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

RE: [redacted], [redacted], [redacted],

and [redacted]

Written Appeal Scheduled: February 11, 2016

APPEAL CONSIDERED BY:

BRIGITTE GEISLER Appeal Committee Member

DECISION AND REASONS

Introduction and Overview

1. [redacted], [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 email received on February 5, 2016.

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 as follows:

- [redacted] ("[redacted]"): a total net claim of $879,664.20, which includes claims for stock dividends ($1,339), cash ($28.92) and also for undocumented amounts ($429,696);[2]
- [redacted] ("[redacted]"): a total net claim of $413,036.92, which includes claims for stock dividends ($945), cash ($331.92) and also for undocumented amounts ($39,010);[3]
- [redacted] ("joint account"): a total net claim of $135,000, all of which is undocumented; and

[2] There is a discrepancy between [redacted] records and the amount acknowledged by the insolvency trustee with respect to the First Leaside Fund Series C investment. CIPF Staff reviewed [redacted] accounts from March 1, 2004 to the time of FLSI insolvency but were unable in all instances to verify the amount(s) claimed. There is also duplication with respect to the First Leaside Wealth Management Fund of 5,000 units (see Appeal Record Volume 1, pp 76, 77, 79 and 170). Accordingly, the claim has been reduced by $5,000.

[3] According to the records submitted by [redacted] on her First Leaside Wealth Management consolidated account information (See Appeal Record Volume 1, p 339), the investment in First Leaside Wealth Management Preferred Shares is overstated by 33,000 units. CIPF Staff were unable to verify these additional units. The insolvency trustee provided an acknowledgement of these units and an amended acknowledgment (see Appeal Record Volume 1, pp 324, 325). Further, it appears that [redacted] has claimed the same 5,000 units of the First Leaside Wealth Management Fund in both her cash and TSFA accounts. Lastly, it also appears that there is a duplication of the First Leaside Fund Series C investment, as [redacted] records (see Appeal Record Volume 1, p 339), and the acknowledgement by the insolvency trustee (Appeal Record, Volume 1, p 314), only recognized 11,332 units. Accordingly the claim has been reduced by $16,332 from $429,368.92 to $413,036.92.

- [redacted] ("[redacted]"): a total net claim of $408,629[4], cash ($84.87) and also for undocumented amounts ($3,544).

There appears to be some discrepancy in the records submitted by the Appellants, as is detailed in the footnotes. To determine the claim amounts, I have effected changes where there has been a duplication of claims, or where the insolvency trustee has not acknowledged the claim. In other respects, I have accepted the claim amounts submitted by the Appellants.

5. It appears that the undocumented amounts for [redacted], [redacted], and their joint account reflect purchases of securities prior to March 1, 2004, the date when FLSI became a member of the Investment Dealers Association (the predecessor of IIROC). I reach this conclusion as [redacted] indicated in his submissions that he had been an investor in Wimberly Apartments Ltd. Partnership since 1991.

6. 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, with the exception of the securities which are undocumented and for which records are unavailable.

(ii) The Appellants' Application for Compensation

7. The Appellants applied to CIPF for compensation for their losses in investments made through FLSI. By separate letters dated September 16, 2014, June 19, 2014, and November 20, 2014, the Appellants were advised that CIPF Staff were unable to recommend payment of their claims. The relevant parts of the letters read as follows:

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[4] [redacted] purchased 25,000 units of First Leaside Properties Fund (Class C) on July 9, 2010 and transferred 15,000 of those units to his TFSA account on January 11, 2011: see Appeal Record, Volume 1, pp 398 and 399. It appears that [redacted] claimed the same 15,000 units in both his cash account and TFSA account. Accordingly, the claim has been reduced by $15,000 from the original claim of $423,629 (rounded by [redacted] from $423,628.87).

> 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.

The letter to [redacted] contained the following similar statements:

> …..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.

8. 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. In effect, these arguments suggest that the Appellants' claims are really of fraud, material non-disclosure and misrepresentations.

9. The Appellants made numerous investments over a long period of time for which records are only available beginning in March, 2004. [redacted] has indicated that he began investing with the First Leaside Group of companies in 1991. Many of the items in [redacted] claim are undocumented, as are all claims in relation to the joint account. It is not unreasonable to conclude

that these investments were made prior to records being available at FLSI beginning in March, 2004. A majority of [redacted] investments were made prior to 2009. All of the investments in the joint account were made prior to 2009.

10. Prior to the commencement of the OSC investigation, there was no evidence of misconduct within the First Leaside Group of companies. In fact, the OSC prosecution of the principals of the First Leaside Group of companies focused 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.

11. The written arguments are focused on the investments made during the time period following the commencement of the OSC investigation into the First Leaside Group (although the Appellants have included all of the investments that they have made within this argument). However, as was fully discussed in the October 27, 2014 decision, the Appellants' arguments of the possible misuse of investors' fund do not lead to the conclusion that what happened in this case falls within the 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 arguments 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 these written arguments which were raised. This Appeal Committee adopts the reasoning in the October 27, 2014 decision.

12. The Appellant [redacted] refers to an investment made on September 9, 2011 as a loan to FLSI. A review of the records indicates that she requested and received a $60,000 investment in Special Notes Limited Partnership.[5] The Appellant appears to suggest that if she had been a creditor of FLSI, rather than a customer, she would have been in a better position with respect to

[5] See Appeal Record Volume 1, pp 252, 254 and 311.

investments made with FLSI. Whether or not that would be the case is unknown, however, such a claim would have ranked with other creditors of the corporate entity. There would be no coverage under the CIPF Coverage Policy which requires that the customer must have an account with the Member for the purpose of transacting securities. Providing a loan to the Member would not make the creditor an "eligible customer".[6]

13. The Appellants written submissions made references to the charging of commissions on the purchases of their investments, contrary to the advice that they were given by Mr. Phillips, a principal of the First Leaside Group of companies that no commissions were payable. The Appellants stated that they would not have invested had they known of the commission charges. No evidence has been presented in these submissions with respect to the commission charges, or in fact, of other charges which were made to the funds other than what can be found in the offering documents which make reference to administration charges. In any event, if there was a misrepresentation to the Appellants with respect to commissions, this is a matter of possible misconduct on the part of Mr. Phillips; misconduct is not a loss resulting from the insolvency of a member under the CIPF Coverage Policy.[7]

14. The Appellants submit that they were advised by FLSI that they were insured by CIPF. They concluded that their investments were "100% safe or we would not have invested most of our money with FLSI…" 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 their investments were safe, in that property held in a customer's account of a member firm would be returned to the customer 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. 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.

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[6] See Appeal Record, Volume 1, p 272 – Coverage Policy as of September 30, 2010.
[7] See Appeal Record, Volume 1, page 103, "…losses are not eligible for payment by CIPF… unsuitable investments".

15. It is important to understand the origins of CIPF and 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 customers of an insolvent member have received their property. The Appellants have received their property or had it acknowledged by the insolvency trustee; 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.

16. 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

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

Dated at Toronto, this 3rd day of March, 2016.

Brigitte Geisler