

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

RE: [REDACTED], [REDACTED], [REDACTED]
and [REDACTED]

Heard: December 11, 2015, by teleconference

HEARD BEFORE:

BRIGITTE GEISLER

Appeal Committee Member

APPEARANCES:

Nicolas Businger

) Counsel for Canadian Investor
) Protection Fund Staff

[REDACTED]

) On his own behalf
) On her own behalf, and on behalf of
) [REDACTED]
) [REDACTED]

DECISION AND REASONS

Introduction and Overview

1. [REDACTED], [REDACTED], [REDACTED] and [REDACTED]
(“[REDACTED]”), (collectively, 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 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 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. On December 11, 2015, 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 was held by teleconference. The Appellants, [REDACTED] and [REDACTED] were in attendance, representing themselves, [REDACTED] and [REDACTED].

Chronology of Events Relevant to the Appellants’ Claim

(i) The Appellants’ Investments and Claim

4. The claim arises from the Appellants’ investments in various First Leaside Group entities as follows:

- i. [REDACTED]: a net investment of \$267,231.97, after allowing for a receipt of \$65,042.03 from the insolvency trustee;
- ii. [REDACTED]: a net investment of \$1,270,251.08, after allowing for a receipt of \$126,201.92 from the insolvency trustee; and

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

iii. [REDACTED]: a net investment of \$1,177,344.83, after allowing for a receipt of \$72,655.17 from the insolvency trustee.

5. Certificates representing the Appellants' purchases were transferred to accounts in the names of the Appellants at Fidelity Clearing Canada ULC or were delivered to their possession.

(ii) *The Appellants' Application for Compensation*

6. The Appellants applied to CIPF for compensation for their losses in investments made through FLSI. By separate letters dated March 2, 2015 and May 13, 2015, the Appellants were advised that CIPF Staff were unable to recommend payment of their claims. The relevant parts of the letters read 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.....

...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.

[REDACTED]: Regarding your claim for unlawful conversion, it does not appear to us that any property held by FLSI for you [REDACTED] was converted or otherwise misappropriated. In addition, we [also] take note of your explanations. However, 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 [were] 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.

Analysis

7. [REDACTED] addressed the email sent to CIPF Staff dated November 27, 2015. He posed a number of questions arising from the email and from prior Appeal decisions, which were addressed by CIPF Staff counsel.

8. [REDACTED] queried why CIPF had paid claims arising from the insolvency of Essex Capital Management Limited (“Essex”), wherein compensation was paid to customers in circumstances of fraud. Those circumstances differ not only for these Appellants but for other FLSI Appellants. In the Essex matter, customers’ funds were misappropriated and removed from their accounts without authorization; this is a fraud. CIPF coverage was applicable, not because it was a fraud *per se*, but because the customers’ property was unavailable to be returned. In the case of FLSI, customers purchased specific investments relating to specific First Leaside Group entities and received certificates representing their investments. 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.

9. In the Essex circumstances, the principals issued fraudulent certificates purporting to be the equivalent of guaranteed investment certificates. As they were not a deposit taking institution, these certificates were not lawfully issued, and in fact, were not recorded with Essex’s carrying broker. This distinguishes it from the First Leaside circumstances where the entities that were created, and the securities which were issued by them, were lawful.² Unlike in the case of Essex, securities were issued and recorded on the books and records of the carrying broker, in the FLSI case, being Penson Financial Services Canada Inc.

² The fact that payments have been made to customers by the insolvency trustee with respect to the various First Leaside entities is confirmation of the fact that these were real entities.

10. ██████████ suggested that the funds which were invested with the First Leaside Group were misappropriated by the principals of First Leaside. ██████████ added that it had been represented that the funds were to be invested in real estate, however, the funds were used to fund other First Leaside entities. A review of the various offering documents for the Appellants investments show that many of the funds in which they invested contained the power to engage in borrowing and lending within the First Leaside Group.³ The Appellants may not have been aware of this ability to engage in non-real estate investments.

11. This submission is similar to that advanced at the October 27, 2014 hearing, arguing that the use of the funds for purposes other than acquiring real estate was an unlawful conversion of property, which should form part of the Coverage Policy under the category of “property unlawfully converted”. The October 27, 2014 decision deals extensively with this and other arguments which were raised. This Appeal Committee adopts the reasoning in the October 27, 2014 decision.

12. ██████████ described how the agents of FLSI represented that First Leaside was a member of IIROC, the OSC and CIPF. They noted that Mr. de Bever, a prominent Canadian businessman, was a member of the Board of FLSI. This gave them confidence to invest with FLSI. It is most regrettable that the Appellants relied upon assurances which appear to have been improperly made, or were at the least incomplete with regard to the purpose and intent of CIPF coverage.

13. Although the CIPF logo appears on FLSI documentation, as required by IIROC rules, it does not follow that CIPF represents or has a relationship with member firms in the same way as a regulator. CIPF is not a regulatory body; it has no powers to investigate or to discipline member firms. That authority lies within IIROC or the OSC. Counsel for CIPF Staff explained that CIPF’s only relationship with its Members is the collection of fees. Some oversight of the audit and supervisory function of IIROC is performed; however, the responsibility for enforcement of

³ For Example, see Appeal Record Volume 2, Tab 7, page 83. The Confidential Offering Memorandum for First Leaside Premier Limited Partnership contains the power to: “borrow money from or lend money to members of the First Leaside Group....”

compliance with industry rules, (which would include misrepresentation with respect to CIPF coverage), lies primarily with IIROC, and in the case of the First Leaside Group entities, also with the OSC.

14. ██████████ observed that investors had not been permitted to form a group to present their claims. It should be pointed out that the normal claim to CIPF would involve missing property, which has not been the case in FLSI. Other than in the extremely rare case where certificates cannot be located, all property held by FLSI has been accounted for. In those rare cases where property is missing and no records are available to CIPF, it appears that the insolvency trustee has acknowledged the claim in any event. In the claims being made by ██████████ and other FLSI Appellants, the issues being dealt with are not that of missing property, but personal to the particular Appellants. In such a case, a group action would not be appropriate.

15. The Appellants made other observations and queried as to why the OSC investigation had not proceeded more expeditiously and been communicated earlier to investors, during all of which, investors continued to deposit funds with the First Leaside Group. It is the Appeal Committee's understanding that a class action suit against the OSC by investors is asking the same question.

16. ██████████ commented that the Appeal Committee should exercise discretion in favour of Appellants' claims. As submitted by counsel for CIPF Staff, the limitations provided in the CIPF coverage policy arise not only from the CIPF Board's mandate but also from the regulatory framework in which CIPF is governed. In the exercise of its discretion, the Appeal Committee must be mindful that the discretion must be exercised within the overall mandate of CIPF which is to ensure that customer property is returned.

17. 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. Unfortunately, it appears that the Appellants believed that the coverage extended far beyond that to include a "guarantee" of the principal of their investments. The Appellants have received their property; accordingly the issue

of CIPF coverage is not applicable. It is most unfortunate that the property has lost almost all of its value.

18. I have sympathy for the losses suffered by the Appellants; however, 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

19. The appeals are dismissed. The decisions of CIPF Staff are upheld.

Dated at Toronto, this 22nd day of December, 2015.

Brigitte Geisler