PACE credit union launches investigation of improper investment sales by brokerage division

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PACE CEO Barbara Dirks, seen at her home in Mississauga on June 10, 2020, said in a letter that the credit union will hire an external law firm to conduct a 'compliance review' examining how clients may have been advised to invest in unduly high-risk products.

CHRISTOPHER KATSAROV/THE GLOBE AND MAIL

PACE Savings and Credit Union is launching an investigation into whether a subsidiary improperly sold risky investment products that lost up to 86 per cent of their value when the coronavirus pandemic upended financial markets.

The credit union, based north of Toronto, is trying to rebuild its battered reputation after allegations of fraud and self-dealing involving former top executives who have since been fired. A provincial regulator seized control of PACE in the fall of 2018 to protect its members and deposits, and has overhauled the management and board of directors.

The investment products now under scrutiny are a fresh concern that has surfaced in the past six weeks. They were sold to investors as early as May, 2018, by financial advisors at Pace Securities Corp., an investment dealer and subsidiary of the credit union. But this May, the credit union announced that Pace Securities will be wound up, stranding those investments at a fraction of their original value.

In a letter to members on Thursday, chief executive Barbara Dirks said the credit union will hire an external law firm to conduct a “compliance review" examining how clients may have been advised to invest in unduly high-risk products, exposing them to huge losses.

“I have enough curiosity and enough concern that I think an independent review is warranted," Ms. Dirks said in an interview. "I think it’s the right thing to do for members. We need to earn back member trust, member respect, one action at a time.”

Ms. Dirks joined PACE as CEO in early April with a mandate to start a new chapter for the credit union. Under a new board of directors elected in January, she is leading a “concerted effort” to put PACE back on track and get it released from special supervision by the Financial Services Regulatory Authority of Ontario. Her team is installing new controls and processes, and shedding loans and business lines that are no longer considered suitable for the credit union.

PACE also hired two key executives in late April: chief financial officer Benjamin Choi, who has experience at Bank of Montreal and British bank Standard Chartered PLC, and chief risk officer Terri O’Brien, formerly head of risk for Interac Corp.

“We’re very much focused on firstly stabilizing the business,” Ms. Dirks said.

Yet, PACE’s plans to turn the page are complicated by lingering problems left over from the previous regime. The demise of Pace Securities, announced on May 15, has become a pressing concern.

The new issue became apparent when some clients received letters dated April 28, saying the value of preferred shares purchased through Pace Securities, which paid generous annual dividends of 5 per cent to 7 per cent annually, had fallen from $10 a piece to $1.62 and $1.44, respectively. Individual investments that were initially worth tens or hundreds of thousands of dollars each had been mostly wiped out, and any hope that they might recover was lost with the decision to shut down Pace Securities.

The Globe and Mail spoke to multiple clients who suffered deep losses on the preferred shares. They described themselves as unsophisticated investors, in some cases retired or near retirement, who were looking for a safe way to earn interest on savings. Instead, financial advisers from Pace Securities steered them to a far more volatile alternative, they said.

The Globe is not identifying some of those clients because they feared repercussions as they try to recover some of what they have lost.

The preferred shares – which have characteristics of both stocks and bonds – were in two companies and sold through advisers at Pace Securities. One firm was Pace Financial Ltd., a subsidiary of the dealer, and the other was First Hamilton Holdings Inc. The CEO of Pace Securities, Joseph Thomson, was also CEO of First Hamilton, which lists former Ontario premier Ernie Eves as its chairman.

Mr. Eves was previously paid consulting fees for advising ex-President Larry Smith on a questionable deal to acquire a currency exchange business, and was once considered for the chairman's role at Pace Securities.

Pace Financial and First Hamilton both sold preferred shares to investors to raise funds, borrowed more against those funds, and invested in corporate debt to generate returns. As the pandemic crisis unfolded, and share prices plunged, the bank that had allowed Pace Financial and First Hamilton to borrow money to leverage investments through a margin account, Laurentian Bank Securities, pulled its support. That meant Pace Securities needed to raise alternate funds, but it wasn't able to.

Mr. Eves did not respond to a request for comment. Mr. Thomson, the CEO of Pace Securities, described the preferred shares as a "medium-risk" investment.

"With respect to the results for investors, there were several parties that were not willing to be co-operative, particularly actions taken by Laurentian, and that led to realizing losses that did not need to be realized," he said.

A 2018 offering memorandum describes First Hamilton's preferred shares as "a risky investment" that is "suitable for investors ... who can afford a total loss of their investment." According to financial statements from February, 2019, obtained by The Globe, all of the bonds First Hamilton invested in were rated below investment grade. Of those, 71 per cent carried ratings that qualify them as "highly speculative," and another 18 per cent were rated lower still.

By contrast, clients said their advisors characterized the shares as a safe investment and did not explain those risks.

Retired Toronto transit worker Elaine Gurney, 63, visited a PACE branch in Etobicoke, Ont., to reinvest $100,000 after a guaranteed investment certificate (GIC) expired. After being directed to speak with an adviser, she walked out with preferred shares in Pace Financial Ltd. She thought she had bought something akin to a Canada Savings Bond, and didn't understand that her principal could be at risk.

“That part was never explained to me," said Ms. Gurney, who doesn’t know how much money she has lost. “I feel betrayed and I am very angry. I want this put right."

PACE’s external review will look closely at “what happened with these shares, how they were sold, suitability, disclosure, those kinds of questions,” Ms. Dirks said. The credit union will also “explore creating a recovery fund” to provide interim relief to members facing hardship from financial losses.”