BRITISH COLUMBIA SECURITIES COMMISSION
Securities Act, RSBC 1996, c. 418

Citation: Re FS Financial Strategies, 2017 BCSECCOM 238 Date: 20170721

Aik Guan "Frankie" Lim, Scott Thomas Low, FS Financial Strategies Inc., FS Financial Services Inc., FS Financial Strategies Services Inc., FS Financial Services (Alberta) Inc., Darrell Wiebe, Chun Ying "Jim" Pan, Chung-Sheng "Johnson" Kao, CC Cornerstone Credit Ltd. (now known as Flexfi Inc.), Afshin Ardalan, WL Strategic Capital Partners Inc., George Lay, Hunter Wei-Shun Wang (aka Hunter Wei Shun Wang), FS Stellar Insurance Services Inc., Nyit Foon "Lydia" Chin, Aike Joo Lim, Verico FS Capital Inc., Gagan Deep Bachra, FS Financial Systems Inc., Chi Kay "Dixon" Wong, and Meng Cher "Philip" Tsai

Panel	Nigel P. Cave	Vice Chair
	Audrey T. Ho	Commissioner
	Gordon Holloway	Commissioner
Application Date	June 28, 2017	
Submissions completed	June 28, 2017	
Date of Ruling	July 21, 2017	

Appearances

Joyce M. Johner	For the Executive Director
Bob Cooper, QC	For Flexfi Inc. and Afshin Ardalan

Ruling

I. Introduction

[1] On February 6, 2017, the Executive Director issued:

a) a temporary order against Aik Guan "Frankie" Lim, Scott Thomas Low, FS Financial Strategies Inc., FS Financial Services Inc., FS Financial Strategies Services Inc., FS Financial Services (Alberta) Inc., Darrell Wiebe, Chun Ying "Jim" Pan, Chung-Sheng "Johnson" Kao, CC Cornerstone Credit Ltd. (now known as Flexfi Inc.), Afshin Ardalan, WL Strategic Capital Partners Inc., George Lay, Hunter Wei-Shun Wang (aka Hunter Wei Shun Wang), FS Stellar Insurance Services Inc., Nyit Foon "Lydia" Chin, Aike Joo Lim, Verico FS Capital Inc., Gagan Deep Bachra, FS Financial Systems Inc., Chi Kay "Dixon" Wong and Meng Cher "Philip" Tsai (the Respondents); and

b) a notice of hearing setting February 17, 2017 to hear the executive director's application to extend the temporary order until a hearing is held and a decision rendered (2017 BCSECCOM 33).

[2] On February 15, 2017, the Respondents applied to the Commission to adjourn the hearing of the executive director's application to extend the temporary order.

[3] On February 17, 2017, the Commission varied and extended the temporary order to March 8, 2017 (2017 BCSECCOM 55), and adjourned the hearing of the executive director's application to extend the temporary order to March 8, 2017.

[4] On March 7, 2017, Aik Guan "Frankie" Lim, Scott Thomas Low, FS Financial Strategies Inc., FS Financial Services Inc., FS Financial Strategies Services Inc., FS Financial Services (Alberta) Inc., Darrell Wiebe, Chun Ying "Jim" Pan, Chung-Sheng "Johnson" Kao, FS Stellar Insurance Services Inc., Nyit Foon "Lydia" Chin, Aike Joo Lim, Verico FS Capital Inc., Gagan Deep Bachra, FS Financial Systems Inc., Chi Kay "Dixon" Wong and Meng Cher "Philip" Tsai (the FS Financial Respondents) applied to the Commission to adjourn the hearing of the executive director's application to extend the temporary order.

[5] On March 8, 2017, the Commission heard the FS Financial Respondents' adjournment application and extended the temporary order until May 19, 2017, and adjourned to May 17, 2017, the hearing of the executive director's application to extend the temporary Order (2017 BCSECCOM 92).

[6] On May 12, 2017, the parties agreed to adjourn the hearing of the executive director's application to extend the temporary order and consented to the extension of the temporary order to May 22, 2018.

[7] On May 16, 2017, the Commission extended the temporary order until May 22, 2018 and adjourned the executive director's application to extend the temporary order to May 22, 2018 (2017 BCSECCOM 171).

[8] On June 14, 2017, Flexfi Inc. and Afshin Ardalan (the Applicants) applied for an order setting aside the temporary order, as it applies to them, on the basis that the agreements Flexfi entered into with other parties for the purposes of raising funds for its business were not "securities" with the definition of such term under the *Securities Act*, RSBC 1996, c. 418.

[9] At the commencement of the hearing of this application, the parties agreed that, notwithstanding the form of the Applicants' application, the sole issue for our consideration was whether the agreements that Flexfi has entered into with third parties for the purposes of raising funds for its business are "securities" under the Act. The following is our ruling on this issue.

[10] We did not receive any submissions on the impact, if any, that our ruling on this issue should have on the temporary order (as it applies to the Applicants).

II. Background

Flexfi and Ardalan

[11] Flexfi is in the business of providing microloans (the average amount of these loans is approximately $2,500) to clients who have little or no access to bank loans.

[12] Flexfi was established in 2013 and is owned 40% by Ardalan (through a family trust), 20% each by two of the other respondents in the notice of hearing (Low and Lim) and 20% by a third party.

[13] Ardalan is the President of Flexfi and has been the President of Flexfi since its inception.

[14] There was considerable evidence entered by the Applicants and by the executive director with respect to the relationships between the Applicants and certain of the other respondents in the notice of hearing. We did not find most of that evidence relevant for the narrow purposes of this ruling. However, we do note (the relevance of which will be discussed below) that Low and Lim have referred persons to the Applicants who have subsequently provided funds to Flexfi in its capital raising efforts.

Flexfi's capital raising structure

[15] The affidavit evidence is that Ardalan made a conscious choice, upon forming Flexfi, to capitalize his new business with loans rather than through equity as he considered equity to be a more expensive source of capital.

[16] Ardalan's evidence is that, at that time, he was aware that Flexfi's capital raising might fall within the jurisdiction of the Act. He says that he did not wish to issue "securities" and, as such, contacted the Commission. He does not remember with whom he spoke, but says that he learned that certain types of debt would be classified as a "security" as defined under the Act and some would not. In particular, he says he was told that a term loan is not normally considered a security but that a promissory note would normally be considered a security. For clarity, the Applicants were clear that they were not introducing this evidence in furtherance of an estoppel argument. Ardalan then says that he consulted (on an informal basis) several lawyers that he knew and he understood their view to be that term loans are generally not securities.

[17] Flexfi commenced raising capital in late 2013 and early 2014 using a document called an "Agreement" which contained three paragraphs. Those agreements included a statement of the amount loaned to Flexfi, the term of the loan, the maturity date and the amount (and timing of payment) of interest payable on the loan. All of these loans have either been repaid or exchanged for a subsequent form of loan agreement (described below).

[18] All of Flexfi's capital raising is now governed by a more extensive, but still simple, loan agreement which contains the following terms:

- the loan amount;
- the borrower's interest obligations (i.e. the interest rate and manner and timing of payment of that interest);
- the maturity date and a pre-payment right; and
- basic events of default, an acceleration clause in the event of default and a default rate of interest.

All of these loans are also unsecured.

Summary of Flexfi's capital raising efforts

[19] Flexfi has raised a total of $6,920,000 from 66 individuals (in 83 transactions). These funds have been sourced from contacts that Ardalan had as well as from individuals introduced to Flexfi/Ardalan by Low and Lim. The majority of these individuals were sourced through Low and Lim.

[20] The Applicants provided affidavits from five individuals (two of whom were husband and wife) who provided funds to Flexfi. Their evidence relevant to the narrow issue before us can be summarized as follows:

- they were all aware that they were lending funds to Flexfi and knew that they were not acquiring an equity interest in the company (they say that this was obvious both from the terms of the agreement and the representations made to them by Ardalan (or others who introduced them to Flexfi) relating to the loan transaction); and
- they did not expect their loan transaction to be governed by securities regulation.

[21] To date, Flexfi has met its obligations under the loans it entered into in its capital raising activities.

III. Positions of the parties

[22] The Applicants say that the loan agreements used by Flexfi to raise capital are commercial loan transactions that do not fall within the definition of "security" under the Act and are therefore outside of the Commission's jurisdiction.

[23] The executive director says that the loan agreements are either an "investment contract" or "other evidence of indebtedness" within the Act's definition of "security".

[24] The parties agree that a decision on whether the loan agreements used by Flexfi are "securities" requires a purposive analysis of the definition of "security" under the Act.

IV. Analysis

[25] Section 1(1) of the Act defines "security" to include "(a) a document, instrument or writing commonly known as a security", "(b) a document evidencing title to, or an interest in, the capital, assets, property, profits, earnings or royalties of a person", "(d) a bond, debenture, note or **other evidence of indebtedness**, share, stock..." and "(l) **an investment contract**." (emphasis added)

[26] On a plain reading of that definition, each of the loan agreements would clearly qualify as an "evidence of indebtedness".

[27] However, not all debtor/creditor arrangements have been found to give rise to "securities" under the Act (or under similar securities legislation in other jurisdictions in North America). Loan arrangements (whether called notes, loan agreements, etc.) can arise in a wide spectrum of transactions, from arrangements that are principally investments in nature (which transaction would fall within the definition of a "security") to those which serve a specific commercial purpose or support a specific commercial transaction (which transaction is less likely to fall within the jurisdiction of the Act).

[28] The question of when a loan arrangement, whatever it is called, is a "security" under the Act and when it is not requires a purposive analysis of the definition of "security". It also requires an analysis of the factual context in which the individual loan arrangement occurs and the context in which the issuer, more broadly, is raising capital.

[29] More succinctly, the British Columbia Court of Appeal in *British Columbia (Securities Commission) v. Gill*, 2003 BCCA 169 agreed with the Commission's submissions, in that case, that a determination of whether lending transactions were "securities" was one of mixed law and fact.

[30] The statutory interpretation analysis starts with two basic, but important, concepts as set out in *Pacific Coast Coin Exchange of Canada Ltd. v. Ontario (Securities Commission)*, [1978] 2 S.C.R. 112:

a) that the Act must be construed broadly to ensure that one of its primary purposes (of protecting the investing public) is met; and

b) that in interpreting whether an instrument falls within the definition of "security", it is the instrument in question's substance, not form, which is paramount.

[31] In *Gill*, faced with the issue of whether loan arrangements between an investment advisor and two of his clients where securities under the Act, the Court of Appeal considered the United States Supreme Court decision *Reves v. Ernst & Young*, 494 U.S. 56 (1990) and applied a purposive approach to the definition of "security".

[32] In *Reves*, the court considered the scope of the word "note" in the context of securities law and set out a rebuttable presumption that any "note" is a security. It further adopted a "family resemblance" test by which it set out criteria for when an instrument might be considered as similar to some of the judicially accepted categories of commercial arrangements that are exceptions to this presumption. The court listed four factors which were relevant in determining whether an instrument is a security:

a) the motivation that would prompt a reasonable seller and buyer to enter the transaction: if the seller's purpose is to raise money for general business purposes and the buyer's purpose is to profit from the returns the instrument is expected to generate, the instrument is likely a security;

b) the intended distribution of the instrument: if it is one in which there will be "common trading for speculation or investment" it is likely a security;

c) the reasonable expectations of the investing public: the more the public expects that an instrument will be a security and thereby regulated by the securities laws, the more likely it is a security; and

d) the existence of another regulatory regime: if there is no other regulatory regime that significantly reduces the risk of the instrument, thereby rendering securities regulation necessary, the more likely it is a security.

The Court of Appeal in *Gill* applied this approach in determining whether the loan arrangements in that case were "evidence of indebtedness" within the definition of "security".

[33] The Applicants submit that the purposive analysis set out above, as applied in the decisions in *Ontario Securities Commission v. Tiffin*, 2016 ONCJ 543 and in *Aviawest Resorts Inc. (Re)*, 2013 BCSECCOM 319 should lead us to the conclusion that Flexfi's loan agreements are not "securities" for the purposes of the Act, but rather are commercial arrangements outside the scope of the Act.

[34] In particular, the Applicants say:

- the Flexfi loan agreements have no equity component and the creditors have no interest in the profits of Flexfi;
- Flexfi intended to borrow funds and not to secure investments;
- the loan agreements are clear on their face that they are loan agreements with no equity component;
- the loan agreements are not assignable or tradeable;

- the loan agreements were not widely distributed and were distributed within a network of business associates and connections of the Flexfi shareholders;
- the loan agreements adequately address investor risk and the lack of regulatory oversight by providing terms that allow the creditors to sue Flexfi in the event of default;
- the lenders had no expectation of the loan agreements being securities under the Act; and
- that the fourth factor set out in *Reves* (i.e. their being another regulatory regime that governs the loan agreement) is not present in this case, but that the absence of another regulatory regime does not, in and of itself, turn the loan agreements into "securities".

[35] We do not agree with the Applicants' submissions and find that Flexfi's loan agreements are securities under the Act.

[36] The first factor in the *Reves* approach is an assessment of the intent of the parties. As described by the US Supreme Court (at page 66):

> First, we examine the transaction to assess the motivations that would prompt a reasonable seller and buyer to enter into it. If the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments and the buyer is interested primarily in the profit the note is expected to generate, the instrument is likely to be a "security." If the note is exchanged to facilitate the purchase and sale of a minor asset or consumer good, to correct for the seller's cash-flow difficulties, or to advance some other commercial or consumer purpose, on the other hand, the note is less sensibly described as a "security."

[37] The Applicants say that because the loan agreements did not provide for an equity interest in Flexfi or other profit distribution mechanism, and contained solely an obligation of Flexfi to pay interest, that we should view the loan agreements as principally commercial arrangements.

[38] If we accepted this rationale then no loan or note would ever be a security, as an obligation to pay interest without an equity interest in the issuer is a standard term for loan transactions.

[39] Further, the definition of "security" under the Act explicitly includes instruments such as bonds and notes (along with "evidence of indebtedness") that do not normally entail an equity interest in the issuer. It is clear that having an equity interest in the issuer is not a pre-condition to an instrument being a "security".

[40] We do not think that loan arrangements are generally to be excluded from the definition of "security." To the contrary, we agree with the *Reves* approach, as applied in *Gill*, that there is a rebuttable presumption that loan arrangements are either notes or evidences of indebtedness within the definition of "security".

[41] Most importantly, the evidence of Ardalan is that the loan agreements were issued as a way for Flexfi to raise capital for general use in its business. That is, in fact, how the funds from the loans have been used. Ardalan acknowledges that he had a choice as to the manner of capitalizing the Flexfi business and, for economic reasons, he chose to enter into loan agreements. Further, there is nothing in the economic arrangements between Flexfi and its creditors that suggest a commercial or consumer arrangement of the kind suggested by the court in *Reves* as being exceptions to the presumption that loan agreements are securities. Flexfi's creditors are not engaged in a commercial manner or in a consumer relationship in any manner with Flexfi other than simply providing capital to Flexfi and getting a relatively high rate of interest in return.

[42] The loan agreements:

- are not secured;
- do not arise as a result of a commercial transaction (other than the mere lending of the funds) between Flexfi and the creditors; and
- are not provided in support of some limited or unique use of proceeds (such as a consumer lending transaction).

[43] The Applicants say that the creditors of Flexfi were not interested in profit and that the loan agreements were clear that no interest in the profits of Flexfi would be allocated to the lenders. We disagree with this narrow characterization of "profit" in the context of the first factor of the *Reves* test. The court in *Reves* at page 68, in note 4, had the following comment on this issue, with which we agree:

> We emphasize that by "profit" in the context of notes, we mean "a valuable return on an investment," which undoubtedly includes interest.

In this case, the Flexfi creditors will receive a relatively high rate of return, in the form of interest on their loans to Flexfi. The only way to view the intent of Flexfi and its creditors is that Flexfi wished to raise capital for its general purposes and the lenders wished to provide funds to Flexfi in return for a profit in the form of a good rate of interest. Those are the motivations typically found in a transaction involving a "security." The Applicants say that we should not view that transaction as an investment. We do not see that it can be characterized in any way other than being an investment.

[44] This case is therefore distinguishable from the Commission's decision (with respect to one of three classes of notes) in *Aviawest* on this question of "commercial intent" versus "investment intent". That decision sets out the following on this issue:

> 61. The vendor incentive notes were part of a commercial transaction. Existing timeshare owners were motivated by the opportunity to exchange their existing timeshare for a product that suited them better. They were further motivated by the discount offered by Aviawest in the form of the promissory note. Aviawest was motivated by the desire to sell more product to existing owners.
>
> 62. The vendor incentive notes were not intended as a general distribution for the purpose of raising capital.
>
> 63. The investing public (in this case, the timeshare owners) did not view the transaction as an investment in Aviawest but as a financial benefit offered by Aviawest as part of the exchange transaction.
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> …
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> 65. In our opinion, the essence of the transaction that gave rise to the vendor incentive notes was commercial, not investment. We find that the vendor incentive notes are not securities.

[45] The second factor in the *Reves* approach is to consider the distribution of the instrument in question. The facts before us relating to the distribution of the loan agreements by Flexfi also support our finding that they are securities.

[46] Flexfi has entered into over 80 transactions with 66 different parties and raised nearly $7 million. This is substantial both in terms of the number of different parties involved and the total amount raised.

[47] The Applicants say that these 66 different parties were sourced from the business networks of the Flexfi shareholders and that this is something other than a broad public distribution of securities.

[48] There is evidence that Flexfi's creditors were sourced from the business networks of the shareholders of Flexfi. However, the nature of those associations was not made clear. Further, it is clear even from Ardalan's affidavits and the affidavits of the five creditors that most of the creditors were not familiar with Flexfi, Ardalan or Flexfi's business prior to assessing the opportunity to make a loan to Flexfi.

[49] Flexfi's relatively broad distribution of loan agreements distinguishes it from the circumstances in *Tiffin*, for example, when a small number of the issuer's own existing clients provided short term, secured loans to assist in the issuer's cash flow difficulties.

[50] The fact that there is no public market for the loan agreements or that they are not intended for public trading or resale is not determinative. There are many "securities" under the Act that have limited or no rights of assignment or transfer.

[51] The Applicants rely heavily on the third *Reves* factor and the affidavit evidence of the five creditors in support of their application. Each of those creditors say that they never expected that their loans to Flexfi would be governed by the provisions of the Act. This evidence was not contradicted by any evidence tendered by the executive director.

[52] We accept this evidence from these creditors. However, we do not find it persuasive in and of itself. The evidence reflects only a small sample of the 66 creditors of Flexfi. Even if we had a broader sampling of the views of the creditors on this issue, we would not be surprised to find that the general investing public was not clear on which kinds of lending transactions fall within the ambit of the Act and which do not.

[53] Finally, as the Applicants have acknowledged, the fourth factor in *Reves* supports a finding that the loan agreements are securities. There are no other regulatory regimes that would serve to limit the risks or otherwise provide consumer protection in the circumstances of this case.

[54] The risks associated with the loan agreements are not fully addressed by the terms of the loan agreements (which provide for a right of action on default) nor are those terms a substitute for investor protection. The right to recover a debt owed by way of civil proceeding (whether express or implied) is common, if not universal, in debt obligations.

[55] In summary, the intent of a purposive analysis of the definition of "security" and a review of the specific facts and context associated with Flexfi's capital raising activities is to determine whether the broad investor protection purposes of the Act should be engaged. We think it clear that they should. Flexfi has entered into unsecured loan agreements offering a relatively high rate of interest with a significant number of creditors, most of whom are only indirectly connected to Flexfi and Ardalan, its principal business operator. It has done so for the purpose of raising capital for its general business purposes and the creditors have lent those funds for the purpose of generating the high rate of interest. These are exactly the circumstances over which the investor protection aspects of the Act were meant to govern. Frankly, if these loan agreements were not securities we have difficulty imagining circumstances in which a simple loan or promissory note arrangement would ever be a security.

[56] As a consequence of this finding, we do not find it necessary to consider whether the loan agreements of Flexfi are also "investment contracts" within the definition of "security" under the Act.

[57] July 21, 2017

For the Commission

Nigel P. Cave
Vice Chair

Audrey T. Ho
Commissioner

Gordon Holloway
Commissioner