

SWING PRICING

The Securities and Exchange Commission (SEC) adopted Rule 22c-1(a)(3) in October 2016 that permits open-end mutual funds to adopt swing pricing. The new swing pricing rule is designed to protect shareholders from fund dilution and enhance how funds manage liquidity risk.

OVERVIEW: WHAT IS SWING PRICING?

Rule 22c-1(a)(3) permits, but does not require, open-end mutual funds – excluding money market and exchange-traded funds – to adopt swing pricing as an anti-dilution technique, beginning November 19, 2018.

Swing pricing protects existing shareholders against fund dilution by passing transaction costs to purchasing or redeeming shareholders. Swing pricing allows funds to adjust the net asset value (NAV) up or down once purchase or redemption limits are exceeded, called the swing threshold.

When the swing threshold is exceeded, funds can swing the NAV up or down by a fixed amount, called the swing factor. By “swinging” the NAV, transaction costs associated with trading are reflected in the NAV, causing trading investors to bear the costs instead of long-term investors.

What Is Swing Threshold?

The swing threshold is the amount of daily net purchases or net redemptions that must be exceeded before swing pricing can be triggered. The swing threshold is a fixed percentage of a fund’s NAV calculated using daily transaction information.

What Is Swing Factor?

The swing factor is the amount a fund’s NAV per share swings up or down after swing threshold is exceeded. In general, the NAV is swung up for net purchases and swung down for net redemptions. The swing factor may not exceed 2% of a fund’s NAV.

The swing factor accounts for daily trading transactions, placing the burden on trading investors to absorb the costs while preventing long-term investors from dilution.

A key challenge for mutual funds is the timing of swing pricing calculations.

SWING PRICING POLICIES AND PROCEDURES

Swing Threshold

Funds are not required to adopt swing pricing, but those that do must establish written policies and procedures that specify the swing threshold and explain how swing factor is determined.

Share Classes

A fund complex may adopt swing pricing for all, some or none of its funds and must apply it to all share classes – funds are not permitted to apply swing pricing to single share classes.

Board Oversight

A fund's board must approve and review a fund's swing pricing operations, including its swing threshold and swing factor. Boards are not responsible for daily administration and management of a fund's swing pricing operations.

WHAT ARE THE CHALLENGES OF SWING PRICING?

A key challenge for funds is the timing of swing pricing calculations. U.S. funds strike NAVs at close of business, but intermediary flows going through trade processing and settlement may not be available until hours later or the next day, after the NAV is struck. This complicates calculations because the trade information used to calculate NAV – and determine the swing factor – may potentially be incomplete.

IS SWING PRICING RIGHT FOR YOUR FUNDS?

When considering swing pricing, evaluate your distribution models to understand if trade flow data will be available within the limited time frame swing pricing is determined.

Other practical considerations include:

- Costs and benefits of incorporating swing pricing into your liquidity risk management program
- Investor education
- Disclosures and their effect on reporting
- Impact of swing pricing on fund performance
- Adjustments in operational processes needed
- Cash flow estimations and cut-off times

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When determining swing threshold, the SEC's final rule states that funds must consider:

- Size, frequency and volatility of historical net purchases or net redemptions during normal and stressed periods
- Investment strategy and liquidity of the fund's portfolio assets
- Cash, cash equivalents, borrowing arrangements and other funding sources
- Costs associated with transactions in the markets in which the fund invests

NORTHERN TRUST ACTIONS AND NEXT STEPS

Northern Trust's Global Fund Services team has experience supporting clients that adopt swing pricing. We're currently reviewing opportunities to prepare for U.S. adoption of swing pricing. If you have questions about swing pricing, talk to your relationship manager or visit northerntrust.com.