

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

RE: [REDACTED] and [REDACTED]

Heard: February 11, 2016, by teleconference

HEARD BEFORE:

BRIGITTE GEISLER

Appeal Committee Member

APPEARANCES:

Graeme Hamilton

)
)

Counsel for Canadian Investor
Protection Fund Staff

)

On behalf of both Appellants

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 February 11, 2016, 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 Appellant, [REDACTED], was in attendance and made submissions on behalf of both Appellants. The Appellant provided an additional submission on February 11, 2016, which he also addressed.

Chronology of Events Relevant to the Appellants' Claim

(i) The Appellants' Investments and Claim

4. The claim arises from the Appellants' purchases of units of First Leaside Premier Limited Partnership and First Leaside Fund (Series B) for a total cost of \$40,029. The claim is reduced by the sum of \$5,370.23 which was received by the Appellants from the insolvency trustee, resulting in a net claim of \$34,658.77.

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.

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 letter dated February 18, 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. ██████████ submitted that there was an unlawful conversion with respect to the purchase of First Leaside Premier Limited Partnership. He advised that he had originally purchased the security but then transferred it to his wife.² He stated that a security representing this investment was never received; however, he acknowledges that he never returned the original certificate showing ownership in his name.³ The certificate in ██████████ name was submitted to CIPF along with his claim documents.

8. ██████████ also submitted that this investment was unlawfully converted, as it was converted to First Leaside Universal LPU. A confirmation of a trade is included with the Appeal Record; however, the trade was cancelled.⁴ Perhaps that was a result of the failure to return the First Leaside Premier Limited Partnership certificate. In any event, regardless of confusion around this investment, ██████████ has not suggested that two separate investments were made. He has

² See Appeal Record Volume 1, Tab 6, pp. 9-10.

³ Indeed, the transfer did not occur. See Appeal Record, Tab 16, pp. 72 (trade confirmation) and 74 (cancellation).

⁴ See Appeal Record Volume 1, Tab 16, pp. 68 and 75.

acknowledged that he retained possession of the First Leaside Premier Limited Partnership certificate and presented it in claims to CIPF. The Appellants have their property; I do not find that there was any unlawful conversion as is alleged.

9. [REDACTED] further submits that because a certificate was not received by his wife for First Leaside Universal LPU, this indicated that she did not have control over the security and that FLSI was in control. He states that this was a failure to return the security and CIPF should cover the cost of this investment. As stated above, this purchase of First Leaside Universal LPU was never completed, and that [REDACTED] continues to retain possession of the First Leaside Premier Limited Partnership certificate.

10. [REDACTED] submits, in his written submission, that coverage should be applicable because of the alleged securities law breaches of the principals of First Leaside Group; and that these breaches resulted in the insolvency of FLSI. Both IIROC and the OSC have found certain conduct on the part of the principals to be improper. Unfortunately, whether or not they engaged in improper conduct is not a relevant consideration in the application of CIPF coverage. While it is unfortunate that customers have lost almost all of the value of their investment funds, in order to qualify for CIPF coverage, there must have been a failure to return the customers' property, which is not in issue in this appeal. Behaviour which fails to meet the standards of the securities industry cannot, by itself, lead to coverage. As was discussed in the October 27, 2014 decision, that kind of interpretation of the Coverage Policy would be completely outside of the purpose of CIPF coverage and the terms of the Coverage Policy.

11. [REDACTED] also submitted that he does not accept that there was a change in market value for his investments, resulting in the loss. He states that the real estate market was not in crisis and that the drop in value of his investments was due to fraud which should be covered by CIPF. He does not offer any evidence with respect to these assertions.

12. ██████████ references the insolvency of Essex Capital Management Limited (“Essex”), wherein compensation was paid to customers in circumstances of fraud.⁵ 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.

13. 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. ██████████ suggested that CIPF should have taken an interest in what was done with the funds which were invested in the First Leaside Group of companies in order to ensure that they were properly applied. Respectfully, this is a role for Boards of Directors of the companies or the auditors, but not something that a non-regulator such as CIPF would, or could, properly undertake, as it has no jurisdiction over, or relationship with, issuers, only with the CIPF Member.

14. 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 property; accordingly the issue of CIPF coverage is not applicable. It 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”.

⁵ ██████████ also submits that compensation was paid in the Thomson Kernaghan insolvency, which is not correct; no payments were made to customers in that matter.

15. As stated above, CIPF does not guarantee the value of an investment. We have heard from many appellants who have stated that they were told that their investments were safe because there was CIPF coverage. It is correct that they were safe, in that they would be returned to the investors in the event of an insolvency, but it seems that it was implied and believed by many investors that the coverage extended far beyond a return of property and included a “guarantee” of the principal of their investment. It does not.

16. ██████████ stated that all of the marketing documentation for the First Leaside Group had included IIROC and CIPF logos, which led the Appellants to believe that they had insurance coverage. He expressed his view that CIPF should be providing protection for the public, but instead has found loopholes and distorted the language to be found on the website. The Board of Directors of CIPF is examining the nature and content of the disclosure of CIPF coverage and acknowledges the insight of investors such as the Appellant.

17. I have considerable sympathy for 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 appeal is dismissed. The decision of CIPF Staff is upheld.

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

Brigitte Geisler