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

RE: [redacted]

Heard: December 9, 2015

HEARD BEFORE:

BRIGITTE GEISLER — Appeal Committee Member

APPEARANCES:

Graeme Hamilton	)	Counsel for Canadian Investor Protection Fund Staff
[redacted]	)	On her own behalf

DECISION AND REASONS

Introduction and Overview

1. [redacted] (the "Appellant") was a client 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 Appellant sought recovery from CIPF on the basis that FLSI was a Member of CIPF and as such the Appellant was 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 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 30, 2010.

3. On December 9, 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 took place at Neeson Arbitration Chambers in Toronto, Ontario. The Appellant was in attendance.

Chronology of Events Relevant to the Appellant's Claim

(i) The Appellant's Investments and Claim

4. The Appellant claims the net amount of $1,055,980.90 with respect to her purchases of various First Leaside Group products. As will be discussed in more detail below, at the hearing, the Appellant adjusted her claim to a net amount of $710,289.31.

5. Certificates representing the Appellant's purchases were either delivered to the Appellant's possession or were transferred to an account in her name at another IIROC Dealer Member. The Appellant acknowledges that she is in possession of all of her certificates.

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

(ii) The Appellant's Application for Compensation

6. The Appellant applied to CIPF for compensation for her losses in investments made through FLSI. By letter dated December 3, 2014, the Appellant was advised that CIPF Staff were unable to recommend payment of her claim. The relevant parts of the letter 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. At the hearing, the Appellant presented a detailed submission, which she had also kindly provided in written form. Included in this submission was a recalculation of her losses to take into account the return of capital as part of the distributions which she has received from her investments and the tax benefits from losses of the partnership investments. This recognition of the return on investments was appreciated and, frankly, is not something which any other Appellant has acknowledged.

8. The Appellant is a sophisticated investor who has high familiarity with the insurance industry. She suggested that most insurance policies had malleability and that the insurer could choose an interpretation which would benefit public policy, if a strict reading of the policy would suggest a denial of coverage. This submission is attractive; however, the analogy to most other insurance regimes fails to recognize the third-party nature of the losses in the First Leaside Group circumstances.

9. In the insurance regime, and similarly for the Canada Deposit Insurance Corporation ("CDIC"), the insurance coverage is for a product which is issued by the insured entity. For example, the Guaranteed Investment Certificate from a bank is issued by that bank and should the bank fail, CDIC will ensure that the investment is returned. In the case of a broker, however, the broker does not issue its own products, but acts as an agent to secure third party products from other sources. Essentially, it only deals in the securities which represent that third-party product. The insolvency of that third-party product is removed from the insolvency of the broker. The CIPF insurance regime insures the return of the security which is held by the broker to the customer, but does not insure against the insolvency of the third-party issuer.

10. In the case of the First Leaside Group, the situation is complicated by the fact that there is such a similarity of names of the CIPF member – FLSI – and the affiliated entities – the First Leaside Group, and the fact that FLSI and many entities of the First Leaside Group went into insolvency at approximately the same time. The losses arising from the insolvency of a particular First Leaside Group entity is not a loss arising from the insolvency of FLSI for which CIPF coverage would be available.

11. Many Appellants acknowledge that had they invested in Bre-X, a notorious gold mining fraud whose shares ultimately had no value, they would not expect that there should be CIPF coverage, even if the broker with whom they were dealing, and on whose books and records was recorded the Bre-X investment, also went insolvent. As stated above, the FLSI insolvency is complicated by the similarity of names and frankly, of management, of the different entities. However, they are separate entities on a legal basis; the various entities have different features such as tax benefits, and different powers within their offering documents. The First Leaside Group entities are not FLSI; and while the insolvency of some of the entities may have impacted upon the insolvency of FLSI, a loss of investment in those entities is not a loss arising from the insolvency of FLSI, which is the basis of any claim made to CIPF.

12. The Appellant submitted that the essence of the CIPF Coverage Policy is that it is all about discretion. She referred to the June 19, 2015 Appeal Committee decision, stating that the reference

to an exercise of discretion which would result in large compensation awards is an acknowledgement that the Coverage Policy is ultimately only about discretion and that the size of the potential claims against the Fund is behind the denial of claims. This is incorrect in two aspects. Firstly, the comments were made only to illustrate that discretion must be exercised within the bounds of the Coverage Policy, which is the basis of CIPF coverage. Secondly, the suggestion that Appeal Committee Members see their role as protecting the Fund is also not the case.

13. As has been stated in the October 27, 2014 decision, the Appeal Committee Members are bound by the terms of the Coverage Policy, including its exclusions. The exercise of discretion is to be limited to circumstances where the outcome would frustrate or defeat the purpose of the compensation scheme. The exercise of discretion should not create a new category of compensation as has been suggested by many Appellants.

14. The Appellant commented that the delivery of securities to investors is contrary to IIROC Rules requiring that Members keep books and records of transactions. The Rules require that any transactions with customers be on the books and records of the Member; however, that does not preclude the mailing of securities into the possession of the customers, being referred to as 'off-book'. There is a certain irony in a claim that delivery of securities is illegal. Delivery of securities was the common practice before the origins of CIPF (at that time the National Contingency Fund), as customers were reluctant to leave securities and cash in the hands of their broker in case there was an insolvency and they couldn't recover their property. The purpose of a custodial insurance regime was to give customers the confidence that their property would be secure at a Member firm. Retaining one's securities at a Member firm has now developed into such a common practice that little thought is given to that practice.

15. Along with her original claim, the Appellant 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. The Appellant argued that the funds she invested were to have been invested in proprietary First Leaside products on the understanding that such funds would be invested in those products for the primary purpose of funding the acquisition and/or

development of various real estate projects. In her submissions at the hearing, she indicated that she did not necessarily entirely support these arguments. It seems worthwhile to at least make some comment in this regard.

16. The adoption of these arguments suggests that the claim is 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.

17. 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 Appellant has received her 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".

18. The Appellant's various submissions, including an allowance for the reduction in the claim amount, as referred to above, were all well- presented and appreciated; however, I do not find them persuasive. I have considerable sympathy for the Appellant's position, as I have in general for the Appellants who have come before the Appeal Committee.

Disposition

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

Dated at Toronto, this 21st day of December, 2015

Brigitte Geisler