

PROPOSED ETF RULE: AN OVERVIEW

On June 28, 2018, the U.S. Securities and Exchange Commission ("SEC") [proposed a new rule](#) for exchange-traded funds ("ETFs"). Proposed Rule 6c-11 (the "Proposed Rule") would impose a more streamlined process for new ETFs, and create more standardized compliance requirements for existing ETFs. This is the first in a series of posts on the new Proposed Rule, its requirements, and next steps for the Proposed Rule.

Where ETFs Stand Now

The SEC blessed the first ETF in 1992, and since then, the SEC has issued over 300 ETF exemptive orders. Despite ETFs growing to \$3.4 trillion in total net assets, the exemptive order application process can be slow and expensive for ETFs. Between 2007 and 2018, the median processing time from filing to approval was 221 days. The SEC also estimates that the cost for a typical ETF filing for exemptive relief is \$100,000. In 2008, the SEC [proposed a rule](#) that would have applied to index-based ETFs and codified certain standard conditions, but it was never finalized in the midst of the economic downturn. In 2015, the SEC [re-issued a request](#) for public comment on the need for and the construction of a new ETF rule proposal.

Proposed Rule 6c-11

Scope and Relief of Proposed Rule 6c-11 The Proposed Rule would be available to ETFs that are organized as open-end funds, including both index-based and actively managed ETFs. It would not be available for leveraged-ETFs or ETFs formed as unit investment trusts ("UITs"). In addition, the Proposed Rule would rescind the exemptive orders for any existing ETF that would fall within the scope of the Proposed Rule. ETFs that meet the Proposed Rule's specific conditions would:

1. redeem shares only in creation unit aggregations;
2. permit ETF shares to be purchased and sold at market prices rather than at net asset value ("NAV") per share;
3. engage in in-kind transactions with certain affiliates; and
4. in certain limited circumstances, pay authorized participants the proceeds from the redemption of shares in more than seven days.

Conditions for Reliance on Proposed Rule 6c-11 The Proposed Rule contains the following five core conditions that if met, would allow for an ETF to take advantage of the relief outlined above:

1. Issuance and Redemption of Shares. The Proposed Rule requires that an ETF issue and redeem "redeemable shares" in the form of "creation units" to and from "authorized participants" in exchange for baskets of securities (and any cash balance).
2. Listing on a National Securities Exchange. An ETF's shares must be listed on a national securities exchange and must trade at market-determined prices.
3. Portfolio Holdings. The Proposed Rule would require an ETF to disclose on its website daily the "portfolio holdings" that will form the basis for each calculation of NAV per share, defined to mean an ETF's securities, assets, or other positions.

4. **Baskets.** The Proposed Rule would require ETFs to adopt and implement written policies and procedures governing the construction of baskets and the process that would be used for the acceptance of baskets. In addition, the Proposed Rule would allow an ETF to use "custom baskets" according to a written custom basket policy. An ETF would also be permitted to construct baskets using cash, securities, or other positions, provided that the ETF has satisfied the appropriate policies and procedures requirement.
5. **Website Disclosure.** The Proposed Rule would require an ETF to disclose certain information on its website regarding: (i) the ETF's NAV per share, market price, and premium or discount, each as of the end of the prior business day; (ii) bid-ask spreads; and (iii) historical information regarding premiums and discounts.

Issues Not Covered by the Proposed Rule

The Proposed Rule does not include several ETF-related issues that current exemptive orders have included or addressed:

- **Leveraged Funds:** Leveraged ETFs, which are designed to provide multiplied returns, would explicitly not be permitted to rely on the Proposed Rule.
- **UITs:** Although the earliest ETFs were organized as UITs, UITs now represent such an insubstantial amount of new ETF applications that the SEC chose to not include them in the Proposed Rule.
- **Intraday Indicative Value:** Existing standards require that an intraday estimate of an ETF's NAV per share (an "intraday indicative value" or "IIV") be widely disseminated at least every 15 seconds during regular trading hours (every 60 seconds for international ETFs). The SEC found that the IIV is no longer widely used by market participants when conducting arbitrage trading.
- **Marketing Disclosures:** The SEC has required that each ETF 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 SEC has explained that given the growth in prevalence of ETFs, it believes such disclosure is no longer necessary.
- **Master-Feeder ETFs:** The SEC has previously allowed ETFs to operate as feeder funds in a "master-feeder" structure. Citing a general lack of interest, the Proposed Rule does not include relief that would allow for the creation of master-feeder ETFs. In addition, the SEC proposed a rescission of its existing master-feeder relief for any ETF not already relying on the relief (as of June 28, 2018).

What's Next?

Comments on the Proposed Rule are due October 1, 2018. In the meantime, check back here for additional analysis of the Proposed Rule.

Explore more in

[Investment Management](#)

Blog series

Asset Management ADVocate

The Asset Management ADVocate provides unique analysis and insight into legal developments affecting asset managers in the United States.

[View the blog](#)