2011 BCSECCOM 16

Mutual Fund Dealers Association of Canada

Section 27 of the *Securities Act,* RSBC 1996, c. 418

Panel	Brent W. Aitken	Vice Chair
	Bradley Doney	Commissioner
	David J. Smith	Commissioner
Date submissions completed	November 25, 2010	
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Submissions filed by		
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Decision

I Introduction

¶ 1 This is a review under section 27(1) of the *Securities Act*, RSBC 1996, c. 418 of the conduct of the Mutual Fund Dealers Association of Canada in connection with

(a) governance decisions its board of directors made following the MFDA's December 4, 2008 annual general meeting of members, and

(b) the solicitation of proxies in connection with a special meeting of MFDA members on October 2, 2009.

¶ 2 In October 2009 MFDA member Partners in Planning Financial Services Ltd. applied under section 28(1) of the Act for a hearing and review of the MFDA's decision to amend its bylaws at the October 2009 special meeting.

¶ 3 In November 2009 we ruled (2009 BCSECCOM 627 and 665) that the Commission would hold a hearing under section 27(1).

¶ 4 In April 2010 Partners withdrew its application. The MFDA and the executive director requested us to discontinue the section 27(1) hearing on the basis that it was no longer in the public interest to hold the hearing.

¶ 5 In June 2010 we refused the request (2010 BCSECCOM 325) and directed the MFDA and the executive director to make comprehensive submissions on three issues:

1. The MFDA's decision-making process and reasoning that led to its conclusion that it was appropriate for two public directors whose terms had expired at the December 2008 annual general meeting to continue as directors after that meeting.

2. The MFDA's decision-making process and reasoning that led to its conclusion that it was appropriate for one of the public directors whose term had expired

at the December 2008 annual general meeting, and who continued as a director thereafter, to continue as a member of the MFDA board governance committee and to become a member of a Task Force established by the board to review governance issues at the MFDA.

3. The details of contacts made by the MFDA with its members in connection with the October 2009 special meeting, including which MFDA representatives contacted which members, and sufficient other information about the proxy solicitation process that would enable us to assess whether the MFDA's conduct was appropriate.

II Nature of review

¶ 6 Section 27 says:

> "27 (1) If the commission considers it to be in the public interest, the commission may make any decision respecting the following:
>
> (a) a bylaw, rule or other regulatory instrument or policy, or a direction, decision, order or ruling made under a bylaw, rule or other regulatory instrument or policy, of a self regulatory body . . . ;
>
> (b) the procedures or practices of a self regulatory body . . . . .
>
> (2) A person affected by a decision made by the commission under subsection (1) must act in accordance with the decision."

¶ 7 In deciding it was in the public interest to hold a hearing and review of this matter, we said (2009 BCSECCOM 665 at para. 21):

> "The system of securities regulation we have in Canada depends on the roles played by regulatory organizations like the MFDA. It is essential that those organizations operate, and are seen to operate, in a manner that leaves no room to question the integrity of their governance, procedures and practices."

¶ 8 When we rejected the application to discontinue the hearing, we said (2010 BCSECCOM 325 at para. 32):

> "The credibility of the MFDA has been impugned by [the Partners] allegations: they must be dealt with. Leaving unanswered significant questions about whether the MFDA's conduct was appropriate would potentially undermine not just the MFDA's credibility, but that of the regulatory system itself."

¶ 9 For the purposes of this review, it is not constructive to speculate about what might have happened had the MFDA pursued a different course, nor to dwell on the consequences of the course the MFDA followed. Instead, we have assessed the MFDA's conduct in terms of whether its actions would lead an objective observer to question the integrity or credibility of the MFDA.

III Issues 1 and 2 – Continuing role of the public directors whose terms had expired

A Background

Events before the December 2008 annual general meeting

¶ 10 The MFDA bylaws set the number of directors at 13 – six public directors, six industry directors, and the CEO. The term of office for a director expires at the third annual general meeting next following his or her election, on the election of a successor. The number of terms for directors is limited: two for public directors, and three for industry directors.

¶ 11 At the time of the December 2008 annual general meeting, there was one public director vacancy. In addition, two of the public directors – Robert Wright (then the board Chair and a member of the board's four-member governance committee) and Janet Pau – had reached their term limits.

¶ 12 The agenda for the annual general meeting included amendments to the bylaws recommended by the MFDA board. The amendments would, among other things, have changed the definition of public director and increased the term limits for public directors from two terms to three.

¶ 13 The board nominated an individual to fill the public director vacancy. This individual's election depended upon the proposed change to the definition of public director. The board also nominated Wright and Pau for re-election. Both having already served two terms, their re-election depended upon the proposed increase in term limits for public directors.

¶ 14 In what in hindsight was an optimistic assessment, the MFDA believed the proposed amendments had broad member support and would be approved. The MFDA says that because of that belief the board did not nominate an alternate slate of public directors in case the amendments did not pass.

Events after the December 2008 annual general meeting

¶ 15 The amendments required a two-thirds majority vote at the meeting to pass. That majority was not attained at the meeting. There was therefore no vote on the election of the individual to fill the public director vacancy, nor on the re-election of Wright and Pau.

¶ 16 The board considered these factors in weighing its options in the aftermath of the annual general meeting:

Status of Wright. The directors had confidence in Wright. Their desire to see him continue on the board as chair and a member of the governance committee is a common theme through all of the MFDA's explanations of the board's decisions, in statements it made both at the time and in its submissions in this proceeding.

Bylaw requirement that there be six public directors. If Wright and Pau did not continue as directors, there would be only three.

Governance committee January 22, 2009 recommendations. There had been discontent among MFDA members about governance issues long before the 2008 annual general meeting. The governance committee recommended that the MFDA conduct a full and open review of four core governance issues (with a view to putting recommended changes to the members at the 2009 annual general meeting):

- public director definition and term limits
- director nomination and election process
- bylaw and rule-making process
- current board constitution

Legal opinion of January 26, 2009. The MFDA's corporate counsel, Borden Ladner Gervais, opined that on the wording of the bylaws, Wright and Pau continued in office as directors until their successors were elected, but that the board was required to call, within a reasonable time, a meeting of members to elect successor public directors. BLG said that an election at the December 2009 annual general meeting, as proposed by the governance committee, would be within a reasonable time.

Alternatives. BLG identified and considered two alternatives to deferring election of the public directors to the December 2009 annual general meeting:
(1) hold a meeting immediately to elect public directors, or
(2) accept Wright's and Pau's resignations. BLG rejected both alternatives on the basis that neither of them would be in the best interests of the MFDA, and neither were required by law. Holding a meeting immediately would mean

invoking the then-current nomination and election process already impugned by a significant number of MFDA members. Accepting Wright's and Pau's resignations would leave only three public directors, requiring the MFDA to carry on its activities without the intended balance of industry and public representation.

¶ 17 The board decided that Wright and Pau would continue as directors, and that Wright would continue his roles as board chair and a member of the board governance committee. The board decided that the election of public directors would be deferred until the December 2009 annual general meeting in accordance with the governance committee's recommendation.

¶ 18 To implement that recommendation, the board established a Task Force, consisting of the four governance committee members (two of whom, including Wright, were public directors and two of whom were industry directors) and two other individuals with relevant experience who were not directors.

¶ 19 The board considered the issue of conflict of interest that arose from the public directors' participation on the Task Force, which would be considering public directors' term limits. The board's answer to this issue was that the conflict was inherent to all directors because all directors would ultimately be affected by term limits. The board concluded that its appointment to the Task Force of the two non-directors would mitigate the conflict.

¶ 20 As to the specific issue of Wright's participation on the Task Force, the directors were moved by the same factors that led them to seek to continue his role as a director, chair of the board, and a member of the governance committee. In addition, they considered his "significant personal knowledge" of the governance challenges being faced by the MFDA demanded his presence on the Task Force.

¶ 21 In September 2009 Partners sent a letter to the MFDA voicing various concerns about the MFDA's governance. The letter was accompanied by an opinion from the law firm Gowling Lefleur Henderson to the effect that Wright and Pau were not entitled to continue as directors after the 2008 annual general meeting.

¶ 22 Faced with a contradiction between the BLG and the Gowling legal opinions, the board obtained a third opinion from Stikeman Elliott, who reviewed the previous two opinions. Stikeman's opinion was that although the language of the bylaws created an inconsistency, the preferred course from a policy point of view, compared to the alternative courses of action, was that Wright and Pau continue as directors.

¶ 23 Wright and Pau are no longer MFDA directors.

Communications with regulators

¶ 24 None of this was happening in a regulatory vacuum.

¶ 25 The MFDA operates under recognition orders issued by seven provincial securities regulators in Canada, including the British Columbia Securities Commission. Under an agreement among those regulators, the BCSC is the principal regulator. It manages the relationship between the MFDA and the recognizing jurisdictions.

¶ 26 BCSC staff representatives attended the December 2008 annual general meeting as observers. Correspondence ensued about the events of the meeting, and the MFDA's proposed response, among the MFDA, the BCSC, and the other regulators.

¶ 27 In particular, correspondence was exchanged between Larry Waite, CEO of the MFDA, and Douglas Hyndman, then chair of the BCSC, as the representative of the regulators.

¶ 28 On February 12, 2009 Waite wrote to Hyndman and the other regulators, describing the MFDA's intended course of action – based on the governance committee recommendations – including the establishment of the Task Force.

¶ 29 Hyndman responded on March 11, asking for more details, including questions about why the board decided to allow Wright and Pau to continue as directors, and about the composition of the Task Force.

¶ 30 Waite replied by email on March 11 enclosing information related to various aspects of the MFDA's plans, including the composition of the Task Force. On March 18 he wrote to Hyndman. He explained the MFDA board's rationale for allowing Wright and Pau to continue to serve (giving the reasons we set forth above) and said the MFDA would consult with the regulators as the process unfolded.

¶ 31 On April 21, Hyndman wrote to Waite acknowledging his March 11 email and March 18 letter. Hyndman said, in part, that he appreciated Waite's explanation of why the MFDA board thought it appropriate and consistent with its recognition orders to allow Wright and Pau to continue as directors. Hyndman then expressed a concern about the continuing public director vacancy. He mentioned nothing about Wright's participation on the Task Force.

¶ 32 Waite replied on April 30, explaining why the MFDA thought it preferable to defer election of the public directors rather than hold an election immediately.

¶ 33 On May 11 BCSC staff emailed staff of the other regulators, asking whether they were satisfied by Waite's responses. Only two regulators replied; both were comfortable with the approach being taken by the MFDA.

¶ 34 The regulators asked the MFDA no more questions on those issues. The MFDA says that had the regulators indicated any concerns with the approach the MFDA was taking, it would have listened to those concerns and seriously considered alternatives to deal with them.

¶ 35 The governance review recommended by the governance committee proceeded, and the MFDA called a special meeting of members for October 2, 2009 to vote on bylaw amendments. In a conference call among the regulators and the MFDA, the BCSC representative told the MFDA that the regulators' immediate concern was that the MFDA be able to elect a full board in compliance with its bylaws at its 2009 annual general meeting, regardless of the outcome of the special meeting.

B Analysis

¶ 36 After the bylaw amendments failed to pass at the December 2008 annual general meeting, the MFDA board was confronted with a difficult situation for which there was no obvious solution.

¶ 37 The board could have chosen to call a special meeting immediately to elect three new public directors, but that would have invoked the existing nomination and election process that many MFDA members found objectionable. This alternative would also have left Wright off the board. This, it is clear, the directors did not consider acceptable.

¶ 38 The board could have accepted Wright's and Pau's resignations and otherwise carried on with the Task Force recommendations. This would have avoided invoking the existing nomination and election process, but would still result in the loss of Wright from the board. There would also remain three vacancies among the public directors for a period of nearly a year. The board identified this as a concern – rightly, it seems, given the regulators' concern over the vacancy of only one public director position during that period.

¶ 39 The board chose to carry on with Wright and Pau as directors and leave the sixth public director position vacant while dealing with the broader imperative of reforming its governance structure. In doing so, it considered the value of

- Wright's continuation as board chair and a member of the governance committee
- dealing with the MFDA members' discontent over governance issues
- minimizing the vacancies among the public directors

¶ 40 In choosing this course, the board relied on the BLG legal opinion, on its face reasonable and, as later events showed, supported by Stikeman. That Gowling came to a different conclusion shows only that the MFDA bylaws were ambiguous.

¶ 41 In our opinion, the factors considered by the board were appropriate and the process it followed in making its decision was reasonable. Its course of action was supported by legal advice – advice that the board had reviewed promptly when a contrary opinion appeared later.

¶ 42 As to the decision to have Wright and Pau continue as directors, the circumstances offered no alternative free from potential criticism. All of the alternatives could have been reasonably defended as the appropriate choice. It was up to the board to decide which, in its judgement, was the most appropriate, and the board did so, using reasonable criteria and a sound process.

¶ 43 The board's decision to have Wright participate on the Task Force followed from its decision to have him continue as a director and a member of the governance committee, whose members formed part of the Task Force.

¶ 44 The board did make one error of judgment. Despite the discontent among some members about the MFDA's governance, it concluded that the bylaw amendments would easily pass at the December 2008 annual general meeting, and so it was not necessary to prepare an alternate slate of public directors in case the amendments did not pass. It appears the directors either did not ask the question, "What happens if the amendments do not pass?" or if they did, they concluded the answer was, "Don't worry – they will."

¶ 45 One of the MFDA's submissions is, in essence, that the board's decisions are defensible, in addition to its other reasons, because the regulators approved its intended course of action.

¶ 46 The executive director says it is the MFDA's responsibility to make its own decisions respecting corporate governance, subject to oversight by the regulator. It is not for the regulators to make those decisions for it.

¶ 47 We agree. A favourable view of a proposed course of action by the regulators would not, in and of itself, excuse board decisions otherwise objectionable on an objective standard.

¶ 48 However, that is not what we are dealing with here. As we have found, the board's decisions were not inappropriate on these issues. In those circumstances, the regulators' views are not relevant to that finding.

¶ 49 That said, it is worth noting that had the regulators voiced strong concerns about any of the MFDA's intended actions, the MFDA board would likely have considered them seriously and perhaps made different decisions as a result. As a practical matter, that the regulators did not do so must have been a source of comfort to the MFDA and incline it to continue on the course it was on.

Finding

¶ 50 We find that the MFDA board's decision that Wright and Pau continue as directors, and that Wright continue his roles as board chair and a member of the board governance committee (and in that capacity to participate on the Task Force), would not lead an objective observer to question the integrity or credibility of the MFDA.

IV Issue 3 – Proxy solicitation process in connection with the October 2009 special meeting

A Background

Proxy solicitation process

¶ 51 The October 2009 special meeting of MFDA members was for them to vote on the Task Force recommendations, including the same amendments increasing the term limits for public directors and changing the eligibility requirements for public directors that had failed to pass at the December 2008 annual general meeting.

¶ 52 As the meeting date approached, the board had been engaged in the MFDA's governance review process for nearly two years. It believed the Task Force recommendations had support among "a significant majority" of MFDA members. The board was concerned, though, that the proposals were at risk of defeat by a minority of opposed members who could prevent approval of the proposals if the turnout for the meeting was low. In its view, this was essentially what happened at the December 2008 annual general meeting.

¶ 53 The governance committee met on September 16, 2009. Some of the board's industry members attended, as well as representatives of MFDA management. The subject of the meeting, according to the MFDA, was "the basis on which the MFDA would ensure that there would be full member representation" at the October special meeting. The conclusion of the meeting was that it would be in order for MFDA industry directors and staff to contact members.

¶ 54 The MFDA proceeded to organize the means of communicating with its members. Those who would contact MFDA members included MFDA directors, officers

and employees, including: industry directors, executives, regional directors, staff from its corporate services and corporate secretary departments, and compliance staff.

¶ 55 The MFDA had followed a similar process for previous meetings of members. "What was different this time," says the MFDA, "was that the MFDA considered it important to contact a large number of members in a short period of time, which led the MFDA to expand its communications exercise, which included the industry directors also contacting members."

¶ 56 Although there was no written script, the MFDA prepared instructions about what those contacting members should say. Those instructions said the MFDA representative should ask whether the member:

- had received the meeting materials
- would be attending the meeting
- understood the proposals to be voted on
- supported the proposals
- if not attending the meeting, would be providing a proxy (and, in that case, to tell the member that the proxy could be in favour of George Aguiar)

¶ 57 Aguiar was an MFDA industry director designated by the board to vote proxies in favour of the resolutions at the meeting.

¶ 58 The form of proxy used by the MFDA was permitted, but not prescribed, by its bylaws. That form provides no direct means of voting for or against any resolutions before a meeting. Instead, it authorizes an MFDA director (for the October meeting, Aguiar) as the proxy to vote on the member's behalf. It also provides a space to appoint a different proxy.

¶ 59 The special meeting proceeded as scheduled on October 2, 2009 and this time, the amendments passed. The MFDA has not implemented the amendments pending the outcome of these proceedings.

The MFDA's view of the proxy solicitation process

¶ 60 In its submissions, the MFDA says it "strongly submits that there was nothing improper in the process followed" to solicit proxies for the October 2009 meeting because the MFDA:

- had no rules for soliciting proxies of its own, the regulators had not prescribed rules or given any guidance for soliciting proxies, and no comparable SROs had rules or guidance to follow
- had used that practice for previous meetings
- had heard no concerns before the October 2009 meeting about how its usual process might be perceived

- did not contact members who were known to it to be opposed to the proposals
- did not contact members facing disciplinary processes
- did not use enforcement staff to contact members
- relied on legal advice and on the experience and advice of its directors in governance matters

¶ 61 The MFDA says the proxy process it followed was consistent with best practices in proxy solicitation, which recognize that "it is both common and appropriate that an organization will solicit proxies in support of initiatives which it is recommending to its members." The MFDA says its decisions about the proxy process "were taken in good faith, with the sincere intention of encouraging member participation in an important process and with absolutely no intention of pressuring any member."

¶ 62 The MFDA acknowledges that, "upon reflection . . . the proxy process which was followed could be perceived as raising concerns."

MFDA's new proxy policy

¶ 63 The board has approved a "Policy for the Holding of Members' Meetings including the Use and Solicitation of Proxies." The MFDA says the policy demonstrates the MFDA's "continued awareness of the nature of its relationship with Members and the corresponding need to be sensitive" and "should address the concerns . . . about how the MFDA will conduct itself in the future."

¶ 64 The policy says that:

- it is a statement of how the board expects to supervise the holding of meetings of members, although when unusual or unforeseen circumstances arise "the board may adopt other procedures or practices"
- it is based on the principle that MFDA members should be able to attend and vote at members' meeting on a basis that is informed, convenient "and allows meaningful input"
- it is important "that management and staff not influence, directly or indirectly, in an inappropriate way" how members participate in MFDA governance "including by way of the use of proxies" and that this principle "be maintained in practice and perceived by members and the public to be so maintained"
- the board will supervise all aspects of the holding of members' meetings, including communications with members and proxy use and solicitation
- the board may exercise its supervisory role directly, or may delegate it to
  - the chair, the governance committee, the governance committee chair
  - independent third party service providers
  - professional advisers, or

- management and staff, where "there is no material risk of, or the perception of, inappropriate influence
- the form of proxy must include a means for the member to instruct the proxyholder to vote for or against specific matters, or to vote for or withhold its vote on the election of directors and the appointment of auditors

Survey of MFDA members

¶ 65 After Partners' application, Commission staff sent a survey about the proxy solicitation process for the October special meeting to all of the MFDA's member firms. Of its 144 member firms, 106 responded.

¶ 66 We have not placed great reliance on the survey. It was a passive process. The responses were voluntary and not under oath. It was conducted by email, so the respondents' demeanour on questioning could not be observed. It offered no opportunity for follow-up questions. As a result, questions perceived as awkward could have been easily avoided.

¶ 67 The survey does not prove that the proxy solicitation process actually affected MFDA members' votes sufficiently to have affected the outcome of the overall vote, nor that it did not affect the outcome.

¶ 68 Of the firms who responded to the survey, the MFDA provides this breakdown of the MFDA representatives designated to contact them before the October 2009 special meeting:

- 41: MFDA industry directors
- 24: MFDA compliance staff
- remainder: MFDA executives, management and staff (other than compliance and enforcement staff)

¶ 69 These are excerpts from the survey responses that raise concerns with the process:

Member A. ". . . if it had not been a secret ballot I certainly would have voted in favour of the MFDA. I wouldn't want an opposing vote recorded. But when I learned that the MFDA was soliciting proxies and that the votes would be recorded by MFDA staff we thought we'd better submit a proxy in favour of the MFDA. After all, they are our regulators. (Note how many people were copied in the e-mail)."

Member B. "When the [MFDA contact person] brought to my attention that George Aguiar was representing a committee of members in favour of the proposed changes and that I could submit my vote through him if I wanted to, I thought it odd that another proxy representative representing a

committee of members opposed to the proposed changes was not also mentioned."

Member C. "I felt intimidated by the call, the dealer was already involved with a third round audit and I was receiving regular calls from the MFDA. Being asked how I was going to vote, made me feel I should not go against the MFDA."

Member D. ". . . after the call, I do remember thinking that that it was inappropriate for a senior member of MFDA management to be making such a call."

Member E. "We were concerned that . . . as a result of declining to send the proxy to the MFDA and declining to advise the MFDA how we were voting any nonconforming vote would be highlighted to the MFDA . . . and that by implication, sending our proxy to another firm vs the MFDA would associate us with that firm in a broader context than just a proxy vote . . . as a result of those concerns we considered abstaining from the vote but chose in the end to participate."

Member F. This member was particularly concerned about the email he received containing the proxy information because it had been copied to other MFDA staff and he was concerned that the MFDA would be aware of how he voted.

Member G. The MFDA contact person asked "if we had received their package on the meeting and if we had sent in the proxy. Suggested it was important and they would like all proxies in. Said it was George Aguiar would be our representative."

Member H. "I felt that the MFDA would at the very least see whether I had voted or not. It never occurred to me until later that they may also have access to how I voted. It is awkward when the regulator/enforcement [*sic*] is involved in the voting which ultimately controls them. . . . I took the path of least resistance and faxed back the only proxy included in the package [in favour of Aguiar] so the MFDA would be aware that I voted."

Member I. The MFDA contact person "asked if I was attending the meeting. I replied yes. They replied the purpose of their call was to encourage attendance and if not attending that we could forward the proxy to a Director."

Member J. The MFDA contact person "reminded me of the meeting and the procedure if I was not attending – by signing the proxy and send to MFDA."

Member K. "The decision on how to vote was affected by the fact that the ballots collected were not anonymous. We had to indicate our name and signature on the voting ballots that were collected."

Member L. "The MFDA did send me a proxy which I sent back. That is probably the reason why I was not contacted and pressured like I was told others were. The day of the meeting I was contacted by an MFDA member from out west. I was told what was going on and I switched my proxy to the person the member suggested ten minutes before the deadline. . . . It is really sad I trusted somebody I do not know and not my regulatory body . . . .

Member M. Aguiar "asked [us] to sign proxy to MFDA board of directors to have board vote on our behalf. Was told the motion would be good for MFDA membership. It was also explained that this would allow for the start of some fair representation to the small dealer. . . . Decision to sign proxy request was based on conversation with George [Aguiar]."

B Analysis

MFDA's submissions

¶ 70 In its submissions, the MFDA says it "strongly submits that there was nothing improper in the process followed" to solicit proxies for the October 2009 meeting. The MFDA says it acted with the "sincere intention of encouraging member participation in an important process and with absolutely no intention of pressuring any member."

¶ 71 In other words, the MFDA would have us believe that its directors' only motivation was to maximize the number of member votes, and not to influence the outcome. In our opinion, the facts say otherwise.

¶ 72 The executive director succinctly identifies the difficulty with the MFDA's submissions on this point:

> "The MFDA's submission regarding the intent behind its proxy solicitation efforts is obscure. The submission states that the MFDA's purpose in soliciting proxies was to encourage overall member participation at the October 2, 2009 special general meeting. At the same time, the MFDA acknowledges that its objective was to influence the outcome of the meeting. These

> purposes are contradictory, and the following statement [from the MFDA submissions] reflects this tension:
>
> > '. . . the intent of the MFDA in all communications with members was to inform members that the process was ongoing and to encourage members to participate (admittedly, with an emphasis on facilitating participation of those members who supported the proposed Bylaw 15).'"

¶ 73 The facts show that the process the directors chose to solicit proxies was calculated to maximize participation, not by all members, but only by those who would vote in favour. Apart from whether pressuring members was the intent, it would have been obvious to an objective observer that the process was fraught with the risk of members' feeling pressure to vote, and to do so in favour of the amendments.

¶ 74 For the reasons that follow, we are left with the inescapable conclusion that the directors designed the proxy solicitation process to produce an outcome – a favourable vote on the amendments by a sufficient majority for them to pass.

Deficiencies of the proxy solicitation process for the October 2009 special meeting

¶ 75 The plan for soliciting proxies for the October 2009 special meeting was created by the board. The strategy was led by the board chair (Wright, a governance committee member), the other governance committee members, and a few select industry directors.

¶ 76 It is apparent from the facts that the board, stung by the defeat of the same amendments at the December 2008 annual general meeting, was determined not to let that happen again. It was this determination that, in our opinion, blinded the directors to obvious deficiencies, described below, in how they reached their decision to proceed as they did, and in the process itself.

<u>Failure to consider the proxy solicitation process in the context of the MFDA's role as an SRO</u>

¶ 77 The root cause of the flaws in the proxy solicitation process lies with the board's failure to consider its process in the context of the structure and purpose of the MFDA.

¶ 78 It appears that the board acted as though the relationship between the MFDA and its members is the same, for proxy solicitation purposes, as the relationship between a corporation and its shareholders. But there are fundamental differences in those relationships – differences that the board ought to have considered.

¶ 79 The MFDA is a regulator. As an SRO, it has the responsibility of establishing and enforcing rules of conduct for its members. It has a supervisory relationship with its members. Through its powers, it can:

- compel a member to take corrective measures in the conduct of its business
- fine a member
- suspend a member
- expel a member

¶ 80 In other words, the MFDA can impose sanctions that significantly affect a member. These include sanctions that can put the member out of business, temporarily or for good.

¶ 81 As a practical matter, the course that these compliance and enforcement measures take is significantly influenced by the exercise of discretion by the MFDA's executive, management and staff.

¶ 82 Clearly, the relationship between the MFDA and its members is not the same as the relationship between a corporation and its shareholders. A shareholder of a corporation is entitled to vote arbitrarily, motivated only by perceived self-interest. The relationship between the MFDA and a member ensures that the risk that the member would feel pressure not only to vote on, but vote in favour of, management-sponsored resolutions, is inherent and foreseeable if MFDA directors, officers or employees are involved in the proxy solicitation process.

Failure to consider the known controversy surrounding the proposed amendments

¶ 83 The amendments were known by the directors to be controversial. They knew there was a significant contingent of MFDA members who were opposed to the amendments, and that at least two MFDA members were soliciting proxies with a view to defeating them. This should have alerted the directors to the risks associated with having MFDA directors, officers, and employees, especially industry directors, executives and compliance staff, personally involved in the solicitation of proxies.

Using MFDA directors, officers, and employees to solicit proxies

¶ 84 The directors apparently proceeded on the basis that members, because they were familiar with their designated contact person, would not feel intimidated by them. This is troubling in two respects. First, their inherent assumption that familiarity would be equivalent to comfort in the context of a proxy solicitation. Second, that

they turned their minds to the issue of intimidation, but failed to deal with it properly.

Sorting of MFDA members into supporters and opponents of the amendments; identification of MFDA members subject to current disciplinary proceedings

¶ 85 The board identified two constituencies of members who could not be counted upon to vote in favour of the resolutions and decided not to solicit their proxies – known opponents (certain to vote against) and members subject to current disciplinary proceedings.

¶ 86 The MFDA says the exclusion of both of these groups is evidence of its sensitivity to the appearance of applying pressure. That statement is problematic.

¶ 87 If the board's objective was solely to maximize member representation at the meeting, then it is hard to see what criticism could have been attracted by the solicitation of proxies from known opponents, or from those subject to disciplinary proceedings. To the contrary, such a course would have been strong evidence that the directors were interested only in getting out the vote.

¶ 88 Instead, the directors decided not to contact known opponents (who would be certain to vote against) or members subject to current disciplinary proceedings (whose loyalties would be uncertain). That decision is more consistent with an objective of achieving a favourable vote, and is telling of the directors' intent.

¶ 89 We do not know how many members were subject to disciplinary proceedings at the time of the solicitation, but at least 33 MFDA members falling into the "known opponent" category were not contacted– 23% of eligible votes. This shows that the board's process was not an even-handed effort to encourage participation by all. In fact, negative votes were not invited, and an objective observer would be bound to conclude that the outcome of the vote could thereby have been affected.

¶ 90 There is another troubling aspect to the board's decision not to solicit members subject to disciplinary proceedings. The MFDA says it shows the board recognized the potential of the appearance, if not the fact, of undue pressure on members arising from the MFDA's status as a regulator. What is puzzling is why the directors apparently ignored this concern when they came to decide which individuals would be responsible for contacting members. They saw that the involvement of enforcement personnel was not appropriate, but they did not recognize that MFDA compliance staff were similarly tainted. They also failed to recognize the appearance of pressure arising from contact from directors and MFDA executives.

Asking members whether they supported the amendments

¶ 91 This question is inconsistent with the MFDA's expressed motive of merely encouraging member voting participation. If the directors were interested only in getting out the vote, why would they care about the member's voting intentions?

¶ 92 The question suggests that a negative response might have resulted in more aggressive follow-up. It would also present an awkward set of choices to members inclined to vote against the amendments but uncomfortable about disclosing their voting intentions. They could tell the truth (revealing their views to their regulator's representative), decline to answer (perhaps putting themselves into a "less-than-cooperative" category), or lie.

Suggesting to members that they could appoint Aguiar as their proxy

¶ 93 There is nothing wrong with inserting the name of a management-sponsored proxyholder in a form of proxy. However, the form of proxy for the October 2009 special meeting did not disclose that Aguiar would be voting for the amendments, and it appears from the survey that the only alternative offered by some MFDA representatives to members not planning to attend the meeting was to sign the proxy giving Aguiar their vote.

Using a form of proxy that provided no direct opportunity to vote against the amendments

¶ 94 The form of proxy the board chose to use for the October 2009 special meeting was allowed by the bylaws, but the bylaws did not prohibit another form. The board should have adopted a form of proxy that provided the opportunity to vote directly for or against the resolutions. A form of proxy that provides the means to vote for or against matters is convenient for the member and allows the member to submit the proxy in favour of the management nominee, regardless of how the proxy is voted. The form used by the MFDA would require a member who wished to vote against the amendments to find another member who would vote as the member wished, and who was planning to attend the meeting – a cumbersome process.

The MFDA's defence

¶ 95 The MFDA's excuses for adopting the process it did are weak. That it had no rules to look to externally did not excuse it from making appropriate ones of its own. That it had proceeded as it did for past meetings only shows that it failed to recognize that the unique circumstances of the October 2009 meeting might call for something different. That it heard no concerns about the process before the meeting is irrelevant – the factors that established the risk of inappropriate pressure were evident. It relied on legal advice, but it was not a solely a legal matter – it was a matter of what process was appropriate for an SRO from a public interest perspective. To the extent it relied on corporate governance expertise

derived from the corporate sector, it failed, as noted above, to make the distinction between public companies and SROs.

Impact of the proxy solicitation process on the outcome of the meeting

¶ 96 In our opinion, the proxy solicitation process followed by the MFDA was sufficiently flawed that the vote at the October 2009 special meeting is irrevocably tainted.

¶ 97 The survey results do nothing to allay that concern. We do not know:

- the views of the 38 member firms (26%) who did not respond to the survey
- the extent to which member firms' candour was inhibited by the survey having been conducted by BCSC staff, who could have been perceived as too close to the MFDA
- what respondents who did not comment on the propriety of the process, if prompted to do so, would have said

¶ 98 We do know that at least the 13 MFDA members quoted above had concerns, in varying degrees, about the process.

¶ 99 Much also depended on the attitude of the member. Some, clearly, are less trusting of the MFDA and what it might do armed with information about how a member voted. Others are prepared to have their views known, with no apparent concern that the MFDA will hold their votes against them.

Deficiencies of the MFDA's proposed proxy policy

¶ 100 The MFDA sets great store by its new proxy solicitation policy, but that policy does not solve the problems highlighted by the process leading up to the October 2009 special meeting.

¶ 101 MFDA members should be encouraged to participate in the MFDA's governance by voting, in person or by proxy, at members' meetings. We agree with the policy's statement of principle that MFDA members should be able to attend and vote at members' meetings on a basis that is informed, convenient and allows meaningful input. It is also obvious that MFDA directors, officers and employees not inappropriately influence how members participate in MFDA governance.

¶ 102 We also agree with the policy's requirement that the form of proxy for members' meetings must include a means for the member to instruct the proxyholder to vote for or against specific matters, or to vote for or withhold its vote on the election of directors and the appointment of auditors. The form or an accompanying circular should also disclose how the management proxyholder will vote for the resolutions at the meeting if the proxy is left blank.

¶ 103 However, the main thrust of the policy is that the MFDA board controls the entire process in its sole discretion. Although it is appropriate that the board have general oversight of the proxy solicitation process, the circumstances surrounding the October 2009 special meeting shows that board oversight alone is no guarantee of an appropriate outcome.

¶ 104 In our opinion, a proxy solicitation process for the MFDA should ensure that:

- proxy solicitation be conducted through independent proxy solicitation service providers
- the board's role in the process be limited to ensuring that the MFDA's independent proxy solicitation process is appropriate and is being followed
- MFDA directors, officers, and employees have no other role in proxy solicitation

Finding

¶ 105 We find that the MFDA board's decision to conduct the proxy solicitation process as it did for the October 2009 special meeting would have led an objective observer to question the integrity and credibility of the MFDA in managing that process.

Decision

¶ 106 It is with great reluctance that we issue directions to the MFDA about how to conduct its proxy solicitation process for member meetings. However, the MFDA insists it did nothing wrong in connection with the October 2009 special meeting, in the face of blatant deficiencies associated with that process. It also says its new policy will solve any perceived shortcoming in its proxy solicitation process, when that is clearly not the case. Regrettably, direction is necessary.

¶ 107 Our directions are intentionally general and expressed as principles. We expect the MFDA to develop policies consistent with the tenor and intent of this decision. The BCSC is the MFDA's principle regulator. We expect BCSC staff, in consultation with the MFDA's other securities regulators, to test the MFDA's policies against our findings and decision. It would not be appropriate or efficient for the Commission to rule further on the implementation details of this decision.

¶ 108 It is important to state that our findings in this matter are restricted to a narrow issue related to the MFDA's internal governance. We are not making any adverse findings about the MFDA's overall integrity or credibility as an SRO.

¶ 109 To the contrary, since the MFDA's incorporation in 1998, its board and executive have built the MFDA into an effective and credible regulator of mutual fund dealers. In oversight audits since its formation, the regulators to whom it is

responsible have found no reason to doubt its fundamental ability to perform its regulatory function.

V Summary of findings and decision

¶ 110 We find that the MFDA board's decision that Wright and Pau continue as directors, and that Wright continue his roles as board chair and a member of the board governance committee, would not lead an objective observer to question the integrity or credibility of the MFDA.

¶ 111 We find that the MFDA board's decision to conduct the proxy solicitation process as it did for the October 2009 special meeting would have led an objective observer to question the integrity and credibility of the MFDA in managing that process.

VI Decision

¶ 112 We direct the MFDA:

1. to use a form of proxy for all meetings of members that provides a convenient means for the member to
   - appoint a proxyholder other than the management nominee
   - instruct a proxyholder to vote for, or to withhold its vote, on the election of directors and the appointment of auditors, and to vote for or against any other matters;

2. to use an independent proxy solicitation firm to administer the process for soliciting proxies for all meetings of members;

3. to ensure that no director, officer or employee of the MFDA communicates with any member of the MFDA in connection with the solicitation of proxies for any meeting of members;

4. to ensure that MFDA member votes are tabulated through a system that ensures that each member's vote will remain unknown to MFDA directors, officers or employees (other than to a director named as a management proxyholder, if it is legally required that the director know the vote of a member who appoints him or her as proxy); and

5. not to implement the amendments passed at the October 2, 2009 special meeting until the members vote on those amendments at a meeting conducted in accordance with these directions.

¶ 113 January 10, 2011

¶ 114 **For the Commission**

Brent W. Aitken
Vice Chair

Bradley Doney
Commissioner

David J. Smith
Commissioner