

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

RE: [REDACTED] and [REDACTED]

Heard: November 25, 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

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

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 November 25, 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 were in attendance, as was [REDACTED], a friend of the Appellants.

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 claim of \$1,188,706 by [REDACTED]; a claim of \$511,220 by [REDACTED]; and a claim for a joint account for the Appellants in the amount of \$16,376. Included in the claim amounts are claims for stock dividends and other amounts (for [REDACTED], a total of \$186,976) which CIPF Staff were unable to verify. The Appellants have received some modest distributions 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 into the possession of the Appellants.

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

(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 22, 2015 to [REDACTED]; December 16, 2014 to [REDACTED]; and October 3, 2014 to both Appellants regarding the joint account, 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. 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 or the conversion of your property. 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.

Analysis

7. The Appellants described meeting with Mr. J. Wilson of FLSI who presented FLSI's membership in IIROC and CIPF as protection for investors. The Appellants stated that they had investigated the First Leaside Group prior to investing and uncovered no negative information. They noted that the promotional literature and verbal information from the principals of FLSI always referred to the First Leaside entities as a group and did not clearly delineate that CIPF coverage only applied to the one entity FLSI.

8. Counsel for CIPF Staff described the role of CIPF vis-à-vis that of IIROC and the OSC, the latter bodies having regulatory and disciplinary authority over members and securities dealers. It is IIROC which primarily regulated FLSI and had the authority to bring disciplinary actions against its members and employees, as they did in the case of Messrs. Wilson and Phillips. The OSC has

primarily authority over the principals and issuers of securities, such as the various entities in the First Leaside Group. In this regard, they implemented cease trade orders against entities in the First Leaside Group, and also took disciplinary action against Messrs. Wilson and Phillips.

9. In contrast, CIPF is not a regulator, but rather a not-for-profit entity which fulfills a specific role in the securities industry in the event of the insolvency of one of its members. 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. The Appellants have received their property; accordingly the issue of CIPF coverage is not applicable.

10. Counsel for CIPF Staff set out the restrictions of CIPF coverage: that there is no coverage for changing market values; for unsuitable recommendations; and/or for the default of an issuer of securities. The losses for the Appellants have resulted from the default or insolvency of the issuers, and the subsequent diminishment of the value of the investments.

11. The Appellants expressed their views that the exclusions from CIPF coverage were not clearly stated by CIPF, and that CIPF could do a better job at ensuring that the narrowness of its coverage is understood by industry participants. As has been stated in other Appeal Committee decisions, these observations by Appellants are taken seriously by the CIPF Board of Directors.

12. In the Appellants' written submissions, they 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, with particular application to investments made after the OSC began investigating the First Leaside Group in 2009. The Appellants argued that they intended the funds they invested be applied to the 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.

13. These written arguments suggest 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.

14. 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. While I have considerable sympathy for the Appellants, 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

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

Dated at Toronto, this 9th day of December, 2015.

Brigitte Geisler