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Via E-Mail

Canadian Securities Administrators
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and

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Dear Sirs and Mesdames:

Re: Proposed National Instrument 23-102 – Use of Client Brokerage Commissions as Payment for Order Execution Services or Research ("Soft Dollar" Arrangements)

We are writing on behalf of RBC Asset Management Inc. ("RBC AM") to provide you with our comments in respect of the above-captioned Proposed National Instrument (the "Proposed Instrument") and the related Proposed Companion Policy 23-102 CP (the "Proposed Policy"). RBC AM is an indirect, wholly-owned subsidiary of Royal Bank of Canada and provides a broad range of investment services to investors through mutual funds, pooled funds and separately managed portfolios.

As a general comment, we would like to thank and congratulate the Canadian Securities Administrators (the "CSA") for their thoughtful and thorough consideration of the issues

of best execution and soft dollar arrangements. We were very pleased to be given the opportunity to comment on Concept Paper 23-402 (the "Concept Paper") and are pleased to be able to provide you with further comments on the Proposed Instrument and Proposed Policy.

We would also like to commend the CSA for striving in the Proposed Instrument to harmonize the Canadian rules governing soft dollar arrangements with global best practices.

Question 1: Should the application of the Proposed Instrument be restricted to transactions where there is an independent pricing mechanism (e.g., exchange-traded securities) or should it extend to principal trading in OTC markets? If it should be extended, how would the dollar amount for services in addition to order execution be calculated?

While we understand the superficial appeal of applying the Proposed Instrument to all securities transactions, we do not believe that a similar approach can be applied to OTC instruments since there is currently no transaction cost transparency in the OTC markets.

RBC AM is comfortable with its cost of execution in OTC markets, especially fixed income markets, and that the value of non-execution services (i.e. research) provided in these markets is lower than in equity markets. Accordingly, the value of "unbundling" or separately identifying the cost of execution vs. non-execution services in these markets is limited in our view.

Question 2: What circumstances, if any, make it difficult for an adviser to determine that the amount of commissions paid is reasonable in relation to the value of goods and services received?

As we indicated in our comments on the Concept Paper, asset managers are only able at best to estimate the costs of execution and research since so many of those costs are currently "bundled". Unless and until dealers are required to unbundle execution charges from charges for proprietary research and other services, advisers would need to estimate whether the amount of commissions paid is reasonable in relation to the value of goods and services received.

Absent the unbundling of charges, we believe there are two ways in which an adviser could try to arrive at a determination that commissions paid are reasonable, although neither method would appear to achieve the level of specificity the CSA is contemplating.

First, an adviser could estimate the cost of execution through a full-service dealer by comparing it to the commission paid to trade a stock on an alternative trading system ("ATS"). The difference between these two commission rates could represent, in large part, the dollar amount paid to the full-service dealer for research or other goods and services. By comparing this amount to the cost of acquiring third party research or other services, the adviser could determine whether the total commissions paid to a full-service

dealer are reasonable. This would be an imperfect system since the cost of execution through a full-service dealer is higher than through an ATS, due to the frequent provision of principal liquidity services that are not available through an ATS.

Alternatively, the adviser could develop a system to ascribe a qualitative value to the proprietary research and other services received by polling its analysts and portfolio managers and asking them to rank the usefulness of different sources of research and other services. This method would not seek to break commission dollars into execution and research portions (i.e. it would not seek to estimate the cost of each), but would allow the adviser to come to a qualitative decision as to whether it and its clients are receiving reasonable value for commission dollars spent with a particular dealer.

Question 3: What are the current uses of order management systems? Do they offer functions that could be considered execution services? If so, please describe these functions and explain why they should, or should not be considered "order execution services."

There are two types of order-management systems ("OMSs") - internal and external. Internal systems (e.g., including Charles River, Macgregor, Eze Castle or Latent Zero) have mixed uses, some of which may be considered execution services, but most of which are administrative in nature. Examples of services provided by internal OMS include report generation, security-master information, compliance monitoring or portfolio administration, and recordkeeping. Given the mixed uses of internal OMS, the separation of the order execution and other services would be required. At RBC Asset Management, we only use clients' brokerage to pay for services directly linked to investment decisions made by a specific fund. Therefore, our position is that internal OMS applications should not be paid for with client brokerage commissions.

External OMS, including ATSs and electronic networks ("ECNs"), provide services such as algorithmic trading functionality and direct market access. External OMS equipment (e.g., a terminal provided by a broker or an electronic network provider), is used mostly by buy-side traders to gain direct access to markets, to execute program trades or use various trading algorithms. All are directly related to order execution. In addition, those tools provide advice on execution strategies, market sentiment and availability of buyers and sellers, and therefore generate value to the fund's unitholders. Therefore, we believe that external OMS systems and services should be considered execution services.

Question 4: Should post-trade analytics be considered order execution services? If so, why?

You have indicated in subsection 3.3(2) of the Proposed Policy that post trade analytics would be considered research to the extent they help determine a subsequent investment or trading decision and are provided before an adviser makes an investment or trading decision. We agree with this position.

Since the Proposed Instrument would permit advisers to pay for both research and order execution services with clients' commission dollars, we assume you have posed Question 4 because post-trade analytics would not appear to satisfy the temporal limitation applicable to research contemplated by subsection 3.3(1) of the Proposed Policy. In our view, although post-trade analytics are clearly received *after* certain trades have been concluded, they are received and considered by the adviser *before* making further trading decisions. To the extent that these types of analytics include information about how well a broker conducted a particular transaction or series of transactions for an investment manager, as well as advice on liquidity and market-related timing, negotiation of the terms of a trade and other aspects of order handling, they assist advisers in assessing trading effectiveness, promote best execution, feed into an adviser's trading decisions and help to promote competition between execution platforms, all of which help determine an adviser's subsequent trading decisions. Accordingly, we believe that post-trade analytics are more properly characterized as research than order execution services.

Since performance management and compliance management tools are not used to determine subsequent investment or trading decisions and are not received during either of the temporal limitations contemplated for research or order execution services, we do not believe they should be paid for with clients' commission dollars. Accordingly, we support the position you have taken in subsection 3.4(1) of the Proposed Policy.

Question 5: What difficulties, if any, would Canadian market participants face in the event of differential treatment of goods and services such as market data in Canada versus the U.S. or the U.K.?

We commend the CSA for attempting in the Proposed Instrument to harmonize the Canadian approach to soft dollar arrangements with those taken by regulators in the U.S. and the U.K.

Without regulators adopting a common approach, global firms that have offices in multiple jurisdictions would face a choice between adopting a single set of internal policies that satisfy the most stringent regulatory requirements or the inconvenience and costliness of developing different processes that would be applicable to different clients' commission dollars, depending on the jurisdiction in which the client is located. From the perspective of satisfying our fiduciary obligation to all of our clients, as well as from a risk management perspective, we believe it makes sense to have only one commission-allocation process or soft-dollar procedure for all offices and subsidiaries regardless of where they are located. From a client's perspective, investors' commission dollars should not be treated differently in different markets.

Question 6: Should raw market data be considered research under the Proposed Instrument? If so, what characteristics and uses of raw market data would support this conclusion?

You have indicated in subsection 3.2(3) of the Proposed Policy that raw market data would be considered order execution services to the extent it assists in the execution of

orders and is received between the point at which an adviser makes an investment or trading decision and the point at which the resulting securities transaction is concluded. We agree with this position.

We do not believe that raw market data satisfies the description of research nor the temporal limitation set out in subsection 3.3(1) of the Proposed Policy. Raw market data is unanalyzed information received and used by traders to determine how and when to execute *current* orders rather than in determining *subsequent* trading decisions. Accordingly, while we agree that it should be permissible to pay for raw market data using clients' commission dollars, we believe it is more properly characterized as order execution services than as research.

Question 7: Do advisers currently use client brokerage commissions to pay for proxy services? If so, what characteristics or functions of proxy-voting services could be considered research? Is further guidance needed in this area?

RBC Asset Management does not use client brokerage commissions to pay for proxy services and has taken the position that proxy-voting services should not be considered research.

We realize that certain proxy services could qualify as research because they provide information and analysis that money managers might consider when determining whether to invest in or retain a position in a security. However, proxy services also have administrative and other non-research purposes that RBC AM considers unsuitable for inclusion in brokerage commissions. We do not believe that further guidance on this subject from CSA is necessary.

Question 8: To what extent do advisers currently use brokerage commissions as partial payment for mixed-use goods and services? When mixed-use goods and services are received, what circumstances, if any, make it difficult for an adviser to make reasonable allocations between the portion of mixed-use goods and services that are permissible and nom-permissible?

RBC Asset Management does not use client brokerage commission to pay for mixed-use services. For example, we do not classify the cost of Bloomberg terminals as 'soft-dollar eligible' because such allocation would require extensive documentation and would always be subject to *ex post facto* questions as to the propriety of the allocation. We have, therefore, generally decided to treat costs for any mixed-use items as corporate operating expenses which are paid for with "hard" dollars.

The only situation in which RBC AM will consider using client commissions to pay for mixed-use services is where an accurate and objective allocation of cost can be determined instead of estimated. For example, if an OMS or another investment tool has a separate module that is used entirely for research or order-execution services, and carries a specific price provided by the vendor, RBC AM believes there would be no question as to the propriety of the allocation.

Question 9: Should mass-marketed or publicly available information or publications be considered research? If so, what is the rationale?

We do not believe that mass-marketed or publicly available information should be considered research as it does not generally contain sufficiently sophisticated analysis to "add value" to advisers' investment or trading decisions, as required by section 3.1(b) of the Proposed Instrument.

We believe that client commission dollars should only be used to pay for information and analysis that is either specifically designed by the author to assist in the investment decision making process or that analyzes economic or political trends with a degree of sophistication that "adds value" to an adviser's investment decisions. Accordingly, we support the approach the CSA has taken in subsection 3.5(1) of the Proposed Policy.

Question 10: Should other goods or services be included in the definitions of order execution services and research? Should any of those currently included be excluded?

We do not see any other services that should be added to the list of eligible items provided by CSA.

Questions 11 to 15

While we are very supportive of the CSA's approach to soft dollar arrangements in Part 3 of the Proposed Instrument and Parts 3 and 4 of the Proposed Policy, we do not fully support the proposed disclosure obligations and level of detail contained in Part 4 of the Proposed Instrument.

General

We believe that the requirement to *provide* the level of disclosure contemplated by subsection 4.1(1) runs contrary to the approach taken by the CSA in recent years which is simply to make certain information of this type available to clients upon request. Once we have agreed on the disclosure requirements, we would strongly urge you to reconsider the obligation to provide such detailed information to clients annually, rather than simply making it available to them upon request.

Disclosure of aggregate soft dollar arrangements and payments

We do not object to the disclosure contemplated by paragraph 4.1(1)(a), since we believe this level of disclosure would be useful and understandable to most clients. We would also point out that this level of disclosure is generally consistent with the information required to be disclosed by U.S. registered investment advisers in Item 12 of Part II of Form ADV.

We would also not object to the requirement to disclose to clients the total aggregate brokerage commissions paid during a year on behalf of all clients (as contemplated by the first part of paragraph 4.1(1)(b) of the Proposed Instrument), nor would we object to the disclosure of the aggregate value of goods and services received from third parties which have been paid for by dealers using a portion of client commissions.

Paragraphs 4.1(1)(b), (c) and (d)

Client-by-client disclosure

We do not support the client-by-client and class of security disclosure contemplated by paragraphs 4.1(1)(b) and (c) of the Proposed Instrument.

We believe that Canadian advisers take the same approach to their soft dollar activities as U.S. advisers, namely that they consider whether the research and other services acquired with a particular client's commission dollars are useful to the adviser's clients generally. Under section 28(e) of the Securities Exchange Act of 1934, a U.S. registered investment adviser is permitted to use a client's commission dollars to acquire permitted research or order execution services if the research or services benefit either that client's account *or* the adviser's clients generally. Any other approach would require an adviser *not* to consider research it acquired using Client A's commission dollars when making investment decisions for Client B. It is not feasible to estimate and track research and commission dollars at a client by client level.

Paragraphs 4.1(1)(b) and (c) of the Proposed Instrument take a very different approach to the extent that they would require advisers to provide breakdowns of commissions and estimates of soft dollar amounts on an client-by-client basis, as well as on a class of security basis. We do not support this approach and believe that the CSA should adopt a similar position and approach to that employed in the U.S.

Finally, we recognize that the client-by-client disclosure contemplated by paragraph 4.1(1)(b) is similar to the requirement under paragraph 3.6(1)(3)(b) of National Instrument 81-106 to estimate the soft dollar portion of commissions paid by mutual funds for disclosure in the notes to their financial statements. Although we are currently complying with this requirement for each of the RBC Funds and the RBC Private Pools, it is a very time consuming process which we do not believe provides unitholders with useful information and we do not support the extension of this disclosure obligation to other clients. We also assume that the Proposed Instrument is not intended to impose any additional disclosure obligations with respect to mutual funds or their investors beyond those contained in NI 81-106 and would encourage the CSA to make that explicit in the Proposed Instrument.

Order Execution Only, Bundled Execution and Third Party Percentages

We do not support the percentage disclosures contemplated by paragraph 4.1(1)(c) of the Proposed Instrument.

We believe it is important to recognize that advisers typically set an annual budget only for *third party goods and services* to be acquired using commission dollars and that that budget does not vary greatly from year to year; advisers' commitments to generate a specified level of commissions with a given dealer are related solely to the cost to that dealer of providing the adviser with such third party goods or services and not to the cost of providing proprietary, "bundled", non-execution goods or services. Since levels of trading activity *do* vary from year to year, a greater percentage of trades will be done on a soft dollar basis in years in which trading activity is quite low. In other words, if an adviser has budgeted to purchase $100,000 of third party research each year, a greater percentage of its trading will be done on a soft dollar a basis in a year where total commissions are $1 million than in a year where total commissions are $10 million.

Given the foregoing, we believe that the percentage disclosures contemplated by paragraphs 4.1(1)(c) and (d) would be very difficult and costly for most advisers to implement. More importantly, though, given the year-to-year fluctuation in trading levels and commissions paid, we do not believe that percentage disclosures will help clients determine whether their commission dollars are being used appropriately.

Subsection 4.2(2)

While we do not object to maintaining the information contemplated by subsection 4.2(2) and making it available to clients upon request, we do not believe such information should be required on a client-by-client basis.

Once again, we appreciate the opportunity to provide you with our comments on the Proposed Instrument and Proposed Policy and would be very happy to speak to you should you have any questions about them.

Yours very truly,

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