Russell OpenWorld®

Russell Investments

Swing pricing: An overview

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Funds in Russell OpenWorld® use Swing Pricing to protect the interests of long term shareholders from the impact of transaction costs resulting from subscription and redemption activities by other shareholders.

Swing pricing is increasingly a frequently used tool to reduce the impact of transaction costs on shareholders.

Introducing swing pricing

When an investor buys or sells shares in an investment fund, the fund incurs dealing costs. Absent a mechanism protecting the interests of other shareholders, these costs are shared across all of the fund's shareholders. As a result, the activity of one shareholder can be to the detriment of other investors in the fund.

Swing pricing is a technique designed to reduce the negative impact of subscriptions and redemptions on "non-trading" investors in a fund. This approach to pricing is being used by a growing number of fund managers.

The purpose of this note is to provide an overview of swing pricing, which is incorporated into the pricing policies for Russell OpenWorld® funds.

How does swing pricing work?

Conceptually, in some respects swing pricing is similar to dual-priced funds that require investors to deal on a bid-offer basis, except that swing pricing is used for single-priced funds. With swing pricing, a single price is issued, and all clients buy and sell at this price. To calculate the dealing price, the funds' administrator calculates the net asset value (NAV) for the fund before consideration of capital activity – subscriptions and redemptions – and then adjusts ("swings") the NAV by a pre-determined amount. The direction of the swing depends on whether the fund is experiencing net inflows or net outflows on the dealing day, while the magnitude of the swing is based on pre-determined estimates of the average trading costs in the asset class.

- If the fund is experiencing net inflows, the NAV is adjusted upwards.
- If the day's dealings generate a net outflow, the NAV is adjusted downwards.

These adjustments serve to insulate non-dealing shareholders from the trading costs triggered by the dealing shareholders.

Swing pricing can be used on either a *full* or *partial* basis. With full swinging, the price swings every day regardless of the size of the net capital flows. With partial swinging, the price swings only if the net capital flows exceed a pre-determined threshold. We will be adopting partial swinging in the Russell OpenWorld® range.

Implications of swing pricing for investors

One of the key principles of swing pricing is that any investor transacting at a volume that would materially impact other fund investors should bear the costs of their trading. The nature of the partial swing pricing mechanism, however, means that if the net trading in the fund does not meet the threshold of materiality, no swing occurs as trading costs do not have a material impact on other shareholders.

The following diagram illustrates the impact of swing pricing on the funds' investors:

Investors in funds using swing pricing never pay more than their own transaction costs – and sometimes they benefit from the swing.

Impact on an Investor Trading on Dealing Day	Price Not Swung	Net Redemptions Exceed Threshold: Price Swings Downward	Net Subscriptions Exceed Threshold: Price Swings Upward
If Subscribing:	Trader benefits; no material impact on long term shareholders	Trader benefits; no material impact on long term shareholders	Trader pays own transaction costs; no material impact on long term shareholders
If Redeeming:	Trader benefits; no material impact on long term shareholders	Trader pays own transaction costs; no material impact on long term shareholders	Trader benefits; no material impact on long term shareholders

Price Swinging Status on Dealing Day

As the diagram illustrates, the price swinging mechanism always protects the interests of longer term shareholders in the fund. The only time that the price swings against an investor transacting is when the investor is redeeming on a day in which net cashflows in the fund exceed the pre-determined redemption threshold, or when the investor is subscribing on a day in which cashflows in the fund exceed the pre-determined net subscription threshold. However, in either of these cases, the result is that the investor pays their own estimated transaction costs (and no more).

Investors should also note that in the event that they subscribe on a day in which the net cashflow exceeds the redemption threshold, the price swing will move in their favour. Similarly, if they redeem on a day when the price is swung upward due to a high level of subscriptions by other investors, they will redeem at a beneficial NAV.

The mechanics: determining swing magnitude and thresholds

The extent to which prices are swung depends on the costs of trading in the particular asset class. To determine the extent of price swing for a particular fund, Russell's investment team calculates a swing adjustment factor based on broker commissions, taxes and other trading-related charges, and foreign exchange costs where relevant. The investment team then makes a recommendation to Russell's Pricing Committee, who makes the final determination. The Committee also sets the threshold of net subscriptions or redemptions which will trigger price swinging. Swing adjustment factors and thresholds are reviewed on a regular basis.

Price swings for most OpenWorld® funds are not expected to exceed 1.5%.

Common with industry best practice to reduce the chance that some investors may try to "game" their trading activity in the funds, it is not our intention to notify investors in advance if the thresholds or swing factors change. However, details are available on request.

Other implications of swing pricing

Investors should be aware of the impact of price swinging on a number of aspects of a fund's administration and performance:

Performance is measured on swung prices. Swing pricing can inflate a fund's risk statistics.

- Performance is measured and reported using swung prices. Since it is possible that prices could have swung on either or both the initial or ending date over a period in which performance is being measured, it is possible that the returns of the fund are influenced by trading activity in the fund, as well as the performance of the fund's investments.
- Price swinging can increase the variability of the fund's returns, causing the fund to appear to have slightly higher risk levels than would be expected based on the underlying holdings. However, as price swinging benefits a fund's long term investors, best practice is to measure performance based on the swung price.
- Performance-related fees are not based on swung prices. Performance fees are intended to remunerate managers based on the success of their investment decisions, and should not be influenced by fund investors' transaction activity. Also, as performance fees are crystallised on specific dates, if the fee was based on a swung price the amount of the fee could be materially distorted. Therefore, performance fees are calculated using un-swung (and un-published) prices. This process is, of course, monitored carefully by the funds' auditors.

Swing pricing is implemented at fund level, not share class level.

- Russell OpenWorld® funds have multiple share classes that invest in the same pool of assets in the fund. The price swing is implemented at the fund level based on net trading activity and associated transaction costs. As the costs are incurred by the fund rather than the share class, the swing is implemented at the fund rather than class level. All share classes are therefore swung by similar percentages.

Conclusion

We recognise that for many clients, price swinging is a new concept. However, we believe it provides a useful compromise between the need to protect the interests of our funds' long term investors and the desire of many of our investors to deal in single priced funds without incurring a separate transaction charge such as an anti-dilution levy.

If you have any further questions about price swinging, please contact your usual Russell representative.

Example of price swinging in action

In this example, we assume there is no market movement and the mid price of the hypothetical fund each day is constant at $10.00. We also assume cash flows exceeding 3% of the Fund's previous trading day's closing Net Asset Value trigger a price swing, and that the price swing adjustment factor on subscriptions and redemptions in excess of the 3% trigger threshold is 0.50%.

Day 1

Fund receives net cash flows less than 3% of the Fund's Net Asset Value from the previous dealing day

⇒ No price swing: all trades for the day are priced at the Fund's Closing Mid Price of $10.00

Day 2

Fund receives cash flows resulting in net redemptions greater than 3% of the previous day's Net Asset Value

Bid or Selling Price = $10.00 (Mid price) less 0.50% swing adjustment factor

⇒ All trades for the day are priced at $9.95

Day 3

Fund receives cash flows resulting in net subscriptions greater than 3% of the previous day's Net Asset Value

Offer or Buying Price = $10.00 (Mid price) plus 0.50% swing adjustment factor

⇒ All trades for the day are priced at $10.05

For more information:

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