

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

RE: [REDACTED] and [REDACTED]

Written Appeal Scheduled: December 9, 2015

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, including an additional written submission dated November 13, 2015.

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 total net value of \$380,510 for ██████████ and \$152,989 for ██████████. These amounts included claims for stock dividends and stock exchanges, as well as securities for which documentation was unavailable. ██████████ claim has been reduced to reflect a payment of \$6,458 received 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 January 6, 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....

....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. The Appellants have been long time investors with the First Leaside Group, with their first investments (that could be verified) being made in August, 2004. Claims have been made for other investments, for which confirming documentation was not available to CIPF as its only access to records begins in March, 2004, when FLSI became a member of IIROC. It must be noted that of the amounts claimed, a small proportion (\$90,000) relates to purchases of First Leaside Group products made after 2009.

8. In their initial written submissions, the Appellants raised arguments similar to those advanced at the October 27, 2014 appeal hearing with reference to the timing of the investment. Those submissions related to allegations of fraud, material non-disclosure and misrepresentations by FLSI during the period within which the First Leaside Group was under investigation by the OSC. The main position advanced was that funds given to FLSI to invest in securities of the First Leaside Group were unlawfully converted by FLSI and as such, the Fund should provide coverage. 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. It must be noted, however, that since the vast majority of the investments were made prior to the start of the OSC investigation, those submissions would be inapplicable to the bulk of the claim being made by the Appellants.

9. [REDACTED] additional submissions made observations concerning the conduct of the OSC investigation. He submitted that the loss was caused by the abrupt interference of regulatory bodies external to FLSI, and the actions taken by the insolvency trustee. He expressed the view that the regulatory actions taken by the OSC and IIROC were insufficient although the OSC did make a finding of fraud with respect to funds raised after the Grant Thornton report was delivered in August, 2011.

10. [REDACTED] believes that a finding of fraud should result in CIPF coverage because an insolvency has occurred. CIPF coverage is applicable when there has been an insolvency and the customer's property has not been returned to the customer. CIPF coverage indirectly includes fraud when a fraudulent act prevents the return of the customer's property.

11. [REDACTED] references the insolvency of Essex Capital Management Limited ("Essex"), wherein compensation was paid to customers in circumstances of fraud.² 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.

12. The CIPF Coverage Policy does not concern itself with the reasons for a member's insolvency, whether it arose because of fraudulent conduct or because of a general business failure. The purpose of the Coverage Policy is to ensure that customers of an insolvent member have received their property.

² [REDACTED] also submits that compensation was paid in the Thomson Kernaghan insolvency, which is not correct; no payments were made to customers in that matter.

13. ██████ submits that the process of an appeal hearing is akin to a “kangaroo court, where outcomes are already pre-determined” because the Appeal Committee Members are also members of the Board of Directors of CIPF. While Appeal Committee Members certainly are also members of the Board of Directors, I can assure ██████ that Appeal Committee Members have not been involved in any fashion with the FLSI insolvency and are excused from Board meetings when FLSI is discussed, other than for statistical information on the progress of the processing of claims. It also appears that he makes this comment because the appeal decisions have been consistent in denying claims of FLSI customers. This consistency arises from the fact that in all of the appeals heard to date, there have not been any instances of customer property being missing.

14. ██████ interprets the Coverage Policy as being entirely discretionary by the CIPF Board of Directors in its application. This is not the view of the Appeal Committee Members, as has been stated in the October 27, 2014 decision. We believe that the exercise of discretion is to be limited to circumstances where the outcome would frustrate or defeat the purpose of the compensation scheme. The exercise of discretion should not create a new category of compensation as has been suggested by many Appellants.

15. ██████ addresses the comments made by another Appeal Committee Member with respect to the limitations of the exercise of this discretion.³ He suggests that the comments are indicative of a bias towards the denial of claims because of the potentially large impact on the CIPF Fund. ██████ is incorrect in two aspects. Firstly, the comments were made only to illustrate that discretion must be exercised within the bounds of the Coverage Policy, as noted above. Secondly, ██████ suggests that Appeal Committee Members see their role as protecting the Fund, which, I can assure him, is not the case.

16. In many of the appeal hearings, Appellants have failed to make a distinction among the various First Leaside Group entities. CIPF coverage is applicable to FLSI only; it is a member of

³ Appeal Committee Decision June 19, 2015.

IIROC. The other First Leaside Group entities are issuers of securities and are regulated by the OSC. For many, confusion arises because FLSI and many of the First Leaside Group entities entered into insolvency at approximately the same time; however, the losses experienced by investors arise from the insolvency of the issuers. The loss is from a decrease in the value of the investments made in the various First Leaside Group products, and not from the insolvency of FLSI. FLSI acted as an agent for the issuers and recorded customers' investments in the issuers on their books and records. Although there was an overlap in the roles of the principals of FLSI and the First Leaside Group, the entities were separate and were separately regulated.

17. It must be noted that CIPF is not a regulator. Its relationship to its members is the collection of fees, which are calculated on the basis of the amount of equity in customer accounts on the members' books and records. Some oversight of the audit and supervisory function of IIROC is performed; however, the responsibility for enforcement of compliance with industry rules lies primarily with IIROC, and in the case of the First Leaside Group entities, also with the OSC.

18. [REDACTED] also made the observation that because the First Leaside Group private equities did not trade on a market, all losses were directly attributed to the insolvency. This seems to imply that publicly traded securities would be treated differently than private securities in the event of an insolvency. This approach would create a regime where different and unfair results would arise for investments made on a public market and on a private basis. Private investments rely upon the issuer for their valuations, rather than being determined by the market forces of a public exchange.

19. [REDACTED] November 13, 2015 submissions were framed as a letter to the Canadian Securities Administrators, complaining of the treatment of FLSI investors by CIPF. Clearly, he has suffered losses and wishes to be compensated, as would anyone in that position. He expresses his complaints against many parties for an inability to prevent the demise of the First Leaside Group. He has stated his disappointment in how the Appeal Committee has interpreted the Coverage Policy.

20. [REDACTED] has also stated that “CIPF is an insurance organization designed to protect investors from unscrupulous activities within the financial world. Their logo, on the stationary of the investment firms should be sufficient for the confidence of the investor that their investment is well protected”. The customers’ investments are protected in that they would be returned to the customer in the event of insolvency. Unfortunately, it appears that the Appellants believed that the coverage extended far beyond that to include a “guarantee” of the principal of their investments. It does not. As stated above, CIPF coverage is to ensure that property is returned to Members’ customers. 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.

21. I have sympathy for the losses suffered by the Appellants; however, I do note that they have been investors for a long period of time and have undoubtedly received returns during that time. 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

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

Dated at Toronto, this 18th day of December, 2015.

Brigitte Geisler