WisdomTree Asset Management, Inc.1 (“WisdomTree”) submits this letter in response to a request for comment by the Securities and Exchange Commission (the “Commission”) in proposing Rule 12d1-4 (the “Proposed Rule” or “12d1-4”) under the Investment Company Act of 1940 (the “Act”), governing the operation of fund of funds arrangements.2 WisdomTree acknowledges the thoughtfulness and care taken by the Commission in preparing the Proposed Rule and commends the Commission’s efforts to enhance and streamline the regulatory framework associated with fund of funds arrangements. WisdomTree also acknowledges that the comment period for the Proposed Rule has closed. However, based on review of the comments that have been filed and WisdomTree’s deep commitment to making ETFs more easily accessible and providing an overall better investing experience, WisdomTree feels compelled to provide comment to the Commission focused on Section 12(d)(1) and its applicability to ETFs.

In sum, WisdomTree believes the concerns that originally led Congress to adopt the limitations in Section 12(d)(1) largely do not apply to ETFs as one or more underlying funds in a fund of funds structure (“Underlying ETFs”). Accordingly, WisdomTree urges the Commission to (i) revise the Proposed Rule to formally exempt the sale of ETFs as Underlying ETFs from the limitations in Section 12(d)(1)(B) and (ii) expand the Proposed Rule to also permit private funds (“Private Funds”) and foreign funds (“Foreign Funds” and, together with Private Funds, “Other

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1 WisdomTree, a registered investment adviser, has been managing exchange traded funds (“ETFs”) since 2006 and is the 8th largest sponsor of ETFs in the United States with assets under management of approximately $40 billion as of November 30, 2019. WisdomTree focuses on creating ETFs for investors that offer thoughtful innovation, smart engineering and redefined investing, launching many first-to-market ETFs in the United States. Together with its affiliates, WisdomTree is the only publicly traded asset management company focused exclusively on ETFs and other exchange traded products (“ETPs”), and is one of the leading sponsors of ETPs globally with total assets under management of approximately $62 billion as of November 30, 2019.

Investment Companies”),3 to invest in Underlying ETFs beyond the limits of Section 12(d)(1)(A) and, along with registered investment companies, beyond the limits in the Proposed Rule. For the reasons discussed herein, and particularly in the context of registered investment companies and Other Investment Companies investing in Underlying ETFs, WisdomTree believes that such changes can be implemented by the Commission in a manner that is consistent with the purpose of Section 12(d)(1), while also providing additional liquidity and enhancing the arbitrage function in the ETF ecosystem to the benefit of all ETF shareholders.

**Concerns Underlying the Limits in Sections 12(d)(1)(A), (B) and (C)**

Congress intended that the restrictions in Section 12(d)(1) of the Act address certain abuses perceived to be associated with the pyramiding of investment companies, which were catalogued in the Commission’s study of funds that preceded the Act.4 That original version of Section 12(d)(1) did not, however, prevent certain abuses in all fund of funds arrangements, at least in part, because Section 12(d)(1) did not apply to the purchase by Other Investment Companies of securities of registered investment companies. Those abuses included: (i) unnecessary duplication of costs (such as sales loads, advisory fees and administrative costs); (ii) diversification without any clear benefit; (iii) undue influence by a fund holding company over its underlying investment companies; (iv) the threat of large scale redemptions of the securities of the underlying investment companies; and (v) unnecessary complexity. The SEC identified these abuses in its 1966 report to Congress, titled Public Policy Implications of Investment Company Growth (the “PPI Report”).

In response to the PPI Report, Congress amended Section 12(d)(1) to apply Section 12(d)(1) to Other Investment Companies, and created the limitations we have today. Section 12(d)(1)(A) of the Act prohibits a registered investment company and Other Investment Companies from acquiring securities of any other investment company or registered investment company, respectively, if such securities represent more than 3% of the total outstanding voting stock of the acquired company. It also prohibits a registered investment company and Foreign Funds from acquiring securities of another investment company or registered investment company, respectively, that are more than 5% of the total assets of the acquiring company, or, together with the securities of any other investment companies, more than 10% of the total assets of the acquiring company.

Section 12(d)(1)(B) of the Act prohibits a registered open-end investment company, its principal underwriter and any other broker-dealer, from knowingly selling the acquired investment company’s shares to a registered investment company or Other Investment Company, if the sale will cause the acquiring investment company to immediately own more than 3% of the acquired investment company’s voting stock. It also prohibits a registered open-end investment

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3 Generally, investment companies exempt from the definition of investment company pursuant to Sections 3(c)(1) or 3(c)(7) of the Act, or foreign or otherwise unregistered investment company.

company, its principal underwriter and any other broker-dealer, from knowingly selling the acquired investment company’s shares if the sale will immediately cause more than 10% of the acquired investment company’s voting stock to be owned by registered investment companies and/or Foreign Funds generally.

Section 12(d)(1)(C) of the Act prohibits any acquiring investment company, and any company or companies controlled by the acquiring investment company, from acquiring securities issued by a registered closed-end investment company if the acquiring company, other investment companies having the same investment adviser as the acquiring company, and companies controlled by such investment companies, own more than 10% of the total assets of the outstanding voting stock of the acquired closed-end investment company.

These limits, placed on investment companies investing in other investment companies, reflected a Congressional attempt to limit certain potential abuses, such as duplication of costs and illusory diversification benefits, that an investing registered investment company and its shareholders should be protected from. They also sought to limit certain potential abuses that an acquired investment company and its shareholders should be protected from, such as undue influence and the threat of large-scale redemptions by an acquiring investment company, including by acquiring Other Investment Companies. The Commission in the PPI Report leading up to the Section 12(d)(1) amendments in 1970 and in seeking Congressional action, stated that fund of funds “serve little or no economic purpose.” However, in 1996, with the passing of the National Securities Markets Improvement Act of 1996 (“NSMIA”), Congress altered its view and recognized that, while the restrictions Congress had placed on investment companies had prevented many potential abuses, those limitations had also overly restricted potential investments in registered investment companies that could be beneficial to fund shareholders. To that end, NSMIA amended Section 12(d)(1)(G) to specifically permit affiliated fund of funds.

Perhaps more importantly, NSMIA added Section 12(d)(1)(J) to the Act. Section 12(d)(1)(J) of the Act provides that the Commission may exempt any person, security, or transaction, or any class or classes of persons, securities or transactions, from any provision of Section 12(d)(1) if the exemption is consistent with the public interest and the protection of investors. Congress urged the SEC to use its exemptive authority under Section 12(d)(1)(J) “in a progressive way as the fund of funds concept continues to evolve over time.”5 The legislative history of NSMIA directs the Commission to consider, among other things, when granting relief under Section 12(d)(1)(J), “the extent to which a proposed arrangement is subject to conditions that are designed to address conflicts of interest and overreaching by a participant in the arrangement, so that the abuses that gave rise to the initial adoption of the Act’s restrictions against investment companies investing in other investment companies are not repeated.”6 Not only have the views of Congress evolved with respect to fund of funds arrangements, but so have the views of the Commission whereby through Commission rules, no-action letters and

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5 Proposal at page 11.
exemptive orders, fund of funds arrangements have continued to expand and proliferate to the benefit of investors.

Congress did not contemplate, nor was Section 12(d)(1) designed to address, the unique hybrid nature of ETFs; ETFs did not exist in 1940 or 1970, and the ETF industry was in its infancy in 1996 with fewer than 20 ETFs available for investment. The Commission has acknowledged the unique nature of ETFs, not only in the myriad of Section 12(d)(1)-related exemptive orders issued to ETFs, but in the treatment of ETFs in the Commission’s recently adopted Rule 22e-4, Rule 6c-11 and the Proposed Rule. The core historical concerns associated with Section 12(d)(1) revolved around potential abuses of power by acquiring investment companies toward acquired investment companies. However, such concerns do not manifest themselves when an investment is made in a passive manner, such as “to gain exposure to a particular market or asset class in an efficient manner,” “to allocate and diversify their investments,”7 or “as a way to efficiently hedge a portion of their portfolio or balance sheet,” which is epitomized by investors investing in ETFs, through the structure of ETFs and via the benefits derived through ETF investing.8

Accordingly, WisdomTree believes that the Commission should specifically address the unique nature of ETFs, act in a progressive way as Congress urged, and revise the Proposed Rule to relax or remove certain Section 12(d)(1) limitations, which were primarily designed for other fund structures. Such limitations unnecessarily inhibit ETFs that may serve as Underlying ETFs from experiencing even greater liquidity for the benefit of all investors via lower bid ask-spreads and an enhanced arbitrage function, as further discussed below.

**Exemption From Section 12(d)(1)(B)**

First and foremost, WisdomTree urges the Commission to exempt ETFs, their distributors and broker-dealers from Section 12(d)(1)(B). Section 12(d)(1)(B), which limits the sale of shares of registered open-end funds to other investment companies, is often viewed as the counterpart to Section 12(d)(1)(A), which limits investment companies purchasing shares of registered investment companies. The legislative history, however, makes it clear that this is only half the story. Section 12(d)(1)(B) was intended to deal with open-end mutual funds, while Section 12(d)(1)(C) provided a separate restriction on closed-end funds. Section 12(d)(1)(C)

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7 Proposal at page 7.
8 Exchange-Traded Funds, Investment Company Act Release No. 33646 (September 25, 2019) (“ETF Rule Release”) at pages 10-11, wherein the Commission also stated that “ETFs have become an increasingly popular investment vehicle over the last 27 years, providing investors with a diverse set of investment options. They also have become a popular trading tool, making up a significant portion of secondary market equities trading.” Further, “[b]ecause certain costs are either absent in the ETF structure or are otherwise partially externalized, many ETFs have lower operating expenses than mutual funds. ETFs also may offer certain tax efficiencies compared to other pooled investment vehicles because redemptions from ETFs are often made in kind…” and “…ETFs that transact on an in-kind basis can execute changes in the ETF’s portfolio without incurring brokerage costs, leading to transaction cost savings…” and “…thereby avoiding the need for the ETF to sell assets and potentially realize capital gains that are distributed to its shareholders.”
does not, however, place that restriction on the acquired fund, but rather on the acquiring fund. Congress noted that:

The stock of closed end companies is usually bought and sold in the secondary trading markets rather than through the issuance of new shares, as in the case of open-end companies. Because of this fact, it would be much more difficult for a buyer or a seller to know how much of a closed end company’s stock was owned by investment companies generally (emphasis added). Therefore, in this case, it is appropriate to apply the 10-percent test only to the holdings of the acquiring company, other investment companies with the same investment adviser, and companies controlled by such investment companies.9

As the Commission stated in the ETF Rule Release, “ETFs possess characteristics of both mutual funds, which issue redeemable securities, and closed-end funds, which generally issue shares that trade at market-determined prices on a national securities exchange and are not redeemable.”10 One of the characteristics that ETFs have in common with closed-end funds is, of course, that shares of ETFs are usually bought and sold in the secondary market. However, closed-end funds, unlike ETFs, frequently experience persistently large premiums or discounts (typically discounts), which have led to activist, closed-end fund investors targeting such closed-end funds, as discussed in a number of comment letters provided to the Commission regarding the Proposal. In contrast, such issues and related investor activism have not arisen with respect to ETF investors because “[t]he combination of the creation and redemption process [as further discussed below] with secondary market trading in ETF shares and underlying securities provides arbitrage opportunities that are designed to help keep the market price of ETF shares at or close to the NAV per share of the ETF.”11

Of course, one of the characteristics that ETFs share with mutual funds as open-end funds is that they do issue new shares, albeit in aggregations called creation units. Nonetheless, ETFs only issue those creation units, through their distributor, to an authorized participant (“AP”), which is either: (i) a broker or other participant in the Continuous Net Settlement System of the NSCC, a clearing agency registered with the Commission, or (ii) a participant in The Depository Trust Company (“DTC”), which, in either case, has signed a “Participant Agreement” with the ETF’s distributor. While APs do enter into a Participant Agreement with the ETF’s distributor, APs are not dealers and do not act as agents for the ETF or its distributor. So, as a matter of fact, ETFs do not directly engage in transactions with other investment companies; nor do agents of the ETF. After an AP obtains creation units from an ETF, the AP can engage in a variety of transactions, which the ETF does not control or is even aware of – including trading in secondary markets. Records of ETF shareholders are held at non-agent intermediaries, and the ETF (or its adviser) does not have any right to obtain beneficial owner data from such intermediaries. ETFs thus have no shareholder recordkeeping mechanism available to them to indicate who their

10 ETF Rule Release at page 9.
11 Id. at pages 10-11.
shareholders are on any given day (other than knowing DTC as a single shareholder).
Accordingly, unlike the mutual funds Congress considered in 1940 and again in 1970, ETFs do not in the ordinary course have actual knowledge of (or even ready access to) the facts that would make a transaction unlawful under Section 12(d)(1)(B) (i.e., “sale” to an “investment company” that “immediately” causes a breach). Further, while an AP could act as an agent for an investment company when purchasing a creation unit, or more likely purchase a creation unit and then sell that creation unit as principal to an investment company, an AP would be doing so as an independent broker-dealer with client confidentiality obligations. In any event, it is “much more difficult for a buyer or a seller to know how much” of an ETF’s shares are owned by acquiring investment companies.

Fortunately, Section 12(d)(1)(A) already imposes strict obligations on the acquiring side of transactions. Thus, WisdomTree believes that exempting ETFs from the provisions of Section 12(d)(1)(B) would not eliminate the protections provided by the Act.

As it stands, there remains unanswered questions as to what compliance obligation Section 12(d)(1)(B) places on ETFs, their distributors, and brokers. WisdomTree continues to believe, as do many other ETF industry participants, that a policy that only allows sales of creation units to APs, which are broker-dealers and not investment companies, should satisfy any compliance obligation under Section 12(d)(1)(B). Further, as previously stated by Barclays Global Fund Advisors (“Barclays”) (now part of BlackRock, Inc.): “…[a] determination by the Commission that ETFs are deemed to have, or should have (emphasis added), knowledge to which they do not in fact have ready access, such an implicit determination could have significant, unforeseen consequences to the processes that have been established for processing and settling orders relating to ETF creation units.” The level of such potential significant,

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12 Extensive additional commentary associated with the 2008 Proposal that included fund of funds relief discussed the unreasonable burden on an ETF or AP in seeking to understand whether an investment in an ETF was owned by an acquiring investment company. While those comments related to the proposed rule’s prohibitions on redemptions by an investment company, the same principal applies to creations, and even more so today in the context of an industry that has grown tremendously since that time. Below are some examples of such comments:

The Investment Company Institute (“ICI”): “There is no reason to force [an ETF, underwriter or broker-dealer] to actively seek a representation from an acquiring fund as to whether the transaction is permitted, and to maintain compliance records indicating that they did so and that they have no reason to believe the transaction is improper.” Available at: https://www.sec.gov/comments/s7-07-08/s70708-9.pdf.

Barclays: “An ETF does not know, and has no reason to know, whether an Authorized Participant is redeeming as principal or as agent on behalf of a customer…[a]n ETF – just like operating companies whose stocks trade on exchanges – does not necessarily know the identity and share balances of its current shareholders. The fact that settlement of transactions in ETF creation units operates in this anonymous, wholesale manner through Authorized Participants, without direct, individual shareholder records, allows ETFs to settle sizable transactions efficiently, as well as to have lower administration costs than most mutual funds”… and “it would be unwise for the Commission to impose requirements inconsistent with this system…” as “[s]uch requirements would serve little or no useful purpose, certainly none that would justify the increased costs to shareholders that would likely result.” Available at: https://www.sec.gov/comments/s7-07-08/s70708-14.pdf.

Vanguard Group, Inc. (“Vanguard”): “An ETF would have no way to know if the AP was [acting] as agent on behalf of a fund….” Available at: https://www.sec.gov/comments/s7-07-08/s70708-19.pdf.

Morgan, Lewis & Bockius LLP on behalf of Morgan Stanley & Co., Inc., JP Morgan Chase & Co., Merrill Lynch, Pierce, Fenner & Smith Inc. and Goldman, Sachs & Co.: “The [acquiring] funds themselves, and not the ETF, the principal underwriters or broker-dealers, are in the best position to know their own ownership status…” and “…to obtain representations from [an acquiring fund] imposes an unfair regulatory burden on the authorized participants and could potentially frustrate otherwise legitimate…activity.” Available at: https://www.sec.gov/comments/s7-07-08/s70708-21.pdf.
unforeseen consequences to the ETF industry has dramatically increased since the comment from Barclays was provided to the Commission in 2008, when the ETF industry was under $500 billion in assets compared to nearly $3.5 trillion today, with similar dramatic growth in the number of ETFs.

It is difficult for WisdomTree to conceive of a reasonable compliance policy for an ETF beyond not selling to investment companies to assure that the 12(d)(1)(B) limits are not breached. For example, even if an ETF had knowledge that an investment company was seeking to acquire shares of an ETF that exceeded the limits of Section 12(d)(1)(B), what could the ETF or its distributor do to prevent sales from the AP or an intermediary to such investment company? An unbounded and unclear compliance obligation might even unnecessarily restrict the issuance of creation units out of uncertainty that ETF shares might ultimately fall into the hands of investment companies in excess of Section 12(d)(1) limits. WisdomTree believes that if APs face uncertainty as to whether creation unit orders will be accepted, they will either refuse to provide liquidity by selling ETF shares short, or will quote wider bid/ask spreads in order to price in the additional risk, and/or exit the market due to increased compliance costs. Less liquidity, wider bid/ask spreads and/or fewer APs will cause demonstrable harm to all current and prospective holders of ETFs, and might impair the efficient functioning of the creation and redemption process or inhibit effectiveness of the ETF arbitrage mechanisms. Further, impeding or frustrating legitimate ETF share purchases will only lead to lower ETF asset growth. WisdomTree has engaged a study (the “NERA Analysis”), the results of which are appended to this letter, that show what the industry has always believed, that asset growth in ETFs leads to lower bid/ask spreads in secondary market transactions.13

Thus, WisdomTree believes the Commission, either by revising the Proposed Rule or otherwise, should provide a specific exclusion for ETFs from the provisions of Section 12(d)(1)(B). WisdomTree believes such an exemption would not lead to any of the abuses contemplated by Congress when adopting Section 12(d)(1), and would be consistent with the public interest and the protection of investors while providing current and prospective ETF shareholders with the benefits described above.

**Underlying ETFs**

WisdomTree also believes that, due to the hybrid nature of ETFs, ETFs are uniquely insulated from many of the potential abuses that led to Congress adopting Section 12(d)(1) of the Act and subsequent amendments. We note, and commend, the Commission for acknowledging that in the Proposed Rule’s limitation on redemptions. Nonetheless, WisdomTree believes

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13 *See also, e.g.*, the comment letter from Vanguard (June 19, 2008) on the 2008 Proposal (“The additional trading volume generated by unregistered funds [investing in ETFs beyond the 12(d)(1) limits] is likely to lead to narrower spreads…”). See also, Gerasimos G. Rompotis, *Active Versus Passive ETFs: An Investigation of Bid-Ask Spread*, The IUP Journal of Applied Finance, Vol. 16, No. 3 (2010) at 7 (“increased market activity benefits investors by narrowing the deviation s between prices offered by ETF seller and buyers”); Benito Sanchez & Peihwang Wei, *The Liquidity of Exchange Traded Funds*, International Review of Applied Financial Issues and Economics, Vol. 2, No. 4 (2010) at 624 (“empirical research generally finds that the bid-ask spreads is a decreasing function of trading volume”); Mingsheng Li et al., *Empirical Analysis of ETF Intraday Trading*, Financial Services Review, Vol. 21 (2012) at 157 (“the smaller spreads of benchmark ETFs are likely driven by the large trading volume, long-trading history, and large capitalization of these ETFs”).
certain of the conditions, as proposed, are not necessary in the case of Underlying ETFs, and place unnecessary limits on investments that do not benefit the ETF or its shareholders and actually inhibit the types of benefits to ETFs and current and prospective shareholders as described herein.

**Control – Mirror Voting**

Under the Proposed Rule, if an acquiring fund and its advisory group held more than 3% of an acquired fund, it would be required to use pass through or mirror vote. We have no objection to requiring pass-through or mirror voting, whether at a 3% trigger or at the 25% trigger in existing exemptive relief.

**Control – Limited Redemptions**

The Proposed Rule would limit redemptions of shares, but would not apply to secondary market transactions in acquired fund shares. While WisdomTree believes that limiting redemptions may give rise to issues for mutual funds, WisdomTree believes that it will have no negative impact on Underlying ETFs. Similar to other investors, an acquiring fund seeking to dispose of shares of an Underlying ETF would generally sell them in the secondary market. Similar to other investors, an acquiring fund seeking to dispose of shares of an Underlying ETF would generally sell them in the secondary market. Since secondary market trading activity occurs away from the Underlying ETFs, the portfolio management of an Underlying ETF would not be disrupted or even directly affected by an acquiring fund’s selling activities in the secondary market. Further, the vast majority of ETFs use an “in-kind” creation/redemption process that is designed to permit ETFs to remain fully invested in portfolio securities. Therefore, Underlying ETFs using this process do not need to hold cash balances to fund potential redemptions and the Underlying ETFs’ investment programs would not be disrupted by large-scale redemptions, whether a redemption amounted to 25% or 95% of an Underlying ETF’s shares. The Underlying ETFs, therefore, would not need to retain excess cash balances to meet redemption requests.

**Control – Purchase Limitations**

Similar to existing exemptive relief, the Proposed Rule would require that an acquiring fund and its advisory group not acquire more than 25% of the outstanding shares of an acquired fund. WisdomTree believes that, in the case of Underlying ETFs, the 25% limit is unnecessary and should be removed or expanded as it would apply to Underlying ETFs. Further, for smaller ETFs, many of which have less than $2.5 million in assets, even a 25% limit only amounts to a $625,000 investment or less. Removing such restrictions would remove a barrier that makes it harder for smaller and mid-size ETFs to compete, which are liquidated in greater numbers than larger ETFs. As discussed above, ETFs have unique characteristics that insulate them from the threats of large redemptions, and the Commission has proposed appropriate safeguards with respect to control through voting. In light of that, a percentage restriction seems to be an arbitrary and unnecessary restriction on investment in Underlying ETFs.

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14 2019 ICI Factbook at page 90 (“On average, 90 percent of the total daily activity in ETFs occurs on the secondary market.”).
Not surprisingly, WisdomTree believes that any restriction on the buying, holding and/or trading of ETF shares is potentially harmful to the ETF and its current and prospective shareholders, and should only be required when the benefits of those restrictions clearly outweigh the burdens. As demonstrated by the NERA Analysis, asset growth in ETFs leads to lower bid/ask spreads in secondary market transactions. Further, “… arbitrage is more effective the smaller and more predictable the associated trading costs are.” Any imposed restriction would, by definition, impede asset growth and not advance ETF shareholder interests.

Other Investment Companies as Acquiring Funds

WisdomTree acknowledges that the types of abuses that led to the Section 12(d)(1) amendments in 1970 largely emanated from abuse at the hands of a Foreign Fund and supports the Commission’s significant regulatory interest in protecting registered investment companies from the types of abuses Section 12(d)(1) was intended to prevent. However, in the Proposal, the Commission notes that “[s]everal commenters on the 2008 proposal urged us to include [P]rivate [F]unds within that proposed rule’s scope.” The Commission further noted the many arguments presented by those commenters. WisdomTree believes those arguments were correct and persuasive in 2008 as they applied to the 2008 Proposal, and remain equally correct and persuasive as applicable to this Proposed Rule, including with respect to Foreign Funds, as many commenters on the Proposal have articulated. Thus, we strongly support revising the Proposed Rule to permit Other Investment Companies to acquire shares of Underlying ETFs beyond the limits of Section 12(d)(1) of the Act. For Underlying ETFs, such investments also provide important benefits. As the Commission recently noted, “…[Private Funds] provide additional liquidity to the ETF market through their trading activity.” The same liquidity benefits to ETFs and their shareholders are also provided by Foreign Funds.

In WisdomTree’s experience, Other Investment Companies have not invested in ETFs any differently than registered investment companies – in other words, Other Investment Companies invest in Underlying ETFs to gain access to a particular market or asset class in an efficient manner, to allocate and diversify their investments and/or as a cost effective hedge to other positions. We note that many of the concerns that led to Congress adopting Section 12(d)(1) initially in 1940 are not present when one or more Other Investment Companies acquire shares of a registered investment company, and more particularly shares of an Underlying ETF. Rather, as discussed above, Congress amended Section 12(d)(1) in 1970, specifically to apply to Other Investment Companies, to deal with Other Investment Companies exerting undue influence over acquired funds, both through voting and the threat of large-scale redemptions of the shares.

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15 ETF Rule Release at page 175.
16 The PPI Report discussed such abuses stemming from a foreign investment company.
17 ETF Rule Release at page 11.
**Voting**

As a general matter, WisdomTree believes the Proposed Rule’s conditions already adequately address the concern about undue influence through voting. WisdomTree believes that the Proposed Rule’s voting restriction, whether triggered at 3%, as proposed in the Proposed Rule, or 25%, the limit used to define “control” in the Act, would apply equally, and provide the same protections, whether the acquiring fund were a registered investment company or Other Investment Company.

**Large-Scale Redemptions**

The PPI Report expresses the following three principal concerns about the threat large-scale redemptions by a fund holding company may have on an underlying fund: (i) underlying funds would need to retain excessive cash balances to satisfy large-scale redemption requests and the retention of excessive cash balances would be inconsistent with the interests of other underlying fund shareholders because the fund would not be fully invested in portfolio securities; (ii) management of a fund holding company may, through threat of redemption, induce deviations from the underlying fund’s investment program or policies; and (iii) large-scale redemptions could burden shareholders with unnecessary capital gains and disrupt the orderly management of the underlying funds. We acknowledge that the limitation on redemptions would be of little import to funds investing in Underlying ETFs. Nonetheless, we also submit that, for the reasons discussed above, large-scale redemptions do not pose a significant threat to Underlying ETFs.

**Reporting and Recordkeeping**

The Commission identified a lack of reporting and recordkeeping requirements as reasons why Other Investment Companies would not be permitted to rely on the Proposed Rule. While Other Investment Companies would not be registered under the Act, the manager of a Private Fund would be required to regularly file Form PF with the Commission and managers of Other Investments Companies may otherwise be required to regularly file Form 13F, which would provide information that allows the Commission to understand the amount of such investments in ETFs. Further, Other Investment Companies, whether U.S. domiciled or foreign-domiciled, are subject to greater regulation today than at the time of the PPI Report and the 2008 Proposal. However, if the Commission believes that such increased global regulation, combined with Form PF and/or Form 13F filings, would not adequately alleviate Commission concerns, including concerns regarding reporting and recordkeeping by Private Funds and/or Foreign Funds, WisdomTree suggests that the Commission clarify in a final rule release or otherwise that such Private Funds and/or Foreign Funds could not rely on the no-action letter granted to *PDR Services Corporation* if such ownership amounted to greater than 25% of an ETF’s shares trade at a price that does not materially deviate from its NAV per share.

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18 SEC No-Action Letter (pub. avail. December 14, 1998), which provides that an ETF’s substantial shareholders are not required to file reports under Section 13(d) of the Securities Exchange Act of 1934, to the extent such ETF’s shares trade at a price that does not materially deviate from its NAV per share.
Underlying ETF’s shares. Hence, Private Funds and/or Foreign Funds could invest in excess of the Section 12(d)(1) limits in an Underlying ETF, but such investment would be limited to 25% of the Underlying ETF’s shares unless such Private Funds and/or Foreign Funds file a Schedule 13D with the Commission. A Schedule 13D filing would not only provide a timely record of ownership to the Commission, but it would also provide the Commission with detailed information regarding, among other required disclosures, the identity of the acquiring investment company, the purpose of the Underlying ETF share acquisition and details about transactions in the Underlying ETF’s shares during the 60 days prior to the filing of the Schedule 13D. 19

WisdomTree believes that the suggestions herein, including the disclosure and filing requirements outlined above, more than adequately address applicable policy concerns underpinning the Section 12(d)(1) limitations with respect to investments in ETFs. Finally, permitting Other Investment Companies to invest to a greater extent in Underlying ETFs will provide additional liquidity to the secondary market, which WisdomTree believes will enhance market efficiency and the arbitrage function in the Underlying ETFs, while also increasing capital formation in the U.S. Of course, the conditions in the Proposed Rule intended to protect the shareholders of Underlying ETFs would provide the same level of protection regardless of whether the acquiring fund is an Other Investment Company or a registered investment company.

Conclusion

WisdomTree appreciates the opportunity to provide comments on the Proposed Rule. WisdomTree respectfully requests that the Commission consider the recommendations set forth above. We are prepared to meet and discuss our recommendations with the Commission and the Staff and to respond to any questions.

(See Next Page)

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19 WisdomTree believes that due to the burden and expense of completing and filing a Schedule 13D, such requirement should be limited to the circumstances noted with respect to Private Funds and/or Foreign Funds, and should not be required more broadly (including with respect to a Schedule 13G filing should the Commission determine that an ownership threshold lower than 25% should trigger a filing and the Private Fund and/or Foreign Fund could qualify to file a Schedule 13G) with respect to investments in Underlying ETFs in excess of the Section 12(d)(1) limits due to the other protections and reasons discussed herein.
Kind Regards,

/s/ Ryan M. Louvar

Ryan M. Louvar, Esq.
General Counsel

cc: The Honorable Jay Clayton
    The Honorable Robert J. Jackson Jr.
    The Honorable Hester M. Peirce
    The Honorable Elad L. Roisman
    The Honorable Allison Herren Lee

    Dalia Blass, Director, Division of Investment Management
Impact of Size on Bid-Offer Spread
Cross-section of ETFs

Average Closing Bid-Ask Spread as a Percentage of Price
U.S. ETF Universe as of October 16, 2019

Data are from FactSet Research Systems.
This chart consists of U.S. ETFs with available bid, ask, closing price, and AUM data available.
Impact of Size on Bid-Offer Spread As ETFs Grow Over Time

Median Bid Ask Spread Size at Percentages of Fund's Highest AUM For Each U.S. ETF

Data are from FactSet Research Systems. This chart consists of U.S. ETFs with available bid, ask, closing price, and AUM data available.
Impact of Size on Bid-Offer Spread
Academic Evidence

• The relationship between the bid-offer spread for secondary market shares and an ETF’s AUM has been the subject of academic study

• Studies have found a strong negative relationship between the size of the bid-offer spread and the AUM and/or the trading volume in the ETF