

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

RE: [REDACTED]; [REDACTED]; [REDACTED] and [REDACTED];
[REDACTED]

Heard: June 15, 2015, by teleconference

HEARD BEFORE:

BRIGITTE GEISLER

Appeal Committee Member

APPEARANCES:

James Gibson

)

Counsel for Canadian Investor
Protection Fund Staff

)

[REDACTED]

)

On his own behalf and on behalf of [REDACTED]
and [REDACTED]

DECISION AND REASONS

Introduction and Overview

1. [REDACTED], [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 (“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 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 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 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 June 15, 2015 an Appeal Committee Member of CIPF’s Board heard an appeal to determine whether to depart from the decision of CIPF Staff. [REDACTED] represented himself and all of the Appellants at the hearing which proceeded by way of teleconference.

Chronology of Events Relevant to the Appellants’ Claims

(i) The Appellants’ Investments and Claim

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

- i. [REDACTED] 2,260 units of Wimberly Fund (Class B Series 8%) purchased for \$2,260 on March 25, 2010; a further 30,740 units purchased for \$30,740 on September 23, 2010; and a further 2,500 units purchased for \$2,500 on November 2, 2010;

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

- ii. 3,000 units of Wimberly Fund (Class B Series 8%) purchased for \$3,000 on June 1, 2010²;
- iii. 25,000 units of Wimberly Fund (Class B Series 8%) purchased for \$25,000 on September 23, 2010;
- iv. 20,000 units of First Leaside Mortgage Fund purchased for \$20,000 on September 23, 2010;
- v. 3,750 units of Wimberly Fund (Class B Series 7%) purchased for \$3,750 on December 6, 2010;
- vi. 20,000 units of First Leaside Mortgage Fund purchased for \$20,000 on December 7, 2010; and
- vii. 5,000 units of First Leaside Wealth Management Fund purchased for \$5,000 on May 24, 2011.

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- viii. 3,000 units of Wimberly Fund Class B 8% Designation 2010 purchased for \$3,000 on June 1, 2010³;
- ix. 13,660 units of Wimberly Class B Series 8% Designation 2010 purchased for \$13,660, being 3,160 units on March 25, 2010; 8,000 units on September 23, 2010, and 2,500 units on November 2, 2010;
- x. 3,750 units of Wimberly Fund Class B Series 7% Designation 2010 purchased for \$3,750 on December 6, 2010; and
- xi. 5,000 units of First Leaside Wealth Management Fund purchased for \$5,000 on May 24, 2011.

██████████ *and* ██████████:

- xii. 23,530 units of First Leaside Premier Limited Partnership purchased for USD\$23,530 on December 23, 2009;⁴

² ██████████ Claim Form reflects a claim for 3,120 units at a value of \$2,780. See Appeal Record, Volume 1, page 197

³ ██████████ Claim Form reflects a claim for 3,040 units at a value of \$2,700. See Appeal Record, Volume 1, page 89.

⁴ The Appellants' Claim Form shows a claim for USD \$23,529.65. See Appeal Record, Volume 1, page 62.

██████████:

- xiii. 35,000 First Leaside Wealth Management Series II Preferred Shares purchased for \$35,000 on September 3, 2010;⁵ and
- xiv. 40,247 units of Wimberly Fund (Class A, Series 8%) purchased for US \$40,247 on September 8, 2010.⁶

5. These securities in the accounts of ██████████ were transferred to accounts in the name of ██████████ at Fidelity Clearing Canada ULC (“Fidelity”) following FLSI’s insolvency, with the exception of items (iii) and (iv). Those securities and the securities in the accounts for the other Appellants were delivered into the possession of the respective Appellants.

6. ██████████, when asked to confirm that his securities were accounted for, indicated that there was inconsistency between his consolidated investment statements from FLSI and the individual monthly statements for the Appellants. CIPF Staff suggested that the discrepancy was the result of some securities having been delivered into the possession of the Appellants and therefore would not show on the monthly statements whereas the consolidated statements would show all investments made with FLSI. ██████████ indicated that he would review his records within the next 48 hours. The Appeal Committee advised that failing his notification to CIPF within that time that there was an issue, the Appeal Committee would conclude that all securities had, in fact, been accounted for. CIPF Staff have confirmed that none of the Appellants have contacted them within the prescribed period of time.

7. By letter dated January 22, 2015, the Appellants confirmed receipt of distributions from Grant Thornton in the amounts of USD\$1,910.60 and CAD\$331.92.

⁵ The Appellants’ Claim Form shows a claim for \$34,249.99. See Appeal Record, Volume 1, page 44.

⁶ The Appellants’ Claim Form shows a claim for \$39,542.57. See Appeal Record, Volume 1, page 44.

The Appellants' Applications for Compensation

8. The Appellants applied to CIPF on May 6, 2013 for compensation for their losses in investments made through FLSI. By letters dated December 20, 2013, the Appellants were advised that CIPF Staff was unable to recommend payment of their claims. The relevant parts of the letters read as follow:

██████, ██████, and ██████ and ██████:

As the basis for explaining your claim to CIPF, you stated:

“Loss occurred due to fraudulent activities at First Leaside. The company was already under investigation by OSC before I started investment and I was not aware of that. I was informed that First Leaside was a member of IIROC and CIPF and was made to believe that there was good oversight and investments were safe. These investments with First Leaside started around August 2010.”

While you have not provided evidence of the truth of those 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 investment and not a loss resulting from the insolvency of FLSI.

The letter to ██████ contained the additional paragraphs:

With respect to the securities that you purchased and which are described in Table 1 below,⁷ 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 described in Table 2⁸ below 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.

⁷ See Paragraph 4 (i), (ii), (v) to (vii) for details of the securities.

⁸ See Paragraph 4 (iii) and (iv) for details of the securities.

The letter to [REDACTED] contained the additional paragraph:

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 and transferred to accounts in your name at another IROC Dealer Member subsequent to February 24, 2012.

The letter to [REDACTED] and [REDACTED] contained the additional paragraph:

In addition, at the date of insolvency, the security described below⁹ was not held by, or in the control of FLSI. Therefore, the loss is not one that is eligible for CIPF coverage, as indicated above.

[REDACTED]:

As the basis for explaining your claim to CIPF, you stated that "...There was no reason to believe that fraudulent activities were underway in First Leaside leading to loss of capital and insolvency." While you have not provided evidence of the truth of those 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 investment and not a loss resulting from the insolvency of FLSI.

In addition, at the date of insolvency, the securities described in the table below¹⁰ 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

9. [REDACTED] addressed what he felt were regulatory shortcomings with respect to FLSI and the First Leaside Group of companies. He queried how membership in CIPF was vetted and what oversight CIPF provided with respect to the conduct of FLSI. CIPF Staff counsel explained that FLSI's initial and continuing registration was the purview of IROC. IROC's regulatory function oversees the business and operations of FLSI on an on-going basis. Becoming a member of CIPF is automatic upon approval of membership with IROC and is not separately reviewed. Also, it must

⁹ See Paragraph 4 (xii) for details for the security

¹⁰ See Paragraph 4 (xiii) and (xiv) for details of the securities

be noted that IIROC 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.

10. ██████ submitted that there was an obligation on CIPF to ensure that its logo and explanations regarding its coverage not create unwarranted expectations. CIPF Staff counsel advised ██████ that there are IIROC rules which regulate the use of the CIPF logo and information regarding CIPF coverage, which rules are enforced by IIROC. He confirmed that CIPF is not a regulatory body. It provides strict guidelines as to the usage of its logo and has produced a brochure for Members to use to describe the limitation in its coverage. If misrepresentations as to coverage were made, those were made by FLSI or the First Leaside Group, which are subject to the oversight of IIROC and the OSC, respectively.

11. ██████ also voiced his concerns that the CIPF failed to clearly and simply describe its mandate and coverage policies on its website and in its materials. In particular, he noted that exclusions from coverage should be more explicitly addressed, especially the lack of coverage for fraudulent activity which is a major concern for investors. In particular, he suggested that a definition for “property unlawfully converted” should be included in the CIPF Coverage Policy, as he felt that this phrase was confusing to investors.

12. In this regard, the argument is similar to that advanced at the October 27, 2014 decision. This argument focused on the interpretation of the phrase “including property unlawfully converted” in the Coverage Policy. The Appellant argued that the funds invested were to have been invested in proprietary First Leaside products. He expressed the concern that those funds may have wrongfully been diverted to the personal benefit of the FLSI principals. As the First Leaside Group products were found to have little or no value upon insolvency, it was argued that this was the result of an improper diversion of the Appellant’s investment funds.

13. 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" which was discussed fully in the October 27, 2014 decision. Such an interpretation would in effect create a new head of coverage.

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 Appellant's arguments, which reasoning is adopted by this Appeal Committee. As in the October 27, 2014 decision, while the Appeal Committee has considerable sympathy for the Appellants' position, I conclude that the 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 24th day of June, 2015

Brigitte Geisler

Brigitte Geisler