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

RE: [redacted]

Heard: October 27, 2014

PANEL:

PATRICK LESAGE	Appeal Committee Member
ANNE WARNER LA FOREST	Appeal Committee Member
BRIGITTE GEISLER	Appeal Committee Member

APPEARANCES:

R. Shayne Kukulowicz Jane O. Dietrich	))	Counsel for [redacted]
James D. G. Douglas James Gibson	))	Counsel for Canadian Investor Protection Fund Staff
Brian Gover	)))	Independent Legal Counsel for the Appeal Committee of the Canadian Investor Protection Fund

DECISION AND REASONS

Introduction and Overview

1. Mr. [redacted] (the "Appellant") was a client of First Leaside Securities Inc. ("FLSI"), an investment dealer. FLSI was declared to be insolvent on February 24th, 2012 and of the $350,000

invested by the Appellant, he recovered a total of $77,900.86 from the insolvency Trustee. The Appellant sought recovery from the Canadian Investor Protection Fund ("CIPF" or the "Fund") on the basis that FLSI was a Member of CIPF and as such the Appellant was entitled to protection through the CIPF Fund that was established to provide coverage in the event of insolvency. CIPF Staff made a decision denying compensation to the Appellant on the basis that the Appellant's losses did not arise as a result of the insolvency of FLSI and thus were not covered under the CIPF Coverage Policy dated September 30th, 2010.

2. On October 27, 2014, a panel of the Appeal Committee (the "Panel") of CIPF heard an appeal to determine whether to depart from the decision of CIPF Staff. The appeal hearing took place at Neeson Arbitration Chambers in Toronto, Ontario and was open to the public. Many investors who had been clients of FLSI were in attendance.

3. CIPF is a not-for-profit organization incorporated under the *Canada Corporations Act*,[1] and continued under the *Canada Not-for-profit Corporations Act*.[2] CIPF is the compensation fund for customers of investment dealers that are members of the Investment Industry Regulatory Organization of Canada ("IIROC").[3] Articles of Continuance filed by CIPF state that the CIPF's purposes include providing protection to clients of investment dealers "who have suffered or may suffer financial loss as a result of the insolvency [of the investment dealer], all on such terms and conditions as may be determined by [CIPF] in its sole discretion".

4. In Ontario, CIPF is overseen by the Ontario Securities Commission ("OSC"). As a condition of their registration, Ontario investment dealers are required by regulation made pursuant to the *Securities Act*[4] to participate in a compensation or contingency fund. CIPF was approved as a compensation fund by an OSC Approval Order.[5] The mandate conferred on CIPF by the Approval Order has been affirmed and given national scope by a Memorandum of Understanding entered into

---

[1] R.S.C. 1970, c. C-32
[2] S.C. 2009, c. 23
[3] Consequently, a member of the Investment Industry Regulatory Organization of Canada is referred to below as an "IIROC Member" or a "Member".
[4] R.S.O. 1990, c. S.5
[5] Similar regulations and approvals in relation to CIPF exist in certain other provinces but are not relevant to this claim, as FLSI conducted business primarily in Ontario.

with twelve of the members of the Canadian Securities Administrators ("CSA"). The Approval Order imposes terms and conditions on CIPF, which provide that CIPF's purpose is to protect customers from losses suffered if their property is unavailable due to the insolvency of an IIROC member.[6] The terms and conditions also require CIPF to maintain coverage policies to provide fair and adequate coverage for such losses and to provide fair and reasonable policies for assessing claims and for an internal review process that allows for reconsideration of claims that have not been accepted for payment by CIPF.[7] The Appeal Committee was created to provide for that internal review process.

CIPF Coverage Policy

5. In furtherance of CIPF's mandate, its Board of Directors enacted a Coverage Policy which has been reviewed and amended from time to time. At the date of FLSI's insolvency, the Coverage Policy dated September 30, 2010 was in force.

6. The salient portions of the CIPF Coverage Policy are reproduced below:

> **Coverage**
>
> CIPF covers customers of Members who have suffered or may suffer financial loss solely as a result of the insolvency of a Member. Such loss must be in respect of a claim for the failure of the Member to return or account for securities, cash balances, commodities, futures contracts, segregated insurance funds or other property, received, acquired or held by, or in the control of, the Member for the customer, including property unlawfully converted. The Board of Directors of CIPF may exercise its discretion in respect of determining the customers eligible for protection and the financial loss suffered.
>
> **Policy**
>
> This Policy has been adopted by the Board of Directors to describe the basis on which it intends to exercise its discretion in authorizing CIPF to make payments to customers of insolvent CIPF Members. The Directors' discretion may be exercised

[6] Paragraph 1 of the terms and conditions states as follows:

> The CIPF provides protection on a discretionary basis to prescribed limits to eligible customers (Customers) of Participating SRO Member Firms suffering losses if Customer property comprising securities, cash and other property held by such Member Firms is unavailable as a result of the insolvency of the Member Firm and, in connection with such coverage, will engage in risk management activities to minimize the likelihood of such losses (CIPF Mandate) …

[7] Paragraphs 4(a) and (c).

> in a manner that is consistent with the right and extent to which a person may be entitled to claim against the customer pool fund of a Member under the Bankruptcy and Insolvency Act (Canada), subject to other restrictions in this Policy and the sole discretion of the Directors to determine protection by CIPF. CIPF and the Directors reserve the right to authorize or withhold payments in a manner other than as prescribed in this Policy.
>
> In the case of any question or dispute as to the eligibility of a customer, the financial loss incurred by a customer for the purposes of payment by CIPF, and the maximum amounts to be paid to a customer, the interpretation of this Policy by the Board of Directors shall be final and conclusive.

7. The Coverage Policy also provides for limitations in terms of coverage; two of these limitations are important in this context:

> i) Losses which do not result from the insolvency of a Member, such as, customers' losses that result from changing market values of securities, unsuitable investments, or the default of an issuer of securities;……
>
> iv) securities or segregated funds that are not held by a Member, or recorded in a customer's account as being held by a Member.

8. In summary, for a claim to be deemed eligible under the Coverage Policy, the following requirements must be satisfied:

- The claimant must have been a customer of an insolvent CIPF Member;
- The loss must have been caused by the insolvency of the CIPF Member; and
- The loss must have been due to the failure to have property held in the customer's account at the date of insolvency returned to the customer, including property unlawfully converted.

Chronology of Events Relevant to the Appellant's Claim

(i) The Appellant's Investments and Claim

9. The Appellant, who is now [redacted] years of age, testified that his investments through FLSI represented most of his life savings. The claim is for $350,000 from the Fund, arising from his investments in two securities, namely: 150,000 First Leaside Wealth Management units ("FLWM Units"), purchased for $150,000 on June 23, 2011; and 200,000 Flex Fund Class B Series 6%

Designation 2011 units ("Flex Fund Units"), purchased for $200,000 on September 28, 2011. Of his $350,000, the Appellant has recovered a total of $77,900.86 ($9,937.86 in relation to the FLWM Units and $67,963.18 for the Flex Fund Units), from the insolvency Trustee, resulting in a net claim of $272,099.14. At the date of FLSI's insolvency (February 24, 2012), the Appellant held the 150,000 FLWM Units in certificate form. The 200,000 Flex Fund Units were recorded in an FLSI account belonging to the Appellant.

(ii) First Leaside Group and the OSC's Investigation

10. FLSI was the investment dealer through which over 1200 customers made investments in various affiliated companies, trusts and limited partnerships (collectively the "First Leaside Group"). FLSI was subject to regulation by the Ontario Securities Commission and was a member of IIROC. In total, FLSI solicited approximately $370 million from investors. Of this total, only $86 million was invested in marketable securities. The balance, $284 million, was invested in securities of the First Leaside Group.

11. In the fall of 2009, the OSC began investigating FLSI. Approximately one year later, in November, 2010, the OSC sought third party market valuations of the real property held by limited partnerships owned by the First Leaside Group. Valuation reports were received by the First Leaside Group in January 2011. In the following month, due to concerns arising from the valuation reports, the OSC urged First Leaside to retain an independent accounting firm with expertise in restructuring and insolvency to conduct a study of First Leaside Group's viability. Investors were not told that the First Leaside Group, including FLSI, was under investigation by the OSC.

12. FLSI continued to collect money from investors during this period.

(iii) Grant Thornton Review and Report

13. In March 2011, Grant Thornton Limited ("Grant Thornton") was retained on behalf of the First Leaside Group to review, report on, and make recommendations in relation to the First Leaside Group's business, assets, affairs and operations. This review was completed in August 2011. Investors were not informed that Grant Thornton was conducting this independent review.

14. The Appellant made his first investment on June 23, 2011 while Grant Thornton was conducting its review. The Appellant instructed FLSI to execute the purchase of 150,000 FLWM units at $1.00 per unit using funds in his cash account. While the Appellant executed a subscription agreement on the same day in which he represented that he had received an offering memorandum in relation to the relevant securities, the Appellant gave evidence that he only received the offering memorandum after he invested his $150,000. It was his evidence that he did not understand at the time that the business of the fund included investing in and advancing loans to other First Leaside Group entities, and that he was unaware that the offering's proceeds would be used to invest in "projects of members of the First Leaside Group" and that selling commissions and fees could be up to $750,000.[8]

15. The Appellant gave evidence that one of the reasons he invested through FLSI was because he believed that his investments were protected by the CIPF. In support of this, he testified that it was represented to him by FLSI that investing with FLSI would be "safer than investing in a bank." An FLWM promotional brochure included reference to membership in both IIROC and CIPF.[9] Membership in both was referred to in the Appellant's account statements.[10]

16. The Appellant also referred to the tri-fold brochure prepared by CIPF itself, which is required to be given to each client of a Member, if requested. The brochure does outline limitations

---

[8] The Confidential Offering Memorandum regarding the FLWM **Units referred to these issues at pp. 8, 16 and 22.**

[9] **The brochure states in part:**

> **Clients also need to be assured that their invested wealth is secure. As a smaller firm, we recognize that our business model must address the perception among some retail** investors that larger firms provide greater protection of client assets than smaller firms.
>
> For this reason, in 2004, [FLSI] became a member of the **Investment Dealers Association of Canada (IDA)** – now the **Investment Industry Regulatory Organization of Canada (IIROC)**. IIROC membership enables the firm to participate in the **Canadian Investor Protection Fund (CIPF)** set up by the investment industry to ensure the return of customers' securities, cash balances and certain other property within defined limits if an investment dealer is not able to do so because it is bankrupt.
>
> CIPF is the great brokerage firm equalizer. Smaller firms become, in a sense, more secure than larger ones, because the bankruptcy of a smaller firm has less potential to exhaust the fund before all of the firm's clients receive the maximum allowable coverage for their accounts. However, relatively few bankruptcies have occurred among member investment dealers given their adherence to exacting CIPF and IDA/IIROC compliance standards. (emphasis added)

[10] IIROC Rule 29.14 prescribes that the CIPF official symbol must be displayed on the front of each confirmation and account statement sent to a customer. Any written, visual or audio advertising must include the words "Member CIPF", and at the option of the Member, the CIPF official symbol.

on coverage. However, the Appellant focused on the following statement which appears on one of the folds: "With the Canadian Investor Protection Fund, you're protected if your investment dealer becomes insolvent".

17. Grant Thornton Limited delivered its report (the "Grant Thornton Report") to the First Leaside Group on August 19, 2011. Shortly thereafter, the report was delivered to the OSC and IIROC. The Grant Thornton Report concluded that the First Leaside Group's future viability was contingent on its ability to raise new capital, and that if the First Leaside Group were restricted from doing so, "[I]t would likely be unable to continue its operations in the ordinary course, as it would have insufficient revenue …" Moreover, based on an asset valuation using the highest third party valuation figures available, "there [was] a significant equity deficit."

18. Despite the Grant Thornton Report's findings, FLSI did not disclose the contents of the report and continued to raise money from investors. Approximately $18.9 million was raised between August 22, 2011 and October 28, 2011, including a second investment made by the Appellant in 200,000 Flex Fund Units at $1.00 per unit in his Registered Retirement Income Fund on September 28, 2011. The Appellant did not read the part of the offering memorandum that referred to the business of the Flex Fund, which included investing in and advancing loans to other First Leaside Group entities.

(iv) Action by the Regulators

19. IIROC designated FLSI in discretionary early warning status on October 28, 2011. Among other things, this action prohibited FLSI from reducing the firm's capital, opening new client accounts or making payments to its directors or affiliates. First Leaside Group agreed to a cease trade order by the OSC, which was implemented on October 31, 2011.

(v) Notice to Investors

20. On November 7, 2011, the First Leaside Group wrote a letter to all investors at the request of the OSC and IIROC. This letter disclosed that the First Leaside Group was being investigated by regulatory authorities and that there was limited, if any, equity in its real estate investments. The

letter also informed the investors of the Grant Thornton Report's conclusion that the "future viability of [First Leaside] Group is contingent on their ability to raise new capital" and that OSC Staff had advised the First Leaside Group that "it is not appropriate to use money raised from new investors to fund the operating losses, rehabilitation costs and distributions of existing limited partnerships."

(vi) First Leaside Group Seeks CCAA Protection

21. On February 24, 2012, the First Leaside Group sought protection under the *Companies' Creditors Arrangement Act*.[11] What ensued was not a reorganization, but a liquidation of very limited assets. Through the resulting proceedings and the subsequent receivership, FLSI investors received a total of somewhere in the range of $12,555.611.32 to $13,764,776.31. Ultimately, investors received an average of less than 7 cents on the dollar for their invested funds.

(vii) Other Proceedings

22. The Appellant also provided information to the Panel about other proceedings before the OSC and IIROC following the insolvency of FLSI. Reference was made to the allegations of staff of the OSC dated 4 June 2012. The allegations state that the principals of FLSI had directed a sales effort after having received the Grant Thornton Report in August 19, 2011 and that these actions resulted in raising a further $18.89 million. [12] The allegations also state that the fact that Grant Thornton was reviewing FLSI, the existence of the Grant Thornton Report, and the Grant Thornton Report were facts investors should have known.[13] Finally the OSC staff alleged that the principals of FLSI had engaged or participated in acts, practice or conduct which they knew or ought to have known would perpetrate a fraud on the investors.[14] It was during this period that the Appellant made his investments in FLSI.

---

[11] R.S.C. 1985, c. C-36
[12] OSC Statement of Allegations at para. 26, at Compendium of the Appellants Tab 8
[13] Ibid., para. 5.
[14] Ibid., para. 6

23. On 16 October 2013, a panel of IIROC found (in the absence of the principals who chose not to participate), that they had "abused the trust placed in them by their clients most of whom were vulnerable elderly people".[15]

(viii) The Appellant's Application for Compensation

24. The Appellant's first purchase was made after the OSC had urged the First Leaside Group to retain an independent accounting firm with expertise in restructuring and insolvency to conduct a viability study of the First Leaside Group.[16] His second purchase occurred after the Grant Thornton Report had been received by FLSI, but had not yet been disclosed.

25. The Appellant applied to CIPF on August 3, 2013 for compensation for his losses in investments made through FLSI. By letter dated December 30, 2013, the Appellant was advised that CIPF Staff were unable to recommend payment of his claim. The relevant part of the letter reads 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, as a basis for explaining your claim, you stated:
>
> > "Based on the CIPF policy and the explicit assurance by First Leaside that our life savings would be secure and covered in any event of FLSI's failure CIPF would pay up to $1,000,000 per account did we feel safe enough to turn our money over First Leaside. We strongly feel CIPF is covering our losses."
>
> 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 investment and not a loss resulting from the insolvency of FLSI.

---

[15] Phillips, Re 2013 IIROC 52 at para. 67.
[16] OSC Statement of Allegations at para. 20 at Compendium of the Appellants Tab 8

26. In addition, the letter indicated that the Appellant's investment in the Flex Fund Units was properly recorded in FLSI's books and records at the date of insolvency (although subsequently transferred to an account in the Appellant's name at another IIROC Dealer Member) and that the FLWM Units were not held by, or in the control of FLSI.

Analysis

27. This appeal requires the Appeal Committee to determine the proper interpretation of the Coverage Policy as it existed on the date of FLSI's insolvency. In general terms, the Appellant's position is that the policy is broad enough, either through the interpretation of the phrase "property unlawfully converted" or through the reference in the Coverage Policy to "discretion" to encompass a claim for losses suffered as a result of fraud, material non-disclosure and/or misrepresentations by FLSI. For its part, CIPF Staff takes the position that such an interpretation is inconsistent not only with the wording of the policy but also with the purpose of CIPF.

28. In addressing the arguments of the parties, we are guided by the approach to interpretation outlined in the decision of the Supreme Court of Canada in *Sattva Capital Corp. v. Creston Moly Corp*.[17] In that case, the Court stated that in determining

> "the intent of the parties and the scope of their understanding … a decision-maker must read the contract as a whole, giving the words their ordinary and grammatical meaning, consistent with the surrounding circumstances known to the parties at the time of the formation of the contract." ……. "The key principle of contractual interpretation … is that the words of one provision must not be read in isolation but should be considered in harmony with the rest of the contract and in light of its purposes and commercial context."[18]

29. We begin by focusing on the meaning of the phrase "property unlawfully converted" and the meaning of the word "discretion " as they exist in the Coverage Policy and then consider the larger commercial context and in particular the Bankruptcy and Insolvency Act and the policy of SIPA, our counterpart in the United states.

---

[17] [2014] S.C.J. No. 53

[18] *Geoffrey L. Moore Realty Inc. v. Manitoba Motor League (c.o.b. CAA Manitoba)*, [2003] M.J. No. 191, [2003] 9 W.W.R. 385 at para. 12 (Man. C.A.), citing *National Trust Co. v. Mead*, [1990] S.C.J. No. 76, [1990] 2 S.C.R. 410 (S.C.C.), quoted in Geoff R. Hall, *Canadian Contractual Interpretation*, Markham: LexisNexis Canada, 2012.

(i) "including property wrongfully converted"

30. The Appellant argued that coverage should be provided by CIPF for the loss of his investments in FLWM and Flex Fund Units (less the recovery provided by the trustee) as his investment monies were "property unlawfully converted"[19] by FLSI when it made the investment in the FLWM and Flex Fund Units. The Appellant's argument is that the phrase "including property wrongfully converted" is ambiguous, requiring that the Appeal Committee engage in a two-step process involving (i) the application of the general rules of contractual interpretation and (ii) if those rules are inconclusive, the application of the *contra proferentum* rule which provides that where a provision is sufficiently ambiguous, it will be construed against the party responsible for drafting the policy. In this regard, the Appellant characterizes the relationship between the Appellant and the CIPF as one of a contract of adhesion. The overall position advanced was that using this approach, the words "including property wrongfully converted" are broad enough to encompass losses arising from fraud, material non-disclosure and misrepresentations by FLSI.

31. CIPF staff responded to these arguments with a number of observations. First, it argued that the purchase of units of the funds by the Appellant was not a conversion of his investment monies, but rather an exchange of money for the investment certificates which were evidence of his investments. Second, CIPF Staff argued that the words "unlawfully converted" are meant to provide CIPF coverage, and a return of the Customer's property, in those circumstances where the monies invested or other property being held, were unlawfully diverted from the Customer's account with the Member. Third, CIPF Staff contended that the funds deposited by the Appellant with FLSI were not unlawfully converted by FLSI. The Appellant's intention and direction was that the money would be used to purchase units of FLWM and Flex Fund. FLSI used the Appellant's money for the purpose for which it was directed. Finally, CIPF Staff submitted that *contra proferentum* has no application in this case because the Coverage Policy does not constitute a contract between the Appellant and a CIPF customer.

[19] CIPF Coverage Policy, see paragraph 5 above

32. After careful consideration, we conclude that fraud, material non-disclosure and/or misrepresentation, as alleged in this case, are not covered by the words "including property unlawfully converted" under CIPF's Coverage Policy. The Appeal Committee does not find the phrase to be ambiguous. It is clear that the intent of the Coverage Policy is to return property in the Customer's account to the Customer in the event of the insolvency of the Member. The inclusion of the phrase simply recognizes that circumstances may arise where the Customer has provided investment funds or other property to the Member for deposit to their account, but the funds were not posted to the Customer's account; in other words, the property has be "unlawfully converted".

33. In the view of the Appeal Committee, it is not intended that the phrase "including property unlawfully converted" be interpreted in a manner that would, in effect, create a new head of coverage. Rather, the phrase is merely meant to ensure inclusivity in the final phrases of the latter half of the passage quoted above: "or other property*, received, acquired or held by, or in the control of, the Member for the customer, including property unlawfully converted*.

34. Given our conclusion that the phrase "including property unlawfully converted" is not ambiguous, there is no need to address whether or not the principle of *contra proferentum* is applicable to the Coverage Policy.

35. The Coverage Policy also provides for specific exclusions from coverage, namely, "losses that result from changing market value of securities, unsuitable investments, or the default of an issuer of securities". The Appellant argued that had it been intended that losses arising from fraud, material non-disclosure and misrepresentation be excluded from the Coverage Policy, this would have been specifically addressed in the list of exclusions. The Appeal Committee does not accept this argument which ignores the purpose and scheme of CIPF Coverage and the clear language of the exclusions. The Coverage Policy explicitly states that unsuitable investments are excluded from coverage. Investments made in circumstances of fraud, material non-disclosure and/or misrepresentation, as suggested by counsel for the Appellant, would certainly be seen as unsuitable investments, which are excluded from the Coverage Policy.

36. While these issues and claims on the CIPF fund have not been litigated in Canada, we take notice of the similar compensation scheme in the U.S. – the Securities Investor Protection Act ("SIPA") [20] – and the litigation arising therefrom. CIPF Coverage Policy is modelled after and in harmony with this scheme for compensation of investors in the event of an investment dealer's insolvency. In a decision arising out of the colossal financial scandal involving Bernard Madoff,[21] the United States Court of Appeals for the Second Circuit held that "SIPA's main purpose is [i]s not to prevent fraud or conversion, but to reverse los[s]es resulting from brokers' insolvency."[22] The court expressly disagreed with the characterization of the [SIPA] statutory scheme "as an insurance guarantee of the securities positions set out in their account statements"[23] and stated,

> It is not at all clear that SIPA protects against all forms of fraud committed by brokers. See *In re Investors Ctr., Inc.*, 129 B.R. 339, 353 (Bankr.E.D.N.Y.1991) ("Repeatedly, this Court has been forced to tell claimants that the fund created for the protection of customers of honest, but insolvent, brokers gives them no protection when the insolvent broker has been guilty of dishonesty, breach of contract or fraud.")[24]

37. We also note that although CIPF coverage applies to Members in Quebec, significantly, the Province of Quebec has established the Financial Compensation Fund to provide coverage to victims of fraud, fraudulent tactics or embezzlement, perpetrated by a financial securities participant. The purpose of this Fund is to provide "protection that is not available elsewhere in North America" [25]. This reflects recognition by at least one Canadian jurisdiction that coverage for fraudulent practices (which would include misrepresentation), is not available. The Appellant's position is that Quebec is unique in this context. We agree that Quebec is unique. It provides some compensation for customers who have suffered from fraudulent conduct at the hands of their broker. Although this Committee finds Quebec's legislation laudable, we note that, neither Ontario nor any other province or territory provides a similar compensation scheme.

---

[20] 15 U.S.C. § 78aaa *et seq.*
[21] *In re Bernard L. Madoff Investment Securities LLC, Debtor*, 654 F.3d 230 (2011)
[22] *Ibid*., at 239
[23] *Ibid*.
[24] *Ibid*.
[25] See *An Act Respecting the Distribution of Financial Products and Services*, C.Q.L.R. c. D-9.2, s. 258.

38. To interpret the phrase "including property unlawfully converted" in a manner that would apply coverage to circumstances involving the misconduct of a Member, such as fraud, material non-disclosure or misrepresentation would be to create an unwarranted extension of the coverage scheme. CIPF would become the arbiter of claims by Customers for losses arising from misconduct, a role which is not contemplated by the regulators nor its Coverage Policy. CIPF has no ability to compel evidence or witnesses, or otherwise act as a judicial or quasi-judicial body. Its purpose and role is to ensure that property belonging to Customers, is returned to the Customers in the event that the Member has become insolvent. It is a custodial protection scheme, not a compensation scheme for alleged wrongdoing.

(ii) Discretion of the Board

39. A central aspect of the Appellant's position was that the Coverage Policy confers a discretion on the Board of Directors and that as such, the Appeal Committee, a Committee of the CIPF Board, can authorize CIPF to compensate him for his loss. This discretion is set out in the CIPF Articles of Continuance under Item 6: Statement of the purpose of the corporation,[26] and in the Coverage Policy.[27] The Appellant submitted that this discretion can and should extend to authorizing coverage for losses incurred due to fraud, material non-disclosure and/or misrepresentations made by FLSI's principals and agents.

40. The Appeal Committee is bound to exercise its discretion within the limits of CIPF's mandate which is to customers in the event of the insolvency of a Member. Although the Coverage Policy provides a residual discretion allowing departure from the Coverage Policy, the Appeal Committee's view is that such a departure from the Coverage Policy should only occur where the application of the Policy might otherwise result in an outcome that frustrates or defeats the purpose of the compensation scheme. It was not intended to use that discretion to create a new head of

[26] CIPF Certificate of Continuance: The purposes of the Corporation are: a) to provide protection to clients of securities dealers, brokers or firms which are members, approved participants or other similar participating organizations of the Investment Industry Regulatory Organization of Canada or any other self-regulatory organization that may be designated or approved by the Corporation or defined in the By-laws of the Corporation ("SRO Members") who have suffered or may suffer financial loss as a result of the insolvency of the SRO Member, all on such terms and conditions as may be determined by the Corporation in its sole discretion.

[27] Coverage Policy, last sentence of the first paragraph: CIPF and the directors reserve the right to authorize or withhold payments in a manner other than as prescribed in this Policy

compensation (i.e. fraud, material non-disclosure, misrepresentation, etc.) which is inconsistent with the purpose and intent of CIPF coverage.

41. Reliance was placed by the Appellant on the decision in *Re Portus Alternative Asset Management Inc*.[28] In that case, a superior court judge exercised the court's inherent jurisdiction to fill what was termed a "functional gap" in the *Bankruptcy and Insolvency Act*[29] ("BIA") in that fraud by or on behalf of a securities firm operated to defeat a customer's otherwise legitimate entitlement to recovery. Part XII of the BIA provides that customers of bankrupt securities firms have a claim for the amount of their "net equity". But because the firm had not used funds received from customers to purchase securities, the customers' net equity was zero. Campbell J. reasoned that it would be contrary to the purpose underlying Part XII of the BIA and neither just nor equitable for that to occur. The relief granted was a declaration that the net equity of each customer was the amount invested, less any amounts received from Portus within a particular time frame. Campbell J. continued, "If it were necessary to do so, I would not hesitate to employ the tools of judicial discretion or indeed inherent discretion to provide recovery for investors."[30]

42. The facts in the *Portus* case are an illustration of the intended meaning of the words "including property unlawfully converted". In that case, funds were given to the Member but failed to reach the Customer's account. That is not the situation in the matter before us.

43. The Appellant asserted that exercising the discretion in favour of allowing compensation would be consistent with the CIPF's mission statement[31] and with the CIPF brochure promoting investments through IIROC Members.

44. The Appeal Committee is not a court. It has no inherent jurisdiction to apply equitable principles, as much as it may have sympathy for the Appellant's position. The Appeal Committee is bound by the heads of compensation cited in its Coverage Policy and the exemptions from

---

[28] (2007), 88 O.R. (3d) 313
[29] R.S.C. 1985, c. B-3
[30] At paragraph 39.
[31] The CIPF's mission statement is "To contribute to the security and confidence of customers of IIROC Dealer Members by maintaining adequate sources of funds to return assets to eligible customers in cases where a Member becomes insolvent".

coverage set out therein. In our view the exercise of our discretion is limited to the Coverage Policy which provides, in general terms, for the return of the Appellant's property to him. There is no dispute that the Appellant has both received the Certificate representing the investment in FLWM Units and that the Flex Fund Units are being held for him in an account in his name.

(iii) The Bankruptcy and Insolvency Act

45. The Coverage Policy expressly provides that the Directors' discretion may be exercised in a manner that is consistent with the right and extent to which a person may be entitled to claim against the customer pool fund of a Member under the Bankruptcy and Insolvency Act (Canada). The Appellant has submitted that the exercise of the Board's discretion should not be constrained by considerations arising out of Part XII of the BIA, as the Coverage Policy applies to losses relating to a Member's insolvency and not only to losses arising from a Member's bankruptcy. The argument is that insolvency is a much broader concept than bankruptcy as provided for under the BIA and thus the discretion is similarly more expansive. The Appeal Committee's view is that the reference in the Coverage Policy to the BIA simply confirms that "customers" of a securities firm have priority claims over the customer pool fund as of the date of bankruptcy. The term "customer" expressly includes a person who has a claim against the securities firm arising out of a wrongful conversion by the securities firm of a security.[32] As we have already indicated, the phrase "wrongful conversion" does not apply to the facts in this case; the funds delivered to FLSI by the Appellant were applied in accordance with his direction.

(iv) Custodial Coverage

46. The purpose and intent of CIPF coverage is custodial in nature. Both the CIPF fund and the SIPA fund in the U.S. were established to deal both with issues arising from the developing practice of customers retaining securities in their brokers accounts and the issues arising from the difficulties of the delivery of stock certificates to Customers who had concerns about leaving their securities in the custody of a member. Prior to the establishment of the SIPA in the U.S., there were substantial issues returning securities to customers in the event of an insolvency. In fact, amendments were

[32] BIA, s. 253.

made to the BIA to create the customer pool so that specific customer securities need not be identified thereby allowing customers to have claims upon the entire customer pool of securities.

47. The Coverage Policy offers compensation for losses arising from a Member's failure as a custodian of customer property. It is coverage for what should be in one's account at the date of insolvency. The Coverage Policy specifically excludes coverage for cash or securities which are not held in the Customer's account at the Member.

48. Moreover, for a claim to be eligible, the relevant loss must arise solely as a result of the insolvency of a Member and be in respect of a Member's failure "to return or account for securities, cash balances ... or other property, received, acquired or held by, or in the control of, the Member for the customer, including property unlawfully converted". CIPF does not cover losses due to bad investment advice or fraud on the part of IIROC Members. The Coverage Policy expressly excludes from coverage losses that do not arise from a Member's insolvency, including losses resulting from the changing market value of securities, unsuitable investments, or the default of a securities issuer.[33]

49. The Appeal Committee views the various sources of information and documentation relating to the establishment, continuation and recognition of CIPF by the regulators as showing a consistency in the extent of the CIPF coverage, that is, coverage that is custodial in nature and provides for the return of customers' securities. It is not a scheme to provide compensation for wrongdoing in the form of material non-disclosure, misrepresentation or otherwise, however sympathetic may be the claim.

[33] The Coverage Policy also excludes losses in respect of "securities or segregated funds that are not held by a Member, or recorded in a customer's account as being held by a Member … unless such securities or funds are in the control of the Member.

Disposition

50. The appeal is dismissed. The decision of CIPF staff is upheld.

Dated at Toronto, this 17th day of December, 2014

Patrick LeSage _____Patrick LeSage_____

Anne Warner La Forest _____Anne Warner La Forest_____

Brigitte Geisler _____Brigitte Geisler_____