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The U.S. Securities and Exchange Commission adopted a new rule under the Investment Company Act of 1940 that will allow exchange-traded funds that satisfy certain standardized conditions to operate without first obtaining individual exemptive relief.[1] At the same time, the SEC adopted related form amendments and issued conditional exemptive relief from certain provisions of the Securities Exchange Act of 1934 with respect to transactions in shares of ETFs that rely on the rule.[2] Taken together, the Commission actions simplify and modernize the regulatory framework governing ETFs and provide ETFs greater operational flexibility than exists under exemptive relief issued in recent years.

Executive Summary

As described in greater detail below, despite the popularity of the ETF product structure, ETFs currently operate pursuant to individual exemptive orders, the terms of which have varied over time. Rule 6c-11 under the 1940 Act (ETF Rule) and the related form amendments (Form Amendments), according to the SEC, are "designed to create a consistent, transparent, and efficient regulatory framework for ETFs … and to facilitate greater competition and innovation among ETFs." Key features of the SEC rulemaking and related actions include the following:

- Custom Baskets. ETFs that rely on the ETF Rule are permitted to use "custom baskets" (creation and redemption baskets that do not correspond *pro rata* to holdings or that differ from other baskets used that business day) provided that they adopt certain policies and procedures that address, in detail, the use of such custom baskets.

- Daily Holdings Disclosure. The ETF Rule eliminates distinctions that exist between index-based and actively managed ETFs under existing exemptive relief. Accordingly, all ETFs (whether index-based or actively managed) that rely on the ETF Rule are required to disclose their portfolio holdings on a daily basis.

- Classification of ETF Shares as "Redeemable Securities". Existing exemptive orders provide exemptions from certain definitions to permit ETFs to redeem shares in creation unit aggregations, rather than on an individual basis. The ETF Rule instead classifies shares of ETFs as "redeemable securities," making certain Exchange Act rule exceptions available to such ETFs. Significantly, the Adopting Release provides that shares of all ETFs, whether or not they rely on the ETF Rule, are considered "redeemable securities" for purposes of relying on these exceptions.

- Bid-Ask Spread Disclosures. Although required bid-ask disclosure is not as extensive as originally proposed, an ETF that relies on the ETF Rule is required to disclose its median bid-ask spread over the past 30 days on its website. In addition, the Form Amendments require certain narrative disclosure regarding trading costs, as

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1 *See* Exchange-Traded Funds, SEC Rel. No. IC-33646 (Sept. 25, 2019) (Adopting Release).

2 *See* SEC Rel. No. 34-87110 (Sept. 25, 2019).

well as prospectus or website disclosure of median bid-ask spread information by ETFs that do not rely on the ETF Rule.

- Rescission of Exemptive Relief. Existing exemptive relief relating to ETFs eligible to rely on the ETF Rule (Eligible ETFs) will be rescinded one year after the effective date of the rule. However, the ETF Rule does not rescind existing exemptive relief for ETFs that are ineligible to rely on the ETF Rule, nor does it rescind exemptive relief contained in ETF exemptive orders permitting certain investments in an ETF in excess of the limits set forth in Section 12(d)(1) of the 1940 Act (Fund of Funds Relief). Notably, the Adopting Release provides that ETFs that rely on the ETF Rule and do not have Fund of Funds Relief may enter into fund of funds arrangements in accordance with the conditions of recent ETF exemptive orders, until the effective date of a new SEC rule permitting registered funds to invest in other funds in excess of the Section 12(d)(1) limits (including Rule 12d1-4, if adopted).

- Exchange Act Relief. As noted above, classification of ETF shares as "redeemable securities" automatically makes certain exceptions from Exchange Act rules available to ETFs. In addition, the SEC issued conditional exemptive relief from certain provisions of the Exchange Act to broker-dealers and other market participants engaged in certain transactions with respect to shares of ETFs relying on the ETF Rule (Exchange Act Relief). This relief is largely provided currently in a series of "class letters" and is subject to conditions that could have limited the flexibility otherwise afforded by the ETF Rule. The Exchange Act Relief eliminates certain conditions of existing relief and further harmonizes the regulatory framework for ETFs. However, unlike the SEC's interpretation of "redeemable securities," the Exchange Act Relief extends only to ETFs that rely on the ETF Rule.

The ETF Rule, the Form Amendments and the Exchange Act Relief will become effective 60 days after publication in the Federal Register, which has not taken place as of October 17, 2019. As existing exemptive relief for Eligible ETFs will be rescinded one year from that date, such ETFs will need to come into compliance with the ETF Rule by that time. The compliance date for the Form Amendments is one year following their effective date. Any filings on the applicable forms on or after the compliance date will need to comply with the Form Amendments.

Background

Operation and Regulation of ETFs

Since their introduction in 1993, ETFs have become one of the most popular pooled investment vehicles in the United States. As of August 2019, the combined assets of ETFs in the United States were approximately $3.94 trillion.[3] ETFs, often viewed as hybrid investment products, possess characteristics similar both to mutual funds (*i.e.*, open-end management investment companies (open-end funds)) and closed-end funds. Like mutual funds and closed-end funds, ETFs are comprised of pools or baskets of securities and other instruments. Unlike mutual funds, however, ETFs do not issue and redeem *individual* shares at net asset value (NAV). Instead, shares of an ETF trade on national securities exchanges and can only be purchased or redeemed at NAV in blocks of shares called "creation

[3] ETF Assets and Net Issuance August 2019, Investment Company Institute (Sept. 26, 2019).

units"[4] by financial institutions known as "authorized participants."[5] Many (but not all) ETFs transact in kind, meaning authorized participants purchase creation units by exchanging a specified "basket" of securities and other instruments for ETF shares and receive a basket upon redemption of a creation unit. To the extent there is a difference between the basket's value and a creation unit's NAV, an amount of cash (*i.e.,* a cash balancing amount) is used to account for the difference.

Like listed shares of operating companies and closed-end funds, ETF shares trade throughout the day in the secondary market at negotiated prices. As with closed-end funds, the market price of ETF shares may differ from the ETF's NAV throughout the trading day. To the extent ETF shares are trading at a premium to (above) or discount to (below) NAV, arbitrage opportunities will exist, which help ensure that the market prices of ETF shares remain at or close to NAV. For example, if an ETF's shares are trading at a premium, an authorized participant can deliver a basket to the ETF in exchange for the more valuable creation unit of ETF shares, and then sell individual ETF shares in the secondary market at a higher price to realize a profit. In the event of a discount, an authorized participant can purchase enough shares in the secondary market to assemble a creation unit and redeem those shares at the higher NAV. These transactions have the effect of increasing or decreasing, as applicable, the supply of ETF shares in the secondary market, thus tending to move the price of an ETF's shares closer to NAV.

Due to their complex and unique structure, ETFs do not satisfy certain requirements under the 1940 Act, which are described in greater detail below. As a result, to date an ETF sponsor needed to obtain individual exemptive relief from the SEC before launching ETFs, with the SEC having granted more than 300 individual exemptive orders that provide relief related to the formation and operation of ETFs (ETF Relief).[6] As the terms of these orders have evolved over time, ETFs are subject to certain varying requirements, which has resulted in unequal treatment of different ETF sponsors and a segmented and inefficient approach to ETF regulation.

Proposed Rule and Industry Comments

In June 2018, the SEC proposed Rule 6c-11 and certain form amendments (Proposal).[7] Industry reaction to the Proposal was generally positive, although industry participants, including Dechert LLP, commented on certain potential areas for enhancement.

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4 The ETF Rule defines a "creation unit" as "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." As discussed in the text, this definition is significant in that it omits any minimum creation unit size requirement.

5 Under the ETF Rule, an "authorized participant" is defined 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." In response to a comment received on the Proposal, the SEC confirmed its view that an authorized participant is not a "principal underwriter," as that term is defined under Section 2(a)(29) of the 1940 Act, solely as a result of it buying and selling ETF shares in creation units.

6 Adopting Release, at 5.

7 *See* Exchange-Traded Funds, SEC Rel. No. IC-33140 (June 28, 2018) (Proposing Release). The SEC had previously proposed Rule 6c-11 in March 2008. *See* Exchange-Traded Funds, SEC Release No. IC-28193 (Mar. 11, 2008). Then-proposed Rule 6c-11 essentially would have codified many of the conditions that the SEC had previously imposed on ETFs through individual exemptive orders. The proposal was never adopted given the shift in SEC focus as a result of the financial crisis later that year.

The following summarizes certain areas of industry comment and changes made by the SEC in response to those comments.

- Median Bid-Ask Spread Disclosures. Under the Proposal, ETFs would have been required to include a question-and-answer (Q&A) section in the summary section of their prospectuses containing certain information about bid-ask spreads, including the median bid-ask spread for the most recent fiscal year and costs associated with bid-ask spreads assuming certain trade frequencies and amounts. ETFs would also have needed to include this information on their website, together with an interactive calculator that would allow investors to customize these cost calculations based on an investor's investment amount and number of trades. Many industry participants opposed these requirements or aspects thereof. Commenters noted, among other things, the lack of uniformity in calculating bid-ask spread, an overemphasis on bid-ask spread information, the potential disconnect between historical bid-ask spread information and current execution costs and prospectus liability concerns.

  In response to industry comments, the SEC made several changes reflected in the final ETF Rule and Form Amendments. As adopted, the ETF Rule requires an ETF to disclose on its website, but not in its prospectus, the median bid-ask spread over the past 30 days.[8] In order to achieve greater uniformity, the ETF Rule provides a discussion of how to calculate median bid-ask spread utilizing national best bid and national best offer information. The SEC did not adopt the interactive calculator requirement, nor did it adopt the Q&A disclosure requirements, which have been replaced with a requirement for ETFs to include certain narrative disclosures in their prospectuses.

- T-1 Orders. As proposed, the ETF Rule would have required an ETF to post both its daily holdings information and its creation and redemption basket for a particular business day before accepting creation or redemption orders for that day. Commenters noted that this could have effectively precluded ETFs from utilizing "T-1" creation or redemption orders (where an ETF creation or redemption order is placed the day before the order is processed, to enable corresponding transactions to be placed in certain non-U.S. markets while those markets are open). Commenters indicated that precluding these types of orders, which allow market participants to minimize trading costs, could result in larger bid-ask spreads and premiums/discounts for ETFs that currently use this order window.

  In response to these concerns, the ETF Rule as adopted requires holdings to be posted prior to the commencement of trading on the ETF's primary listing exchange, thus allowing for T-1 orders. In response to other comments, the SEC determined not to require an ETF to publish its creation and redemption basket on its website, on the basis that its publication would provide little value to market participants and could result in confusion to the extent it is mistaken for holdings information.

- Exchange Act Relief. The Proposal would have partially addressed Exchange Act relief by providing that shares of ETFs relying on the ETF Rule are "redeemable securities," thereby making them eligible for: (i) the Rule 11d1-2 exemption for "securities issued by a registered open-end investment company;" and (ii) the exceptions provided in Rules 101 and 102 of Regulation M and Rule 10b-17 for "redeemable securities" issued by open-end funds. While supportive of this approach, commenters suggested that this classification be extended to all ETFs, not only those relying on the rule. Accordingly, as noted above, the Adopting Release

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[8] An ETF that does not rely on the ETF Rule is required to include median bid-ask spread for the most recent fiscal year in its prospectus *or* to comply with the ETF Rule's website disclosure requirements.

provides that shares of all ETFs, whether or not eligible to rely on the ETF Rule, are considered "redeemable securities" for purposes of relying on these exceptions.

In addition, the SEC issued the Exchange Act Relief in response to comments recommending that the SEC address other Exchange Act provisions from which ETFs seek relief, so as to harmonize the regulatory framework further. As noted above, this relief eliminates certain conditions of existing relief, but unlike the SEC's interpretation of "redeemable securities" extends only to ETFs that rely on the ETF Rule.

- Section 22(e) Relief. Consistent with current exemptive orders, the Proposal contemplated an exemption from Section 22(e) of the 1940 Act to permit ETFs to pay authorized participants redemption proceeds in more than seven days under certain circumstances. As proposed, the exemption included a "sunset provision," providing for its automatic expiration in 10 years. This was based on the SEC's view that technological advancements and "changes in market infrastructures" would result in additional shortening of settlement cycles. Commenters generally opposed the sunset provision on the basis that it is difficult to predict such developments, which could be gradual, and that local market holidays could nonetheless continue to result in settlement delays. As adopted, the ETF Rule does not include a sunset provision.

- Presentation of Holdings Disclosure Information. Under the Proposal, an ETF's daily holdings disclosure would have been required to be presented in the manner prescribed in Article 12 of Regulation S-X, resulting in a uniform disclosure approach across ETFs. While commenters generally supported a uniform disclosure approach, several opposed the use of the Regulation S-X standard on the basis that its requirements are unduly burdensome or unnecessary in this context.

  In response to the comments received, the SEC has provided for more streamlined daily holdings disclosure. As adopted, the ETF Rule requires disclosure of a subset of the information actively managed ETFs must disclose under the exchanges' generic listing standards, as set forth in greater detail below.

The following sections provide more detail regarding the ETF Rule, Form Amendments and Exchange Act Relief, including certain ways in which they differ from existing exemptive relief and the Proposal.

The ETF Rule

Scope of the ETF Rule and Impact on Existing Exemptive Relief

The ETF Rule will allow Eligible ETFs (including most ETFs operating today) to operate without individual exemptive relief. The ETF Rule differs from current exemptive orders in that it does not distinguish between index-based ETFs (*i.e.,* ETFs that have stated investment objectives of seeking returns that correspond to the returns of a securities index) and actively managed ETFs (*i.e.,* ETFs that pursue other investment strategies).[9] An index-based or actively managed ETF may rely on the ETF Rule if it satisfies: (i) the definition of an ETF set forth in the ETF Rule; and (ii) the conditions set forth in the ETF Rule. The definition of an ETF set forth in the ETF Rule requires, among other things, that the ETF be structured as an open-end fund, as discussed further under "Definition of Exchange-Traded Fund" below. The conditions set forth in the ETF Rule are discussed in detail in "Conditions of the ETF Rule" below.

[9] The Adopting Release notes that the distinction between index-based and actively managed ETFs is largely a result of their historical evolution and that such ETFs are similar operationally. Furthermore, the SEC indicates that a distinction between such ETFs is not warranted "given the proliferation of highly customized, often methodologically complicated indexes."

The following types of ETFs are ***not*** Eligible ETFs for purposes of the ETF Rule:

- ETFs Organized as Unit Investment Trusts (UIT ETFs). The SEC explains that, due to their unmanaged nature, UIT ETFs would require different conditions than those for open-end ETFs. The SEC also cites the declining popularity of UIT ETFs, as demonstrated by the fact that there are only eight UIT ETFs currently on the market.

- Leveraged/Inverse ETFs.[10] The SEC explains that leveraged/inverse ETFs involve different policy considerations than those that the ETF Rule seeks to address and that leveraged/inverse ETFs' use of derivatives ties in to the SEC's broader consideration of funds' use of derivatives. The Adopting Release therefore indicates that the SEC "should complete its broader consideration of the use of derivatives by registered funds before considering allowing leveraged/inverse ETFs to rely on the rule." The ETF Rule's inapplicability to leveraged/inverse ETFs is also consistent with the SEC staff's moratorium, in place since 2009, on issuing new exemptive orders for leveraged/inverse ETFs.

- ETFs Structured as Share Classes of a Multi-Class Fund (Share Class ETFs). The SEC acknowledges that while it has previously granted exemptive orders to certain Share Class ETFs, those exemptive orders included an additional exemption from Sections 18(f)(1) and 18(i) under the 1940 Act, which most ETFs do not need. The SEC also notes that this relief raises policy considerations that it does not intend to address through the ETF Rule.

- Non-Transparent Actively Managed ETFs. Since the date of the Proposal, the SEC has granted its first exemptive order permitting certain ETFs that are actively managed to operate without disclosing their portfolio holdings on a daily basis (Non-Transparent ETFs).[11] The SEC notes that Non-Transparent ETFs will not meet the daily portfolio holdings disclosure requirement of the ETF Rule and therefore will not be eligible to rely on the ETF Rule.

In connection with the adoption of the ETF Rule, the Commission is rescinding the ETF Relief-related portions of existing exemptive orders for Eligible ETFs, effective one year from the effective date of the ETF Rule. The Commission believes that rescinding existing exemptive relief for Eligible ETFs will result in "a consistent, transparent and efficient framework for [Eligible ETFs]." Because more recent exemptive orders by their terms expire on the effective date of an SEC rule permitting the operation of ETFs, the SEC is amending those orders to provide for expiration one year after the effective date of the ETF Rule in order to allow time for ETFs to come into compliance with the rule.

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[10] For purposes of the ETF Rule, "leveraged/inverse ETFs" are defined as ETFs that seek "directly or indirectly, to provide investment returns that correspond to the performance of a market index by a specified multiple, or to provide investment returns that have an inverse relationship to the performance of a market index, over a predetermined period of time." This definition differs slightly from that included in the Proposal, which defined "leveraged ETFs" as 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 (emphases added)." The Adopting Release also clarifies that this definition: (i) does not cover all ETFs that track an index with derivatives as constituents; and (ii) covers leveraged/inverse ETFs "regardless of whether the returns they seek over a predetermined time period are evenly divisible by 100." The SEC explains that the definition "will capture those ETFs that have historically been considered 'leveraged/inverse ETFs' in the marketplace."

[11] *See* Precidian ETFs Trust, et al., Investment Company Act Release Nos. 33440 (Apr. 8, 2019) [84 FR 14690 (Apr. 11, 2019)] (notice) and 33477 (May 20, 2019) (order).

Exemptions Provided by the ETF Rule

The ETF Rule addresses the specific exemptions provided by current exemptive orders as follows:

- Treatment of ETF Shares as "Redeemable Securities". Current exemptive orders provide exemptions from Sections 2(a)(32) and 5(a)(1) of the 1940 Act to permit ETFs to redeem shares only in creation unit aggregations, rather than individual shares. These exemptions are necessary for ETFs to be viewed as open-end funds under the 1940 Act because a key element of the definition of an "open-end company" in Section 5(a)(1) is the issuance of "redeemable securities." The definition of a "redeemable security" in Section 2(a)(32) contemplates the ability of the holder thereof to redeem the security and receive its proportionate share of the fund's net assets or the cash equivalent. Rather than provide an exemption from these provisions, the ETF Rule classifies shares of ETFs as "redeemable securities," meaning that ETFs operating in reliance on the ETF Rule meet the definition of an open-end company.[12]

- Trading of ETF Shares at Market-Determined Prices. Consistent with current exemptive orders, the ETF Rule provides exemptions from Section 22(d) of the 1940 Act and Rule 22c-1 thereunder to permit dealers to buy and sell shares of ETFs at market prices rather than at NAV. Section 22(d) prohibits funds and dealers from selling a "redeemable security" to the public at a price other than the current public offering price described in the prospectus. Rule 22c-1 requires funds and dealers to sell a "redeemable security" at a price based on its NAV, with limited exceptions. An ETF requires exemptions from these provisions for dealers in its shares because such shares trade in the secondary market at market prices rather than at prices described in the ETF's prospectus or based on NAV.

- In-Kind Transactions with Certain Affiliates. Consistent with current exemptive orders, the ETF Rule provides an exemption from Sections 17(a)(1) and (2) of the 1940 Act to permit ETFs to engage in in-kind transactions with certain affiliates. Sections 17(a)(1) and (2) prohibit an affiliated person of a fund (first-tier affiliate) or an affiliated person of such a person (second-tier affiliate) from selling any security or other property to, or purchasing any security or other property from, a fund.[13] Because in-kind creations and redemptions involve the sale and purchase, respectively, of assets to and from an ETF, these restrictions could be triggered, for example, where an authorized participant or other market participant owns 5% or more of the shares of an ETF or an investment company that is an affiliated person of the ETF.[14] As a result, the ETF Rule provides an exemption from Sections 17(a)(1) and (2) to permit in-kind creation and redemption transactions involving

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12 As described elsewhere herein, this makes certain exceptions from Exchange Act rules available to ETFs relying on the ETF Rule (and, based on guidance in the Adopting Release, to all ETFs).

13 Under Section 2(a)(3) of the 1940 Act, the term "affiliated person" of another person includes, among others: (i) any person directly or indirectly owning, controlling or holding with power to vote, five percent or more of the outstanding voting securities of such other person; and (ii) any person directly or indirectly controlling, controlled by or under common control with, such other person. Under Section 2(a)(9) of the 1940 Act, a control relationship is presumed where a person owns more than 25% of a company's outstanding voting securities.

14 An investment company with the same investment adviser as an ETF may be deemed to be under common control with the ETF, rendering such investment company a first-tier affiliate, and the authorized participant or other market participant a second-tier affiliate, of the ETF.

persons who are first- or second-tier affiliates of an ETF solely by reason of holding with the power to vote 5% or more of: (i) the ETF's shares; or (ii) any investment company that is an affiliated person of the ETF.[15]

Although the Adopting Release acknowledges that multiple commenters requested that this relief be expanded to include other types of affiliates, such as an ETF's investment adviser (for purposes of providing seed capital) or to broker-dealers affiliated with an ETF's investment adviser, the SEC declined to expand the scope of the exemption provided in the ETF Rule. The SEC explains that extending the relief would raise "novel affiliation issues" and that because the ETF Rule is "generally intended to codify existing relief" it would not be appropriate to expand the scope of the exemption first in the ETF Rule. The Adopting Release notes, however, that an expansion of this relief may be considered through the regular exemptive application process.

- Additional Time for Delivering Redemption Proceeds. Consistent with current exemptive orders, the ETF Rule provides an exemption from Section 22(e) of the 1940 Act, under certain circumstances, to permit ETFs to pay authorized participants redemption proceeds in more than seven days.[16] Section 22(e) prohibits funds from suspending or delaying the right of redemption for more than seven days after the tender of a security for redemption.[17] Delivery cycles for transferring foreign investments to redeeming investors, as well as local market holiday schedules, make it difficult for ETFs that hold foreign investments and redeem creation units in kind to comply with this provision. The exemption set forth in the ETF Rule applies where local market holidays, a series of consecutive holidays and/or extended delivery cycles for transferring foreign investments to redeeming authorized participants prevent an ETF from delivering a foreign investment to an authorized participant within seven days. Instead, the ETF is required to deliver the foreign investment as soon as practicable, and in any event within 15 days after the authorized participant's tender of ETF shares. Unlike under existing exemptive relief, the exemption permits delayed delivery only with respect to the particular foreign investment, and not the entire basket.

  A "foreign investment" for purposes of the ETF Rule is defined 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), and that is traded on a trading market outside of the U.S." In response to comments received on the Proposal, the SEC revised this definition to eliminate the reference to "no established United States public trading market" in order to ease commenters' concerns that the definition, as proposed, would have required an ETF "to buy and sell the U.S.-traded equivalent of a foreign-traded security when one is available."

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15 The ETF Rule differs from current exemptive orders in that it does not specifically state that the exemption from Sections 17(a)(1) and (2) applies to first- or second-tier affiliates of an ETF by reason of holding with the power to vote in excess of 25% of the ETF's shares or an affiliated fund's shares. The Adopting Release clarifies, however, that the language "5% or more" also encompasses "in excess of 25%," and therefore, that the SEC is not limiting the scope of this exemption to exclude control affiliates. Accordingly, the scope of the relief provided in the ETF Rule does not differ from that provided in current exemptive relief.

16 As discussed above, this relief does not include a sunset provision as had been proposed.

17 Further, as discussed below under "Other Differences from Current Exemptive Relief" and consistent with the Proposal, the ETF Rule eliminates the requirement under current exemptive relief for an ETF to include disclosure in its statement of additional information (SAI) regarding foreign holidays that may result in redemption delays.

Although current exemptive orders also provide Fund of Funds Relief, the SEC is not yet adopting proposed Rule 12d1-4, which would permit certain fund of funds arrangements and replace existing Fund of Funds Relief.[18] Instead, Eligible ETFs may continue to rely on the Fund of Funds Relief in their existing exemptive orders, which is not rescinded in connection with the ETF Rule. Notably, the Adopting Release provides that Eligible ETFs that do not have Fund of Funds Relief may enter into fund of funds arrangements in accordance with the conditions of recent ETF exemptive orders, until the effective date of a new SEC rule (including Rule 12d1-4, if adopted). Accordingly, new ETF market entrants will be able to avail themselves of the same Fund of Funds Relief that exists for other ETFs without having to seek a separate order.

Many existing exemptive orders also provide exemptions from certain provisions of the 1940 Act to permit ETFs to operate as feeder funds in a master-feeder structure (Master-Feeder Relief). As proposed, the SEC is: (i) rescinding the portions of existing exemptive orders that relate to Master-Feeder Relief for ETFs that did not rely on such relief as of June 28, 2018; and (ii) amending the portions of existing exemptive orders that relate to Master-Feeder Relief, for ETFs that did rely on such relief as of June 28, 2018, to prevent the formation of additional feeder funds. Although some commenters had opposed this aspect of the Proposal, the Adopting Release reiterates the SEC's concerns with existing Master-Feeder Relief, in particular the possibility that ETFs transacting in kind will nonetheless bear costs associated with cash transactions by other feeder funds. As such, the SEC continues to believe that such concerns should be addressed through individual exemptive relief, rather than through the ETF Rule.

Definition of "Exchange-Traded Fund"

The definition of "exchange-traded fund" under the ETF Rule incorporates certain requirements with respect to ETF operations. Under the ETF Rule, an "exchange-traded fund" is defined as "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."[19]

Significantly, the definition of "creation unit" in the ETF Rule does not incorporate a minimum creation unit size. This differs from current exemptive relief, which in certain cases sets forth a specified minimum, and provides an ETF flexibility to set its creation unit size at an amount the ETF believes to be appropriate based on its investment strategy and other factors.[20]

With respect to the redemption of creation units, the Adopting Release notes that ETFs (like other open-end funds) are only permitted to suspend redemptions under the circumstances set forth in Section 22(e) of the 1940 Act, and

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18 *See* Fund of Funds Arrangements, SEC Release No. IC-33329 (Dec. 19, 2018). For a discussion of Rule 12d1-4, please refer to *Dechert OnPoint*, SEC Proposes Changes to Regulatory Framework of Fund of Funds Arrangements and Requests Comments on Potential Changes to AFFE Disclosure Requirements.

19 The SEC notes that the requirement that shares trade at market-determined prices is not intended to require a minimum amount of trading volume, but instead to differentiate ETFs from other types of listed products, such as exchange-traded managed funds, that trade based on NAV.

20 As discussed below, existing Exchange Act relief imposes a minimum creation unit size in certain circumstances. However, this requirement is also eliminated under the Exchange Act Relief issued by the SEC in connection with the adoption of the ETF Rule.

are subject to the 2% limitation on redemption fees set forth in Rule 22c-2 under the 1940 Act.[21] The SEC acknowledges that several commenters advocated for the Commission to exclude ETFs from the 2% redemption fee limitation set forth in Rule 22c-2, but nonetheless maintains that, consistent with its approach of regulating ETFs as open-end funds, ETFs are subject to the limitations of Rule 22c-2. Likewise, the SEC continues to believe that an ETF "generally may suspend the issuance of creation units only for a limited time and only due to extraordinary circumstances," notwithstanding certain comments it received on this point.

The ETF Rule explicitly recognizes the ability of an ETF to sell or redeem individual shares in connection with reorganizations, mergers, conversions or liquidations, on the date of the transaction. This builds on statements in certain exemptive applications contemplating individual redeemability in connection with a termination. In response to a comment received on the Proposal, the SEC modified the ETF Rule to clarify that an ETF "is not limited to transacting with authorized participants" when effecting these transactions.

Conditions of the ETF Rule

In order to rely on the ETF Rule, an ETF is required to comply with various conditions. The conditions are similar in many ways to conditions under current ETF Relief, but also reflect certain differences that the SEC "believe[s] will improve the overall regulatory framework for [ETFs]." The table below sets forth the conditions included in the ETF Rule[22] and notes the differences between those conditions and the conditions that apply under current ETF Relief, including instances where current ETF Relief includes an express condition not contained in the ETF Rule. The table is based on recent exemptive orders granted by the SEC (*i.e.*, relief issued from approximately 2010 to present); there may be differences in ETFs' existing exemptive relief requirements, in particular for those ETFs with older exemptive orders (*i.e.*, relief issued in approximately 2009 or earlier).

Topic	ETF Rule Condition	Comparison to Current Exemptive Relief
Website Disclosure –Holdings and Baskets	Each business day, an ETF must disclose prominently on its website, which is publicly available and free of charge[23] before the opening of regular trading on the primary listing exchange of the ETF shares:[24]	Currently, daily disclosure of portfolio holdings is only required for: (i) actively managed ETFs; (ii) ETFs that seek to track an index for which a first- or second-tier affiliate of the ETF or its investment adviser or distributor serves as index provider (Self-Indexed ETFs); and (iii) 130/30 and

[21] ETFs may charge a fixed transaction fee for creation and redemption transactions, together with a variable fee designed to compensate the ETF for the costs associated with the portion of the creation or redemption transaction effected in cash.

[22] A condition prohibiting the operation of leveraged/inverse ETFs in reliance on the ETF Rule is described above and accordingly is omitted from the table.

[23] With respect to the "publicly available website" posting requirements under the ETF Rule, the Adopting Release specifies 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" (*e.g.*, requiring usernames/passwords to access the information or imposing usage restrictions). The SEC also encourages ETFs to consider the use of technology to make information more accessible, such as provision of information in downloadable or machine-readable format.

[24] As discussed above, under the Proposal an ETF would have been required to disclose holdings and basket information on its website before it began accepting purchase and redemption orders, thereby potentially impacting the ability to utilize T-1 orders. This timing requirement and the basket posting requirement were eliminated in the final version of the rule. Also as discussed above, the final version of the rule does not require holdings information to be presented in the manner prescribed in Article 12 of Regulation S-X, but instead requires certain specified information about each holding, as set forth in the table.

Topic	ETF Rule Condition	Comparison to Current Exemptive Relief
	i. The estimated cash balancing amount, if any; and ii. The following information for each portfolio holding (i.e., security, asset or other position held by the ETF) that will form the basis of the next calculation of current NAV per share:[25] a. Ticker symbol; b. CUSIP or other identifier; c. Description of holding;[26] d. Quantity of each security or other asset held;[27] and e. Percentage weight of the holding in the portfolio.	long/short index-based ETFs. Accordingly, ETFs that seek to track third-party indices are generally not required to disclose holdings daily, but are required to do so under the ETF Rule. There is currently no prescribed format for the disclosure of holdings, although the exchanges' "generic listing standards" for actively managed ETFs, as well as orders approving exchange rule changes pursuant to Rule 19b-4 under the Exchange Act to list certain ETFs (19b-4 Orders), require certain specified information.[28]
Website Disclosure – Current NAV and Market Price	Each business day, an ETF must disclose prominently on its website, which is publicly available and free of charge, the ETF's current NAV per share, market price and premium or discount, each as of the end of the prior business day. "Market price" is defined as: 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 between the national	The disclosure required is generally consistent with disclosure required today, except that the ETF Rule provides more specificity with respect to the "market price" information to be used. Under current exemptive relief, either the market closing price or the midpoint of the bid/ask spread at the time of calculation may be used (without the "more accurately reflect" qualifier for use of the midpoint of bid/ask spread or specific reference to the national best bid and national best offer).

25 The ETF Rule requires such portfolio holdings to be the ETF's portfolio holdings as of the close of business on the prior business day, such that changes in the portfolio are reflected on a T+1 basis. There is no comparable express condition under current exemptive relief, although the condition is consistent with statements made in support of current exemptive relief.

26 As an example, the Adopting Release indicates that ETFs holding debt securities should provide the security's name, maturity date, coupon rate and effective date, where applicable.

27 Here the Adopting Release indicates that ETFs should generally utilize the measure typically associated with quantifying that class of security (*e.g.*, number of shares for equity securities, par value for debt securities and dollar value of cash held). The Adopting Release indicates that, in the case of derivatives, an ETF generally should include both the notional value and number of contracts, together with a general description that includes the type of derivative. The Adopting Release goes on to suggest that ETFs "consider several of the other reporting fields in Form N-PORT, for example, depending on the type of investment the ETF holds, in order to provide investors with the necessary information."

28 Where an ETF is not eligible for listing pursuant to the generic listing standards adopted by an exchange, the exchange must obtain a 19b-4 Order to list the ETF. The conditions of a particular 19b-4 Order apply only to the ETF(s) to which the 19b-4 Order relates.

Topic	ETF Rule Condition	Comparison to Current Exemptive Relief
	best bid and national best offer as of that time.	
Website Disclosure – Premium and Discount	Each business day, an ETF must disclose prominently on its website, which is publicly available and free of charge: i. A table showing the number of days the ETF'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 ETF, if shorter); ii. A line graph showing ETF 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 ETF, if shorter); and iii. If the ETF's premium or discount is greater than 2% for more than seven consecutive trading days, a statement that the ETF's premium or discount, as applicable, was greater than 2% and a discussion of the factors that are reasonably believed to have materially contributed to the premium/discount, which must be maintained on the website for at least one year thereafter.[29]	While not an express condition to the exemptive relief, Form N-1A currently requires an ETF to include tabular premium and discount information in its prospectus and annual report. This inclusion may be omitted if an ETF provides a website that can be used to obtain the information required to be included in the prospectus. The line graph and disclosure where an ETF's premium or discount is greater than 2% for more than seven consecutive trading days reflect new requirements not currently imposed by exemptive relief.
Website Disclosure – Median Bid-Ask Spread	Each business day, an ETF must disclose prominently on its website, which is publicly available and free of charge, the ETF's median bid-ask spread for the most recent 30-day period. The ETF Rule specifies the methodology for this calculation. [30]	Current exemptive relief does not require disclosure of an ETF's median bid-ask spread.

[29] The SEC acknowledges in the Adopting Release that it received various comments with respect to the 2% threshold and requirement to disclose material factors, but continues to believe that the threshold and requirement are appropriate. Notably, the Adopting Release also specifies that "[d]eviations that do not meet the objective 2% threshold, but that would be material to an investment decision, must be disclosed," citing Rule 10b-5 under the Exchange Act and Section 34(b) of the 1940 Act.

[30] Specifically, the median bid-ask spread is expressed as a percentage rounded to the nearest hundredth and computed by: (i) identifying the ETF's national best bid and national best offer as of the end of each 10 second interval during each trading day of the last 30 calendar days; (ii) dividing the difference between each such bid and offer by the midpoint of the national best bid and national best offer; and (iii) identifying the median of those values. As discussed above, the Proposal would have required more extensive bid-ask spread information both in an ETF's prospectus and on its website.

Topic	ETF Rule Condition	Comparison to Current Exemptive Relief
Construction of Baskets	An ETF 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. If the ETF utilizes a custom basket (described further below under "Custom Baskets"), these written policies and procedures also must: 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.	Current exemptive relief does not explicitly require written policies and procedures governing basket construction, although ETFs may have such procedures as part of procedures to comply with their exemptive relief. In addition, as discussed in greater detail below under "Custom Baskets," current exemptive relief does not generally permit the use of custom baskets. However, older exemptive relief may permit custom baskets without any express requirement to adopt policies and procedures. In addition, current exemptive relief frequently includes an express condition that prohibits an ETF's investment adviser, directly or indirectly, from causing any authorized participant (or any investor on whose behalf an authorized participant may transact with the ETF) to acquire any basket instrument for that ETF through a transaction in which the ETF could not engage directly.
Listing on a National Securities Exchange	The definition of "exchange-traded fund" in the ETF Rule requires that an ETF's shares be listed on a national securities exchange and traded at market-determined prices.[31]	Current exemptive relief requires shares of an ETF to be listed on an exchange.

[31] In response to requests from commenters that the SEC clarify what constitutes a "delisting" for purposes of the ETF Rule, the Adopting Release indicates that: (i) an ETF is no longer listed as of the effective date of the removal of its shares from listing pursuant to Rule 12d2-2 under the Exchange Act; and (ii) a trading halt, trading suspension or temporary non-compliance notice from the exchange is not a "delisting" for purposes of the ETF Rule.

Topic	ETF Rule Condition	Comparison to Current Exemptive Relief
Marketing Restrictions	No marketing disclosure requirements.	Current exemptive relief places certain restrictions on the marketing of ETFs. Specifically, an ETF may not be advertised or marketed as an open-end fund or a mutual fund, and advertising material containing certain information must prominently disclose that shares are not individually redeemable and can be purchased and redeemed only in creation units. The Adopting Release indicates that the SEC no longer believes these requirements are needed, given investors' familiarity with ETFs.[32]

The ETF Rule also adds recordkeeping requirements that are not imposed by current exemptive relief. Specifically, the ETF Rule requires ETFs to maintain the following records for no less than five years, the first two in an easily accessible place: (i) written agreements between authorized participants and an ETF or its service providers permitting the authorized participants to transact with the ETF in creation units (authorized participant agreements);[33] and (ii) certain specified information about each basket used to effectuate a creation or redemption transaction, including information about the basket instruments[34] and, for custom baskets, a statement that the basket complied with the ETF's custom basket procedures, discussed below. Unlike the Proposal which required only the name and position of each basket constituent, the final ETF Rule requires that an ETF's basket records include "the ticker symbol, CUSIP or other identifier, description of holding, quantity of each holding and percentage weight" of each basket constituent.

Custom Baskets

One of the most noteworthy aspects of the ETF Rule is the fact that it affords ETFs the flexibility to use "custom baskets" for creation and redemption transactions. Although certain older exemptive orders do not restrict the use of custom baskets, more recent exemptive orders require ETFs to use baskets that generally correspond *pro rata* to

32 The SEC requested comments on ETF and exchange-traded product (ETP) nomenclature, including ways to address potential confusion between ETFs and types of ETPs that are not registered under the 1940 Act. The Adopting Release indicates the SEC's belief that it needs to consider these issues prior to adopting an ETP naming system. Accordingly, the SEC is continuing to consider the comments it received and "encourage[s] ETP market participants to continue engaging with their investors, with each other, and with the Commission on these issues."

33 The SEC notes its belief that most ETFs already retain authorized participant agreements as a matter of established business practice.

34 Under the Proposal, records would have been required to include the "names and quantities of the positions composing the basket." As adopted, the ETF Rule specifies that records must instead include the following for each basket instrument: (i) ticker symbol, CUSIP or other identifier; (ii) description of holding; (ii) quantity of each holding; and (iv) percentage weight of each holding. The SEC notes its belief that these requirements "will better enable [SEC] examination staff to evaluate compliance with the rule and other applicable provisions of the federal securities laws."

their portfolio holdings, with certain limited exceptions.[35] The shift toward more stringent restrictions on basket composition was intended to address the concern that authorized participants could leverage their relationships with ETFs to "cherry pick" more desirable securities away from ETFs or "dump" less desirable securities onto ETFs. As described in the Adopting Release, however, the SEC now recognizes that there are potential benefits to using custom baskets in circumstances beyond those carved out as exceptions in recent exemptive orders. These potential benefits include, among others, narrower bid-ask spreads, more efficient arbitrage, lower transaction costs and tax efficiencies. As a result, ETFs relying on older exemptive orders that provide flexibility to use custom baskets are at a competitive advantage. The ETF Rule removes this restriction for all Eligible ETFs, thereby leveling the playing field.

Under the ETF Rule, a custom basket is defined as a basket[36] that is (i) "composed of a non-representative selection of the [ETF's] portfolio holdings,"[37] or (ii) "[a] representative basket that is different from the initial basket used in transactions on the same business day." The Adopting Release explains that if an ETF uses multiple baskets during the same business day, each basket after the initial basket is considered a "custom basket." Consistent with the Proposal, and while acknowledging several comments against the position, the SEC provides that a "custom basket" includes any basket in which cash is substituted in lieu of a portion of basket assets. The SEC noted that although it generally agrees that cash substitutions "may not raise the same concerns as securities substitutions," the use of cash substitutions may raise concerns about "overreach" by authorized participants, for example in connection with redemptions during periods of market stress.[38]

As set forth in the table above, each ETF relying on the ETF Rule must adopt certain written policies and procedures relating to the construction of baskets (standard basket procedures). In order to utilize custom baskets under the ETF Rule, an ETF must adopt an expanded version of these written policies and procedures governing the use of custom baskets (custom basket procedures) and comply with certain recordkeeping requirements related to custom basket transactions. As noted above, an ETF's custom basket procedures must 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), as well as identify the titles and roles of the employees of the ETF's investment adviser responsible for reviewing custom baskets for compliance with the parameters.

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[35] As described in the Proposing Release, recent exemptive orders contain exceptions from the *pro rata* requirement in limited circumstances, such as: (i) where bonds cannot be broken up beyond certain minimum sizes needed for transfer and settlement; (ii) where rounding is needed to eliminate fractional shares; and (iii) where the basket includes positions (such as "to be announced" transactions, short positions and derivatives) that cannot be transferred in kind. For index-based ETFs, current exemptive relief also permits: (i) the use of a "representative sampling" of the ETF's portfolio, provided that, among other things, the representative sampling is the same for all authorized participants on a given day; and (ii) the use of a non-*pro rata* basket for temporary periods to effect changes to holdings as a result of an index rebalancing.

[36] Specifically, under the ETF Rule, a "basket" is defined as "the securities, assets or other positions in exchange for which an [ETF] issues (or in return for which it redeems) creation units." Thus, ETFs may transact on an in-kind basis, on a cash basis or both.

[37] According to the Adopting Release, these include baskets that do not reflect: (i) a *pro rata* representation of the ETF's holdings; (ii) a representative sampling of holdings; or (iii) changes based on the rebalance or reconstitution of an ETF's underlying index. The Adopting Release further specifies that a basket that corresponds *pro rata* to the ETF's holdings except minor deviations where inclusion of a particular holding is not operationally feasible would generally not be a "custom basket," except where the ETF uses different baskets in other transactions that day.

[38] The Adopting Release acknowledges, however, that an ETF's custom basket procedures (as described below) could contain "more streamlined requirements for certain cash substitutions that present lower risks."

The Adopting Release sets forth guidance with respect to the content of both general basket procedures and custom basket procedures. With respect to standard basket procedures, the Adopting Release indicates that such procedures must describe the ETF's methodology for constructing baskets and should, for example: (i) address the circumstances under which the basket may exclude positions for which it is not operationally feasible to transact in kind; (ii) when and how representative sampling may be used to construct baskets;[39] and (iii) if applicable, how the ETF will effect changes resulting from a rebalance or reconstitution of the ETF's underlying index.

The Adopting Release states that "effective" basket procedures "should provide specific parameters regarding the methodology and process that the ETF would use to construct or accept each custom basket" and should incorporate compliance testing requirements (such as back testing or other periodic reviews) for confirming that the parameters continue to be effective. The Adopting Release further indicates that custom basket procedures should be consistently applied and that ETFs must put in place a process that will be followed if they wish to make revisions to or deviate from the specified parameters. Custom basket procedures should also, per the SEC, "include reasonable controls designed to prevent inappropriate differential treatment among authorized participants." The SEC notes, however, that the requirement for "detailed parameters" does not preclude ETFs from addressing a variety of circumstances in the custom basket procedures, and that ETFs can tailor their procedures based on the different risks associated with different types of baskets (*e.g.*, cash vs. security substitutions, creations vs. redemptions).

In the Adopting Release, the SEC notes that several commenters opposed the requirement to specify the titles or roles of employees who must review baskets for compliance with the custom basket procedures and/or expressed opposition to the SEC's statement in the Proposing Release that ETFs "may want to consider whether" non-portfolio management employees should review the components of custom baskets in connection with a creation or redemption order. Accordingly, the SEC provides further guidance on this topic in the Adopting Release. The SEC indicates that it continues to believe that an ETF's investment adviser "is in the best position to design and administer" the ETF's custom basket procedures, as well as to determine the employees responsible for determining compliance with the procedures. The SEC states that, "[t]o the extent that a particular ETF's investment adviser determines that its portfolio management employees are the appropriate employees to be responsible for compliance with" the ETF's custom basket procedures, it believes that the requirements of Rule 38a-1 under the 1940 Act (relating to fund compliance programs) sufficiently address potential conflicts of interest associated with this approach. The SEC confirms that an ETF's general basket procedures and custom basket procedures should be covered by the ETF's Rule 38a-1 compliance program and other Rule 38a-1 requirements[40] and that board oversight of the ETF and its compliance program "would provide an additional layer of protection for an ETF's use of custom baskets."

Other Differences from Current Exemptive Relief

Current exemptive relief for ETFs is based on various material representations made by applicants, which impose other requirements beyond the explicit conditions of the orders. Consistent with the Proposal, many of the requirements associated with these material representations are not included in the ETF Rule, thereby allowing ETFs more flexibility with respect to their operations. These include:

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39 Under existing exemptive relief, a basket reflects a "representative sample" if it consists entirely of existing holdings and is designed to generate performance highly correlated to that of the ETF's portfolio.

40 For example, the SEC notes that the ETF's compliance policies and procedures could require "post hoc, periodic review of a sample of custom baskets used by the ETF" by the chief compliance officer or other compliance professionals.

- Disclosure of Intraday Indicative Value (IIV). Current exemptive relief contemplates dissemination of an IIV, or intraday estimate of an ETF's NAV per share, at regular intervals throughout the trading day. The SEC notes that market makers generally use their own proprietary algorithms, rather than publicly-disseminated IIVs, to value shares throughout the trading day. Accordingly, the ETF Rule does not include this requirement. As IIV disclosure is also required by exchange listing standards and 19b-4 Orders, the requirement continues to apply absent further action by the exchanges. While not requiring IIV disclosure as a condition to rely on the ETF Rule, the SEC notes that accurate intraday information may be helpful to retail investors and "encourage[s] the ETF industry to undertake efforts to develop intraday value metrics targeted at" such investors.

- Requirements Applicable to Self-Indexed ETFs. Current exemptive relief imposes various requirements on Self-Indexed ETFs. In addition to full portfolio transparency as described above, the relief requires that, among other things: (i) the registration statement prominently disclose that the index provider is an affiliated index provider and describe the nature of the affiliation; (ii) the adviser's Form ADV include a discussion of any affiliated index provider and any attendant material conflicts of interest; (iii) the adviser's compliance policies and procedures include provisions designed to minimize conflicts of interest among a Self-Indexed ETF and affiliated accounts seeking to track the same index; (iv) the ETF's board periodically review the ETF's use of the affiliated index provider; and (v) the affiliated index provider permit the Self-Indexed ETF to use the index at no cost to the ETF. The Adopting Release sets forth the SEC's belief that existing requirements under the federal securities laws (such as compliance program and codes of ethics requirements) "adequately address any special concerns" associated with Self-Indexed ETFs.[41]

- Disclosure of Foreign Holiday Schedules. In order to rely on current Section 22(e) relief, an ETF must disclose in its SAI those holidays that are expected to prevent the delivery of redemption proceeds in seven calendar days and the maximum number of days (up to 15 calendar days) needed to deliver the proceeds. As set forth in the Proposing Release, the ETF Rule does not include this requirement on the basis that the information is not relevant to investors on the secondary market, as well as the SEC's belief that information regarding possible delays is generally covered in authorized participant agreements. An ETF sponsor should review its authorized participant agreements to confirm that this information is in fact covered.

- Permitted Index Components. Under current exemptive relief, index-based ETFs must seek investment results that correspond, before fees and expenses, to the performance of a "securities index." This means derivatives that do not qualify as "securities" within the meaning of the 1940 Act (*e.g.*, swaps, futures on broad-based indices) cannot be included in the index. Given the lack of distinction between index-based and actively managed ETFs under the ETF Rule, and therefore the elimination of any requirements specific to index-based ETFs, this requirement no longer applies. Nonetheless, an ETF that seeks to track an index containing derivatives will generally not be able to rely on the exchanges' generic listing standards; therefore, in order to be listed, such an ETF would need a 19b-4 Order.

- 80% Test for Index-Based ETFs. The ETF Rule eliminates the requirement under current exemptive relief for an index-based ETF to invest at least 80% of its assets, exclusive of collateral held from securities lending, in the component securities of its underlying index. Nonetheless, in the release adopting Rule 35d-1 under the

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41 In addition, exchange rules require that where an investment adviser or broker-dealer is an index provider for an ETF's underlying index, the investment adviser or broker-dealer must implement a "fire wall" around personnel with access to information about adjustments and changes to the index. *See, e.g.*, NYSE Arca Rule 5.2(j)(3), Commentary .01(b)(1); Cboe BZX Exchange Rule 14.11(c)(3)(B)(i).

1940 Act, which relates to fund names, the SEC indicated that "[i]ndex funds ... generally would be expected to invest more than 80% of their assets in investments connoted by the applicable index," even though reference to an index would not itself trigger the Rule 35d-1 requirements.[42] Accordingly, an index-based ETF should consider this guidance and its particular facts and circumstances (such as whether the ETF's name otherwise triggers the requirement to have a policy under Rule 35d-1) in evaluating the impact of this change on its existing 80% test.

- Other Portfolio Requirements. Due to the lack of distinction between index-based ETFs and actively managed ETFs noted above, various representations in current exemptive relief relating to investment strategies and portfolio instruments are eliminated, including: (i) for index-based ETFs, expected tracking error of less than 5% relative to the index; (ii) for actively managed ETFs, an explicit requirement that the board periodically review and approve the use of derivatives; (iii) for both index-based and actively managed ETFs, a prohibition on investment in depositary receipts that the adviser deems to be illiquid, for which pricing information is not readily available, or for which an affiliated person serves as the depositary bank; and (iv) for 130/30 and long/short index-based ETFs, specific requirements with respect to relative long and short exposures. While the elimination of these representations does not necessarily result in changes to ETF operations, ETFs and investment advisers now have the flexibility to consider the best approach in these areas – such as board oversight of derivatives and evaluation of liquidity – consistent with other requirements under the federal securities laws and practices for the entire fund complex, rather than in the specific context of ETF exemptive relief.

Exchange Act Relief

Given that ETFs are exchange-traded, their structure also implicates certain provisions of the Exchange Act. However, as under the 1940 Act, the ETF structure is not specifically contemplated by the Exchange Act. Accordingly, ETFs generally seek relief from certain Exchange Act sections and rules.[43] Currently, this relief is largely provided in a series of "class" letters, meaning the letters can be relied on by ETFs meeting the requirements set forth therein without the need for separate relief.[44] ETFs that do not meet the requirements of the applicable class letters or guidance may apply for separate relief.

Relief with respect to these provisions is currently subject to various conditions, including conditions relating to: creation unit size; number of component securities and/or issuers held by the ETF; maximum percentage weighting of holdings; and IIV disclosure. These conditions differ based on the letter or series of letters (or guidance) on which the

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[42] *See* Investment Company Names, SEC Rel. No. IC-24828 (Jan. 17, 2001). Rule 35d-1 requires a fund to adopt an 80% policy meeting certain requirements, to the extent its name suggests a focus on a particular type of investment, industry, or country or geographic region or suggests that the fund's investments are tax-exempt. Where an ETF's name triggers the Rule 35d-1 requirements, ETFs often rely on the 80% policy required by the exemptive relief to satisfy both the exemptive relief and Rule 35d-1 requirements.

[43] As set forth in greater detail below, the Exchange Act sections and rules are Section 11(d)(1) of the Exchange Act and Rules 11d1-2, 10b-10, 15c1-5, 15c1-6, 10b-7 and 14e-5 thereunder, as well as Rules 101 and 102 of Regulation M.

[44] *See, e.g.*, Securities Industry Association (pub. avail. Nov. 21, 2005) (SIA Letter); Class Relief for Exchange Traded Index Funds (pub. avail. Oct. 24, 2006) (providing class relief for equity index-based ETFs) (Equity Class Letter); Class Relief for Fixed Income Exchange-Traded Funds (pub. avail. Apr. 9, 2007) (providing class relief for fixed-income index-based ETFs) (Fixed-Income Class Letter); and Frequently Asked Questions About Regulation M (last revised Sept. 10, 2010) (providing Regulation M relief for actively managed ETFs).

ETF relies, which depends on whether the ETF is index-based or actively managed, as well as on its investments (*e.g.*, equity securities, fixed-income securities, shares of other ETFs).

One of the key open questions prior to the Proposal's issuance was whether it would cover Exchange Act relief, thereby eliminating the need for ETFs to rely on the patchwork of exemptions provided to date and/or seek individual relief. In the Proposal, the SEC partially addressed the need for Exchange Act relief through its proposal to classify shares of ETFs relying on the ETF Rule as "redeemable securities." The Proposal did not, however, address the relief from Section 11(d)(1) of the Exchange Act and Rules 10b-10, 15c1-5, 15c1-6 and 14e-5 thereunder, although the SEC sought comment as to whether ETFs relying on the ETF Rule should be exempted from other Exchange Act provisions. Accordingly, by requiring ETFs to continue to comply with certain conditions of Exchange Act relief (such as minimum creation unit sizes), the Proposal could have limited the flexibility otherwise provided by the ETF Rule.

The Adopting Release notes that the SEC received several comments recommending that the classification of ETF shares as "redeemable securities" be extended to ETFs that do not rely on the ETF Rule and that existing Exchange Act relief be further harmonized with the ETF Rule. In response to these comments, the SEC has taken two steps. First, the SEC specifies in the Adopting Release that shares of all ETFs, whether or not they rely on the ETF Rule, are considered "redeemable securities" for purposes of relying on the exceptions to Rules 101(c)(4) and 102(d)(4) of Regulation M and Rules 10b-17(c) and 11d1-2 under the Exchange Act.[45] In addition, the SEC has issued the Exchange Act Relief, which grants conditional relief from Section 11(d)(1) of the Exchange Act and Rules 10b-10, 15c1-5, 15c1-6 and 14e-5 thereunder to broker-dealers and other market participants engaged in certain securities transactions involving shares of ETFs that rely on the ETF Rule. The Exchange Act Relief is subject to certain conditions, which vary based on the particular Exchange Act section or rule, but eliminates certain other requirements that exist under current Exchange Act relief.[46] Taken together, the interpretation of ETF shares as "redeemable securities" and the issuance of the Exchange Act Relief address all Exchange Act sections and rules from which ETFs generally seek relief (but only for those ETFs that rely on the ETF Rule).

The following table sets forth the provisions from which ETFs generally seek relief, the rationale therefor, and the conditions applicable to such relief under the SEC's "redeemable securities" interpretation or the Exchange Act Relief, as applicable.

Section/Rule	Request	Conditions
Section 11(d)(1)	ETFs seek an exception to permit broker-dealers, including broker-dealers that are also authorized participants, to extend credit with respect to ETF shares, subject to certain conditions.	• The ETF must rely on the ETF Rule. • The ETF must meet the diversification requirement applicable to a regulated

[45] The specific requirements of existing relief eliminated based on this classification vary based on rule, type of fund (actively managed vs. index-based, equity vs. fixed income) and whether the ETF has received individual relief with respect to a particular provision. To the extent an ETF does not rely on the ETF Rule (and therefore cannot rely on the Exchange Act Relief), it may nonetheless need to continue to comply with some or all of the requirements that would otherwise have been eliminated based on this classification.

[46] The Exchange Act Relief specifically provides, for example, that it is available "without regard to the number of ETF shares in the ETF's creation or redemption baskets or the value of those creation and redemption baskets" (citation omitted).

Section/Rule	Request	Conditions
		investment company under the Internal Revenue Code.[47] • For both broker-dealer authorized participants as well as non-authorized participant broker-dealers, aside from non-cash compensation currently permitted under FINRA Rule 2341(1)(5)(A), (B) or (C), neither the broker-dealer, nor any natural person associated with the broker dealer, may receive from a Fund Complex[48] any payment, compensation or other economic incentive to promote or sell shares of the ETF outside of the Fund Complex.[49] • With respect to broker-dealer authorized participants only (and except to the extent permitted under Rule 11d1-1), the broker dealer may not extend, maintain or arrange for the extension or maintenance of credit to or for a customer on shares of the ETF until 30 days have passed from the commencement of trading of the ETF's shares.
Rule 11d1-2	ETFs request relief to allow broker-dealers to treat ETF shares as "securities issued by a registered open-end investment company or unit investment trust as defined in the [1940 Act]," thereby providing an exemption from Section 11(d)(1) to permit extension of credit on shares of the ETFs, provided they have been held for more than 30 days	• No conditions beyond operation as an ETF (under interpretive position in Adopting Release).
Rule 10b-10	ETFs request relief to allow broker-dealers to omit specific information about an ETF's component securities from confirmations relating to ETF trades.	• The ETF must rely on the ETF Rule. • The ETF must meet the diversification requirement applicable to a regulated

47 This diversification requirement replaces the requirement under the SIA Letter that an ETF consist 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 (or, for fixed income index-based ETFs, the various requirements of the Fixed Income Class Letter).

48 For purposes of the Exchange Act Relief, a "Fund Complex" is the issuer of the ETF shares, any other issuer of ETF shares that holds itself out to investors as a related company for purposes of investment or investor services; any investment adviser, distributor, sponsor or depositor of any such issuer; or any "affiliated person" (as defined in Section 2(a)(3) of the 1940 Act) of any such issuer or any such investment adviser, distributor, sponsor or depositor.

49 This condition, together with the condition that follows in the table, is consistent with existing relief.

Section/Rule	Request	Conditions
		investment company under the Internal Revenue Code. • Confirmations relating to ETF trades must contain all of the information required under Rule 10b-10(a), except for identity, price and number of shares or units (or principal amount) of each component security; such confirmations must contain a statement that omitted information will be provided upon request; and requests for omitted information must be fulfilled in accordance with Rule 10b-10(c).[50]
Rules 15c1-5 and 15c1-6	ETFs request relief to allow broker-dealers to effect transactions in ETF shares without disclosing a control relationship with an issuer of an ETF's component securities or its participation or interest in a distribution of a component security	• The ETF must rely on the ETF Rule. • The ETF must meet the diversification requirement applicable to a regulated investment company under the Internal Revenue Code. • Broker-dealers must provide any information to which a customer is entitled to under either Rule 15c1-5 or Rule 15c1-6 upon request and in a timely manner.
Rules 101 and 102 of Regulation M	ETFs seek relief to permit treatment of ETF shares as "redeemable securities issued by an open-end management investment company or a unit investment trust," and therefore as "excepted securities" for purposes of Rules 101 and 102. These rules are anti-manipulation provisions that generally prohibit distribution participants and affiliated purchasers from purchasing ETF shares during the "restricted period," which is ongoing for an ETF in light of its continuous distribution	• No conditions beyond operation as an ETF (under interpretive position in Adopting Release).
Rule 10b-17	Given that ETFs are unable to predict the amount of a dividend 10 days in advance, ETFs seek relief with respect to notice requirements regarding dividend amounts. Specifically, ETFs request to rely on the rule's exception for "redeemable securities issued by open-end investment companies and unit investment	• No conditions beyond operation as an ETF (under interpretive position in Adopting Release).

50 This condition is consistent with existing relief.

Section/Rule	Request	Conditions
	trusts registered with the Commission under the [1940 Act]."	
Rule 14e-5	ETFs seek relief to permit "covered persons" with respect to a tender offer involving an ETF's component securities to engage in secondary market transactions in the ETF's shares and redeem ETF shares in creation unit aggregations during the existence of such tender offer.	• The ETF must rely on the ETF Rule.[51] • A broker-dealer must meet the following requirements: (i) a broker-dealer acting as a dealer-manager of a tender offer may not purchase subject securities or related securities for the purpose of facilitating a tender offer; (ii) if the composition of an ETF's portfolio changes and the exception under Rule 14e-5(b)(5) is unavailable because either the basket contains fewer than 20 securities or the subject securities and related securities make up more than 5% of the value of the basket, any purchases of a component security by a broker-dealer acting as a dealer-manager of a tender offer must be for the purpose of adjusting a basket in the ordinary course of its business and not facilitating a tender offer; and (iii) except for the relief specifically granted under the Exchange Act Relief, a broker-dealer acting as a dealer-manager of a tender offer must comply with Rule 14e-5.[52]

The Adopting Release notes that the SEC received comments requesting that ETF insiders and large shareholders be exempt from certain reporting requirements under Section 13(d) and Section 16 of the Exchange Act beyond the conditions of existing SEC staff no-action relief. The existing relief provides that the SEC staff will not recommend enforcement action for failure to file reports under Section 13(d) and Section 16(a) provided that, among other things, there is no material deviation between an ETF's NAV and market price.[53] In declining to eliminate this condition, the SEC stated that providing these exemptions where such a deviation exists "would be inconsistent with the exemptions in the [ETF Rule]," which are premised on market price and NAV being closely tied.

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51 Currently, an index-based ETF seeking to rely on class relief for Rule 14e-5 must rely on the Equity Class Letter, which contains conditions relating to diversification, minimum creation unit size and public float and average daily trading volume of portfolio securities, among other requirements. No Rule 14e-5 class relief exists for actively managed equity ETFs, so to date all such ETFs needed to apply for individual relief. Rule 14e-5 is not applicable to fixed-income ETFs.

52 These conditions are consistent with existing relief under Rule 14e-5.

53 *See* PDR Services Corporation, SEC Staff No-Action Letter (pub. avail. December 14, 1998); Select Sector SPDR Trust, SEC Staff No-Action Letter (pub. avail. May 6, 1999).

Amendments to Disclosure Forms

Amendments to Form N-1A

The ETF Rule amends Form N-1A (the registration form used by ETFs structured as open-end funds) to make certain ETF-related and other changes. Although not as significant as originally proposed, the Form Amendments include disclosure requirements designed to provide secondary market investors with more information about trading costs. Notably, the Form Amendments apply to all ETFs using that form, even ETFs that cannot rely on the ETF Rule, and eliminate disclosure distinctions tied to creation unit size.

Definitions

The amendments include two changes to the Definitions section of Form N-1A: (i) amendment of the definition of "Exchange-Traded Fund" to add a reference to the ETF Rule; and (ii) amendment of the definition of "Market Price" to have the same meaning as under the ETF Rule.

Fee Table

As proposed, the SEC has made two changes to Item 3 of Form N-1A that apply to *all* open-end funds: (i) a clarification that the fees and expenses reflected in a fund's fee and expense table may be higher where an investor *sells*, and not just buys or holds, shares; and (ii) the addition of a statement that investors may be subject to other fees, such as brokerage commissions and fees paid to financial intermediaries, that are not reflected in a fund's fee and expense table.[54]

ETF Trading and Associated Costs

The Proposal would have provided for the addition of a series of six Q&As below the fee and expense table in a new section called "Exchange-Traded Fund Trading Information and Related Costs." The ETF Rule instead amends Item 6 of Form N-1A, which relates to the purchase and sale of fund shares, to require ETFs to disclose information about ETF trading and associated costs in narrative form and cross-reference the ETF's website where investors can find additional information. Specifically, an ETF must disclose (i) that ETF shares may only be bought and sold in the secondary market through a broker or dealer at a market price; (ii) that because ETF shares trade at a market price rather than NAV, shares may trade at a premium or discount; (iii) that an investor buying or selling on the secondary market may incur costs attributable to the difference between the highest price a buyer is willing to pay for shares (bid) and the lowest price a seller is willing to accept for shares (ask) (*i.e.*, the bid-ask spread); and (iv) if applicable, how to access recent information (including NAV, market price, premiums and discounts and bid-ask spreads) on the ETF's website.

Median Bid-Ask Spread

The amendments also change Item 6 to require ETFs not relying on the ETF Rule to either provide the ETF's median bid-ask spread for the most recent fiscal year in its prospectus or comply with the ETF Rule's bid-ask spread website

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54 This is essentially an expanded version of the disclosure contemplated under the SEC staff's interpretative guidance regarding "clean shares" as set forth in a response to a request from Capital Group. *See* Response of the Office of Chief Counsel, Division of Investment Management (pub. avail. Jan. 11, 2017). In light of this change, the SEC eliminated the form provision requiring ETFs to modify the narrative disclosure to specify that the information does not reflect brokerage commissions investors may bear in connection with purchases and sales of ETF shares.

disclosure requirements. With respect to the prospectus requirement, where the ETF has less than a year of trading data, it will be required to state that it does not have sufficient trading history to report the information as proposed.

Premium/Discount Information

Currently, Item 11(g)(2) of Form N-1A requires an ETF to disclose in its prospectus premium/discount information for the most recently completed calendar year and most recently completed calendar quarters since that year, and Item 27(b)(7)(iv) requires an ETF to disclose in its annual report premium/discount information for the most recently completed five fiscal years, in each case unless the information required to be included in the prospectus is posted on the ETF's website. The SEC believes that this information would be duplicative of the more up-to-date premium/discount information that would be available on the ETF's website under the ETF Rule. Accordingly, the amendments remove the premium and discount disclosure requirements in Items 11(g)(2) and 27(b)(7)(iv) for ETFs relying on the ETF Rule. ETFs not relying on the ETF Rule must continue to provide premium and discount information in accordance with Items 11(g)(2) and 27(b)(7)(iv) unless they choose to comply with the ETF Rule's website disclosure requirements. However, the SEC has revised Item 27(b)(7)(iv) to require premium/discount for only the most recently completed calendar year and the most recently completed calendar quarters since that year, consistent with Item 11(g)(2).

Disclosure Requirements Inapplicable to ETFs and Eliminated Disclosures

Under current Form N-1A, ETFs that transact in creation units of not less than 25,000 shares are exempt from certain disclosure requirements. Specifically, if an ETF transacts in creation units of not less than 25,000 shares, it may omit: (i) fee table disclosure regarding fees charged in connection with purchases and redemptions;[55] (ii) disclosures required by Items 6(a) and (b), relating to minimum initial and subsequent investment requirements and the process for redeeming shares; and (iii) disclosures required by Items 11(a)(2), (b) and (c), relating to the timing for NAV calculation and the price at which purchases and redemptions are effected, as well as the procedures for purchasing and redeeming fund shares. Under the Form Amendments, all ETFs may omit these disclosures, regardless of creation unit size. The SEC explains that, based on staff experience, it no longer believes these requirements are necessary given that retail investors do not generally transact in creation unit aggregations through authorized participants and a "robust" flow of information exists with respect to the creation and redemption process.

The amendments also remove Item 6(c)(i) of Form N-1A, as the information covered by this subsection is currently covered by Form N-CEN.[56]

Amendments to Form N-8B-2

As the SEC believes that investors should receive consistent disclosure for all ETFs, including UIT ETFs, the SEC amended Form N-8B-2 (the registration form for unit investment trusts) to conform to the amendments to Form N-1A.

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55 Under Instruction 1(e)(ii) to Item 27(d)(1) of Form N-1A, these fees are also excluded for purposes of calculating the expense examples included in shareholder reports for such ETFs.

56 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 a basket; (ii) explain that the individual shares of the ETF may only be purchased and sold on a national securities exchange through a broker-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 premium or discount.

Amendments to Form N-CEN

The SEC amended Item C.7 of Form N-CEN (the new form for registered investment company annual reports), which requires funds to disclose their reliance on certain exemptive rules during the reporting period, to refer to the ETF Rule. The SEC also removed the reference to "DTC Participants" from the definition of "Authorized Participant" in Form N-CEN, to match the definition in the ETF Rule. The Adopting Release notes that this change also eliminates the need for future amendments in the event that additional clearing agencies register with the SEC.

Technical and Conforming Amendments

The SEC also adopted certain technical and conforming amendments to Form N-1A, Form N-8B-2, Form N-CSR, Form N-PORT and Regulation S-X based on other recent SEC rulemakings. Among other changes, these amendments require a money market fund to state the following in their annual and semi-annual reports: (i) the fund files its complete schedule of portfolio holdings with the SEC each month on Form N-MFP; (ii) those reports are available on the SEC's website; and (iii) the fund makes portfolio holdings information available to shareholders on its website.

Conclusion

The adoption of the ETF Rule will be helpful for new ETF sponsors in that it will allow them to launch ETFs that meet the conditions of the ETF Rule without the need to seek individual exemptive relief. Nonetheless, the routine nature of existing exemptive relief in recent years, combined with the operationally complex process for initially launching ETFs, often meant that the process of obtaining exemptive relief did not significantly impact a new ETF sponsor's time to market. Accordingly, the impact of the SEC's rulemaking and related actions will be most significant for existing Eligible ETFs, which will benefit from the more flexible and consistent regulatory framework offered by the ETF Rule and Exchange Act Relief. Such ETFs will first, however, need to: (i) review and update their compliance policies and procedures to reflect their reliance on the ETF Rule, rather than individual exemptive relief; (ii) adopt basket policies and procedures consistent with the ETF Rule and guidance set forth in the Adopting Release; and (iii) update their websites to provide for the information, including median bid-ask spread information, required by the ETF Rule.

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