

May 27, 2009

Via email to rule-comments@sec.gov

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: Exchange-Traded Funds; File No. S7-07-08; Release Nos. 33-8901; IC-28193;
Affiliate Restrictions in connection with ETF Creation Activity

Dear Ms. Murphy:

In the past several years, the financial markets have experienced the continued expansion and growth of exchange-traded funds (“ETFs”) as efficient investment vehicles. The attractive structural features of ETFs include: in-kind creation-redemption, promoting tax efficiency; exchange trading, providing an intraday exposure management tool for investors; and, in contrast to non-exchange traded mutual funds, street-side clearing (the same as for other exchange-traded equity securities), which is cost effective for issuers and investors. Ultimately, we believe this growth is evidence of demand by investors for cost effective, efficient investment choices. In all, we are observing the use of the ETF structure as a flexible packaging mechanism selected by registered investment companies in order to continue offering investment choices for investors that are competitive at the product development level with the mutual fund and closed end fund industry.

In the interest of fostering this growth, NYSE Arca, Inc. (the “Exchange”)¹ wishes to take this opportunity to inform the Commission Staff of recent developments relating to the startup and commencement of exchange trading of ETFs. The Exchange is in ongoing communication with ETF market participants, including market makers, issuers and index advisers about ways to provide a liquid and robust marketplace for existing and new ETFs. Through our extensive relationships, we understand from these market participants that it is especially important that the universe of market participants permitted to engage in initial ETF creation activity be as broad as possible, thereby reducing the burden of the Exchange’s Lead Market Maker to provide the initial minimum supply of fund share aggregations (“initial creation units”) required for exchange listing of the ETF.

¹ NYSE Arca, Inc. is a wholly-owned subsidiary of NYSE Euronext.



Ms. Elizabeth M. Murphy
U.S. Securities and Exchange Commission
May 27, 2009
Page 2 of 4

Currently, the Exchange's Lead Market Makers play a major role in providing the initial creation units required to begin trading, and engaging in ongoing creation unit activity in view of market demands. The Exchange's market makers provide the initial creation unit by creating at least the minimum number of shares required for exchange trading to begin (generally, 100,000 shares). Over the past few years, the desire on the part of the market makers to fund the initial creation units and thereafter carry any remaining creation unit share inventory while issuers build retail demand has diminished significantly in view of overall market conditions, increased regulatory risk embedded in Reg SHO, changing cost structures and demands on market makers' use of capital.

The Exchange believes it is critical for issuers to have new means for providing initial creation units in a manner that best serves investors, while maintaining secondary market pricing integrity. In addition, the Exchange expects that the availability of new sources of initial funding would enhance innovation in the development of additional ETF products and competition among ETF issuers as well as reduce the burden on market makers of being the sole holder of initial creation unit share inventory.

We commend the Commission's initiatives in streamlining the startup process for new ETF issues registered under the Investment Company Act of 1940 ("1940 Act"), most importantly in its recent proposal to adopt Rule 6c-11 under the 1940 Act.² As we stated in our initial letter commenting on the Rule 6c-11 Proposal,³ we believe that reducing burdens associated with the 1940 Act application process will bring more products to investors more quickly and at lower cost, and will enhance innovation and competition among ETF issuers.

Consistent with the Commission's initiative to facilitate the startup of new ETFs, we believe there is the need for ETF issuers to be able to avail themselves of both affiliated and unaffiliated market participants willing to take on the commitment to supply the initial creation units in order to subsequently bolster Lead Market Maker interest in a sustainable, vibrant, and liquid secondary market. We understand that several ETF issuers are considering alternatives that would require Commission exemptions in order to allow issuer-affiliated entities to participate in the creation of initial creation units (a process similar to 'self seeding' by open-ended mutual funds) and disclose such syndicated participation, including

² See Release Nos. 33-8901; IC-28193; File No. S7-07-08 (March 11, 2008); 73 FR 14617 (March 18, 2008) ("Rule 6c-11 Proposal").

³ See letter from Mary Yeager, Corporate Secretary, NYSE Arca, Inc., to Florence E. Harmon, Deputy Secretary, SEC, dated May 29, 2008.



Ms. Elizabeth M. Murphy
U.S. Securities and Exchange Commission
May 27, 2009
Page 3 of 4

exemptions regarding the use of possible sales charges, Rule 12b-1 fees or other means to facilitate syndicated offerings of ETFs.

The Commission, in its Rule 6c-11 Proposal regarding the reduction of affiliate restrictions in connection with ETF creations, proposed to permit “first-tier” and “second-tier” affiliates of the ETF to purchase and redeem creation units through in-kind transactions-- activity which, absent an exemption, would be prohibited under Sections 17(a)(1) and (a)(2) of the 1940 Act.⁴ In response to the Commission’s request for comment on whether the proposed relief should be extended to other affiliates, several commenters on the Rule 6c-11 Proposal supported extension of the Commission’s proposed relief for a broader range of affiliates -- and not just to “first-tier” or “second-tier” affiliates -- including broker-dealers affiliated with an ETF’s advisor.⁵ We strongly support extension of the proposed relief to an advisor’s affiliated broker-dealer and believe such extension would provide an additional vital source of initial seed capital for ETFs.

Furthermore, the Exchange believes that potential improper informational advantages are or can be adequately addressed. First, the ETF creation and redemption procedures, including the portfolio baskets and the net asset value of these baskets, are disclosed and publicly available to all investors and are the same for all market participants, whether institutional or retail. Thus, there should be no creation unit informational advantage for an issuer-affiliated entity. Additionally, we believe affiliated entities of an ETF issuer can be reasonably

⁴ See Rule 6c-11 Proposal, pages 41-42. The Commission stated that “section 17(a) prohibits these in-kind purchases and redemptions by persons who are affiliated with the ETF, including those affiliated because they own 5 percent or more, and in some cases more than 25 percent, of the ETF’s outstanding securities (“first-tier affiliates”), and by persons who are affiliated with the first-tier affiliates or who own 5 percent or more, and in some cases more than 25 percent, of the outstanding securities of one or more funds advised by the ETF’s investment adviser (“second-tier affiliates”)”. Rule 6c-11 Proposal, page 41.

⁵ See, e.g., letter dated May 16, 2008 from Ira P. Shapiro, Associate General Counsel, Barclays Global Fund Advisors; letter dated May 19, 2008 from James E. Ross, Senior Managing Director, State Street Global Advisors; letter dated May 29, 2008 from Keith F. Higgins, Chair, Federal Regulation of Securities Committee, Section of Business Law, American Bar Association; letter dated May 30, 2008 from Katten Muchin Rosenman LLP.



Ms. Elizabeth M. Murphy
U.S. Securities and Exchange Commission
May 27, 2009
Page 4 of 4

expected to have firewalls and other mechanisms designed to prevent the misuse of non-public information by affiliated entities.⁶

In connection with developing new avenues of ETF syndication, it will likely be necessary for issuers to explore new ideas regarding sales charges, Rule 12b-1 or other fees. We recognize that the overall low cost structure of ETFs has been instrumental to their market acceptance. However, new funding structures, potentially involving the imposition of sales charges on IPO participants that benefit from the wider breadth of investors involved in the IPO process, may be workable with the funds' low cost structure. As ETF issuers propose new and creative ways to manage a syndicated ETF offering process, we believe it is important for the Division of Investment Management and the Division of Trading and Markets to work with issuers to implement syndication procedures that provide an incentive to market participants to create sufficient supplies of ETF shares, while treating initial and secondary market participants equitably. We believe that an appropriate balance between ETF issuer needs and investor protection can be achieved consistent with the 1940 Act.

We would be pleased to assist the Commission staff in any way to help address this issue. Please contact the undersigned if you have any questions or comment.

Sincerely,

cc: Andrew J. Donohue, Division of Investment Management
Michael W. Mundt, Division of Investment Management
James Brigagliano, Division of Trading and Markets
Daniel Gallagher, Division of Trading and Markets
Elizabeth King, Division of Trading and Markets

⁶ Several commenters referenced in note 5, above, have recommended that any broker-dealer affiliate exclusion not apply to an affiliated specialist or Lead Market Maker because of their potential control over market price and other potential conflicts. The Exchange agrees that any such exclusion should not extend to a specialist or Lead Market Maker affiliated with an ETF adviser.