SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 239, 270, and 274

[Release Nos. 33–10515; IC–33140; File No. S7–15–18]

RIN 3235–AJ60

Exchange-Traded Funds

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission (the ''Commission'') is proposing a new rule under the Investment Company Act of 1940 (the ''Investment Company Act'' or the ''Act'') that would permit exchange-traded funds (''ETFs'') that satisfy certain conditions to operate without the expense and delay of obtaining an exemptive order. In connection with the proposed exemptive rule, the Commission proposes to rescind certain exemptive orders that have been granted to ETFs and their sponsors. The Commission also is proposing certain disclosure amendments to Form N–1A and Form N–8B–2 to provide investors who purchase and sell ETF shares on the secondary market with additional information regarding ETF trading costs, regardless of whether such ETFs are structured as registered open-end management investment companies (''open-end funds'') or unit investment trusts (''UITs''). Finally, the Commission is proposing related amendments to Form N–CEN. The proposed rule and form amendments are designed to create a consistent, transparent, and efficient regulatory framework for ETFs and to facilitate greater competition and innovation among ETFs.

DATES: Comments should be received on or before October 1, 2018.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's internet comment form (*http://www.sec.gov/rules/proposed.shtml*); or
- Send an email to *rule-comments@sec.gov.* Please include File Number S7–15–18 on the subject line.

Paper Comments

- Send paper comments to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090.

All submissions should refer to File Number S7–15–18. This file number should be included on the subject line if email is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's internet website (*http://www.sec.gov/rules/proposed.shtml*). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly.

Studies, memoranda, or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on the Commission's website. To ensure direct electronic receipt of such notifications, sign up through the ''Stay Connected'' option at *www.sec.gov* to receive notifications by email.

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SUPPLEMENTARY INFORMATION: The Commission is proposing for public comment 17 CFR 270.6c–11 (new rule 6c–11) under the Investment Company Act [15 U.S.C. 80a–1 *et seq.*]; amendments to Form N–1A [referenced in 17 CFR 274.11A] under the Investment Company Act and the Securities Act of 1933 [15 U.S.C. 77a *et seq.*] (''Securities Act''); and amendments to Forms N–8B–2 [referenced in 17 CFR 274.12] and N–CEN [referenced in 17 CFR 274.101] under the Investment Company Act.[1]

[1] Unless otherwise noted, all references to statutory sections are to the Investment Company Act, and all references to rules under the Investment Company Act are to title 17, part 270 of the Code of Federal Regulations [17 CFR part 270].

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I. Introduction

The Commission is proposing rule 6c–11 under the Investment Company Act to permit ETFs that satisfy certain conditions to operate without the expense and delay of obtaining an exemptive order from the Commission under the Act. This rule would modernize the regulatory framework for ETFs to reflect our 26 years of experience with these investment products. It is designed to create a consistent, transparent, and efficient regulatory framework for ETFs and to facilitate greater competition and innovation among ETFs.

The Commission approved the first ETF in 1992. Since then, ETFs registered with us have grown to $3.4 trillion in total net assets.[2] They now account for approximately 15% of total net assets managed by investment companies,[3] and are projected to continue to grow.[4] ETFs currently rely on exemptive orders, which permit them to operate as investment companies under the Act, subject to representations and conditions that have evolved over time.[5] We have granted over 300 of these orders over the last quarter century, resulting in differences in representations and conditions that have led to some variations in the regulatory structure for existing ETFs.[6]

Proposed rule 6c–11 would simplify this regulatory framework by eliminating conditions included within our exemptive orders that we no longer believe are necessary for our exemptive relief and removing historical distinctions between actively managed and index-based ETFs. In connection with the proposed rule, we also propose to rescind certain exemptive orders that have been granted to ETFs and their sponsors. As a result, proposed rule 6c–11 would level the playing field for ETFs that are organized as open-end funds and pursue the same or similar investment strategies.[7] The proposed rule also would assist the Commission with regulating ETFs, as funds covered by the rule would no longer be subject to the varying provisions of exemptive orders granted over time, and instead would be subject to a consistent regulatory framework. Furthermore, creating an efficient regulatory framework for ETFs would allow Commission staff and industry resources to focus the exemptive order process on products that do not fall within the scope of our proposed rule.

In addition, we are proposing certain disclosure amendments to provide additional information to investors who purchase and sell ETF shares in the secondary markets, and to provide investors who purchase UITs with the same disclosures that we propose to require of ETFs organized as open-end funds. The proposed amendments would include new disclosures regarding certain unique costs associated specifically with ETFs, such as the bid-ask spread and premiums and discounts from the ETF's net asset value (''NAV'').

Our proposal takes into account the comments we received in response to our 2008 ETF proposal, which was designed to codify the exemptive relief that had been issued to ETFs at that time.[8] Developments in the ETF industry since the 2008 proposal and interim Commission actions also have informed the parameters of proposed rule 6c–11 and the related disclosure amendments that we are proposing.[9]

A. Overview of Exchange-Traded Funds

ETFs are a type of exchange-traded product (''ETP'').[10] ETFs possess characteristics of both mutual funds, which issue redeemable securities, and closed-end funds, which generally issue shares that trade at market-determined prices on a national securities exchange and are not redeemable.[11] Because ETFs

[2] This figure is based on data obtained from Bloomberg. As of December 2017, there were 1,900 ETFs registered with the Commission. *See id.*

[3] ICI, 2018 Investment Company Fact Book (58th ed., 2018) (''2018 ICI Fact Book''), *available at https://www.ici.org/pdf/2018_factbook.pdf,* at 96. When the Commission first proposed a rule for ETFs in 2008, aggregate ETF assets were less than 7% of total net assets held by mutual funds. *See* Exchange-Traded Funds, Investment Company Act Release No. 28193 (Mar. 11, 2008) [73 FR 14618 (Mar. 18, 2008)] (''2008 ETF Proposing Release'').

[4] *See* Greg Tusar, *The evolution of the ETF industry,* Pension & Investments (Jan. 31, 2017), *available at http://www.pionline.com/article/20170131/ONLINE/170139973/the-evolution-of-the-etf-industry* (describing projections that ETF assets could double to $6 trillion by 2020).

[5] As the orders are subject to the terms and conditions set forth in the applications requesting exemptive relief, references in this release to ''exemptive relief'' or ''exemptive orders'' include the terms and conditions described in the related application. *See, e.g., infra* footnote 6.

[6] Since 2000, our ETF exemptive orders have provided relief for future ETFs. *See, e.g.,* Barclays Global Fund Advisors, Investment Company Act Release Nos. 24394 (Apr. 17, 2000) [65 FR 21215 (Apr. 20, 2000)] (notice) and 24451 (May 12, 2000) (order) and related application (''Barclays Global 2000''). This relief has allowed ETF sponsors to form ETFs without filing new applications to the extent that the new ETFs meet the terms and conditions set forth in the exemptive order. Applications granted before 2000, unless subsequently amended, did not include this relief.

[7] As discussed below, the scope of proposed rule 6c–11 does not include ETFs that: (i) Are organized as UITs; (ii) seek to exceed the performance of a market index by a specified multiple or to provide returns that have an inverse relationship to the performance of a market index, over a fixed period of time (''leveraged ETFs''); or (iii) are structured as a share class of a fund that issues multiple classes of shares representing interests in the same portfolio (''share class ETFs''). These ETFs would continue to operate pursuant to the terms of their exemptive orders. *See infra* sections II.A.1 (UIT ETFs), II.A.3 (leveraged ETFs), and II.E (share class ETFs).

[8] *See* 2008 ETF Proposing Release, *supra* footnote 3. Comment letters on the 2008 ETF Proposing Release are available at *http://www.sec.gov/comments/s7-07-08/s70708.shtml.*

[9] *See, e.g.,* Request for Comment on Exchange-Traded Products, Exchange Act Release No. 75165 (June 12, 2015) [80 FR 34729 (June 17, 2015)] (''2015 ETP Request for Comment''), at section I.A; Report of the Staffs of the CFTC and SEC to the Joint Advisory Committee on Emerging Regulatory Issues, *Findings Regarding the Market Events of May 6, 2010* (Sept. 30, 2010) (''Final May 6 Report''), *available at http://www.sec.gov/news/studies/2010/marketevents-report.pdf.* Comment letters on the 2015 ETP Request for Comment are available at *https://www.sec.gov/comments/s7-11-15/s71115.shtml.*

[10] ETFs are investment companies registered under the Investment Company Act. *See* 15 U.S.C. 80a–3(a)(1). Other types of ETPs are pooled investment vehicles with shares that trade on a securities exchange, but they are not ''investment companies'' under the Act because they do not invest primarily in securities. Such ETPs may invest primarily in assets other than securities, such as futures, currencies, or physical commodities (*e.g.,* precious metals). Still other ETPs are not pooled investment vehicles. For example, exchange-traded notes are senior, unsecured, unsubordinated debt securities that are linked to the performance of a market index and trade on securities exchanges.

[11] The Act defines ''redeemable security'' as any security that allows the holder to receive his or her proportionate share of the issuer's current net assets upon presentation to the issuer. 15 U.S.C. 80a–2(a)(32). While closed-end fund shares are not redeemable, certain closed-end funds may elect to repurchase their shares at periodic intervals pursuant to 17 CFR 270.23c–3 (rule 23c–3) under the Act (''interval funds''). Based on staff analysis, there were 39 interval funds, representing approximately $21 billion in assets, in 2017. Other closed-end funds may repurchase their shares in tender offers pursuant to 17 CFR 240.13e–4 (rule

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have characteristics that distinguish them from the types of investment companies contemplated by the Act, they require exemptions from certain provisions of the Investment Company Act in order to operate. The Commission (and Commission staff under delegated authority) now routinely grants exemptive orders permitting ETFs to operate as investment companies under the Investment Company Act, generally subject to the provisions of the Act applicable to open-end funds (or UITs).[12] These exemptive orders reflect our determination that, based on the factual representations offered by the applicants and the conditions to which the applicants have agreed, the requested relief is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Investment Company Act.[13] The Commission also has approved the standards of national securities exchanges, under which ETF shares are listed and traded.[14]

As discussed above, ETFs have become an increasingly popular investment vehicle over the last 26 years. They also have become a popular trading tool, making up a significant portion of secondary market equities trading. During the first quarter of 2018, for example, trading in U.S.-listed ETFs made up approximately 18.75% of U.S. equity trading by share volume and 28.2% of U.S. equity trading by dollar volume.[15]

Investors can buy and hold shares of ETFs (sometimes as a core component of a portfolio) or trade them frequently as part of an active trading or hedging strategy.[16] ETF investors can sell ETF shares short, write options on them, and set market, limit, and stop-loss orders on them. Moreover, because certain costs are either absent in the ETF structure or are otherwise partially externalized, many ETFs have lower operating expenses than mutual funds.[17] ETFs also may offer certain tax efficiencies compared to other pooled investment vehicles because redemptions from ETFs are often made in kind (that is, by delivering certain assets from the ETF's portfolio, rather than in cash), thereby avoiding the need for the ETF to sell assets and potentially realize capital gains that are distributed to its shareholders.

ETFs today provide investors with a diverse set of investment options. While the first ETFs held portfolios of securities that replicated the component securities of broad-based domestic stock market indexes, some ETFs now track more specialized indexes, including international equity indexes, fixed-income indexes, or indexes focused on particular industry sectors such as telecommunications or healthcare.[18] Some ETFs seek to track highly customized or bespoke indexes, while others seek to provide a level of leveraged or inverse exposure to an index over a fixed period of time.[19] Investors also have the ability to invest in ETFs that do not track a particular index and are actively managed.[20]

B. Operation of Exchange-Traded Funds

An ETF issues shares that can be bought or sold throughout the day in the secondary market at a market-determined price. Like other investment companies, an ETF pools the assets of multiple investors and invests those assets according to its investment objective and principal investment strategies. Each share of an ETF represents an undivided interest in the underlying assets of the ETF. Similar to mutual funds, ETFs continuously offer their shares for sale.

Unlike mutual funds, however, ETFs do not sell or redeem individual shares. Instead, ''authorized participants'' that have contractual arrangements with the ETF (or its distributor) purchase and redeem ETF shares directly from the ETF in blocks called ''creation units.''[21] An authorized participant may act as a principal for its own account when purchasing or redeeming creation units from the ETF. Authorized participants also may act as agent for others, such as market makers, proprietary trading firms, hedge funds or other institutional investors, and receive fees for processing creation units on their behalf.[22] Market makers, proprietary trading firms, and hedge funds provide additional liquidity to the ETF market through their trading activity. Institutional investors may engage in primary market transactions with an ETF through an authorized participant as a way to efficiently hedge a portion of their portfolio or balance sheet or to

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13e–4) under the Securities Exchange Act of 1934 (the ''Exchange Act'').

[12] Historically, ETFs have been organized as open-end funds or UITs. *See* 15 U.S.C. 80a–5(a)(1) (defining the term ''open-end company'') and 15 U.S.C. 80a–4(2) (defining the term ''unit investment trust''). Some fund groups have multiple orders covering different types of ETFs (*e.g.,* one order covering ETFs organized as UITs and another covering ETFs organized as open-end funds or one order covering index-based ETFs and another covering actively managed ETFs).

[13] *See* 15 U.S.C. 80a–6(c).

[14] Additionally, ETFs regularly request relief from 17 CFR 242.101 and 242.102 (rules 101 and 102 of Regulation M); section 11(d)(1) of the Exchange Act and 17 CFR 240.11d1–2 (''rule 11d1–2'' under the Exchange Act); certain other rules under the Exchange Act (*i.e.,* 17 CFR 240.10b–10, 240.10b–17, 240.14e–5, 240.15c1–5, and 240.15c1–6 (rules 10b–10, 10b–17, 14e–5, 15c1–5, and 15c1–6)); and 17 CFR 242.200(g) (rule 200(g) of Regulation SHO). *See* 2015 ETP Request for Comment, *supra* footnote 9, at section I.D.2 (discussing the exemptive and no-action relief granted to ETPs under the Exchange Act and the listing process for ETP securities for trading on a national securities exchange).

[15] These estimates are based on trade and quote data from the New York Stock Exchange and Trade Reporting Facility data from FINRA.

[16] *See, e.g.,* Chris Dieterich, *Are You An ETF 'Trader' Or An ETF 'Investor'?,* Barrons (Aug. 8, 2017), *available at https://www.barrons.com/articles/are-you-an-etf-trader-or-an-etf-investor-1470673638;* Greenwich Associates, *Institutions Find New, Increasingly Strategic Uses for ETFs* (May 2012) (''More than one-in-five asset managers that use [ETFs] report employing ETFs for active exposures in domestic equities and commodities, and about 17% note using them for active exposures in international equities.''); Joe Renninson, *Institutional Investors Boost Ownership of ETFs,* Financial Times (Apr. 13, 2017), *available at https://www.ft.com/content/c70113ac-ab83-33ac-a624-d2d874533fb0?mhq5j=e7.*

[17] For instance, ETFs typically do not bear distribution or shareholder servicing fees. In addition, ETFs that transact on an in-kind basis can execute changes in the ETF's portfolio without incurring brokerage costs, leading to transaction cost savings.

[18] The Commission historically has referred to ETFs that have stated investment objectives of maintaining returns that correspond to the returns of a securities index as ''index-based'' ETFs. *See, e.g.,* Parker Global Strategies, LLC, *et al.,* Investment Company Act Release Nos. 32528 (Mar. 10, 2017) [82 FR 14043 (Mar. 16, 2017)] (notice) and 32595 (Apr. 5, 2017) (order) and related application (''Parker Global Strategies'').

[19] Inverse ETFs are often marketed as a way for investors to profit from, or at least hedge their exposure to, downward moving markets. *See infra* section II.A.3.

[20] An actively managed ETF's investment adviser, like an adviser to any actively managed mutual fund, generally selects securities consistent with the ETF's investment objectives and policies without trying to track the performance of a corresponding index. Actively managed ETFs represent approximately 1.3% of total ETF assets as of September 2017. Based on data obtained from the Market Information Data Analytics System (''MIDAS''), Bloomberg, and Morningstar Direct.

[21] Our exemptive orders typically contain a representation by the applicant that an authorized participant will be either: (a) A broker or other participant in the continuous net settlement system of the National Securities Clearing Corporation, a clearing agency registered with the Commission and affiliated with the Depository Trust Company (''DTC''), or (b) a DTC participant, which has executed a participant agreement with the ETF's distributor and transfer agent with respect to the creation and redemption of creation units. *See, e.g.,* Emerging Global Advisors, LLC, *et al.,* Investment Company Act Release Nos. 30382 (Feb. 13, 2013) [78 FR 11909 (Feb. 20, 2013)] (notice) and 30423 (Mar. 12, 2013) (order) and related application. Proposed rule 6c–11(a) would define ''authorized participant'' as a member or participant of a clearing agency registered with the Commission, which has a written agreement with the ETF or one of its service providers that allows the authorized participant to place orders for the purchase and redemption of creation units.

[22] *See* David J. Abner, *The ETF Handbook: How to Value and Trade Exchange Traded Funds,* 2nd ed. (2016) (''ETF Handbook'').

gain exposure to a strategy or asset class.[23]

An authorized participant that purchases a creation unit of ETF shares directly from the ETF deposits with the ETF a ''basket'' of securities and other assets identified by the ETF that day, and then receives the creation unit of ETF shares in return for those assets.[24] The basket is generally representative of the ETF's portfolio[25] and, together with a cash balancing amount, equal in value to the aggregate NAV of the ETF shares in the creation unit.[26] After purchasing a creation unit, the authorized participant may hold the individual ETF shares, or sell some or all of them in secondary market transactions.[27] Investors then purchase individual ETF shares in the secondary market. The redemption process is the reverse of the purchase process: The authorized participant redeems a creation unit of ETF shares for a basket of securities and other assets.

The combination of the creation and redemption process with secondary market trading in ETF shares provides arbitrage opportunities that are designed to help keep the market price of ETF shares at or close to the NAV per share of the ETF.[28] For example, if ETF shares are trading on national securities exchanges at a ''discount'' (a price below the NAV per share of the ETF), an authorized participant can purchase ETF shares in secondary market transactions and, after accumulating enough shares to compose a creation unit, redeem them from the ETF in exchange for the more valuable securities in the ETF's redemption basket. The authorized participant's purchase of an ETF's shares on the secondary market, combined with the sale of the ETF's basket assets, may create upward pressure on the price of the ETF shares, downward pressure on the price of the basket assets, or both, bringing the market price of ETF shares and the value of the ETF's portfolio holdings closer together.[29] Alternatively, if ETF shares are trading at a ''premium'' (a price above the NAV per share of the ETF), the transactions in the arbitrage process are reversed and, when arbitrage is working effectively, keep the market price of the ETF's shares close to its NAV.

Market participants also can engage in arbitrage activity without using the creation or redemption processes. For example, if a market participant believes that an ETF is overvalued relative to its underlying or reference assets (*i.e.,* trading at a premium), the market participant may sell ETF shares short and buy the underlying or reference assets, wait for the trading prices to move toward parity, and then close out the positions in both the ETF shares and the underlying or reference assets to realize a profit from the relative movement of their trading prices. Similarly, a market participant could buy ETF shares and sell the underlying or reference assets short in an attempt to profit when an ETF's shares are trading at a discount to the ETF's underlying or reference assets. As with the creation and redemption process, the trading of an ETF's shares and the ETF's underlying or reference assets may bring the prices of the ETF's shares and its portfolio assets closer together through market pressure.[30]

The arbitrage mechanism is important because it provides a means to maintain a close tie between market price and NAV per share of the ETF, thereby helping to ensure ETF investors are treated equitably when buying and selling fund shares. In granting relief under section 6(c) of the Act for ETFs to operate, the Commission has relied on this close tie between what retail investors pay (or receive) in the secondary market and the ETF's approximate NAV to find that the required exemptions are necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act. Investors also have come to expect that an ETF's market price will maintain a close tie to the ETF's NAV per share, which may lead some investors to view ETFs more favorably than similar closed-end funds.[31] On the other hand, this expectation may lead investors to view ETFs as a less attractive investment option or cause them to sell ETF shares if market price and NAV per share diverge, particularly during periods of market stress.[32]

II. Discussion

Given the growth in the ETF market, ETFs' popularity among retail and institutional investors, and our long experience regulating this investment and trading vehicle, we believe that it is appropriate to propose a rule that would allow most ETFs to operate without first obtaining an exemptive order from the Commission under the Act. We believe that such a rule would create a consistent, transparent and efficient regulatory framework for the regulation of most ETFs and level the playing field for these market participants. Proposed

[23] *Id.*

[24] An ETF may impose fees in connection with the purchase or redemption of creation units that are intended to defray operational processing and brokerage costs to prevent possible shareholder dilution (''transaction fees'').

[25] The basket might not reflect a *pro rata* slice of an ETF's portfolio holdings. Subject to the terms of the applicable exemptive relief, an ETF may substitute other securities or cash in the basket for some (or all) of the ETF's portfolio holdings. Restrictions related to flexibility in baskets have varied over time. *See infra* section II.C.5.

[26] An open-end fund is required by law to redeem its securities on demand from shareholders at a price approximating their proportionate share of the fund's NAV at the time of redemption. *See* 15 U.S.C. 80a–22(d). Title 17 CFR 270.22c–1 (''rule 22c–1'') generally requires that funds calculate their NAV per share at least once daily Monday through Friday. *See* rule 22c–1(b)(1). Today, most funds calculate NAV per share as of the time the major U.S. stock exchanges close (typically at 4:00 p.m. Eastern Time). Under rule 22c–1, an investor who submits an order before the 4:00 p.m. pricing time receives that day's price, and an investor who submits an order after the pricing time receives the next day's price. *See also* 17 CFR 270.2a–4 (''rule 2a–4'') (defining ''current net asset value'').

[27] ETFs register offerings of shares under the Securities Act, and list their shares for trading under the Exchange Act. Depending on the facts and circumstances, authorized participants that purchase a creation unit and sell the shares may be deemed to be participants in a distribution, which could render them statutory underwriters and subject them to the prospectus delivery and liability provisions of the Securities Act. *See* 15 U.S.C. 77b(a)(11) (defining the term ''underwriter'').

[28] To date, the arbitrage mechanism has been dependent on daily portfolio transparency.

[29] As part of this arbitrage process, authorized participants are likely to hedge their intraday risk. For example, when ETF shares are trading at a discount to an estimated intraday NAV per share of the ETF, an authorized participant may short the securities composing the ETF's redemption basket. After the authorized participant returns a creation unit of ETF shares to the ETF in exchange for the ETF's baskets, the authorized participant can then use the basket assets to cover its short positions.

[30] Some studies have found the majority of all ETF-related trading activity takes place on the secondary market. *See, e.g.,* Rochelle Antoniewicz & Jane Heinrichs, *Understanding Exchange-Traded Funds: How ETFs Work,* ICI Research Perspective 20, No. 5 (Sept. 2014) (''Antoniewicz''), *available at https://www.ici.org/pdf/per20-05.pdf,* at 2 (''On most trading days, the vast majority of ETFs do not have any primary market activity—that is, they do not create or redeem shares.'').

[31] Scott W. Barnhart & Stuart Rosenstein, *Exchange-Traded Fund Introductions and Closed-End Fund Discounts and Volume,* 45 The Financial Review 4 (Nov. 2010) (within a year of the introduction of a similar ETF, the average discount widens significantly and volume falls significantly in U.S. domestic equity, international equity, and U.S. bond closed-end funds, which may indicate that closed-end funds lose some desirability when a substitute ETF becomes available). As of December 31, 2017, total net assets of ETFs were $3.4 trillion compared to $275 billion for closed-end funds. *See* 2018 ICI Fact Book, *supra* footnote 3.

[32] *See* Staff of the Office of Analytics and Research, Division of Trading and Markets, *Research Note: Equity Market Volatility on August 24, 2015* (Dec. 2015) (''August 24 Staff Report''), *available at https://www.sec.gov/marketstructure/research/equity_market_volatility.pdf* (discussing spikes in ETF trading volume on August 24, 2015 when U.S. equity markets experienced unusual price volatility). *See also infra* section II.B.2 (discussing intraday deviations between market price and NAV as well as contemporaneous deviations between market price and the intraday value of the ETF's portfolio).

rule 6c–11 includes several conditions designed to address the concerns underlying the relevant statutory provisions and to support a Commission finding that the exemptions necessary to allow ETFs to operate are in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act. The proposed conditions are based upon the existing exemptive relief for ETFs, which we believe have served to support an efficient arbitrage mechanism, but reflect several modifications based on our experience regulating this product.

A. Scope of Proposed Rule 6c–11

Proposed rule 6c–11 would define an ETF as a registered open-end management investment company that: (i) Issues (and redeems) creation units to (and from) authorized participants in exchange for a basket and a cash balancing amount (if any); and (ii) issues shares that are listed on a national securities exchange and traded at market-determined prices.[33]

1. Organization as Open-End Funds

Proposed rule 6c–11 would be available only to ETFs that are organized as open-end funds. The vast majority of ETFs currently in operation are organized as open-end funds, although the earliest ETFs were organized as UITs (''UIT ETFs'').[34] These early UIT ETFs represent a significant amount of assets within the ETF industry.[35] For example, two of the largest ETFs by total net assets and estimated dollar trading volume (SPDR S&P 500 ETF Trust (SPY) and PowerShares QQQ Trust, Series 1 (QQQ)) are organized as UITs.

A UIT is an investment company organized under a trust indenture or similar instrument that issues redeemable securities, each of which represents an undivided interest in a unit of specified securities.[36] By statute, a UIT is unmanaged and its portfolio is fixed. Substitution of securities may take place only under certain pre-defined circumstances.[37] A UIT does not have a board of directors, corporate officers, or an investment adviser to render advice during the life of the trust. By contrast, ETFs organized as open-end funds are managed by investment advisers and, in addition to replicating an index, can be actively managed or use a ''sampling'' strategy to track an index.[38] Unlike an ETF structured as a UIT, an open-end fund ETF may participate in securities lending programs and has greater flexibility to reinvest dividends from portfolio securities.[39] ETFs structured as open-end funds also may invest in derivatives, which typically require a degree of management that is not provided for in the UIT structure.[40] As a result, we understand that most ETF sponsors now prefer the open-end fund structure over the UIT structure given the increased investment flexibility the open-end structure affords. Indeed, we have received very few exemptive applications for new UIT ETFs since 2002 and no new UIT ETFs have come to market in that time.[41]

The rule we proposed in 2008 would not have included UIT ETFs within its scope.[42] Comments on the 2008 ETF Proposing Release were mixed with regard to providing relief to UITs, with two commenters supporting the exclusion of UITs.[43] On the other hand, two commenters argued that the Commission should expand the rule to include UITs, contending that sponsors in the future may choose the UIT structure for some reason unforeseen today.[44] Some commenters also stated that existing UIT ETFs should be able to rely on the rule, which may provide broader relief than provided by their exemptive orders.[45]

While we acknowledge that excluding UIT ETFs would result in a segment of ETF assets that are outside the regulatory framework of proposed rule 6c–11, we do not believe there is a need to include ETF UITs within the scope of the proposed rule given the limited sponsor interest in developing ETFs organized as UITs. In addition, even if we were to include UIT ETFs within the scope of the rule, we believe that the unmanaged nature of the UIT structure would require conditions that differ from the conditions applicable to ETFs

[33] *See* proposed rule 6c–11(a) (defining ''exchange-traded fund''). Under the proposed rule, the term ''basket'' would be defined to mean the securities, assets, or other positions in exchange for which an ETF issues (or in return for which it redeems) creation units. The term ''exchange-traded fund'' thus would include ETFs that transact on an in-kind basis, on a cash basis, or both.

[34] *See, e.g.,* SPDR Trust, Series 1, Investment Company Act Release Nos. 18959 (Sept. 17, 1992) [57 FR 43996 (Sept. 23, 1992)] (notice) and 19055 (Oct. 26, 1992) (order) and related application (''SPDR'').

[35] As of Dec. 31, 2017, for example, the eight existing UIT ETFs had total assets of approximately $379 billion, representing approximately 11.3% of total assets invested in ETFs (based on data obtained from MIDAS, Bloomberg, and Morningstar Direct).

[36] *See* section 4(2) of the Act [15 U.S.C. 80a–4]. A UIT has a fixed life—a termination date for the trust is established when the trust is created.

[37] The exemptive relief granted to UIT ETFs does not provide relief from the portion of section 4(2) that requires that UIT securities represent an undivided interest in a unit of specified securities. Because a UIT must invest in ''specified securities,'' the investment strategies that a UIT ETF can pursue are limited. All UIT ETFs today seek to track the performance of an index by investing in the component securities of the index in the same approximate proportions as in the index (*i.e.,* ''replicating'' the index). The trustee of an UIT ETF may make adjustments to the ETF's portfolio only to reflect changes in the composition of the underlying index. *See* Actively Managed Exchange-Traded Funds, Investment Company Act Release No. 25258 (Nov. 8. 2001) [66 FR 57614 (Nov. 15, 2001)] (''2001 Concept Release''), at n.11.

[38] An ETF that uses a sampling strategy includes assets in its portfolio that are designed, in the aggregate, to reflect the underlying index's capitalization, industry, and fundamental investment characteristics, and to perform like the index. The ETF implements the strategy by acquiring a subset of the underlying index's component securities and may invest a portion of the ETF's portfolio in securities and other financial instruments (including derivatives) that are not included in the corresponding index if the adviser believes the investment will help the ETF track the underlying index. *See* 2008 ETF Proposing Release, *supra* footnote 3.

[39] UIT dividends are held in a non-interest bearing account and paid out quarterly. The inability to reinvest dividends can have a cash drag on the tracking performance of a UIT ETF. *See* A. Seddik Meziani, *Exchange-Traded Funds: Investment Practices and Tactical Approaches* (2016), at 22.

[40] *See* Use of Derivatives by Registered Investment Companies and Business Development Companies, Investment Company Act Release No. 31933 (Dec. 11, 2015) [80 FR 80883 (Dec. 28, 2015)] (''Derivatives Proposing Release''), at n.139.

[41] The Commission has received applications for ETFs structured as a UIT, but with features that are different from typical UIT-structured ETFs. *See* Application of Elkhorn Securities, LLC and Elkhorn Unit Trust (Mar. 6, 2017) (''Elkhorn Application''); Application of Precidian ADRs LLC (Aug. 1, 2014) (''Precidian ADR Application''). The Commission has not taken any action on the Elkhorn Application, and the Precidian ADR Application was withdrawn by the applicant. Two orders modifying relief for existing ETFs organized as UITs were issued in 2007. *See* NASDAQ–100 Trust, Series 1, *et al.,* Investment Company Act Release Nos. 27740 (Feb. 27, 2007) [72 FR 9594 (Mar. 2, 2007)] (notice) and 27753 (Mar. 20, 2007) (order) and related application; BLDRS Index Funds Trust, *et al.,* Investment Company Act Release Nos. 27745 (Feb. 28, 2007) [72 FR 9787 (Mar. 5, 2007)] (notice) and 27768 (Mar. 21, 2007) (order) and related application.

[42] *See* 2008 ETF Proposing Release, *supra* footnote 3, at text accompanying nn.63–67 (noting that the Commission had not received an exemptive application for a new ETF to be organized as a UIT since 2002 and, as a result, there did not appear to be a need to include UIT relief in the proposed rule).

[43] *See* Comment Letter of Xshares Advisors LLC (May 20, 2008) (''Xshares 2008 Comment Letter''); Comment Letter of the Investment Company Institute (May 19, 2008) (''ICI 2008 Comment Letter'').

[44] *See* Comment Letter of Katten Muchin Rosenman LLP (May 30, 2008) (''Katten 2008 Comment Letter''); Comment Letter of the Federal Regulation of Securities Committee, Section of Business Law, American Bar Association (May 29, 2008) (''ABA 2008 Comment Letter'').

[45] *See* Comment Letter of State Street Global Advisors (May 19, 2008) (''SSgA 2008 Comment Letter''); Comment Letter of NYSE Arca (May 29, 2008) (''NYSE Arca 2008 Comment Letter''); Katten 2008 Comment Letter.

organized as open-end funds, requiring a regulatory framework that would be different than our proposed structure for open-end ETFs. The exemptive relief that has been granted to UIT ETFs, for example, provides that the trustee will make adjustments to the ETF's portfolio only pursuant to the specifications set forth in the trust formation documents in order to track changes in the ETF's underlying indexes.[46] The trustee does not have discretion when making these portfolio adjustments.[47] In most cases, therefore, a UIT ETF uses baskets that correspond *pro rata* to the ETF's portfolio holdings.[48] The rule we are proposing would allow ETFs the flexibility to use baskets that differ from a *pro rata* representation of the ETF's portfolio if certain conditions are met.[49] Because the conditions we are proposing related to basket flexibility require ongoing management and board oversight, we do not believe that extending such basket flexibility to UIT ETFs would be appropriate given the unmanaged nature of a UIT.

Instead, we believe that UIT ETFs should continue to operate pursuant to their exemptive orders, which include terms and conditions that are appropriately tailored to address the unique features of a UIT.[50] The exemptive relief granted to UIT ETFs includes relief from sections of the Act that govern key aspects of a UIT's operations.[51] For example, because UITs are prohibited from paying fees beyond those necessary to cover the costs of administrative and bookkeeping services, UIT ETFs require exemptive relief from section 26(a)(2)(C) of the Act to allow the ETF to pay certain enumerated expenses.[52] However, because UITs are unmanaged and are not overseen by boards, the exemptive order for each UIT ETF contains its own list of permissible capped expenses that vary among the different UIT ETFs.[53]

To the extent that ETF sponsors develop unforeseen, novel UIT ETFs, we believe that the Commission should review such products as part of its exemptive process to determine whether the relief is necessary or appropriate in the public interest and consistent with the protection of investors. We therefore are not proposing to include ETFs structured as UITs within the scope of proposed rule 6c–11.[54]

We request comment on whether proposed rule 6c–11 should be available only to ETFs structured as open-end funds.

• Should the rule provide exemptive relief for both ETFs organized as open-end funds and ETFs organized as UITs? Are we correct that ETF sponsors will likely prefer the open-end structure to the UIT structure when forming ETFs in the future? If not, why?

• If UIT ETFs were included in the scope of the proposed rule, should they be subject to the same proposed conditions or should we tailor particular conditions in light of the unmanaged nature of a UIT? For example, how should the proposed rule address basket composition for UIT ETFs? Should UIT ETFs only be permitted to replicate their index, or should we allow them to engage in representative sampling on a *pro rata* basis? Should a UIT ETF only be permitted to substitute cash (instead of other securities) for particular basket assets? Should we allow a UIT ETF to substitute basket assets only in certain enumerated circumstances (*e.g.,* only when the basket asset is not eligible for trading by an authorized participant or is not available in sufficient quantity for delivery to or from the authorized participant)?

• If UIT ETFs were included within the scope of the rule, should we expressly limit the types of indexes that such ETFs may track given the unmanaged nature of the UIT structure and the potential for specialized or bespoke indexes to be inconsistent with a fixed portfolio? For example, should we provide that ETFs structured as UITs may only track broad-based securities indexes? Should we limit the derivatives holdings of UIT ETFs or restrict them from tracking indexes that include certain types of derivatives? If so, what types of derivatives should be permitted?

• If we were to include UIT ETFs within the scope of rule 6c–11, should we provide an exemption from section 26(a)(2)(C), consistent with our exemptive orders, to permit the payment of certain expenses associated with the creation and maintenance of the ETF? If so, should we limit the amount of expenses that may be reimbursed? What should the limit be, and why? Should we limit the reimbursement to no more than 20 basis points of the ETF's NAV per share on an annualized basis, consistent with some of the exemptive orders granted to UIT ETFs? Should this limit be higher (*e.g.,* 30 basis points) or lower (*e.g.,* 10 basis points)? Should the rule enumerate the expenses that may be reimbursed? For example, should the rule permit the reimbursement of any or all of the following: (i) Annual index licensing fees; (ii) annual federal and state fees for the registration of newly issued creation units; and (iii) expenses of the sponsor relating to the development, printing, and distribution of marketing materials? Are there other expenses that should be permissible reimbursements under such an exemption?

• Our exemptive orders for UIT ETFs also include relief from section 14(a) of the Act, which provides that no registered investment company may make an initial public offering of its securities unless it has a net worth of at least $100,000 or is assured, via private subscriptions, of issuing at least $100,000 in securities in the offering.[55] If UIT ETFs were included within the scope of the rule, would they need relief from section 14(a) of the Act consistent with our prior exemptive relief? If so, what conditions should we consider as part of the rule? Alternatively, should we consider amending rule 14a–3 under the Act, which provides an exemption from section 14(a) for UITs that invest in "eligible trust securities?" [56] If so, how should we define "eligible trust securities"? For example, should equity securities be added to the definition of "eligible trust securities"? Should we

[46] *See, e.g.,* SPDR, *supra* footnote 34.

[47] *See id.*

[48] *See id.* (permitting baskets accepted by UIT ETF for purchases of creation units to include the cash equivalent of a component security of the underlying index only where: (i) The trustee determines that the index security is likely to be unavailable or available in insufficient quantity; or (ii) a particular investor is restricted from investing or transacting in such index security).

[49] *See infra* section II.C.5.

[50] Unlike the exemptive relief we have granted to certain ETFs organized as open-end funds (*see supra* footnote 6), the relief we have granted to ETFs organized as UITs does not provide relief for future ETFs formed pursuant to the same order.

[51] *See, e.g.,* SPDR, *supra* footnote 34.

[52] Section 26(a)(2)(C) of the Act requires that the trust indenture for a UIT prohibit payments to the depositor or to any affiliated person thereof, except payments for performing bookkeeping and other administrative services of a character normally performed by the trustee or custodian itself. 15 U.S.C. 80a–26(a)(2)(C).

[53] *See, e.g.,* NASDAQ–100 Trust, Series 1, Investment Company Act Release Nos. 23668 (Jan. 27, 1999) [64 FR 5082 (Feb. 2, 1999)] (notice) and 23702 (Feb. 22, 1999) (order) and related application (exemption from section 26(a)(2)(C) to permit UIT to reimburse the sponsor up to a maximum of 20 basis points) ("NASDAQ 100"); Midcap SPDR Trust, Series 1, Investment Company Act Release Nos. 20797 (Dec. 23, 1994) [60 FR 163 (Jan. 3, 1995)] (notice) and 20844 (Jan. 18, 1995) (order) and related application (30 basis points).

[54] While we do not propose to include ETFs organized as UITs within the scope of proposed rule 6c–11, we are proposing amendments to Form N–8B–2 to require them to provide certain additional disclosures regarding trading costs. *See infra* section II.I.

[55] *See* NASDAQ 100, *supra* footnote 53.

[56] Eligible trust securities under rule 14a–3 include corporate debt securities (including nonconvertible preferred stock), government and municipal securities, and units of a previously issued series of a UIT. The term does not include equity securities. *See* rule 14a–3(b).

include other types of securities within that definition? For example, should we include FLEX options within the definition?[57]

- Are there any other exemptions we should consider for UIT ETFs?
- If we were to include UIT ETFs in rule 6c–11, are there any specific disclosures that should be required, other than the ones proposed herein?
- If we do not include UIT ETFs within the scope of the rule, should we nonetheless require them to comply with any of the rule's requirements for ETFs organized as open-end funds?

2. Index-Based ETFs and Actively Managed ETFs

Proposed rule 6c–11 would provide exemptions for both index-based ETFs and actively managed ETFs, but would not by its terms establish different requirements based on whether an ETF's investment objective is to seek returns that correspond to the returns of an index. We believe that index-based and actively managed ETFs that comply with the proposed rule's conditions function similarly with respect to operational matters, despite different investment objectives or strategies, and do not present significantly different concerns under the provisions of the Act from which the proposed rule grants relief. For example, both index-based and actively managed ETFs register under the Act, issue and redeem shares in creation unit sizes in exchange for baskets of assets, list on national securities exchanges, and allow investors to trade ETF shares throughout the day at market-determined prices in the secondary market.

The distinction between index-based ETFs and actively managed ETFs in our current exemptive orders is largely a product of ETFs' historical evolution. The Commission did not approve the first actively managed ETF until nearly 15 years after index-based ETFs were introduced.[58] As discussed in a 2001 concept release on actively managed ETFs, the Commission was initially concerned that actively managed ETFs would not be able (or willing) to provide portfolio transparency, potentially hindering the arbitrage mechanism deemed critical to the operation of an ETF.[59] Actively managed ETFs were novel at the time of the 2008 ETF Proposing Release, and the Commission solicited comment on whether a proposed ETF rule should specifically include actively managed ETFs.[60] Six commenters supported this approach,[61] while a few commenters questioned whether it was premature to allow actively managed ETFs to operate using the rule.[62]

The actively managed ETF market has grown considerably since 2008. There are now over 200 actively managed ETFs with approximately $45.8 billion in assets.[63] The Commission has observed how actively managed ETFs operate during this time, and has not identified any operational issues that suggest additional conditions for actively managed ETFs are warranted. As noted below, we believe that the arbitrage mechanism for existing actively managed ETFs has worked effectively with small deviations between market price and NAV per share.[64]

We believe that permitting index-based and actively managed open-end ETFs to operate under the proposed rule subject to the same conditions would provide a level playing field among those market participants. Furthermore, we believe that it would be unreasonable to create a meaningful distinction within the rule between index-based and actively managed ETFs given the evolution of indexes over the last decade. The proliferation of highly customized, often methodologically complicated, indexes has blurred the distinction between such products.[65] At the same time, ETF industry practices in areas such as portfolio transparency have converged between these types of funds.[66] We therefore believe that eliminating the regulatory distinction between index-based ETFs and actively managed ETFs would help to provide a more consistent and transparent regulatory framework for ETFs organized as open-end funds. This approach also would be consistent with our regulation of other types of open-end funds, which does not distinguish between actively managed and index-based strategies.

The rule we proposed in 2008 similarly would not have distinguished between index-based ETFs and actively managed ETFs, except in one respect—it would have permitted an index-based ETF to disclose daily the composition of its index in lieu of disclosing its portfolio holdings.[67] However, we believe that distinguishing between index-based ETFs and actively managed ETFs in this manner is no longer necessary given that all ETFs that could rely on the proposed rule currently provide full portfolio transparency.[68]

We request comment on whether proposed rule 6c–11 should provide

[57] FLexible EXchange options (''FLEX options'') are a type of customized equity or index option contracts. Some traditional UITs have exemptive relief from section 14(a) to invest in FLEX options with expiration dates that coincide with UIT's maturity date. *See e.g.,* Olden Lane Securities LLC, *et al.,* Investment Company Act Release Nos. 32589 (April 3, 2017) [82 FR 17048 (April 7, 2017)] (notice) and 32619 (May 1, 2017) (order) and related application.

[58] *See, e.g.,* WisdomTree Trust, *et al.,* Investment Company Act Release Nos. 28147 (Feb. 6, 2008) [73 FR 7776 (Feb. 11, 2008)] (notice) and 28174 (Feb. 27, 2008) (order) and related application (''2008 WisdomTree Trust''); Barclays Global Fund Advisors, *et al.,* Investment Company Act Release Nos. 28146 (Feb. 6, 2008) [73 FR 7771 (Feb. 11, 2008)] (notice) and 28173 (Feb. 27, 2008) (order) and related application (''Barclays Global 2008''). Approximately 100 exemptive orders have been issued since 2008 for actively managed, transparent ETFs.

[59] *See* 2001 Concept Release, *supra* footnote 37, at n.31 and accompanying and following text. Comment letters to the 2001 Concept Release are available at *http://www.sec.gov/rules/concept/s72001.shtml.*

[60] *See* 2008 ETF Proposing Release, *supra* footnote 3, at section III.A.2.

[61] *See e.g.,* Comment Letter of the Vanguard Group, Inc. (June 19, 2008) (''Vanguard 2008 Comment Letter''); Xshares 2008 Comment Letter; Comment Letter of Barclays Global Fund Advisors (May 16, 2008) (''BGFA 2008 Comment Letter''); ICI 2008 Comment Letter; SSgA 2008 Comment Letter; Comment Letter of Mutual Fund Directors Forum (May 21, 2008).

[62] *See* Comment Letter of Brown & Associates LLC (May 19, 2008); Katten 2008 Comment Letter.

[63] These estimates are based on data obtained from MIDAS, Bloomberg and Morningstar Direct as of December 31, 2017.

[64] *See infra* section II.B.2.

[65] *See, e.g.,* John Waggoner, *Smart-beta ETFs Take in Billions in New Assets,* Investment News (Oct. 11, 2017), *available at http://www.investmentnews.com/article/20171011/FREE/171019982/smart-beta-etfs-take-in-billions-in-new-assets*); Brendan Conway, *New Trend: The ''Bespoke'' ETF,* Barron's (Jan. 17, 2014), *available at http://www.barrons.com/articles/new-trend-the-aposbespokeapos-etf-1389970766.*

[66] All ETFs that could rely on the proposed rule currently provide full portfolio transparency as a matter of market practice, although only actively managed ETFs and some index-based ETFs with affiliated index providers are required to do so pursuant to their exemptive orders. *See infra* section II.C.4. *See also, e.g.,* Guggenheim Funds Investment Advisors, LLC, *et al.,* Investment Company Act Release Nos. 30560 (June 14, 2013) [78 FR 37614 (June 21, 2013)] (notice) and 30598 (July 10, 2013) (order) and related application. Earlier relief granted to ETFs with affiliated index providers did not require full portfolio transparency, but included conditions that were intended to address potential conflicts of interest. *See, e.g.,* HealthShares Inc., *et al.,* Investment Company Act Release Nos. 27916 (July 27, 2007) [72 FR 42447 (Aug. 2, 2007)] (notice) and 27930 (Aug. 20, 2007) (order) and related application; WisdomTree Investments, Inc., *et al.,* Investment Company Act Release Nos. 27324 (May 18, 2006) [71 FR 29995 (May 24, 2006)] (notice) and 27391 (June 12, 2006) (order) and related application (''2006 WisdomTree Investments'').

[67] For these purposes, an index-based ETF was defined as an ETF that has a stated investment objective of obtaining returns that correspond to the returns of a securities index (whose provider discloses on its internet website the identities and weightings of the component securities and other assets of that index). *See* 2008 ETF Proposing Release, *supra* footnote 3. *See also infra* section II.C.4 (discussing proposed condition regarding portfolio transparency).

[68] *See* 2015 ETP Request for Comment, *supra* footnote 9.

exemptions to index-based ETFs and actively managed ETFs subject to the same conditions.

• Should the rule maintain the historical distinction between index-based ETFs and actively managed ETFs? Do investors find this distinction meaningful?

• If the rule maintains the distinction, what conditions of the rule should differ between index-based and actively managed ETFs? For example, some applications for index-based ETFs include a representation that the ETF will invest at least 80% of its assets, exclusive of collateral held from securities lending, in the component securities of its underlying index.[69] Should the rule include a similar condition?

• Should the proposed rule include requirements relating to index-based ETFs with an affiliated index provider? If so, what requirements and why? For example, should ETFs with affiliated index providers be required to adopt additional policies and procedures designed to further limit information sharing between portfolio management staff and index management staff? How should we define ''index provider'' for these purposes?

• Are there operational differences between index-based and actively managed ETFs that should be addressed in the proposed rule?

3. Leveraged ETFs

Although the proposed rule would not distinguish between actively managed ETFs and index-based ETFs in general, it would take a different approach with respect to leveraged ETFs, which are a type of index-based ETF that presents unique considerations.[70] ''Leveraged ETFs'' refers to ETFs that seek, directly or indirectly, to provide returns that exceed the performance of a market index by a specified multiple or to provide returns that have an inverse relationship to the performance of a market index, over a fixed period of time.[71] A leveraged ETF seeks to amplify the returns of its underlying index or to profit from a decline in the value of its underlying index. It also typically seeks to deliver the targeted return over a short period of time, such as a day. This means that investors holding shares over periods longer than the targeted period may experience performance that is different, and at times substantially different, from the targeted returns. Leveraged ETFs seek to achieve their targeted returns by using financial derivatives. These funds are sometimes referred to as trading tools because they can be used by investors to hedge against or profit from short-term market movements without using margin.[72]

The strategy that leveraged ETFs pursue requires them to rebalance their portfolios on a daily basis in order to maintain a constant leverage ratio. This daily reset, and the effects of compounding,[73] can result in performance that differs significantly from some investors' expectations of how index investing generally works.[74] This effect can be more pronounced in volatile markets.[75] As a result, buy-and-hold investors in a leveraged ETF with an intermediate or long-term time horizon—who may not evaluate their portfolios frequently—may experience large and unexpected losses.[76]

Leveraged ETFs, and their use of derivatives, also may raise issues under section 18 that we are evaluating as part of our broader consideration of the use of derivatives by registered funds and business development companies.[77] In

[69] There are some variations in this representation for index-based funds that invest in fixed-income securities and foreign securities. *See, e.g.,* Destra Exchange-Traded Fund Trust, *et al.,* Investment Company Act Release Nos. 33048 (Mar. 14, 2018) [83 FR 12208 (Mar. 20, 2018)] (notice) and 33071 (Apr. 10, 2018) (order) and related application (''Each Fund . . . will invest at least 80% of its assets, exclusive of collateral held from securities lending, in Component Securities of its respective Underlying Index, or in the case of Fixed Income Funds, in the Component Securities of its respective Underlying Index and [to-be-announced transactions] representing Component Securities, and in the case of Foreign Funds, in Component Securities and depositary receipts representing foreign securities such as [American Depositary Receipts and Global Depositary Receipts] representing such Component Securities (or, in the case of Foreign Funds tracking Underlying Indexes for which Depositary Receipts are themselves Component Securities, underlying stocks in respect of such Depositary Receipts.'') (internal footnotes omitted).

[70] We use the term ''leveraged ETFs'' in this release to refer to ETFs that pursue leveraged strategies (*i.e.,* those that seek to provide returns that exceed the performance of a market index by a specified multiple over a period of time) and inverse strategies (*i.e.,* those that seek to provide returns that have an inverse relationship to, or provide returns that are an inverse multiple of, the performance of a market index over a fixed period of time). At the end of December 2017, 187 ETFs employed leveraged or inverse investment strategies. All of these ETFs are structured as open-end funds. In total, these ETFs had total net assets of $35.26 billion or approximately 1% of all ETF assets. *See infra* footnote 427 and following text.

[71] *See* proposed rule 6c–11(c)(4); *see also* Item C.3.c. of Form N–CEN (requiring funds to identify if they seek to achieve performance results that are a multiple of an index or other benchmark, the inverse of an index or other benchmark, or a multiple of the inverse of an index or other benchmark).

[72] *See* ETF Handbook, *supra* footnote 22, at 266.

[73] For example, as a result of compounding, leveraged ETFs can outperform a simple multiple of its index's returns over several days of consistently positive returns, or underperform a simple multiple of its index's returns over several days of volatile returns.

[74] *See* Office of Investor Education and Advocacy, SEC, *Leveraged and Inverse ETFs: Specialized Products with Extra Risks for Buy-and-Hold Investors* Investor Alert and Bulletins (Aug. 1, 2009), *available at http://www.sec.gov/investor/pubs/leveragedetfs-alert.htm*; FINRA, *Non-Traditional ETFs: FINRA Reminds Firms of Sales Practice Obligations Relating to Leveraged and Inverse Exchange-Traded Funds,* Regulatory Notice 09–31 (June 2009), *available at http://www.finra.org/sites/default/files/NoticeDocument/p118952.pdf* (''FINRA Regulatory Notice 09–31'') (providing an example of a four-month period where a specified index gained 2%, while an ETF seeking to deliver twice the daily return of that index fell 6%, and the related ETF seeking to deliver twice the inverse of the index's daily return fell 26%).

[75] *See* FINRA Regulatory Notice 09–31, *supra* footnote 74 (''Using a two-day example, if the index goes from 100 to close at 101 on the first day and back down to close at 100 on the next day, the two-day return of an inverse ETF will be different than if the index had moved up to close at 110 the first day but then back down to close at 100 on the next day. In the first case with low volatility, the inverse ETF loses 0.02 percent; but in the more volatile scenario the inverse ETF loses 1.82 percent. The effects of mathematical compounding can grow significantly over time, leading to scenarios such as those noted above.'').

[76] *See id.* (reminding member firms of their sales practice obligations relating to leveraged ETFs and noting that leveraged ETFs are typically not suitable for retail investors who plan to hold these products for more than one trading session). *See also, e.g., SEC* v. *Hallas,* No. 1:17-cv-2999 (S.D.N.Y. Sept. 27, 2017); FINRA News Release, *FINRA Sanctions Oppenheimer & Co. $2.9 Million for Unsuitable Sales of Non-Traditional ETFs and Related Supervisory Failures* (June 8, 2016), *available at http://www.finra.org/newsroom/2016/finra-sanctions-oppenheimer-co-29-million-unsuitable-sales-non-traditional-etfs.* The Commission also settled an enforcement action against an investment adviser under section 206(4) of the Investment Advisers Act of 1940 (the ''Advisers Act'') and rule 206(4)–7, finding the adviser violated these provisions by failing to adequately implement written compliance policies that were designed to ensure that recommendations of single inverse ETFs to non-discretionary advisory clients were suitable for each individual client. *See In Re Morgan Stanley Smith Barney, LLC,* Investment Advisers Act Release No. 4649 (Feb. 14, 2017) (settled action), *available at https://www.sec.gov/litigation/admin/2017/ia-4649.pdf.*

[77] The staff has not supported new exemptive relief for leveraged ETFs since 2009. The orders issued to current leveraged ETF sponsors prior to the staff moratorium, as amended over time, relate to leveraged ETFs that seek investment results of up to 300% of the return (or inverse of the return) of the underlying index. Rydex ETF Trust, *et al.,* Investment Company Act Release Nos. 27703 (Feb. 20, 2007) [72 FR 8810 (Feb. 27, 2007)] (notice) and 27754 (Mar. 20, 2007) (order) and related application; Rafferty Asset Management, LLC, *et al.,* Investment Company Act Release Nos. 28379 (Sept. 12, 2008) [73 FR 54179 (Sept. 18, 2008)] (notice) and 28434 (Oct. 6, 2008) (order) and related application. *See also* ProShares Trust, *et al.,* Investment Company Act Release Nos. 28696 (Apr. 14, 2009) [74 FR 18265 Apr. 21, 2009)] (notice) and 28724 (May 12, 2009) (order) and related application (amending the applicant's prior order) (''ProShares''); Rafferty Asset Management, LLC, *et al.,* Investment Company Act Release Nos. 28889 (Aug. 27, 2009) [74 FR 45495 (Sept. 2, 2009)] (notice) and 28905 (Sept. 22, 2009) (order) and related application (amending the applicant's prior order) (''Rafferty'').

2015, for example, we proposed new 17 CFR 270.18f–4 (''rule 18f–4'' under the Act). Proposed rule 18f–4 was designed to address the investor protection purposes and concerns underlying section 18 of the Act and to provide an updated and more comprehensive approach to the regulation of funds' use of derivatives transactions.[78]

In light of our ongoing consideration, including the potential staff recommendation of a re-proposal on funds' use of derivatives, we do not believe it is appropriate to permit additional leveraged ETF sponsors to form leveraged ETFs and operate under our proposed rule at this time.[79] Accordingly, we propose to include a condition that would prevent leveraged ETFs from relying on proposed rule 6c–11.[80] ETFs that seek to provide returns that exceed the performance (or inverse performance) of a market index by a specified multiple over a fixed period could not operate under our proposed rule.

The daily or other periodic reset, and more particularly the effects of compounding, are what distinguish a leveraged ETF strategy from other strategies pursued by ETFs. The proposed condition relating to leveraged ETFs thus includes a temporal element (*i.e.,* ''over a fixed period of time'') in order to specifically capture ETFs that seek to deliver the leveraged or inverse return of a market index over a fixed period of time, daily or otherwise.[81] In addition, the proposed rule's use of the term ''multiple'' includes leverage that is not evenly divisible by 100, such as a fund that seeks to provide a return equal to 150% of the performance of an index.[82] Finally, we believe it is important to specify that an ETF may not *indirectly* seek to provide returns that exceed the performance of a market index by a specified multiple or to provide returns that have an inverse relationship to the performance of a market index over a fixed period of time in order to prevent a fund from circumventing this condition, such as by embedding inverse leverage in the underlying index.

We request comment on excluding leveraged ETFs from the scope of funds that may rely on the proposed rule.

• Do commenters agree that it is appropriate for proposed rule 6c–11 to include a condition that an ETF may not seek, directly or indirectly, to provide returns that exceed the performance of a market index by a specified multiple, or to provide returns that have an inverse relationship to the performance of a market index, over a fixed period of time?

• Alternatively, do commenters believe that the structure and operation of leveraged ETFs do not raise issues that warrant our excluding them from a rule of general applicability related to the structure and operations of ETFs? If so, are there any conditions specific to leveraged ETFs that should be part of the rule? For example, should we permit leveraged ETFs to operate in reliance on the rule but prohibit a leveraged ETF that exceeds a specific multiple of the performance, or inverse performance, of a market index? If so, what multiple should we use? For example, ETFs currently may not seek investment results over 300% of the return (or inverse of the return) of the underlying index. Should we maintain the status quo with respect to the maximum amount of leveraged market exposure that leveraged ETFs may obtain (*i.e.,* 300%)? Should we limit ETFs to a higher or lower multiplier? If so, what multiplier and why?

• Does the proposed rule's use of ''a fixed period of time'' effectively describe the daily reset mechanism in leveraged ETFs? Are there other descriptions we should use? Could an ETF seek to provide returns that are a multiple, or inverse, of an index without this limitation? For example, would such an ETF be able to operate without the daily (or other periodic) reset? Would such an ETF raise the same investor protection issues as the leveraged ETFs that we are proposing to exclude from relying on proposed rule 6c–11? Would they raise other investor protection issues? If so, what issues and why?

• Does the proposed rule prevent an ETF from circumventing this limitation by embedding leverage in an index or through any other means? If not, should we consider other conditions or limitations, and if so, what? For example, should the rule provide that an ETF may not ''obtain'' or ''provide'' leveraged exposure, rather than stating that an ETF may not ''seek'' to provide leveraged exposure as proposed? Alternatively, should we define leveraged ETFs as funds currently do in their applications (*i.e.,* to achieve its investment objective by corresponding to a specified multiple of the performance (either 125%, 150% or 200%), or the inverse performance, or the inverse multiple (either 125%, 150% or 200% of the opposite) of the performance of a particular securities index)?[83]

• Proposed rule 6c–11 does not seek to address any concerns raised under section 18 of the Act by leveraged ETFs. Do commenters agree that this is appropriate? Should we consider additional conditions in rule 6c–11 for leveraged ETFs designed to address concerns raised under section 18 or other investor protection concerns raised by their strategies? If so, what conditions? Should we provide any relief to these ETFs under section 18 of the Act?

• What types of investors purchase shares of leveraged ETFs? What is the proportion of volume from retail versus institutional trading? How do these different types of investors utilize leveraged ETFs? What is the typical holding period of leveraged ETFs by each type of investor?

• What types of intermediaries are active with leveraged ETF investments? Are the current suitability requirements for intermediaries effective with respect to leveraged ETFs? What specific methods, if any, are intermediaries using to meet their suitability obligations for these products? Should we propose as part of a future rulemaking that leveraged ETFs be subject to additional requirements, particularly for retail investors?[84]

[78] *See* Derivatives Proposing Release, *supra* footnote 40. Section 18 of the Act limits a fund's ability to obtain leverage or issue senior securities. 15 U.S.C. 80a–18.

[79] *See supra* footnote 77. As discussed in more detail in section II.G below, we are not proposing here to rescind the existing leverage ETF orders. Existing leveraged ETF sponsors would continue to operate under their exemptive orders. Existing leveraged ETFs, however, would be subject to the proposed amendments to Form N–1A discussed below.

[80] Proposed rule 6c–11(c)(4).

[81] The current exemptive orders that allow leveraged ETFs contemplate a daily reset, because the orders relate to ETFs that pursue daily investment objectives. *See supra* footnote 77. For example, one application describes its leveraged ETFs as ''seek[ing] to provide daily investment results, before fees and expenses, that correspond to 300% of the daily performance, or 300% of the inverse (opposite) daily performance, of its Underlying Index.'' *See* Rafferty, *supra* footnote 77. Another describes its leveraged ETFs as ''attempt[ing], on a daily basis, to achieve its investment objective by corresponding to a specified multiple of the performance (either 125%, 150% or 200%), or the inverse performance, or the inverse multiple (either 125%, 150% or 200% of the opposite) of the performance of a particular securities index.'' *See* ProShares, *supra* footnote 77.

[82] Similarly, an ''inverse ETF'' includes both inverse strategies (*i.e.,* −100% of an index's performance) and leveraged inverse strategies (*e.g.,* −125% or −200% of an index's performance).

[83] *See supra* footnote 81.

[84] *See, e.g.,* NASD, *Structured Products: NASD Provides Guidance Concerning the Sale of Structured Products,* Notice to Members (September 2005), *available at http://www.complinet.com/file_store/pdf/rulebooks/nasd_0559ntm.pdf*; *see also* FINRA, *Complex Products: Heightened Supervision of Complex Products,* Regulatory Notice 12–03 (January 2012), *available at http://www.finra.org/sites/default/files/NoticeDocument/p125397.pdf.*

• The Commission understands that leveraged ETFs typically provide enhanced disclosure of the risks of investing in the ETF.[85] Do investors understand leveraged ETFs better today than they did when Commission staff and FINRA jointly issued an investor alert expressing the concern that individual investors may be confused about the performance objectives of leveraged ETFs?[86] For example, are investors more likely to be aware that leveraged ETFs are typically designed to achieve their stated performance objectives on a periodic basis (*e.g.,* daily)? Do investors understand that leveraged ETFs may not achieve those performance objectives over the long-term?[87]

• Leveraged ETFs typically include charts in their disclosures that explain the potential impact of compounding to an investor's returns. Should we amend Form N–1A to require leveraged ETFs to include such a chart to better explain the impact of compounding? Are there other disclosures that we should require leveraged ETFs to provide? If so, what are they?

• Should we propose rules governing leveraged ETF marketing materials to address concerns that leveraged ETFs may be marketed to investors that do not have an appropriate risk tolerance to invest in these products or that lack understanding of leveraged ETFs' strategies and risks? For example, should we require leveraged ETFs to include prescribed cautionary disclosures regarding these strategies and risks?

B. Exemptive Relief Under Proposed Rule 6c–11

Proposed rule 6c–11 would provide ETFs within the scope of the rule with exemptions from certain provisions of the Act that are necessary to allow ETFs to operate. These exemptions are generally consistent with the relief we have given to ETFs under our exemptive orders.[88] Proposed rule 6c–11 would permit an ETF that meets the conditions of the rule to: (i) Redeem shares only in creation unit aggregations; (ii) permit ETF shares to be purchased and sold at market prices rather than at NAV per share; (iii) engage in in-kind transactions with certain affiliates; and (iv) in certain limited circumstances, pay authorized participants the proceeds from the redemption of shares in more than seven days. As discussed below in section II.C, the exemptions would be subject to certain conditions that are designed to address the concerns underlying the relevant statutory provisions and to support a Commission finding that the exemptions are in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act.[89]

1. Treatment of ETF Shares as ''Redeemable Securities''

Under proposed rule 6c–11, an ETF, as defined in the rule, would be considered to issue a ''redeemable security'' within the meaning of section 2(a)(32) of the Act.[90] As discussed above, ETFs have features that distinguish them from both traditional open-end and closed-end funds. A defining feature of open-end funds is that they offer redeemable securities, which allow the holder to receive his or her proportionate share of the fund's NAV per share upon presentation of the security to the issuer. Although individual ETF shares cannot be redeemed, except in limited circumstances,[91] they can be redeemed in creation unit aggregations.[92] Therefore, we believe that ETF shares are most appropriately classified under the proposed rule as redeemable securities within the meaning of section 2(a)(32),[93] and that ETFs should be regulated as open-end funds within the meaning of section 5(a)(1) of the Act.[94]

The arbitrage mechanism that is central to the operation of an ETF (and the conditions in our relief designed to facilitate an effective arbitrage mechanism) serves to keep the market price of ETF shares at or close to the ETF's NAV per share. As a result, even though only authorized participants may redeem creation units directly from the ETF at NAV per share, investors are able to sell their ETF shares on the secondary market at or close to NAV, similar to investors in an open-end fund that redeem their shares directly from the fund at NAV per share.[95] The shares of closed-end funds, on the other hand, generally trade on the secondary market at a discount or premium to NAV.

Our exemptive orders have provided exemptions from sections 2(a)(32) and 5(a)(1) of the Act so that ETFs may register under the Act as open-end funds while issuing shares redeemable in creation units only. Unlike our exemptive orders, however, the proposed rule would not provide an exemption from the definition of ''redeemable security'' in section 2(a)(32) or from the definition ''open-end company'' in section 5(a)(1). We believe that it is more appropriate for the proposed rule to address these questions of status by classifying ETF shares as ''redeemable securities.'' Thus,

[85] This understanding is based on Commission staff review of registration statements filed with the Commission and ETF websites.

[86] *See supra* footnote 74.

[87] *See e.g.,* Paolo Guasoni and Eberhard Mayerhofer, Leveraged Funds: Robust Replication and Performance Evaluation (2017) (''Leveraged and inverse exchange-traded funds seek daily returns equal to fixed multiples of indexes' returns. Trading costs implied by frequent adjustments of funds' portfolios create a tension between tracking error, reflecting short-term correlation with the index, and excess return, the long-term deviation from the leveraged index's performance.''); Lu Lei, Jun Wang, and Ge Zhang, *Long-term performance of leveraged ETFs,* 21 Financial Services Review 1 (2012) (''Overall our results caution against the use of leveraged ETFs as long-term investment substitutes for long or short positions of the benchmark indices.'').

[88] Our exemptive orders also provide relief allowing certain types of funds to invest in ETFs beyond the limits of section 12(d)(1) of the Act. We are not addressing this relief at this time. *See infra* section II.G. However, we are proposing to rescind the master-feeder relief that we previously granted to ETFs that do not rely on the relief as of the date of this proposal (June 28, 2018). We also propose to grandfather existing master-feeder arrangements involving ETF feeder funds, but prevent the formation of new ones, by amending relevant exemptive orders. *See infra* section II.F.

[89] *See* 15 U.S.C. 80a–6(c).

[90] Proposed rule 6c–11(b)(1).

[91] *See infra* section II.C.1 (discussing circumstances where ETF shares can be individually redeemed).

[92] *See* proposed rule 6c–11(a) (defining an exchange-traded fund, in part, as a registered open-end management company that issues and redeems its shares in creation units). The proposed rule would define ''creation unit'' to mean a specified number of ETF shares that the ETF will issue to (or redeem from) an authorized participant in exchange for the deposit (or delivery) of a basket and a cash balancing amount (if any). *See* proposed definition of ''creation unit'' in rule 6c–11(a).

[93] If ETF shares were not classified as redeemable securities within the meaning of section 2(a)(32) of the Act, an ETF would be subject to the provisions of the Act applicable to closed-end funds. *See* 15 U.S.C. 80a–5(a)(2) (defining a ''closed-end company'' as any management company other than an open-end company).

[94] 15 U.S.C. 80a–5(a)(1) (defining ''open-end company''); 15 U.S.C. 80a–2(a)(32) (defining ''redeemable security'').

[95] *See* Robert Engle & Debojyoti Sarkar, *Premiums-Discounts and Exchange Traded Funds,* 13 Journal of Derivatives 4 (Summer 2006) (''Engle Article'') (observing that premiums and discounts for domestic ETFs are generally small and highly transient, and that while premiums and discounts are larger and more persistent in international ETFs, they are smaller and less persistent than the premiums and discounts of international closed-end funds); *but see, e.g.,* Bradley Kay, *Has the ETF Arbitrage Mechanism Failed?,* Morningstar (Mar. 11, 2009), *available at http://news.morningstar.com/articlenet/article.aspx?id=283302* (stating that market prices for ETFs may deviate significantly from NAV during periods of market stress); Chris Dieterich, *Greece ETF Pacing for Record Tumble on Huge Volume: Here's What You Need to Know,* Barron's (June 29, 2015), *available at https://www.barrons.com/articles/greece-etf-pacing-for-record-tumble-on-huge-volume-heres-what-you-need-to-know-1435597369* (noting that ETFs tied to Greek and Egyptian stocks traded at significant discounts to NAV when the exchanges on which the underlying stocks traded were closed).

any ETF operating in compliance with the rule's conditions and requirements would meet the definition of open-end company.[96]

ETFs operating in reliance on the proposed rule would be subject to the requirements imposed under the Act and our rules that apply to all open-end funds.[97] We note that our approach is substantially similar to the 2008 proposal, which was generally supported by commenters.[98] In addition, in our view the rules under the Exchange Act that apply to redeemable securities issued by an open-end fund would apply to ETFs relying on the proposed rule.[99] Thus, proposed rule 6c–11 would result in ETFs relying on proposed rule 6c–11 becoming eligible for the ''redeemable securities'' exceptions in 12 CFR 242.101(c)(4) and 242.102(d)(4) (''rules 101(c)(4) and 102(d)(4) of Regulation M'') and 12 CFR 240.10b–17(c) (''rule 10b–17(c) under the Exchange Act'') in connection with secondary market transactions in ETF shares and the creation or redemption of creation units. Similarly, we would view ETFs relying on rule 6c–11 as within the ''registered open-end investment company'' exemption in rule 11d1–2 under the Exchange Act.[100]

We request comment on this aspect of the proposed rule.

- Are there differences between ETFs and other open-end funds that would justify not applying certain open-end fund provisions of the Act or our rules to ETFs? For example, we adopted tailored liquidity risk management program requirements for ETFs under 17 CFR 270.22e–4 (''rule 22e–4'').[101] Should we consider tailored requirements for ETFs in connection with other provisions?
- As we discussed above, ETFs relying on proposed rule 6c–11 would be able to rely on the ''redeemable securities'' exceptions in rules 101(c)(4) and 102(d)(4) of Regulation M and rule 10b–17(c) under the Exchange Act and the ''registered open-end investment company'' exemption in rule 11d1–2 under the Exchange Act. Should the Commission exempt ETFs relying on proposed rule 6c–11 from any other rules under the Exchange Act?[102] If so, which rules and why? For example, ETFs typically request relief from Exchange Act section 11(d)(1) and rule 11d1–2 thereunder; and 17 CFR 240.10b–10, 240.15c1–5, and 240.15c1–6 (rules 10b–10, 15c1–5, and 15c1–6 under Exchange Act). Should the Commission provide relief from these provisions under the Exchange Act? If so, what conditions should apply to such relief, if any, and why? For example, ETFs currently rely on relief that is conditioned on: minimum creation unit sizes;[103] dissemination of the Intraday Indicative Value (''IIV'');[104] restrictions on the payment of certain cash compensation or economic incentives;[105] minimum levels of diversification in the ETF's basket;[106] and whether the ETF is managed to track an index.[107] Should we eliminate or modify any or all of these conditions? We requested comment on exchange listing standards for ETFs and other ETPs in 2015.[108] Do commenters have updated views on those requests for comment?

2. Trading of ETF Shares at Market-Determined Prices

Section 22(d) of the Act, among other things, prohibits investment companies, their principal underwriters, and dealers from selling a redeemable security to the public except at a current public offering price described in the prospectus.[109] Rule 22c–1 generally requires that a dealer selling, redeeming, or repurchasing a redeemable security do so only at a price based on its NAV.[110] Together, section 22(d) and rule 22c–1 are designed to: (i) Prevent dilution caused by certain riskless trading practices of principal underwriters and dealers; (ii) prevent unjust discrimination or preferential treatment among investors purchasing and redeeming fund shares; and (iii) preserve an orderly distribution of investment company shares.[111] ETFs seeking to register under the Act obtain exemptions from these provisions because investors may purchase and sell individual ETF shares from and to dealers on the secondary market at market-determined prices (*i.e.,* at prices other than those described in the prospectus or based on NAV). Consistent with our prior exemptive orders, proposed rule 6c–11 would provide exemptions from these provisions.[112]

As discussed above, only authorized participants can purchase and redeem shares directly from an ETF at NAV per share and only in creation unit aggregations. Because authorized participants (and other market participants transacting through an authorized participant) can take advantage of disparities between the market price of ETF shares and NAV per share, they may be in a different position than investors who buy and sell individual ETF shares only on the secondary market.[113] However, if the arbitrage mechanism is functioning effectively, entities taking advantage of these disparities in market price and NAV per share move the market price to a level at or close to the NAV per share of the ETF. The proposed rule would provide exemptions from section 22(d) and rule 22c–1 because we believe this

[96] Section 5(a)(1) defines an ''open-end company'' as ''a management company which is offering for sale or has outstanding any redeemable security of which it is the issuer.'' 15 U.S.C. 80a–5(a)(1).

[97] *See, e.g.,* 15 U.S.C. 80a–22; 17 CFR 270.22c–1.

[98] *See* 2008 ETF Proposing Release, *supra* footnote 3. *See also* ICI 2008 Comment Letter; Xshares 2008 Comment Letter.

[99] *See, e.g.,* 17 CFR 240.15c3–1. *See also* Securities Transaction Settlement Cycle, Exchange Act Release No. 80295 (Mar. 22, 2017) [82 FR 15564 (Mar. 29, 2017)] (''T+2 Adopting Release'') (shortening the standard settlement cycle for most broker-dealer securities transactions to two business days).

[100] *Cf.* Securities Industry Association, SEC Staff No-Action Letter (Nov. 21, 2005) (treating certain equity index-based ETFs as registered open-end investment companies for purposes of rule 11d1–2).

[101] *See* Investment Company Liquidity Risk Management Programs, Investment Company Act Release No. 32315 (Oct. 13, 2016) [81 FR 82142 (Nov. 18, 2016)] (''LRM Adopting Release''), at sections II.A. and II.J.

[102] *See, e.g., supra* footnote 14.

[103] *See, e.g.,* Letter from James A. Brigagliano, Deputy Director, Division of Trading and Markets, to W. John McGuire, Morgan, Lewis & Bockius LLP re: U.S. One Trust Actively-Managed Exchange Traded Fund of Exchange Traded Funds, dated May 4, 2010 (conditioning relief under Exchange Act Section 11(d)(1) on the ETFs continuously redeeming, at NAV, creation unit aggregations of 50,000 shares valued at a minimum of $1.25 million).

[104] *Id.* (representing that the ETFs would disseminate the IIV every 15 seconds throughout the trading day).

[105] *See, e.g.,* Letter from Catherine McGuire, Chief Counsel, Division of Market Regulation to Securities Industry Association, dated Nov. 21, 2005, at n.3 and accompanying text.

[106] *Id.* (defining, in part, a ''qualifying ETF'' as consisting of a basket of twenty or more component securities with no one component security constituting more than 25% of the total value of the ETF).

[107] *Id.*

[108] 2015 ETP Request for Comment, *supra* footnote 9, at n.106 and accompanying and following text.

[109] 15 U.S.C. 80a–22(d).

[110] *See* 17 CFR 270.22c–1.

[111] *See generally* Mutual Fund Distribution Fees; Confirmations, Investment Company Act Release No. 29367 (July 21, 2010) [75 FR 47064 (Aug. 4, 2010)] (discussing legislative history of section 22(d)).

[112] *See* proposed rule 6c-11(b)(2). The reference in the proposed rule to ''repurchases . . . at market-determined prices'' refers to secondary market transactions with dealers. Thus, the rule would not allow an ETF to repurchase shares from an investor at market-determined prices.

[113] *See, e.g.,* Comment Letter of Barclays Global Investors on 2001 Concept Release (Jan. 11, 2002) (''[D]uring periods of market volatility . . . it is not unreasonable to assume that some retail investors would buy or sell ETF shares at secondary market prices moving in the opposite direction of a fund's NAV.'').

arbitrage mechanism—and the conditions in this rule designed to promote a properly functioning arbitrage mechanism—have adequately addressed, over the significant operating history of ETFs, the potential concerns regarding shareholder dilution and unjust discrimination that these provisions were designed to address.

We proposed the same exemptions in 2008 and commenters who addressed this aspect of the 2008 ETF Proposing Release supported the Commission's approach.[114] Commenters on the 2015 ETP Request for Comment also addressed the existing arbitrage mechanism, generally arguing that it is effective and efficient in ensuring that an ETF's market price does not vary substantially from its NAV per share.[115] On the other hand, one commenter questioned the efficacy of the arbitrage mechanism, particularly at the close of trading when bid-ask spreads tend to widen.[116] One commenter asserted that the arbitrage mechanism does not work well for ETFs holding securities that do not trade during U.S. market hours.[117] Another commenter argued that even if the arbitrage mechanism corrects price mismatches between market price and NAV per share, it does so by creating an unfair windfall for authorized participants who can capitalize on information asymmetries and operational advantages to extract value from the market.[118]

The arbitrage mechanism is the foundation for why retail and other secondary market investors generally can buy and sell ETF shares at prices that are at or close to the prices at which authorized participants are able to buy and redeem shares directly from the ETF at NAV. In the Commission's experience, the deviation between the market price of ETFs and NAV per share, each calculated as of the close of trading each day, generally has been relatively small.[119] For example, during 2016–2017, the closing price of ETFs based on U.S. equity indexes were within 1% of NAV for 97.9% of trading days and within 1% of NAV for actively managed ETFs investing in U.S. equities for 98.5% of trading days. The absolute weighted average of the daily difference between the NAV and market price during a six-month period ending in December 2017 was 0.014% for ETFs based on U.S. equities indexes and 0.074% for actively managed ETFs investing in U.S. equities.[120]

Other types of ETFs have had a somewhat higher deviation between NAV per share and market price. During 2016–2017, the closing price for index-based and actively managed ETFs investing in international equities, for example, were within 1% of NAV for 87.4% and 86.8% of trading days, respectively. Similarly, the absolute weighted average of the daily difference between the NAV and market price during a six-month period ending in December 2017 for index-based and actively managed ETFs investing in U.S. fixed-income securities were 0.067% and 0.068%, respectively. The absolute weighted average of daily difference between NAV per share and market price during the six-month period studied was 0.206% for ETFs based on international equities indexes and 0.390% for actively managed ETFs investing in international equities.[121]

These numbers represent only broad averages with respect to end-of-day differences, however, and intraday deviations between market price and NAV per share may be greater under certain circumstances. These figures also do not reflect intraday deviations between market prices and the contemporaneous value of the ETF's portfolio.[122] However, one academic paper has shown that deviations between intraday market prices and estimated intraday values for domestic ETFs also were generally small.[123]

The Commission and its staff have observed the operation of the arbitrage mechanism during periods of market stress when the deviation between intraday market prices and the next-calculated NAV per share significantly widened for short periods of time. During periods of extraordinary volatility in the underlying ETF holdings, it may be difficult for authorized participants or market makers to confidently ascribe precise values to an ETF's holdings, thereby making it more difficult to effectively hedge their positions.[124] These market participants may widen their quoted spreads in ETF shares or, in certain cases, may elect not to transact in or quote ETF shares, rather than risk loss.[125]

Market makers may have already exhibited this behavior in periods of extraordinary volatility.[126] For example,

[114] *See* ICI 2008 Comment Letter; Xshares 2008 Comment Letter.

[115] *See, e.g.,* Comment Letter of KCG Holdings, Inc. on 2015 ETP Request for Comment (Aug. 17, 2015); Comment Letter of Vanguard on 2015 ETP Request for Comment (Aug. 17, 2015); Comment Letter of Charles Schwab & Co., Inc. and Charles Schwab Investment Management, Inc. on 2015 ETP Request for Comment (Aug. 17, 2015) (''Schwab ETP Comment Letter'') (noting that it had not identified any significant systemic differences in efficiency across various ETF products, regardless of ETF's investment strategy).

[116] *See* Comment Letter of ETF Consultants.com, Inc. on 2015 ETP Request for Comment (Aug. 17, 2015); *see also infra* section II.H regarding bid-ask spreads.

[117] *See* Comment Letter of James J. Angel, Ph.D., CFA on 2015 ETP Request for Comment (Aug. 17, 2015).

[118] *See* Comment Letter of Occupy the SEC on 2015 ETP Request for Comment (Aug. 21, 2015).

[119] Figures in this section represent an analysis by Commission staff of market data obtained from Bloomberg Professional Services and Morningstar. In preparing this analysis, staff used the market price of each ETF as of the close of trading each day.

[120] An ETF can trade at a premium or discount to its NAV per share on any given day. When taking an average over many days, premiums (which have a positive difference) and discounts (which have a negative difference) may offset each other. Therefore, to calculate deviation from NAV, we use the absolute value of premiums and discounts when calculating weighted average differences to prevent such offsetting.

[121] International equity ETFs can provide exposure to markets that do not overlap with U.S. trading hours. In these circumstances, the deviation between NAV per share and market price may be attributable in large part to obtaining exposure to those markets when they are closed.

[122] Most funds calculate NAV per share once per day as of the time the major U.S. stock exchanges close. *See supra* footnote 26.

[123] Engle Article, *supra* footnote 95. For domestic ETFs, the study showed intraday average daily premium of 0.25 basis points with an average standard deviation of 11.8 basis points. For international ETFs, the respective figures were 23.7 basis points and an average standard deviation of 64.8 basis points. The intraday premium was measured every minute as the percentage difference between: (i) The average of the bid and the ask of the ETF shares; and (ii) the intraday indicative value (IIV) of the ETF's portfolio. *See infra* sections II.C.3 and II.C.6 for a discussion of the IIV and the potential problems associated with using the IIV as a tool to measure the current value of the ETF's portfolio on an ongoing basis.

[124] *See generally* Itzhak Ben-David, *et al., Exchange Traded Funds (ETFS),* National Bureau of Econ., Working Paper No. 22829 (Nov. 2016), *available at http://www.nber.org/papers/w22829* (''Ben-David'') (''Because of sparse liquidity in some exchanges [on the morning of August 24, 2015], some of the arbitrage programs diagnosed unreliable price data and withdrew from the market, leading to a positive feedback loop.'').

[125] *See also* Milan Borkovec, *et al., Liquidity and Price Discovery in Exchange-Traded Funds: One of Several Possible Lessons from the Flash Crash,* 1 The Journal of Index Investing 2 (2010) (''Borkovec'') (reporting that liquidity of ETFs declined dramatically during the ''Flash Crash,'' causing spreads to widen significantly).

[126] *See* Ben-David, *supra* footnote 124 (''ETF market makers and [authorized participants] arguably withdrew from the market after a trading pause in the futures market, which they used to hedge their exposure in volatile trading sessions.'') (internal citations omitted). Many ETFs disclose the risk that ETF shares will trade at a premium or discount, particularly during times of market disruptions, in their prospectuses as part of their principal risk disclosure. *See, e.g.,* iShares Trust rule 485(b) Registration Statement (Nov. 1, 2017), *available at https://www.sec.gov/Archives/edgar/data/1100663/000119312517327588/d486424d485bpos.htm* (''Market Trading Risk: The Fund faces numerous market trading risks, including the potential lack of an active market for Fund shares, losses from trading in secondary markets, periods of high volatility and disruptions in the creation/redemption process. ANY OF

Continued

on May 6, 2010, the prices of many U.S.-based equity products experienced a significant decline and recovery, and many of the securities that experienced the greatest price changes were equity-based ETFs.[127] Significant price volatility on the morning of August 24, 2015 triggered limit up-limit down pauses in many equity securities, including many ETFs.[128] In both instances, certain ETFs saw larger intraday premiums/discounts and wider bid-ask spreads for portions of the trading day.[129] Deviations between market price and NAV per share were closed after relatively short periods, however, as the arbitrage mechanism resumed its effectiveness.[130]

Accordingly, we recognize that under certain circumstances, including during periods of market stress, the arbitrage mechanism may work less effectively for a period of time. We also recognize that secondary market investors who trade in ETF shares during these periods may be harmed by trading at a price that is not close to the NAV per share of the ETF (or the contemporaneous value of the ETF's portfolio). On balance, however, we believe these investors are more likely to weigh the potential benefits of ETFs (*e.g.,* low cost and intraday trading) against any potential for market price deviations when deciding whether to utilize ETFs.[131] Further, we believe that the conditions we are proposing as part of rule 6c–11, along with other recent actions that are designed to promote an effective arbitrage mechanism,[132] would continue to result in a sufficiently close alignment between an ETF's market price and NAV per share in most circumstances, and provide an appropriate basis for the exemptive relief we are proposing. We particularly find this to be the case given the benefits ETFs offer investors, as discussed above.

Furthermore, to the extent that there are instances where bid-ask spreads widen, or premiums and discounts persist, the proposed rule and disclosure amendments would require ETFs to disclose certain information on their website.[133] We believe that it is important for investors to be informed where costs may increase beyond what they would reasonably expect. Our exemptive orders have required ETFs' websites to disclose, among other things, the ETF's NAV per share for the prior business day, the market closing price or the midpoint of the bid-ask spread at the time of the calculation of NAV, and a calculation of the premium or discount of the market closing price or midpoint of the bid-ask spread against NAV per share.[134] However, the proposed rule and disclosure amendments would require ETFs to disclose additional information on their websites that is not currently required under our exemptive orders.[135]

In particular, as discussed in section II.C.6, we are proposing to require ETFs to disclose on their websites the median bid-ask spread for the ETF's most recent fiscal year and certain historical information about the extent and frequency of an ETF's premiums and discounts. This would allow investors to be more aware of this risk when deciding whether to invest in ETFs generally or in a particular ETF. Our proposed amendments to Form N–1A would require additional disclosure regarding ETF trading information and related costs, including information relating to high-end (95th percentile) spread costs.[136] We also request comment below on whether there are other ways to calculate premiums and discounts, or other metrics we should consider, to better inform investors about an ETF's history of deviations between intraday market prices and (i) the next-calculated NAV; or (ii) the contemporaneous value of the ETF's portfolio.[137]

We request comment on the proposed exemptions from section 22(d) of the Act and rule 22c–1 thereunder.

- Is the proposed relief sufficient to facilitate transactions in ETF shares on the secondary market?
- Will the proposed conditions (discussed below) promote the arbitrage mechanism and support the Commission granting this relief? Are there other conditions we should consider?
- Under what circumstances could a premium or discount for an ETF develop or persist? For example, when would a premium or discount develop due to a break-down in the arbitrage mechanism? Are there instances where a premium or discount may develop or persist because of price discovery, such as when the underlying markets for the ETF's component securities are closed? Are there instances where a premium or discount may develop or persist because of transaction costs relating to the ETF's basket securities? How can these circumstances be distinguished from one another? Should we consider any changes to our proposal to account for these different circumstances?
- Would the arbitrage mechanism contemplated by the proposed rule keep ETF market prices at or close to NAV per share under normal market conditions? How should this be measured? For example, is it appropriate to assess premiums and discounts solely by comparing ETF market prices to the ETF's NAV, which typically is calculated at the end of the day? Should intraday calculations play a larger role when assessing premiums and discounts? Should we, for example, assess the efficiency of the arbitrage mechanism by comparing the mean/median of the market prices on a given trading day against the end of day NAV? Alternatively, should we compare the mean/median of the market price on a given trading day against an intraday

THESE FACTORS, AMONG OTHERS, MAY LEAD TO THE FUND'S SHARES TRADING AT A PREMIUM OR DISCOUNT TO NAV.'').

[127] *See* Final May 6 Report, *supra* footnote 9, at n.36 and accompanying text (noting that ETFs accounted for approximately 70% of all securities with trades broken pursuant to the clearly erroneous execution rules on May 6).

[128] *See* August 24 Staff Report, *supra* footnote 32 (noting that ETFs as a class accounted for almost all of the 1,279 trading halts on August 24, 2015, but 80% of ETFs did not experience a single trading halt).

[129] *See* Borkovec, *supra* footnote 125; Ben-David, *supra* footnote 124.

[130] *See* Borkovec, *supra* footnote 125, at 40; *see also* Ananth Madhavan, *Exchange-Traded Funds, Market Structure, and the Flash Crash,* 68 Financial Analysts Journal 20 (2012) (''Madhavan Article'').

[131] The Commission has taken steps to address disruptions in the arbitrage mechanism. For example, the Commission approved changes to the limit up-limit down rules following the market events on August 24, 2015. *See* Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Clarify the Operation of the Regulation NMS Plan to Address Extraordinary Market Volatility, Exchange Release No. 78435 (July 28, 2016) [81 FR 51239 (Aug. 3, 2016)]; Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Extend the Effective Date of SR–FINRA–2016–028, Exchange Release No.78660 (Aug. 24, 2016) [81 FR 59676 (Aug. 30, 2016)].

[132] For example, rule 22e–4 under the Act requires ETFs to consider certain additional factors that address the relationship between the liquidity of the ETF's portfolio and the arbitrage mechanism in assessing, managing, and periodically reviewing its liquidity risk. *See* LRM Adopting Release, *supra* footnote 101. We have taken these requirements into consideration in developing the conditions in this proposal.

[133] *See infra* section II.C.6.

[134] *See, e.g.,* Fidelity Commonwealth Trust, Investment Company Act Release Nos. 32166 (June 29, 2016) [81 FR 44063 July 6, 2016)] (notice) and 32191 (July 26, 2016) (order) and related application; Claymore Exchange-Traded Fund Trust, Investment Company Act Release Nos. 27469 (Aug. 28, 2006) [71 FR 51869 (Aug. 31, 2006)] (notice) and 27483 (Sept. 18, 2006) (order) and related application.

[135] *See infra* footnote 278 and accompanying and following text (noting that, currently, Form N–1A provides an ETF with the option to omit certain historical information regarding premiums and discounts from its prospectus and annual report if the disclosure is provided on its website).

[136] *See infra* section II.H.

[137] *See infra* section II.C.6.

measure of the value of an ETF's portfolio?

3. Affiliated Transactions

Section 17(a) of the Act generally prohibits an affiliated person of a registered investment company, or an affiliated person of such person, from selling any security or other property to or purchasing any security from the company.[138] Purchases and redemptions of ETF creation units are typically effected in kind, and section 17(a) prohibits these in-kind purchases and redemptions by affiliated persons of the ETF. An affiliated person of an ETF includes, among others: (i) Any person directly or indirectly owning, controlling, or holding with power to vote, 5% or more of the outstanding voting securities of the ETF; (ii) any person 5% or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote by the ETF; and (iii) any person directly or indirectly controlling, controlled by, or under common control with the ETF.[139]

ETF applicants have requested, and we have granted, exemptive relief from section 17(a) of the Act for: (i) Persons affiliated with the ETF based on their ownership of 5% or more of the ETF's outstanding securities (''first-tier affiliates''); and (ii) affiliated persons of the first-tier affiliates or persons who own 5% or more of the outstanding securities of one or more funds advised by the ETF's investment adviser (''second-tier affiliates'').[140] In seeking this relief, applicants have stated that first- and second-tier affiliates are not treated differently from non-affiliates when engaging in purchases and redemptions of creation units.[141] All purchases and redemptions of creation units are at an ETF's next-calculated NAV pursuant to rule 22c–1. Additionally, the securities deposited or delivered upon redemption are valued in the same manner, using the same standards, as those securities are valued for purposes of calculating the ETF's NAV per share.

Proposed rule 6c–11 similarly would provide exemptions from sections 17(a)(1) and (a)(2) of the Act with regard to the deposit and receipt of baskets to a person who is an affiliated person of an ETF (or who is an affiliated person of such a person) solely by reason of: (i) Holding with the power to vote 5% or more of an ETF's shares; or (ii) holding with the power to vote 5% or more of any investment company that is an affiliated person of the ETF.[142] We believe that this relief is necessary to facilitate the efficient functioning of the arbitrage mechanism. Without it, an authorized participant or other market participant that becomes an affiliated person of the ETF due to its holdings would be prevented from engaging in arbitrage using an in-kind basket. This, in turn, could have the adverse effect of limiting the pool of market participants that could engage in arbitrage. Ultimately, it could result in the deviation between market price and NAV per share widening in cases where there are very few authorized participants or other market participants actively engaged in transactions with the ETF. The arbitrage mechanism for newly launched ETFs could be particularly challenged without this relief because every purchaser of a creation unit would be considered an affiliated person of the ETF so long as there are fewer than twenty creation units outstanding. We also believe that this relief is appropriate because all purchases and redemptions of creation units are at an ETF's next-calculated NAV, and the securities deposited or delivered upon redemption would be valued in the same manner, using the same standards, as those securities are valued for purposes of calculating the ETF's NAV.

The exemption in proposed rule 6c–11(b)(3) is similar to the section 17(a) exemption we proposed in 2008, although the relief would be subject to certain additional conditions related to custom baskets.[143] Commenters who addressed the proposed relief in 2008 supported it.[144] Several commenters, however, requested that the relief be expanded to cover additional types of affiliated relationships, such as broker-dealers that are affiliated with the ETF's adviser.[145] These commenters noted that any Commission concern of undue influence by the affiliate would be addressed by the federal securities laws and regulations that prohibit manipulative practices and misuse of nonpublic information, and that ETFs would benefit from an increase in entities eligible to transact with the ETF.[146] An increase in the number of authorized participants could also help to reduce the potential for an ETF to be reliant on one or more particular authorized participants.[147]

While we acknowledge that an increase in entities eligible to transact with an ETF could facilitate the arbitrage mechanism and reduce concentration risk, we preliminarily do not believe that it is appropriate to expand the scope of affiliated persons covered by the exemption at the same time that we are permitting additional flexibility with respect to custom baskets. The proposed rule would allow an ETF to utilize custom baskets if certain conditions are met, increasing the possibility that affiliates and non-affiliates could be treated differently in connection with an ETF's receipt or delivery of baskets.[148] We believe that the conditions related to the issuance or acceptance of custom baskets in proposed rule 6c–11 would provide appropriate protections against overreaching and similar abusive practices when an ETF exchanges a custom basket with an affiliate; however, limiting the types of affiliates that are permitted to rely on this exemption would serve as an additional protection against potential disparate treatment in connection with an ETF's receipt or delivery of baskets.

We request comment on this aspect of the proposed rule.

- Without an exemption from section 17(a) of the Act, would ETFs or authorized participants bear any costs that they do not incur today?
- As discussed above, the exemptive relief from section 17(a) of the Act that we are proposing would apply only to

[138] 15 U.S.C. 80a–17(a).

[139] 15 U.S.C. 80a–2(a)(3)(A), (B) and (C). A control relationship is presumed when one person owns more than 25% of another person's outstanding voting securities. 15 U.S.C. 80a–2(a)(9).

[140] *See, e.g.,* Barclays Global 2000, *supra* footnote 6 (''Because purchases and redemptions of Creation Units may be 'in-kind' rather than cash transactions, section 17(a) may prohibit affiliated persons of an [ETF] from purchasing or redeeming Creation Units.'').

[141] *See e.g.,* Barclays Global 2008, *supra* footnote 58.

[142] *See* proposed rule 6c–11(b)(3).

[143] *See id.* To utilize custom baskets, proposed rule 6c–11(c)(3) would require an ETF to adopt and implement written policies and procedures that: (i) Set forth detailed parameters for the construction and acceptance of custom baskets that are in the best interests of the ETF and its shareholders, including the process for any revisions to, or deviations from, those parameters; and (ii) specify the titles or roles of the employees of the ETF's investment adviser who are required to review each custom basket for compliance with those parameters.

[144] *See, e.g.,* Comment Letter of Barclays Capital Inc. (May 8, 2008); ICI 2008 Comment Letter; SSgA 2008 Comment Letter.

[145] *See, e.g.,* ICI 2008 Comment Letter; BGFA 2008 Comment Letter.

[146] *See, e.g.,* ICI 2008 Comment Letter; ABA 2008 Comment Letter.

[147] Item E.2.a. of Form N–CEN requires ETFs to provide certain identifying information regarding its authorized participants. *See* Investment Company Reporting Modernization Adopting Release, Investment Company Act Release No. 32314 (Oct. 13, 2016) [81 FR 81870 (Nov. 18, 2016)] (''Reporting Modernization Adopting Release'') (''[C]ollecting information concerning these entities on an annual basis will allow [the Commission] to understand and better assess the size, capacity, and concentration of the authorized participant framework and also inform the public about certain characteristics of the ETF primary markets.'').

[148] *See* proposed rule 6c–11(c)(3).

in-kind purchases and redemptions of creation units, and only to persons affiliated with the ETF (or affiliates of those persons) by reason of holding the power to vote 5% or more of the ETF's shares or holding the power to vote 5% or more of any investment company that is affiliated with the ETF. Should the relief extend to parties that are affiliated persons of an ETF for other reasons, or to non-creation unit transactions, such as portfolio transactions? For example, should a broker-dealer that is affiliated with the ETF's adviser be allowed to transact in kind with the ETF? If so, should the proposed rule include any additional conditions to minimize potential risks of overreaching for this type of affiliated person? How would expanding the scope of the exemption in this manner interact with the proposed conditions regarding basket flexibility?

4. Additional Time for Delivering Redemption Proceeds

Section 22(e) of the Act generally prohibits a registered open-end management investment company from postponing the date of satisfaction of redemption requests for more than seven days after the tender of a security for redemption.[149] This prohibition can cause operational difficulties for ETFs that hold foreign investments and exchange in-kind baskets for creation units. For example, local market delivery cycles for transferring foreign investments to redeeming investors, together with local market holiday schedules, can sometimes require a delivery process in excess of seven days. These ETFs have previously requested, and we have granted, relief from section 22(e) so that they may satisfy redemptions up to a specified maximum number of days (depending upon the local markets), as disclosed in the ETF's prospectus or statement of additional information (''SAI''). Other than in the disclosed situations, these ETFs satisfy redemptions within seven days.[150]

Section 22(e) was designed to prevent unreasonable delays in the actual payment of redemption proceeds.[151] Proposed rule 6c–11 would provide an exemption from section 22(e) of the Act because we believe that the limited nature of the exemption addresses the concerns underlying this section of the Act. As proposed, rule 6c–11 would grant relief from section 22(e) to permit an ETF to delay satisfaction of a redemption request for more than seven days if a local market holiday, or series of consecutive holidays, the extended delivery cycles for transferring foreign investments to redeeming authorized participants, or the combination thereof prevents timely delivery of the foreign investment included in the ETF's basket.[152] To rely on this exemption, an ETF would be required to deliver foreign investments as soon as practicable, but in no event later than 15 days after the tender to the ETF.[153] This proposed exemption thus would permit a delay in the delivery of foreign investments only if the foreign investment is being transferred in kind as part of the basket.[154]

The exemption would permit a delay only to the extent that additional time for settlement is actually required, when a local market holiday, or series of consecutive holidays, or the extended delivery cycles for transferring foreign investments to redeeming authorized participants prevents timely delivery of the foreign investment included in the ETF's basket. To the extent that settlement times continue to shorten, the ''as soon as practicable'' language embedded in the exemption is designed to minimize any unnecessary settlement delays.[155] If a foreign investment settles in less than 15 days, the ETF would be required to deliver it pursuant to the standard settlement time of the local market where the investment trades.

In addition, given the continued movement toward shorter settlement times in markets around the world, we believe that the relief from section 22(e) in the proposed rule does not need to be permanent. Accordingly, we propose to include a sunset provision in the proposed rule relating to the relief from section 22(e). Absent further action by the Commission, the exemption from section 22(e) for postponement of delivering redemption proceeds would expire ten years from the rule's effective date. We believe that technological innovation and changes in market infrastructures and operations will lead to further shortening of settlement cycles, although these developments may be gradual. Therefore, we believe it is appropriate for the relief from section 22(e) to be limited in duration to ten years.[156]

In 2008, we proposed a similar exemption for postponement of delivering redemption proceeds. However, that exemption would have allowed up to 12 days to deliver redemption proceeds without an offsetting requirement to deliver as soon as practicable and without a sunset provision.[157] Commenters on the 2008 proposal agreed that the specified delay in satisfying redemption requests seemed reasonable because it was for a limited period of time and disclosed to investors.[158] However, one commenter suggested increasing the period of time for settlement beyond 12 days consistent with the terms of exemptive orders that had been issued to some ETFs.[159] Since 2012, numerous applicants for exemptive relief have indicated that payment or satisfaction of redemption requests may take as long as 15 days after a redemption request is received, and we have issued orders permitting delayed delivery of settlement proceeds for up to 15 days.[160] We believe an extended

[149] 15 U.S.C. 80a–22(e).

[150] *See, e.g.,* Parker Global Strategies, *supra* footnote 18.

[151] *See Investment Trusts and Investment Companies: Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency,* 76th Cong., 3d Sess. 291–293 (statements of David Schenker).

[152] Proposed rule 6c–11(b)(4). This relief from the requirements of section 22(e) would not affect any obligations arising under rule 15c6–1 under the Exchange Act, which requires that most securities transactions be settled within two business days of the trade date. 17 CFR 240.15c6–1.

[153] Proposed rule 6c–11(b)(4).

[154] While mutual funds also may invest in foreign investments that require a delivery process in excess of seven days, mutual funds typically deliver redemption proceeds in cash, rather than in kind. Mutual funds, ETFs that redeem in cash, and ETFs that substitute cash in lieu of a particular foreign investment in a basket do not require an exemption from section 22(e) of the Act.

[155] Austria, Belgium, Bulgaria, Croatia, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Italy, Ireland, the Netherlands, Latvia, Lichtenstein, Lithuania, Luxembourg, Malta, Norway, Poland, Portugal, Romania, Slovakia, Slovenia, Spain (certain fixed-income trades only), Sweden, Switzerland, and the United Kingdom moved to a T+2 settlement cycle by the end of 2014, while Australia and New Zealand transitioned to a T+2 settlement cycle in 2016. *See* Amendments to Securities Transaction Settlement Cycle, Exchange Act Release No. 78962 (Sept. 28, 2016) [81 FR 69240 (Oct. 5, 2016)], at n.134. Like the United States, Mexico, Canada, Peru and Argentina moved to a T+2 settlement cycle in September 2017. *See* T+2 Adopting Release, *supra* footnote 99. *See also* Annie Massa, *Your Trades Will Soon Spend Less Time Stuck in Market's Plumbing,* Bloomberg Markets (Aug. 31, 2017), *available at https://www.bloomberg.com/news/articles/2017-08-31/your-trades-will-soon-spend-less-time-stuck-in-market-s-plumbing.* There are many securities that trade over the counter (OTC) in certain foreign markets with agreed-upon settlement timeframes between the parties that could extend beyond the settlement timeframes of central securities depositories.

[156] ETFs that invest in foreign investments from jurisdictions that continue to require more than seven days to deliver redemption proceeds would have the option of redeeming in cash rather than in-kind once the exemptive relief sunsets. Such ETFs also could request targeted exemptive relief from section 22(e) from the Commission.

[157] *See* 2008 ETF Proposing Release, *supra* footnote 3.

[158] *See, e.g.,* Katten 2008 Comment Letter; Xshares 2008 Comment Letter.

[159] Katten 2008 Comment Letter (recommending up to 14 days).

[160] *See, e.g.,* Legg Mason ETF Trust, Investment Company Act Release Nos. 30237 (Oct. 22, 2012)

settlement period in these circumstances of 15 days, with the requirement that delivery nevertheless be made as soon as practicable, is reasonable in light of the limited nature and duration of the exemption.

The exemption we proposed in 2008 would have required an ETF to disclose in its registration statement the foreign holidays that it expects may prevent timely delivery of foreign securities, and the maximum number of days that it anticipates it will need to deliver the foreign securities.[161] We are not proposing a similar requirement for several reasons. First, we do not believe this disclosure is relevant to investors who purchase ETF shares on the secondary market, because the settlement of these investors' ETF trades would be unaffected by the potential delay. Only authorized participants engaged in redemption transactions with the ETF (and market participants that use the authorized participants as their agents for transacting with the ETF) would be affected. We believe that information regarding these potential delays is typically covered in the agreement governing the relationship between the ETF and the authorized participant (an ''authorized participant agreement'') and would likely be shared by the authorized participant with other market participants, as necessary.[162] Therefore, authorized participants already have information regarding potential delays. Second, given that these delays are typically covered by the authorized participant agreement, we do not believe it is necessary to require ETFs to provide registration statement disclosures.

The proposed rule would define ''foreign investment'' as any security, asset or other position of the ETF issued by a foreign issuer (as defined by rule 3b–4 under the Exchange Act) for which there is no established U.S. public trading market (as that term is used in Regulation S–K under the Securities Act).[163] This definition differs from the one we proposed in 2008 in that it references rule 3b–4 rather than enumerating the types of foreign entities that are considered issuers of foreign investments.[164] We believe this approach is appropriate because it creates consistency with a long-accepted definition under Exchange Act rules.[165] The reference to whether the investment has an ''established U.S. public trading market'' is designed to make the relief unavailable to an ETF that could trade the investment in its basket on a U.S. market, thereby avoiding the settlement delay that is the basis for the relief.[166] In addition, this definition is not limited to ''foreign securities,'' but also would include other investments that may not be considered securities. Although these other investments may not be securities, they may present the same challenges for timely settlement as foreign securities if they are transferred in kind. This approach is consistent with the terms of some recent exemptive orders that provide relief from section 22(e) for the delivery of foreign investments that may not be securities.[167]

We request comment on this aspect of the proposed rule.

- Is this relief necessary, particularly given that many non-U.S. jurisdictions have shorter settlement periods today than when we began granting this relief to ETFs? We specifically request comment regarding how frequently ETFs rely on this exemption. Should we permit the delayed delivery of settlement proceeds for up to 15 days? Is this period too long or too short? Should the rule refer to the applicable local market's settlement cycle without specifying a number of days? Should we require that the ETF deliver foreign investments as soon as practicable, as proposed, in order to minimize unnecessary settlement delays?
- Should we include a sunset provision for this relief as proposed? Is the duration of the proposed sunset provision appropriate? Should it be longer or shorter?
- Is the proposed definition of ''foreign investment'' appropriate for identifying investments that may routinely settle more than seven days after a redemption request? For example, are there circumstances where a U.S. entity could be subject to delays due to local market restrictions? Should we utilize a definition found elsewhere in rules and regulations set forth under the Exchange Act, the Investment Company Act, or other securities laws (*e.g.,* the definition of ''foreign security'' set forth in rule 15a–6 under the Exchange Act, or the definition of ''foreign assets'' set forth in rule 17f–5 under the Investment Company Act)? Alternatively, should we utilize the definition of ''foreign security'' set forth in the 2008 ETF Proposing Release, or utilize an entirely new definition? If recommending an alternate definition, please explain the specific types of investments that would be better captured or that would be excluded by that definition.
- Should the rule also provide relief if an ETF has foreign investments in its portfolio (and not in a particular basket)? If so, why? Should the rule permit the delayed delivery of the entire basket (instead of the specific foreign investments in a basket) if the basket is composed substantially of foreign investments subject to potential delays in the delivery of settlement proceeds?
- Are we correct that information regarding potential delays in the delivery of settlement proceeds for foreign investments typically is covered in the authorized participant agreement? If so, are we also correct that authorized participants acting as agents typically would share this information with their customers if it is a part of the redemption process?
- Should the rule require disclosure in an ETF's Statement of Additional Information of the foreign holidays an ETF expects may prevent timely delivery of the foreign investments and the maximum number of days it anticipates it would need to deliver the foreign investments as required by current exemptive orders? For example, should we require ETFs relying on this exemption to include a more general statement in their prospectus or SAI that the ETF may take up to 15 days to deliver settlement proceeds for certain foreign investments affected by foreign holidays, rather than the more specific statement of each holiday an ETF expects may prevent timely delivery of the investments that is currently required? Should these disclosures be included in an ETF's sales literature or

[77 FR 65425 (Oct. 26, 2012)] (notice) and 30265 (Nov. 16, 2012) (order) and related application (''Legg Mason'').

[161] *See* 2008 ETF Proposing Release, *supra* footnote 3.

[162] For example, an authorized participant acting as an agent typically would share this information with its customer if it is a necessary part of the creation or redemption process.

[163] *See* proposed rule 6c–11(a); *see also* rule 201(a) of Regulation S–K [17 CFR 229.201(a)] (describing how a registrant should identify its principal United States market or markets); rule 3b–4 of the Exchange Act [17 CFR 240.3b–4].

[164] The 2008 proposal defined ''foreign security'' as any security issued by a government or political subdivision of a foreign country, or corporation or other organization incorporated or organized under the laws of any foreign country and for which there is no established U.S. public trading market. *See* 2008 ETF Proposing Release, *supra* footnote 3.

[165] Rule 3b-4 under the Exchange Act was adopted in 1967. *See* Adoption of Rules Relating to Foreign Securities, Exchange Act Release No. 8066 (Apr. 28, 1967) [32 FR 7848 (May 30, 1967)].

[166] The rule does not rely on registration status because an unregistered large foreign private issuer may have an active U.S. market for its securities, in which case the ETF should be able to meet redemption requests in a timely manner. *See* Termination of a Foreign Private Issuer's Registration of a Class of Securities Under Section 12(g) and Duty to File Reports Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934, Exchange Act Release No. 55540 (Mar. 27, 2007) [72 FR 16934 (Apr. 5, 2007)].

[167] *See, e.g.,* Redwood Investment Management, LLC, *et al.,* Investment Company Act Release Nos. 33076A (Apr. 26, 2018) [83 FR 19367 (May 2, 2018)] (notice) and 33100 (May 21, 2018) (order) and related application.

on its website? Alternatively, should we require ETFs to provide a written notice of the foreign holidays an ETF expects may prevent timely delivery of the foreign investments to authorized participants as a condition to rule 6c–11? If so, how often should this information be updated?

• Do secondary market investors or others use information regarding delays in the delivery of foreign investments?

C. Conditions for Reliance on Proposed Rule 6c–11

Proposed rule 6c–11 would require ETFs to comply with certain conditions that would allow them to operate within the scope of the Act, and that are designed to protect investors and to be consistent with the purposes fairly intended by the policy and provisions of the Act. These conditions are generally consistent with the conditions we have imposed under our exemptive orders, which we believe have effectively accommodated the unique structural and operational features of ETFs while maintaining appropriate protections for ETF investors. The conditions also reflect certain changes to the conditions imposed under our exemptive orders that, based on 26 years of experience regulating ETFs, we believe will improve the overall regulatory framework for these products.

1. Issuance and Redemption of Shares

Proposed rule 6c–11 would include several requirements in the paragraph defining ''exchange-traded fund,'' including a requirement that the ETF issue (and redeem) creation units to (and from) authorized participants in exchange for baskets and a cash balancing amount (if any).[168] As such, the proposed rule would seek to preserve the existing structure, reflected in our ETF exemptive orders, whereby only an authorized participant of an ETF may purchase creation units from (or sell creation units to) the ETF. This requirement is designed to preserve an orderly creation unit issuance and redemption process between ETFs and authorized participants. An orderly creation unit issuance and redemption process is of central importance to the arbitrage mechanism, which forms the basis for several of the proposed rule's exemptive provisions.

The proposed rule would define an authorized participant as a member or participant of a clearing agency registered with the Commission, which has a written agreement with the ETF or one of its service providers that allows the authorized participant to place orders for the purchase and redemption of creation units.[169] This definition differs from the definition of ''authorized participant'' we recently adopted in connection with Form N–CEN, which, in relevant part, defines the term as a broker-dealer that is also a member of a clearing agency registered with the Commission or a DTC Participant and has a written agreement with the ETF or one of its service providers that allows the authorized participant to place orders to purchase and redeem creation units of the ETF.[170] Our proposed definition also differs from the definition of authorized participant in our ETF exemptive orders and Form N–CEN, because it does not include a specific reference to an authorized participant's participation in DTC since DTC is itself a clearing agency.[171] We believe the definition that we are proposing remains largely consistent with our existing exemptive relief, while eliminating unnecessary terms. As discussed further below, we are proposing a corresponding amendment to Form N–CEN.[172]

The proposed rule would define the term ''creation unit'' to mean a specified number of ETF shares that the ETF will issue to (or redeem from) an authorized participant in exchange for the deposit (or delivery) of a basket and a cash balancing amount (if any).[173] In their exemptive applications, ETFs have stated that they would establish a specific creation unit size (*i.e.,* a minimum number of shares).[174] Creation unit aggregations may differ among ETFs based on an ETF's investment strategy, the type and availability of the assets in the basket, and the types of authorized participants (and other market participants) that are expected to engage in creation and redemption transactions with the ETF. For example, an ETF tracking a narrowly focused niche strategy may establish a smaller creation unit size than an ETF tracking a broad-based index, such as the S&P 500, in order to facilitate arbitrage. Accordingly, we do not believe it is necessary to mandate a particular maximum or minimum creation unit size for all types of ETFs. This approach is consistent with our 2008 proposal, and commenters who addressed this aspect of the 2008 proposal generally supported it.[175]

While we believe that creation unit sizes are an important component in effective arbitrage, we do not propose to expressly require, as we proposed in 2008, that an ETF establish creation unit sizes reasonably designed to facilitate arbitrage.[176] Commenters on this aspect of the 2008 proposal generally believed that the proposed standard was too vague and that an ETF would not have an incentive to establish creation unit sizes that would be too large or too small to facilitate effective arbitrage.[177] Some commenters also questioned the description of arbitrage embedded within the 2008 definition of creation unit on the basis that the definition did not capture all forms of arbitrage.[178]

As we noted in the 2008 proposal, a large creation unit size could reduce the willingness or ability of authorized participants (and other market participants) to engage in creation unit purchases or redemptions.[179] Impeding the ability of authorized participants to purchase and redeem ETF shares could disrupt arbitrage pricing discipline, which could lead to more frequent occurrences of premiums or discounts to NAV per share of the ETF. Conversely, a small creation unit size could discourage market making and render creation units irrelevant because the ETF could issue and redeem ETF shares much like a mutual fund.[180] We agree with the view that ETFs are not likely to have an incentive to set very large or very small creation unit sizes that could disrupt the arbitrage

[168] *See* proposed rule 6c–11(a). *See also infra* section II.C.5 (discussing definitions of baskets and cash balancing amount).

[169] Proposed rule 6c–11(a).

[170] *See* Instruction to Item E.2 of Form N–CEN. *See also* Reporting Modernization Adopting Release, *supra* footnote 147.

[171] *See, e.g.,* Legg Mason, *supra* footnote 160. The 2008 proposal would not have defined the term ''authorized participant'' because this term was not used in the definition of an ETF. *See* 2008 ETF Proposing Release, *supra* footnote 3 (defining ETF to mean, in relevant part, a registered open-end management company that issues (or redeems) creation units in exchange for the deposit (or delivery) of basket assets).

[172] *See infra* section II.J.

[173] Proposed rule 6c–11(a).

[174] *See, e.g.,* Legg Mason, *supra* footnote 160.

[175] *See* 2008 ETF Proposing Release, *supra* footnote 3; *see also, e.g.,* Comment Letter of James J. Angel (May 16, 2008); Comment Letter of Chapman and Cutler LLP (May 19, 2008) (''Chapman 2008 Comment Letter'').

[176] *See* 2008 ETF Proposing Release, *supra* footnote 3 (describing arbitrage, for these purposes, as ''the purchase (or redemption) of shares from the ETF with an offsetting sale (or purchase) of shares on a national securities exchange at as nearly the same time as practicable for the purpose of taking advantage of a difference in the Intraday Value and the [market price] of the shares.'').

[177] *See, e.g.,* Vanguard 2008 Comment Letter; BGFA 2008 Comment Letter. *But see* Xshares 2008 Comment Letter (''The proposal to 'establish creation unit sizes the number of which is reasonably designed to facilitate arbitrage' seems to describe the process that we apply when determining the basket size and is appropriate, as is the definition of arbitrage.'').

[178] *See* ICI 2008 Comment Letter; Katten 2008 Comment Letter.

[179] *See* 2008 Proposing Release, *supra* footnote 3.

[180] *See id.*

mechanism and that an ETF would establish a size that is appropriate for market demand given its investment strategies and objectives. Moreover, we believe that the conditions in the proposed rule designed to promote effective arbitrage are better suited for that purpose than conditions related to creation unit size.

An ETF generally would issue and redeem shares only in creation unit size aggregations under the proposed rule. However, the proposed rule would permit an ETF to sell or redeem individual shares on the day of consummation of a reorganization, merger, conversion or liquidation.[181] In a merger, for example, an acquired ETF typically transfers substantially all of its assets to a surviving ETF in exchange for interests in the surviving ETF. We understand that, under these limited circumstances, a surviving ETF may need to issue shares, not necessarily in creation unit aggregations, to shareholders of the acquired ETF without utilizing authorized participants. Similarly, an ETF may need to issue individual shares in connection with a reorganization, conversion, or liquidation. We also understand that the redemptions that take place in connection with these transactions are generally intended to facilitate the transactions themselves and compensate individual shareholders that may be exiting the reorganized, merged, converted or liquidated ETF—activities likely to involve small cash amounts and to be outside the scope of an authorized participant's expected role of transacting in creation units. We believe that permitting ETFs to conduct redemptions with investors other than authorized participants in these limited circumstances is operationally necessary to facilitate reorganizations, mergers, conversions or liquidations. Permitting ETFs to transact with other investors in these limited circumstances also is consistent with prior exemptive relief, which permits ETF shares to be individually redeemable in connection with the termination of an ETF.[182]

An additional issue related to the issuance and redemption of ETF shares is the extent to which an ETF may directly or indirectly suspend these processes. An ETF that suspends the issuance or redemption of creation units indefinitely could cause a breakdown of the arbitrage mechanism, resulting in significant deviations between market price and NAV per share. Such deviations may be harmful to investors that purchase shares at market prices above NAV per share and/or sell shares at market prices below NAV per share. An ETF may suspend the redemption of creation units only in accordance with section 22(e) of the Act,[183] and an ETF may charge transaction fees on creation unit redemptions only in accordance with 17 CFR 270.22c–2 (''rule 22c–2'').[184] In addition, we believe an ETF generally may suspend the issuance of creation units only for a limited time and only due to extraordinary circumstances, such as when the markets on which the ETF's portfolio holdings are traded are closed for a limited period of time.[185] We also believe that an ETF could not set transaction fees so high as to effectively suspend the issuance of creation units.

We request comment on this requirement.

- Should we require, as proposed, that an ETF issue (and redeem) creation units to (and from) authorized participants in exchange for baskets and a cash balancing amount if any? Are there alternative formulations that we should consider? Does this provision facilitate the arbitrage mechanism?
- Should we define ''authorized participant'' as proposed? Should other criteria apply? For example, should the definition require authorized participants to be registered broker-dealers?
- Instead of amending the definition of ''authorized participant'' in Form N–CEN as proposed below in order to correspond with proposed rule 6c–11, should we use the existing Form N–CEN ''authorized participant'' definition for rule 6c–11? Should we have the same definition of ''authorized participant'' for both rule 6c–11 and Form N–CEN? Would different definitions cause confusion or operational difficulties?
- Do commenters agree with our understanding that ETFs are not likely to have an incentive to set very large or very small creation unit sizes that could disrupt the arbitrage mechanism?
- Should we establish requirements for creation unit sizes and/or dollar amounts? Alternatively, should we establish a standard for how ETFs must establish creation unit sizes? If so, what standard should be established? Do differently sized creation units present different operational challenges? If so, please explain these challenges, and provide data to support such a view.
- Would institutional investors engage in more create/redeem transactions with an ETF, through an authorized participant, if the ETF established a smaller creation unit size? If so, what are the costs and benefits of this result? Would it impact the efficiency of the ETF's arbitrage mechanism? If so, how?
- Should we permit an ETF to sell or redeem individual shares on the day of consummation of a reorganization, merger, conversion or liquidation as proposed? Should we define any or all of the terms ''reorganization,'' ''merger,'' ''conversion'' and ''liquidation'' for purposes of this condition? If so, how should those terms be defined? For example, as an alternative, should we consider the definition for ''merger'' in 17 CFR 270.17a–8 (''rule 17a–8'' under the Act)?[186] Are there other circumstances or transactions that should be included within this provision? For example, should we specify in this provision that shares may be issued other than in creation unit size aggregations as part of a dividend reinvestment program? Is any additional relief needed to conduct these transactions? Should the relief be limited to the day of consummation of the transaction, as proposed? Should the relief be limited in time at all? Should more time be provided? If so, how much time?
- Do commenters generally agree that an ETF may suspend creations only in limited circumstances? Do commenters generally agree that an ETF could not set transaction fees so high as to effectively suspend the issuance of

[181] *See* proposed rule 6c–11(c)(5).

[182] *See, e.g.,* Application of FFCM, LLC, *et al.* (June 12, 2017), at n.23 (''Therefore, in the event of a termination, the Board in its discretion could determine to permit the Shares to be individually redeemable. In such circumstances, the Fund might elect to pay cash redemptions to all shareholders, with an 'in-kind' election for shareholders owning in excess of a certain stated minimum amount.'').

[183] Section 22(e) of the Act permits open-end funds to suspend redemptions and postpone payment for redemptions already tendered for any period during which the New York Stock Exchange is closed (other than customary weekend and holiday closings) and in three additional situations if the Commission has made certain determinations. *See* LRM Adopting Release, *supra* footnote 101, at n.36.

[184] *See supra* footnote 24 and accompanying text. Rule 22c–2 limits redemption fees to no more than 2% of the value of shares redeemed. *See* rule 22c–2(a)(1)(i). In other contexts, the Commission has limited redemption fees paid by redeeming shareholders, as well as swing pricing NAV adjustments, to no more than 2%. *See* Investment Company Swing Pricing, Investment Company Act Release No. 32316 (Oct. 13, 2016) [81 FR 82084 (Nov. 18, 2016)] (describing liquidity fees under rule 2a–7 and the swing factor upper limit under rule 22c–1).

[185] *See* Comment Letter of BlackRock on 2015 ETP Request for Comment (Aug. 11, 2015) (noting that suspensions of creations are rare, but an ETF could suspend creations when it is unable to increase its exposure to underlying assets, such as when a non-U.S. market suspends capital inflows).

[186] *See* rule 17a–8(b)(1) (defining ''merger'' as the ''merger, consolidation, or purchase or sale of substantially all of the assets between a registered investment company (or a series thereof) and another company'').

creation units? Is any additional guidance needed? Should we consider including provisions in rule 6c–11 that would permit ETFs to suspend creations or redemptions in particular circumstances?

2. Listing on a National Securities Exchange

Proposed rule 6c–11 defines ''exchange-traded fund,'' in part, to mean a fund that issues shares that are listed on a national securities exchange and traded at market-determined prices.[187] Exchange-listing is one of the fundamental characteristics that distinguishes an ETF from other types of open-end funds (and UITs) and is one reason that ETFs need certain exemptions from the Act and the rules thereunder. The Commission has premised all of its previous exemptive orders on an ETF listing its shares for trading on a national securities exchange.[188] Listing on an exchange provides an organized and continuous trading market for the ETF shares at market-determined prices. Trading on an exchange also is important to a functioning arbitrage mechanism. We proposed a similar condition in 2008 that would have required ETF shares to be approved for listing and trading on a national securities exchange.[189] Commenters on the 2008 proposal generally agreed that listing on an exchange would provide an organized and continuous trading market for the ETF shares.[190]

The proposed definition would require that the ETF's shares be traded at market-determined prices. Like other exchange-traded equity securities, however, we understand that there may be instances where ETF shares simply may not trade for a given period due to a lack of market interest.[191] This proposed requirement is not designed to establish a minimum level of trading volume for ETFs necessary in order to rely on the rule, but rather to distinguish ETFs from other products that are listed on exchanges, but trade at NAV-based prices (*i.e.,* exchange-traded managed funds).[192]

An ETF that is delisted from a national securities exchange would not meet the definition of ''exchange-traded fund,'' and would no longer be eligible to rely on the proposed rule. Such a fund thus would be required to meet individual redemption requests within seven days pursuant to section 22(e) of the Act or liquidate.[193] We requested comment in the 2008 proposal on whether the rule should include an exception for ETF shares that are delisted for a short time or suspended from listing.[194] Commenters generally did not support such an exception, asserting that it would be difficult for the Commission to identify all of the circumstances in which such an exception would be appropriate, and recommended that ETFs seek individual exemptive relief from the listing requirement under these circumstances.[195] We are not aware of any ETF requesting an order that omits the requirement that its shares be listed on an exchange. Therefore, we do not propose to include an exemption for ETFs whose shares are suspended or delisted.

We request comment on this requirement.

• Should the rule make allowance for shares that are delisted for a short time, or for halts or suspensions in trading? If so, how would the arbitrage mechanism function in these circumstances?

3. Intraday Indicative Value

Exchange listing standards include a requirement that an intraday estimate of an ETF's NAV per share (an ''intraday indicative value'' or ''IIV'') be widely disseminated at least every 15 seconds during regular trading hours (60 seconds for international ETFs).[196] Our orders also require the dissemination of the IIV, and ETFs have stated in their exemptive applications that an ETF's IIV is useful to investors because it allows them to determine (by comparing the IIV to the market value of the ETF's shares) whether and to what extent the ETF's shares are trading at a premium or discount.[197] We are not proposing, however, to require the dissemination of an ETF's IIV as a condition of the proposed rule. We understand that market makers today typically calculate their own intraday value of an ETF's portfolio with proprietary algorithms that use an ETF's daily portfolio disclosure and available pricing information about the assets held in the ETF's portfolio.[198] We further understand that they generally use the IIV, if at all, as a secondary or tertiary check on the value that their proprietary algorithms generate.[199]

We believe that the IIV is no longer used by market participants when conducting arbitrage trading. In today's fast-moving markets, 15 seconds is likely too long for purposes of efficient market making and could result in poor execution.[200] An ETF's current value changes every time the value of any underlying component of the ETF portfolio changes. Therefore, the IIV for a more frequently traded component security might not effectively take into account the full trading activity for that security, despite being available every 15 seconds. In particularly volatile

[187] Proposed rule 6c–11(a). For purposes of the rule, a ''national securities exchange'' would be defined as an exchange that is registered with the Commission under section 6 of the Exchange Act.

[188] *See, e.g.,* PowerShares Capital Management LLC, *et al.,* Investment Company Act Release Nos. 28140 (Feb. 1, 2008) [73 FR 7328 (Feb. 7, 2008)] (notice) and 28171 (Feb. 27, 2008) (order) and related application (''PowerShares'').

[189] *See* 2008 ETF Proposing Release, *supra* footnote 3.

[190] *See, e.g.,* NYSE Arca 2008 Comment Letter; SSgA 2008 Comment Letter.

[191] Based on staff analysis of data obtained from Bloomberg, approximately 5% of ETFs do not trade on the secondary market on a given trading day.

[192] Proposed rule 6c–11 would not apply to exchange-traded managed funds (ETMFs), which are not ETFs, but rather hybrids between mutual funds and ETFs. Unlike ETFs, secondary market transactions in ETMFs do not occur at a market-determined price. Rather, they occur at the next-determined NAV plus or minus a market-determined premium or discount that may vary during the trading day. *See* Eaton Vance Management, *et al.,* Investment Company Act Release Nos. 31333 (Nov. 6, 2014) [79 FR 67471 (Nov. 13, 2014)] (notice) and 31362 (Dec. 2, 2014) (order) and related application.

[193] Indeed, an ETF that does not comply with the provisions of the rule would be required to comply with the Investment Company Act in all respects unless it was relying on other relief.

[194] *See* 2008 ETF Proposing Release, *supra* footnote 3, at text following n.94.

[195] BGFA 2008 Comment Letter; ICI 2008 Comment Letter.

[196] *See, e.g.,* NYSE Arca Equities Rule 5.2–E(j)(3), Commentary .01(c) (stating that the IIV may be based upon ''current information regarding the required deposit of securities and cash amount to permit creation of new shares of the series or upon the index value''); *see also supra* footnote 14 and accompanying text. The IIV is also sometimes referred to as the ''iNAV'' (indicative net asset value) or the ''PIV'' (portfolio indicative value).

[197] *See, e.g.,* 2006 WisdomTree Investments, *supra* footnote 66.

[198] David J. Abner, *The ETF Handbook: How to Value and Trade Exchange Traded Funds* (2010), at 90 (''Since stock trading now takes place in microseconds, a lot can happen between two separate 15-second quotes. Professional traders are not using the published IIVs as a basis for trading. Most, if not all, desks that are trading ETFs are calculating their own [NAV of the ETF] based on real time quotes . . . that they are generating within their own systems.'').

[199] *See, e.g.,* Spruce ETF Trust, *et al.,* Investment Company Act Release Nos. 31301 (Oct. 21, 2014) [79 FR 63964 (Oct. 27, 2014)] (notice) and 31337 (Nov. 14, 2017) (order permitting withdrawal of application) and related application (withdrawn).

[200] *See, e.g.,* Gary Gastineau, *How to Minimize Your Cost of Trading ETFs, ETF.com* (June 22, 2009), *available at http://www.etf.com/publications/journalofindexes/joi-articles/6042-how-to-minimize-your-cost-of-trading-etfs.html,* at Figure 2 and related discussion. *See also* Comment Letter of ICI on NASDAQ proposed rule change relating to iNAV pegged orders for ETFs, File No. SR–NASDAQ–2012–117 (Nov. 8, 2012), at 4 (''Professional equity traders operate at speeds calculated in fractions of a second. In such markets, 15 seconds can be an eternity, and establishing an order price based on data that is nearly 15 seconds old could result in poor execution.'').

markets, the dissemination lag of the IIV may not reflect the actual value of the ETF.[201]

The IIV also may not reflect the actual value of an ETF that holds securities that do not trade frequently. For example, the IIV can be stale or inaccurate for ETFs with foreign securities or less liquid debt instruments. For such ETFs, there may be a difference in value between the IIV, which is constructed using the last available market quotations or stale prices, and the ETF's NAV, which uses fair value when market quotations are not readily available.[202] Moreover, because there currently are no uniform methodology requirements, the IIV can be calculated in different, and potentially inconsistent, ways.

Several commenters to the 2008 ETF Proposing Release, which would have included an IIV dissemination requirement, agreed that market professionals no longer rely on the exchange-published IIV.[203] Commenters on the 2015 ETP Request for Comment also stated that the IIV is not always reliable, and in some cases is misleading, particularly when the underlying holdings are less liquid, or, in the case of certain international ETFs, not traded during the same hours as the ETF shares.[204]

As discussed below, we are proposing that rule 6c–11 condition its relief on the daily disclosure of portfolio holdings. We believe that this disclosure would promote the availability of information to market participants to support their ability to calculate an estimated intraday value of the ETF's portfolio holdings using their own methodologies. Therefore, the proposed rule would not include a requirement for IIV dissemination.

We request comment on this aspect of our proposal.

- Should proposed rule 6c–11 condition relief on dissemination of the IIV? If so, who should be required to disseminate the IIV? The national securities exchange on which the ETF is listed? Other entities?
- Are we correct in our understanding that market participants today typically calculate their own intraday values of an ETF portfolio by utilizing proprietary algorithms?
- Do market participants use the published IIV for any purpose, whether or not related to its original purpose of facilitating arbitrage? For example, do some market participants use the IIV as a secondary or tertiary check on their internal calculations of an ETF's intraday value?
- Do retail investors use or rely on the IIV, and if so, how? Do they use the IIV for international and fixed-income ETFs, and if so, how? Is there a risk that this information could be misleading in certain circumstances? Would omitting the IIV have a disparate impact on retail investors as opposed to more sophisticated market participants?
- Do the published IIVs provide an accurate indication of the value of ETFs' underlying holdings? Does the answer vary depending on the type of the ETF's underlying holdings? If we were to include a requirement to disseminate the IIV, should and can changes be made to improve its accuracy? For example, should we require that the IIV be disseminated at more frequent intervals? If so, how frequently (*e.g.,* every second, every five seconds)? Should we require that the IIV be disseminated for all ETFs or only specific types of ETFs?
- If we were to include an IIV requirement, should we establish a uniform method for calculation of the IIV for all ETFs relying on the rule? If so, what should that method take into account? How should fair valued securities be treated? Alternatively, should we prescribe methodologies for ETFs based on the types of portfolio holdings?
- If the IIV is no longer required pursuant to exemptive relief or regulation, would ETFs continue to publish this information? If so, should we require ETFs that voluntarily disseminate the IIV to follow certain prescribed methodologies? For example, should we require that these ETFs disseminate the IIV more frequently? If so, how frequently?

4. Portfolio Holdings

As discussed above, since the first exemptive order for an ETF, the Commission has relied on the existence of an arbitrage mechanism to keep the market prices of ETF shares at or close to the NAV per share of the ETF.[205] One mechanism that facilitates the arbitrage mechanism is daily portfolio transparency. Portfolio transparency provides authorized participants and other market participants with an important tool to facilitate valuing the ETF's portfolio on an intraday basis, which, in turn, would enable them to assess whether arbitrage opportunities exist. It also provides information necessary to hedge the ETF's portfolio. The ability to hedge is important because market makers generally trade to provide liquidity, balance supply and demand, and profit from arbitrage opportunities (without seeking to profit from taking a directional position in a security).[206] Without the ability to hedge, market makers may widen spreads or be reluctant to make markets because doing so may require taking on greater market risk than the firm is willing to bear. For this reason, to facilitate the ability of market makers to make markets in ETF shares, our exemptive orders have historically required ETFs to provide a certain degree of daily transparency.[207] Furthermore, Commission staff has observed that all ETFs that could rely on the proposed rule currently provide full transparency as a matter of industry market practice.

[201] *See Understanding iNAV, ETF.com, available at http://www.etf.com/etf-education-center/21028-understanding-inav.html http://www.etf.com/etf-education-center/21028-understanding-inav.html?nopaging=1*; Gary Gastineau, Exchange-Traded Funds Manual, 2nd Ed. (2010), at 200–202.

[202] Section 2(a)(41)(B) of the Act defines ''value'' as: ''(i) with respect to securities for which market quotations are readily available, the market value of such securities; and (ii) with respect to other securities and assets, fair value as determined in good faith by the board of directors.'' This definition also is used in rule 2a–4 under the Act as the required basis for computing a fund's current NAV per share. With daily portfolio disclosure, market participants can estimate fair value on their own for the holdings of current ETFs. 15 U.S.C. 80a–2(a)(41)(B).

[203] *See* BGFA 2008 Comment Letter; Xshares 2008 Comment Letter.

[204] *See* Schwab ETP Comment Letter, *supra* footnote 115, at 7 (''[A]s the ETF marketplace has expanded into such markets as fixed income, precious metals, and foreign securities the published data points can be potentially misleading when the reference asset the ETF is covering is not open for pricing or transactions . . . [t]he requirement for publication of the IIV every 15 seconds seems antiquated in the evolving electronic trading world in which we are currently immersed. Trading now occurs in micro and nano seconds and the lag between the published IIV value and real time quoting and trading has essentially made the calculation of limited worth even when the reference asset is open for pricing.''); Comment Letter of Eaton Vance Corp. to Request for Comment on Exchange-Traded Products (File No. S7–11–15) (Aug. 17, 2015) (stating that the IIV is ''frequently highly misleading'' as an indicator of current fund value and investor trading costs); *see also* John Spence, *ETFs Unfairly Blamed in Recent Market Drama,* USA Today (June 27, 2013), *available at https://www.usatoday.com/story/money/personalfinance/2013/06/27/etfs-criticism-investing/2464741/* (''[I]t's meaningless to compare the share price of any international equity ETF with a stale NAV based on stock prices that are several hours old.'').

[205] *See supra* section I.B.

[206] *See* Stanislav Dolgopolov, *Regulating Merchants of Liquidity: Market Making From Crowded Floors to High Frequency Trading,* 18 U. of Penn Journal of Business Law 3 (2016), at 652 (''[T]he distinguishing feature of a market maker is being 'pretty well always even.''').

[207] Exemptive orders for actively managed ETFs and recent orders for index-based ETFs with an affiliated index provider have required full portfolio transparency. Exemptive orders for index-based ETFs with an unaffiliated index provider have required publication of the ETF's baskets.

a. Transparency of Portfolio Holdings

Proposed rule 6c–11 would require an ETF to disclose prominently on its website, which is publicly available and free of charge, the portfolio holdings that will form the basis for each calculation of NAV per share.[208] The portfolio holdings disclosure must be made each business day before the opening of regular trading on the primary listing exchange of the ETF's shares and before the ETF starts accepting orders for the purchase or redemption of creation units.[209] For portfolio transparency to facilitate effective arbitrage, authorized participants or other market participants buying or selling ETF shares, whether on the secondary market or in a primary transaction, should have access to portfolio composition information at the time of the transaction. The proposed rule's timing requirements, therefore, are designed to prevent an ETF from disclosing its portfolio holdings only after the beginning of trading or after the ETF has begun accepting orders for the next business day.

In addition, the proposed rule would require the portfolio holdings that form the basis for the ETF's NAV calculation to be the ETF's portfolio holdings as of the close of business on the prior business day.[210] Changes in an ETF's holdings of portfolio securities would therefore be reflected on a T+1 basis. This condition is consistent with current ETF practices and enables an ETF to disclose at the beginning of the business day the portfolio that will form the basis for the next NAV calculation, helping to facilitate the efficient functioning of the arbitrage process.[211]

We believe that portfolio transparency is an effective means to facilitate the arbitrage mechanism. As noted above in our discussion of the IIV, authorized participants and other market participants today calculate the value of an ETF's net assets with proprietary algorithms that use an ETF's daily portfolio disclosure and available pricing information about the assets held in the ETF's portfolio on an ongoing basis during the course of the trading day. This information allows market participants to identify instances where an arbitrage opportunity exists and to effectively hedge their positions.

The 2008 proposal would have required actively managed ETFs to disclose the identities and weightings of the portfolio securities and other assets held by the ETF on the ETF's website each business day (*i.e.* full portfolio transparency). By contrast, index-based ETFs would have been required to have a stated investment objective of obtaining returns that correspond to the returns of a securities index, whose provider discloses on its website the identities and weightings of the component securities and other assets of the index (*i.e.* index transparency).[212] Commenters on that proposal generally concurred with the importance of transparency to the arbitrage mechanism and supported including a transparency requirement in the proposed rule.[213] Some commenters, however, asserted that index transparency may not be effective for ETFs whose portfolios sample an index or include holdings in proportions that are different from those in the index.[214] These commenters urged the Commission to consider alternative approaches, including permitting index-based ETFs to disseminate the identities and weightings of the securities in the basket, if the basket is a representative sample of the portfolio.[215]

We are proposing to require full transparency for all ETFs under this rule rather than proposing alternative transparency requirements for index-based ETFs or actively managed ETFs.[216] We generally agree with commenters on the 2008 proposal that portfolio transparency provides more detailed information than the index alone when an index-based ETF utilizes sampling techniques or holds derivatives or other instruments and, as noted above, all ETFs that could rely on the proposed rule already provide full portfolio transparency as a matter of market practice. Full portfolio transparency also may be useful for investors when they are determining the efficacy of an index-based ETF tracking a particular index because performance of two ETFs tracking the same index can differ based on sampling practices.[217] Similarly, where the primary information used to support the arbitrage mechanism is information about holdings, full portfolio transparency may be more helpful to market makers modelling ETFs that seek to track highly customized or bespoke indexes.

We seek comment on the portfolio transparency condition of the proposed rule.

- Should the rule include other transparency options? For example, should we have different transparency requirements for index-based ETFs and actively managed ETFs, similar to those proposed in 2008? Would disclosure of an index's constituents alone provide detailed enough information to allow market participants to effectively hedge the ETF's portfolio when an index-based ETF utilizes sampling techniques or holds derivatives or other instruments? Do index providers make information about index constituents easily accessible today? Are there other alternatives we should consider? For example, would disclosure of an ETF's basket provide a basis for effective hedging? In setting forth an option, please explain how your proposed level of transparency would allow effective arbitrage.

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[208] Proposed rule 6c–11(c)(1)(i)(A). *See also* proposed rule 6c–11(a) (defining the term ''portfolio holdings'' to mean the securities, assets, or other positions held by the ETF). For purposes of this proposed requirement, as well as other requirements to disclose information on a publicly available website under proposed rule 6c–11, we believe that an ETF should not establish restrictive terms of use that would effectively make the disclosures unavailable to the public or otherwise difficult to locate. For example, the proposed required website disclosure should be easily accessible on the website, presented without encumbrance by user name, password, or other access constraints, and should not be subject to usage restrictions on access, retrieval, distribution or reuse. We also would encourage ETFs to consider whether there are technological means to make the disclosures more accessible. For example, today, ETFs could include the portfolio holdings information in a downloadable or machine-readable format, such as comma-delimited or similar format.

[209] For these purposes, ''business day'' is defined as any day the ETF is open for business, including any day when it satisfies redemption requests as required by section 22(e) of the Act. *See* proposed rule 6c–11(a).

[210] *See* proposed rule 6c–11(c)(2). Pursuant to this condition, an ETF would not be permitted to reflect portfolio changes on a T+0 basis, notwithstanding the ability to do so under rule 2a–4 under the Act.

[211] *See, e.g.,* Morgan Stanley ETF Trust, *et al.,* Investment Company Act Release Nos. 32484 (Feb. 21, 2017) [82 FR 11956 (Feb. 27, 2017)] (notice) and 32539 (Mar. 21, 2017) (order) and related application (''Morgan Stanley'').

[212] In the event the ETF tracks multiple indexes, the 2008 ETF Proposing Release would have permitted an ETF to provide full transparency like actively managed funds. *See* 2008 ETF Proposing Release, *supra* footnote 3.

[213] *See, e.g.,* BGFA 2008 Comment Letter.

[214] *See, e.g.,* ICI 2008 Comment Letter. *See also* Vanguard 2008 Comment Letter (opposing index transparency (as well as daily portfolio holdings disclosure) for index-based ETFs, voicing concerns about front running in the context of index-based ETFs).

[215] Commenters asserted that compliance with the index transparency requirement we proposed in 2008 would be difficult for ETFs that have licensing rights to an index that may preclude them from publicly disclosing the components of the index. *See, e.g.,* NYSE Arca 2008 Comment Letter; Comment Letter of Russell Investments (Aug. 27, 2008). Today, Commission staff, through conversations with ETF industry participants, understands the preference for this basket transparency approach to be significantly lessened.

[216] *See supra* section II.A.2.

[217] *See, e.g.,* Ben Johnson, *Assessing the Total Cost of ETF Ownership,* Morningstar Advisor (Apr. 12, 2017), *available at http://beta.morningstar.com/articles/802211/assessing-the-total-cost-of-etf-ownership.html.*

- Are there any circumstances that would prevent an index-based ETF from disclosing its portfolio holdings?
- Are we correct that all ETFs that could rely on the proposed rule currently provide full transparency as a matter of market practice?
- Would publicly available website disclosure of portfolio holdings be an effective way to convey this information? If not, what other means of disclosure should the rule require or permit? For example, should we allow ETFs to comply with the transparency condition by transmitting a portfolio composition file or ''PCF'' to a central clearing facility? Would this method provide information to enough market participants to facilitate the arbitrage mechanism? Would it give fair and equal access to all market participants? Should we require ETFs to provide daily portfolio holdings information to the Commission through other means, such as filing on EDGAR?
- Should proposed rule 6c–11 define ''publicly available'' for purposes of the website disclosure requirements? If so, what definition should we use? For example, should the rule require that all information publicly posted on a website pursuant to rule 6c–11 be and remain freely and persistently available and easily accessible by the general public on the ETF's website and that the information must be presented in an easily accessible manner, without encumbrance, and must not be subject to any restrictions, including restrictions on access, retrieval, distribution and reuse?
- Should we require ETFs to reflect changes in portfolio holdings no earlier than a T+1 basis as proposed? Is this condition necessary?
- Should we define ''business day'' as proposed or are there alternative definitions we should consider? Do commenters believe that ETFs are likely to calculate NAV per share more than once each business day in the future? If so, would a ''business day'' standard cause compliance challenges with the portfolio holdings disclosure requirements?
- Should the rule require that portfolio holdings disclosure be provided before the opening of regular trading on the primary listing exchange of the ETF's shares and before the ETF starts accepting orders for the purchase or redemption of creation units? Alternatively, should the rule exclude timing requirements? Are there operational issues that would make compliance with the timing requirements challenging or costly?
- Should we consider exemptions for ETFs with non-transparent or partially transparent portfolios as part of proposed rule 6c–11? Would a rule of general applicability be the appropriate means to provide an exemption for ETFs using a novel arbitrage mechanism?

b. Disclosure of Securities, Assets or Other Investment Positions

The proposed rule would require ETFs to disclose on their websites all portfolio holdings that will form the basis for the ETF's next calculation of NAV per share. Under the proposed rule, the term ''portfolio holdings'' is defined to mean an ETF's securities, assets, or other positions.[218] As a result, an ETF would be required to disclose its cash holdings, as well as holdings that are not securities or assets, including short positions or written options.[219] We believe that this approach would provide more consistent and comprehensive information regarding an ETF's portfolio holdings compared to other means of disclosure, allowing market participants to fairly and effectively value the entirety of the ETF's portfolio holdings. We believe this, in turn, would facilitate the arbitrage mechanism by allowing authorized participants and other market participants to more effectively hedge their exposure to a particular ETF.

In order to standardize the manner in which portfolio holdings are presented on the ETF's website, the proposed rule would require that portfolio holdings information be presented and contain information regarding description, amount, value and/or unrealized gain/loss (as applicable) in the manner prescribed within 17 CFR 210.12–12, 210.12–12A, 210.12–13, 210.12–13A, 210.12–13B, 210.12–13C, and 210.12–13D (''Article 12 of Regulation S–X''), which sets forth the form and content of fund financial statements.[220] This framework should be efficient for such disclosure because ETFs already comply with it for financial reporting purposes and track the relevant information for daily NAV calculations. Based on a staff review of ETF websites, there is currently little consistency regarding how portfolio holdings information is presented, particularly with respect to derivatives. We believe that this inconsistency may lead to investor confusion.[221]

The proposed rule would not require disclosure of intraday changes in the portfolio holdings of the ETF or advance disclosure of portfolio trades because changes in holdings would not affect the composition of the ETF's portfolio that serves as a basis for NAV calculation until the next business day.[222] The selective disclosure of nonpublic information regarding intraday changes in portfolio holdings and advance disclosure of portfolio trades, however, could result in the front-running of an ETF's trades, causing the ETF to pay more to obtain a security. We have stated that registered investment companies' compliance policies and procedures required by 17 CFR 38a–1 (''rule 38a–1'' under the Act) should address potential misuses of nonpublic information, including the disclosure to third parties of material information about a fund's portfolio, its trading strategies, or pending transactions, and the purchase or sale of fund shares by advisory personnel based on material, nonpublic information about the fund's portfolio.[223] ETFs are also required to describe their policies and procedures on portfolio security disclosure in the Statement of Additional Information and post such policies and procedures

[218] *See* proposed rule 6c–11(a).

[219] Under the proposed rule, for example, an ETF would have to disclose that it entered into a written call option, under which it would sacrifice potential gains that would result from the price of the reference asset increasing above the price at which the call may be exercised (*i.e.,* the strike price). Unless the ETF discloses the presence of these and similar liabilities, authorized participants and other investors may not be able to fully evaluate the portfolio's exposure.

[220] *See* 17 CFR 210.12–12, 210.12–12A, 210.12–13, 210.12–13A, 210.12–13B, 210.12–13C, and 210.12–13D. For investments in securities, securities sold short, and other investments, this would include the name of issuer and title of issue (as prescribed within the S–X schedules including any related footnotes on the description columns), balance held at close of period, number of shares, principal amount of bonds, and value of each item at close of period. For derivatives, this would include the description (as prescribed within the S–X schedules including any related footnotes), number of contracts, value, expiration date (as applicable), unrealized appreciation/depreciation (as applicable), and amount and description of currency to be purchased and to be sold (as applicable).

[221] We recognize that the generic listing standards for actively managed ETFs also currently require website disclosure of the ticker, CUSIP, description of the holding, and percentage of net assets for each portfolio holding. *See* NYSE Arca Rule 8.600–E(c)(2); Nasdaq Rule 5735(c)(2); Cboe BZX Rule 14.11(i)(3)(B).

[222] *See supra* footnote 208. None of our exemptive orders has required advance disclosure of intraday changes in the portfolio of the ETF or advance disclosure of portfolio trades. Instead, our orders have required ETFs to use the prior business day's portfolio holdings.

[223] Compliance Programs of Investment Companies and Investment Advisers, Investment Company Act Release No. 26299 (Dec. 17, 2003) [68 FR 74714 (Dec. 24, 2003)] (''Rule 38a–1 Adopting Release''). ETFs typically disclose (and would be required to disclose pursuant to proposed rule 6c–11) portfolio holdings information with greater frequency than other open-end funds, which are generally required to publicly disclose holdings on a quarterly basis.

on their websites.[224] As we noted in the release adopting these disclosures, a fund or investment adviser that discloses the fund's portfolio securities may only do so consistent with the antifraud provisions of the federal securities laws and the adviser's fiduciary duties.[225] Moreover, divulging nonpublic portfolio holdings to selected third parties is permissible only when the fund has legitimate business purposes for doing so and the recipients are subject to a duty of confidentiality, including a duty not to trade on the nonpublic information.[226]

We seek comment on this aspect of the proposed rule.

- Should we require ETFs to present the description, amount, value and unrealized gain/loss in the manner prescribed within Article 12 of Regulation S–X? Would such a presentation be more or less effective in disclosing portfolio holdings information than current website disclosure practices for ETFs? Do investors use current portfolio holding disclosures? Do current disclosure practices regarding portfolio holdings result in investor confusion? For example, do investors find the lack of consistency around the presentation of derivatives holdings confusing?
- Should we consider excluding any of the requirements in Article 12 of Regulation S–X? For example, is information regarding unrealized gain and loss useful for all ETFs? Should we only require that disclosure for ETFs that transact with authorized participants on a cash basis? Will disclosure of non-securities investment positions and assets permit investors, particularly authorized participants and other market participants engaged in arbitrage activities, to assess the full scope of the ETF's portfolio holdings?
- Is there any additional or alternative holdings information that we should require ETFs to disclose on their websites? For example, should we require daily disclosure regarding the ticker, CUSIP, or other identifier; sub-categories of holdings; and the percentage of net assets for each holding?
- Should ETFs be required to disclose all liabilities as part of their portfolio holding disclosure? For example, would disclosure of bank borrowings allow authorized participants and other market participants to evaluate the impact of leverage from these types of borrowings on the ETF's portfolio? How would the arbitrage mechanism work without this disclosure?
- Would the presentation requirements facilitate clear and uniform disclosure? Are there alternative presentation requirements we should consider? If so, what would those requirements be?
- The proposed rule would not require disclosure of intraday changes in the portfolio holdings of the ETF or advance disclosure of portfolio trades because changes in holdings would not affect the composition of the ETF's portfolio that serves as a basis for NAV calculation until the next business day. Should we require ETFs to disclose intraday changes in the portfolio or require advance disclosure of portfolio trades? Would such disclosure requirements improve transparency in a meaningful way? Would such disclosure requirements be costly to implement? Would an ETF or its investors suffer any harm if such information were disclosed? If so, how?
- Should we require ETFs to maintain portfolio holdings disclosure on their websites for periods longer than one day? If so, for how long (*e.g.,* 30 days)?
- ETFs trade in both portfolio assets (*e.g.,* when rebalancing) and creation units (when transacting with authorized participants). Does this raise any execution issues for ETFs? For example, how do ETFs prevent certain counterparties from receiving preferential treatment? [227] Are the policies and procedures noted above adequate to protect nonpublic information from misuse by authorized participants and other market participants that have access to ETF sensitive trade data? For example, how do ETFs ensure that authorized participants are not trading ahead of ETF rebalancing trades or other changes to its portfolio? Are there other requirements that we should adopt to protect ETFs and their investors? For example, should an ETF be required to maintain communications (including electronic communications) with its authorized participants?
- ETFs currently are not subject to Regulation FD, which prohibits the selective disclosure of information by publicly traded companies and other issuers.[228] Should we amend Regulation FD to apply to ETFs given that any information that is selectively disclosed may be immediately used to trade ETF shares (or the ETF's portfolio holdings) on the secondary market and given the proposed relief from section 17(a) for affiliated transactions? [229]

5. Baskets

Proposed rule 6c–11 would require each ETF relying on the rule to adopt and implement written policies and procedures governing the construction of baskets and the process that would be used for the acceptance of baskets.[230] In addition, the proposed rule would provide an ETF with the flexibility to use ''custom baskets'' if the ETF has adopted written policies and procedures setting forth detailed parameters for the construction and acceptance of custom baskets that are in the best interests of the ETF and its shareholders. The proposed rule also would require an ETF to disclose prominently on its website, which is publicly available and free of charge, information regarding a published basket that will apply to orders for the purchase or redemption of creation units each business day.[231] We believe that the conditions we are proposing related to baskets would provide ETFs with the ability to customize baskets in circumstances that would benefit the ETF and its investors, while at the same time putting in place protections against the potential for authorized participants to overreach by dictating the composition of baskets to the detriment of other ETF investors.[232]

[224] *See* Items 9(d) and 16(f) of Form N–1A; *see also* Disclosure Regarding Market Timing and Selective Disclosure of Portfolio Holdings, Investment Company Act Release No. 26418 (Apr. 20, 2004) [69 FR 22299 (Apr. 23, 2004)] (''Disclosure of Portfolio Holdings Release''), at section II.C.

[225] *See* Disclosure of Portfolio Holdings Release, *supra* footnote 224, at section II.C.

[226] *Id.*

[227] *See, e.g.,* Interpretive Release Concerning the Scope of Section 28(e) of the Securities Exchange Act of 1934 and Related Matters, Exchange Act Release No. 34–23170 (Apr. 28, 1986), at section V (discussing obligation of money manager to obtain best execution of client transactions).

[228] 17 CFR 243.

[229] Regulation FD does not apply to investment companies, other than closed-end funds. The releases proposing and adopting Regulation FD do not specifically discuss ETFs. *See* Selective Disclosure and Insider Trading, Investment Company Act Release No. 24209 (Dec. 20, 1999) [64 FR 72590 (Dec. 28, 1999)] (proposing release), at paragraph preceding n.54 (''Investment companies that are continually offering their securities to the public already are required to update their prospectuses to disclose material changes subsequent to the effective date of the registration statement or any post-effective amendment, and are not permitted to sell, redeem, or repurchase their securities except at a price based on their securities' net asset value. While we believe that Regulation FD would offer little additional protection to investors in these types of investment companies and therefore they should be excluded from its coverage, these considerations do not apply in the case of closed-end investment companies.''). *See also* Selective Disclosure and Insider Trading, Investment Company Act Release No. 24599 (Aug. 15, 2000) [65 FR 51716 (Aug. 24, 2000)] (adopting release).

[230] *See* proposed rule 6c–11(c)(3). The proposed rule would define ''basket'' to mean the securities, assets or other positions in exchange for which an ETF issues (or in return for which it redeems) creation units. *See* proposed rule 6c–11(a).

[231] *See* proposed rule 6c–11(c)(1)(i)(B).

[232] *See, e.g.,* proposed rule 6c–11(c)(2).

a. Basket Flexibility

Where an ETF uses in-kind creations and redemptions, the composition of the basket is an important aspect of the efficient functioning of the arbitrage mechanism.[233] Basket composition affects the costs of assembling and delivering the baskets that will be exchanged for creation units as well as the costs of liquidating basket securities when redeeming creation units. For example, the number of positions included in a basket, as well as the difficulty and cost of trading those positions, will affect the cost of basket transactions. A basket with hundreds of relatively small positions may prove less efficient than a basket with fewer positions.

Basket composition also is important to ETF portfolio management. Each in-kind creation or redemption increases or decreases positions in the ETF's portfolio. Managing the composition of a basket allows the ETF to add certain instruments to its portfolio during the creation process (by including those securities in the basket that it will accept in exchange for a creation unit), or, conversely, to remove certain portfolio holdings during the redemption process (by including them in a redemption basket while not accepting them in the creation unit). This can be an efficient way for a portfolio manager to execute changes in the ETF's portfolio because the manager can make the changes without incurring the additional expenses of trades in the market. When an ETF does not have flexibility to manage basket composition, however, it may result in undesired changes to the portfolio, such as the loss of desirable bonds when paying redemptions in kind.

The exemptive relief we have provided ETFs relating to baskets has evolved over time. Our earliest ETF orders for index-based ETFs organized as UITs provided that in-kind purchases of creation units were to be made using a basket of securities substantially similar to the composition and weighting of the ETF's underlying index.[234] Given the unmanaged nature of the UIT structure, a UIT ETF's basket generally reflected a *pro rata* representation of the ETF's portfolio.[235]

Early orders for ETFs organized as open-end funds included few explicit restrictions on baskets, and these orders did not expressly limit ETFs' baskets to a *pro rata* representation of the ETF's portfolio holdings.[236] Since approximately 2006, however, as the ETF industry grew and the Commission gained more experience with ETFs, our exemptive orders have placed tighter restrictions on ETFs' composition of baskets.[237] These orders expressly require that the ETF's basket generally correspond *pro rata* to its portfolio holdings, while identifying certain limited circumstances under which an ETF may use a non-*pro rata* basket.[238] Our recent exemptive orders, for example, permit ETFs to use baskets that do not correspond *pro rata* to the ETF's portfolio holdings when it is impossible to break up bonds beyond certain minimum sizes needed for transfer and settlement or where rounding is necessary to eliminate fractional shares.[239] The orders have allowed baskets to deviate from a *pro rata* representation where the basket includes positions that cannot be transferred in kind, such as "to be announced" transactions ("TBA transactions"), short positions, and derivatives.[240] We have also permitted index-based ETFs to use non-*pro rata* baskets where the ETF has determined to use representative sampling of its portfolio to create its basket,[241] and for temporary periods to replicate changes in the ETF's portfolio holdings as a result of the rebalancing of the ETF's securities market index.

Our recent exemptive orders also have permitted ETFs to specifically substitute cash for some or all of the securities in the ETF's basket in certain limited circumstances, including where the basket includes securities that are not eligible for trading due to local trading restrictions or are not available in sufficient quantity for purchases of creation units.[242] In addition, while most existing ETFs typically engage in creation and redemption transactions on an in-kind basis, we have permitted ETFs to use an all-cash basket.[243] Due to the limited transferability of certain financial instruments, some ETFs operate on a cash-only basis under their exemptive orders.[244]

The requirement that baskets correspond *pro rata* to the ETF's portfolio holdings, and the increasingly limited exceptions to the *pro rata* requirement, were designed to address the risk that an authorized participant could take advantage of its relationship with the ETF and pressure the ETF to construct a basket to be used only for that authorized participant and that favors the authorized participant to the detriment of the ETF's shareholders. For example, because ETFs rely on authorized participants to maintain the secondary market by promoting an effective arbitrage mechanism, an authorized participant holding less liquid or less desirable securities potentially could pressure an ETF into accepting those securities in its basket in exchange for liquid ETF shares (*i.e.,* dumping). An authorized participant also could pressure the ETF into including in its basket certain desirable securities in exchange for ETF shares tendered for redemption (*i.e.,* cherry-

[233] *See supra* section I.B.

[234] *See, e.g.,* SPDR, *supra* footnote 34.

[235] *See supra* section II.A.1. A UIT ETF could substitute cash for basket assets in certain limited circumstances. *See, e.g.,* SPDR, *supra* footnote 34.

[236] *See* WEBs Index Fund, Inc., *et al.,* Investment Company Act Release Nos. 23860 (June 7, 1999) [64 FR 31658 (June 11, 1999)] (notice) and 23890 (July 6, 1999) (order) and related application.

[237] *See, e.g.,* 2006 WisdomTree Investments, *supra* footnote 66; *see also infra* footnote 245 and accompanying paragraph.

[238] *See* 2006 WisdomTree Investments, *supra* footnote 66 ("[I]n limited circumstances and only when doing so would be in the best interest of a Fund as determined by the Advisor or Subadvisor, each Fund may designate Deposit Securities that may not be an exact pro rata reflection of such Fund's Portfolio Securities. For example, a Fund might designate a non-*pro rata* basket of Deposit Securities if one or more Portfolio Securities were not readily available, or in order to facilitate or reduce the costs associated with a rebalancing of a Fund's portfolio in response to changes in its Underlying Index.").

[239] *See, e.g.,* Nationwide Fund Advisors, *et al.,* Investment Company Act Release Nos. 32727 (July 6, 2017) [82 FR 32214 (July 12, 2017)] (notice) and 32771 (Aug. 1, 2017) (order) and related application.

[240] *Id.* In the TBA market, lenders enter into forward contracts to sell agency mortgage-backed securities and agree to deliver such securities on a settlement date in the future. The specific agency mortgage-backed securities that will be delivered in the future may not yet be created at the time the forward contract is entered into. The purchaser will contract to acquire a specified dollar amount of mortgage-backed securities, which may be satisfied when the seller delivers one or more mortgage-backed securities pools at settlement. *See* LRM Adopting Release, *supra* footnote 101, at n.381.

[241] *See* Morgan Stanley, *supra* footnote 211. In this context, representative sampling means that the ETF's baskets do not reflect a *pro rata* representation of the ETF's portfolio but contain assets from the ETF's portfolio that have been determined by the ETF to constitute a representative sample of the portfolio. *See id.* Our exemptive orders have expressly limited the circumstances under which the ETF may use representative sampling to select its basket assets: (i) The sample must be designed to generate performance that is highly correlated to the performance of the ETF's portfolio; (ii) the sample must consist entirely of instruments that are already included in the ETF's portfolio; and (iii) the sample must be the same for all authorized participants on a given business day. *See id.*

[242] *See, e.g.,* J.P. Morgan Exchange-Traded Fund Trust, *et al.,* Investment Company Act Release Nos. 30898 (Jan. 30, 2014) [79 FR 6941 (Feb. 5, 2014)] (notice) and 30927 (Feb. 25, 2014) (order) and related application. These orders also generally require an ETF to use the same basket for both purchases and redemptions on a particular business day, subject to certain exceptions. *See, e.g., id.*

[243] *See, e.g.,* 2006 WisdomTree Investments, *supra* footnote 66.

[244] *See, e.g.,* ProShares Trust, *et al.,* Investment Company Act Release Nos. 27975 (Sept. 21, 2007) [72 FR 55257 (Sept. 28, 2007)] (notice) and 28014 (Oct. 17, 2007) (order) and related application.

picking). In either case, the ETF's other investors would be disadvantaged and would be left holding shares of an ETF with a less liquid or less desirable portfolio of securities. These abuses also could occur when a liquidity provider or other market participant engages in primary market transactions with the ETF by using an authorized participant as an agent.[245]

Based on our experience with ETFs, however, we recognize that there are many circumstances, in addition to the specific circumstances enumerated in our orders, where allowing baskets to differ from a *pro rata* representation or allowing the use of different baskets for different authorized participants could benefit the ETF and its shareholders. For instance, ETFs without basket flexibility typically are required to include a greater number of individual securities within their baskets when transacting in kind, making it more difficult and costly for authorized participants and other market participants to assemble or liquidate baskets.[246] This could result in wider bid-ask spreads and potentially less efficient arbitrage. In such circumstances, these ETFs may be at a competitive disadvantage to ETFs with greater basket flexibility. As a result, these differing conditions and requirements for basket composition in our exemptive orders may have created a disadvantage for newer ETFs that are subject to our more recent, stringent restrictions on baskets.

Moreover, we believe that certain exceptions to a *pro rata* basket requirement may help ETFs operate more efficiently. For example, a lack of basket flexibility may cause some ETFs, particularly fixed-income ETFs, to satisfy redemption requests entirely in cash in order to avoid losing hard-to-find securities and to preserve the ETF's ability to achieve its investment objectives.[247] ETFs that meet redemptions in cash may be required to maintain larger cash positions to meet redemption obligations, potentially resulting in cash drag on the ETF's performance. The use of cash baskets also may be less tax-efficient than using in-kind baskets to satisfy redemptions, and may result in additional transaction costs for the purchase and sale of portfolio holdings.[248]

We believe it is appropriate, therefore, to provide additional basket flexibility, subject to conditions designed to address concerns regarding the potential risk of overreaching. Additional basket flexibility potentially could benefit ETF investors through more efficient arbitrage and narrower bid-ask spreads, among other benefits.[249] Further, we believe that permitting the same level of basket flexibility for all ETFs relying on the rule would give a consistent structure to ETFs relying on the rule and would remove a barrier to entry for new ETFs.

As proposed, rule 6c–11 would require all ETFs relying on the rule to adopt and implement written policies and procedures that govern the construction of baskets and the process that will be used for the acceptance of baskets.[250] These policies and procedures would be required to cover the methodology that the ETF would use to construct baskets. For example, the policies and procedures should detail the circumstances when the basket may omit positions that are not operationally feasible to transfer in kind. The policies and procedures should detail when the ETF would use representative sampling of its portfolio to create its basket, and how the ETF would sample in those circumstances.[251] The policies and procedures also should detail how the ETF would replicate changes in the ETF's portfolio holdings as a result of the rebalancing or reconstitution of the ETF's securities market index, if applicable.

In addition to requiring that ETFs relying on the proposed rule adopt and implement policies and procedures regarding the composition of baskets, the proposed rule defines two particular types of baskets as ''custom baskets,'' which are subject to additional conditions designed to protect ETF investors. First, baskets that are composed of a non-representative selection of the ETF's portfolio holdings would be defined as custom baskets.[252] A non-representative selection of the ETF's portfolio holdings would include, but not be limited to, baskets that do not reflect: (i) A *pro rata* representation of the ETF's portfolio holdings;[253] (ii) a representative sampling of the ETF's portfolio holdings; or (iii) changes due to a rebalancing or reconstitution of the ETF's securities market index, if applicable.

Second, different baskets used in transactions on the same business day are defined as custom baskets under the proposed rule.[254] For example, if an ETF exchanges a basket with an authorized participant that reflects a representative sampling of the ETF's portfolio holdings and a different basket with either the same or another authorized participant that represents a different representative sampling, both baskets would be custom baskets. Similarly, if an ETF substitutes cash in lieu of a portion of basket assets for a single authorized participant, that basket would be a custom basket.

We believe the use of custom baskets presents an increased risk that the ETF may be subject to improper pressure by an authorized participant to create specific baskets that favor that authorized participant. For example, using a custom basket could give authorized participants more opportunities for cherry-picking, dumping, or other abuses, including the potential for manipulative trading in the underlying portfolio securities. The proposed rule includes heightened process requirements for ETFs that use custom baskets as a means to protect against these risks. We believe that requiring an ETF that relies on the proposed rule to adopt basket policies and procedures that include specified

[245] *See supra* footnote 22 and accompanying text.

[246] *See* Schwab ETP Comment Letter, *supra* footnote 115, at n.10 (''[W]e looked at the daily National Securities Clearing Corporation Portfolio Composition Files for three Fixed-Income ETFs that each seek to track the Barclays U.S. Aggregate Bond Index. The first ETF is subject to the *pro rata* requirement and on the August 7, 2015 trade date that ETF included 1,486 securities in its creation basket. The second and third ETFs are not subject to the *pro rata* requirement. In striking contrast, on the same trade date these two ETFs included only 64 and 56 securities in their creation baskets, respectively.'').

[247] As discussed above, many ETFs, including fixed-income ETFs, are permitted under their exemptive orders to satisfy redemptions entirely in cash where the ETF holds thinly traded securities, among other circumstances. *See, e.g.,* Pacific Investment Management Company LLC *et al.,* Investment Company Act Release Nos. 28723 (May 11, 2009) [74 FR 22772 (May 14, 2009)] (notice) and 28752 (June 1, 2009) (order) and related application.

[248] In-kind redemptions allow ETFs to avoid taxable events that arise when selling securities for cash within the ETF.

[249] *See infra* footnote 438 and accompanying paragraph; *see also infra* footnote 444 and accompanying text.

[250] *See* proposed rule 6c–11(c)(3). We note that ETFs already may have policies and procedures governing the construction of baskets in order to comply with the representations and conditions of their exemptive orders. These policies and procedures, however, would not have been subject to the requirements we are proposing for custom basket policies and procedures, which we discuss below.

[251] *See supra* footnote 38 for a discussion of sampling.

[252] *See* proposed rule 6c–11(a) (defining ''custom baskets'' to include baskets that are composed of a non-representative selection of the ETF's portfolio holdings).

[253] A basket that is a *pro rata* representation of the ETF's portfolio holdings, except for minor deviations when it is not operationally feasible to include a particular instrument within the basket, generally would not be considered a ''custom basket.''

[254] *See* proposed rule 6c–11(a) (defining ''custom baskets'' to include different baskets used in transactions on the same business day).

requirements is an appropriately tailored means to address concerns that authorized participants may overreach. Furthermore, we believe that the consistent implementation of custom basket policies and procedures would discipline the basket process and would act as a safeguard against potential cherry picking or dumping of unwanted securities by authorized participants.[255]

Under the proposed rule, an ETF using custom baskets must adopt policies and procedures that: (i) Set forth detailed parameters for the construction and acceptance of custom baskets that are in the best interests of the ETF and its shareholders, including the process for any revisions to, or deviation from, those parameters; and (ii) specify the titles or roles of the employees of the ETF's investment adviser who are required to review each custom basket for compliance with those parameters (''custom basket policies and procedures'').[256] Effective custom basket policies and procedures should provide specific parameters regarding the methodology and process that the ETF would use to construct or accept each custom basket. An ETF's custom basket policies and procedures should describe the ETF's approach for testing compliance with the custom basket policies and procedures and assessing (including through back testing or other periodic reviews) whether the parameters continue to result in custom baskets that are in the best interests of the ETF and its shareholders. The custom basket policies and procedures should be consistently applied and must establish a process that the ETF will adhere to if it wishes to make any revisions to, or deviate from, the parameters. In addition, ETFs should consider adopting reasonable controls designed to prevent inappropriate differential treatment among authorized participants.

As part of the custom basket policies and procedures, an ETF must specify the titles or roles of employees of the ETF's investment adviser who are required to review each custom basket for compliance with the parameters set forth in those policies and procedures. An ETF may want to consider whether employees outside of portfolio management should review the components of custom baskets before approving a creation or redemption. Finally, as discussed in more detail below in section II.D, the ETF would be required to create a record stating that each custom basket complies with the ETF's custom basket policies and procedures.[257]

We believe that the ETF's investment adviser is in the best position to design and administer the custom basket policies and procedures and to establish parameters that are in the best interests of the ETF and its shareholders.[258] The ETF's adviser (and personnel) would be familiar with the ETF's portfolio holdings and would be able to assess whether the process and methodology used to construct or accept a custom basket would be in the best interests of the ETF and its shareholders and whether a particular custom basket complies with the parameters set forth in the custom basket policies and procedures. We believe that these requirements would allow an ETF to establish a tailored framework for the utilization of custom baskets, while also requiring the ETF to put into place safeguards against abusive practices related to basket composition. Custom basket policies and procedures designed and utilized in the best interests of an ETF and its shareholders may help the ETF manage its portfolio more efficiently, facilitate the arbitrage mechanism for the ETF, provide liquidity in markets for the ETF's shares and/or the ETF's underlying portfolio holdings, or provide other benefits to the ETF.

In addition, ETFs currently are required by rule 38a–1 under the Act to adopt, implement and periodically review written policies and procedures reasonably designed to prevent violations of the federal securities laws.[259] An ETF's compliance policies and procedures should be appropriately tailored to reflect its particular compliance risks. An ETF's basket policies and procedures (including its custom basket policies and procedures), therefore, should be covered by the ETF's compliance program and other requirements under rule 38a–1.[260] For example, an ETF would be required to preserve the basket policies and procedures pursuant to the requirements of rule 38a–1(d)(1). We believe that the ETF's board of directors' oversight of the ETF's compliance policies and procedures, as well as their general oversight of the ETF, would provide an additional layer of protection for an ETF's use of custom baskets.

Our 2008 proposal did not expressly contemplate that an ETF would be permitted to substitute other securities in lieu of other basket assets.[261] Instead, the proposal noted that in some circumstances it may not be practicable, convenient or operationally possible for the ETF to operate on an in-kind basis, and indicated that a fund could substitute cash for some or all of the securities in the basket.[262] Commenters on this aspect of the 2008 proposal agreed with the definition of basket and did not recommend any modifications.[263]

Under proposed rule 6c–11, however, an ETF would be permitted to construct baskets using cash, securities, or other positions, provided that the ETF has satisfied the appropriate policies and procedures requirement (*i.e.,* the standard requirement or the heightened requirement for custom baskets). As noted above, the use of in-kind baskets can result in several advantages to an ETF and its investors, including tax efficiencies and transaction cost savings. We believe that this approach would provide ETFs with flexibility to cover operational circumstances that make the inclusion of certain portfolio securities and other positions in a basket operationally difficult (or impossible), while also facilitating portfolio management changes in a cost- and tax-efficient manner. We believe that an ETF's policies and procedures should include details regarding the

[255] In addition, in a highly competitive market, such as the market for ETFs, low performance or high tracking error would make ETFs undesirable for participants in both the primary and secondary markets. ETFs that do not guard closely against dumping and cherry-picking could have diminished performance or higher tracking error over time, which would likely cause flows out of the fund.

[256] Proposed rule 6c–11(c)(3)(i). We also are proposing to require ETFs to maintain records detailing the composition of each custom basket. *See infra* section II.D.

[257] *See* proposed rule 6c–11(d)(2)(ii).

[258] An investment adviser has a fiduciary duty to act in the best interests of a fund it advises. *See* section 36(a) under the Act. *See also, e.g., Rosenfeld* v. *Black,* 445 F.2d 1337 (2d Cir. 1971); *Brown* v. *Bullock,* 194 F. Supp. 207, 229, 234 (S.D.N.Y.), aff'd, 294 F.2d 415 (2d Cir. 1961); *In re* Provident Management Corp., Securities Act Release No. 5155 (Dec. 1, 1970), at text accompanying n.12; Rule 38a-1 Adopting Release, *supra* footnote 223, at n.68.

[259] *See* Rule 38a–1 Adopting Release, *supra* footnote 223.

[260] For example, rule 38a–1 requires a fund's chief compliance officer to provide a written report to the ETF's board of directors, no less frequently than annually, that addresses, among other things, the operation of the fund's compliance policies and procedures and any material changes made to those policies and procedures since the date of the last report and any material changes to the policies and procedures recommended as a result of the annual review of the policies and procedures. *See* rule 38a–1(a)(4)(iii)(A).

[261] The 2008 proposal would have defined the term ''basket assets'' as the securities or other assets specified each business day in name and number by an ETF as the securities or assets in exchange for which it will issue or in return for which it will redeem ETF shares. *See* 2008 ETF Proposing Release, *supra* footnote 3.

[262] *See id.,* at nn.120–121 (describing the circumstances in which an ETF may use cash in lieu of certain securities in the basket).

[263] *See, e.g.,* ICI 2008 Comment Letter.

circumstances in which cash, securities, or other positions would be substituted.

We seek comment on this aspect of the proposed rule.

- Is our proposed definition of ''baskets'' appropriate? Should the term exclude investments that are not securities or assets? Should the term exclude instruments that cannot be transferred in kind?
- Is our proposed requirement that all ETFs adopt written policies and procedures governing basket construction appropriate? Are there alternatives we should consider? For example, should we require only ETFs that use custom baskets to adopt policies and procedures? Or, instead of requiring ETFs to adopt policies and procedures governing basket construction generally and custom basket policies and procedures, should we adopt a single requirement that all ETFs adopt policies and procedures governing the construction of baskets? If so, what parameters should be placed on those policies and procedures? What parameters, if any, should we place on board oversight of the policies and procedures governing the construction of baskets?
- Instead of permitting basket flexibility as proposed, should we require baskets to reflect a *pro rata* representation of the ETF's portfolio holdings? Should we enumerate specific exemptions to the *pro rata* representation requirement? If so, what should those exemptions include? For example, should we include an exemption for an authorized participant prohibited from transacting in a certain basket security? Should we require baskets to be representative of the ETF's portfolio holdings according to some other criteria?
- Should we allow ETFs to utilize baskets that deviate from a *pro rata* representation of the ETF's portfolio holdings, but require ETFs to utilize the same basket for all transactions on a particular business day? If so, why?
- Do the proposed basket conditions appropriately address concerns of overreaching by authorized participants or other market participants, including those that are first- or second-tier affiliates identified in the rule? Should the proposed rule include any other conditions to minimize the potential risks of overreaching or other conflicts of interest by such affiliates? For example, should we limit the ability of an ETF to utilize a custom basket when an authorized participant or other market participant is an affiliate covered by the proposed exemption from section 17(a)?
- Is our proposed definition of ''custom basket'' appropriate? Alternatively, should the term encompass any basket that deviates from a *pro rata* representation of the identities and quantities of the portfolio holdings held by the ETF? Should we provide additional guidance regarding instances where the basket is composed of a non-representative selection of the ETF's portfolio? Should we include examples in the definition of ''custom baskets''?
- Are there any reasons to prohibit an ETF from using a custom basket? If so, what are they?
- Should we provide additional guidance or include additional requirements in the rule regarding the elements of effective custom basket policies and procedures? For example, should custom basket policies and procedures set forth the minimum number of positions that would be included in a custom basket? Should the custom basket policies and procedures set forth parameters regarding the effect of the custom basket on the value of the ETF's portfolio holdings, its tracking error (if applicable), and the portfolio's risks? Should these policies and procedures set forth the circumstances under which the ETF would substitute cash in lieu of portfolio holdings after considering the effect cash would have on performance, trading costs, and if accepting cash would have tax consequences? Should they set forth the parameters in which the ETF will accept odd-lot securities in a custom basket? Are there any other considerations that should be included? Alternatively, should we eliminate any or all of the considerations discussed above?
- Should we require an ETF to adopt policies and procedures that set forth detailed parameters for the construction or acceptance of custom baskets that are in the best interests of the ETF and its shareholders as proposed? Should we require the policies and procedures to include a process for any revisions to or deviation from the parameters as proposed? Are there other parameters we should consider? Should we require the custom basket policies and procedures to list the titles or roles of the employees who review each custom basket for compliance with the parameters as proposed? Should we provide guidance regarding how this review should be done in cases where the ETF is sub-advised? Should we require that this review be done only by employees outside of portfolio management? If so, which employees and why?
- As proposed, rule 6c–11 would require an ETF to create a record stating that each custom basket complies with the ETF's custom basket policies and procedures.[264] Should we establish any other recordkeeping requirements relating to basket flexibility?
- Should the proposed rule require the ETF's investment adviser to review the basket policies and procedures (including the custom basket policies and procedures) on an annual basis or with such frequency as the ETF's adviser deems reasonable and appropriate? Should the proposed rule include board reporting requirements? For example, should the proposed rule require the adviser to deliver an annual report to the ETF's board regarding the implementation of the basket policies and procedures?

b. Posting of a Published Basket

We also are proposing to require an ETF to post on its website information regarding a published basket at the beginning of each business day, as well as the estimated cash balancing amount if any.[265] We believe this disclosure would contribute to the efficiency of the arbitrage mechanism by providing authorized participants and other market participants with timely information regarding the contents of a basket that the ETF will accept for creations and redemptions each business day. This, in turn, would allow market participants to value the contents of the basket on an intraday basis to determine whether arbitrage opportunities exist. This information also permits market makers to compare the ETF's portfolio holdings with the basket.

In particular, we are proposing to require that an ETF publish on its website one basket that it would exchange for orders to purchase or redeem creation units to be priced based on the ETF's next calculation of NAV per share each business day.[266] This ''published'' basket must be disclosed before the opening of trading of the ETF's shares and before the ETF begins accepting orders for the purchase or redemption of creation units to be priced based on the ETF's next calculation of NAV.[267] This requirement is designed to mitigate possible inefficiencies in the arbitrage

[264] *See* proposed rule 6c–11(d)(2)(ii).

[265] *See* proposed rule 6c–11(c)(1)(i)(B) and (C). Under proposed rule 6c–11(a), the ''cash balancing amount'' would be defined as an amount of cash to account for any differences between the value of a basket and the NAV of a creation unit. Our ETF exemptive orders have recognized a cash balancing amount to reconcile any difference between the asset value of a creation unit and the value of the ETF's basket.

[266] *See* proposed rule 6c–11(c)(1)(i)(B).

[267] *See id.*

mechanism that could result from delaying the publication of an ETF's basket.[268]

Under this requirement, an ETF would publish a basket that it would accept if presented by any authorized participant in exchange for creation units (or present to an authorized participant redeeming creation units).[269] Accordingly, an ETF that planned to use only custom baskets on a particular business day (*e.g.,* a basket reflecting a non-representative selection of the ETF's portfolio holdings), would be required to post a custom basket as its ''published'' basket.

Because an ETF would be required to post only one published basket to comply with this condition, there may be occasions where an ETF would not post the contents of every custom basket. We considered proposing that ETFs be required to publish, after the close of trading on each business day, information regarding every basket used by the ETF to serve as an additional check against overreaching by authorized participants. However, we preliminarily believe that this requirement is an unnecessary additional burden, resulting in compliance and other operational costs for ETFs to review the information before it is posted. Instead, as discussed below in section II.D, we are proposing to require ETFs to maintain records detailing the composition of baskets, which would allow our staff to review an ETF's baskets as part of an examination.

The 2008 proposed rule did not require ETFs to disclose their baskets. We did note in that proposal, however, that basket disclosure was a widely adopted industry practice and facilitated effective arbitrage activity.[270] On this issue, commenters on the 2008 proposal stated that it was not necessary for the Commission to require ETFs to disclose their baskets because that information was available in the portfolio composition files provided each business day by ETFs to the National Securities Clearing Corporation (''NSCC'').[271] While this still may be true, the composition of an ETF's basket for a given day may be important information to not only authorized participants and large institutional investors (who, as NSCC members, have access to the daily portfolio composition files), but to other market participants as well. For example, the information allows investors to compare the ETF's baskets for a given day with its portfolio holdings, assists market participants who are building their intraday hedge (we understand that some market participants primarily look to the baskets rather than the whole portfolio), and is important for purposes of estimating any cash balancing amounts as it allows market participants to compare the basket to the whole portfolio. We also believe that this proposed basket disclosure requirement is sufficiently narrow to not impose a significant burden on ETFs because it requires only one basket-related disclosure each trading day, at the beginning of the day.

We request comment on this proposed requirement.[272]

- Are we correct that disclosure of an ETF's basket facilitates the arbitrage mechanism? Is an ETF's basket composition useful information to ETF investors in the secondary market?
- Should we require the posting of a basket as proposed? Should we provide additional guidance regarding what types of basket would constitute a published basket?
- Would the disclosure of one basket at the beginning of each business day provide enough information to all market participants about an ETF's basket composition, particularly for ETFs using custom baskets? Should we instead require ETFs to disclose each basket used on a given business day after the close of trading on the ETF's website? Would these approaches cause competitive concerns or cause significant operational challenges? What costs and benefits would be associated with a requirement to publish all baskets used each business day? Would such an approach allow better policing of potential overreaching by authorized participants?
- If an ETF is no longer willing to accept the basket posted on its website on a particular business day because of market events, should the rule require the ETF to post a replacement basket on the website that the ETF would accept?
- Our proposal is designed to strike a balance between process and oversight requirements (*i.e.,* policies and procedures governing basket construction) and disclosure requirements. Do commenters agree with this approach? Would additional basket transparency lessen the need for policies and procedures relating to basket composition? Is there a more appropriate balance between the two types of requirements that we should consider?
- Is our proposed definition of ''cash balancing amount'' appropriate?
- Should we require the disclosure of baskets on an ETF's website as proposed? Alternatively, should we allow ETFs to comply with the basket transparency condition by sending the portfolio composition file to a central clearing facility in accordance with current practices? What would be the costs or operational burdens of each approach? Would the website disclosure of this information benefit any market participants (including retail investors) that may not have access to the portfolio composition file? If so, how would market participants use this information?

6. Website Disclosure

There has been a significant increase in the use of the internet as a tool for disseminating information,[273] and we believe that many investors obtain information regarding ETFs on the ETFs' websites. Proposed rule 6c–11 therefore would require ETFs to disclose certain information on their websites as a condition to the rule.[274] As noted above, we believe that the arbitrage mechanism works more efficiently when certain data is publicly available to investors each trading day, and are therefore proposing ETF website disclosures in order to provide transparency of portfolio holdings and baskets.[275] In addition, we are proposing several website disclosure requirements that are designed to provide investors with key metrics to evaluate their investment and trading decisions in a format that is easily accessible and frequently updated. Specifically, the proposed rule would require disclosure regarding: (i) The ETF's NAV per share, market price, and premium or discount, each as of the end of the prior business day; (ii) bid-ask spreads; and (iii) historical information regarding premiums and discounts.

Some of these conditions are based on our exemptive relief, which has required ETFs to disclose on their

[268] As proposed, an ETF relying on the rule also would be required to disclose its portfolio holdings that will form the basis of the next calculation of NAV per share in this manner. *See* proposed rule 6c–11(c)(1)(i)(A).

[269] Our proposal does not prevent an ETF from changing the assets in a published basket to respond to market conditions after the basket is published.

[270] *See* 2008 ETF Proposing Release, *supra* footnote 3, at n.27 and accompanying text. Many exemptive orders also require ETFs to make basket information available on a daily basis. *See, e.g.,* Salt Financial, LLC, *et al.,* Investment Company Act Release Nos. 32974 (Jan. 23, 2018) [83 FR 4097 (Jan. 29, 2018)] (notice) and 33007 (Feb. 21, 2018) (order) (''Salt Financial'').

[271] *See, e.g.,* NYSE Arca 2008 Comment Letter.

[272] We request comment regarding additional proposed website disclosures at *infra* section II.C.6.

[273] *See, e.g.,* Reporting Modernization Adopting Release, *supra* footnote 147.

[274] Proposed rule 6c–11(c)(1).

[275] *See supra* sections II.C.4 and II.C.5.

websites certain information regarding their investments and operations, including quantitative information regarding discounts or premiums at which the ETF's shares trade on the secondary market.[276] Our orders have required ETFs to publicly disclose on their websites: (i) The prior business day's NAV per share; (ii) the market closing price or the midpoint of the bid-ask spread at the time of the calculation of NAV; and (iii) a calculation of the premium or discount of the market closing price or midpoint of the bid-ask spread against NAV per share.[277] Similarly, Form N–1A currently provides an ETF with the option to omit certain historical information regarding premiums and discounts from its prospectus and annual report if the disclosure is provided on its website.[278] Based on our experience overseeing ETFs, we are proposing additional website disclosure requirements that have not been part of our exemptive relief or Form N–1A requirements. We also are requesting comment regarding ways to better inform investors about intraday deviations between an ETF's market price and: (i) NAV per share; (ii) the contemporaneous value of its portfolio; or (iii) both. Each of the proposed website disclosures is discussed below.

a. Daily NAV, Market Price, and Premiums and Discounts

Proposed rule 6c–11(c)(1)(ii) would require ETFs to post on their websites, on each business day, the ETF's current NAV per share, market price, and premium or discount, each as of the end of the prior business day. This disclosure provides investors with a ''snapshot'' view of the difference between an ETF's NAV per share and market price on a daily basis. It is designed to alert investors to the relationship between NAV per share and the market price of the ETF's shares and that they may sell or purchase ETF shares at prices that do not correspond to NAV of the ETF. It also is designed to allow investors to compare this information across ETFs. For example, an investor using this information likely would notice that ETFs tracking emerging markets tend to have greater premiums or discounts than ETFs tracking broad-based domestic indexes. We believe that daily website disclosure of this information would promote transparency and help investors better understand the risk that an ETF's market price may be higher or lower than the ETF's NAV per share. We further believe that ETF investors use this information today, as ETFs currently provide this website disclosure pursuant to the terms of their exemptive orders.

This proposed requirement is consistent with our exemptive orders and generally consistent with our 2008 proposal, except we have changed the definition of ''market price''.[279] Proposed rule 6c–11 would define the term ''market price'' to mean: (i) The official closing price of an ETF share; or (ii) if it more accurately reflects the market value of an ETF share at the time as of which the ETF calculates current NAV per share, the price that is the midpoint of the national best bid and national best offer (''NBBO''), calculated as of the time NAV per share is calculated.[280]

The 2008 proposed rule would have defined ''market price'' only as the last price at which ETF shares trade on their principal U.S. trading market during a regular trading session. However, we believe that using the ''official closing price,'' as opposed to the ''closing market price,'' is a better measure of an ETF's market price, particularly in situations where the last trade of the day was not reflective of the actual market price (*e.g.,* due to an erroneous order). Exchanges have detailed rules regarding the determination of the official closing price of a security.[281] For example, if a listing exchange experiences a systems disruption and cannot conduct closing auctions, exchanges use their back-up procedures to determine the ''official closing price'' for the affected securities (such as relying on a backup exchange's closing auction). As a result, we preliminarily believe that using the ''official closing price'' provides a more precise measurement of an ETF's market price, including during disruptive market events.

Commenters on the 2008 ETF Proposing Release who addressed this aspect of the proposal opposed the proposed definition of market price because of concerns that the last price at which an ETF trades could be stale at the time as of which NAV per share is calculated.[282] These commenters suggested that ETFs instead be permitted to use the midpoint between the highest bid and the lowest offer at the time as of which the ETF's NAV is calculated.[283] We generally agree and, as a result, we are proposing to permit ETFs to use a price that is the midpoint of the NBBO as of that time, if it is more accurate.[284] Because security information processors calculate NBBO continuously during the trading day, NBBO has the benefit of being a verifiable third-party quote. We believe that this approach provides an appropriate degree of flexibility to an ETF when its last reported sales price may be stale, while at the same time providing a consistent and verifiable methodology for how ETFs determine market price.

As discussed in more detail below, the proposed definition of market price also differs from the definition currently used in Form N–1A.[285] Form N–1A defines ''market price'' as the last reported sale price or, if it more accurately reflects the current market value of the ETF's shares, ''a price within the range of the highest bid and lowest offer.'' [286] We believe specifying that an ETF must use the midpoint of the NBBO, rather than ''a price within the range of the highest bid and lowest offer'' still provides the ETF with flexibility in determining a market price for its shares that accurately reflects the shares' market value. At the same time, requiring ETFs to use the midpoint in these circumstances would mitigate the potential for gaming practices that could inaccurately minimize a deviation between market price and NAV per share when showing premiums and discounts.[287] We are proposing to amend Form N–1A to remove the definition of market price in that form

[276] *See, e.g.,* Barclays Global 2008, *supra* footnote 58.

[277] *See supra* footnote 134 and accompanying text.

[278] *See infra* section II.H.

[279] *See* 2008 ETF Proposing Release, *supra* footnote 3.

[280] *See* proposed rule 6c–11(a).

[281] *See, e.g.* Self-Regulatory Organizations; New York Stock Exchange LLC; NYSE MKT LLC; Notice of Filings of Amendment No. 1, and Order Granting Accelerated Approval of Proposed Rule Changes, as Modified by Amendment No. 1, to Provide for How the Exchanges Would Determine an Official Closing Price if the Exchanges are Unable to Conduct a Closing Transaction, Exchange Act Release No. 78015 (June 8, 2016) [81 FR 38747 (June 14, 2016)] (NYSE backup procedures).

[282] *See, e.g.,* Chapman 2008 Comment Letter (noting that shares of some smaller ETFs may not trade often or at all on a particular day); ICI 2008 Comment Letter (noting that closing price may be less accurate because the last trade occurred at a much earlier time than the time as of which NAV is calculated).

[283] *See, e.g.,* Chapman 2008 Comment Letter.

[284] *See* proposed rule 6c–11(a) (defining ''market price''); *see also* rule 600(b)(42) of Regulation NMS (defining NBBO). [17 CFR 242.600]. The NBBO represents the highest bid and lowest offer for an ETF share consolidated across all exchanges.

[285] *See infra* section II.H.1.

[286] *See* General Instruction A to Form N–1A.

[287] An ETF would use the market price of an ETF share in calculating premiums and discounts. *See* proposed rule 6c–11(a) (defining ''premium or discount'' to mean the positive or negative difference between the market price of an ETF share and the ETF's current NAV per share, expressed as a percentage of the ETF's current NAV per share).

as it would no longer be used in the same manner.[288]

We believe that the daily premium/discount disclosures (and calculation methodology) we are proposing would provide investors with useful information regarding ETFs that frequently trade at a premium or discount to NAV per share. For example, some ETFs have frequent deviations between closing market price and NAV per share. These ETFs typically hold non-U.S. securities and trade during hours when the markets for their non-U.S. holdings are closed, allowing the trading price of ETF shares to reflect expected changes in the next opening price of the non-U.S. holdings (*i.e.,* to help ''discover'' the price of the holdings). ETFs also may have greater premiums and discounts to the extent that there are greater transaction costs associated with assembling baskets. In addition, an ETF with less liquid portfolio holdings also may show a deviation between closing market price and NAV per share,[289] and an ETF with a less efficient arbitrage mechanism may frequently show this type of end of day deviation.[290]

We understand, however, that proposed premium/discount disclosure would not provide investors with information regarding intraday deviations between market prices and the next-calculated NAV or the contemporaneous value of the ETF's underlying securities, even if the deviation is significant. Some commentators have stated that the lack of disclosure regarding intraday deviations could, in some circumstances, be misleading.[291] For example, some ETFs had relatively large intraday deviations between market price and intraday indicative values on August 24, 2015 that were not reflected as a ''premium'' or ''discount'' because market price and NAV per share were tightly correlated by the end of the day.[292]

While we believe that additional information regarding intraday deviations could help ETF investors understand both the potential for intraday deviations and the circumstances under which deviations have occurred in the past, developing an accurate and cost-effective methodology to calculate intraday deviations for all types of ETFs is challenging. For example, there are many ways to calculate a market price metric, such as the average of execution prices on a business day or the midpoint of the NBBO measured at specific intervals during the course of the trading day. These measures, however, often do not provide a meaningful picture of intraday deviations because they can give outliers either outsized importance (in the case of averages), particularly for ETFs with low trading volume, or insufficient importance (in the case of medians). In addition, the systems necessary to calculate and track these measures can be complex and costly.

Similarly, developing an accurate measure of the contemporaneous value of the ETF's portfolio is complex. As we noted in our discussion of the IIV,[293] calculations of contemporaneous value can be stale or inaccurate for ETFs with foreign securities or less liquid debt instruments for which market quotations are not readily available. For such an ETF, a contemporaneous value calculated using last available market quotations or stale prices may show a premium/discount to any ETF share price that factors in fair valuations of the ETF's portfolio holdings. Moreover, without prescribed uniform methodology requirements, contemporaneous values can be calculated in different, and potentially inconsistent, ways and lead to non-comparable premium/discount disclosure. We request comment below on potential alternative calculations and disclosure requirements that could inform investors about intraday deviations.[294]

b. Bid-Ask Spread Disclosure

As discussed in more detail below, our proposed amendments to Form N–1A would include new requirements for an ETF to disclose information regarding bid-ask spreads on its website and in its prospectus.[295] Specifically, an ETF would be required to disclose the median bid-ask spread for the ETF's most recent fiscal year. A bid-ask spread is the difference between the highest price a buyer is willing to pay to purchase shares of the ETF (bid) and the lowest price a seller is willing to accept for share of the ETF (ask).[296] The proposed website disclosures are designed to inform investors that they may bear bid-ask spread costs when trading ETFs on the secondary market, which ultimately could impact the overall cost of the investment. We are concerned that investors may not be aware of the impact trading costs may have on their investments in ETFs,[297] and therefore, propose to require ETFs to disclose median bid-ask spread information pursuant to a prescribed methodology that would be set forth in Form N–1A. We believe that this information would provide ETF investors with greater understanding of these costs and would allow investors to compare this information across ETFs. Spread costs for ETFs can vary significantly, and disclosure regarding these costs could aid comparisons of ETFs pursuing similar investment strategies. We believe this information also would allow investors to better understand the costs of investing in an ETF.[298]

We are proposing to require the disclosure of the bid-ask spread information on an ETF's website to provide trading information that can help investors make better informed investment decisions in a format that is easily accessible and relied upon by a growing segment of investors. Given the importance of this information to understanding the total expenses an investor may bear when investing in an ETF, we preliminarily believe that bid-ask spread information also should be included in an ETF's prospectus. Without this bid-ask spread information, we preliminarily believe

[288] *See infra* section II.H.1.

[289] *See* LRM Adopting Release, *supra* footnote 101, at n.33 and accompanying text.

[290] *See id* at text following n.524 (''[S]hares of an ETF whose underlying securities are relatively less liquid may not be able to be counted on to provide liquidity to a fund investing in these shares during times of stress. In the case of a significant decline in market liquidity, if authorized participants were unwilling or unable to trade ETF shares in the primary market, and the majority of trading took place among investors in the secondary market, the ETF's shares could trade continuously at a premium or a discount to the value of the ETF's underlying portfolio securities.'').

[291] *See, e.g.,* Henry T.C. Hu and John D. Morley, *A Regulatory Framework for Exchange-Traded Funds,* 91 S. Cal. Law Review (forthcoming 2018) (''Hu and Morley'') at 53 (''While simplicity and other reasons help explain the SEC's decision to look only at the close and not intra-day performance, the result was an emphatically reassuring picture being presented to investors. As a result, an investor may have a misleading sense as to the true risks and returns of the ETF.'').

[292] *See supra* footnote 128 and accompanying text.

[293] *See supra* section II.C.3.

[294] Many ETFs provide qualitative disclosures in their prospectuses regarding the potential for periods of market volatility that could lead to deviations from NAV per share. *See, e.g., supra* footnote 126.

[295] *See* proposed amendment to Item 3 of Form N–1A. *See also infra* section II.H.2. for a discussion of the bid-ask spread disclosure requirements. We are also proposing to require ETFs to provide an interactive calculator that would provide investors with the ability to customize the hypothetical bid-ask spread disclosures in Item 3 of Form N–1A to the investor's specific investing situation. *See id.*

[296] *See* proposed amendment to Item 3 of Form N–1A.

[297] *See, e.g.,* Simon Constable, *How to Measure ETF Spreads,* The Wall Street Journal (Nov. 5, 2017), *available at https://www.wsj.com/articles/how-to-measure-etf-spreads-1509937200.*

[298] As discussed in more detail below, mutual fund investors typically do not incur bid-ask spread costs in connection with their investment in a mutual fund. *See infra* section II.H.2.

the fee and expense information provided in a prospectus may not always provide a complete picture of an investment's true costs and/or allow investors to easily compare prospectus disclosures across certain investment options.[299]

c. Historical Information Regarding Premiums and Discounts

We also are proposing to require that ETFs disclose on their websites historical information about the extent and frequency of an ETF's premiums and discounts. In particular, proposed rule 6c–11(c)(1)(iii) and (iv) would require an ETF to post on its website both a table and line graph showing the ETF's premiums and discounts for the most recently completed calendar year and the most recently completed calendar quarters of the current year. Alternatively, for new ETFs that do not yet have this information, the proposed rule would require the ETF to post this information for the life of the fund.

Currently, an ETF is required to disclose historical premium/discount information in its prospectus by providing tabular disclosure of the number of trading days during the most recently completed calendar year and quarters since that year ended on which the market price of the ETF shares was greater than the ETF's NAV per share and the number of days it was less than the ETF's NAV per share.[300] An ETF currently may omit the disclosure of specific premium/discount information in its prospectus or annual report if the ETF provides the information on its website and discloses in the prospectus or annual report a website address where investors can locate the information.[301] We believe that investors may find this tabular information helpful in understanding how often an ETF trades at a premium or discount and the size of such premiums and discounts and are proposing to require publication of a table on the ETF's website as part of proposed rule 6c–11.[302]

We additionally believe that graphic disclosure could assist some investors with understanding how the arbitrage mechanism performs for an ETF under various market conditions. Depending on a variety of factors, an ETF could have persistent premiums or discounts (or both) from the ETF's NAV. For example, certain classes of ETFs, such as those that invest in less liquid securities, like high-yield bonds, and securities that trade on international markets, have more persistent deviations in ETF share prices from the ETF's NAV.[303] Additionally, for certain types of ETFs, the disclosure may inform investors about the pricing of the ETF's portfolio holdings. ETFs holding foreign securities that are traded on markets that are closed during U.S. trading hours, for example, may have persistent premiums or discounts resulting from this timing differential. In other cases, a persistent deviation between market price and NAV per share could demonstrate inefficiencies in an ETF's arbitrage mechanism.[304]

While past performance cannot predict how an ETF will trade in the future, we believe that it is important that investors, and particularly retail investors, understand that certain classes of ETFs could have a larger and more persistent deviation from NAV, which could result in a higher cost to investors and a potential drag on returns. In addition to alerting secondary market investors that an ETF's NAV per share and market price may differ, these disclosures would provide information regarding the frequency and extent of these deviations. These disclosures thus would help investors understand the value of their investment and could help shape whether they want to invest in a particular ETF.

We believe that presenting the data as both a table and a line graph would provide investors with useful information in a variety of formats that are easy to view and understand, depending on the investor's preference. For example, investors may find the proposed tabular disclosure an easy to understand demonstration of how often the ETF traded at a premium or discount. However, the tabular disclosure does not allow investors to observe the degree of those deviations, particularly during periods of market stress. For example, two ETFs may have traded at a discount for the same number of days. One ETF's daily deviations could have been small with little effect on investors trading on those days, whereas the other ETF could have had significant discounts. These distinctions would not be apparent based on the required tabular disclosure, but would be observable with the graphic disclosure we are proposing. As a result, in order to assist investors with understanding an ETF's premiums and discounts, we are proposing both tabular and graphical representations of daily premium and discounts.[305] In order to eliminate potentially duplicative disclosure requirements, we are proposing to eliminate historical premium/discount disclosure requirements in Item 11(g)(2) and Item 27(b)(7)(iv) of Form N–1A.[306]

Proposed rule 6c–11(c)(1)(v) also would require any ETF whose premium or discount was greater than 2% for more than seven consecutive trading days to post that information on its website, along with a discussion of the factors that are reasonably believed to have materially contributed to the premium or discount. We propose that ETFs posting this information be required to post it on their websites on the trading day immediately following the day on which the ETF's premium or discount triggered this provision (*i.e.,* on the trading day immediately following the eighth consecutive trading day on which the ETF had a premium or discount greater than 2%) and maintain it on their websites for at least one year following the first day it was posted.

We believe that this proposed disclosure of information about ETFs' premiums and discounts would promote transparency regarding the significance and/or persistency of deviations between market price and NAV per share, and thus may permit investors to make more informed

[299] Required prospectus disclosures for open-end funds currently include shareholder fees such as sales charges and redemption fees, as well as annual fund operating expenses. *See* Item 3 of Form N–1A.

[300] Instruction 2 to Item 11(g)(2) of Form N–1A. ETFs are also required to include a table with premium/discount information in their annual reports for the five most-recently completed fiscal years. Item 27(b)(7)(iv) of Form N–1A.

[301] Item 11(g)(2) of Form N–1A; Item 27(b)(7)(iv) of Form N–1A. Although the time period required in the disclosure is different in the prospectus and annual report, ETFs are permitted to omit both disclosures by providing on their websites only the premium/discount information required by Item 11(g)(2) (the most recently completed fiscal year and quarters since that year).

[302] *See* proposed rule 6c–11(c)(1)(iii).

[303] *See* Hu and Morley, *supra* footnote 291, at 12 (noting that certain kinds of ETFs have much higher 95% confidence intervals of almost 600 basis points) (internal citations omitted).

[304] *See, e.g.,* Crystal Kim, *This Levered Gold Mining ETF Looks Super Scary,* Barrons (Apr. 20, 2017), *available at https://www.barrons.com/articles/this-levered-gold-mining-etf-looks-super-scary-1492700892* (linking an ETF trading at a significant premium to NAV to the ETF's suspension of creation units, and in turn, linking the suspension to the limited availability of certain investments the ETF needed to make in order to seek its investment objective).

[305] Under the proposal, the historical premium/discount information would be required for the most recently completed calendar year and the most recently completed calendar quarters of the current year. This period was chosen as it was consistent with existing requirements in Item 11(g)(2) of Form N–1A. We believe the time period would allow investors to readily observe the extent and frequency of deviations from NAV per share in a graphic format.

[306] *See infra* section II.H.4.

investment decisions. This information also may provide the market (and the Commission) with information regarding the efficiency of an ETF's arbitrage mechanism. As noted above, in the Commission's experience, the deviation between the market price of ETFs and NAV per share, averaged across broad categories of ETF investment strategies and over time periods of several months, has been relatively small.[307] Therefore, we believe that limiting this disclosure to ETFs that have a premium or discount of greater than 2% for more than seven consecutive trading days would serve to highlight potentially unusual circumstances when an ETF has a persistent premium or discount.[308]

Given the proposed threshold, we do not believe that many ETFs would be required to disclose this information.[309] However, there could be certain categories of ETFs that could be particularly affected. An ETF that invests in foreign securities, for example, may be more likely to experience a persistent deviation between market price and NAV per share given that many foreign markets are closed during the U.S. trading day. Such deviations may be pronounced if the market on which the ETF's underlying securities trade is closed.[310]

The proposed rule would require the disclosure to include a discussion of the factors that are reasonably believed to have contributed to the premium or discount. We believe that this requirement would provide secondary market investors with useful context for the disclosed deviations. In addition, we believe that requiring ETFs to maintain it on their website for at least one year following the first day it was posted would identify those ETFs that historically have had such an instance of persistent deviation between market price and NAV per share.[311]

We request comment on our proposed website disclosure requirements for ETFs.[312]

- Would the proposed website disclosures be useful in informing investors of certain ETF characteristics and risks? For example, would the disclosures alert investors to the relationship between NAV per share and the market price of the ETF's shares? Would they assist investors in understanding that they may sell or purchase ETF shares at prices that do not correspond to NAV per share of the ETF or that may reflect a premium or discount to NAV per share that is not in line with the typical premium or discount for the same ETF? Would they assist investors in assessing costs associated with premiums and discounts and/or bid-ask spreads? Would the proposed requirements promote the goals of enhancing transparency and encouraging market discipline on ETFs? Understanding that ETF investors would be required to access each ETF's website, would this information allow investors to compare data across ETFs? Should we require ETFs to present their disclosures in a structured format on their websites or in a filing with the Commission in order to facilitate comparisons among ETFs?
- To what extent would the proposed website disclosure requirements increase ETFs' costs or result in operational challenges?
- Should we require that information regarding NAV per share, market price, and premiums and discounts be posted on an ETF's website each business day as proposed? Should we specify the time by which such information must be posted? For example, should we require that an ETF post the information on its website before the opening of trading each business day?
- Should we define ''market price'' as proposed? Does the proposed definition provide ETFs with too much discretion in determining market price? Should we define market price using only the ''official closing price''? Is there an alternative price that we should require instead of ''official closing price'' that would more accurately reflect the ETF's share price at market close? Should we provide an alternative calculation of market price, by using the midpoint of the NBBO, as proposed? Is the midpoint of the NBBO an appropriate alternative? If not, what method is appropriate? Do ETFs and their service providers currently receive the NBBO for their securities? If not, what are the additional costs, if any, of receiving a NBBO quote? Should we require ETFs to disclose if, for example, they use the midpoint of the NBBO rather than the official closing price? Should we define an alternative closing price? For example, should we use a definition similar to the one used by NYSE ARCA?[313] Alternatively, should we adopt the definition of ''market price'' currently used in Form N–1A, which may provide even more discretion by not referencing the midpoint? What definition of market price would provide the most accurate presentation of market value? Would there be investor confusion because of the proposed change?
- Does calculating premiums and discounts using market close information provide investors with information they would use?
- Should we instead require a calculation and disclosure of an intra-day premium or discount as compared to the next-calculated NAV? How would investors use the disclosure of intraday deviations between market prices and the next-calculated NAV? Would such disclosure be costly and/or burdensome to produce? What calculation methodology should we require for this disclosure? For example, should we require ETFs to disclose information regarding the difference between: (i) The mean or median of execution prices on a business day; and (ii) the next-calculated NAV per share, in order to capture situations where deviations between market price and NAV per share significantly widened during the trading day, but were tightly correlated at the time as of which NAV is calculated? Alternatively, should we require ETFs to disclose information regarding the difference between: (i) The midpoint of the NBBO calculated every minute; and (ii) the next-calculated NAV? If so, should the midpoint of the NBBO be calculated more or less frequently? Are there other ways to calculate intraday market prices that would provide investors with meaningful information regarding intraday deviations between market price and NAV per share? If we require this type of disclosure, should it be in addition to, or an alternative of, current premium/discount disclosures? Alternatively, would 5th and/or 95th percentile data be useful in this context? How frequently should ETFs disclose

[307] *See supra* footnotes 119–120 and accompanying text.

[308] This belief is based on data obtained from Morningstar and Bloomberg.

[309] *See infra* footnote 477 and accompanying text.

[310] *See* Tom Lyndon, *China A-Shares ETFs Trading at Steep Discount to NAV*, ETF Trends (Jul. 9, 2015), *available at http://www.etftrends.com/2015/07/china-a-shares-etfs-trading-at-steep-discount-to-nav/* (reporting that U.S.-listed China A-shares ETFs were trading at a steep discount to the underlying market because of the fact that a significant number of companies stopped trading on China's mainland stock exchanges).

[311] We recognize that historical information relating to these deviations may not be predictive of future deviations, and request comment below regarding whether the rule should require ETFs to include a legend in proximity to the historical information warning of its limitations.

[312] For our specific requests for comment regarding an ETF's daily portfolio and basket website disclosure, see our discussions of those subjects, at *supra* sections II.C.4 and II.C.5, respectively.

[313] *See* NYSE Arca Rule 1.1(ll) (defining how official closing price is determined if the exchange does not conduct a closing auction or if a closing auction trade is less than a round lot); *see also* Securities Exchange Act Release No. 82907 (March 20, 2018) [83 FR 12980 (March 26, 2018)] (order).

information regarding intraday deviations between market prices and the next-calculated NAV? How long should ETFs be required to maintain this information on their website?

• Should we instead require calculation and disclosure of an intra-day premium or discount as compared to the contemporaneous value of the ETF's portfolio? How would investors use the disclosure of intraday deviations between market price and the contemporaneous value of the ETF's portfolio? Would such disclosure be costly and/or burdensome to produce? What calculation methodology should we require for this disclosure? For example, despite the limitations of the IIV in the context of arbitrage activity, could the IIV be useful for the measurement and long-term tracking of an ETF's intraday market prices? If so, should we prescribe a uniform methodology for the calculation of the IIV? Should we require ETFs to value their portfolio holdings more frequently for purposes of assessing any deviations between market prices and the ETF's portfolio holdings, such as hourly or three times a day? Are there other ways to value an ETF's portfolio on an intraday basis that we should consider? How frequently should ETFs disclose information regarding intraday deviations with the contemporaneous value of the ETF's portfolio? How long should ETFs be required to maintain this information on their website?

• Alternatively, should we require ETFs to assess the efficiency of their arbitrage mechanism pursuant to internal methodologies and require ETFs to provide narrative disclosure regarding intraday deviations between market price and (i) NAV; (ii) the contemporaneous value of the ETF's portfolio; or (iii) both?

• We are proposing to require ETFs to disclose the ETF's median bid-ask spread for the most recent fiscal year. How would investors use this information? Is the median bid-ask spread an appropriate metric? For example, the median bid-ask spread would not capture extreme events and stress periods. Should we require additional bid-ask spread metrics, such as average spread, high-end spread (*e.g.,* 95th percentile) or effective spread?[314] If so, why is it preferable and how should it be calculated? Should we require ETFs to provide the median or mean spreads for the year?

• Should we require that the bid-ask spread information be included on both an ETF's website and in its prospectus? Would investors benefit from having this information in both places? Should we instead require it only on an ETF's website? Should the information be required to be updated more or less frequently than proposed? If so, how frequently? For example, should we require an ETF to disclose on its website a trailing average spread over the course of a year, updated daily? Are there particular categories of investors that may not use or have access to the internet? If so, are there alternative ways of communicating this information to them in a cost-effective manner?

• Proposed rule 6c–11(c)(1)(iii) would require an ETF to post on its website a table showing the ETF's premiums and discounts for the most recently completed calendar year and the most recently completed calendar quarters of the current year. As we discussed above, this disclosure is a condition in many of our exemptive orders and required by Form N–1A. Do investors or their advisers use this information? Are there other forms of presenting this data that would be easier for investors to understand?

• Proposed rule 6c–11(c)(1)(iv) would require an ETF to post on its website a line graph showing the ETF's premiums and discounts for the most recently completed calendar year and the most recently completed calendar quarters of the current year. How would investors and their advisers use a line graph? Are there other forms of presenting this data that would be easier for investors to understand?

• Should ETFs be required to include intra-day premiums and discounts (calculated using one of the methodologies for which we request comment above) as part of the line graph? How would this disclosure be used by investors?

• Should we require ETFs to provide both forms of disclosure (*i.e.,* table and line graph)? Would investors use this information? Should we require more layered disclosure, such as an interactive tool where investors can enter different variables to better understand historical premiums and discounts?

• Should the table and line graph cover the most recently completed calendar year and the most recently completed calendar quarters of the current year as proposed or are there other periods we should consider? Should the period be longer or shorter? Should we consider fiscal year periods instead of calendar year periods? If so, what period and why? How would this change impact the comparability of the information across ETFs? In order to give investors more information on market dislocations that particularly affect ETFs, should we also require tabular and graphic disclosure for major market events over past five or ten years?

• Proposed rule 6c–11(c)(1)(v) would require any ETF whose premium or discount was greater than 2% for more than seven consecutive trading days to post that information on its website, along with a discussion of the factors that are reasonably believed to have materially contributed to the premium or discount threshold. Should we require this proposed disclosure? Is 2% an appropriate premium or discount? If not, should we consider a higher or lower threshold for this disclosure (*e.g.,* 1% or 5%)? If so, why? Should we vary the premium or discount based on other factors, such as fund strategy, asset class, geographic region, or historic premium/discount for the class? Should we instead base the reporting threshold on a different statistic, such as standard deviation? Should it be based on the average absolute value of the premium or discount over a seven-day period?[315]

• Is the seven consecutive trading day requirement appropriate? Should we require a shorter or longer period of time? If so, what period and why? Is there a more appropriate balance between the magnitude (2%) and length (seven consecutive trading days) of an ETF's premium or discount than we have proposed (*e.g.,* 10% for one day or 5% for two days)?

• Should we permit ETFs to determine what percentage premium or discount threshold is appropriate and what time period to disclose, based on the ETF's particularized circumstances?

• Should we require any additional measures to trigger the proposed rule 6c–11(c)(1)(v) disclosure requirement? Should we require a second measure of non-consecutive days in addition to the seven trading day requirement? For example, should we also require a disclosure of factors if the ETF's premium or discount was greater than 2% for seven of the past 30 days?

• We propose that ETFs posting this information be required to post it by the end of the trading day immediately following the day on which the requirement was triggered. Is this a reasonable period of time to post this information? Why or why not? We also propose that ETFs posting this

[314] For the purposes of this comment request, we consider the effective spread the ''actual'' spread (*i.e.,* the difference between bid and the ask). We consider the average spread to be the figure that takes the average bids and asks over a period of time and finds the difference between them. As noted in the comment request, we also are soliciting input on calculation methodology.

[315] *See supra* footnote 120 (describing calculation of absolute value).

information be required to maintain it on their websites for at least one year following the first day it was posted. Should these time periods be shorter or longer?

• As an alternative (or in addition) to requiring disclosure of this information on an ETF's website, should we require disclosure in an ETF's prospectus or shareholder reports? Or should we require that it be publicly filed on EDGAR in a different regulatory filing?

• Would this disclosure requirement disproportionately affect particular types of ETFs? Would investors use this information in assessing ETFs, or could it lead to confusion?

• Should we require a discussion of the factors that are reasonably believed to have materially contributed to the premium or discount? Would this requirement provide investors with useful context for deviations between market price and NAV per share or would ETFs rely on boilerplate disclosure?

• Should we provide additional guidance or impose additional requirements for cases where a deviation persists for an extended period (*i.e.,* much longer than seven days)?

• In addition to the disclosures regarding instances where the premium or discount was greater than 2% for more than seven consecutive trading days, should we require that ETFs disclose other information relating to premiums and discounts? For example, should we require ETFs to disclose rolling average premium and discount for a prior period? If so, what period? Should we require ETFs to provide the greatest premium and/or discount for the previous month, quarter, or year? If so, what period would be most useful to investors and other market participants?

• Should we require ETFs to disclose index tracking error, if applicable? If so, how should we define tracking error? For what period should we require tracking error? Where should such disclosure be made and how frequently?

• Should we require ETFs to include a disclaimer indicating the potential limitations of historical disclosures on its website? If so, should the rule prescribe the legend that should be used and where the legend should be placed? Should we require a legend similar to the current performance-related disclosure legend in Form N–1A, which states that ''past performance . . . is not necessarily an indication of how the Fund will perform in the future''? [316]

• We are proposing that ETFs provide certain disclosures on their websites on a daily basis. Should we require funds to provide these disclosures less frequently? Are there other places that funds should be required to report this information?

• Should we require this information to be posted ''prominently'' on the ETF's website? Should we provide any other instruction as to the presentation of this information, in order to highlight the information and/or lead investors efficiently to the information? For example, should we require that the information be posted on the main page of a particular ETF series? Should the information be accessible in no more than two clicks from the ETF complex's home page? Should we adopt presentation requirements that would aid in the comparability of this information for different ETFs? In particular, should we adopt presentation requirements for the premium/discount line graph?

• In our discussion of the proposed amendments to Item 3 of Form N–1A, we are proposing an exception from the disclosure requirements of trading information and related costs for newly created ETFs with limited trading history. Should there be a similar exception for newly created ETFs from the website disclosure requirements of the ETF's NAV per share, market price, premium or discount, and bid-ask spreads as of the end of the prior business day? Should the exception apply to the requirement to disclose historical information regarding the ETF's premiums and discounts? Why or why not?

• Should we require ETFs to post the proposed additional website disclosures in a structured format and/or to file them on EDGAR or make them available in another centralized repository?

7. Marketing

Our exemptive orders and our 2008 proposal included a condition requiring each ETF to identify itself in any sales literature as an ETF that does not sell or redeem individual shares and to explain that investors may purchase or sell individual ETF shares through a broker via a national securities exchange.[317] This condition was designed to help prevent investors, particularly retail investors, from confusing ETFs with mutual funds. Given that ETFs have been available for over 26 years, and the market has developed a familiarity with the product, we no longer believe this condition is necessary. We believe that retail investors generally understand that, unlike mutual funds, individual ETF shares may be purchased and sold only on secondary markets. We further believe that the website and registration statement disclosures we are proposing provide retail investors more useful information regarding the exchange-traded nature and costs of ETFs.[318] Therefore, we are not proposing to include such a marketing disclosure requirement in rule 6c–11.

We request comment on this aspect of our proposal.

• Are we correct that a condition requiring an ETF to identify itself in any sales literature as an ETF that does not sell or redeem individual shares and to explain that investors may purchase or sell individual ETF shares through a broker via secondary markets is no longer necessary? Do retail investors understand that individual ETF shares can be bought and sold only on secondary markets? If not, should proposed rule 6c–11 condition relief on the inclusion of statements in an ETF's sales literature regarding the purchase and sale of ETF shares on secondary markets? Alternatively, should we consider adding a disclosure requirement only to Form N–1A?

• Should we consider other limitations regarding ETF sales literature?

• If the rule includes such a condition, how should we define sales literature? Should we define sales literature as we proposed in 2008? [319] Are there other definitions that we should consider, including by reference to the definition in 17 CFR 230.156 (''rule 156'')? [320]

[316] *See* Item 4(b)(2)(i) of Form N–1A.

[317] *See* 2008 ETF Proposing Release, *supra* footnote 3. Commenters who addressed this aspect of the 2008 proposal generally supported this condition. *See* ICI 2008 Comment Letter; Katten 2008 Comment Letter; Xshares 2008 Comment Letter.

[318] The proposed website disclosure requirements are described in section II.C.6 and the proposed amendments to Form N–1A are described in section II.H.

[319] The 2008 proposed rule, consistent with the use of the term in section 24(b) of the Act and the existing definition in rule 34b–1 under the Act, would have defined the term ''sales literature'' as ''any advertisement, pamphlet, circular, form letter, or other sales material addressed to or intended for distribution to prospective investors other than a registration statement filed with the Commission under section 8 of the Act.'' *See* 2008 ETF Proposing Release, *supra* footnote 3.

[320] Rule 156 under the Securities Act defines the term ''sales literature'' to include ''any communication (whether in writing, by radio, or by television) used by any person to offer to sell or induce the sale of securities of any investment company.'' It also states that communications between issuers, underwriters and dealers are included in the definition of sales literature if such communications, or the information contained therein, can be reasonably expected to be communicated to prospective investors in the offer or sale of securities or are designed to be employed in either written or oral form in the offer or sale of securities. *See* 17 CFR 230.156(c).

• If the rule included a condition regarding sales literature, should it also include an exception to permit an ETF to disclose to investors that it will issue or redeem individual shares in order to consummate a reorganization, merger, conversion or liquidation?

• To further prevent investors from confusing ETFs with mutual funds, should the rule require an ETF to include the identifier ''ETF'' in its name?

• To further prevent investors from confusing ETFs with mutual funds, should the rule require an ETF to explicitly disclose in its sales literature that shareholders may pay more than NAV when buying shares and may receive less than NAV when selling ETF shares?

• Should the rule impose any additional conditions or require any additional disclosures to help investors distinguish ETFs from other ETPs, such as exchange-traded notes or commodity pools that are not subject to the Investment Company Act? Should the Commission consider proposing naming conventions based on these or other distinctions in a future rulemaking? Are naming conventions useful to investors? Should ETFs be required to use a different identifier (*e.g.,* ''IC'' for ETFs that are registered under the Investment Company Act) before or after ''ETF'' to distinguish them from other ETPs? Should all ETPs be required to have identifiers (*e.g.,* ETF–N (for exchange-traded notes), ETF–IC (for ETFs that are not leveraged ETFs), ETF–C (for exchange-traded commodity pools), ETF–L (for leveraged ETFs))?

• Alternatively, are there ways we could address investor confusion by restricting certain sales practices? For example, should we consider proposing restrictions in a future rulemaking on how intermediaries communicate with retail investors about ETPs unless they disclose certain information designed to clearly differentiate ETPs that are not registered under the Act from ETFs that are registered investment companies?

D. Recordkeeping

For the reasons discussed above, authorized participants play a central role in the proper functioning of the ETF marketplace.[321] One of the defining characteristics of authorized participants under the proposed rule is that they have a written agreement with an ETF or one of the ETF's service providers whereby the authorized participant is allowed to purchase or redeem creation units directly from the ETF (''authorized participant agreement'').[322] Thus, these agreements are critical to understanding the relationship between the authorized participant and the ETF. While we believe that most ETFs are currently preserving copies of their written authorized participant agreements pursuant to our current recordkeeping rules, for avoidance of doubt, we are proposing to expressly require that ETFs relying on rule 6c–11 preserve and maintain copies of all such agreements.[323]

This requirement is designed to provide our examination staff with a basis to determine whether the relationship between the ETF and the authorized participant is in compliance with the requirements of proposed rule 6c–11 and other provisions of the Act and rules thereunder, based on the specific terms of their written agreement, including, but not limited to, terms related to postponement of redemptions and transaction fees. We did not include a specific preservation requirement for authorized participant agreements in the 2008 proposal.[324] However, Commission staff's experience with the ETF industry since 2008, including our examination staff's experience, has reinforced our belief that authorized participant agreements must be preserved.

We are also proposing to require ETFs to maintain information regarding the baskets exchanged with authorized participants. In particular, the proposed rule would require an ETF to maintain records setting forth the following information for each basket exchanged with an authorized participant: (i) The names and quantities of the positions composing the basket; (ii) identification of the basket as a ''custom basket'' and a record stating that the custom basket complies with the ETF's custom basket policies and procedures (if applicable); (iii) cash balancing amounts (if any); and (iv) the identity of the authorized participant conducting the transaction.[325] These records would provide our examination staff with a basis to understand how baskets are being used by ETFs, as well as to evaluate compliance with the rule and other provisions of the Act and rules thereunder. In particular, we believe these records would allow our examination staff to evaluate whether the use of custom baskets is appropriate.

ETFs would be required to maintain these records for at least five years, the first two years in an easily accessible place. The retention period is consistent with the period provided in rules 22e–4 and 38a–1(d) under the Act. Funds currently have compliance program-related recordkeeping procedures in place that incorporates this type of retention period, and we preliminarily believe consistency with that period would minimize any compliance burden to funds.

We request comment on these proposed recordkeeping requirements.

• Are these requirements necessary in light of the benefits that would result from Commission examination? Are there other records that we should require ETFs to preserve or other feasible alternatives that would minimize recordkeeping burdens? What are the costs associated with maintaining the proposed recordkeeping requirements under the rule and what effects would the proposed recordkeeping requirements have on an ETF's compliance policies and procedures?

• Do ETFs already preserve their agreements with authorized participants under our current recordkeeping requirements?

• Should we require an ETF to maintain a record stating that the custom basket complies with the ETF's custom basket policies and procedures? Is there any additional information that we should require ETFs to maintain in connection with their baskets? Should we require ETFs to record information regarding any transaction fees assessed in connection with each basket? Are there alternatives to this proposed recordkeeping requirement that would enable the Commission to examine the composition of ETFs' baskets, while minimizing the recordkeeping burdens imposed on ETFs?

• Are there other records we should consider requiring ETFs to maintain regarding transaction fees?[326] Should we consider requiring ETFs to disclose information regarding transaction fees

[321] *See supra* section I.

[322] Proposed rule 6c–11(a) (defining ''authorized participant'').

[323] *See* proposed rule 6c–11(d)(1).

[324] *See* 2008 ETF Proposing Release, *supra* footnote 3. Our orders also do not include a specific preservation requirement. *See, e.g.,* Salt Financial, *supra* footnote 270.

[325] *See* proposed rule 6c–11(d)(2).

[326] We understand transaction fees are imposed by ETFs to defray the transaction expenses associated with the creation or redemption, as applicable, and prevent possible dilution resulting from the purchase or redemption of creation units. For cash baskets, the ETF may assess transaction fees to offset certain operational, brokerage and spread costs relating to the ETF's purchasing or selling of securities. Transaction fees can impact secondary market investors in ETF shares because an authorized participant or other market maker can cause the spread to widen on ETF shares to recoup or offset some of the costs from paying the transaction fees.

in their registration statement or on Form N–CEN? For example, should ETFs be required to describe transaction fees and the amount of such fees that are charged in connection with effecting purchases and redemptions of creation units? Should there be disclosure about the aggregate dollar amount or percentage of transaction fees paid over particular periods? Should we require ETFs to disclose the dollar amount (or percentage) of transaction fees waived over a particular periods? If so, how should this information be presented? Should we require ETFs to include narrative disclosure regarding waivers, noting for example, that the waiver of transaction fees may result in additional costs borne by the ETF?

• Should we require ETFs to maintain these records for five years, the first two years in an easily accessible place, as proposed? Should we use a different retention period, such as the six-year retention period under 17 CFR 270.31a–2 (rule 31a–2 under the Act)?

• Would compliance with these proposed requirements have any effect on ETFs' internal compliance policies and procedures?

• Should we instead, or additionally, require that ETFs file their authorized participant agreements as exhibits to their registration statements? Why or why not?

• Are there any additional alternative recordkeeping requirements we should consider?

E. Share Class ETFs

The proposed rule does not provide any relief from sections 18(f)(1) or 18(i) of the Act or expand the scope of 17 CFR 270.18f–3 (''rule 18f–3'' under the Act) (the multiple class rule).[327] Sections 18(f) and (i) of the Act were intended, in large part, to protect investors from certain abuses associated with complex investment company capital structures, including conflicts of interest among a fund's share classes.[328] These provisions also were designed to address certain inequitable and discriminatory shareholder voting provisions that were associated with many investment company securities before the enactment of the Act.[329]

In 1995, the Commission adopted rule 18f–3 under the Act to create a limited exemption from sections 18(f)(1) and 18(i) for funds that issue multiple classes of shares with varying arrangements for the distribution of securities and provision of services to shareholders.[330] That rule generally provides that, notwithstanding sections 18(f)(1) and 18(i) of the Act, a registered open-end management investment company or series or class thereof may issue more than one class of voting stock, provided that each class, among other requirements, has in all other respects the same rights and obligations as each other class.[331]

An ETF cannot rely on rule 18f–3 to operate as a share class within a fund because the rights and obligations of the ETF shareholders would differ from those of investors in the fund's mutual fund share classes. For example, ETF shares would be redeemable only in creation units, while the investors in the fund's mutual fund share classes would be individually redeemable. Similarly, ETF shares are tradeable on the secondary market, whereas mutual fund shares classes would not be traded.

An ETF structured as a share class of a fund that issues multiple classes of shares representing interests in the same portfolio would not be permitted to rely on proposed rule 6c–11. We recognize that the Commission has granted ETFs exemptive relief from the aforementioned provisions of section 18 of the Act in the past, subject to various conditions.[332] However, relief from section 18 raises policy considerations that are different from those we seek to address in this rule, which is intended to address broadly the common type of relief that most ETFs have sought.

For example, an ETF share class that transacts with authorized participants on an in-kind basis and a mutual fund share class that transacts with shareholders on a cash basis may give rise to differing costs to the portfolio. As a result, while certain of these costs may result from the features of one share class or another, all shareholders would generally bear these portfolio costs.[333] At the same time, the share class structure also can provide benefits to each share class, including economies of scale. Given these additional policy considerations, we believe it is appropriate for ETFs to continue to request relief from sections 18(f)(1) and 18(i) of the Act through our exemptive application process, and for the Commission to continue to weigh these policy considerations in the context of the facts and circumstances of each particular applicant.

We request comment on this aspect of the proposal.

• Should proposed rule 6c–11 include exemptions from sections 18(f)(1) or 18(i) of the Act, or should we expand the scope of rule 18f–3 under the Act? Why or why not?

• If commenters believe that such exemptions should be included in the proposed rule, should the rule include conditions designed to take into account the potential costs and benefits of a fund with both mutual fund and ETF share classes? If so, what conditions? Are we correct in our preliminary belief that combining an ETF share class with traditional share classes of a mutual fund may, in certain circumstances, result in the costs and benefits described above?

F. Master-Feeder ETFs

Many of our recent ETF orders contain relief allowing ETFs to operate as feeder funds in a master-feeder structure.[334] In general, an ETF that operates as a feeder fund in a master-feeder structure functions like any other ETF. An authorized participant deposits a basket with the ETF and receives a

[327] *See* 15 U.S.C. 80a–18(f)(1) and (i); 17 CFR 270.18f–3. Section 18(f)(1) of the Act generally prohibits a fund from issuing a class of ''senior security,'' which is defined in section 18(g) to include any stock of a class having priority over any other class as to distribution of assets or payment of dividends. *See* 15 U.S.C. 80a–18(g). Section 18(i) of the Act provides that all shares of stock issued by a fund must have equal voting rights.

[328] *See* Exemption for Open-End Management Investment Companies Issuing Multiple Classes of Shares, Investment Company Act Release No.19955 (Dec. 15, 1993) [58 FR 68074 (Dec. 23, 1993)] (proposing release), at nn.20 and 21 and accompanying text.

[329] *See id.*

[330] *See* Exemption for Open-End Management Investment Companies Issuing Multiple Classes of Shares, Investment Company Act Release No. 20915 (Feb. 23, 1995) [60 FR 11876 (Mar. 2, 1995)] (adopting release) (''Multiple Class Adopting Release''), at n.8 and accompanying text.

[331] *See* 17 CFR 270.18f–3(a)(4).

[332] *See* Vanguard Index Funds, *et al.,* Investment Company Act Release Nos. 24680 (Oct. 6, 2000) [65 FR 61005 (Oct. 13, 2000)] (notice) and 24789 (Dec. 12, 2000) (order) and related application; Vanguard Index Funds, *et al.,* Investment Company Act Release Nos. 26282 (Dec. 2, 2003) [68 FR 68430 (Dec. 8, 2003)] (notice) and 26317 (Dec. 29, 2003) (order) and related application; Vanguard International Equity Index Funds, *et al.,* Investment Company Act Release Nos. 26246 (Nov. 3, 2003) [68 FR 63135 (Nov. 7, 2003)] (notice) and 26281 (Dec. 1, 2003) (order) and related application; Vanguard Bond Index Funds, *et. al.,* Investment Company Act Release Nos. 27750 (Mar. 9, 2007) [72 FR 12227 (Mar. 15, 2007)] (notice) and 27773 (Apr. 25, 2007) (order) and related application (collectively, the ''Vanguard orders'').

[333] These costs can include brokerage and other costs associated with buying and selling portfolio securities in response to mutual fund share class cash inflows and outflows, cash drag associated with holding the cash necessary to satisfy mutual fund share class redemptions, and distributable capital gains associated with portfolio transactions.

[334] *See, e.g.,* T. Rowe Price Associates, Inc., *et al.,* Investment Company Act Release Nos. 30299 (Dec. 7, 2012) [77 FR 74237 (Dec. 13, 2012)] (notice) and 30336 (Jan. 2, 2013) (order) and related application; SSgA Funds Management, Inc., *et al.,* Investment Company Act Release Nos. 29499 (Nov. 17, 2010) [75 FR 71753 (Nov. 24, 2010)] (notice) and 29524 (Dec. 13, 2010) (order) and related application (''SSgA'').

creation unit of ETF shares in return for those assets. Conversely, an authorized participant that redeems a creation unit of ETF shares receives a basket from the ETF. In a master-feeder arrangement, however, the feeder ETF then also enters into a corresponding transaction with its master fund. The ETF may use the basket assets it receives from an authorized participant to purchase additional shares of the master fund, or it may redeem shares of the master fund in order to obtain basket assets and satisfy a redemption request.

Because the feeder ETF may, in the course of these transactions, temporarily hold the basket assets, it would not be able to rely on section 12(d)(1)(E) of the Act, which requires that a feeder fund hold no investment securities other than securities of the master fund.[335] To accommodate these unique operational characteristics of ETFs, our recent exemptive orders have allowed a feeder ETF to rely on section 12(d)(1)(E) without complying with section 12(d)(1)(E)(ii) of the Act to the extent that the ETF temporarily holds investment securities other than the master fund's shares for use as basket assets. These orders also provided the feeder ETF and its master fund with relief from sections 17(a)(1) and 17(a)(2) of the Act, with regard to the deposit by the feeder ETF with the master fund and the receipt by the feeder ETF from the master fund of basket assets in connection with the issuance or redemption of creation units,[336] and section 22(e) of the Act if the feeder ETF includes a foreign security in its basket assets and a foreign holiday (or a series of consecutive holidays) prevents timely delivery of the foreign security.[337]

The exemptive orders we have granted to master-feeder ETFs, however, do not include relief from section 18 under the Act inasmuch as investment by several feeder funds or by mutual fund and ETF feeder funds in the same class of securities issued by a master fund generally do not involve a senior security subject to section 18. We are concerned, as discussed above, that if an ETF feeder fund transacts with a master fund on an in-kind basis, but non-ETF feeder funds transact with the master fund on a cash basis, all feeder fund shareholders would bear costs associated with the cash transactions.[338]

We understand that while many orders contain this relief, only one fund complex has established master-feeder arrangements involving ETF feeder funds, and each arrangement involves an ETF as the sole feeder fund.[339] Given the lack of interest in this structure and our concerns noted above, we are proposing to rescind the master-feeder relief granted to ETFs that do not rely on the relief as of the date of this proposal (June 28, 2018).[340] However, we also propose to grandfather existing master-feeder arrangements involving ETF feeder funds, but prevent the formation of new ones, by amending relevant exemptive orders.[341] Because these existing master-feeder ETFs involve only one feeder fund for each master fund, we do not believe they would raise the policy concerns discussed above so long as they do not add feeders, and therefore do not believe it is necessary to require these structures to change their existing investment practices.[342]

We request comment on the lack of master-feeder relief in proposed rule 6c–11.

- Are we correct that the market interest for ETFs using master-feeder structures, as discussed above, is limited?
- Should the proposed rule include master-feeder relief for ETFs, as provided in certain of our exemptive orders and discussed above? Why or why not?
- Should we amend the exemptive relief relied upon by existing master-feeder arrangements? Alternatively, should we also rescind the master-feeder relief relied upon by existing arrangements? If so, how would these ETFs be impacted if we also rescinded their relief?
- If the proposed rule provided master-feeder relief for master-feeder structures that include ETF and mutual fund feeder funds, should the rule include conditions designed to take into account the potential costs and benefits of such structures? If so, what conditions? For example, should the proposed rule require a determination that the investment in a master fund is in the best interest of the ETF and its shareholders? If so, who should be required to make such a determination? How frequently should such a determination be made? Alternatively, should the proposed rule provide master-feeder relief for master-feeder structures but allow only ETF feeder funds? If so, what conditions should apply?

G. Effect of Proposed Rule 6c–11 on Prior Orders

The Commission has authority under the Act to amend or rescind our orders when necessary or appropriate to the exercise of the powers conferred elsewhere in the Act. Pursuant to this authority, we are proposing to amend and rescind the exemptive relief we have issued to ETFs that would be permitted to rely on the proposed rule.[343] Our proposed rescission of orders would specifically be limited to the portions of an ETF's exemptive order that grant relief related to the formation and operation of an ETF and, with the exception of certain master-feeder relief discussed above in section II.F, would not rescind the relief from section 12(d)(1)[344] and sections 17(a)(1) and (a)(2)[345] under the Act related to

[335] Section 12(d)(1) of the Act limits the ability of a fund to invest substantially in shares of another fund. *See* sections 12(d)(1)(A)–(C) of the Act; *see also infra* footnote 344. Section 12(d)(1)(E) of the Act allows an investment company to invest all of its assets in one other fund so that the acquiring fund is, in effect, a conduit through which investors may access the acquired fund. *See* section 12(d)(1)(E)(ii) of the Act.

[336] Relief from the affiliated transaction prohibitions in sections 17(a)(1) and 17(a)(2) of the Act is necessary because these sections would otherwise prohibit the feeder ETF and its master fund from selling to or buying from each other the basket assets in exchange for securities of the master fund. *See* 15 U.S.C. 80a–17(a)(1)–(2).

[337] *See* 15 U.S.C. 80a–22(e) (generally requiring the satisfaction of redemptions within seven days). *See also supra* section III.B.4.

[338] *See supra* footnote 333 and accompanying text.

[339] *See, e.g.,* SSGA Active Trust Prospectus (Oct. 31, 2017), *available at https://us.spdrs.com/public/SPDR_ACTIVE%20ETF%20TRUST_PROSPECTUS.pdf.*

[340] *See infra* section II.G.

[341] Based on staff analysis, we preliminarily believe that the fund complex currently utilizing this relief operates nine master-fund arrangements, each involving only one ETF as the sole feeder fund. *See* SSgA, *supra* footnote 334.

[342] Rescinding the relief for existing master-feeder ETFs would require them to change the manner in which they invest. For example, transactions between each of the affected master funds and its corresponding feeder fund could be transacted in cash, rather than in-kind, obviating any need for exemptive relief for the feeder fund to hold securities other than those issued by the master fund. Alternatively, the feeder funds could opt to pursue their investment objectives through direct investments in securities and/or other financial instruments, rather than through investments in master funds.

[343] *See* section 38(a) of the Act, 15 U.S.C. 80a–37(a).

[344] Section 12(d)(1) generally limits the ability of registered investment companies (including ETFs) to acquire securities issued by other investment companies in excess of certain thresholds, and the ability of registered open-end investment companies (including ETFs) from knowingly selling securities to other investment companies in excess of certain thresholds. The conditions set forth in ETF exemptive applications for relief necessary to create a fund of funds structure is generally designed to prevent the abuses that led Congress to enact section 12(d)(1), including abuses associated with undue influence and control by acquiring fund shareholders, the payment of duplicative or excessive fees, and the creation of complex structures. *See* Salt Financial, *supra* footnote 270. We also note that certain standalone exemptive orders, unrelated to ETF operations, are often granted to applicants to permit investments in ETFs beyond the limits in section 12(d)(1) of the Act; we are not proposing to rescind such exemptive orders.

[345] *See supra* section II.B.3.

fund of funds arrangements involving ETFs.[346]

The terms of the exemptive relief granted to ETFs have evolved over time and have resulted in an uneven playing field among ETF complexes, subjecting ETFs that pursue the same or similar investment strategies to different operational requirements. Moreover, many ETF complexes have multiple exemptive orders permitting them to operate ETFs. Some of those orders contain different conditions for relief and different representations by the applicants regarding how the ETFs formed pursuant to the order would operate. Many of those orders also provide relief for future ETFs created pursuant to the terms of a particular exemptive order.[347] As a result, ETF complexes with multiple orders can effectively choose the exemptive relief that would be applicable to a new ETF by selecting what legal entity should form the new ETF series. Moreover, differences in the terms of our various orders have had varying impact on the structure and costs of an ETF. For example, shares of an ETF with a less flexible basket condition in its order could have wider spreads than a similarly situated ETF with more flexible basket compositions. However, investors may not be able to discern the difference between these two ETFs' orders. As we have stated elsewhere in this release, among our goals in proposing rule 6c–11 is to create a consistent, transparent and efficient regulatory framework for many ETFs. We do not believe this goal would be furthered if ETFs that could rely on the rule continue to rely on those orders.

In addition, we began including a condition in our ETF exemptive orders in 2008 stating that the relief permitting the operation of ETFs would expire on the effective date of any Commission rule that provides relief permitting the operation of ETFs.[348] The purpose of this automatic expiration condition was to better establish equal footing between ETFs that have received exemptive relief and ETFs that may rely solely on a Commission rule, and to reduce competitive advantages that could potentially arise out of the conditions for relief set forth in our earlier exemptive orders.[349] Of the approximately 300 orders we have issued that provide ETF exemptive relief, approximately 200 include this automatic expiration condition, and thus the ETF relief would terminate if and when proposed rule 6c–11 is adopted and goes into effect. To provide time for ETFs to transition to rule 6c–11, however, we propose to amend these existing orders to provide that the ETF relief contained in those orders will terminate one year following the effective date of any final rule. Absent this modification or our determining to delay the effectiveness of any final rule 6c–11, the ETF relief included in orders with the automatic expiration provision could expire before ETFs were able to make any adjustments necessary to rely on rule 6c–11.

We believe that rescinding ETF exemptive relief in connection with the proposed rule (and amending those orders that require ETF exemptive relief to automatically expire in order to allow a transitional period to any final rule) would result in a more transparent framework for covered ETFs, as those ETFs would no longer be subject to differing and sometimes inconsistent provisions of their exemptive relief. The relief and related conditions proposed under rule 6c–11, moreover, are largely consistent with our recent orders, and in some cases, provide ETFs with additional flexibility. For example, proposed rule 6c–11 would provide many ETFs with additional basket flexibility beyond what is currently permitted by their exemptive orders.[350] We preliminarily believe, therefore, that the operations of most existing ETFs would not be significantly negatively affected by the need to comply with the requirements of rule 6c–11 as opposed to their exemptive relief. However, in order to limit any hardship that revocation of existing exemptive relief would have on current ETFs with orders that do not automatically expire, we are proposing a one-year period after the effective date before we rescind that exemptive relief to give those ETFs time to bring their operations into conformity with the requirements of proposed rule 6c–11.

We do not propose to rescind the exemptive relief of ETFs that would not be permitted to rely on the proposed rule. Specifically, we do not propose to rescind the exemptive relief for ETFs organized as UITs,[351] ETFs that are organized as a share class of a fund,[352] or leveraged ETFs.[353] We believe it is appropriate for ETFs seeking to utilize these structures to continue to request relief from the Commission through our exemptive application process, and for the Commission to continue to make facts-and-circumstances-based determinations regarding whether such relief is appropriate for any particular applicant.

The Commission does not believe that it is necessary to give individual hearings to the holders of the prior exemptive relief or to any other person. Proposed rule 6c–11 would be prospective in effect and is intended to set forth for covered ETFs the Commission's exemptive standards for ETFs organized as open-end funds. Recipients of existing exemptive relief may make their views known in the context of the comment process that accompanies this rulemaking, and those views will be given due consideration. Finally, investment companies would be able to request Commission approval to operate as an ETF under conditions that differ from those in proposed rule 6c–11.

We request comment on our proposal to revoke existing ETF and certain existing master-feeder exemptive relief.

- Should we revoke some or all of the existing ETF exemptive relief? If not, why not? Would allowing existing exemptive relief to continue create an unequal playing field for ETF market participants? If not, why not?
- As discussed above, we are proposing a one year period before rescinding existing ETF exemptive relief. Is the one year period appropriate for ETFs with existing ETF exemptive

[346] ETF exemptive relief typically segregates exemptive relief from section 17(a) under the Act necessary to create a fund of funds structure from section 17(a) exemptive relief necessary for the operation of the ETFs. This segregation of ''Fund of Funds Relief'' and ''ETF Relief'' appears in numerous representations and enumerated conditions set forth in applications for exemptive relief. *See, e.g.,* Salt Financial, *supra* footnote 270.

[347] *See supra* footnote 12.

[348] *See e.g.,* PowerShares, *supra* footnote 188; Javelin Exchange-Traded Trust, Investment Company Act Release Nos. 28350 (July 31, 2008) [73 FR 46066 Aug. 7, 2008)] (notice) and 28637 (Aug. 26, 2008) (order) and related application. In some cases, the automatic expiration condition applies to the ETF-related relief only, and expressly does not apply to certain other exemptive relief requested, such as master-feeder and ''fund of funds'' relief under section 12 of the Act. *See, e.g.,* Fidelity Merrimack Street Trust, *et al.,* Investment Company Act Release Nos. 30464 (Apr. 16, 2013) [78 FR 23793 (Apr. 22, 2013)] (notice) and 30513 (May 10, 2013) (order) and related application (''The requested relief, other than the Fund of Funds Relief and the Section 17 relief related to a master-feeder structure, will expire on the effective date of any Commission rule under the Act that provides relief permitting the operation of actively managed exchange traded funds.'').

[349] *See* 2008 ETF Proposing Release, *supra* footnote 3.

[350] *See* proposed rule 6c–11(c)(3); *see also supra* section II.C.5. We note that a subset of the ETFs operating under exemptive relief has basket flexibility that would not be broadened by the proposed rule. Under the proposed rule, however, such ETFs would be required to adopt and implement written policies and procedures related to the construction of baskets and the process for the acceptance of baskets by the ETF.

[351] *See* discussion of ETFs organized as UITs, *supra* section II.A.1.

[352] *See* Vanguard orders, *supra* footnote 332.

[353] *See* discussion of leveraged ETFs, *supra* section II.A.3.

relief to bring their funds into compliance with rule 6c–11? If not, how long should this period last? Why? We are proposing to implement this one year period, in part, by amending existing orders with an automatic expiration condition to provide that the ETF exemptive relief contained in these orders would terminate one year following the effective date of any final rule. Should we, instead, delay the effectiveness of rule 6c–11 for one year? Are there different approaches we should consider?

• Should we consider rescinding the exemptive relief for ETFs organized as UITs or ETFs organized as a share class of a fund and instead allow such ETFs to be covered by rule 6c–11? If so, how would such ETFs comply with the requirements of the rule? For example, would they have to restructure or liquidate?

• Should we, as proposed, rescind the exemptive relief that we have previously granted that allows ETFs to operate as feeder funds in a master-feeder structure if they do not rely on the relief as of the date of this proposal? Do funds plan to use this relief in the future? If so, what kind of ETF master-feeder structures do funds envision creating? For what purpose?

• We understand that the existing structures are organized with an ETF as the sole feeder fund. Is this understanding correct? Should we amend the exemptive relief applicable to these funds as proposed?

• Would our proposal to rescind certain of our previously issued ETF exemptive relief, and allow the ETF exemptive relief contained in the orders with automatic expiration provisions to expire one year following the effective date of rule 6c–11, eliminate any competitive advantages arising from the relief we have granted via exemptive order?

• Would existing ETFs face significant challenges in complying with the conditions of rule 6c–11 rather than exemptive relief?

• Should we consider other approaches? For example, should we consider rescinding only ETF exemptive relief previously granted to ETF complexes that have multiple exemptive orders permitting them to operate ETFs?

• Should we consider not rescinding any of the approximately 100 pre-2008 orders that do not include the automatic expiration provision? Should we consider amending the orders that contain the automatic expiration provision of the ETF exemptive relief to remove that provision? Under these approaches, in which certain ETF exemptive orders would be left in place, ETFs would continue operating under different sets of conditions. Would permitting ETFs to operate under different sets of conditions have an adverse effect on competition and capital formation?

• Are there other approaches to the existing ETF exemptive relief that we should consider in view of proposed rule 6c–11?

• Exemptive relief granted prior to 2009 generally includes relief from section 24(d) of the Act to exempt broker-dealers selling ETF shares from the obligation to deliver prospectuses in most secondary market transactions, and the rescission of the ETF exemptive relief from those orders would eliminate this relief. We understand, however, that broker-dealers have not relied upon this relief and, subsequent to the adoption of amendments to rule 498 under the Securities Act permitting the delivery of an ETF's summary prospectus, most market participants use the summary prospectus to satisfy prospectus delivery obligations.[354] Are we correct in our understanding? Should we provide relief from section 24(d) for ETFs that have this relief in their exemptive orders if we were to rescind those orders? If so, why?

H. Amendments to Form N–1A

As discussed above in section II.C.6, because of the exchange-traded nature of ETFs, ETF investors may be subject to different costs than mutual fund investors. For example, while an ETF may, in some cases, have a lower expense ratio than a comparable mutual fund, an ETF investor will be subject to certain unique costs associated specifically with ETFs, such as the bid-ask spread and premiums and discounts from the ETF's NAV. As a result of these differences, ETF investors may not be fully aware of the full costs associated with their investment in an ETF.

We therefore are proposing several amendments to Form N–1A, the registration form used by open-end funds to register under the Act and to offer their securities under the Securities Act. The proposed amendments are designed to provide investors who purchase ETF shares in secondary market transactions with additional information regarding ETFs, including information regarding costs associated with an investment in ETFs. The proposal also would eliminate certain disclosures that would be duplicative of the proposed amendments to Item 3 of Form N–1A regarding the exchange-traded nature of ETFs. Finally, we are requesting comment on whether we should create a new ETF-specific registration form.

1. Definitions

We are proposing several amendments to Form N–1A to reflect the adoption of proposed rule 6c–11.[355] First, we are proposing to amend the definition of ''Exchange-Traded Fund'' in Form N–1A to add a specific reference to proposed rule 6c–11.[356] Currently, Form N–1A defines ''Exchange-Traded Fund'' to include a fund or class that has formed and operates in reliance on an exemptive rule adopted by the Commission.[357] We believe that Form N–1A should make specific reference to proposed rule 6c–11, rather than a generic exemptive rule, and that this change would be consistent with Form N–1A's general approach of referring specifically to exemptive rules in other defined terms.

Second, we propose to remove the defined term ''Market Price'' from the Definitions section of Form N–1A in light of our other proposed changes to Form N–1A. Market Price, as presently defined in Form N–1A, is used in several items that we are proposing to eliminate from the Form.[358] The remaining instances in which ''Market Price'' is used do not require the use of a defined term, as they contemplate a more general use of the term, such as the requirement in Item 11 of Form N–1A that an ETF explain in its prospectus that the price of its shares is based on Market Price.[359] Accordingly, given our proposed changes to Form N–1A, we do not believe it is necessary to include ''Market Price'' as a defined term, and propose to remove this definition from the Form.

We request comment on the proposal to amend the definition section of Form N–1A.

• Should we, as proposed, revise the definition of the term ''Exchange-Traded

[354] *See* rule 498 under the Securities Act [17 CFR 230.498].

[355] All of the definitions discussed in this section would appear in Proposed General Instruction A of Form N–1A.

[356] Specifically, the proposed definition of ''exchange-traded fund'' would be a fund or class, the shares of which are listed and traded on a national securities exchange, and that has formed and operates under an exemptive order granted by the Commission or in reliance on rule 6c–11 under the Act.

[357] General Instruction A to Form N–1A.

[358] *See, e.g.,* proposed changes to Item 3 of Form N–1A.

[359] Item 11(a)(1) of Form N–1A. Also, in addition to the defined term ''Market Price,'' Form N–1A currently uses the undefined term ''market price'' in several instances where a more general use of the term is appropriate. *See, e.g.,* Instruction 3 to Item 11(g) of Form N–1A. Our proposed amendments to the Form also include the use of the undefined term ''market price.'' *See, e.g.,* proposed changes to Item 3 of Form N–1A.

Fund'' in Form N–1A to make specific reference to proposed rule 6c–11?

• Should we, as proposed, remove the defined term ''Market Price'' from the Definitions section of the General Instruction to Form N–1A? Alternatively, should we replace the current definition with a reference to the defined term ''Market price,'' as defined in proposed rule 6c–11?

2. Item 3 of Form N–1A

Item 3 of Form N–1A requires funds to include a table describing the fees and expenses investors may pay if they buy and hold shares of the fund. Item 3 does not currently distinguish between ETFs and mutual funds, and only requires disclosure of sales loads, exchange fees, maximum account fees and redemption fees that funds charge directly to shareholders.[360] We therefore are proposing several amendments to this Item to clarify that there are certain fees that are not reflected in the fee table for both mutual funds and ETFs and to require new disclosure requirements that capture ETF-specific trading information and costs. Like all information disclosed in Items 2, 3, or 4 of Form N–1A, the information disclosed in amended Item 3 would have to be tagged and submitted in a structured data format.[361]

a. Changes That Affect Mutual Funds and ETFs

First, we are proposing a narrative disclosure that would clarify that, in addition to the current disclosures relating to investors who buy or hold shares, the fees and expenses reflected in the Item 3 expense table may be higher for investors if they *sell* shares of the fund.[362] This amendment would be applicable to both mutual funds and ETFs given that an investor may incur expenses other than redemption fees when selling shares of either a mutual fund or ETF. For example, although less common than they were in the past, an investor may incur a back-end sales load when selling a mutual fund share. Likewise, an investor may bear costs associated with bid-ask spreads when selling ETF shares.

We are also proposing to require a statement that investors may be subject to other fees not reflected in the table, such as brokerage commissions and fees to financial intermediaries.[363] We believe this is appropriate disclosure for both ETFs and mutual funds because brokerage commissions and fees to financial intermediaries could be applicable to ETFs and mutual funds alike.

b. Changes That Affect ETFs

Because ETF shares are exchange-traded, secondary market investors in ETF shares are subject to trading costs, such as bid-ask spreads, that are not currently required to be disclosed under Item 3. Trading costs, like all costs and expenses, affect investors' returns on their investment.[364] In addition, some investors use ETFs more heavily as trading vehicles compared to mutual funds, and the extent of the trading costs borne by an investor depends on how frequently the investor trades ETF shares. We believe that investors could overlook these costs and that additional disclosure would help them better understand the total costs of investing in an ETF. Disclosure would also facilitate comparisons between different investment options.[365]

As a result, we are proposing a new section in Item 3 that would require disclosure of certain ETF trading information and trading costs.[366] This proposed section is formatted as a series of question and answers (''Q&As''). We believe this format would help facilitate an investor's understanding of certain terminology and cost calculations. The proposed Q&A disclosures would require information related to the trading of ETFs on the secondary market and the costs associated with such trading. The specific question and answer disclosures are shown in Figure 1 below.

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[360] Item 3 of Form N–1A.

[361] *See* General Instruction C.3.g.(i) to Form N–1A.

[362] Proposed amendments to Item 3 of Form N–1A. In order to eliminate duplicative disclosures, we are proposing to amend Instruction 1(e) of Item 3 to eliminate the requirement that ETFs modify the narrative explanation for the fee table to state that investors may pay brokerage commissions on their purchase and sale of ETF shares, which are not reflected in the example. We are also proposing to eliminate the instruction that funds may only exclude fees charged for the purchase and redemption of the Fund's creation units if the fund issues or redeems shares in creation units of net less than 25,000 shares. Thus, as proposed, an ETF may exclude from the fee table any fees charged for the purchase and redemption of the Fund's creation units regardless of the number of shares. *See* proposed Instruction 1(e)(ii) to Item 3; *see also* proposed Instruction 1(e)(ii) to Item 27(d)(1) (proposing the same modification for the expense example in an ETF's annual and semi-annual reports); *see also infra* footnote 397 and accompanying and following text.

[363] Proposed amendments to Item 3 of Form N–1A.

[364] *See* SEC Office of Investor Education and Advocacy, Investor Bulletin: How Fees and Expenses Affect Your Investment Portfolio (Feb. 2014), *available at https://www.sec.gov/investor/alerts/ib_fees_expenses.pdf,* at 2 (''As with any fee, transaction fees will reduce the overall amount of your investment portfolio.''); *see also* Andrea Coombes, *Calculating the Costs of an ETF,* The Wall Street Journal (Oct. 23, 2012), *available at https://www.wsj.com/articles/SB100008723963904440 24204578044293008576204.*

[365] Alex Bryan & Michael Rawson, *The Cost of Owning ETFs and Index Mutual Funds,* Morningstar Manager Research (Dec. 1, 2014), *available at http://global.morningstar.com/us/documents/pr/Cost-Of-Owning-Index-ETF-MFS.pdf,* at 15 (''While trading commissions are the most conspicuous component of trading costs, indirect trading costs, such as the bid-ask spread and market impact of trading can often be more important.'').

[366] Proposed amendments to Item 3 of Form N–1A.

Exchange-Traded Fund Trading Information and Related Costs

What information do I need to know about how the Exchange-Traded Fund ("ETF") trades?

Individual shares of an ETF may only be bought and sold in the secondary market through a broker or dealer at a market price. The market price can change throughout the day due to the supply of and demand for ETF shares, and changes in the value of the Fund's underlying investments, among other reasons. Because ETF shares trade at market prices rather than net asset value, shares may trade at a price greater than net asset value (premium) or less than net asset value (discount).

What costs are associated with trading shares of an ETF?

An investor may incur costs when buying or selling shares on an exchange that are ***in addition to*** the costs described above. Examples include brokerage commissions, costs attributable to the bid-ask spread, and costs attributable to premiums and discounts.

What is the bid-ask spread?

The bid-ask spread is the difference between the highest price a buyer is willing to pay to purchase shares of the Fund (bid) and the lowest price a seller is willing to accept for shares of the Fund (ask). The bid-ask spread can change throughout the day due to the supply of or demand for ETF shares, the quantity of shares traded, and the time of day the trade is executed, among other factors. For the ETF's most recent fiscal year ended [____], the median bid-ask spread was

XX.XX%.

How does the bid-ask spread impact my return on investment?

The impact of the bid-ask spread depends on your trading practices. For example, based on the ETF's fiscal year-end data, purchasing $10,000 worth of ETF shares and then immediately thereafter selling $10,000 worth of ETF shares (*i.e.*, a "round-trip"), your cost, in dollars, would be as follows:

<u>For a SINGLE round-trip (each trade being $10,000)</u>

Assuming mid-range spread cost:	$ ____________
Assuming high-end spread cost:	$ ____________

But what if I plan to trade ETF shares frequently?

Based on the ETF's most recent fiscal year-end data, completing 25 round-trips of $10,000 each, your cost, in dollars, would be as follows:

<u>For 25 round-trips (each trade being $10,000)</u>

Mid-range spread cost:	$ ____________
High-end spread cost:	$ ____________

***Where* can I get more trading information for the ETF?**

The ETF's website at [www.[Series-SpecificLandingPage.com]] includes recent information on the Fund's net asset value, market price, premiums and discounts, as well as an interactive calculator you can use to determine how the bid-ask spread would impact your specific investment.

Figure 1

Q&A 1. Currently, Item 6(c) of Form N–1A requires that ETFs disclose that: (i) Shares may only be purchased and sold on a national securities exchange through a broker-dealer; and (ii) the price of ETF shares is based on market price, and since ETFs trade at market prices rather than at net asset value, shares may trade at a price greater than net asset value (premium) or less than net asset value (discount).[367] We are proposing to move this description from Item 6 to Q&A 1 in Item 3. We believe that moving this information to Item 3 would consolidate relevant disclosures regarding ETF trading costs and provide the investor with helpful background information relating to ETF trading.[368] We also propose to replace the reference to ''national securities exchange'' with a reference to ''secondary markets'' to reflect that ETFs can be bought and sold over the counter or on an alternative trading system in addition to their primary listing exchanges.

Q&A 2. The second Q&A we are proposing identifies the specific costs associated with trading shares of an ETF, such as brokerage commissions, bid-ask spread costs, and potential costs attributable to premiums and discounts. This question clarifies that the costs being discussed in the questions that follow should be considered *in addition* to the costs previously discussed in the fee table.

Q&A 3. Proposed Q&A 3 would include ETF-specific disclosures relating to the median bid-ask spread for the ETF's most recent fiscal year.[369] Costs attributable to the bid-ask spread may increase or decrease when certain market conditions exist or certain factors are present. We believe that this disclosure would inform investors regarding the potential impact of spread costs, including for investors who frequently trade ETF shares. We also believe that disclosure regarding median bid-ask spreads would provide a helpful metric for ETF investors to determine an ETF's historic liquidity, since a narrower bid-ask spread typically signals higher liquidity and a wider bid-ask spread generally signals lower liquidity.[370] Investors can use the bid-ask spread to assess the ETF's tradability in comparison to other similar ETFs.[371]

The proposed Q&A would describe the bid-ask spread as the difference between the highest price a buyer is willing to pay to purchase shares of the ETF (bid) and the lowest price a seller is willing to accept for share of the ETF (ask). We are proposing to require this description because some investors may not be familiar with the term ''bid-ask spread,'' making it difficult for them to meaningfully analyze the specific bid-ask spread number that we propose to include in this Q&A. The proposed Q&A also would explain that the bid-ask spread can change throughout the day due to the supply of or demand for ETF shares, the quantity of shares traded, and the time of day the trade is executed, among other factors.

In addition, we are proposing that an ETF calculate and disclose its median bid-ask spread over the most recently completed fiscal year.[372] We propose that the median bid-ask spread be calculated by using trading data from each trading day of the ETF's prior fiscal year.[373] Each daily bid-ask spread would be calculated by taking the average of the intraday bid-ask spreads, which are measured by using the best bid and best ask, respectively, at ten-second intervals throughout the trading day. We understand that this is a widely accepted method for calculating the bid-ask spread and believe that using the best bid and ask would be administratively easier and less burdensome than other methods of calculating the bid and ask price, such as weighting or averaging bid and ask prices throughout the trading day. We propose that the bid-ask spread be calculated by taking the difference between the bid and the ask and dividing that difference by the midpoint between the bid and the ask. The median would be expressed as a percentage, rounded to the nearest hundredth percent.

As proposed, an ETF would be required to use data from the full trading day without excluding certain time periods, because we believe the spread metric should represent the costs that an actual investor could face at any time during the day. We note, however, that costs related to the bid-ask spread can fluctuate throughout the day. For example, the bid-ask spread tends to be higher at the beginning of the trading day and towards the end of the trading day.[374] At market open, wide spreads may persist until all underlying stocks open and start trading. At market close, market makers may be less willing to purchase ETF shares because they do not want to hold the ETF shares overnight.

We propose to require ETFs to use one full fiscal year of data because we believe a full year would capture spreads during varying market events throughout the year. Although we considered requiring ETFs to use a full calendar year of data for this disclosure requirement in order to promote greater comparability among ETFs, we are concerned that using calendar year data would necessarily mean that information in certain ETF prospectuses would be over a full year old.[375] We preliminarily believe that, to the extent there are any concerns that using fiscal year data instead of calendar year data may undermine comparability of the spreads of different ETFs when there are significant market events in a particular calendar year, such concerns are mitigated by the relatively low impact of a single market event to a full year's

[367] Item 6(c) of Form N–1A.

[368] *See* proposed amendments to Item 3 of Form N–1A.

[369] As discussed above, given the importance of this information to understanding the total expenses an investor may bear when investing in an ETF, we propose that bid-ask spread information be included in both the ETF's prospectus and on the ETF's website. Proposed Instruction 5(a) to Item 3 of Form N–1A. *See also infra* section II.C.6.

[370] CFA Institute Research Foundation, *Comprehensive Guide to Exchange-Traded Funds (ETFS)* (2015), *available at https://www.cfapubs.org/doi/pdf/10.2470/rf.v2015.n3.1,* at 67–8 (''CFA Guide''). *See also* Allen B. Atkins & Edward A. Dyl, *Transactions Costs and Holding Periods for Common Stocks,* 52 Journal of Finance 1, 309–325 (1997) (''Additional evidence of an association between transactions costs and trading volume can be found in the literature on bid-ask spreads.''). Literature also suggests that the bid-ask spread could be affected by increased transaction costs. *See* Gerald W. Buetow & Brian J. Henderson, *Are Flows Costly to ETF Investors?,* 40 Journal of Portfolio Management 3, 101 (Spring 2014), *available at http://www.bfjlaward.com/pdf/25949/100-112_Henderson_JPM_0417.pdf* (noting that authorized participants are likely to pass transaction fees onto shareholders through the spread).

[371] *See* CFA Guide, *supra* footnote 370, at 69 (noting that ''for some ETFs, even though the underlying securities are liquid, bid–ask spreads may be wide simply because the ETF trades so little that the chances of an [authorized participant] rolling up enough volume to use the creation/redemption process are low'').

[372] Proposed Instruction 5(a) to Item 3 of Form N–1A.

[373] Proposed Instruction 5(b) to Item 3 of Form N–1A.

[374] Ogden H. Hammond & Michael Lieder, J.P. Morgan Asset Management, *Debunking myths about ETF liquidity* (May 2015), *available at https://am.jpmorgan.com/blob-gim/1383272223898/83456/1323416812894_Debunking-myths-about-ETF-liquidity.pdf,* at 6 (noting that certain ETF liquidity patterns tend to repeat and are well known to veteran traders, such as limited trading of ETFs immediately prior to the close). *See also* Sunil Wahal, *Entry, Exit, Market Makers, and the Bid-Ask Spread,* 10 Rev. Financial Stud 871 (1997), *available at http://www.acsu.buffalo.edu/~keechung/MGF743/Readings/H1.pdf* (''Large-scale entry (exit) is associated with substantial declines (increases) in quoted end-of-day inside spreads, even after controlling for the effects of changes in volume and volatility. The spread changes are larger in magnitude for issues with few market makers; however, even for issues with a large number of market makers, substantial changes in quoted spreads take place.'').

[375] For example, if the ETF's fiscal year end was August 31, the annual update would be required to be filed no later than December 29, which would include spread cost information from the prior calendar year for up to one year thereafter, meaning that the spread cost information could be almost two years old. By using fiscal year end data, the information would never be more than 16 months old.

median bid-ask spread. Using one full fiscal year of data also is consistent with all other requirements for Item 3 of Form N–1A.[376]

Under our proposal, an ETF would be required to disclose median bid-ask spread instead of average bid-ask spread because we believe the median spread better represents the spread that the average investor would experience, whereas the average spread better represents the spread of an average ETF share in a given transaction. We believe sorting the spreads across the entire fiscal year to determine the median—rather than taking the median spread of each trading day throughout the fiscal year first, sorting each day's median, and taking the median spread across all trading days—provides a better representation of the true median across the entire fiscal year. Requiring disclosure of the median bid-ask spread also avoids the problem of an outlier skewing the bid-ask spread figure. For example, if the spread is .05 in nine instances but 1.00 in one instance, then the average spread will be 0.145 which we believe is a less accurate reflection of the bid-ask spread for that fund.

Q&A 4 and 5. We also propose to require ETFs to include questions on how the bid-ask spread impacts the return on a hypothetical $10,000 investment for both buy-and-hold and frequent traders.[377] These examples are designed to allow secondary market investors to see the impact that bid-ask spreads can have on the investor's trading expenses and ultimately the return on investment. For example, a hypothetical example of spread costs can highlight that these costs can be a drag on returns for someone who trades frequently in certain types of ETFs. On a percentage basis, spread costs for a single trade can equal, if not exceed, the ETF's annual operating expenses in some cases. If an investor trades in and out of an ETF several times within a relatively short period of time, the costs attributable to the bid-ask spread can increase rapidly. Transparency into trading costs also may promote greater comparability among ETFs and other investment products, such as mutual funds. For example, two ETFs may have very similar expense ratios, but one ETF consistently has higher bid-ask spreads, which could make the cost of that ETF significantly higher than the one with a low bid-ask spread.

The proposed example in Q&A 4 would require disclosure of hypothetical trading costs attributable solely to the median bid-ask spread based on data from the ETF's prior fiscal year.[378] Specifically, the spread costs example would demonstrate the hypothetical impact of the ETF's bid-ask spread for one $10,000 ''round-trip'' trade (*i.e.,* one buy *and* sell transaction). The proposed example reflects costs that are in addition to the annual fund operating expenses, which are currently disclosed in Item 3 of N–1A.[379] Thus, to assist investors with comparing the costs of investing in various ETFs, we believe that it is appropriate to use the same hypothetical investment amount, $10,000, which is used for the current expense example in Item 3 of Form N–1A.

To illustrate that more frequent trading can significantly increase costs, the proposed example in Q&A 5 demonstrates the costs associated with 25 $10,000 round-trip trades (50 total trades). This figure represents approximately two round-trip trades each month. While the number of trades that an investor makes during the course of a year can vary depending on the type of investor and the type of investment strategy the ETF pursues, we believe that an example showing the spread costs of 50 total trades could provide useful information for those that trade frequently.[380] As discussed in more detail below, our proposal also would allow investors to obtain more tailored information regarding their costs on the ETF's website.[381]

Pursuant to this requirement, an ETF would be required to disclose ''mid-range spread costs'' and ''high-end spread costs.'' The mid-range spread costs would be calculated by using the median spread, divided by two, and then multiplying the resulting number by a $10,000 trade size and the number of transactions. The high-end spread costs would be calculated by using the same calculated spread data from the ETF's prior fiscal year, except instead of choosing the median spread, the disclosure would represent the 95th percentile spread, after sorting that year's data.[382] We preliminarily believe that utilizing the 95th percentile spread (*i.e.,* the spread representing the threshold for the highest 5% of spreads) is appropriate for the purposes of representing high-end spread costs.

We considered whether to also include ''low-end spread costs'' but determined that the combination of presenting ''mid-range spread costs'' and ''high-end spread costs'' would provide the most meaningful disclosure to investors. Many ''low-end spread costs'' for ETFs with significant volume have a penny spread and would therefore not provide as useful of a comparison across funds. Furthermore, some ''mid-range spread costs'' and ''high-end spread costs'' could account for more than 50% of the cost of an initial investment in an ETF, whereas a ''low-end spread cost'' might only account for a small fraction of an investor's overall costs. We request comment on this point below.

An investor could use both the median bid-ask spread figure from proposed Q&A 4 and the costs information in Q&A 5 to better assess the overall cost impact of the bid-ask spread. Proposed Q&As 1–5 also would provide investors with a better understanding of the basic terminology needed to understand some frequently overlooked costs associated with investing in ETFs, and then provide the data needed to understand how those costs materialize for the particular fund and how those costs compare to other ETFs.

Q&A 6. *Cross-reference to ETF's website and Interactive Calculator Requirement.* As discussed above, proposed rule 6c–11 would require daily website disclosure of several items, including the NAV per share, market price, and premium or discount. As the disclosures on an ETF's website would be updated daily, we believe a cross-reference in Form N–1A to the website disclosures would enable investors to receive timely and granular information that could assist with making an investment decision.

[376] *See* Item 3 of Form N–1A.

[377] The proposal uses $10,000 in order to maintain consistency with the cost example in Item 3 of Form N–1A.

[378] Proposed Instruction 5(b) to Item 3 of Form N–1A.

[379] Item 3 of Form N–1A. Item 3 only requires 1- and 3-year expense examples for annual fund operating expenses for ''New Funds.''

[380] We acknowledge the inherent difficulty of setting a number of trades that reflects an ''average investor.'' Based on staff experience, however, we preliminarily believe that 50 total trades, which represents approximately 2 round-trip transactions per month, is a reasonable figure to utilize for the purposes of demonstrating the costs of trading for a frequent trader in Q&A 5.

[381] *See* proposed Instruction 5(e) to Item 3 of Form N–1A.

[382] We are proposing to divide the bid-ask spread by two on the assumption that the value of an ETF share is the midpoint between the bid price and the ask price. Therefore, the ''cost'' attributable to the bid-ask spread of executing one trade would be, in the case of purchasing a share of an ETF, the difference between the ask price and the midpoint between the bid and the ask prices—in other words, this difference would represent the cost above which the share was valued for this purpose and not the full ''round-trip'' cost. Likewise, in the case of selling an ETF share, the ''cost'' attributable to the bid-ask spread of executing one trade would be the difference between the bid and the midpoint between the bid and the ask prices. To calculate the cost of multiple trades, the single trade cost would be multiplied by the number of transactions.

Accordingly, we propose to require a statement in Q&A 6 that would refer investors to the ETF's website for more information.[383] Item 11(g) currently requires an ETF to provide a website address in its prospectus if the ETF omits the historical premium/discount information from the prospectus and includes this information on its website instead. As a result, many ETFs already include a website address in their prospectus.[384]

In addition, proposed Instruction 5(e) to Item 3 would require an ETF to provide an interactive calculator in a clear and prominent format on the ETF's website. The purpose of the interactive calculator is to provide investors with the ability to customize the hypothetical calculations in Item 3 to their specific investing situation. For example an investor with an investment of $2,500 opposed to $10,000 or wishing to trade 10 times opposed to the 25 times presented in Item 3 could use the calculator to find more tailored cost-related information. We are sensitive to the fact that creating a web-based interactive calculator is not without cost, especially for smaller fund complexes. We have tried to mitigate these costs by limiting the proposed investor-input to two data points: Investment amount and number of trades. We also tried to limit the complexity of the tool by proposing to require the interactive calculator to use the calculations detailed in Instructions 5(a)—(d) to Item 3 to provide the information required by Q&As 3–5, which relates to the bid-ask spread.

c. Exception for ETFs With Limited Trading History

Trading information and related costs may not be useful to secondary market investors in an ETF that has only a limited amount of trading history since inception. Therefore, we are proposing that an ETF that had its initial listing on a national securities exchange after the beginning of its most recently completed fiscal year would not be required to include the ETF's median bid-ask spread or the spread cost example in its Item 3 disclosure, nor would the ETF be required to provide an interactive calculator on its website.[385] We preliminarily believe this information is most useful when there is at least one full fiscal year of data underlying the metrics. Without a minimum amount of trading data to calculate this information, the resulting calculations could be skewed for any number of reasons. For example, it is possible that the time of year during which the ETF was trading or the fact that an ETF was relatively new to the market and had not had significant marketing to gain interest for shares of the ETF resulted in low trading volume and higher bid-ask spreads. We propose to require a newly launched ETF to provide a brief statement to the effect that the ETF does not have sufficient trading history to report trading information and related costs.[386] The proposed amendment would prohibit a new ETF from disclosing data based on very short trading histories, which we preliminarily believe could be misleading. This approach would also be consistent with our treatment of other disclosure items such as portfolio turnover data and annual returns.[387]

We seek comment on our proposed amendments to Item 3:

• Should we require ETFs and mutual funds to include a statement that investors may be subject to other costs not reflected in the fee table, such as brokerage commissions and other fees to financial intermediaries? Would this disclosure be confusing to individual investors, particularly those investing in mutual funds?

• In addition to the statement regarding brokerage commissions, should we require quantitative disclosure of the range of brokerage commissions for transactions? Should this disclosure be required of both mutual funds and ETFs? Where in the registration statement should such disclosure be included? Or, would disclosure of brokerage commissions raise challenges too great to require disclosure? For example, would variations in methods used to collect and set commissions make such disclosure too complex? How costly or difficult would it be to obtain information about brokerage commissions?

• Should other costs be disclosed in Item 3? If so, which costs and why? How and where should those other costs be disclosed? Should Item 3 include market price range or NAV range? What other trading information, if any, should be included in Item 3 and why? For example, should we require ETFs to disclose information regarding the number of days the ETF's shares traded on a national securities exchange, the ETF's average daily volume, and/or the ETF's total number of shares outstanding? If so, how should we require these metrics to be calculated and disclosed?

• Should we include the specific ETF disclosures in Item 3? Should we require that those disclosures be made in a Q&A format? Would investors understand and find the proposed Q&A format useful? Are there other formats we should consider? Should we permit ETFs to use any format that is designed to effectively convey the information to investors?

• Should we replace the reference to "national securities exchange" with "secondary markets" in Q&A 1 as proposed?

• Should we require ETFs to explain bid-ask spreads and the factors that could affect bid-ask spreads in Item 3? Are there other explanations (or means to calculate bid-ask spreads) that we should consider? Are there other factors that could impact bid-ask spreads that we should include in this explanation?

• Should the median bid-ask spread information be included in the prospectus? Should this information be included in Item 3 or in a different section of the registration statement? If so, where? Alternatively, should we require disclosure of this information on an ETF's website?

• To what extent is historical spread data predictive of future spread data? Should we require language indicating that historical spread data may not be predictive of future spread data?

• Should the spread calculation exclude data from the beginning and end of the trading day? If so, what time periods should it exclude and why? For example, should we exclude the first and last 15 minutes of each trading day?

• Should the spread calculation be based on data from an ETF's fiscal-year end or calendar-year end and why? Would the use of fiscal-year make comparability among funds more difficult since funds have different fiscal-year ends? Should the spread calculation be based on data from more than one year? If so, how many years and why? Should the spread calculation be based on data that, in addition to the fiscal or calendar year, also includes

[383] Proposed amendments to Item 3 of Form N–1A would require an ETF to include the following statement in its prospectus: "The ETF's website at [*www.[Series-SpecificLandingPage.com]*] includes recent information on the Fund's net asset value, market price, premiums and discounts, as well as an interactive calculator you can use to determine how the bid-ask spread would impact your specific investment." The Commission explained in a 2000 release that filers submitting HTML documents on EDGAR should take reasonable steps when they create the document in order to prevent URLs from being converted into hyperlinks. *See* Rulemaking for Edgar System, Securities Act Release No. 33–7855 (Apr. 24, 2000).

[384] As discussed above, we propose to replace the historical premium/discount information in Item 11(g) with line graph disclosure regarding premiums and discounts that would be required by proposed rule 6c–11(c)(1)(iv). *See supra* section II.C.6.

[385] Proposed Instruction 5(a) to Item 3 of Form N–1A.

[386] *Id.*

[387] *See* Items 3 and 4 of Form N–1A.

data from the most recently completed fiscal or calendar quarter, respectively? Should the calculation be done on a daily basis first and then again across the entire fiscal year?

• Should the calculation for the bid-ask spread throughout the trading day be done more or less frequently than every ten seconds? If so, how frequently and why?

• Should the bid and ask be calculated using a different method, such as weighting the prices throughout the book? If so, explain the method and why it should be used.

• Should a metric other than median be used for the spread calculation? For example, should we use average spread or effective spread? [388] If so, why is it preferable and how should it be calculated? Would the use of a different spread calculation provide more comprehensive information about extreme market events? For example, should we also require disclosure of additional percentiles towards the extreme of the distribution, such as the 95th percentile?

• Instead of using the bid-ask spread as an indicator of trading costs, is there another method that would better reflect an ETF's overall trading costs? If so, what is that metric, why is it better than disclosing the bid-ask spread, and how should it be calculated and disclosed?

• How difficult or costly would it be for ETFs to obtain the data necessary to calculate median bid-ask spread as proposed? Are there any negative consequences of disclosing the bid-ask spread? If so, what are they?

• When calculating the spread costs example, should the bid-ask spread be divided by two for each transaction listed or should each transaction reflect the full round-trip spread cost?

• Should we require disclosure of costs associated with ''mid-range spread costs'' and ''high-end spread costs'', as proposed? Should we additionally include a requirement to disclose ''low-end spread costs''? Why or why not? Would the disclosure of this data result in retail investor confusion?

• Is the $10,000 trade amount used in the spread costs example reasonable? Should we consider a lower trade amount? Alternatively, should the spread costs example show varying trade sizes calculated using varying book depths? If so, what trade sizes and why should they be used?

• Should the spread example include a different number of transactions? If so, how many transactions should be used for each column and why? Should the number of transactions vary based on the type of investment strategy the ETF pursues? If so, how should we determine the number of transactions and corresponding ETF types?

• Are there any negative consequences of disclosing the spread costs example? If so, what are they?

• Should each ETF be required to disclose a website address in Item 3 as proposed? Should we permit an ETF to comply with this requirement by including a general web address to an investment company complex's website or should we require a series-specific landing page for the ETF? Would a cross-reference to the ETF's series-specific page be useful?

• Should we require ETFs to disclose information regarding premiums and discounts in Item 3 of Form N–1A, either in addition to, or in lieu of, the disclosures proposed in rule 6c–11? If so, should the information be based on data over the entire fiscal year or calendar year? Do commenters believe that the reference to the ETF's website, where such information may be found, provides investors with useful information regarding these potential costs?

• Would investors find the information in our proposed amendments to Item 3 helpful in comparing between different investment options?

• Should we require funds, as proposed, to provide investors with an interactive calculator on their website? Would investors find an interactive calculator helpful to better understand the costs of investing in ETFs? Are there data points that we have not discussed that the interactive calculator should include? Should the interactive calculator be required for both mutual funds and ETFs? For example, should the interactive calculator be expanded to include fee table information for both ETFs and mutual funds? Are there any challenges to posting an interactive calculator that we are not considering? What costs would be associated with developing this type of calculator?

• Should we require funds to provide an interactive calculator on their website for other costs, such as any costs attributable to premiums or discounts? If so, what would be the user inputs and outputs for the calculator? How would the calculator calculate such a cost?

• Should there be an exception to the requirement to disclose trading information and related costs for newly launched ETFs as proposed? If not, why not? Should a newly launched ETF nevertheless be required to provide an interactive calculator on its website? Should the threshold for the exemption to include trading information and related costs disclosure instead be based on Form N–1A's definition of ''New Fund'' [389] or a different period of time? If so, why? Should there be an exception to disclosing trading information and related costs for any other reason (*e.g.,* limited trading book depth, low volume, or trading only on a percentage of the days throughout the year)? If so, what should the threshold be and why?

• In lieu of providing an exception from the requirement to disclose trading information and related costs for newly launched ETFs, should we instead adopt a requirement for ETFs to disclose this information once the ETF reaches or exceeds a specified threshold of trading volume for a specified period of time, regardless of how long it has been in operation? Put differently, should we base this exception on level of trading volume rather than the length of an ETF's operation? If so, what should such thresholds be? If not, why not?

3. Item 6 of Form N–1A

Currently, Item 6(c)(i) of Form N–1A requires an ETF to: (i) Specify the number of shares it will issue or redeem in exchange for the deposit or delivery of baskets; (ii) explain that the individual shares of the ETF may only be purchased and sold on a national securities exchange through a broker or dealer; and (iii) disclose that the price of ETF shares is based on the market price and as a result, shares may trade at a price greater than NAV (premium) or less than NAV (discount).[390] The number of shares the ETF issues or redeems in exchange for the deposit or delivery of baskets is largely duplicative of reports required in Form N–CEN.[391] We therefore propose to remove this requirement from Item 6.[392] The remainder of the information required by Item 6(c)(i) is proposed to be moved to the Item 3 disclosure.[393] In order to eliminate duplicative disclosure, we propose to remove these requirements

[388] *See supra* footnote 314.

[389] Instruction 6 to Item 3 of Form N–1A defines a ''New Fund'' as ''a Fund that does not include in Form N–1A financial statements reporting operating results or that includes financial statements for the Fund's initial fiscal year reporting operating results for a period of 6 months or less.'' The instruction permits New Funds to estimate ''Other Expenses'' and to complete only 1- and 3-year portions of the expense example. *Id.*

[390] Item 6(c)(i) of Form N–1A.

[391] *See* Item E.3.a of Form N–CEN; *see also* Reporting Modernization Adopting Release, *supra* footnote 147, at n.1100 and accompanying text (requiring ETFs ''to report the number of ETF shares required to form a creation unit as of the last business day of the reporting period.'').

[392] *See* proposed amendments to Item 6 of Form N–1A.

[393] *See* proposed amendments to Item 3 of Form N–1A.

from Item 6.[394] As noted above, moving this information to Item 3 would consolidate relevant disclosures regarding the fees and trading costs that may be borne by an ETF investor in one place.

Additionally, Item 6(c)(ii) currently requires ETFs issuing shares in creation units of less than 25,000 to disclose the information required by Items 6(a) and (b).[395] Current Items 6(a) and (b) require funds to: (i) Disclose their minimum initial or subsequent investment requirements; (ii) disclose that the shares are redeemable; and (iii) describe the procedures for redeeming shares. We are proposing to eliminate these disclosures.[396] When we adopted these requirements, we reasoned that individual investors may be more likely to indirectly transact in creation units through authorized participants if the creation unit size was less than 25,000 shares.[397] Based on staff experience, we understand that retail investors do not engage in primary transactions through authorized participants. Furthermore, to the extent that authorized participants act as agents for market makers in primary transactions with the ETF, we believe that the flow of information on how to purchase and redeem shares is robust given the market maker's relationship with an authorized participant. Therefore, we do not believe that this disclosure would be beneficial.

We request comment on the proposed amendments to Item 6.

- Should we remove the disclosure regarding creation unit sizes from Form N–1A, as proposed? Are we correct in our understanding that this disclosure is largely duplicative of disclosure required in Form N–CEN? Are we correct in our belief that investors do not find this information useful in the context of a prospectus? Instead of removing this disclosure from Form N–1A entirely, should we move it to the Statement of Additional Information? Do retail investors typically use the information on creation unit size and if so, for what purpose? Is our belief correct that this information is more useful for authorized participants and market makers and less useful to investors purchasing individual shares on an exchange?
- Alternatively, should we require ETFs to disclose information regarding their creation unit sizes or transaction fees, or both, on their websites?
- Should ETFs continue to disclose in Item 6 (or any other Item included within the summary prospectus disclosure) information currently required by Items 6(a) and (b)? If so, why? Should this disclosure be based on a numerical threshold, and if so, what would the appropriate threshold be and why?
- Should we require ETFs to provide disclosure regarding transaction fees associated with the purchase and redemption of creation units? If so, where should such disclosure be provided?
- Are we correct in our understanding that that the flow of information on how to purchase and redeem ETF shares is robust due to the relationship between market makers and authorized participants?

4. Item 11 of Form N–1A

Item 11(g)(1) currently specifies that an ETF may omit information required by Items 11(a)(2), (b), and (c) if the ETF issues or redeems shares in creation units of not less than 25,000 shares each.[398] Similar to the reasoning discussed above regarding amendments to Item 6,[399] we propose to amend Item 11(g)(1) to permit all ETFs, not just ones with creation unit sizes of not less than 25,000 shares, to omit the information required by Items 11(a)(2), (b), and (c).[400]

Item 11(a)(2) requires a fund to disclose when calculations of NAV are made and that the price at which a purchase or redemption is effected is based on the next calculation of NAV after the order is placed.[401] Item 11(b) and (c) require a fund to describe the procedures used for purchasing and redeeming the fund's shares.[402] In our view, eliminating these disclosure requirements for all ETFs would not detract from an understanding of how authorized participants transact directly with the ETF in the primary market. As discussed above, the proposed rule would define an authorized participant as a member or participant of a clearing agency registered with the Commission, which has a contractual arrangement with the ETF or one of the ETF's service providers.[403] Thus, we believe the parties who purchase or redeem shares from the ETF directly would either have the knowledge necessary to do so without additional procedural disclosure or the ability to request such information.

Item 11(g)(2) currently includes a requirement for an ETF to provide a table showing the number of days the market price of the ETF's shares was greater than the ETF's NAV per share for certain time periods.[404] As discussed above, we propose to require information about the premium and discount of the ETF's shares to their NAV per share to be included on the ETF's website. Thus, we are proposing to remove the information currently required by Item 11(g)(2), as more timely information would be available on the ETF's website. For the same reasons, we are also proposing to eliminate Item 27(b)(7)(iv) of Form N–1A, which requires ETFs to include a table with premium/discount information in their annual reports for the five most-recently completed fiscal years.[405]

We request comment on the proposal to remove the requirement to disclose information required by Items 11(a)(2), (b), and (c) as well as the proposal to remove the requirement to disclose the premium/discount information in the prospectus and annual report.

- Should we keep this disclosure in the prospectus? If we were to keep this disclosure requirement, should we require ETFs to disclose different information about the procedures to purchase and redeem shares directly with the ETF?
- Do most ETFs provide the premium/discount information required by this information on their websites? If we were to keep the requirement to disclose the premium/discount information in the prospectus, should it mirror the information proposed to be required on the ETF's website?

5. Potential Alternatives to Current ETF Registration Forms

As discussed above, open-end funds, including ETFs organized as open-end funds, are required to file Form N–1A to

[394] *See* proposed amendments to Item 6 of Form N–1A.

[395] Item 6(c)(ii) of Form N–1A.

[396] *See* proposed amendments to Item 6 of Form N–1A.

[397] *See* Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, Investment Company Act Release No. 28584 (Jan. 13, 2009) [74 FR 4546 (Jan. 26, 2009)] (''Summary Prospectus Adopting Release''), at nn.170–72.

[398] Item 11(g)(1) of Form N–1A.

[399] *See supra* section I.H.3.

[400] Proposed Item 11(g)(1) of Form N–1A.

[401] Item 11(a)(2) of Form N–1A. Item 11(a)(1) already requires that ETFs include an explanation that the price of fund shares is based on market price. Item 11(a)(1) of Form N–1A.

[402] Item 11(b) and (c) of Form N–1A.

[403] *See* proposed rule 6c–11(a).

[404] Item 11(g)(2) of Form N–1A. The item provides that an ETF may omit the table if it provides a website address that investors can use to obtain the premium/discount information required by the item.

[405] Although the time period required by this disclosure is different than the requirement in Item 11(g)(2), ETFs are permitted to omit both disclosures by providing on their websites only the premium/discount information required by Item 11(g)(2) (the most recently completed fiscal year and quarters since that year).

register under the Act and to offer their securities under the Securities Act. UITs, including ETFs organized as UITs, initially register under the Investment Company Act on Form N–8B–2 and register their offerings of securities under the Securities Act on Form S–6.[406] However, ETFs, regardless of structure, operate differently than the other investment companies that register on Forms N–1A and N–8B–2. For example, unlike traditional open-end funds and UITs, ETFs are exchange-traded and investors rely on the arbitrage mechanism to ensure that the ETF's shares trade at or close to its NAV.[407] As a result of these differences, in addition to our proposed amendments to Form N–1A and Form N–8B–2, we are seeking comment on whether we should create a new registration form that is specifically designed for ETFs or consider other disclosure formats as part of a future rulemaking.

- Should we create a new registration form for ETFs? What types of ETFs should be required to file reports on such a form? For example, should we limit the form to ETFs that would be subject to proposed rule 6c-11? Or should all ETFs, including UIT ETFs, file reports on such a form?
- What type of ETF-specific information should such a form include? Should the form require more disclosure on the effectiveness of the arbitrage mechanism?[408] Should the disclosures require qualitative disclosures that relate specifically to ETFs, including the performance of the ETF's arbitrage mechanism? Should this disclosure be required as part of an annual report?[409] Should we require a discussion of the ETF's bid-ask spread or premiums and discounts throughout the year? Should the form include a discussion of ETF-specific risk factors? If so, what risk factors should be included?
- Should we require ETFs to provide investors with a short summary document that provides key information about the ETF? What type of information should the document include? For example, should it include information related to the ETF's strategy, portfolio investments, costs, risks, or performance? Should we require it to be in a standardized format?[410]
- As an alternative to a new ETF form, or in addition to such a form, should we consider a summary prospectus targeted specifically at ETFs and their unique features?
- Should we require ETFs to file periodic reports, such as on Form 8–K? Under what circumstances should we require periodic reports? For example, should we require ETFs to file periodic reports after a market event that adversely affects the arbitrage mechanism during the trading day?

I. Amendments to Form N–8B–2

Form N–8B–2 is the registration form under the Investment Company Act for UITs which are currently issuing securities and is used for registration of ETFs organized as UITs.[411] For the reasons discussed above in section II.A.1, we believe that UIT ETFs should be regulated pursuant to their exemptive orders, rather than a rule of general applicability and are not proposing to include them within the scope of proposed rule 6c–11. However, we believe that it is important for investors to receive consistent disclosures for ETF investments, regardless of the ETF's form of organization.[412] We are therefore proposing to amend Form N–8B–2[413] to require UIT ETFs to provide disclosures that mirror certain of our proposed disclosure changes in Form N–1A.[414] Below are the proposed Form N–8B–2 amendments and the corresponding sections in Form N–1A.

Disclosure topic	Proposed Form N–1A ETF disclosure	Corresponding Form N–8B–2 proposed disclosure
Definitions for Exchange-Traded Fund	General Instructions Part A	General Instructions *Definitions.*[415]
Information Concerning Fees and Costs	Item 3. Risk/Return Summary: Fee Table	Item I.13(h).
Information Concerning Fees and Costs	Item 3. Exchange-Traded Fund Trading Information and Related Costs.	Item I.13(i).

UIT ETFs, like other ETFs, are exchange-traded. As a result, secondary market investors in UIT ETFs, like other ETFs, are subject to costs, such as: bid-ask spreads; brokerage commissions for buying and selling shares of a UIT ETF through a broker-dealer; and potential costs related to purchasing UIT ETF shares at a premium or discount to NAV per share. As with investors in ETFs organized as open-end funds, we believe that unit holders could overlook these costs for UIT ETFs. We believe that additional disclosure would help investors better understand the total costs of investing in a UIT ETF. Accordingly, we are proposing disclosure requirements in Form N–8B–

[406] *See infra* section II.0.

[407] *See generally* Hu and Morley, *supra* footnote 291 (proposing a new ETP disclosure regime that ''responds to the significance of the arbitrage mechanism, model-related complexities and evolving understandings and conditions'').

[408] *See generally id.*

[409] *Id.; see also* Item 27(b)(7) of Form N–1A.

[410] For example, in 2017, the Canadian Securities Administrators began requiring ETFs traded on Canadian exchanges to provide investors with a document, not to exceed four pages in length, called ''ETF Facts.'' The ETF Facts document is required to include certain information about the ETF, including, among other things, information related to the ETF's investments, risks, and performance, as well as background information about ETFs generally. *See* Canadian Securities Administrators, Mandating a Summary Disclosure Document for Exchange-Traded Mutual Funds and Its Delivery—CSA Notice of Amendments to National Instrument 41–101 (Dec. 8, 2016), available at *http://www.osc.gov.on.ca/documents/en/Securities-Category4/ni_20161208_41-101_traded-mutual-funds.pdf.*

[411] While open-end funds register with the Commission with Form N–1A, UITs must register with two forms: Form S–6 which is used for registering the offering of the UITs' units under the Securities Act, and Form N–8B–2, which is used for registration under the Investment Company Act. Form S–6, which must be filed with the Commission every 16 months, provides certain content requirements, mainly by referencing to the disclosure requirements in Form N–8B–2.

[412] *See* 2008 ETF Proposing Release, *supra* footnote 3, at section III.D.1. for a general discussion of ETF prospectus delivery requirements. Since UITs issue securities, and not subject to any of the applicable exemptions, both sponsors and dealers are required to deliver a current prospectus to unit holders. *See* section 5(b) of the Securities Act (requiring prospectus delivery with the sale of securities, including units of UITs); *see also* section 24(d) of the Act (eliminating the ''dealer exception'' in section 4(3) of the Securities Act for transactions in redeemable securities by UITs); *see also supra* footnote 27.

[413] Because Form S–6 requires UIT prospectuses to include disclosure required by specified provisions of Form N–8B–2, the proposed disclosure amendments to Form N–8B–2 would also apply to prospectuses on Form S–6.

[414] *See* section II.H.

[415] The proposed definition of the term ''exchange-traded fund'' in Form N–1A covers ETFs organized as open-end funds and includes ETFs relying on either exemptive orders or rule 6c–11 to operate. Form N–8B–2, on the other hand, is for UITs, which would not be able to rely on rule 6c–11 to operate. Accordingly, the proposed definition of ''exchange-traded fund'' in Form N–8B–2 omits the reference to rule 6c–11.

2 that mirror those of Item 3 of Form N–1A, thus requiring prospectuses on Form S–6 for UIT ETFs to disclose that an ETF investor may pay additional fees, such as brokerage commissions and other fees to financial intermediaries, and to provide certain ETF trading information and related costs.[416]

As discussed above, the proposed instructions to Item 3 would require median bid-ask spread to be disclosed on an ETF's website. UIT ETFs would be subject to this requirement as well. We note in this regard that UIT ETFs currently are not subject to website disclosure requirements regarding trading costs or other information. However, as a matter of practice, UIT ETFs generally disclose information regarding market price, NAV per share, premium and discounts, and spreads on their websites today.[417]

We request comment on the proposed amendments to Form N–8B–2.

- Should we require ETFs organized as UITs to provide disclosures that are consistent with Form N–1A in the manner proposed?
- Do the proposed amendments to Form N–8B–2 ensure consistency between ETFs organized as open-end funds and UIT ETFs? Why or why not?
- Are there additional amendments to Form N–8B–2 the Commission should consider? Are there any amendments to Form S–6 that the Commission should consider? For example, should we consider requiring UIT ETFs to provide disclosure regarding market price, NAV per share, and premiums and discounts? Should we consider requiring UIT ETFs to provide graphic disclosure regarding the ETF's historical premiums and discounts? Should we permit UIT ETFs to omit such premium/discount in their registration statement if they include those disclosures on the ETF's website?
- Would the proposed trading cost requirements in Form N–8B–2 Items I.13(h)–(i) result in UIT ETFs having to disclose information not currently disclosed on their websites? If so, what information would be disclosed that is not currently disclosed?

[416] *See* proposed Items 13(h) and (i) of Form N–8B–2. *See also supra* section II.H.2 describing the ETF trading information and related costs disclosure requirements.

[417] UIT ETFs also would be required to provide certain ETF specific information in reports on Form N–CEN. *See* Part E of Form N–CEN. Additionally, a UIT ETF would be required to provide certain information relating to the index that it tracks, including the return difference and whether the index is constructed by an affiliated person or is exclusive to the UIT. *See* Item E.4 of Form N–CEN.

J. Amendments to Form N–CEN

Form N–CEN is a structured form that requires registered funds to provide census-type information to the Commission on an annual basis.[418] Item C.7. of Form N–CEN requires management companies to report whether they relied on certain rules under the Investment Company Act during the reporting period.[419]

We are proposing to add to Form N–CEN a requirement that ETFs report if they are relying on rule 6c–11.[420] While Form N–CEN already requires funds to report if they are an ETF,[421] we are proposing to collect specific information on which funds are relying on rule 6c–11 in order to better monitor reliance on rule 6c–11 and to assist us with our accounting, auditing and oversight functions, including compliance with the Paperwork Reduction Act.

As discussed above in section II.C.1, we are also changing the definition of "authorized participant" in Form N–CEN to exclude the specific reference to an authorized participant's participation in DTC in order to obviate the need for future amendments if additional clearing agencies become registered with the Commission. Revised Form N–CEN would define the term as "a member or participant of a clearing agency registered with the Commission, which has a written agreement with the Exchange-Traded Fund or Exchange-Traded Managed Fund or one of its service providers that allows the authorized participant to place orders for the purchase and redemption of creation units." [422]

We request comment on our proposed amendments to Form N–CEN.

- Should we require any additional information concerning proposed rule 6c-11? If so, what information and where? For example, should we require ETFs to provide information to the Commission on a monthly basis on Form N–PORT? If so, what information?
- Should we amend the definition of "authorized participant" in Form N–CEN as proposed or should we retain its existing definition?

III. Economic Analysis

A. Introduction

ETF sponsors seeking to operate an ETF currently need to obtain an order from the Commission that exempts them from certain provisions of the Act that otherwise would prohibit several features essential to the ETF structure. Obtaining such exemptive relief typically has resulted in expenses and delays in forming new ETFs. In addition, the conditions in the exemptive orders issued by the Commission have evolved over time. As a result, some ETF sponsors may have a competitive advantage over other sponsors because some existing exemptive orders allow the sponsors to launch new funds under the terms and conditions of those orders, and because the terms in some of the existing exemptive orders may be more flexible than others.

Proposed rule 6c–11 would allow ETFs that satisfy certain conditions to operate without obtaining an exemptive order from the Commission. As discussed above, the Commission also proposes to rescind the exemptive relief we have issued to ETFs that could rely on the proposed rule. However, we anticipate that ETFs whose exemptive relief would be rescinded under the proposed rule generally would be able to rely on the proposed rule without substantially changing their current operations, as the conditions for relying on the proposed rule would be similar to those contained in existing exemptive relief, consistent with existing market practice, or generally more flexible than those contained within existing exemptive relief.[423] ETFs that wish to operate in a manner not covered by the proposed exemptive rule could seek individual exemptive relief from the Commission.

We believe that proposed rule 6c–11 would establish a regulatory framework that: (1) Reduces the expense and delay currently associated with forming and operating certain ETFs unable to rely on existing orders; and (2) creates a level playing field for ETFs that could rely on the proposed rule. As such, the proposed rule would enable increased product competition among certain ETF providers, which could lead to lower fees for investors, encourage financial innovation, and increase investor choice in the ETF market.

Furthermore, the amendments to Forms N–1A and N–8B–2 as well as the additional website disclosures required by the proposed rule are intended to improve the information about ETFs available to the market and to allow

[418] *See* Reporting Modernization Adopting Release, *supra* footnote 147.

[419] Item C.7. of Form N–CEN.

[420] Proposed Item C.7.k. of Form N–CEN.

[421] *See* Item C.3.a.i. of Form N–CEN.

[422] *See* proposed amendment to Instruction to Item E.2 of Form N–CEN.

[423] As discussed in more detail below, some conditions in the proposed rule and the scope of the relief provided are less flexible than those included in certain exemptive orders (*e.g.,* the absence in the proposed rule of master-feeder relief) and others represent requirements that were not included in exemptive orders (*e.g.,* basket policies and procedures and the recordkeeping requirements).

investors to more readily obtain information about fund products, resulting in reduced investor search costs. To the extent that the proposed amendments would improve investors' ability to evaluate the performance and other characteristics of fund products, the proposed amendments might result in better informed investor decisions and more efficient allocation of investor capital among fund products, and might further promote competition among ETFs and between ETFs and mutual funds.

The proposed rule and amendments to Forms N–1A and N–8B–2 also may impact non-ETF products and market participants. To the extent that the proposed rule would lead to lower investor search costs, lower fees, and increased product innovation and investor choice in the ETF market, investors may shift their investments towards ETFs and away from funds similar to ETFs, such as mutual funds. Such a shift in investor demand also may affect broker-dealers and investment advisers, whose customers and clients may show increased interest in and demand for ETFs. Moreover, because ETF shares are traded on the secondary market, the proposed rule also could affect exchanges, alternative trading systems, facilities for OTC trading, broker-dealers, and clearing agencies to the extent that the rule causes changes in the ETF trading activity they support.

B. Economic Baseline

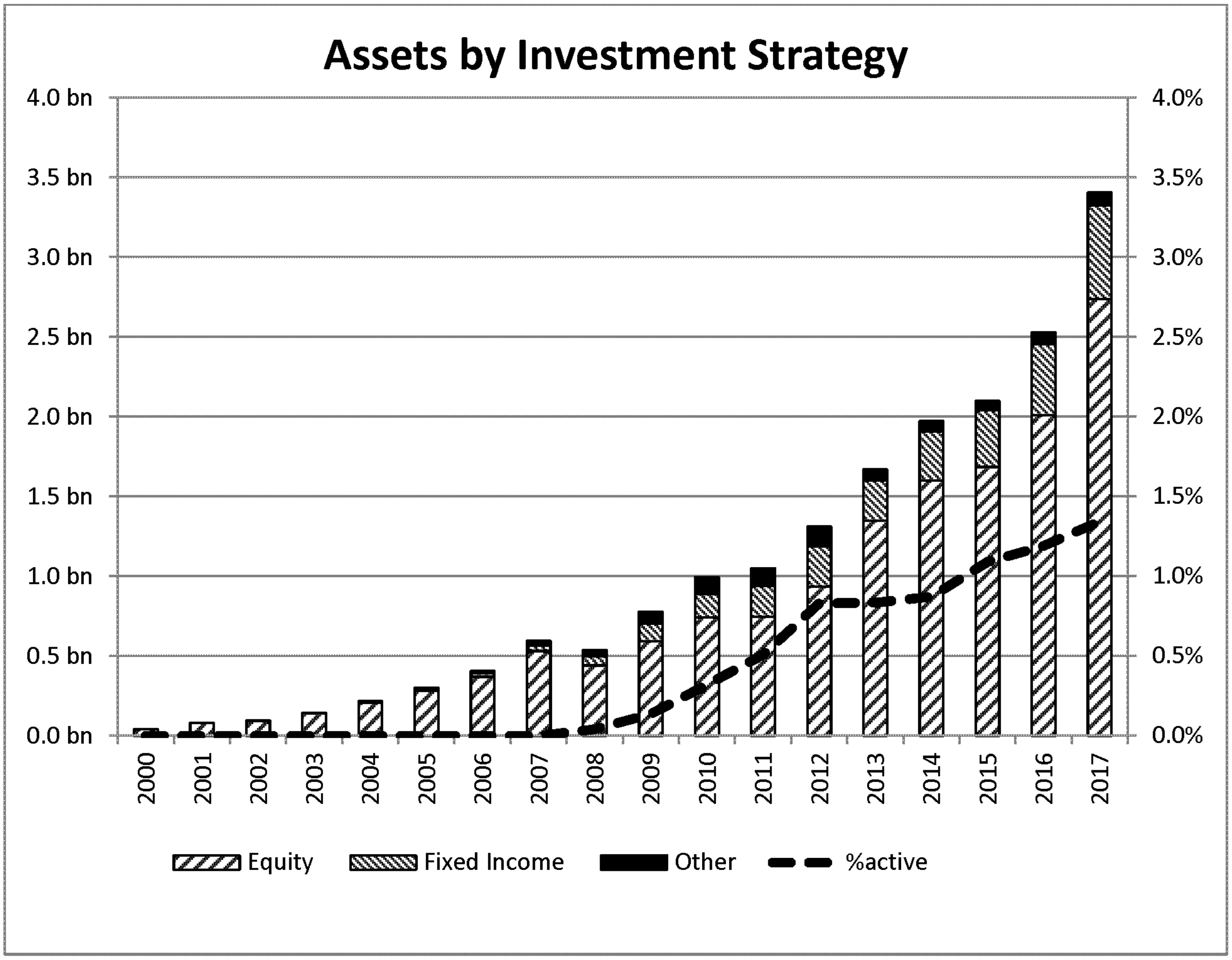
1. ETF Industry Growth and Trends

The ETF industry has experienced extensive growth since the first US ETF began trading in 1993.[424] From 1993 to 2002, an average of 10 new ETFs registered each year and ETF net assets increased by an average of $10.7 billion annually. Industry growth accelerated from 2003 to 2006, when, on average, 62 new ETFs and $77 billion in net assets were added to the industry annually. Since 2007, the industry has seen an average of 141 new ETF entrants and an average growth of $272.8 billion annually. Since 2007, ETF net assets have grown at an average rate of 18.4% per year, which compares to 4.2% for closed-end funds and 9.7% for open-end funds over the same period.[425]

At the end of December 2017, there were 1,900 registered ETFs that had a total of $3.4 trillion in net assets, spanning six broad investment style categories. ETFs are predominantly structured as open-end funds; however, eight funds that together represented 10.9% of ETF total net assets ($372.8 billion) were structured as UITs, and 70 ETFs that together represented 25.1% of total net assets ($854.9 billion) were structured as a share class of an open-end fund. The chart illustrates growth in ETF net assets by investment strategy beginning in 2000 (left-hand side axis). It also tracks the percentage of net assets invested in actively managed ETFs (right-hand side axis).

[424] For the purpose of this release, we focus exclusively on ETFs that trade on US exchanges.

[425] The number and net assets of ETFs are based on a staff analysis of Bloomberg data. Growth rates for open- and closed-end funds are based on a staff analysis of Morningstar data.



The bars show ETF net assets (in $ billions on the left vertical axis) at the end of each year by investment strategy beginning in 2000. "Other" includes commodity, specialty, mixed allocation, and alternative investment strategies. The dashed line shows the percentage of total ETF net assets in active strategies (on the right vertical axis). The data is from Bloomberg.

Although indexing is still the most common ETF strategy, over time ETFs have evolved to offer, among other things, active management, leveraged and inverse investment strategies, and exposure to various types of foreign securities. At the end of December 2017, 187 ETFs, structured as open-end funds, employed leveraged or inverse investment strategies.[426] In total, leveraged ETFs had total net assets of $35.26 billion or approximately 1% of all ETF net assets. None of the eight registered ETFs structured as UITs employed leveraged or inverse investment strategies. Of the remaining unleveraged ETFs, both index-based and active, 1,705 funds had combined net assets of $3 trillion operated as open-end funds, while eight funds had $372.8 billion in net assets operated as UITs.[427]

There were 206 actively managed ETFs with total net assets of $45.8 billion. The remaining 1,694 funds with combined $3.36 trillion in net assets were index-based funds. Of these, 1,686 with total net assets of $2.987 trillion were structured as open-end funds and eight with total net assets of $372.8 billion were structured as UITs.

The majority of ETFs, in total 1,456, held some foreign exposure in their portfolio according to Morningstar data. These ETFs had total net assets of $2.976 trillion. Of these funds, seven were structured as UITs and had $350.4 billion in net assets. The remaining 1,449 funds and $2.63 trillion in net assets were organized as open-end funds. On average, these ETFs reported foreign exposure of 37.75%. This number was 57.13% for ETFs structured as UITs and 37.66% for ETFs structured as open-end funds.[428]

2. Exemptive Order Process

As discussed above, ETFs seeking to operate as investment companies historically have needed exemptive relief from the Commission. Since the first exemptive relief was granted in 1992, the Commission has issued approximately 300 exemptive orders to

[426] As of the end of December 2017, 1,635 ETFs were neither organized as a UIT, nor as a share class of an open-end fund, and do not pursue leveraged or inverse investment strategies. During 2017, the number of such funds grew by 124. (In the last five years, the increase in such funds ranged from 90 in 2013 to 181 in 2015.)

[427] Bloomberg defines actively managed or index-based managed funds according to disclosure in the fund prospectus.

[428] We estimate funds' foreign holdings on April 11, 2018 from Morningstar data. For each ETF, foreign holdings of equity and debt securities are combined to obtain the approximate percentage of assets invested in foreign securities. Morningstar provided foreign holding data for 1,724 ETFs. In this data, 268 funds, one of which is structured as a UIT, reported holding no foreign securities and 176 funds from the original 1,900 are missing foreign holdings data.

ETFs. The average number of approved exemptive orders between 1992 and 2006 was approximately 2.5 per year, which has increased to approximately 25 per year since 2007.

Based on our review of exemptive orders that granted relief for unleveraged ETFs between January 2007 and mid-March 2018, the median processing time from the filing of an initial application to the issuance of an order was 221 days, although there was considerable variation.[429] Depending on the complexity of a fund's application, some ETF sponsors received exemptive relief in a relatively short period of time (the 10th percentile of the processing time was 83 days) while others waited over one year for approval (the 90th percentile of the processing time was 686 days).

In addition to the processing time associated with applying for an exemptive order, Commission staff estimates that the direct cost of a typical fund's application for ETF relief (associated with, for example, legal fees) is approximately $100,000, which may vary considerably depending on the complexity of the prospective fund.

3. Market Participants

As discussed above, several non-ETF market participants may be affected by the proposed rule, including fund sponsors, authorized participants, trading venues, and institutional and retail investors.

Using data from Bloomberg, we find that there are 83 unique ETF sponsors with approximately 1,900 ETFs as of December 31, 2017. The median number of ETFs per sponsor is eight and the mean is 23, suggesting that a small number of sponsors have a large share of the ETF market (in terms of number of ETFs). Indeed, the top five sponsors operate a combined 898 ETFs, whereas the bottom half of sponsors operate only a combined 121 ETFs.

An ETF (or one of its service providers) has contractual arrangements with a set of authorized participants, who can place orders for the purchase or redemption of creation units with the ETF.[430] While we currently lack data on authorized participants, a 2015 survey-based study of fifteen fund sponsors, which together offer two-thirds of all existing ETFs (covering 90% of all ETF assets), finds that the average ETF has 34 authorized participant agreements.[431] The study further reports that creation and redemption transactions occurred only on between 10% to 20% of trading days and that only 10% of the daily activity in all ETF shares (by volume) are creations or redemptions.[432]

ETF shares are mainly traded on securities exchanges.[433] Table 1 lists the 10 exchanges with the largest average daily ETF trading volume, measured over the 30 business days ending on February 12, 2018. The data is from Bloomberg and shows that NYSE Arca handles the largest portion of ETF trades ($23.8 billion), followed by Nasdaq InterMarket ($12.8 billion), and Cboe BZX Exchange ($11.0 billion).

TABLE 1—ETFS LISTED ON NATIONAL EXCHANGES AND THEIR TRADING VOLUME

Exchange	Number of ETFs	Trading volume (billion)
NYSE Arca	1,899	$23.8
NASDAQ InterMarket	1,537	12.2
Cboe BZX Exchange, Inc	1,840	11.0
Cboe EDGX Exchange, Inc	1,864	7.4
Cboe BYX Exchange, Inc	1,816	4.5
NASDAQ Global Market	339	3.2
Nasdaq BX, Inc	1,801	2.7
Chicago Stock Exchange, Inc	169	2.5
Cboe EDGA Exchange, Inc	1,781	2.4
NASDAQ OMX PSX	1,343	2.2

The table reports the number of ETFs traded at each exchange and the average daily ETF trading volume, measured over the 30 business days ending on February 12, 2018. Trading volume is calculated as trade price multiplied by the number of shares relating to each price by exchange. The figures reflect an analysis by the Commission staff using data obtained through a subscription to Bloomberg.

Both institutional and retail investors participate in the ETF secondary market. Using combined data from WRDS SEC Analytics Suite, Morningstar, and the Center for Research in Security Prices (CRSP) from the first quarter of 2014 to the fourth quarter of 2016, we estimate that institutions own, on average, 43% of ETF shares, when calculating the average using equal weights for all ETFs, and 55%, when calculating the average using total net assets (''TNA'')-based weights. The difference between the equal-weighted and TNA-weighted average institutional ownership numbers—43% vs. 55%—suggests that institutional investors tend to hold larger shares of ETFs with larger TNA. The table also shows that the median ownership by institutional investors is 40%. Additionally, the table shows that there is considerable variation in institutional investor holdings, ranging from an average for the 5th percentile of 6% to an average for the 95th percentile of 90%.[434] However, we observe that the average institutional holding did not change considerably over time during the sample period.

[429] The earliest order in our sample was approved on 1/17/2007 and the latest order was approved on 4/10/2018.

[430] Some market makers and other market participants engage in creation and redemptions indirectly through authorized participants. *See supra* section I.B. The Commission, however, lacks data on the number of such market participants.

[431] *See* Antoniewicz, *supra* footnote 30. While we currently lack data on authorized participants, we note that, starting July 30, 2018, Form N–CEN Item E.2 will require a fund to provide certain information regarding its authorized participants, including the authorized participant's name, the SEC file number, CRD number, and other information. *See* Reporting Modernization Adopting Release, *supra* footnote 147. This Item, however, will not provide data about other market participants that may transact through authorized participants.

[432] NSCC is the sole provider of clearing services for ETF primary market transactions. Whether a creation or redemption order is eligible to be processed through NSCC depends on the eligibility for NSCC processing of the securities in the ETF's basket. *See* Antoniewicz, *supra* footnote 30.

[433] In the first quarter of 2018, 68% of ETF trading by dollar volume was executed on exchanges, 23% over the counter, and 10% using alternative trading systems (ATSs), based on Trade and Quote (TAQ) data provided by the New York Stock Exchange, Trade Reporting Facility (TRF) data provided by FINRA, and ATS information made publicly available on the FINRA website.

[434] The data we use is from Form 13F filings, which does not capture all institutional positions because Form 13F does not require reporting of short positions (which would lead to an overstatement of institutional ownership) and because not all institutional investors are required to file the form, for example because they exercise investment discretion in less than $100 million in Section 13(f) securities (which would lead to an understatement of institutional ownership).

TABLE 2—INSTITUTIONAL OWNERSHIP OF ETFS

Quarter	Equal-weighted average (%)	TNA-weighted average (%)	SD (%)	P5 (%)	P25 (%)	P50 (%)	P75 (%)	P95 (%)
2014Q1	40	53	24	6	22	37	56	86
2014Q2	42	54	25	7	22	37	58	90
2014Q3	41	55	24	7	23	38	59	88
2014Q4	43	55	24	6	24	40	60	88
2015Q1	41	54	24	5	22	38	58	85
2015Q2	42	55	25	6	23	40	60	91
2015Q3	44	56	26	7	25	41	62	94
2015Q4	44	57	26	5	24	43	62	92
2016Q1	44	57	26	5	24	42	62	92
2016Q2	43	56	26	6	23	41	61	92
2016Q3	43	56	26	5	24	41	62	91
2016Q4	44	57	25	6	24	42	61	91
Average	43	55	25	6	23	40	60	90

The table reports the quarterly institutional ownership ratio of ETFs, measured as the total number of shares owned by institutional investors divided by the total shares outstanding adjusted for share splits. SD refers to standard deviation. Columns P5 to P95 refer to the 5th to 95th percentiles. All descriptive stats are equal-weighted except TNA-Weighted Average. The figures reflect an analysis by the Commission staff using data from 2014Q1 to 2016Q4 obtained through a subscription to WRDS SEC Analytics Suite and the Center for Research in Security Prices (CRSP).

Further analysis shows that the ownership structure varies considerably by the type of ETF. Using Morningstar categories, for the fourth quarter of 2016, Table 3 below shows that ETFs' equal-weighted average institutional ownership ranges from 23% for alternative ETFs to 56% for taxable bond ETFs. We also find that TNA-weighted average institutional ownership is higher than equal-weighted average institutional ownership for international equity, municipal bond, sector equity, taxable bond, and U.S. ETFs, suggesting that institutional investors tend to hold ETFs with larger TNA within these categories. The converse is true for allocation, alternative and commodity ETFs. The table also shows that there is large variation within categories.[435]

TABLE 3—INSTITUTIONAL OWNERSHIP OF ETFS BY MORNINGSTAR CATEGORY FOR 2016: Q4

Quarter	Equal weighted average (%)	TNA weighted average (%)	SD (%)	P5 (%)	P25 (%)	P50 (%)	P75 (%)	P95 (%)
Allocation	43	38	26	8	23	36	58	95
Alternative	23	16	22	2	6	17	33	68
Commodities	41	38	20	10	29	39	59	71
International Equity	48	63	23	12	31	46	64	91
Municipal Bond	48	55	16	15	39	50	59	74
Sector Equity	42	57	22	10	26	40	58	83
Taxable Bond	56	63	21	20	41	57	72	91
U.S. Equity	45	60	23	11	29	43	59	93

The table reports the institutional ownership ratio of ETFs, measured as the total number of shares owned by institutional investors divided by the total shares outstanding adjusted for share splits, by Morningstar Category. SD refers to standard deviation. Columns P5 to P95 refer to the 5th to 95th percentiles. All descriptive stats are equal-weighted except TNA-Weighted Average. The figures reflect an analysis by the Commission staff using data for 2016Q4 obtained a through subscription to WRDS SEC Analytics Suite and the Center for Research in Security Prices (CRSP).

4. Secondary Market Trading, Arbitrage, and ETF Liquidity

Unlike shares of open-end funds, ETF shares are traded in the secondary market at prices that may deviate from the ETF's NAV. As a result, ETF investors may trade shares at prices that do not necessarily reflect the intrinsic value of the underlying ETF assets.[436] To reduce the frequency and size of ETF premiums and discounts, our exemptive orders have contained several conditions designed to facilitate an efficient arbitrage mechanism, help ensure the proper functioning of the ETF market, and ultimately protect investors.

One set of conditions has required that ETFs be listed on a national stock exchange and that exchanges publish the fund's IIV every 15 seconds for domestic ETFs and every 60 seconds for international ETFs. Another condition, which was designed to support the effective functioning of the arbitrage mechanism, is portfolio transparency. All ETFs in operation today have a provision in their exemptive order that requires them to provide some degree of transparency regarding their portfolio

[435] Morningstar category is assigned based on the underlying securities in each portfolio. Per Morningstar, funds in *allocation* categories seek to provide both income and capital appreciation by investing in multiple asset classes, including stocks, bonds, and cash. Funds in *alternative* strategies employ investment approaches (similar to those used by hedge funds) designed to offer returns different than those of the long-only investments in the stock, bond, or commodity markets. *International equity* portfolios expand their focus to include stocks domiciled in diverse countries outside the United States though most invest primarily in developed markets. *Municipal bond* strategies are generally defined by state or national focus and duration exposure. A fund is considered state-specific if at least 70% of its assets are invested in municipal securities issued by the various government entities of a single state. *Sector-specific equity* funds are usually equity funds, in that they maintain at least 85% exposure to equity. *Fixed Income Taxable bond* portfolios invest at least 80% of assets in securities that provide bond or cash exposure. *U.S. equity* portfolios are defined as maintaining at least 85% exposure to equity and investing at least 70% of assets in U.S.-domiciled securities.

[436] It is possible for both the ETF's NAV per share and its share price to deviate from the intrinsic value of the ETF's underlying portfolio. In addition, there may be cases in which the ETF's share price is closer to the intrinsic value of the ETF's portfolio than its NAV per share. *See, e.g.,* Madhavan, Ananth, & Aleksander Sobczyk, *Price Discovery and Liquidity of Exchange-Traded Funds,* 14 Journal of Investment Management 2 (2016).

holdings. As discussed above, actively managed ETFs and some ETFs that track an index from an affiliated index provider have been required to disclose their holdings prior to the commencement of trading each business day (*i.e.,* full portfolio transparency). Other index-based ETFs are permitted to disclose their portfolio holdings indirectly, by specifying which index they seek to track, as long as the index provider lists the constituent securities on its website (*i.e.,* index transparency) or by disclosing the components of their baskets. Based on a staff review of 100 index-based ETFs, randomly selected from all index-based ETFs, and 50 actively-managed ETFs, randomly selected from all actively-managed ETFs, all 150 ETFs maintain a website and provide the ETF's complete daily portfolio holdings. Therefore, we believe that all index-based and actively-managed ETFs that could rely on the proposed rule now, including those that are not subject to a full transparency condition in their exemptive order, currently provide full portfolio transparency.[437]

The degree to which ETFs have flexibility in choosing the composition of creation and redemption baskets plays an important role for the effective functioning of the arbitrage mechanism. A more flexible basket composition may, among other considerations discussed in more detail below, allow authorized participants to exchange baskets for ETF shares at a lower cost, thus increasing arbitrage activity and efficient functioning of markets.[438] The extent to which our exemptive orders have allowed ETFs to use creation and redemption baskets that deviate from a *pro rata* representation of the ETF's portfolio holdings (*i.e.,* basket flexibility) has evolved over time. ETFs that received their exemptive orders in the early period from 1992–1995 were mostly structured as UITs and, as a result, the creation and redemption baskets were mostly a strict *pro rata* representation of the index, plus some cash balancing amount. From 1996 to 2006, exemptive orders for ETFs, which then were mostly structured as open-end funds, did not expressly limit baskets to a *pro rata* representation of the ETF's portfolio holdings. From 2006 to 2010, the Commission limited basket flexibility in exemptive orders for ETFs organized as open-end funds by requiring baskets to generally represent a *pro rata* slice of the fund's portfolio holdings and including conditions limiting the circumstances under which substitutions would be permitted. Starting around 2011, the exemptive orders required baskets to be a strict *pro rata* slice of the portfolio holdings and, in addition, to be the same for all authorized participants, with minor exceptions.[439]

For ETFs that hold foreign investments in their portfolio, the redemption process for these securities may take more than the seven days specified under section 22(e) of the Act. The Commission has granted exemptive relief to certain ETFs who hold foreign investments, in many instances up to 15 days, to satisfy redemption of a foreign investment.

Many exemptive orders have required ETFs to disclose on their website, free of charge, the previous day's NAV and the price of the ETF shares, as well as the premium or discount associated with the ETF's share price at the market close.[440] Based on a staff review of the websites of 150 randomly selected ETFs, all of which provided the previous day's NAV, price of the ETF shares (one active ETF provided a price based on the midpoint between the bid and ask prices while the remainder of the active and all index-based ETFs provided closing prices), as well as the premium or discount associated with the ETF share price at the market close, we believe that all ETFs that could rely on the proposed rule currently disclose this information on their website.[441]

ETFs have also been required to have contractual agreements with authorized participants to purchase or redeem ETF shares in creation unit aggregations in exchange for a basket of securities and other assets. Having an accurate estimate of the current ETF share value and an opportunity to efficiently create or redeem ETF shares in creation unit sizes allows authorized participants to engage in arbitrage activity that brings the market price of ETF shares and the value of the ETF's portfolio closer together. As noted earlier, market participants can also engage in arbitrage activity in the secondary market by taking a long and short position on the ETF shares and the underlying basket assets. For example, if the ETF is trading at a premium relative to the NAV per share of the ETF's portfolio, a market participant can short the ETF and buy the underlying basket assets in proportion to the ETF shares. Alternatively, if the ETF is trading at a discount relative to NAV per share, a market participant may buy the ETF and short the underlying basket assets in proportion to the ETF shares. Then the market participant could realize a profit by closing the position when the gap between the ETF's share price and NAV per share gets closer to zero. This trading activity could help close the gap even further.

However, authorized participants, other market participants, and arbitrageurs acting in secondary markets may incur costs and be exposed to risk when engaging in arbitrage. The costs include bid-ask spreads and transaction fees associated with the arbitrage trades. In addition, during the time it takes arbitrageurs to execute these trades, they are exposed to the risk that the prices of the basket assets and the ETF shares change. As a consequence, arbitrageurs may decide to wait for any mispricing between the market price of ETF shares and NAV per share to widen until the expected profit from arbitrage is large enough to compensate for any additional costs and risks associated with engaging in the transaction.

Using data from Bloomberg, we find that ETFs, on average, trade at a price slightly higher than the NAV per share (*i.e.,* at a premium), as shown in Table 4 below. The equal-weighted and TNA-weighted average premium/discount over the last 15 years for all ETFs in the dataset are, respectively, 0.074% and 0.065%, and the median is 0.024%, indicating that the prices of ETF shares are, on average, higher than the NAV per share. One study finds similar results and concludes that, on average, ETF market prices tend to reflect NAV per share closely. However, consistent with the study, we find that ETF premiums/discounts vary significantly.[442] For example, we find

[437] The samples were randomly drawn from all index-based ETFs and all actively managed ETFs currently trading according to Bloomberg. We recognize that the selection of ETFs examined by Staff overweights the sample of actively managed ETFs relative to the entire population of actively managed ETFs. Our sampling procedure was done to avoid small sample bias as equally proportioned sampling would call for a survey of approximately 2 actively managed funds.

[438] A more flexible basket composition may create potential risks such as dumping and cherry-picking, as discussed in more detail below.

[439] Our exemptive orders have generally included future funds relief to allow sponsors to form and operate new ETFs without having to obtain additional exemptive orders. *See supra* footnote 5. As a result, the Commission does not have records that would allow us to determine the specific exemptive order under which any particular fund is operating. We thus do not quantify the number of funds operating under each of the different basket flexibility conditions included in our orders.

[440] In addition, some funds disclose some historical information on premiums and discounts on their website pursuant to the flexibility provided on Form N–1A. *See supra* section II.C.6.c.

[441] *See supra* footnote 437.

[442] Commenters to our 2015 ETP Request for Comment, *supra* footnote 9, report qualitatively similar results. *See, e.g.,* Comment Letter of Eaton Vance Corp. to Request for Comment on Exchange-Traded Products (File No. S7–11–15) (Aug. 17, 2015).

that the average premiums/discounts ranges from 0.03% in 2003 to 0.14% in 2009, and the average standard deviation of premiums/discounts ranges from 0.16% in 2017 to 0.60% in 2008. Moreover, not all ETF shares trade at a premium. For example, the table shows, in a given year, *at least* 25% of ETF shares trade at a discount, at an average discount of −0.044% between all years (see the column P25).

TABLE 4—TIME-SERIES AVERAGES OF CROSS-SECTIONAL DESCRIPTIVE STATISTICS OF PREMIUM/DISCOUNT (%) USING DAILY DATA

Year	Equal weighted average	TNA weighted average	SD	P5	P25	P50	P75	P95
2003	0.134	0.030	0.235	−0.215	−0.061	0.015	0.091	0.343
2004	0.095	0.039	0.262	−0.259	−0.060	0.023	0.095	0.549
2005	0.058	0.078	0.276	−0.221	−0.038	0.036	0.111	0.617
2006	0.074	0.082	0.338	−0.344	−0.042	0.029	0.141	0.671
2007	0.140	0.079	0.386	−0.389	−0.060	0.034	0.198	0.639
2008	0.087	0.100	0.603	−0.785	−0.142	0.055	0.343	1.054
2009	0.126	0.143	0.537	−0.557	−0.079	0.020	0.342	1.027
2010	0.072	0.066	0.353	−0.436	−0.046	0.022	0.164	0.635
2011	0.035	0.068	0.412	−0.550	−0.040	0.021	0.170	0.766
2012	0.058	0.072	0.286	−0.309	−0.019	0.022	0.141	0.582
2013	0.060	0.035	0.278	−0.352	−0.025	0.017	0.091	0.432
2014	0.046	0.038	0.216	−0.245	−0.013	0.016	0.082	0.351
2015	0.036	0.042	0.235	−0.25	−0.015	0.015	0.079	0.401
2016	0.026	0.044	0.228	−0.222	−0.015	0.013	0.091	0.389
2017	0.069	0.058	0.159	−0.085	−0.008	0.015	0.094	0.332
Average	0.074	0.065	0.320	−0.348	−0.044	0.024	0.149	0.586

The table reports time-series averages of cross-sectional descriptive statistics of premiums/discounts (%). The TNA-Weighted Average is weighted based on an ETF's previous month's total net assets. SD refers to standard deviation. Columns P5 to P95 refer to the 5th to 95th percentiles. Fund premiums or discounts are from daily Bloomberg data covering 1,838 funds for a total of 2,732,620 daily observations. Per Bloomberg, premium/discount (%) is the difference between the fund's closing price on the day of the most recent Net Asset Value (NAV) and the NAV of the fund on that day. The data covers the period from 01/03/2003 to 08/31/2017.

Premiums and discounts to NAV per share also vary considerably by the type of assets that make up the ETF.[443] We use Morningstar investment categories to divide ETFs into groups of similar assets and, in Table 5, report the time-series averages of cross-sectional descriptive statistics for premiums/discounts in the different Morningstar Investment Categories. We find that the TNA-weighted average premium/discount ranges from as low as 0.003% for alternative to 0.197% for taxable bond ETFs. The results are qualitatively similar for equal-weighted average premium/discounts.

TABLE 5—TIME-SERIES AVERAGES OF CROSS-SECTIONAL DESCRIPTIVE STATISTICS OF PREMIUM/DISCOUNT (%) BY MORNINGSTAR INVESTMENT CATEGORY

Category	Equal weighted average	TNA weighted average	SD	P5	P25	P50	P75	P95
Allocation	0.072	0.083	0.233	−0.119	−0.039	0.047	0.237	0.295
Alternative	0.007	0.003	0.345	−0.404	−0.126	−0.004	0.116	0.468
Commodities	0.211	0.112	0.481	−0.545	0.011	0.084	0.158	1.007
International Equity	0.185	0.193	0.440	−0.482	−0.068	0.204	0.458	0.833
Municipal Bond	0.086	0.076	0.314	−0.358	−0.090	0.061	0.273	0.532
Sector Equity	0.031	0.013	0.189	−0.243	−0.074	0.005	0.085	0.304
Taxable Bond	0.207	0.197	0.206	−0.068	0.088	0.188	0.273	0.539
U.S. Equity	−0.001	0.005	0.079	−0.104	−0.036	0.008	0.048	0.113

The table reports time-series averages of cross-sectional descriptive statistics of premiums/discounts (%). The funds are first divided into groups based on Morningstar categories. The TNA-Weighted Average is weighted based on an ETF's previous month's total net assets. SD refers to standard deviation. Columns P5 to P95 refer to the 5th to 95th percentiles. Fund premiums or discounts are from daily Bloomberg data covering 1,838 funds for a total of 2,732,620 daily observations. Per Bloomberg, premium/discount (%) is the difference between the fund's closing price on the day of the most recent Net Asset Value (NAV) and the NAV of the fund on that day. The data covers the period from 01/03/2003 to 08/31/2017.

When the ETF arbitrage mechanism functions effectively, ETFs also should trade at smaller bid-ask spreads.[444] As shown in Table 6, the TNA-weighted average bid-ask spread, as a percentage of the mid-price, has declined from 0.062% in 2012 to 0.030% in 2017.[445] The table shows a qualitatively similar decreasing pattern when using equal-weighted average bid-ask spreads. The percentiles of the bid-ask spreads also follow a decreasing trend. For example, we observe that the median bid-ask spread drops from 0.024% in 2012 to 0.016% in 2017 (see column P50). The table also shows that the bid-ask spread varies considerably. For example, the average standard deviation of the bid-ask spread (0.081%) is almost twice as large as its average (0.043%).

[443] *See* Engle Article, *supra* footnote 95.

[444] *See, e.g.,* CFA Guide, *supra* footnote 370.

[445] This analysis starts in 2012 because the available data begins in that year.

TABLE 6—TIME-SERIES AVERAGES OF CROSS-SECTIONAL DESCRIPTIVE STATISTICS OF RELATIVE BID-ASK SPREAD (%)

Year	Equal weighted average	TNA weighted average	SD	P5	P25	P50	P75	P95
2012	0.370	0.062	0.125	0.007	0.016	0.024	0.049	0.275
2013	0.330	0.053	0.106	0.006	0.014	0.022	0.048	0.212
2014	0.273	0.038	0.061	0.005	0.012	0.020	0.045	0.114
2015	0.324	0.039	0.067	0.005	0.012	0.019	0.045	0.122
2016	0.372	0.037	0.066	0.005	0.011	0.019	0.038	0.111
2017	0.349	0.030	0.063	0.004	0.009	0.016	0.030	0.086
Average	0.336	0.043	0.081	0.005	0.012	0.020	0.043	0.153

This table reports time-series averages of cross-sectional descriptive statistic of relative bid-ask spreads (%). The TNA-Weighted Average is weighted based on an ETF's previous month's total net assets. SD refers to standard deviation. Columns P5 to P95 refer to the 5th to 95th percentiles. Bid-ask spreads are from daily Bloomberg data covering 1,838 funds for a total of 1,843,729 daily bid-ask spreads. Per Bloomberg, the bid-ask spread (%) is the average of all bid/ask spreads taken as a percentage of the mid-price. The data covers the period from 01/03/2003 to 08/31/2017.

Table 7 reports bid-ask spreads for ETF shares by Morningstar category. US Equity ETFs have the smallest average bid-ask spread of 0.027%, whereas allocation ETFs—funds that seek to provide both income and capital appreciation by investing in multiple asset classes, including stocks, bonds, and cash strategy—have the largest average bid-ask spread of 0.223%.

TABLE 7—TIME-SERIES AVERAGES OF CROSS-SECTIONAL DESCRIPTIVE STATISTICS OF RELATIVE BID-ASK SPREAD (%) BY MORNINGSTAR INVESTMENT

Category	Equal weighted average	TNA weighted average	SD	P5	P25	P50	P75	P95
Allocation	0.590	0.223	0.307	0.073	0.084	0.147	0.227	0.642
Alternative	0.391	0.094	0.162	0.017	0.03	0.047	0.089	0.315
Commodities	0.353	0.041	0.060	0.009	0.009	0.009	0.061	0.118
International Equity	0.450	0.072	0.110	0.017	0.024	0.030	0.086	0.212
Municipal Bond	0.281	0.100	0.111	0.038	0.045	0.064	0.107	0.306
Sector Equity	0.285	0.061	0.092	0.015	0.018	0.036	0.062	0.198
Taxable Bond	0.306	0.043	0.080	0.011	0.014	0.016	0.041	0.159
U.S. Equity	0.207	0.027	0.041	0.006	0.012	0.014	0.029	0.081

This table reports time-series averages of cross-sectional descriptive statistic of relative bid-ask spreads (%). The funds are first divided into groups based on Morningstar categories. The mean is weighted based on an ETF's previous month TNA and the data covers the period from 01/03/2012 to 08/31/2017. SD, Min and Max refer to standard deviation, minimum and maximum. Columns P5 to P95 refer to the 5th to 95th percentiles. Bid-ask spreads are from daily Bloomberg data covering 1,838 funds for a total of 1,843,729 daily bid-ask spreads. Per Bloomberg, the bid-ask spread (%) is the average of all bid/ask spreads taken as a percentage of the mid-price.

The summary statistics presented thus far in this section suggest that the arbitrage mechanism generally functions effectively during normal market conditions. However, as described above in section III.B, the Commission has observed periods of market stress during which the arbitrage mechanism has functioned less effectively and during which there were significant deviations for some ETFs between market price and NAV per share and when bid-ask spreads widened considerably. We note, however, that these conditions only persisted for very short periods of time for the periods of market stress we have observed, suggesting that the arbitrage mechanism recovered quickly.[446]

C. Benefits and Costs of Proposed Rule 6c–11 and Amendments to Forms N–1A and N–8B–2

The Commission is sensitive to the economic effects that could result from proposed rule 6c–11 and amendments to Forms N–1A and N–8B–2, including benefits and costs. However, as discussed in further detail below, the Commission is unable to quantify many of the economic effects, either because they are inherently difficult to quantify or because we lack the information necessary to provide a reasonable estimate.

1. Proposed Rule 6c–11

Proposed rule 6c–11 would allow new ETFs to operate in reliance on a rule rather than individual exemptive orders if they meet the requirements and conditions of the rule. In addition, we propose to rescind all existing ETF exemptive orders, with the exception of: (i) The section 12(d)(1) relief included in those orders;[447] and (ii) orders relating to ETFs structured as UITs, leveraged ETFs, and those that are organized as a share class of a mutual fund.[448] This section first evaluates the general considerations associated with the proposed rulemaking and then discusses the effects of the specific requirements and conditions of the proposed rule.

a. General Considerations

Proposed rule 6c–11 would grant exemptive relief from the provisions of the Act that would otherwise prohibit several features essential to the ETF structure. This section evaluates the overall effect of reducing the expense and delay of operating certain new ETFs by granting this exemptive relief as part of a rule rather than through the individual exemptive order process.

As the requirements and conditions of the proposed rule are either similar to those contained in existing exemptive orders, consistent with market practice, or generally provide more flexibility, we anticipate that the proposed rule and the related rescission of ETF exemptive

[446] *See, e.g.* Madhavan Article, *supra* footnote 130.

[447] The proposal would however rescind relief that has been provided to allow master-feeder arrangements for those ETFs that do not currently rely on the relief. In addition, we propose to grandfather existing master-feeder arrangements involving ETF feeder funds, but prevent the formation of new ones, by amending relevant exemptive orders.

[448] ETFs relying on exemptive orders that we propose to rescind could no longer rely on their orders to launch additional ETFs.

relief would not require any existing ETFs whose exemptive relief would be rescinded to significantly change the way they operate. Conversely, some funds whose exemptive orders contain conditions that are more restrictive than those contained in the proposed rule may decide to change the way they operate in order to make use of such increased flexibility.

Relative to the baseline, proposed rule 6c–11 would eliminate the costs associated with applying to the Commission for an exemptive order to form and operate as an ETF for funds relying on the rule. Specifically, the process of forming new ETFs in reliance on the proposed rule would be quicker, more predictable, less complex, and therefore less costly than obtaining an exemptive order as new ETFs are currently required to do. ETFs that could not rely on the rule, which includes those structured as UITs, leveraged ETFs, and those that are organized as a share class of a mutual fund, would continue to be required to apply for an exemptive order to form and operate.[449]

As described above in section IV.B.2, we estimate that the cost for a typical ETF of filing for exemptive relief is $100,000. In addition, based on our review of exemptive orders that granted relief for unleveraged ETFs between January 2007 and mid-March 2018, the median processing time from the filing of an initial application to the issuance of an order was 221 days, although there was considerable variation. Thus, any new ETF planning to operate within the parameters set forth by the proposed rule would save this expected cost and avoid this delay. In addition, such ETFs would avoid the uncertainty about the length of the delay associated with the exemptive order process, allowing sponsors to better control the timetable for launching a new ETF product in a way that maximizes benefits to its business. Conversely, funds that are not able to comply with the conditions of the rule would continue to need to apply for an exemptive order. Assuming that the number of new ETFs seeking to form and operate under the proposed rule that would otherwise have needed to apply for exemptive relief is equal to the average number of ETFs that have applied for exemptive relief since 2007, these cost and time savings would accrue to approximately 25 ETFs per year.[450] Using this assumption, the annual costs savings to this group of ETF sponsors would equal $2.5 million.[451] We are unable to quantify the benefit a new ETF would derive from avoiding the delay and the uncertainty about the length of the delay associated with the exemptive order process as the cost of a delayed registration for a new ETF is inherently difficult to measure.

By eliminating the need for ETFs that can rely on the proposed rule to seek an exemptive order from the Commission, the proposed rule would also eliminate certain indirect costs associated with the exemptive application process. Specifically, ETFs that apply for an order forgo potential market opportunities until they receive the order, while others forgo the market opportunity entirely rather than seek an exemptive order because they have concluded that the cost of seeking an exemptive order would exceed the anticipated benefit of the market opportunity.

In addition, we believe that the proposed rule would make it easier for some fund complexes to ensure that each ETF in the complex is in compliance with regulations. Specifically, we anticipate that it would be easier, and thus less costly, for ETF complexes that today operate funds under multiple exemptive orders to ensure compliance with a single set of requirements and conditions contained in the proposed rule rather than with multiple exemptive orders to the extent that the orders vary in the requirements and conditions they contain.

We acknowledge that fund complexes may initially incur costs associated with assessing the requirements of the proposed rule. However, we believe that these costs would be relatively small.[452] In addition, we anticipate that it would be easier for third-party providers, such as lawyers and compliance consultants, to offer services that help ETFs ensure compliance with the proposed rules, which will have broad applicability, than is currently the case with ETFs relying on exemptive orders with varying conditions. As a result, third party service providers may be able to reduce the price of their services, compared to the baseline, for ETFs that could rely on the proposed rule, which may partially or fully offset the initial costs of studying the requirements of the proposed rulemaking that ETFs may incur.

We expect that the proposed rule also would benefit ETF investors to the extent it would remove a possible disincentive for ETF sponsors to form and operate new ETFs that provide investors with additional investment choices for which these sponsors currently do not have relief. As noted above, the direct and indirect costs of the exemptive application process may discourage potential sponsors, particularly sponsors interested in offering smaller, more narrowly focused ETFs that may serve the particular investment needs of certain investors. By eliminating the need for individual exemptive relief we anticipate that the proposed rule would accelerate the rate at which the ETF industry would otherwise grow. In those circumstances, the proposed rule would provide ETF investors with greater investment choices.

As we discuss below in section IV.D, we believe that the proposed rule could increase competition in the ETF market as a whole, which could also lead to lower fees. Any effect of increased competition on fees would likely be larger for segments of the ETF market that currently may be less competitive (*e.g.,* active ETFs) and smaller for segments of the market that currently may be more competitive (*e.g.,* index-based ETFs tracking major stock indices).

Additionally, some types of funds could experience reductions in trading costs associated with bid-ask spreads or premiums and discounts to NAV per share. Specifically, as discussed below in section IV.C.1.c, the proposed rule's increased basket flexibility could reduce

[449] As discussed below, some ETFs would incur additional costs as a result of the rule's requirement to adopt and implement written policies and procedures that govern the construction of basket assets and the process that will be used for the acceptance of basket assets, the rule's additional website disclosure requirements, and the proposed amendments to Forms N–1A and N–8B–2. The operation of such ETFs may therefore become more costly, on balance, to the extent that these costs are not offset by the benefits from the other parts of the proposed rule, such as the increased basket flexibility and, for new funds, the reduced costs of forming the fund.

[450] Compared to the baseline, these cost and time savings would only accrue to such new ETFs whose sponsors have not received exemptive relief that would allow such ETFs to operate.

[451] This estimate is based on the following calculation: 25 × $100,000 = $2,500,000.

[452] We estimate that assessing the requirements of the proposed rule would require 5 hours of a compliance manager ($298 per hour) and 5 hours of a compliance attorney ($352 per hour), resulting in a cost of $6,500 (10 × $298 + 10 × $352) per fund. The total cost for all 1,635 ETFs that could rely on the proposed rule would thus be $10,627,500 (1,635 × $6,500). The Commission's estimates of the relevant wage rates are based on salary information for the securities industry compiled by the Securities Industry and Financial Markets Association's Office Salaries in the Securities Industry 2013. The estimated wage figures are modified by Commission staff to account for an 1,800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits, overhead, and adjusted to account for the effects of inflation. *See* Securities Industry and Financial Markets Association, Report on Management & Professional Earnings in the Securities Industry 2013 (''SIFMA Report'').

the cost of arbitrage for authorized participants of fixed-income, international and actively managed ETFs more than for authorized participants and other market participants of other types of ETFs. This could potentially lead to a reduction in costs for investors associated with bid-ask spreads and premiums and discounts to NAV per share for fixed-income and international ETFs that could be significantly smaller or immaterial for other types of ETFs.

As discussed above, by eliminating the need for individual exemptive relief, we anticipate that the proposed rule would, over time, lead to an increase in ETFs that can meet the requirements and conditions of the rule and thus reinforce the current growth trend in the ETF industry. In addition, the proposed rule would increase demand for such ETFs, to the extent that such ETFs lower their fees to investors and investors are sensitive to fees.[453] To the extent that some ETFs would experience larger reductions in trading costs (*e.g.,* fixed-income, international, and active) or larger increases in competition (*e.g.,* actively managed), demand for these types of ETFs would likely increase more than for other types of ETFs. The increased demand would likely be due in part to investors substituting away from comparable types of funds, such as mutual funds, and possibly due to investors increasing the rate at which they save.[454] Consequently, the proposed rule could increase total assets of ETFs and could decrease total assets of other funds, such as mutual funds. The size of these effects would depend on the degree to which ETFs would lower their fees or experience reduced trading costs, as well as on the sensitivity of investor demand for ETFs and other funds to changes in ETF fees and trading costs. We are unable to quantify these effects on investor demand for various types of funds, in part, because we cannot estimate the extent to which funds would lower their fees or experience reduced trading costs and how lower fees and trading costs could change investor demand.

Since ETFs are traded in the secondary market, an increase in total assets of ETFs would likely coincide with larger trade volumes for the exchanges where ETFs are traded, as well as the clearing agencies and broker-dealers involved in these trades. To the extent that these market participants are compensated by volume, the proposed rule would thus benefit them by leading to an increase in revenues.

In addition, we expect the proposed rule to remove applications for more standard forms of exemptive relief from consideration, leaving for staff review only applications for more complex or novel exemptive relief that falls outside the parameters of the proposed rule. To the extent that this speeds up the processing time for these remaining applications, the proposal may reduce the indirect costs of forming and operating for funds that seek to operate outside its parameters.

b. Conditions for Reliance on Proposed Rule

Proposed rule 6c–11 contains several conditions that are designed to facilitate an effective arbitrage mechanism, reduce costs, and inform and protect investors. Beyond the general impact of reducing the expense and delay of new ETFs discussed above, much of the codification of conditions in proposed rule 6c–11 does not offer any additional benefits or costs when measured against the baseline, as they are generally codifications of the current regulatory practice. However, some conditions are departures from current exemptive orders or current market practice and we discuss the effects of these departures in more detail below.

i. Conditions We Believe May Facilitate an Effective Arbitrage Mechanism

Arbitrage is the practice of buying and selling equivalent or similar assets (or portfolios of assets) in different markets to take advantage of a price difference.[455] As a consequence, arbitrageurs generate price pressure that works to equalize the prices of these assets across different markets. Arbitrage is thus important for investors as it helps ensure that asset prices reflect market fundamentals (*i.e.,* are efficient) irrespective of the market in which they are traded.

The ETF structure makes use of such an arbitrage mechanism with the goal of establishing a close link between the price of an ETF's shares and the NAV per share of the ETF portfolio. Specifically, as discussed above, the combination of the creation and redemption process with the secondary market trading in ETF shares provides arbitrage opportunities that, if effective, help keep the market price of ETF shares at or close to the NAV per share of the ETF and also help reduce bid-ask spreads of ETF shares. Smaller deviations of ETF prices from the NAV per share of the ETF benefit investors as they allow investors to transact in ETF shares at prices closer to the value of the ETF's underlying portfolio of securities. Similarly, small bid-ask spreads for ETF shares benefit investors as they reduce the cost to trading ETF shares.[456]

There are several factors that are important for arbitrageurs to determine the existence of arbitrage opportunities and execute an arbitrage strategy effectively. First, when the assets involved in the arbitrage are similar but not the same, as is the case for ETFs, arbitrage will be more effective the more closely the prices of the two assets track each other and the more transparency arbitrageurs have into any factors that may cause price differences between the two assets. In addition, arbitrage requires that arbitrageurs have the ability to enter into the trades necessary to execute the arbitrage strategy, and arbitrage is more effective the smaller and more predictable the associated trading costs are. The proposed rule contains several provisions (many codifying current exemptive orders) that take these considerations into account and are designed to promote the effective functioning of the arbitrage mechanism for ETFs.

First, the proposed rule would require ETFs relying on the rule to adopt and implement written policies and procedures that govern the construction of basket assets and the process that will be used for the acceptance of basket assets, including policies and

[453] There is research to support that fund investors are sensitive to fees. For instance, one paper (Erik R. Sirri & Peter Tufano, *Costly Search and Mutual Fund Flows,* 53 The Journal of Finance 5 (1998)) finds that ''lower-fee funds and funds that reduce their fees grow faster''. However, we acknowledge that there are studies that suggest that investors' sensitivity to fees may be limited. For instance, one experimental study (James J. Choi, David Laibson, & Brigitte C. Madrian, *Why does the law of one price fail? An experiment on index mutual funds,* 23 The Review of Financial Studies 4 (2010)) finds that investors may not always pick the lowest-fee fund when presented with a menu of otherwise identical funds to choose from. In addition, other studies (*e.g.,* Michael J. Cooper, Michael Halling, & Wenhao Yang, *The Mutual Fund Fee Puzzle,* Working Paper (2016)) find evidence of significant fee dispersion among mutual funds, even after controlling for other observable differences between funds. While these studies investigate the sensitivity of investors to fees of mutual funds rather than ETFs, we believe that these results are likely hold for ETFs as well. We are not aware of any studies that specifically study the sensitivity of ETF investors to fees.

[454] Investments in ETFs are one of many ways for investors to save. If investors choose to increase their investment in ETFs, there can be two sources for this additional investment: (1) An increase in overall savings and (2) a decrease in savings allocated to other investments, such as mutual funds. These two sources are not mutually exclusive, so that an increase in ETF investments can be accompanied by both an increase in overall savings and a decrease in savings invested elsewhere, for example in mutual funds.

[455] *See, e.g.,* Jonathan B. Berk & Peter DeMarzo, Corporate Finance, 3rd Ed (2013).

[456] For a detailed discussion of the ETF arbitrage mechanism, *see, e.g.,* CFA Guide, *supra* footnote 370.

procedures specific to the creation of custom baskets.

As discussed in section II.C.5.a, the proposed additional policies and procedures requirements for custom baskets are designed to reduce the potential for cherry-picking, dumping, and other potential abuses by authorized participants. We acknowledge that this principles-based approach may not be effective at preventing all such abuses by authorized participants. However, as proposed, ETFs would be required to maintain records related to the custom baskets used, which would allow the Commission to examine for potential abuses.

As outlined above, current exemptive orders contain varying provisions for basket flexibility. However, based on a staff review of existing orders, we believe that the existing ETFs that would operate under the proposed rule and have their exemptive orders rescinded would not be required to change how they construct their baskets, because the proposed rule would give ETFs the ability to implement policies and procedures for basket flexibility, subject to certain enumerated requirements for the custom basket policies and procedures. In addition, we expect that some existing ETFs that would operate under the proposed rule would be able to implement policies and procedures with respect to basket flexibility that would give them more flexibility than what is allowed by their existing exemptive orders.

We believe that fixed-income, international, and actively managed ETFs would particularly benefit from the increased basket flexibility the rule would afford compared to existing exemptive orders. Specifically, the increased basket flexibility should allow fixed-income ETFs to avoid losing hard-to-find bonds when meeting redemptions or to use sampling techniques to construct baskets that are composed of fewer individual bonds and thus reduce trading costs for authorized participants. Similarly, international ETFs would be able to tailor their creation and redemption baskets to accommodate difficulties in transacting in certain international securities. In addition, actively managed ETFs would, in certain instances, be able to use the increased basket flexibility to acquire or dispose of securities by adjusting the composition of the creation or redemption basket rather than by directly purchasing or selling the securities. In these instances, actively managed funds would be able to reduce certain transaction costs, such as those associated with bid-ask spreads.

For these reasons we believe the proposed rule would benefit ETFs that make use of the increased basket flexibility the rule affords as well as their investors to the extent that ETFs are able to implement procedures that facilitate the arbitrage mechanism or reduce costs for the ETFs. Due to a lack of data, however, we are unable to quantify the number of ETFs that would choose to implement policies and procedures to increase basket flexibility, and thus the potential benefits arising to ETFs and their investors.

To the extent that existing ETFs do not already have policies and procedures governing basket assets in place, ETFs would incur a cost associated with developing and implementing such policies and procedures.[457] However, such costs may be partially or totally offset by the basket flexibility discussed above. As discussed in section IV.B, we estimate that an average ETF would incur an initial cost of $10,268 [458] associated with setting up the process for documenting the construction and acceptance of baskets and with documenting and adopting the custom basket policies and procedures. In addition, we estimate that an average ETF would incur an ongoing cost of $3,985 [459] each year to review and update its custom basket policies and procedures as well as its process for documenting the construction and acceptance of baskets. We thus estimate that the total industry cost associated with the policies and procedures requirement in the proposed rule for ETFs that could rely on the rule in the first year would equal $23,303,655.[460]

Second, the proposed rule would require an ETF to disclose prominently on its website the portfolio holdings that will form the basis for the next calculation of NAV per share. We believe that this requirement supports the effective functioning of the arbitrage mechanism as it allows authorized participants to identify arbitrage opportunities and chose an appropriate hedging strategy.

As discussed above in section III.B.4, the requirements for portfolio transparency in existing exemptive orders have varied.[461] As also discussed in section III.B.4, based on a staff review of ETFs' websites, we understand that all ETFs that could rely on the proposed rule currently provide daily full portfolio transparency, including all actively managed ETFs, and thus already bear ongoing costs associated with maintaining such disclosures.[462] However, we believe that the ETFs that could rely on the proposed rule would incur a one-time cost associated with reviewing whether their current portfolio disclosure is compliant with the requirements of proposed rule 6c–11 and, if necessary, make changes to the information that is presented on their website.[463] We estimate this one-time cost to be $1,939.50 for the average ETF, resulting in an aggregate one-time cost of $3,171,082.50 for all ETFs that could rely on the proposed rule.[464]

Finally, the proposed rule also would require additional disclosure by the ETF of the median daily bid-ask spread over the most recent fiscal year on its website. We believe that this

[457] While exemptive orders do not require ETFs to have policies and procedures for basket assets in place, we believe that some ETFs may currently have methodologies or compliance policies for basket assets in place.

[458] *See infra* footnote 553.

[459] *See infra* footnote 554.

[460] This estimate is based on the following calculation: ($10,268 + $3,985) × 1,635 ETFs = $23,303,655. This estimate may be an over-estimate in that it assumes that all ETFs, regardless of their actual use of custom baskets, would implement policies and procedures for custom basket assets.

[461] Actively managed ETFs and some ETFs that track an index from an affiliated index provider have been required to disclose their holdings prior to the commencement of trading each business day (*i.e.,* full portfolio transparency). Other index-based ETFs are permitted to disclose their portfolio holdings indirectly, by specifying which index they seek to track, as long as the index provider lists the constituent securities on its website (*i.e.,* index transparency) or by disclosing the components of their baskets. Some index-based ETFs have been required to provide full portfolio transparency. *See* discussion of portfolio transparency, *supra* section II.C.4.a; *see also supra* footnote 207 and accompanying text.

[462] From a staff review of ETF websites, the sampled index and actively-managed ETFs already provide daily portfolio holdings. Extrapolating the sampled results to the entire universe of ETFs, ETFs in general should bear no additional costs above the baseline to collect and maintain on their websites these holdings. If some ETFs that were not sampled, however, do not currently maintain on their websites their daily portfolio holdings, Commission staff estimates that an ETF each year would spend approximately 5 hours of professional time to update the relevant web page daily with this information at a cost of $1,405.50. *See supra* note 537. We preliminarily believe that the number of ETFs that would have to bear these additional costs would be small due to our experience with the sampled ETFs.

[463] The proposed rule would require that portfolio holdings information be presented and contain information regarding description, amount, value and/or unrealized gain/loss (if applicable) in the manner prescribed within Article 12 of Regulation S–X.

[464] This estimate is based on the following calculations: 3 hours (for website development) × $296.50 per hour (blended rate for a senior systems analyst ($274) and senior programmer ($319) + 2 hours (for review of current portfolio disclosures) × $325 (blended rate for a compliance manager ($298) and a compliance attorney ($352)) + $400 for external website development = $1,939.50. The industry cost is 1,635 × $1,939.50 = $3,171,082.50.

requirement would further inform investors about the expected cost of trading an ETF and facilitate comparison of transaction costs across ETFs. As such, the disclosure of median bid-ask spreads could reduce investors' uncertainty about the trading environment and facilitate the selection of ETF investments that fit individual investors' needs. Currently, disclosure of median bid-ask spreads by ETFs are not required by exemptive orders, although some funds may voluntarily provide this information on their websites. For those funds that do not already disclose this information, they would have to implement processes and systems to compute the median bid-ask spreads and would have to accommodate a new data point on their web page to report this information. We preliminarily do not believe the incremental cost of such disclosure will be substantial. The estimated costs for computing and establishing processes and systems to update the median bid-ask spread are $296.50 per fund, while aggregate costs for computing and updating the web pages of ETFs to include the median bid-ask spread would be $484,777.50.[465] We preliminarily believe that funds will incorporate the processes of updating the median bid-ask spread with other daily processes associated with updating the web page, such as reporting the daily portfolio holdings, and therefore, there will be no additional daily costs associated with updating the median bid-ask spread on the webpage. We also believe that funds currently maintain a record of historical prices as a matter of current business practices which could be used to satisfy the requirement at a nominal cost, as discussed above. If a fund does not maintain a record of historical prices, it may incur a one-time estimated cost of $296.50 to satisfy the requirement, or an upper bound of $484,777.50 in aggregate, assuming that no ETFs currently maintain historical price records.[466]

ii. Omission of Conditions We Believe May Save Costs for Funds

First, the proposed rule would not contain a requirement that an ETF's IIV be disseminated at least every 15 seconds during regular trading hours (60 seconds for international ETFs), as is currently required under all exemptive orders. We believe that many sophisticated institutional market participants do not rely on the IIV to value an ETF's assets, as discussed above in section II.C.3.

In some cases, the IIV may not reflect the actual value of an ETF's assets (*e.g.,* for funds that invest in foreign securities whose markets are closed during the ETF's trading day or funds whose assets trade infrequently, as is the case for certain bond funds). In those cases, we believe that both institutional and retail market participants would benefit from the omission of the IIV as a requirement of the proposed rule by avoiding the possibility that investors base their investment decisions on this potentially misleading information. However, the IIV may, for certain funds, provide a reasonably accurate estimate of the value of an ETF's assets, including for those funds whose underlying assets are very frequently traded during the ETF's trading day. Less sophisticated institutional investors as well as retail investors relying on the IIV for those ETFs may thus find the IIV useful and could see their ability to evaluate ETFs reduced without this metric.[467]

Exchange listing standards currently require the IIV to be disseminated. As long as exchange listing standards continue to include this requirement, the proposed rule's omission of such a requirement would not represent a change from the baseline and would not result in any costs or benefits to market participants. Nonetheless, if the listing standards change, ETFs would not be subject to the cost of dissemination of IIV information under the proposed rule.

Second, under the terms of the exemptive orders, ETFs are required to disclose in their registration statement that redemptions may be postponed for foreign holidays. The proposed amendments to Forms N–1A and N–8B–2 do not contain such a requirement and would thus eliminate the cost of preparing and updating this disclosure for existing ETFs. As discussed above in section III.B.4, we believe that such a requirement is not necessary, since this information is already covered by the agreement between the ETF and the authorized participant.[468] As discussed in section III.C.1, we further believe that such a disclosure would not be relevant for retail investors, who purchase ETF shares on the secondary market.

Third, the proposed rule would not require an ETF to identify itself in any sales literature as an ETF that does not sell or redeem individual shares and explain that investors may purchase or sell individual ETF shares through a broker via a national securities exchange. Although this condition has been included in our exemptive orders, we no longer believe that it is necessary given that markets have become familiar with ETFs in the multiple decades they have been available. The omission of such a requirement could lead to cost savings for existing and future ETFs associated with preparing and reviewing this disclosure for sales literature.[469]

iii. Website Disclosure Provisions

Proposed rule 6c–11 would require an ETF to disclose certain information prominently on its website, which is publicly accessible and free of charge.[470] The goal of these disclosure requirements is to provide investors with key metrics to evaluate their trading and investment decisions in a location that is easily accessible and frequently updated.[471] Based on a staff

[465] Commission staff estimate a one-time cost of computing and implementing processes and systems for daily updating of the median bid-ask spread of one burden hour at a per hour cost of $296.50 (blended rate for a senior systems analyst ($274) and senior programmer ($319)). The one-time cost of updating the web page to include the median bid-ask spread would be incorporated as part of the web page development discussed in section IV.B.1 (*see also infra* footnote 535). As median bid-ask spreads are not currently required to be reported or computed by ETFs, we estimate that the aggregate costs would be $296.50 × 1,635 ETFs = $484,777.50.

[466] Commission staff estimate a one-time cost of computing and implementing processes and systems for daily updating of historical prices of one burden hour at a per hour cost of $296.50 (blended rate for a senior systems analyst ($274) and senior programmer ($319)). Although we preliminarily estimate that funds already maintain a record of historical prices, an upper bound on aggregate costs would be estimated at $296.50 × 1,635 ETFs = $484,777.50.

[467] While the IIV may be very accurate for ETFs whose underlying assets trade frequently (and thus are liquid as well), such ETFs also tend to have small premiums/discounts to NAV per share, reducing the incremental usefulness of the IIV for investors in these ETFs compared to observing only the ETF's share price.

[468] As discussed above, we believe that authorized participants would share this information with other market participants as necessary, for example when a market participant uses an authorized participant as agent for transacting with an ETF and this information is a necessary part of the creation or redemption process.

[469] We estimate that the omission of this requirement would save 0.25 hours of a compliance attorney ($352 per hour), resulting in a cost savings of $88 (0.25 × $352) per fund each year. The total cost savings for all 1,635 ETFs that could rely on the proposed rule would thus be $143,880 (1,635 × $88).

[470] *See supra* footnote 208.

[471] According to the most recent U.S. census data, approximately 77.2% of U.S. households had some form of internet access in their home in 2015 and 86.8% have a computer (*e.g.,* desktop, laptop, tablet or smartphone). *See* Camille Ryan & Jamie M. Lewis, *Computer and internet Usage in the United States: 2015,* ACS–37 (Sept. 2017), *available at https://www.census.gov/content/dam/Census/library/publications/2017/acs/acs-37.pdf*; *see also* Sarah Holden, Daniel Schrass & Michael Bogdan, *Ownership of Mutual Funds, Shareholder Sentiment, and Use of the internet, 2017* (Oct. 2017), *available at https://www.ici.org/pdf/per23-07.pdf* (''[i]n mid-2017, 95 percent of households owning mutual funds had internet access, up from about two-thirds in 2000'' and ''86 percent of

review of ETFs' websites, we believe that all ETFs that could rely on the proposed rule currently have a website.[472] As a consequence, existing ETFs would generally not incur any additional cost associated with the creation and technical maintenance of a website.

As discussed above, a requirement for daily website disclosures of NAV, closing price, and premiums and discounts—each as of the end of the prior business day has been included in substantially all exemptive relief orders starting from 2008. As discussed in section III.B.4, based on a staff review of ETFs' websites, we believe that all ETFs that could rely on the proposed rule currently provide daily website disclosures of NAV, closing price, and premiums or discounts.[473] As a consequence, existing ETFs would generally not incur any additional cost associated with these website disclosure requirements.

Our exemptive orders have not included requirements for line graph and tabular historical information regarding premiums and discounts. However, Form N–1A contains tabular website disclosures relating historical premium/discount in Items 11(g)(2) and 27(b)(7)(iv), which we are proposing to eliminate.[474] Nonetheless, we anticipate that all existing ETFs that fall within the scope of the proposed rule would incur some additional costs associated with these disclosures. We believe that substantially all ETFs already have the required data available to them as part of their regular operations (as it is required by Form N–1A and also allows ETFs to monitor the trading behavior of their shares), as well as have systems (such as computer equipment, an internet connection, and a website) in place that can be used for processing this data and uploading it to their websites. However, these ETFs would still incur the costs associated with establishing and following (potentially automated) processes for processing and uploading this data to their websites. We estimate that an average ETF would incur a one-time cost of $1,939.5 [475] for implementing this website disclosure and an ongoing cost of $473.25 [476] per year for updating the relevant web page with this information. We thus estimate the total industry cost, in the first year, to ETFs that could rely on the proposed rule for providing this website disclosure, of $3,944,846.35.

Our exemptive orders have not included a requirement for ETFs to provide disclosure of the factors that materially contributed to a premium or discount, if known, if an ETF's premium or discount is greater than 2% for more than seven consecutive trading days. As a result, under the proposed rule those ETFs that experience such a premium or discount would incur additional costs associated with determining what factors contributed to the premiums or discounts and drafting and uploading a discussion to their website. Based on a staff analysis of historical data on ETF premiums and discounts from 2008 to 2017 using Bloomberg data, we believe that this disclosure requirement would be triggered for, on average, 4.7% of those ETFs that could rely on the proposed rule per year.[477] We estimate that a fund required to make such a disclosure in a given year would incur an average cost of $1,438.50, yielding a total annual industry cost of $110,541.53.[478]

The proposed rule would also require an ETF to post on its website one ''published'' basket at the beginning of each business day. While we believe that authorized participants already have access to this information in the daily portfolio composition file provided to NSCC, many market participants, such as smaller institutional investors and retail investors, are not NSCC members and do not currently have access to this information.

Our exemptive orders have not included requirements for daily website disclosures of ETF baskets. As a result, we anticipate that all existing ETFs that rely on the proposed rule would incur additional costs associated with this disclosure.[479] Since specifying basket assets is part of the regular operation of an ETF, we believe that all ETFs already have the required data available to them. In addition, we believe that most ETFs already have systems (such as computer equipment, an internet connection, and a website) in place that can be used for processing this data and uploading it to their websites. However, these ETFs would still incur the costs associated with establishing and following (potentially automated) processes for processing and uploading this data to their websites. We estimate that an average ETF would incur a one-time cost of $2,909.25 [480] for implementing this website disclosure and an ongoing cost of $784 [481] per year for updating the relevant web page daily with this information. We thus estimate the total industry cost, in the first year, to ETFs that could rely on the proposed rule for providing this website disclosure, of 6,038,463.75.[482]

As discussed in section IV.A above, the proposed disclosures on ETFs' websites, which are publicly available and free of charge, would enable investors to more readily obtain certain key metrics for individual ETFs,

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mutual fund-owning households with a household head aged 65 or older had internet access in mid-2017''); Andrew Perrin & Maeve Duggan, *Americans' Internet Access: 2000–2015,* Pew Research Center (June 2015), *available at http://assets.pewresearch.org/wp-content/uploads/sites/14/2015/06/2015-06-26_internet-usage-across-demographics-discover_FINAL.pdf* (finding in 2015, 84% of all U.S. adults use the internet). Retail investors that do not have internet access in their homes may have access outside their homes, such as at public libraries.

[472] *See supra* footnote 437.

[473] *See supra* footnote 437.

[474] *See infra* section II.H.4.

[475] This estimate is based on the following calculations: 3 hours (for website development) × $296.50 per hour (blended rate for a senior systems analyst ($274) and senior programmer ($319)) + (2 hours (for review of website disclosures) × $325 (blended rate for a compliance manager ($298) and a compliance attorney ($352)) + $400 for an external website developer to develop the web page = $1,939.50.

[476] This estimate is based on the following calculations: 0.5 hours (for website updates) × $296.50 per hour (blended rate for a senior systems analyst ($274) and senior programmer ($319)) + (1 hour (for review of website disclosures) × $325 (blended rate for a compliance manager ($298) and a compliance attorney ($352) = $473.25.

[477] This estimate represents the average of the percentage of ETFs for which the reporting requirement was triggered at least once in a given year, for those ETFs that could rely on the proposed rule. During the sample period from 2008 to 2017, the percentage of ETFs for which the reporting requirement was triggered at least once varied from 1.5% in 2010 to 10% in 2008.

[478] We believe that such disclosure would require 4 internal hours (2.5 hours for the compliance attorney to determine if this requirement has been triggered and produce a draft of the required disclosures + 1.5 hours for the webmaster to include the information on the website), at a time cost of (2.5 hours × $352 compliance attorney hourly rate) + (1.5 hours × $239 webmaster hourly rate) in addition to $200 for external website development = $1,738.50. The annual cost of this requirement for those ETFs that could rely on the proposed rule is calculated as 4.7% × 1,635 ETFs × $1,738.50 = $110,541.53.

[479] As proposed, the rule would require that basket information be presented and contain information regarding description, amount, value and/or unrealized gain/loss (if applicable) in the manner prescribed within Article 12 of Regulation S–X.

[480] This estimate is based on the following calculations: 4.5 hours (for website development) × $296.50 per hour (blended rate for a senior systems analyst ($274) and senior programmer ($319)) + (3 hours (for review of website disclosures) × $325 (blended rate for a compliance manager ($298) and a compliance attorney ($352)) + $600 for an external website developer to develop the web page = $2,909.25.

[481] This estimate is based on the following calculations: 1 hour (for website updates) × $296.50 per hour (blended rate for a senior systems analyst ($274) and senior programmer ($319)) + (1.5 hours (for review of website disclosures) × $325 (blended rate for a compliance manager ($298) and a compliance attorney ($352) = $784.

[482] This estimate is based on the following calculation: 1,635 ETFs × ($2,909.25 + $784) = $6,038,463.75.

potentially resulting in better informed investment decisions.[483] The proposed conditions standardize certain content requirements to facilitate investor analysis of information while allowing ETFs to select a format for posting information that the individual ETF finds most efficient and appropriate for their website. Because the information in the proposed disclosures would be made available on individual websites, in the format chosen by the ETF, we acknowledge that an investor's ability to efficiently extract information from website disclosures for purposes of aggregation, comparison, and analysis across multiple funds and time periods may be limited. Investors seeking to compare multiple ETFs would have to visit the website of every ETF, navigate to the relevant section of the website, and extract the information provided in the format chosen by the fund. Depending on the manner in which a typical fund investor would use the website disclosures, these considerations may decrease the information benefits of the proposed disclosures. However, we recognize that investors may rely on third-party providers that aggregate such information for all ETFs into a structured format that investors can more easily access and process for the purpose of statistical and comparative analyses. While investors may incur costs of obtaining information from third-party service providers, it would likely be lower than the cost they would incur than if they performed the collection themselves, and the cost of such services may otherwise be reduced as a result of competition among service providers. Overall, we believe that requiring ETFs to provide this information on their websites would ultimately provide an efficient means for facilitating investor access to information.

c. Recordkeeping

The proposed rule would require that ETFs preserve and maintain copies of all written authorized participant agreements for at least five years, the first two years in an easily accessible place. This requirement would provide Commission examination staff with a basis to evaluate whether the authorized participant agreement is in compliance with the rule and other provisions of the Investment Company Act and the rules thereunder, and would also promote internal supervision and compliance.[484] As the agreement forms the contractual foundation on which authorized participants engage in arbitrage activity, compliance of the agreement with the proposed rule is important for the arbitrage mechanism to function properly.

We are also proposing to require ETFs to maintain information regarding the baskets exchanged with authorized participants on each business day the ETF exchanged creation units, including a record stating that the custom basket complies with the ETF's custom basket policies and procedures. As discussed above, we believe that these records would help our examination staff understand how baskets are being used by ETFs, evaluate compliance with the rule and other provisions of the Act and rules thereunder, and examine for potential overreach by ETFs in connection with the use of custom baskets or transactions with affiliates.

Existing exemptive orders have not required ETFs to preserve and maintain copies of authorized participant agreements or information about basket composition. However, we believe that most ETFs already preserve and maintain copies of authorized participant agreements as well as data on baskets used as a matter of established business practice. Existing ETFs that do not already preserve and maintain copies of these documents and data, as well as all new ETFs that would operate under the proposed rule, would incur maintenance and storage costs associated with these requirements. As discussed in section IV.B, we estimate that an average ETF that does not currently comply with these recordkeeping requirements would incur an annual cost of $380 per year[485] to maintain these records.[486] Assuming that 20% of ETFs would incur this cost, the total industry cost for ETFs that could rely on the proposed rule would be $124,260 per year.[487] In addition, the existing orders have not required that ETFs prepare and maintain a record stating that custom baskets comply with the custom basket policies and procedures. We anticipate that all ETFs that could operate under the proposed rule will incur additional recordkeeping costs associated with the requirement that custom baskets comply with custom basket policies and procedures. Assuming that 25% of the total annual recordkeeping costs can be attributed to the new requirement for custom baskets, we estimate a total cost per ETF of $95 per year for the requisite five-year period and an annual industry cost of $155,325 for ETFs that could rely on the rule.[488]

d. Master-Feeder Relief

The proposed rule would rescind the master-feeder relief granted to ETFs that do not rely on the relief as of the date of this proposal. We are proposing to rescind such relief because there generally is a lack of interest in ETF master-feeder arrangements, and certain master-feeder arrangements raise policy concerns discussed above. While there are currently many exemptive orders that contain the master-feeder relief, it is our understanding that only one fund complex currently relies on this relief to structure several master-feeder arrangements with one master and one feeder fund each.[489] As discussed above, we would also propose to grandfather existing master-feeder arrangements involving ETF feeder funds, but prevent the formation of new ones, by amending relevant exemptive orders.[490] As a result, we do not expect that the rescission of the existing master-feeder relief would impose costs on ETFs that currently rely on the relief to structure master-feeder arrangements.

[483] *See supra* footnote 208.

[484] ETFs already will be required to provide some information about authorized participants on Form N–CEN, including the name of each authorized participant, additional identifying information, and the dollar values of the fund shares the authorized participant purchased and redeemed during the reporting period. However, this information alone would not be sufficient for Commission staff to evaluate whether a fund's authorized participant agreements are in compliance with the proposed rule.

[485] *See infra* footnote 544.

[486] An average ETF would have to maintain and store 34 authorized participant agreements. *See supra* footnote 431 and accompanying text.

[487] This estimate is based on the following calculation: 1,635 ETFs × $380 × 20% = $124,260.

[488] This estimate is based on a total record keeping cost of $380 per ETF over five years, *see infra* note 544, 25% × $380 = $95, $95 × 1,635 ETFs = $155,325.

[489] *See supra* footnote 341.

[490] As discussed above, without this relief, the affected funds could continue operating by effecting creation and redemption transactions between authorized participants and the feeder fund (as well as the transactions between the master and feeder fund) in cash rather than in kind. As cash creations and redemptions can be less efficient than in-kind transactions for certain ETFs, this could impose a cost on the ETFs that are part of the fund family. Cash redemptions and creations could also affect the current relationships that funds have with authorized participants if the authorized participants would be unwilling to perform the arbitrage function when receiving cash instead of baskets of securities, which could have unintended spillover effects on the secondary market trading of these funds' shares. Alternatively, these feeder funds may opt to pursue their investment objectives through direct investments in securities and/or other financial instruments, rather than through investments in master funds. Such a restructuring of the funds involved would also lead to costs (primarily associated with legal and accounting work) on the ETFs that are part of the fund family. As a result, if this change would require portfolio transactions to occur at the fund, there could be additional costs such as lower overall total returns to the fund or that investors may find the fund to be a less attractive investment.

At the same time, the rescission of the relief may benefit investors in prospective feeder ETFs to the extent that it protects them from any concerns associated with feeder ETFs discussed above.[491]

2. Disclosure (Amendments to Forms N–1A and N–8B–2)

The amendments to Form N–1A and N–8B–2 are designed to provide authorized participants and investors with tailored information regarding the costs associated with investing in ETFs. As discussed in section IV.A above, we expect that the new disclosures would benefit investors by helping them better understand and compare specific funds, potentially resulting in more informed investment decisions, more efficient allocation of investor capital, and greater competition for investor capital among funds.

As discussed above, we propose to add a set of Q&As related to fees and trading information and costs that we anticipate would help investors better understand costs specific to ETFs, such as bid-ask spreads, brokerage commissions, and purchasing or selling ETF shares at a premium or discount to NAV. The answers to the Q&As would include information about trading costs specific to an ETF, such as the median bid-ask spread over the previous year.

In addition, the proposed amendments to Forms N–1A and N–8B–2 would require an ETF to provide information on the ETF's median bid-ask spread as well as an interactive calculator on the ETF's website that can be used to determine how the bid-ask spread would impact the costs associated with frequent trading of ETF shares. As discussed above, the purpose of the interactive calculator is to provide investors with the ability to customize the hypothetical calculations in Item 3 of Form N–1A to their specific investing situation by choosing either the number or size of the hypothetical round-trip trades, or both.

While we believe that substantially all ETFs already have the required data for these new disclosures on Forms N–1A and N–8B–2 and for the interactive calculator as part of their regular operations, these funds would still incur costs for processing the data, entering them into the form, and programming the interactive calculator.[492] We estimate that each ETF would incur a one-time cost of $6,710 [493] and an ongoing cost of $3,355 [494] per year.[495] We thus estimate that the total industry cost for ETFs in the first year would equal $19,123,500.[496]

D. Effects on Efficiency, Competition, and Capital Formation

This section evaluates the impact of proposed rule 6c–11 and the amendments to Forms N–1A and N–8B–2 on efficiency, competition, and capital formation. However, as discussed in further detail below, the Commission is unable to quantify many of the effects on efficiency, competition and capital formation either because they are inherently difficult to quantify or because it lacks the information necessary to provide a reasonable estimate.

1. Efficiency

The proposed rule would likely increase total assets of ETFs, as a result of reducing the expense and delay of forming and operating new ETFs organized as open-end funds, reducing the cost for certain ETFs to monitor their own compliance with regulations, and as well increased competition among ETFs as discussed below. At the same time, the proposed rule could lead to a decrease in total assets of other fund types that investors may regard as substitutes, such as certain mutual funds.[497] As a result, ETF ownership (as a percentage of market capitalization) for some securities, such as stocks and bonds, would likely increase, and ownership by other funds, such as mutual funds, would likely decrease. The academic literature that we discuss in this section suggest that such a shift in ownership could affect the price efficiency (the extent to which an asset price reflects all public information at any point in time) and liquidity of these portfolio securities.[498]

The literature suggests that a shift in stock ownership towards ETFs may improve some dimensions of price efficiency while impeding price efficiency along other dimensions. Specifically, the results in one paper suggest that stock prices incorporate systematic information more quickly when they are held in ETF portfolios.[499] The evidence in this paper thus indicates that ETF activity increases stock market efficiency with regard to systematic information, *i.e.,* information relating to market-wide risks. On the other hand, some studies find that an increase in ETF ownership may introduce non-fundamental volatility into stock prices, *i.e.,* cause temporary deviations of stock prices from their fundamental values. For example, one paper finds that ownership by US equity index ETFs is associated with higher volatility among component stocks and argues that the increased volatility is non-fundamental.[500] Another paper finds that higher authorized participant arbitrage activity in US equity ETFs is

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[491] *See supra* section II.F.

[492] As discussed in more detail below in section V.D, the ongoing costs of complying with the proposed amendments to Form N–8B–2 for all UIT ETFs as well as the one-time initial costs for existing UIT ETFs would accrue to Form S–6.

[493] We estimate that each ETF would incur a one-time burden of an additional 20 hours, at a time cost of an additional $6,710 (10 hours x $335.50 (blended rate for a compliance attorney ($352) and a senior programmer ($319)) = $6,710) to draft and finalize the required disclosure, amend its registration statement, implement the interactive calculator, and update its website.

[494] We estimate that each ETF would incur an ongoing burden of an additional 10 hours, at a time cost of an additional $3,355 (10 hours × $335.50 (blended rate for a compliance attorney ($352) and a senior programmer ($319)) = $3,355) each year to review and update the proposed disclosures.

[495] Like all information disclosed in Items 2, 3, or 4 of Form N–1A, the information disclosed in amended Item 3 would have to be tagged and submitted in a structured data format. *See supra* footnote 361. We note that we are adopting amendments to require the use of Inline XBRL format in a companion release, which would apply to the information disclosed in amended Item 3 according to the compliance dates of those amendments. *See* Inline XBRL Filing of Tagged Data, Investment Company Act Release No. 33139 (June 28, 2018). Given that filers already have systems in place to submit the existing information in Item 3 in a structured format and that filers will already be required to update those systems to comply with the Inline XBRL requirement, we believe that there would not be any significant additional costs associated with the information in amended Item 3 being filed in a structured format.

[496] This estimate is based on the following calculation: 1,900 ETFs × ($6,710 + $3,355) = $19,123,500.

[497] The proposed disclosure requirements would also serve to increase investors' awareness of the trading costs that they can incur when trading ETFs, which can be substantial in some cases. As a result, investors who may previously not have been fully aware of these costs may shift their demand away from ETFs and towards other types of funds, such as mutual funds. We believe, however, that the rulemaking as a whole is likely to increase demand for ETFs rather than decrease it.

[498] In documenting the impact of ETF arbitrage on price efficiency and liquidity, the academic literature does not generally distinguish ETFs that could rely on the rule from those that could not. However, these studies investigate a broad range of ETFs with varying degrees of relief including basket flexibility. Therefore, we believe that the subsample of ETFs that could rely on the rule (those organized as open-end funds that are not leveraged) is representative of those used in the academic literature. As a result, we believe that inferences from the academic research generally apply to ETFs that can rely on the rule.

[499] Lawrence Glosten, Suresh Nallareddy & Yuan Zou, *ETF Trading and Informational Efficiency of Underlying Securities,* Columbia Business School Research Paper No. 16–71 (2016).

[500] *See* Itzhak Ben-David, Francesco Franzoni & Rabih Moussawi, *Do ETFs Increase Volatility?,* Swiss Finance Institute Research Paper No. 11–66 (2017). This paper also finds that mutual fund ownership is associated with higher volatility in the underlying indexes. Thus, to the extent that part of the increase in ETF assets would be accompanied by a decrease in mutual fund assets, the net effect on price efficiency would be unclear.

associated with a higher correlation of returns among stocks in the ETF's portfolio.[501] The authors find evidence that changes in the prices of these stocks tend to partially revert over the next trading day and argue that the increased co-movement in returns is thus a sign of excessive price movement due to non-fundamental shocks that ETF trading helps propagate.

The proposed rule could decrease the liquidity of stocks held by ETFs, as one study finds that higher ownership of a stock by US equity ETFs is associated with lower liquidity as measured by market impact.[502] Conversely, the academic literature offers mixed evidence regarding the impact of ETFs on bond liquidity. While one paper finds that increased ETF ownership is associated with lower bond liquidity for investment grade bonds,[503] another study finds that bonds included in ETFs experience improvements in their liquidity.[504]

A shift in stock ownership towards ETFs could also have an effect on the co-movement of liquidity for stocks held by ETFs. Specifically, one paper observes that the liquidity of a stock with high ETF ownership co-moves with the liquidity of other stocks that also have high ETF ownership.[505] The authors argue that this co-movement in liquidity represents a risk to investors, as it exposes them to the possibility that many assets in their portfolio will be illiquid at the same time.

Since we do not know the degree to which the proposed rule would increase ETF ownership of stocks and bonds, we are unable to quantify the proposed rule's effects on price efficiency and liquidity.

As a result of the proposed rule's allowance of increased basket flexibility, some ETFs that did not already have this flexibility in their baskets may choose to increase the weight of more liquid securities and decrease the weight of less liquid securities in their baskets compared to their portfolios.[506] During normal market conditions, this may lead those ETFs' shares to trade at smaller bid-ask spreads, thus benefiting investors. We note, however, that such a reduction in bid-ask spreads by over-weighting more liquid securities may not work during stressed market conditions, if a large proportion of such an ETF's portfolio securities become less liquid.[507] As a result, the gap between bid-ask spreads of some ETFs' shares during normal and stressed market periods may grow as a result of the proposed rulemaking, which some investors may not anticipate and fail to fully take into account when making their investment decisions.[508]

Finally, the proposed amendments to Forms N–1A and N–8B–2 as well as the additional website disclosures required by proposed rule 6c–11 would allow investors and other market participants to better understand and compare ETFs using more relevant and standardized disclosure. For example, as discussed above, the proposed amendments to Item 3 of Form N–1A would add a requirement for ETFs to disclose their median bid-ask spread and include a statement that ETF investors may be subject to other expenses that are specific to ETF trading, including brokerage commissions and potential costs related to purchasing ETF shares at a premium or discount to NAV per share.[509] These costs are not currently required to be disclosed by Item 3. Since these costs are incurred by ETF investors and not mutual fund investors, we believe that adding this disclosure would help investors and other market participants better assess and compare fees and expenses between certain funds and fund types, such as ETFs and mutual funds. Thus, the proposed rule could help investors make more informed investment decisions that are more suited for their investment objectives. The degree to which investors would benefit from the ability to make more informed investment decisions is inherently difficult to quantify, so we are unable to estimate the size of this benefit.

2. Competition

The proposed rule would likely increase competition among ETFs that could rely on the proposed rule. The first channel through which the proposed rule would likely foster competition is by reducing the costs for ETF sponsors to form new ETFs that comply with the conditions set by the proposed rule. This cost reduction would lower the barriers to entering the ETF market, which would likely lead to increased competition among ETFs that could rely on the proposed rule.

In addition, new ETFs that enter the market in reliance on the proposed rule as well as those existing ETFs that would have their exemptive relief rescinded and replaced by the proposed rule, would no longer be subject to requirements that vary between exemptive orders. Instead, these ETFs would operate under uniform requirements, which would help promote competition among ETFs that could rely on the proposed rule.

An increase in competition among ETFs that could rely on the proposed rule would likely also lead to an increase in competition between those ETFs and ETFs that could not rely on the proposed rule as well as other types of funds and products that investors may perceive to be substitutes for ETFs, such as certain mutual funds.[510]

Furthermore, as discussed above, the proposed website disclosures and amendments to Forms N–1A and N–8B–2 would allow investors to compare ETFs and other open-end investment companies, which could further foster

[501] Zhi Da & Sophie Shive, *Exchange Traded Funds and Asset Return Correlations,* Working Paper, Notre Dame University (2016).

[502] *See* Sophia JW. Hamm, *The effect of ETFs on stock liquidity,* Working Paper, Ohio State University (2014). However, the study also finds the same relationship for ownership by index mutual funds. Thus, to the extent that part of the increase in ETF assets would be accompanied by a decrease in mutual fund assets, the net effect on price efficiency would be unclear.

[503] Caitlin Dillon Dannhauser, *The Impact of Innovation: Evidence from Corporate Bond ETFs,* Journal of Financial Economics, forthcoming (2016) (''Dannhauser Article'').

[504] Jayoung Nam, *Market Accessibility, Corporate Bond ETFs, and Liquidity,* Working Paper, Indiana University Bloomington (2017).

[505] Vikas Agarwal, Paul Hanouna, *et al., Do ETFs Increase the Commonality in Liquidity of Underlying Stocks,* Working Paper, Villanova University (2017).

[506] This would be the case for those ETFs that hold less liquid securities in their portfolios.

[507] Under rule 22e–4 under the Act, an ETF is required to consider: (i) The relationship between portfolio liquidity and the way in which, and the prices and spreads at which, ETF shares trade, including, the efficiency of the arbitrage mechanism and the level of active participation by market participants (including authorized participants); and (ii) the effect of the composition of baskets on the overall liquidity of the ETF's portfolio as part of its assessment, management and review of liquidity risk. *See* LRM Adopting Release, *supra* footnote 101.

[508] Conversely, some ETFs may choose to decrease, rather than increase, the weight of more liquid securities and increase the weight of less liquid securities in their basket compared to their portfolio in order to reduce transaction costs borne by an ETF's existing/remaining shareholders when the ETF must buy and sell portfolio holdings. This would lead to a reduction in transaction costs for existing/remaining shareholders and to an increase in transactions costs for authorized participants and, ultimately, investors buying and selling ETF shares. Thus, we believe that most funds would choose to limit such behavior as they would likely find it to be in their best interest to balance costs imposed on remaining and existing/remaining shareholders.

[509] James J. Angel, Todd J. Broms, & Gary L. Gastineau, *ETF Transaction Costs Are Often Higher Than Investors Realize,* 42 The Journal of Portfolio Management 3, 65–75 (2016) find that the cost of trading ETF shares depends both on bid-ask spreads as well as premiums and discounts to NAV per share.

[510] The types of funds and products that investors may consider substitutes for ETFs would depend on an individual investor's preferences and investment objectives. Other types of products that some investors may consider to be substitutes for ETFs include closed-end funds and other exchange-traded products, such as exchange-traded notes and commodity pools.

competition among open-end investment companies as well as between open-end investment companies and other types of funds that investors may perceive to be substitutes for open-end investment companies, such as closed-end funds and certain exchange-traded products.

Increased competition would likely lead to lower fees for investors, encourage financial innovation, and increase consumer choice in the markets for ETFs, open-end investment companies, and other types of funds that investors may perceive to be substitutes.[511] Due to the limited availability of data, however, we are unable to quantify these effects.

To the extent the proposed rule would increase the number and total assets of ETFs, more authorized participants or other market participants may enter the market. This could lead to increased competition among authorized participants or other market participants and result in authorized participants or other market participants exploiting arbitrage opportunities sooner (*i.e.,* when premiums/discounts to NAV per share are smaller). As a result, bid-ask spreads may tighten and premiums/discounts to NAV per share for ETF shares may decrease. As authorized participants and some of the other market participants that engage in ETF arbitrage are large broker-dealers, however, we would expect new entries of authorized participants or other arbitrageurs as a result of the rule to be limited and any effects on bid-ask spreads and premiums/discounts to NAV per share to be small.

3. Capital Formation

The proposed rule may lead to increased capital formation. Specifically, an increase in the demand for ETFs, to the extent that it would increase demand for intermediated assets as a whole, would likely spill over into primary markets for equity and debt securities. As a consequence, companies may be able to issue new debt and equity at higher prices in light of the increased demand for these assets in secondary markets created by ETFs. As a consequence, the cost of capital for firms could fall, facilitating capital formation.

The conclusion that an increase in the demand for ETFs may lower the firm's cost of capital is further supported by a paper[512] that finds that bonds with a higher share of ETF ownership have lower expected returns.[513] Due to the limited availability of data, however, we are unable to quantify these effects of the proposed rule on capital formation.

E. Reasonable Alternatives

1. Treatment of Existing Exemptive Relief

As discussed above, we propose to rescind the exemptive relief we have issued to ETFs that would be permitted to rely on the proposed rule. As an alternative, we considered allowing ETFs with existing exemptive relief in orders that do not contain a self-termination clause to continue operating under their relief rather than requiring them to operate in reliance on the rule.

The Commission believes that allowing ETFs to continue operating under their existing relief would create differences in the conditions under which funds operate. Specifically, some ETFs that determine they do not need the additional flexibility (*e.g.,* basket flexibility) the proposed rule would provide compared to their existing exemptive relief could choose to continue operating under their existing relief rather than in reliance on the rule. This could allow these ETFs to circumvent the other requirements that are part of the rule (*e.g.,* daily website disclosure of the basket assets). This self-selection would create a disparity in the conditions under which ETFs are allowed to operate.

Measured against the baseline, the alternative would thus have smaller benefits arising from improved disclosure, including that the alternative would not level the playing field among ETFs with regard to these conditions and thus not be as effective at promoting product competition as the proposed rule. In addition, it would be more difficult for the Commission to evaluate compliance with regulations under the alternative compared to the proposed rule, as some of the ETFs whose exemptive relief we propose to rescind could choose to continue to operate under their exemptive relief. The Commission also believes that the costs to funds associated with rescinding the existing exemptive relief would be minimal, as we anticipate that substantially all funds whose relief would be rescinded would be able to continue operating with only minor adjustments, other than being required to comply with the additional website disclosures and to develop basket asset policies and procedures.[514]

2. ETFs Organized as UITs

Proposed rule 6c–11 would be available only to ETFs that are organized as open-end funds.[515] As an alternative, we considered including ETFs organized as UITs in the scope of the proposed rule. However, as discussed above in section III.A.1, we believe that the terms and conditions of the existing exemptive orders for UITs are appropriately tailored to address the unique features of the UIT structure.

In addition, as also discussed above, ETFs have greater investment flexibility under the open-end fund structure than the UIT structure, which leads us to believe that most new ETFs entering into the market would prefer to operate under the open-end fund structure rather than the UIT structure. No new UIT ETFs have come to market in recent years, and we do not think that there would be significant economic benefits to including UITs in the scope of the proposed rule, and thus we propose to exclude ETFs organized as UITs from the proposed rule.[516]

3. Basket Flexibility

Proposed rule 6c–11would require ETFs relying on the rule to adopt and implement written policies and procedures that govern the construction of basket assets and the process that will be used for the acceptance of basket assets. As an alternative, we considered requiring that an ETF's basket generally correspond *pro rata* to its portfolio holdings, while identifying certain limited circumstances under which an ETF may use a non-*pro rata* basket, as

[511] As discussed above, the proposed rule would likely lead to increased competition both among ETFs that could rely on the proposed rule as well as between ETFs that could rely on the rule and those that could not. While we believe that increased competition generally is conducive to innovation, any increased competition in the ETF market resulting from the proposed rule would be more likely to involve novel ETFs that would continue to need to obtain exemptive relief from the Commission.

[512] Dannhauser Article, *supra* footnote 503.

[513] We acknowledge that there is research (*see* Yakov Amihud & Haim Mendelson, *Asset Pricing and the Bid-Ask Spread,* 17 Journal of Financial Economics 2, 223–249 (1986)) that provides evidence that expected returns of an asset are positively associated with its liquidity. As discussed above, the academic literature suggests that stocks with a higher share of ETF ownership have lower liquidity (whereas the evidence on the effect of underlying bonds is mixed). Thus, there may be an offsetting effect that could weaken the potential benefits of the rule for capital formation through new equity issuances by firms.

[514] Some ETFs may change the way they operate voluntarily by taking advantage of the increased basket flexibility of the proposed rule.

[515] As discussed in above in section IV.B.1, while the vast majority of ETFs currently in operation are organized as open-end funds, some early ETFs, which currently have a significant amount of assets, are organized as UITs. Examples include SPDR S&P 500 ETF Trust (SPY) and PowerShares QQQ Trust, Series 1 (QQQ).

[516] We note that fund sponsors that plan to launch a new ETF organized as a UIT would continue to be able to rely on the exemptive order process.

we have done in our exemptive orders since approximately 2006.[517]

The requirement included in these orders was designed to address the risk that an authorized participant or other market participant could take advantage of its relationship with the ETF (*i.e.,* engage in cherry picking or dumping). However, as discussed above, we believe that the proposed rule's additional policies and procedures requirements for custom baskets would provide a principles-based approach that is designed to limit potential abuses so that they would be unlikely to cause significant harm to investors. In addition, as also discussed above in section III.C.1.b, we believe that the increased basket flexibility under the proposed rule would benefit the effective functioning of the arbitrage mechanism, particularly benefiting fixed-income, international, and actively managed ETFs.[518]

4. Website Disclosure of Every Basket Used by an ETF

Proposed rule 6c–11 would require ETFs to post, on the ETF's website at the beginning of each business day, a published basket applicable to orders for the purchase or redemption of creation units to be priced based on the ETF's next calculation of NAV. Because an ETF would be required to post only one published basket to comply with this condition, it would not be required to post the contents of its other custom baskets in many instances. As an alternative, we considered proposing that ETFs be required to publish information regarding every basket used by the ETF after the close of trading on each business day.

The additional disclosure under this alternative could reveal whether an authorized participant has pressured an ETF into accepting illiquid securities in exchange for liquid ETF shares (*i.e.,* dumping) or into giving an authorized participant desirable securities in exchange for ETF shares tendered for redemption (*i.e.,* cherry-picking) by comparing an ETF's portfolio assets and published basket to the baskets used by various authorized participants throughout the day.

However, the proposed rule contains additional conditions for basket policies and procedures, which seek to prevent overreaching. Moreover, the proposed rule would require an ETF to maintain records regarding the baskets used, which would allow Commission staff to examine an ETF's use of basket flexibility. Consequently, we believe that the risk for these abusive practices under the proposed rule would be low while, at the same time, the rule would avoid additional operational and compliance costs for ETFs to post and review the information, under the alternative.[519]

5. The Use of a Structured Format for Additional Website Disclosures and the Filing of Additional Website Disclosures in a Structured Format on EDGAR

As discussed in section II.C.6 above, we are proposing to require ETFs to post on their websites certain disclosures to enable investors to more readily obtain certain key metrics for individual ETFs. The proposed rule would allow ETFs to select a format for posting information that the individual ETF finds most efficient and appropriate for the content management system of their website.

As an alternative, we could require ETFs to post the disclosures in a structured format on their websites. Structured disclosures are made machine-readable by having reported disclosure items labeled (tagged) using a markup language that can be processed by software for analysis.[520] Compared with each ETF selecting its own layout and format for the website disclosures, the resulting standardization under this alternative would allow for extraction, aggregation, comparison, and large-scale analysis of reported information through significantly more automated means than is possible with unstructured formats such as HTML. This alternative would facilitate the extraction and analysis through automated means of an individual fund's disclosures over time—which would offer the greatest benefit for higher-frequency ETF disclosures—and potentially the comparison of disclosures across a small number of ETFs. However, requiring a structured disclosure format would not lower the collection burden incurred by the requirement to separately visit each website to obtain each ETFs disclosure.

The structured data requirement could impose an incremental cost on ETFs of tagging the information in a structured format, particularly to the extent that ETFs don't otherwise structure this data for their own purposes. Although, if the XML format is used for the additional disclosure, the incremental cost of tagging information in a structured format would likely be small.[521]

As another alternative, we could require ETFs to make the additional website disclosures available in a centralized repository in a structured format, such as by filing them on EDGAR. Making the information available in a structured format on EDGAR would likely improve its accessibility and the ability of investors, the Commission, and other data users to efficiently extract information for purposes of aggregation, comparison and analysis of information across multiple funds and time periods.[522] As stated above, if the XML format is used for the additional disclosure, the incremental cost of tagging the information in a structured format would likely be small. However, funds would still incur a cost of filing the disclosures on EDGAR, which might be higher than the cost of posting the disclosures on individual ETF websites.

6. Treatment of Leveraged ETFs

As discussed in section II.A.3. above, leveraged ETFs would not be able to

[517] ETFs whose orders we are proposing to rescind and that are operating under exemptive orders issued before approximately 2006, which included few explicit restrictions, would have reduced basket flexibility under the alternative compared to the baseline.

[518] Section III.D discusses the possibility that some ETFs may use the increased basket flexibility of the proposed rule to over- or under-weight securities in their baskets compared to their portfolios based on the liquidity of these securities. Such a practice would not be possible under the alternative that would require an ETF's basket to generally correspond *pro rata* to its portfolio holdings.

[519] We estimate that, under the alternative, an average ETF would incur a one-time cost of $3,879 (6 hours (for website development) × $296.50 per hour (blended rate for a senior systems analyst ($274) and senior programmer ($319)) + (4 hours (for review of website disclosures) × $325 (blended rate for a compliance manager ($298) and a compliance attorney ($352)) + $800 for an external website developer to develop the web page = $3,879) for implementing this website disclosure and an ongoing cost of $1,596.50 (1 hour (for website updates) × $296.50 per hour (blended rate for a senior systems analyst ($274) and senior programmer ($319)) + (4 hours (for review of website disclosures) × $325 (blended rate for a compliance manager ($298) and a compliance attorney ($352)) = $1,596.50) per year for updating the relevant web page daily with this information.

[520] Structured information can be stored, shared and presented in different systems or platforms. Standardized markup languages, such as XML or XBRL, use sets of data element tags for each required reporting element, referred to as taxonomies.

[521] For example, based on staff experience with XML filings, the costs of tagging the information in XML are expected to be minimal given the technology that will be used to structure the data. XML is a widely used data format, and based on the Commission's understanding of current practices, most reporting persons and third party service providers have production systems already in place to report schedules of investments and other information. Therefore, we believe systems should be able to accommodate XML data without significant costs, and large-scale changes will likely not be necessary to output structured data files.

[522] The Commission has implemented requirements for the structuring of certain information disclosed by funds. *See, e.g.,* Release No. 33–10231 (Oct. 13, 2016) [81 FR 81870]; Release No. IC–29132 (Feb. 23, 2010) [75 FR 10059]; Release No. 33–9006 (Feb. 11, 2009) [74 FR 7747].

rely on proposed rule 6c–11. As an alternative, we considered permitting leveraged ETFs to rely on the proposed rule, while maintaining the status quo of existing exemptive orders with respect to the amount of leveraged market exposure that leveraged ETFs may obtain (*i.e.,* 300% of the return or inverse return).[523] This alternative would thus prohibit a leveraged ETF from seeking a performance result, directly or indirectly, that exceeds three times the performance, or inverse performance, of the specified market index or benchmark. This alternative could benefit competition among leveraged ETFs as compared to the baseline, as fund sponsors that currently do not have an exemptive order permitting them to operate this type of ETF could enter the market. As a result, fees for leveraged ETFs would likely decrease and their assets could increase. However, as discussed in detail in section II.A.3., in light of our ongoing consideration, including the potential staff recommendation of a re-proposal on funds' use of derivatives, we do not believe it is appropriate to permit sponsors to form and operate leveraged ETFs in reliance on our proposed rule.

F. Request for Comments

The Commission requests comment on all aspects of this initial economic analysis, including whether the analysis has: (1) Identified all benefits and costs, including all effects on efficiency, competition, and capital formation; (2) given due consideration to each benefit and cost, including each effect on efficiency, competition, and capital formation; and (3) identified and considered reasonable alternatives to the proposed new rule and disclosure amendments. We request and encourage any interested person to submit comments regarding the proposed rule, our analysis of the potential effects of the proposed rule and proposed amendments, and other matters that may have an effect on the proposed rule. We request that commenters identify sources of data and information as well as provide data and information to assist us in analyzing the economic consequences of the proposed rule and proposed amendments. We also are interested in comments on the qualitative benefits and costs we have identified and any benefits and costs we may have overlooked. In addition to our general request for comment on the economic analysis associated with the proposed rule and proposed amendments, we request specific comment on certain aspects of the proposal:

- Would the proposed rule require any existing ETFs whose exemptive orders would be rescinded to materially change the way they operate? If so, what types of funds would have to materially change the way they operate and it what ways? Would these funds require any additional exemptive relief to continue operating?
- Would the elimination of the direct costs of obtaining exemptive relief result in additional benefits to ETFs or their investors? Are there other costs of the proposed rule that would offset any cost savings resulting from not having to file an exemptive application?
- Would the proposed rule result in greater product innovation in the ETF market? Would the proposed rule result in increased investment options?
- Are we correct to assume that substantially all ETFs that are currently not required to make daily website disclosures of NAV, closing price, and premiums and discounts would have the data required to make these disclosures available to them as part of their regular operations as well as systems (such as computer equipment, an internet connection, and a website) in place that can be used for processing this data and uploading it to their websites? If not, what data or systems would currently be unavailable, which ETFs would it be unavailable for, and what would the cost of acquiring the unavailable data or systems be?
- Do ETFs already have policies and procedures in place governing the composition of baskets? How long would it take and how much would it cost to implement such policies and procedures for funds that do not already have them in place, particularly the custom basket policies and procedures?
- Are we correct to assume that substantially all ETFs would already have the required data available for daily website disclosures of bid-ask spreads and historical information regarding premiums and discounts as well as systems (such as computer equipment, an internet connection, and a website) in place that can be used for processing this data and uploading it to their websites? If not, what data or systems would currently be unavailable, which funds would it be unavailable for, and what would the cost of acquiring the unavailable data or systems be?
- Are we correct to assume that substantially all funds would already have the required data to complete the new disclosures required by the proposed amendments to Forms N–1A and N–8B–2 available to them as part of their regular operations? If not, what data would currently be unavailable, which funds would it be unavailable for, and what would the cost of acquiring the unavailable data be?
- Is our estimate correct that the cost to a typical fund for applying for an ETF exemptive order is approximately $100,000? If not, what would be a more accurate estimate?
- How many ETFs (representing how much in assets) currently are required to disclose on their website, free of charge, the previous day's NAV and the price of the ETF shares, as well as the premium or discount associated with the closing price and information pertaining to the composition and proportion of underlying holdings? How many ETFs (representing how much in assets) are not required to provide this disclosure but nevertheless voluntarily provide it?
- Do commenters agree that requiring ETFs to make the additional website disclosures available in a structured format, which is an alternative we considered, would be associated with only a small cost of tagging this information?
- Would the proposed rule lead to more competition and lower fees in the leveraged ETF market if leveraged ETFs were allowed to rely on the rule?

IV. Paperwork Reduction Act

A. Introduction

Proposed rule 6c–11 would result in new ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 (''PRA'').[524] In addition, the proposed amendments to Form N–1A, Form N–8B–2, and Form N–CEN would impact the collection of information burden under those forms and Form S–6.[525] Proposed rule 6c–11 also would impact the current collection of information burden of rule 0–2 under the Act.[526]

The titles for the existing collection of information are: ''Form N–1A under the Securities Act of 1933 and under the Investment Company Act of 1940, Registration Statement for Open-End Management Companies'' (OMB No. 3235–0307); ''Form N–8B–2 under the Investment Company Act of 1940, Registration Statement of Unit Investment Trusts Which are Currently Issuing Securities'' (OMB No. 3235–0186); ''Form S–6 [17 CFR 239.19], for registration under the Securities Act of 1933 of Unit Investment Trusts registered on Form N–8B–2'' (OMB Control No. 3235–0184); ''Form N–

[523] *See supra* footnote 77.

[524] 44 U.S.C. 3501–3520.

[525] 17 CFR 274.11A; 17 CFR 274.12; 17 CFR part 101; 17 CFR 239.16.

[526] 17 CFR 270.0–2.

CEN'' (OMB Control No. 3235–0730); and ''Rule 0–2 under the Investment Company Act of 1940, General Requirements of Papers and Applications'' (OMB Control No. 3235–0636). The title for the new collection of information would be: ''Rule 6c–11 under the Investment Company Act of 1940, 'Exchange-traded funds.' '' The Commission is submitting these collections of information to the Office of Management and Budget (''OMB'') for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

We published notice soliciting comments on the collection of information requirements in the 2008 ETF Proposing Release and submitted the proposed collections of information to OMB for review and approval in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11.[527] We received no comments on the collection of information requirements.

We discuss below the collection of information burdens associated with proposed rule 6c–11 and its impact on rule 0–2 as well as proposed amendments to Forms N–1A, N–8B–2, S–6 and N–CEN.

B. Proposed Rule 6c–11

Proposed rule 6c–11 would permit ETFs that satisfy certain conditions to operate without first obtaining an exemptive order from the Commission. The rule is designed to create a consistent, transparent, and efficient regulatory framework for such ETFs and facilitate greater competition and innovation among ETFs. The proposal attempts to eliminate historical distinctions and conditions that we no longer believe are necessary and thus appropriately level the playing field for such ETFs that pursue the same or similar investment strategies.

Proposed rule 6c–11 would require an ETF to disclose certain information on its website, to maintain certain records, and to adopt and implement written policies and procedures governing their constructions of baskets, as well as written policies and procedures that set forth detailed parameters for the construction and acceptance of custom baskets that are in the best interests of the ETF and its shareholders. These requirements are collections of information under the PRA.

The respondents to proposed rule 6c–11 would be ETFs registered as open-end management investment companies other than ETFs within multiple-class funds or leveraged ETFs.[528] This collection would not be mandatory, but would be necessary for those ETFs seeking to operate without individual exemptive orders. We estimate that 1,635 ETFs would likely rely on rule 6c–11.[529] Information provided to the Commission in connection with staff examinations or investigations would be kept confidential subject to the provisions of applicable law.

1. Website Disclosures

Under the proposal, ETFs would be required to post on their websites: (i) The ETF's NAV per share, market price, and premium or discount; and (ii) historical information regarding premiums and discounts. In addition, proposed rule 6c–11 would require an ETF to disclose on its website, each business day, the portfolio holdings that will form the basis for each calculation of NAV per share,[530] and information regarding a published basket that will apply to orders for the purchase or redemption of creation units each business day.[531] As proposed, the rule would require that portfolio holdings and basket information be presented and contain information regarding description, amount, value and/or unrealized gain/loss (if applicable) in the manner prescribed within Article 12 of Regulation S–X.[532] Additionally, the proposed rule would require an ETF to disclose on its website a tabular chart and line graph showing the ETF's premiums and discounts for the most recently completed calendar year and the most recently completed calendar quarters of the current year. For new ETFs that do not yet have this information, the proposed rule would require the ETF to post this information for the life of the fund. As discussed above, we believe the disclosures provide useful information to investors who purchase and sell ETF shares on national securities exchanges.

Proposed rule 6c–11(c)(1)(v) also would require any ETF whose premium or discount was greater than 2% for more than seven consecutive trading days to post that information on its website, along with a discussion of the factors that are reasonably believed to have materially contributed to the premium or discount.[533] Given the proposed threshold, we do not believe that many ETFs would be required to disclose this information on a routine basis. For purposes of this PRA, we assume that all ETFs will be required to make this disclosure only once in their lifetime. Therefore, we believe that this requirement will impose only initial costs and that there will be no ongoing costs associated with it.[534]

For purposes of the PRA analysis, we estimate that an ETF would incur a one-time average burden of 25 hours associated with updating the relevant website disclosures, at a time cost of $7,697.50.[535] The staff estimates the initial external cost would be $2,000 for an external website developer to develop the web page.[536] Amortized over a 3-year period, the hour burden per ETF would be approximately 8.3 hours, at a time cost of $2,565.8, and an external cost of approximately $666.65. Additionally, Commission staff estimates that an ETF each year would spend approximately 5 hours of professional time to update the relevant web page daily with this information, at a time cost of $1,405.50.[537] Commission staff does not believe there will be any ongoing external costs related to the website disclosure requirements. Accordingly, we estimate that the total burden for drafting, reviewing and uploading the website disclosures would be 21,745.50 hours,[538] at a time

[527] *See* 2008 ETF Proposing Release, *supra* footnote 3.

[528] *See* proposed rule 6c–11(a) (defining ''exchange-traded fund'').

[529] *See supra* footnote 425 and accompanying text. This is estimate does not include UIT ETFs, share class ETFs, or leveraged ETFs.

[530] *See* proposed rule 6c–11(c)(1)(i)(A).

[531] *See* proposed rule 6c–11(c)(1)(i)(B).

[532] *See supra* footnote 220.

[533] This information would be posted on the trading day immediately following the eighth consecutive trading day on which the ETF had a premium or discount greater than 2% and be maintained on the ETF's website for at least one year following the first day it was posted. *See supra* at text following footnote 306.

[534] For purposes of this analysis, we estimate that 1,635 ETFs would be required to make this disclosure at least once in their lifetime.

[535] This estimate is based on the following calculations: (15 hours (for website development) × $296.50 per hour (blended rate for a senior systems analyst ($274) and senior programmer ($319)) + (10 hours (for review of website disclosures) × $325 (blended rate for a compliance manager ($298) and a compliance attorney ($352)) = $7,697.50).

[536] Based on staff experience, the staff estimates that each ETF initially would spend an additional $2,000 on external website developers.

[537] This estimate is based on the following calculations: (2 hours (for website updates) × $296.50 per hour (blended rate for a senior systems analyst ($274) and senior programmer ($319)) + (2.5 hours (for review of website disclosures) × $325 (blended rate for a compliance manager ($298) and a compliance attorney ($352)) = $1,405.50. *See* SIFMA Report, *supra* footnote 452.

[538] This estimate is based on the following calculation: 13.3 hours × 1,635 ETFs = 21,745.50 hours.

cost of approximately $6,493,075.50,[539] and an external cost of $1,089,972.75.[540]

2. Recordkeeping

The proposed rule requires that ETFs to preserve and maintain copies of all written authorized participant agreements.[541] Additionally, we are proposing to require ETFs to maintain records setting forth the following information for each basket exchanged with an authorized participant: (i) The names and quantities of the positions composing the basket; (ii) identification of the basket as a ''custom basket'' and a record stating that the custom basket complies with the ETF's custom basket policies and procedures (if applicable); (iii) cash balancing amounts (if any); and (iv) the identity of the authorized participant conducting the transaction.[542]

ETFs would have to maintain these records for at least five years, the first two years in an easily accessible place.[543] We estimate that the burden would be 5 hours per ETF to retain these records, with 2.5 hours spent by a general clerk and 2.5 hours spent by a senior computer operator. We estimate a time cost per ETF of $380.[544] We estimate the total recordkeeping burden related to rule 6c–11 would be 8,175 hours, at an aggregate cost of $621,300.[545]

3. Policies and Procedures

As proposed, rule 6c–11 would require ETFs relying on the proposed rule to adopt and implement written policies and procedures that govern the construction of baskets and the process that will be used for the acceptance of basket assets.[546] Additionally, to use custom baskets, an ETF would be required to adopt and implement written policies and procedures setting forth detailed parameters for the construction and acceptance of custom baskets that are in the best interests of the ETF and its shareholders.[547] These policies and procedures also may include a periodic review requirement in order to ensure that the ETF's custom basket procedures are being consistently followed.[548] Finally, as discussed above, such an ETF would be required to maintain records detailing the composition of each custom basket.

For purposes of this PRA analysis, we estimate that an ETF would incur a one-time average burden of 6 hours associated with setting up the process for documenting the construction and acceptance of baskets.[549] Accordingly, we estimate that a total initial burden associated with setting up the process for documenting the construction and acceptance of baskets would be 9,810 hours,[550] at a time cost of $4,094,325.[551] An ETF utilizing custom baskets would also incur a one-time average burden of 20 hours associated with documenting and adopting the custom basket policies and procedures. Amortized over a 3-year period, this would be an annual burden per ETF of about 2 hours for documenting the construction and acceptance of baskets and an annual burden per ETF of about 6.7 hours for the custom basket policies and procedures. Accordingly, we estimate that a total burden for initial documentation and review of both the process for documenting the construction and acceptance of baskets as well as an ETF's custom basket policies and procedures would be 42,510 hours,[552] at a time cost of $16,788,180.[553] Amortizing these costs over three years, the annual burden of complying with these requirements would be 14,170 hours, at a time cost of $5,596,060. We also estimate that there would be no external cost for an ETF associated with these requirements.

We estimate that each ETF would incur an ongoing burden of an additional 10 hours, at a time cost of an additional $3,985 [554] each year to review and update its custom basket policies and procedures as well as its process for documenting the construction and acceptance of baskets. In aggregate, we estimate that the total ongoing costs associated with these requirements are 16,350 hours, at a time cost of $6,515,475.[555] We do not estimate that there will be any ongoing external costs associated with these requirements. Therefore, we estimate that the total initial and ongoing costs associated with complying with the policies and procedures requirements of proposed rule 6c–11 would be 30,520 [556] hours at a time cost of $12,111,535.[557]

4. Estimated Total Burden

We estimate that the total hour burdens and time costs associated with proposed rule 6c–11, including the burden associated with: (i) Website disclosure; (ii) recordkeeping; and (iii) developing policies and procedures, would result in an average aggregate annual burden of 60,440.5 hours [558] and an average aggregate time cost of $19,225,910.50.[559] We also estimate that there are $1,089,972.75 external costs associated with this collection of information. [560] Therefore, to comply with rule 6c–11 each ETF would incur an annual burden of approximately 36.97 [561] hours, at an average time cost of approximately $11,758.97 [562], and an external cost of $666.65.[563]

[539] This estimate is based on the following calculation: $3,971.3 × 1,635 ETFs = $6,493,075.50.

[540] This estimate is based on the following calculation: $666.65 × 1,635 ETFs = $1,089,972.75.

[541] *See* proposed rule 6c–11(d).

[542] *See supra* footnote 325 and accompanying text.

[543] *Id.*

[544] This estimate is based on the following calculations: 2.5 hours × $60 (hourly rate for a general clerk) = $150; 2.5 hours × $92 (hour rate for a senior computer operator) = $230. $150 + $230 = $380.

[545] We estimate that 1,635 ETFs would be required to maintain these records.

[546] *See* proposed rule 6c–11(c)(3).

[547] *See* proposed rule 6c–11(c)(3)(i).

[548] *See supra* text accompanying footnote 256.

[549] We estimate that all ETFs relying on the rule will use custom baskets to some extent. Moreover, we estimate that the cost associated with this requirement is small because the records detailing the composition of each custom basket are readily available.

[550] This estimate is based on the following calculations: 6 hours × 1,635 ETFs = 9,810 hours.

[551] This estimate is based on the following calculations: 3 hours × 317 (hourly rate for a senior manager) = $951; 2 hours × 511 (hourly rate for chief compliance officer) = $1,022; 1 hour × $352 (hourly rate for compliance attorney) = $352; $951 + $1,022 + $352 = $2,325; $2,325 × 1,635 ETFs = $3,801,375.

[552] This estimate is based on the following calculation: (6 hours + 20 hours) × 1,635 ETFs = 42,510 hours.

[553] These estimates are based on the following calculations: 12 hours × $317 (hourly rate for a senior portfolio manager) = $3,804; 12 hours × $480 (blended hourly rate for assistant general counsel ($449) and chief compliance officer ($511) = $5,760; 2 hours (for a fund attorney's time to prepare and review materials) × $352 (hourly rate for a compliance attorney) = $704. $3,804 + $5,760 + $704 = $10,268; $10,268 × 1,635 ETFs = $16,788,180. *See* SIFMA Report, *supra* footnote 452.

[554] These estimates are based on the following calculations: 5 hours × $317 (hourly rate for a senior portfolio manager) = $1,585; 5 hours × $480 (blended hourly rate for assistant general counsel ($449) and chief compliance officer ($511) = $2,400. $1,585 + $2,400 = $3,985.

[555] This estimate is based on the following calculation: $3,985 × 1,635 ETFs = $6,515,475.

[556] This estimate is based on the following calculation: 14,170 hours + 16,350 hours = 30,520 hours.

[557] This estimate is based on the following calculation: $5,596,060 + $6,515,475 = $12,111,535.

[558] This estimate is based on the following calculation: 21,745.5 hours + 8,175 hours + 30,520 hours = 60,440.5 hours.

[559] This estimate is based on the following calculation: $6,493,075.50 + $621,300 + $12,111,535 = $19,225,910.50.

[560] *See supra* footnote 540 and accompanying text.

[561] This estimate is based on the following calculation: 60,440.5 hours ÷ 1,635 ETFs = 36.97 hours.

[562] This estimate is based on the following calculation: $19,225,910.50 ÷ 1,635 ETFs = $11,758.97.

[563] This estimate is based on the following calculation: $1,089,972.75 ÷ 1,635 ETFs = $666.65.

C. Rule 0–2

Section 6(c) of the Act provides the Commission with authority to conditionally or unconditionally exempt persons, securities or transactions from any provision of the Act if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act. Rule 0–2 under the Act, entitled ''General Requirements of Papers and Applications,'' prescribes general instructions for filing an application seeking exemptive relief with the Commission.[564] We currently estimate for rule 0–2 a total hour burden of 5,340 hours at an annual time cost of $2,029,200.60 and the total annual external cost burden is $14,090,000.[565]

As discussed above, proposed rule 6c–11 would permit ETFs that satisfy the conditions of the rule to operate without the need to obtain an exemptive order from the Commission under the Act. Therefore, proposed rule 6c–11 would alleviate some of the burdens associated with rule 0–2 because it would reduce the number of entities that require exemptive relief in order to operate.[566] Based on staff experience, we estimate that approximately one-third of the annual burdens associated with rule 0–2 are attributable to ETF applications. Therefore, we estimate that proposed rule 6c–11 would result in a decrease of the annual burden of rule 0–2 to approximately 3,738 [567] hours at an annual time cost of $1,420,440.42 [568] and an annual external cost of $9,863,000.[569]

D. Form N–1A

Form N–1A is the registration form used by open-end management investment companies. The respondents to the proposed amendments to Form N–1A are open-end management investment companies registered or registering with the Commission. Compliance with the proposed disclosure requirements of Form N–1A is mandatory for open-end funds (to the extent applicable) including all ETFs organized as open-end funds. Responses to the disclosure requirements are not confidential. We currently estimate for Form N–1A a total burden hour of 1,579,974 burden hours, with an estimated internal cost of $129,338,408, and external cost of $124,820,197.[570]

We are proposing amendments to Form N–1A designed to provide investors who purchase ETF shares in secondary market transactions with tailored information regarding ETFs, including information regarding costs associated with an investment in ETFs.[571] Specifically, the proposed amendments to Form N–1A would require new disclosures regarding fees and expenses, such as brokerage commission and financial intermediary fees, and certain trading costs.[572] In addition, we are proposing to include instructions in Form N–1A requiring an ETF to provide bid-ask spread information on the ETF's website and an interactive calculator, in a clear and prominent format on the ETF's website, to allow investors to customize certain hypothetical calculations to their specific investing situation.[573]

We also are proposing amendments to Form N–1A designed to eliminate certain disclosures for ETFs that are duplicative of the new disclosures we are proposing, discussed above, or are no longer necessary.[574] These proposed amendments include eliminating certain disclosures in Item 6(c) of Form N–1A relating to creation units, secondary market transactions, premiums and discounts, as well as certain disclosures required of ETFs issuing creation units of less than 25,000 shares. Additionally, we are proposing to eliminate historical premium/discount disclosure requirements in Item 11(g)(2) and Item 27(b)(7)(iv) of Form N–1A.

Form N–1A generally imposes two types of reporting burdens on investment companies: (i) The burden of preparing and filing the initial registration statement; and (ii) the burden of preparing and filing post-effective amendments to a previously effective registration statement (including post-effective amendments filed pursuant to 17 CFR 230.485(a) or (b) (rule 485(a) or 485(b) under the Securities Act), as applicable). We estimate that each ETF would incur a one-time burden of an additional 10 hours, at a time cost of an additional $3,355,[575] to draft and finalize the required disclosure and amend its registration statement. We further estimate that an ETF would incur a one-time average burden of 10 hours associated with implementing the bid-ask spread disclosures and interactive calculator on its website, at a time cost of $3,355,[576] as required by proposed Instruction 5(e) to Item 3. In the aggregate, we estimate that ETFs would incur a one-time burden of an additional 20 hours, at a time cost of an additional $6,710 to comply with the proposed Form N–1A disclosure requirements for ETFs. Amortizing the one-time burden over a three-year period results in an average annual burden of an additional 6.67 hours at a time cost of an additional $2,236.67.

We estimate that each ETF would incur an ongoing burden of an additional 5 hours, at a time cost of an additional $1,677.50 [577] each year to review and update the proposed disclosures.[578] We also estimate that each ETF would incur an ongoing burden of an additional 5 hours, at a time cost of an additional $1,677.50,[579] relating to the bid-ask spread disclosures and to maintain the interactive calculator on its website. In aggregate, we estimate that each ETF would incur an annual ongoing burden of an additional 10 hours, at a time cost of an additional $3,355, to comply with the proposed Form N–1A disclosure requirements. We do not estimate any change to the external costs associated with the proposed amendment for Form N–1A.

In total, we estimate that ETFs, other than UIT ETFs, would incur an average

[564] *See* Supporting Statement of Rule 0–2 under the Investment Company Act of 1940, General Requirements of Paper Applications (Nov. 23, 2016), *available at https://www.reginfo.gov/public/do/PRAViewICR?ref_nbr=201602-3235-008* (summarizing how applications are filed with the Commission in accordance with the requirements of rule 0–2).

[565] This estimate is based on the last time the rule's information collection was submitted for PRA renewal in 2016.

[566] As discussed above, we expect to continue to receive applications for complex or novel ETF exemptive relief that are beyond the scope of the proposed rule. *See supra* at text following footnote 454.

[567] This estimate is based on the following calculation: 5,340 hours − (5,340 hours × 0.3) = 3,738 hours.

[568] This estimate is based on the following calculation: $2,029,200.60 − ($2,029,200.60 × 0.3) = $1,420,440.42.

[569] This estimate is based on the following calculation: $14,090,000 − ($14,090,000 × 0.3) = $9,863,000.

[570] This estimate is based on the last time the form's information collection was submitted for PRA renewal in 2017.

[571] *See* proposed Instruction 5(e) to Item 3 of Form N–1A.

[572] *See* proposed amendments to Item 3 of Form N–1A.

[573] Proposed Instruction 5(e) to Item 3 of Form N–1A.

[574] *See supra* footnotes 390–397 and accompanying text.

[575] This estimate is based on the following calculation: 10 hours × $335.50 (blended rate for a compliance attorney ($352) and a senior programmer ($319)) = $3,355.

[576] *Id.*

[577] This estimate is based on the following calculation: 5 hours × $335.50 (blended rate for a compliance attorney ($352) and a senior programmer ($319)) = $1,677.50.

[578] The estimated burden associated with the amendments to Form N–1A accounts for the proposal to remove the information currently required by Item 11(g)(2) and Item 27(b)(7)(iv) of Form N–1A.

[579] *Id.*

annual increased burden of approximately 31,596.4 hours,[580] at a time cost of approximately $10,579,307.2,[581] to comply with the proposed Form N–1A disclosure requirements. We do not estimate any change to the external costs associated with the proposed amendment for Form N–1A.

E. Disclosure Amendments to Forms N–8B–2 and S–6

Form N–8B–2 is used by UITs to initially register under the Investment Company Act pursuant to section 8 thereof.[582] UITs are required to file Form S–6 in order to register offerings of securities with the Commission under the Securities Act.[583] As a result, UITs file Form N–8B–2 only once when the UIT is initially created and then use Form S–6 to file all post-effective amendments to their registration statements in order to update their prospectuses.[584] We currently estimate for Form S–6 a total burden of 106,620 hours, with an internal cost burden of approximately $34,000,000, and an external cost burden estimate of $67,359,556.[585] Additionally, we currently estimate for Form N–8B–2 a total burden of 10 hours, with an internal cost burden of approximately $3,360, and an external burden estimate of $10,000.[586]

In order to assist investors with better understanding the total costs of investing in a UIT ETF, we are proposing disclosure requirements in Form N–8B–2 that mirror those disclosures proposed for Form N–1A.[587] All UIT ETFs would be subject to these disclosure requirements. For existing UIT ETFs, the one-time and ongoing costs of complying with the amendments to Form N–8B–2 would accrue on Form S–6.[588]

For purposes of the PRA analysis, we estimate that each UIT ETF would incur a one-time burden of an additional 20 hours, at a time cost of an additional $6,710 [589] to draft and finalize the required disclosure and amend its Form S–6. For each newly created UIT ETF, these same costs would be incurred on Form N–8B–2.[590] Therefore, in the aggregate, we estimate that existing UIT ETFs would incur a one-time burden of an additional 160 hours,[591] at a time cost of an additional $53,680,[592] to comply with the proposed Form N–8B–2 disclosure requirements on Form S–6. Additionally, in the aggregate, we estimate that newly created UIT ETFs would incur a one-time burden of an additional 20 hours, at a time cost of an additional $6,710, to comply with the proposed amendments and complete Form N–8B–2. Amortizing the one-time burden for both existing and newly created UIT ETFs over a three-year period results in an average annual burden of an additional 6.67 hours, at a time cost of an additional $2,236.67.

We estimate that each UIT ETF would incur an ongoing burden of an additional 10 hours, at a time cost of an additional $3,355, each year to review and update the proposed disclosures on Form S–6. In aggregate, we estimate that UIT ETFs would incur an annual burden of an additional 80 hours,[593] at a time cost of an additional $26,840,[594] to comply with the proposed Form N–8B–2 disclosure requirements on Form S–6.

Additionally, we estimate that newly created UIT ETFs would also incur an average annual increased burden of approximately 10 hours, at a time cost of an additional $3,355, to complete Form N–8B–2. We do not estimate any change to the external costs, on either Form N–8B–2 or Form S–6, associated with the proposed amendments to Form N–8B–2.

F. Form N–CEN

As discussed above, Form N–CEN is a structured form that requires registered funds to provide census-type information to the Commission on an annual basis.[595] The Commission is proposing amendments to Form N–CEN to require ETFs to report if they are relying on rule 6c–11.[596]

In the Reporting Modernization Adopting Release, we estimated that the Commission would receive an average of 3,113 reports on Form N–CEN.[597] We estimated that the average annual hour burden per response for Form N–CEN for the first year to be 32.37 hours and 12.37 hours in subsequent years.[598] Amortizing the burden over three years, we estimated that the average annual hour burden per fund per year to be 19.04 hours and the total aggregate annual hour burden to be 59,272 hours.[599] Finally, we estimated that all applicable funds will incur, in the aggregate, external annual costs of $2,088,176 to prepare and file reports on Form N–CEN.[600]

Based on Commission staff experience, we believe that our proposal to require ETFs to report if they are relying on rule 6c–11 would increase the estimated burden hours associated with Form N–CEN by approximately 0.1 hours, both initially and on an ongoing basis.[601] Therefore, in the aggregate, we estimate that ETFs will incur an annual burden of an additional 163.5 hours to comply with the proposed amendments to Form N–CEN.[602] We estimate that there are no additional external costs associated with this collection of information.

G. Request for Comments

We request comment on whether these estimates are reasonable. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments in order to: (i) Evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of the burden of the proposed

580 This estimate is based on the following calculation: (6.7 hours + 10 hours) × 1,892 ETFs = 31,596.4 hours.

581 This estimate is based on the following calculation: ($2,236.67 + $3,355) × 1,892 ETFs= $10,579,307.20.

582 *See* Form N–8B–2 [17 CFR 274.12].

583 *See* Form S–6 [17 CFR 239.16]. Form S–6 is used for registration under the Securities Act of securities of any UIT registered under the Act on Form N–8B–2.

584 Form S–6 incorporates by reference the disclosure requirements of Form N–8B–2 and allows UITs to meet the filing and disclosure requirements of the Securities Act.

585 This estimate is based on the last time the form's information collection was submitted for PRA renewal in 2014.

586 This estimate is based on the last time the form's information collection was submitted for PRA renewal in 2018.

587 *See* proposed Items 13(h) and (i) of Form N–8B–2. *See also supra* section II.H.5.

588 *See supra* footnote 583.

589 This estimate is based on the following calculation: 20 hours × $335.50 (blended rate for a compliance attorney ($352) and a senior programmer ($319)) = $6,710.

590 Although we noted above that no new UIT ETFs have come to market since 2002, for purposes of calculating the time and cost burdens associated with completing Form N–8B–2, we estimate that 1 UIT ETF will be created annually. *See supra* footnote 41 and accompanying text.

591 This estimate is based on the following calculation: 20 hours × 8 UIT ETFs= 160 hours.

592 This estimate is based on the following calculation: $6,710 × 8 UIT ETFs = $53,680.

593 This estimate is based on the following calculation: 10 hours × 8 UIT ETFs = 80 hours.

594 This estimate is based on the following calculation: $3,355 × 8 UIT ETFs = $26,840.

595 *See* Reporting Modernization Adopting Release, *supra* footnote 147. The compliance date for Form N–CEN is June 1, 2018.

596 *See* proposed Item C.7.k. of Form N–CEN.

597 *See* Reporting Modernization Adopting Release, *supra* footnote 147, at text accompanying n.1524.

598 *See id.,* at text accompanying nn.1531–1532.

599 *See id.,* at text accompanying nn.1533–1534.

600 *See* Reporting Modernization Adopting Release, *supra* footnote 147, at text accompanying n.1538.

601 This estimate stems from the Commission staff's understanding of the time it takes to complete initially complete and review items on Form N–CEN.

602 This estimate is based on the following calculation: 0.1 hours × 1,635 ETFs = 163.5 hours.

collections of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) determine whether there are ways to minimize the burden of the collections of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons wishing to submit comments on the collection of information requirements of the proposed rules and amendments should direct them to the OMB, Attention Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy to, Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090, with reference to File No. S7–15–18. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this release; therefore a comment to OMB is best assured of having its full effect if OMB receives it within 30 days after publication of this release. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7–15–18, and be submitted to the Securities and Exchange Commission, Office of FOIA Services, 100 F Street NE, Washington, DC 20549–2736.

V. Initial Regulatory Flexibility Analysis

The Commission has prepared the following Initial Regulatory Flexibility Analysis (''IRFA'') in accordance with section 3 of the Regulatory Flexibility Act[603] regarding our proposed new rule 6c–11 and proposed amendments to Form N–1A, Form N–8b–2, and Form N–CEN.

A. Reasons for and Objectives of the Proposed Actions

As described more fully above, proposed rule 6c–11 would allow ETFs that meet the conditions of the rule to form and operate without the expense and delay of obtaining an exemptive order from the Commission. The Commission's objective is to create a consistent, transparent and efficient regulatory framework for ETFs and to facilitate greater competition and innovation among ETFs. The Commission also believes the proposed disclosure amendments would provide useful information to investors who purchase and sell ETF shares in secondary markets. Finally, the goal of the proposed amendments to Form N–CEN is for the Commission to be able to better monitor reliance on rule 6c–11 and to assist the Commission with its accounting, auditing and oversight functions.

B. Legal Basis

The Commission is proposing new rule 6c–11 pursuant to the authority set forth in sections 6(c), 22(c), and 38(a) of the Investment Company Act [15 U.S.C. 80a–6(c), 22(c), and 80a–37(a)]. The Commission is proposing amendments to registration Form N–1A under the authority set forth in sections 6, 7(a), 10 and 19(a) of the Securities Act of 1933 [15 U.S.C. 77f, 77g(a), 77j, 77s(a)], and sections 8(b), 24(a), and 30 of the Investment Company Act [15 U.S.C. 80a–8(b), 80a–24(a), and 80a–29]. The Commission is proposing amendments to registration Form N–8b–2 under the authority set forth in section 8(b) and 38(a) of the Investment Company Act [15 U.S.C. 80a–8(b) and 80a–37(a)]. The Commission is proposing amendments to Form N–CEN under the authority set forth sections 8(b), 30(a), and 38(a) of the Investment Company Act [15 U.S.C. 80a–8(b), 80a–29(a), and 80a–37(a)].

C. Small Entities Subject to the Rule

An investment company is a small entity if, together with other investment companies in the same group of related investment companies, it has net assets of $50 million or less as of the end of its most recent fiscal year.[604] Commission staff estimates that, as of December 2017, there are approximately 8 open-end ETFs that may be considered small entities.[605] Commission staff estimates there are no UIT ETFs that would be considered small entities subject to the proposed disclosures for Form N–8B–2.[606]

D. Projected Reporting, Recordkeeping, and Other Compliance Requirements

The proposed amendments would amend current reporting requirements for ETFs considered small entities.

1. Rule 6c–11

Proposed rule 6c–11 would require an ETF to disclose on its website: (i) Portfolio holding information and information regarding a published basket on each business day; (ii) the ETF's current NAV per share, market price, and premium or discount, each as of the end of the prior business day; (iii) if an ETF's premium or discount is greater than 2% for more than seven consecutive trading days, a discussion of the factors that are reasonably believed to have materially contributed to the premium or discount; and (iv) a table and line graph showing the ETF's premiums and discounts.[607] We also are proposing to require that ETFs preserve and maintain copies of all written authorized participant agreements, as well as records setting forth the following information for each basket exchanged with an authorized participant: (i) The names and quantities of the positions composing the basket; (ii) identification of the basket as a ''custom basket'' and a record stating that the custom basket complies with the ETF's policies and procedures (if applicable); (iii) cash balancing amounts (if any); and (iv) the identity of the authorized participant conducting the transaction.[608] Proposed rule 6c–11 would also require ETFs relying on the proposed rule to adopt and implement written policies and procedures that govern the construction of baskets and the process that will be used for the acceptance of basket assets.[609] ETFs using custom baskets under the proposed rule must adopt custom basket policies and procedures that include certain enumerated requirements.[610]

We estimate that approximately 8 ETFs are small entities that would comply with proposed rule 6c–11, and we do not believe that their costs would differ from other ETFs. As discussed above, we estimate that an ETF would incur an annual burden of approximately 36.97 hours, at an average time cost of approximately $11,758.97, and an external cost of $666.65.[611]

2. Disclosure and Reporting Requirements

We are proposing amendments to Form N–1A and Form N–8B–2 designed to provide investors who purchase ETF shares in secondary market transactions with tailored information regarding ETFs, including information regarding costs associated with an investment in ETFs. Specifically, proposed amendments to Form N–1A would require new disclosure regarding fees and expenses, such a brokerage

[603] *See* 5 U.S.C. 603(a).

[604] 17 CFR 270.0–10(a).

[605] This estimate is derived from an analysis of data reported on Form N–1A with the Commission for the period ending December, 2017.

[606] This estimate is derived from an analysis of data reported on Forms S–6 and N–8B–2 with the Commission for the period ending December 2017.

[607] *See* proposed rule 6c–11(c)(1)(iii) and (iv).

[608] *See supra* section II.C.5.a.

[609] Proposed rule 6c–11(c)(3).

[610] Proposed rule 6c–11(c)(3).

[611] *See supra* footnote 561 and accompanying text.

commission and financial intermediary fees, and additional information on certain trading costs.[612] In addition, we are proposing to include instructions in Form N–1A requiring an ETF to provide bid-ask spread information on the ETF's website and an interactive calculator, in a clear and prominent format on the ETF's website, to allow investors to customize certain hypothetical calculations to their specific investing situation.[613] Proposed amendments to Form N–8B–2 mirror proposed disclosures for Form N–1A. We are also proposing amendments to Form N–CEN that would require ETFs to report on Form N–CEN if they are relying on rule 6c–11. The proposed Form N–CEN amendments are designed to assist us with monitoring reliance on rule 6c–11 as well with our accounting, auditing and oversight functions, including compliance with the PRA.

All ETFs would be subject to the proposed disclosure and reporting requirements, including ETFs that are small entities. We estimate that 8 ETFs are small entities that would be required to comply with the proposed disclosure and reporting requirements.[614]

As discussed above, we estimate that each ETF, including ETFs that are small entities, would incur a one-time burden of an additional 10 hours, at a time cost of an additional $3,355 to draft and finalize the required disclosure and amend its registration statement.[615] We further estimate that ETFs, including ETFs that are small entities, would incur a one-time average burden of 10 hours associated with implementing the interactive calculator on its website, at a time cost of $3,355, as required by proposed Instruction 5(e) to Item 3. In the aggregate, we estimate that ETFs, including ETFs that are small entities, would incur a one-time burden of an additional 20 hours, at a time cost of an additional $6,710, to comply with the proposed Form N–1A disclosure requirements for ETFs.[616]

We also estimate that each ETF, including ETFs that are small entities, would incur an ongoing burden of an additional 5 hours, at a time cost of an additional $1,677.50, each year to review and update the proposed disclosures. We further estimate that each ETF, including ETFs that are small entities, would incur an ongoing burden of an additional 5 hours, at a time cost of an additional $1,677.50, to maintain the interactive calculator on its website. In aggregate, we estimate that each ETF, including ETFs that are small entities, would incur an annual ongoing burden of an additional 10 hours, at a time cost of an additional $3,355, to comply with the proposed Form N–1A disclosure requirements. We do not estimate any change to the external costs associated with the proposed amendments to Form N–1A.[617]

As discussed above, because the amendments made to Form N–8B–2 mirror those made on Form N–1A, we believe that UIT ETFs, including UIT ETFs that are small entities, would incur the same costs as all ETFs associated with updating their registration statements. However, none of the UIT ETFs are small entities.

E. Duplicative, Overlapping or Conflicting Federal Rules

Commission staff has not identified any federal rules that duplicate, overlap, or conflict with the proposed regulations.

F. Significant Alternatives

The RFA directs the Commission to consider significant alternatives that would accomplish our stated objectives, while minimizing any significant economic impact on small entities. We considered the following alternatives for small entities in relation to the proposed regulations:

- Exempting ETFs that are small entities from the proposed disclosure, reporting or recordkeeping requirements, to account for resources available to small entities;
- establishing different disclosure, reporting or recordkeeping requirements or different frequency of these requirements, to account for resources available to small entities;
- clarifying, consolidating, or simplifying the compliance requirements under the amendments for small entities; and
- using performance rather than design standards.

We do not believe that exempting any subset of ETFs, including small entities, from proposed rule 6c–11 or proposed form amendments would permit us to achieve our stated objectives. Nor do we believe establishing different disclosure, reporting or recordkeeping requirements or different frequency of these requirements for small entities would permit us to achieve our stated objectives. Similarly, we do not believe that we can establish simplified or consolidated compliance requirements for small entities under the proposed rule without compromising our objectives. As discussed above, the conditions necessary to rely on proposed rule 6c–11 and the reporting, recordkeeping and disclosure requirements are designed to provide investor protection benefits, including, among other things, tailored information regarding ETFs, including information regarding costs associated with an investment in ETFs. These benefits should apply to investors in smaller funds as well as investors in larger funds. Similarly, we do not believe it would be in the interest of investors to exempt small ETFs from the proposed disclosure and reporting requirements or to exempt small ETFs from the proposed recordkeeping requirements. We believe that all ETF investors, including investors in small ETFs, would benefit from disclosure and reporting requirements that permit them to make investment choices that better match their risk tolerances. We further note that the current disclosure requirements for reports on Form N–1A and Form N–8B–2 do not distinguish between small entities and other funds.[618]

Finally, we believe that proposed rule 6c–11 and related disclosure and reporting requirements appropriately use a combination of performance and design standards. Proposed rule 6c–11 provides ETFs that satisfy the requirements of the rule with exemptions from certain provisions of the Act necessary for ETFs to operate. Because the provisions of the Act from which ETFs would be exempt provide important investor and market protections, the conditions of the proposed rule must be specifically designed to ensure that these investor and market protections are maintained. However, where we believe that flexibility is beneficial, we proposed performance-based standards that provide a regulatory framework, rather than prescriptive requirements, to give funds the opportunity to adopt policies and procedures tailored to their specific

[612] *See supra* footnote 572 and accompanying text.

[613] Proposed Instruction 5(e) to Item 3 of Form N–1A.

[614] *See supra* footnote 605.

[615] *See supra* footnote 576 and accompanying text.

[616] *See supra* footnote 576 and accompanying text.

[617] *Id.*

[618] *See* Reporting Modernization Adopting Release, *supra* footnote 147, at section V.E (noting that small entities currently follow the same requirements that large entities do when filing reports on Form N–SAR, Form N–CSR, and Form N–Q, and stating that the Commission believes that establishing different reporting requirements or frequency for small entities (including with respect to proposed Form N–PORT and proposed Form N–CEN) would not be consistent with the Commission's goal of industry oversight and investor protection).

needs without raising investor or market protection concerns.[619]

G. General Request for Comment

The Commission requests comment regarding this analysis. We request comments on the number of small entities that would be subject to the proposed ETF regulations and whether the proposed ETF regulations would have any effects that have not been discussed. We request that commenters describe the nature of any effects on small entities subject to the proposed ETF regulations and provide empirical data to support the nature and extent of such effects. We also request comment on the estimated compliance burdens of the proposed ETF regulations and how they would affect small entities.

VI. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or ''SBREFA,'' [620] the Commission must advise OMB whether a proposed regulation constitutes a ''major'' rule. Under SBREFA, a rule is considered ''major'' where, if adopted, it results in or is likely to result in:

• An annual effect on the economy of $100 million or more;

• A major increase in costs or prices for consumers or individual industries; or

• Significant adverse effects on competition, investment or innovation.

We request comment on whether our proposal would be a ''major rule'' for purposes of SBREFA. We solicit comment and empirical data on:

• The potential effect on the U.S. economy on an annual basis;

• Any potential increase in costs or prices for consumers or individual industries; and

• Any potential effect on competition, investment, or innovation.

Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

VII. Statutory Authority

The Commission is proposing new rule 6c–11 pursuant to the authority set forth in sections 6(c), 22(c), and 38(a) of the Investment Company Act [15 U.S.C. 80a–6(c), 80a–22(c), and 80a–37(a)]. The Commission is proposing amendments to registration Form N–1A under the authority set forth in sections 6, 7(a), 10 and 19(a) of the Securities Act of 1933 [15 U.S.C. 77f, 77g(a), 77j, 77s(a)], and sections 8(b), 24(a), and 30 of the Investment Company Act [15 U.S.C. 80a–8(b), 80a–24(a), and 80a–29]. The Commission is proposing amendments to registration Form N–8B–2 under the authority set forth in section 8(b) and 38(a) of the Investment Company Act [15 U.S.C. 80a–8(b) and 80a–37(a)]. The Commission is proposing amendments to Form N–CEN under the authority set forth in sections 8(b), 30(a), and 38(a) of the Investment Company Act [15 U.S.C. 80a–8(b), 80a–29(a), and 80a–37(a)].

List of Subjects

17 CFR Part 239

Reporting and recordkeeping requirements, Securities.

17 CFR Parts 270 and 274

Investment companies, Reporting and recordkeeping requirements, Securities.

Text of Proposed Rules and Form Amendments

For reasons set out in the preamble, title 17, chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

■ 1. The authority citation for part 239 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77f, 77g, 77h, 77j, 77s, 77z–2, 77z–3, 77sss, 78c, 78*l*, 78m, 78n, 78o(d), 78o–7 note, 78u–5, 78w(a), 78*ll*, 78mm, 80a–2(a), 80a–3, 80a–8, 80a–9, 80a–10, 80a–13, 80a–24, 80a–26, 80a–29, 80a–30, and 80a–37; and sec. 107 Pub. L. 112–106, 126 Stat. 312, unless otherwise noted.

* * * * *

PART 270—RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

■ 2. The authority citation for part 270 continues to read, in part, and is amended by adding a sectional authority for § 270.6c–11 to read as follows:

Authority: 15 U.S.C. 80a–1 *et seq.,* 80a–34(d), 80a–37, 80a–39, and Pub. L. 111–203, sec. 939A, 124 Stat. 1376 (2010), unless otherwise noted.

* * * * *

Section 270.6c–11 is also issued under 15 U.S.C. 80a–6(c) and 80a–37(a).

* * * * *

■ 3. Section 270.6c–11 is added to read as follows:

§ 270.6c–11 Exchange-traded funds.

(a) *Definitions.* For purposes of this section:

Authorized participant means a member or participant of a clearing agency registered with the Commission, which has a written agreement with the exchange-traded fund or one of its service providers that allows the authorized participant to place orders for the purchase and redemption of creation units.

Basket means the securities, assets or other positions in exchange for which an exchange-traded fund issues (or in return for which it redeems) creation units.

Business day means any day the exchange-traded fund is open for business, including any day when it satisfies redemption requests as required by section 22(e) of the Act (15 U.S.C. 80a–22(e)).

Cash balancing amount means an amount of cash to account for any difference between the value of the basket and the net asset value of a creation unit.

Creation unit means a specified number of exchange-traded fund shares that the exchange-traded fund will issue to (or redeem from) an authorized participant in exchange for the deposit (or delivery) of a basket and a cash balancing amount if any.

Custom basket means:

(i) Baskets that are composed of a non-representative selection of the exchange-traded fund's portfolio holdings; or

(ii) Different baskets used in transactions on the same business day.

Exchange-traded fund means a registered open-end management company:

(i) That issues (and redeems) creation units to (and from) authorized participants in exchange for a basket and a cash balancing amount if any; and

(ii) Whose shares are listed on a national securities exchange and traded at market-determined prices.

Exchange-traded fund share means a share of stock issued by an exchange-traded fund.

Foreign investment means any security, asset or other position of the ETF issued by a foreign issuer as that term is defined in § 240.3b–4 of this title, and for which there is no established United States public trading market, as that term is used in 17 CFR 227.201 (Item 201 of Regulation S–K under the Securities Act of 1933).

Market price means:

(i) The official closing price of an exchange-traded fund share; or

(ii) If it more accurately reflects the market value of an exchange-traded

[619] *See e.g., supra* section II.C.5 (noting that proposed rule 6c–11 would provide an ETF with the flexibility to use ''custom baskets'' if the ETF has adopted written policies and procedures that set forth detailed parameters for the construction and acceptance of custom baskets that are in the best interests of the ETF and its shareholders).

[620] Public Law 104–121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

fund share at the time as of which the exchange-traded fund calculates current net asset value per share, the price that is the midpoint between the national best bid and national best offer as of that time.

National securities exchange means an exchange that is registered with the Commission under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f).

Portfolio holdings means the securities, assets or other positions held by the exchange-traded fund.

Premium or discount means the positive or negative difference between the market price of an exchange-traded fund share at the time as of which the current net asset value is calculated and the exchange-traded fund's current net asset value per share, expressed as a percentage of the exchange-traded fund share's current net asset value per share.

(b) *Application of the Act to Exchange-Traded Funds.* If the conditions of paragraph (c) of this section are satisfied:

(1) *Redeemable security.* An exchange-traded fund share is considered a ''redeemable security'' within the meaning of section 2(a)(32) of the Act (15 U.S.C. 80a–2(a)(32)).

(2) *Pricing.* A dealer in exchange-traded fund shares is exempt from section 22(d) of the Act (15 U.S.C. 80a–22(d)) and § 270.22c–1(a) with regard to purchases, sales and repurchases of exchange-traded fund shares at market-determined prices.

(3) *Affiliated transactions.* (i) A person who is an affiliated person of an exchange-traded fund (or who is an affiliated person of such a person) solely by reason of the circumstances described in paragraphs (b)(3)(i)(A) and (B) of this section is exempt from sections 17(a)(1) and 17(a)(2) of the Act (15 U.S.C. 80a–17(a)(1) and (a)(2)) with regard to the deposit and receipt of baskets:

(A) Holding with the power to vote 5% or more of the exchange-traded fund's shares; or

(B) Holding with the power to vote 5% or more of any investment company that is an affiliated person of the exchange-traded fund.

(4) *Postponement of redemptions.* If an exchange-traded fund includes a foreign investment in its basket, and if a local market holiday, or series of consecutive holidays, or the extended delivery cycles for transferring foreign investments to redeeming authorized participants prevents timely delivery of the foreign investment in response to a redemption request, the exchange-traded fund is exempt, with respect to the delivery of the foreign investment, from the prohibition in section 22(e) of the Act (15 U.S.C. 80a–22(e)) against postponing the date of satisfaction upon redemption for more than seven days after the tender of a redeemable security if the exchange-traded fund delivers the foreign investment as soon as practicable, but in no event later than 15 days after the tender of the exchange-traded fund shares. The exemption provided in paragraph (b)(4) of this section will expire and no longer be effective on [date ten years from effective date of rule].

(c) *Conditions.* (1) Each business day, an exchange-traded fund must disclose prominently on its website, which is publicly available and free of charge:

(i) Before the opening of regular trading on the primary listing exchange of the exchange-traded fund shares and before the exchange-traded fund starts accepting orders for the purchase or redemption of creation units:

(A) The portfolio holdings that will form the basis of the next calculation of current net asset value per share;

(B) A basket applicable to orders for the purchase or redemption of creation units to be priced based on the next calculation of current net asset value; and

(C) The estimated cash balancing amount, if any;

(ii) The exchange-traded fund's current net asset value per share, market price, and premium or discount, each as of the prior business day;

(iii) A table showing the number of days the exchange-traded fund's shares traded at a premium or discount during the most recently completed calendar year and the most recently completed calendar quarters since that year (or the life of the exchange-traded fund, if shorter);

(iv) A line graph showing exchange-traded fund share premiums or discounts for the most recently completed calendar year and the most recently completed calendar quarters since that year (or the life of the exchange-traded fund, if shorter); and

(v) If the exchange-traded fund's premium or discount is greater than 2% for more than seven consecutive trading days, a discussion of the factors that are reasonably believed to have materially contributed to the premium or discount, which must be maintained on the website for at least one year thereafter; and

(vi) The exchange-traded fund must present the description, amount, value and unrealized gain/loss in the manner prescribed within 17 CFR 210.12–12, 210.12–12A, 210.12–13, 210.12–13A, 210.12–13B, 210.12–13C, and 210.12–13D (Article 12 of Regulation S–X) for each portfolio holding or basket asset required to be disclosed pursuant to paragraphs (c)(1)(i) of this section.

(2) An exchange-traded fund must reflect changes in the exchange-traded fund's portfolio holdings in the first calculation of net asset value per share on the first business day following the trade date.

(3) An exchange-traded fund must adopt and implement written policies and procedures that govern the construction of baskets and the process that will be used for the acceptance of baskets; *provided, however,* if the exchange-traded fund utilizes a custom basket:

(i) These written policies and procedures also must:

(A) Set forth detailed parameters for the construction and acceptance of custom baskets that are in the best interests of the exchange-traded fund and its shareholders, including the process for any revisions to, or deviations from, those parameters; and

(B) Specify the titles or roles of the employees of the exchange-traded fund's investment adviser who are required to review each custom basket for compliance with those parameters.

(4) The exchange-traded fund may not seek, directly or indirectly, to provide returns that exceed the performance of a market index by a specified multiple, or to provide returns that have an inverse relationship to the performance of a market index, over a fixed period of time.

(5) Notwithstanding the definition of exchange-traded fund in paragraph (a) of this section, an exchange-traded fund is not prohibited from selling (or redeeming) individual shares on the day of consummation of a reorganization, merger, conversion or liquidation.

(d) *Recordkeeping.* The exchange-traded fund must maintain and preserve for a period of not less than five years, the first two years in an easily accessible place:

(1) All written agreements (or copies thereof) between an authorized participant and the exchange-traded fund or one of its service providers that allows the authorized participant to place orders for the purchase or redemption of creation units;

(2) For each basket exchanged with an authorized participant, records setting forth:

(i) The names and quantities of the positions composing the basket exchanged for creation units;

(ii) If applicable, identification of the basket as a custom basket and a record stating that the custom basket complies with policies and procedures that the exchange-traded fund adopted pursuant to paragraph (c)(3)(i) of this section;

(iii) Cash balancing amount, if any; and

(iv) Identity of authorized participant transacting with the exchange-traded fund.

PART 274—FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

■ 4. The general authority citation for part 274 continues to read, in part, as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78*l*, 78m, 78n, 78o(d), 80a–8, 80a–24, 80a–26, 80a–29, and Pub. L. 111–203, sec. 939A, 124 Stat. 1376 (2010), unless otherwise noted.

* * * * *

■ 5. Form N–1A (referenced in §§ 239.15A and 274.11A) is amended as follows:

■ a. In General Instruction A revise the definition of ''Exchange-Traded Fund.''

■ b. In General Instruction A, remove the definition of ''Market Price.''

The additions and revisions read as follows:

Note: The text of Form N–1A does not, and this amendment will not, appear in the *Code of Federal Regulations.*

Form N–1A

* * * * *

GENERAL INSTRUCTIONS

* * * * *

A. Definitions

* * * * *

''Exchange-Traded Fund'' means a Fund or Class, the shares of which are listed and traded on a national securities exchange, and that has formed and operates under an exemptive order granted by the Commission or in reliance on rule 6c–11 [17 CFR 270.6c–11] under the Investment Company Act.

* * * * *

■ 6. Amend Item 3 of Form N–1A to read as follows:

BILLING CODE 8011–01–P

Item 3. Risk/Return Summary: Fee Table

Include the following information, in plain English under rule 421(d) under the Securities Act, after Item 2:

Fees and Expenses of the Fund

This table describes the fees and expenses that you may pay if you buy, hold and sell shares of the Fund. <u>You may pay other fees not described below, such as brokerage commissions and other fees to financial intermediaries, which are not reflected in the tables and examples below.</u> You may qualify for sales charge discounts if you and your family invest, or agree to invest in the future, at least $[ ] in [name of fund family] funds. More information about these and other discounts is available from your financial intermediary and in [identify section heading and page number] of the Fund's prospectus and [identify section heading and page number] of the Fund's statement of additional information.

Shareholder Fees (fees paid directly from your investment)

Maximum Sales Charge (Load) Imposed on Purchases (as a percentage of offering price)	______%
Maximum Deferred Sales Charge (Load) (as a percentage of____________)	______%
Maximum Sales Charge (Load) Imposed on Reinvested Dividends [and other Distributions] (as a percentage of___________)	______%
Redemption Fee (as a percentage of amount redeemed, if applicable)	______%
Exchange Fee	______%
Maximum Account Fee	_____%

Annual Fund Operating Expenses (expenses that you pay each year as a percentage of the value of your investment)

Management Fees	______%
Distribution [and/or Service] (12b-1) Fees	______%
Other Expenses	______%
___________________________________	______%
____________________________________	______%
Total Annual Fund Operating Expenses	______%

Example

This Example is intended to help you compare the cost of investing in the Fund with the cost of investing in other mutual funds.

The Example assumes that you invest $10,000 in the Fund for the time periods indicated and then redeem all of your shares at the end of those periods. The Example also assumes that your investment has a 5% return each year and that the Fund's operating expenses remain the same.

	1 year	3 years	5 years	10 years
Although your actual costs may be higher or lower, based on these assumptions your costs would be:	$	$	$	$
You would pay the following expenses if you did not redeem your shares:	$	$	$	$

The Example above does not reflect sales charges (loads) on reinvested dividends [and other distributions]. If these sales charges (loads) were included, your costs would be higher.

Exchange-Traded Fund Trading Information and Related Costs

What information do I need to know about how the Exchange-Traded Fund ("ETF") trades?

Individual shares of an ETF may only be bought and sold in the secondary market through a broker or dealer at a market price. The market price can change throughout the day due to the supply of and demand for ETF shares, and changes in the value of the Fund's underlying investments, among other reasons. Because ETF shares trade at market prices rather than net asset value, shares may trade at a price greater than net asset value (premium) or less than net asset value (discount).

What costs are associated with trading shares of an ETF?

An investor may incur costs when buying or selling shares on an exchange that are ***in addition to*** the costs described above. Examples include brokerage commissions, costs attributable to the bid-ask spread, and costs attributable to premiums and discounts.

What is the bid-ask spread?

The bid-ask spread is the difference between the highest price a buyer is willing to pay to purchase shares of the Fund (bid) and the lowest price a seller is willing to accept for shares of the Fund (ask). The bid-ask spread can change throughout the day due to the supply of or demand for ETF shares, the quantity of shares traded, and the time of day the trade is executed, among other factors. For the ETF's most recent fiscal year ended [___], the median bid-ask spread was

XX.XX%.

How does the bid-ask spread impact my return on investment?

The impact of the bid-ask spread depends on your trading practices. For example, based on the ETF's fiscal year-end data, purchasing $10,000 worth of ETF shares and then immediately thereafter selling $10,000 worth of ETF shares (*i.e.*, a "round-trip"), your cost, in dollars, would be as follows:

For a SINGLE round-trip (each trade being $10,000)	
Assuming mid-range spread cost:	$ ____
Assuming high-end spread cost:	$ ____

But what if I plan to trade ETF shares frequently?

Based on the ETF's most recent fiscal year-end data, completing 25 round-trips of $10,000 each, your cost, in dollars, would be as follows:

For 25 round-trips (each trade being $10,000)	
Mid-range spread cost:	$ ____
High-end spread cost:	$ ____

Where can I get more trading information for the ETF?

The ETF's website at [www.[Series-SpecificLandingPage.com]] includes recent information on the Fund's net asset value, market price, premiums and discounts, as well as an interactive calculator you can use to determine how the bid-ask spread would impact your specific investment.

Portfolio Turnover

The Fund pays transaction costs, such as commissions, when it buys and sells securities (or "turns over" its portfolio). A higher portfolio turnover rate may indicate higher transaction costs and may result in higher taxes when Fund shares are held in a taxable account. These costs, which are not reflected in annual fund operating expenses or in the example, affect the Fund's performance. During the most recent fiscal year, the Fund's portfolio turnover rate was ________% of the average value of its portfolio.

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■ 7. Amend Instruction 1 of Item 3 of Form N–1A as follows:

* * * * *

Instructions

1. *General*

(a) Round all dollar figures to the nearest dollar and all percentages to the nearest hundredth of 1%.

(b) Include the narrative explanations in the order indicated. A Fund may modify the narrative explanations if the explanation contains comparable information to that shown. The narrative explanation regarding sales charge discounts is only required by a Fund that offers such discounts and should specify the minimum level of investment required to qualify for a discount as disclosed in the table required by Item 12(a)(1).

(c) Include the caption ''Maximum Account Fees'' only if the Fund charges these fees. A Fund may omit other captions if the Fund does not charge the fees or expenses covered by the captions.

(d)

(i) If the Fund is a Feeder Fund, reflect the aggregate expenses of the Feeder Fund and the Master Fund in a single fee table using the captions provided. In a footnote to the fee table, state that the table and Example reflect the expenses of both the Feeder and Master Funds.

(ii) If the prospectus offers more than one Class of a Multiple Class Fund or more than one Feeder Fund that invests in the same Master Fund, provide a separate response for each Class or Feeder Fund.

(e) If the Fund is an Exchange-Traded Fund, exclude any fees charged for the purchase and redemption of the Fund's creation units.

* * * * *

■ 8. Amend Instruction 5 of Item 3 of Form N–1A to read as follows:

* * * * *

5. *Exchange-Traded Fund Trading Information and Related Costs.*

(a) Include the median bid-ask spread for the Fund's most recent fiscal year only if the Fund is an Exchange-Traded Fund. However, do not include the median bid-ask spread for any Exchange-Traded Fund that had its initial listing on a national securities exchange after the beginning of the most recently completed fiscal year. For an Exchange-Traded Fund that had an initial listing after the beginning of the most recently completed fiscal year, explain that the Exchange-Traded Fund did not have a sufficient trading history to report trading information and related costs. Information should be based on the most recently completed fiscal year end. The Fund also must provide information on the Fund's website, which is publicly accessible, free of charge, that investors can use to obtain the bid/ask spread information required in this Item.

(b) Bid-Ask Spread (Median). Calculate the median bid-ask spread by dividing the difference between the ask and the bid by the midpoint of the ask and the bid for each ten-second interval throughout each trading day of the Exchange-Traded Fund's most recent fiscal year. Once the bid-ask spread for each ten-second interval throughout the fiscal year is determined, sort the spreads from lowest to highest. If there is an odd number of spread intervals, then the median is the middle number. If there is an even number of spread intervals, then the median is the average between the two middle numbers. Express the spread as a percentage, rounded to the nearest hundredth percent.

(c) Determine the mid-range spread cost for each number of transactions in the table according to the following formula:

$(S_{Mid}/2) * \$10,000 * T$

Where:

S_{Mid} = Median spread as calculated in Instruction 5(b) during most recently completed calendar year, expressed as a percentage;

T = Number of Transactions (1 and 25).

(d) Determine the high-end spread cost for each number of transactions in the table according to the following formula:

$(S_{High}/2) * \$10,000 * T$

Where:

S_{High} = High-end spread is calculated by dividing the difference between the ask and the bid by the midpoint of the ask and the bid for each ten-second interval throughout each trading day of the Exchange-Traded Fund's most recently completed fiscal year. Once the bid-ask spread for each ten-second interval throughout the fiscal year is determined, sort the spreads from lowest to highest. The high end spread is the number closest to the 95th percentile, expressed as a percentage. If two numbers are equally close to the 95th percentile, use the average of the two numbers;

T = Number of Transactions (1 and 25).

(e) Provide an interactive calculator in a clear and prominent format on the Fund website which uses the calculations in Instructions 5(a)–(d) to Item 3 to provide the information required by Q&As 3, 4 and 5.

* * * * *

■ 9. Amend Item 6 of Form N–1A as follows:

* * * * *

Item 6. Purchase and Sale of Fund Shares

(a) *Purchase of Fund Shares.* Disclose the Fund's minimum initial or subsequent investment requirements.

(b) *Sale of Fund Shares.* Also disclose that the Fund's shares are redeemable and briefly identify the procedures for redeeming shares (*e.g.,* on any business day by written request, telephone, or wire transfer).

(c) *Exchange-Traded Funds.* If the Fund is an Exchange-Traded Fund, the Fund may omit the information required by this Item.

* * * * *

■ 10. Amend Items 11(a)(1) and 11(g) of Form N–1A as follows:

* * * * *

Item 11. Shareholder Information

(a) *Pricing of Fund Shares.* Describe the procedures for pricing the Fund's shares, including:

(1) An explanation that the price of Fund shares is based on the Fund's net asset value and the method used to value Fund shares (market price, fair value, or amortized cost); except that if the Fund is an Exchange-Traded Fund, an explanation that the price of Fund shares is based on a market price.

* * * * *

(g) *Exchange-Traded Funds.* If the Fund is an Exchange-Traded Fund, the Fund may omit from the prospectus the information required by Items 11(a)(2), (b), and (c).

* * * * *

■ 11. Remove Item 27(b)(7)(iv) of Form N–1A and instructions thereto.

■ 12. Amend Instruction 1(e)(ii) of Item 27(d)(1) of Form N–1A as follows:

* * * * *

Instructions

* * * * *

1. *General.*

* * * * *

(e) If the fund is an Exchange-Traded Fund:

* * * * *

(ii) Exclude any fees charged for the purchase and redemption of the Fund's creation units.

* * * * *

■ 13. Amend Form N–8B–2 (referenced in §§ 239.16 and 274.12) as follows:

The additions and revisions read as follows:

Note: The text of Form N–8B–2 does not, and this amendment will not, appear in the *Code of Federal Regulations.*

Form N–8B–2

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GENERAL INSTRUCTIONS FOR FORM N–8B–2

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Definitions

* * * * *

Exchange-Traded Fund (ETF): The term ''Exchange-Traded Fund'' or ''ETF'' means a trust, the shares of which are listed and traded on a national securities exchange, and that has formed and operates under an exemptive order granted by the Commission.

* * * * *

Information Concerning Loads, Fees, Charges, and Expenses

13.

* * * * *

(h) If the trust is an Exchange-Traded Fund, furnish an explanation indicating that an ETF investor may pay additional fees not described by any other item in this form, such as brokerage commissions and other fees to financial intermediaries.

(i) If the trust is an Exchange-Traded Fund, furnish the disclosures and information set forth in Item 3 of Form N–1A [referenced in 17 CFR 274.11A], in the section of that Item titled ''Exchange-Traded Fund Trading Information and Related Costs.'' Provide information specific to the trust as necessary, utilizing the ETF-specific methodology set forth in the Instructions to Form N–1A Item 3.

* * * * *

■ 14. Amend Items C.7. and E.2. Form N–CEN (referenced in § 274.101):

The additions read as follows:

Note: The text of Form N–CEN does not, and this amendment will not, appear in the *Code of Federal Regulations.*

FORM N–CEN

ANNUAL REPORT FOR REGISTERED INVESTMENT COMPANIES

* * * * *

Part C. Additional Questions for Management Investment Companies

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Item C.7.

* * * * *

k. Rule 6(c)–11 (17 CFR 270.6c–11): ____

* * * * *

Part E. Additional Questions for Exchange-Traded Funds and Exchange-Traded Managed Funds

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Item E.2.

* * * * *

Instruction. The term ''authorized participant'' means a member or participant of a clearing agency registered with the Commission, which has a written agreement with the Exchange-Traded Fund or Exchange-Traded Managed Fund or one of its service providers that allows the authorized participant to place orders for the purchase and redemption of creation units.

* * * * *

By the Commission.

Dated: June 28, 2018.

Brent J. Fields,

Secretary.

[FR Doc. 2018–14370 Filed 7–30–18; 8:45 am]

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