

CSA Notice 81-303
YEAR 2000 DISCLOSURE FOR MUTUAL FUNDS

Introduction

In January 1998, the Canadian Securities Administrators (the "CSA") issued CSA Staff Notice 41-301 (and 51-302) entitled "The Year 2000 Challenge Disclosure Issues" (the "CSA Staff Notice"). In the CSA Staff Notice, the views of the staff of each of the Canadian Securities Administrators ("Staff") on the broad categories of Year 2000 disclosure expected of reporting issuers, including mutual funds, was set out. The Ontario Securities Commission (the "OSC"), on behalf of the CSA, sent a letter to mutual fund managers in March 1998 reminding them of their responsibilities concerning the Year 2000 and requesting managers to consider the disclosure obligations of the mutual funds they managed, in light of the CSA Staff Notice. The purpose of this Notice is to provide additional guidance on Year 2000 disclosure in the specific circumstances of mutual funds and mutual fund managers.

The CSA Staff Notice describes four broad categories of information for disclosure, in order to provide meaningful Year 2000 disclosure:

- the issuer's vulnerability to Year 2000 issues;
- evaluation of the issuer's situation and plans for critical systems;
- status of implementation of the issuer's remediation plans and the expected timing of completion; and
- information about associated costs.

Mutual Fund Prospectus Disclosure

Because of the key role mutual funds play in the financial services industry, Staff believe it is important for the funds and their managers to provide investors with detailed disclosure of their Year 2000 readiness. Mutual funds are generally not required to provide management's discussion and analysis to accompany financial statements, although, in Québec, mutual funds are required to provide in their annual report a brief description of their activities, their important subsidiaries, and a brief management's discussion and analysis to accompany financial statements. Therefore, Staff are of the view that the simplified prospectus is the appropriate document for detailed Year 2000 disclosure.

Over the past year, Staff have been reviewing Year 2000 disclosure provided in preliminary and pro forma simplified prospectuses of mutual funds. Staff have been assessing this disclosure against the discussion contained in the CSA Staff Notice, taking into consideration a mutual fund's and fund manager's specific operations and circumstances.

Staff have noted the following common deficiencies in mutual fund disclosure:

- many mutual funds, especially those managed by fund companies that rely heavily on third party service providers, provide minimal disclosure concerning this third party reliance and how the fund managers are monitoring the progress of the service providers' Year 2000 initiatives;
- disclosure of the costs for remediation of systems and whether those costs will be passed along to the funds was often not presented or was limited to a statement that the costs would be immaterial to the fund(s) and did not itemize these costs;
- contingency plans are not described in detail other than to say the fund manager is developing or has developed a contingency plan;
- the percentage completed, or timetable for completion, of the implementation, testing or remediation and contingency plans are almost never disclosed; and
- the potential impact of the Year 2000 issue on portfolio investments and how this issue affects portfolio management decisions is often not discussed.

Acceptable Year 2000 Disclosure by Mutual Funds

Staff will continue to review Year 2000 disclosure contained in simplified prospectuses until such time as mutual funds and their managers no longer face material Year 2000 issues. To minimize the need for Staff to request additional disclosure during the comment period for renewal or preliminary simplified prospectuses, Staff wish to provide specific guidance about their expectations for Year 2000 disclosure by mutual funds. This guidance identifies the minimum disclosure Staff believe is important to provide a basis for investors to make informed investment decisions. The guidance is not intended to preclude the inclusion of additional information that fund managers feel is appropriate.

The simplified prospectus of a mutual fund should, at a minimum, discuss the following points, as they relate to the specific circumstances of the fund manager's and the fund's operations:

The Fund's vulnerability to Year 2000 Issues

1. The nature of the Year 2000 issue in the context of the operations of the fund and its manager.
2. Any internal exposure of the in-house systems used by the fund manager to the Year 2000 issue that could affect the operations of the fund. For example, the systems used for transfer agency, fund accounting and pricing of the fund should be considered as well as any in-house portfolio management systems.
3. The extent of reliance by the fund and fund manager on third party service providers and the potential impact of Year 2000 issues relating to the service providers on the operations of the fund or the fund manager. For example, are all the operations of the fund performed by a third party service provider? Does the

fund manager rely on external pricing sources in order to determine the net asset value?

4. Is the portfolio manager taking into consideration the Year 2000 issue when making investment decisions? Are current investment holdings, especially those in foreign or developing countries, being reviewed, to the extent possible, for their Year 2000 readiness? Are investment strategies being modified to take into account potential Year 2000 concerns?

Evaluation of the Fund Manager's Situation and Plans for Critical Systems

1. Does the fund manager have a contingency plan? If so, a description of the main elements of that plan should be provided. The fund manager should discuss how it is preparing to handle the most reasonably likely worst case scenarios. Is the plan being updated for new information? If the contingency plan is not in place or not yet completed, what is the time frame for completion?
2. Is the fund manager monitoring the progress of plans made by service providers to achieve Year 2000 compliance? If so, how? Have the service providers tested their systems? Have assurances been obtained from the service providers? How is the fund manager monitoring the development by service providers of contingency plans?

Status of Implementation of the Fund Manager's Remediation Plans

1. The status of testing of mission critical systems (percentage completion), or timetable for completion of testing and remediation planning for in-house systems of the fund manager and/or third party service providers. When will the tested systems be implemented in normal operations?

Costs associated with the Year 2000 Issue

1. The costs associated with the Year 2000 issue. What costs, if any, are being passed along to the fund and on what basis?
2. If applicable, discuss the legal ability of the fund manager to pass along costs associated with the Year 2000 issue to the fund. Explain how the particular costs relate to the relevant legal authority.
3. What impact will these costs have on the fund manager or, if applicable, the mutual fund? If the costs are to be charged to the fund, disclose the percentage impact on the fund's management expense ratio.

Financial Statement Disclosure

Fund managers should note that, in June 1998, the Accounting Standards Board of the CICA issued an Accounting Guideline AcG-10 "The Year 2000 Issue" (the "Guideline"). The Guideline, which applies to all entities preparing financial statements in accordance with generally accepted accounting principles, provides that, as a minimum, financial statements should include disclosure of the inherent uncertainty that the Year 2000 issue causes for an entity's future financial results. The Guideline establishes criteria for additional financial statement disclosure such that the disclosure should be factual and verifiable and consistent with the disclosure on the inherent uncertainties. The Guideline also discusses the going concern implications of the Year 2000 issue and provides examples of other effects that may need to be considered in preparing financial statements.

Fund managers should review the Guideline when preparing Year 2000 disclosure to be included in the notes to the financial statements of the mutual funds.

Consequences of a Mutual Fund Failing to Meet Adequately its Year 2000 Disclosure Obligations

Staff have indicated in their February 19, 1999 CSA Staff Notice 51-303 "CSA Follow-up of Inadequate Year 2000 Disclosure" that failure of reporting issuers to provide appropriate Year 2000 disclosure in a prospectus or annual information form may result in a delay in the issuance of a receipt for a final prospectus or a delay in acceptance for filing of an annual information form as well as other possible regulatory action. This statement is applicable to mutual funds.

Questions may be addressed to any of:

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April 30, 1999