Investors sue Ontario over supervision of risky syndicated mortgages

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A group of investors has launched a class-action lawsuit against the Ontario government alleging that the provincial regulator responsible for licensing mortgage brokers was negligent in allowing the sale of risky syndicated mortgage investment products marketed by the Tier 1 group of companies.

Two investors in products offered by Tier 1, which raised funds for proposed Ontario real estate developments that have since collapsed or been placed in receivership, are acting as the representative plaintiffs in the proposed class action.

Syndicated mortgages are provided by a group of investors, typically to finance early stage costs for new development projects. Financing raised by Tier 1, which is under the control of a court-appointed trustee, was expected to fund a development group planning to build condominiums, multiunit homes for Alzheimer's patients and student residences.

The popularity of syndicated mortgages surged over the past decade as retail investors hunted for alternatives to low-rate, fixed-income products. But some syndicated mortgages pose risks that many don't understand, and position the investors behind other creditors if the developments fail.

The lawsuit alleges that the Financial Services Commission of Ontario – which was renamed the Financial Services Regulatory Authority of Ontario in June – and a number of its senior officials "carried out their duties on behalf of FSCO in a negligent manner."

A spokesman for the Ministry of the Attorney-General said that the government had not yet been served with the statement of claim. "As this matter is subject to litigation, it would be inappropriate to comment," Brian Gray said.

The lawsuit, which was filed in Ontario Superior Court in Brampton on Nov. 1, will be a test of Ontario's Crown Liability and Proceedings Act. The new law has placed a higher burden on those seeking to sue the government, forcing them to persuade a judge at the outset that the claim has a reasonable chance of success before they are permitted to proceed with the litigation.

Mitchell Wine, one of the lawyers behind the proposed class action, acknowledged in a statement that his clients face obstacles. But he said that his firm, which has acted for many aggrieved investors in an earlier class-action case against Tier 1, as well as claims against Canada's most prolific distributor of syndicated mortgage investment products, Fortress Real Developments Inc., has amassed "sufficient evidence" to pursue the government for damages.

The “regulation was so poorly carried out that the Crown should be held liable for investor losses,” Mr. Wine said. “It is difficult to succeed in litigation against the Crown but we believe there is sufficient evidence against FSCO and its employees to justify the commencement of this action.”

The claim states that in 2016, FSCO took action against Tier 1, obtaining a court order that placed a trustee, Grant Thornton Ltd., in control of many its assets. Since that time, Grant Thornton has recovered $23.4-million of the $131-million raised.

However, the claim alleges that before that time, many warnings to FSCO about syndicated mortgages went unheeded, which allowed the products to continue to be sold by both Tier 1 and Fortress.

The claim alleges that these warnings came from a wide range of concerned individuals: a government employee in Prince Edward Island, an official with the Canada Revenue Agency, as well as many mortgage brokers.

The claim also alleges that Royal Bank of Canada conducted an investigation of Tier 1 in 2014, which prompted the bank to stop doing business with the company. An RBC banker, the claim alleges, brought its concerns to the attention of FSCO in a meeting. The claim does not include any supporting evidence for its assertions about RBC or the other whistle-blowers.

The representative plaintiffs, Betty Wei, a 64-year-old human-resources staffer, and her husband, Lawrence Vanderklei, a 61-year-old engineer, also allege that the Tier 1 marketing information they received listed FSCO licence numbers. The couple “relied upon the fact that the mortgage industry was regulated by the province of Ontario,” the lawsuit says.

Bhaktraj Singh, the Tier 1 official alleged in the claim to have “controlled” the company has, in the meantime, struck a settlement as part of a lawsuit initiated against him, court documents show.

Mr. Singh was a shareholder in a number of the development companies that relied on Tier 1 mortgages, and which have been placed in receivership. On Nov. 1, the receiver, which had launched a claim against Mr. Singh, disclosed in court filings that, after “lengthy investigations and due diligence,” it had agreed to settle with him for $2.1-million.

A previous report by the receiver stated that Mr. Singh, and companies under his control, had received $9.4-million in fees and other payments from the corporations. “The receiver is reasonably satisfied that the Singh defendants have disclosed all their assets,” the Nov. 1 court filings state.