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Citation: Home Capital Group Inc. (Re), 2017 ONSEC 32
Date: 2017-08-09

IN THE MATTER OF
HOME CAPITAL GROUP INC., GERALD SOLOWAY,
ROBERT MORTON and MARTIN REID

REASONS AND DECISION
(Sections 127 and 127.1 of the *Securities Act*, RSO 1990, c S.5)

Hearing: August 9, 2017

Decision: August 9, 2017

Panel:	D. Grant Vingoe	Vice-Chair and Chair of the Panel
	Timothy Moseley	Commissioner
	Garnet Fenn	Commissioner
Appearances:	Jennifer Lynch Cullen Price	For Staff of the Commission
	Peter F.C. Howard Edward J. Waitzer Samaneh Hosseini	For Home Capital Group Inc.
	Terrence O'Sullivan Niklas Holmberg	For Gerald Soloway
	James Douglas Graeme Hamilton	For Robert Morton
	David Hausman Jonathan Wansbrough	For Martin Reid

REASONS AND DECISION

The following reasons have been prepared for publication in the Ontario Securities Commission Bulletin, based on the reasons delivered orally in the hearing as edited and approved by the panel, to provide a public record of the oral reasons.

[1] This hearing concerns a settlement agreement (the "**Settlement Agreement**") among Commission Staff ("**Staff**"), Home Capital Group Inc. ("**HCG**"), Gerald Soloway, HCG's founder and CEO, Robert Morton, HCG's CFO, and Martin Reid, HCG's President (collectively, the "**Respondents**").

[2] As stated in the Commission's recent decision in *Re Electrovaya Inc.*, 2017 ONSEC 25 at para 1:

> Continuous disclosure by reporting issuers is a cornerstone of our securities regulatory regime. It is intended to provide, on an ongoing basis, the full and accurate information concerning all material facts and events relating to reporting issuers that is necessary for investors to have confidence in the fair and efficient operation of our securities markets. Accordingly, disclosures made by reporting issuers must be current, balanced and accurate.

[3] In the absence of full disclosure of material information regarding the business and operations of an issuer, investors are trading based upon a deficient understanding of information known to the issuer affecting the value of the issuer's securities. Investors will be winners or losers based on this disclosure deficit, rather than an appropriate disclosure record. A failure of disclosure harms confidence in our capital markets. Disclosure of material changes by a reporting issuer is not a discretionary decision for management, but a regulatory requirement and public responsibility. A delay by management in the release of information regarding events that have occurred that have caused or can reasonably be expected to cause a deterioration in financial results poses a fundamental risk that management will postpone the release of information in the hope that it can manage itself out of a hole. This is not management's prerogative. One of the responsibilities of a public company is to forthwith disclose such information to the market.

[4] As admitted by the Respondents in the Settlement Agreement, from May 2015 until July 2015, HCG misled its investors about the causes of a decline in HCG's mortgage originations, omitting to disclose until July 10, 2015 that it had terminated three underwriters, two brokerages and thirty brokers because it had discovered falsified loan applications in its broker channels. These terminations resulted from an internal investigation that commenced in August 2014, which was prompted by irregularities found in applications handled by a particular underwriter. The scope of the internal investigation expanded from there. The terminations occurred between mid-November 2014 and February 10, 2015. The terminated brokers and brokerages accounted for approximately 10% of HCG's 2014 originations.

[5] On the first trading day following HCG's July 10th press release announcing the terminations, which had caused an immediate drop in mortgage originations, HCG's stock price fell 18.9%.

[6] Mr. Reid had stated in his internal President's Report at the end of April 2015 that the deterioration in originations was mainly due to remedial actions taken as a result of the internal investigation. Mr. Morton stated in a memorandum to the Audit Committee of HCG's Board of Directors, dated May 4, 2015, that the deterioration could not be attributed to seasonality and weather alone, and he raised a concern about the need to publicly disclose the terminations.

[7] Despite the views of Mr. Morton and Mr. Reid and the state of internal knowledge at HCG concerning the effect of the terminations and remedial efforts, HCG's public disclosures, including statements made in the first quarter 2015 Interim Filing, issued May 6, 2015, attributed the drop to factors such as seasonality, the harsh winter, macroeconomic factors and "on-going review of its business partners ensuring that quality is within the Company's risk appetite", without referring to the broker and brokerage terminations. The Operational Risk section of the interim management discussion and analysis also stated that HCG may encounter a financial loss as a result of an event with a third party service provider and HCG may change relationships as appropriate, but the disclosure did not mention the specific effects of the terminations that had been effected months before and remedial efforts that had been underway for many months. In an earnings call with analysts on May 7, 2015, in which all three individual respondents participated, when asked about factors affecting originations, Mr. Soloway did not explain the effect of the terminations and ongoing remediation efforts, instead reciting other factors contributing to the decline.

[8] The Agreed Facts in the Settlement Agreement posit May 2015 as the beginning of the period in which disclosure was required. Given the timing of the internal statements made by Mr. Reid and Mr. Morton and that the Interim Filing, as certified by Mr. Soloway and Mr. Morton, was made on May 6, 2015, we understand how this time could reasonably be employed as the latest time by which disclosure was required by HCG. Actual disclosure was not made until over two months later.

[9] Staff and the Respondents request approval of the settlement embodied in the Settlement Agreement. This is a highly negotiated settlement, carefully coordinated with class proceedings in Ontario, for which there is a separate application for settlement approval before the Superior Court of Justice being advanced in conjunction with the settlement agreement presented to this Panel. A settlement saves time and resources for the Staff of the Commission, and allows HCG to move forward in its business activities without the overhang of protracted proceedings that affect confidence in HCG as a publicly traded financial institution. This is a particularly relevant consideration in this matter since HCG has, as reflected in the Settlement Agreement, made substantial changes in its Board of Directors and management, including the withdrawal of the individual respondents from board and officer roles with HCG, and the addition of a new independent Chair and independent directors. These changes represent a significant mitigating factor in considering sanctions with respect to HCG. A settlement in this matter also curtails the uncertainty affecting the market for HCG's securities and the negative effect this uncertainty has on

investors. A financial institution should have a compelling interest in avoiding the loss of confidence resulting from regulatory violations and the proceedings that rightly follow.

[10] In addition to the governance and leadership changes, other mitigating factors that this Panel considers relevant, as agreed by the Parties and set out in the Settlement Agreement, include:

a. Upon learning of the irregularities involved in mortgage applications, HCG conducted an internal investigation, the Board of Directors established an independent committee to oversee the investigation and appointed an accounting firm to assist in the investigation. HCG consulted with its external professional advisers throughout the investigation, including following the earnings call with analysts.

b. HCG reported the identified irregularities to Canada Mortgage and Housing Corporation, the Office of the Superintendent of Financial Institutions, its insurer and auditors, and kept them apprised about developments.

c. HCG implemented significant remediation measures including separation of origination and underwriting functions, reallocating resources to enhance underwriter verification of applicant income, and initiated a review of underwriter compensation practices to emphasize risk mitigation.

d. HCG acted in good faith with regard to disclosure decisions in reliance on professional advisers.

e. HCG voluntarily delivered to Staff a whistleblower memorandum from a vice president of HCG, dated June 1, 2015, within days of the memorandum's date. This memorandum was entitled, "*Failure to Comply with Timely and Continuous Disclosure Obligations and related Concerns - Fraudulent Mortgages*". The individual respondents cooperated with Staff in its subsequent investigations after that receipt.

[11] A settlement will ordinarily be approved if the sanctions agreed to by the parties are within a reasonable range of appropriateness in light of the facts admitted in the settlement agreement, taking into account the settlement process and its benefits as well as mitigating factors. Similarly, a panel, after a contested hearing, may or may not have found facts that are the same or different from those agreed to by the parties. In addition, even if substantially the same facts were found by the panel following a contested hearing, other sanctions than agreed might be imposed by such a panel.

[12] A panel considering a proposed settlement must rely on Staff's negotiations in reaching the settlement. A panel cannot know of potential facts that are excluded in the settlement agreement or the range of sanctions that were considered. A panel can only rely upon the facts agreed to by Staff in the settlement agreement and the context and responses to questions from the panel provided by the parties in a confidential settlement conference convened pursuant to Rules 12.1 to 12.5 of the *Ontario Securities Commission Rules of Procedure* (2014), 37 OSCB 4168. Such a conference was held in this matter in June of this year.

[13] In the case of a settlement, a Commission panel must be satisfied that the settlement is fair and reasonable and the approval of the settlement is in the public interest, based on the facts and sanctions agreed to by the parties, in light of applicable regulatory principles, prior Commission sanctions and the regulatory settlement process.

[14] The purpose of the Commission's sanctioning authority is to protect investors and the fair operation of our securities markets and to deter, both specifically and generally, future conduct that is inconsistent with securities laws or the public interest. These goals are furthered by seeking to ensure that public companies respect their continuous disclosure obligations and advise the marketplace of material changes on a timely basis. Once an internal investigation or other processes have produced concrete information rising to the level of a material change, disclosure is required unless confidential treatment of such information is sought and afforded by the Commission in accordance with Ontario securities law.

[15] In this case, we have concluded that approval of the Settlement Agreement with HCG, Gerald Soloway, Robert Morton and Martin Reid is in the public interest on the basis of the Agreed Facts and the agreed sanctions are within a reasonable range of appropriate sanctions.

[16] HCG has made a payment held in trust by its attorneys in the amount of $10 million for the benefit of the proposed class in the pending Ontario class action, excluding certain related parties of HCG defined as "Excluded Persons".

[17] HCG shall conduct a review and deliver to Staff a report concerning its continuous disclosure practices and any changes proposed and/or implemented as a result of its review.

[18] HCG has paid costs of the Commission related to this matter in the amount of $500,000.

[19] Each of the individual respondents shall be reprimanded.

[20] Each of the individual respondents shall immediately resign any position that any of them hold as an officer or director of a reporting issuer.

[21] Mr. Soloway is prohibited from becoming or acting as an officer or director of any reporting issuer for four years.

[22] Mr. Morton and Mr. Reid are each prohibited from becoming or acting as an officer or director of any reporting issuer for two years.

[23] Mr. Soloway has paid an administrative penalty in the amount of $1 million to the Commission, which amount is designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b)(i) or (ii) of the *Securities Act*, RSO 1990, c S.5 (the "**Act**").

[24] Mr. Morton and Mr. Reid have each paid an administrative penalty in the amount of $500,000 to the Commission, which amounts are designated for allocation or use by the Commission in accordance with subsection 3.4(2)(b)(i) or (ii) of the Act.

[25] The payments being held in trust for the benefit of the investors and the administrative penalties have been paid and the terms and conditions of the Settlement Agreement demonstrate the individual respondents' acceptance of

responsibility for HCG's admitted disclosure failings. This acceptance is highlighted by the individual respondents' agreement to attend at this hearing and be reprimanded. Mr. Soloway, Mr. Morton and Mr. Reid, you are each hereby reprimanded.

[26] For all of these reasons, the panel has determined to approve the Settlement Agreement and will sign an order substantially in the form of the order in Schedule "A" to the Settlement Agreement. With that, the panel wishes to thank all counsel for their helpful submissions in the settlement conference that preceded this hearing and in this hearing. The hearing is now concluded.

Dated at Toronto this 9th day of August, 2017.

"*D. Grant Vingoe*"
D. Grant Vingoe

"*Timothy Moseley*"
Timothy Moseley

"*Garnet Fenn*"
Garnet Fenn