

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

**RE:** [REDACTED] and [REDACTED]

**June 22, 2015**

**HEARD BEFORE:**

BRIGITTE GEISLER

Appeal Committee Member

**APPEARANCES:**

James Gibson

)  
)

Counsel for Canadian Investor  
Protection Fund Staff

[REDACTED]

)  
)

On their own behalves

**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 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 with its reasons released on December 17, 2014.<sup>1</sup>

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 June 22, 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 at Neeson Arbitration Chambers in Toronto, Ontario. The Appellants were in attendance.

### **Chronology of Events Relevant to the Appellants' Claim**

#### *(i) The Appellants' Investments and Claim*

4. The claim arises from the purchase by the Appellants of various First Leaside Group products as follows:

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- i. 10,000 units of First Leaside Wealth Management Fund for a value of \$10,000 purchased on December 23, 2010. On January 31, 2011 an additional 60,000 units were purchased for \$60,000;
- ii. 25,000 units of First Leaside Universal Limited Partnership for a value of \$25,000 purchased on December 23, 2010;

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

- iii. 20,000 units of First Leaside Mortgage Fund (Class A) for a value of \$20,000 purchased on January 31, 2011. On April 5, 2011, an additional 50,000 units were purchased for a value of \$50,000, and;
- iv. 7,489 units of FLEX Fund (Class B) for a value of \$7,489 purchased on July 20, 2011;

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- v. 150,000 units of First Leaside Wealth Management Fund for a value of \$150,000 purchased on February 4, 2011;
- vi. 50,000 units of First Leaside Mortgage Fund (Class A) for a value of \$50,000 purchased on April 5, 2011; and
- vii. 7,489 units of FLEX Fund (Class B) for a value of \$7,489 purchased on July 20, 2011.

5. Each of the Appellants claimed the purchase of \$50,000 First Leaside Mortgage Class A Trust Units and \$7,489 FLEX Fund Class B Trust Units. The Appellants have advised that these purchases should be allocated equally between them. This results in each Appellant's claim being reduced by the amount of \$28,744.50.

6. The Appellants provided an additional schedule showing various cash deposits being held at Fidelity Clearing Canada ULC ("Fidelity"), which they assumed were the cash deposits which had previously been held at FLSI. CIPF Staff clarified (by referring to account statements), that the existing cash deposits had been transferred at their request to accounts which had been opened at another financial institution. Although not all statements for the accounts shown on the schedule presented by the Appellants were available, the one statement presented indicated that at least part of the cash had originated as a "return of capital". CIPF Staff surmised that the accumulation of cash may have been payments received from the insolvency trustee. The Appellants stated that they would contact the insolvency trustee to seek clarification. They did confirm, on the basis of the foregoing information that all securities and cash which had been on deposit with FLSI had been received by them, either through accounts at Fidelity (which were subsequently transferred to another financial institution), or were delivered to them.

(ii) *The Appellants' Application for Compensation*

7. The Appellants applied to CIPF on August 13, 2012 for compensation for their losses in investments made through FLSI. By letters dated January 13, 2014, amended by an additional letter dated June 27, 2014 to [REDACTED], 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. In addition, as a basis for explaining your claim, you stated:

- "... I have looked at the mandate of CIPF and while these claims on the surface may not follow the typical mandate of the CIPF, I believe, based on the following facts that they should be allowed and paid due to the way in which these assets were sold and how they were represented by First Leaside... In August, the OSC put a stop trade order on First Leaside which ultimately killed the value in the company and installed the auditor to try and unravel the complex investment vehicles, to value them and ultimately sell them off and get investors as much money as possible. ... like most Canadians we have worked hard, paid off our debts, ... I believe this is one area where the Government has a responsibility to help protect investors, especially when there are questions and probes over a 2 year period which we are no [sic] privy to. ..."

[REDACTED]: We take note of your explanation. 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.

With respect to the securities that you purchased and which are described in Table 1 below,<sup>2</sup> they were properly recorded in the books and records of FLSI at the date of insolvency. Those securities were transferred to accounts in your name at another IIROC Dealer Member subsequent to February 24, 2012.

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<sup>2</sup> See Paragraph 4, with the exception of (ii) for details of the securities.

In addition, at the date of insolvency, the security described in Table 2 below<sup>3</sup> was not held by, or in the control of, FLSI. Therefore, the loss is not one that is eligible for CIPF coverage, as indicated above.

██████████: While you have not provided evidence of the truth of all of the assertions in support of your claim, 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.

With respect to the securities that you purchased, they were recorded in the books and records of FLSI at the date of insolvency. Those securities were transferred to accounts in your name at another IIROC Dealer Member subsequent to February 24, 2012.

In addition, you indicated that your loss, or part of it, was a result of “the default of an issuer of securities”. As mentioned above, losses resulting from the default of an issuer of securities are not covered by CIPF.

## Analysis

8. The Appellants described the process by which they came to be investors at FLSI. They indicated that they were troubled by the use of the phrase “guaranteed” when the investment return was described to them, however, they noted that there was a long history of success for the First Leaside Group. They observed that, in their view, the FLSI group was engaged in fraud in making representations of flourishing properties, which were then revealed to be in poor condition. In addition, they noted the complex inter-relationships of the various FLSI group companies as was described in the Grant Thornton Report. Had they been aware of these inter-relationships, it would have discouraged their investing with FLSI. Further, they noted that they had been pleased to see noteworthy Canadian businessmen as members of the board of FLSI, which gave FLSI the impression of credibility and stability.

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<sup>3</sup> See Paragraph 4 (ii) for details of the security.

9. The Appellants stated that they were conservative investors and were content to receive a lower rate of return in exchange for lower risk. They were surprised and disappointed to learn that the OSC had labelled many FLSI Group products as being high-risk. They noted that they were not a wealthy family and that the loss of these funds is having a significant impact on their ability to educate their children and plan for their retirement.

10. The Appellants commented on the process by which many entities in the First Leaside Group eventually ended up in insolvency. They noted that the OSC investigation process was lengthy and that there were about three months between the time when the Grant Thornton report was delivered and when investors were first notified that there were issues with the First Leaside Group. Had the fact of the investigation been made available to the public on a more timely basis, it would have been a decisive factor in the Appellants decision to invest with FLSI, as they noted that their first investment was made when the OSC investigation was already underway.

11. The Appellants noted that FLSI was regulated by IIROC, a fact in which they took comfort. They were also mindful of FLSI's membership in CIPF, which was represented by FLSI's principals as providing insurance coverage against a loss in their investments. IIROC's regulatory function relates to the business and operations of FLSI. It does not have jurisdiction over the various proprietary products that were marketed by FLSI to various investors. Those products, or issuers, were under the jurisdiction of the OSC, which, having concerns over those operations, began an investigation into the First Leaside Group in the fall of 2009. The jurisdiction of IIROC, and by extension, CIPF, within the limits of its mandate, is confined to FLSI only.

12. As stated in other Appeal Committee decisions, IIROC rules provide for strict guidelines as to the usage of the CIPF logo and CIPF has produced a brochure for Members to use to describe the limitation in its coverage. If misrepresentations as to coverage were made, those were by FLSI or the First Leaside Group, which are subject to the oversight of IIROC and the OSC, respectively. CIPF is not a regulatory body.

13. The October 27, 2014 decision addressed various issues including the arguments relating to the interpretation of the phrase “including property unlawfully converted” in the Coverage Policy. An adoption of these arguments would 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 Appellants addressed the limited nature of CIPF coverage. They queried whether the CIPF board of directors was considering the expansion of coverage to include issues of fraud. CIPF Staff advised of the coverage for investor fraud being offered by the Quebec government, which is also subject to various restrictions, including the amount of any claim upon the fund. The Appeal Committee confirmed that all submissions relating to clarifying information regarding CIPF coverage were being taken very seriously by the CIPF board of directors.

15. The purpose of CIPF coverage is limited to custodial coverage; in other words, to ensure that the clients of an insolvent member have received their property. As was indicated in the October 27, 2014 decision, the CIPF brochure outlines limitations on coverage. The documentation provided by the Appellants confirms that the certificates representing their investments were delivered to them or were transferred to accounts in their names at Fidelity.

16. The Appeal Committee has considerable sympathy for the Appellants’ position, I conclude that their submissions in this appeal are not persuasive and do not give rise to a successful claim for compensation from CIPF.

### **Disposition**

17. The appeal is dismissed. The decision of CIPF Staff is upheld.

Dated at Toronto, this 24<sup>th</sup> day of June, 2015

Brigitte Geisler

Brigitte Geisler