



## How Low Can Home Capital Group Inc. Go?

### Description

My [recent article](#) spoke of a long-term short play for **Home Capital Group Inc.** ([TSX:HCG](#)) for reasons completely separate from the recent announcement this past week that the company is facing Ontario Securities Commission (OSC) enforcement action following allegations the company had improperly disclosed a significant number of mortgage applications containing falsified income information on loan applications.

Since my article was published, Home Capital Group's stock is down approximately 13%, and speculation abounds that this company's stock price may take a larger hit in the long term due to potentially increased headwinds for the mortgage-lending company.

I'll take a look at new reasons why Home Capital Group may fall faster than expected.

### The allegations

The OSC has alleged that Home Capital Group "failed to meet its continuous disclosure obligations" and subsequently served the company with an enforcement action late Friday afternoon. The enforcement action pertains to a disclosure made by Home Capital Group in 2015 that brokers and brokerages representing the firm had falsified income information on mortgage applications in 2014 and 2015.

The parties responsible were suspended by Home Capital Group, and the company's stock price took a 21% hit in July 2015 after mortgage origination numbers came in lower than expected relating to the suspension.

Home Capital Group asserts that it believes it has satisfied all disclosure requirements, and the company will be given the chance to respond the enforcement action before the OSC decides whether or not to commence proceedings.

### The bigger, more pressing issue

Analysts are less concerned with the OSC enforcement action than they are with the possibility of a

class-action lawsuit, as previous disclosure failures have led to such suits in the past. An analyst from **National Bank of Canada** points to a 2009 class-action lawsuit brought against **Manulife Financial Corp.** in which the firm settled the \$1 billion lawsuit for \$69 million.

General agreement is that the proposed economic penalties imposed by the OSC on Home Capital Group would be manageable; however, a class-action suit or other further actions brought against Home Capital Group could yield much bigger problems for the mortgage lender in the long term.

What is likely to happen, regardless of whether OSC proceedings commence or a class-action lawsuit is brought against Home Capital Group, is that the market will assign a higher risk premium to this company. In addition to the legal risks associated with the most recent announcement, the firm engages in a significant portfolio of non-prime and sub-prime lending which, while carrying higher yields, carries higher risk — risk the market may be forced to price in more heavily into the company's stock price.

In any case, this is one firm I remain extremely cautious of.

Stay Foolish, my friends.

#### **CATEGORY**

1. Bank Stocks
2. Investing

#### **POST TAG**

1. Editor's Choice

#### **TICKERS GLOBAL**

1. TSX:HCG (Home Capital Group)

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