

# SUMMARY

of the  
**Statement of Claim**

Nov 1, 2019

As you will see from the Statement of Claim, the regulation and supervision of the syndicated mortgage market in Ontario by the Financial Services Commission of Ontario (“**FSCO**”) was, at a minimum, grossly negligent.

One is hard-pressed not to conclude after reading the Statement of Claim that something more than mere negligence is at play. It is difficult to conclude otherwise in light of the inexplicable inaction of FSCO during the years in question.

## **Overview**

- The Tier 1 SMI’s related to 16 development projects in the province of Ontario (the “**Projects**”).
- FSCO is a regulatory commission established by the province of Ontario under the provisions of the *Financial Services Commission of Ontario Act, 1997*, S.O. 1997, c. 28 (the “**FSCO Act**”) with a legislative mandate to regulate, *inter alia*, the mortgage brokerage industry in Ontario pursuant to the provisions of the *Mortgage Brokerages, Lenders and Administrators Act, 2006*, S.O. 2006, c. 29 (the “**MBLAA**”) and its regulations.
- The Defendant Her Majesty the Queen in Right of Ontario (the “**Crown**”) is responsible by statute for the actions of FSCO officers, employees and agents pursuant to the provisions of the *Crown Liability and Proceedings Act, 2019*, S.O. 2019, c. 7 (the “**CLPA**”).
- Only brokerages, brokers and agents licensed by FSCO under the provisions of the *MBLAA* may deal or trade in mortgages in the province of Ontario.<sup>1</sup> The *MBLAA* and its regulations set out high standards of practice for mortgage brokerages, principal brokers, brokers, agents, mortgage administrators and brokerage officers and directors.
- First Commonwealth and Tier 1 Mortgage were both licensed by FSCO. They sold the SMI’s developed by Tier 1.
- On October 20, 2016 the Superintendent of Financial Services (the “**Superintendent**”) had Application CV-16-11567-00CL (the “**Application**”) issued in the Superior Court of Ontario (Commercial List) seeking the appointment of a trustee over the assets, undertakings and properties of the Trustees. The application was granted and Grant Thornton Limited (“**GTL**”) was appointed as trustee.
- Since its appointment, GTL has distributed to the Investors approximately \$23.4 million of the \$131 million of Investors’ money or about 17.9% of the total value of the SMI’s.

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<sup>1</sup> Sections 2 and 3 of the *MBLAA*

- The majority of Investors will lose all or a significant portion of the funds invested in the Tier 1 SMI's.

## **Theory of the Plaintiffs' Case**

### **a) The Facts**

- The developers of the Projects (the "**Developers**") were the borrowers/mortgagors under the Tier 1 SMI's. The SMI's were held and administered on behalf of the Investors by trustee corporations (the "**Trustees**") that were incorporated by Tier 1 for this purpose.
- Bhaktraj Singh ("**Singh**") was a director, officer and shareholder of Tier 1. He controlled the company. He was also a licensed mortgage agent with First Commonwealth. Singh controlled at least 14 of the 16 Trustees and was a shareholder or had a profit participation in at least 11 of the 16 Developers.
- When the Superintendent commenced his application in October 2016 to close down Tier 1 Advisory, the grounds relied upon for the relief sought were:
  - a) There was inadequate disclosure to the Investors by Tier 1, First Commonwealth and Tier 1 Mortgage of Singh's conflicts of interest as the principal of Tier 1, the controlling shareholder of almost all the Trustees and a profit participant in most of the Developers. The Trustees had a fiduciary duty to represent the interests of the Investors but Singh's multiple interests created a conflict that impeded the ability of the Trustees to properly enforce the terms of the SMI's on behalf of the Investors.
  - b) There was inadequate disclosure to the Investors of the true value of the mortgaged properties underlying the Projects. The properties were raw land. Yet investors were given appraisals of the "as is" or current value for the land as if the proposed projects had been fully constructed.
  - c) The Trustees administered the SMI's on behalf of the Investors. Yet, they had not been licensed for this role under the *MBLAA* as required.
- The other Defendants to the action other than the Crown are:
  - a) Brian Mills ("**Mills**") was the Superintendent, the Chief Executive of FSCO, at the relevant times herein. It is one of the Superintendent's responsibilities to administer and enforce the *FSCO Act* as well as other statutes that confer powers on or assign duties to the Superintendent. Among the statutes is the *MBLAA*.
  - b) Anatol Monid ("**Monid**") was the Director (Licensing and Market Conduct Division) and then the Executive Director (Licensing and Market Conduct Division) of FSCO during the relevant times herein.
  - c) John Doe and Jane Doe were officers, employees and/or agents of FSCO whose identities are not currently known by the Plaintiffs and who were solely or partially responsible for FSCO's wrongful actions as set out in the Statement of Claim.

## The Plaintiffs' legal position

- The Plaintiffs legal position is that Tier 1, First Commonwealth and Tier 1 Mortgage did not provide proper disclosure to them prior to their investment as required by the *MBLAA* and according to common law.
- The most significant omissions were:
  - a) The failure to disclose significant material risks with SMI's in general and with Tier 1 SMI's in particular.
  - b) Failure to disclose that Tier 1, First Commonwealth, Tier 1 Mortgage, the Developers and the Trustees were related companies with conflicts of interest.
  - c) Failure to disclose that the Trustees had not been licensed under the *MBLAA* to act as administrators of the SMI's.
  - d) Failure to disclose that the ILA obtained by the Investors was not true independent legal advice as it was paid for by the Developers and did not disclose the legal risks associated with the SMI's.
  - e) Failure to disclose the true fees and commissions that would be paid to mortgage brokerages, brokers, agents and referring parties.
  - f) Failure to disclose that the true "as is" value of the mortgage properties had been overstated and the appraisals were not proper appraisals as mandated by FSCO under the *MBLAA* and as required by the standards set by the Appraisal Institute of Canada.
  - g) Failure to disclose that an investment in the Tier 1 SMI's was not eligible for investment through registered plans because the LTV ratio exceeded 100% based on the true (lower) current value of the mortgage properties.
  - h) Failure to disclose that a portion of Investors' capital would be withheld from the Developers as an interest reserve for payment of interest. Accordingly, interest to the Investors was not paid by the borrower but was paid by the Investors themselves contrary to the *MBLAA*.<sup>2</sup> Investors who invested in the Tier 1 SMI's outside of a registered plan would then pay income tax for "interest payments" that were, in fact, repayments of capital.
  - i) Failure to disclose that Olympia Trust as an Alberta-licensed trust company was not legally authorized to carry on business in Ontario and that it was illegal for FSCO-licensed parties and unlicensed parties to solicit Ontario business for Olympia Trust.<sup>3</sup>
- The Plaintiffs plead that had they received full and proper disclosure with respect to SMI's generally and the Tier 1 SMI, they never would have proceeded with their investments.

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<sup>2</sup> This was contrary to section 23(1) of O.Reg. 189/08 that required administrators of mortgages to pay interest to investors obtained from the borrower.

<sup>3</sup> Sections 31 and 213 of the *Loan and Trust Corporations Act*, R.S.O. 1990, c. L-25

- In making their investments, the Plaintiffs relied upon the fact that the mortgage industry was regulated by the province of Ontario. The marketing information they received listed the FSCO license numbers of First Commonwealth and Tier 1 Mortgage.
- While the Plaintiffs were not familiar with the relevant legislation governing SMI's in Ontario, they knew the sector was regulated and believed the Government of Ontario ensured that SMI's were properly structured and sold to Ontario investors.
- The Plaintiffs plead they would not have proceeded with their investments had they known of the lack of proper regulation and oversight by FSCO of Tier 1, First Commonwealth and Tier 1 Mortgage and other SMI's offered in Ontario.
- Paragraphs 68-184 (pages 19-39) of the Statement of Claim set out in detail the 15 separate acts of negligence, misfeasance or misconduct by a public authority of FSCO:
  - a) FSCO Publications and Emails - FSCO publications set out the commission's statutory mandate and its self-identified priorities. These include protecting the public interest, enhancing public confidence in FSCO-regulated sectors and increasing awareness of mortgage fraud. As early as 2013-2014, Monid identified mortgage product suitability and mortgage fraud as "high priority" FSCO areas of focus.
  - b) FSCO and Olympia Trust - FSCO is responsible for the licensing of trust companies pursuant to the provisions of the *LTCA*. Olympia Trust is licensed as a trust company under the laws of the province of Alberta. Under the provisions of the *LTCA*, only federally and Ontario incorporated trust companies may carry on business in Ontario. In 2011 and 2013 Olympia Trust requested a license from FSCO but was rejected. Olympia Trust nevertheless started to do business in Ontario.  

FSCO knew that Olympia Trust was doing business in Ontario and knew the company was unlawfully soliciting business in Ontario since at least June 2014 and perhaps earlier but took no steps to prohibit this business until August 2017. The evidence will be that had Olympia Trust not carried on business in Ontario, it would not have been possible for SMI's to be sold to holders of registered plans like RRSPs, TFSAs, RRIFs, LIFs or LIRAs (no other Ontario trust company or bank would accept the business). Without registered plan investment in SMI's, there would have been no Tier 1 SMI business.
  - c) Unlicensed Solicitation of Mortgage Business - The *MBLAA*'s provisions prohibit any unlicensed entities from soliciting mortgage business in Ontario.<sup>4</sup> Advertisements by unlicensed entities that refer interested people to licensed mortgage brokerages are also prohibited by the *MBLAA*. Notwithstanding these provisions, advertising for SMI's was widespread by unlicensed companies via social media, websites, trade shows and direct-to-consumer marketing. Monid and other senior employees at FSCO knew of this activity since 2011 but took no steps to prohibit the unlicensed activity until 2014.
  - d) Lack of Suitability of SMI's for investors – FSCO officers identified SMI's as high risk investments unsuitable for most investors in 2014 but no steps were taken by FSCO to deal with the issue.

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<sup>4</sup> Sections 2 and 3 of the *MBLAA*

- e) Lack of Disclosure of Material Information in Disclosure Documents - FSCO officers identified this as an issue in 2014 but no steps were taken by FSCO to deal with the issue.
- f) SMI Solicitations Emphasized the Safety and Security of SMI's - FSCO officers identified this as an issue in 2014 but no steps were taken by FSCO to deal with the issue.
- g) Appraisals Provided to Investors were Invalid – FSCO required that appraisals state the “as is” value of mortgage properties. Instead, investors were given values based on the value of the property as if it had been developed. This is a prospective value based on the definitions established by the Appraisal Institute of Canada. The current values of the properties were not high enough to meet the parameters set out by CRA for registered plan investments. FSCO officers identified this as an issue but no steps were taken by FSCO to deal with the issue.
- h) Royal Bank of Canada Reported a Tier 1 “Boiler Room” to FSCO in 2014 – Tier 1 had been a customer of the Royal Bank of Canada (“RBC”). As a result of unusual activity in the Tier 1 account, RBC conducted an investigation of Tier 1’s business. The investigation resulted in RBC refusing to do further business with Tier 1. In August 2014 an employee of RBC contacted FSCO to report on its findings with respect to Tier 1. The information provided to FSCO was that RBC considered Tier 1’s activities to be fraudulent. An RBC employee described the Tier 1 business as a “boiler room”. A report was made to Monid. He was asked to authorize further investigation of Tier 1’s activities. Monid never responded to this request. Nothing further occurred.
- i) SMI's are a Ponzi Scheme - In July 2013, a representative of CRA contacted FSCO employees to warn that the SMI's had the attributes of a Ponzi scheme. Subsequently, FSCO received a complaint that SMI's marketed by another company, Fortress, amounted to a Ponzi-scheme. FSCO took only cursory steps to investigate. There was no review of documents underlying the SMI's including property appraisals and MBLAA-mandated disclosure information. The file was closed even though the investigation disclosed evidence of unlicensed solicitation activity and also disclosed that Olympia Trust was illegally doing business in Ontario.
- j) CRA and Tax Eligibility - By June of 2015, FSCO employees were advised by CRA that the SMI's were not, in fact, tax-eligible because the LTV ratios of the mortgaged properties exceeded 100%. No steps were taken by FSCO to deal with this problem, a problem with potentially enormous consequences for the Investors.
- k) Mortgage Brokers Alert FSCO to SMI Issues - Monid was advised repeatedly since 2012 by senior mortgage brokers with longstanding and strong reputations in the industry that there were problems with the SMI's. In 2012 and at later times, Monid stated that he would investigate the SMI's in response to these concerns. No investigation appears to have taken place.
- l) Licensing by FSCO - FSCO has failed to take proper steps in licensing and regulating mortgage brokerages and mortgage brokers and agents. In one case, a mortgage brokerage and agent were licensed even though the agent had been suspended for 15 years by the Ontario Securities Commission and ordered to pay \$3 million in penalties.

- m) Complaints to FSCO and Internal Staff Concerns - Consumer complaints and inquiries to FSCO with respect to SMI's grew dramatically between 2011 to 2014. The first FSCO file related to an SMI complaint was dated March 2, 2011. In 2012, FSCO received one complaint. That grew to 11 in 2013 and 22 in 2014. In addition, consumer "inquiries" about SMI's went from 4 in 2012 to 11 in 2013 to 28 in 2014. In the 17 month period between from January 2014 to June 2015, FSCO received 42 complaints and 45 inquiries.

Notwithstanding the high volume of complaints, many of which were identified by compliance officers as worthy of investigation, as a result of direction from Mills, Monid, John Doe or Jane Doe (or some combination of these individuals), most complaints were never investigated. In the cases where further investigation proceeded, the underlying documents relating to the SMI, its structure and value and the disclosure made to investors were never reviewed by FSCO staff. Not surprisingly, the conclusion usually reached was that the complaints had no merit and the files were closed.

Within FSCO itself, employees began to raise concerns about the regulation of SMI's in 2014 and 2015. In 2015, SMI's and FSCO started to receive intense media and consumer attention. FSCO staff identified 21 contraventions of the *MBLAA* and three contraventions of the *LTCA*.

In May 2015 a meeting was held with Mills and other senior FSCO employees including Monid. FSCO's actions (and inaction) as set out in this Statement of Claim were discussed during the meeting. Among the references made during the meeting was that FSCO's actions showed an absence of due diligence in the face of fraudulent activity.

The conclusion of the meeting was an order from Mills that oversight and investigations related to SMI's be enhanced.

Olympia Trust had also been discussed during the meeting. Staff were told to take steps to prohibit Olympia Trust from continuing to carry on business in Ontario.

Notwithstanding Mills' directive, oversight and investigations related to SMI's were not enhanced. Mills took no steps to follow up to ensure his instructions were carried out. No steps were taken to prohibit Olympia Trust from carrying on business in Ontario until August, 2017, over two years later.

- n) FSCO Examinations - Tier 1 first came to FSCO's attention in January 2014 as a result of a consumer complaint about unlicensed activity by Tier 1. This was almost three years before FSCO took steps to halt Tier 1's business. FSCO issued Tier 1 with a warning letter regarding promotional materials posted on Tier 1's website and in its brochures.

In April and May of 2014 FSCO carried out an examination of First Commonwealth pursuant to the provisions of section 30 of the *MBLAA*. Five mortgage transactions were reviewed. Four of the five revealed seven contraventions of the *MBLAA* or its regulations.

The contraventions included:

- i) Three of the five files did not contain Disclosures signed by the Investors.
- ii) In the other two files, the Investor did not receive the Disclosure.
- iii) Appraisal fees and legal fees were not disclosed to Investors in two files.

During the 2014 examination the underlying documents relating to the Tier 1 SMI's were not reviewed. The structure of the Tier 1 SMI's was not reviewed. Nor was there a review of Tier 1's disclosure to Investors. Had these steps been taken, FSCO would have become aware of the issues that caused it to commence the Application seeking GTL's appointment in October of 2016.

This would presumably have resulted in FSCO taking steps to appoint a trustee in the spring of 2014 instead of the fall of 2016. The difference of two and a half years would have resulted in a reduction of up to \$105 million in Investor losses as most of the money raised by Tier 1 from Investors was after this date.

A consumer complaint caused FSCO to open a new file against Tier 1 Mortgage in June of 2014. Once again, investigation did not include a review of underlying documents for Tier 1 SMI's and Investor disclosure. Accordingly, no compliance issues were noted.

A further examination of Tier 1, First Commonwealth and Tier 1 Mortgage was scheduled for the fall of 2014. The examination was intended to focus more intensively on the issues being raised internally about SMI's by FSCO staff in 2014. The examination would have been conducted by FSCO compliance officers who had expertise with respect to SMI's, a change from previous examinations often involving compliance officers with little knowledge of the mortgage industry.

The examination would finally have involved a review of the documentation related to the structure and soundness of the SMI's and the disclosure provided to Investors. The examinations did not proceed. No reason was ever given for the cancellation.

## **The Legal Issues**

- There are four distinct legal issues that affect the ability of the Plaintiffs to obtain recovery.

Discussion of each issue will follow:

- a) Will leave be granted to the Plaintiffs under the newly enacted provisions of the *CLPA*?
- b) Did FSCO owe a **duty of care** to the Investors and, if so, did it carry out its duties in a proper manner. Is there a good faith defence to any negligence?
- c) Did the actions of FSCO constitute **misfeasance** in a public office?
- d) Did the actions of FSCO constitute the **tort of misconduct** by a public authority?

**NOTE:** this paper is a **Summary**. For full details, refer to the entire 55 page Statement of Claim.