended statement of allegations relating to the principals of FLSI dated April 25, 2013 and their decision dated January 14, 2015 as well as media material indicating that the OSC had found FLSI's principals guilty of securities fraud.

² Decision released on March 18, 2016.

9. These arguments have been raised by other investors and are aimed at demonstrating that the claims at issue fit within the Coverage Policy. The difficulty for the Appellants is that the Coverage Policy provides that the loss must result from a failure to return their property to them, including property unlawfully converted. The relevant property in this case is the securities representing the Appellants' investments. These were purchased at the Appellants' direction and are with the Appellants either in certificate form or accounted for in statements showing that the units are currently held by Fidelity. There has thus been no failure to return property. The Coverage Policy also provides that the loss suffered must be caused by the insolvency of FLSI. There is a distinction between FLSI and the issuers in which the Appellants invested. The documents associated with the investments outlined the risks associated with and the allowable business of the investments. As in other cases, I do not question that the Appellants were likely induced to purchase these investments through misconduct, fraud, material non-disclosure and/or misrepresentation by the principals of FLSI. But the Coverage Policy only addresses the case where there is a failure to return property and that is not this case.

10. In the materials the Appellants originally submitted to CIPF Staff and in their submissions in relation to this appeal, the Appellants raised concerns in relation to the marketing of CIPF coverage and that this induced investment in private securities in circumstances where First Leaside management had control of the securities including their valuation. In support of their position, the Appellants appended to their materials a CIPF brochure and some of the marketing materials that were given to them in relation to First Leaside Investments in which the CIPF logo appears. It is worth noting that the brochure clearly states that the protection is within defined limits and advises individuals to review the CIPF website for more detail. Furthermore, although the CIPF logo appears on FLSI documentation, that is required by IIROC rules and it does not mean that CIPF represents or has a relationship with its Member firms. It is of concern to the CIPF Board of Directors that its coverage has been misrepresented and that members of the public may misunderstand it. As has been noted in other decisions of the Appeal Committee, a review of CIPF's communications with investors through its website and brochures is being undertaken.

11. Finally, the Appellants raised concerns in relation to the failure of the regulatory system for private securities. In that regard, the Appellants' included with their submissions documentation relating to Penson and a brochure relating to IIROC and the minimum capital requirements that it sets to reduce the possibility of firms failing. The brochure also refers to the protection provided by CIPF. The difficulty for the Appellants is that this appeal process relates to the application of the Coverage Policy and not CIPF's failure to engage in regulatory oversight. As I have noted in other decisions, CIPF is not a regulator and has no power to investigate or discipline Members. That authority rests with the OSC or IIROC. Rather, CIPF is a fund providing coverage in accordance with the relevant coverage policy in effect at the time of insolvency of an IIROC Member.

Disposition

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

Dated at Toronto, this 10th day of June, 2016

Anne Warner La Forest