MUTUAL FUNDS AND GOVERNANCE:
Taking Care of Your Investments

2007 Edition
“We are proud to be able to add value for mutual fund investors by subjecting the activities of RBC Asset Management to ongoing independent scrutiny on their behalf.”

Mary Ritchie, FCA, Member of the Board of Governors and Chair of the Financial Advisory Committee
A MESSAGE FROM YOUR BOARD OF GOVERNORS

Integrity is a matter of having a set of principles and adhering to them consistently. As members of a board, we expect the highest levels of integrity of each other, and we encourage the management team, whose actions we oversee, to demonstrate a culture of integrity and an appropriate “tone at the top.” These are essential to the success of a business based on investors’ trust.

In 2006, the Board of Governors led the Canadian mutual fund industry by becoming the first independent review committee. RBC Asset Management and the Board of Governors put into effect new securities regulation designed to enhance investor protection, long before the regulatory deadline. The depth of experience brought to this new role by members of the Board of Governors, and the integrity on which our working relationship with the fund manager is based, enabled us to act quickly to bring the full benefit of the new regulation to investors in the RBC Funds and RBC Private Pools.

We recognize that mutual fund investors are far removed from the fund manager and its decisions. The role of the Board of Governors is to help regulators fill that gap by providing independent oversight of certain actions of the fund manager.

We are proud to support integrity in the mutual fund industry and to be associated with the team of dedicated individuals at RBC Asset Management.

Lloyd R. McGinnis, OC, PEng
Chair of the Board of Governors
A MESSAGE FROM YOUR FUND MANAGER

Our aim is to provide a superior investing experience based on our core principles of delivering value, choice and transparency to investors. Transparency, a key element in building trust and confidence in our relationship with mutual fund investors, means helping investors to understand what to expect from our products, how we manage the mutual funds, what services we provide and what we’re paid for those services.

Transparency also means communicating candidly with the Board of Governors about conflict of interest matters. Every day, we work hard to honour our duty to act in the best interests of the mutual funds. The Board of Governors sees the evolution of our policies for managing conflicts and oversees our plans to help us achieve a fair and reasonable result for the funds.

RBC Asset Management recognized the opportunity to add value for investors when new fund governance regulation brought with it relief from certain investment restrictions. We moved swiftly to establish the Board of Governors as the independent review committee of the mutual funds and to comply with the new regulation. Since December 1, 2006, the RBC Funds and RBC Private Pools have been in a position to benefit from this new regime.

We don’t take your trust in us for granted. We will continue to find ways to meet our commitment to deliver value, choice and transparency. Leadership in fund governance is one of the ways we deliver on that promise.

Thank you for your trust.

M. George Lewis, CFA, CA
Chairman and Chief Executive Officer
RBC Asset Management Inc.
A MATURING INDUSTRY

In 2006, stocks and mutual funds accounted for approximately 37 per cent of Canadian household financial assets, double the share in 1990. As of May 31, 2007, Canadians held over $700 billion in approximately 2,000 mutual funds managed by more than 100 mutual fund managers. A sizeable amount of Canadians’ savings – and the public trust – is invested in this industry.

Securities regulators, who are responsible for protecting investors, are squarely focused on maintaining investor confidence in the management of their mutual funds. As the Canadian mutual fund industry has grown, regulators’ focus on mutual fund governance has increased.

That focus led to the May 2006 issue by the Canadian Securities Administrators of National Instrument 81-107, Independent Review Committee for Investment Funds, which requires all mutual funds to have an independent review committee. The rule came into force on November 1, 2006 and allows funds until November 1, 2007 to fully comply with its requirements.

The new fund governance rule is intended to enhance mutual fund investor protection. Independent fund governance helps to ensure that the interests of the fund (and ultimately, of the fund’s investors) are at the forefront when a fund manager is faced with a potential conflict of interest.
“Independent fund governance reinforces the bond of trust between mutual fund managers and their investors.”

Brenda Vince, President of RBC Asset Management Inc.
A mutual fund is a pool of many individuals’ investment dollars, which is used to purchase securities according to a stated investment objective. Pooling allows each investor to access a diversified portfolio of securities and the expertise of a team of professional investment managers, even if the individual has only a small amount to invest. Most mutual funds also benefit investors by providing daily unit valuations and by offering investment liquidity – the ability to redeem on demand.

Most mutual fund managers, such as RBC Asset Management Inc., create mutual funds and offer units of the funds to investors through dealers. A fund manager is responsible for the day-to-day operation of a mutual fund. It provides services or retains other firms to provide services to the fund.

Among other things, the fund manager oversees the portfolio manager who invests the fund’s money, it selects the custodian of the fund’s assets, it provides record-keeping systems to record fund transactions and investor transactions, and it produces prospectuses, management reports and financial statements for the fund. Management fees and administration fees are charged to the fund for these services and become part of the expenses of the fund, which are used in calculating the fund’s management expense ratio, or MER.

Independent fund governance is an additional service provided to a fund. Fees paid and expenses reimbursed to the members of the independent review committee and other costs incurred to comply with the new fund governance regulation also form part of the expenses of the fund.
RBC FUNDS AND GOVERNANCE

Canadian mutual fund managers participate in a heavily regulated industry, under rules that protect the interests of mutual fund investors. A fund manager’s executive team and its board of directors have obligations to protect the interests of the manager as well as the interests of the mutual fund and its investors. Securities laws specifically require them to put the interests of the mutual fund and its investors first.

The RBC Funds are mutual fund trusts, and The Royal Trust Company is the trustee. Mutual fund investors are the owners of units of the funds. The trustee may conduct the day-to-day business of the funds or delegate that role to a mutual fund manager. In the case of the RBC Funds, the trustee has made RBC Asset Management Inc., its affiliate, responsible for management of the Funds. RBC Asset Management is both trustee and manager of the RBC Private Pools.

Governance, in any kind of organization, is the framework of people, policies and procedures within which decisions are made and actions are taken. Good governance includes a separate oversight function to help ensure that the established policies and procedures are followed.

At RBC Asset Management, Chairman and CEO George Lewis and his executive team take responsibility for the management of the RBC Funds and RBC Private Pools. Layers of governance are provided by those who oversee the activities of the executive team: the Board of Directors of RBC Asset Management Inc., the Chief Compliance Officer, the external auditors of the mutual funds and the RBC internal audit service.

In addition, since December 1, 2006, the Board of Governors has provided independent oversight of the fund manager’s proposed actions in conflict of interest matters relating to the mutual funds, in accordance with new securities regulation.

It has long been recognized at RBC that oversight of the fund manager by an independent board, whose role is to look at management decisions from the perspective of the mutual fund investors, is an important element of fund governance. From 1966, independent directors and trustees of the RoyFunds provided oversight, and from 1994, the advisory Board of Governors represented the voice of mutual fund investors at the management table. The tradition of independent fund governance continues today with the Board of Governors. The Board serves as the independent review committee of the mutual funds regarding conflict of interest matters and continues to provide advice to the fund manager on other issues relating to the mutual funds.
NEW FUND GOVERNANCE REGULATION

After more than six years of review and consultation, the Canadian Securities Administrators published *National Instrument 81-107, Independent Review Committee for Investment Funds* in May 2006. This new rule requires all mutual funds and investment funds to have an independent review committee, or IRC.

RBC Asset Management and members of the Board of Governors were active participants in the Canadian Securities Administrators’ development of the new rule. Experience in working together as an independent board and management team allowed the Governors and executives to play a significant consultative role in this important regulatory development.

The IRC is required to provide independent fund governance by reviewing situations where a reasonable person would consider the fund manager or its affiliate to have an interest that may conflict with the fund manager’s ability to act in the best interests of a fund.

The IRC must form an opinion about whether the fund manager’s proposed action in these situations achieves a fair and reasonable result for the fund and to make a recommendation to the fund manager. In certain cases, where a proposed action is otherwise prohibited by current mutual fund rules, the fund manager is only able to act with the prior approval of the IRC.

The new rule requires the IRC to produce an annual report to mutual fund investors about its activities. The IRC must also report if it becomes aware of any conflict of interest situation in which the fund manager acted but the IRC did not give a positive recommendation, or in which the fund manager did not meet a condition of the IRC approval.

Through our experience, we have seen the value to investors of strong fund governance. We moved quickly to put the new rule into effect and establish the Board of Governors as the IRC for the RBC Funds and RBC Private Pools. Building on our tradition of independent fund governance, RBC Asset Management will continue to assist the Board of Governors in the development and implementation of best practices in governance in order to add value for the investors of the mutual funds we manage.

**REGULATORY FOCUS ON MUTUAL FUND GOVERNANCE**

For example, according to law, a mutual fund cannot participate in an initial public offering of securities underwritten by a related company. However the new rule now allows the RBC Funds and RBC Private Pools to participate without delay in underwritings by RBC Dominion Securities Inc., a major Canadian underwriter, if the Board of Governors has given its approval. The relief from this investment restriction and other similar restrictions broadens investment options and also presents cost-saving opportunities for the mutual funds.
RBC fund manager establishes advisory Board of Governors to oversee RBC Funds

RBC fund manager and Governors provide information for Regulator’s 1995 publication

RBC fund manager and Governors provide fund governance expertise for Regulators’ 2000 publication

RBC fund manager and Governors comment on Regulators’ Concept Proposal

RBC Funds obtain regulatory relief to permit purchases of Royal Bank common shares, with Independent Committee oversight

RBC establishes Independent Committee to oversee related-party transactions

RBC Funds obtain first regulatory relief to permit purchases of certain RBC Dominion Securities underwritings, with Independent Committee oversight

RBC Asset Management and Governors comment in support of proposed regulation

Board of Governors begins oversight of RBC Private Pools

RBC Asset Management establishes Board of Governors as Independent Review Committee

National Instrument 81-107 is put into effect for RBC Funds and RBC Private Pools as of December 1, 2006

Board of Governors publishes first reports to mutual fund investors under new fund governance rule

Regulator publishes “Regulatory Strategies for the Mid-’90s: Recommendations for Regulating Investment Funds”

› Recommendations for regulatory change across fund industry

› Includes recommendation for funds to have an independent oversight board

Regulators publish “Making it Mutual: Aligning the Interests of Investors and Managers”

› Begins discussion about a regulatory requirement for independent fund governance

Concept Proposal “Striking a Balance: A Framework for Regulating Mutual Funds and their Managers” is published

› Includes proposal for independent fund governance regulation

Proposed regulation: National Instrument 81-107

› Proposes mandatory independent oversight of fund conflicts of interest

Regulators publish final “National Instrument 81-107, Independent Review Committee for Investment Funds”

› Rule allows funds until November 1, 2007 to fully implement use of independent review committee
The Board of Governors, which was originally established as an advisory oversight board in 1994, was continued as the independent review committee for the RBC Funds and RBC Private Pools on December 1, 2006. The full Board meets with the executive team of RBC Asset Management at least four times per year, and each meeting agenda provides time for the Governors to meet privately without management.

The Board and its three sub-committees regularly receive presentations from the executives on mutual fund industry issues and policies and procedures relating to the mutual funds.

In addition to its role as an independent review committee, the Board of Governors provides advice to the fund manager on other issues impacting the mutual funds.

The Board of Governors has policies and procedures for assessing the independence of each Governor and for preserving objectivity when the Board performs its functions on behalf of the mutual funds.
“Responsible mutual fund managers devote significant time and resources to acting in the best interests of the funds, but the added oversight of independent fund governance gives the mutual fund investor a voice at the management table.”

Michael Thorley, Vice Chair of the Board of Governors and Chair of the Investment Conflicts Committee
The Board of Governors

LLOYD R. MCGINNIS, OC, PEng
WINNIPEG, MANITOBA
CEO, ISIS Canada Research Network

A member of the Board since its inception in 1994, Lloyd McGinnis is the Chair of the Board of Governors. He has extensive experience in engineering innovation, sustainable development and governance. Dr. McGinnis is a professional engineer and is the Chief Executive Officer of ISIS Canada Research Network. He was appointed an Officer of the Order of Canada in 2003.

MICHAEL G. THORLEY
TORONTO, ONTARIO
Retired law partner

Michael Thorley has served on the Board of Governors since 1994. He is the Vice Chair of the Board of Governors, Chair of the Investment Conflicts Committee and a member of the Financial Advisory Committee. He has experience in professional liability insurance matters and risk management and serves as Chair of the Canadian Lawyers Liability Assurance Society. Mr. Thorley is a lawyer and was formerly a partner of Torys LLP, a major international law firm.

MARY C. RITCHIE, FCA
 EDMONTON, ALBERTA
President, Richford Holdings Ltd.

Mary Ritchie is the Chair of the Financial Advisory Committee of the Board of Governors and a member of the Investment Conflicts Committee. She has been a member of the Board since 2002. Ms. Ritchie is a chartered accountant and serves on the Accounting Standards Oversight Council of the Canadian Institute of Chartered Accountants. She is the President of Richford Holdings Ltd. and a member of the boards of directors of various public companies.

ELAINE C. PHÉNIX,
MONTREAL, QUÉBEC
President, Phénix Capital Inc.

Elaine Phénix is the Chair of the Governance Committee of the Board of Governors and has served on the Board since 1999. She is a financial strategy consultant with business and regulatory experience in Canadian capital markets. She is a former executive vice-president of the Montreal Exchange. Ms. Phénix is the President of Phénix Capital Inc. and has extensive experience as a corporate director.

SELWYN B. KOSSUTH,
MISSISSAUGA, ONTARIO
Independent financial consultant

Selwyn Kossuth is a member of the Financial Advisory Committee and the Investment Conflicts Committee of the Board of Governors. He has served on the Board since 1995. Mr. Kossuth is a former executive director of the Ontario Securities Commission, is a past president and chief executive officer of the Investment Funds Institute of Canada, and currently serves as an adjudicator on disciplinary hearing panels of the Mutual Fund Dealers Association of Canada, a securities regulatory organization.

LINDA S. PETCH
VICTORIA, BRITISH COLUMBIA
President, Petch & Associates Management Consultants Ltd.

Linda Petch joined the Board of Governors in 2006 and is a member of the Governance Committee. She is the President of Petch & Associates Management Consultants Ltd., a company that provides corporate training and management services in board governance, communications and organizational change to public, private and non-profit organizations. Ms. Petch serves on the boards of directors of various non-profit organizations.

JOSEPH P. SHANNON
PORT HAWKESBURY, NOVA SCOTIA
President, Atlantic Corporation Ltd.

Joseph Shannon is a member of the Governance Committee of the Board of Governors and has been a member of the Board since 1998. Mr. Shannon is President of Atlantic Corporation Ltd., the parent company of major businesses serving the Atlantic region. He has experience in regulated industries, business development and community development. Mr. Shannon serves as a director or advisor to a number of Cape Breton and Nova Scotia organizations.

CHARLES F. MACFARLANE
TORONTO, ONTARIO
Corporate Director and Consultant

Charles Macfarlane joined the Board of Governors in 2006, after his retirement as Executive Director and Chief Administrative Officer of the Ontario Securities Commission, a position he held from 1998. Mr. Macfarlane is a member of the Financial Advisory Committee of the Board of Governors. He was formerly a senior executive of major Canadian trust companies, including The Royal Trust Company, which he served from 1969 to 1993.

JAMES W. YUEL
SASKATOON, SASKATCHEWAN
Chief Executive Officer, PIC Investment Group Inc.

James Yuel has served on the Board of Governors since 2000 and is a member of the Governance Committee. He is Chief Executive Officer of PIC Investment Group Inc., the parent company for a wide range of businesses based in western Canada. He has extensive experience in strategic business development and global export. Mr. Yuel served for eight years as a board member of the Canadian Chamber of Commerce and is a past President of the Saskatchewan Chamber of Commerce.
THE ROLE OF THE BOARD OF GOVERNORS

The new fund governance rule requires the fund manager to identify the conflicts of interest it faces in the operation of its mutual fund. The manager must establish policies and procedures to address those conflicts. The fund manager bears the obligation to present those conflicts of interest and related policies to the independent review committee, or IRC, of the fund.

As the IRC of the RBC Funds and RBC Private Pools, the role of the Board of Governors is to review conflict of interest matters that are presented to it by RBC Asset Management Inc., including the proposed actions of the fund manager and the manager's related policies and procedures. In some cases, the fund manager cannot act in a conflict of interest matter without the prior approval of the Board of Governors. In others, the fund manager must seek a recommendation of the Board of Governors.

In all reviews of conflict of interest matters, the Board of Governors must consider whether the manager's proposed action achieves a fair and reasonable result for the mutual fund.

Conflict of interest matters comprise a small portion of the decisions made by a fund manager in the operation of its mutual funds. For many years, RBC Asset Management has valued the advice of the Board of Governors regarding other issues impacting the mutual funds. Today, the Board of Governors also continues in its advisory role.

The Chair of the Board of Governors, Lloyd McGinnis, is responsible for managing the mandate, responsibilities and functions of the Board. The Chair is the spokesperson for the Board and acts as chair of all meetings of the Board of Governors.

Due to the number of mutual funds and the complexity of issues considered by the Board of Governors, portions of the work of the Board are conducted through three sub-committees: the Financial Advisory Committee, the Investment Conflicts Committee and the Governance Committee. The sub-committees report on their work to the full Board of Governors.

The four-member Financial Advisory Committee chaired by Mary Ritchie reviews conflict of interest matter policies relating generally to fund financial results and expenses. The Committee also provides advice concerning the relationship with the independent auditor of the mutual funds and financial disclosures.

The Investment Conflicts Committee reviews conflict of interest matter policies regarding fund
investments, in particular those involving related parties. The Committee reviews those policies relating to ongoing actions, such as investments in securities of related parties, which require the approval of the Board of Governors. The Investment Conflicts Committee has three members and is chaired by Michael Thorley.

The fund governance rule requires an IRC to have a written charter setting out its functions and responsibilities, to select members to fill any vacancies, to review and assess the effectiveness of the IRC, its sub-committees and its members, and to set the compensation of its members. The four-member Governance Committee chaired by Elaine Phénix is responsible for advising the Board of Governors on these and other governance issues.

Meetings of the Board of Governors and its sub-committees address a full agenda of issues and receive presentations from executives of the fund manager. Members receive written materials in advance of each meeting. Governors ask questions of executives, participate in discussions, make determinations and provide advice directly to the executive team of the fund manager.

The Board of Governors publishes an annual report to unitholders about its activities for the year.
An independent governing body is particularly valuable to a mutual fund manager, given the manager’s dual responsibility to mutual fund investors and to its own shareholders. It is clear that since the role of the independent board is to speak for the mutual funds and their investors, the members of the oversight board must have an independence of mind, and be able to act objectively. The fund manager has a duty to make management decisions in the best interests of the mutual fund. The role of independent fund governance is to add the voice of mutual fund investors to that decision-making process, particularly in situations involving potential conflicts between the interests of the fund manager and the interests of the mutual fund.

Providing investors with the assurance of independent fund governance can help them have confidence that their interests are being addressed. Independent fund governance allows a review of a mutual fund manager’s proposed activities from the perspective of mutual fund investors. It can be provided in a cost-effective way by a group of individuals, independent of the fund manager, which helps the fund manager to meet its duty to the mutual fund investors.

Members of an independent fund governance body are not involved in the management of the mutual funds they oversee and owe no duty to the fund manager or to its shareholders.

The fund manager is required to put the interests of the mutual funds first and it owes duties both to its shareholders and to the mutual funds it manages.

The independent fund governance board acts exclusively in the best interests of the mutual funds.
we encourage the management team, whose actions we oversee, to demonstrate a culture of integrity and an appropriate ‘tone at the top’.

Lloyd McGinnis, Chair of the Board of Governors

L to R: Brenda J. Vince, M. George Lewis, Daniel E. Chornous, Frank Lippa
## Fund Governance in Action

Highlights of fund governance proceedings under the new rule for the RBC Funds and RBC Private Pools

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<th>Establish Board of Governors as independent review committee and appoint first members</th>
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<td>Financial Advisory Committee</td>
<td>Review conflict of interest matter policies and proposed actions</td>
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<td>Review draft format of year-end fund financial disclosures</td>
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<td>Board of Governors</td>
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<td>Receive fund manager presentations and sub-committee reports on conflict of interest matters and policies</td>
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<td>Grant approvals, recommendations and standing instructions on conflict of interest matters</td>
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<td>Receive external auditor’s report and review year-end fund financial disclosures</td>
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<td>Review proposal for fixed administration fee for RBC Funds</td>
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<td>Approve 2006 Board of Governors reports to unitholders</td>
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<td>Board of Governors</td>
<td>Publish first annual reports from Board of Governors to unitholders of RBC Funds and RBC Private Pools</td>
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<td>Committee</td>
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<td>Financial Advisory Committee</td>
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<td>Board of Governors</td>
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<td>Conduct annual review of Governor independence</td>
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<td>Make determinations on new conflict of interest matters and amendments to existing policies</td>
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<td>Set Governor compensation</td>
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<td>Consider reappointments of Governors with expiring terms</td>
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“We have found that independent fund governance is effective when the fund manager maintains a culture of transparency. Open communication is key to a successful working relationship.”

Elaine Phénix, member of the Board of Governors and Chair of the Governance Committee
For more information about mutual fund governance, please see:
RBC Asset Management www.rbcam.com
Investment Funds Institute of Canada www.ific.ca
Canadian Securities Administrators www.csa-acvm.ca

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