Ontario's financial regulator begins process to hand back control of PACE credit union to members

James Bradshaw   Published 15 hours ago

The administration of PACE, and the scandal underlying it, have taken a toll on the credit union.

Christopher Katsarov

Ontario's financial regulator is preparing to hand control of PACE Savings and Credit Union back to its members after holding a vote Monday to elect a new board of directors.

The credit union, which has more than 39,000 members, has been under the control of the Financial Services Regulatory Authority of Ontario (FSRA) while the regulator pursues a civil lawsuit alleging widespread fraud and misconduct by PACE's former senior leaders.

Hundreds of PACE members attended Monday's meeting near the credit union's headquarters in Vaughan, Ont., and elected a ninemember board – a key first step toward turning the page on a turbulent 16 months. Members also agreed to amend two of PACE’s bylaws to shrink the number of board seats and scrap a provision that limited nominees to those who had been members for at least a year.

The regulator had the legal right to appoint the board, but chose to put it to a members’ vote, presenting a slate of candidates after a search by executive recruitment company Odgers Berndtson. Had the slate been rejected, PACE would have stayed under administration, and FSRA would have gone “back to the drawing board,” Mark White, FSRA’s chief executive officer, said at Monday’s meeting.

“This is an unusual situation where the issues at PACE were governance-related, and they were not financial," he told members. “There aren’t a lot of precedents for this, so we are making up a process that we think works under the legal regime, and works to represent member interests."

PACE’s troubles surfaced in September, 2018, when a regulator, Deposit Insurance Corp. of Ontario (DICO), seized control of PACE using a rare power reserved for stabilizing financial institutions in serious distress. DICO alleged that PACE’s president, Larry Smith, and his son Phillip Smith, who was CEO, had engaged in a pattern of self-dealing, collecting secret commissions on some of the credit union’s loans and investments, aided by a complicit board. When FSRA was created last June, it absorbed DICO and took over the administration of PACE.

Even now, PACE faces an array of challenges. The regulator is seeking millions of dollars in damages through its lawsuit against Larry and Phillip Smith, who both deny FSRA's allegations. Several of the Smiths' family members and business associates, as well as most of the credit union's former directors, are also named as defendants.

The administration of PACE, and the scandal underlying it, have taken a toll on the credit union. Interim CEO Rubina Havlin said at Monday's meeting that PACE expects "a noticeably smaller profit this year." Operating income was $3.7-million in 2019, compared with $8.5-million in 2018. And after new management tightened lending policies and began offloading risky loans, PACE's overall lending portfolio has shrunk by $100-million, to $760-million.

The cost of administration to members has been between $4-million and $5-million over the past 12 months, Ms. Havlin said, although a FSRA spokesperson said the direct cost excluding litigation is $2.2-million. But Mr. White said administration has another "hidden" cost: "Regulators are not meant to operate businesses," he said. "The book is being de-risked, which is of course what a regulator would like to do. But there is also the possibility that business is not being done to its fullest."

The alleged misconduct at PACE was so extensive that FSRA launched an investigation in November into whether some of its own staff, who formerly worked at DICO, had ignored warnings that could have brought the issues at PACE to light sooner. But the probe reported earlier this month that it had found no evidence of improper conduct.

PACE is still under FSRA's administration but, with a new board in place, the regulator is crafting a transition plan to move PACE into supervision – a lesser level of oversight, although FSRA would still attend all board meetings and sign off on key decisions.

The final step would be to take PACE out of supervision and back to normal monitoring, once FSRA is confident the credit union's governance and finances are on solid footing.