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

RE: [redacted]

Heard: 16 April 2015

PANEL:

ANNE WARNER LA FOREST		Appeal Committee Member

APPEARANCES:

Scott Allison and [redacted]	)	On behalf of [redacted]
	)	
	)	
James Gibson	)	Counsel for Canadian Investor
	)	Protection Fund Staff

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 1200 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 it was suspended by IIROC on February 24, 2012, the same date FLSI was declared to be insolvent and 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 dated October 27, 2014.[1]

2. The Appellant purchased 150,000 units of the Wimberly Fund (Class B Series 8%) on November 29, 2010. She later transferred 12,000 units of the Wimberly Fund units into Province of Ontario Real Return Bonds on December 12, 2010. At the hearing it became clear that there had also been a further purchase of 12,000 units of the Wimberly Fund as evidenced by a certificate dated December 13, 2010. Her total claim then is for $150,000.00.

3. The Appellants sought recovery from the 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.

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

4. On April 16, 2015, an Appeal Committee Member of CIPF's Board heard the Appellant's appeal. The main issue in the appeal was whether to depart from the decision of CIPF Staff that denied compensation for losses suffered by the Appellant. The appeal was held by teleconference.

Chronology of Events Relevant to the Appellants' Claims

5. As just noted the Appellant held 138,000 units in the Wimberly Fund as of December 12, 2010. This investment was held on book in a registered retirement account and was transferred to Fidelity in December of 2012. As outlined in the Confidential Offering Memorandum relating to the Wimberly Fund dated May 10, 2010, the Wimberly Fund had the capacity to deal with promissory notes issued by First Leaside entities or otherwise with First Leaside securities. As to the certificate dated December 13, 2010, the Appellant was in possession of the certificate of ownership for these units and it thus appears that they were held "off book" and had been delivered to her.

6. The Appellant made her investment after the OSC had begun to investigate FLSI and around the time that the OSC sought third party market valuations of the real property held by limited partnerships owned by the First Leaside Group.

The Appellant's Application for Compensation

7. The Appellant applied to CIPF for compensation for losses in her investments in FLSI prior to the October 12, 2013 deadline for submitting claims that was set by the CIPF Board of Directors. The Appellants also provided additional information setting out her position in her claim forms.

8. By letter dated October 24, 2014, the Appellant was advised that CIPF Staff was unable to recommend payment of her claims. The relevant part of the letter reads 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. In addition, as a basis for explaining your claim, you stated: "[...]The removal of market price for the Wimberly shares indicated on the November 30, 2011 account statement came directly after the Ontario Securities Commission and FLSI agreed

> that FLSI would cease trading securities on 7 November 2011. Thus the apparent loss in the investment came as a result of the insolvency of FLSI, not a change in the market value of the security, an unsuitable investment, or the default of the issuer of the security [...]"
>
> 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 breach 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 other 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.
>
> In addition, with respect to the securities that your purchased, they were properly recorded in the books and records of FLSI at the date of insolvency . Those securities were transferred to an account in your name at another IIROC Dealer Member subsequent to February 24, 2012. Therefore, the loss is not one that is eligible for CIPF coverage, as indicated above.

9. The Appellant requested an appeal on January 30, 2015. Additional material was submitted on April 2, 2015.

Analysis

10. The Appellant made submissions in the correspondence mentioned above. Many of the arguments raised by the Appellants are similar to those that were addressed in the October 27, 2014 decision and in this regard, I rely upon our analysis in that decision at paragraphs 27 through 49.

11. The Appellants emphasized two arguments at the hearing.

12. First, the in their written submissions, the Appellant's counsel argued that CIPF should not be able to evade responsibility in circumstances where investors are relying upon protection that is not fully explained but advertised by the dealer and relied upon by the investor. In support of this submission, the Appellant referred to statements made in the CIPF brochure to the effect that dealer insolvency does not happen very often because IIROC, the Securities Commissions, and CIPF

require that members comply with regulatory procedures. The Appellant also referred to an interview with the then Chair of the CIPF Coverage Committee in which he stated as follows: "Investment advisors play an important role in helping their clients understand the inherent risks associated with all types of investments. CIPF relies on investment advisors taking the time to explain what CIPF coverage does and doesn't protect." Finally, reference was made to the CIPF disclosure policy which does not include any requirement that dealers provide materials on or explain CIPF coverage policy or limits.

13. In their oral submissions, counsel for the Appellant expressly referred to a letter from the Appellant in which she stated as follows: "CIPF Membership [is] stamped on stationary from First Leaside. We were led to believe that only responsible ethical entities could belong to CIPF. Membership implied there was on-going governance, due-diligence and compliance with government regulations."

14. For his part, counsel for CIPF Staff stated that the role of the Appeal Committee is to interpret the language in the Coverage Policy. In reviewing the language of that policy, he quite correctly stated that the circumstances in this case simply do not fall within the scope of coverage. Specifically, coverage under the Policy extends to losses that arise as a result of a member's insolvency. While counsel for CIPF acknowledged that the Appellant had suffered losses, the losses were those of an issuer of securities, the Wimberly Fund, and not the member. Furthermore, the loss must be one where the CIPF member fails to account for securities or cash held by or in the control of the member. In this case, it was acknowledged by the Appellant that 138,000 units in the Fund had been transferred to Fidelity and that Fidelity held the certificate for the remaining 12,000 units in the Wimberly Fund.

15. Looking beyond the policy, CIPF does not have control over how the scope of coverage is described by others. As we indicated in the October 27, 2014 decision, the CIPF brochure does outline limitations on coverage. Furthermore, any misrepresentations in relation to CIPF were made by FLSI and oversight of members is within the jurisdiction of IIROC. While there is no question that the principals of FLSI acted wrongfully, those actions constitute regulatory breaches and are not within the scope of the Coverage Policy.

16. Second, the Appellant submitted that the date of declared insolvency, February 24, 2012, is arbitrary and that a more appropriate date would be November 7, 2011, the date that FLSI advised its investors that it had agreed to voluntarily cease trading. In support of this argument, counsel for the Appellant directed us to the Coverage Policy which provides that "the date at which the financial loss of a customer is determined shall be fixed by CIPF as the date of bankruptcy of the Member, if applicable, or the date on which, in the opinion of CIPF, the Member became insolvent". He then referred us to a definition of the term, "insolvent" from the CIPF website which provides that "for purposes of CIPF coverage, a CIPF Member is insolvent when a trustee/receiver has been appointed or when customers cease to have unrestricted access to their accounts, for example because the CIPF Member has been suspended by IIROC". Counsel for the Appellant submitted that investors ceased to have any access to their accounts by November 7, 2011.

17. By reference to the CIPF website, counsel for the Appellant then argued that the loss should be assessed by reference to the total client net equity – the total market value of the assets in the account – using the last statements that were issued to the Appellant on September 30, 2011. These statements indicated a value of $1 per unit. Since the Appellant held 150,000 units, he argued that she was entitled to recover $150,000.

18. For its part, counsel for CIPF Staff referred to the same provision in the Coverage Policy, noting that it provides for the alternatives of bankruptcy, or the on date which, in the opinion of the Directors, the member became insolvent. In this regard, he pointed out that in an earlier section of the Coverage Policy, there is reference to the directors exercising discretion in a manner that is consistent with the right and extent to which a person may be entitled to claim against the customer pool fund of a member under the *Bankruptcy and Insolvency Act*. His point here was that the discretion referred to in the Coverage Policy is often exercised to ensure that parallel proceedings under the *Bankruptcy and Insolvency Act* proceed smoothly using the same date of bankruptcy. In this case the date of bankruptcy was settled by the trustee as February 24, 2012 and the date for CIPF coverage is consistent with that date. As for ceasing to have access to their accounts, counsel for CIPF Staff again drew a distinction between FLSI and the First Leaside Group, pointing out that the voluntary cease trade in this case referred to the First Leaside Group and not FLSI, the IIROC

and CIPF Member. Finally, counsel for the Appellant suggested that the approach of net equity argued for by the Appellant was not appropriate in these circumstances on the basis that the value provided for on the statement was simply a reference to the purchase price of the units and not a market value of the assets in the Appellant's account. This is because the units were not publicly traded. In his submission, the value of the units was a matter for the trustee in bankruptcy or the Appeal Committee to determine.

19. In a previous hearing before the Appeal Committee, another claimant sought to challenge the date of insolvency adopted by the directors of CIPF. It is important to restate that the Coverage Policy is concerned only with the insolvency of the member - here FLSI - and not the issuers in whose investment vehicles the investors have placed their monies. In this regard, the Coverage Policy states:

> The date at which the financial loss of a customer is determined shall be fixed by the Directors as the date of bankruptcy *of the Member*, if applicable, or the date on which, in the opinion of the Directors, the Member became insolvent.

In this case, CCAA proceedings were commenced on February 23, 2012 and the following day, FLSI was suspended by IIROC. In any event, it was determined by the Appeal Committee that the date of FLSI's insolvency is not an issue to be debated as part of proceedings before the Appeal Committee; the date of bankruptcy of the Member is determined by the Directors. Given these comments, there is no need to assess the net equity of the units as of November 7, 2011.

20. The Appeal Committee has considerable sympathy for the Appellants. As I stated at the hearing, the Appellant engaged in more due diligence than is often the case. Unfortunately, her submissions do not give rise to a successful claim for compensation from CIPF.

Disposition

21. The appeal is dismissed. The decision of the CIPF Staff is upheld.

Dated at Toronto, this 28th day of April, 2015.

Anne Warner La Forest