Evaluating Swing Pricing: Operational Considerations

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Background and Purpose

In October 2016, the Securities and Exchange Commission (SEC) amended Rule 22c-1 of the Investment Company Act of 1940 ('40 Act) to permit, but not require, mutual funds (except for money market funds) to use swing pricing.[1] The SEC believes that swing pricing could be an effective tool in mitigating potential shareholder dilution, and may be an additional tool to manage a fund's liquidity risk.

Implementing swing pricing will require a fund to address and overcome significant operational hurdles, and doing so is likely to be complex and multifaceted. The operational considerations outlined below are intended to assist funds that may be considering whether implementation of swing pricing is feasible. Funds considering whether to use swing pricing should conduct a careful and deliberate analysis of their business model, examine possible effects on their intermediary partners, and evaluate the impact on their shareholder bases.

What Is Swing Pricing?

Swing pricing is viewed as a means of enabling funds to more equitably allocate portfolio transaction costs attributable to large shareholder purchase or redemption orders. Through adjustments to a fund's daily per-share net asset value (NAV), swing pricing causes purchasing or redeeming shareholders, rather than the fund, to bear estimated portfolio transaction costs attributable to their activity.

Under swing pricing, a fund would adjust its NAV per share by a swing factor[2] once the level of net purchases into, or net redemptions[3] from, the fund exceeds a predetermined swing threshold.[4] In effect, swing pricing involves a second step in the valuation process, whereby a fund measures daily net purchase or redemption activity and adjusts (or swings) the per-share NAV. The NAV adjusts upward in the case of a (sizable) net purchase of fund shares or downward in the case of a (sizable) net redemption of fund shares (so that transacting shareholders bear the transaction costs from resulting purchases or sales of portfolio investments).

1 *Investment Company Swing Pricing*, SEC Release No. IC-32316 (Oct. 13, 2016) (referred to in this paper as the *release*), available at www.sec.gov/rules/final/2016/33-10234.pdf. For a detailed summary of the final amendments, see Institute Memorandum no. 30333, dated October 21, 2016.

2 See infra, note 6 and accompanying text, for the SEC's definition of *swing factor*.

3 A fund would need net fund flow information, or sufficient information, to reasonably estimate whether it has crossed the swing threshold with high confidence before the time it releases its NAV for share trade processing so that it could make any necessary NAV adjustments.

4 See infra, note 7 and accompanying text, for the SEC's definition of swing threshold.

Summary of SEC's Swing Pricing Rule Amendments

The key provisions of the SEC's final swing pricing rule amendments[5] include the following:

- Policies and procedures: A fund that chooses to use swing pricing must establish and implement swing pricing policies and procedures to mitigate dilution. Those policies and procedures must provide that the fund adjust its NAV per share by a single or multiple swing factors[6] once the level of net purchases into or net redemptions from the fund exceeds an applicable swing threshold.[7]
- Board review and approval: The fund's board, including a majority of the independent directors, must approve:
  (i) the fund's swing pricing policies and procedures;
  (ii) the fund's swing threshold(s) and the upper limit on the swing factor(s) used, and any changes to the swing threshold(s) or the upper limit on the swing factor(s) used; and
  (iii) the designation of the fund's investment adviser or person(s) responsible for administering the swing pricing policies and procedures (known as the *administrator*). The board also must review, no less frequently than annually, a written report prepared by the administrator.[8]
- Reporting: Standardized total returns included in the fund's registration statement and financial statements are based on the generally accepted accounting principles (GAAP) NAV, which includes the cumulative effects of swing pricing through the period along with financial reporting adjustments. The per-share impact of amounts retained by the fund due to swing pricing must be included in the fund's disclosures of per-share operating performance.

5 In response to the proposal, ICI submitted an extensive comment letter that addressed various elements of swing pricing, including ICI members' diverse views on swing pricing, operational impediments to swing pricing in the United States, general considerations regarding swing pricing, and specific comments on the swing pricing amendments. See letter from David W. Blass, General Counsel, Investment Company Institute, to Brent J. Fields, Secretary, SEC, dated January 13, 2016, pages 54–69 and Appendices D and E, available at www.sec.gov/comments/s7-16-15/s71615-54.pdf.

6 The swing factor is the amount, expressed as a percentage of the fund's NAV and determined pursuant to the fund's swing pricing procedures, by which the fund adjusts its NAV per share once net purchases or redemptions exceed the applicable swing threshold. A fund must consider the following factors in setting its swing factor(s): (i) the establishment of an upper limit on the swing factor(s) used, which may not exceed 2 percent of the NAV per share; and (ii) the determination that the factor(s) used are reasonable in relationship to the applicable near-term costs. In setting the swing factor and upper limit, the administrator (the person(s) responsible for administering the swing pricing policies and procedures) may consider only near-term costs expected to be incurred by the fund as a result of net purchases or net redemptions that occur on the day the swing factor(s) is used, including spread costs, transaction fees and charges arising from asset purchases or asset sales resulting from those purchases or redemptions, and borrowing-related costs associated with satisfying redemptions.

7 The swing threshold is the amount of net purchases or redemptions of fund shares, expressed as a percentage of the fund's NAV, that triggers swing pricing. The amendments impose a partial swing pricing methodology (i.e., by requiring a threshold, a fund's NAV per share will not swing on those days that net flows fall short of it), although they do not stipulate a minimum threshold amount. A fund must consider the following factors in setting its threshold: (i) the size, frequency, and volatility of historical net purchases or net redemptions of fund shares during normal and stressed periods; (ii) the fund's investment strategy and the liquidity of its portfolio investments; (iii) the fund's holdings of cash and cash equivalents, and borrowing arrangements and other funding sources; and (iv) the costs associated with transactions in the markets in which the fund invests.

8 The report must describe (i) the administrator's review of the adequacy of the fund's swing pricing policies and procedures and the effectiveness of their implementation, including the impact on mitigating dilution; (ii) any material changes to the fund's swing pricing policies and procedures since the date of the last report; and (iii) the administrator's review and assessment of the fund's swing threshold(s), swing factor(s), and swing factor upper limit considering the applicable requirements, including the information and data supporting the determination of the swing threshold(s), swing factor(s), and swing factor upper limit.

Changes in the Final Amendments

The final amendments broadly resemble the proposed amendments. However, the final amendments differ in that they:

» Require funds to establish and disclose a swing factor upper limit, which may not exceed 2 percent of the fund's NAV per share

» Permit the use of multiple swing factors and swing thresholds

» Eliminate the consideration of "market impact" when setting a fund's swing factor

» Refine certain financial statement and performance reporting requirements related to swing pricing

The rule amendments will become effective on November 19, 2018. The SEC believes that this period will allow the industry to address the necessary changes to operations and systems and will help alleviate competitive concerns.

Benefits and Disadvantages of Swing Pricing

The SEC believes that swing pricing could be a useful tool in mitigating potential dilution of fund shareholders and managing fund liquidity. Nevertheless, the SEC and others recognize possible benefits and disadvantages.

Potential Benefits

» Mitigation of potential dilution arising from fund share purchase and redemption activity and more equitable treatment of fund shareholders

» Preservation of investment returns (by externalizing transaction costs)

» Advantages relative to other anti-dilution measures (e.g., redemption fees might require coordination with service providers)[9]

» Potential deterrence of redemptions motivated by any first-mover advantage

Potential Disadvantages

» Increased performance volatility and tracking error

» Inability to know in advance the precise impact of swing pricing on particular purchase and redemption requests, and resulting lack of transparency to investors

» On a day when the NAV swings, all orders receive the same adjusted NAV, regardless of whether the size of an individual shareholder's order alone (which could be quite small) would create material trading costs for the fund

» The potential for inappropriate disclosure of a new type of material nonpublic information (e.g., information about the swing pricing methodology and fund flows)

» Disincentive for large institutional investors to provide advance notice of significant redemptions or purchases (large shareholders might instead stagger purchases or redemptions over a number of days in an effort to avoid swinging the NAV to their detriment)

» Lack of precision in accounting for the transaction costs that result from shareholder purchase and redemption activity

[9] Whatever the relative merits of using redemption fees or swing pricing, each requires extensive coordination between funds and their intermediary partners.

Swing Pricing in Europe: A Model for the United States?

In the release, the SEC noted that swing pricing has been used successfully in Europe for several years. Indeed, some funds (especially funds domiciled in the United Kingdom, Ireland, and Luxembourg) use swing pricing in Europe,[10] in part because their operating models and distribution infrastructure permit them to obtain or derive accurate estimates of, or actual information about, capital flows before the time they calculate their NAVs. The timing of order receipt, the types of orders received, and the time at which fund valuation occurs all contribute to successful use of swing pricing in Europe.

These conditions or practices differ markedly from those in the United States, however, and not all European practices are easily replicated in the United States. For example, in many instances, European funds employ multiple trading cutoff times—specifically, earlier times apply to manual and intermediary orders, and to orders requiring foreign currency exchange. Thus, European funds have received most daily trading activity in their shares shortly after the market close, which creates far greater certainty in cash flow estimates than in the US fund market, where complete fund flow information is not available until after overnight processing is finalized on the majority of fund orders.

Operational Impediments to Swing Pricing in the United States

To adopt swing pricing in the United States, a fund would need some means of obtaining timely and reasonably accurate daily fund flow information. Without it, the fund would be unable to determine with high confidence whether it has crossed its swing threshold on a given day.

Calculation and Dissemination of NAV

Rule 22c-1(a) under the '40 Act requires funds and dealers in fund shares to transact fund shares at the NAV next computed after receipt of an order to buy or redeem.[11] In calculating a fund's NAV, the fund manager follows established, board-approved valuation policies and procedures. In practice, funds commonly cut off orders, value all portfolio investments, and price their shares as of 4:00 p.m. (ET).[12]

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10 See generally Swing Pricing, Association of the Luxembourg Fund Industry (December 2015) ("ALFI Swing Pricing Guidelines"), available at www.alfi.lu/sites/alfi.lu/files/Swing-Pricing-guidelines-final.pdf, for a discussion of swing pricing practices of Luxembourg-domiciled funds.

11 Additionally, Rule 22c-1(b)(1) states, "The current net asset value of any such security shall be computed no less frequently than once daily, Monday through Friday, at the specific time or times during the day that the board of directors of the investment company sets…."

12 Some funds stipulate a fixed time—for example, 4:00 p.m. (ET). Others stipulate that they will stop accepting orders and price their shares as of the close of trading on the New York Stock Exchange (NYSE). Most of the time, these policies will yield the same result, because the NYSE ordinarily closes at 4:00 p.m. (ET).

Near the end of each business day, the fund accountant (which can be the fund manager or a different service provider) transmits a file listing the fund's portfolio investments to a pricing vendor. The vendor inserts the current market price[13] for each investment into the file and transmits it to the fund accountant. The fund accountant then applies a series of controls to validate the prices received. After researching and resolving any exceptions generated by the controls, the fund accountant uses the reviewed prices (and fair values, as necessary) to value the fund's investments and calculate its NAV. The NAV then is disseminated through a variety of methods to the fund's transfer agent, intermediary distribution partners, media outlets, and shareholders, ordinarily between 6:00 p.m. and 8:00 p.m. (ET).

Impact of Intermediary Relationships

Currently, intermediaries such as broker-dealers, retirement recordkeepers, and bank trust departments generate the majority of most funds' order volume and fund flow activity.[14] Typically, the intermediary transmits aggregated trades following the fund's trade cutoff time, in accordance with applicable prospectus provisions, regulations, and agreements with the fund. Intermediaries provide, at most, limited intraday order flow information.[15] Some funds have developed a process with their transfer agents to receive intraday order flow information, although generally these data reflect only activity from shareholders that place orders directly with the transfer agent and exclude most, or all, of the activity from intermediary-serviced shareholders.

Critical daily information flows from intermediaries to funds and also from funds to intermediaries. Many intermediary systems require receipt of the daily closing NAV to initiate transaction processing.[16] This is because not all orders that intermediaries receive from their clients are in dollars—they also may be denominated in shares or percentages of holdings.[17] Receipt of a fund's daily NAV is essential to process transactions based on shares and percentages.

13 If a pricing vendor does not have a price for an investment, the fund would fair value the investment (i.e., make a good faith determination of the amount for which the security could be sold in a current transaction).

14 Fund/SERV® is a service of the National Securities Clearing Corporation (NSCC)—a subsidiary of the Depository Trust & Clearing Corporation (DTCC)—and is most commonly used for clearance and settlement of mutual fund share transactions submitted by intermediaries to funds. In 2015, Fund/SERV® settled $5 trillion in more than 219 million mutual fund share transactions, according to the Depository Trust & Clearing Corporation's *2015 Annual Report*.

15 If an order will exceed a previously communicated dollar threshold, some intermediaries provide prior notification of these large trades (such as a future-dated retirement plan rebalancing or lineup change) to the fund. These notifications of activity that has not yet occurred typically are handled through manual procedures and are provided on a "best efforts" only basis.

16 Although trade processing is dependent upon receipt of a fund's closing NAV, intermediaries comply with Rule 22c-1 regarding the receipt of trade instructions in good order by the required fund cutoff time.

17 For example, if clients decide to rebalance their accounts to achieve a revised asset allocation (i.e., X percent equity, X percent fixed income), a NAV is needed for each fund in the account to determine the purchase and redemption transactions necessary to reach the new allocation.

Impact to Intermediaries' Systems

Ideally, a fund would receive all actual transaction flows from all of its intermediaries before the time to decide whether the swing threshold had been exceeded; however, it is highly unlikely that all intermediaries will be able to provide full actual flow information in this way. In recognition of this, the final amendments indicate that a fund may determine that its shareholder flows have crossed the swing threshold based on receipt of sufficient information about daily purchase and redemption activity to allow the fund to reasonably estimate, with high confidence,[18] whether it has crossed the swing threshold.

Regardless of the policies and procedures developed by a fund to determine if the swing threshold has been crossed, intermediaries' systems, as currently structured, present challenges.

For intermediaries to be able to disseminate cash flow estimates before receipt of daily fund NAVs would require extensive reengineering of their systems. Some intermediary systems do not initiate their end-of-day batch processing until all NAVs are received for the funds offered on their platforms. A complete set of NAVs is necessary to process exchange transactions[19] and to provide shareholders with same-day account balances. In addition, many intermediaries use the trading and technology capabilities of other intermediaries (e.g., clearing dealers, retirement platforms) to deliver transactions to funds. These clearing entities must incorporate all activity from underlying tier(s) of intermediaries, before creating aggregate purchase and/or redemption transactions for transmission to funds during the overnight hours. Consequently, a delay in transmitting a NAV for a single fund can adversely affect the ability of intermediaries or clearing entities to disseminate final transaction data to all of the funds on their platforms.

A unique version of omnibus intermediary processing occurs for tax-deferred qualified retirement plan accounts (e.g., 401(k) and 403(b) plans). Retirement plan recordkeepers receive instructions[20] from plan participants to buy or sell shares held in the plan. These instructions require the current day's NAV for conversion into purchase and redemption transactions. Once the orders are created, these transactions must be evaluated against the retirement plan's own rules for determining a valid transaction; the applicability of a plan rule could vary based on the NAV used for the order calculation.[21] When the order complies with plan guidelines, the transaction can be submitted to the fund for processing.

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[18] The release states, "We acknowledge that full information about shareholder flows is not likely to be available to funds by the time such funds need to make the decision as to whether the swing threshold has been crossed, but we do not believe that complete information is necessary to make a reasonable high confidence estimate. Instead, a fund may determine its shareholder flows have crossed the swing threshold based on receipt of sufficient information about the fund shareholders' daily purchase and redemption transaction activity to allow the fund to reasonably estimate, with high confidence, whether it has crossed the swing threshold." See pages 55–58 of the release for SEC guidance related to making reasonable estimates.

[19] In an exchange, the redemption proceeds from one fund are used to acquire shares of a second fund.

[20] An example of an instruction would be to rebalance an investor's 401(k) plan holdings to a target asset allocation or model portfolio. First, each position must be valued, and then appropriate buy/sell/exchange transactions are created and processed to align the investor's account balances to the allocation model targets.

[21] Retirement plan documents identify the specific criteria that must be applied to orders before the order can be released to the fund for processing (e.g., applying contribution limits, loan transaction guidelines, hardship distribution eligibility).

Under these current system structures, funds typically receive most aggregate purchase and redemption transactions reflecting omnibus[22] intermediary customers' activity no later than 6:00 a.m. (ET) the following morning for processing.

Because of these current operational conventions in the United States, a fund wishing to incorporate swing pricing faces a classic "chicken-and-egg" conundrum. That is, a fund needs timely and accurate fund flow information from intermediaries to calculate and disseminate its daily NAV, but in many cases intermediaries need a NAV from the fund before finalizing and disseminating final daily flow information to the fund.

As one possible means of arriving at reasonable estimates of fund flows, the release suggests applying the previous day's NAV to current transaction activity. But this too would require extensive intermediary system enhancements, because intermediaries' current systems have numerous controls in place to prevent the use of stale or prior day NAVs.

Operational Considerations: Can You Make Swing Pricing Work?

If a fund is considering using swing pricing, it may choose to undertake some or all of the following steps:

- Know your intermediaries: An intermediary's ability to provide timely fund flow information in a swing pricing environment will be affected by both its type (e.g., broker-dealer, clearing firm, retirement plan recordkeeper) and the account structures used (e.g., omnibus, NSCC Networking,[23] direct-at-fund). Therefore, when assessing the use of swing pricing, funds should consider:
  - The types of intermediary partners they have and the account structures used, along with the percentages of fund assets attributable to each
  - Time(s) of day when intermediaries generally send trade activity to the fund (e.g., in which NSCC Fund/SERV cycle the majority of trading takes place)
  - The method(s) used by intermediaries to place trade activity (through NSCC only, phone, fax, and interface outside the NSCC)
- Know your account base: Assess your account base in order to gain insight into the timing of trade flows. Retirement plan activity tends to be received in the later trading cycles (often in the last cycle of the day) because of the nature of recordkeepers' processing models and systems. Retail or taxable account trading activity occurs at various points throughout the day, and flows are often known closer to the fund's designated closing time. Additionally, the percentage of accounts and fund assets held directly at the fund may affect a fund's ability to understand overall flows earlier in the day.

[22] Under this model, an omnibus account includes the shares of multiple investors—sometimes numbering in the thousands—that are customers of the intermediary. Omnibus accounts are held on the books of a fund in the name of the intermediary, acting on behalf of its customers. When an intermediary submits its transactions for an omnibus account, it usually consolidates the transactions of all customers who are purchasing or redeeming shares of the same fund that day into one or a few "summary" transactions for processing by the fund.

[23] The NSCC Networking service supports the exchange and reconciliation of investor account activity data.

- Know your flows: Understand the typical timing of the trade flows to help assess swing pricing challenges. Because receipt of flow information is fundamental to determining whether to swing the NAV on any given day, a fund could ask:
  - When does it receive the majority of the day's trade activity?
  - Which Fund/SERV activity cycle(s) include the majority of the day's trade activity? In which cycles are the volumes concentrated?
  - Which intermediaries generate the most flows and at what time?
  - Are there any patterns (e.g., payroll processing, program rebalances) that would assist in estimating future flows?
  - What is the degree of predictability associated with each of the above?
- Talk to intermediary partners about current and potential capabilities: Under the rule, intermediaries are not obligated to furnish final fund flow information (or estimates) to funds by a particular time. Therefore, funds must rely on intermediaries to do so voluntarily. Funds considering swing pricing may discuss swing pricing with intermediaries/recordkeepers and any accommodations they may be able to make to provide flow information (including estimates) earlier than the current norm. Potential discussion topics include:
  - When do intermediaries currently receive the majority of trade activity from their investors?
  - Can changes be made to provide funds with the trade activity earlier that do not require extensive system changes?
  - Can the intermediary provide a reasonable estimate of the day's activity? If so, as of when?
  - What are the intermediary's NAV needs (e.g., does it need the NAV before transmitting trade activity)?
  - Can the intermediary provide sufficient current flow information that would allow the fund to use the prior day's NAV for estimation purposes? If so, as of when?
  - What dependencies do introducing intermediaries create in the clearing dealer's or retirement platform's ability to deliver estimates?
- Conduct a live exercise: Funds should consider conducting real-time simulations of swing pricing using a week or several weeks of current data. This will help funds understand what flow data are available at 4:00 or 4:30 p.m. (ET) (or other specified times) and whether and to what extent the NAV should swing. This testing can continue periodically and include additional flows in order to comprehensively evaluate the potential impact of swing pricing scenarios. Additionally, this testing could serve to validate lessons learned during the "know your flow" exercise described above. These two exercises together could help a fund determine the time at which it could reasonably estimate with high confidence whether it has crossed the swing threshold, and whether that time occurs before the cutoff for calculating and disseminating the fund's daily NAV.

- Evaluate the impact of swing pricing on fund cutoff times for accepting trades: In light of the operational challenges, funds may consider adopting earlier cutoff times for trading and pricing, asking the following:
  - Will an earlier cutoff time assist with the implementation of swing pricing?
  - Will an earlier cutoff time affect shareholders if trades that normally would have been priced on day of receipt are priced on the following trade date due to an earlier trade cutoff time?
  - Would an earlier cutoff time otherwise be viewed unfavorably by shareholders?
- Evaluate the ability to obtain reasonable estimates: Though the final amendments do not contain a safe harbor for liabilities as the result of a decision to swing the price based upon estimated flows, the release notes that a fund may determine its shareholder flows have crossed the swing threshold based on receipt of sufficient information about the fund shareholder's daily purchase and redemption transaction activity to allow the fund to reasonably estimate, with high confidence, whether it has crossed the swing threshold.[24] The release contemplates the use of the previous day's NAV applied to current transaction activity as one possible means of arriving at a reasonable estimate. Therefore, funds should determine if (and as of what time each day) reasonable estimates can be obtained from a sufficiently large number of intermediaries as a means of complementing actual fund flow information. The factors outlined above may assist with that determination.
- Identify all touchpoints within your NAV calculation process and how swing pricing would affect them, asking the following:
  - Which internal or external entities or parties are involved?
  - At what point in the process is each party involved?
  - What inputs (including flows) are needed at what point(s) to determine if the threshold has been exceeded and if the price should swing?
  - What systems changes may be required to support the application of swing factors to a calculated NAV?
- Determine what the swing pricing decision point would look like, asking the following:
  - What are the triggers or threshold?
  - Is it automatic or is manual intervention needed?
  - Who is involved in the determination process?
  - Who (e.g., Valuation Committee, transfer agent) needs to be notified if the threshold is triggered?
  - Who will likely serve as the person(s) designated by the board to be responsible for administering the swing pricing policies and procedures and for determining the swing factor?
  - Which entity will be responsible for storing the original and adjusted calculated NAVs for recordkeeping purposes?
  - What system enhancements may be needed for calculation and recordkeeping purposes?

[24] See supra, note 19 and accompanying text.

- Assess the need for policies and procedures for back-testing of the estimate process and related systems to assess accuracy and determine whether operational changes are warranted.
- Assess how swing pricing affects the delivery of NAVs to downstream systems, affiliates, and intermediaries, including whether or not the overall window for delivery may change.[25]
- Determine how swing pricing affects the fund's valuation policies, asking the following:
  - What is the best way to incorporate or make reference to swing pricing within a policy?
  - What is the impact on existing pricing error policies?
  - What constitutes a pricing error in relation to the use of swing pricing?[26]
  - How should swing pricing be accounted for in a fund's NAV correction/error policy (e.g., the use of estimates, what constitutes an error in this context, and under what circumstances would transactions be reprocessed)?
- Consider the impact to the fund's financial reporting and total return calculations, asking the following:
  - How will swing pricing be reflected in the fund's balance sheet, statement of changes in net assets, financial statement notes, and financial highlights?
  - How will swing pricing be incorporated into total return calculations and reported through all channels?
- Determine the impact of swing pricing to the fund's disclosures, including the prospectus, shareholder report, website, other marketing materials, and shareholder account statements, asking the following:
  - Are shareholders receiving sufficient disclosure about the risks of swing pricing (including what will constitute an "error," the risk of NAV miscalculations, and how the fund will handle them) in the prospectus?
- Consider the recordkeeping requirements outlined within the final rule, including which information and documents must be maintained and the period of time they must be maintained.[27]

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25 In a letter to the SEC, the Global Association of Risk Professionals (GARP) recommended, among other things, shifting the NAV publication time from 6:00 p.m. (ET) to 8:00 p.m. (ET). The GARP letter is available at www.sec.gov/comments/s7-16-15/s71615-33.pdf.

26 The release states that fund management with oversight by the fund's board is in the best position to tailor and oversee any error correction policies that may relate to swing pricing. It also states, "We believe that as long as the fund has followed reasonable practices, policies, and procedures in gathering sufficient information in determining whether net investor flows (which may include reasonable estimates) have exceeded the applicable threshold used for swing pricing, such differences [in actual versus estimated net flows] would not in and of itself result in a determination of a NAV pricing error requiring reprocessing of transactions or a financial statement adjustment to the fund's NAV." (See the release at page 110.)

27 Among other items, a fund must maintain its swing pricing policies and procedures for six years under the amendments to Rule 22c-1. Additionally, the SEC's amendments to Rule 31a-2 under the '40 Act require a fund that uses swing pricing to preserve records evidencing and supporting each computation of an adjustment to the NAV of the fund's shares based on the fund's swing pricing policies and procedures.

Consider the following with respect to fund boards of directors:

- Education regarding swing pricing, including potential benefits/disadvantages, and operational challenges/limitations. The relative advantages and disadvantages (and thus the desirability of swing pricing) may vary by fund, and fund management may recommend swing pricing for some funds but not others.
- Information or data points (e.g., historical information about fund flows or transaction costs) to support the board's obligations regarding the approval of swing pricing policies and procedures, the swing threshold, and the swing factor upper limit
- Recommendation regarding the appropriate party or parties to be designated by the board to serve as administrator of the fund's swing pricing policies and procedures, such as a committee or an individual
- Board reporting[28]
    - The frequency of board review of swing pricing
        - Concurrent with discussion of other valuation policies
        - At an established frequency, especially in early days of swing pricing use
        - At regularly scheduled meetings, but only if a NAV has swung
    - The frequency of receipt of reports about the use of swing pricing and the content of those reports

Conclusion

The considerations outlined above are based on the final rule amendments and the existing market structure. As the industry moves forward in exploring the use of swing pricing and how it may be implemented, it is likely that these considerations will change. To support members' analysis of swing pricing, ICI will continue to work with members on an ongoing basis.

[28] The final rule specifies that the fund's board of directors review, at least annually, a written report prepared by the administrator. The final rule also lays out the minimum requirements for such reports. See supra, note 8 and accompanying text.

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