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SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 210, 232, 239, 270, and 274

[Release Nos. 33-10695; IC-33646; File No. S7-15-18]

RIN 3235-AJ60

Exchange-Traded Funds

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission (the "Commission") is adopting a new rule under the Investment Company Act of 1940 (the "Investment Company Act" or the "Act") that will 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 final rule, the Commission will rescind certain exemptive relief that has been granted to ETFs and their sponsors. The Commission also is adopting 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 and associated 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 adopting related amendments to Form N-CEN. The final rule and form amendments are designed to create a consistent, transparent, and efficient regulatory framework for ETFs that are organized as open-end funds and to facilitate greater competition and innovation among ETFs. The Commission also is adopting technical amendments to Form N-CSR, Form N-1A, Form N-8B-2, Form N-PORT, and Regulation S-X.

DATES: *Effective Date:* This rule is effective [insert date 60 days after publication in the *Federal Register*]. *Compliance Dates:* The applicable compliance dates are discussed in section II.L. of this final rule.

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SUPPLEMENTARY INFORMATION: The Commission is adopting 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] The Commission also is adopting technical amendments to Form N-CSR [referenced in §274.128], Form N-1A, Form N-8B-2, and Form N-PORT [referenced in § 274.150] under the Investment Company Act, and 17 CFR 210.12-01 through 210.12-29 (Article 12 of Regulation S-X).

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[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 adopting 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 will modernize the regulatory framework for ETFs to reflect our more than two decades of experience with these investment products. The rule is designed to further important Commission objectives, including establishing a consistent, transparent, and efficient regulatory framework for ETFs and facilitating greater competition and innovation among ETFs.

The Commission approved the first ETF in 1992. Since then, ETFs registered with the Commission have grown to $3.32 trillion in total net assets.[2] They now account for approximately 16% 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

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[2] This figure is based on data obtained from Bloomberg. As of December 2018, there were approximately 2,000 ETFs registered with the Commission.

[3] ICI, 2019 Investment Company Fact Book (59th ed., 2019) ("2019 ICI Fact Book"), *available at* https://www.ici.org/pdf/2019_factbook.pdf, at 93. 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 reach $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.*, 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.

differences in representations and conditions that have led to some variations in the regulatory structure for existing ETFs.[6]

On June 28, 2018, we proposed new rule 6c-11 under the Investment Company Act, which 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.[7] We also proposed to rescind certain exemptive orders that have been granted to ETFs and their sponsors in order to level the playing field for ETFs that are organized as open-end funds and pursue the same or similar investment strategies.[8] In addition, the Commission proposed certain disclosure amendments to Form N-1A and Form N-8B-2 to provide investors additional information regarding ETF trading and associated costs, regardless of whether ETFs are organized as open-end funds or UITs. Finally, the Commission proposed related amendments to Form N-CEN.

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6 In addition, since 2000, our ETF exemptive orders have provided relief for future ETFs. *See id*. 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 *See* Exchange-Traded Funds, Investment Company Act Release No. 33140 (June 28, 2018) [83 FR 37332 (July 31, 2018)] ("2018 ETF Proposing Release").

8 Proposed rule 6c-11 did 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; 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"). Under the proposal, these ETFs would continue to operate pursuant to the terms of their exemptive orders. Since that time, we have granted an exemptive order permitting certain ETFs that are actively managed to operate without being subject to the daily portfolio transparency condition included in other actively managed ETF orders ("non-transparent ETFs"). *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) and related application ("2019 Precidian"). Because these non-transparent ETFs do not provide daily portfolio transparency, they would not meet the conditions of rule 6c-11. We use the term "actively managed ETFs" in this release to refer to actively managed ETFs that provide daily portfolio transparency and "non-transparent ETFs" to refer to actively managed ETFs that do not.

We received more than 85 comment letters on the proposal.[9] As discussed in greater detail below, commenters were supportive of the adoption of an ETF rule and generally supported rule 6c-11 as proposed. Commenters did, however, recommend modifications or clarifications to certain aspects of the rule. For example, several commenters suggested expanding the scope of ETFs covered by the rule or the scope of certain exemptions.[10] Many commenters recommended modifications to the proposed rule's conditions, particularly relating to the timing and presentation of portfolio holdings information, the requirements related to custom baskets, the publication of basket information, and the availability of an intraday indicative value.[11] In addition, although commenters were largely supportive of our efforts to improve the information that ETFs disclose to investors about the trading costs of investing in ETFs, several commenters objected to the bid-ask spread disclosure requirements and the related interactive calculator.[12] Others recommended alternatives to the proposed format and placement of the trading cost disclosures.[13] Finally, commenters were largely supportive of our proposal to

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9 The comment letters on the 2018 ETF Proposing Release (File No. S7-15-18) are available at https://www.sec.gov/comments/s7-15-18/s71518.htm.

10 *See, e.g.,* Comment Letter of BNY Mellon (Sept. 27, 2018) ("BNY Mellon Comment Letter") (suggesting the rule should cover all ETFs registered under the Investment Company Act); Comment Letter of Dechert LLP (Sept. 28, 2018) ("Dechert Comment Letter") (suggesting that the Commission should provide ETFs with uniform exemptive relief from certain provisions of the Securities Exchange Act of 1934 (the "Exchange Act")).

11 *See, e.g.,* Comment Letter of the Asset Management Group of the Securities Industry and Financial Markets Association (Sept. 28, 2018) ("SIFMA AMG Comment Letter I") (relating to the timing and presentation of portfolio holdings and basket information); Comment Letter of the Investment Company Institute (Sept. 21, 2018) ("ICI Comment Letter") (relating to custom baskets); Comment Letter of Professor James G. Angel, Georgetown University (Oct. 1, 2018) ("Angel Comment Letter") (relating to intraday indicative values).

12 *See, e.g.*, Comment Letter of Independent Directors Council (Sept. 27, 2018) ("IDC Comment Letter"); Comment Letter of State Street Global Advisors (Oct. 1, 2018) ("SSGA Comment Letter I").

13 *See e.g.*, Comment Letter of The Vanguard Group, Inc. (Sept. 28, 2018) ("Vanguard Comment Letter"); Comment Letter of BlackRock, Inc. (Sept. 26, 2018) ("BlackRock Comment Letter"); IDC Comment Letter; Comment Letter of Fidelity Investments (Sept. 28, 2018) ("Fidelity Comment Letter").

rescind certain exemptive orders that have been granted to ETFs and their sponsors and to replace such relief with rule 6c-11.[14]

After consideration of the comments we received, we are adopting rule 6c-11 and the proposed form amendments with several modifications that are designed to reduce the operational challenges that commenters identified, while maintaining protections for investors and providing investors with useful information regarding ETFs. As proposed, we also are rescinding the exemptive relief that we have issued to ETFs that fall within the scope of rule 6c-11, while retaining the exemptive relief granted to ETFs outside the scope of the rule. In addition, we are retaining the exemptive relief allowing ETFs to enter into fund of funds arrangements. We believe that the resulting regulatory framework will level the playing field for ETFs that are organized as open-end funds and pursue the same or similar investment strategies.[15] The rule also will assist the Commission with regulating ETFs, as funds covered by the rule will no longer be subject to the varying provisions of exemptive orders granted over time. Furthermore, rule 6c-11 will allow Commission staff, as well as funds and advisers seeking exemptions, to focus exemptive relief on products that do not fall within the rule's scope.

The Commission will continue to monitor this large, diverse and important market. We welcome continued engagement with ETF sponsors, investors and other market participants on

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[14] *See, e.g.*, Comment Letter of Federal Regulation of Securities Committee, Business Law Section, American Bar Association (Oct. 11, 2018) ("ABA Comment Letter"); ICI Comment Letter; Comment Letter of Invesco Ltd. (Sept. 26, 2018) ("Invesco Comment Letter"). Exemptive orders granted to ETFs and their sponsors often include relief allowing funds to invest in other funds in excess of statutory limits. We did not propose to rescind that relief. *See infra* section 0.

[15] Additionally, as discussed below in section 0, the Commission is issuing an order granting an exemption from certain provisions of the Exchange Act and the rules thereunder for certain transactions in securities of ETFs that can rely on rule 6c-11. *See* Order Granting a Conditional Exemption from Exchange Act Section 11(d)(1) and Exchange Act Rules 10b-10; 15c1-5; 15c1-6; and 14e-5 for Certain Exchange Traded Funds, Release No. 34-87110 (September 25, 2019) ("ETF Exchange Act Order").

matters related to the ETF market, including with regard to ETFs that do not fall within the scope of rule 6c-11 and ETFs that may not function in a manner consistent with the expectations embodied in our regulatory framework.

A. Overview of Exchange-Traded Funds

ETFs are a type of exchange-traded product ("ETP").[16] 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.[17] Because ETFs 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 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).[18] The Commission also has approved the listing standards of national securities exchanges under which ETF shares are listed and traded.[19]

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[16] 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.

[17] 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 rule 23c-3 under the Act. Other closed-end funds may repurchase their shares in tender offers pursuant to rule 13e-4 under the Exchange Act.

[18] 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").

[19] 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); and 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)). *See* Request

As discussed above, ETFs have become an increasingly popular investment vehicle over the last 27 years, providing investors with a diverse set of investment options.[20] They also have become a popular trading tool, making up a significant portion of secondary market equities trading. During the first quarter of 2019, for example, trading in U.S.-listed ETFs made up approximately 18.3% of U.S. equity trading by share volume and 27.2% of U.S. equity trading by dollar volume.[21]

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.[22] Because certain costs are either absent in the ETF structure or are otherwise partially externalized, many ETFs have lower operating expenses than mutual funds.[23] 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

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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.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).

20 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. 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 predetermined period of time. 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. Investors also have the ability to invest in ETFs that do not track a particular index and are actively managed. *See* 2018 ETF Proposing Release, *supra* footnote 7, at nn.18–20.

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

22 *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-investor1470673638; Greenwich Associates, *Institutions Find New, Increasingly Strategic Uses for ETFs* (May 2012). ETF investors also can sell ETF shares short, write options on them, and set market, limit, and stop-loss orders on them.

23 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.

cash), thereby avoiding the need for the ETF to sell assets and potentially realize capital gains that are distributed to its shareholders.

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."[24] 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.[25] 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 gain exposure to a strategy or asset class.[26]

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[24] As discussed below, rule 6c-11(a)(1) defines "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.

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

[26] *Id*.

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.[27] The basket is generally representative of the ETF's portfolio,[28] and together with a cash balancing amount, it is equal in value to the aggregate net asset value ("NAV") of the ETF shares in the creation unit.[29] 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.[30] 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 and underlying securities provides arbitrage opportunities that are designed to help

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[27] 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").

[28] 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 0.

[29] 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). 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").

[30] 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").

keep the market price of ETF shares at or close to the NAV per share of the ETF.[31] 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 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.[32] 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

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[31] The arbitrage mechanism for ETFs that would be subject to rule 6c-11 has been dependent on daily portfolio transparency.

[32] 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 basket assets, the authorized participant can then use the basket assets to cover its short positions.

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.[33]

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.[34] 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 or some types of ETFs more favorably than similar closed-end funds.[35] On the other hand, if the expectation of a close tie to NAV per share is not met, investors may sell or refrain from purchasing ETF shares.[36]

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[33] 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 I"), *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."); 2019 ICI Factbook, *supra* footnote 3 ("On average, 90 percent of the total daily activity in ETFs occurs on the secondary market.").

[34] *See* 15 U.S.C. 80a-6(c).

[35] 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, 2018, total net assets of ETFs were $3.4 trillion compared to $250 billion for closed-end funds. *See* 2019 ICI Fact Book, *supra* footnote 3.

[36] *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*

II. DISCUSSION

Given the growth in the ETF market, ETFs' popularity among retail and institutional investors, and our long experience regulating this investment vehicle, we believe that it is appropriate to adopt a rule that will allow most ETFs to operate without first obtaining an exemptive order from the Commission under the Act. We believe, and commenters on proposed rule 6c-11 generally agreed, that such a rule will help create a consistent, transparent, and efficient regulatory framework for the regulation of most ETFs and help level the playing field for these market participants.[37]

As adopted, rule 6c-11 will exempt ETFs organized as open-end funds from certain provisions of the Act and our rules. The exemptions will permit an ETF to: (i) redeem shares only in creation unit aggregations; (ii) permit ETF shares to be purchased and sold at market prices, rather than NAV; (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.

These exemptions are subject to 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 conditions are based upon existing exemptive relief for ETFs, which we believe has served to support an efficient arbitrage mechanism, but reflect several modifications based on our experience regulating this product and commenters' input on the proposed rule.

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https://www.sec.gov/marketstructure/research/equity_market_volatility.pdf.

[37] *See, e.g.*, BlackRock Comment Letter; IDC Comment Letter; Fidelity Comment Letter; Angel Comment Letter; Comment Letter of Nasdaq, Inc. (Sept. 28, 2018) ("Nasdaq Comment Letter").

- First, rule 6c-11 will require an ETF to disclose portfolio holdings each business day on its website before the opening of trading on the ETF's primary listing exchange in a standardized manner. The rule also will require daily website disclosure of the ETF's NAV, market price, premium or discount, and the extent and frequency of an ETF's premiums and discounts. These disclosures are designed to promote an effective arbitrage mechanism and inform investors about the risks of deviation between market price and NAV when deciding whether to invest in ETFs generally or in a particular ETF.
- In addition, the rule will require daily website disclosure of the ETF's median bid-ask spread over the last thirty calendar days. This requirement is designed to provide investors with additional information regarding potential costs associated with buying and selling ETF shares.
- With respect to baskets, the rule will require an ETF 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. The rule will allow ETFs to use "custom baskets" if their basket policies and procedures: (i) set forth detailed parameters for the construction and acceptance of custom baskets that are in the best interest 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. As discussed below, these conditions will provide ETFs with additional basket flexibility, which we believe could benefit investors through more efficient arbitrage and narrower bid-ask spreads, subject to protections designed to address the risks that such flexibility may present.
- Rule 6c-11 also will include a condition that excludes an ETF that seeks, directly or indirectly, to provide investment returns over a predetermined period of time that: (i) correspond to the performance of a market index by a specified multiple; or (ii) have an inverse relationship to the performance of a market index (including by an inverse multiple) ("leveraged/inverse ETFs").[38]
- An ETF also must retain certain records under rule 6c-11, including information regarding each basket exchanged with an authorized participant

In order to harmonize the regulation of most ETFs, we are rescinding, one year after the effective date of rule 6c-11, those portions of our prior ETF exemptive orders that grant relief related to the formation and operation of an ETF, including certain master-feeder relief.[39] We are not rescinding the exemptive relief of UIT ETFs, leveraged/inverse ETFs, share class ETFs,

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38 *See infra* section 0.

39 *See infra* sections II.F. and II.G. We are also amending approximately 200 ETF exemptive orders that automatically expire on the effective date of a rule permitting the operation of ETFs to give them time to make any adjustments necessary to rely on rule 6c-11.

and non-transparent ETFs, however, which are outside the scope of rule 6c-11. In addition, we are not rescinding the portions of our prior ETF exemptive orders allowing funds to invest in ETFs in excess of statutory limits in connection with this rulemaking and we are providing relief to allow newly formed ETFs to enter into certain fund of funds arrangements.[40]

Finally, we are adopting amendments to Forms N-1A and N-8B-2 to eliminate certain disclosures that we believe are no longer necessary and to require ETFs that do not rely on rule 6c-11 to provide secondary market investors with disclosures regarding certain ETF trading and associated costs. For example, the form amendments will require such an ETF to provide median bid-ask spread information either on its website or in its prospectus. We believe these amendments will provide investors who purchase ETF shares in secondary market transactions with information to better understand the total costs of investing in an ETF.

A. Scope of Rule 6c-11

1. Organization as Open-End Funds

As proposed, rule 6c-11 will 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.[41] ETFs

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[40] *See infra* section 0. In December 2018, we proposed new 17 CFR 270.12d1-4 (rule 12d1-4 under the Act) to streamline and enhance the regulatory framework applicable to fund of funds arrangements. *See* Fund of Funds Arrangements, Investment Company Act Release No. 33329 (Dec. 19, 2018) [84 FR 1286 (Feb. 1, 2019)] (proposing release) ("FOF Proposing Release"). In connection with proposed rule 12d1-4, we also proposed to rescind the exemptive orders granting relief for certain fund of funds arrangements, including the relief from sections 12(d)(1)(A) and (B) that has been included in our ETF exemptive orders. *See id*. at nn.236–237 and accompanying text.

[41] *See* rule 6c-11(a)(1). Under the rule, the term "basket" will 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 will include ETFs that transact on an in-kind basis, on a cash basis, or both.

organized as UITs ("UIT ETFs") will continue operating pursuant to their exemptive orders, which include terms and conditions more appropriately tailored to address the unique features of a UIT.[42] Additionally, as proposed, our form amendments will require UIT ETFs to provide disclosures similar to those provided by other ETFs that are subject to the Investment Company Act.

We understand that most ETF sponsors prefer the open-end fund structure over the UIT structure given the increased investment flexibility the open-end structure affords.[43] For example, ETFs organized as open-end funds can be actively managed or use a "sampling" strategy to track an index.[44] An open-end ETF also may participate in securities lending programs, has greater flexibility to reinvest dividends, and may invest in derivatives, which typically require a degree of management that is not provided for in the UIT structure.[45]

Commenters addressing this aspect of the proposal generally supported excluding UIT ETFs from the scope of rule 6c-11. These commenters stated that the structural and operational

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42 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. *See* section 4(2) of the Act [15 U.S.C. 80a-4]. By statute, a UIT is unmanaged and its portfolio is fixed. Substitution of securities may take place only under certain pre-defined circumstances. A UIT does not have a board of directors, corporate officers, or an investment adviser to render advice during the life of the trust. *See* 2018 ETF Proposing Release, *supra* footnote 7, at section II.A.1.

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.

43 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. *See* 2018 ETF Proposing Release, *supra* footnote 7, at section II.A.1.

44 UIT ETFs seek to track the performance of an index by investing in the component securities of an index in the same approximate proportions as in the index (*i.e.*, "replicating" the index) rather than acquiring a subset of the underlying index's component securities or other financial instruments that the ETF's adviser believes will help the ETF track the underlying index (*i.e.*, "sampling" the index). In addition, because the exemptive relief granted to UIT ETFs does not provide relief from the portion of section 4(2) that requires UIT securities to represent an undivided interest in a unit of "specified securities," the investment strategies that a UIT ETF can pursue are limited. *See id*. at n.37.

45 *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.

nuances associated with UIT ETFs would make their inclusion in rule 6c-11 impractical.[46] These commenters also generally agreed that existing UIT ETFs should continue to rely on their individual exemptive orders, and that the Commission should review new UIT ETFs as part of the exemptive order process. One commenter suggested, however, that the Commission consider potential updates to UIT ETFs' exemptive orders to account for certain sponsor services that were not contemplated at the time the orders were granted.[47]

After considering comments, we continue to believe that rule 6c-11 should apply only to ETFs organized as open-end funds, while UIT ETFs should continue to rely on their existing exemptive orders.[48] We acknowledge that excluding UIT ETFs will result in a segment of ETF assets outside the regulatory framework of rule 6c-11. However, we do not believe there is a need to include UIT ETFs within the scope of the 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, the unique structural and operational aspects of UIT ETFs noted by commenters would necessitate a regulatory framework that differs from the structure we are adopting for open-end ETFs. We believe that the unmanaged nature of the UIT structure, in particular, would require conditions

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46 *See, e.g.*, Invesco Comment Letter; SSGA Comment Letter I; Comment Letter of CFA Institute (Nov. 15, 2018) ("CFA Institute Comment Letter"); Comment Letter of Cboe Global Markets, Inc. (Oct. 1, 2018) ("Cboe Comment Letter") (stating that the "unique issue set applicable to UITs as compared to non-UIT ETFs warrant the disparate treatment between UITs and other ETFs.").

47 Invesco Comment Letter (stating that these services include chief compliance officer services and ongoing trading services). UIT ETFs have obtained exemptive relief from section 26(a)(2)(C) of the Act to allow the ETF to pay certain enumerated expenses. *See* 2018 ETF Proposing Release, *supra* footnote 7, at n.52 and accompanying text.

48 The vast majority of ETFs currently in operation are organized as open-end funds, though the earliest ETFs were organized as UIT ETFs, and these early UIT ETFs represent a significant portion of the assets within the ETF industry. As of Dec. 31, 2018, 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).

that differ from the conditions applicable to open-end ETFs. For example, rule 6c-11 will 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 such conditions require ongoing management and board oversight, we do not believe that extending such basket flexibility to UIT ETFs would be appropriate.[50] The relief granted to UIT ETFs also includes relief from sections of the Act that govern key aspects of a UIT's operations, which differ from the relief we are providing under rule 6c-11.[51] In short, we believe including UIT ETFs within the scope of rule 6c-11 would complicate the rule significantly and would continue to result in a regulatory framework where the relief and conditions applicable to UIT ETFs and open-end ETFs differ.

To the extent that ETF sponsors develop 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 also believe that the Commission's exemptive process is well-suited to handle requests to modify existing UIT ETF exemptive relief.

Consistent with the proposal, we are not rescinding existing exemptive orders that allow UIT ETFs to operate. Two commenters addressing the exclusion of UIT ETFs from the rule urged the Commission to clarify that UIT ETFs operating pursuant to their exemptive orders can nevertheless continue marketing themselves as "ETFs."[52] As discussed below, the Commission is not limiting use of the term "ETF" or "exchange-traded fund" to funds relying on rule 6c-11.

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49 *See infra* section 0.

50 *See* 2018 ETF Proposing Release, *supra* footnote 7, at nn.46–48 and accompanying text.

51 *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").

52 *See* SSGA Comment Letter I; SIFMA AMG Comment Letter I.

UIT ETFs therefore may continue to use these terms in their marketing materials and otherwise hold themselves out as "ETFs." Further, while UIT ETFs are excluded from the scope of rule 6c-11, we are adopting amendments to Form N-8B-2 that will require them to provide certain additional disclosures regarding ETF trading costs.[53]

2. Index-Based ETFs and Actively Managed ETFs

Consistent with the proposal, rule 6c-11 will provide exemptions for both index-based ETFs and actively managed ETFs, but will 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. Index-based and actively managed ETFs that comply with the rule's conditions function similarly with respect to operational matters, despite different investment objectives or strategies. 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.[54] Since 2008, however, the actively managed ETF market has grown considerably.[55] The Commission has observed how actively managed ETFs operate during this time, and has not

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53 *See* Form N-8B-2 disclosure requirements *infra* section 0.

54 *See* 2018 ETF Proposing Release, *supra* footnote 7, at n.58. Approximately 100 exemptive orders have been issued since 2008 for actively managed, transparent ETFs.

55 Based on data obtained from MIDAS, Bloomberg and Morningstar Direct as of December 31, 2018, we estimate that there are now over 270 actively managed ETFs with approximately $72 billion in assets.

identified any operational issues that suggest additional conditions for actively managed ETFs are warranted.

Commenters that addressed this aspect of the proposal supported the rule's elimination of the historical distinction between index-based and actively managed ETFs.[56] Specifically, commenters agreed that ETFs operate similarly irrespective of whether they are index-based or actively managed, and stated that there are no operational issues that warrant additional conditions for actively managed ETFs.[57] In addition, one commenter stated that, in its experience, deviations between market price and NAV per share are more variable across asset classes underlying ETFs than between index-based and actively managed ETFs investing in the same asset class.[58]

We continue to believe that index-based and actively managed ETFs do not present significantly different concerns under the provisions of the Act from which the rule grants relief

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56 *See, e.g.*, ICI Comment Letter; Invesco Comment Letter; Comment Letter of the Index Industry Association (Sept. 30, 2018); Comment Letter of the Fixed Income Market Structure Advisory Committee (Oct. 29, 2018) ("FIMSAC Comment Letter"); Comment Letter of NYSE Arca, Inc. (Oct. 10, 2018) ("NYSE Arca Comment Letter"); CFA Institute Comment Letter; Comment Letter of J.P. Morgan Asset Management (Oct. 1, 2018) ("JPMAM Comment Letter").

57 *See, e.g.*, NYSE Arca Comment Letter; Comment Letter of WisdomTree Asset Management, Inc. (Oct. 1, 2018) ("WisdomTree Comment Letter"). As discussed in section 0. *infra*, however, some commenters opposed, or suggested alternatives to, full portfolio transparency for actively managed ETFs.

We also received 43 comment letters requesting that the Commission approve an ETP with an investment objective that seeks results that correspond to the performance of bitcoins or other digital assets. *See, e.g.*, Comment Letter of Charles Brown (July 12, 2018); Comment Letter of Lars Hoffman (July 14, 2018). Rule 6c-11, however, is based on existing relief for ETFs relating to the formation and operation of ETFs under the Investment Company Act and does not relate to specific strategies. *See* Letter from Dalia Blass, Director of Investment Management, to Paul Schott Stevens, President and CEO, Investment Company Institute and Timothy W. Cameron, Asset Management Group – Head, Securities Industry and Financial Markets Association (Jan. 18, 2018), *available at* http://www.sec.gov/divisions/investment/noaction/2018/cryptocurrency-011818.htm (noting that in the staff's view ETFs and other funds that hold substantial amounts of cryptocurrencies and related products raise significant questions regarding how they would satisfy certain other requirements of the Investment Company Act and its rules). The Commission continues to welcome engagement with the public on issues related to cryptocurrency ETPs.

58 *See* JPMAM Comment Letter ("[O]ur active ETFs trade with similar, and at times lower, deviations than our index ETFs; all of them typically trade within 50 basis points of their NAVs.").

because they function similarly with respect to operational matters. As noted below, the arbitrage mechanism for existing actively managed ETFs has worked effectively with small deviations between market price and NAV per share.[59] Permitting index-based and actively managed open-end ETFs to operate under the rule subject to the same conditions also will 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 proliferation of highly customized, often methodologically complicated indexes. Commenters agreed that the proliferation of these indexes has blurred the distinction between index-based and actively managed ETFs, while ETF industry practices in areas such as portfolio transparency generally do not vary between these types of funds.[60] We therefore believe that eliminating the regulatory distinction between index-based ETFs and actively managed ETFs for purposes of exemptive relief under the Act will help to provide a more consistent and transparent regulatory framework for ETFs organized as open-end funds. This approach is consistent with our regulation of other types of open-end funds, which does not distinguish between actively managed and index-based strategies.

In addition, consistent with our proposal, rule 6c-11 does not include additional conditions relating to index-based ETFs with affiliated index providers ("self-indexed ETFs"). Commenters generally agreed with the proposal's approach to self-indexed ETFs, indicating that

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59 *See supra* section 0.

60 *See* FIMSAC Comment Letter ("[I]ndustry participants note that distinctions between active and passive products . . . are increasingly blurred with the advent of 'smart beta' or factor products, or of index products with active elements . . . .); JPMAM Comment Letter ("[A]s the proposal notes, practices around portfolio transparency have converged across index-based and actively managed ETFs.").

existing securities laws adequately address any special concerns presented by these ETFs.[61] One commenter, however, noted that the concerns that were expressed by the Commission when it granted individualized exemptive relief for self-indexed ETFs remain important.[62] This commenter stated that the Commission should permit self-indexed ETFs only "on the condition that [an information] firewall between the index provider and the asset manager exists."[63]

We agree with the commenters who stated that the existing federal securities laws adequately address any special concerns that self-indexed ETFs present, including the potential ability of an affiliated index provider to manipulate an underlying index to the benefit or detriment of a self-indexed ETF.[64] For example, ETF sponsors are likely to be in a position to

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61 *See* Invesco Comment Letter; BlackRock Comment Letter; IIA Comment Letter; JPMAM Comment Letter; SSGA Comment Letter ("[C]urrent regulatory requirements . . . effectively require a heightened set of requirements associated with affiliated index providers…"); WisdomTree Comment Letter ("Advisers are already required to adopt policies designed to prevent portfolio information from being misappropriated.").

62 *See* Morningstar Comment Letter. *See also* 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 ("Guggenheim Funds") (discussing concerns regarding the ability of an affiliated index provider to manipulate an underlying index to the benefit or detriment of a self-indexed ETF and the potential for conflicts that may arise with respect to the personal trading activity of an affiliated index provider's personnel). Guggenheim Funds permitted a self-indexed ETF to address these concerns through full portfolio transparency, instead of certain policies and procedures that had been required in earlier exemptive orders for self-indexed ETFs. *But 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.

63 *See* Morningstar Comment Letter.

64 *See* 17 CFR 270.38a-1 (rule 38a-1 under the Act) (requiring funds to adopt policies and procedures reasonably designed to prevent violation of federal securities laws); 17 CFR 270.17j-1(c)(1) (rule 17j-1(c)(1) under the Investment Company Act) (requiring funds to adopt a code of ethics containing provisions designed to prevent certain fund personnel ("access persons") from misusing information regarding fund transactions); section 204A of the Investment Advisers Act of 1940 ("Advisers Act") (15 U.S.C. 80b-204A) (requiring an adviser to adopt policies and procedures that are reasonably designed, taking into account the nature of its business, to prevent the misuse of material, non-public information by the adviser or any associated person, in violation of the Advisers Act or the Exchange Act, or the rules or regulations thereunder); section 15(g) of the Exchange Act (15 U.S.C. 78o(f)) (requiring a registered broker or dealer to adopt policies and procedures reasonably designed, taking into account the nature of the broker's or dealer's business, to prevent the misuse of material, nonpublic information by the broker or dealer or any person associated with the broker or dealer, in violation of the Exchange Act or the rules or regulations thereunder).

understand the potential circumstances and relationships that could give rise to the misuse of non-public information, and can develop appropriate measures to address them. Therefore, we continue to believe that portfolio transparency combined with existing requirements should be sufficient to protect against the abuses addressed in exemptive applications of ETF sponsors that either use affiliated index providers or create their own indexes.[65]

3. Leveraged/Inverse ETFs

As proposed, rule 6c-11 includes a condition that excludes leveraged/inverse ETFs.[66] These ETFs may not rely on the rule, and will instead continue to operate pursuant to their exemptive orders.[67] Broadly speaking, leveraged/inverse ETFs seek to amplify the returns of an underlying index by a specified multiple or to profit from a decline in the value of an underlying index over a predetermined period of time using financial derivatives. Leveraged/inverse ETFs also rebalance their portfolios on a daily or other periodic basis in order to maintain a constant leverage ratio.[68] These funds' use of leverage together with this periodic rebalancing (or "reset"), and the resulting effects of compounding, can result in performance that differs significantly from some investors' expectations of how index investing generally works.

For example, as a result of compounding, a leveraged/inverse ETF can outperform a simple multiple of its index's returns over several days of consistently positive returns, or

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Cf., e.g., Rule Commentary .02(b)(i) of NYSE American Rule 1000A (requiring a "fire wall" between an ETF and an affiliated index provider).

65 *See infra* section 0. (discussing requirements in rule 6c-11 regarding portfolio transparency).

66 *See* rule 6c-11(c)(4).

67 As of December 2018, 167 ETFs employed leveraged or inverse investment strategies. These ETFs had total net assets of $29.64 billion or approximately 1% of all ETF assets.

68 *See* 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 II") (providing a description of maintaining a stated ratio to an underlying index as a daily investment objective).

underperform a simple multiple of its index's returns over several days of volatile returns.[69] Investors holding shares over periods longer than the time period targeted by the ETF's investment objective may experience performance that is different, and at times substantially different, from the returns of the targeted index over the same investment period. Buy-and-hold investors with an intermediate or long-term time horizon that invest in a leveraged/inverse ETF—who may not evaluate their portfolios frequently—may experience large and unexpected losses or otherwise experience returns that are different from what they anticipated.[70] As a result, leveraged/inverse ETFs are complex products that serve a markedly different investment purpose than most other ETFs.[71]

Leveraged/inverse ETFs' use of derivatives also raises issues under section 18 of the Act, which limits a fund's ability to obtain leverage.[72] The Commission has been evaluating these

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69 *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").

70 *See* FINRA Regulatory Notice 09-31, *supra* footnote 69 (reminding member firms of their sales practice obligations relating to leveraged/inverse ETFs and noting that leveraged/inverse ETFs are typically not suitable for retail investors who plan to hold these products for more than one trading session).

71 *See* Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Investment Advisers Act Release No. 5248 (June 5, 2019) [84 FR 33669 (July 12, 2019)] at n.39 and accompanying text ("[I]nverse or leveraged exchange-traded products that are designed primarily as short-term trading tools for sophisticated investors may not be in the best interest of a retail client absent an identified, short-term, client-specific trading objective and, to the extent that such products are in the best interest of a retail client initially, they would require daily monitoring by the adviser"). *See also* Regulation Best Interest, Exchange Act Release No. 86031 (June 5, 2019) [84 FR 33318 (July 12, 2019)] at text accompanying n.596 (stating that broker-dealers recommending leveraged or inverse exchange-traded products with a daily reset should understand that such products may not be suitable for, and as a consequence also not in the best interest of, retail customers who plan to hold them for longer than one trading session, particularly in volatile markets); Order Granting Approval of a Proposed Rule Change, as Modified by Amendment No. 2, to Amend Nasdaq Rules 5705 and 5710 to Adopt a Disclosure Requirement for Certain Securities, Exchange Act Release No. 85362 (Mar. 19, 2019) [84 FR 11148 (Mar. 25, 2019)] (adopting certain disclosure requirements for leveraged/inverse ETFs).

72 15 U.S.C. 80a-18.

section 18 issues as part of a broader consideration of derivatives use by registered funds and business development companies ("BDCs").[73] We therefore proposed to exclude leveraged/inverse ETFs from the scope of rule 6c-11 so that the Commission could consider these concerns in a comprehensive manner with other funds that use leverage.[74] We also proposed to allow leveraged/inverse ETFs and their sponsors to continue to rely on their existing exemptive relief in order to preserve the status quo.[75]

Most commenters who addressed this aspect of the proposal agreed that leveraged/inverse ETFs present issues and concerns that should be addressed outside the context of rule 6c-11.[76] One such commenter stated that leveraged/inverse ETFs present "highly specific and accentuated risks" and stated that the Commission should regulate these products under tailored exemptive orders.[77] Other commenters urged the Commission to consider additional investor protection requirements for leveraged/inverse ETFs, such as requiring marketing

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[73] *See* Derivatives Proposing Release, *supra* footnote 45 (proposing new rule 18f-4 under the Act, which 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' (including leveraged/inverse ETFs') use of derivatives transactions).

[74] Proposed rule 6c-11 would have provided that an ETF relying on the rule "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." *See* proposed rule 6c-11(c)(4).

[75] The staff has not supported new exemptive relief for leveraged/inverse ETFs since 2009. The orders issued to current leveraged/inverse ETF sponsors, as amended over time, relate to leveraged/inverse ETFs that seek daily 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 ("Rafferty I"). *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 II, *supra* footnote 68.

[76] *See* BlackRock Comment Letter; Invesco Comment Letter; SSGA Comment Letter I; Comment Letter of ICE Data Services (Oct. 1, 2018) ("IDS Comment Letter"); FIMSAC Comment Letter; CFA Institute Comment Letter; *see also* Cboe Comment Letter (indicating that these ETFs should be "treated differently" but not specifically stating whether such ETFs should be excluded from the scope of the rule).

[77] *See* Invesco Comment Letter.

materials to notify retail investors about the risks of investing in these instruments or other enhanced disclosure requirements.[78] Some commenters stated that the Commission should not permit leveraged/inverse ETFs to use the terms "ETF" or "exchange-traded fund" in their names, because investors might mistakenly assume that all products referred to as ETFs are structured and regulated like "traditional" ETFs.[79]

Other commenters were less specific as to whether the Commission should regulate leveraged/inverse ETFs under exemptive orders or through a separate rule, but stated that leveraged/inverse ETFs should be regulated by means other than rule 6c-11.[80] One commenter agreed that leveraged/inverse ETFs "raise important disclosure and investor protection issues," but strongly encouraged the Commission to "initiate proceedings, whether as part of its consideration of derivative usage or otherwise, to determine what its future approach" to leveraged/inverse ETFs will be.[81]

Sponsors of leveraged/inverse ETFs, however, advocated that the rule should not exclude leveraged/inverse ETFs. They asserted that leveraged/inverse ETF investors understand the special concerns related to these products, accept the products' risks, and utilize the products appropriately.[82] One of these commenters stated that the rule's exemptive relief targets ETFs'

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78 *See* CFA Institute Comment Letter; Nasdaq Comment Letter (stating that there is significant investor confusion regarding existing leveraged/inverse ETFs' daily investment horizon). *See also* Comment Letter of Rafferty Asset Management, LLC (Oct. 1, 2018) ("Direxion Comment Letter") (supporting enhanced disclosure requirements for leveraged/inverse ETFs if reliance on rule 6c-11 is allowed for the operation of leveraged/inverse ETFs).

79 *See* BlackRock Comment Letter; FIMSAC Comment Letter.

80 *See* SSGA Comment Letter I ("Leveraged ETFs . . . present issues which are appropriately addressed through means other than the Proposed ETF Rule."); IDS Comment Letter ("IDS believes that leveraged and inverse ETFs strategies carry significantly different risk profiles than index-based ETFs. For that reason we agree that they should be excluded from the scope of funds that may rely on the proposed rule.").

81 Comment Letter of the Mutual Fund Directors Forum (Oct. 1, 2018) ("MFDF Comment Letter").

82 *See* Direxion Comment Letter ("Given [certain data findings and educational efforts by regulators, brokerage firms, and the ETFs themselves] we believe it would be hard for investors *not* to understand that

structural and operational characteristics, and that leveraged/inverse ETFs are structured and operated in the same manner as other ETFs within the rule's scope.[83] Among other similarities, the commenter noted that leveraged/inverse ETFs are structured as open-end funds, provide full portfolio transparency, and accept creation and redemption baskets using the same operating mechanisms as other ETFs. The commenter also opined that leveraged/inverse ETFs should not be excluded from the scope of the rule because other ETFs that utilize leverage in their investment strategies are not excluded from the scope of the rule.

Another commenter did not object to excluding leveraged/inverse ETFs from rule 6c-11, but opined that the proposed rule's condition excluding leveraged/inverse ETFs was overly broad, potentially capturing ETFs that have an inverse relationship to the performance of a market index or ETFs that use other hedging strategies to reduce risk.[84] This commenter also asked the Commission to confirm that the exclusion would not, in effect, apply to every ETF that seeks to track an index that includes derivatives. Additionally, several commenters did not specifically address leveraged/inverse ETFs, but generally stated that rule 6c-11 should apply across all ETFs registered under the Investment Company Act to create an even playing field.[85]

After considering these comments, we have determined to include a condition that prevents leveraged/inverse ETFs from relying on the rule.[86] Although leveraged/inverse ETFs are structurally and operationally similar to other types of ETFs within the scope of rule 6c-11,

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our leveraged ETFs are complex products that are 'different' from other ETFs, and we have not seen any recent empirical data or other evidence to the contrary."); Comment Letter of ProShare Advisors LLC (Oct. 1, 2018) ("ProShares Comment Letter").

83 *See* ProShares Comment Letter.

84 *See* Cboe Comment Letter (stating that the exclusion should cover only those inverse ETFs that seek to provide returns that exceed the performance of a market index by a "specified inverse multiple").

85 *See, e.g.,* BNY Mellon Comment Letter.

86 *See* Rule 6c-11(c)(4).

we believe it is premature to permit sponsors to form and operate leveraged/inverse ETFs in reliance on the rule without first addressing the investor protection purposes and concerns underlying section 18 of the Act. We therefore believe that the Commission should complete its broader consideration of the use of derivatives by registered funds before considering allowing leveraged/inverse ETFs to rely on the rule.

Given that rule 6c-11 is intended to help create a consistent regulatory framework for ETFs and a level playing field among ETF sponsors, we acknowledge that excluding leveraged/inverse ETFs from the rule's scope and permitting existing leveraged/inverse ETFs to continue to operate pursuant to their exemptive orders at this time delays, in part, achieving those goals. However, because leveraged/inverse ETFs raise policy considerations that are different from those we seek to address in the rule, we believe rule 6c-11 should exclude leveraged/inverse ETFs.

As adopted, rule 6c-11 will exclude ETFs that seek to provide leveraged or inverse investment returns over a predetermined period of time. The periodic reset that such strategies necessitate distinguish leveraged/inverse ETFs from other types of ETFs that may use leverage. In the proposal we did not specify the period of time over which an ETF had to seek to deliver a leveraged or inverse return of an index to be covered by the proposed rule's leveraged/inverse ETF exclusion, and we similarly decline to specify a period of time here.[87] However, the condition relating to leveraged/inverse ETFs continues to include a temporal element (*i.e.*, "over a predetermined period of time") in order to specifically capture ETFs that seek to deliver the leveraged or inverse return of a market index over a set period of time, daily or otherwise.[88]

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[87] *See* 2018 ETF Proposing Release, *supra* footnote 7, at section II.A.3.

[88] *See* rule 6c-11(c)(4). The current exemptive orders that allow leveraged/inverse ETFs contemplate a daily

In addition, while the rule uses the term "multiple," leveraged/inverse ETFs with strategies that seek directionally leveraged or inverse returns of an index present the investor protection concerns discussed above regardless of whether the amplification factor or inverse factor is evenly divisible by 100 (*e.g.*, a fund that seeks to provide a daily investment return equal to 150% of the performance of an index). Thus, to clarify the rule's use of the term "multiple," leveraged/inverse ETFs are excluded from the scope of the rule regardless of whether the returns they seek over a predetermined time period are evenly divisible by 100.[89] The exclusion also includes strategies that pursue a specified range of a multiple or inverse multiple of an index's performance (*e.g.*, 200% to 300% of an index's performance or -200% to -300% of an index's performance). This approach is consistent with our existing exemptive orders and will capture those ETFs that have historically been considered "leveraged/inverse ETFs" in the marketplace.

We also continue to believe that it is important to specify that an ETF relying on the rule may not *indirectly* seek to provide investment returns that correspond to 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 predetermined period of time in order to prevent a fund from circumventing this condition, such as by embedding leverage in the underlying index.[90]

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reset, because the orders relate to ETFs that pursue daily investment objectives. *See* 2018 ETF Proposing Release, *supra* footnote 7 at n.77 and related discussion. Proposed rule 6c-11 used the term "fixed period of time" to prevent both these ETFs and leveraged/inverse ETFs contemplating non-daily resets (*e.g.*, weekly or monthly resets) from relying on the rule. *See* proposed rule 6c-11(c)(4). Rule 6c-11 as adopted uses the term "predetermined period of time" to clarify that leveraged/inverse ETFs contemplating predetermined but variable resets (*e.g.*, leveraged/inverse ETFs that contemplate a range of daily-to-weekly resets) are similarly prohibited from relying on the rule.

[89] Additionally, though a strict mathematical interpretation of the term "multiple" may include a multiple of 100%, an ETF that simply seeks to track the performance of an index is not considered "leveraged" for these purposes and may rely on the rule. *But see infra* footnotes 90-91 and accompanying text.

[90] Rule 6c-11(c)(4) (emphasis added). *See also* 2018 ETF Proposing Release, *supra* footnote 7, at text

For example, an ETF could not circumvent the rule's conditions and rely on the rule to track an index if the index itself tracks 300% or -100% of the performance of the S&P 500.[91] In response to commenter concerns discussed above, however, this does not mean that the exclusion would apply to every ETF that tracks an index with constituents that are derivatives.[92] Whether a particular index is "leveraged" would depend on the economic characteristics of the index's constituents, and not just on whether some or all of the constituents are derivatives.

Finally, we are not adopting enhanced website or other disclosure requirements for leveraged/inverse ETFs at this time as some commenters had recommended. We believe all registered funds that pursue leveraged or inverse strategies raise similar disclosure issues. We therefore believe that the Commission should address any such potential disclosure issues separately for all leveraged/inverse registered funds.

B. Exemptive Relief under Rule 6c-11

Rule 6c-11 will provide ETFs that fall within the scope of the rule exemptive relief from certain provisions of the Act that are necessary to allow ETFs to operate. These exemptions are consistent with the relief we have given to ETFs under our exemptive orders.[93] As discussed below in section II.C., the exemptions will be subject to conditions that are designed to address the concerns underlying the relevant statutory provisions and to support a Commission finding

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following n.82.

91 The exemptive orders that we have issued to sponsors of leveraged/inverse ETFs do not provide relief to ETFs described as seeking investment returns that correspond to the performance of a leveraged or inverse leveraged market index over a predetermined period of time. *See supra* footnote 75.

92 *See supra* footnote 84 and following text.

93 *See* 2018 ETF Proposing Release, *supra* footnote 7, at n.88 and related discussion. 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. *See infra* section 0. (discussing our treatment of master-feeder relief) and section 0. (discussing our treatment of other relief for fund investments in ETFs).

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.[94]

1. Treatment of ETF Shares as "Redeemable Securities"

Consistent with our proposal, ETFs relying on rule 6c-11 will be considered to issue a "redeemable security" within the meaning of section 2(a)(32) of the Act.[95] 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, they can be redeemed in creation unit aggregations.[96] Therefore, we believe that ETF shares are most appropriately classified under the final rule as redeemable securities within the meaning of section 2(a)(32), and that ETFs should be regulated as open-end funds within the meaning of section 5(a)(1) of the Act.[97]

Unlike our exemptive orders, which have provided exemptions from the definitions of "redeemable security" in section 2(a)(32) and "open-end company" in section 5(a)(1), rule 6c-11 will not provide exemptions from these definitions. Instead, we believe that it is more

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94 *See* 15 U.S.C. 80a-6(c).

95 Rule 6c-11(b)(1).

96 *See* rule 6c-11(a)(1) (defining an exchange-traded fund, in part, as a registered open-end management company that issues and redeems its shares in creation units). The rule defines "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* rule 6c-11(a)(1). *See also infra* section 0. (discussing circumstances where ETF shares can be individually redeemed).

97 15 U.S.C. 80a-2(a)(32) (defining "redeemable security"); 15 U.S.C. 80a-5(a)(1) (defining "open-end company" as "a management company which is offering for sale or has outstanding any redeemable security of which it is the issuer"). If ETF shares were not classified as redeemable securities within the meaning of section 2(a)(32) of the Act, an ETF that is a management company (as defined under the Act) 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).

appropriate for the rule to address these questions of status by classifying ETF shares as "redeemable securities." Thus, any ETF that relies on the rule's conditions and requirements will be subject to requirements imposed under the Act and our rules that apply to open-end funds.[98]

In addition, the rules under the Exchange Act that apply to transactions in redeemable securities issued by an open-end fund will apply to ETFs relying on rule 6c-11.[99] Shares issued by ETFs relying on rule 6c-11 therefore are eligible for 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 in connection with secondary market transactions in ETF shares and the creation or redemption of creation units. ETFs relying on rule 6c-11 similarly will qualify for the "registered open-end investment company" exemption in rule 11d1-2 under the Exchange Act.

Many commenters supported our proposed classification of ETF shares as "redeemable securities."[100] Commenters also supported our view that the arbitrage mechanism that is central to the operation of an ETF (and the conditions in the final rule 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.[101] As a result, even though only authorized participants may redeem creation

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98 *See, e.g.*, 15 U.S.C. 80a-22; 17 CFR 270.22c-1. ETFs that are management companies and operate in reliance on rule 6c-11 and those that operate in reliance on an exemptive order would equally be subject to the Act and our rules as open-end funds.

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)] (shortening the standard settlement cycle for most broker-dealer securities transactions to two business days).

100 *See, e.g.*, ICI Comment Letter; Fidelity Comment Letter; Comment Letter of the Asset Management Group of the Securities Industry and Financial Markets Association (Feb. 22, 2019) ("SIFMA AMG Comment Letter II"); Vanguard Comment Letter; SSGA Comment Letter; Comment Letter of Virtu Financial, Inc. (Oct. 3, 2018) (Virtu Comment Letter"); Comment Letter of Eaton Vance Corp. (Oct. 4, 2018) ("Eaton Vance Comment Letter"); ABA Comment Letter.

101 *See, e.g.*, ICI Comment Letter. *See also* 2018 ETF Proposing Release, *supra* footnote 7, at n.95 and related discussion.

units at NAV per share, commenters agreed that 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 at NAV per share.[102]

Commenters also supported the resulting eligibility for the redeemable securities exceptions and the registered open-end investment company exemption under the Exchange Act rules discussed above.[103] Commenters stated that such treatment would reduce regulatory complexity and eliminate potential inconsistencies between rule 6c-11 and this Exchange Act relief.[104] Several commenters recommended extending the "redeemable security" classification to ETFs that are not eligible to rely on rule 6c-11, such as UIT ETFs or share class ETFs, to make them similarly eligible for the exceptions under the Exchange Act that apply to redeemable securities issued by an open-end fund.[105]

After considering comments, we are clarifying that we view securities of all ETFs, including those that do not rely on rule 6c-11, as eligible for 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 in connection with secondary market transactions in ETF shares and the creation or redemption of creation units and the exemption in rule 11d1-2 under the Exchange Act for securities issued by a registered open-end investment company or unit investment trust. We believe that securities issued by ETFs that are exempt from the definitions of "redeemable security" in section 2(a)(32) and "open-end company" in section 5(a)(1) of the Investment Company Act pursuant to their

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102 *See, e.g.*, ICI Comment Letter; Virtu Comment Letter.

103 *See, e.g.*, Dechert Comment Letter; BlackRock Comment Letter; Invesco Comment Letter I; ABA Letter.

104 *See, e.g.*, Vanguard Comment Letter; Dechert Comment Letter; WisdomTree Comment Letter; ABA Comment Letter; SIFMA AMG Comment Letter I.

105 *See* ICI Comment Letter; Dechert Comment Letter; SIFMA AMG Comment Letter I; Vanguard Comment Letter; SSGA Comment Letter I; ABA Comment Letter; BlackRock Comment Letter.

orders do not raise different concerns with respect to these Exchange Act provisions than those issued by ETFs relying on rule 6c-11.

Several commenters recommended further harmonization between rule 6c-11 and certain other Exchange Act relief that ETFs must currently seek in order to operate.[106] Commenters expressed concern that this Exchange Act relief is duplicative or, in some cases, inconsistent with other requirements applicable to ETFs.[107] In particular, commenters noted that rule 6c-11 as proposed would not address relief for ETFs from section 11(d)(l) of the Exchange Act as well as rules 10b-10, 15c1-5, 15c1-6, and 14e-5 thereunder.[108] Commenters also recommended that the ETF generic listing standards of national securities exchanges be broadened and harmonized with any final ETF rule.[109]

We agree that complementary exemptive relief under the Exchange Act could further reduce regulatory complexity, administrative delay, and eliminate potential inconsistencies between rule 6c-11 and the related Exchange Act relief that ETFs must obtain to operate. Accordingly, the Commission is issuing an order granting exemptive relief to ETFs operating in reliance on rule 6c-11 from the requirements of section 11(d)(1) of the Exchange Act and rules

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106 *See, e.g.*, BlackRock Comment Letter; ICI Comment Letter; Fidelity Comment Letter; SIFMA AMG Comment Letter I; Comment Letter of John Hancock Investments (Oct. 1, 2018) ("John Hancock Comment Letter"); Comment Letter of Flow Traders US LLP (Oct. 1, 2018) ("Flow Traders Comment Letter").

107 *See, e.g.*, BlackRock Comment Letter. *See also, e.g.*, ICI Comment Letter ("Currently, ETFs often must satisfy multiple and sometimes conflicting requirements from different divisions within the SEC."). Commenters also expressed concerns about the administrative delay in obtaining these additional approvals. *See, e.g.*, SIFMA AMG Comment Letter I.

108 *See, e.g.*, Dechert Comment Letter; *see also* 2015 ETP Request for Comment, *supra* footnote 19.

109 *See, e.g.*, Cboe Comment Letter ("Cboe encourages the Commission to evaluate exchange proposals to broaden their generic listing standards …in order to achieve efficiencies with exchange listing processes in a manner very similar to those which [rule 6c-11] is designed to accomplish."). *See also, e.g.*, ABA Comment Letter, Nasdaq Comment Letter.

10b-10, 15c1-5, 15c1-6, and 14e-5 under the Exchange Act for ETFs, where certain conditions are met.[110]

Finally, commenters asked that we exempt ETF insiders and large shareholders from certain section 13(d) and section 16 reporting requirements under the Exchange Act beyond the conditions in several staff no-action letters.[111] The staff no-action letters stated that the staff would not recommend enforcement action to the Commission if certain insiders and large shareholders of ETFs seeking to track the performance of a benchmark index through a replication strategy did not file reports under section 13(d) and section 16(a) based on certain facts and circumstances, including that there is no material deviation between the ETF's secondary market price and NAV.[112] Commenters stated that the portfolio transparency requirements in rule 6c-11 would address the concerns underlying section 13(d) and section 16 without conditioning relief on there being no material deviation between the ETF's market price and NAV per share.[113]

As discussed above, the exemptions we are providing today under rule 6c-11 are based on the existence of a close tie between market price and NAV per share. Expanding on the existing staff no-action letters by providing exemptions from the reporting requirements in sections 13(d) and 16 even when there is a material deviation between market price and NAV

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110 *See* ETF Exchange Act Order, *supra* footnote 15. ETFs that do not operate in reliance on rule 6c-11 and currently have relief from the Exchange Act provisions discussed above may continue to rely on such relief.

111 *See, e.g.*, Fidelity Comment Letter; Comment Letter of Thompson Hine LLP (Oct. 1, 2018) ("Thompson Hine Comment Letter").

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

113 *See, e.g.*, Thompson Hine Comment Letter.

would be inconsistent with the exemptions in rule 6c-11. We therefore refrain from taking additional action concerning the conditions outlined in our existing staff no-action letters.

2. Trading of ETF Shares at Market-Determined Prices

Rule 6c-11 will provide exemptions from section 22(d) and rule 22c-1 to permit secondary market trading of ETF shares at market-determined prices as proposed. 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.[114] 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.[115] 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.[116] 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, rule 6c-11 will provide exemptions from these provisions.[117]

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

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[114] 15 U.S.C. 80a-22(d).

[115] *See* 17 CFR 270.22c-1.

[116] *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)).

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

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.[118] 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 final rule will provide exemptions from section 22(d) and rule 22c-1 because we believe this 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.

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 has generally been relatively small.[119] However, we recognize that under certain circumstances, including during periods of market stress, the arbitrage mechanism may work less effectively.[120] We also recognize that secondary market investors who trade in ETF shares

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118 *See* 2018 ETF Proposing Release, *supra* footnote 7, at n.113 and accompanying discussion.

119 In an analysis of various asset classes during 2017–2018, end-of-day deviations between closing price of ETFs and NAV were relatively rare and generally not persistent. *See also id*., at nn.119–123 and accompanying text (discussing similar staff analysis for 2016–2017 period).

120 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.

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 continue to 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.[121] Further, we believe that the conditions we are adopting as part of rule 6c-11, along with other recent actions that are designed to promote an effective arbitrage mechanism, will 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 granting.[122] We particularly find this to be the case given the benefits ETFs offer investors as discussed above.

Moreover, to the extent that there are instances where bid-ask spreads widen, or premiums and discounts persist, the final rule and disclosure amendments will require ETFs to disclose certain information on their website.[123] These disclosure requirements are designed to

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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. *See* 2018 ETF Proposing Release, *supra* footnote 7, at nn.124–130 and accompanying text.

121 *See id.*, at n.131 and accompanying text. The Commission also 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 Act 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 Act Release No.78660 (Aug. 24, 2016) [81 FR 59676 (Aug. 30, 2016)].

122 For example, 17 CFR 270.22e-4 (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* Investment Company Liquidity Risk Management Programs, Investment Company Act Release No. 32315 (Oct. 13, 2016) [81 FR 82142 (Nov. 18, 2016)] ("LRM Adopting Release"). We have taken these requirements into consideration in adopting the conditions in rule 6c-11.

123 *See infra* section 0.

increase investor awareness of these risks. We continue to believe that it is important for investors to be informed where costs may increase beyond what they would reasonably expect.

Commenters generally agreed that rule 6c-11 should provide the proposed exemptions from section 22(d) and rule 22c-1.[124] These commenters highlighted the ability of investors to transact in ETF shares intraday at market-determined prices as one of the primary benefits of the ETF structure. Commenters also agreed with our observation that the arbitrage mechanism generally has kept the deviation between the ETF market price and NAV per share relatively small, and that an efficient arbitrage mechanism adequately addresses potential concerns under section 22(d) and rule 22c-1.[125] One commenter agreed that, on balance, given the historically insignificant and short duration of unusual ETF premiums and discounts, and the relatively low risks presented to investors as a result, ETF investors are likely to weigh the potential benefits of ETFs against any potential for market price deviations when selecting an investment in ETFs.[126]

3. Affiliated Transactions

As proposed, rule 6c-11 will provide exemptions from sections 17(a)(1) and (a)(2) of the Act with regard to the deposit and receipt of baskets by 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.[127] The relief from section

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124 *See, e.g.,* ICI Comment Letter; SSGA Comment Letter I; Invesco Comment Letter.

125 *See, e.g.,* ICI Comment Letter; Invesco Comment Letter.

126 *See* Invesco Comment Letter.

127 *See* rule 6c-11(b)(3).

17(a) in rule 6c-11 is consistent with the exemptive relief that we have granted to ETF applicants.[128]

Section 17(a) of the Act generally prohibits an affiliated person of a registered investment company, or an affiliated person of such person, from knowingly selling any security or other property to or purchasing any security from the company.[129] Purchases and redemptions of ETF creation units are typically effected in kind, and section 17(a) would prohibit 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.[130]

Commenters expressed support for our proposed exemptions from sections 17(a)(1) and (a)(2), concurring with our view that this relief is necessary to facilitate the efficient functioning of the arbitrage mechanism.[131] Commenters noted that, without this relief, an authorized

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128 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"). 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. 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. *See* 2018 ETF Proposing Release, *supra* footnote 7, at nn.140-141 and accompanying discussion.

129 15 U.S.C. 80a-17(a).

130 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).

131 *See e.g.*, Thompson Hine Comment Letter; ICI Comment Letter; JPMAM Comment Letter; SSGA Comment Letter I; Fidelity Comment Letter; SIFMA AMG Comment Letter I.

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, which, in turn, could have the adverse effect of limiting the pool of market participants that could engage in arbitrage.[132] Ultimately, this 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. Commenters also stated that in-kind purchases and redemptions of ETF creation units between an ETF and authorized participants, which may be affiliated persons, or affiliated persons of affiliated persons, as a result of such transactions are not the types of potentially harmful transactions that section 17(a) is designed to prevent.[133]

We continue to believe that this relief is appropriate to facilitate the efficient functioning of the arbitrage mechanism after considering comments. As noted above, all purchases and redemptions of creation units with such an affiliated person are at an ETF's next-calculated NAV, and an ETF would value the securities deposited or delivered upon redemption in the same manner, using the same standards, as the ETF values those securities for purposes of calculating the ETF's NAV. We do not believe that these transactions will give rise to the policy concerns that section 17(a) is designed to prevent.

Several commenters asked us to confirm that the section 17(a) relief in rule 6c-11 would extend to entities that are affiliated with the ETF by virtue of holding more than 25% of the

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[132] *See, e.g.*, ICI Comment Letter. Newly launched ETFs could face particular challenges 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.

[133] *See, e.g.*, Thompson Hine Comment Letter; *see also* 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") ("To prevent self-dealing and overreaching by persons in a position to take advantage of the fund, the Investment Company Act prohibits funds from entering into certain transactions with affiliated persons.") (internal citations omitted).

ETF's shares or more than 25% of any investment company that is an affiliated person of the ETF ("25% holders"), consistent with the terms of our existing exemptive orders.[134] Our proposal was designed to provide relief from section 17(a) similar to our orders.[135] We do not believe that an express reference to 25% holders in rule 6c-11(b)(3) is necessary, however, because the rule text will capture entities that are affiliated with the ETF by virtue of share ownership greater than 5%. We confirm that 25% holders are within the scope of this exemption.

A number of commenters also recommended expanding the relief to cover additional types of affiliated relationships, such as exempting broker-dealers that are affiliated with the ETF's adviser,[136] or permitting an ETF's adviser or its affiliates to transact with the ETF to provide in-kind seed capital to the ETF.[137] These commenters noted that increasing the entities eligible to transact with an ETF could further help facilitate the arbitrage mechanism, reduce concentration risk, and lower transaction costs. These commenters also noted that a fund's policies and procedures on baskets and custom baskets, as well as the federal securities laws and regulations that prohibit manipulative practices and misuse of nonpublic information, would address potential concerns regarding overreaching and similar abusive practices by these affiliated entities.

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134 *See e.g.*, SIFMA Comment Letter I. The related exemptive application to our orders usually includes an express reference to holders of 25% or more of the ETF's shares or 25% or more of an investment company that is an affiliated person of the ETF. *See, e.g.*, Pacer Funds, *et al.*, Investment Company Act Release Nos. 33374 (Feb. 13, 2019) [84 FR 5125 (Feb. 20, 2019)] (notice) and 33397 (March 12, 2019) (order).

135 Our 2008 proposal expressly included section 17(a) relief for 25% holders. *See* 2008 ETF Proposing Release, *supra* footnote 3. One commenter on that proposal stated that the reference to 25% holders was superfluous in light of the reference to 5% holders. *See* Comment Letter of Stradley Ronan Stevens & Young, LLP (May 19, 2008).

136 *See* ICI Comment Letter; JPMAM Comment Letter; SSGA Comment Letter I.

137 *See* Fidelity Comment Letter; SIFMA AMG Comment Letter I.

While permitting additional types of affiliated entities to transact with the ETF could provide additional benefits to an ETF, expanding the scope of affiliated persons covered by the exemption would constitute novel section 17(a) relief. To date, our exemptive orders have been narrowly tailored to permit in-kind purchases and redemptions between an ETF and certain affiliates to facilitate efficient arbitrage. Expanding this relief would raise novel affiliation issues that would require a careful consideration of whether the current protections embedded in our relief sufficiently address any risks posed by such transactions with additional categories of affiliates. This would be especially the case if the exemption were expanded to include affiliated entities such as the ETF's sponsor and other service providers that typically have greater ability to influence an ETF. Given that rule 6c-11 is generally intended to codify existing relief for ETFs, we therefore do not believe that it is appropriate to expand the scope of affiliated persons covered by the exemption as part of this rulemaking, although such exemptions may be considered within our regular exemptive applications process.

4. Additional Time for Delivering Redemption Proceeds

We are adopting, largely as proposed, an exemption from section 22(e) to permit an ETF to delay satisfaction of a redemption request in the case of certain foreign investments for which a local market holiday or the extended delivery cycles of another jurisdiction make timely delivery unfeasible. 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.[138] 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

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[138] 15 U.S.C. 80a-22(e).

transferring foreign investments to redeeming investors, together with local market holiday schedules, can sometimes require a delivery process in excess of seven days.[139]

Section 22(e) was designed to prevent unreasonable delays in the actual payment of redemption proceeds.[140] Rule 6c-11 will 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. Rule 6c-11 will 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, or 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.[141]

Under this exemption, an ETF must deliver foreign investments as soon as practicable, but in no event later than 15 days after the tender to the ETF. The exemption therefore will 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.[142] If a foreign investment settles in less

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139 ETFs that hold foreign investments 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.

140 *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).

141 Rule 6c-11(b)(4). The relief from section 22(e) does not affect any obligations arising under rule 15c6-1 under the Exchange Act, which requires that most securities transactions settle within two business days of the trade date. 17 CFR 240.15c6-1.

142 This exemption permits a delay in the delivery of foreign investments only if the foreign investment is being transferred in kind as part of the basket. 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

than 15 days, the rule will require an ETF to deliver it pursuant to the standard settlement time of the local market where the investment trades. 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.[143]

Commenters generally supported our proposed exemption from section 22(e).[144] Commenters stated that the relief would provide additional assurance that an ETF could postpone payment of redemption proceeds in certain circumstances outside of its control.[145] One commenter observed that a period of 15 days, accompanied by a requirement that delivery be made as soon as practicable, is appropriate and reasonable.[146] Another commenter agreed that it was appropriate to limit the exemption to the particular foreign investment and not the entire basket.[147]

Proposed rule 6c-11 would have included a ten-year sunset provision in light of the continued movement toward shorter settlement times in markets around the world.[148] Commenters generally objected to the proposed sunset provision, citing a number of reasons for why the section 22(e) relief would likely remain necessary beyond the sunset period. Although we continue to believe that technological innovation and changes in market infrastructures and

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of a particular foreign investment in a basket do not require an exemption from section 22(e) of the Act.

143 *See* 2018 ETF Proposing Release, *supra* footnote 7, at n.155 (discussing settlement cycles for various foreign markets).

144 *See, e.g.*, ICI Comment Letter; Fidelity Comment Letter; Comment Letter of Charles Schwab Investment Management (Oct. 1, 2018) ("CSIM Comment Letter"); John Hancock Comment Letter.

145 *See* John Hancock Comment Letter; ICI Comment Letter.

146 *See* CSIM Comment Letter.

147 *See* ICI Comment Letter.

148 *See* 2018 ETF Proposing Release, *supra* footnote 7, at n.156 and accompanying text (proposing that the exemption from section 22(e) for postponement of delivering redemption proceeds expire ten years from the rule's effective date).

operations should lead to further shortening of settlement cycles, we recognize commenters' concerns that these developments may be gradual and difficult to predict.[149] Moreover, given that certain local market holidays may last for up to seven business days, we agree with commenters that settlement within seven days may continue to pose challenges even in light of continued technological progress and changes in market operations.[150] We therefore are not adopting a sunset provision to limit the relief from section 22(e) to ten years from the rule's effective date.

The rule will 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), and that is traded on a trading market outside of the U.S.[151] As under the proposal, this definition is not limited to "foreign securities," but also includes 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.[152] We received no comments on this aspect of the definition of "foreign investment."

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149 *See, e.g.*, Dechert Comment Letter; CSIM Comment Letter; ICI Comment Letter; Invesco Comment Letter; Fidelity Comment Letter; WisdomTree Comment Letter; ABA Comment Letter.

150 *See, e.g.*, Invesco Comment Letter (citing Taiwan market holidays); CSIM Comment Letter; Fidelity Comment Letter; ICI Comment Letter; John Hancock Comment Letter.

151 *See* rule 6c-11(a)(1). We believe this approach is appropriate because it creates consistency with a long-accepted definition under Exchange Act rules.

152 *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.

Unlike our proposal, we are not defining "foreign investment" as an investment for which there is no "established U.S. public trading market."[153] A number of commenters recommended that we modify or eliminate this aspect of the definition.[154] These commenters expressed concern that this requirement could make the exemption from section 22(e) unavailable whenever a foreign issuer has issued a security in the U.S. Commenters stated that ETFs investing in certain foreign markets typically hold the security that is traded in the foreign issuer's local trading market ("foreign-traded security") rather than its U.S.-traded equivalent.[155] These commenters explained that this is particularly true for ETFs tracking certain international indexes because those indexes often include foreign-traded securities, which generally have greater liquidity and trading volume than their U.S.-traded equivalents. Several commenters cited potential compliance costs, operational considerations (*e.g.*, transacting in the foreign-traded security may entail lower transaction costs for the ETF), and possible disruptions to their investment strategy (*e.g.*, tracking error) that might result due to this requirement.[156]

The proposed definition of foreign investment was designed to make relief from section 22(e) unavailable to an ETF that included a foreign issuer's U.S.-traded investment in its basket, thereby avoiding the settlement delay that is the basis for the relief.[157] It was not intended to

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153 *See* 2018 ETF Proposing Release, *supra* footnote 7, at n.166 and accompanying text (proposing to 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)).

154 *See* ICI Comment letter; SIFMA AMG Comment Letter I; SSGA Comment Letter I; BlackRock Comment Letter; Invesco Comment Letter.

155 *See, e.g.*, ICI Comment Letter; SIFMA Comment Letter I.

156 *See, e.g.*, BlackRock Comment Letter (stating that "ETFs currently do not monitor whether a foreign issuer has equivalent securities that both trade on a US market and the foreign issuer's local market since our primary investment practices are to invest in the securities of the underlying index."); Invesco Comment Letter; SSGA Comment Letter I.

157 *See* 2018 ETF Proposing Release, *supra* footnote 7, at n.166 and accompanying discussion. As proposed, the rule will not rely on registration status because an unregistered large foreign private issuer may have an

require an ETF to buy and sell the U.S.-traded equivalent of a foreign-traded security when one is available, nor was it intended to deny section 22(e) relief to an ETF that includes a foreign-traded security in its basket because a U.S.-traded equivalent exists. In order to address commenters' concerns and potential confusion, however, we have eliminated the requirement that the foreign investment have "no established U.S. public trading market." Instead, in relevant part, rule 6c-11(a)(1) will define "foreign investment" as an investment that "is traded on a trading market outside of the U.S."[158] We believe this definition will capture the foreign investments that may experience settlement delays without creating unintended consequences for ETF portfolio management. Under rule 6c-11, a delay in settlement is permitted only to the extent that additional time for settlement is actually required due to a local market holiday or the extended delivery cycles in a foreign market. As a result, the exemption from section 22(e) already is unavailable where an ETF could readily trade an investment in its basket on a U.S. market.

C. Conditions for Reliance on Rule 6c-11

Rule 6c-11 requires ETFs to comply with certain conditions designed to protect investors and to be consistent with the purposes fairly intended by the policy and provisions of the Act in order to operate within the scope of the Act. These conditions generally are consistent with the conditions in our exemptive orders, which we believe have effectively accommodated the unique

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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)].

158 *See, e.g.*, BlackRock Comment Letter (recommending that "foreign investment" be defined by reference to whether "there is an established trading market […] outside of the US"). As proposed, we also are not requiring 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. *See* 2018 ETF Proposing Release, *supra* footnote 7, at n.161 and accompanying discussion. No commenters disagreed with this aspect of the proposal.

structural and operational features of ETFs while maintaining appropriate protections for ETF investors. The conditions also reflect certain modifications that, based on our experience regulating ETFs and comments we received on the proposal, we believe will improve the overall regulatory framework for these products.

1. Issuance and Redemption of Shares

As proposed, the definition of exchange-traded fund under rule 6c-11 will require that an ETF issue (and redeem) creation units to (and from) authorized participants in exchange for baskets and a cash balancing amount (if any).[159] This definition is designed to preserve the existing ETF structure, reflected in our exemptive orders, which permit only an authorized participant of an ETF to purchase creation units from (or sell creation units to) the ETF. An orderly creation unit issuance and redemption process is essential to a properly functioning arbitrage mechanism. Commenters supported the proposed definition of exchange-traded fund.[160]

Rule 6c-11 will define an authorized participant to mean a member or participant of a clearing agency registered with the Commission that 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, as proposed.[161] This definition differs from the definition of "authorized participant" in the Commission's exemptive orders and Form N-CEN because it does not include a specific reference to an authorized participant's participation in DTC, as DTC

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159 *See* rule 6c-11(a)(1). *See also infra* section 0.(discussing definitions of baskets and cash balancing amount).

160 *See, e.g.,* Invesco Comment Letter.

161 *See* rule 6c-11(a)(1).

is itself a clearing agency.[162] We proposed to amend Form N-CEN to make the two definitions consistent. We believe the definition that we are adopting remains largely consistent with the exemptive relief we have granted to ETFs, while eliminating unnecessary terms.

Several commenters expressed support for the proposed definition of authorized participant.[163] One commenter, however, asserted that rule 6c-11 should use the existing definition of authorized participant in Form N-CEN to avoid confusion and regulatory inconsistency.[164] We believe that amending Form N-CEN to make the definition of authorized participant consistent with the definition in rule 6c-11 addresses this commenter's concern.[165]

We also received several comments on issues relating to authorized participants more generally. One commenter, for example, suggested that the Commission confirm that authorized participants who buy and sell ETF shares in creation units are not considered, for that reason alone, "principal underwriters" under the Investment Company Act.[166] The commenter stated that the plain language of section 2(a)(29) of the Act would exclude an authorized participant from the definition of principal underwriter when the authorized participant purchases ETF shares through a principal underwriter acting as agent for the ETF.[167] We agree that an authorized participant that purchases ETF shares from the ETF's principal underwriter is not a

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162 *See* 2018 ETF Proposing Release, *supra* footnote 7, at nn.170–171. Form N-CEN, in relevant part, defined 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. *See* Form N-CEN, Item E.2.

163 *See* SSGA Comment Letter I; ICI Comment Letter; Cboe Comment Letter.

164 *See* Invesco Comment Letter.

165 *See infra* section 0.

166 *See* ABA Comment Letter.

167 *Id*. (noting that the definition of principal underwriter excludes "a dealer who purchases from such company through a principal underwriter acting as agent.").

principal underwriter as defined in section 2(a)(29) of the Act solely because it buys and sells ETF shares in creation units.

Another commenter suggested that the Commission require an ETF to have a minimum number of authorized participants (*i.e.*, 2 or 3) to reduce the risk of anti-competitive behavior and to safeguard the arbitrage mechanism.[168] This commenter, however, also pointed to data indicating that large ETFs (with more than $790 million in assets) typically have an average of nine active authorized participants, and that smaller ETFs (with less than $27 million in assets) have an average of two active authorized participants.[169] This commenter further noted that it has observed ETFs using single authorized participants in "some markets outside of the United States" but that this type of arrangement is "less common within the United States."[170]We have not observed the types of "excessive deviations" between ETFs' NAV and market price that, according to this commenter, could indicate that ETFs' use of one authorized participant is a persistent problem.[171] Additionally, based upon Form N-CEN data through September 5, 2019, we found that out of 1672 funds reviewed that could rely on rule 6c-11, only 30 (approximately 1.8% of the funds reviewed) reported having fewer than 2 authorized participants. We therefore do not believe that it is appropriate at this time to prescribe a minimum number of authorized participants that an ETF may use.

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168 *See* Comment Letter of Jane Street Capital, LLC (Oct. 1, 2018) ("Jane Street Comment Letter"). Another commenter suggested that the Commission should provide guidance regarding ETF sponsors giving certain APs special treatment in the negotiation of baskets. *See* Comment Letter of Bluefin Trading, LLC (Oct. 19, 2018) ("Bluefin Comment Letter"). We address this comment in our discussion of custom basket policies and procedures, *infra*, in section 0.

169 *See* Jane Street Comment Letter (citing "The Role and Activities of Authorized Participants of Exchange-Traded Funds," Investment Company Institute, March 2015).

170 *See id*.

171 *See, e.g.*, 2018 ETF Proposing Release, *supra* footnote , at section II.B.2

As proposed, rule 6c-11 will 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).[172] Rule 6c-11 will not mandate a maximum or minimum creation unit size or otherwise place requirements on creation unit size. We continue to believe, and commenters agreed, that ETFs are incentivized to establish creation unit sizes that are appropriate for market demand pursuant to their investment strategies and objectives.[173] Thus, ETFs are not likely to set very large or very small creation unit sizes that could disrupt the arbitrage mechanism or prevent the use of in-kind baskets when in-kind baskets would otherwise be desirable for an ETF to obtain the typical efficiencies of ETFs. We also believe that the conditions in rule 6c-11, as adopted, are better suited to promote effective arbitrage than conditions related to creation unit size.[174]

An ETF generally would issue and redeem shares in creation unit size aggregations, rather than as individual shares, under the rule. We proposed to permit an ETF to sell or redeem individual shares on the day of consummation of a reorganization, merger, conversion, or liquidation.[175] In these limited circumstances, an ETF may need to issue or redeem individual

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172 *See* rule 6c-11(a)(1).

173 *See* 2018 ETF Proposing Release, *supra* footnote 7, at nn.175–176 and accompanying text (noting that 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). *See, e.g.*, ICI Comment Letter; SIFMA AMG Comment Letter I; Vanguard Comment Letter. *See also* Nasdaq Comment Letter (noting that minimum creation unit size requirement can lead to wider spreads, particularly for newer, thinly-traded ETFs).

174 One commenter also suggested that the rule should not require an ETF to define a specific creation unit size, noting that permitting variable creation unit sizes could help further facilitate market making and reduce transaction costs. *See* Nasdaq Comment Letter. The rule's definition of "creation unit" will require an ETF to specify a single number of ETF shares composing a creation unit. Although an ETF could not use variable creation unit sizes under this definition, an ETF could change its specified creation unit size as conditions change over time.

175 *See* 2018 ETF Proposing Release, *supra* footnote 7, at text preceding n.82 (discussing proposed rule 6c-11(c)(5)).

shares, and may need to transact without utilizing authorized participants. Commenters that addressed this aspect of the proposal generally supported it.[176] One commenter, however, suggested that the rule should explicitly provide that an ETF may transact with investors other than authorized participants in these limited circumstances.[177] We agree and have modified rule 6c-11 to clarify that, on the day of a reorganization, merger, conversion, or liquidation, an ETF may sell or redeem individual shares and is not limited to transacting with authorized participants.[178] We believe that permitting ETFs to conduct redemptions with investors other than authorized participants in these circumstances is operationally necessary to facilitate these transactions and will allow an ETF to compensate individual shareholders exiting the reorganized, merged, converted or liquidated ETF—activities likely to involve small amounts and to be outside the scope of an authorized participant's expected role of transacting in creation units.

Commenters also addressed the Commission's proposed guidance concerning the extent to which an ETF may directly or indirectly suspend the issuance or redemption of ETF shares.[179] 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 harm investors that purchase shares at market prices above NAV per share and/or sell shares at market prices below NAV per share.

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176 *See, e.g.*, BlackRock Comment Letter; Thompson Hine Comment Letter.

177 *See* Thompson Hine Comment Letter. This commenter also suggested moving this exception to the definition of exchange-traded fund because it is not a condition to reliance on the rule. We agree and have moved this exception to rule 6c-11(a)(2).

178 *See* rule 6c-11(a)(2).

179 *See* 2018 ETF Proposing Release, *supra* footnote 7, at section II.C.1.

With respect to redemptions, an ETF may suspend the redemption of creation units only in accordance with section 22(e) of the Act,[180] and may charge transaction fees on these redemptions only in accordance with rule 22c-2.[181] While no commenters disagreed with our statement in the 2018 ETF Proposing Release that an ETF may suspend redemptions only in compliance with section 22(e), several commenters requested that we eliminate the 2% cap on redemption fees for ETFs.[182] One commenter asserted that, unlike the mutual fund redemption fees that were the Commission's focus in adopting rule 22c-2, the transaction fees charged by an ETF on redemptions are not intended to inhibit frequent trading of the ETF's shares, but are primarily designed to protect shareholders against the costs of certain cash redemptions.[183] This commenter further stated that an ETF's inability to pass through certain incremental costs to an authorized participant could adversely impact performance and result in dilution of the interests of the ETF's remaining shareholders.

As discussed above, we believe that ETFs should be regulated as open-end funds and that ETF shares are most appropriately classified as redeemable securities under the relevant provisions of the Act. In adopting the 2% limit on redemption fees under rule 22c-2, we stated

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180 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 122, at n.36.

181 17 CFR 270.22c-2 (rule 22c-2) limits redemption fees to no more than 2% of the value of shares redeemed. *See* rule 22c-2(a)(1)(i).

182 *See, e.g.*, Dechert Comment Letter; WisdomTree Comment Letter; Invesco Comment Letter (noting that the redemption fee framework for ETFs under rule 22c-2 is "workable" in most circumstances, but that in certain circumstances greater flexibility to charge redemption fees in excess of 2% would benefit ETFs). Commenters did not provide any fee-related data in support of their contention that the 2% limit on redemption fees should be eliminated for ETFs.

183 *See* Dechert Comment Letter. *See also* Invesco Comment Letter (noting that these fees include the difference between the cash in-lieu amount calculated on the trade date and the actual sale price of the security (reflecting market movement)).

that higher redemption fees would impose an undue restriction on the redeemability of shares.[184] Consistent with this belief, our exemptive orders permitting ETFs to operate as open-end funds have not permitted ETFs to charge transaction fees in excess of the 2% limit. We believe the 2% limit allows ETFs to pass on certain costs related to the redemption transaction to authorized participants, while preserving the redeemability of ETF shares.[185] Accordingly, we believe that ETFs may charge transaction fees on the redemption of creation units only in accordance with rule 22c-2.

We also stated in the 2018 ETF Proposing Release that we believe that 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.[186] Some commenters agreed that an ETF may suspend creations only for a limited time and only due to extraordinary circumstances, but requested that we provide clarification regarding the specific circumstances under which an ETF may suspend creations.[187] Other commenters did not support our position on this issue. For example, one commenter stated that current ETF practices for suspending creations have proven effective and advocated against limiting or imposing restrictions on the circumstances in which ETFs may

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184 *See* Mutual Fund Redemption Fees, Investment Company Act Release No. 26782 (March 11, 2005) [70 FR 13328 (March 18, 2005)] (noting that a goal of the Commission under the Act is to preserve the redeemability of mutual fund shares).

185 *See id.* at text accompanying nn. 29-30. Mutual funds, particularly those that invest in foreign markets, may face similar types of costs and are subject to the 2% cap in rule 22c-2.

186 *See* 2018 ETF Proposing Release, *supra* footnote 7, at n.185 and accompanying text. In addition, we stated that an ETF could not set transaction fees so high as to effectively suspend the issuance of creation units. *See id*. One commenter addressed this issue, stating that ETFs generally do not set transaction fees at a level that would effectively suspend creations "in lieu of transparently informing the market that creations are halted." Jane Street Comment Letter.

187 *See, e.g.*, BlackRock Comment Letter; SIFMA AMG Comment Letter I; SSGA Comment Letter I; Vanguard Comment Letter; Invesco Comment Letter.

suspend creations.[188] Another commenter recommended that, rather than precluding an ETF from suspending the issuance of creation units, the Commission should require ETFs that suspend creations to add supplemental disclosures addressing the risk that the ETF's market price may deviate from NAV per share.[189]

As discussed above, however, the expected close tie between an ETF's market price and NAV per share provides a basis for our relief from section 22(d) and rule 22c-1 under rule 6c-11 (as well as our prior exemptive orders).[190] If a suspension of creations impairs the arbitrage mechanism, it could lead to significant deviations between what retail investors pay (or receive) in the secondary market and the ETF's approximate NAV. Such a result would run counter to the basis for relief from section 22(d) and rule 22c-1 and therefore would be inconsistent with rule 6c-11.

2. Listing on a National Securities Exchange

As proposed, rule 6c-11 will define an "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.[191] Exchange-listing is one of the fundamental characteristics that distinguishes ETFs 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. Exchange-listing provides an

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188 *See* Comment Letter of ETF BILD LLC (Oct. 1, 2018) ("ETF BILD Comment Letter") ("[T]here may be a variety of reasons to suspend creations and limiting them or [restricting] certain activity will not allow for differentiation of the circumstances related to the underlying securities…. [C]urrent practices developed in the ETF industry allow for the flexibility needed to address this issue.").

189 *See* Eaton Vance Comment Letter. Another commenter suggested requiring any ETF that suspends creations, or otherwise has its creation process halted, to immediately notify the market via a Form 8-K or other mechanism. *See* Jane Street Comment Letter.

190 *See supra* section 0 (discussing the potential concerns regarding shareholder dilution, unjust discrimination and preferential treatment among investors purchasing and redeeming fund shares that section 22(e) and rule 22c-1 were designed to address).

191 Rule 6c-11(a)(1). As proposed, rule 6c-11(a)(1) also will define a "national securities exchange" as an exchange that is registered with the Commission under section 6 of the Exchange Act.

organized and ongoing trading market for the ETF shares at market-determined prices, and therefore is important to a functioning arbitrage mechanism.[192] The Commission has premised all of its previous exemptive orders on an ETF listing its shares for trading on a national securities exchange.

Several commenters generally supported the requirement that an ETF list its shares on a national securities exchange.[193] On the other hand, one commenter stated that ETFs that are temporarily suspended from listing or engaged in an orderly delisting and liquidation process should not fall outside of the scope of the proposed rule.[194] Another commenter opined that delisted ETFs should remain within the rule to prevent a possible race to redeem the ETF's shares that could result from confusion about the ETF's regulatory status.[195] This commenter stated the definition of exchange-traded fund instead should include ETFs that have been listed within the past 90 days. Other commenters requested that we clarify the specific circumstances that constitute a "delisting," citing trading suspensions and trading halts as examples of circumstances that should not disqualify an ETF from relying on rule 6c-11.[196] These commenters also urged the Commission to clarify that a temporary non-compliance notice from

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192 As proposed, the definition also requires that an ETF's shares trade at market-determined prices. This 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 ("ETMFs")). *See* 2018 ETF Proposing Release, *supra* footnote 7, at text accompanying n.192. Commenters did not address this aspect of the definition of exchange-traded fund.

193 *See, e.g.*, ICI Comment Letter; SSGA Comment Letter I.

194 SIFMA AMG Comment Letter I.

195 Thompson Hine Comment Letter ("[D]eeming the former ETF to no longer have [status as an ETF under the rule] may lead to confusion and a possible race to redeeming shares by remaining shareholders while liquid assets are still available.").

196 See SSGA Comment Letter I; ICI Comment Letter; Invesco Comment Letter. See also FINRA, Investor Alert, When Trading Halts: What You Need to Know About Halts, Suspensions and Other Interruptions (February 7, 2013), available at http://www.finra.org/investors/alerts/when-trading-stops-halts-suspensions-other-interruptions (describing trading halts and trading suspensions).

an exchange for failure to continuously meet the exchange's listing standards would not disqualify an ETF from relying on the rule.

As noted above, the listing requirement was designed to ensure that all ETF shares have an organized and ongoing secondary trading market to support an effective arbitrage mechanism. We therefore continue to believe that an ETF should no longer be eligible to rely on rule 6c-11 and must meet individual redemption requests within seven days pursuant to section 22(e) of the Act or liquidate if it is not listed on an exchange.[197] In response to commenters' request that we clarify the specific circumstances constituting a "delisting" for purposes of rule 6c-11, an ETF is considered no longer listed on an exchange as of the effective date of the removal of the ETF's shares from listing pursuant to rule 12d2-2 under the Exchange Act.[198] Circumstances such as a trading suspension, a trading halt, or a temporary non-compliance notice from the exchange therefore would not constitute a "delisting" for purposes of rule 6c-11. An ETF also may request temporary relief from the Commission to permit the ETF to suspend redemptions for a limited period of time where necessary to protect ETF shareholders.[199]

3. Intraday Indicative Value ("IIV")

As proposed, rule 6c-11 will not require ETFs to disseminate an intraday estimate of their NAV per share (an "intraday indicative value" or "IIV") as a condition for reliance on the rule. Our orders require the dissemination of an 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

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[197] 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.

[198] *See* 17 CFR 240.12d2-2 (rule 12d2-2 under the Exchange Act) (requiring a national securities exchange to file with the Commission an application on Form 25 (17 CFR 249.25) to strike a class of securities from listing on a national securities exchange and/or registration under section 12(b) of the Exchange Act).

[199] *See* section 22(e)(3) of the Act.

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 on an intraday basis.[200] The exchange listing standards also currently require ETFs to disseminate an IIV at least every 15 seconds during regular trading hours.[201]

We did not propose, however, an IIV dissemination requirement under rule 6c-11 because of our concerns regarding the accuracy of IIV estimates for certain ETFs.[202] For example, the IIV may not accurately reflect the value of an ETF that holds securities that trade less frequently. 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 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.[203] Conversely, in today's fast moving markets, given the dissemination lags, the IIV may not accurately reflect the value of an ETF that holds frequently traded component securities.[204] Because there are no uniform

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200 *See, e.g.*, 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").

201 *See, e.g.*, NYSE Arca Equities Rule 5.2E(j)(3), Commentary .01(c) (stating that 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"). The IIV is also sometimes referred to as the "iNAV" (indicative net asset value) or the "PIV" (portfolio indicative value).

202 *See* 2018 ETF Proposing Release, *supra* footnote 7, at section II.C.3. The exemptive relief we provided to certain non-transparent ETFs included a condition requiring those ETFs to provide a verified intraday indicative value ("VIIV") throughout the trading day. *See* 2019 Precidian, *supra* footnote 8. Those ETFs' VIIV, considering their limited investment strategies, addressed the Commission's concerns regarding the traditional IIV. *See id*.

203 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 ETF's current holdings. 15 U.S.C. 80a-2(a)(41)(B).

204 An ETF's current portfolio value changes every time the value of any underlying component of the ETF changes. The IIV for an ETF that includes a more frequently traded component security might not reflect

methodology requirements, the IIV also can be calculated in different and potentially inconsistent ways.

In addition, we understand that market makers and authorized participants no longer use IIV to evaluate arbitrage opportunities for ETFs that provide full portfolio transparency.[205] These market participants 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 and generally use the IIV as a secondary or tertiary check on the value that their proprietary algorithms generate.

The majority of commenters that addressed IIV requirements supported our proposed approach. For example, commenters agreed that authorized participants and other market participants calculate their own intraday values based on other sources of information such as an ETF's published baskets and portfolio holdings.[206] Some of these commenters stated, therefore, that the proposed rule's conditions regarding daily portfolio holdings information would provide more useful information to market participants than IIV.[207] Commenters also agreed that IIV can have significant limitations depending on the types of securities the ETF holds. For example, one commenter stated that these limitations for ETFs holding fixed income securities are the

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the most recent trading information for that underlying security.

205 *See* ETF Handbook, *supra* footnote 25.

206 *See, e.g.*, Jane Street Comment Letter; Invesco Comment Letter; WisdomTree Comment Letter; Vanguard Comment Letter ("These other sources of data include the ETF's published basket, its last published portfolio holdings list, the index tracked by the ETF, and data from third party vendors").

207 *See* Comment Letter of Legg Mason, Inc. (Oct. 1, 2018) ("Legg Mason Comment Letter"); Cboe Comment Letter. *See also* SSGA Comment Letter I ("[t]o the extent there is market demand for information similar to the IIV by market participants absent a regulatory mandate, we expect industry-led solutions will be available, perhaps as part of a broader discussion around market price validation.").

result of market structure issues and that increasing the frequency of the IIV publication would not change these limitations.[208]

Commenters also noted that under current regulatory requirements, IIV can be confusing or misleading to market participants. For example, one commenter stated that current requirements for IIV actually reduce ETF transparency, because the IIV does not reflect the true value of an ETF due to dissemination delays, stale pricing for underlying holdings, and inconsistent calculation methodologies.[209] One commenter opined that IIV is inaccurate for 80% of all ETFs and the rule should not require its dissemination.[210] Another commenter stated that "[IIV] is, at best, slow and likely stale and, at worst confusing, inaccurate, and misleading."[211] In addition, several of these commenters stated that the IIV requirements across regulatory regimes applicable to ETFs should be harmonized.[212] Specifically, these commenters noted that, even if rule 6c-11 were to omit an IIV requirement, existing relief under the Exchange Act and certain exchange listing requirements would require ETFs to continue disseminating IIV. They encouraged the Commission to work with the exchanges to remove these listing requirements.

Some commenters disagreed with this aspect of the proposal and encouraged the Commission to require ETFs to disseminate IIV as a requirement of the rule. These commenters generally asserted that IIV—despite its limitations—can be useful to retail investors.[213] One

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208 *See* Legg Mason Comment Letter (noting, for example, that fixed-income securities are predominantly traded by dealers and not on exchanges). *See also* ICI Comment Letter.

209 *See* SSGA Comment Letter I.

210 Comment Letter of ETF.com (Aug. 28, 2018) ("ETF.com Comment Letter") (stating that "the idea of contemporaneous measure of fair value is enticing" but IIV "is not accurate enough for authorized participants to use in arbitrage analysis.").

211 Cboe Comment Letter.

212 *See, e.g.*, Invesco Comment Letter; SIFMA AMG Comment Letter I; WisdomTree Comment Letter; SSGA Comment Letter I; ETF.com Comment Letter.

213 *See, e.g.*, Angel Comment Letter; Nasdaq Comment Letter; IDS Comment Letter.

such commenter stated that IIV is important for informed trading of ETFs (and other ETPs) by retail investors because it is an "important signal of the value of the underlying portfolio."[214] One commenter stated that IIV allows investors to screen for significant price deviations that could signal breakdowns in the market maker arbitrage process.[215]

Some of these commenters noted that an ETF's IIV may be the only source of pricing information publicly available to retail investors.[216] Another commenter asserted that the rule should include an IIV requirement, but that market participants, particularly retail investors, also would benefit from an explanation of the potential limitations of IIV.[217] Many of the commenters who recommended that the Commission retain an IIV requirement also recommended that the Commission standardize and otherwise improve the IIV calculation.[218]

After considering these comments, we continue to believe that rule 6c-11 should not require ETFs to disseminate IIV as IIV is not necessary to support the arbitrage mechanism for ETFs that provide daily portfolio holdings disclosure. Instead, rule 6c-11's portfolio holdings disclosure will provide market participants with the relevant data to input into their internal algorithms and thus allow them to determine if arbitrage opportunities exist.

We also do not believe that IIV will provide a reliable metric for retail investors to assess all ETFs relying on rule 6c-11 given the breadth of asset classes that ETFs may hold (and the particular shortcomings of IIV when an ETF holds assets that do not trade contemporaneously

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214 *See* Angel Comment Letter.

215 *See* Nasdaq Comment Letter.

216 *See* IDS Comment Letter. S*ee also* CFA Comment Letter; Eaton Vance Comment Letter.

217 *See* FIMSAC Comment Letter.

218 *See, e.g.*, NYSE Comment Letter; IDS Comment Letter; Nasdaq Comment Letter; Eaton Vance Comment Letter. *See also* Angel Comment Letter (recommending dissemination on standard CQS and UTP feeds, one-second updates, and standardization of IIV suffixes).

with the ETF or are traded less frequently). Furthermore, retail investors do not have easy access to IIV through free, publicly available websites today even for those asset classes where an IIV may be more reliable. A staff review of the websites for the ten largest ETFs by assets under management found that none provides a real-time IIV on its website. Some of these ETFs disclose a specific ticker symbol for the ETF's IIV (as opposed to the ticker symbol for the ETF itself) on their websites, others provide the IIV with a delay of up to 45 minutes, while others provide no information about the ETF's IIV at all.[219] A review of several publicly available, free financial websites also found that not all of these websites provide an ETF's IIV.[220] Where these websites did provide the IIV, it was delayed by at least 15 minutes.[221] We believe this raises a significant risk that retail investors using these websites may be receiving stale IIVs for ETFs. We have noted, and commenters agreed, that even the 15-second interval for dissemination of an ETF's IIV required under the exchange listing standards may be too infrequent to effectively reflect the full trading activity for component securities, and therefore to reflect the actual value of the ETF. Therefore, we do not believe that adopting rule 6c-11 without an IIV requirement would remove information from the market that retail investors could reliably use when making investment decisions.

We considered whether to require an ETF to publicly disseminate a modified IIV on its website on a real time basis as a condition to rule 6c-11, requiring ETFs to calculate IIVs more frequently and in a more accessible manner. We also considered creating a methodology that takes into account circumstances when market prices for underlying assets are not available or

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219 Fewer than half of the ETFs included in the review use a specific ticker symbol that allows an investor to locate the ETF's IIV (*e.g.*, the ETF's ticker symbol followed by ".iv" or "–iv").

220 When input into a free financial website, the IIV was provided with a delay of at least 15 minutes.

221 *See, e.g.*, https://finance.yahoo.com/quote/%5ESPY-IV/; https://www.morningstar.com/etfs/arcx/spy/betaquote.html.

should not be used to reflect the ETF's intraday value. However, we believe that these modifications are not necessary given that an ETF operating in reliance on rule 6c-11 will provide full portfolio transparency on its website.

We recognize that intraday information accurately reflecting the current value of an ETF's shares can be important to retail investors and encourage the ETF industry to undertake efforts to develop intraday value metrics targeted at these investors.[222] We believe that ETFs are in a position to consider and develop tailored metrics for ETFs holding different asset classes in a format that is useful for retail investors. As one commenter noted, rule 6c-11's portfolio holdings disclosure requirements may promote a market-based solution to today's IIV shortcomings by making the information required to calculate intraday values broadly available in a standardized, user-friendly format, which could "encourage pricing services and other potential providers to develop commercial ETF intraday valuation services that would compete in the market on the basis of timeliness, accuracy, reliability and price."[223]

4. Portfolio Holdings Disclosure

Since the first exemptive order for an ETF, the Commission has relied on the existence of an arbitrage mechanism to keep market prices of ETF shares at or close to the NAV per share of the ETF. One mechanism that facilitates the arbitrage mechanism is daily portfolio

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[222] One commenter noted that a lack of disclosure regarding potential intraday deviations could, in some circumstances, be misleading. *See* Comment Letter of Henry Hu and John Morley, Yale Law School (Aug, 27, 2018) "(Hu and Morley Comment Letter") (incorporating article by Henry T. C. Hu, University of Texas Law School and John D. Morley, *A Regulatory Framework for Exchange-Traded Funds*, 91 S. Cal. Law Review 839–941 (July 2018) at 920, which describes a particular ETF that "suffered extraordinary [intraday] departures from NAV on August 24, 2015" and noting how "[in looking] 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.").

[223] *See* Eaton Vance Comment Letter.

transparency.[224] Portfolio transparency provides authorized participants and other market participants with a tool to facilitate valuing the ETF's portfolio on an intraday basis, which, in turn, enables them to identify arbitrage opportunities and to effectively hedge their positions. Accordingly, as proposed, rule 6c-11 will require an ETF to disclose prominently on its website, publicly available and free of charge, the portfolio holdings that will form the basis for each calculation of NAV per share.[225]

We received numerous comments on this aspect of the proposal. Many commenters generally supported requiring full, daily portfolio holdings disclosure on the ETF's website as a condition for reliance on rule 6c-11.[226] These commenters agreed with our view that portfolio transparency supports an efficient arbitrage mechanism and thus helps maintain the close tie between the market price of an ETF's shares and the value of its portfolio. One commenter stated that portfolio transparency is important to individual investors because it allows them to

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224 Our exemptive orders for actively managed ETFs and recent orders for self-indexed ETFs have required full portfolio transparency. Exemptive orders for index-based ETFs with an unaffiliated index provider have required publication of the ETF's baskets. We understand, however, that all ETFs that can rely on rule 6c-11 currently provide full transparency as a matter of industry practice.

225 Rule 6c-11(c)(1)(i). For purposes of this requirement, as well as other requirements to disclose information on a publicly available website under rule 6c-11, 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 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. However, this requirement does not preclude the ETF from making other, unrelated sections of its website private or password protected. We also 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.

226 *See, e.g.*, Comment Letter of Stuart Cary (July 3, 2018) ("Cary Comment Letter"); ETF.com Comment Letter; Comment Letter of Jack Reagan (July 12, 2018) ("Reagan Comment Letter"); BlackRock Comment Letter; Cboe Comment Letter; BNY Mellon Comment Letter; Fidelity Comment Letter; SIFMA AMG Comment Letter I; CSIM Comment Letter; Virtu Comment Letter; Eaton Vance Comment Letter.

better discern differences between ETFs that purport to track similar indexes or have similar investment objectives.[227]

On the other hand, one commenter did not support daily disclosure of an ETF's full portfolio, opining that an effective arbitrage mechanism is sufficiently supported by disclosure of well-constructed baskets with performance that closely tracks the performance of both the fund and its index.[228] This commenter further asserted that daily portfolio transparency may harm ETF investors by permitting market participants to front-run index funds, which could negatively impact the prices at which the ETF trades portfolio holdings and thus reduce investors' returns. This commenter recommended, as an alternative to the proposed requirement, that the Commission require ETFs to provide daily disclosure of portfolio holdings, with an exception for the portion of holdings that are "subject to sensitive trading strategies," such as those related to index changes.[229]

One commenter supported requiring daily portfolio transparency for index-based ETFs, but opposed requiring it for actively managed ETFs, due to the risk of market participants using the portfolio holdings disclosures to front-run or piggyback on actively managed strategies.[230] Similarly, another commenter asserted that daily portfolio transparency is not a necessary condition for effective arbitrage, and noted that the risks of front-running and "free riding" that

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227 *See* CSIM Comment Letter.

228 Vanguard Comment Letter.

229 *Id.* (recommending that the rule permit ETFs to disseminate a list of index securities that, when combined with disclosed portfolio holdings, would be reasonably designed to track the ETF's (and the index's) performance).

230 *See* Invesco Comment Letter (recommending that the rule permit actively managed ETFs to delay disclosure of portfolio holdings at least two days).

arise from portfolio transparency were preventing it from offering more actively managed ETFs.[231]

We continue to believe ETFs relying on rule 6c-11 should provide full daily portfolio transparency in order to facilitate an efficient arbitrage process. Notably, we believe it is likely that all current ETFs that may rely on the rule already provide full portfolio transparency as a matter of market practice and this approach will eliminate regulatory distinctions between index-based and actively managed ETFs that rely on rule 6c-11. Moreover, although we recognize there are alternative approaches to facilitate efficient arbitrage, the Commission has limited experience with such approaches, which are new and continuing to evolve and we therefore believe that these alternatives should be considered within our exemptive applications process.

Accordingly, rule 6c-11 will require full, daily portfolio holdings disclosure for ETFs relying on the rule. As discussed below, however, the portfolio transparency requirement we are adopting includes several modifications from the proposed rule, including modifications regarding the required timing and presentation of the portfolio holdings disclosure.

a. *Timing of Portfolio Holdings Disclosure*

Rule 6c-11 will require website disclosure of an ETF's portfolio holdings on each business day before the opening of regular trading on the primary listing exchange of the ETF's shares.[232] Our proposal also would have required an ETF to disclose its portfolio holdings before the ETF starts accepting orders for the purchase or redemption of creation units.[233] The proposed rule's timing requirements were designed to prevent an ETF from disclosing its portfolio

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231 *See* JPMAM Comment Letter. *See also* Dechert Comment Letter (urging the Commission to consider moving to a more uniform, standardized approach in determining whether to grant exemptive relief for non-fully transparent ETFs).

232 Rule 6c-11(c)(1)(i).

233 *See* proposed rule 6c-11(c)(1)(i).

holdings only after the beginning of trading or after the ETF has begun accepting orders for the next business day.[234]

We received several comments on this aspect of the proposal, particularly on the proposed requirement that an ETF disclose its portfolio holdings before the ETF starts accepting orders on a given business day. Several commenters opposed the proposed timing requirement because it could prevent certain ETFs from accepting creation and redemption orders shortly after the US market closes ("T-1 orders").[235] These commenters explained that T-1 orders allow ETFs, authorized participants, and other market participants to place orders for the purchase and sale of portfolio securities in non-U.S. markets with hours that do not overlap (or have limited overlap) with U.S. market hours when those markets are open.[236] An ETF that holds Japanese equities, for example, may permit authorized participants to submit T-1 orders (between 4:00 pm ET and 5:00 pm ET) to allow for trading in the underlying Japanese securities before the Japanese market closes (2:00 am ET).[237] Some commenters explained that the operational steps necessary to disclose an ETF's portfolio holdings would take 2-3 hours after NAV calculation (typically 4:00 pm ET) and the requirement to disclose portfolio holdings before accepting orders therefore would eliminate the T-1 order window.[238]

Several commenters discussed the benefits of permitting ETFs to accept T-1 orders. Commenters stated that T-1 orders allow market participants to align the execution time of underlying securities transactions with the NAV calculation of the order, and thus minimize costs

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234 *See* 2018 Proposing Release, *supra* footnote 7, at n.209 and accompanying text.

235 *See, e.g.*, ICI Comment Letter; BlackRock Comment Letter.

236 *See, e.g.*, Invesco Comment Letter.

237 *See* ICI Comment Letter.

238 *See* Invesco Comment Letter.

and support effective arbitrage.[239] Some commenters stated that eliminating the T-1 order window may lead to wider bid-ask spreads, larger premiums/discounts, and greater tracking differences for these ETFs.[240] One commenter stated that, without T-1 orders, an ETF may have uninvested cash for longer periods of time (leading to increased tracking error) and authorized participants may need to hedge their exposures for longer than usual due to the delay between when the creation order is placed and when the ETF acquires the portfolio securities (leading to wider bid-ask spreads).[241] Another commenter noted that moving the T-1 order window later into the evening to allow the ETF to calculate and disclose its portfolio holdings before accepting T-1 orders would require an additional staffing shift, and thus would impose additional staffing costs on sponsors, custodians, and other market participants.[242]

Commenters recommended alternatives to the proposed rule's timing requirements. Several commenters suggested we require portfolio holdings disclosure only before the opening of regular trading on the primary listing exchange.[243] These commenters asserted that authorized participants placing purchase or redemption orders on a T-1 basis are able to assess and hedge market risk associated with transacting in underlying foreign securities prior to regular trading in U.S. equity markets. Other alternatives suggested by commenters included: (i) carving out ETFs

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239 *See, e.g.*, ICI Comment Letter (discussing the importance to authorized participants of the ability to trade or hedge the underlying exposures at the same time the ETF strikes its NAV); BlackRock Comment Letter; Jane Street Comment Letter (stating that "market participants have found that that benefits of agreeing to an order shortly after market close outweighs] the costs imposed by lack of certainty").

240 *See, e.g.*, ICI Comment Letter (asserting that inability to trade at T-1 could introduce slippage, which in turn may lead to wider bid-ask spreads and larger premium/discounts); CSIM Comment Letter; Comment Letter of OppenheimerFunds (Oct. 1, 2018) ("OppenheimerFunds Comment Letter"). *See also* BlackRock Comment Letter ("Many ETFs in the marketplace currently take orders prior to publication of basket or portfolio holdings information and operate efficiently and with tight spreads.").

241 *See* Dechert Comment Letter.

242 *See* Invesco Comment Letter.

243 *See* NYSE Comment Letter; CSIM Comment Letter; WisdomTree Comment Letter.

investing in foreign markets from the proposed timing requirements;[244] and (ii) permitting ETFs to accept T-1 orders provided that they first share certain standardized information with authorized participants.[245]

After considering these comments, we are not adopting the proposed requirement that an ETF disclose its portfolio holdings before it starts accepting orders for the purchase or redemption of creation units. Instead, rule 6c-11 will require an ETF to disclose the portfolio holdings that will form the basis for the ETF's next calculation of NAV per share each business day before the opening of regular trading on the primary listing exchange of the exchange-traded fund shares.[246] This will accommodate T-1 orders, as requested by commenters, and is consistent with our existing exemptive orders.[247]

The goal of our proposed timing requirement was to facilitate effective arbitrage by providing authorized participants and other market participants buying and selling ETF shares with portfolio holdings information at the time of the transaction. We believe that accommodating T-1 orders, but requiring disclosure before the opening of regular trading on the primary listing exchange of the ETF's shares, will nonetheless allow for effective arbitrage. Commenters stated that ETFs utilizing T-1 orders have shown relatively narrow bid-ask spreads and small premiums and discounts, and stated that precluding T-1 orders could have the unintended effect of actually widening bid-ask spreads and disrupting existing market

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244 *See* Nasdaq Comment Letter.

245 *See* Invesco Comment Letter (suggesting that, as a condition for accepting T-1 orders, ETFs be required to provide APs with (1) the last-published portfolio holdings, (2) applicable corporate action information, (3) data relating to index changes, and (4) an updated basket file).

246 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* rule 6c-11(a)(1).

247 *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), and related application ("Salt Financial") (requiring disclosure of portfolio holdings before commencement of trading on the exchange).

practices.[248] Moreover, staff review of the websites of several ETFs that disclose that they use T-1 orders indicates that these ETFs' bid-ask spreads and premiums and discounts fall approximately within the same range as ETFs that do not use T-1 orders.

We considered whether to impose other conditions for the acceptance of T-1 orders, such as disclosure of the last published portfolio holdings. However, given the information already available to market participants and the data demonstrating that existing market practices have led to effective arbitrage, we do not believe additional conditions are currently necessary to facilitate arbitrage for these orders.

b. *Presentation of Portfolio Holdings Disclosure*

Rule 6c-11 will require an ETF to disclose standardized information regarding each portfolio holding.[249] The rule, however, will not require this information to be presented and contain information in the manner prescribed within Article 12 of Regulation S-X as proposed.[250] In response to concerns and suggestions of commenters, we have modified this condition to require ETFs to disclose a limited set of information for each portfolio holding.[251]

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248 *See, e.g.*, Jane Street Comment Letter; ICI comment Letter; BlackRock Comment Letter; SIFMA AMG Comment Letter I.

249 Rule 6c-11(c)(1)(i). As proposed, the term "portfolio holdings" is defined to mean an ETF's securities, assets, or other positions. *See* rule 6c-11(a)(1). As a result, ETFs relying on rule 6c-11 are required to disclose securities, their cash holdings, as well as holdings that are not securities or assets, including short positions or written options. For example, an ETF will 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. We did not receive any comments on this definition.

250 *See* 2018 ETF Proposing Release, *supra* footnote 7, at nn.220–221 (noting that a staff review of ETF websites found little consistency in how portfolio holdings information was presented, particularly with respect to derivatives, which could lead to investor confusion).

251 *See infra* footnotes 256–259 and accompanying text.

Commenters on this aspect of the proposal agreed that there currently is little consistency in the presentation of holdings information by ETFs,[252] and generally agreed this disclosure should be standardized.[253] Several commenters, however, stated that the specific presentation standard included in the proposed rule (*i.e.*, Article 12 of Regulation S-X) is not an appropriate framework for daily portfolio holdings disclosures by ETFs.[254] Commenters asserted that certain of the Article 12 requirements are overly burdensome for daily disclosure or unnecessary to achieve the Commission's goal of facilitating effective arbitrage.[255]

Some commenters recommended alternative approaches. Several commenters, for example, suggested using disclosure requirements based on the generic listing standards for actively managed ETFs.[256] One of these commenters stated that using the generic listing

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252 *See, e.g.*, Cary Comment Letter; ETF.com Comment Letter.

253 *See, e.g.*, BlackRock Comment Letter; BNY Mellon Comment Letter; Fidelity Comment Letter.

254 *See, e.g.*, Fidelity Comment Letter; ICI Comment Letter. The proposed Article 12 presentation requirements would have required an ETF to 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 the ETF's investments in securities, securities sold short, and other investments. For derivatives, Article 12 would require disclosure that includes 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). *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.

255 *See, e.g.*, WisdomTree Comment Letter (explaining that Article 12 requires detailed categorization of investments by investment type, industry, and country or geographic region and also requires identification of fair valued and non-income producing securities); SIFMA AMG Comment Letter I (stating that information such as appreciation and depreciation for derivatives, as required under Article 12, would be difficult and impractical to calculate and disseminate on a daily basis); Comment Letter of Franklin Resources, Inc. (Oct. 1, 2018) ("Franklin Templeton Comment Letter") (noting that certain data required under Article 12 is updated only on a quarterly basis and would not be easily accessible on a daily basis); BlackRock Comment Letter; ICI Comment Letter.

256 *See, e.g.*, BlackRock Comment Letter; Fidelity Comment Letter; Eaton Vance Comment Letter. *See also* ICI Comment Letter (noting that standardizing "the presentation formats based on exchange listing requirements would obviate the need for two separate schedules, a costly and largely redundant exercise with no additional benefit"). The listing exchanges' current generic listing standards for actively managed ETFs require disclosure of ticker symbol; CUSIP or other identifier; description of the holding; identity of the asset upon which the derivative is based; strike price for any options; quantity of each security or other asset held as measured by (i) par value, (ii) notional value, (iii) number of shares, (iv) number of contracts,

standards would provide "more streamlined portfolio holdings disclosure that includes a subset of the items required by Article 12 that is most relevant and useful for investors."[257] Other commenters stated that the Commission should consider a more limited set of requirements, such as: (i) the name of the security; (ii) the size of the position; (iii) the percentage exposure to such security; and (iv) the security's value.[258] Some commenters also recommended that, in addition to website disclosure, rule 6c-11 require ETFs to file portfolio holdings information in a central public location, such as EDGAR.[259]

We proposed the Article 12 framework because ETFs are already required to comply with Article 12 for periodic financial reporting purposes and therefore we believed that it would provide an efficient way to standardize daily portfolio holdings disclosure. After considering comments, however, we believe that a more streamlined requirement will provide standardized portfolio holdings disclosure in a more efficient, less costly, and less burdensome format, while still providing market participants with relevant information. Accordingly, rule 6c-11 will require an ETF to post a subset of the information required by the listing exchanges' current generic listing standards for actively managed ETFs. Rule 6c-11 will require ETFs to disclose the following information for each portfolio holding on a daily basis: (1) ticker symbol; (2)

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and (v) number of units; maturity date; coupon rate; effective date; market value; and percentage weight of the holding in the portfolio. *See, e.g.*, NYSE Arca Rule 8.600-E(c)(2); Nasdaq Rule 5735(c)(2); Cboe BZX Rule 14.11(i)(3)(B).

257 *See* BlackRock Comment Letter.

258 *See, e.g.*, WisdomTree Comment Letter. *See also* CSIM Comment Letter (suggesting that Commission adopt an ETF holdings disclosure requirement similar to what money market funds report on fund websites); Cary Comment Letter (recommending disclosure of the portfolio holding's ticker symbol and weighting in the portfolio as minimum requirements); Comment Letter of ICE Data Services, Intercontinental Exchange (Oct. 1, 2018) ("IDS Comment Letter") (stating that Commission should consider a standardized nomenclature for ETFs' description of derivative holdings).

259 *See, e.g.*, Reagan Comment Letter. *See also* Morningstar Comment Letter (recommending that the Commission also require ETFs to disclose the information and other website disclosure requirements in structured format for analysis and comparison purposes); FIMSAC Comment Letter (recommending the rule require ETFs to file certain website disclosures on EDGAR or another public, centralized database).

CUSIP or other identifier; (3) description of holding; (4) quantity of each security or other asset held; and (5) percentage weight of the holding in the portfolio.[260] We believe that this framework will provide market participants with the information necessary to support an effective arbitrage mechanism and eliminate potential investor confusion due to a lack of standardization.

As commenters suggested, to arbitrage an ETF's holdings, market participants generally must be able to identify the security or asset held, the quantity held, and percentage weighting of the holding in the ETF's portfolio.[261] To enable market participants to identify the investment held, we are requiring the ETF to disclose the ticker, CUSIP or other identifier (where applicable) of the holding, and to provide a description of the holding. Because certain investments may not have been assigned a common securities identifier, we are requiring the ETF to provide a brief description of the investment to allow an investor to effectively hedge the ETF.[262] For example, ETFs holding debt securities should include the security's name, maturity date, coupon rate, and effective date, where applicable, to assist investors in identifying the specific security held.[263] To indicate the quantity of a security or other asset held, the ETF generally should use the measure typically associated with quantifying that class of security,

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260 Article 12 of Regulation S-X also generally requires disclosure of these items, but does not require a ticker, CUSIP, or other identifier for a holding. *See, e.g.*, 17 CFR 210.12-12, 210.12-12A (requiring disclosure of name of issuer and title of issue). We believe that such identifiers can allow market participants to efficiently identify the asset or security held, and thus we included this requirement, which is required under the current generic listing standards for actively managed ETFs.

261 *See, e.g.*, WisdomTree Comment Letter.

262 *See, e.g.*, 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"), at section II.A.4.g.i. (discussing use of unique securities identifiers for portfolio holdings and observing that some holdings lack such identifiers).

263 Based on our experience with structured portfolio reporting, such as Form N-PORT, we believe that this information will provide a sufficient amount of data for a market participant to understand the payment profile of the investment and therefore arbitrage the ETF's portfolio holdings. *See id*., at section II.A.4.g.ii.

such as number of shares for equity securities, par value for debt securities, number of units for securities, such as UITs, that are measured in units, and dollar value for cash. With respect to derivatives, the ETF generally should provide both the notional value of the derivative and number of contracts, as well as a general description of the investment, which should include the type of derivative (*i.e.*, swap, option, forward). ETFs also may want to 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.

We continue to believe that the ETF's website is the most effective location for the disclosure of portfolio holdings information. By posting the portfolio information on its website, free of charge, the ETF makes the information available to a broad range of investors, including retail investors, and other market participants.[264] We further believe, and commenters agreed, that requiring ETFs to file their portfolio holdings information on EDGAR would impose additional costs on ETFs that are not justified in light of other available disclosure methods.[265] Moreover, the purpose of this requirement is to allow ETF investors to understand and potentially arbitrage the ETF's holdings. We therefore do not believe that requiring ETFs to file daily portfolio holding disclosure on EDGAR or other centralized location in order to provide potentially greater comparability across ETFs is justified in light of current market practices and the additional costs associated with such a requirement.[266] In addition, other documents, such as

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[264] *See* 2018 ETF Proposing Release, *supra* footnote 7, at n.271 and accompanying text (discussing advantages of website posting over use of National Securities Clearing Corporation ("NSCC") portfolio composition file).

[265] *See, e.g.*, Invesco Comment Letter (stating that additional dissemination requirements, such as EDGAR, would be costly).

[266] As stated above, however, we encourage ETFs to consider whether there are technological means, such as including portfolio holdings information in a machine-readable format, to make these disclosures more accessible. *See supra* footnote 225.

reports on Form N-PORT or Form N-CEN, registration statements on Form N-1A, and consolidated structured datasets derived from those submissions, provide centralized, structured information, including information about portfolio holdings, that can be analyzed and compared across ETFs, albeit on a less frequent basis.[267]

c. *Portfolio Holdings that Will Form the Basis for the ETF's NAV Calculation*

As proposed, rule 6c-11 will 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.[268] Changes in an ETF's holdings of portfolio securities would therefore be reflected on a T+1 basis. We did not receive any comments on this proposed condition, which is consistent with current ETF practices. We continue to believe that requiring an ETF to disclose the portfolio that will form the basis for the next NAV calculation at the beginning of the business day will help to facilitate the efficient functioning of the arbitrage process while protecting against potential front-running of the ETF's trades.

Accordingly, rule 6c-11 will not require ETFs to disclose intraday changes in portfolio holdings because these changes would not affect the portfolio composition serving as a basis for NAV calculation until the next business day.[269] We continue to believe that the selective disclosure of nonpublic information regarding intraday changes in portfolio holdings (or any advance disclosure of portfolio trades) could result in the front-running of an ETF's trades, causing the ETF to pay more to obtain a security.[270] We have stated that registered investment

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267 *See, e.g.*, Part C of Form N-PORT.

268 *See* rule 6c-11(c)(1)(i). *See also* 2018 Proposing Release, *supra* footnote 7, at nn.210-211 and accompanying text.

269 *See* 2018 ETF Proposing Release, *supra* footnote 7, at note 222 and accompanying text.

270 We also requested comment in the proposal on whether we should amend Regulation FD to apply to ETFs. Regulation FD prohibits the selective disclosure of material information by publicly traded companies and

companies' compliance policies and procedures required by 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.[271] ETFs also are required to describe their policies and procedures on portfolio security disclosure in the Statement of Additional Information and post such policies and procedures on their websites.[272]

5. Baskets

As proposed, rule 6c-11 will require an ETF relying on the rule to adopt and implement written policies and procedures governing the construction of baskets and the process that the ETF will use for the acceptance of baskets.[273] In addition, as proposed, the rule will provide an ETF with flexibility to use "custom baskets" if the ETF has adopted 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

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other issuers. *See* 2018 ETF Proposing Release, *supra* footnote 7, at n.228. We received two comments stating that ETFs should be subject to Regulation FD. *See* Eaton Vance Comment Letter; Jane Street Comment Letter. However, we are not amending Regulation FD at this time in order to further explore certain aspects of applying Regulation FD to ETFs, which unlike other entities subject to this regulation, are continuously offered.

271 Rule 38a-1 Adopting Release, *supra* footnote 133. Pursuant to rule 6c-11, ETFs are required to disclose portfolio holdings information with greater frequency than other open-end funds, which are generally required to publicly disclose holdings on a quarterly basis. However, we have previously noted that 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. *See* 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. 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. *Id*.

272 *See* Items 9(d) and 16(f) of Form N-1A; *see also* Disclosure of Portfolio Holdings Release, *supra* footnote 271, at section II.C.

273 *See* rule 6c-11(c)(3). The rule will 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* rule 6c-11(a)(1).

revisions to, or deviations from, those parameters; and (ii) specify the titles or roles of 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").[274]

a. *Basket Policies and Procedures*

When 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. Basket composition affects the costs of assembling and delivering the baskets exchanged for creation units as well as the costs of liquidating basket securities when redeeming creation units.[275] Basket composition also is important to ETF portfolio management, as each in-kind creation or redemption increases or decreases positions in the ETF's portfolio, and allows portfolio managers to add or remove certain portfolio holdings. 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, undesired changes to the portfolio may result, such as the loss of desirable bonds when paying redemptions in kind.

The exemptive relief relating to baskets evolved over time. 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.[276]

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274 *See* rule 6c-11(c)(3); *see also infra* footnote 298 and accompanying text.

275 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.

276 *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. Our earliest ETF orders for ETFs organized as UITs provide 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. Given the unmanaged nature of the UIT structure, a UIT ETF's basket generally reflected a pro rata representation of the ETF's portfolio. *See* SPDR, *supra* footnote 51.

Since approximately 2006, however, our orders placed tighter restrictions on an open-end ETF's composition of baskets.[277] These orders expressly require 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.[278]

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 that favors an 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-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.[279]

Based on our experience with ETFs, however, we believe there are many circumstances, in addition to the specific circumstances enumerated in our orders, where allowing basket assets to differ from a *pro rata* representation or allowing the use of different baskets could benefit the

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277 *See, e.g.*, 2006 WisdomTree Investments, *supra* footnote 200.

278 *See id.*; *see also* 2018 ETF Proposing Release, *supra* footnote 7, at nn. 238–242 and accompanying text (describing the circumstances when a basket could deviate from a *pro rata* representation of the ETF's portfolio under recent exemptive orders).

279 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.

ETF and its shareholders. For instance, ETFs without basket flexibility typically are required to include a greater number of individual securities within their basket when transacting in kind, making it more difficult and costly for authorized participants and other market participants to assemble or liquidate baskets. 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 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 later, more stringent restrictions on baskets.

Moreover, certain exceptions to a *pro rata* basket requirement may help ETFs operate more efficiently. For example, ETFs, particularly fixed-income ETFs, that do not have basket flexibility may 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.[280] ETFs that meet redemptions in cash may 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.[281]

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280 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 LLCP, *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.

281 In-kind redemptions allow ETFs to avoid taxable events and certain transaction costs that arise when selling securities for cash within the ETF. *See, e.g.*, Prudential Investments LLC, *et al*., Investment Company Act Release Nos. 32351 (Nov. 1, 2016) (notice) [81 FR 78228 (Nov. 7, 2016)] and 32374 (Nov. 30, 2016) (order) and related application (stating that cash redemptions may result in adverse tax consequences and higher transaction costs, such as brokerage costs, than in-kind redemptions). Additionally, based upon Form N-CEN data through September 5, 2019, the median transaction fee charged to an authorized participant for the use of an in-kind basket to satisfy a redemption was approximately $350.00, while the median transaction fee for the use of a basket that was partially or fully composed of cash was approximately $375.00, when charged on a per-creation-unit basis.

We therefore proposed to provide additional basket flexibility, subject to conditions designed to address concerns regarding the potential risk of overreaching. Specifically we proposed to require ETFs to adopt: (i) policies and procedures governing the construction of baskets and the process that would be used for the acceptance of baskets generally; and (ii) heightened process requirements for ETFs using custom baskets, including policies and procedures specifically covering the use of custom baskets.[282]

Commenters generally supported requiring ETFs to adopt policies and procedures governing the construction of baskets.[283] One commenter stated, for example, that this requirement is consistent with other investment and portfolio management processes that require guidelines, oversight and recordkeeping.[284] Commenters also generally supported our proposal to permit ETFs relying on the rule to use custom baskets provided they adopt certain heightened process requirements.[285] These commenters agreed that providing ETFs with the flexibility to use custom baskets potentially could benefit ETF investors through more effective arbitrage and more efficient portfolio management.[286] One commenter provided the results of an analysis it performed indicating that fixed-income ETFs with basket flexibility had narrower bid-ask spreads, had lower tracking differentials (*i.e.*, the difference between the ETF's daily return and the daily return of its benchmark), and traded at smaller discounts than fixed-income ETFs without basket flexibility.[287]

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282 *See* 2018 ETF Proposing Release, *supra* footnote 7, at section II.5.a.

283 *See, e.g.*, ICI Comment Letter; BlackRock Comment Letter; SIFMA AMG Comment Letter I.

284 *See* SIFMA AMG Comment Letter I.

285 *See, e.g.*, ICI Comment Letter; BlackRock Comment Letter; Invesco Comment Letter; BNY Mellon Comment Letter; IDC Comment Letter; Fidelity Comment Letter.

286 *See, e.g.*, BlackRock Comment Letter.

287 *See* ICI Comment Letter. *See also infra* footnotes 573–574 and accompanying text.

One commenter, however, asserted that the rule should not afford custom basket flexibility to all ETFs relying on it.[288] Rather, this commenter opined that the rule should require fixed-income ETFs to make in-kind, *pro rata* redemptions upon shareholder request (with limited substitutions for holdings that cannot be settled or transferred) because, under certain market conditions, custom baskets can lead to greater price volatility and dislocation from NAV for these ETFs.

Some commenters, although generally supporting custom basket flexibility and the proposed heightened process requirements, requested that we modify or clarify certain aspects of the proposed condition.[289] For example, one commenter did not support requiring "detailed parameters" for the construction and acceptance of custom baskets, stating that the rule should permit ETF sponsors to develop broad policies and procedures to cover the wide range of circumstances that may arise relating to custom baskets.[290] Another commenter stated that the Commission should explicitly set forth the appropriate considerations for custom basket policies and procedures, such as periodic monitoring and testing and oversight of the custom basket process.[291] This commenter also stated that the Commission should clarify that an ETF has discretion to tailor its custom basket policies and procedures to address different risks, considerations, and requirements for different types of custom baskets, particularly those involving cash substitutions.

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288 *See* Bluefin Comment Letter.

289 *See, e.g.*, ICI Comment Letter; BlackRock Comment Letter; Invesco Comment Letter; BNY Mellon Comment Letter; IDC Comment Letter; Fidelity Comment Letter; Dechert Comment Letter.

290 *See* Invesco Comment Letter.

291 *See* BlackRock Comment Letter.

We are adopting the basket conditions under rule 6c-11 as proposed. Rule 6c-11 therefore will require an ETF 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 as proposed.[292] These policies and procedures must cover the methodology that the ETF will use to construct baskets. For example, the policies and procedures should detail the circumstances under which the basket may omit positions that are not operationally feasible to transfer in kind. The policies and procedures also 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. 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 underlying securities market index, if applicable. We believe this policies and procedures requirement will protect against overreaching and other abusive practices in circumstances where an ETF uses a basket that does not reflect a *pro rata* slice of the ETF's portfolio holdings, but does not meet the definition of custom basket.

Rule 6c-11 also will require the policies and procedures to (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.[293] We continue to believe that an ETF and its shareholders may benefit from custom baskets and that

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292 *See* rule 6c-11(c)(3).

293 Rule 6c-11(c)(3)(i) and (ii).

the heightened process requirements for custom baskets in rule 6c-11 serve to protect the ETF and its shareholders from the risks that custom baskets may present.

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. They also 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. An ETF should consistently apply the custom basket policies and procedures 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, an ETF's custom basket policies and procedures should include reasonable controls designed to prevent inappropriate differential treatment among authorized participants.

We do not believe that the requirement for "detailed parameters" would prevent an ETF sponsor from developing policies and procedures to cover the wide range of circumstances that may arise relating to custom baskets.[294] ETFs may tailor their custom basket policies and procedures to address different risks and requirements for different types of custom baskets. For example, an ETF could develop tailored procedures when it uses cash substitutions that differ from the procedures it uses when substituting securities and other positions. An ETF's custom basket policies and procedures also could address the differing considerations for custom baskets depending on the direction of the trade (*i.e.*, whether the custom basket is being used for a creation or a redemption).[295] This condition provides ETFs with flexibility to cover operational

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[294] *See* Invesco Comment Letter.

[295] *See* BlackRock Comment Letter.

circumstances that make the inclusion of certain portfolio securities and other positions in a basket operationally difficult (or impossible), while facilitating portfolio management changes in a cost- and tax-efficient manner.

Although one commenter opined that fixed-income ETFs present unique concerns, we believe that requiring fixed-income ETFs to establish detailed parameters for the construction and acceptance of custom baskets that are in the best interests of the ETF and its shareholders will address the risks associated with custom baskets. As discussed above, we also believe that fixed-income ETFs (and their shareholders) may experience the most pronounced benefits from basket flexibility.[296] As a result, all ETFs that comply with the conditions in rule 6c-11 will have basket flexibility.

One commenter stated that the Commission should confirm that the "best interests of the ETF and its shareholders" standard included in rule 6c-11(c)(3)(i) includes the ETF's shareholders generally rather than individually, on the basis that the adviser to an ETF owes a fiduciary duty only to the ETF, and that ETFs cannot evaluate the interests of individual shareholders.[297] The "best interests of the ETF and its shareholders" in this context is not intended to apply to each ETF shareholder individually, but rather to the ETF's shareholders generally. This formulation is consistent with other Commission rules.[298]

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296 *See supra* footnotes 280–281 and accompanying text and footnote 287 and accompanying text.

297 *See* SIFMA AMG Comment Letter I.

298 *See, e.g.*, 17 CFR 270.12b-1 (rule 12b-1 under the Act) (providing that fund board may approve distribution plan under rule 12b-1 only if, among other things, the board concludes "that there is a reasonable likelihood that the plan will benefit the company and its shareholders"); 17 CFR 270.2a-7 (rule 2a-7 under the Act) (providing that board of a money market fund, in order to use certain share price calculation methods, must determine "that it is in the best interests of the fund and its shareholders" to maintain a stable net asset value per share).

As proposed, rule 6c-11 also will require an ETF, as part of its custom basket policies and procedures, to 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. Several commenters did not support this requirement as proposed.[299] One of these commenters stated that the rule should require ETFs to identify only the employees that are responsible for approving custom baskets that deviate from the parameters set forth in the policies and procedures.[300] Another commenter stated that the review requirement is overly prescriptive and could cause operational challenges when an ETF is sub-advised.[301]

In addition, several commenters did not support the statement in the 2018 ETF Proposing Release that 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.[302] Commenters stated that approval of custom baskets is a typical portfolio management function, and that requiring non-investment personnel to review custom baskets before approving a creation or redemption would be impractical, burdensome, and would detract from the flexibility custom baskets provide.[303] One commenter requested that the Commission clarify that the requirement to approve custom baskets applies only to employees with discretionary or direct

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299 *See, e.g.*, SIFMA AMG Comment Letter I; WisdomTree Comment Letter I.

300 *See* SIFMA AMG Comment Letter I.

301 *See* WisdomTree Comment Letter.

302 *See, e.g.*, Dechert Comment Letter; Fidelity Comment Letter; JPMAM Comment Letter; SIFMA AMG Comment Letter I; Invesco Comment Letter; CSIM Comment Letter; SSGA Comment Letter I.

303 *See, e.g.*, Dechert Comment Letter; Fidelity Comment Letter; JPMAM Comment Letter; Invesco Comment Letter; CSIM Comment Letter.

supervisory authority over custom baskets, and not to employees responsible for governance, back-testing, or periodic reviews.[304]

We continue to 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.[305] We also believe that the adviser is in the best position to determine which employee (or employees) are responsible for determining whether an ETF's custom baskets comply with the custom basket policies and procedures depending on its own structure, strategy, and other relevant circumstances (including whether the ETF is sub-advised). The ETF's adviser (and personnel) are familiar with the ETF's portfolio holdings and are able to assess whether the process and methodology used to construct or accept a custom basket is 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 will allow an ETF to establish a tailored framework for the use of custom baskets, while also requiring the ETF to put into place safeguards against abusive practices related to basket composition.

To 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 custom basket policies and procedures, we believe that the requirements of rule 38a-1 under the Act provide appropriate safeguards to address possible conflicts of interest that could arise from

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304 *See* BlackRock Comment Letter.

305 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 64, at n.68. *See also supra* footnote 64 (discussing certain other obligations for registered investment advisers).

such an arrangement. For example, 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.[306] 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.[307] For example, an ETF would be required to preserve the basket policies and procedures pursuant to the requirements of rule 38a-1(d)(1). Also, 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.[308]

b. *Definition of Custom Baskets*

As proposed, rule 6c-11 will define "custom baskets" to include two categories of baskets. First, a basket containing a non-representative selection of the ETF's portfolio holdings would constitute a custom basket.[309] These types of custom baskets include, but are not limited to, baskets that do not reflect: (i) a *pro rata* representation of the ETF's portfolio holdings; (ii) a

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306 *See* Rule 38a-1 Adopting Release, *supra* footnote 133. Among other things, rule 38a-1 requires a fund's chief compliance officer to provide a written report to the fund'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).

307 The compliance policies and procedures could require, for example, the ETF's chief compliance officer or other compliance professionals to conduct a post hoc, periodic review of a sample of custom baskets used by the ETF.

308 Several commenters expressed support for the description in the 2018 ETF Proposing Release of the oversight role of ETF boards, including with respect to custom basket policies and procedures. *See* ETF.com Comment Letter; IDC Comment Letter; Nasdaq Comment Letter.

309 Rule 6c-11(a)(1).

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.[310]

Second, if different baskets are used in transactions on the same business day, each basket after the initial basket would constitute a custom basket. For example, if an ETF exchanges a basket with either the same or another authorized participant that reflects a representative sampling that differs from the initial basket, that basket (and any such subsequent baskets) would be a custom basket.[311] 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 received a number of comments on the proposed definition of custom basket. Several commenters asserted that baskets including cash substitutions should not be subject to the heightened policies and procedures requirement for custom baskets, and thus should be excluded from the definition of custom baskets.[312] These commenters asserted that baskets with cash substitutions do not raise the same concerns about conflicts or overreach as securities substitutions.[313] Commenters also contended that the use of cash substitutions as part of standard (*i.e.*, non-custom) baskets is a routine portfolio management matter that is necessary for the efficient operation of ETFs.[314] One commenter suggested several technical changes to the

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310 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" except to the extent different baskets are used in transactions on the same business day.

311 When making the best interest determination for such custom baskets, the ETF should consider how this change in sampling affects the ETF's portfolio.

312 *See, e.g.*, ICI Comment Letter; BlackRock Comment Letter; Fidelity Comment Letter; Dechert Comment Letter; SIFMA AMG Comment Letter I; SSGA Comment Letter I.

313 *See, e.g.*, Fidelity Comment Letter ("Purchasing or redeeming using a cash basket does not create opportunities for 'cherry picking,' 'dumping' or other abuses ... and therefore does not give rise to the risk of overreaching that the proposed custom basket policies and procedures were designed to prevent."); ICI Comment Letter; BlackRock Comment Letter; SIFMA AMG Comment Letter I; JPMAM Comment Letter.

314 *See, e.g.*, SIFMA AMG Comment Letter I (asserting that "the use of cash is driven by restrictions

proposed definition of custom basket in rule 6c-11 to treat cash substitutions as part of a non-custom, *pro rata* basket under certain enumerated circumstances.[315]

After consideration of these comments, we are adopting the definition of "custom basket" as proposed. While we generally agree with commenters that cash substitutions may not raise the same concerns as securities substitutions, an ETF's use of cash substitutions may raise concerns regarding the potential for an authorized participant to overreach, particularly in connection with redemptions. For example, during periods of market stress, an authorized participant may demand cash from the ETF instead of less liquid securities in exchange for ETF shares, impacting the liquidity of the ETF's portfolio and the ability of the ETF to satisfy additional cash redemption requests from authorized participants.[316]

We also considered excluding certain types of cash substitutions from the definition of custom baskets where authorized participant overreach is unlikely, consistent with the approach taken in our recent exemptive orders.[317] However, we are concerned that such an approach may fail to effectively capture all circumstances in which an ETF may substitute cash. We believe that the policies and procedures requirements for custom baskets will provide ETFs with sufficient flexibility to design custom basket policies and procedures that are tailored to address

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applicable to authorized participants, restrictions on in-kind transactions in certain markets, or authorized participants' inability to access individual securities."); JPMAM Comment Letter. *See also* CSIM Comment Letter (recommending that the standard basket policies and procedures, rather than the custom basket policies and procedures, cover cash substitutions).

315 *See* BlackRock Comment Letter (recommending that we deem a basket to be *pro rata* if it: (1) substitutes cash for odd lot positions or as a result of minimum trade sizes; (2) substitutes cash due to security specific restrictions, such as corporate actions or regulatory reasons; (3) substitutes cash for positions or other instruments that cannot be delivered in-kind (*e.g.*, derivatives, to-be-announced (or "TBA") transactions); or (4) is otherwise representative of the ETF).

316 *See generally* LRM Adopting Release, *supra* footnote 122.

317 For example, authorized participant overreach is unlikely where the ETF substitutes cash for odd lot positions or as a result of minimum trade sizes.

the different risks that cash substitutions and securities substitutions may present. An ETF could, for example, design custom basket policies and procedures with more streamlined requirements for certain cash substitutions that present lower risks.[318]

c. *Basket Publication Requirement*

Proposed rule 6c-11 would have required an ETF to post information regarding 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 (a "published basket") on its website each business day.[319] This proposed disclosure requirement was designed to: (i) facilitate arbitrage by providing authorized participants and other market participants with timely information regarding the contents of a basket that the ETF will accept each day; and (ii) allow market participants that do not have access to an ETF's daily portfolio composition file to compare the ETF's basket with its portfolio holdings, assist in building intraday hedges, and estimate the cash balancing amount. After considering comments, however, the Commission is not including a basket publication requirement in rule 6c-11.

Commenters generally did not support requiring disclosure of a published basket on the ETF's website.[320] For example, one commenter asserted that the proposed published basket was "speculative," and had little value, particularly for certain types of fixed-income ETFs.[321] Several commenters contended that the contents of an ETF's basket are irrelevant for secondary market investors and publication of an ETF's basket could result in confusion, particularly if the

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318 *See* BlackRock Comment Letter.

319 *See* proposed rule 6c-11(c)(1)(i).

320 *See, e.g.*, SIFMA AMG Comment Letter I; Invesco Comment Letter I; Nasdaq Comment Letter; CSIM Comment Letter.

321 *See, e.g.*, SIFMA AMG Comment Letter I; *see also* CSIM Comment Letter ("CSIM does not believe that disclosure of one standard basket for orders to create or redeem creation units on an ETF's website would be useful disclosure to either individual investors or authorized participants as proposed.").

basket is mistaken for portfolio holdings information.[322] Other commenters stated that the publication requirement could delay the process by which the ETF and an authorized participant negotiate the contents of a custom creation or redemption basket.[323] Another commenter stated that we should require an ETF to provide its published basket through the NSCC, rather than through its website, because the market participants that would use the published basket currently are able to access it either directly through the NSCC or through intermediaries.[324]

After considering these comments, the Commission is not including in rule 6c-11 a requirement that an ETF post information regarding one published basket that it would exchange for orders to purchase or redeem creation units. We proposed this condition, in part, because we were concerned that certain market participants that needed access to basket information for arbitrage purposes would not have access to ETF portfolio composition files.[325] However, we understand from commenters that market participants that use basket information, including those seeking to hedge exposure to an ETF, currently have access to this information through the NSCC, an intermediary, or the ETF itself. We are, however, requiring ETFs to provide daily website disclosure of portfolio holdings, which we believe will provide market participants with the necessary tools to determine if an arbitrage opportunity exists and to hedge the ETF's portfolio.[326] As a result, we believe that the publication of a single published basket would provide little additional value to market participants assessing the existence of arbitrage

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322 *See, e.g.*, CSIM Comment Letter; ICI Comment Letter. One commenter also noted that the proposed amendments to Form N-1A eliminated other disclosure that were relevant only to authorized participants and potentially confusing to secondary market investors. *See* ICI Comment Letter.

323 *See, e.g.*, Invesco Comment Letter; Nasdaq Comment Letter.

324 *See* OppenheimerFunds Comment Letter.

325 *See* 2018 ETF Proposing Release, *supra* footnote 7, at section II.5.b.

326 *See* rule 6c-11(c)(1); *see also* 2018 ETF Proposing Release, *supra* footnote 7, at section II.C.4. (stating that 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).

opportunities. We also agree with commenters' concerns that some investors may confuse the published basket information with an ETF's portfolio holdings information.

We requested comment on whether we should require an ETF to publish certain information regarding each basket used by the ETF to ameliorate some of the limitations associated with publication of a single basket each day and to serve as an additional check against overreaching by authorized participants.[327] However, commenters stated that such a requirement would be costly to implement and unnecessarily burdensome, particularly because basket composition information is not used by secondary market investors.[328] In addition, commenters asserted that publication of each basket could raise the risk that market participants front-run trades in basket securities or attempt to replicate authorized participants' or other market makers' trading strategies, particularly for those ETFs that have more frequent primary market transactions.[329] Rule 6c-11 as adopted instead will require ETFs to maintain certain information regarding each basket exchanged with an authorized participant.[330] We believe that this record keeping requirement is a more efficient way to ensure compliance with the rule, while mitigating concerns regarding potential overreaching by authorized participants.

6. Website Disclosure

There has been a significant increase in the use of the internet as a tool for disseminating information, and many investors obtain information regarding ETFs on ETF websites.[331] Rule

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327 *See* 2018 ETF Proposing Release, *supra* footnote 7, text following nn.269 and 272.

328 *See, e.g.,* ICI Comment Letter; SSGA Comment Letter I; Vanguard Comment Letter.

329 *See, e.g.,* ICI Comment Letter; SSGA Comment Letter I; SIFMA Comment Letter; Vanguard Comment Letter (also opining that publication of each custom basket could confuse investors); *but see* Morningstar Comment Letter (advocating for disclosure of all baskets in a structured format).

330 *See infra* section 0.

331 *See, e.g.,* Reporting Modernization Adopting Release *supra* footnote 262.

6c-11 therefore will require ETFs to disclose certain information on their websites as a condition to the rule.[332] The website disclosure requirements 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, under rule 6c-11 the following information must be disclosed publicly and prominently on the ETF's website:[333]

- NAV per share, market price, and premium or discount, each as of the end of the prior business day;
- A table and chart showing the number of days the ETF's shares traded at a premium or discount during the most recently completed calendar year and calendar quarters of the current year;[334]
- For ETFs whose premium or discount was greater than 2% for more than seven consecutive trading days, disclosure that the premium or discount was greater than 2%, along with a discussion of the factors that are reasonably believed to have materially contributed to the premium or discount; and
- Median bid-ask spread over the most recent thirty calendar days.

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332 Rule 6c-11(c)(1).

333 *See* rule 6c-11(c)(1); *see also supra* footnote 225.

334 This requirement is similar to a current requirement in Item 11(g)(2) of Form N-1A, which requires disclosed percentages to be rounded to the nearest hundredth of one percent. *See* Current Instruction 2 to Item 11(g)(2) of Form N-1A. ETFs may similarly round percentages disclosed in response to this provision of rule 6c-11.

a. *Disclosure of Prior Business Day's NAV, Market Price, and Premium or Discount*

As proposed, rule 6c-11 will require an ETF to post on its website the ETF's current NAV per share, market price, and premium or discount, each as of the end of the prior business day.[335] 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.

Commenters generally supported this requirement, observing that the investors should have easy access to the required information.[336] Some commenters, however, questioned the benefits of the premium or discount disclosure requirement. One such commenter stated that premium and discount disclosures do not provide the same benefit to shareholders as NAV per share and market price.[337] Another commenter, while not objecting to the posting of daily premiums or discounts, opined that emphasizing this information would be unnecessary and—to the extent that a discount might be understood by prospective investors as a bargain—potentially misleading.[338]

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335 Rule 6c-11(c)(1)(ii); 2018 ETF Proposing Release, *supra* footnote 7, at section II.C.6. Proposed rule 6c-11 would have required this information "as of the prior business day." Proposed rule 6c-11(c)(1)(ii). For clarity, the final rule will specify that the information be provided "as of *the end* of the prior business day." Rule 6c-11(c)(1)(ii). This is consistent with our existing exemptive orders.

336 *See* ETF.com Comment Letter; ICI Comment Letter (stating that the commenter does "not object to" the requirement); NYSE Comment Letter (stating that the website disclosure requirements in rule 6c-11 "sufficiently address Commission concerns about investors' better understanding trading costs"); Virtu Comment Letter; CSIM Comment Letter.

337 *See* Invesco Comment Letter.

338 *See* SSGA Comment Letter I ("Similarly, investors may choose not to buy ETF shares because of a premium, when in fact the NAV is based on stale prices from an earlier close."). One commenter recommended that we also require footnote disclosure when premium or discount information is known to include inaccurate data due to exchange-hours overlap issues (*i.e.*, when the ETF does not trade contemporaneously with its underlying holdings). *See* ETF.com Comment Letter. Rule 6c-11 as adopted will not require additional footnote disclosure in these circumstances because a majority of ETFs do not have this type of timing issue and the recommended disclosure may not capture other circumstances where an ETF's premium or discount reflects inaccurate data. ETFs may include this context alongside the premium/discount disclosures on their websites as applicable.

We continue to believe that daily website disclosure of NAV per share and market price will promote transparency and alert investors to the relationship between NAV per share and market price. We also believe that this information will help investors better understand the risk that an ETF's market price may be higher or lower than the ETF's NAV per share and compare this information across ETFs. Daily premium/discount disclosures also will provide investors with useful information regarding ETFs that frequently trade at a premium or discount to NAV per share.[339] We believe that ETF investors use this information today.[340]

These disclosures are consistent with our exemptive orders except that rule 6c-11 includes a definition of "market price" that differs from the definition applicable to those orders. Rule 6c-11 defines "market price" as: (A) the official closing price of an ETF share; or (B) 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") as of that time.[341]

One commenter addressed our proposed definition of "market price" and asserted that the rule should permit ETFs to use the midpoint of the NBBO without evaluating whether it more

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339 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, and an ETF with a less efficient arbitrage mechanism may frequently show this type of end of day deviation.

340 One commenter suggested that investors are more likely to look for information on the website of the entity with which they interact, such as a broker-dealer. *See* JPMAM Comment Letter. However, we believe that ETF issuers, as the entities that are the subject of this rule's relief, should provide investors with this information to assist those shareholders who visit the ETF's website in the first instance. Moreover, another commenter stated that smaller investors rely predominantly on website disclosures for their investment analysis. *See* ETF.com Comment Letter.

341 *See* rule 6c-11(a)(1).

accurately reflects the market value of the ETF's shares.[342] We continue to believe, however, that using the "official closing price" provides a more precise measurement of an ETF's market price than other alternatives, including during disruptive market events.[343] Requiring use of the midpoint of the NBBO only if it more accurately reflects market value also provides an appropriate degree of flexibility to an ETF when its closing price may be stale or otherwise does not reflect the ETF share's market value, while at the same time providing a consistent and verifiable methodology for how ETFs determine market price.[344] Therefore, we have determined to adopt the definition of "market price" for purposes of this website disclosure requirement as proposed.

b. *Disclosure of Table and Line Graphs of the ETF's Premiums and Discounts*

As proposed, rule 6c-11 will 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.[345] For new ETFs that do not yet have this information, the rule will require the ETF to post this information for the life of the fund.[346] We believe that presenting the data as both a table and a line graph will provide

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342 *See* WisdomTree Comment Letter. An ETF uses the market price of an ETF share in calculating premiums and discounts. *See* rule 6c-11(a)(1) (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).

343 *See* 2018 ETF Proposing Release, *supra* footnote 7, at n.281 and accompanying text. We believe that using the "official closing price" is a better measure than, for example, only the last price at which ETF shares traded on their principal U.S. trading market during a regular trading session, 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.

344 Use of the midpoint of the NBBO, for example, mitigates the potential for gaming practices that could inaccurately minimize a deviation between market price and NAV per share when showing premiums and discounts. Because security information processors calculate NBBO continuously during the trading day, NBBO has the benefit of being a verifiable third-party quote.

345 Rule 6c-11(c)(1)(iii)–(iv).

346 For example, an ETF that has been in existence for 4 months should provide this disclosure for its first

investors with useful information in formats that are easy to view and understand, depending on the investor's preference.[347] This disclosure is similar to current requirements that allow an ETF to omit certain premium/discount disclosures from its prospectus and annual report if the ETF posts on its website a table showing the number of trading days the ETF traded at a premium and the number of days it traded at a discount.[348]

Commenters were generally supportive of this requirement.[349] However, some commenters recommended that the rule require only one of the two presentations.[350] We recognize, as commenters observed, that the same information underlies both presentations. However, each presentation highlights different information, as illustrated in Figure 1 and Table 1 below. The tabular disclosure shows investors how often the ETF traded at a premium or discount. The graphic disclosure shows investors the degree of those deviations, particularly during periods of market stress, and could assist some investors with understanding how the arbitrage mechanism performs for an ETF under various market conditions.[351] Different

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quarter of operations.

347 While past performance cannot predict how an ETF will trade in the future, 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.

348 *See* 2018 ETF Proposing Release, *supra* footnote 7, at n.300 and accompanying text; *see also infra* section 0. (discussing the elimination of this requirement in Form N-1A for funds relying on rule 6c-11).

349 *See, e.g.*, JPMAM Comment Letter; ETF.com Comment Letter; ICI Comment Letter (does not object to requirements).

350 John Hancock Comment Letter (recommending elimination of the proposed line graph requirement as it would result in disclosure duplicative of the table); WisdomTree Comment Letter (stating the line graph requirement would be adequate and that the required table would be too detailed).

351 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.

audiences also may find one presentation more effective.[352] Therefore, we continue to believe that the rule should require both disclosures, and are adopting this aspect of the rule as proposed.

[352] Another commenter recommended that we require ETFs to provide a separate line graph showing an ETF's market price and NAV per share over the most recently completed calendar year and quarters. *See* JPMAM Comment Letter. While we agree that this context could be informative, we believe that the rule as proposed appropriately balances the usefulness of the line graph disclosure with the costs of preparation. Of course, ETFs may include this context alongside the required disclosures on their websites, so long as the information is not misleading.

FIGURE 1: SAMPLE PREMIUM AND DISCOUNT LINE GRAPH

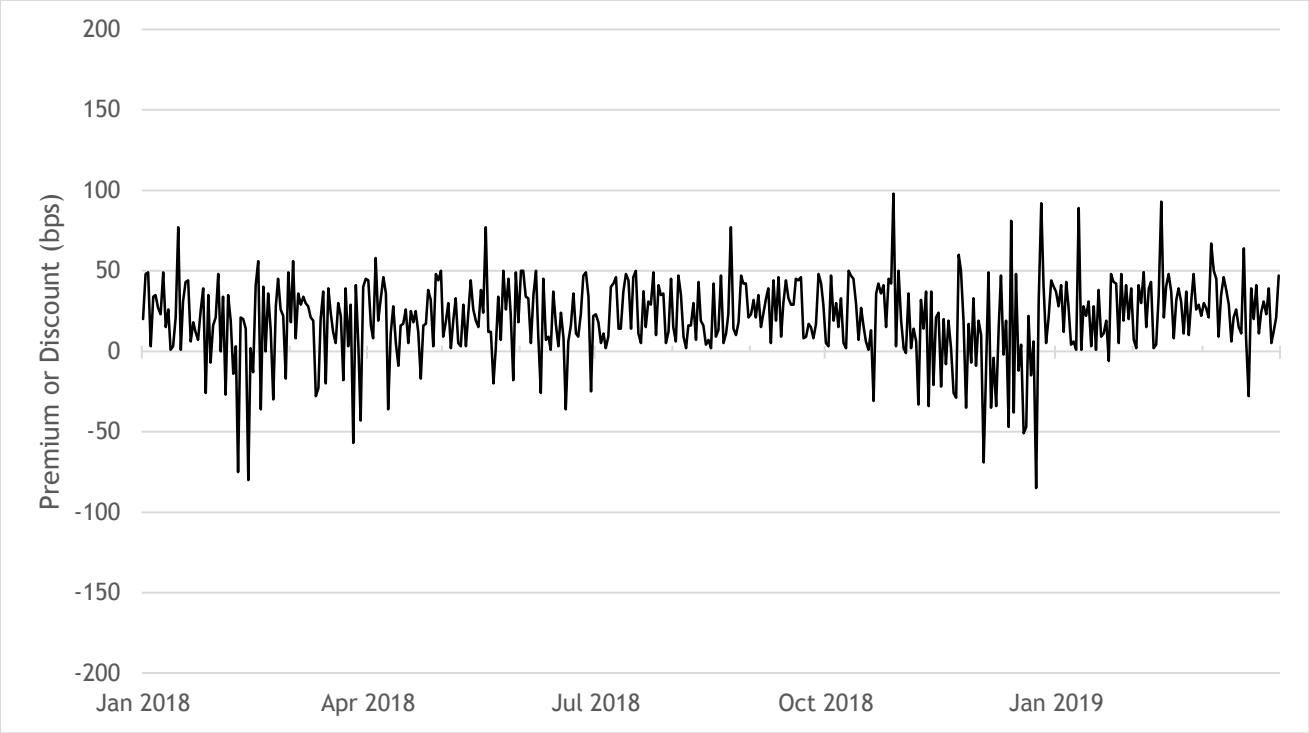

TABLE 1: SAMPLE PREMIUM AND DISCOUNT TABLE

	Calendar Year 2018	First Quarter of 2019
Days traded at premium	202	59
Days traded at discount	47	2

The rule will require historical premium/discount information for the most recently completed calendar year and the most recently completed calendar quarters of the current year as proposed. Some commenters recommended that we require ETFs to update this information on a daily basis or require ETFs to present intra-day premiums or discounts in certain circumstances.[353] However, after considering the usefulness of timely information for investors and other data users and the costs of more frequent collection and publication of the information,

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[353] *See* CFA Comment Letter; Eaton Vance Comment Letter; Comment Letter of Hagens Berman (Oct. 1, 2018) ("Hagens Berman Comment Letter"). ("[T]he new rule should require disclosure of the gross discount spreads that have reoccurred during times of high volatility or lack of liquidity.").

we continue to believe the rule should require disclosure of this information only on a quarterly basis. First, this period is consistent with existing prospectus disclosure requirements, and we believe the time period will allow investors to readily observe the extent and frequency of deviations from NAV per share in a graphic format. Second, as discussed above, although the trailing historical data is subject to a less frequent quarterly updating requirement, the *current* premium or discount is required to be disclosed daily.

c. *Disclosure of ETF Premiums or Discounts Greater than 2%*

As proposed, rule 6c-11 will require an ETF whose premium or discount was greater than 2% for more than seven consecutive trading days to post that information on its website,[354] along with a discussion of the factors that are reasonably believed to have materially contributed to the premium or discount.[355] We continue to believe that disclosure of such periods will promote transparency about the significance and persistence of deviations between market price and NAV per share, and may help investors to make more informed investment decisions.[356]

One commenter supported this requirement, stating that daily premium and discount information is an important metric for investors.[357] This commenter stated that its internal metrics suggest that it would be unusual for ETFs to trigger the proposed disclosure requirement, and therefore the disclosure "would not be burdensome" for ETFs. Other commenters, however,

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354 We have modified the proposed rule text to further clarify that an ETF must post a statement that the ETF's premium or discount, as applicable, was greater than 2%—and not only the factors reasonably believed to have materially contributed to the premium or discount. *See* rule 6c-11(c)(1)(vi).

355 Rule 6c-11(c)(1)(vi). The rule will require ETFs to post this information 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.

356 2018 ETF Proposing Release, *supra* footnote 7, at text preceding n.307 (stating that the proposed information also may provide the market (and the Commission) with information regarding the efficiency of an ETF's arbitrage mechanism).

357 *See* Invesco Comment Letter.

opposed the proposed requirement, expressing concern that ETFs holding certain asset classes are more likely to trigger the requirement than others, and that disclosure by ETFs that frequently trigger the requirement could become inappropriately repetitive.[358]

We recognize that this disclosure requirement may affect certain categories of ETFs more than others. 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 for an extended period of time. We believe that this information could help to inform investors about the nature of these ETFs and the potential for frequent deviations.

However, we believe this requirement will affect a broader range of ETFs than just those investing in certain foreign markets. For example, we estimate that, out of a total 2,046 ETFs, 11 alternative ETFs, 20 international equity ETFs, 2 sector equity ETFs, 1 taxable bond ETF, and 15 U.S. equity ETFs would have triggered the 2% premium or discount disclosure requirement in 2018.[359] In addition, during the period from 2008 to 2018, we estimate that the percentage of ETFs that would have triggered the reporting requirement at least once varied from 1.5% to 10%.[360] Even if certain ETFs make the disclosure more frequently or predictably than others because of this variation, we believe that the requirement will promote transparency regarding the significance and persistence of deviations between market price and NAV per share, and thus

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358 *See, e.g.,* ICI Comment Letter; Nasdaq Comment Letter; WisdomTree Comment Letter.

359 These figures are based on Bloomberg and Morningstar data for calendar year 2018 and estimate the number of ETFs with at least one instance that would have triggered the 2% premium or discount reporting requirement. As discussed in detail below, on a percentage basis, we estimate that 0.3% of taxable bond ETFs, 0.6% of sector equity ETFs, 3.1% of U.S. equity ETFs, 4.2% of international equity ETFs, and 4.8% of alternative ETFs would have triggered this disclosure requirement in 2018.

360 *See infra* footnote 597 and accompanying text.

may permit investors to make more informed investment decisions. Moreover, we believe that this disclosure helps inform investors that certain types of ETFs are more likely to experience persistent premiums or discounts than others.

Other commenters expressed concern with the requirement that an ETF include a discussion of the factors that are reasonably believed to have contributed to the premium or discount.[361] These commenters stated that an ETF may have difficulty identifying these factors before it makes the required disclosure. Although the required information will be subjective in some cases, we believe that this requirement can provide secondary market investors with useful context for the disclosed deviations. For example, the identification of factors that are reasonably believed to contribute to the premium or discount *at that time* may inform ETF investors and other market participants about factors potentially contributing to the premium or discount, even if additional contributing factors may later be identified. Such disclosed factors might include, for example, that many of an ETF's portfolio securities are traded on foreign markets that are closed during the U.S. trading day or that the markets on which the ETF's underlying securities are traded were closed due to extended holidays or for other reasons. Because the requirement to disclose these factors will continue to apply while the premium or discount persists, the disclosure may change and become better developed over time as the ETF refines its analysis of what it reasonably believes is causing the persistent premium or discount. As a result, such a disclosure also could inform ETF investors and other market participants about the premium's or discount's persistence.

Another commenter recommended that we shorten the time an ETF is required to maintain the disclosure on its website (to, *e.g.*, 45 days), asserting that the required information is

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[361] *See* ICI Comment Letter; SSGA Comment Letter I.

likely to be most useful when it is most recent and grows less important over time.[362] Rule 6c-11, however, will require ETFs to maintain the disclosure on their website for at least one year following the first day it was posted to help investors identify ETFs that historically have had persistent deviations between market price and NAV per share. Additionally, although we are requiring maintenance of this disclosure for at least one year, the requirement to post the information will continue to apply as the premium or discount persists—that is, the one-year maintenance requirements will not obviate the need for an ETF to post more current information if otherwise required.[363] Thus, the continued availability of the posted information over the required one-year period will not substitute for or prevent more current and timely disclosure.

Finally, some commenters expressed concerns with the 2% threshold.[364] For example, one commenter recommended a materiality standard instead of a 2% threshold.[365] Another commenter recommended raising the threshold to 5 or 10% and shortening the period over which it is measured.[366] As discussed 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.[367] We therefore believe that limiting this disclosure to ETFs that have a premium or discount of greater than 2% for more than seven consecutive trading days will serve to highlight potentially unusual

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362 CSIM Comment Letter.

363 Rule 6c-11(c)(1)(vi).

364 *See* John Hancock Comment Letter; Nasdaq Comment Letter; WisdomTree Comment Letter (asserting that the proposed threshold was "arbitrary").

365 *See* John Hancock Comment Letter.

366 *See* Nasdaq Comment Letter.

367 *See supra* footnote 359 and accompanying text; 2018 ETF Proposing Release, *supra* footnote 7, at nn.119–120, 307 and accompanying text (discussing the relatively small size of historic deviations between ETF market prices and NAV per share in the context of calibrating the threshold).

circumstances of an ETF with a persistent premium or discount. In Table 2 below, we summarize the effect that different variations on the proposed threshold recommended by the commenter would have had on the number of ETFs that would have triggered the requirement in 2018.

TABLE 2: NUMBER OF ETFs THAT WOULD HAVE TRIGGERED THE REQUIREMENT IN 2018

	3-Day Period			7-Day Period		
Category	2%	5%	10%	2%	5%	10%
Allocation	2					
Alternative	15	2		11		
Commodities						
International Equity	48	4		20	1	
Municipal Bond						
Sector Equity	10	1		2	1	
Taxable Bond	3			1		
U.S. Equity	29	5		15	3	
Total	107	12	None	49	5	None

As shown above, a 10% threshold would not have required any ETFs to provide this information in 2018, and a 5% threshold, even over just a three-day period, would have only required disclosure by 12 ETFs. After considering the commenter's recommended modifications to the threshold, we believe that the proposed threshold of 2% over more than seven consecutive trading days will more effectively highlight those patterns of sustained premiums or discounts that will be informative to investors than will the recommended alternatives. We also believe that in this circumstance the objective 2% threshold will result in more consistent application of the disclosure requirement than would a more subjective materiality standard. Furthermore,

deviations that do not meet the objective 2% threshold, but that would be material to an investment decision, must be disclosed.[368]

d. *Median Bid-Ask Spread*

Rule 6c-11 will require daily website disclosure of the ETF's median bid-ask spread calculated over the most recent 30-day period.[369] The bid-ask spread information is 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 have modified this requirement from our proposal, which would have required an ETF to disclose the median bid-ask spread for the ETF's most recent fiscal year on its website and in its prospectus.[370]

Comments on the proposed website disclosure of an ETF's bid-ask spread were mixed. Many commenters opposed this requirement, asserting that the proposed disclosures would require ETFs to bear costs and liability for data collected by third parties,[371] and that other sources (*e.g.*, financial intermediaries, the Commission) were in a better position to provide bid-ask spread information.[372] Some commenters noted that the bid-ask spread information may be misleading to investors if the historical information is not representative of current execution

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368 *See* rule 10b-5 under the Exchange Act [17 CFR 240.10b-5]; *see also* section 34(b) of the Act [15 USC 80a-33].

369 Rule 6c-11(c)(1)(v). In calculating the median bid-ask spread, an ETF would be required to: (i) identify the ETF's NBBO as of the end of each 10 second interval during each trading day of the last 30 calendar days; (ii) divide the difference between each such bid and offer by the midpoint of the NBBO; and (iii) identify the median of those values.

370. Although we proposed these bid-ask spread disclosure requirements as amendments to Forms N-1A and N-8B-2, rule 6c-11 will require ETFs relying on it to provide median bid-ask spread disclosure on its website as a condition to the rule. Our amendments to Form N-1A will provide an ETF that does not rely on rule 6c-11 with the option of providing the information required by rule 6c-11 on its website or the median bid-ask spread over the ETF's most recent fiscal year in its prospectus. *See infra* section 0.

371 *See, e.g.*, BNY Mellon Comment Letter; John Hancock Comment Letter.

372 *See, e.g.*, IDC Comment Letter; Invesco Comment Letter; SSGA Comment Letter I.

costs or if the bid-ask spread information is overemphasized.[373] Others expressed concern that there is no uniform method for computing bid-ask spread, which could make bid-ask spreads difficult to compare across different investment options.[374] Still others supported it as an alternative to the parallel proposed prospectus disclosure requirements.[375] For example, some commenters stated that providing more recent bid-ask spread data on an ETF's website alongside other ETF trading data would give investors more useful and timely information.[376] Commenters also expressed concern about potential liability under section 11 of the Securities Act for bid-ask spread data included in the prospectus if an investor's actual bid-ask spread costs differ materially from the bid-ask spread disclosed in the prospectus.[377]

While we recognize the costs for ETFs to collect and publish this bid-ask spread data, we believe that quantitative information regarding median bid-ask spreads will provide ETF investors with greater understanding of the costs associated with investing in ETFs. This will help investors make more informed investment decisions. We acknowledge that historical bid-ask spread data may reflect differences that result from varying methods of computing bid-ask spread. However, we have modified the proposal in several respects, such as using NBBO for computing the bid-ask spread, to make the computation more uniform. We therefore do not believe that the variance will be large enough to outweigh the importance of giving investors a greater understanding of these potential trading costs. We similarly understand that bid-ask spread may not reflect an individual investor's actual spread, as an individual's spread may

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373 *See, e.g.*, John Hancock Comment Letter; CSIM Comment Letter.

374 *See, e.g.*, IDC Comment Letter; John Hancock Comment Letter.

375 *See, e.g.*, Fidelity Comment Letter (expressing support for website disclosure with a rolling 30-day median calculation methodology); Dechert Comment Letter; Thomson Hine Comment Letter.

376 *See, e.g.*, OppenheimerFunds Comment Letter; SIFMA AMG Comment Letter I.

377 *See, e.g.*, ABA Comment Letter; CSIM Comment Letter; Dechert Comment Letter; 15 U.S.C. 77k.

depend on the execution strategies employed by an intermediary (such as mid-point pricing), the size of a particular order, or other factors. We nonetheless believe that the bid-ask spread is a helpful tool for investors making better informed trading decisions and that website disclosure can provide that information in a format that is easily accessible and relied upon by investors.

Based on comments we received, however, we are modifying certain of the bid-ask spread requirements to make the disclosure more cost-effective for ETFs, while maintaining or enhancing the utility for investors. First, the rule will require an ETF to disclose its median bid-ask spread only on its website, instead of requiring disclosure both on an ETF's website and in its prospectus as proposed.[378] ETFs will present the median bid-ask spread disclosure alongside other ETF-specific disclosures, such as premium and discount and market price, which should mitigate some commenters' concerns relating to the overemphasis of bid-ask spread data.

Second, some commenters suggested shortening the look-back period for calculating the bid-ask spread metric, such as to a 30- or 45-day rolling period.[379] One commenter noted that a shorter look-back period may show a more representative spread level, particularly for a newly launched ETF, as spreads are likely to tighten as the ETF matures.[380] Several commenters also suggested that the Commission require ETFs to provide a time-weighted average bid-ask spread

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378 *See infra* section 0. (discussing our determination not to adopt certain prospectus disclosure requirements that we proposed).

379 *See, e.g.*, BlackRock Comment Letter (30-day period); BNY Mellon Comment Letter (30-day period); Cboe Comment Letter (45-day period); ETF.com Comment Letter (45-day period).

380 *See* BlackRock Comment Letter (providing an example showing an ETF that saw its spread improve from 35 basis points at inception in January 2016 to 4.03 basis points in July 2018, and observing that its median bid-ask spread over the prior fiscal year ending July 31, 2018 was 6.34 basis points, while its median bid-ask spread over the prior month was 4.03 basis points).

rather than the proposed median bid-ask spread.[381] These commenters stated that a time-weighted average is more helpful for investors because it represents a "typical" bid-ask spread. We agree that a bid-ask spread metric based on the more recent inputs from the last 30 days may provide a better representation of the costs that an investor may incur when trading ETF shares. Accordingly, we are shortening the look-back period for calculating the bid-ask spread from the most recent fiscal year to the most recent 30-day period on a rolling basis.[382] We think the 30-day look-back period strikes an appropriate balance between reflecting only very short term fluctuations and reflecting information that is no longer representative of current execution costs. We do not think it is necessary to require a time-weighted average rather than the proposed median, however, because rule 6c-11 requires an ETF to determine the median by first identifying the exchange-traded fund's national best bid and national best offer as of the end of each 10 second interval during each trading day. This methodology (and the resulting number of data points) has the same effect as time-weighting. In addition, requiring an ETF to disclose the median of bid-ask spreads is less likely to give disproportionate effect to outlier values than a time-weighted average.

Finally, we are modifying the proposal to require that an ETF use the NBBO in calculating median bid-ask spreads.[383] While the proposal did not specify that the NBBO must be used, after considering comments recommending more uniformity regarding bid-ask spread disclosures,[384] we believe that requiring ETFs to use the NBBO when calculating the median will

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381 *See, e.g.*, Fidelity Comment Letter; JPMAM Comment Letter.

382 Rule 6c-11(c)(1)(v).

383 Rule 6c-11(c)(1)(v)(A)–(B).

384 *See supra* footnote 374 and accompanying text.

increase consistency and comparability of the resulting disclosure across ETFs.[385] In addition, we believe that requiring use of NBBO will help to reduce costs associated with obtaining the required information, because the NBBO also is an input to the market price disclosure requirement.

We also proposed related amendments to Form N-1A that would have required an ETF to provide: (i) examples in the ETF's prospectus showing how bid-ask spreads impact the return on a hypothetical investment for both buy-and-hold and frequent traders; and (ii) an interactive calculator in a clear and prominent format on the ETF's website that would allow an investor to customize the hypothetical bid-ask spread calculations to its specific investing situation.[386] These requirements were 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.

Commenters generally opposed requiring bid-ask spread examples in the summary prospectus or summary section. For example, some commenters expressed concerns regarding the costs of obtaining the underlying bid-ask spread data from third parties.[387] Some commenters also noted that the historical bid-ask spread data, which ETFs would use to calculate the examples, is not representative of current trading costs and could mislead investors if

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385 The NBBO also is used in the definition of market price in rule 6c-11. Rule 6c-11(a)(1); *see also supra* section 0. Requiring NBBO is likely to result in more uniform and comparable calculations across funds.

386 *See* proposed amendment to Item 3 of Form N-1A. The proposed 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) and, to illustrate that more frequent trading can significantly increase costs, it would demonstrate the costs associated with 25 $10,000 round-trip trades (50 total trades). 2018 ETF Proposing Release, *supra* footnote 7, at section II.H.2.

387 *See, e.g.*, BNY Mellon Comment Letter; ICI Comment Letter; John Hancock Comment Letter; OppenheimerFunds Comment Letter.

disclosures overemphasize this information.[388] Other commenters suggested alternatives to the proposed examples such as using hypothetical brokerage commissions and bid-ask spreads, rather than using actual historical bid-ask spreads.[389] However one commenter supported this aspect of the proposal, stating that it would yield "relevant and helpful" information.[390]

Many commenters raised similar concerns regarding the proposed interactive calculator, including that varying data sources and calculation methodologies may result in an inconsistent investor experience across ETFs.[391] Other commenters noted that the interactive calculator was limited to bid-ask spread data, which placed undue emphasis on spreads as a component of an ETF investor's trading costs.[392] Commenters also noted that the proposed requirement may result in additional vendor and licensing costs.[393]

After considering comments, we are not adopting the proposed bid-ask spread examples or interactive calculator requirements. We are instead requiring ETFs relying on rule 6c-11 to provide more recent bid-ask spread information on their website. We believe that streamlining the required bid-ask spread disclosures will mitigate commenters' concerns that investors may fail to understand the relevance of the bid-ask spread information or the potential impact of bid-ask spreads on their specific trading situations. We are also persuaded by commenters that an

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388 *See, e.g.*, Vanguard Comment Letter (noting that in the second quarter of 2018, Vanguard's retail brokerage clients paid less than 5% of the bid-ask spread when trading Vanguard ETFs with an effective spread/quoted spread of 1.89%, and approximately 97% of those market orders were executed inside the NBBO, with 94% of those orders at midpoint or better). *See also* ABA Comment Letter; BlackRock Comment Letter; CSIM Comment Letter.

389 *See, e.g.*, SIFMA AMG Comment Letter II.

390 *See* FIMSAC Comment Letter.

391 Fidelity Comment Letter; Invesco Comment Letter; SIFMA Comment Letter I; Vanguard Comment Letter.

392 *See, e.g.*, Vanguard Comment Letter. *See also* Eaton Vance Comment Letter (recommending replacing the proposed interactive calculator with new requirements for website trading information).

393 *See, e.g.*; ICI Comment Letter; JPMAM Comment Letter. *See also* WisdomTree Comment Letter (stating that broker-dealers are better suited to provide the information required by the proposed interactive calculator).

interactive calculator focused solely on bid-ask spread costs may overemphasize those costs and thereby obscure the effect of other costs of investing in ETFs.

7. Marketing

As proposed, rule 6c-11 will not include certain requirements related to ETF marketing, which were included in our exemptive orders. Specifically, rule 6c-11 will not require an ETF to: (i) identify itself in its sales literature as an ETF that does not sell or redeem individual shares, and (ii) explain that investors may purchase or sell individual ETF shares through a broker via a national securities exchange.[394] Our exemptive orders included a condition requiring this information to help prevent investors, particularly retail investors, from confusing ETFs with mutual funds, at a time when ETFs were not a well-known investment product.

The comments on this aspect of the proposal were mixed. Commenters who supported the proposal generally agreed that the market has developed a familiarity with ETFs and that retail investors generally understand that, unlike mutual funds, individual ETF shares may be purchased and sold only on secondary markets.[395] One commenter disagreed, asserting that many investors do not understand the distinctions between ETFs and mutual funds.[396] This commenter suggested that the rule require an ETF to include a statement in its sales literature noting that buyers of ETF shares may pay more than the shares' current value and that sellers of ETF shares may receive less than current value. Another commenter noted that requiring this type of disclosure in ETF sales literature would help put investors on notice that the ETF pricing mechanism works differently than that of mutual funds.[397]

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394 *See* 2018 ETF Proposing Release, *supra* footnote 7.

395 *See, e.g.*, Invesco Comment Letter; ICI Comment Letter.

396 Eaton Vance Comment Letter.

397 CFA Comment Letter.

We continue to believe that ETF investors have grown familiar with ETFs and the fundamental distinctions between ETFs and mutual funds, and that this disclosure is now unnecessary. The disclosure requirements we are adopting also should provide ETF investors, including retail investors, with useful information regarding the exchange-traded nature of ETFs and ETF pricing, including the potential for market price to deviate from NAV per share.[398]

8. ETF and ETP Nomenclature

We requested comment on whether the Commission should address possible investor confusion arising from the nomenclature that has developed for identifying ETPs, including confusion between ETFs and other types of ETPs that are not registered under the Act.[399] We asked, for example, whether the Commission should consider proposing to require a naming convention or other identification scheme to assist investors in distinguishing ETFs from other ETPs in a future rulemaking. We also asked whether we could address investor confusion by restricting certain sales practices, such as by proposing restrictions on how intermediaries communicate with retail investors about ETPs unless they disclose certain information designed to clearly differentiate ETPs that are not subject to the Act from ETFs that are registered investment companies.

Several commenters generally supported a classification system for ETPs to assist investors in distinguishing among these different products.[400] One commenter stated that

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398 The website disclosure requirements are described in section 0 and the amendments to Form N-1A are described in section 0.

399 *See* 2018 ETF Proposing Release, *supra* footnote 7, at section II.C.7. *See also supra* footnote 16 (describing differences between ETFs and other types of ETPs, such as exchange-traded notes and commodity pools).

400 *See, e.g.*, BlackRock Comment Letter; Invesco Comment Letter; Cboe Comment Letter; FIMSAC Comment Letter; Hu and Morely Comment Letter (incorporating article by comment letter's authors suggesting that ETFs can be categorized into three groups, "Investment Company ETFs," "Commodity Pool ETFs," and "Operating Company ETFs," based on the applicable regulatory framework, but not

leveraged/inverse ETFs, commodity pools, and exchange-traded notes have differences that investors should understand prior to making investment decisions.[401] Commenters expressed varying views, however, regarding which types of ETPs should call themselves ETFs under an ETP classification system. One commenter asserted that the Commission should permit only ETFs that fall squarely within proposed rule 6c-11 to call themselves ETFs.[402] Two commenters provided examples of comprehensive classification systems for ETPs that would not permit "exchange-traded notes," "exchange-traded commodities," or "exchange-traded instruments" (including leveraged/inverse ETFs) to refer to themselves as ETFs.[403] One commenter opined that the Commission should not preclude leveraged/inverse ETFs from calling themselves ETFs, as that would "confuse investors and muddle both the existing regulatory framework applicable to ETFs and fund naming conventions."[404] Another commenter asserted that UITs and other ETFs that fall outside the scope of the rule should nonetheless be permitted to call themselves ETFs.[405]

One commenter asserted that Commission action relating to ETP naming is premature at the present time.[406] This commenter encouraged ETF market participants to engage in a dialogue "around refining existing ETP disclosures, adding new elements as useful to investors, and developing an industry-led standard ETP disclosure approach beneficial to investors and all market participants."

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suggesting a related nomenclature system).

401 *See* Invesco Comment Letter. *See also* BlackRock Comment Letter.

402 *See* Invesco Comment Letter.

403 *See* BlackRock Comment Letter; FIMSAC Comment Letter.

404 *See* ProShares Comment Letter.

405 *See* SIFMA AMG Comment Letter I.

406 *See* Comment Letter of State Street Global Advisors (Feb. 4, 2019).

We agree that these issues need to be examined and discussed in more depth before the implementation of an ETP naming system. We will continue to consider the comments we received and, if appropriate, will take steps to address investor confusion relating to ETF and ETP nomenclature. At present, we believe that the term "ETF" is generally associated with ETPs regulated under the Investment Company Act. Leveraged/inverse ETFs, for example, are regulated under the Act and are structurally and operationally similar to ETFs that will rely on rule 6c-11. As a result, we do not believe it is appropriate to require leveraged/inverse ETFs to use a naming convention that does not include the term "ETF." Similarly, because UIT ETFs are subject to a substantially similar regulatory regime as ETFs structured as open-end funds (and subject to similar regulatory safeguards), we do not find it appropriate to require UIT ETFs to utilize a naming convention that does not include the term "ETF." We encourage ETP market participants to continue engaging with their investors, with each other, and with the Commission on these issues.

D. Recordkeeping

We are adopting, as proposed, an express requirement that ETFs relying on rule 6c-11 preserve and maintain copies of all written agreements between an authorized participant and the ETF (or one of the ETF's service providers) that allow the authorized participant to purchase or redeem creation units ("authorized participant agreements").[407] One commenter supported this aspect of the proposal.[408] Another commenter, however, stated that this requirement is

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[407] *See* rule 6c-11(d)(1). For example, an authorized participant and the ETF's principal underwriter may enter into the authorized participant agreement.

[408] *See* ICI Comment Letter.

unnecessary because ETFs already generally implement robust recordkeeping programs pursuant to their policies and procedures.[409]

After considering these comments, we believe it is appropriate for rule 6c-11 to specifically require that ETFs preserve and maintain authorized participant agreements. Authorized participants play a central role in the proper functioning of the ETF marketplace and authorized participant agreements are critical to understanding the relationship between an authorized participant and an ETF. Requiring the preservation of authorized participant agreements 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 rule 6c-11 and other provisions of the Act and rules thereunder, based on the specific terms of their written agreement. 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 believe it is appropriate to expressly require that ETFs relying on rule 6c-11 preserve and maintain copies of all such agreements.

We also are adopting, largely as proposed, a requirement that ETFs maintain information regarding the baskets exchanged with authorized participants. Rule 6c-11 will require an ETF to maintain records setting forth the following information for each basket exchanged with an authorized participant: (i) ticker symbol, CUSIP or other identifier, description of holding, quantity of each holding, and percentage weight of each holding composing the basket exchanged for creation units;[410] (ii) if applicable, an identification of the basket as a "custom

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409 *See* Invesco Comment Letter.

410 As discussed below, proposed rule 6c-11 would have required ETFs to maintain the "names and quantities of the positions composing the basket" exchanged for creation units and did not require additional information about the ticker symbol, CUSIP or other identifier, or a description of the holding. *See* proposed rule 6c-11(d)(2).

basket" and a record stating that the custom basket complies with the ETF's custom basket policies and procedures; (iii) cash balancing amounts (if any); and (iv) the identity of the authorized participant conducting the transaction.[411]

Commenters generally supported requiring ETFs to maintain records regarding baskets.[412] One commenter stated that clear, auditable records would help Commission staff monitor custom basket usage and its impact on the ETF arbitrage process.[413] Another agreed that the records would provide Commission staff with a basis to understand how baskets are being used by ETFs and to evaluate compliance with the rule and other requirements.[414] As noted above, one commenter stated that it is unnecessary for the rule to contain any recordkeeping provisions.[415]

After considering these comments, we believe that requiring ETFs to maintain records regarding each basket exchanged with authorized participants will provide our examination staff with a basis to understand how baskets are being used by ETFs, particularly with respect to custom baskets. In order to provide our examination staff with detailed information regarding basket composition, however, we have modified rule 6c-11 to require the ticker symbol, CUSIP or other identifier, description of holding, quantity of each holding, and percentage weight of each holding composing the basket exchanged for creation units as part of the basket records, instead of the name and quantities of each position as proposed.[416] We believe that this additional information will better enable our examination staff to evaluate compliance with the

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411 *See* rule 6c-11(d)(2).

412 *See* ICI Comment Letter; Nasdaq Comment Letter; SIFMA AMG Comment Letter I.

413 *See* SIFMA AMG Comment Letter I.

414 *See* ICI Comment Letter.

415 *See* Invesco Comment Letter.

416 *See* proposed rule 6c-11(d)(2).

rule and other applicable provisions of the federal securities laws. Moreover, we do not believe that requiring ETFs to maintain detailed information regarding basket composition will create operational challenges or unduly burden ETFs because rule 6c-11 already requires ETFs to disclose the same information for each portfolio holding as part of the portfolio transparency requirements.[417]

As proposed, the rule will require ETFs 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 incorporate this type of retention period and we believe consistency with that period will minimize any compliance burdens to ETFs subject to rule 6c-11. The commenter that addressed this aspect of the recordkeeping requirement supported the proposed retention period.[418]

E. Share Class ETFs

As proposed, rule 6c-11 does not provide 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) (the multiple class rule).[419] Sections 18(f) and (i) of the Act were intended, in large part, to protect investors from certain abuses associated

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[417] This modification aligns the rule's recordkeeping requirements in paragraph (d) with the information the ETF must already collect and disclose as part of the portfolio transparency requirements. Proposed rule 6c-11 would have required an ETF to post on its website information regarding a published basket at the beginning of each business day and to present the description, amount, value and unrealized gain/loss in the manner prescribed by Article 12 of Regulation S-X for each basket asset. As discussed above, we are not adopting a basket publication requirement as part of rule 6c-11, and therefore the rule does not set forth recordkeeping requirements relating to the proposed basket publication requirement. *See supra* section 0.

[418] *See* Invesco Comment Letter (agreeing with the five-year retention timeline despite generally objecting to the rule's recordkeeping requirements).

[419] *See* 15 U.S.C. 80a–18(f)(1) and (i). Section 18(f)(1) of the Act generally prohibits a registered open-end company 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 registered management company must have equal voting rights.

with complex investment company capital structures, including conflicts of interest among a fund's share classes.[420] 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.[421] Rule 18f-3 created a limited exception from sections 18(f)(1) and 18(i) for certain funds but requires, among other things, that each share class of a fund have the same rights and obligations as each other class.[422] An ETF cannot rely on rule 18f-3 to operate as a share class within a fund, however, because the rights and obligations of the ETF shareholders would differ from those of investors in the fund's mutual fund share classes.[423] Therefore, absent any separate relief from sections 18(f)(1) or 18(i) of the Act, an ETF structured as a share class of a fund that issues multiple classes of shares representing interests in the same portfolio cannot operate in reliance on rule 6c-11.

We recognize that the Commission has previously granted ETFs exemptive relief from the provisions of section 18 of the Act in the past, subject to various conditions.[424] However, relief from section 18 raises policy considerations that are different from those we are seeking to

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420 *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.

421 *See id*.

422 *See* 17 CFR 270.18f–3(a)(4); Exemption for Open-End Management 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.

423 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.

424 *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").

address in this rule. 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.[425]

Three commenters stated that it was unnecessary for rule 6c-11 to provide relief for share class ETFs.[426] One commenter, a sponsor of share class ETFs, stated that it is unnecessary for the rule to encompass share class ETFs because it is currently uncommon for ETF issuers to seek the exemptive relief necessary for such ETFs.[427] Another stated that our proposed treatment is appropriate given the nuances associated with those products, [428] and the third similarly indicated that share class ETFs present issues that would be more appropriately addressed through means other than rule 6c-11.[429]

Two other commenters, however, opined that rule 6c-11 (or a separate future rule) should provide relief for share class ETFs in order to create a more level ETF playing field.[430] Additional commenters echoed the importance of leveling the ETF playing field without

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425 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.

426 *See* Vanguard Comment Letter; Invesco Comment Letter; SSGA Comment Letter I.

427 *See* Vanguard Comment Letter.

428 *See* Invesco Comment Letter.

429 *See* SSGA Comment Letter I.

430 *See* BNY Mellon Comment Letter; OppenheimerFunds Comment Letter.

specifically addressing share class ETFs.[431] Another commenter urged the Commission to explore granting relief from the relevant provisions of section 18 broadly to the fund industry.[432]

Leveling the ETF playing field is a goal for rule 6c-11, and we acknowledge that our approach will result in there being a segment of ETF assets that are unable to rely on the rule. At the same time, we continue to believe that share class ETFs raise policy considerations that are different from those we seek to address in the rule. With such concerns unresolved, we do not believe it is appropriate to broadly grant relief from sections 18(f)(1) and 18(i) of the Act for share class ETFs at this time. Share class ETFs are structurally and operationally different from the other types of ETFs within the scope of rule 6c-11.[433] We therefore continue to believe it is appropriate for share class ETFs 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 assess all relevant policy considerations in the context of the facts and circumstances of each particular applicant. We are not rescinding exemptive relief previously granted to share class ETFs.

We also are adopting amendments to Form N-1A that will require share class ETFs to provide certain additional disclosures regarding ETF trading costs. As discussed in more detail below in section II.H., these disclosure amendments are designed to help ensure consistent disclosures to investors between ETFs relying on proposed rule 6c-11 and share class ETFs operating pursuant to individualized exemptive relief. The rule and form amendments require all

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431 *See* ETF.com Comment Letter (stating that the disclosure requirements of any final rule should apply to all ETFs, regardless of whether the ETFs rely on the final rule); Invesco Comment Letter (indicating that the Commission should generally abstain from regulatory actions that allow only certain market participants to benefit from innovation).

432 *See* MFDF Comment Letter.

433 For example, when an ETF is structured as a share class of an open-end fund, the open-end fund has other share classes representing interests in the same portfolio. These interests (and the cash flows associated with the other share classes) can impact the fund's portfolio. In addition, share class ETFs do not provide daily portfolio transparency. *See* Vanguard orders, *supra* footnote 424.

ETFs that are subject to the Investment Company Act to provide similar disclosures in order to help investors compare products.

F. Master-Feeder ETFs

Many of our recent ETF orders allow ETFs to operate as feeder funds in a master-feeder structure.[434] 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 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.[435] To accommodate the unique operational characteristics of these 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

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434 *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").

435 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. 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.

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,[436] 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.[437]

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 does 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.[438] Due to these concerns, and the lack of market interest in this structure, we proposed to rescind the master-feeder relief granted to ETFs that did not rely on the relief as of the date of the proposal (June 28, 2018). We also proposed to grandfather existing master-feeder arrangements involving ETF feeder funds, but prevent the formation of new ones, by amending relevant exemptive orders.

One commenter stated that it did not object to preventing the formation of new master-feeder arrangements and rescinding master-feeder relief (with the exception of master-feeder

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436 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).

437 *See* 15 U.S.C. 80a-22(e) (generally requiring the satisfaction of redemptions within seven days). *See also supra* section 0.

438 *See supra* footnote 425 and accompanying text.

relief that funds actively relied on as of the date of the Proposing Release).[439] Other commenters, however, indicated that the rule should provide relief for master-feeder structures[440] or that the Commission should not rescind existing master-feeder relief.[441] Some of these commenters indicated that failing to provide relief for master-feeder structures would cause an uneven playing field among ETFs but did not address the concerns discussed above.[442]

Other commenters set forth potential methods for mitigating such concerns. For example, one commenter indicated that the Commission could address its concerns regarding potential cross-subsidization by requiring master funds to impose certain transaction fees,[443] while another indicated that the Commission should address these concerns by requiring each feeder fund in a master-feeder structure to transact with the master fund consistently (*i.e.*, only in cash or only in kind).[444] An additional commenter suggested that an ETF's board should evaluate whether a master-feeder structure's overall benefits outweigh its overall costs in order to address these concerns.[445] Another commenter indicated that it has already invested resources exploring various approaches to an ETF master-feeder structure, including models that it believed would address the Commission's concerns.[446]

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439 *See* ICI Comment Letter.

440 *See* ETF.com Comment Letter; BNY Mellon Comment Letter; Dechert Comment Letter.

441 *See* Fidelity Comment Letter; Eaton Vance Comment Letter.

442 *See* ETF.com Comment Letter; BNY Mellon Comment Letter.

443 *See* Eaton Vance Comment Letter.

444 *See* Fidelity Comment Letter.

445 *See* Dechert Comment Letter. This commenter also opposed excluding exemptive relief for master-feeder structures based on a lack of market interest because the ETF industry is dynamic and interest in master-feeder structures may develop in the future. *Id.*

446 *See* Fidelity Comment Letter.

As discussed in the context of share class ETFs, leveling the ETF playing field is a goal for rule 6c-11, and we acknowledge that our approach will result in there being a segment of ETF assets that are unable to rely on the rule. Like share class ETFs, however, we continue to believe that master-feeder funds raise policy considerations that are different from those we seek to address in the rule and are structurally and operationally distinct from other ETFs within the scope of rule 6c-11. We do not believe it is appropriate to broadly grant exemptive relief for master-feeder funds. Instead, we continue to believe that the Commission should consider the special concerns presented by ETFs in master-feeder structures in the context of the facts and circumstances of each particular applicant through individualized exemptive applications. The Commission's exemptive relief process is well-suited for applicants to set forth novel methods of mitigating the Commission's concerns, such as the methods suggested above. The process allows applicants to experiment with many different approaches, and may eventually assist the Commission in identifying a particular solution that is appropriate for a broader rule. Any ETF that is exploring a particular approach is free to bring its methodology forward in an exemptive application, which should help mitigate commenters' concerns about future changes in the ETF industry and resources already committed to such research. As proposed, therefore, we will rescind the master-feeder relief granted to ETFs that did not rely on the relief as of the date of the proposal (June 28, 2018).[447]

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[447] One commenter indicated that this date provided an insufficient notice period for ETFs interested in pursuing the master-feeder structure and recommended "a sunset provision of at least 3 years from the effective date of the final rule to allow ETFs that have been developing this structure sufficient time to test and implement it." *See id*. Exemptive orders for existing ETF master-feeder structures that rely on the relief will not be rescinded, however, and ETFs interested in pursuing a master-feeder structure in the future may apply for individualized exemptive relief. We therefore believe that such a 3-year sunset provision is unnecessary.

Only one fund complex had established as of June 28, 2018 master-feeder arrangements involving ETF feeder funds, and each arrangement involves an ETF as the sole feeder fund. We understand that all but one of the complex's original ETF feeder funds has discontinued its use of a master-feeder structure.[448] Because this arrangement involves only one ETF feeder fund for its master fund, we do not believe it will raise the policy concerns discussed above without new, additional feeders, and therefore do not believe it is necessary to require this structure to change its existing investment practices by rescinding the relief.[449] Instead, as proposed, we are amending this fund complex's existing exemptive orders to prevent the complex from forming new master-feeder ETFs.[450]

G. Effect of Rule 6c-11 on Prior Orders

As proposed, we have determined to exercise our authority under the Act to amend and rescind the exemptive relief we have issued to ETFs that will be permitted to operate in reliance on rule 6c-11.[451] Accordingly, one year following the effective date of rule 6c-11, we will rescind those portions of our prior ETF exemptive orders that grant relief related to the formation and operation of an ETF, including master-feeder relief except as described in section II.F. We will not rescind the exemptive orders of UIT ETFs, leveraged/inverse ETFs, share class ETFs, or non-transparent ETFs. We also are not rescinding the relief we have provided to ETFs from section 12(d)(1) and sections 17(a)(1) and (a)(2) under the Act related to fund of funds arrangements involving ETFs as discussed below.

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448 *See, e.g.*, SSGA Active Trust Prospectus (Oct. 31, 2017), *available at* https://www.sec.gov/Archives/edgar/data/1516212/000119312518313788/d635918d497.htm.

449 *See* 2018 ETF Proposing Release, *supra* footnote 7, at n.342 (noting that rescinding the relief for existing master-feeder ETFs would require them to change the manner in which they invest).

450 The amendment to the exemptive order will expressly provide that the complex cannot create new master-feeder structures as of June 28, 2018.

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

Commenters generally supported the rescission of the exemptive relief granted to ETFs that fall within the scope of rule 6c-11,[452] while permitting ETFs that could not rely on rule 6c-11 to continue to rely on their individual exemptive orders.[453] One commenter stated that rescission of these orders will further the Commission's regulatory goal to create a consistent, transparent, and efficient regulatory framework for ETFs.[454]

After reviewing comments, we continue to believe that rescinding ETF exemptive relief in connection with rule 6c-11 will result in a consistent, transparent, and efficient framework for ETFs that operate in reliance on rule 6c-11, as those ETFs would no longer be subject to differing and sometimes inconsistent provisions of their exemptive relief. Moreover, investment companies that seek to operate an ETF under conditions that differ from those in rule 6c-11 are able to request exemptive relief from the Commission.

In addition, approximately 200 of our current ETF exemptive orders automatically expire on the effective date of any Commission rule that provides relief permitting the operation of ETFs.[455] We have determined, as proposed, to amend those orders to provide that the ETF relief

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452 *See, e.g.*, ABA Comment Letter; ICI Comment Letter.

453 *See, e.g.*, ICI Comment Letter; Eaton Vance Comment Letter. In addition, one commenter stated that, because the commenter has designed its ETFs around the basket flexibility afforded by its exemptive orders, it would oppose the rescission of prior orders if the final rule limits ETFs' ability to use custom baskets. *See* Invesco Comment Letter. As discussed above, rule 6c-11 will permit an ETF to use custom baskets if it meets certain conditions. *See supra* section 0.

454 *See* ABA Comment Letter. One commenter, a sponsor of ETMFs as well as ETFs, requested that the Commission amend the terms and conditions relating to custom baskets in the ETMF orders to correspond to the treatment of custom baskets in rule 6c-11. *See* Eaton Vance Comment Letter. We believe this request is beyond the scope of the proposal. However, the commenter may seek to amend its order as part of the exemptive application process.

455 *See* 2018 ETF Proposing Release, *supra* footnote 7, at n.348 and accompanying text (noting that the Commission began including a condition in its 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).

contained therein will terminate one year following the effective date of rule 6c-11 to allow time for these ETFs to make any adjustments necessary to rely on rule 6c-11.

We continue to believe that the one-year period for the termination of our ETF exemptive relief is sufficient to give ETFs that are operating under exemptive orders time to bring their operations into conformity with the requirements of rule 6c-11. We did not receive any comments on this aspect of the proposal. We also did not receive any comments stating that the need to comply with the requirements of rule 6c-11, as opposed to their exemptive relief, would significantly negatively affect the operations of existing ETFs.

Finally, we did not propose to rescind the fund of funds exemptive relief included in our ETF exemptive orders.[456] This relief permits an ETF to create fund of funds structures, subject to certain conditions set forth in the ETF's exemptive application, 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. The conditions for fund of funds relief for ETFs are substantially similar across our exemptive orders.

Commenters generally agreed that we should not rescind the fund of funds exemptive relief, but asserted that the Commission should include fund of funds relief in a final rule or provide such relief through other means.[457] Some commenters stated that because fund of funds relief is part of standard ETF exemptive orders, the Commission also should permit new ETFs to

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[456] *See id.* at n.344 and accompanying text.

[457] *See, e.g.*, Dechert Comment Letter; ABA Comment Letter; MFDF Comment Letter; SSGA Comment Letter; WisdomTree Comment Letter; OppenheimerFunds Comment Letter. Commenters also suggested that the Commission should permit funds relying on sections 3(c)(l) and 3(c)(7) under the Act to be acquiring funds under any future fund of funds relief. *See* Dechert Comment Letter; OppenheimerFunds Comment Letter. While the subject matter of these comments falls outside the scope of the proposal of rule 6c-11, this issue is addressed as part of the proposed fund of funds rules. *See* FOF Proposing Release, *supra* footnote 40.

rely on the terms and conditions of fund of funds relief previously granted to existing ETFs.[458] These commenters stated that failing to provide this relief would frustrate the Commission's purpose of allowing new ETFs to enter the market without obtaining an exemptive order from the Commission.

In December 2018, we proposed new rule 12d1-4 under the Act to streamline and enhance the regulatory framework applicable to fund of funds arrangements for registered investment companies, including ETFs.[459] In connection with that proposed rule, we also proposed to rescind our exemptive orders granting relief to certain fund of funds arrangements, including the relief from sections 12(d)(1)(A) and (B) that, as discussed above, has been included in our ETF exemptive orders. The Commission has not yet acted upon this proposal and is not rescinding the fund of funds relief in existing exemptive orders in connection with this rulemaking.

We agree with commenters, however, that new entrants to the ETF market would be at disadvantage to existing ETFs without fund of funds relief. Accordingly, ETFs relying on rule 6c-11 that do not have exemptive relief from sections 12(d)(1)(A) and (B) and section 17(a)(1) and (2) of the Act may enter into fund of funds arrangements as set forth in our recent ETF exemptive orders, provided that they satisfy the terms and conditions for fund of funds relief in those orders.[460] This relief will be available only until the effective date of a new Commission

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458 *See, e.g.*, ABA Comment Letter; Dechert Comment Letter.

459 *See* FOF Proposing Release, *supra* footnote 40, at nn.236–237 and accompanying text.

460 *See* Salt Financial, *supra* footnote 247. Our exemptive orders permitting ETFs to enter into fund of funds arrangements include relief from section 17(a) of the Act. Section 17(a) would prohibit an ETF that is an acquiring fund that holds 5% or more of an acquired fund's securities from making any additional investments in the acquired fund. In addition, fund of funds arrangements involving funds that are part of the same group of investment companies or that have the same investment adviser (or affiliated investment advisers) implicate section 17(a), regardless of whether an acquiring fund exceeds the 5% threshold. Furthermore, where an ETF is an acquired fund, section 17(a) would prohibit the delivery or deposit of

rule permitting registered funds to acquire the securities of other registered funds in excess of the limits in section 12(d)(1), including rule 12d1-4 if adopted.[461]

H. Amendments to Form N-1A

We are adopting 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, that are designed to provide ETF investors with additional information regarding ETF trading and associated costs. Commenters generally supported providing additional information to investors regarding ETF trading, but many suggested specific modifications to the proposals.[462] After considering these comments, we are adopting the following amendments to Form N-1A:

- Adding the term "selling" to current narrative disclosure requirements to clarify that the fees and expenses reflected in the expense table may be higher for investors if they buy, hold, *and sell* shares of the fund (*Item 3*);
- Streamlined narrative disclosures relating to ETF trading costs, including bid-ask spreads (*Item 6*);

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basket assets on an in-kind basis by an affiliated fund (that is, by exchanging certain assets from the ETF's portfolio, rather than in cash). *See* FOF Proposing Release, *supra* footnote 40, at nn.60–64 and accompanying text. The relief we are providing from section 17(a) does not extend beyond the scope of the relief we have provided in our exemptive orders to ETFs. We are providing the relief from sections 12(d)(1)(A) and (B) and section 17(a) in accordance with our authority under sections 6(c), 12(d)(1)(J), and 17(b) of the Act. *See* 15 U.S.C. 80a-6(c), 15 U.S.C. 80a-12(d)(1)(J), and 15 U.S.C. 80a-17(b).

461 For the reasons discussed above, we find that this 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. *See* 15 U.S.C. 80a-6(c). We similarly find that such an exemption is consistent with the public interest and the protection of investors. *See* 15 U.S.C. 80a-12(d)(1)(J).

462 We also received a comment requesting that we confirm the applicability of the civil liability provisions in sections 11 and 12 of the Securities Act to investors that purchase ETF shares on the secondary markets. *See* Hagens Berman Comment Letter. This rulemaking is intended to codify existing relief for ETFs relating to the formation and operation of ETFs under the Investment Company Act. Accordingly, the applicability of those Securities Act provisions is beyond the scope of this rulemaking.

- Requiring ETFs that do not rely on rule 6c-11 to disclose median bid-ask spread information on their websites or in their prospectus (*Item 6*);
- Excluding ETFs that provide premium/discount disclosures in accordance with rule 6c-11 from the premium and discount disclosure requirements in Form N-1A (*Items 11 and 27)*; and
- Eliminating disclosures relating to creation unit size and disclosures applying only to ETFs with creation unit sizes of less than 25,000 shares (*Items 3, 6, 11 and 27*).

1. Fee Disclosures for Mutual Funds and ETFs (Item 3)

As proposed, we are adopting a narrative disclosure that will specify that the fees and expenses reflected in the Item 3 expense table also may be higher for investors if they sell shares of the fund.[463] Currently, this item requires disclosure indicating only that the table describes fees and expenses investors may pay if they *buy and hold* shares of the fund. However, both mutual funds and ETF investors also may incur expenses other than redemption fees when selling fund shares.[464] We are therefore amending this disclosure to specify that investors may pay the fees and expenses described in Item 3 if they buy, hold, *and sell* shares of the fund.[465]

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[463] Item 3 of Form N-1A (requiring, for example, disclosure of sales loads, exchange fees, maximum account fees, and redemption fees that funds charge directly to shareholders). We also are amending Instruction 1(e) of Item 3, as proposed, to eliminate: (i) 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; and (ii) the instruction to 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 not 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 also* Instruction 1(e)(ii) to Item 27(d)(1) (adopting the same modification for the expense example in an ETF's annual and semi-annual reports).

[464] For example, 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.

[465] *See* Item 3 of Form N-1A.

Commenters who addressed this proposed change supported it because it will help investors better understand that they may incur costs in addition to those in the fee table.[466]

We also are adopting, as proposed, a requirement to include a statement that investors may be subject to other fees not reflected in the table, such as brokerage commissions and fees to financial intermediaries.[467] Commenters who addressed this proposed requirement supported it.[468] We continue to believe this is an appropriate disclosure for both ETFs and mutual funds, as investors in ETFs and mutual funds alike may incur brokerage commissions and fees to financial intermediaries.

2. Disclosures Regarding ETF Trading and Associated Costs (Item 6)

We are adopting amendments to Item 6 of Form N-1A that: (i) will require an ETF to provide narrative disclosure identifying specific costs associated with buying and selling ETF shares and directing investors to its website for additional information; and (ii) allow an ETF that is not subject to rule 6c-11 the option to provide disclosure regarding the ETF's median bid-ask spread on its website or in its prospectus.[469] These form amendments differ in several respects from our proposal, which would have required an ETF to disclose information regarding how ETF shares trade and the associated costs, including information regarding bid-ask spreads, as part of the fund's fee table disclosure.

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466 *See, e.g.*, CSIM Comment Letter; FIMSAC Comment Letter; IDC Comment Letter.

467 Item 3 of Form N-1A.

468 *See, e.g.*, IDC Comment Letter; Invesco Comment Letter.

469 Rule 6c-11 will require an ETF to disclose its median bid-ask spread for the last thirty calendar days on its website as a condition to the rule. Rule 6c-11(c)(1)(v). We also are amending the definition of "Exchange-Traded Fund" in Form N-1A to add a specific reference to rule 6c-11. *See* General Instruction A of Form N-1A (defining "exchange-traded fund" as 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). We are adopting this definition as proposed.

a. *Narrative Disclosures*

Secondary market investors in ETF shares are subject to trading costs when purchasing and selling ETF shares that ETFs are not currently required to disclose in their prospectuses. Trading costs, like all costs and expenses, affect investors' returns on their investment.[470] In addition, some investors use ETFs more heavily as trading vehicles compared to mutual funds and may thus incur substantial trading costs. We believe that investors could overlook these costs and that additional disclosure would help them better understand these costs when purchasing or selling ETF shares.

As a result, we proposed to require ETFs to include a series of questions and answers—or Q&As—in Item 3 that would have provided investors with narrative disclosure regarding ETF trading and associated costs, as well as quantitative disclosures regarding bid-ask spreads.[471] Although many commenters supported providing information regarding trading costs to investors, commenters raised concerns regarding the quantitative aspects of the bid-ask spread disclosures.[472] In addition, comments on the proposed Q&A format were mixed. Some commenters supported the format, stating that it provided a user-friendly method for identifying

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470 *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/SB10000872396390444024204578044293008576204.

471 We also proposed to move certain disclosure regarding the purchase of ETF shares from Item 6 to Item 3, consolidating relevant disclosures regarding the fees and trading costs that an ETF investor may bear in one place. 2018 ETF Proposing Release, *supra* footnote 7, at text accompanying nn.391–394.

472 *See also supra* section 0. (discussing median bid-ask spread disclosure requirements in rule 6c-11 and our determination not to adopt amendments that would have required an ETF to provide: (i) hypothetical examples in its prospectus of how the bid-ask spread impacts return on investment; and (ii) an interactive calculator on its website to allow investors the ability to customize those hypothetical calculations).

certain costs.[473] Many others expressed concerns that this format would significantly lengthen the summary prospectus, potentially resulting in less investor-friendly formats or increased printing costs.[474] Some commenters asserted that the proposed Q&A format may be more appropriate for inclusion in the statutory prospectus rather than the summary prospectus.[475]

We continue to believe that investors could overlook certain trading costs when buying or selling ETF shares and that additional disclosure will help them better understand these costs. However, we agree with commenters that the extent of trading cost disclosures we proposed to require in Item 3 could obscure other key information regarding other fees and expenses and potentially give bid-ask spread disclosures undue prominence. We also agree that ETFs and their investors may benefit from flexibility in the manner of presenting the required information, especially if the proposed format would unduly distract from other key information. We therefore are permitting ETFs to use formats other than Q&As to present this information.[476] In addition, we are moving the narrative disclosures regarding trading costs to Item 6 of Form N-1A, which provides investors with information regarding the purchase and sale of fund shares to avoid overemphasizing these costs.

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473 *See, e.g.*, CFA Institute Comment Letter; FIMSAC Comment Letter.

474 *See, e.g.*, CSIM Comment Letter (stating the that proposed format would require ETFs to rethink the presentation of the summary); Fidelity Comment Letter (stating that the proposed format would subsume other more important information and that concise narrative disclosure would be preferable); Vanguard Comment Letter (stating the sponsors should be permitted to determine how best to present this information).

475 BlackRock Comment Letter; CSIM Comment Letter.

476 *See* Item 6(c) of Form N-1A. An ETF must provide the required information using plain English principles under rule 421(d) under the Securities Act. *See* General Instructions to Form N-1A. The applicable standards provide ETFs and other funds with flexibility, for example, in determining whether to use headings in a question-and-answer format. Enhanced Disclosure and New Prospectus Delivery Option for Open-End Management Investment Companies, Investment Company Act Release No. 28584 (Jan. 13, 2009) [74 FR 4546, 4549 n.39 (Jan. 26, 2009)] ("Summary Prospectus Adopting Release").

We also are streamlining several of the narrative disclosure requirements we proposed. First, we are adopting a requirement that the ETF's summary prospectus or summary section cross-reference the ETF's website.[477] Rule 6c-11 will require daily website disclosure of several items, including the NAV per share, market price, premium or discount, and bid-ask spread information. Form N-1A also will permit ETFs to omit certain information from their registration statements if they satisfy certain of the rule's website disclosure conditions.[478] This disclosure will inform investors how to access this information.

Commenters did not specifically address this proposed requirement. However, in general, commenters expressed support for website disclosure requirements, including as a substitute for certain registration statement disclosure requirements.[479] We believe a cross-reference in Form N-1A to the required website disclosures will enable investors to receive timely and granular information that could assist with making an investment decision and are therefore adopting the requirement substantially as proposed in Item 6.

We also are adopting a requirement to provide narrative disclosure regarding bid-ask spreads.[480] As noted above, commenters generally did not address the substance of the

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477 Item 6(c)(4) of Form N-1A. The form amendments permit an ETF to combine the information required by this website cross-reference requirement into the information required by Item 1(b)(1) of Form N-1A and 17 CFR 230.498(b)(1)(v) (rule 498(b)(1)(v)) in order to avoid duplicative references to the ETF's website. Instruction 4 to Item 6 of Form N-1A (referring to the website cross-reference disclosure requirements in the summary prospectus cover page and the statutory prospectus back cover page). However, by requiring a cross-reference to the ETF's website, the Commission does not intend for such information to be incorporated by reference into the prospectus.

478 *See, e.g.*, Instruction 1 to Item 6 of Form N-1A. 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.

479 *See, e.g.*, SIFMA AMG Comment Letter I; Fidelity Comment Letter.

480 Our proposal would have required an ETF to: (i) 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 shares of the ETF (ask); (ii) 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

disclosures, but raised concerns regarding the length of the disclosures. One commenter, however, asserted that the proposed requirement to disclose certain additional costs associated with buying and selling ETF shares would be redundant of information required by Item 3.[481]

We continue to believe that narrative bid-ask spread disclosure will inform investors regarding the potential impact of spread costs and provide investors with additional context to understand that the costs attributable to the bid-ask spread may increase or decrease when certain market conditions exist or certain factors are present. However, streamlining this disclosure to provide investors with key information regarding bid-ask spreads will both aid investor understanding and eliminate some of the length associated with the proposed disclosure requirement. Accordingly, our amendments to Form N-1A will require an ETF to state that an investor may incur costs attributable to 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 shares of the ETF (ask) when buying or selling shares in the secondary market ("the bid-ask spread").[482] This information, combined with the website cross-reference requirement, will direct ETF investors to website disclosures regarding median bid-ask spreads.

Finally, Item 6 will continue to require ETFs to disclose: (i) that individual shares may only be purchased and sold on secondary markets 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

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trade is executed, among other factors; and (iii) identify a set of specific costs, including bid-ask spreads, associated with buying and selling ETF shares. *See* 2018 ETF Proposing Release, *supra* footnote 7, at section II.H.2.

481 *See* ABA Comment Letter.

482 *See* Item 6(c)(3) of Form N-1A.

asset value, shares may trade at a price greater than net asset value (premium) or less than net asset value (discount).[483]

b. *Median Bid-Ask Spread Requirement*

Rule 6c-11 will require an ETF to provide website disclosure of median bid-ask spreads.[484] We believe that this disclosure will provide ETF investors with greater understanding of the costs associated with investing in ETFs. In order to provide similar disclosures to investors in ETFs that are outside the scope of rule 6c-11, we are adopting amendments to Form N-1A requiring the disclosure of median bid-ask spreads.

We proposed amendments to Form N-1A that would have required all open-end ETFs to disclose quantitative information about bid-ask spreads, both in an ETF's prospectus and on its website.[485] As discussed above, some commenters expressed concerns with these requirements, and we have made several modifications to mitigate those concerns while maintaining or enhancing the usefulness of the required disclosures. Those modifications include not adopting the proposed requirement for hypothetical bid-ask spread examples in the ETF's prospectus and interactive calculator, and instead only requiring ETFs relying on rule 6c-11 to provide disclosure of median bid-ask spread on their website.[486]

However, we continue to believe that all ETF investors should receive key information about bid-ask spread costs, and appreciate that ETFs that are not relying on rule 6c-11 may want

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483 Item 6(c) of Form N-1A. We proposed to move this disclosure to Item 3 to consolidate background information relating to ETF trading in one place. 2018 ETF Proposing Release, *supra* footnote 7, at section II.H.3. However, we are not adopting the proposed amendments to Item 3 and instead adding additional disclosures regarding ETF trading costs to Item 6. As proposed, amended Item 6 also will replace the current reference to "national securities exchange" with "secondary markets" because ETFs can also be bought and sold over the counter.

484 *See* rule 6(c)(1)(v).

485 *See* 2018 ETF Proposing Release, *supra* footnote 7, at sections II.H.2.b and II.I.

486 *See supra* section 0.

the flexibility to provide more timely bid-ask spread information on their websites.[487] We are therefore amending Form N-1A to require an ETF that is not subject to rule 6c-11 to: (i) provide the ETF's median bid-ask spread for its most recent fiscal year in its prospectus; or (ii) comply with the bid-ask spread website disclosure requirements in rule 6c-11(c)(1)(v).[488] We believe that this disclosure requirement will provide all ETF investors with quantitative bid-ask spread information, while providing ETFs not subject to rule 6c-11 with the flexibility to provide either website or prospectus disclosure.[489] This requirement also is consistent with our current approach to the disclosure of premiums and discounts in Form N-1A and, based on our experience with that disclosure, we believe most ETFs will opt to post bid-ask spread information on their websites as some ETFs do today on a voluntary basis.[490]

Although rule 6c-11 contemplates more current website disclosure for ETFs relying on rule 6c-11, we are adopting a lookback period of the ETF's most recent fiscal year for the prospectus bid-ask spread disclosure requirement. We are adopting this period for consistency with other disclosures in Form N-1A and to avoid establishing a requirement that would require more frequent updating of an ETF's prospectus. ETFs that opt to provide this information on their website, however, will provide median bid-ask spread information for the most recent thirty-day period on a rolling basis. Finally, newly launched ETFs subject to this prospectus

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487 *See infra* section 0. (discussing similar changes for Form N-8B-2).

488 *See* Item 6(c)(5) of Form N-1A (requiring disclosure of the median bid-ask spread for the ETF's most recent fiscal year in the summary prospectus or summary section of the prospectus); Instruction 1 to Item 6(c)(5) of Form N-1A (permitting an ETF to omit the information required if the ETF satisfies the requirements of paragraph (c)(1)(v) of rule 6c-11). As with the parallel website disclosure requirement, we are modifying the proposed methodology to clarify that the observations must be based on trades on the primary listing exchange and that the observations should be as of the end of each ten-second interval. Instruction 2 to Item 6(c)(5) of Form N-1A. We also are making similar amendments to Form N-8B-2 in order to extend this requirement to UIT ETFs. *See infra* section 0

489 Item 6(c)(5) of Form N-1A. *See* 2018 ETF Proposing Release, *supra* footnote 7, at section II.H.2.b.

490 *See* Items 11(g)(2) and 27(b)(7)(iv) of Form N-1A.

requirement with less than a year of trading data will be required to provide a brief statement to the effect that the ETF does not have sufficient trading history to report trading information and related costs as proposed.[491]

c. *Historical Premium and Discount Disclosures (Items 11 and 27)*

Rule 6c-11 will require ETFs to provide certain disclosures regarding premiums and discounts on their websites.[492] We believe premium/discount disclosure will help investors better understand that an ETF's market price may be higher or lower than the ETF's NAV per share and will provide investors with useful information regarding ETFs that frequently trade at a premium or discount to NAV. We are adopting amendments to Form N-1A that will exclude only those ETFs that provide premium/discount disclosures in accordance with rule 6c-11 from the premium and discount disclosure requirements in Form N-1A.

We proposed to eliminate existing disclosure requirements regarding premiums and discounts in Form N-1A since rule 6c-11 would require an ETF to provide more timely information on its website.[493] One commenter supported this amendment, stating that information relevant to premiums and discounts is already disclosed on a timely basis on ETF websites and therefore a duplicative registration statement requirement is not necessary.[494] Another commenter, however, stated that the Commission should apply disclosure requirements

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491 Instruction 1 to Item 6(c) of Form N-1A. Newly launched ETFs seeking to satisfy the requirements of paragraph (c)(1)(v) of the rule should provide median bid-ask spread information for the most recent thirty-day period once the ETF has more than 30-days of trading data.information.

492 *See* rule 6c-11(c)(1).

493 Item 11(g)(2) of Form N-1A currently requires 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. Item 27(b)(7)(iv) of Form N-1A requires an ETF to include a table with premium/discount information in its annual reports for the five most recently completed fiscal years. ETFs currently are permitted to omit both disclosures by providing on their websites the premium/discount information required by Item 11(g)(2).

494 *See* Invesco Comment Letter.

to all ETFs, including those that cannot rely on rule 6c-11, so that all ETF investors receive the same information.[495]

After considering comments, we are eliminating the premium and discount requirements in Items 11(g)(2) and 27(b)(7)(iv) for ETFs relying on rule 6c-11.[496] However, ETFs not relying on rule 6c-11 must include premium and discount information in both the prospectus and annual report unless they choose to comply with the website disclosure requirements in rule 6c-11(c)(1)(ii)–(iv) and (c)(1)(vi).[497] We agree that all ETF investors should receive similar premium/discount disclosure, regardless of the form of exemptive relief.

We acknowledge that the premium and discount disclosure requirements under rule 6c-11 are broader than what was required under Form N-1A.[498] However, to ensure consistency of website disclosure across ETFs, we are amending Form N-1A to require that if an ETF not relying on rule 6c-11 chooses to disclose the premium and discount disclosures on its website to satisfy the Form N-1A requirement, it must conform with the requirements in rule 6c-11.[499] Nonetheless, consistent with our experience with the current Form N-1A requirement, we believe

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495 *See* ETF.com Comment Letter.

496 Item 11(g)(2) of Form N-1A; Item 27(b)(7) of Form N-1A.

497 Items 11(g)(2) and 27(g)(2) of Form N-1A.

498 Unlike current Form N-1A, rule 6c-11 will require disclosure of 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 and disclosure regarding persistent premium or discount of greater than 2%, in addition to a table showing premiums and discounts, in order to omit the premium/discount disclosures in the ETF's prospectus and annual report.

499 We also are retaining the definition of the term "Market Price" in Form N-1A and amending it to reference the market price definition in rule 6c-11 as a result of the premium/discount disclosure requirements in the form. *See* General Instruction A to Form N-1A. Harmonizing the definition of market price in Form N-1A and rule 6c-11 will reduce regulatory confusion and will result in a more uniform methodology for calculating premiums and discounts for ETFs that provide premium/discount disclosure in accordance with rule 6c-11 and ETFs that provide premium/discount disclosures in their prospectuses and annual reports pursuant to these disclosure requirements. *See id.*; rule 6c-11(a)(1). We are making similar amendments to Form N-8B-2 in order to extend the premium/discount disclosure requirements to UIT ETFs. *See infra* section 0.

that most ETFs not relying on rule 6c-11 will choose to comply with the website disclosure requirements in rule 6c-11.

3. Eliminated Disclosures

We are adopting the removal of certain disclosure requirements from Form N-1A relating to ETFs. We are removing the requirement that an ETF specify the number of shares it will issue or redeem in exchange for the deposit or delivery of basket assets.[500] The number of shares the ETF issues or redeems in exchange for the deposit or delivery of baskets is largely duplicative of information provided in reports on Form N-CEN.[501] Commenters did not address this aspect of the proposal, and we are adopting it as proposed.

We also are eliminating several disclosure requirements in Items 6 and 11 that applied only to ETFs that issue or redeem shares in creation units of less than 25,000 shares.[502] 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.[503] Based on staff experience, however, we believe that these disclosures are unnecessary as retail investors generally do not engage in primary transactions through authorized participants and the current flow of information about the purchase and redemption

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500 Item 6(c)(i) of current Form N-1A.

501 *See* Item E.3.a of Form N-CEN.

502 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). Items 6(a) and (b) require funds to: (i) disclose the minimum initial or subsequent investment requirements; (ii) disclose that the shares are redeemable; and (iii) describe the procedures for redeeming shares. Item 11(g)(1) currently provides 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. Item 11(a) 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. Items 11(b) and (c) require a fund to describe the procedures used when purchasing and redeeming the fund's shares.

503 Summary Prospectus Adopting Release, *supra* footnote 476.

process is robust.[504] One commenter supported eliminating these disclosure requirements, and we are eliminating these requirements as proposed.[505]

I. Amendments to Form N-8B-2

Form N-8B-2 is the registration form under the Investment Company Act for UITs that are currently issuing securities, and it is used for registration of ETFs organized as UITs.[506] Because Form S-6 requires UIT prospectuses to include disclosure required by specified provisions of Form N-8B-2, the disclosure requirements of Form N-8B-2 also apply to prospectuses on Form S-6. We are adopting several amendments to Form N-8B-2 that will mirror requirements we are adopting in Form N-1A.

Although we are not including UIT ETFs within the scope of rule 6c-11, we believe that it is important for investors to receive consistent disclosures for ETF investments, regardless of the ETF's form of organization. Secondary market investors in UIT ETFs, like other ETFs, are subject to trading costs that unit holders could overlook. We believe that additional disclosure will help investors better understand the total costs of investing in a UIT ETF. We therefore proposed to amend Form N-8B-2 to require UIT ETFs to provide the same disclosures regarding ETF trading and the associated costs as ETFs organized as open-end funds would disclose on Form N-1A.

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504 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.

505 *See* Invesco Comment Letter.

506 While open-end funds register with the Commission on Form N-1A, UITs must register on 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, requires certain content, mainly by reference to the disclosure requirements in Form N-8B-2.

Commenters that addressed this proposed provision generally supported these changes,[507] and we are amending Form N-8B-2 to mirror the amendments to Form N-1A with the modifications discussed above.[508] As with other ETFs that are not within the scope of rule 6c-11, these amendments will give UIT ETFs the option to forego certain disclosures relating to bid-ask spreads and premiums and discounts provided that the ETF conforms with rule 6c-11's corresponding website disclosure requirements.[509]

Below, Table 3 summarizes the amendments to Form N-8B-2 and the corresponding requirements in Form N-1A.

TABLE 3

DISCLOSURE TOPIC	FORM N-1A ETF DISCLOSURE REQUIREMENT	CORRESPONDING FORM N-8B-2 DISCLOSURE REQUIREMENT
Definitions for Exchange-Traded Fund and Market Price	General Instructions Part A	General Instructions *Definitions*[510]
Information Concerning Fees and Costs	Item 3. Risk/Return Summary: Fee Table	Item I.13(h)
Information Concerning Purchase and Sale of Fund Shares	Item 6(c). Purchase and Sale of Fund Shares	Item I.13(i)
Table Showing Premium and Discount Information	Item 11(g)(2)	Item I.13(j)

507 *See* ICI Comment Letter (supporting mirroring proposed disclosure changes in Form N-1A, subject to comments regarding the amendments to Form N-1A).

508 Items I.13(h) and (i) of Form N-8B-2. *See also supra* section 0. (describing the ETF trading information and related costs disclosure requirements).

509 Although UIT ETFs currently are not subject to website disclosure requirements regarding trading costs or other information, UIT ETFs generally disclose information regarding market price, NAV per share, premium and discounts, and spreads on their websites today.

510 The 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 cannot rely on rule 6c-11 to operate. Accordingly, the definition of "exchange-traded fund" in Form N-8B-2 omits the reference to rule 6c-11.

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.[511] As proposed, we are adopting a new requirement that will collect specific information on which ETFs are relying on rule 6c-11.[512] We believe that this requirement will allow us to better monitor reliance on rule 6c-11 and assist us with our accounting, auditing, and oversight functions, including compliance with the Paperwork Reduction Act.[513]

We also are changing the definition of "authorized participant" in Form N-CEN to conform the definition with rule 6c-11 by deleting a specific reference to an authorized participant's participation in DTC.[514] In addition to reducing regulatory confusion by harmonizing the definition of "authorized participant" with rule 6c-11, this change also will obviate the need for future amendments if additional clearing agencies become registered with the Commission.[515] Commenters that addressed the proposed amendments to Form N-CEN expressed support, and we have determined to adopt the amendments as proposed.

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511 *See* Reporting Modernization Adopting Release, *supra* footnote 262.

512 Item C.7.k of Form N-CEN. 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. In addition, Item C.3.a.i of Form N-CEN already requires funds to report if they are an ETF.

513 *See* Reporting Modernization Adopting Release, *supra* footnote 262.

514 Item E.2 of Form N-CEN.

515 As proposed, the amendments to Form N-CEN will define the term "authorized participant" 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." *See* Instruction to Item E.2 of Form N-CEN.

K. Technical and Conforming Amendments to Form N-1A, Form N-8B-2, Form N-CSR, Form N-PORT, and Regulation S-X

In October 2016, the Commission adopted new rules and forms and amended other rules and forms under the Investment Company Act to modernize the reporting and disclosure of information by registered investment companies.[516] In February 2019, the Commission adopted an interim final rule that amended the timing requirements for filing reports on Form N-PORT.[517] We are making the following technical corrections as a result of these rulemakings, as well as correcting certain other outdated citations and instructions:

- Correcting footnote 1 of 17 CFR 210.12-14 (rule 12-14 of Regulation S-X) by replacing a reference to Column E with a reference to Column F.[518]
- Amending General Instruction B.4.(a) of Form N-1A to update outdated citation references to 17 CFR 230.400 through 230.498 (Regulation C) by replacing references to 17 CFR 230.497 (rule 497) with references to rule 498.[519]
- Amending General Instruction B.4.(d) of Form N-1A to update outdated citation references to 17 CFR 232.10 through 232.903 (Regulation S-T) by replacing references to rule 903 with references to rule 501.[520]
- Amending Instruction 4(b) to Item 13 of Form N-1A by deleting outdated instructions regarding changes in methodology for determining the ratio of expenses to average net assets.[521]

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516 *See* Reporting Modernization Adopting Release, *supra* footnote 262.

517 *See* Amendments to the Timing Requirements for Filing Reports on Form N-PORT, Investment Company Act Release No. 33384 (Feb. 27, 2019) [84 FR 7980 (Mar. 6, 2019)] ("Interim Final Rule Release").

518 *See* rule 12-14, note 1.

519 *See* General Instruction B.4.(a) of Form N-1A.

520 *See* General Instruction B.4.(d) of Form N-1A.

- Amending Form N-1A to require money market funds to state in their annual and semi-annual reports that: (i) their monthly portfolio holdings are available on Form N-MFP; (ii) the money market fund's reports on Form N-MFP are available on the Commission's website; and (iii) the money market fund makes portfolio holdings information available to shareholders on its website.[522] This amendment will reflect the fact that money market funds report monthly portfolio holdings on Form N-MFP rather than reporting portfolio holdings for the first and third fiscal quarters on Form N-PORT.
- Amending Form N-CSR to correct references to item numbers in General Instruction D and in the instruction to Item 13.[523]
- Amending General Instruction F (Public Availability) of Form N-PORT to read "With the exception of the non-public information discussed below, the information reported on Form N-PORT for the third month of each Fund's fiscal quarter will be made publicly available upon filing."[524] This amendment will reflect the Commission's action making quarter-end reports on Form N-PORT public immediately upon filing, with the exception of the non-public fields identified in General Instruction F.[525]
- Withdrawing Instruction 23 of Reporting Modernization Adopting Release, which would have amended 17 CFR 232.401 (rule 401 of Regulation S-T) to remove

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521 *See* Instruction 4(b) to Item 13.

522 *See* Instruction to Item 27(d)(3) of Form N-1A.

523 *See* General Instruction D to Form N-CSR and Item 13 of Instruction 13 of Form N-CSR.

524 *See* Instruction F to Form N-PORT.

525 *See* Interim Final Rule Release, *supra* footnote 517, at n.35 and accompanying text.

references to Form N-Q.[526] The amendment is no longer necessary because rule 401 was rescinded by a subsequent rulemaking.[527]

- Amending Item IX of Form N-8B-2 to clarify the required designation of exhibits and the use of incorporation by reference in order to conform to similar instructions in other Investment Company forms.[528]

L. Compliance Dates

The Commission is providing for a transition period for the amendments to Forms N-1A, N-8B-2, and N-CEN. Specifically, we are adopting compliance dates for our amendments to Form N-1A, Form N-8B-2, and Form N-CEN of [insert date 425 days after publication in the *Federal Register*], one year following the amendments' effective date. All registration statements, post-effective amendments, and reports on these forms filed on or after the compliance date must comply with the amendments. Based on the staff's experience, we believe that this will provide adequate time for ETFs and other funds to compile and review the information that must be disclosed.

III. OTHER MATTERS

Pursuant to the Congressional Review Act,[529] the Office of Information and Regulatory Affairs has designated this rule a "major rule," as defined by 5 U.S.C. 804(2). If any of the provisions of these rules, or the application thereof to any person or circumstance, is held to be

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526 *See* Reporting Modernization Adopting Release, *supra* footnote 262; *see also* 17 CFR 232.401.

527 *See* Inline XBRL Filing of Tagged Data, Investment Company Act Release No. 33139 (June 28, 2018) [83 FR 40846 (Aug. 16, 2018)].

528 *See, e.g.*, Item 28 of Form N-1A.; Item 26 of Form N-6.

529 5 U.S.C. 801 *et seq*.

invalid, such invalidity shall not affect other provisions or application of such provisions to other persons or circumstances that can be given effect without the invalid provision or application.

IV. ECONOMIC ANALYSIS

We are mindful of the costs imposed by, and the benefits obtained from, our rules. Section 2(c) of the Investment Company Act, section 2(b) of the Securities Act, and section 3(f) of the Exchange Act state that when the Commission is engaging in rulmaking under such titles and is required to consider or determine whether the action is necessary or appropriate in (or, with respect to the Investment Company Act, consistent with) the public interest, the Commission shall consider whether the action will promote efficiency, competition, and capital formation, in addition to the protection of investors. Further, section 23(a)(2) of the Exchange Act requires the Commission to consider, among other matters, the impact such rules would have on competition and states that the Commission shall not adopt any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. The following analysis considers, in detail, the potential economic effects that may result from the rule, including the benefits and costs to investors and other market participants as well as the broader implications of the rule for efficiency, competition, and capital formation.

A. Introduction

ETFs 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 structure and operation of ETFs. 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 exemptive orders allow the sponsors to

launch new funds under the terms and conditions of those orders, and because the terms in some of these orders may be more flexible than others.

Rule 6c-11 will allow ETFs that satisfy certain conditions to operate without obtaining an exemptive order from the Commission. The Commission also is rescinding the exemptive relief we have issued to ETFs that will be permitted to operate in reliance on the rule. However, we anticipate that ETFs whose exemptive relief will be rescinded under the rule generally will be able to rely on the rule without substantially changing their current operations, as the rule's conditions are similar to those contained in existing exemptive relief, consistent with existing market practice, or generally more flexible than those contained within existing exemptive relief.[530] ETFs that wish to operate in a manner not covered by the final exemptive rule can seek individual exemptive relief from the Commission.[531]

We believe that rule 6c-11 will 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 can rely on the rule. As such, the rule will enable increased product competition among certain ETF providers, which can lead to lower fees for investors, encourage financial innovation, and increase investor choice in the ETF market.

The increased basket flexibility the rule affords in particular may benefit ETFs and their shareholders. To the extent that ETFs are able to implement basket policies and procedures that

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530 As discussed in more detail below, some conditions in the rule and the scope of the relief provided are less flexible than those included in certain exemptive orders (*e.g.* the absence 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).

531 We are not rescinding the exemptive orders for certain categories of ETFs (*i.e.*, UIT ETFs, share class ETFs, leveraged/inverse ETFs and non-transparent ETFs), with the exception of master-feeder relief that funds did not rely on as of the date of the 2018 ETF Proposing Release (June 28, 2018).

better facilitate the arbitrage mechanism, these ETFs may reduce their bid-ask spreads and thereby lower transaction costs for their investors. In addition, certain ETFs may be able to use the increased basket flexibility to reduce trading costs the ETF incurs.[532]

The amendments to Forms N-1A and N-8B-2 as well as the additional website disclosures required by the rule are intended to improve the information about ETFs available to the market and to allow investors to more readily obtain information about fund products, resulting in reduced investor search costs. To the extent that the disclosure requirements will improve investors' ability to evaluate the performance and other characteristics of fund products, the amendments may result in better informed investor decisions and more efficient allocation of investor capital among fund products, and may further promote competition among ETFs and between ETFs and mutual funds.

The 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 rule will 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 rule also can 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.

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[532] Several of the anticipated benefits of rule 6c-11 may be associated with metrics that will be measurable only after funds operate in reliance on the rule; such metrics include changes in bid-ask spreads, premiums/discounts to NAV per share, fund fees, and the number of ETFs. These metrics may help facilitate evaluation of the extent to which the rule has generated the anticipated benefits, although these metrics may also be affected by developments independent of rule 6c-11.

B. Economic Baseline

1. ETF Industry Growth and Trends

The ETF industry has experienced extensive growth since the first U.S. ETF began trading in 1993.[533] 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 137 new ETF entrants and an average growth of $241.2 billion annually. Since 2007, ETF net assets have grown at an average rate of 17.2% per year, which compares to 3.2% for closed-end funds and 6.3% for open-end funds over the same period.[534]

At the end of December 2018, there were 1,978 registered ETFs, totaling $3.3 trillion in net assets and spanning six broad investment style categories. ETFs are predominantly structured as open-end funds; however, eight UIT ETFs together represented 10.3% of ETF total net assets ($340.6 billion), and 68 share class ETFs together represented 25.6% of total net assets ($854.6 billion). The chart illustrates growth in ETF net assets by investment strategy beginning in 2000. It also tracks the percentage of net assets invested in actively managed ETFs.

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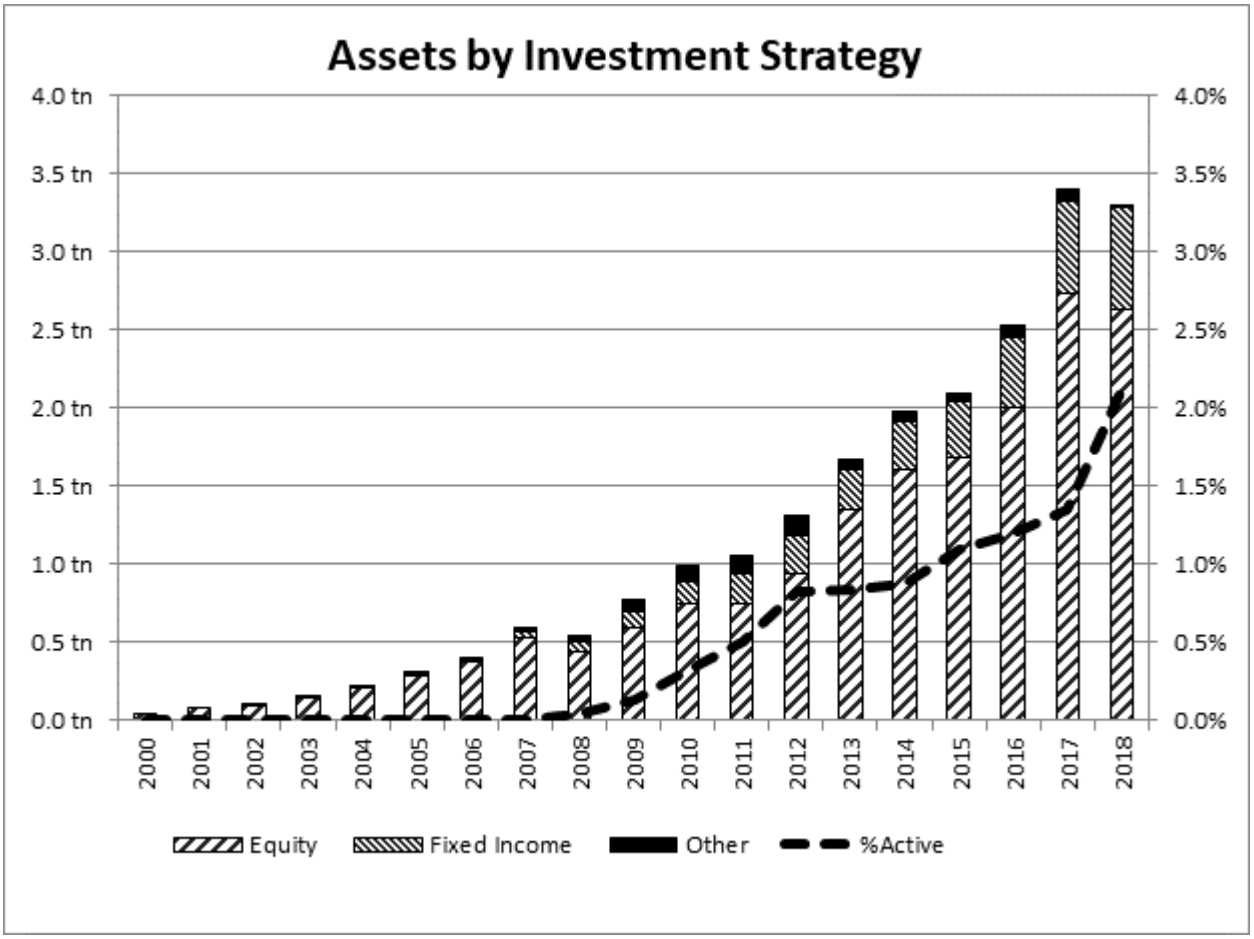
533 For the purpose of this release, we focus exclusively on ETFs that trade on U.S. exchanges.

534 Unless otherwise noted, the number and net assets of ETFs in this section of the Release 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 $ trillions 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 actively managed strategies (on the right vertical axis).

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 (in both index-based and actively managed ETFs). At the end of December 2018, there were 167 leveraged/inverse ETFs that were structured as open-end funds.[535] In total, leveraged/inverse ETFs had total net assets of $29.64

[535] *See supra* footnote 91 (noting that the exemptive orders that we have issued to sponsors of leveraged/inverse ETFs do not provide relief to ETFs described as seeking investment returns that correspond to the performance of a leveraged or inverse leveraged market index over a predetermined period of time).

billion or approximately 1% of all ETF net assets. None of the eight registered UIT ETFs employed leveraged or inverse investment strategies. Of the remaining unleveraged ETFs, both index-based and actively managed, 1,705 ETFs had combined net assets of $3 trillion operated as open-end funds, while eight UIT ETFs had $340.6 billion in net assets.[536]

There were 257 actively managed ETFs with total net assets of $69.5 billion. The remaining 1,721 ETFs, with a combined $3.23 trillion in net assets, were index-based ETFs. Of these, 1,713 ETFs with total net assets of $2.892 trillion were structured as open-end funds and eight UIT ETFs had total net assets of $340.6 billion.

The majority of ETFs (1,615) held some foreign exposure in their portfolio according to Morningstar data. These ETFs had total net assets of $2.921 trillion. Of these funds, seven were UIT ETFs and had $320.6 billion in net assets. The remaining 1,608 ETFs accounting for $2.6 trillion in net assets were organized as open-end funds. On average, these ETFs reported foreign exposure of 40.15% (56.87% for UIT ETFs and 40.07% for ETFs structured as open-end funds).[537]

2. Exemptive Order Process and Certain Conditions under Existing Orders

ETFs seeking to operate as investment companies required exemptive relief from the Commission. Since the first exemptive order was granted in 1992, the Commission has issued approximately 300 exemptive orders to ETFs. The average number of approved exemptive

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

537 We estimate funds' foreign holdings on February 27, 2019 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 1,970 ETFs. In this data, 363 funds, one of which is a UIT ETF, reported holding no foreign securities and 8 funds from the original 1,978 are missing foreign holdings data.

orders between 1992 and 2006 was approximately 2.5 per year, which has increased to approximately 29 per year since 2007.

Based on our review of exemptive orders that granted relief for unleveraged ETFs between January 2007 and early April 2019, the median processing time from the filing of an initial application to the issuance of an order was 213 days, although there was considerable variation.[538] 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 87 days) while others waited over one year for approval (the 90th percentile of the processing time was 669 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.

These exemptive orders permit ETFs to operate as investment companies under the Investment Company Act, subject to representations and conditions, some of which have changed over time.[539] For example, as discussed above, our orders have required ETFs that will rely on rule 6c-11 to provide some degree of transparency regarding their portfolio holdings.[540] Actively managed ETFs and some self-indexed ETFs have been required to disclose their full portfolio holdings each day, while other index-based ETFs are permitted to specify the index

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538 The earliest order in our sample was approved on January 17, 2007 and the latest order was approved on April 2, 2019. This data does not include orders for non-transparent ETFs.

539 ETFs generally have obtained similar exemptive relief under these orders. However, over time, our exemptive orders generally have increased the maximum number of days that an ETF holding foreign investments can delay the satisfaction of redemptions as part of the relief from section 22(e) of the Act (from 12 days to 15 days).

540 *See supra* footnote 224.

they seek to track (as long as the index provider lists the constituent securities on its website) or disclose the components of their baskets. Based on a staff review of 150 randomly selected ETFs, which included 100 index-based ETFs and 50 actively managed ETFs, however, all 150 ETFs maintain a website and provide the ETF's complete daily portfolio holdings. Therefore, we believe it is likely that all ETFs that can rely on the rule, including those that are not subject to a full transparency condition in their exemptive order, currently provide full portfolio transparency.[541]

ETFs' flexibility to use custom baskets also has evolved over time under our exemptive orders. From 1996 to 2006, exemptive orders for open-end ETFs did not expressly limit baskets to a *pro rata* representation of the ETF's portfolio holdings. Since approximately 2006, however, our exemptive orders placed increasingly tighter restrictions on ETFs' composition of baskets.[542] Because our exemptive orders have generally included future funds relief to allow sponsors to form and operate new ETFs, we are unable to quantify the number of funds operating under each of the different basket flexibility conditions included in our orders.[543]

Many exemptive orders also have required ETFs to provide certain website disclosures on their website, free of charge.[544] Based on a staff review of the websites of 150 randomly

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541 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 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. Commenters did not disagree with statements in the proposing release that ETFs that can rely on the rule maintain a website and provide the ETF's complete daily portfolio holdings.

542 *See* 2018 ETF Proposing Release, *supra* footnote 7, at nn.236–241 and accompanying text.

543 *See supra* footnote 5.

544 *See* 2018 ETF Proposing Release, *supra* footnote 7, at section II.C.6.c. Substantially all exemptive orders starting in 2008 include a requirement for daily website disclosures of NAV, closing price, and premiums and discounts—each as of the end of the prior business day.

selected ETFs, all 150 ETFs provided the previous day's NAV, price of the ETF shares,[545] and the premium or discount associated with the ETF share price at the market close. Accordingly, we believe that all ETFs that can rely on rule 6c-11 currently disclose this information on their website.[546] Our exemptive orders also have included other requirements, including the publication of the ETF's IIV every 15 seconds.

3. Market Participants

Several non-ETF market participants may be affected by the rule, including fund sponsors, authorized participants, liquidity providers, trading venues, and institutional and retail investors.

Using data from Bloomberg, we estimate that there are 81 unique ETF sponsors with approximately 1,978 ETFs as of December 31, 2018. The median number of ETFs per sponsor is six and the mean is 24, 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 965 ETFs, whereas the bottom half of sponsors operate only a combined 118 ETFs.

An ETF (either directly or through a service provider) has contractual arrangements with authorized participants to purchase or redeem ETF shares in creation unit size aggregations in exchange for a basket of securities and other assets. Based on data from Form N-CEN as of July 26, 2019, the median ETF has 23 authorized participant agreements and 4 active authorized participants.[547,548] Larger ETFs tend to have more authorized participant agreements, with the

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545 One actively managed ETF provided a price based on the midpoint between the bid and ask prices, while the remainder of the actively managed ETFs and all index-based ETFs provided closing prices.

546 Commenters did not disagree with a statement in the proposing release that all ETFs that can rely on the rule currently provide this information on their website.

547 Beginning July 30, 2018, ETFs started reporting information on authorized participants in response to Item E.2 of Form N-CEN. As of July 26, 2019, 1,739 ETFs had filed the form.

median number of authorized participant agreements ranging from 13 for the smallest quarter of ETFs to 33 for the largest quarter of ETFs. Larger ETFs also tend to have more active authorized participants, ranging from a median of 2 to 7 for the smallest and largest quarters of ETFs, respectively. A 2015 survey-based study of fifteen fund sponsors reports, however, 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.[549]

Some authorized participants also act as registered market makers in ETF shares. Other liquidity providers for ETF shares include market makers that are not authorized participants, hedge funds, and proprietary trading firms. According to a 2014 survey, the median number of liquidity providers for an ETF was 17, while the median number of authorized participants that are registered market makers for an ETF was 4.[550]

ETF shares are mainly traded on national securities exchanges.[551] Table 4 lists the 9 exchanges with the largest average daily ETF trading volume, measured over the 30 business days ending on March 7, 2019. The data shows that NYSE Arca handles the largest portion of

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548 An active AP is an authorized participant that engaged in creation or redemption activity during the reporting period. Some market makers and other market participants engage in creation and redemptions indirectly through authorized participants. *See supra* section 0. Data on the number of such market participants is not reported on Form N-CEN.

549 *See* Rochelle Antoniewicz & Jane Heinrichs, *The Role and Activities of Authorized Participants of Exchange-Traded Funds*, ICI Report (Mar. 2015) ("Antoniewicz II"). The study also points out that NSCC is the sole provider of clearing services for ETF primary market transactions and that 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 also* 2019 ICI Factbook, *supra* footnote 3 ("On average, 90 percent of the total daily activity in ETFs occurs on the secondary market.").

550 *See* Antoniewicz II, *supra* footnote 549; *see also* 2019 ICI Factbook, *supra* footnote 3.

551 In the first quarter of 2019, 64% of ETF trading by dollar volume was executed on exchanges, 26% over the counter without using alternative trading systems (ATSs), and 10% over the counter using 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.

ETF trades ($15.3 billion), followed by Cboe BZX Exchange ($6.6 billion), and Cboe EDGX Exchange ($4.5 billion).

TABLE 4: ETFS TRADED ON NATIONAL EXCHANGES AND THEIR TRADING VOLUME

Exchange	Number of ETFs	Trading Volume
NYSE Arca, Inc.	1,939	$ 15.3 billion
Cboe BZX Exchange, Inc.	1,813	$ 6.6 billion
Cboe EDGX Exchange, Inc.	1,815	$ 4.5 billion
Cboe BYX Exchange, Inc.	1,721	$ 3.6 billion
The Nasdaq Stock Market LLC	348	$ 2.6 billion
Cboe EDGA Exchange, Inc.	1,668	$ 2.1 billion
Nasdaq PHLX LLC	1,070	$ 1.9 billion
Nasdaq BX, Inc.	1,671	$ 1.5 billion
NYSE Chicago, Inc.	184	$ 1.2 billion

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 March 7, 2019. 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 Commission staff using data obtained through a subscription to Bloomberg.

Both institutional and retail investors participate in the ETF secondary market. As shown in Table 5 below, from the first quarter of 2015 to the fourth quarter of 2017, we estimate that institutions own, on average, 43% of ETF shares, when calculating the average using equal weights for all ETFs, and 57% 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. 57%—suggests that institutional investors tend to hold larger ETFs. In addition, there is considerable variation in the degree to which ETF shares are held by institutions, ranging from an average for the 5th percentile of 6% to an average for the 95th percentile of 90%.[552] However, we observe that the average institutional holding did not change considerably over time during the sample period.

[552] 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 not all institutional investors are required to file the form (which would lead to an understatement of institutional ownership).

TABLE 5: INSTITUTIONAL OWNERSHIP OF ETFS

Quarter	Equal-Weighted Average	TNA-Weighted Average	SD	P5	P25	P50	P75	P95
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%
2017Q1	43%	58%	25%	6%	24%	42%	61%	91%
2017Q2	44%	55%	25%	6%	25%	42%	61%	90%
2017Q3	43%	61%	25%	6%	24%	42%	61%	88%
2017Q4	44%	58%	24%	7%	25%	43%	61%	87%
Average	43%	57%	25%	6%	24%	41%	61%	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 2015Q1 to 2017Q4 obtained through a subscription to WRDS SEC Analytics Suite and the Center for Research in Security Prices (CRSP).

Further analysis shows that institutional ownership varies considerably by the type of ETF. Using Morningstar Categories, for the fourth quarter of 2017, Table 6 below shows that ETFs' equal-weighted average institutional ownership ranges from 20% 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 larger ETFs within these categories. The converse is true for allocation, alternative, and commodity ETFs. The table also shows that there is large variation within categories.[553]

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553 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

TABLE 6: INSTITUTIONAL OWNERSHIP OF ETFS BY MORNINGSTAR CATEGORY FOR 2017:Q4

Category	Equal-Weighted Average	TNA-Weighted Average	SD	P5	P25	P50	P75	P95
Allocation	46%	40%	27%	10%	22%	41%	67%	94%
Alternative	20%	11%	20%	2%	6%	13%	26%	64%
Commodities	43%	40%	16%	16%	39%	39%	57%	61%
International Equity	48%	62%	22%	10%	33%	49%	66%	85%
Municipal Bond	52%	63%	16%	22%	40%	51%	64%	74%
Sector Equity	43%	59%	21%	12%	27%	42%	57%	82%
Taxable Bond	56%	63%	20%	24%	43%	56%	69%	89%
U.S. Equity	46%	59%	21%	10%	31%	44%	61%	87%

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 2017Q4 obtained a through subscription to WRDS SEC Analytics Suite and the 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 NAV of the underlying ETF assets.[554] As discussed above, however, authorized participants engage in primary market arbitrage activity that brings the market price of ETF shares and the NAV of the ETF's portfolio closer together.[555] Market participants also can engage in arbitrage activity in the secondary market by taking offsetting positions in the ETF shares and the underlying basket assets.

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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.

554 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.*, Ananth Madhavan & Aleksander Sobczyk, *Price Dynamics and Liquidity of Exchange-Traded Funds*, Journal of Investment Management, Second Quarter 2016, at 1.

555 *See supra* section 0.

Using data from Bloomberg, we find that ETFs, on average, have closing prices slightly higher than the NAV per share (*i.e.*, trade at a premium at market close), as shown in Table 7 below. The equal-weighted and TNA-weighted average premium/discount over the last 15 years for all ETFs in the dataset are 0.07% and 0.06%, respectively, and the median is 0.02%, indicating that the closing 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.[556] However, consistent with the study, we find that ETF premiums/discounts vary significantly.[557] For example, we find that the (weighted) average premium/discount ranges from 0.02% in 2018 to 0.14% in 2009, and the standard deviation of premiums/discounts ranges from 0.16% in 2017 to 0.59% 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, on average.

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556 *See* Antti Petajisto, *Inefficiencies in the Pricing of Exchange-Traded Funds*, Financial Analysts Journal, First Quarter 2017, at 24.

557 Commenters to our 2015 ETP Request for Comment, *supra* footnote 19, reported 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).

TABLE 7: 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
2004	0.10	0.04	0.26	-0.26	-0.06	0.02	0.09	0.55
2005	0.06	0.08	0.28	-0.22	-0.04	0.04	0.11	0.62
2006	0.07	0.08	0.34	-0.34	-0.04	0.03	0.14	0.67
2007	0.14	0.08	0.38	-0.39	-0.06	0.03	0.20	0.64
2008	0.09	0.10	0.59	-0.77	-0.14	0.05	0.34	1.03
2009	0.12	0.14	0.53	-0.55	-0.08	0.02	0.34	1.02
2010	0.07	0.07	0.35	-0.43	-0.05	0.02	0.16	0.63
2011	0.04	0.07	0.41	-0.54	-0.04	0.02	0.17	0.76
2012	0.06	0.07	0.28	-0.31	-0.02	0.02	0.14	0.58
2013	0.06	0.03	0.28	-0.35	-0.03	0.02	0.09	0.43
2014	0.05	0.04	0.22	-0.25	-0.01	0.02	0.08	0.35
2015	0.04	0.04	0.23	-0.25	-0.01	0.02	0.08	0.40
2016	0.03	0.04	0.23	-0.22	-0.01	0.01	0.09	0.39
2017	0.07	0.06	0.16	-0.10	-0.01	0.02	0.09	0.33
2018	0.03	0.02	0.22	-0.32	-0.03	0.01	0.07	0.36
Average	0.07	0.06	0.31	-0.35	-0.04	0.02	0.14	0.57

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. Premiums or discounts are from daily Bloomberg data covering 2,235 ETFs for a total of 3,319,782 daily observations. Per Bloomberg, premium/discount (%) is the difference between the ETF's closing price on the day of the most recent NAV and the NAV of the fund on that day. The data covers the period from 01/02/2004 to 12/31/2018.

Premiums and discounts to NAV per share also vary considerably by the types of assets held by the ETF.[558] We use Morningstar Investment Categories to divide ETFs into groups of similar assets and, in Table 8 below, 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 0.002% for alternative ETFs to 0.183% for taxable bond ETFs. The results are qualitatively similar for the equal-weighted average premium/discount.

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558 *See, e.g.*, Robert Engle & Debojyoti Sarkar, *Premiums-Discounts and Exchange Traded Funds*, Journal of Derivatives, Summer 2006, at 27 (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).

TABLE 8: 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	0.068	0.077	0.222	-0.124	-0.039	0.046	0.222	0.287
Alternative	0.006	0.002	0.317	-0.388	-0.119	-0.004	0.110	0.444
Commodities	0.199	0.105	0.446	-0.501	0.009	0.079	0.150	0.924
International Equity	0.176	0.181	0.422	-0.467	-0.071	0.192	0.438	0.799
Municipal Bond	0.071	0.059	0.290	-0.351	-0.097	0.050	0.241	0.477
Sector Equity	0.030	0.012	0.183	-0.234	-0.070	0.005	0.081	0.294
Taxable Bond	0.192	0.183	0.196	-0.075	0.080	0.175	0.257	0.506
U.S. Equity	0.003	0.006	0.076	-0.098	-0.033	0.008	0.046	0.109

The table reports time-series averages of cross-sectional descriptive statistics of premiums/discounts (%). The ETFs 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. Premiums or discounts are from daily Bloomberg data covering 2,235 ETFs for a total of 3,319,782 daily observations. Per Bloomberg, premium/discount (%) is the difference between the fund's closing price on the day of the most recent NAV and the NAV of the fund on that day. The data covers the period from 01/02/2004 to 12/31/2018.

When the ETF arbitrage mechanism functions effectively, ETFs also should trade at smaller bid-ask spreads.[559] As shown in Table 9 below, the TNA-weighted average bid-ask spread, as a percentage of the mid-price, has been relatively constant over the years, ranging from highs of 0.37% in 2012 and 2016 to a low of 0.31% in 2018.[560] Equal-weighted average bid-ask spreads averaged 0.33% and were considerably higher than TNA-weighted bid-ask spreads, which averaged 0.04%, reflecting that larger ETFs tend to have smaller bid-ask spreads. The table also shows that the bid-ask spread varies considerably between ETFs, with an average of the 5th percentile of bid-ask spreads of 0.01% and an average of the 95th percentile of bid-ask spreads at 0.16%.

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559 *See, e.g.*, Joanne M. Hill, Dave Nadig, & Matt Hougan, *Comprehensive Guide to Exchange-Traded Funds (ETFS)*, CFA Institute Research Foundation (2015), *available at* https://www.cfapubs.org/doi/pdf/10.2470/rf.v2015.n3.1 ("CFA Guide").

560 This analysis starts in 2012 because the available data begins in that year.

TABLE 9: 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	0.37	0.06	0.12	0.01	0.02	0.02	0.05	0.27
2013	0.33	0.05	0.10	0.01	0.01	0.02	0.05	0.21
2014	0.27	0.04	0.06	0.01	0.01	0.02	0.04	0.11
2015	0.32	0.04	0.07	0.00	0.01	0.02	0.05	0.12
2016	0.37	0.04	0.07	0.01	0.01	0.02	0.04	0.11
2017	0.34	0.03	0.07	0.00	0.01	0.02	0.03	0.11
2018	0.31	0.05	0.09	0.01	0.01	0.02	0.04	0.16
Average	0.33	0.04	0.08	0.01	0.01	0.02	0.04	0.16

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 2,235 ETFs for a total of 2,477,272 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 01/02/2004 to 12/31/2018.

Table 10 below reports bid-ask spreads for ETF shares by Morningstar Category. U.S. Equity ETFs have the smallest average bid-ask spread of 0.03%, whereas allocation ETFs—ETFs 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 0.21%.

TABLE 10: TIME-SERIES AVERAGES OF CROSS-SECTIONAL DESCRIPTIVE STATISTICS OF RELATIVE BID-ASK SPREAD (%) BY MORNINGSTAR INVESTMENT CATEGORY

Category	Equal-Weighted Average	TNA-Weighted Average	SD	P5	P25	P50	P75	P95
Allocation	0.57	0.21	0.30	0.06	0.07	0.14	0.22	0.64
Alternative	0.38	0.10	0.16	0.02	0.03	0.05	0.09	0.33
Commodities	0.30	0.06	0.07	0.02	0.02	0.02	0.08	0.14
International Equity	0.43	0.07	0.11	0.02	0.02	0.03	0.08	0.21
Municipal Bond	0.29	0.10	0.11	0.03	0.04	0.06	0.10	0.30
Sector Equity	0.28	0.06	0.09	0.01	0.02	0.04	0.06	0.20
Taxable Bond	0.29	0.04	0.08	0.01	0.01	0.02	0.04	0.15
U.S. Equity	0.21	0.03	0.04	0.01	0.01	0.01	0.03	0.09

This table reports time-series averages of cross-sectional descriptive statistic of relative bid-ask spreads (%). The ETFs 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 12/31/2018. 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 2,235 ETFs for a total of 2,477,272 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, 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. 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.[561]

C. Benefits and Costs of Rule 6c-11 and Form Amendments

The Commission is sensitive to the economic effects that can result from rule 6c-11 and amendments to Forms N-1A and N-8B-2, including benefits and costs. Where possible, the Commission quantifies the likely economic effects; however, the Commission is unable to quantify certain economic effects because it lacks the information necessary to provide estimates or ranges. In some cases, quantification is particularly challenging due to the difficulty of predicting how market participants will act under the conditions of the rule. Nevertheless, as described more fully below, the Commission is providing both a qualitative assessment and quantified estimate of the economic effects, including the initial and ongoing costs of the additional disclosure requirements, where feasible.

1. Rule 6c-11

Rule 6c-11 will allow 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 are rescinding all existing ETF exemptive orders, with the exception of: (i) the section 12(d)(1) relief

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[561] *See, e.g.*, Ananth Madhavan, *Exchange-Traded Funds, Market Structure, and the Flash Crash*, Financial Analysts Journal, July/Aug. 2012, at 20.

included in those orders that permit certain fund of funds arrangements;[562] and (ii) orders relating to UIT ETFs, leveraged/inverse ETFs, share class ETFs, and non-transparent ETFs. This section first evaluates the general considerations associated with the rulemaking and then discusses the effects of the specific requirements and conditions of the rule.

a. *General Considerations*

Rule 6c-11 will grant exemptive relief from the provisions of the Act that 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 rule are either similar to those contained in existing exemptive orders, consistent with market practice, or generally provide more flexibility, we anticipate that the rule and the related rescission of ETF exemptive relief will not require any existing ETFs whose exemptive relief will be rescinded to significantly change the way they operate. Conversely, some ETFs whose exemptive orders contain conditions that are more restrictive than those contained in the rule may decide to change the way they operate in order to make use of such increased flexibility.

Relative to the baseline, rule 6c-11 will 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 rule will be quicker, more predictable, less complex, and therefore less costly than obtaining an exemptive order as new ETFs that cannot rely on existing orders are currently required to do. ETFs that cannot rely on

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562 We will, however, rescind relief from sections 12(d)(1) and 17(a)(1) and (2) that have been provided to allow master-feeder arrangements for those ETFs that do not currently rely on the relief. *See supra* section 0. In addition, we will grandfather existing master-feeder arrangements involving ETF feeder funds, but prevent the formation of new ones under existing orders, by amending relevant exemptive orders. *See id*.

the rule will continue to be required to apply for an exemptive order to form and operate, unless they have an existing exemptive order that includes future fund relief.[563]

As described above in section IV.B.2, we estimate that the cost for a typical unleveraged 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 early April 2019, the median processing time from the filing of an initial application to the issuance of an order was 213 days, although there was considerable variation. Thus, any new ETF planning to operate within the parameters set forth by the rule will 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 each sponsor 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 will continue to need to apply for an exemptive order. Assuming that the number of new ETFs seeking to form and operate under the rule that would otherwise need to apply for exemptive relief is equal to the annual average number of ETFs that have applied for exemptive relief since 2007, these cost and time savings would accrue to approximately 29 ETFs per year.[564] Using this assumption, the annual costs savings to this group of ETF sponsors are approximately $2.9 million.[565] We are unable to quantify the benefit

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563 *See supra* footnote 42 (noting that UIT ETFs' orders do not include relief for future ETFs formed pursuant to the same order). As discussed below, some ETFs will 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 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 rule, such as the increased basket flexibility and, for certain new ETFs, the reduced costs of forming the fund.

564 Compared to the baseline, these cost and time savings will only accrue to new ETFs whose sponsors have not received exemptive relief that would allow such ETFs to operate.

565 This estimate is based on the following calculation: 29 x $100,000 = $2,900,000.

a new ETF will 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.[566]

By eliminating the need for ETFs that can rely on the rule to seek an exemptive order from the Commission, the rule will 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 rule will 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 will 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 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 rule. However, we believe that these costs will be relatively small.[567] In

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566 Costs arising from the delay and the uncertainty associated with the exemptive order process include primarily forgone profits and costs associated with missed business opportunities. We do not have access to data on ETFs' profits, and commenters did not provide such data. Additionally, forgone profits associated with missed business opportunities, such as forgoing a "first-mover advantage," can be highly variable and dependent on specific circumstances.

567 We estimate that assessing the requirements of the final rule will require 5 hours of a compliance manager ($309 per hour) and 5 hours of a compliance attorney ($365 per hour), resulting in a cost of $3,370 (5 x $309 + 5 x $365) per fund. The total cost for all 1,735 ETFs that can rely on the rule will thus be $5,846,950 (1,735 x $3,370). 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 1800-hour work-year and multiplied by 2.93 to account for bonuses,

addition, we anticipate that it will be more efficient for third-party providers, such as lawyers and compliance consultants, to offer services that help ETFs ensure compliance with the rule, 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 can rely on the rule, which may partially or fully offset the initial costs of studying the requirements of the rulemaking that ETFs may incur.

We expect that the rule also will benefit ETF investors to the extent that it will remove a possible disincentive for sponsors to form and operate new ETFs that provide investors with additional investment choices if they 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.

As we discuss below in section IV.D.2, we believe that the 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 will likely be larger for segments of the ETF market that currently may be less competitive (*e.g.*, actively managed ETFs) and smaller for segments of the market that currently may be more competitive (*e.g.*, index-based ETFs tracking major stock indices).

By eliminating the need for individual exemptive relief, we anticipate that the rule will, over time, increase the number of ETFs and thus reinforce the current growth trend in the ETF industry. In addition, the rule will increase demand for such ETFs, to the extent that such ETFs

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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").

lower their fees to investors and investors are sensitive to fees.[568] To the extent that some ETFs will experience larger reductions in trading costs (*e.g.*, fixed-income, international, and actively managed ETFs, as discussed below in section IV.C.1.b.i.) or larger increases in competition (*e.g.*, actively managed ETFs, as discussed above in this section), demand for these types of ETFs will likely increase more than for other types of ETFs. The increased demand will 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.[569] Consequently, the rule could increase total assets of ETFs and could decrease total assets of other funds. The size of these effects will depend on the degree to which ETFs will 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, in part, because we cannot estimate the extent to which funds will lower their fees or experience reduced trading costs and how lower fees and trading costs will change investor demand.

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568 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 Journal of Finance 1589 (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. 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 Review of Financial Studies 1405 (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 to hold for ETFs as well. We are not aware of any studies that specifically study the sensitivity of ETF investors to fees.

569 Investments in ETFs are one of many ways for investors to allocate savings. 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.

Since ETFs are traded in the secondary market, an increase in total assets of ETFs will likely coincide with larger trade volumes for the exchanges where ETFs are traded, as well as for the clearing agencies and broker-dealers involved in these trades. To the extent that these market participants are compensated by volume, the rule will thus benefit them by leading to an increase in revenues.[570]

In addition, we expect the rule to reduce the number of applications for ETF exemptive relief. This will allow Commission staff more time to review applications for exemptive relief from registered investment companies, including those for more complex or novel ETFs that will continue to require exemptive relief. To the extent that this speeds up the processing time for these remaining applications, the rule may reduce the indirect costs of forming and operating for ETFs that seek to operate outside its parameters and for other registered investment companies that require exemptive relief to operate and, as a result, may promote innovation among these types of funds.

b. *Conditions for Reliance on Rule 6c-11*

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, many of the conditions in rule 6c-11 do not offer 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.

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570 To the extent that investors substitute away from products that are comparable to ETFs, such as mutual funds, an increase in revenue for entities facilitating ETF transactions may be offset by a decrease in revenue for entities facilitating fewer transactions in those other products.

i. *Conditions That 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.[571] As a consequence, arbitrageurs generate price pressure that works to equalize the prices of these assets across different markets. This is 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.

There are several factors that are important for arbitrageurs to consider in order 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.[572] The rule contains conditions that take these considerations into account and are designed to promote the effective functioning of the arbitrage mechanism for ETFs.

The rule will 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

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571 *See, e.g.*, Jonathan B. Berk & Peter DeMarzo, Corporate Finance (3rd ed. 2013).

572 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 are likely to decide to wait for any deviation 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.

the acceptance of basket assets, including policies and procedures specific to the creation of custom baskets if the ETF uses custom baskets.

Although current exemptive orders contain varying provisions for basket flexibility, we do not believe that the rule will require existing ETFs to change how they construct baskets. Instead, the rule will give some ETFs more flexibility for constructing baskets than what is allowed by their existing exemptive orders, provided they adopt and implement custom basket policies and procedures.

We believe that fixed-income, international, and actively managed ETFs will particularly benefit from the increased basket flexibility under the rule if they currently operate under exemptive orders that do not allow custom baskets. For example, 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, thus reducing trading costs for authorized participants. Similarly, international ETFs will be able to tailor their creation and redemption baskets to accommodate difficulties in transacting in certain international securities. In addition, actively managed ETFs will, 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 will be able to reduce certain transaction costs, such as those associated with bid-ask spreads.

For these reasons, we believe that, to the extent that ETFs are able to implement procedures that facilitate the arbitrage mechanism or reduce costs for those ETFs, the rule will benefit ETFs that use the increased basket flexibility the rule affords and will ultimately benefit their investors. One commenter submitted results from an empirical analysis that supported this

assessment.[573] For example, the commenter observes that fixed-income ETFs that currently have increased basket flexibility exhibit smaller bid-ask spreads and reduced premiums and discounts to NAV, particularly during times of market stress.[574] Due to a lack of data, we are unable to quantify the number of ETFs that would choose to implement custom basket policies and procedures, and thus the potential benefits accruing to ETFs and their investors.

To the extent that existing ETFs do not already have policies and procedures governing basket assets in place or that existing policies and procedures are not consistent with the requirements of the rule, ETFs will incur costs associated with developing and implementing such policies and procedures. However, such costs may be partially or totally offset by the basket flexibility discussed above. We estimate that an average ETF will incur an initial cost of $10,718[575] associated with establishing and implementing standard and custom basket policies and procedures. In addition, we estimate that an average ETF will incur an ongoing cost of $4,135[576] each year to review and update its basket policies and procedures. We thus estimate

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573 *See* ICI Comment Letter (providing the results of an empirical analysis indicating that fixed-income ETFs with basket flexibility had narrower bid-ask spreads, lower tracking differentials, and traded at smaller discounts than fixed-income ETFs without basket flexibility). The commenter conducted a survey to identify fixed-income ETFs that currently have increased basket flexibility. While the commenter provided the results of an empirical analysis based on this data, the commenter did not provide the Commission with the survey responses themselves.

574 Conversely, another commenter stated that increased basket flexibility may reduce arbitrage efficiency for fixed-income ETFs, particularly during market stress. *See* Bluefin Comment Letter. This commenter observes that such ETFs may choose to include less liquid portfolio holdings in redemption baskets in greater than pro-rata proportions, thereby increasing trading costs for arbitrageurs and leading to larger premiums and discounts. While we acknowledge this concern, ETFs generally are incentivized to choose custom baskets that reduce premiums and discounts for the benefit of transacting shareholders. In addition, as discussed above in section 0, we believe that requiring fixed-income ETFs to establish detailed parameters for the construction and acceptance of custom baskets that are in the best interests of the ETF and its shareholders addresses the risks associated with custom baskets.

575 This estimate is based on the following calculations: 12 hours x $329 per hour (senior manager) + 7 hours x $530 (chief compliance officer) + 2 hours x $365 (compliance attorney) + 5 hours x $466 (assistant general counsel) = $10,718. *See infra* section 0, Table 13.

576 This estimate is based on the following calculations: 5 hours x $329 per hour (senior manager) + 2.5 hours x $530 (chief compliance officer) + 2.5 hours x $466 (assistant general counsel) = $4,135. *See infra*

that the total industry cost associated with the policies and procedures requirement in the rule for ETFs that can rely on the rule in the first year will equal $25,769,955.[577]

Finally, although the rule's custom basket policies and procedures requirements are designed to reduce the potential for cherry-picking, dumping, and other potential abuses, we acknowledge that this principles-based approach may not be effective at preventing all such abuses. However, ETFs will be required to maintain records related to the custom baskets used, which will allow the Commission to examine for potential abuses.

As proposed, the rule also will 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. This information allows authorized participants and other arbitrageurs to identify arbitrage opportunities and execute arbitrage trades that reduce premiums and discounts to NAV per share, ultimately benefiting all investors. In addition, we agree with a commenter who stated that portfolio transparency helps investors to better discern differences between ETFs that track similar indexes or have similar investment objectives.[578]

The requirements for portfolio transparency in existing exemptive orders have varied. However, based on a staff review of ETFs' websites, we understand that all ETFs that can rely on the rule currently provide daily full portfolio transparency. Thus, ETFs that can rely on the rule already bear the ongoing costs associated with maintaining such disclosures.[579] We believe

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section 0, Table 13.

577 This estimate is based on the following calculation: ($10,718 + $4,135) x 1,735 ETFs = $25,769,955. 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. It also may overestimate costs because some fund complexes may use the same basket policies and procedures for all ETFs within the complex.

578 *See* CSIM Comment Letter.

579 In the 2018 ETF Proposing Release, we estimated that an ETF that does not currently maintain daily

that the ETFs that can rely on the rule will 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.[580] We estimate this one-time cost to be $1,997 for the average ETF, resulting in an aggregate one-time cost of $3,463,928 for all ETFs that can rely on the rule.[581]

Some commenters raised concerns that providing daily portfolio information on an ETF's website could expose the fund and its investors to costs associated with "front-running" and, in the case of actively managed ETFs, "piggybacking."[582] However, based on our understanding that all ETFs that can rely on the rule currently provide daily full portfolio transparency, the rule will not change the degree to which ETFs and their investors are exposed to such costs compared to the baseline.

As proposed, rule 6c-11 would have required that an ETF's portfolio holdings disclosure be made on each business day: (1) before the opening of regular trading on the primary listing exchange of the ETF's shares; and (2) before the ETF starts accepting orders for the purchase or redemption of creation units. The rule will omit the second requirement in order to

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portfolio holdings on its website would spend approximately 5 hours of professional time to update the relevant webpage daily at a cost of $1,405.50 each year. Because we believe all ETFs that can rely on the rule already provide this information on their websites, we believe that very few, if any, ETFs would have to bear these additional costs.

580 The rule will require ETFs to provide certain information for each portfolio holding. These item requirements are a more limited set of the information currently required by the listing exchanges' generic listing standards for actively managed ETFs.

581 This estimate is based on the following calculations: 1.5 hours x $284 (senior systems analyst) + 1.5 hours x $331 (senior programmer) + 1 hour x $309 (compliance manager) + 1 hour x $365 (compliance attorney) + $400 for external website development = $1,997. The industry cost is 1,735 x $1,997 = 3,463,928. This estimate is conservative as it does not assume a cost reduction for actively managed ETFs that already comply with the listing standards on which the item requirements for the portfolio holding disclosure under the rule are based.

582 *See supra* section 0.

accommodate the current industry practice of T-1 creation and redemption orders.[583] We agree with commenters that T-1 orders facilitate ETF arbitrage for certain ETFs holding foreign securities by allowing arbitrageurs to align the execution time of underlying securities with the NAV calculation of the order.[584] Compared to the proposal, we therefore believe that this aspect of the rule will lead to narrower bid-ask spreads and smaller premiums and discounts, benefiting investors in these ETFs.

Compared to the proposal, the rule will require ETFs to present enumerated information regarding each portfolio holding (which are a more limited set of the disclosures currently required by the listing exchanges' generic listing standards for actively managed ETFs), rather than the description, amount, value, and unrealized gain/loss of each position in the manner prescribed by Article 12 of Regulation S-X. As discussed above in section II.C.4.b, we believe that this information will focus the disclosure on the pieces of information that are most relevant to investors while reducing the burden for ETFs of complying with the disclosure requirement. As a result, we believe that the disclosure format under the rule will provide similar benefits to investors at lower costs to ETFs.[585]

ii. *Other Cost Savings From the Rule*

Under the terms of the exemptive orders, ETFs are required to disclose in their registration statement that redemptions may be postponed for foreign holidays. Rule 6c-11 does not contain such a requirement and will thus eliminate the cost of preparing and updating this

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583 *See supra* section 0. This timing requirement is consistent with the transparency requirements of our existing exemptive orders.

584 *See id.*

585 The cost estimates in this section of the economic analysis reflect the cost reduction, compared to the proposal, associated with the change in the format of the disclosure. *See* also *infra* footnote 682 and accompanying text.

disclosure for existing ETFs. This information is already covered by the agreement between the ETF and the authorized participant.[586]

The terms of the exemptive orders also 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. The rule will not include such a requirement, as 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 will lead to cost savings for existing and future ETFs associated with preparing and reviewing this disclosure for sales literature.[587]

iii. *Intraday Indicative Value*

The rule will not require an ETF to disseminate its IIV, as is currently required under all exemptive orders and current exchange listing standards. To the extent that current exchange listing standards require IIV to be disseminated, the rule's omission of such a requirement will not represent a change from the baseline and will not result in any costs or benefits to market participants.

We believe, and commenters agreed, 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 addition, the IIV may not reflect the intrinsic value of certain ETFs' assets (*e.g.*, for funds that invest in foreign securities whose markets are closed during the ETF's trading day or funds

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586 We believe that authorized participants would share this information with other market participants as necessary. For example, an authorized participant acting as agent typically would share this information with its customer if it is a necessary part of the creation or redemption process.

587 We estimate that the omission of this requirement will save 0.25 hours of a compliance attorney ($365 per hour), resulting in a cost savings of $91 (0.25 x $365) per fund each year. The total cost savings for all 1,735 ETFs that can rely on the rule will thus be $158,319 (1,735 x $91).

whose assets trade infrequently, as is the case for certain bond funds).[588] An investor who relies on stale or inaccurate IIV information to purchase or sell ETF shares could be exposed to price risk until the position is closed and could incur the trading costs associated with these trades. Furthermore, as discussed above in section II.C.3, based on a staff review of the websites of the ten largest ETFs by assets under management and of several publicly available free websites, we do not believe that investors have easy access to IIV through free, publicly available websites.

Some commenters stated that retail investors relying on IIV could see their ability to evaluate ETFs reduced without this metric.[589] As we stated in the proposing release, we agree that the IIV may provide a reasonably accurate estimate of the value of certain ETFs' portfolios, including those ETFs whose underlying assets are very liquid and frequently traded during the ETF's trading day. However, as discussed above in section II.C.3, we have concerns regarding the accuracy of IIV estimates and the lack of uniform methodology requirements. Moreover, retail investors do not have easy access to IIV through free, publicly available websites today even for those assets classes where IIV may be more reliable. Therefore, we do not believe that IIV provides information that retail investors can reliably use when making investment decisions and thus do not believe that it is a necessary condition for ETFs that are operating in reliance on rule 6c-11.

iv. *Website Disclosure Provisions*

Rule 6c-11 will require an ETF to disclose certain information prominently on its website.[590] The goal of these disclosure requirements is to provide investors with key metrics to

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588 Commenters agreed that traditional IIV can have significant limitations, for example for ETFs holding fixed-income securities. *See, e.g.*, ICI Comment Letter. *See also supra* footnote 202.

589 *See, e.g.*, Angel Comment Letter; Nasdaq Comment Letter; IDS Comment Letter.

590 *See supra* footnote 225.

evaluate their trading and investment decisions in a location that is easily accessible and frequently updated.[591] Based on a staff review of ETFs' websites, we believe that all ETFs that can rely on the rule currently have a website and currently provide daily website disclosures of NAV, closing price, and premiums or discounts.[592] As a consequence, existing ETFs generally will not incur any additional cost associated with the creation and technical maintenance of a website or these specific website disclosure requirements.

Our exemptive orders have not included requirements for line graph and tabular historical information regarding premiums and discounts. While Form N-1A contains tabular website disclosures related to historical premiums/discounts in Items 11(g)(2) and 27(b)(7)(iv), which we are eliminating for ETFs that will rely on rule 6c-11, we anticipate that all existing ETFs that fall within the scope of the rule will still incur some additional costs associated with these disclosures.[593] 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 allows ETFs to monitor the trading behavior of their shares), and have systems (such as computer equipment, an internet connection, and a website) in place that can be used for processing this data and

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591 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*, U.S. Census Bureau 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*, ICI Research Perspective (Oct. 2017), *available at* https://www.ici.org/pdf/per23-07.pdf (stating that "[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 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). We acknowledge that the benefits of the website disclosure requirement would be attenuated for those investors who lack internet access or otherwise are not able to access ETFs' websites.

592 *See supra* section 0.

593 *See supra* section 0.

uploading it to their websites. However, these ETFs will 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 will incur a one-time cost of $1,997[594] for implementing this website disclosure and an ongoing cost of $491[595] per year for updating the relevant webpage with this information. We thus estimate the total cost, in the first year, to ETFs that can rely on the rule for providing this website disclosure, of $4,315,379.[596]

Our exemptive orders have not included a requirement for ETFs to provide disclosure if an ETF's premium or discount is greater than 2% for more than seven consecutive trading days and the factors that materially contributed to a premium or discount, if known. As a result, under the rule those ETFs that experience such a premium or discount will 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 2018 using Bloomberg data, we believe that, on average, 4.5% of ETFs that can rely on the rule will trigger this disclosure requirement each year.[597] As suggested by commenters, this disclosure requirement is likely to affect certain categories of ETFs more than others.[598] For

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594 This estimate is based on the following calculations: 1.5 hours x $284 (senior systems analyst) + 1.5 hours x $331 (senior programmer) + 1 hour x $309 (compliance manager) + 1 hour x $365 (compliance attorney) + $400 for external website development = $1,997.

595 This estimate is based on the following calculations: 0.25 hours x $284 (senior systems analyst) + 0.25 hours x $331 (senior programmer) + 0.5 hour x $309 (compliance manager) + 0.5 hour x $365 (compliance attorney) = $491.

596 This estimate is based on the following calculation: ($1,997 + $491) x 1,735 ETFs = $4,315,379.

597 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 rule. During the sample period from 2008 to 2018, the percentage of ETFs for which the reporting requirement was triggered at least once varied from 1.5% (2010) to 10% (2008).

598 *See supra* footnote 358 and accompanying text.

example, in 2018, we estimate that the reporting requirement would not have been triggered for any allocation ETFs, commodity ETFs, or municipal bond ETFs, while it would have been triggered for 0.3% of taxable bond ETFs, 0.6% of sector equity ETFs, 3.1% of U.S. equity ETFs, 4.2% of international equity ETFs, and 4.8% of alternative ETFs. We estimate that an ETF required to make such a disclosure in a given year will incur an average cost of $1,504, yielding a total annual industry cost of $117,405.[599]

The rule also will require additional disclosure by the ETF of the median bid-ask spread for the most recent 30-day period on its website. This requirement is modified from the proposal, which would have required an ETF to disclose the median bid-ask spread for the ETF's most recent fiscal year on its website and in its prospectus.

We believe that the rule's disclosure requirement will 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. We agree with commenters that actual bid-ask spreads paid by ETF investors can be influenced by a variety of factors, including order size, market conditions, as well as the broker-dealer used.[600] Nevertheless, we believe that requiring the disclosure of bid-ask spread information is still valuable to investors as it is indicative of the general magnitude of

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599 We believe that such disclosure will require 1.25 hours for a compliance attorney and the compliance manager to determine if this requirement has been triggered and produce a draft of the required disclosures + 0.75 hours for a senior programmer and a senior systems analyst to include the information on the website, at a time cost of (1.25 hours x $365 compliance attorney hourly rate) + (1.25 hours x $309 compliance manager hourly rate) + (0.75 hours x $331 senior programmer hourly rate) + (0.75 hours x $284 senior systems analyst hourly rate) in addition to $200 for external website development = $1,504. The annual cost of this requirement for those ETFs that can rely on the rule is calculated as 4.5% x 1,735 ETFs x $1,504 = $117,405. This estimate includes costs for website development, which would only be incurred by an ETF making this disclosure for the first time.

600 *See, e.g.,* Vanguard Comment Letter (also pointing out that, in certain circumstances, broker-dealers can obtain price improvements leading to market orders being executed either within the NBBO or at midpoint or better).

an ETF's trading costs attributable to bid-ask spreads. In addition, we believe bid-ask spreads can help investors rank ETFs in terms of expected execution costs, as an ETF with historically larger bid-ask spreads can be expected to be more costly to trade than an ETF with historically lower bid-ask spreads, when holding other factors that impact execution costs, such as order size, market conditions, and the broker-dealer, constant.

Existing exemptive orders do not require ETFs to disclose median bid-ask spreads. As a result, we assume that all ETFs operating under the final rule will have to implement processes and systems to compute the median bid-ask spreads and will have to accommodate a new data point on their webpage to report this information.[601] We estimate that an ETF will incur a one-time estimated cost of $8,294 to comply with this requirement.[602] In addition, we estimate that an ETF that purchases NBBO information to compute bid-ask spread will incur an additional ongoing annual cost of $4,042.[603] Assuming that all ETFs will have to purchase data to satisfy this requirement, we estimate an upper bound for the total industry cost in the first year of $21,401,659.[604]

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601 Based on a review of 150 randomly selected ETFs, which included 100 index-based ETFs and 50 actively managed ETFs, 10 percent of index-based ETFs and 1.5 percent of actively managed ETFs provided some information on bid-ask spreads. However, all ETFs that provided such information displayed bid-ask spreads only for a particular point in time (for example as of the time the prior day's NAV was struck) rather than median bid-ask spreads computed for the most recent 30-day period, as required by the rule.

602 This estimate is based on the following calculations: 6.5 hours x $284 (senior systems analyst) + 6.5 hours x $331 (senior programmer) + 4 hour x $309 (compliance manager) + 4 hour x $365 (compliance attorney) + $1,600 for external website development = $8,294.

603 In the 2018 ETF Proposing Release, we stated that we believed ETFs currently maintain a record of historical price data as a matter of current business practices which could be used to satisfy the requirement to compute bid-ask spreads at a nominal cost. *See* 2018 ETF Proposing Release, *supra* footnote 7, at section III.C.1. Some commenters, however, suggested that some ETFs would incur costs to purchase data collected by third parties, although these commenters did not provide specific estimates of such costs. *See, e.g.*, BNY Mellon Comment Letter; John Hancock Comment Letter. Assuming a data cost of $2,500 per year, we estimate that an ETF that would need to purchase the data will incur the following ongoing cost: 1 hours x $284 (senior systems analyst) + 1 hours x $331 (senior programmer) + 1.375 hours x $309 (compliance manager) + 1.375 hours x $365 (compliance attorney) + $2,500 (data) = $4,042.

604 This estimate is based on the following calculation: ($8,294 + $4,042) x 1,735 ETFs = $21,401,659.

The requirement of disclosures on ETFs' websites we are adopting will enable investors to more readily obtain certain key information for individual ETFs, potentially resulting in better informed trading decisions.[605] The conditions standardize certain content requirements to facilitate investor analysis of information while allowing ETFs to select a layout for displaying the required information that the individual ETF finds most efficient and appropriate for its website. Because the information will be made available on individual websites, in the layout 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 ETFs and time periods may be limited. Investors seeking to compare multiple ETFs will have to visit the website of every ETF, navigate to the relevant section of the website, and extract the information provided in the layout chosen by the fund. Depending on the manner in which a typical fund investor will use the website disclosures, these considerations may decrease the information benefits of the new 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 will likely be lower than the cost they would incur 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 will ultimately provide an efficient means for facilitating investor access to information.

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605 *See supra* footnote 225.

c. *Recordkeeping*

The rule will require ETFs to 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 will 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 also will promote internal supervision and compliance.[606] As the agreement forms the contractual foundation on which authorized participants engage in arbitrage activity, compliance of the agreement with applicable rules is important for the arbitrage mechanism to function properly.

We also are requiring ETFs to maintain information regarding the baskets exchanged with authorized participants on each business day, including a record identifying any custom basket and stating that the custom basket complies with the ETF's custom basket policies and procedures. We believe that these records will 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 other applicable law, 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, or to prepare and maintain a record identifying each custom basket and stating that custom baskets comply with the custom basket policies and procedures. However, we believe that most ETFs, as a matter of

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[606] ETFs already are 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 rule.

established business practice, already preserve and maintain copies of authorized participant agreements as well as data on baskets used.[607]

As discussed below in section V.B.2, we estimate the average annual cost for an ETF to comply with these recordkeeping requirements is $393 per year.[608] Assuming that (1) 80% of ETFs already preserve and maintain copies of authorized participant agreements as well as information on basket composition; (2) no ETF currently maintains records identifying any custom basket and stating that the custom basket complies with the ETF's custom basket policies and procedures; and (3) 25% of the total annual recordkeeping costs can be attributed to the new recordkeeping requirements for custom baskets, the total industry cost for ETFs that can rely on the rule will be $544,790 per year.[609]

d. *Master-Feeder Relief*

We will rescind the master-feeder relief granted to ETFs, with the exception of master-feeder relief that funds relied on as of the date of the 2018 ETF Proposing Release (June 28, 2018). We are rescinding such relief because there generally is a lack of industry interest in ETF master-feeder arrangements, and certain master-feeder arrangements raise policy concerns, as discussed above in section II.F. 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

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607 One commenter stated that ETFs generally already implement robust record keeping programs. *See* Invesco Comment Letter.

608 *See infra* section 0, Table 12. An average ETF would have to maintain and store 24 authorized participant agreements. *See also supra* footnotes 547–549 and accompanying text.

609 This estimate is based on the following calculation: 1,735 ETFs x (20% + 80% * 75%) x $393 = $544,790. The final rule will require ETFs to maintain additional information on basket composition (ticker symbol, CUSIP or other identifier, description of holding, quantity of each holding, and percentage weight of each holding composing the basket). We believe that this additional requirement does not present a significant additional recordkeeping cost.

this relief to structure master-feeder arrangements with one master and one feeder fund each.[610] We will grandfather existing master-feeder arrangements involving ETF feeder funds, but prevent the formation of new ones under existing orders, by amending relevant exemptive orders.[611] As a result, we do not expect that the rescission of the existing master-feeder relief will impose costs on ETFs that currently rely on the relief to structure master-feeder arrangements. However, to the extent that an ETF without a grandfathered master-feeder arrangement would apply for an exemptive order that grants master-feeder relief, such an ETF would incur costs associated with the exemptive order application.[612] 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.[613]

2. Amendments to Forms N-1A, N-8B-2, and N-CEN

The amendments to Forms N-1A and N-8B-2 are designed to provide investors with tailored information regarding the costs associated with investing in ETFs.[614] As discussed in

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610 *See* 2018 ETF Proposing Release, *supra* footnote 7, at n.339 and accompanying text. *See also supra* footnote 448 and accompanying text.

611 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 investors finding the fund to be a less attractive investment.

612 One commenter indicated that it has invested resources exploring various approaches to an ETF master-feeder structure. *See* Fidelity Comment Letter.

613 *See supra* section 0.

614 As proposed, we also are amending Forms N-1A and N-8B-2 to include narrative disclosures for both

section II.H above, we believe that the new disclosures will 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.

We are amending Forms N-1A and N-8B-2 to include information on ETF trading and associated costs that we anticipate will help investors better understand costs specific to ETFs, such as bid-ask spreads.[615] In a departure from the proposal, we are eliminating the Q&A format for these disclosures, which will allow ETFs to determine the format for conveying the required disclosures to investors. In addition, the narrative disclosures will be streamlined and included in Item 6 of Form N-1A, whereas the proposed disclosure in Q&A format would have been included in Item 3. As discussed above in section II.H, we believe that the updated format and location will improve the usefulness of the disclosure to ETF investors.

ETFs will incur costs associated with these new disclosures on Forms N-1A and N-8B-2.[616] ETFs structured as open-end funds are currently required to disclose information about premiums and discounts to NAV per share in reports on Form N-1A. However, UIT ETFs, which file reports with the Commission on Form N-8B-2, are not required to make such disclosures. We estimate that this reporting requirement will increase the incremental cost for

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mutual funds and ETFs that will clarify that the fees and expenses reflected in the expense table may be higher for investors if they sell shares of the fund. *See supra* section 0.

615 Rule 6c-11 will require ETFs that rely on the rule to provide the median bid-ask spread for the last thirty calendar days and certain disclosures regarding premiums and discounts on their websites. Our amendments to Forms N-1A and N-8B-2 will require ETFs that do not rely on rule 6c-11 to disclose median bid-ask spread information on their websites or in their prospectus and exclude only those ETFs that provide premium/discount disclosures in accordance with rule 6c-11 from the premium and discount disclosure requirements in Form N-1A.

616 As discussed in more detail below in section 0, 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.

UIT ETFs compared to ETFs structured as open-end funds. In addition, ETFs that rely on rule 6c-11 will be exempt from the Form N-1A disclosure requirements related to bid-ask spreads and premiums and discounts to NAV per share (as such disclosures will be required under rule 6c-11 to be provided on their websites), which reduces the incremental cost we estimate for open-end funds that can rely on the rule compared to those that cannot. Taking these considerations into account, we estimate that each ETF that is structured as an open-end fund will incur a one-time cost of $3,799[617] and an ongoing cost of $1,899[618] per year if it can rely on rule 6c-11, and a one-time cost of $6,960[619] and an ongoing cost of $3,480[620] per year if it cannot rely on rule 6c-11. We estimate that a UIT ETF will incur a one-time cost of $8,352[621] and an ongoing cost of $3,480[622] per year. We thus estimate that the total industry cost for this requirement for ETFs in the first year would equal $12,434,736.[623]

As proposed, we are amending Form N-CEN to require identification of ETFs that are relying on rule 6c-11.[624] We believe that this requirement will allow the Commission to better

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617 This estimate is based on the following calculations: 5.46 hours x $365 (compliance attorney) + 5.46 hours x $331 (senior programmer) = $3,799.

618 This estimate is based on the following calculations: 2.73 hours x $365 (compliance attorney) + 2.73 hours x $331 (senior programmer) = $1,899.

619 This estimate is based on the following calculations: 10 hours x $365 (compliance attorney) + 10 hours x $331 (senior programmer) = $6,960.

620 This estimate is based on the following calculations: 5 hours x $365 (compliance attorney) + 5 hours x $331 (senior programmer) = $3,480.

621 This estimate is based on the following calculations: 12 hours x $365 (compliance attorney) + 12 hours x $331 (senior programmer) = $8,352.

622 This estimate is based on the following calculations: 5 hours x $365 (compliance attorney) + 5 hours x $331 (senior programmer) = $3,480.

623 This estimate is based on the following calculation: 1,735 ETFs structured as an open-end fund that can rely on the rule x ($3,799 + $1,899) + 235 ETFs structured as an open-end fund that cannot rely on the rule ($6,960 + $3,480) + 8 UIT ETFs ($8,352 + $3,480) = $12,434,736.

624 We also are changing the definition of "authorized participant" in Form N-CEN to conform the definition with rule 6c-11 by excluding specific reference to an authorized participant's participation in DTC (Item E.2 of Form N-CEN).

monitor reliance on rule 6c-11 and assist us with our accounting, auditing, and oversight functions, including compliance with the Paperwork Reduction Act. We believe that the incremental cost of this requirement to ETFs is minimal.

D. Effects on Efficiency, Competition, and Capital Formation

This section evaluates the impact of rule 6c-11 and the amendments to Forms N-1A, N-8B-2, and N-CEN on efficiency, competition, and capital formation. However, as discussed in further detail below, the Commission is unable to quantify 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 rule will 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 increasing competition among ETFs as discussed below. At the same time, the rule could lead to a decrease in total assets of other fund types that investors may regard as substitutes, such as certain mutual funds.[625] As a result, ETF ownership (as a percentage of market capitalization) for some securities, such as stocks and bonds, will likely increase, and ownership by other funds, such as mutual funds, will likely decrease. We are aware of only a limited amount of academic literature regarding ETFs. This literature suggests that such a shift in ownership could have a limited

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[625] The disclosure requirements will also serve to increase investors' awareness of ETF trading costs, 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.

effect on the price efficiency (*i.e.*, the extent to which an asset price reflects all public information at any point in time) and liquidity of these portfolio securities.[626]

The literature also suggests that a shift in stock ownership towards ETFs may somewhat improve certain dimensions of price efficiency while possibly attenuating 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.[627] 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 U.S. equity index ETFs is associated with moderately higher volatility among component stocks and asserts that the increased volatility is non-fundamental.[628] Another paper finds that higher authorized participant arbitrage activity in U.S. equity ETFs is associated with a moderately higher correlation of returns among stocks in the ETF's portfolio.[629] The authors observed that changes in the prices of these stocks tend to partially revert over the next trading day and state that the increased co-movement in returns is

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[626] 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 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.

[627] Lawrence Glosten, Suresh Nallareddy, & Yuan Zou, *ETF Trading and Informational Efficiency of Underlying Securities* (Columbia Business School, Research Paper No. 16-71, 2016).

[628] *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.

[629] Zhi Da & Sophie Shive, *Exchange Traded Funds and Asset Return Correlations* (Working Paper, 2016).

thus a sign of excessive price movement due to non-fundamental shocks that ETF trading helps propagate.

To a limited extent, the rule could decrease the liquidity of stocks held by ETFs, as one study finds that higher ownership of a stock by U.S. equity ETFs is associated with somewhat lower liquidity as measured by market impact.[630] 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,[631] another study finds that bonds included in ETFs experience improvements in their liquidity.[632]

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.[633] The authors assert that this co-movement in liquidity exposes investors to the possibility that multiple assets in their portfolio will be illiquid at the same time.

Since we do not know the degree to which the rule will increase ETF ownership of stocks and bonds, we are unable to quantify the rule's effects on price efficiency and liquidity. However, the effects documented in the literature surveyed above are generally small, so that we do not anticipate that the rule would have a significant effect on the price efficiency or liquidity of assets held by ETFs.

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630 *See* Sophia J.W. Hamm, *The Effect of ETFs on Stock Liquidity* (Working Paper, 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.

631 Caitlin Dillon Dannhauser, *The Impact of Innovation: Evidence from Corporate Bond ETFs*, Journal of Financial Economics (forthcoming 2016) ("Dannhauser Article").

632 Jayoung Nam, *Market Accessibility, Corporate Bond ETFs, and Liquidity* (Working Paper, 2017).

633 Vikas Agarwal et al., *Do ETFs Increase the Commonality in Liquidity of Underlying Stocks* (Working Paper, 2017).

As a result of the 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.[634] During normal market conditions, this may lead those ETFs' shares to trade at smaller bid-ask spreads, thus benefiting investors. Such a reduction in bid-ask spreads by over-weighting more liquid securities may not continue to be possible during stressed market conditions, however, if a large proportion of such an ETF's portfolio securities become less liquid.[635] 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 rule, which some investors may not anticipate and fail to fully take into account when making their investment decisions.[636]

Finally, the amendments to Forms N-1A and N-8B-2 as well as the additional website disclosures required by rule 6c-11 we are adopting will allow investors and other market participants to better understand and compare ETFs using more relevant and standardized disclosure. For example, the amendments to Item 6 of Form N-1A will add a requirement for ETFs to include a statement that ETF investors may be subject to other expenses that are specific

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634 This would be the case for those ETFs that hold less liquid securities in their portfolios.

635 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 122.

636 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. 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 transacting and existing/remaining shareholders.

to ETF trading, including bid-ask spreads.[637] These costs are not currently required to be disclosed as part of the prospectus. Since these costs are incurred by ETF investors and not mutual fund investors, we believe that adding this disclosure requirement will 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 final rule could help investors make more informed investment decisions that are more suited to their investment objectives. The degree to which investors will 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 rule will likely increase competition among ETFs that can rely on the rule. The first channel through which the rule will likely foster competition is by reducing the costs for ETF sponsors to form new ETFs that comply with the conditions set by the rule. This cost reduction will lower the barriers to entering the ETF market, which will likely lead to increased competition among ETFs that can rely on the rule.

In addition, new ETFs that enter the market in reliance on the rule, as well as those existing ETFs that will have their exemptive relief rescinded and replaced by the rule, will no longer be subject to requirements that vary among exemptive orders.[638] Instead, these ETFs will operate under uniform requirements, which will help promote competition among ETFs that can rely on the rule. An increase in competition among ETFs that can rely on the rule will likely also

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637 James J. Angel, Todd J. Broms, & Gary L. Gastineau, *ETF Transaction Costs Are Often Higher Than Investors Realize*, Journal of Portfolio Management, Spring 2016, at 65, find that the cost of trading ETF shares depends both on bid-ask spreads as well as premiums and discounts to NAV per share.

638 Some fund sponsors that operate ETFs outside the scope of rule 6c-11 may voluntarily decide to comply with certain provisions of the rule. For example, one sponsor that operates share class ETFs stated that it intends to modify its current practices, as necessary, to be consistent with the custom basket requirements contemplated by the proposed rule for all its U.S. ETFs. *See* Vanguard Comment Letter.

lead to an increase in competition among those ETFs, ETFs that cannot rely on the rule, and other types of funds and products that investors may perceive to be substitutes for ETFs.[639]

Furthermore, the new website disclosures and amendments to Forms N-1A and N-8B-2 will allow investors to better compare ETFs and mutual funds, which can further foster competition among these types of funds as well as between these types of funds and other types of funds that investors may perceive to be substitutes for ETFs and mutual funds, such as closed-end funds and certain ETPs.

Increased competition will likely lead to lower fees for investors, encourage financial innovation, and increase consumer choice in the markets for ETFs, mutual funds, and other types of funds that investors may perceive to be substitutes.[640] Due to the limited availability of data, however, we are unable to quantify these effects.

To the extent the rule will increase the number and total assets of ETFs, more authorized participants or other market participants that engage in ETF arbitrage, such as hedge funds and principal trading firms, may enter the market. This may 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. We would expect new entries of authorized

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639 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 mutual funds, closed-end funds, and other ETPs, such as exchange-traded notes and commodity pools.

640 The rule will likely lead to increased competition both among ETFs that can rely on the rule. as well as between ETFs that can rely on the rule and those that cannot, to the extent that investors perceive these ETFs as substitutes. While we believe that increased competition generally is conducive to innovation, any increased competition in the ETF market resulting from the rule will be more likely to involve novel ETFs that will continue to need to obtain exemptive relief from the Commission.

participants or other arbitrageurs as a result of the rule to be limited, however, and any effects on bid-ask spreads and premiums/discounts to NAV per share to be small.

3. Capital Formation

The rule may lead to increased capital formation. Specifically, an increase in the demand for ETFs, to the extent that it increases demand for intermediated assets as a whole, will 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 and 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[641] that finds that bonds with a higher share of ETF ownership have lower expected returns.[642] Due to the limited availability of data, however, we are unable to quantify these effects of the rule on capital formation.

E. Reasonable Alternatives

1. Website Disclosure of Basket Information

Rule 6c-11 does not include a basket publication requirement. As an alternative, we considered requiring an ETF to post on its website one "published" basket each business day before the opening of trading of the ETF's shares, as we proposed. This disclosure would allow smaller institutional investors and retail investors that are not NSCC members and do not

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641 Dannhauser Article, *supra* footnote 631.

642 We acknowledge that there is research (*see* Yakov Amihud & Haim Mendelson, *Asset Pricing and the Bid-Ask Spread*, 17 Journal of Financial Economics 223 (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.

currently have access to basket information to compare the ETF's "published basket" with its portfolio holdings.[643] However, we agree with commenters that the benefit of this information to these investors is likely to be limited, as secondary market arbitrage typically does not require information regarding an ETF's basket composition.[644] In addition, ETFs would incur additional costs associated with this disclosure.[645]

We also considered requiring an ETF to publish information regarding every custom basket used by the ETF after the close of trading on each business day. This information 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 the 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 rule contains conditions for basket policies and procedures, which seek to prevent overreaching. Moreover, the rule will require an ETF to maintain records regarding the baskets used, which will allow Commission staff to examine an ETF's use of basket flexibility. We also agree with commenters that requiring publication of all baskets could disadvantage an

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643 Commenters stated that authorized participants already have access to basket information through the daily portfolio composition file provided to NSCC. In addition, other institutional investors that use basket information for hedging purposes, such as an investor using an authorized participant as an agent, have access to this information through the NSCC, an intermediary (such as an authorized participant), or the ETF itself. *See supra* section 0.

644 *See, e.g.*, CSIM Comment Letter; ICI Comment Letter.

645 Our exemptive orders have not included requirements for daily website disclosures of ETF baskets, though some exemptive orders contemplate disclosure of daily basket assets through NSCC. 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.

ETF and its shareholders by allowing market participants to front-run trades by authorized participants (or other arbitrageurs that use an authorized participant as an agent) in basket securities, particularly for those ETFs that have more frequent primary market transactions.[646]

Consequently, we believe that the risk for abusive practices under the rule will be low while, at the same time, the rule will avoid additional operational and compliance costs for ETFs to post and review the information as well as potential costs associated with front-running trades in basket securities under the alternative.

2. Disclosure of ETF Premiums or Discounts Greater than 2%

As proposed, the rule will 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. One commenter suggested that we raise the threshold for the size of the premiums or discounts to five or ten percent while shortening the period over which the premium or discount has to be sustained for the requirement to trigger.[647] Based on this suggestion, we considered an alternative that would require any ETF whose premium or discount was greater than five percent for more than three consecutive trading days to post that information on its website, along with a discussion as required under the rule.

Under both the rule and the alternative, ETFs with premiums or discounts greater than five percent for more than seven consecutive trading days would provide the disclosure. The disclosure threshold under the rule will also capture ETFs with premiums or discounts greater than two and up to five percent for more than seven consecutive trading days, which would not

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646 *See, e.g.*, ICI Comment Letter; SSGA Comment Letter I; Vanguard Comment Letter.

647 Nasdaq Comment Letter.

be captured under the alternative. Conversely, the disclosure threshold under the alternative would also capture ETFs with premiums or discounts greater than five percent for between three and six consecutive trading days, which will not be captured under the rule.

We estimate that 1.7 percent of those ETFs that can rely on the rule would trigger the alternative disclosure threshold per year, compared to 4.5 percent under the rule. From 2008 and 2018, the percentage of ETFs that would have triggered the requirement would have been largest in 2008. In that year, 4.6 percent of ETFs that could have relied on the rule would have triggered the alternative threshold, compared to 10 percent under the rule.[648] In addition, an ETF that triggers the reporting requirement under the alternative would make its disclosure sooner after the premium or discount first exceeds the threshold, as the measurement period is shorter compared to the rule.

The lower incidence of reporting under the alternative would decrease the costs incurred by ETFs associated with making the disclosure,[649] but also reduce the reporting of persistent premiums and discounts available to investors in that it would eliminate reporting of discounts below the 5% threshold. While the shorter observation period under the alternative would make the information about premiums and discounts available to investors sooner, rule 6c-11 will require ETFs to disclose the prior day's premium/discount to NAV per share on its website every day, so that timely information about the size of ETF's premiums/discounts will still be available to investors under the rule.

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648 *See supra* footnote 597 and accompanying text. Our estimate of the percentage of ETFs that would have to satisfy the requirement under the alternative is based on the same methodology and data as our estimate for the rule's reporting threshold.

649 We estimate a total annual industry cost of $47,457,745 (=1.7 % x 1,735 ETFs x $1,609). This estimate uses the same assumptions as our estimate of the cost of this requirement under the rule. *See supra* footnote 599 and accompanying text.

Another commenter suggested that we adopt a materiality standard rather than a fixed numerical threshold to trigger the reporting requirement.[650] We considered an alternative under which each ETF would make its own determination as to when a premium/discount to NAV per share is material and thus would be reported. As a result, ETFs would almost certainly differ in the size and duration of a premium/discount that they would consider to be material. In addition, ETFs might adopt varying criteria to determine whether a premium/discount is deemed material based on the asset class of the ETF or general market conditions. While we are unable to predict how the alternative would impact the frequency of reporting compared to the rule, we believe that the alternative might lead to inconsistent reporting practices among ETFs, which would likely reduce the usefulness of the requirement to investors, compared to the rule.

3. Website and Prospectus Disclosure of the Median Bid-Ask Spread Calculated Over the Most Recent 1-Year Period

Rule 6c-11 will require an ETF to disclose the median bid-ask spread calculated over the most recent 30-day period on its website.[651] As an alternative, we considered requiring an ETF to disclose the median bid-ask spread for the ETF's most recent fiscal year on its website and in its prospectus, as proposed.

We agree with commenters that computing the median bid-ask spread over a 30-day rolling period, rather than over the proposed 1-year lookback period, may provide a more accurate predictor of trading costs for newly launched ETFs whose bid-ask spreads may tighten as the ETFs mature.[652] In addition, as an ETF's prospectus cannot be updated every day, we

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650 John Hancock Comment Letter (recommending a materiality standard instead of a 2% threshold).

651 Our amendments to Form N-1A will provide ETFs that do not rely on rule 6c-11 with the option to provide the same information on its website or the median bid-ask spread over the ETF's most recent fiscal year in its prospectus. *See supra* section 0.

652 *See supra* footnote 380 and accompanying text. Conversely, there may also be instances where future bid-

believe it is appropriate to require ETFs to make this disclosure on their websites. As a result, we believe that requiring ETFs to disclose the median bid-ask spread over the most recent 30-day period on their websites will increase the benefits of the bid-ask spread disclosure to investors compared to the alternative, particularly for newly-launched ETFs.

4. Additional Disclosures Showing the Impact of Bid-Ask Spreads

We considered amending Forms N-1A and N-8B-2 to require an ETF to provide: (1) examples in the ETF's prospectus showing how bid-ask spreads impact the return on a hypothetical investment for both buy-and-hold and frequent traders; and (2) an interactive calculator on the ETF's website that would allow an investor to customize the hypothetical bid-ask spread calculations to its specific investing situation, as proposed. Some investors may find the additional disclosures under this alternative useful to understand the effect of transaction costs resulting from bid-ask spreads on their investments; however, we agree with commenters that this benefit could be diminished by over-concentrating investor focus on bid-ask spreads, thereby potentially obscuring the importance of other components of ETF transaction costs (*e.g.* order size, market conditions, and the extent to which a broker-dealer improves upon quoted bid-ask spreads).[653] In addition, the omission of these requirements will save ETFs the costs associated with providing examples showing how bid-ask spreads impact the return on a hypothetical investment and implementing the interactive calculator on its website.

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ask spreads may be better predicted by the median bid-ask spread computed over a 1-year lookback period, as compared to a 30-day rolling period (*e.g.*, when recent bid-ask spreads are not representative of how an ETF typically has traded.

653 *See, e.g.*, Vanguard Comment. *See also* Eaton Vance Comment Letter.

5. *Website Disclosure of a Modified IIV*

As proposed, rule 6c-11 will not require ETFs to disseminate IIV as a condition for reliance on the rule. As an alternative, we considered requiring an ETF to publicly disseminate a modified IIV on its website on a real time basis as a condition to rule 6c-11, requiring ETFs to calculate IIVs more frequently and in a more accessible manner. We also considered creating a methodology that takes into account circumstances when market prices for underlying assets are not available or should not be used to reflect the ETF's intraday value. As we discussed above in section II.C.3, such a modified IIV would benefit retail and less sophisticated institutional investors by allowing them to better evaluate the value of an ETF intra-day. However, we are concerned that these modifications would not cure the shortcomings of IIV for ETFs in a uniform manner. We encourage the ETF industry to undertake efforts to develop intraday value metrics targeted at these investors as we believe that ETFs are in a position to consider and develop tailored metrics for ETFs holding different asset classes in a format that is useful for retail investors.

6. *The Use of a Structured Format for Additional Website Disclosures and the Filing of Additional Website Disclosures in a Structured Format on EDGAR*

The rule will require ETFs to post on their websites certain disclosures to enable investors to more readily obtain certain key metrics for individual ETFs. As an alternative, we considered requiring 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.[654] The resulting standardization under this alternative would allow for extraction, aggregation,

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[654] 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.

comparison, and analysis of reported information through significantly more automated means than is possible with unstructured formats such as HTML.[655] 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 burden on investors and other data users of separately visiting each website to obtain each ETF's disclosure.

The structured data requirement could impose a cost on ETFs of tagging the information in a structured format, particularly to the extent that ETFs do not otherwise structure this data in this manner for their own purposes.[656] However, we believe that if the XML format, for example, were used for structuring the additional disclosure, the incremental cost of tagging information in each such disclosure would likely be relatively modest.[657]

As another alternative, we considered requiring ETFs to make the additional website disclosures available in a centralized repository in a structured format, such as by filing them on

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655 Several commenters agreed with our assessment of the benefits of a structured disclosure format. One commenter stated that "having such information submitted in a standardized, structured format to the Commission and available publicly would aid comparison and analysis." The commenter further indicated that such information should be provided in the XBRL format on a daily basis. *See* Morningstar Comment Letter. Another commenter expressed general support for having "standardized basket reporting in XBRL." *See* Angel Comment Letter. Another commenter recommended that ETFs "be required to disclose their daily portfolio holdings using a common downloadable or machine-readable format specified by the Commission." *See* Eaton Vance Comment Letter. A different commenter recommended that "portfolio holdings information be supplied in a standard file format with comma-separated value." See SSGA Comment Letter I.

656 *See, e.g.*, CSIM Comment Letter (stating that "[t]he alternatives described in the proposal, including the use of structured disclosures, will not be user-friendly for individual investors and will incur unnecessary costs to the ETF.").

657 For example, based on staff experience with XML filings, the costs of tagging the information in XML are minimal given the technology that would 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 would be able to accommodate XML data without significant costs, and large-scale changes would likely not be necessary to output structured data files.

EDGAR.[658] 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, such as third-party data aggregators, to efficiently extract information for purposes of aggregation, comparison, and analysis of information across multiple funds and time periods.[659] Requiring the information to be filed on EDGAR also would enable data users to retain access to such historical information in the event that such information is subsequently removed from the fund's website.[660] We recognize that filers might incur additional costs under this alternative, compared to the requirement in the rule to post the additional disclosures in an unstructured format on fund websites.[661] Such costs would likely vary across filers, depending on the systems and processes they currently have in place, such as for internal reporting, posting of website updates, and submission of regulatory filings, and the manner in which filers currently maintain data required for the additional disclosures under the final rule.[662]

7. Pro Rata Baskets

Rule 6c-11 will 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

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658 The Commission has previously adopted rules requiring the structuring of certain information disclosed by funds. *See, e.g.*, Reporting Modernization Adopting Release, *supra* footnote 262; Money Market Fund Reform, Investment Company Act Release No. 29132 (Feb. 23, 2010) [75 FR 10059 (Mar. 4, 2010)]; Interactive Data for Mutual Fund Risk/Return Summary, Investment Company Act Release No. 28617 (Feb. 11, 2009) [74 FR 7747 (Feb. 19, 2009)].

659 One commenter agreed with the assessment in the 2018 ETF Proposing Release of the benefits of making the additional website disclosures available in a centralized repository in a structured format, stating that "[a]ll holdings and basket information should be filed in a central location (such as EDGAR) in a common format. It is too difficult to search many funds groups for this information and then putting it in a common format for analysis." *See* Reagan Comment Letter.

660 *See* Reagan Comment Letter.

661 *See* Invesco Comment Letter (supporting dissemination via the ETF sponsor's website and opposing any additional dissemination requirements, such as filing on EDGAR, stating that building a separate data feed would involve additional costs and internal resources).

662 Such costs would also depend on the specific nature of the EDGAR filing requirement under this alternative.

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 we have done in our exemptive orders since approximately 2006.[663]

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, we believe that the rule's additional policies and procedures requirements for custom baskets will 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, we believe that the increased basket flexibility under the rule will benefit the effective functioning of the arbitrage mechanism, particularly benefiting fixed-income, international, and actively managed ETFs.[664]

8. Treatment of Existing Exemptive Relief

As proposed, we will rescind the exemptive relief we have issued to ETFs that will be permitted to rely on the 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 that would otherwise be

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663 ETFs whose orders we are rescinding 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 in that they are required to adopt custom basket policies and procedures under rule 6c-11.

664 Section 0 *supra* discusses the possibility that some ETFs may use the increased basket flexibility of the 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.

subject to rule 6c-11 operate. Specifically, some ETFs that determine they do not need the additional flexibility (*e.g.*, basket flexibility) the rule will provide could choose to continue operating under their existing relief rather than in reliance on conditions of the rule, such as standardized presentation of portfolio holdings. This self-selection would perpetuate existing disparity in the conditions under which these ETFs are allowed to operate.

Measured against the baseline, the alternative would thus have smaller benefits arising from improved disclosure. For example, an ETF that chose to continue to operate under its existing exemptive relief would not be required to present its portfolio holdings in the standardized format prescribed by rule 6c-11. As discussed in section IV.C.1.b.i above, we believe that this requirement will benefit investors of ETFs that are subject to rule 6c-11 by allowing them to more easily identify arbitrage opportunities and compare ETFs that have similar investment objectives. In addition, the alternative would not level the playing field among ETFs subject to rule 6c-11 with regard to these conditions and thus not be as effective at promoting product competition as the rule. One commenter agreed, stating that the rescission of the orders will further the Commission's regulatory goal of creating a consistent regulatory framework for ETFs.[665] In addition, it would be more difficult for the Commission to evaluate compliance with applicable law under the alternative compared to the rule, as some of the ETFs whose exemptive relief we will 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

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[665] *See supra* footnote 454 and accompanying text.

ETFs whose relief will be rescinded will be able to continue operating with only minor adjustments, other than being required to develop basket asset policies and procedures.[666]

9. ETFs Organized as UITs

Rule 6c-11 will be available only to ETFs that are organized as open-end funds.[667] As an alternative, we considered including ETFs organized as UITs in the scope of the rule. However, as discussed above in section II.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 ETFs have greater investment flexibility under the open-end fund structure than the UIT structure, we believe that most new ETFs entering into the market will 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 rule.[668]

10. *Treatment of Leveraged/Inverse ETFs*

As discussed in section II.A.3 above, leveraged/inverse ETFs will not be able to rely on final rule 6c-11. As an alternative, we considered permitting leveraged/inverse ETFs to rely on the rule, while maintaining the status quo of existing exemptive orders with respect to the

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666 Under the alternative, some ETFs may voluntarily change operational or compliance functions in order to be able to operate under the rule, if this provides the ETFs increased basket flexibility compared to operating under their existing exemptive orders.

667 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).

668 ETFs sponsors that plan to launch a new ETF organized as a UIT will continue to be able to rely on the exemptive order process.

amount of leveraged market exposure that leveraged/inverse ETFs may obtain (*i.e.*, 300% of the return or inverse return).[669]

This alternative could benefit competition among leveraged/inverse 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/inverse ETFs would likely decrease and their assets could increase. However, as discussed in detail in section II.A.3 above, while leveraged/inverse ETFs are structurally and operationally similar to other types of ETFs within the scope of rule 6c-11, we believe it is premature to permit sponsors to form and operate leveraged/inverse ETFs in reliance on the rule without first addressing the investor protection purposes and concerns underlying section 18 of the Act. We therefore believe that the Commission should first complete its broader consideration of the use of derivatives by registered funds before considering allowing leveraged/inverse ETFs to rely on the rule.

V. PAPERWORK REDUCTION ACT

A. Introduction

Rule 6c-11 will result in new "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[670] In addition, the amendments to Form N-1A, Form N-8B-2, and Form N-CEN will impact the collection of information burden under those forms and Form S-6.[671] Rule 6c-11 also will impact the current collection of information burden of rule 0-2 under the Act.[672]

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669 *See supra* footnote 72.

670 44 U.S.C. 3501–3520.

671 17 CFR 274.11A; 17 CFR 274.12; 17 CFR part 101; 17 CFR 239.16.

672 17 CFR 270.0-2.

The titles for the existing collections 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-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 2018 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. We received no comments on the collection of information requirements. We discuss below the collection of information burdens associated with rule 6c-11 and its impact on rule 0-2 as well as the amendments to Forms N-1A, N-8B-2, S-6 and N-CEN.

B. Rule 6c-11

Rule 6c-11 will 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 rule attempts to eliminate historical distinctions and conditions that we no longer believe are necessary and thus appropriately level the playing field for open-end ETFs that pursue the same or similar investment strategies.

Rule 6c-11 will require an ETF to disclose certain information on its website, to maintain certain records, and to adopt and implement written policies and procedures governing its 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 rule 6c-11 will be ETFs registered as open-end management investment companies other than share class ETFs, leveraged/inverse ETFs, or non-transparent ETFs. This collection will not be mandatory, but will be necessary for those ETFs seeking to operate without individual exemptive orders, including all ETFs whose existing exemptive orders will be rescinded. In the 2018 ETF Proposing Release, we estimated that 1,635 ETFs would likely rely on rule 6c-11.[673] We did not receive public comment on this estimate, but are updating the estimate to 1,735 ETFs to reflect industry data as of December 31, 2018.[674] Information provided to the Commission in connection with staff examinations or investigations will be kept confidential subject to the provisions of applicable law.

1. Website Disclosures

Rule 6c-11 will 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.[675] The rule will require

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673 2018 ETF Proposing Release, *supra* footnote 7, at section IV.B. This estimate did not include UIT ETFs, share class ETFs, leveraged/inverse ETFs, or non-transparent ETFs. *Id.*

674 This figure is based on a staff analysis of Bloomberg data.

675 Rule 6c-11(c)(1)(i).

that the portfolio holdings information contain specified information, including description and amount of each position.[676] Additionally, the rule will require an ETF to disclose on its website: (i) the ETF's NAV per share, market price, and premium or discount, each as of the end of the prior business day; (ii) 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 (or for the life of the fund if shorter); and (iii) the ETF's median bid-ask spread over the last thirty calendar days.[677]

Rule 6c-11(c)(1)(vi) also will 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.[678] Given the threshold for this requirement, we do not believe that many ETFs will be required to disclose this information on a routine basis. In the 2018 ETF Proposing Release, we estimated that all ETFs will be required to make this disclosure only once in their lifetime.[679] Therefore, we believed that this requirement will impose only initial costs and that there will be no ongoing costs associated with it.[680]

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676 Rule 6c-11(c)(1)(i).

677 Rule 6c-11(c)(1)(ii)–(v).

678 Rule 6c-11(c)(1)(vi). 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* section 0.

679 2018 ETF Proposing Release, *supra* footnote 7, at section IV.B.1.

680 For purposes of this analysis, we estimate that 1,735 ETFs would be required to make this disclosure at least once in their lifetime.

TABLE 11: WEBSITE DISCLOSURE PRA ESTIMATES

	Initial hours	Annual hours[1]		Wage rate[2]	Internal time costs	Initial external cost burden	Annual external cost burden
PROPOSED ESTIMATES[3]							
Website development	7.5 hours	2.5 hours	×	$274 (senior systems analyst)	$685	$2,000	$666.65
	7.5 hours	2.5 hours	×	$319 (senior programmer)	$797.50		
Review of website disclosures	5 hours	1.7 hours	×	$298 (compliance manager)	$506.60		
	5 hours	1.7 hours	×	$352 (compliance attorney)	$598.40		
Website updates		1 hour	×	$274 (senior systems analyst)	$274		
		1 hour	×	$319 (senior programmer)	$319		
Review of updated website disclosure		1.25 hours	×	$298 (compliance manager)	$372.50		
		1.25 hours	×	$352 (compliance attorney)	$440		
Total annual burden per ETF	25 hours	13.3 hours			$3,971.30	$2,000	$666.65
Number of ETFs		× 1,635			× 1,635	× 1,635	× 1,635
Total annual burden		21,745.5 hours			$6,493,075.50	$3,270,000	$1,089,972.75
FINAL ESTIMATES							
Website development	11.25 hours[4]	3.75 hours	×	$284 (senior systems analyst)[5]	$1,065	$3,000[4]	$1,000
	11.25 hours[4]	3.75 hours	×	$331 (senior programmer)[5]	$1,241.25		
Review of website disclosures	7.5 hours[4]	2.5 hours	×	$309 (compliance manager)[5]	$772.50		
	7.5 hours[4]	2.5 hours	×	$365 (compliance attorney)[5]	$912.50		
Website updates		1.5 hours[4]	×	$284 (senior systems analyst)[5]	$426		
		1.5 hours[4]	×	$331 (senior programmer)[5]	$496.50		
Review of updated website disclosure		1.875 hours[4]	×	$309 (compliance manager)[5]	$579.38		
		1.875 hours[4]	×	$365 (compliance attorney)[5]	$684.36		
Total annual burden per ETF	37.5 hours	19.25 hours			$6,177.49	$3,000	$1,000
Number of ETFs		× 1,735[5]			× 1,735[5]	× 1,735[5]	× 1,735[5]
Total annual burden		33,398.75 hours			$10,717,945.15	$5,205,000	$1,735,000

Notes:
1. Includes initial burden estimates annualized over a three-year period.
2. *See supra* footnote 567.
4. Estimate revised to reflect modifications from the proposal.
5. Estimate revised to reflect updated industry data.

3. 2018 Proposing Release, *supra* footnote 7, at section IV.B.1.

Table 11 above summarizes the proposed PRA estimates included in the 2018 ETF Proposing Release and the final PRA estimates associated with the website disclosures in rule 6c-11.[681] We did not receive public comment on our proposed estimates, but we have revised them as a result of updated industry data and modifications from the proposal. Specifically, we are increasing the initial and ongoing internal and external burden estimates by 50 percent each to account for our modification to the proposal that will require ETFs to disclose median bid-ask spread information on their websites as part of rule 6c-11, partially offset by the elimination of the proposed published basket requirement and the modification to the proposed requirement to disclose portfolio holdings related to timing and presentation of those holdings.[682] In addition, we are revising the estimated wage rates and estimated number of ETFs that will be subject to the rule to reflect updated industry data.

2. Recordkeeping

Rule 6c-11 will require an ETF to preserve and maintain copies of all written authorized participant agreements.[683] Additionally, the rule will require ETFs to maintain records setting forth the following information for each basket exchanged with an authorized participant: (i) ticker symbol, CUSIP or other identifier, description of holding, quantity of each holding, and percentage weight of each holding composing the basket; (ii) if applicable, 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.[684] ETFs would have to

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681 2018 ETF Proposing Release, *supra* footnote 7, at section IV.B.1.

682 *See supra* section 0, section 0.

683 *See* rule 6c-11(d).

684 *See supra* footnote 410 and accompanying text. Although we have modified the recordkeeping

maintain these records for at least five years, the first two years in an easily accessible place.[685]

requirement from the proposal, we do not believe the modified requirements would increase the time or cost burdens set forth in the 2018 ETF Proposing Release. *See* 2018 ETF Proposing Release, *supra* footnote 7, at section IV.B.2.

685 *Id.*

TABLE 12: RECORDKEEPING PRA ESTIMATES

	Initial hours	Annual hours		Wage rate[1]	Internal time costs	Initial external cost burden	Annual external cost burden
PROPOSED ESTIMATES[2]							
Recordkeeping	0 hours	2.5 hours	×	$60 (general clerk)	$150		
	0 hours	2.5 hours	×	$92 (senior computer operator)	$230		
Total annual burden per ETF	0 hours	5 hours			$380		
Number of ETFs		× 1,635			× 1,635		
Total annual burden	0 hours	8,175 hours			$621,300.00	$0	$0
FINAL ESTIMATES							
Recordkeeping	0 hours	2.5 hours	×	$62 (general clerk)[3]	$155		
	0 hours	2.5 hours	×	$95 (senior computer operator)[3]	$237.50		
Total annual burden per ETF	0 hours	5 hours			$392.50		
Number of ETFs		× 1,735[3]			× 1,735		
Total annual burden		8,675 hours			$680,987.50	$0	$0

Notes:

1. Based on SIFMA Report, *supra* footnote 567, as modified by Commission staff.
2. *See* 2018 ETF Proposing Release at section IV.B.2.
3. Estimate revised to reflect updated industry data.

Table 12 above summarizes the proposed PRA estimates included in the 2018 ETF Proposing Release and the final PRA estimates associated with the recordkeeping requirements in rule 6c-11.[686] We did not receive public comment on our proposed estimates, but we have revised the estimates as a result of updated industry data. Specifically, we have updated the estimated wage rates and the estimated number of ETFs that will be subject to the rule and thus the recordkeeping requirement. We do not estimate that there will be any initial or ongoing external costs associated with the recordkeeping requirement.

3. Policies and Procedures

As proposed, rule 6c-11 will require 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 basket assets.[687] 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.[688] 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.[689] Finally, as discussed above, an ETF using custom baskets would be required to maintain records detailing the composition of each custom basket.

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686 *See* 2018 ETF Proposing Release, *supra* footnote 7, at section IV.B.2.

687 *See* rule 6c-11(c)(3).

688 *See* rule 6c-11(c)(3).

689 *See supra* text following footnote 293.

TABLE 13: POLICIES AND PROCEDURES PRA ESTIMATES

	Initial hours	Annual hours[1]		Wage rate[2]	Internal time costs	Initial external cost burden	Annual external cost burden
PROPOSED ESTIMATES[3]							
Establishing and implementing standard baskets policies and procedures	3 hours	1 hour	×	$317 (senior manager)	$317		
	2 hours	.67 hours	×	$511 (chief compliance officer)	$340.67		
	1 hour	.33 hours	×	$352 (compliance attorney)	$117.33		
Establishing and implementing custom baskets policies and procedures	9 hours	3 hours	×	$317 (senior manager)	$951		
	5 hours	1.67 hours	×	$449 (ass't general counsel)	$748.33		
	5 hours	1.67 hours	×	$511 (chief compliance officer)	$851.67		
	1 hour	.33 hours	×	$352 (compliance attorney)	$117.33		
Reviewing and updating baskets policies and procedures		5 hours	×	$317 (senior manager)	$1585		
		2.5 hours	×	$449 (ass't general counsel)	$1,122.50		
		2.5 hours	×	$511 (chief compliance officer)	$1,277.50		
Total annual burden per ETF		18.67 hours			$7,428.33		
Number of ETFs		× 1,635			× 1,635		
Total annual burden		30,525 hours[4]			$12,145,320[4]	$0	$0
FINAL ESTIMATES							
Establishing and implementing standard baskets policies and procedures	3 hours	1 hour	×	$329 (senior manager)[5]	$329		
	2 hours	.67 hours	×	$530 (chief compliance officer)[5]	$353.33		
	1 hour	.33 hours	×	$365 (compliance attorney)[5]	$121.67		
Establishing and implementing custom baskets policies and procedures	9 hours	3 hours	×	$329 (senior manager)[5]	$987		
	5 hours	1.67 hours	×	$466 (ass't general counsel)[5]	$776.67		
	5 hours	1.67 hours	×	$530 (chief compliance officer)[5]	$883.33		
	1 hour	.33 hours	×	$365 (compliance attorney)[5]	$121.67		
Reviewing and updating baskets policies and procedures		5 hours	×	$329 (senior manager)[5]	$1645		
		2.5 hours	×	$466 (ass't general counsel)[5]	$1165		
		2.5 hours	×	$530 (chief compliance officer)[5]	$1325		
Total annual burden per ETF		18.67 hours			$7,707.67	$0	$0
Number of ETFs		× 1,735[5]			× 1,735		
Total annual burden		32,392.45 hours			$13,372,807.45		

Notes:

1. Includes initial burden estimates annualized over a three-year period.
2. Based on SIFMA Report, *supra* footnote 567, as modified by Commission staff.
3. *See* 2018 ETF Proposing Release at section IV.B.3.
4. The proposed estimates shown here for the total annual hour and cost burdens (30,525 hours and $12,145,320) are not identical to the totals provided in the 2018 ETFs Proposing Release. *See supra* footnote 7, at section IV.B.2 (estimating total hour and cost burdens of 30,520 hours and $12,111,525). This discrepancy is due to our calculation of the annual hours in the 2018 ETF Proposing Release, in which the total initial burden hours were calculated before being amortized over 3 years (*i.e.*, divided by 3). Here, the initial burden hours were amortized over 3 years before we calculated the total annual hour and cost burdens, resulting in slightly higher totals. This does not affect the final estimates set forth above.
5. Estimate revised to reflect updated industry data.

Table 13 above summarizes the proposed PRA estimates included in the 2018 ETF Proposing Release and the final PRA estimates associated with the policies and procedures requirements in rule 6c-11.[690] We did not receive public comment on our proposed estimates, but we are revising the estimates as a result of updated industry data. Specifically, we have updated the estimated wage rates and the estimated number of ETFs that will be subject to the rule and thus the policies and procedures requirement. We do not estimate that there will be any initial or ongoing external costs associated with this requirement.

4. Estimated Total Burden

TABLE 14: RULE 6c-11 TOTAL PRA ESTIMATES

	Internal hour burden	Internal burden time cost	External cost burden
Website disclosure	33,398.75 hours	$10,717,945.15	$1,735,000
Recordkeeping	8,675 hours	$680,987.50	$0
Developing policies and procedures	32,392.45 hours	$13,372,807.45	$0
Total annual burden	74,466.2 hours	$24,771,740.10	$1,735,000
Number of ETFs	÷ 1,735	÷ 1,735	÷ 1,735
Average annual burden per ETF	42.92 hours	$14,277.66	$1,000

As summarized in Table 14 above, we estimate that the total hour burdens and time costs associated with rule 6c-11, including the burden associated with website disclosure, recordkeeping, and developing policies and procedures will result in an average aggregate annual burden of 74,466.2 hours and an average aggregate time cost of $24,771,740.10. We also estimate that there are external costs of $1,735,000 associated with this collection of information. Therefore, each ETF will incur an annual burden of approximately 42.92 hours, at an average time cost of approximately $14,277.66, and an external cost of $1,000 to comply with rule 6c-11.

690 *See* 2018 ETF Proposing Release, *supra* footnote 7, at section IV.B.2.

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.[691]

As discussed above, rule 6c-11 will 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, rule 6c-11 will alleviate some of the burdens associated with rule 0-2 because it will reduce the number of entities that require exemptive relief in order to operate.[692] Based on staff experience, we estimate that approximately one-third (rounded in the 2018 ETF Proposing Release and here to 30%) of the annual burdens associated with rule 0-2 are attributable to ETF applications.

TABLE 15: RULE 0-2 PRA ESTIMATES

	Annual hours	Annual internal time cost	Annual external cost burden
Rule 0-2 burdens currently approved	x = 5,340	y = $2,029,200.60	z = $14,090,000
Estimated effect of rule 6c-11 on rule 0-2 burdens	- 0.3(x)	- 0.3(y)	- 0.3(z)
Revised estimated burden	3,738 hours	$1,420,440.42	$9,863,000

691 *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).

692 We expect to continue to receive applications for complex or novel ETF exemptive relief that are beyond the scope of the rule. *See supra* at text following footnote 569.

Table 15 above summarizes the proposed estimates included in the 2018 ETF Proposing Release.[693] We did not receive public comment on these estimates, and we have not revised them.

D. Form N-1A

Form N-1A is the registration form used by open-end management investment companies. The respondents to the amendments to Form N-1A are open-end management investment companies registered or registering with the Commission. Compliance with the 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 hour burden of 1,642,490 burden hours and external cost of $131,139,208.[694]

We are adopting amendments to Form N-1A designed to provide investors who purchase open-end ETF shares in secondary market transactions with tailored information regarding ETFs, including information regarding purchasing and selling shares of ETFs.[695] Specifically, the amendments to Form N-1A will require new narrative disclosures regarding ETF trading and associated costs.[696] In addition, we are requiring an ETF that does not rely on rule 6c-11 to disclose median bid-ask spread information on their websites or in their prospectuses.[697] The amendments also exclude ETFs that provide premium/discount disclosures on their websites in

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693 *See* 2018 ETF Proposing Release, *supra* footnote 7, at section IV.B.2.

694 This estimate is based on the last time the form's information collection was submitted for PRA approval in 2019. When we issued the 2018 ETF Proposing Release, the current estimate for Form N-1A was 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.

695 *See supra* section 0.

696 *See supra* section 0.

697 *See supra* section 0

accordance with rule 6c-11 from the premium discount disclosure requirements in Form N-1A.[698] We also are adopting amendments to Form N-1A designed to eliminate certain disclosures for ETFs that are no longer necessary.[699]

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 rule 485(a) or 485(b) under the Securities Act, as applicable).

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698 *See supra* section 0.

699 *See supra* section 0.

TABLE 16: FORM N-1A PRA ESTIMATES

	Initial hours	Annual hours[1]		Wage rate[2]	Internal time costs	Annual external cost burden
PROPOSED ESTIMATES[3]						
Draft and finalize disclosure and amend registration statement	5 hours	1.67 hours	×	$352 (compliance attorney)	$587.84	
	5 hours	1.67 hours	×	$319 (senior programmer)	$532.73	
Bid-ask spread and interactive calculator requirements	5 hours	1.67 hours	×	$352 (compliance attorney)	$587.84	
	5 hours	1.67 hours	×	$319 (senior programmer)	$532.73	
Review and update disclosures		2.5 hours	×	$352 (compliance attorney)	$880	
		2.5 hours	×	$319 (senior programmer)	$797.50	
Maintain bid-ask spread and interactive calculator		2.5 hours	×	$352 (compliance attorney)	$880	
		2.5 hours	×	$319 (senior programmer)	$797.50	
Total new annual burden per ETF	20 hours	16.67 hours			$5,591.67	
Number of ETFs		× 1,892			× 1,892	
Total new annual burden		31,596.4 hours			$10,579,307.20	
FINAL ESTIMATES						
Draft and finalize disclosure and amend registration statement	5 hours	1.67 hours	×	$365 (compliance attorney)[4]	$609.55	
	5 hours	1.67 hours	×	$331 (senior programmer)[4]	$552.77	
Bid-ask spread and premium or discount requirements	1 hour[5]	0.33 hours	×	$365 (compliance attorney)[4]	$121.67	
	1 hour[5]	0.33 hours	×	$331 (senior programmer)[4]	$110.33	
Review and update disclosures		2.5 hours	×	$365 (compliance attorney)[4]	$912.50	
		2.5 hours	×	$331 (senior programmer)[4]	$827.50	
Maintain bid-ask spread requirements		0.5 hours[5]	×	$365 (compliance attorney)[4]	$182.50	
		0.5 hours[5]	×	$331 (senior programmer)[4]	$165.50	
Total new annual burden per ETF	7 hours	10 hours			$3,482.32	
Number of ETFs		× 1,970[4]			× 1,970[4]	
Total new annual burden		19,700 hours			$6,860,170.40	$ 0
Current burden estimates		+ 1,642,490 hours				+ $131,139,208
Revised burden estimates		1,662,190 hours				$131,139,208

Notes:
1. Includes initial burden estimates annualized over a three-year period.
2. See *supra* footnote 567.
4. Estimate revised to reflect updated industry data.
5. Estimate revised to reflect modifications from the proposal.

3. 2018 Proposing Release, *supra* footnote 7, at section IV.D.

Table 16 above summarizes the proposed PRA estimates included in the 2018 ETF Proposing Release and the final PRA estimates associated Form N-1A as amended.[700] We did not receive public comment on our proposed PRA estimates, but we are revising our estimates as a result of updated industry data and modifications from the proposal. Specifically, we are decreasing the initial and ongoing internal and external burden estimates associated with the bid-ask spread and interactive calculator requirements by 80 percent each to account for our elimination of the hypothetical example and interactive calculator requirements and our decision to apply the prospectus bid-ask spread requirements only to those ETFs that do not comply with the website disclosure requirements in rule 6c-11, partially offset by the additional premium or discount requirements.[701] In addition, we are revising the estimated wage rates and estimated number of ETFs that will be subject to the rule to reflect updated industry data.

As summarized in Table 16 above, we estimate that the total hour burdens and time costs associated with the amendments to Form N-1A will result in an average aggregate annual burden of 19,700 hours at an average aggregate time cost of $6,860,170.40. We do not estimate any change in external cost. Therefore the revised aggregate estimates for Form N-1A, including the new amendments, are 1,662,190 hours and $131,338,208 in external costs.

E. 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.[702] UITs are required to file Form S-6 in order to register offerings of securities with the Commission under the Securities Act.[703] As a result, UITs file Form

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700 2018 Proposing Release, *supra* footnote 7, at section IV.B.1.

701 *See supra* sections 0.

702 *See* Form N-8B-2 [17 CFR 274.12].

703 *See* Form S-6 [17 CFR 239.16]. Form S-6 is used for registration under the Securities Act of securities of

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.[704] We currently estimate for Form S-6 a total burden of 107,245 hours, with an internal cost burden of approximately $34,163,955, and an external cost burden estimate of $68,108,956.[705] 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.[706]

To assist investors with better understanding the total costs of investing in a UIT ETF, we are adopting disclosure requirements in Form N-8B-2 that mirror those disclosures we are adopting for Form N-1A.[707] All UIT ETFs will 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 will accrue on Form S-6.

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any UIT registered under the Act on Form N-8B-2.

704 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.

705 This estimate is based on the last time the form's information collection was submitted for PRA revision in 2019.

706 This estimate is based on the last time the form's information collection was submitted for PRA renewal in 2018.

707 *See supra* section 0.

TABLE 17: FORM S-6 PRA ESTIMATES

	Initial hours	Annual hours[1]		Wage rate[2]	Internal time costs	Annual external cost burden
PROPOSED ESTIMATES[3]						
Draft and finalize disclosure and amend Form S-6	10 hours	3.33 hours	×	$352 (compliance attorney)	$1,173.32	
	10 hours	3.33 hours	×	$319 (senior programmer)	$1,063.33	
Review and update disclosures on Form S-6		5 hours	×	$352 (compliance attorney)	$1,760	
		5 hours	×	$319 (senior programmer)	$1,595	
Total new annual burden per UIT ETF	20 hours	16.67 hours			$5,591.65	
Number of UIT ETFs		× 8			× 8	
Total new annual burden		133.36 hours			$44,733.20	
FINAL ESTIMATES						
Draft and finalize disclosure and amend Form S-6	12 hours[4]	4 hours	×	$365 (compliance attorney)[5]	$1,460	
	12 hours[4]	4 hours	×	$331 (senior programmer)[5]	$1,324	
Review and update disclosures on Form S-6		5 hours	×	$365 (compliance attorney)[5]	$1,825	
		5 hours	×	$331 (senior programmer)[5]	$1,655	
Total new annual burden per ETF	24 hours	18 hours			$6,264	
Number of UIT ETFs		× 8			× 8	
Total new annual burden		114 hours			$50,112	$ 0
Current burden estimates		+ 107,245 hours				+ $68,108,956
Revised burden estimates		107,359 hours				$68,108,956

Notes:
1. Includes initial burden estimates annualized over a three-year period.
2. See *supra* footnote 567.
3. 2018 Proposing Release, *supra* footnote 7, at Section IV.E.
4. Estimate revised to reflect modifications from the proposal.
5. Estimate revised to reflect updated industry data.

TABLE 18: FORM N-8B-2 PRA ESTIMATES

	Initial hours	Annual hours[1]		Wage rate[2]	Internal time costs	Annual external cost burden
PROPOSED ESTIMATES[3]						
Draft and finalize disclosure and file Form N-8B-2	10 hours	3.33 hours	×	$352 (compliance attorney)	$1,173.32	
	10 hours	3.33 hours	×	$319 (senior programmer)	$1,063.33	
Complete Form N-8B-2		5 hours	×	$352 (compliance attorney)	$1,760	
		5 hours	×	$319 (senior programmer)	$1,595	
Total new annual burden per UIT ETF	20 hours	16.67 hours			$5,591.65	
Number of new UIT ETFs		× 1			× 1	
Total new annual burden		16.67 hours			$5,591.65	
FINAL ESTIMATES						
Draft and finalize disclosure and file Form N-8B-2	12 hours[4]	4 hours	×	$365 (compliance attorney)[5]	$1,460	
	12 hours[4]	4 hours	×	$331 (senior programmer)[5]	$1,324	
Complete Form N-8B-2		5 hours	×	$365 (compliance attorney)[5]	$1,825	
		5 hours	×	$331 (senior programmer)[5]	$1,655	
Total new annual burden per UIT ETF	24 hours	18 hours			$6,264	
Number of new UIT ETFs		× 1			× 1	
Total new annual burden		18 hours			$6,264	$ 0
Current burden estimates		+ 10 hours				+ $10,000
Revised burden estimates		28 hours				$10,000

Notes:
1. Includes initial burden estimates annualized over a three-year period.
2. See *supra* footnote 567567.
3. 2018 Proposing Release, *supra* footnote 7, at section IV.E.
4. Estimate revised to reflect modifications from the proposal.
5. Estimate revised to reflect updated industry data.

Table 17 and Table 18 above summarize the proposed PRA estimates included in the 2018 ETF Proposing Release and the final PRA estimates associated with Forms S-6 and N-8B-2, respectively.[708] We did not receive public comment on our proposed estimates, but we are revising our estimates as a result of updated industry data and modifications from the proposal. Specifically, we are increasing the initial internal burden estimate for both Form S-6 and Form N-8B-2 by 20 percent to account for the additional premium and discount requirement, partially offset by the modifications to the proposed fee and expense requirements, including those relating to bid-ask spreads.[709] In addition, we are revising the estimated wage rates to reflect updated industry data.[710]

As summarized in Table 17 above, we estimate that the total hour burdens and time costs associated with the amendments to Form S-6 will result in an average aggregate annual burden of 114 hours at an average aggregate time cost of $50,112. We do not estimate any change in external cost. Therefore, the revised aggregate estimates for Form S-6, including the new amendments, are 107,359 hours and $68,108,956 in external costs.

As summarized in Table 18 above, we estimate that the total hour burdens and time costs associated with the amendments affecting Form N-8B-2 will result in an average aggregate annual burden of 18 hours at an average aggregate time cost of $6,264. We do not estimate any change in external cost. Therefore, the revised aggregate estimates for Form N-8B-2, including the new amendments, are 28 hours and $10,000 in external costs.

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708 2018 ETF Proposing Release, *supra* footnote 7, at section IV.E.

709 *See supra* section 0.

710 After reviewing updated industry data, no revisions to the estimated number of UIT ETFs that will be subject to the form are necessary.

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.[711] Today, the Commission is adopting amendments to Form N-CEN to require ETFs to report if they are relying on rule 6c-11.[712] We currently estimate for Form N-CEN total burden hours of 74,425 and external costs of $2,088,176.[713]

TABLE 19: FORM N-CEN PRA ESTIMATES

	Annual hours	Annual external cost burden
PROPOSED ESTIMATES[1]		
Report reliance on rule 6c-11	0.1 hours	
Number of ETFs	× 1,635	
Total new annual burden	163.5 hours	
FINAL ESTIMATES		
Report reliance on rule 6c-11	0.1 hours	
Number of ETFs	× 1,735[2]	
Total new annual burden	173.5 hours	$ 0
Current burden estimates	+ 74,425 hours	+ $2,088,176
Revised burden estimates	74,598 hours	$2,088,176

Notes:
1. 2018 Proposing Release, *supra* footnote 7, at section IV.F.
2. Estimate revised to reflect updated industry data.

Table 19 above summarizes the proposed estimates included in the 2018 ETF Proposing Release and the final PRA estimates associated with Form N-CEN as amended.[714] We did not receive public comment on these estimates, but we are revising our proposed estimates as a result

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711 *See* Reporting Modernization Adopting Release, *supra* footnote 262.

712 *See supra* section 0.

713 This estimate is based on the last time the form's information collection was submitted for PRA approval in 2017.

714 2018 ETF Proposing Release, *supra* footnote 7, at section IV.F.

of updated industry data. Specifically, we are revising the estimated number of ETFs that will be subject to the rule to reflect updated industry data. As summarized in Table 19, we estimate that the total hour burdens and time costs associated with the amendments to Form N-CEN will result in an average aggregate annual burden of 173.5 hours. We do not estimate any change in external cost. Therefore the revised aggregate estimates for Form N-CEN, including the new amendments, are 74,598 hours and $2,088,176 in external costs.

VI. FINAL REGULATORY FLEXIBILITY ANALYSIS

The Commission has prepared the following Final Regulatory Flexibility Analysis ("FRFA") in accordance with section 4(a) of the Regulatory Flexibility Act ("RFA"),[715] regarding new rule 6c-11 and amendments to Form N-1A, Form N-8B-2, and Form N-CEN. An Initial Regulatory Flexibility Analysis ("IRFA") was prepared in accordance with the RFA and included in the 2018 ETF Proposing Release.[716]

A. Need for and Objectives of the Rule and Form Amendments

As described more fully above, rule 6c-11 will 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 amendments to Forms N-1A and N-8B-2 will provide useful information to investors who purchase and sell ETF shares in secondary markets. Finally, the Commission believes the amendments to Form N-CEN will allow the Commission to better

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715 *See* 5 U.S.C. 603.

716 *See* 2018 ETF Proposing Release, *supra* footnote 7, at section V.

monitor reliance on rule 6c-11 and will assist the Commission with its accounting, auditing and oversight functions.

All of these requirements are discussed in detail in section II above. The costs and burdens of these requirements on small ETFs are discussed below as well as above in our Economic Analysis and Paperwork Reduction Act Analysis, which discuss the costs and burdens on all ETFs.

B. Significant Issues Raised by Public Comments

In the 2018 ETF Proposing Release, we requested comment on every aspect of the IRFA, including the number of small entities that would be affected by the proposed rule and amendments, the existence or nature of the potential impact of the proposals on small entities discussed in the analysis and how to quantify the impact of the proposed rule and amendments. We also requested comment on the broader impact of the proposed rule and amendments on all relevant entities, regardless of size. After consideration of the comments we received on the proposed rule and amendments, we are adopting the rule and amendments with several modifications that are designed to reduce certain operational challenges that commenters identified, while maintaining protections for investors and providing investors with useful information regarding ETFs. However, none of the modifications were significant to the small-entity cost burden estimates discussed below. Revisions to the estimates are instead based on updated figures regarding the number of small entities impacted by the new rule and amendments and updated estimated wage rates.

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.[717] Commission staff estimates that, as of December 2018, there are approximately 9 open-end ETFs that may be considered small entities.[718] Commission staff estimates there are no UIT ETFs that would be considered small entities subject to the proposed disclosures for Form N-8B-2.[719]

D. Projected Reporting, Recordkeeping, and Other Compliance Requirements

The new rule and amendments will impact current reporting, recordkeeping and other compliance requirements for ETFs considered small entities.

1. Rule 6c-11

Rule 6c-11 will require an ETF to disclose on its website: (i) portfolio holding information 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, to post that information and a discussion of the factors that are reasonably believed to have materially contributed to the premium or discount; (iv) a table and line graph showing the ETF's premiums and discounts; and (v) the ETF's median bid-ask spread over the last thirty calendar days.[720] The new rule also will require that ETFs preserve and maintain copies of all written authorized participant agreements,

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[717] 17 CFR 270.0-10(a).

[718] This estimate is derived from an analysis of data reported on Form N-1A with the Commission for the period ending December, 2018.

[719] 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 2018.

[720] *See* rule 6c-11(c)(1).

as well as records setting forth the following information for each basket exchanged with an authorized participant: (i) ticker symbol, CUSIP or other identifier, description of holding, quantity of each holding, and percentage weight of each holding 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.[721] Additionally, rule 6c-11 will require 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 basket assets.[722] ETFs using custom baskets under the rule must adopt custom basket policies and procedures that include certain enumerated requirements.[723]

We estimate that approximately 9 ETFs are small entities that will comply with rule 6c-11, and we do not believe that their costs would differ from other ETFs. As discussed above, we estimate that an ETF will incur an annual burden of approximately 36.97 hours, at an average time cost of approximately $11,758.97, and an external cost of $1,000.00.[724]

As we discuss in greater detail in section IV.C.1 above, we expect rule 6c-11 to have other, generally unquantifiable economic effects. For example, by eliminating the need for ETFs that can rely on the rule to seek an exemptive order from the Commission, the rule will also eliminate certain indirect costs associated with the exemptive application process.[725] Specifically, ETFs that apply for an order forgo potential market opportunities until they receive the order,

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721 *See* rule 6c-11(d).

722 Rule 6c-11(c)(3).

723 Rule 6c-11(c)(3).

724 *See supra* Table 13.

725 *See supra* section 0.

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.[726] We also believe that the rule could increase competition in the ETF market as a whole, which could also lead to lower fees.[727]

2. Other Disclosure and Reporting Requirements

The amendments to Form N-1A and Form N-8B-2 are 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, the amendments to Form N-1A will: (i) require new disclosure regarding ETF trading and associated costs; (ii) require ETFs that are not subject to rule 6c-11 to disclose median bid-ask spread information on their websites or in their prospectuses; and (iii) exclude ETFs that provide premium/discount disclosures in accordance with rule 6c-11 from the premium and discount disclosure requirements in the form.[728] Amendments to Form N-8B-2 mirror proposed disclosures for Form N-1A. In addition, amendments to Form N-CEN will require ETFs to report on Form N-CEN whether they are relying on rule 6c-11 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 (including ETFs that do not rely on rule 6c-11) will be subject to the amended Form N-1A or Form N-8B-2 (depending on the ETF's structure as an open-end fund or UIT), and Form N-CEN disclosure and reporting requirements, including ETFs that are small entities. We estimate that 9 ETFs are small entities that will be required to comply with the requirements

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726 *See id.*

727 *See id.*

728 *See supra* section 0.

on Form N-1A and Form N-CEN.[729] We estimate that each ETF, including ETFs that are small entities, will incur a one-time burden of 7 hours, at a time cost of $4,176 to draft and finalize the required disclosure and amend its registration statement.[730] We also estimate that each ETF, including ETFs that are small entities, will incur an ongoing burden of an additional 3 hours, at a time cost of an additional $2,088, to comply with the Form N-1A disclosure requirements.[731] We do not estimate any change to the external costs associated with the amendments to Form N-1A.[732] The total administrative cost for of the Form N-CEN disclosure requirement to ETFs is .1 hours.[733]

As we discuss in greater detail in section IV.C.2 above, we expect the new disclosure amendments to have other, generally unquantifiable economic effects. For example, we believe that the new disclosures will 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.[734] We also believe the amendment to Form N-CEN will allow the Commission to better monitor reliance on rule 6c-11 and assist us with our accounting, auditing, and oversight functions, including compliance with the Paperwork Reduction Act.[735]

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729 *See supra* footnotes 718 and 719. As discussed above, the amendments to Form N-8B-2 mirror those made to Form N-1A. We therefore believe that UIT ETFs will incur the same costs as all ETFs associated with updating their registration statements. However, none of the UIT ETFs are small entities.

730 *See supra* Table 16.

731 *See id.*

732 *See id.*

733 *See supra* Table 19.

734 *See supra* section 0.

735 *See id.*

E. Agency Action to Minimize Effect on Small Entities

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 adopted regulations:

- exempting ETFs that are small entities from the 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 rule 6c-11 or the related form amendments will 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 rule without compromising our objectives. As discussed above, the conditions necessary to rely on 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 disclosure and reporting requirements or to exempt small ETFs from the recordkeeping requirements. We believe that all ETF investors, including investors in small ETFs, will benefit from disclosure and reporting requirements that

permit them to make investment choices that better match their risk tolerances. Additionally, the current disclosure requirements for reports on Form N-1A and Form N-8B-2 do not distinguish between small entities and other funds.[736]

Finally, we believe that rule 6c-11 and related disclosure and reporting requirements appropriately use a combination of performance and design standards. 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 rule must be specifically designed to ensure that these investor and market protections are maintained. However, where we believe that flexibility is beneficial, we adopted 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 needs without raising investor or market protection concerns.[737]

VII. STATUTORY AUTHORITY

The Commission is adopting 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 adopting amendments to registration Forms N-1A and N-CSR under the authority set forth in sections 6, 7(a), 10 and 19(a) of the Securities Act of 1933 [15

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[736] *See* Reporting Modernization Adopting Release, *supra* footnote 262, 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).

[737] *See e.g., supra* section 0. (noting that rule 6c-11 will 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).

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 adopting 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 adopting amendments to Form N-CEN and Form N-PORT 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)]. The Commission is adopting amendments to Regulation S-X under the authority set forth in sections 7, 8, 10, and 19 of the Securities Act [15 U.S.C. 77g, 77h, 77j, 77s] , and sections 8(b), 30(a), 31, and 38(a) of the Investment Company Act [15 U.S.C. 80a-8(b), 80a-29(a), 80a-30, and 80a-37(a)]. The Commission is providing relief in Section II.G, permitting ETFs relying on rule 6c-11 to enter into fund of funds arrangements, pursuant to the authority set forth in sections 6(c), 12(d)(1)(J) and 17(b).

List of Subjects

17 CFR Part 210

Accounting, Investment companies, Reporting and recordkeeping requirements, Securities.

17 CFR Part 239

Reporting and recordkeeping requirements, Securities.

17 CFR Parts 270 and 274

Investment companies, Reporting and recordkeeping requirements, Securities.

TEXT OF RULES AND FORM AMENDMENTS

Correction

In final rule FR Doc. 2016-25349, published in the issue of Friday, November 18, 2016

(81 FR 81870), make the following correction:

On page 82019, in the second column, remove amendatory instruction 23 for § 232.401, which was to be effective August 1, 2019, but was delayed until May 1, 2020, in a rule published on December 14, 2017 (82 FR 58731).

For reasons set out in the preamble, title 17, chapter II of the Code of Federal Regulations is amended as follows:

PART 210—FORM AND CONTENT OF AND REQUIREMENTS FOR FINANCIAL STATEMENTS, SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934, INVESTMENT COMPANY ACT OF 1940, INVESTMENT ADVISERS ACT OF 1940, AND ENERGY POLICY AND CONSERVATION ACT OF 1975

1. The authority citation for part 210 continues to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77nn(25), 77nn(26), 78c, 78j-1, 78l, 78m, 78n, 78o(d), 78q, 78u-5, 78w, 78ll, 78mm, 80a-8, 80a-20, 80a-29, 80a-30, 80a-31, 80a-37(a), 80b-3, 80b-11, 7202 and 7262, and sec. 102(c), Pub. L. 112-106, 126 Stat. 310 (2012), unless otherwise noted.

§210.12-14 [Amended]

2. Amend §210.12-14 by removing the phrase in footnote 1 "(5) balance at close of period as shown in Column E" and adding in its place "(5) balance at close of period as shown in Column F".

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

3. 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.

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PART 270—RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

4. The authority citation for part 270 is revised by adding a sectional authority for § 270.6c-11 in numerical order to read in part 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.

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Section 270.6c-11 is also issued under 15 U.S.C. 80a-6(c) and 80a-37(a).

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5. Section 270.6c-11 is added to read as follows:

§ 270.6c-11 Exchange-traded funds.

(a) *Definitions*. (1) 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:

(A) A basket that is composed of a non-representative selection of the exchange-traded fund's portfolio holdings; or

(B) A representative basket that is different from the initial basket used in transactions on the same business day.

Exchange-traded fund means a registered open-end management company:

(A) That issues (and redeems) creation units to (and from) authorized participants in exchange for a basket and a cash balancing amount if any; and

(B) 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 that is traded on a trading market outside of the United States.

Market price means:

(A) The official closing price of an exchange-traded fund share; or

(B) If it more accurately reflects the market value of an exchange-traded 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.

(2) Notwithstanding the definition of exchange-traded fund in paragraph (a)(1) 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, and is not limited to transactions with authorized participants under these circumstances.

(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*. 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) and (ii) 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:

(i) Holding with the power to vote 5% or more of the exchange-traded fund's shares; or

(ii) 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.

(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, the following information (as applicable) for each portfolio holding that will form the basis of the next calculation of current net asset value per share:

(A) Ticker symbol;

(B) CUSIP or other identifier;

(C) Description of holding;

(D) Quantity of each security or other asset held; and

(E) Percentage weight of the holding in the portfolio;

(ii) The exchange-traded fund's current net asset value per share, market price, and premium or discount, each as of the end 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);

(v) The exchange-traded fund's median bid-ask spread, expressed as a percentage rounded to the nearest hundredth, computed by:

(A) Identifying the exchange-traded fund'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;

(B) Dividing the difference between each such bid and offer by the midpoint of the national best bid and national best offer; and

(C) Identifying the median of those values; and

(vi) If the exchange-traded fund's premium or discount is greater than 2% for more than seven consecutive trading days, a statement that the exchange-traded fund'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 or discount, which must be maintained on the website for at least one year thereafter.

(2) The portfolio holdings that form the basis for the exchange-traded fund's next calculation of current net asset value per share must be the ETF's portfolio holdings as of the close of business on the prior business day.

(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, 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 exchange-traded fund 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 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 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.

(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 ticker symbol, CUSIP or other identifier, description of holding, quantity of each holding, and percentage weight of each holding 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) 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

6. The general authority citation for part 274 continues to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 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.

* * * * *

7. Form N-1A (referenced in §§ 239.15A and 274.11A) is amended as follows:

a. In General Instruction A, revising the definition of "Exchange-Traded

Fund."

b. In General Instruction A, revising the definition of "Market Price."

c. In General Instruction B.4.(a), removing the phrases "[17 CFR 230.400 - 230.497]" and "rules 480 - 485 and 495 - 497 of Regulation C" and adding in their place "[17 CFR 230.400 - 230.498]" and "rules 480 - 485 and 495 - 498 of Regulation C."

d. In General Instruction B.4.(d), removing the phrase "Regulation S-T [17 CFR 232.10 - 232.903]" and adding in its place "Regulation S-T [17 CFR 232.10 - 232.501]."

e. In Item 3, revising the first paragraph under the heading "Fees and Expenses of the Fund".

f. Revising Instruction 1(e) of Item 3, Item 6(c), and Items 11(a)(1) and 11(g).

g. In instruction 4(b) to Item 13, removing the sentence "If a change in the methodology for determining the ratio of expenses to average net assets results from applying paragraph 2(g) of rule 6-07, explain in a note that the ratio reflects fees paid with brokerage commissions and fees reduced in connection with specific agreements only for periods ending after September 1, 1995."

h. Revising Item 27(b)(7)(iv), Instruction 1(e)(ii) of Item 27(d)(1), and Item 27(d)(3).

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

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"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.

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"Market Price" has the same meaning as in rule 6c-11 [17 CFR 270.6c-11] under the Investment Company Act.

* * * * *

Item 3. Risk/Return Summary: Fee Table

* * * * *

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. **You may pay other fees, such as brokerage commissions and other fees to financial intermediaries, which are not reflected in the tables and examples below.** 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.

* * * * *

Instructions

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1. *General*

* * * * *

(e) If the Fund is an Exchange-Traded Fund, exclude any fees charged for the purchase and redemption of the Fund's creation units.

* * * * *

Item 6. Purchase and Sale of Fund Shares

*** * * * ***

(c) *Exchange-Traded Funds*. If the Fund is an Exchange-Traded Fund, the Fund may omit the information required by paragraphs (a) and (b) of this Item and must disclose:

(1) That Individual Fund shares may only be bought and sold in the secondary market through a broker or dealer at a market price;

(2) That 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);

(3) That an investor may incur costs attributable to 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) when buying or selling shares in the secondary market (the "bid-ask spread");

(4) If applicable, how to access recent information, including information on the Fund's net asset value, Market Price, premiums and discounts, and bid-ask spreads, on the Exchange-Traded Fund's website; and

(5) The median bid-ask spread for the Fund's most recent fiscal year.

Instructions

1. A Fund may omit the information required by paragraph (c)(5) of this Item if it satisfies the requirements of paragraph (c)(1)(v) of Rule 6c-11 [17 CFR 270.6c-11(c)(1)(v)] under the Investment Company Act.

2. An Exchange-Traded Fund that had its initial listing on a national securities exchange at or before the beginning of the most recently completed fiscal year must include the median bid-ask spread for the Fund's most recent 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.

3. Bid-Ask Spread (Median). Calculate the median bid-ask spread by dividing the difference between the national best bid and national best offer by the

mid-point of the national best bid and national best offer as of the end of 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.

4. A Fund may combine the information required by Item 6(c)(4) into the information required by Item 1(b)(1) and Rule 498(b)(1)(v) [17 CFR 230.498(b)(1)(v)] under the Securities Act.

* * * * *

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:

(1) The Fund may omit from the prospectus the information required by Items 11(a)(2), (b), and (c).

(2) Provide a table showing the number of days the Market Price of the Fund shares was greater than the Fund's net asset value and the number of days it was less than the Fund's net asset value (i.e., premium or discount) for the most recently completed calendar year, and the most recently completed calendar quarters since that year (or the life of the Fund, if shorter). The Fund may omit the information required by this paragraph if it satisfies the requirements of paragraphs (c)(1)(ii)–(iv) and (c)(1)(vi) of Rule 6c-11 [17 CFR 270.6c-11(c)(1)(ii)–(iv) and (c)(1)(vi)] under the Investment Company Act.

* * * * *

Item 27. Financial Statements

* * * * *

(b) * * *

(7) * * *

* * * * *

(iv) Provide a table showing the number of days the Market Price of the Fund shares was greater than the Fund's net asset value and the number of days it was less than the Fund's net asset value (i.e., premium or discount) for the most recently completed calendar year, and the most recently completed calendar quarters since that year (or the life of the Fund, if shorter). The Fund may omit the information required by this paragraph if it satisfies the requirements of paragraphs (c)(1)(ii)–(iv) and (c)(1)(vi) of Rule 6c-11 [17 CFR 270.6c-11(c)(1)(ii)–(iv) and (c)(1)(vi)] under the Investment Company Act.

* * * * *

(d) * * *

(1) * * *

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.

* * * * *

(3) * * *

Instruction

A Money Market Fund will omit the statement required by Item 27(d)(3) and instead provide a statement that (i) the Money Market Fund files its complete schedule of portfolio holdings with the Commission each month on Form N-MFP; (ii) the Money Market Fund's reports on Form N-MFP are available on the Commission's website at http://www.sec.gov; and (iii) the Money Market Fund makes portfolio holdings information available to shareholders on its website.

* * * * *

8. Form N-8B-2 (referenced in §§ 239.16 and 274.12) is amended as follows:

a. In the General Instructions, revising the definitions of "Exchange-Traded Fund" and "Market Price".

b. In Item 13, adding paragraphs (h), (i), and (j).

c. In Item IX, adding an undesignated paragraph following the heading.

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

* * * * *

GENERAL INSTRUCTIONS FOR FORM N-8B-2

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Definitions

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Exchange-Traded Fund (ETF): The term "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.

* * * * *

Market Price. The term "Market Price" has the same meaning as in rule 6c-11 [17 CFR 270.6c-11] under the Investment Company Act.

* * * * *

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 6(c) of Form N-1A [referenced in 17 CFR 274.11A]. Provide information specific to the trust as necessary, utilizing the ETF-specific methodology set forth in the Instructions to Form N-1A Item 6(c). The Fund may omit the information required by Item 6(c)(5) of Form N-1A if it satisfies the requirements of paragraph (c)(1)(v) of Rule 6c-11 [17 CFR 270.6c-11(c)(1)(v)] under the Investment Company Act.

(j) If the trust is an Exchange-Traded Fund, provide a table showing the number of days the Market Price of the Fund shares was greater than the Fund's net asset value and the number of days it was less than the Fund's net asset value (i.e., premium or discount) for the most recently completed calendar year, and the most recently completed calendar quarters since that year (or the life of the Fund, if shorter). The Fund may omit the information required by this paragraph if it satisfies the requirements of paragraphs (c)(1)(ii)–(iv) and (c)(1)(vi) of Rule 6c-11 [17 CFR 270.6c-11(c)(1)(ii)–(iv) and (c)(1)(vi)] under the Investment Company Act.

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IX

EXHIBITS

Subject to General Instruction 2(d) regarding incorporation by reference and rule 483 under the Securities Act, file the exhibits listed below as part of the registration statement. Letter or number the exhibits in the sequence indicated, unless otherwise required by rule 483. Reflect any exhibit incorporated by reference in the list below and identify the previously filed document containing the incorporated material.

* * * * *

9. Amend Form N-CEN (referenced in § 274.101) as follows:

a. Adding Item C.7.k.

b. Revising the Instruction to Item E.2.

The addition and revision 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

* * *

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

* * *

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.

* * *

10. Amend Form N-CSR (referenced in §274.128) as follows:

a. In General Instruction D, remove the phrase "Item 12(a)(1)" and add in its place "Item 13(a)(1)".

b. In the instruction to Item 13, remove the phrase "Instruction to Item 11" and add in its place "Instruction to Item 13".

11. Amend Form N-PORT (referenced in § 274.150) by revising the first paragraph of General Instruction F to read as follows:

Note: The text of Form N-PORT does not, and this amendment will not, appear in the *Code of Federal Regulations*.

FORM N-PORT

MONTHLY PORTFOLIO INVESTMENTS REPORT

* * *

GENERAL INSTRUCTIONS

* * *

F. Public Availability

With the exception of the non-public information discussed below, the information reported on Form N-PORT for the third month of each Fund's fiscal quarter will be made publicly available upon filing.

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By the Commission.

Dated: September 25, 2019

Vanessa A. Countryman
Secretary

[FR Doc. 2019-21250 Filed: 10/23/2019 8:45 am; Publication Date: 10/24/2019]