

Dilution adjustment: The J.P. Morgan Asset Management approach for the UK domiciled funds: JPMorgan Fund ICVC, JPMorgan Fund II ICVC and JPMorgan Fund III ICVC

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As part of its commitment to protect the best interest of its clients, JPMorgan Funds Limited (the “ACD”) has implemented a dilution adjustment mechanism (also known as swing pricing) in respect of JPMorgan Fund ICVC, JPMorgan Fund II ICVC and JPMorgan Fund III ICVC (collectively, the “Funds”). Dilution adjustment aims to protect existing shareholders from the performance dilution effects they may suffer as a result of transactions by other investors in a fund. It is implemented in a clear and systematic fashion.

Trading activity impact on fund performance

Trading activity incurs costs that dilute the value of existing shareholders’ investments in a single-priced fund that does not use dilution adjustment. The Funds are valued on a mid-price basis, which means that if the investment manager is required to transact in the market as a result of subscriptions or redemptions in a fund, the costs associated with this activity (transaction costs, spread, taxes such as stamp duty) are charged to the fund. This causes performance to be diluted for all shareholders invested in the fund.

To lessen the impact of dilution and to treat investors fairly, a price at which shares in a fund are bought or sold (the “price per share”) can be adjusted to make a contribution to the cost of transactions in the fund. In essence, the fund’s single price is adjusted upwards in the case of large inflows and downwards in the case of large outflows, impacting the investors who are buying or selling rather than ongoing investors in the fund.

The mechanics of dilution adjustment

The dilution adjustment threshold is a pre-determined level currently set as a percentage of the fund’s net asset value, as described in more detail later. If net inflows into a fund exceed this level, the price per share will be adjusted (or swung) upwards according to the rate of the applicable dilution adjustment. The price adjustment means that subscribing investors contribute to the cost of their transactions by paying more to enter the fund.

In certain situations, it might be in the interests of shareholders in a particular fund to grow the assets under management. In order to attract inflows, the ACD may suspend the dilution adjustment to offer factor, and allow investors to subscribe at mid, until

such time that the fund reaches a certain size or for a specific period of time (eg 6 months), whichever comes first. Existing investors would remain protected as the dilution arising from large inflows would be compensated to the fund by the ACD. Where this happens any shareholders that redeem may receive redemption proceeds that will be lower than would have been the case if the dilution adjustment had been applied. In these situations the ACD will continue to adjust (or swing) the price in the event of net outflows as normal.

If the net outflows from the fund exceed the dilution adjustment threshold, the price per share will be adjusted (or swung) downwards according to the rate of the applicable dilution adjustment and exiting shareholders will take a reduced amount out of the fund.

When a fund is typically expanding or contracting, the ACD may apply a dilution adjustment on a semi-permanent basis to reflect the trend of net flows into or out of the fund.

The decision to apply a dilution adjustment is based on the overall net flows into the fund from all investors, not per client or per share class. The price per share shifts for all share classes of a fund, not just for those share classes experiencing inflows or outflows on a given day.

The performance benefits of dilution adjustment

Dilution adjustment aims to protect the overall performance of the funds, to the benefit of existing shareholders. Investors should be aware that adjusting (or swinging) the price per share is likely to increase the tracking error of funds and may introduce volatility into the daily prices. This should not be interpreted as an increase in the inherent level of portfolio risk, though.

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J.P. Morgan Asset Management governance on dilution adjustment

The rates of dilution adjustment for each fund is determined by the J.P. Morgan Asset Management Swing Pricing Committee (the “Committee”), which typically meets quarterly to ensure the appropriate level of protection. In exceptional market conditions the Committee will meet and review more frequently.

The Committee analyses the bid/offer spreads, transaction costs and potential taxes for each market in which the portfolio of each fund is invested in order to determine the appropriate rates of dilution adjustment. This means that the rates of dilution adjustment will vary from one fund to another, depending on the asset class(es) in which they invest, the geographical focus of the fund, etc.

In order to prevent additional dilution to shareholders and to protect fund performance for ongoing investors, the rates of dilution adjustment will be reviewed quarterly by the Committee to ensure that it is as accurate as possible. The rates of dilution

adjustment applicable to a specific fund as of a certain date can be found in the relevant Fund’s prospectus.

The dilution adjustment threshold is set by the Committee at a level to ensure that those flows that would represent a significant amount of dilution in the fund are captured. Small net inflows or outflows may not require any trading activity and would not justify adjusting (or swinging) the price.

Under normal market conditions, the dilution adjustment threshold is typically 1%, however, the dilution adjustment threshold might differ or might not be applied to certain funds. In addition, the dilution adjustment threshold may be changed in response to the exceptional market circumstances. The ACD reserves the right to review the dilution adjustment threshold without prior notification. Details of the rates of dilution adjustments applied and the threshold are available from the registered office of the ACD.

Details of the funds subject to the dilution adjustment waiver are published on the website: www.jpmorgan.co.uk/investor.

Further information

For additional information, please refer to the relevant Fund prospectus or contact your usual local representative.

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