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Standard & Poor's
A Division of The McGraw-Hill Companies

January 11, 2002

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: File No. S7-20-01 (Actively Managed Exchanged-Traded Funds)

Dear Mr. Katz:

Standard & Poor's is pleased to have this opportunity to comment on the issues raised in the concept release issued by the Securities and Exchange Commission concerning actively managed exchange-traded funds ("ETFs").

STANDARD & POOR'S

Standard & Poor's, a division of The McGraw-Hill Companies, Inc., is a leader in providing financial data, analytical research, and investment and credit opinions to the global capital markets. It has more than 5,000 employees located in 18 countries. Standard & Poor's Investment Services group designs, maintains, and publishes financial indices that measure the performance of various asset classes. Among the firm's many products is the S&P 500 Composite Stock Price Index ("S&P 500"), the premier U.S. portfolio index. The S&P 500 is an unmanaged statistical index that is based on stock prices of selected and weighted samplings of common stocks of leading United States public companies in a variety of industries and that is considered representative of large-cap U.S. stocks. The S&P 500 is the index on which the SPDR Trust, the world's largest ETF, is based, and approximately 55% of all the assets invested in ETFs in the United States are in ETFs that are based on Standard & Poor's indices. Financial services companies, analysts, and investors regularly rely on the S&P 500, as well on Standard & Poor's other indices, as the basis for investments and as benchmarks for measuring investment performance.

Standard & Poor's also maintains its Stock Appreciation Ranking System (STARS) that reflects the opinions of Standard & Poor's equity analysts on the price appreciation potential of approximately 1100 stocks. In addition, Standard & Poor's provides custom-developed financial communications services and products to many of the country's leading financial institutions and tracks the performance of nearly 60,000 institutional, pension, insurance and mutual funds worldwide. With 400 professionals in 13 countries who track and analyze funds, Standard & Poor's is the world's leading provider of mutual fund information and analysis. In light of the services and products that it provides, Standard & Poor's believes that it is well positioned to provide useful comments on some of the various issues relating to actively managed ETFs.

COMMENTS ON VARIOUS ISSUES RAISED BY ACTIVELY MANAGED ETFs

Standard & Poor's congratulates the Commission and its staff for issuing the concept release. The release identifies many important issues raised by actively managed ETFs and, we are confident, will result in the receipt of information that will persuade the Commission and its staff to conclude that all exemptions necessary for the operation of such an ETF are in the public interest and consistent with the protection of investors and the policy and provisions of the Investment Company Act of 1940 (the "Act"). Although there are some differences between index-based and actively managed ETFs, we believe that the products raise essentially the same structural concerns under the Act. As discussed below, Standard & Poor's believes that actively managed ETFs will be an attractive investment alternative for several categories of market participants. Accordingly, we recommend that the Commission exempt all actively managed ETFs that meet these structural precepts from the appropriate provisions of the Act.

1. Overview

Standard & Poor's believes that a properly structured and operated actively managed ETF would afford significant benefits that are in the public interest. Among other benefits, which are discussed in more detail below, the availability of an actively managed ETF would: provide increased investment opportunities that should encourage diversified investment; provide a low-cost pooled investment product for small and middle-sized accounts of individuals and institutions that would be available at intra-day prices reflecting minute-by-minute market conditions rather than only closing prices; make available a vehicle that would attempt to achieve an investment objective other than tracking the return of a particular index; provide a security that should be freely available in response to market demand; provide competition for comparable products available in U.S. markets; attract capital to the U.S. equity markets; facilitate the implementation of diversified investment management techniques; and provide a more tax efficient investment vehicle than most traditional, actively managed mutual funds or closed-end funds.

Although an application relating to an actively managed ETF would not be identical to applications relating to index-based ETFs, we believe that the exemptions and order for any actively managed ETF would be substantially and conceptually similar to those granted in response to applications filed by issuers or sponsors of index-based ETFs.

2. Exchange-Traded Pooled Investment Products

Shares of an actively managed ETF would allow investors to trade a portfolio of securities in a size comparable to a share of common stock. Trading in pooled investment products could be an important investment strategy, due in part to the widely acknowledged benefits of diversification.

Shares of an actively managed ETF would provide a useful investment opportunity to investors seeking the advantages of a pooled investment product traded throughout the day on an exchange. Unlike the basket products formerly available on the New York Stock Exchange, the Chicago Board Options Exchange and the Chicago Stock Exchange, which provided a mechanism only for the direct purchase of baskets of a large number of securities having market values that left them beyond the reach of the typical retail investor, each share of an actively managed ETF would represent a fractional interest in the Fund's portfolio and would be an investment accessible to a much broader market. Indeed, the substantial and growing popularity of SPDRs, MidCap SPDRs, Select Sector SPDRs, DIAMONDS, BGI's iShares, QQQs and other index-based ETFs strongly suggests that actively managed ETFs likely would be attractive to investors and very well received by the investing public.

Because actively managed ETFs, to the extent practicable, would redeem their redeemable securities principally in-kind rather than for cash, there should be only a minimal need for such ETFs to maintain cash reserves for redemptions. Even in cases where a Fund might allow or require cash redemptions, we would anticipate that portfolio securities would be sold or temporary bank borrowing arrangements would be used to obtain the necessary cash redemption proceeds. This approach would enable the resources of an actively managed ETF to be committed as fully as possible to investing in qualifying securities. Such a Fund should, therefore, be able to invest in qualifying securities more effectively and completely than traditional open-end mutual funds and other pooled investment products, which are forced to allocate a portion of their assets for cash redemptions.

3. Shares of an Actively Managed ETF as a Pooled Investment Alternative

Traditional open-end mutual funds do not enable investors to buy or redeem shares throughout the day. Shares of an actively managed ETF, which would be listed on an exchange, would trade throughout the exchange's trading day. Also, the price at which such shares trade would be disciplined by arbitrage opportunities created by the option continually to purchase or redeem shares in Creation Units, which should result in the shares not trading at a material discount or premium in relation to their net asset or redemption value. The continuous ability to purchase and redeem shares in Creation Units also means that share prices in secondary trading ordinarily should not be affected greatly by limited or excess supply.

4. Benefits to Individual Investors

Standard & Poor's believes that the structure and operation of an actively managed ETF, and in particular its unique distribution structure, would cause the level of secondary market trading in the shares of the Fund to exceed greatly the primary market activity of creating shares in Creation Units. We anticipate that gradually the creation of shares in Creation Units, on a relative basis, would diminish and ultimately become overshadowed by the secondary market trading. We further believe that within only a few months after the commencement of trading, healthy secondary trading market activity in shares of actively managed ETFs would develop, consistent with the market that developed after the launch of SPDRs, MidCap SPDRs, Select Sector SPDRs, iShares, DIAMONDS, and QQQs. This type of liquid market for shares of actively managed ETFs would benefit investors by, among other things, allowing competition to drive down bid/asked spreads.

Another major benefit to individual investors that would be associated with actively managed ETFs relates to the transparency of each Fund's portfolio. As discussed further below, Standard & Poor's agrees with the Commission that actively managed ETFs must have sufficient transparency to ensure arbitrage opportunities that would reduce any deviations between the NAV and the share price. This transparency, whatever the degree that the Commission ultimately requires, will provide investors with a far greater level of knowledge concerning the securities holdings of their Funds than that of investors in traditional, open-end mutual funds, which are required under the Act to disclose their portfolio holdings only once every six months within sixty days after the close of the relevant period.

5. Maintaining a Competitive Position in the International Financial Community

To maintain a competitive position in global securities markets, U.S. participants must respond to new developments and encourage the development of new and innovative investment products. Actively managed ETFs, a variation of which already trade on the Deutsche Bourse in Germany and other exchanges outside the U.S., would allow U.S. and foreign investors seeking investment returns that exceed the market averages to participate in a significant segment of the securities market through a single securities trade. Financial vehicles such as actively managed ETFs would, in addition, provide these investors greater access to U.S. markets and would draw them to those markets.

6. Additional Comments

As discussed above, Standard & Poor's believes that actively managed ETFs will prove to be very attractive to investors and can be structured and operated in such a way as to be consistent with the policies and provisions of the Act. In this section, we address several of the specific issues raised in the concept release.

The concept release observed that "many of the details concerning the potential operations of actively managed ETFs are apparently still in development." The release also sought comments on how investors would use actively managed ETFs and on the benefits such ETFs are expected to provide. We believe that actively managed ETFs will generally operate in much the same way as index-based ETFs and that they will be highly attractive to investors; however, the details concerning the operation of these products are difficult at this point to specify. As for the nature of investors' use of actively managed ETFs, we view the enormous popularity of index-based ETFs as evidence that investors want and will use these products in a similar manner - to gain exposure to different asset classes through a highly liquid investment that can be traded intra-day at prices near net asset value. The primary distinction between actively managed and traditional index-based ETFs is that the former will cater primarily to investors who seek to rely on the ability of a fund manager to outperform, rather than meet, market averages. Any uncertainty regarding the operation and use of actively managed ETFs should not cause the Commission to hesitate to grant the necessary exemptive relief for the operation of actively managed ETFs, provided an exemptive application is otherwise persuasive. At this stage in their development, the situation of actively managed ETFs is very much like that of the SPDR Trust in terms of available knowledge in 1992 when the Commission granted the exemptive relief that permitted the SPDR Trust, the first ETF of its kind, to commence operations. Events have confirmed the Commission's wisdom in granting exemptive relief to the SPDR Trust, and we are confident that the experience with actively managed ETFs will be as benign and beneficial as the experience with index-based products has been.

The concept release noted that the "unique structure of an ETF - in which investors can buy and redeem Creation Units at NAV, and can sell and purchase individual ETF shares in the secondary market at market price - is designed, among other things, to ensure arbitrage opportunities that would reduce any deviations between the NAV and the market price of ETF shares." The release also noted that the transparency of an ETF's portfolio is one of two factors that may contribute significantly to the effectiveness of arbitrage with respect to the ETF structure. The release requested comments on what level of transparency would have to occur and how frequent the disclosure about the portfolio composition would have to be to allow for effective arbitrage activity. Although concerns about "front running" and "free riding" as discussed in the release are legitimate, Standard & Poor's believes that the Commission's main objectives in evaluating actively managed ETFs must be to ensure adequate portfolio transparency and to protect against investor harm resulting from inadequate dissemination of portfolio information. Whatever level of transparency and frequency of disclosure requirements are eventually adopted by the Commission, they must be designed to result in arbitrage opportunities that will eliminate any material deviations between the NAV and market price of the shares.

The Commission also requested information concerning what the uses, benefits and risks of actively managed ETFs would be, which are legitimate requests and which are addressed to some extent above. The release also asks whether such an ETF would possess the "low expenses and tax efficiency associated with existing [index-based] ETFs." Although we believe that index-based and actively managed ETFs are in many respects very similar in this regard, Standard & Poor's does not believe that the Commission should place undue focus on these issues. The focus should not be on whether actively managed ETFs will be used in the same way by, or will provide identical level of benefits to, investors as index-based ETFs. Rather, the focus should be on whether actively-managed ETFs will be used by, or benefit, investors. As discussed above, we believe that such ETFs will prove to be popular to investors precisely because of the benefits they will provide. For example, although actively managed ETFs may not be as tax efficient as the index-based variety, the former will not necessarily have to sell shares to meet redemption requests and will be able to satisfy such requests with high basis shares. Such features of actively managed ETFs will lead to clear tax efficiencies, especially when compared to traditional, open-end mutual funds. Ultimately, however, the market, through choices made by individual investors, will determine whether actively managed ETFs are useful to investors or provide sufficient benefits.

In the concept release, the Commission expressed concern about whether investors would be confused about the nature of actively managed ETFs. Standard & Poor's is not aware of any problem of investor confusion with respect to index-based ETFs, and therefore would not expect there to be any investor confusion with respect to actively managed ETF products. In any event, we are confident that the disclosure requirements of the Securities Act of 1933 and the Act are more than sufficient to address and eliminate the risk of investor confusion.

Finally, the Commission asked whether the operation of an actively managed ETF would "place investors who have the financial resources to purchase or redeem a Creation Unit at NAV in a different position than most retail investors who may buy and sell ETF shares only at market price." Assuming, as we anticipate, that the Commission will adopt the most appropriate requirements relating to the level of portfolio transparency and to the frequency of disclosure of portfolio composition, we would not expect any material deviations to develop between the market price and the NAV of ETF shares. Therefore, Standard & Poor's does not believe that the operation of an actively managed ETF would give rise to discriminatory treatment of shareholders that the Investment Company Act was designed to prevent.

Even if the operation of an actively managed ETF were to result in the more favorable treatment of large investors relative to most retail investors who buy and sell ETF shares only at market prices, such differential treatment would not necessarily discriminate against shareholders in a manner that is proscribed by the Act. Indeed, the Commission has accepted that, in certain circumstances, it is permissible for larger investors to receive differential treatment in the purchase and sale of fund securities. For example, Exchange Act rule 22d-1 allows for scheduled variations in sales loads, and multiple class funds allow larger investors to purchase fund securities at a lower cost and rule 18f-3 of the Act permits the creation of lower-cost classes of shares for institutional investors.

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Standard & Poor's appreciates the opportunity to comment on this important concept release. We would be pleased to furnish any additional information that the Commission may request. Questions or requests for additional information should be directed to David B. Stafford, Associate General Counsel, The McGraw-Hill Companies, Inc., 1221 Avenue of the Americas, 48th Floor, New York, New York 10020.

Sincerely,

Leo C. O'Neill

Leo C. O'Neill
President
Standard & Poor's