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By Electronic Submission

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Brent J. Fields, Secretary

U.S. Securities and Exchange Commission

100 F Street, N. E.

Washington, D.C. 20549-1090

RE: File No. S7-15-18 – Comment on Proposed ETF Rule

Legg Mason, Inc. (“Legg Mason”), through its affiliates and subsidiaries, has \$752 billion in aggregate assets under management and sponsors and advises 11 exchange-traded funds (“ETFs”) in the U. S. We appreciate the opportunity to comment on the above-referenced proposal of the U. S. Securities and Exchange Commission (the “Commission”). We applaud and support the efforts that the Commission has taken to create a comprehensive proposal to standardize requirements for the operation of ETFs through proposed Rule 6c-11 under the Investment Company Act of 1940 (“1940 Act”), and we believe that many aspects of the proposed rule will greatly benefit investors. In addition, the proposed rule would provide a streamlined approval process for most ETFs and will allow issuers to come to market in an easier and more cost-efficient manner, thereby promoting innovation and bringing investors greater investment choices. We particularly wish to note that the inclusion of custom baskets in Rule 6c-11 will help level the playing field across ETF providers, but more importantly, allow for better transaction efficiency and cost savings for investors. In addition to custom baskets, the ability for sponsors to define basket sizes without a minimum size could also allow ETF sponsors to further help reduce overall transaction costs for investors.

We would like to provide you our views on certain aspects of proposed Rule 6c-11 that we believe merit further consideration as the Commission looks to finalize its rule proposal. In particular, we recommend:

- Eliminating the requirement to distribute intraday indicative values (“IIVs”) for ETFs subject to the rule,
- Permitting acceptance of creation/redemption orders prior to the publishing of the next day’s basket, and
- Refining the custom basket definition to eliminate “cash-in-lieu” transactions that are part of a regular basket for ETF creation/redemption.

Intraday Indicative Value

As proposed, Rule 6c-11 would not require the dissemination of an IIV as a requirement for relief under the 1940 Act. The proposing release (Release No. 33-10515) also asks how the IIV is currently used and about the accuracy of the available IIVs, as currently constituted. The proposing release asks for comment as to whether dissemination of the IIV should be a condition for relief under Rule 6c-11 as it may be adopted.

We agree with the Commission that publishing IIVs should no longer be a condition to the relief. We believe that daily portfolio holdings represent a much more significant and useful piece of information for market participants than the IIV. Market participants use the widely available portfolio holdings information in estimating the value of the portfolio for arbitrage purposes. Institutional market participants have, in our view, implemented sophisticated models that facilitate ETF hedging and that serve to narrow bid-asked spreads based in the information about the actual holdings of transparent ETFs, both index-based and active. Based on our experience, we believe that market makers and other market participants have ample information to engage in trading and arbitrage activities without reference to the IIV for the ETFs covered by the rule.

Further, we agree with the Commission that IIVs have significant limitations in the context of international securities, given the nature of international markets and the timing of availability of information. Similarly, the underlying information for IIVs based on the pricing of the fixed income instruments is not typically intraday. Fixed income securities are predominately traded by dealers and not on exchanges. As a consequence of this market structure, the IIV for many ETFs that invest in fixed income securities have less precision than for exchange-traded equities. This pricing limitation is true even if the portfolio is highly liquid. We do not believe that increasing the frequency of the IIV publication would change these market structure limitations of the underlying information for the IIV.

Nevertheless, we also believe that, as new and innovative products come to the market that cannot rely on the generic Rule 6c-11 (such as semi- or non-transparent ETFs), IIVs may be an appropriate tool to assist with arbitrage and market acceptance.

Order Acceptance

We do not believe that a requirement to publish basket information and portfolio holdings information before the acceptance of orders is either practical or advantageous for shareholders. The purpose of having an early acceptance time for creation and redemption orders is to prevent existing shareholders from dilution with respect to funds with non-U.S. holdings, while continuing to permit in-kind transactions that are beneficial to all shareholders by reducing transaction costs and providing the potential tax benefits inherent in an ETF structure.

Among the operational issues associated with publishing the basket and portfolio holdings prior to order acceptance for funds with significant holdings of non-U.S. securities is the need to execute transactions in foreign markets that do not permit or facilitate in-kind transactions for certain securities. Many foreign markets trade earlier in the day than markets in the United States because of time zone differences. For a number of operational and risk-control reasons, authorized participants prefer to place trades in ETFs at the same time that they are buying the underlying securities, which is the day before trade date because of the time zone differences. Thus, permitting order acceptances on T -1 facilitates better authorized participant transactions and can serve to reduce bid-asked spreads and premiums and discounts in ETF shares.

There are other operational reasons that impact the practicality of providing basket information for non-U.S. securities prior to order acceptance. It is not currently feasible for ETFs to provide basket and portfolio holding information much earlier than 8:00 p.m. ET, while the optimal time for acceptance of those orders is typically earlier, such as on the close of trading in New York. Accordingly, we recommend that the Commission permit earlier order acceptances in its adoption of a final rule.

Custom Baskets

We support the rule proposal's policy of permitting flexibility in custom basket transactions. Custom baskets allow ETFs to operate in a more efficient manner for both portfolio managers and investors. Nevertheless, we would recommend that the Commission reconsider its proposed definition of "custom basket." As currently written in the proposed rule, custom baskets include "baskets that are composed of a non-representative selection of the exchange-traded fund's portfolio holdings." This definition would include items that the ETF industry would not normally recognize as "custom," specifically, the regular practice of having a specified cash amount as part of a non-custom basket ("cash-in-lieu" transactions). There are many practical realities that limit the ability to include a security in a basket (and require substituting a cash amount in the basket), including limitations on in-kind transactions in certain foreign markets, odd-lots, minimum

trading sizes or other regulatory restrictions. We see no regulatory purpose for discouraging cash as part of a regular published basket, and we would recommend that the final wording of Rule 6c-11 be refined to reflect this portion of the custom basket definition. We believe that the current practice of permitting cash-in-lieu transactions as part of a regular basket has served the ETF marketplace well and should be continued.

With respect to the publication of custom baskets, we agree with the Commission that a requirement to publish each custom basket would result in unnecessary operational complexity and costs and should not be required as part of the final rule.

Conclusion

Thank you for the opportunity to submit this comment letter and for your consideration of these comments. Please direct any questions about these comments that you may have to the undersigned.

Sincerely,

Legg Mason, Inc.

By: 

Robert I. Frenkel

Vice President and Deputy General Counsel