

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

RE: [REDACTED],

[REDACTED] or [REDACTED], and [REDACTED]

Heard: May 16, 2016

HEARD BEFORE:

BRIGITTE GEISLER

Appeal Committee Member

APPEARANCES:

Graeme Hamilton

)
)

Counsel for Canadian Investor
Protection Fund Staff

[REDACTED]

)
)

On his own behalf and on behalf of

[REDACTED]

)

[REDACTED]
On her own behalf

DECISION AND REASONS

Introduction and Overview

1. [REDACTED], [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 May 16, 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 at Neeson Arbitration Chambers in Toronto, Ontario. ██████████ made submissions on behalf of all of the Appellants at the appeal hearing. Following the hearing, ██████████ provided a written copy of his submissions, as well as copies of two monthly statements which are referred to below.

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 as follows:

- ██████████ ("██████████"): a total net claim of \$6,385 which includes a claim for stock dividends (\$837) and a claim for an undocumented amount of \$548 for which neither ██████████ nor CIPF Staff have any information other than ██████████ advising that it was noted in the Acknowledgement of Claim from the insolvency trustee;
- ██████████ ("██████████"): a total net claim of \$31,581, which includes claims for stock dividends (\$3,590), and also for undocumented amounts (\$2,709), similar to ██████████ claim;

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

- [REDACTED] and [REDACTED] (“joint account”): a total net claim of \$25,200; and
- [REDACTED]: a total net claim of \$10,097.

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

(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 January 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.

7. The Appellant [REDACTED] noted that his son had received a full return of his investment, including interest and that other investors had also received a return of most of their investment. He questioned how this was determined and questioned the actions of the insolvency trustee. Counsel for CIPF Staff confirmed that these were actions taken by the insolvency trustee and outside of the CIPF mandate and function. He noted, however, that the payments from the insolvency trustee were determined from the realized assets of the different First Leaside Group entities (investments), which would account for a variation in the payouts made to investors.

8. [REDACTED] also suggested that the role of the regulatory bodies was less than satisfactory, querying whether the actions of the OSC had in fact caused the insolvency. He expressed his

opinion that the regulators had failed to protect the investors, especially noting the considerable length of the OSC investigation. He further suggested that the Grant Thornton Report encouraged the First Leaside Group to continue to raise money from investors, as the Report had commented that new funds were required to sustain the entities. He stated that CIPF, as an agent of the regulators, failed to protect investors. CIPF is not an agent of the regulators, it is an independent body financed through levies on IIROC Member firms.

9. [REDACTED] also queried the valuations which appeared on his monthly statements in the fall of 2011 noting that his September statement showed value, whereas his November statement showed no value for his investments. The November statement had changed the “market price” for his investments from \$1.00/unit to N/A – Not Available. Since a market price was not available, and all of the investments were in First Leaside Group products, the result was that there was no value showing for the account. In such circumstances, Members are required to follow certain protocols to determine the value of securities which are not publicly traded. As a cease trade order had been issued on October, 31, 2011, Penson (the carrying broker) ceased to show value for the First Leaside Group investments. This was not a statement that the investments were valueless, but that the value was not available.

10. [REDACTED] expressed his concern about the date of the insolvency as determined by CIPF. He submitted that the actual insolvency was much earlier than the February 24, 2012 date which has been the operative date for CIPF purposes. He stated that since the accounts were now showing a zero value that this was to CIPF’s benefit as it could now claim that the decrease in value of the investments was due to market value loss. These are interesting arguments; however, this attributes to CIPF a role greater than its mandate, which is to ensure that property held at Member firm is returned to investors.

11. In this respect, it is important to understand 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 customers of an insolvent Member have received their property. The Appellants have received their property or had it acknowledged by the insolvency trustee; 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.

12. [REDACTED] also questioned as to the origin of the various minimal payouts which had been received by investors. He queried how the insolvency trustee could make these payouts, as the customers' statements were showing that these investments had no value. As was stated above, the zero values were derived from an inability to place an accurate valuation upon the securities; reference to zero values on the statements did not mean that those securities had a zero value. The minimal payouts also demonstrate that the losses suffered by customers were due to the declining value of the underlying assets of the investments, and not the insolvency.

13. There was some issue raised with respect to the claim by [REDACTED] of \$548 as an undocumented amount. [REDACTED] was unable to show whence the claim arose, other than indicating that he relied upon the Acknowledgement of Claim Form from the insolvency trustee which had made reference to this amount. It was speculated that this may have been an upcoming stock dividend, as it appears to have been a practice of the First Leaside Group to show these amounts on investment portfolio valuations, even though they had not yet been received.

14. [REDACTED] also noted that First Leaside was a member of the OSC and IIROC and that their practices had been reviewed by the OSC and other regulators and had passed inspection on more than one occasion. He commented that when the Appellants made their first investment, they were informed that there was CIPF coverage which provided them with some level of comfort. This was reconfirmed through email sent to investors in 2010. He commented that the CIPF and IIROC logos appeared on various of the First Leaside Group literature and promotional material, but nothing was done by these bodies to protect the investors.

15. In their written submissions, the Appellants raised 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. In effect, these arguments suggest that the Appellants' claims are really of fraud, material non-disclosure and misrepresentations.

16. 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. However, as was fully discussed in the October 27, 2014 decision, the Appellants' arguments of the 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 arguments would, in effect, create a new head of coverage relating to fraud, material non-disclosure and misrepresentation. The October 27, 2014 decision deals extensively with these written arguments which were raised. This Appeal Committee adopts the reasoning in the October 27, 2014 decision.

17. The Appellants submit that they were advised by FLSI that they were insured by CIPF. 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 their investments were safe, in that property held in a customer's account of a Member firm would be returned to the customer 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. 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. I have considerable sympathy for the losses suffered by 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

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

Dated at Toronto, this 3rd day of June, 2016.

Brigitte Geisler