October 1, 2018

Via email to rule-comments@sec.gov

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Release Nos. 33-10515 and IC-33140 (File No. S7-15-18): Exchange-Traded Funds; Proposed Rule

Dear Mr. Fields:

We appreciate the opportunity to submit this letter in response to the request for comments contained in the above-captioned U.S. Securities and Exchange Commission's (the "Commission") proposed rule release (the "Proposing Release") regarding proposed Rule 6c-11 (the "Proposed Rule") under the Investment Company Act of 1940, as amended (the "1940 Act"). The Proposed Rule would permit certain exchange-traded funds ("ETFs") to operate without an exemptive order, subject to the conditions contained therein.

Thompson Hine LLP counsels a variety of financial firms on entering the ETF business, and represents existing ETFs, their advisers and their boards on an ongoing basis. These comments represent our views and not necessarily the views of our clients.

We applaud the Commission and its Division of Investment Management for proposing a rule that is long overdue and that strikes the appropriate balance between sensible regulation of ETFs without burdening one of history's most successful financial products with unnecessary restrictions. Our comments concern the following aspects of the Proposing Release: (i) the Proposed Rule's treatment of index-based and actively-managed ETFs; (ii) the exemptive relief provided under the Proposed Rule from other sections of the 1940 Act; (iii) the proposed amendments to Form N-1A; (iv) the Proposing Release's request for comments on the need for relief or guidance with respect to relevant sections of the Securities Exchange Act of 1934, as amended (the "1934 Act"), and rules thereunder; and (v) conditions for reliance on the Proposed Rule. These are discussed below.

The Proposed Rule's Treatment of Index-Based ETFs and Actively-Managed ETFs

The Proposed Rule does not distinguish between index-based and actively-managed ETFs. Section II.A.2. of the Proposing Release requests comment on whether the Proposed Rule should

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apply additional conditions to index-based ETFs, such as a requirement for such an ETF to invest at least 80% of the ETF's assets in its benchmark index (an "Index-Based 80% Test"). We support the Proposed Rule's current approach of not distinguishing between index-based and actively-managed ETFs, and would not support an Index-Based 80% Test, for the reasons discussed below.

As noted in the Proposing Release, exemptive applications for certain index-based ETFs contain representations to the effect that each such ETF will invest at least 80% of its assets in securities of its respective underlying index. Index-based ETFs are also subject to Rule 35d-1 under the 1940 Act, which requires that ETFs must invest at least 80% of their net assets (plus any borrowings for investment purposes) in securities suggested by their name. If index-based ETFs are also required to invest at least 80% of their net assets in securities of their benchmark index, would limit flexibility with respect to how the fund is managed, unless the index is entirely comprised of securities suggested by the ETF's name (assuming the index is based on an asset class and not a style of investing).[1] If the index was not entirely comprised of securities suggested by the ETF's name, having both requirements would result in situations where the ETF may need to introduce tracking error by investing in securities that are suggested by their name but not included in the index in order to maintain compliance with the Rule 35d-1 requirement.

Exemptive Relief Under Proposed Rule 6c-11 from Other Sections of the 1940 Act

Affiliated Transactions

The Proposed Rule would provide exemptions from sections 17(a)(1) and (a)(2) of the 1940 Act with regard to the deposit and receipt of baskets to 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.

We support this provision because transactions between ETFs and authorized participants ("APs") technically affiliated with such ETFs are not the types of potentially harmful transactions that Section 17(a) is designed to prevent or be subject to conditional exemptive relief. Furthermore, it cannot be overstated how important APs are to ETFs, especially with respect to the arbitrage process. While many ETFs have relationships with a dozen or more APs, other ETFs, especially new entrants into the industry, may have relationships with three or fewer

[1] *See* Frequently Asked Questions about Rule 35d-1 (Investment Company Names), Responses to Questions 8-9 (stating that Rule 35d-1 applies to names that suggest a type of investment, rather than an investment objective or strategy) *available at* https://www.sec.gov/divisions/investment/guidance/rule35d-1faq.htm.

APs. Eliminating certain APs from serving in this vital capacity because of technical affiliations would not serve any purpose, especially since APs play the most important role in facilitating the narrowing of an ETF's shares price to its net asset value per share.

For these reasons, we recommend that the Commission expand the scope of the Section 17(a)(1) and (2) exemption to include first- and second-tier APs of an ETF by reason of holding with the power to vote 25% or more of the ETF's shares or an affiliated fund's shares. In addition, for the same reasons, we recommend that the Commission expand the affiliation relief to make it available to other types of affiliated APs, including broker-dealers that are (a) affiliates of an ETF's adviser, or (b) affiliates of affiliates of the ETF because of companies under the common control of the AP.

Amendments to Form N-1A

Information on Bid/Ask Spread Costs

The Proposing Release includes amendments to Item 3 of Form N-1A regarding trading costs. One of the new questions and answers ("Q&As") added to Form N-1A would require an ETF to calculate and disclose its median bid-ask spread, using trading data from each trading day of the ETF's prior fiscal year, over the most recently completed fiscal year.

As the Commission notes in the Proposing Release,[2] due to the timing of annual update requirements, the median bid-ask spread information disclosed would be four months old at the time the new prospectus is available. This would therefore impair comparability of this information across ETF complexes, as the fiscal year ends of ETFs vary.

To enable comparability across ETFs and ensure the completeness of information, we would suggest that the Commission make this requirement (if it is included in the final rule) optional if an ETF includes median bid/ask spread information for the previous four quarters, which is current up to the most recent calendar quarter. This would be similar to the approach taken for premium/discount information today and would enable ETF providers to provide current and comparable information for investors.[3]

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2 Proposing Release at note 375 and accompanying text.

3 Form N-1A, Item 11(g), which requires registrants to "[p]rovide a table showing the number of days the Market Price [as defined in the form] of the [ETF] shares was greater than the [ETF]'s net asset value and the number of days it was less than the [ETF]'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." That item specifies that the ETF may omit such table if it "provides an Internet address at the [ETF]'s Web site, which is publicly accessible, free of charge, that investors can use to obtain the premium/discount information required."

Purchase, Redemption and Pricing of Shares

Item 23 of Part B of Form N-1A requires ETFs to describe how the Fund's shares are offered to the public to the extent that the prospectus does not do so.[4]

Currently, the industry generally has interpreted Item 23 to require disclosure of the intricacies of the creation/redemption process and related matters including disclosure about the following: (i) detailed procedures for creation and redemption of creation units, fund deposits, cash purchase methods, the role of APs, DTC and NSCC; (ii) timing of submission of orders, issuance of creation units; and (iii) cash redemption methods. This typically results in a dozen of more pages of disclosure in the SAI that is virtually of no interest or use to a retail investor and is already available to APs, market makers, distributors, administrators, transfer agents and custodians in other documents that are more up-to-date.

We therefore recommend that the Commission consider adding an instruction to Item 23 of Form N-1A specifying what disclosure is required with respect to the purchase and redemption of Creation Units and limiting such disclosure by, for example, requiring a website URL for more information about this process. By doing so, the Commission would help advance the goal of reducing disclosure creep in the SAI, avoiding jargon that is counter to the Plain English requirements of SEC disclosure documents and reducing unnecessary exposure to Section 11 liability for directors and officers who sign an ETF's registration statement.

Request for Guidance or Exemptive Relief from Certain 1934 Act Sections and Rules Thereunder

Section II.B.1. of the Proposing Release requests comment on whether the Commission should provide ETFs with relief from certain provisions and rules under the 1934 Act in the final rule. In this connection, we note that ETFs have typically relied on the no-action relief granted by the Commission staff (the "Staff") to the Select Sector SPDR Trust[5] from reporting requirements under Section 16(a) of the 1934 Act that would arguably be applicable to ETFs as they register their shares under Section 12 of the 1934 Act. As discussed further below, as the SPDR Letter contains a condition that creates uncertainty as whether the relief would continue to be available

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4 Item 6(c) of Form N-1A, in relevant part, requires an ETF to "[s]pecify the number of shares that the Fund will issue (or redeem) in exchange for the deposit or delivery of basket assets (i.e., the securities or other assets the Fund specifies each day in name and number as the securities or assets in exchange for which it will issue or in return for which it will redeem Fund shares) and explain" the significant aspects of the ETF's status as a listed security of a fund that calculates NAV (individual shares may only be purchased on an exchange at the market price, which may be higher or lower than NAV).

5 *Select Sector SPDR Trust*, SEC No-Action Letter (pub. avail. May 6, 1999) (the "SPDR Letter")

to ETFs that trade at significant premiums or discounts to NAV, we request that the Commission provide interpretative guidance to elaborate on this condition or use its rulemaking authority to specifically exempt ETFs from the scope of Section 16(a) reporting requirements without such a condition.

The SPDR Letter provided relief from the requirements of Section 16(a) of the 1934 Act to directors, officers and 10% holders of an ETF's shares that would otherwise be subject to the reporting requirements of that section ("Section 16 Insiders"). Section 16 Insiders of closed-end funds are subject to Section 16 by virtue of Section 30(h) of the 1940 Act, which by its terms does not apply to open-end funds. The Staff's response posited that this distinction may be based on the fact that open-end funds issue and redeem shares at NAV, which would eliminate informational advantages of insiders of the open-end funds. As noted by the Staff's response, unlike closed-end funds, the arbitrage mechanism that is inherent to the operation of ETFs would ordinarily be expected to result in a close correlation to NAV. This provided a basis to conclude "there is no risk that an insider could engage in the type of abuse that Section 16 is designed to prevent," since the market price would ordinarily be expected to equal the NAV. Presumably because the relief in the SPDR Letter was based on the anticipated correlation of market price and NAV, the Staff cautioned that the relief in that letter would no longer be available if shares "begin to trade at prices that materially deviate from NAV."

Because the Proposed Rule would require daily transparency of an ETF's holdings, arguably this also serves to eliminate the potential informational advantages of Section 16 Insiders of ETFs. It is worth emphasizing that the SPDR Letter was issued prior to the advent of actively-managed and self-indexed ETFs, whose exemptive orders have historically required full portfolio transparency as opposed to publication of an ETF's baskets.[6] As a result, even in situations of significant premiums or discounts, it seems unlikely that a Section 16 Insider would possess an informational advantage that would suggest a need for the reporting requirements of Section 16(a) of the 1934 Act.

Accordingly, we recommend that that the Commission use its rulemaking authority to specifically exempt ETFs from the scope of Section 16(a) reporting requirements without such a condition or, in the alternative, provide interpretative guidance to elaborate on the condition.

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[6] See Proposing Release, Section II.C.4, at n. 207.

Conditions for Reliance on Proposed Rule 6c-11

Definition of Exchange-Traded Fund

Under the Proposed Rule, an ETF that is delisted from a national securities exchange would not meet the definition of "exchange-traded fund," and would no longer be eligible to rely on the Proposed Rule. The Commission noted in the Proposing Release that such an ETF would be required to meet individual redemption requests within seven days pursuant to section 22(e) of the 1940 Act or liquidate.

We are concerned that a delisting of an ETF that triggers the automatic "conversion" of it into a mutual fund required to redeem shareholders within seven days of a redemption request would have unintended consequences with no regulatory purpose, while interfering with customary liquidation process designed to treat all remaining shareholders equally and fairly. Depending on the type of an ETF and its holdings, liquidation and distribution of cash and any other assets may take from 30 to 90 days. Clouding this process by deeming the former ETF to no longer have that status may lead to confusion and a possible race to redeeming shares by remaining shareholders while liquid assets are still available. Removing the exemptions provided by the Proposed Rule for in-kind redemptions to APs that hold more than 5% of an ETF's shares and the relief from Section 22(e) with respect to foreign markets with longer settlement times simply because the ETF has been delisted would serve to make a liquidation situation even more problematic for foreign ETFs with a relatively concentrated shareholder base.

We therefore recommend that the definition of "exchange-traded fund" be modified to address this situation by perhaps including ETFs that have been listed on a national securities exchange within the past 90 days or issuing no-action relief or interpretative guidance on this issue outside of the Proposed Rule.

Relief for Reorganizations, Mergers, Conversions or Liquidations

Paragraph (c)(5) of the Proposed Rule would permit an ETF to sell (or redeem) individual shares in the context of a reorganization, merger, conversion or liquidation. We support this provision of the Proposed Rule but have two technical drafting suggestions noted below.

The Proposed Rule is silent on the buyer or seller of the ETF's individual shares on the day of consummation of a reorganization, merger, conversion or liquidation. As discussed in Section II.C.1. of the Proposing Release, merging ETFs would need to transfer shares to shareholders that are not APs. This provision of the Proposed Rule should be revised to explicitly clarify, consistent with the discussion in the Proposing Release, that an ETF can issue

or redeem shares to non-APs in the context of a reorganization, merger, conversion or liquidation.

Finally, this paragraph seems more appropriate in paragraph (b) of the Proposed Rule or as a modification of the definition of "exchange-traded fund," as it is not a condition for reliance on the Proposed Rule.

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If the Commission or its staff have any questions or wish to discuss the comments discussed herein, please contact Bibb L. Strench at [redacted] or [redacted] or Christopher D. Carlson at [redacted] or [redacted].

Very truly yours,

Thompson Hine LLP

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