Swing Pricing

Protecting long-term shareholders from the impact of transaction costs resulting from subscription and redemption activity is a significant consideration for fund promoters. Trading activity can dilute shareholders’ interests in a mutual fund because the single price at which investors buy and sell the fund’s shares only reflects the value of its net assets priced by the custodian using a single price.

Dealing costs and spreads that arise as a result of trading the underlying assets of the fund for flows into, and out of, the fund are not taken into account. In consequence, these costs impact all shareholders in the fund, not only those subscribing or redeeming on any dealing day, resulting in dilution of the fund performance.

There are different methodologies that can be applied to a fund to mitigate this dilution effect. These include the application of an anti-dilution levy (ADL) to shares dealt on any dealing day and also the use of Swing Pricing.

From 1 April 2013, State Street Global Advisors (SSGA) has implemented a Swing Pricing mechanism for the majority of funds within its Luxembourg-based fund range, SSGA Luxembourg SICAV. This methodology protects the interests of long-term shareholders from the impact of transaction costs resulting from subscription/redemption activity within the funds. The SSGA Enhanced Emerging Markets Equity and SSGA Emerging Markets SRI Enhanced Equity funds will continue to operate under an ADL on subscription/redemption activity.

What Is Swing Pricing?

As introduced above, swing pricing is an anti-dilution mechanism which protects fund shareholders by countering the dilution effect of subscription and redemption activity. With swing pricing, a single price is issued for the fund and all clients buy and sell shares at this price. This single price incorporates a swing in the Net Asset Value (NAV) of the fund in consideration of subscription and redemption activity on a dealing day. The direction and extent of the swing is dependent on the magnitude and direction of the dealing activity, as described overleaf.

SSGA Luxembourg SICAV

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Basis

Swing pricing can be applied on either a full or partial basis.

- **Full swing** means that the price is swung each day, regardless of the size of the net capital flows.
- **Partial swing** means that the price swings only if the calculated net capital flows exceed a pre-determined threshold.

SSGA’s approach to swing pricing is that we will normally alter the price whenever there are net purchases or net sales in a fund although for certain funds a threshold is employed (partial swing).

Swing Factor and Direction

Practically, the price swings in accordance with the pre-determined swing threshold and the swing factor is set individually for each fund based on market conditions, as well as other elements which influence the overall transaction costs (such as commissions, taxes and other fiscal charges). The swing factor represents the magnitude of the swing, while its direction depends on whether the fund is receiving net inflows or outflows on any particular dealing day.
Swing Pricing | January 2015

- If the day’s dealings within the fund results in a net inflow, the NAV is adjusted upwards.
- If it results in a net outflow, the NAV is adjusted downwards.

Setting the Swing Factor

Swing factors for each fund are both calculated by the administrator of the SSGA Luxembourg SICAV and reviewed by SSGA’s Dilution Effect Review Group on a monthly basis. The calculation of the swing factor is based on an analysis of the bid/offer spreads, broker commissions, fiscal and other applicable trading charges, as well as foreign exchange costs where relevant and will therefore vary across the funds within the SICAV fund range depending on the underlying market exposure for each fund.

Setting the Swing Threshold

Swing thresholds are defined by the SSGA Investment team and are reviewed by the Dilution Effect Review Group on an annual basis. The threshold levels are calculated on a fund-by-fund basis considering the level at which capital activity and related trading within the mutual fund becomes material and dilutes the value of shareholders’ holdings. As with the swing factor, the threshold level will be dependent on the underlying asset class and regional exposure of the fund and will therefore vary across the fund range.

Calculation of the Net Asset Values

The swing effects on the NAV per share are considered by the fund administrator during the normal process of calculating the NAV of the fund. The administrator calculates the NAV as normal and then swings it by a pre-determined amount (the swing factor) if the net dealing activity is above the swing threshold.

If the swing threshold is reached for a fund on any given dealing day, the NAV of the fund is adjusted to include the effects of the net transaction costs, the swing. The direction of the swing is determined by the direction of the daily net capital flows. When there are net capital inflows, the swing factor increases the NAV (to take account of subscriptions of fund units); but where there are net outflows, the swing factor reduces the NAV (to take account of unit redemptions). In both cases, the same NAV applies to all incoming and outgoing investors on a particular date. The swing mechanism thus protects non-dealing shareholders from the trading costs triggered by the dealing shareholders.

Illustrative Example of the Swing Pricing Mechanism

To illustrate, assume the NAV per share of a hypothetical XYZ fund is constant at €100.00. We also assume that there is no market movement during the period. The swing factor for the XYZ fund is set at 0.05% (5 basis points) and the swing threshold for the same fund is set at 5% of its previous trading day’s closing total NAV.

Case 1: A net inflow of 10% of the total NAV

The Fund receives dealing requests resulting in a net cash inflow (net subscriptions) above 5% of the Fund’s NAV from the previous dealing day. Price will swing to €100 plus 0.05% swing adjustment.

Result: price swings upwards and all capital trades for the day will be priced at €100.05.

Case 2: A net outflow of 10% of the total NAV

The Fund receives dealing requests resulting in a net cash outflow (net redemptions) above 5% of the Fund’s NAV from the previous dealing day. Price will swing to €100 minus 0.05% swing adjustment.

Result: price swings downwards and all capital trades for the day will be priced at €99.95.

Case 3: A Subscription order of 2% of the total NAV

The Fund receives dealing requests resulting in a net cash inflow (net subscriptions) below 5% of the Fund’s NAV from the previous dealing day. Price will not swing and remains at the mid-price of €100.

Result: price will not swing and all capital trades for the day will be priced at €100.

Performance

Factsheets for funds in the SSGA Luxembourg SICAV show the performance of the funds gross of fees and gross of the effect of swing pricing. A disclosure will be included on the factsheet to this effect.

Conclusion

SSGA has determined that the application of the swing pricing mechanism to the majority of funds in the SSGA Luxembourg SICAV is the optimal solution to protect long-term shareholders from the dilution effect of capital trading activity. The introduction of the swing pricing mechanism is to ensure that investors subscribing or redeeming from a fund bear the related trading costs associated with their activity and therefore protecting the interests of existing shareholders.

Further Questions

If you have any further questions on Swing Pricing, please contact your SSGA Client Relationship Manager.