

## Not Home Free Yet: Financial Institution Faces New Lawsuit Despite Creative Comprehensive Global Settlement for Disclosure Violations

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### Key Takeaways

- **Complexity of resolving parallel regulatory and civil proceedings for disclosure violations.** The ability for a public company to achieve a truly global resolution and move forward remains a difficult minefield even in circumstances of a creative coordinated settlement of both securities regulatory and class action proceedings.
- **Importance of rigorous disclosure compliance regimes and with continuous disclosure obligations.** The Ontario Securities Commission (the “OSC”) seized the opportunity in this matter to emphasize the importance of continuous disclosure obligations, noting that untimely disclosure “poses a fundamental risk that management will postpone the release of the information in the hope it can manage itself out of a hole.” A well-developed, comprehensive plan to quickly address potential disclosure deficiencies and navigate on multiple fronts has increasingly become a critical requirement for public companies and their officers and directors.

### Background

In 2017, Home Capital Group Inc. (“HCG”), as well as certain former senior executives, faced overlapping securities regulatory and class action proceedings<sup>1</sup> arising from a failure to make accurate and timely disclosure of the reason for the decline in its residential mortgage business.

These proceedings related to HCG’s misleading statements regarding the reason for the decline in its mortgage originations and its failure to disclose until July 10, 2015 that it had terminated multiple underwriters, brokerages and brokers from November 2014 to January 2015 following its discovery of falsified loan applications during an internal investigation. HCG relied on external professional advisors in making decisions on disclosure and materiality, a fact acknowledged subsequently in the securities regulatory settlement, described more fully below.<sup>2</sup>

The subsequent disclosure regarding the internal investigation and the terminations of brokers and brokerages, which accounted for approximately 10% of Home Capital’s 2014 mortgage originations, had a significant market impact with a share price drop of 18.9%. More importantly, the announcement of

regulatory proceedings by the OSC against HCG and certain former senior executives in April 2017 had a similar significant market impact with a 20% drop in share price, notwithstanding the passage of time since the clarifying disclosure in July 2015.

In August 2017, HCG reached a carefully coordinated settlement of both the securities regulatory and class action proceedings, as described more fully below. Notwithstanding this creative, comprehensive settlement, HCG and certain former senior executives are now facing additional stakeholder lawsuits relating to the same disclosure allegations.

## **Comprehensive Settlement Agreement but No Closure**

Following lengthy negotiations and with the assistance of a mediator, during which HCG, former senior executives of HCG, the proposed class of shareholders, the OSC and various insurers were all separately represented, the parties reached a carefully coordinated agreement to resolve both the class action and the regulatory proceeding with each settlement contingent on the other obtaining the requisite approval of the Court and the OSC, respectively.

These settlements comprised a global payment of \$29.5 million, with \$1 million ultimately allocated to the OSC,<sup>3</sup> payment of OSC costs of \$500,000 and various other non-monetary orders in the OSC settlement.<sup>4</sup>

In recognition of the increased frequency and complexity of settlements in the securities regulatory environment, largely a by-product of the prevalence of parallel civil proceedings (primarily class actions) and the limited availability of no-admission regulatory settlements, the settlement was approved by the OSC and the Court,<sup>5</sup> with both bodies lauding the associated administrative efficiencies and swift resolution, which allowed HCG to move forward in its business activities without the overhang of protracted proceedings that affect investor confidence.

The securities class action settlement was made on a no admissions of liability basis and a full release in favour of HCG and others. Importantly, the OSC settlement was made on a “with admissions” basis in which HCG and the former senior executives admitted a failure to comply with statutory disclosure obligations by making misleading and inaccurate statements (both in public filings and oral statements by senior executives during analyst calls) and failing to make timely disclosure of required facts.

Despite this seemingly comprehensive resolution, HCG and certain former senior executives are now facing additional lawsuits relating to the same disclosure allegations from stakeholders who opted out of the proposed securities class action, including a claim by a short seller seeking damages of \$4 million on the basis that HCG’s misrepresentations caused the premature closure of the short positions, as well as similar claims by other opt-out shareholders seeking damages of approximately \$72 million.

The potential use of the admissions made in the OSC settlement in these subsequent civil actions, creates

additional complexity for public companies like HCG, and their directors and officers in effectively defending such subsequent civil actions. More importantly, this development illustrates the elusive nature of full closure and the minefield of risks and challenges in overcoming prior disclosure deficiencies.

For further information regarding these issues or if you have any questions, please contact Wendy Berman, John M. Picone, David Kelman, or any other member of our Securities Litigation Group.

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<sup>1</sup> A securities class action was filed against HCG and certain former senior executives in February 2017. A securities regulatory proceedings was commenced by the Ontario Securities Commission against HCG and certain former senior executives in April 2017.

<sup>2</sup> See Reasons for decision dated August 9, 2017, paragraph 10; Settlement Agreement dated June 14, 2017, paragraphs 57 and 60.

<sup>3</sup> The OSC settlement included payment of a total of \$12 million (comprising \$10 million paid by HCG and \$2 million collectively by the former senior executives) and of that amount \$11 million was allocated for the benefit of the proposed class in the securities class action.

<sup>4</sup> The non-monetary orders, including among other things, an order that HCG conduct a review of its continuous disclosure practices and provide a review report to the OSC, orders that HCG executives resign from any position held as an officer or director of a reporting issuer and banning them from becoming an officer and director for varying periods of time.

<sup>5</sup> The OSC approved the settlement agreement on August 9, 2017 and the Ontario Superior Court approved the settlement of the class action on August 21, 2017.

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