

**BOARD OF GOVERNORS OF THE
ROYAL MUTUAL FUNDS**

June 7, 2002

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario
M5H 3S8

and

Denise Brousseau, Secretary
Commission des valeurs mobilières du Québec
800 Victoria Square, Stock Exchange Tower
P.O. Box 246, 22nd Floor
Montreal, Québec
H4Z 1G3

Dear Sirs/Mesdames:

**Re: Concept Proposal 81-402 – Striking a New Balance: A Framework for
Regulating Mutual Funds and their Managers (the “Concept Proposal”)**

We are pleased to submit comments on behalf of the Royal Mutual Funds’ Board of Governors in response to the Canadian Securities Administrators’ (the “CSA”) recently published proposals for an improved fund governance regime. We are very supportive of the basic structure proposed by the CSA in the Concept Proposal for regulating mutual funds through independent fund governance agencies. By mandating independent fund governance, the CSA recognizes that the mutual fund industry in Canada is maturing and that it is necessary for regulation to keep pace with international standards.

We have reviewed and concur with the comments of RBC Funds Inc., the manager of the Royal Mutual Funds. Accordingly, we have limited our comments to those questions that specifically relate to the roles and responsibilities of an independent fund governance agency, as well as to the appointment and compensation of governance agency members.

History and Structure of the Royal Mutual Funds' Board of Governors

The Royal Mutual Funds has had a Board of Governors, the majority of whom are independent, in place for more than 8 years. Prior to the creation of the Board of Governors, a number of its existing members served for several years as individual trustees for the then Royfunds. Accordingly, we feel that we are in a unique position to comment on the role and experience of an existing governance agency. The Board of Governors is currently comprised of the following individuals, who possess diverse backgrounds in the financial services industry and represent different geographical areas in Canada:

Gordon J. Feeney, Chairman of the Board of Governors (Chairman, Audit Committee)
Mary Arnold, Managing Director, Arnold Consulting Group Ltd.
Selwyn Kossuth, Financial Consultant (Member, Audit Committee)
Lloyd R. McGinnis, Chief Executive Officer, ISIS Canada
Elaine C. Phénix, President Phénix Capital Inc.
Joseph P. Shannon, President Atlantic Corporation
Michael G. Thorley, Partner, Torys (Member, Audit Committee)
Jim Yuel, President and Chief Executive Officer, PIC Investment Group Inc.

Condensed resumes for the above Members of the Board of Governors are attached as Appendix "A" for your reference. The duties of the Board of Governors as set out in the Declaration of Trust for the Royal Mutual Funds are described in Appendix "B".

Appointment of Governance Agency Members

We are of the view that from a practical standpoint it makes more sense for the fund manager to make the initial appointments of governance agency members, as well as to recommend future appointments for approval by the governance agency. The fund manager is better positioned to identify qualified candidates with the necessary skills for the governance agency.

Under the Declaration of Trust for the Royal Mutual Funds, the trustee, in consultation with the fund manager, appoints members of the Board of Governors and sets their compensation. We strongly believe based on the actions taken over its history that this in no way has affected the independence or impartiality of members of the Board of Governors or of its Audit Committee. We are of the view that the risk of "an insurmountable bias in favour of the fund manager" resulting from the fund manager's appointment of governance agency members is unfounded.

Roles and Responsibilities of the Governance Agency

We have carefully reviewed the proposed responsibilities for a governance agency set out in the Concept Proposal and are of the view that a number of the proposed responsibilities fall within the fund manager's domain and are not properly responsibilities that should be carried out by governance agency members.

We are of the view that the governance agency's role should be limited to providing general oversight of the fund manager's affairs and should focus on areas where they can represent the interests of unitholders. We would be very pleased to provide you with further details if these are required.

Audit Committee Role

We submit that the audit committee of the governance agency can be effective and add value to unitholders if it has a clearly defined oversight role. All members of the Audit Committee of the Board of Governors of the Royal Mutual Funds are independent of RBC Funds Inc.

i) Review of Financial Statements

We believe that it is entirely appropriate for those agency members that act as an audit committee to review financial statements (once they have been approved by the manager) from a unitholder perspective and provide comment on them concerning clarity of disclosure or other areas within their mandate, such as related party transactions (as our Audit Committee currently does). In this review function, the audit committee clearly represents the interests of unitholders. However, we do not agree with the proposal that governance agency members *approve* the financial statements. The approval of financial statements is a fundamental responsibility of the manager and should be performed by the manager's audit committee.

ii) Review of Related Party Transactions

The Audit Committee of the Board of Governors of the Royal Mutual Funds is specifically charged with reviewing policies and procedures relating to related party transactions and certain transactions which involve a potential conflict of interest to ensure that the investment has been made within established guidelines and without undue influence. The Audit Committee must also review internal controls established to prevent improper influence in the conduct of related party transactions and other conflicts of interest.

We believe that these responsibilities have been a cornerstone of the Board of Governors through its Audit Committee and indeed, the Ontario Securities Commission ("OSC") acknowledged the important role that an independent body and its committees can play in monitoring conflicts of interest in *Royal Trust Mortgage Fund and Royal Mutual Funds Inc.*, (1996) 19 OSCB 5429. In that case, the OSC issued an order exempting the manager of the then Royal Funds from the requirements of clause 118(2)(b) of the *Securities Act* (Ontario) by allowing the sale by a mortgage fund of commercial and residential mortgages to related parties. A condition imposed on that transaction was that it had to be approved by a majority of the independent members of the Audit Committee after they reviewed the transaction and a fairness opinion and report prepared by independent auditors. The Audit Committee was instrumental in providing the OSC with

comfort that the valuation of a portfolio of related party mortgages was equitable and in the best interests of unitholders.

Similarly, in 1997, the Audit Committee of the Board of Governors of the Royal Mutual Funds was instrumental in the Royal Bank Mortgage Fund obtaining relief from the British Columbia Securities Commission (“BCSC”) with respect to the purchase and sale of Royal Bank mortgages (In the Matter of the Royal Mortgage Fund – Exemption Order Under Section 130(b) of the *Securities Act* (British Columbia) - December 1, 1997). The BCSC accepted that the Audit Committee would provide the required oversight role through post transaction review of the pricing of related party mortgages to ensure that unitholder interests were protected at all times.

We submit that it should be a fundamental responsibility of a governance agency to ensure that a fund manager implements appropriate policies and procedures with respect to related-party transactions to confirm that such transactions are in unitholders’ best interests. Governance agencies may be in a better position than securities regulators to review and monitor such policies, and address any issues that may arise in a timely manner. In our view, the approach of using a governance agency to monitor manager compliance with policies on related party transactions can and should replace the current prescriptive rules relating to these types of transactions.

We note that relaxation of the current restrictions relating to related party transactions (in favour of governance oversight) can only take place effectively on a national basis. Accordingly, it is of paramount importance that the new fund governance regime be nationally accepted and implemented across all jurisdictions in Canada and not adopted on a piecemeal basis only by certain jurisdictions. We strongly encourage the CSA to ensure that harmonization across all jurisdictions is achieved on this very important initiative.

iii) Communication with and Removal of External Auditors

We agree that governance agency members should be permitted to communicate directly with internal and external auditors of the funds, but should only be required to do so to the extent such communication is necessary to fulfil their roles and responsibilities (as our members presently do). Our Audit Committee plays an important role in monitoring the activities of the external auditors of the funds. They meet regularly with the auditors to discuss issues ranging from the conduct of the audit process to the independence of the auditors. These activities are unitholder focused and must be distinguished from legal responsibility for the approval of financial information in the financial statements.

In addition, where there is an ongoing relationship between the governance agency and the external auditors, we believe that it is entirely appropriate that governance agencies be responsible for reviewing and approving proposals to remove auditors of the funds, provided that this approval is in lieu of any required unitholder approval.

Compensation of governance agency members

We do not believe that governance agency members should set their own compensation. Again, our experience with the Royal Mutual Funds' Board of Governors suggests that the independence of the governance agency members will not be compromised if the mutual fund manager sets the compensation of the agency members directly. We believe that given the relatively small and specialized talent pool available for governance agency members, market forces will quickly establish appropriate benchmark compensation.

Concluding Remarks

Thank you for providing us with an opportunity to share our comments and concerns. If you have any questions, or require any additional information, please do not hesitate to contact D'Arcy Chadwick, Assistant General Counsel, at (416) 955-3592 (or by e-mail at darcy.chadwick@rbc.com), who will ensure that your enquiries will be forwarded to the appropriate member of the Board.

Sincerely,

Gordon J. Feeney

Elaine C. Phénix

Mary Arnold

Joseph P Shannon

Selywn Kossuth

Michael G. Thorley

Lloyd R. McGinnis

Jim Yuel