ETF BILD PROJECT

Business Insights | Leadership Discussion

October 1, 2018

Via E-mail [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:

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

ETF BILD

The ETF BILD (Business Insights & Leadership Discussion) is a forum located at www.etfbild.com with a mission to be the catalyst for discussions on the most pressing issues faced by the business leaders of the exchange traded fund (ETF) industry. The ETF BILD Project is at the intersection of academic research and actionable business leadership. The ETF BILD Project is focused on the business insights, leadership, and discussion of the ETF industry.

PROPOSED RULE 6c-11

ETF BILD commends the Commission, particularly its Division of Investment Management, for proposing a rule that is long overdue and strikes the appropriate balance between sensible regulation of ETFs without burdening one of history's most successful financial products with unnecessary restrictions. On a basic level, Rule 6c-11 eliminates the need for new entrants in the ETF industry from wasting both their resources to file for exemptive orders and those of the Commission to process such orders. While Rule 6c-11 is largely based on conditions in prior exemptive orders and conditions in Rule 6c-11 as proposed in 2008, the Commission successfully pared back those conditions that are no longer necessary.

We caution the Commission, as we do in certain of our comments, to be sensitive to places in Rule 6c-11 and the Proposing Release that blur the lines between the different industry participants: the adviser/sponsor to the ETF, the Indexer, the stock exchanges that trade ETFs (the "Exchanges") and the APs/market participants. Each such participant are impacted differently by Rule 6c-11 and each are in a unique position to advance many of the goals of the Rule. In addition, we emphasize that while the Commission should be commended for designing a rule and eliciting comments through questions that focus on the individual investor, it should realize that ETFs are used by a variety of types of investors: long-term investors, short-term investors, arbitrage traders, day traders, mutual funds and ETFs and institutional investors. Our comments reflect that out of this group, protecting the long-term ETF investor is of upmost importance.

Arbitrage Mechanism

We applaud the Commission for maintaining the arbitrage mechanism as the cornerstone of ETF regulation and exercising regulatory restraint by not adding superfluous conditions to a process that has consistently resulted in an ETF's market price being close to its net asset value per share ("NAV") since the first ETF launched in 1992. With respect to certain concerns the Commission raised in the Proposing Release about the ETF arbitration process during times of stress, we believe that these concerns should be seen in the context of larger market structure issues. ETFs operate under the rules of corporate equity securities where there is no disclosure during times of stress of whether or not a stock is trading at fair value. As seen in previous market stress conditions, the markets revert back to norm in a manner of seconds or minutes. Proper disclosure on websites of ETF issuers would be difficult to execute and more difficult to be used as an informational portal for investors to obtain that information in real time. We suggest to further protect investors. Exchange rules that govern the halting of stocks be reviewed to include more specific process for ETFs.

In the context of the arbitrage mechanism, the Commission in the Proposing Release asked a number of questions about premiums and discounts of an ETF's share price to its NAV. The Commission asked when would a premium or discount develop due to a breakdown in the arbitrage mechanism. Breakdowns in the arbitrage mechanism would most often be due to price discovery issues of the underlying securities or inability to transact in the underlying securities. Some ETFs track non-equity assets like commodities and potentially cryptocurrencies. The inability to obtain proper pricing or execute transactions in those markets could cause a breakdown in the arbitrage function.

The Commission also asked whether there are instances where a premium or discount may develop or persist because of transaction costs relating to the ETF's basket securities. We can foresee circumstance from costs in trading and clearing of international securities and non-equity assets as a potential scenario where transaction costs would be prohibitive. These situations are mostly addressed in the product design of the ETF and approved by the ETF's Board of Directors (the "ETF Board") prior to launching the ETF. However, market conditions in other markets occur and could cause pricing issues effecting the arbitrage function.

The Commission followed up with the question regarding how these circumstances can be distinguished from one another. These issues are a function market structure and occur in other contexts. We can look at the example of the closed-end fund structure where premium and discounts persist typically on a daily basis. They are disclosed at the end of day to investors and a prolonged situation over multiple days would be sufficient for long term ETF investors to recognize and react to an ongoing situation in an ETF. Those that occur and correct themselves rarely effect long-term investors. Transactions that occur outside the normal market price can be broken under Exchange rules and those rules need to be reviewed to see how the effects of premium and discounts in ETFs are handled.

The Commission asked whether the arbitrage mechanism contemplated by Rule 6c-11 keeps ETFs' market prices at or close to NAV under normal market conditions. We would again refer to the rules and practices of closed-end fund issuers for the calculations and dissemination of premium and discounts. We agree that end-of-day dissemination would work for ETFs in the context of long-term investors. If short-term traders/investors need more real time information a market solution to provide that data rather than a regulatory solution should be the answer.

With respect to information regarding intraday changes in portfolio holdings, the Commission asked whether the dissemination of such information should play a larger role when assessing premiums and discounts. Such information may not be necessary for long-term investors; however, since the trading community maybe in need of such information for a more efficient arbitrage function to exist we once again suggest a market solution.

The Commission asked whether it is of value to assess the efficiency of the arbitrage mechanism by comparing the mean/median of the market prices on a given trading day against the end of day NAV or whether it is preferable to compare the mean/median of the market price on a given trading day against an intraday measure of the value of an ETF's portfolio. This may be too difficult to educate investors on the relevance and calculation of this data. The disclosure of the premium/discount at end of day would eliminate the need to this. We also feel these issues are already being addressed at the ETF Board level. Quarterly review of premium and discounts commonly occurs at the ETF Board level when Boards are monitoring how well the arbitrage process is functioning for a given ETF. Taking the extra step to disclosure premium/discounts on a daily basis would add to investor transparency of this issues and allow ETF Boards to react more quickly if a market dislocation becomes an ongoing problematic situation.

Creation Units

The Commission in the Proposing Release asks whether it should establish requirements for creation unit sizes and/or dollar amounts. Creation unit sizes commonly are 100,000 shares, 50,000 shares and 25,000 shares, with a recent trend towards 25,000 shares. Creation unit size is usually a function of the cost of the basket and discussed with the lead market maker and APs prior to launching the ETF. For example, some small ETF issuers and their lead market makers prefer a smaller creation unit size because it facilitates a greater number of creation transactions and asset growth. It has been at the purview of the ETF issuer and should remain there on a case by case process. Thus, we believe this deserves a market solution rather than a regulatory solution. We therefore believe that the Commission should not regulate creation unit sizes. We further note that the recent trend towards smaller creation unit sizes has not adversely effected the ETF arbitrage mechanism.

Suspending Creations and Redemptions

The Commission asked for input regarding whether an ETF may suspend creations only in limited circumstances. In our view, there may be a variety of reasons to suspend creations and limiting them or impose restrictions to certain activity will not allow for differentiation of the circumstances related to the underlying securities. The liquidity levels of various underlying securities or the suspension of trading in certain securities are the main reason for a majority of creation suspensions. We believe current practices developed in the ETF industry allow for the flexibility needed to address this issue.

Website Disclosure

Proposed Rule 6c-11 requires an ETF to disclose prominently on its website the portfolio holdings that will form the basis for each calculation of NAV per share. Website disclosure of portfolio holdings has proven to be an effective way to convey an ETF's portfolio holdings. Accordingly, we agree with this condition and believe current standards and practices are sufficient in this area. However, they could be improved upon.

We urge the Commission to study and ask for industry input on generally how ETF industry information is generated and disseminated. Currently, over 100 advisers to ETFs post on their website ETF basket information. While Form N-1A imposes certain requirements on how such disclosure is made, ETFs vary on how such information is presented, which sometimes making it difficult for website visitors to find such information. Since ETF issuers already are required to send basket information in the form of portfolio composition files (PCFs) via the National Securities Clearing Corporation ("NSCC") and are published daily through the facilities of the NSCC, it makes more sense for there to be a single industry source where collecting, housing and disseminating such information occurs. Furthermore, small- and medium-sized ETF complexes would achieve costs savings by not having to maintain websites posting such information. We therefore recommend that the Rule 6c-11 website basket disclosure requirement remain in place but that the Commission collaborate with the ETF and the Fintech industries to develop and implement an industry website that contains daily basket information. This solution may take time to evolve. For example, the industry may be able to take advantage of distributed ledger (or blockchain) technology to provide basket and holdings information to APs. This technology also could be used to verify creation and redemption transactions with APs.

Brokerage Commission Costs

Proposed Rule 6c-11 requires new prospectus disclosure that includes, among other disclosure items, a narrative explanation that investors may be subject to brokerage and other fees when buying or selling ETF shares and a new Q&A section designed to provide information about bid-ask spreads and other trading costs. The Q&A also must provide links to the ETF's website, which must feature an interactive calculator for hypothetical cost-related information.

For a variety of reasons, we believe that this requirement will proved to be onerous to ETF advisers and recommend that the Commission eliminate these disclosure requirements from Rule 6c-11. The type and scope of the disclosure required by the Commission has not been required during the existence of the ETF industry and we are unaware of significant industry problems necessitating such disclosure. Instead, ETF investors have made ETFs one of the most successful products in financial history and reaped billions of dollars of savings in the form of lower fees as compared to other financial products. We also believe that the Commission places too much emphasis in the Proposing Release on comparisons between ETFs and mutual funds. While we recognize that ETF investors may be subject to different costs than mutual fund investors, investors have a variety of investment product choices in addition to these products including separately managed accounts, hedge funds, individual securities and others each with their unique cost structures.

Indexed ETFs

In the Proposing Release, the Commission asked whether Rule 6c-11 should include requirements relating to index-based ETFs with an affiliated index provider. We suggest the Commission should be concerned that these rules do not create a situation where a "regulatory advantage" for affiliated index providers or traditional index providers exists. The index provider, affiliated or non-affiliated, play a significant role in function of a public security and investors need a transparent and consistent process for all indexing operations. Our concern in any rules related to the indexer is to make allowances for the protection of their Intellectual property and the both affiliated and non-affiliated indexers are protected in the same manner.

Conclusion

For the reasons discussed above, we support the SEC's proposed ETF Rule. If the SEC or its staff have any questions or wish to discuss the comments discussed herein, please contact us at [redacted].

Very truly yours,

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