Home Capital: Where were the regulators?

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“Poor governance at a public corporation does not necessarily lead to shareholder loss, but where a major equity erosion occurs, failed governance is generally present.

Home Capital Group Inc. is not an exception. The Ontario Securities Commission has made allegations (which have been not proven) against the company and three individuals – the company’s chief executive officer, chief financial officer and president at the time – of making materially misleading disclosures for 2014 and in 2015. The OSC allegations of failed disclosure were not made public until about two years later, on April 19, 2017. Regulatory proceedings are now under way. Shrewd investors shorted the stock months earlier. A proposed class action lawsuit has been filed. The alleged actions of the defendants and governance failings of the board of Home Capital will be pursued in the normal manner.

Investors became aware of OSC enforcement proceedings when Home Capital, not the OSC, advised on Feb. 10 that it had received enforcement notices. Why did the OSC’s investigation into 2015 events remain undisclosed and take so long while significant shareholder value was at risk and retail investors traded on information the OSC now alleges was materially misleading? At the beginning of 2015, the shares traded around $42 per share; they are now rated speculative, closing at $8.04 on April 28, after sinking to $5.99 earlier in the week.

Of related interest is the recent announcement of Canada’s multiple securities agencies that they are considering reducing the “regulatory burden on reporting issuers” and identifying areas of securities legislation that “could benefit from a reduction of undue regulatory burden, without compromising investor protection and the efficiency of the capital markets”. The focus includes reducing “the ongoing costs of remaining a reporting issuer [i.e. continuous disclosure requirements].” At the end of the day, it is the retail investor that bears the cost of reduced “regulatory burdens”.

There are several other regulatory issues to note. Many senior bank executives and controlling shareholders of other financial institutions also constantly express critical views of the heavy costs of regulatory burdens and unnecessary compliance obligations. Many market-orientated economists, including those in public office, have pressed for deregulation to reduce costs.

However, the former chairman of the U.S. Federal Reserve, Alan Greenspan, however, did recant his prior testimony of the ability of financial institutions to self-regulate after he witnessed the 2008 Great Recession associated with the subprime mortgage crisis and that related housing bubble. The current generation of Canadian financial supervisors should not easily forget the threatening flames from the $34-billion default of so-called “asset-backed securities”. After pleas from the Caisse de dépôt et placement du Québec, a major player in this market, the Bank of Canada and Department of Finance actively intervened to prevent a potential systemic destabilization, including by agreeing to indemnities from liability for the domestic and foreign banks involved. Regulators’ acceptance of the supplications of those they regulate often results in future losses to investors, taxpayers and the public generally.

The safety, soundness, prudent business practices and governance of Home Capital’s operating subsidiaries, Home Trust and Home Bank, are supervised by the Office of the Superintendent of Financial Institutions and Canada Deposit Insurance Corp. These financial businesses operated with an unstable business model, providing subprime mortgages and consumer loans financed by short-term, high-interest deposits and investment certificates. Has Ottawa not learned the severe consequences that can erupt from this funding mismatch after earlier experiences? Presumably, Home Trust and Home Bank were high on Ottawa’s watchlist, but shareholders and depositors, whose money was exposed, were not aware.

So where were the regulators? What did they know and when did they know it? This is not a call for increased regulation. It is an appeal for more efficient supervision and greater transparency between the regulators and the public whose interests they serve, not the primary concerns of the regulated. If this requires changes in law and policy, let’s re-address them so that retail investors and consumers of financial services can make fully informed decisions.”

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