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April 8, 2004

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario
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-and-

Denise Brosseau, Secretary
Commission des valeurs mobilieres du Quebec
Stock Exchange Tower
800 Victoria Square
P.O. Box 246, 22nd Floor
Montreal, Quebec
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Dear Sirs:

Re: Proposed National Instrument 81-107

I am internal counsel for Royal Bank of Canada and its wealth management affiliates. I am writing on behalf of RBC Asset Management Inc. ("RBCAM"), which acts as the manager and primary portfolio adviser to the RBC Funds, to provide you with our comments on proposed National Instrument 81-107 – Independent Review Committee for Mutual Funds ("NI 81-107" or "the Instrument").

We have also participated in the preparation of the comment letters submitted to you by the Investment Funds Institute of Canada ("IFIC") and the Canadian Bankers' Association (the "CBA") and we are supportive of their contents. This letter is intended to highlight and elaborate on the issues that are of particular concern to us.

General

The family of funds currently known as the RBC Funds was formed in 1994 upon the merger of the RoyFunds (the family of funds formerly available only through branches of Royal Bank of Canada) and the Royal Trust Funds (the family of funds formerly available only through Royal Trust). The Declaration of Trust (the "DoT") under which the Funds are formed has provided since 1994 for the establishment of a Board of Governors (the "BoG"). The BoG is required to consist of between 3 and 12 members, a majority of whom must be independent of the Trustee and its affiliates. Generally, the DoT provides that the role of the BoG is to "advise the Trustee and any Manager in the administration of its duties and deal with situations where there exists a conflict or potential for conflict between the interests of the Trustee or the Manager of a Fund or any Affiliate of the Trustee or the Manager on the one hand and the interests of such Fund and the Participants thereof on the other". While the BoG's role is, in most cases, only advisory in nature, the BoG must give its approval to (a) remove the auditors of a Fund and appoint new auditors and (b) increase the amount of any management fee paid by a Fund. The DoT contemplates the establishment of committees of the BoG and provides that the BoG and its committees may establish their own internal procedures.

As one of very few Canadian mutual fund managers that have voluntarily adopted a governance model that includes a body independent of management whose sole role is to represent the interests of securityholders, RBCAM is generally very supportive of the objectives of the Instrument. RBCAM and its predecessors have argued for many years in favour of the implementation of a regulatory model that would exempt mutual funds and their portfolio managers from certain of the conflict of interest provisions of provincial securities laws and National Instrument 81-102 where an independent body plays a role.

Our comments below are based largely on our experience in working with the BoG over the past 10 years.

"Rules" vs. "Commentary"

We are generally very suppportive of the principles based approach the CSA has adopted in the rules portion of the Instrument. However, we feel strongly that certain parts of the commentary contain mandatory or prohibitive language which, following the reasoning of the Ontario Court of Appeal in *Ainsley Financial Corp. v. Ontario (Securities Commission)*, 21 O.R. (3d) 104, is inappropriate in regulatory documents that are not intended to have the force of law.

For example, Commentary 3 following section 2.3 provides that members of an Independent Review Committee (an "IRC") "should" be appointed with staggered terms. The use of the word "should" suggests that the CSA has a relatively strong view about the importance of staggered terms, but its placement in the commentary, which does not have the force of law, means that it is not mandatory. If the CSA believes that staggered terms are an important and necessary element of the structure of an IRC, this requirement should be included in in the rules section of the Instrument, not in the commentary.

Conversely, if the CSA does not have a strong view on the matter, we believe that the first two sentences of commentary 3 should be deleted.

Similarly, we believe that commentary 4 following section 2.4 is inappropriate as commentary since it provides that the persons described in it "would not be considered to be independent for the purposes of this Instrument and could not be members of an independent review committee of the mutual fund". In our view, the guidance provided in commentary 3 following section 2.4 takes the right approach and should be sufficient. We also have significant substantive concerns regarding commentary 4, which are described below, and, accordingly, we believe that commentary 4 should either be deleted in its entirety or recast using language that makes clear that the circumstances described in it are intended only as guidance.

Finally, we are concerned about the detailed list of business conflicts and related party conflicts contained in commentaries 4 and 5 following section 3.1. With respect to commentary 4, the CSA has indicated that the list contains "examples of situations when a manager might experience a conflict". While this language suggests that the list is intended only to provide guidance with respect to the types of matters that *may* give rise to conflicts, the use of such an extensive and detailed list is very uncommon in other CSA policy documents and we are concerned that CSA staff and others will begin to treat the list as though it were mandatory. With respect to commentary 5, we believe it is the CSA's intention that all of the circumstances described in the list be put before the IRC and, accordingly (as described further below) we believe commentary 5 should be moved into the rules.

Independence

100% Independence Requirement

We disagree with the requirement in subsection 2.4 (1) that every member of an IRC be independent. The United States Securities and Exchange Commission (the "SEC") recently proposed amendments which would require that 75 per cent of the members of a board of directors of a registered mutual fund, including the chair of the board, be independent in order for the fund to be able to rely on certain exemptions from the SEC's rules regarding serious conflicts of interest. We believe the CSA should adopt a similar approach.

Given that the Instrument provides for an IRC of three members, we would urge the CSA to require only that two-thirds of the IRC's members be independent.

Independence "Test"

We are very supportive of the principles for determining independence that are articulated in subsections 2.4 (2) and (3) of the Instrument. In particular, we support the concept that only a "material relationship" would result in a person being "not independent" for the purposes of the Instrument. We are also very supportive of

commentary 3 following section 2.4 which provides fund managers and IRC members with further guidance respecting the types of relationships that should be examined, but which reiterates that only those which might interfere with the exercise of an IRC member's independent judgement should be considered "material".

However, we are very concerned about the CSA's intention in including commentary 4. As indicated above, we believe the strongly mandatory language used in the first paragraph of commentary 4 is inappropriate for that part of the Instrument which is not intended to have the force of law. We would also very strongly oppose the provisions of commentary 4 if they were to be moved to become part of the rules portion of the Instrument.

As part of a very large group of financial services companies that employ approximately 55,000 people in Canada, we are very concerned about a rule which would deem as "not independent" anyone whose immediate family member is or at any time during the previous 3 years has been an employee of an entity related to RBC AM.

In addition, as part of a very large group of financial services companies that engage the services of many Canadian law firms and which engage all of the major accounting firms to provide either audit or non-audit services, we are also very concerned about a rule which would deem as "not independent" any lawyer or accountant whose firm has provided services to the Funds or any company that is part of the RBC group of companies.

Finally, we are very concerned about a rule that, upon implementation, would deem as "not independent" all of the current members of the RBC Funds BoG because each of them will have accepted a consulting or compensatory fee from the RBC Funds during the past three years. We assume that this is not a result that the CSA intended.

Accordingly, while we are generally very supportive of the objectives and principles set out in section 2.4 of the Instrument, we would strongly urge the CSA either to delete commentary 4 in its entirety or to recast it as guidance or as a list of circumstances that a fund manager or the members of an IRC should take into consideration in determining whether a proposed member is independent.

Conflicts of Interest

While we are supportive of the intent behind section 3.1 of the Instrument, we believe that it requires redrafting.

As currently drafted, we do not believe that susection 3.1 (1) actually sets out an identifiable test for matters that must be referred to an IRC. In other words, subsection (1) would appear to require the manager to apply the reasonable person test to determine whether a conflict exists, rather than to determine whether, in the face of a conflict, the action the manager is proposing to take is reasonable or responsible in the circumstances. Even if subsection (1) does articulate a test, it is, in our view, subsumed by the much

broader language of subsection (2) which provides that a manager would be considered to have a conflict where the manager or an entity related to the manager has an interest in the matter that is "different from" the best interests of the mutual fund.

We are also concerned that the current drafting, particularly the use of the phrase "different from" in subsection (2) in combination with the very long list of matters set out in commentary 4, would require a manager to place too many matters before the IRC, impairing its ability to effectively manage its funds on a timely basis.

As part of large group of financial services companies, RBC AM and the Funds are currently subject to all of the related-party prohibitions set out in provincial securities legislation and National Instrument 81-102. The DoT for the Funds currently requires that all of the matters contemplated by commentary 5 be referred to the BoG for consideration and advice and we believe that it would be appropriate for these matters to appear in the rules rather than the commentary.

In our view, section 3.1 would be a much clearer and stronger articulation of the matters that must be considered by an IRC if it were rewritten such that subsection (1) would provide that each of the matters set out in commetary 5 must be referred to the IRC and subsection (2) were to read as follows:

> *"In addition to the matters set out in subsection (1), the manager must refer to the mutual fund's independent review committee any matter in which,*
>
> *(a) the manager or an entity related to the manager has an interest in the matter which conflicts with the best interests of the mutual fund; and*
> *(b) a reasonable person would question whether the manager is able to objectively determine whether its proposed course of action is reasonable in the circumstances."*

Structure of the IRC

Section 2.1 of the Instrument would require each mutual fund to have an independent committee. In the commentary following section 2.1, the CSA indicates that no specific legal structure will be mandated, that a manager may establish a separate IRC for each fund or for each group of funds or that more than one manager may use the same IRC.

The Funds currently have a BoG comprising 8 members, 7 of whom we consider to be independent. The BoG is specifically required under the DoT to "advise the Trustee and any Manager in the administration of its duties and deal with situations where there exists a conflict or potential for conflict between the interests of the Trustee or the Manager of a Fund or any Affiliate of the Trustee or the Manager on the one hand and the interest of such Fund and the Participants thereof on the other". The BoG is also permitted to establish committees and fix their duties and responsibilties and has, to date, created 2 committees: the Audit Committee (comprising 4 members, 3 of whom we consider to be independent; the Audit Committee sometimes considers matters which may involve

business conflicts) and the Independent Committee (comprising 3 members, all of whom are independent; the Independent Committee was formed to deal with related party conflicts in respect of which the Funds have obtained regulatory relief).

We believe there is a significant benefit to the Funds and to RBC AM to having a large, geographically representative advisory Board of Governors which meets at regularly scheduled times throughout the year. However, we have also found that having a smaller Independent Committee, which makes decisions and simply reports back to the full BoG, has allowed RBC AM and the Funds to deal with certain related party conflicts quickly and effectively.

Under NI 81-107, our current structure would raise questions about the liability of the full BoG for decisions taken by either the Audit Committee or the Independent Committee. Under section 115 of the *Canada Business Corporations Act* (the "CBCA") and section 127 of the *Ontario Business Corporations Act* (the "OBCA"), this issue is addressed by specifically empowering full boards of directors to delegate their decision-making authority to committees. In these circumstances, members of the board who are not also members of a committee only become liable for decisions or actions taken by the committee if they do not satisfy their statutory duties when selecting the members of the committee. We understand that specific authority to delegate to committees was necessary because no such authority exists at common law.

Accordingly, we would urge the CSA to include language in the rules portion of the Instrument that would explicitly permit an IRC of more than 3 members to delegate its responsibilities to a committee of at least 3 members.

Liability, Insurance and Ability to Retain Independent Advisers

It has been our experience that people serving on our BoG are concerned about personal liability and RBC AM ensures that insurance coverage is maintained for them. The cost of maintaining this coverage is not currently charged to the RBC Funds.

Cost Issues

We have experienced increasing difficulty in obtaining coverage over the past two years and premiums approximately tripled between 2002 and 2003, even though the RBC Funds and the BoG have never been subject to a claim. As a result of the recent mutual fund late trading and market timing scandals in the United States, we are expecting premiums to further increase this year and to see further "exclusions" from coverage.

The availability of insurance and the size of premiums may be further affected by the scope of the IRC's responsibilities as established by section 3.1 of the Instrument. As discussed above, we believe that the broad language of subsection 3.1 (2) and the long list of matters contemplated by commentary 4 will result in too many matters being put before the IRC. We believe that the broader the CSA chooses to make the mandate of the IRC, the more difficult or expensive it is likely to be to obtain insurance coverage.

Finally, to the extent that the CSA proceeds with the Instrument without capping liability for members of an IRC, we would expect IRCs to rely frequently on their authority under section 2.7 to engage independent counsel and other advisors which, of course, will result in increased MERs for the affected funds.

Based on the foregoing, we agree with those who have argued that insurance coverage may not be available or may be prohibitively expensive if members of an IRC have unlimited liability and that costs to funds may be increased.

Accordingly, we would urge the CSA to consider the changes we have suggested to the drafting of section 3.1 and to consider whether it is possible to have the applicable provincial securities acts amended to give the CSA members authority to limit IRC members' liability.

Responsibility for and Scope of Insurance Coverage

We are very concerned about the commentary contained in section 2.8 of the Instrument. In particular, commentary 2 provides that any insurance coverage purchased by a mutual fund for the members of an IRC should not cover liability resulting from a failure to fulfill responsibilities or to satisfy the standard of care. Aside from the question of whether this provision should be part of the rules or the commentary, we would point out that this approach is contrary to the approach taken in section 124 of the CBCA which permits a corporation to purchase insurance that would cover a breach of the standard of care. We acknowledge, however, that the CSA's approach is consistent with the approach taken in section 136 of the OBCA.

While the Instrument is silent with respect to whether a fund's manager could purchase insurance that would cover a breach of the standard of care, we are concerned that there may be an implication in section 2.4 (i.e. the "material relationship" concept) or in commentary 2 following section 2.7 that the manager could not do so. We believe a fund manager should be permitted to purchase this insurance for IRC members.

Accordingly, to the extent the CSA wishes to prohibit a fund from purchasing insurance for IRC members which would cover liability for breach of the standard of care, we would urge that (a) commentary 2 following section 2.8 be moved into the rules portion of the Instrument and (b) the commentary be amended to explicity indicate that managers are not prohibited from purchasing such insurance.

Other Matters

We strongly oppose the requirement in subsection 2.5 (2) that an IRC deliberate and decide on a recommendation in the absence of any representative of the manager or any entity related to the manager. In our experience, it would be impractical and unnecessary to prohibit manager representatives from being present. The "deliberation" process frequently involves members of the IRC asking questions which only the manager or its

representatives can answer. While we would not object to a provision permitting the IRC to deliberate and decide on matters in the absence of the manager or its representatives, we believe that this should be a matter of procedure that should be left to the IRC to decide on a case by case basis.

While we do not disagree with the requirement in subsection 2.11 (1) to disclose information about IRC members and the IRC's charter in a mutual fund's prospectus, we do not understand why that information should also be contained in its periodic continuous disclosure reports.

Please feel free to contact me directly if you wish to discuss this matter further.

Yours truly,

"Mark Pratt"

Mark D. Pratt
Senior Counsel
RBC Law Group

cc: M. George Lewis
Brenda Vince
Peggy Dowdall-Logie
The Board of Governors of the RBC Funds