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

RE: [redacted] and [redacted]

Written Appeal Scheduled: February 18, 2016

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 ("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]

[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 appeals 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' investments in various First Leaside Group products for a net claim by [redacted] of $437,942.42 which was reduced by the receipt of $73,803.58 from the insolvency trustee; and a net claim by [redacted] of $333,744.38, which was also reduced by the receipt of $43,602.62 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 the possession of the Appellants.

(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 5, 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:

> 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. In addition, we 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 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. In their written submissions, the Appellants raised 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 Appellants submitted that they intended the funds they 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. Prior to the commencement of the OSC investigation, there is no evidence that has been presented with respect to misconduct within the First Leaside Group of companies. In fact, the OSC prosecution of the principals of the First Leaside Group of companies focused only on an even more limited time period in 2011; during this period the Grant Thornton Report was received, but not communicated to the public, and the First Leaside Group continued to raise investment funds.

9. These written arguments are focused on investments made during the time period following the commencement of the OSC investigation into the First Leaside Group (although [redacted] has included all of the investments that he made within this argument).[2] However, as was fully discussed in the October 27, 2014 decision, the Appellants' arguments regarding possible misuse of investors' fund do not lead to the conclusion that what happened in this case falls within the

[2] [redacted] began investing in 2006 and had invested $227,620 prior to 2009.

meaning of the phrase "including property unlawfully converted" as set out in the Coverage Policy. That phrase is intended to address the situation where there is a failure to return property to the customer because it has been improperly confiscated by the broker, an issue which has not been raised in this Appeal. To apply the interpretation suggested by these written submissions would, in effect, create a new head of coverage relating to fraud, material non-disclosure and misrepresentation. The October 27, 2014 decision deals extensively with the written arguments which were raised. This Appeal Committee adopts the reasoning in the October 27, 2014 decision.

10. The Appellants further submitted that there was an unlawful conversion of investor funds because the asset values of investments:

> "…were improperly reported on statements by not accounting for the very high fees and commissions taken (see IIROC findings/Convictions) nor the fact that assets were often invested in overvalued real estate that was almost 100% leveraged already (e.g. WALP). In reality FLSI was insolvent since late 2008 from an asset perspective, and was only able to avoid cash flow insolvency for several years by using new investor assets to cover operating expenses, without disclosing this to investors." [3]

11. This argument fails to distinguish between the CIPF Member – FLSI, and the other First Leaside entities. The Appellants invested through FLSI, the distribution agent for the First Leaside Group of companies. When the Appellants state that "FLSI was insolvent since late 2008", I believe they are making reference not to FLSI, but to the various First Leaside Group of companies in which they had invested. The same comment applies to the balance of their submissions as noted in the above paragraph. While it is understandable that there might be confusion regarding the relationship among the various entities since many of them bore similar names, it is important to distinguish the entities with respect to CIPF's Coverage Policy.

12. CIPF's mandate relates to its Member firms, which in this case was only FLSI. The other First Leaside entities were issuers, in other words, they raised investment money from the public, in exchange for which they issued shares. These entities are regulated by the OSC who has the

[3] See Appeal Record Volume 1, Part A, Tab 27 p. 179 and Part B, Tab 24, p. 307.

responsibility to monitor issuers. This failure to distinguish among the First Leaside entities forms most of the submissions made by the Appellants.

13. The Appellants submit that they should receive back the value of their investments as shown on their September or November, 2011 statements. The reason that they provide for this is that the statements following the insolvency show the value of their investments as N/A, meaning 'not available'. Accordingly, they suggest that the value prior to the insolvency be used as these statements continue to show their investments having their original values of the $1/unit that was invested.[4] It must be noted that the value of their investments, as shown on their statements is derived from the First Leaside companies themselves, rather than an independent source such as a stock exchange. A carrying broker (for FLSI it was initially Penson, then Fidelity) is required to ensure that a proper value for unlisted securities is shown on statements, and when the value cannot be determined, to indicate N/A, which is why this notation was used after the insolvency. The truest value of the First Leaside Group of companies which became insolvent was provided by the insolvency trustee; however, this would have been after legal and accounting expenses.

14. The Appellants submitted that claimants were not being treated fairly as individual appeals were being held, rather than a joint appeal by all investors. I am not aware of why CIPF Staff determined that appeals should proceed individually; however, I would suspect that it arises from the fact that there has not been an issue of missing property in any of the claims which I have seen to date. CIPF's mandate is to ensure that a customer's property has been returned to the customer. Since that has been the case, the appeals would need to be individually considered as the submissions would be particular to that Appellant.

15. It is important to understand the restrictive nature of CIPF coverage. CIPF's mandate is to provide coverage that is custodial in nature; in other words, to ensure that the clients of an insolvent member have received their property. The Appellants have received their certificates or had them transferred to accounts in their names; accordingly the issue of CIPF coverage is not applicable. It

[4] This is the case, generally speaking. For some of the Appellants' investments, they made share exchanges which provided a different value for the shares.

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.

16. As stated above, CIPF coverage is to ensure that property is returned to Members' customers. It does not extend beyond that to include a "guarantee" of the principal of the investment. It is not an insurance scheme to cover fraud, like the one that can be found in Quebec. In fact, the existence of the Quebec fund confirms the narrowness of CIPF coverage in that the Quebec government realized that there was a gap in coverage for investor losses as a result of fraud and has provided limited coverage.

17. I have considerable 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

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

Dated at Toronto, this 4th day of March, 2016.

Brigitte Geisler