Commission de Surveillance du Secteur Financier

Swing Pricing Mechanism - FAQ

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Introduction

Please find hereafter a list of questions / answers in relation to the swing pricing mechanism (applied similarly to dilution levy).

The principles outlined below apply to all regulated funds in Luxembourg (UCITS, UCI part II, SIF) which apply the swing pricing mechanism (hereafter “UCI”).

Where changes are required to the UCI’s prospectus, articles of association or management regulation, these should be included at the next update.

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Swing Pricing Mechanism - FAQ

1. Should the articles of incorporation or the management regulations of a UCI provide for the use of the swing pricing mechanism?

30 July 2019

The articles of incorporation or the management regulations of a UCI should permit adjustments to the net asset value in order to counter the dilution effects of capital activity.

2. What information should be mentioned in the prospectus of a UCI in relation to the application of the swing pricing mechanism?

30 July 2019

The prospectus of a UCI should, at a minimum, provide a description of the following items in relation to the application of the swing pricing mechanism:

- the swing pricing mechanism, including details on the NAV adjustment mechanism in case of net subscriptions (inflows) or redemptions (outflows), the use of any specific subscription / redemption threshold before the swing pricing mechanism becomes applicable (i.e. whether partial or full swing pricing mechanism is utilised);
- the reasons for applying the swing pricing mechanism, including notably the benefits for the investors;
- the impacts of using the swing pricing mechanism, including notably the impact on the subscribing and redeeming investors and the fact that the swing pricing mechanism is applied on the capital activity at the level of the UCI and does not address the specific circumstances of each individual investor transaction;
- the maximum swing factor applicable (as a percentage of the NAV or in monetary value); UCIs can differentiate in this context between normal and unusual market conditions if they provide a precise definition of unusual market conditions (e.g. higher market volatility);
- an indication of the components underlying the swing factor, e.g. the bid/ask spread, transaction costs, transaction taxes and other tax related matters, market impact, etc.;
- an indication of the decision process and the decision makers approving the swing factor to be applied;
- the sub-funds of a UCI in scope of the swing pricing mechanism (this information may be shared as well through a reference to a website).

Finally, it is recommended to disclose in the prospectus that any performance fee will be charged on the basis of the unswung NAV.

3. Should the annual and semi-annual report of a UCI provide for disclosure in relation to the use of the swing pricing mechanism?

30 July 2019

Yes.

The annual and semi-annual report of a UCI should provide for a description of the swing pricing mechanism, thereby covering at a minimum the following items:

- the swing pricing mechanism, including details on the NAV adjustment mechanism in case of net subscriptions (inflows) or redemptions (outflows), the use of any specific subscription / redemption threshold before the swing pricing mechanism becomes applicable (i.e. whether partial or full swing pricing mechanism is utilised);
- the maximum swing factor applicable (as a percentage of the NAV or in monetary value); UCIs can differentiate in this context between normal and unusual market conditions if they provide a precise definition of unusual market conditions (e.g. higher market volatility).

In addition, the list of sub-funds of a UCI that have applied the mechanism (whether the NAV has swung or not) during the financial period should be made available to the investors. This information should be provided either directly in the annual and semi-annual report or by referencing an appropriate website in the annual and semi-annual report.

4. Does the CSSF Circular 02/77 apply to an administrative error in relation to the application of the swing pricing mechanism?

30 July 2019

Yes.

If an administrative error (e.g. the swing factor applied was not the one approved by the governing body or the UCI was swung in the wrong direction) in relation to the application of the swing pricing mechanism leads to a material NAV calculation error in accordance with CSSF Circular 02/77, the procedures relating to the correction of calculation errors as set forth in that Circular have to be followed, including the determination of the financial impact of the NAV calculation error and the compensation of the prejudice which results from the calculation error for the UCI and/or its investors.

If the impact of the swing pricing mechanism error is below the materiality threshold as determined in accordance with CSSF Circular 02/77, the CSSF still considers that the UCI should be compensated when it was not protected from the level of dilution it should have been, had the swing pricing mechanism policy approved by the Board of Directors of the investment fund manager and, if applicable, the Board of Directors of the UCI and set out in the prospectus been applied properly.

For illustrative purposes, we consider the example of an administrative error where a swing factor applied, has a non-material impact on the NAV in accordance with the materiality thresholds of CSSF Circular 02/77 (i.e. below the materiality threshold) – e.g. the swing factor is different from the factor that would have been applied in accordance with the swing pricing mechanism policy approved by the Board of Directors of the investment fund manager and, if applicable, the Board of Directors of the UCI and set out in the prospectus (either higher or lower):

1) Applied swing factor higher than instruction		
Case	Impact to UCI	Corrective actions
The swing factor instructed to the UCI administrator was 30 bps on an equity fund and the administrative agent incorrectly applied a swing factor of 50 bps on the NAV. The difference of 20 bps does not exceed the materiality threshold applied to the UCI.	In that situation the UCI has not been harmed, but over-protected (in both the net subscription and net redemption scenario).	The UCI has not suffered any prejudice and thus no compensation is required. Transacting shareholders will not be compensated as the NAV is not materially impacted in accordance with CSSF Circular 02/77.
2) Applied swing factor lower than instruction		
Case	Impact to UCI	Corrective actions
The swing factor instructed to the UCI administrator was 96 bps on a fixed income fund and the administrative agent incorrectly applied a swing factor of 69 bps on the NAV. The difference of 27 bps does not exceed the materiality threshold applied to the UCI.	In that situation the UCI has been harmed (in both the net subscription and net redemption scenario).	The UCI has suffered a prejudice and thus needs to be compensated for the shortfall of dilution protection. Transacting shareholders will not be compensated as the NAV is not materially impacted in accordance with CSSF Circular 02/77.

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5. What are the organisational requirements that apply in the context of the application of the swing pricing mechanism by a UCI?

30 July 2019

In accordance with article 109 (1) (a) of the Law of 17 December 2010 relating to undertakings for collective investment, respectively article 16 of the Law of 12 July 2013 on alternative investment fund managers, investment fund managers (i.e. UCITS management companies, authorized AIFM, self-managed UCITS and AIFs) are required to have among others sound administrative and accounting procedures as well as adequate internal control mechanisms.

On that basis, the CSSF considers that the organization of investment fund managers applying the swing pricing mechanism for UCIs they manage should provide for robust policies, processes and procedures governing the application of that mechanism as well as the related operational risks. More particularly, investment fund managers should establish and implement a detailed swing pricing mechanism policy approved by the Board of Directors of the investment fund manager and, if applicable, by the Board of Directors of the UCI as well as specific operational procedures governing the day-to-day application of the swing pricing mechanism. It must be noted that the CSSF expects that those policies, processes and procedures are in place before the use of the swing pricing mechanism.

The policy and the related operational procedures should in particular cover elements such as the following (non-exhaustive list):

- the governance process, together with the different stakeholders involved, applied in relation to the application of the swing pricing mechanism;
- the oversight of the delegate in case of delegation of activities pertaining to the application of the swing pricing mechanism;
- the methodology applied for the determination and the periodic review of the swing factors and thresholds;
- the maximum swing factor applicable (as a percentage of the NAV or in monetary value) – a differentiation in this context between normal and unusual market conditions can be performed if a precise definition of unusual market conditions (e.g. higher market volatility) is provided for in the policy;
- the review process, together with the related frequency and the related triggers (e.g. market circumstances, portfolio composition), of the swing factors as well as the operational implementation of potential swing factor changes;
- the situations which may result in the non-application of swing pricing mechanism (e.g. grace period on initial launch);
- the treatment of corporate actions concerning the UCI (mergers, liquidations, contributions in-kind);
- the ongoing monitoring of the application of the swing pricing mechanism;
- the periodic review of the adequacy and the effectiveness of the swing pricing mechanism policy, processes and procedures.

6. **Can UCIs (UCITS, UCI Part II & SIFs) increase the swing factor to be applied on the NAV up to the maximum level laid down in the prospectus without prior notification to the CSSF?**

~~20 March 2020~~xx August 2021

Yes~~, this can be done without prior notification to the CSSF~~.

7. **Can UCIs increase the applied swing factor beyond the maximum swing factor laid down in the fund prospectus in the following situations:**

- **where the fund prospectus formally offers the possibility to the Board of Directors of the UCI or, if applicable, the Management Company to go beyond the maximum level under certain predefined conditions?**

- **where the fund prospectus does not offer the possibility to the Board of Directors of the UCI or, if applicable, the Management Company to go beyond the maximum level laid down in the prospectus?**

~~7 April 2020~~xx August 2021

In the first case, the Board of Directors of the UCI or, if applicable, the Management Company can decide to increase the swing factor in accordance with the provisions and conditions of the prospectus. The decision must be duly justified and take into account the best interest of the investors.

In this case, the UCI has to provide the CSSF (case officer in charge of UCI) with a detailed notification of the resolution, including a specific explanation on the reasons for such resolution.

In addition, the Board of Directors must communicate this decision to current as well as new investors through the usual communication channels as laid down in the prospectus. The CSSF must simultaneously receive a copy of this communication to investors.

In the second case, the CSSF does not permit, to go beyond the maximum level laid down in the prospectus. The CSSF expects UCIs to update their prospectus to formally provide for the possibility given to the Board of Directors of the UCI or, if applicable, the Management Company to go beyond the maximum level under certain predefined conditions

~~on a temporary basis and in case of exceptional market circumstances, the Board of Directors of the UCI or, if applicable, the Management Company, given the current exceptional market circumstances involved by the COVID-19, to increase the swing factor beyond the maximum level mentioned in the UCI prospectus. This decision must again be duly justified and take into account the best interest of the investors.~~

~~In the second case, the CSSF permits on a temporary basis the Board of Directors of the UCI or, if applicable, the Management Company, given the current exceptional market circumstances involved by the COVID-19, to increase the swing factor beyond the maximum level mentioned in the UCI prospectus. This decision must again be duly justified and take into account the best interest of the investors.~~

~~The UCI has to provide the CSSF (case officer in charge of UCI) with a detailed notification of the resolution, including a specific explanation on the reasons for such resolution.~~

~~In both cases, the Board of Directors must communicate this decision to current as well as new investors through the usual communication channels as laid down in the prospectus. For the second case, the communication to investors has to be made before applying an increase of the swing factor beyond the maximum swing factor laid down in the fund prospectus. The CSSF must simultaneously receive a copy of this communication to investors.~~

~~Furthermore, for the second case, an update of the UCI prospectus to formally provide for the possibility to the Board of Directors of the UCI or, if applicable, the Management Company to go beyond the maximum level under certain predefined conditions, has to be performed at the earliest convenience.~~

8. ~~T~~Where the fund prospectus formally offers the possibility to the Board of Directors of the UCI or, if applicable, the Management Company to go beyond the maximum swing factor laid down in the prospectus, to what extent can a UCI increase the applied swing factor beyond the maximum swing factor disclosed in the fund prospectus?

~~7 April 2020~~xx August 2021

The CSSF usually observes that the maximum swing factors laid down in the UCI prospectus vary between 1% and 3%.

In accordance with question ~~b)~~7 above, the maximum swing factor could be raised beyond the maximum level laid down in the UCI prospectus on a temporary basis provided the following minimum elements are observed:

- the revised swing factors are the result of a robust internal governance process and are based on a robust methodology (including market / transaction data -based analysis) that provides for an accurate NAV which is representative of prevailing market conditions;
- an appropriate communication is made to investors through the usual communication channels, such as the ordinary notice to investors, through the fund's internet website or other way as disclosed in the prospectus. ~~When the fund prospectus does not yet offer the possibility to go beyond the maximum level laid down in the fund prospectus, this communication must be made before applying the increased swing factor beyond the maximum level laid down in the fund prospectus.~~

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For a swing factor adjustment going beyond the maximum swing factor laid down in the UCI prospectus in force, the CSSF can ask the UCI to justify on an ex-post basis the level of the swing factor applied and to provide documentary evidence that such factor was at any time representative of the prevailing market conditions.

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