

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

RE: [REDACTED] and [REDACTED]

May 15, 2015

WRITTEN APPEAL CONSIDERED BY:

BRIGITTE GEISLER

Appeal Committee Member

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 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 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 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

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

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. The Appellants requested that their appeal be considered on the basis of written materials which they provided.

Chronology of Events Relevant to the Appellants' Claim

(i) The Appellants' Investments and Claim

4. The claim arises from the Appellants' purchases of various First Leaside Group products as follows:

██████████:

- i. 49,000 shares of First Leaside Wealth Management Preferred Shares for a cost of \$49,000 purchased on April 1, 2004;²
- ii. 416 units of First Leaside Fund (Series B) for a cost of \$498.33 on October 14, 2005; 416 units purchased for a cost of \$494.37 on October 17, 2005; and a further purchase of 6 units for a cost of \$7.08 on October 27, 2005. A further claim arising out of acquisition of units in this fund at an unknown date and purchase cost is made for \$521.00;
- iii. 416 units of First Leaside Fund (Series B) for a cost of \$494.37 on October 17, 2005, and a further purchase of 3 units for a cost of \$3.54 on October 27, 2005. A further claim is made in relation to 51 units acquired at an unknown date and purchase cost. These units were exchanged for 470 units of First Leaside Fund Series B Trust Units on December 29, 2006;

² The Appellant ██████████ has claimed a value of \$1.25 per share for a claim of \$61,250.

- iv. 25,000 units of First Leaside Expansion Limited Partnership on November 16, 2005 for a cost of \$25,000. A further 6,777 units were purchased on December 24, 2010 for a cost of \$6,777;
- v. 1,151 units of First Leaside Properties Fund (Class B) purchased on March 27, 2009 for a cost of \$1,151;
- vi. 519 units of First Leaside Properties Fund (Class C) purchased on March 27, 2009 for \$519. Stock dividends were received on December 31, 2009 and December 31, 2010 for 36 and 5 units, respectively. A further amount of \$94.49 is claimed in relation to units acquired at an unknown purchase price and date;
- vii. 5,000 units of First Leaside Properties Fund (Class C) purchased on May 1, 2009 for \$5,000. Stock dividends were received on December 31, 2009 and April 15, 2011 for 307 and 498 units, respectively. A further amount of \$451.36 is claimed in relation to units acquired at an unknown purchase price and date;
- viii. 5,000 units of First Leaside Fund (Series C) purchased on January 28, 2010 for a cost of \$5,000. A stock dividend was received on April 15, 2011 for 444 units. A further amount of \$431.62 is claimed in relation to units acquired at an unknown purchase price and date;
- ix. 6,800 units of First Leaside Fund (Series C) purchased on January 28, 2010 for a cost of \$6,800. A further amount of \$1,190.84 is claimed in relation to units acquired at an unknown purchase price and date;
- x. 5,000 units of First Leaside Wealth Management Fund purchased on June 14, 2011 for a cost of \$5,000.

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- xi. 31,000 shares of First Leaside Wealth Management Preferred Shares for a cost of \$31,000 purchased on April 1, 2004;³
- xii. 416 units of First Leaside Fund (Series B) for a cost of \$498.33 on October 14, 2005; and a further purchase of 3 units for a cost of \$3.54 on October 27, 2005. On October 17, 2005, an additional 416 units for a cost of \$494.37 were purchased, with a further purchase of 3 units

³ The Appellant ██████████ has claimed a value of \$1.25 per share for a claim of \$38,628.

- for a cost of \$3.54 on October 27, 2005. A further claim is made in relation to 51 units acquired at unknown date and purchase cost. The October 17, 2005 and 3 of the October 27, 2005 units were exchanged for 470 units of First Leaside Fund Series B Trust Units on December 29, 2006. An additional claim of \$51 is also made in relation to units acquired at an unknown date and purchase cost;
- xiii. 25,000 units of First Leaside Expansion Limited Partnership on November 16, 2005 for a cost of \$25,000. A further 6,090 units were purchased on December 24, 2010 for a cost of \$6,090. A claim of \$25,000 is also made in relation to units acquired at an unknown date or purchase price;
 - xiv. 1,222 units of First Leaside Properties Fund (Class B) purchased on March 27, 2009 at a cost of \$1,222;
 - xv. 5,000 units of First Leaside Properties Fund (Class C) purchased on May 1, 2009 for \$5,000. Stock dividends were received on December 31, 2009 and April 15, 2011 for 339 and 32 units, respectively. A further amount of \$1,140 is claimed in relation to units acquired at an unknown purchase price and date;
 - xvi. 8,379 units of First Leaside Fund (Series C) purchased on January 28, 2010 for a cost of \$8,379. A stock dividend was received on April 15, 2011 for 444 units. A further amount of \$299.20 is claimed with in relation to units acquired at an unknown purchase price and date;
 - xvii. 5,000 units of First Leaside Wealth Management Fund purchased on June 14, 2011 for a cost of \$5,000.

- ██████████ or ██████████
- xviii. 29,851 units of Wimberly Apartments Limited Partnership for a cost of \$20,000.17 on December 9, 2004. A further 45,617 units were purchased on December 16, 2009 for \$31,931.90. However, the claim is for \$40,623.27;
 - xix. 50,000 units of First Leaside Expansion Limited Partnership for a cost of \$50,000 on October 17, 2005; a further 100,000 and 30,000 units were purchased on December 13, 2007 and December 24, 2010 for \$100,000 and \$30,000, respectively. A further claim is made in relation to 105,000 units acquired at an unknown date and purchase cost;

- xx. 50,000 units of First Leaside Visions 1 Limited Partnership on December 13, 2007 for a cost of \$50,000;
- xxi. 56,046 units of First Leaside Elite Limited Partnership on September 8, 2008 for a cost of \$56,046;
- xxii. 50,049 units of Development Notes Limited Partnership purchased on August 19, 2009 for a cost of \$50,049. A further purchase of 60,000 units for \$60,000 was made on August 6, 2010;
- xxiii. 60,000 units of First Leaside Wealth Management Fund purchased on December 24, 2010 for \$60,000.
- xxiv. 60,000 units of Special Notes Limited Partnership purchased on September 9, 2011 for \$60,000;
- xxv. \$55,000 in relation to the purchase of an unknown number of units of First Leaside on an unknown date;
- xxvi. \$14,023 in relation to the purchase of an unknown number of units of First Leaside Fund (Series B) on an unknown date; and
- xxvii. \$329,301 in relation to purchase of an unknown number of units of First Leaside Fund (Series A) on an unknown date.

5. The majority of the securities were delivered out to the Appellants with the exception of the following which were transferred to accounts in the names of the Appellants at Fidelity Clearing Canada ULC (“Fidelity”):

- a. the securities listed in paragraph 4 (iii); (vii); (viii); (x);
- b. 5805 units of First Leaside Properties Fund (Class C), as described in paragraph 4 (xv);
- c. 5,444 units of First Leaside Fund (Series C), as described in paragraph 4 (xvi); and
- d. the security listed in paragraph 4 (xvii).

(ii) The Appellants’ Application for Compensation

6. The Appellants applied to CIPF on October 22, 2012 for compensation for their losses in investments made through FLSI. By letters dated December 30, 2013, the Appellants were advised

that CIPF Staff were unable to recommend payment of their claims. The relevant parts of the letters read as follows:

██████████: CIPF does not cover customers' losses that result from other causes such as dealer misconduct, changing market values of securities, unsuitable investments or the default of an issuer of securities.

With respect to the securities that you purchased, and which are described in Table 1 below,⁴ 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 IROC Dealer Member subsequent to February 24, 2012.

At the date of insolvency, the securities described in Table 2 below,⁵ 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.

In addition you indicated that you 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.

██████████: As a basis for explaining your claim to CIPF, you stated: "Loss of funds that were insured by CIPF." 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 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.

With respect to the securities that you purchased, and which are described in Table 1 below,⁶ 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 IROC Dealer Member subsequent to February 24, 2012.

At the date of insolvency, the securities described in Table 2 below,⁷ 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.

⁴ See paragraph 5 for details of which securities were transferred to Fidelity.

⁵ See paragraph 5 for details of which securities were in the possession of the Appellant.

⁶ See paragraph 5 for details of which securities were transferred to Fidelity.

⁷ See paragraph 5 for details of which securities were in the possession of the Appellant,

In addition you indicated that you 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.

██████████ or ██████████: CIPF does not cover customers’ losses that result from other causes such as dealer misconduct, changing market values of securities, unsuitable investments or the default of an issuer of securities. In addition, we note that the CIPF Coverage Policy limits coverage to CDN \$1 million per account.

At the date of insolvency, the securities described in the table below,⁸ 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.

In addition you indicated that you 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.

Analysis

7. The Appellants raised arguments similar to those advanced at the October 27, 2014 hearing. This included interpretation of the phrase “including property unlawfully converted” in the Coverage Policy. The Appellants argued 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. They submitted that all of their investments were made after 2008, during the period in which the Ontario Securities Commission (“OSC”) was investigating the First Leaside Group⁹, and were unlawfully converted by FLSI for their own use.

8. After reviewing the dates of the investments, I have concluded that this submission cannot be wholly substantiated. Of the total claimed amounts of \$1,293,386.27, only 27.55% of those investments for which the dates can be verified were made after 2008. The majority of the investments by the Appellants were either made prior to 2009, were stock dividends received (and

⁸ See paragraph 5 for details of which securities were in the possession of the Appellant.

⁹ The OSC investigation began in the fall of 2009. For ease of the calculations in paragraph 8, all purchases made in 2009 were deemed to be after the OSC began its investigations, even though some purchases were made in the first half of 2009.

as such were not funds deposited with the First Leaside Group), or were investments for which no documentation supporting the amount or date of the investment has been submitted. Any submissions relating to the allegation of “property unlawfully converted” would not be applicable to 72.45% of the claimed amounts.

9. With respect to that portion of the Appellants’ claims for investments made after 2008, the Appeal Committee is of the view that the adoption of these arguments suggests that the Appellants’ claims are really of fraud, material non-disclosure and/or misrepresentation which does not fall within the meaning of the phrase "including property unlawfully converted" as was discussed fully in the October 27, 2014 decision. Such an interpretation would in effect create a new head of coverage.

10. The Appellants addressed what they felt were shortcomings by the regulators with respect to FLSI. This included an obligation by the OSC and IIROC to regulate the conduct of the First Leaside Group. They noted that FLSI had been in business for at least 20 years and during that period of time the First Leaside Group appeared to be operating profitably. They questioned how IIROC could have continued “to endorse First Leaside for SEVEN YEARS, if the investment options provided did not meet IIROC’s ‘high regulatory and investment industry standards’”.

11. IIROC’s regulatory function relates to the business and operations of FLSI. It does not have jurisdiction over the various proprietary products that were marketed by FLSI to various investors. Those products, or issuers, were under the jurisdiction of the OSC, which, having concerns over those operations, began an investigation into the First Leaside Group in the fall of 2009. The jurisdiction of IIROC, and by extension, CIPF, within the limits of its mandate, is confined to FLSI only.

12. The Appellants also submitted that the First Leaside Group of products should not have been sold to them as they were not “accredited investors”, which they submitted was a required designation in order to purchase their investments. They offered no substantiation for this submission other than their own statements and copies of tax summaries for various years for [REDACTED]

█. While various FLSI new account application forms for the Appellants were also provided, all of the financial information has been redacted.

13. The purchase of prospectus funds does not require that the purchaser be an “accredited investor”. Various other products may require that designation. Whether or not the Appellants did qualify, or in fact, needed to qualify as accredited investors, is a regulatory function, and not part of CIPF’s mandate.

14. CIPF is not a regulator. Its mandate and its coverage is custodial in nature, in other words, to ensure that the clients of an insolvent member have received their property. This custodial coverage is set out in CIPF’s mandate, which is approved by the OSC and other provincial securities regulators. The mandate is restricted to this coverage, and does not extend to coverage for fraud, material non-disclosure and/or misrepresentation. The nature and extent of the coverage is discussed in full in the October 27, 2014 decision.

15. The October 27, 2014 decision deals extensively with the Appellants’ arguments and the reasoning in the October 27, 2014 decision is adopted by this Appeal Committee. As in the October 27, 2014 decision, 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

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

Dated at Toronto, this 19th day of May, 2015

Brigitte Geisler

Brigitte Geisler