

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

RE: [REDACTED]

Heard: February 9, 2016

HEARD BEFORE:

ANNE W. LA FOREST

Appeal Committee Member

APPEARANCES:

Nicolas Businger

) Counsel for Canadian Investor
) Protection Fund Staff

[REDACTED]

) On his own behalf

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 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 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 9, 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 took place at Neeson Arbitration Chambers in Toronto, Ontario. The Appellant was in attendance and made submissions on his own behalf.

Chronology of Events Relevant to the Appellant's Claim

(i) The Appellant's Investments and Claim

4. The Appellant invested in ten different First Leaside Group products between May 20, 2008 and September 20, 2011. The total claim is in the amount of \$1,249,779.32.

5. Certificates representing the Appellant's purchases were either delivered to his possession or the units were transferred to an account in his name at Fidelity Clearing Canada ULC in December 2012. The materials filed before me establish this and statements made by the Appellant during the hearing confirm these matters.

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

(ii) *The Appellant's Application for Compensation*

6. The Appellant applied to CIPF for compensation for his losses in investments made through FLSI. By letter dated December 3, 2014, the Appellant was advised that CIPF Staff were unable to recommend payment of their claims. The relevant parts of the letter to the Appellant read as follows:

Regarding the 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, the loss appears to have been a loss caused by a change in the market value of the 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.

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 securities [which were held off book] were not held by, or in the control of, FLSI. Therefore, the loss is not one that is eligible for CIPF coverage, as indicated above.

Analysis

7. The Appellant provided submissions in writing at the hearing and also made oral submissions. The arguments are summarized and answered below.

8. The Appellant argued that CIPF should provide coverage as it had done so in similar cases in the past where fraud had been present. In this regard, the Appellant referred to the Essex Capital Management Limited matter (“Essex”), a case where the CIPF provided coverage to customers of a Member. The circumstances in Essex differ from the situation in FLSI in a critical sense. As has been noted in other decisions of the Appeal Committee, the Coverage Policy provides coverage in circumstances where, as a result of the insolvency of a Member of CIPF, there is a failure to return or account for property. The opening paragraph of the Coverage Policy reads as follows:

CIPF covers customers of Members who have suffered or may suffer financial loss solely as a result of the insolvency of a Member. *Such loss must be in respect of a claim for the failure of the Member to return or account for securities, cash balances ... or other property, received, acquired or held by, or in the control of, the Member for the customer, including property unlawfully converted.* [emphasis added]

In Essex, it was not the fraud of the Member that resulted in compensation but rather that customer funds were misappropriated and removed from their accounts without authorization such that property could not be returned to investors. That is not this case. In the case of FLSI, customers purchased specific investments relating to specific First Leaside Group entities and received their property either in the form of certificates or their property was accounted for in the customers’ accounts at FLSI. There may well have been fraud and in this regard, the Appellant has noted that both IIROC and the OSC have taken action against the principals of FLSI, but what “triggers” coverage under the Coverage Policy is not fraud but the failure to return or account for property that should have been in customer accounts as at the date of insolvency. The Appellant has received his property and thus this is not an issue for CIPF coverage.

9. The Appellant also objected to the CIPF Staff decision on the basis that the loss was not caused by the insolvency of FLSI but rather was caused by a loss of market value of the units he had purchased. The Appellant argued that the units that were purchased in the First Leaside Group could not be traded and that they are not liquid such that it is inappropriate to refer to market value in this context. The Coverage Policy expressly provides for coverage of financial loss that arises solely as result of the insolvency of the Member. The Coverage Policy also expressly excludes losses that do not result from the insolvency of a Member such as “customer losses that result from changing market values of securities, unsuitable investments or the default of an issuer of securities”. The difficulty in this case is that there is a distinction that must be drawn between FLSI and the issuers representing the First Leaside Group. The Coverage Policy requires that the loss arise from the insolvency of the Member – here FLSI. The loss suffered by the Appellants arises from a decrease in the value of the investments made in the various First Leaside Group products and not from the insolvency of FLSI.

10. The Appellant also noted that the CIPF logo was used to lull investors into a false sense of security and that it had an obligation to provide regulatory oversight and ensure Member compliance. In terms of oversight, it is important to note that CIPF is not a regulator in the sense outlined by the Appellant. The responsibility for enforcement of compliance with industry rules lies primarily with IIROC and in the case of the issuers in the First Leaside Group, with the OSC. 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 in the same way as a regulator. 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. In his written submissions and at the hearing, the Appellant argued that the Appeal Committee should exercise the discretion provided for in the Coverage Policy and that the refusal to cover FLSI customers was being “driven” by the size of the claims being made by FLSI customers and CIPF acting to protect its own interests. Specifically, the Appellant submitted that the CIPF

had underestimated the potential loss that might arise when it accepted FLSI as a Member and as a result, is refusing to cover losses suffered by FLSI customers. In support of this argument, the Appellant referred to another Appeal Committee decision in which the Appeal Committee Member responded as follows to an argument that he should rely on the word “discretion” in the Coverage Policy to cover that appellant’s losses:

As attractive as that position is, particularly where so many investors have lost so much and the consequences of those losses have often been so devastating, it would in my view be beyond judicious discretion to cover the appellant’s \$94,000+ loss in this case. In part I say that because if the Committee were to exercise that discretion ... it would be only reasonable to provide that same coverage to all the FLSI investor clients. The result would be an approximate \$200,000,000 discretionary payment. In any event ‘discretion’ cannot be stretched to allow a whole new classification of coverage that is clearly not included in existing coverage. I decline to make such Order.²

12. In response to this argument, I refer to the October 27, 2014 decision regarding the meaning of the word “discretion” in the Coverage Policy. In that decision, the Appeal Committee discussed the exercise of discretion as follows at paragraph 40:

The Appeal Committee is bound to exercise its discretion within the limits of CIPF’s mandate which is to customers in the event of the insolvency of a Member. Although the Coverage Policy provides a residual discretion allowing departure from the Coverage Policy, the Appeal Committee’s view is that such a departure from the Coverage Policy should only occur where the application of the Policy might otherwise result in an outcome that frustrates or defeats the purpose of the compensation scheme. It was not intended to use that discretion to create a new head of compensation (i.e. fraud, material non-disclosure, misrepresentation, etc.) *which is inconsistent with the purpose and intent of CIPF coverage* [emphasis added].

I rely on this statement here; i.e. the word “discretion” in the Coverage Policy is not intended to allow the establishment of a new category of coverage that is plainly excluded by the purpose and intent of the Coverage Policy. Furthermore, it seems to me that the Appeal Committee Member’s statement in the decision referred to by the Appellant is intended to make this exact point; the word “discretion” cannot be stretched to allow a whole new class of coverage. The Appeal Committee

² Appeal Committee decision dated June 19, 2015 at paragraph 22.

Member refers to the amount of the payment as a means of demonstrating the point. It also strikes me that rather than being driven to exclude payments to appellants, the Appeal Committee member was acknowledging that he would like to make such an order but that it would be improper to do so, given the language of the Coverage Policy.

13. Finally, I would note that the Appellant also made comments in his submissions to the effect that FLSI's insolvency was not caused "of its own accord" but was due to the actions taken by IIROC in the name of public policy. As I have noted in other decisions, the Appeal Committee is not a court and its role is limited to reviewing whether or not the facts as presented are such that they would fall within the terms of the Coverage Policy. I thus make no comments on these points.

14. I have considerable sympathy for the losses suffered by the Appellant but unfortunately, I cannot use discretion in a manner that is inconsistent with the purpose and intent of CIPF coverage and I am otherwise unable to find that his losses fall within the Coverage Policy. The Appellant's losses did not arise from a failure by FLSI to return or account for the Appellant's property.

Disposition

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

Dated at Toronto, this 18th day of March, 2016

Anne Warner La Forest