Royal Bank of Canada
Royal Trust Tower, 6th Floor
Toronto, Ontario
M5W 1P9

August 25, 2005

Via E-Mail

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon Territory
Registrar of Securities, Nunavut

c/o John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 3S8
email: jstevenson@osc.gov.on.ca

and

Anne-Marie Beaudoin, Directrice du secretariat
Autorité des marchés financiers
Tour de la Bourse
800, square Victoria
C.P. 246, 22e etage
Montreal, Quebec H4Z 1G3
email: consultation-en-cours@lautorite.qc.ca

Dear Mr. Stevenson and Ms. Beaudoin:

Re: Proposed National Instrument 81-107

We are responding to the request for comments on the Canadian Securities Administrators' (the "CSA") Proposed National Instrument 81-107 and consequential

amendments to National Instrument 81-101, National Instrument 81-102 and National Instrument 81-106 (collectively, the "Proposed Rule") on behalf of RBC Asset Management Inc. ("RBC AM"). RBC AM is an indirect, wholly-owned subsidiary of the Royal Bank of Canada. It provides a broad range of investment services to investors through mutual funds, pooled funds and separately managed portfolios and currently has over $50 billion in assets under management.

General Comments

We commend the CSA for introducing a mandatory fund governance regime as it will not only enhance investor protection, but also improve the fairness and efficiency of Canada's capital markets. The CSA has recognized that fund governance is an important component of investment fund regulation and that changes are necessary to ensure that regulation keeps pace with the complexity of the industry, as well as with global standards.

Fund governance is described in the Proposed Rule as only one of the necessary elements of support for the proper operation of a fund; the others are manager regulation, product regulation, disclosure and investor rights and regulator presence. We supported this five-pillar approach for a renewed framework for regulating mutual funds and their managers as outlined in Concept Proposal 81-402 – Striking a New Balance: A Framework for Regulating Mutual Funds and their Managers which was published by the CSA in March 2002. As the CSA has chosen to move forward with the fund governance proposal first, there is a risk that fund governance will be asked to address issues that would be more appropriately dealt with under one of the other pillars. This may have been the source of some of the criticisms of the earlier draft of the Proposed Rule. In our view, it is important that fund governance stand together with, and not be expected to replace, the other four pillars. Therefore, we hope that the CSA will not charge independent review committees ("IRCs") with responsibilities that should properly reside under one of the other pillars. For example, the reporting of a breach of securities laws is properly a management responsibility, not an IRC obligation.

It is also essential that the Proposed Rule be accepted and implemented across all jurisdictions in Canada and not adopted on a piecemeal basis by only certain jurisdictions as the costs of differing rules will far outweigh the potential benefits. We encourage the CSA to ensure that harmonization across all jurisdictions is achieved on this very important initiative.

In comparing the Proposed Rule to its earlier version, we were encouraged to see that the CSA has taken steps towards adopting a more principles-based approach. However, there are still a number of elements of the Proposed Rule that are unnecessarily prescriptive. We hope that the CSA will take further measures to ensure that the final form of the Proposed Rule is principles-based as this approach allows for more flexibility in determining what structure and rules/procedures work for a particular organization and encourages organizations to look beyond prescriptive rules to the spirit or the intent of the rule.

Specific Questions

1. ***The Proposed Rule now applies to publicly offered mutual funds including commodity pools, scholarship plans, LSIFs or VCFs, closed-end funds, and listed/quoted mutual funds. The CSA has requested feedback on the expanded scope of the Proposed Rule and has asked what conflicts of interest exist in the management of these funds, the anticipated cost of the Proposed Rule on these funds, whether there are additional practical considerations for each of these structures that should be address, and what other mechanisms managers of these fund use today or could use to address conflicts of interest.***

   The CSA requested feedback on the impact of including smaller investment funds in the Proposed Rule.

The CSA has chosen to move forward with a governance structure that is intended to address not only related party conflicts, i.e. Part 21 of the *Securities Act* (Ontario) and Part 4 of National Instrument 81-102 ("NI 81-102"), but also certain business conflicts. Large and small funds are subject to the same regulatory framework and rules. While managers of smaller or independent fund companies may not face the same type or the same extent of conflicts as managers of larger fund groups with complex business structures, many of the issues to be considered by an IRC will be equally applicable to large and small funds. Therefore, it would be inappropriate to exempt funds from the governance regime as proposed simply on the basis of size.

In many cases, the rules regarding investment funds that are not public mutual funds are limited. Mutual funds are subject to competition from a number of investment alternatives and not all of these substitutes are subject to the same regulatory burden (or extent of regulation) as retail mutual funds. By extending the Proposed Rule to include all publicly offered mutual funds, the CSA has acknowledged that such a regulatory gap is not desirable and is taking steps to create a more level playing field among investment products. As alternatives become more popular, parity in regulatory regimes becomes increasingly important – investors should be entitled to expect that similar products are regulated similarly.

2. ***The CSA is retaining the existing conflict of interest provisions and self-dealing prohibitions and restrictions in securities legislation and providing exemptions based on certain conditions. The CSA requested feedback both on the approach and the specific drafting of the provisions.***

Approach

We are supportive of the approach of using an independent governance agency to monitor compliance with policies on related party transactions and replacing or allowing for exemptions from the current conflict of interest rules. Allowing a fund manager, in conjunction with its IRC, to develop its own rules should allow for a governance regime that protects the interest of unitholders without artificially restraining practices that may be beneficial to unitholders.

Related Party Transactions

It appears from our review of the Proposed Rule that the CSA intended to establish a regime that would permit related party transactions on terms similar to those imposed by the CSA in recent exemptive relief orders. However, the provisions of the Proposed Rule regarding purchases of related party underwritings and related issuers are somewhat contradictory and require clarification. In particular, the following issues need to be addressed:

- the conditions articulated in section 4.1 of NI 81-102 are unclear as they appear to require that a purchase be made both pursuant to a distribution and on a stock exchange;
- the purchase of private placements would not be permitted under section 4.1 of NI 81-102 because such a purchase would not be on a stock exchange;
- purchases of both new issues and private placements would not be permitted under section 6.1 of the Proposed Rule because such purchases would not be on a stock exchange; and
- section 5.4 of the Proposed Rule which permits the IRC to provide a manager with standing instructions for particular types of actions by the manager in conflict of interest matters would appear to require an IRC to consider the conditions of prior relief orders obtained by a fund. This creates an uneven playing field for funds that obtained prior relief and funds that did not. If the intent was that prior orders granted by the CSA be used by an IRC for guidance, this section should be clarified.

Once the rules on related party transactions are finalized, we expect that we will work with other fund managers in similar circumstances to develop guidelines and best practices in respect of policies and procedures. It is also likely participants may require guidance from the CSA on issues or questions that arise. As the industry becomes comfortable with the rules and the role of an IRC, processes and standards will be achieved that are transparent and beneficial to investors.

3. The Proposed Rule requires the IRC to monitor and assess, at least annually, the adequacy and effectiveness of the fund manager's written policies and procedures related to conflict of interest matters, and the fund manager's compliance with the IRC's instructions on these matters. The Proposed Rule also gives the IRC the authority to communicate directly with securities regulatory authorities and requires the IRC to report a breach of a condition imposed by securities legislation or the IRC in relation to inter-fund trading, transactions in securities of related underwriters and purchases of securities underwritten by related dealers.

As we stated in the *General Comments* section, we believe that the Proposed Rule should be principles-based where possible and allow managers and IRCs to develop their own policies and procedures.

An example of over-prescriptiveness of the Proposed Rule is with respect to the obligation on the part of the IRC to report to securities regulatory authorities the non-compliance with a condition imposed by securities legislation and include such non-compliance in its annual public report. We believe that the lack of any *de minimus* or materiality threshold is inappropriate. It should be left to the IRC to determine the appropriate action in respect of a breach of policy. IRC members should have the right and the option, but not the obligation, to report to regulatory securities authorities. In practice, an IRC would likely consider both the severity of the breach and the response of management, including a manager's self-disclosure to regulators, in determining whether or not it also needs to communicate with the regulators or include such matter in its annual report.

4. The Proposed Rule specifies the key governance practices expected of the IRC and the manager including the appointment of a chair, the establishment of nominating criteria for the appointment of IRC member, orientation and continuing education, self-assessments and reporting obligations. The CSA requested feedback on their approach.

Structure of the IRC

The RBC Funds have had an independent Board of Governors ("BOG") for eleven years. The mandate of the BOG is to advise the trustee and manager in the administration of its duties and deal with situations where there exists a conflict or potential conflict between the interests of the trustee or the manager of a fund or any affiliate of the trustee or the manager and the interest of such fund and the participants thereof. The BOG is permitted to establish committees and fix their duties and responsibilities.

As we stated in our comment letter on the first draft of Proposed National Instrument 81-107 (the "2004 Proposal"), we have found that there is a significant benefit to both the RBC Funds and RBC AM in having a large, geographically representative advisory BOG. However, having smaller committees, which make decisions and report back to the BOG has allowed the BOG to deal with the size and complexity of our operations effectively and in a much more timely fashion than would otherwise be possible.

We also stated in our comment letter on the 2004 Proposal that our current structure would raise questions about the liability of the full Board of Governors for decisions of committees and urged the CSA to include language in the Proposed Instrument that would explicitly permit an IRC of more than three members to delegate defined responsibilities to a committee of at least three members with a defined mandate and reporting structure.

Section 3.1 of the Proposed Rule will require each mutual fund to have an IRC. The subsequent commentary clarifies that each manager may establish a structure that takes into account the unique characteristics of the fund group.

We were pleased to see that the CSA commented that it was important to provide flexibility for fund managers to determine how to best structure their IRCs as this is an endorsement of the principles-based approach that we support. However, the CSA stated

that it did not feel it was necessary to explicitly permit the specific arrangement we outlined in our comment letter on the 2004 Proposal.

Under common law, if a duty is imposed, it cannot be delegated. However, Canadian corporate statutes expressly permit delegation of certain powers of a board of directors to a committee of the board of directors, so that a corporate committee's decision is valid without ratification by the full board. Trust statutes also permit delegation in a similar fashion.

Our external counsel has advised that they would not likely be able to provide an opinion that an IRC could effectively delegate any of its responsibilities created under the Proposed Rule to a committee of the IRC unless delegation was specifically authorized. Under the current drafting of the Proposed Rule, if the IRC were to delegate, it would need to have each decision come back to the "full" IRC for action or approval. Therefore, delegation under the Proposed Rule would not have an effective result.

As we do not believe that we could operate our fund governance structure cost effectively without committees and because there is no diminishment of protection to unitholders of the funds, we cannot think of a reason not to provide the IRC with the authority to delegate. Therefore, we recommend that the Proposed Rule be amended to specifically permit delegation.

Procedures

Section 4.1 of the Proposed Rule requires the IRC to deliberate and decide on any conflict of interest matter referred to it in the absence of management. Based on our experience, we believe that this requirement is overly prescriptive and not necessary to ensure that the IRC is acting with an independence of mind and without the influence of management. The deliberation process involves members of the IRC asking questions of management followed by a decision/recommendation by the IRC. If there were a number of matters to be dealt with at a meeting, the Proposed Rule would result in senior executives continuously entering and leaving the meeting room so that the IRC could "deliberate and decide" on each issue.

We believe that there is merit to governance committee discussions without the involvement or attendance of management and therefore we schedule *in camera* sessions for each BOG and committee meeting. However, this should be a matter of procedure that is left to each IRC to decide.

5. In the 2004 Proposal, the CSA proposed to remove the requirement for the majority of changes contemplated under section 5.1 of NI 81-102. The CSA no longer proposes to eliminate most of the securityholder approvals outlined in the 2004 Proposal and believe that a securityholder vote should be required for proposed changes that affect the 'commercial bargain' between a fund manager and investors. The CSA requested feedback on their revised approach.

We support the concept that a securityholder vote only be required for proposed changes to a mutual fund that affect the commercial bargain between unitholders and the manager and we support the proposal that other changes such as a change in auditor, be considered by a fund's IRC.

We would like to thank the OSC for the opportunity to provide these comments on the Proposed Rule. Please feel free to contact either Brenda Vince at 416-955-2238 or Reena S. Lalji at 416-955-7826 if you have questions or would like to discuss any of the matters raised in this letter.

Yours truly,

"Brenda Vince"

Brenda Vince
President, RBC Asset Management Inc.

"Reena S. Lalji"

Reena S. Lalji
Senior Counsel, RBC Law Group