

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

RE: [REDACTED]; [REDACTED]

Heard: 13 January 2015

PANEL:

ANNE WARNER LA FOREST

Appeal Committee Member

APPEARANCES:

[REDACTED]

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)

On their own behalves

James Gibson

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Counsel for Canadian Investor
Protection Fund Staff

Sam Robinson

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Independent Legal Counsel for the
Appeal Committee of the Canadian
Investor Protection Fund

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 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 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. FLSI was declared to be insolvent on February 24, 2012. The following investments were made by the Appellants:

- i. [REDACTED] purchased 5,000 units of First Leaside Properties Fund (Class B) on March 27, 2009 and 5,496 units of First Leaside Properties Fund (Class B) on May 7, 2010 for a total investment of \$10,496.
- ii. [REDACTED] made investments in a number of First Leaside products for a total investment cost claim of \$410,505.

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 CIPF Fund that 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

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

insolvency of FLSI and thus were not covered under the CIPF Coverage Policy dated September 30, 2010.

4. On January 13, 2015, an Appeal Committee Member of CIPF's Board heard the Appellants' appeals. The main issue in each appeal is to determine whether to depart from the decision of CIPF Staff which denied compensation for losses suffered by the Appellant. The appeals were heard together at Neeson Arbitration Chambers in Toronto, Ontario and the hearing was open to the public. [REDACTED] and [REDACTED] were in attendance and made submissions on their own behalves.

Chronology of Events Relevant to the Appellants' Claims

5. [REDACTED] is now [REDACTED] years of age and is retired. As noted above, she had purchased 10,496 units in First Leaside Properties Fund (Class B) and these amounts were held in a TFSA account. Both of these investments were held on book and were transferred to Fidelity in December of 2012 following FLSI's insolvency.

6. [REDACTED] is now [REDACTED] years of age and described himself as a person with average knowledge of investments. He became an investor with FLSI in 2006. His investments are listed, in summary as follows:

- i. 200,000 units of First Leaside Fund, Series B on September 11, 2006;
- ii. 200,000 units of First Leaside Series II Preferred Shares on May 16, 2007;
- iii. 5,000 units of First Leaside Properties Fund (Class B) on March 27, 2009; and
- iv. 5,505 units of First Leaside Properties Fund (Class B) on May 7, 2010.

7. The investments in the First Leaside Fund, Series B and First Leasides Series II Preferred Shares were held in a registered retirement account and the investments in First Leaside Properties Fund were held in a TFSA account. All of these investments were held on book and were transferred to Fidelity in December of 2012 following FLSI's insolvency.

8. The losses suffered by the Appellants have had a significant impact on their retirement plans and they have been forced to sell their home. The Appellants indicated that as late as October of 2011, John Wilson of FLSI was encouraging them to invest and they had agreed to invest a further \$115,000 but fortunately, due to the timing of the shutdown of FLSI, the cheque was not cashed and was returned to them.

The Appellants' Application for Compensation

9. The Appellants applied to CIPF for compensation for their losses in investments made through 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 regarding the claim and specifically, on a claim form dated 15 March 2012, [REDACTED] indicated that the amount claimed was due to the default of an issue of securities. Written correspondence dated September 29, 2013 was also provided.

10. By letters dated April 24, 2014 and July 10, 2014, the Appellants were advised that CIPF Staff was unable to recommend payment of their claims. The relevant parts of the letter reads as follows:

[REDACTED]: 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 investment 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.

In addition, with respect to the securities that you 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 Deal Member subsequent to February 24, 2012.

██████████: 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 investment 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.

In addition, with respect to the securities that you 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 Deal Member subsequent to February 24, 2012.

You also indicated that your loss, or part of it, was a result of "the default of an issuer of securities". As mentioned above, losses resulting from the default of an issuer of securities are not covered by CIPF.

11. The Appellants provided a written response to the decision of the CIPF staff. ██████████' response is dated May 11, 2014 and the response of ██████████ is dated July 17, 2014.

Analysis

12. All of the investments made by the Appellants with the exception of the investments on May 7, 2010 predate regulators' inquiries into FLSI, which began in the fall of 2009. The Appellant ██████████ acknowledged that he started receiving monthly distributions on his First Leaside investments on April 9, 2007 and did so until October 14, 2011. The total amount received was \$220,400.00

13. Both of the Appellants made arguments in their correspondence mentioned above and at the oral hearing. Many of the arguments raised by the Appellants are similar to those that were addressed in the October 27th 2014 decision and in this regard, we rely upon our analysis in that decision at paragraphs 27 through 49. The Appellants emphasized certain arguments in relation to their own circumstances.

14. First, the Appellant's submissions focussed on the fact that FLSI made a point of featuring CIPF logos on all their statements and promotional materials and FLSI representative told them that they would be protected by the CIPF. These actions gave them more confidence in investing. In their view, the CIPF logo gave the illusion of protection to investors and in effect allowed IIROC members to use the logo as a marketing strategy and to give the member a degree of legitimacy that encouraged reliance by investors. As one of the Appellants put the matter, the CIPF logo allowed Fund members the opportunity to get business and that in their view gave rise to a corresponding duty of oversight. The Appellants stated that they invested in FLSI because the CIPF logos were there. 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.

15. Second, the Appellants stated that in their view, their funds were unlawfully converted and that their losses fell within the phrase "including property unlawfully converted" in the Coverage Policy. The Appellants argue that the funds they invested were to have been invested in proprietary First Leaside products on the understanding that such funds would be invested in those products for the primary purpose of funding the acquisition and/or development of various real estate products. The Appeal Committee is of the view that the Appellants' claim is really one of fraud, material non-disclosure and/or misrepresentation and does not fall within the meaning of the phrase "including property unlawfully converted". Such an interpretation would in effect create a new head of coverage.

16. Third, the Appellants also argued that the Appeal Committee was given discretion by the Coverage Policy and that we had the capacity to provide coverage if we wanted to do so. As we have indicated in the October 27, 2014 decision, the Appeal Committee is bound to exercise its discretion within the limits of the CIPF mandate which is to provide custodial coverage to customers in the event of the insolvency of a Member. While the Coverage Policy provides a residual discretion, it is limited to cases where the application of the Policy might result in an outcome that frustrates or defeats the purpose of the compensation scheme. It is not intended to use discretion to create a new head of compensation such as misrepresentation or the default of an issuer. In his submissions, counsel for CIPF Staff stated that the levies charged for CIPF coverage

were based upon a particular understanding of coverage to ensure that the cost of investment remained reasonable. Thus, our discretion is limited to the Coverage Policy which, in general terms, provides for the return of the Appellants' property. In this case, the Appellants' investments were held by FLSI at the date of insolvency and were subsequently transferred to Fidelity.

17. Finally, there was some argument to the effect that the Coverage Policy had been revised in 2010 after the OSC began their investigation in the fall of 2009. The Appellants expressed concern that those changes might be related to the FLSI insolvency. CIPF Staff in their submissions made clear that the changes that occurred in the Coverage Policy during the period in question related to changes in self regulatory organizations and specifically, the emergence of IIROC.

18. The Appeal Committee appreciated the care with which the Appellants made their submissions and in particular their comments relating to preventing problems of this kind in the future. Unfortunately, their submissions do not give rise to a successful claim for compensation from CIPF.

Disposition

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

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

Anne Warner La Forest