

SECURITIES AND EXCHANGE COMMISSION

[Release No. IC-27703; 812-13337]

Rydex ETF Trust, et al.; Notice of Application

February 20, 2007

Agency: Securities and Exchange Commission (“Commission”).

Action: Notice of an application for an order under section 6(c) of the Investment Company Act of 1940 (the “Act”) for an exemption from sections 2(a)(32), 5(a)(1), 22(d) and 24(d) of the Act and rule 22c-1 under the Act, and under sections 6(c) and 17(b) of the Act for an exemption from sections 17(a)(1) and (a)(2) of the Act.

Applicants: Rydex ETF Trust (“Trust”), PADCO Advisors II, Inc. (“Advisor”), and Rydex Distributors, Inc. (“Distributor”).

Summary of Application: Applicants request an order that would permit: (a) series of an open-end management investment company to issue shares of limited redeemability; (b) secondary market transactions in the shares of the series to occur at negotiated prices on a national securities exchange, as defined in section 2(a)(26) of the Act, such as the New York Stock Exchange LLC (“NYSE”), The NASDAQ Stock Market, Inc. (“Nasdaq”) and the American Stock Exchange LLC (“Amex”) (each, an “Exchange”); (c) dealers to sell shares of the series of the Trust to purchasers in the secondary market unaccompanied by a prospectus, when prospectus delivery is not required by the Securities Act of 1933 (the “Securities Act”); and (d) certain affiliated persons of a series to deposit securities into, and receive securities from, the series in connection with the purchase and redemption of aggregations of the series’ shares.¹

¹ The Trust currently operates pursuant to an order that grants such relief to offer series that match the performance of equity securities indices. In the Matter of Rydex ETF Trust, et al., Investment Company Act Release Nos. 25948 (Continued)

Filing Dates: The application was filed on October 27, 2006. Applicants have agreed to file an amendment during the notice period, the substance of which is reflected in this notice.

Hearing or Notification of Hearing: An order granting the requested relief will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to the Commission's Secretary and serving applicants with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 p.m. on March 19, 2007, and should be accompanied by proof of service on applicants, in the form of an affidavit or, for lawyers, a certificate of service. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Commission's Secretary.

Addresses: Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090. Applicants: Rydex ETF Trust; PADCO Advisors II, Inc.; and Rydex Distributors, Inc., 9601 Blackwell Road, Suite 500, Rockville, MD 20850.

For Further Information Contact: Laura L. Solomon, Senior Counsel, at (202) 551-6915, or Julia Kim Gilmer, Branch Chief, at (202) 551-6871 (Division of Investment Management, Office of Investment Company Regulation).

Supplementary Information: The following is a summary of the application. The complete application may be obtained for a fee at the Commission's Public Reference Desk, 100 F Street, NE, Washington, DC 20549-0102 (tel. 202-551-5850).

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(Feb. 27, 2003) (notice) and 25970 (Mar. 25, 2003) (order), amended by Investment Company Act Release Nos. 27183 (Dec. 8, 2005) (notice) and 27202 (Jan. 4, 2006) (order), ("Prior Order").

Applicants' Representations:

1. The Trust is an open-end management investment company registered under the Act and organized as a Delaware statutory trust. The Trust is authorized to offer an unlimited number of series (the "Funds"). The Advisor is registered as an investment adviser under the Investment Advisers Act of 1940 ("Advisers Act"). Each Fund will be advised by the Advisor or an entity controlled by or under common control with the Advisor. The Advisor may enter into subadvisory agreements with additional investment advisers to act as subadviser to the Trust and any of its Funds. Any subadviser to the Trust or a Fund will be registered under the Advisers Act. The Distributor is registered as a broker-dealer under the Securities Exchange Act of 1934 ("Exchange Act") and will act as the distributor and principal underwriter for each Fund's shares ("Shares").

2. The Trust currently offers eight series that seek to match the performance of equity securities indices pursuant to the Prior Order. Applicants seek relief to offer additional series with different types of investment objectives (each such series, a "New Fund"). The New Funds will seek daily investment results that correspond, before fees and expenses, to: (a) 125%, 150% or 200% of the return of equity securities indices ("Leveraged Funds"); or (b) move in the opposite direction of the performance of equity securities indices in multiples of 100%, 125%, 150% or 200% ("Inverse Funds"). Applicants propose to initially offer ninety-six New Funds.²

3. In addition to equity securities, the New Funds may invest in short-term debt instruments that meet the definition of "Eligible Security" in rule 2a-7 under the Act ("Money Market Instruments"), and in futures contracts, options, equity caps, collars and floors, swap agreements, forward contracts, and reverse repurchase agreements (collectively, "Financial

² The underlying indices for these New Funds (each, an "Underlying Index") are identified in the application.

Instruments”) in order to meet their investment objectives. Leveraged Funds will invest 80% or more of their total assets in equity securities contained in the relevant Underlying Index and up to 20% of their total assets in Financial Instruments and Money Market Instruments. The Inverse Funds will only invest in Financial Instruments and Money Market Instruments; they will not invest in equity securities.

4. The Advisor will seek to achieve the investment objectives of the New Funds by using a mathematical model that takes into account a variety of specified criteria, the most important of which are: (a) the net assets in each New Fund’s portfolio at the end of each trading day; (b) the amount of required exposure to the Underlying Index; and (c) the positions in equity securities, Financial Instruments and Money Market Instruments at the beginning of each trading day. On each day that a New Fund is open for business (“Business Day”), including as required by section 22(e) of the Act, the full portfolio holdings of each New Fund will be disclosed on the website of the Trust and/or the Exchange where the Shares are primarily listed (“Primary Listing Exchange”). The portfolio holdings information disclosed each Business Day will form the basis for that New Fund’s net asset value (“NAV”) calculation as of 4:00 pm that day and will reflect portfolio trades made on the immediately preceding Business Day. Intra-day values of each Underlying Index will be disseminated every 15 seconds throughout the trading day.

5. For the New Funds, applicants expect a daily tracking error of less than 5% (excluding the impact of expenses and interest, if any) to the specified multiple, inverse or inverse multiple, respectively, of the performance of the relevant Underlying Index.

6. Each New Fund will issue Shares in aggregations of 25,000 to 100,000 Shares (each, a “Creation Unit”). Applicants expect the price of a Creation Unit to be a minimum of \$1 million. Creation Units may be purchased only by or through the Distributor or a party that has

entered into a participant agreement with the Distributor (an “Authorized Participant”). An Authorized Participant must be either (a) a broker-dealer or other participant in the continuous net settlement system of the National Securities Clearing Corporation, a clearing agency that is registered with the Commission, or (b) a participant in the Depository Trust Company (“DTC”) system.

7. Creation Units of Leveraged Funds generally will be purchased and redeemed in exchange for an “in-kind” transfer of securities and cash (“In-Kind Payment”). Inverse Funds will generally be purchased and redeemed entirely for cash because of the limited transferability of Financial Instruments.³ An investor making an In-Kind Payment will be required to transfer to the Trust a “Deposit Basket” consisting of: (a) a basket of equity securities consisting of some or all of the securities in the relevant Underlying Index or equivalent equity securities selected by the Advisor to correspond to the performance of the Underlying Index (the “Deposit List”);⁴ and (b) a cash amount equal to the differential, if any, between the market value of the equity securities in the Deposit Basket and the NAV per Creation Unit (“Balancing Amount”).⁵ An investor purchasing a Creation Unit from a New Fund will be charged a fee (“Transaction Fee”)

³ The Trust may also accept and deliver all-cash payments for the purchase and redemption of Creation Units of any New Fund in certain limited circumstances.

⁴ The New Funds must comply with the federal securities laws in accepting Deposit Securities and satisfying redemptions with securities on the Redemption List (defined below), including that such securities are sold in transactions that would be exempt from registration under the Securities Act of 1933.

⁵ On each Business Day, prior to the opening of trading on the NYSE, the Trust’s index receipt agent will make available the list of the names and the required number of shares of each equity security included in the current Deposit Basket and the Balancing Amount for each New Fund. Such Deposit Basket will apply to all purchases of Creation Units until a new Deposit Basket for a New Fund is announced. The Primary Listing Exchange will disseminate every 15 seconds during regular trading hours, through the facilities of the Consolidated Tape Association, an amount representing on a per share basis the sum of the current value of the securities on the Deposit List, and the estimated amount of cash and Money Market Instruments held in the portfolio of a Leveraged Fund. If such New Funds hold Financial Instruments, the amount would also include, on a per share basis, the marked-to-market gains or losses of the Financial Instruments held by the Leveraged Fund. For Inverse Funds, the Primary Listing Exchange will disseminate an amount representing, on a per share basis, the estimated amount of cash and Money Market Instruments, and the marked-to-market gains or losses of the Inverse Fund’s Financial Instruments.

to prevent the dilution of the interests of the remaining shareholders resulting from the New Fund incurring costs in connection with the purchase of the Creation Units.⁶ The maximum Transaction Fee and any variations or waivers of the Transaction Fee will be disclosed in the current prospectus (“Prospectus”) and the method of determining the Transaction Fees will be disclosed in the Prospectus and/or statement of additional information (“SAI”).

8. All orders to purchase Creation Units must be placed on a Business Day with the Distributor. The Distributor also will be responsible for delivering the Prospectus to those persons purchasing Creation Units and for maintaining records of the orders and acknowledgements of acceptance for orders.

9. Persons purchasing Creation Units from a New Fund may hold the Shares or sell some or all of them in the secondary market. Shares of the New Funds will be listed on an Exchange and trade in the secondary market in the same manner as other exchange-traded funds. It is expected that one or more Exchange members will act as a specialist or market maker and maintain a market on the listing Exchange for Shares.⁷ The price of Shares traded on an Exchange will be based on a current bid/offer market. The initial trading price for each Share of each New Fund will fall in the range of \$50 to \$250. Transactions involving the sale of Shares in the secondary market will be subject to customary brokerage commissions and charges.

10. Applicants expect that purchasers of Creation Units will include institutional and retail investors, arbitrageurs, traders, financial advisors, portfolio managers and other market

⁶ A purchaser permitted to substitute cash for certain securities on the Deposit List may be assessed a higher Transaction Fee to cover the cost of purchasing such securities, including operational processing and brokerage costs, and part or all of the spread between the expected bid and offer side of the market relating to such securities.

⁷ The listing requirements established by Nasdaq require that at least two market makers be registered in Shares in order for the Shares to maintain a listing. Registered market makers must make a continuous two-sided market in a listing or face regulatory sanctions.

participants.⁸ An Exchange specialist or market maker, in providing for a fair and orderly secondary market for Shares, also may purchase or redeem Creation Units for use in its market-making activities. Applicants expect that the market price of Shares will be disciplined by arbitrage opportunities created by the ability to purchase or redeem Creation Units at their NAV, which should ensure that the market price of Shares at or close to 4:00 p.m. stays close to the NAV on that Business Day.

11. Shares will not be individually redeemable. Shares will only be redeemable in Creation Units through the Distributor, which will act as the Trust's agent for redemption. To redeem, an investor must accumulate enough Shares to constitute a Creation Unit. An investor redeeming a Creation Unit of a Leveraged Fund generally will receive an "in-kind" payment comprised of equity securities published by the Trust's index receipt agent (the "Redemption List") plus a Balancing Amount equal to the difference between the market value of the equity securities on the Redemption List and the NAV of the Shares being redeemed. Redemptions of Creation Units for Inverse Funds will occur entirely in cash. A redeeming investor will pay a Transaction Fee to offset the transactional expenses associated with redeeming Creation Units.

12. Applicants state that neither the Trust nor any New Fund will be advertised, marketed or otherwise held out as a "mutual fund." The term "mutual fund" will not be used in the Prospectus except to compare and contrast the Trust or a New Fund with conventional mutual funds. In all marketing materials where the features or methods of obtaining, buying, or selling Creation Units are described or where there is reference to redeemability, applicants will include a prominent statement to the effect that individual Shares are not redeemable except in

⁸ Shares will be registered in book-entry form only. DTC or its nominee will be the record or registered owner of all outstanding Shares. DTC or its participants will maintain records reflecting the beneficial owners of Shares.

Creation Units. The same approach will be followed in connection with reports and other communications to shareholders, as well as any other investor education materials issued or circulated in connection with Shares. The Trust will provide copies of its annual and semi-annual shareholder reports to DTC participants for distribution to beneficial holders of Shares.

Applicants' Legal Analysis:

1. Applicants request an order under section 6(c) of the Act granting an exemption from sections 2(a)(32), 5(a)(1), 22(d) and 24(d) of the Act and rule 22c-1 under the Act, and under sections 6(c) and 17(b) of the Act granting an exemption from sections 17(a)(1) and 17(a)(2) of the Act.

2. Section 6(c) of the Act provides that the Commission may exempt any person, security or transaction, or any class of persons, securities or transactions, from any provision of the Act, if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act.

Sections 5(a)(1) and 2(a)(32) of the Act

3. Section 5(a)(1) of the Act defines an “open-end company” as a management investment company that is offering for sale or has outstanding any redeemable security of which it is the issuer. Section 2(a)(32) of the Act defines a redeemable security as any security, other than short-term paper, under the terms of which the holder, upon its presentation to the issuer, is entitled to receive approximately his proportionate share of the issuer’s current net assets, or the cash equivalent. Because Shares will not be individually redeemable, applicants request an order that would permit the Trust, which is registered as an open-end management investment company, to issue Shares of New Funds that are redeemable in Creation Units only. Applicants

state that investors may always redeem Shares in Creation Units from the Trust. Applicants further state that because the market price of Shares will be disciplined by arbitrage opportunities, investors should be able to sell Shares in the secondary market at or close to 4:00 p.m. on a Business Day at prices that do not vary substantially from the NAV on that Business Day.

Section 22(d) of the Act and Rule 22c-1 under the Act

4. Section 22(d) of the Act, among other things, prohibits a dealer from selling a redeemable security, which is currently being offered to the public by or through a principal underwriter, except at a current public offering price described in the prospectus. Rule 22c-1 under the Act generally requires that a dealer selling, redeeming, or repurchasing a redeemable security do so only at a price based on its NAV. Applicants state that secondary market trading in Shares will take place at negotiated prices, not at a current offering price described in the Prospectus as required by section 22(d) of the Act, and not at a price based on NAV as required by rule 22c-1 under the Act. Applicants request an exemption under section 6(c) from these provisions.

5. Applicants assert that the concerns sought to be addressed by section 22(d) of the Act and rule 22c-1 under the Act with respect to pricing are equally satisfied by the proposed method of pricing Shares. Applicants maintain that while there is little legislative history regarding section 22(d), its provisions, as well as those of rule 22c-1, appear to have been intended to (a) prevent dilution caused by certain riskless-trading schemes by principal underwriters and contract dealers, (b) prevent unjust discrimination or preferential treatment among buyers, and (c) ensure an orderly distribution of shares by eliminating price competition

from dealers offering shares at less than the published sales price and repurchasing shares at more than the published redemption price.

6. Applicants believe that none of these purposes will be thwarted by permitting Shares to trade in the secondary market at negotiated prices. Applicants state that (a) secondary market trading in Shares does not involve the Trust's assets and cannot result in dilution of an investment in Shares, and (b) to the extent different prices exist during a given trading day, or from day to day, such variances occur as a result of third-party market forces, such as supply and demand, not as a result of unjust or discriminatory manipulation. Therefore, applicants assert that secondary market transactions in Shares will not lead to discrimination or preferential treatment among purchasers. Finally, applicants contend that the proposed distribution system will be orderly because competitive forces in the marketplace will ensure that the difference between the market price of Shares and their NAV remains narrow.

Section 24(d) of the Act

7. Section 24(d) of the Act provides, in relevant part, that the prospectus delivery exemption provided to dealer transactions by section 4(3) of the Securities Act does not apply to any transaction in a redeemable security issued by an open-end investment company. Applicants request an exemption from section 24(d) to permit dealers selling Shares to rely on the prospectus delivery exemption provided by section 4(3) of the Securities Act.⁹

⁹ Applicants do not seek relief from the prospectus delivery requirement for non-secondary market transactions, such as transactions in which an investor purchases Shares in Creation Units from the issuer or an underwriter. Applicants state that persons purchasing Creation Units will be cautioned in the Prospectus that some activities on their part may, depending on the circumstances, result in their being deemed statutory underwriters and subject them to the prospectus delivery and liability provisions of the Securities Act. The Prospectus will state that whether a person is an underwriter depends upon all the facts and circumstances pertaining to that person's activities. For example, a broker-dealer firm and/or its client may be deemed a statutory underwriter if it takes Creation Units after placing an order with the Distributor, breaks them down into the constituent Shares, and sells Shares directly to its customers, or if it chooses to couple the purchase of a supply of new Shares with an active selling effort involving solicitation of secondary market demand for Shares. The Prospectus also will state that dealers who are not

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8. Applicants state that secondary market investors will regard Shares in a manner similar to other securities, including closed-end fund shares that are listed, bought and sold on an Exchange. Applicants note that shares of closed-end fund investment companies are sold in the secondary market unaccompanied by a prospectus.

9. Applicants contend that Shares, as a listed security, merit a reduction in the compliance costs and regulatory burdens resulting from the imposition of prospectus delivery obligations in the secondary market. Because Shares will be exchange-listed, prospective investors will have access to several types of market information about Shares. Applicants state that information regarding market price and volume will be continually available on a real-time basis throughout the day from the relevant Exchange, automated quotation systems, published or other public sources or on-line information services. Applicants expect that the previous day's closing price and volume information for Shares also will be published daily in the financial section of newspapers. In addition, the Trust expects to maintain a website that includes quantitative information updated on a daily basis, including, for each New Fund, daily trading volume, the NAV and the reported closing price (or in the alternative, the mid-point of the bid-ask spread at the time of calculation of such NAV (the "Bid/Ask Price")).¹⁰ The website will also include, for each New Fund, closing price (or Bid/Ask Price) and data in chart format displaying the frequency distribution of discounts and premiums of the closing price (or Bid/Ask

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"underwriters" but are participating in a distribution (as contrasted to ordinary secondary market trading transactions), and thus dealing with Shares that are part of an "unsold allotment" within the meaning of section 4(3)(C) of the Securities Act, would be unable to take advantage of the prospectus delivery exemption provided by section 4(3) of the Securities Act.

¹⁰ The Bid/Ask Price of a New Fund is determined using the highest bid and the lowest offer on the Primary Listing Exchange as of the time of calculation of such new Fund's NAV.

Price) against the NAV, within appropriate ranges, for each of the four previous calendar quarters.

10. Investors also will receive a product description (“Product Description”) describing the Trust, the New Funds and the Shares. Applicants state that, while not intended as a substitute for a Prospectus, the Product Description will contain information about Shares that is tailored to meet the needs of investors purchasing Shares in the secondary market.

Sections 17(a)(1) and (2) of the Act

11. Section 17(a) of the Act generally prohibits an affiliated person of a registered investment company, or an affiliated person of such a person, from selling any security to or purchasing any security from the company. Section 2(a)(3) of the Act defines “affiliated person” to include any person directly or indirectly owning, controlling, or holding with power to vote 5% or more of the outstanding voting securities of the other person and any person directly or indirectly controlling, controlled by, or under common control with, the other person. Section 2(a)(9) of the Act provides that a control relationship will be presumed where one person owns 25% or more of another person’s voting securities. Applicants state that one or more holders of Creation Units could own more than 5% of a New Fund, or in excess of 25% of that New Fund, and could be deemed affiliated with the Trust or such New Fund under section 2(a)(3)(A) or 2(a)(3)(C) of the Act. Also, an Exchange specialist or market maker for Shares of any New Fund might accumulate, from time to time, more than 5% or in excess of 25% of that New Fund’s Shares. Applicants request an exemption from section 17(a) of the Act under sections 6(c) and 17(b) of the Act, to permit persons that are affiliated persons of the New Funds solely by virtue of a 5% or 25% ownership interest (or affiliated persons of such affiliated persons that

are not otherwise affiliated with the New Fund) to purchase and redeem Creation Units through “in-kind” transactions.

12. Section 17(b) of the Act authorizes the Commission to exempt a proposed transaction from section 17(a) of the Act if evidence establishes that the terms of the transaction, including the consideration to be paid or received, are reasonable and fair and do not involve overreaching on the part of any person concerned, and the proposed transaction is consistent with the policies of the registered investment company and the general provisions of the Act. Applicants contend that no useful purpose would be served by prohibiting the affiliated persons of a New Fund described above from purchasing or redeeming Creation Units through “in-kind” transactions. The deposit and redemption procedures for “in-kind” purchases and redemptions of Creations Units will be effected in exactly the same manner for all purchases and redemptions. The securities contained in the “in-kind” transactions will be valued in the same manner and according to the same standards as the securities held by the relevant New Fund. Therefore, applicants state that “in-kind” purchases and redemptions will afford no opportunity for the affiliated persons described above to effect a transaction detrimental to the other holders of its Shares. Applicants also believe that “in-kind” purchases and redemptions will not result in abusive self-dealing or overreaching by affiliated persons of the New Funds.

Applicants’ Conditions:

Applicants agree that any order granting the requested relief will be subject to the following conditions:

1. Applicants will not register a series of the Trust not identified in the application, by means of filing a post-effective amendment to the Trust’s registration statement or by any other means, unless applicants have requested and received with respect to such series, either (a)

exemptive relief from the Commission, or (b) a no-action letter from the Division of Investment Management of the Commission.

2. The Prospectus and the Product Description will clearly disclose that, for purposes of the Act, Shares are issued by the New Funds and that the acquisition of Shares by investment companies is subject to the restrictions of section 12(d)(1) of the Act, except as permitted by an exemptive order that permits registered investment companies to invest in a New Fund beyond the limits in section 12(d)(1), subject to certain terms and conditions, including that the registered investment company enter into an agreement with the New Fund regarding the terms of the investment.

3. As long as the Trust operates in reliance on the requested order, the Shares will be listed on an Exchange.

4. Neither the Trust nor any New Fund will be advertised or marketed as an open-end fund or a mutual fund. The Prospectus will prominently disclose that Shares are not individually redeemable shares and will disclose that the owners of the Shares may acquire those Shares from the Trust and tender those Shares for redemption to the Trust in Creation Units only. Any advertising material that describes the purchase or sale of Creation Units or refers to redeemability will prominently disclose that Shares are not individually redeemable and that owners of Shares may acquire those Shares from the Trust and tender those Shares for redemption to the Trust in Creation Units only.

5. Before a New Fund may rely on the order, the Commission will have approved, pursuant to rule 19b-4 under the Exchange Act, an Exchange rule or an amendment thereto, requiring Exchange members and member organizations effecting transactions in Shares to deliver a Product Description to purchasers of Shares.

6. The website for the Trust, which will be publicly accessible at no charge, will contain the following information, on a per Share basis, for each New Fund: (a) the prior Business Day's NAV and the closing price (or the mid-point of the bid-ask spread at the time of calculation of such NAV (the Bid/Ask Price)), and a calculation of the premium or discount of such closing price (or Bid/Ask Price) against such NAV; and (b) data in chart format displaying the frequency distribution of discounts and premiums of the closing price (or Bid/Ask Price) against the NAV, within appropriate ranges, for each of the four previous calendar quarters (or the life of the New Fund, if shorter). In addition, the Product Description for each New Fund will state that the website for the Trust has information about the premiums and discounts at which the Shares have been traded.

7. The Prospectus and annual report for each New Fund will also include: (a) the information listed in condition 6(b), (i) in the case of the Prospectus, for the most recently completed year (and the most recently completed quarter or quarters, as applicable), and (ii) in the case of the annual report, for the immediately preceding five years (or the life of the New Fund, if shorter); and (b) the following data, calculated on a per Share basis for one, five and ten year periods (or life of the New Fund, if shorter), (i) the cumulative total return and the average

annual total return based on NAV and closing price (or Bid/Ask Price), and (ii) the cumulative total return of the relevant Underlying Index.

For the Commission, by the Division of Investment Management, pursuant to delegated authority.

Florence E. Harmon
Deputy Secretary