

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

RE: [REDACTED]

Heard: January 29, 2016

HEARD BEFORE:

BRIGITTE GEISLER

Appeal Committee Member

APPEARANCES:

[REDACTED]

) On his own behalf

Nicolas Businger

) 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 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 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 January 29, 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 took place at Neeson Arbitration Chambers in Toronto, Ontario. The Appellant was in attendance.

Chronology of Events Relevant to the Appellant's Claim

(i) The Appellant's Investments and Claim

4. The Appellant claims the net amount of \$60,813.40² with respect to his purchases of four First Leaside Group products. The claim includes a claim for an undocumented amount of \$591.38 in relation to the Wimberly Fund (Class C Series 8%). According to the records available to CIPF Staff, 104,555 units of First Leaside Fund (Series C) were recorded on the books and records of FLSI at the date of insolvency. The Appellant makes a claim of \$12,102.02 with respect to this investment. The Appeal Committee accepts the Appellant's calculations with respect to the claim amounts.

5. Certificates representing the Appellant's purchases were either delivered to the Appellant's possession or were transferred to an account in his name at Fidelity Clearing Canada ULC.

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

² The claim total of \$55,813.40 submitted by [REDACTED] in his claim form is miscalculated. The sum total of the investments claimed is \$60,813.40.

(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 September 26, 2014, the Appellant was advised that CIPF Staff were unable to recommend payment of his claim. The relevant parts of the letter read 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. 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 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.

Analysis

7. The Appellant included in his written appeal 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 Appellant submitted that he intended the funds he 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. Although I was unable to reconcile the amounts claimed with the dates of purchase, it would appear that the Appellant is attempting to restrict his claim to investments made after 2008 to coincide with the time periods during which the OSC was conducting its investigation of the First Leaside Group.

9. As stated in other Appeal Committee decisions, these arguments suggest that the Appellant's claim is really of fraud, material non-disclosure and misrepresentations. However, as was discussed fully in the October 27, 2014 decision, these arguments 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. Such an interpretation would, in effect, create a new head of coverage.

10. The Appellant noted that when he began investing with the First Leaside Group, some of his investments were in the form of direct loans to First Leaside Wealth Management. The Appellant contended that as a consequence of FLSI gaining membership in the Investment Dealers Association ("IDA", now IIROC), in 2004, the IDA required that these loans to the parent company of FLSI be converted into specific investment products. He asserted that this was a deliberate action on the part of the IDA to avoid a scenario similar to that of Essex Capital Management Limited ("Essex"), wherein compensation was paid to customers who had lent money to the IDA Member.

11. The Essex circumstances were different from what occurred with FLSI. In the Essex matter, customers invested in a product manufactured by Essex, called corporate investment certificates, which were unlawful under banking regulations (as Essex was acting in a deposit taking function without authorization). Further, the investments were not actually made as no certificates representing these investments were deposited with Essex's carrying broker, and, in some cases, the customers' funds were misappropriated and removed from their accounts without authorization. CIPF coverage was applicable because the customers' property was unavailable to be returned.

12. As well, in the Essex matter, only customers of Essex itself were compensated by CIPF. Other investors who had dealt directly with a related company called Nelbar Financial Corporation ("Nelbar") were not eligible for compensation through CIPF as Nelbar was not an IDA Member. Similarly, if the Appellant made investments or loans directly to the First Leaside Group he would not be eligible for CIPF coverage as none of those entities is an IIROC member.

13. In the case of FLSI, customers purchased specific investments relating to specific First Leaside Group entities and received certificates representing their investments. There was no misappropriation, as investments were purchased as directed. There may have been misconduct by agents of FLSI with respect to representations regarding the suitability of the investment in a particular First Leaside Group entity and CIPF coverage, but CIPF specifically does not provide coverage in instances of broker misconduct.

14. The Appellant appears to have suggested that if he had been a creditor of FLSI, rather than a customer, he would have been in a better position with respect to investments made with FLSI. Whether or not that would be the case is unknown, however, a claim would have ranked with other creditors of the corporate entity. There would be no coverage under the CIPF Coverage Policy which requires that the customer must have an account with the Member for the purpose of transacting securities. Providing a loan to the Member would not make the creditor an “eligible customer”.³

15. The Appellant suggested that CIPF is a mere extension of IIROC. That is not a correct assertion. While CIPF fees are collected from IIROC members and CIPF coverage is restricted to IIROC members, the two entities are separate and distinct in their functions, powers and obligations. IIROC is a regulatory body with authority to discipline its members. CIPF is a not-for-profit entity created for the sole purpose to guarantee the return of customer assets held at an insolvent IIROC member. This return of assets does not include an insurance against the default of an issuer or the loss of value of an investment.

16. The Appellant submitted that the discretion available in the Coverage Policy be exercised to his benefit. Counsel for CIPF Staff noted that the discretion is not boundless. As stated in the October 27, 2014 decision, the exercise of discretion is to be limited to circumstances where the outcome would frustrate or defeat the purpose of the compensation scheme. The exercise of

³ See Appeal Record, Volume 1, page 105 – Coverage Policy as of September 30, 2010.

discretion should not create a new category of compensation as has been suggested by many Appellants.

17. The Appellant also submitted that he was misled regarding the nature of CIPF coverage which, he noted, was prominently displayed on various FLSI documentation and promotional material. The Appeal Committee has previously heard this argument and have sympathy for the investors who may have been misled by how FLSI characterized CIPF coverage. However, as stated above, CIPF is not a regulator. The improper or misleading use of the CIPF logo and concerns that have been expressed by investors that CIPF's own brochure could be more direct in its language has been noted by the Appeal Committee and the Board of Directors of CIPF.

18. CIPF's mandate and its coverage is custodial in nature; in other words, to ensure that the clients of an insolvent member have received their property. The Appellant has received his 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".

19. I have sympathy for the losses suffered by the Appellant; however, I conclude that the Appellant's submissions in this appeal are not persuasive and do not give rise to a successful claim.

Disposition

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

Dated at Toronto, this 4th day of February, 2016

Brigitte Geisler