

U.S. Securities and Exchange Commission
Fixed Income Market Structure Advisory Committee

Recommendations for Investor Education and Data on ETFs
October 29, 2018

Executive Summary

The FIMSAC has reached several conclusions and recommendations regarding education and data. The recommendations are summarized briefly as follows:

- **The FIMSAC recommends that the Commission encourage the formation of an industry-wide group to promote investor education.** The group should address the following:
 - **Education of Financial advisors:** Create robust and detailed trading module within existing required certifications for financial advisors, and emphasize continuing education.
 - **Communication with Retail:** Adapt financial advisor education content to suit retail audience. Improve disclosures along the lines as proposed Rule 6c-11 for consistent disclosures and improve investor awareness.
 - **Identification of Standard Information Concerning ETFs:** Identify key data elements, common definitions for such data elements, and where such data elements may be procured or found that are necessary for analyzing and comparing ETFs across the market. This effort should also focus on common data and formatting standards and should include key information regarding ETF portfolio and trading data.
- **The FIMSAC recommends the creation of a centralized and widely accessible database hosting the key data elements noted above.** Identified data that is needed to support and further investor education, should be made readily accessible to all industry stakeholders, on a non-discriminatory basis. Sensitive data should be delayed but available for academic and industry research.

Broad Observations

The FIMSAC wishes to acknowledge and commend the strong and ongoing efforts by FINRA and other regulatory and industry bodies such as the Investment Company Institute (ICI) to improve investor education. ETF education and data standardization will become increasingly important upon implementation of the proposed SEC Rule 6c-11, and the sub-committee has summarized our findings and recommendations herein.

Numerous industry participants have commented on the importance of investor education work, and the need for ongoing regulatory efforts to strengthen the ecosystem and improve the outcome for investors, particularly retail investors. In addition to our recommendations surrounding various standardized disclosures for ETFs, we believe the intermediary community plays an important role in proper dissemination of relevant information surrounding bond funds and ETFs. The FIMSAC is in favor of continuing these efforts and recommends the Commission to

continue to play a role in consolidating and coordinating educational efforts where possible.

Education: Delivery and Level

Educational needs of retail investors differ from those of institutional investors. As such, we recommend that information aimed at retail investors should be delivered in a different manner and with distinct, plain language.

- a. There is a general view among industry participants that education content would be more likely to be impactful if it was provided from a cross-section of academics and industry groups/participants. We recommend formation of an industry wide group that includes ETF issuers, academics and others to further education as described below.¹
- b. Most ETF issuers post a wide variety of data on their websites, and many provide separate data feeds to individual data vendors such as Bloomberg and FactSet. However, information may vary substantially across these issuers (e.g., some, but not all exclude negative earnings from reported PE ratios?). We recommend that the Commission, in conjunction with a group of industry representatives, specify a common standard that includes both definitions (e.g., Are bid-ask spreads time-weighted, and over what duration?) and formatting standards/conventions (e.g., CSV, XML, etc.). It is worth noting a similar precedent was set when the industry agreed on standards for fixed income portfolio aggregated cash flow data (ACF) reporting. Such standards would simplify the task of gathering and comparing data for all levels of investors, especially retail investors.
- c. The FIMSAC recognizes the special need to place greater emphasis on investor trading knowledge, particularly around ETFs. ETFs trade on exchanges and hence investments in these products requires a minimum understanding of trading, including order types (e.g., market/limit etc.) and transaction costs (commissions/bid-ask spreads etc.). We support the Commission's proposal to expand disclosure of historical bid/ask spreads associated with ETFs, and have recommended consideration of additional historical information which would enhance investor education in this area.²
- d. The FIMSAC Subcommittee on ETFs and Bond Funds ("ETFs and Bond Funds Subcommittee") also noted the significant structural differences between bond mutual funds and ETFs, including liquidity. These important differences may be relevant to investors in times of stress (and among other times) and the ETFs and Bond Funds Subcommittee intends to continue its work in this area in the coming months.

In addition, the structural differences between ETFs and mutual funds may have important tax implications which may not be apparent to investors but which may be particularly relevant to certain retail investors.

¹ See David Nadig ("The ETF Rule: ETF.com's Comment Letter" August 30, 2018) available at <https://www.etf.com/sections/blog/etf-rule-etfcoms-comment-letter?nopaging=1>

² See Letter from FIMSAC to Brent J. Fields, Secretary, SEC (Oct. 29, 2018) (Recommendation for an Exchange-Traded Product Classification Scheme).

- e. Some education must be completed at the platform level, as well as through certification programs.
- The FIMSAC recommends that the Commission and industry work towards a robust and detailed trading module within existing required certifications for financial advisors. Items that would be covered include:
 - Appropriate use of order types (e.g., limit/stop/market, and education on why an unlimited buy order should not be placed at 5PM for the next day's trading);
 - Recognition that ETF premiums/discounts can be misleading when NAV is stale, perhaps because of non-synchronous trading or exchange-hours;
 - Understanding of market impact for larger trades;
 - Awareness that transactions may occur at prices different from intraday intrinsic value depending on market volatility, liquidity, and time of day, including after-hours trading; and
 - Correct usage of terms such as "ETF" as specified by our recommended classification schema.
 - In addition, because of the ongoing evolution of market structure generally, we recommend that continuing education surrounding the trading of ETFs should be emphasized broadly, in addition to certification programs.
 - Language used in content development should be modified for a retail audience. Improved disclosure of risks and management of expectations are key components of this concept. The Commission's Proposed Rule 6c-11 Request for Comment outlined specific potential areas for consistent disclosures, which we believe will be effective in improving investor awareness.

Data: Availability and Standardization

- f. The ETFs and Bond Funds Subcommittee will be drafting (for FIMSAC's consideration at the full January 2019 meeting) a report considering its findings on bond funds in stressed markets, as per its charter. While this report will be specific to this topic and refer to technical/academic research, the ETFs and Bond Funds Subcommittee also believes that investor education would be enhanced with more general materials, particularly those that clearly highlight the differences between open-end mutual funds and ETFs.
- g. We believe it is important to improve the availability, quality and quantity of data related to this market. As we believe that Fixed Income ETFs and Bond Funds will continue to grow, it will be critical for regulators to have consistent, readily available data to analyze. Feedback received from academics highlighted that data on ETFs is hard to find and not centralized or standardized. This comment also applies to advisors and others – including sophisticated investors – who note the difficulty in comparing even basic data (such as bid-offer spreads) across asset managers. Other

important data, such as the ratio of primary to secondary market volumes or number of authorized participants) is difficult to find.

- We would recommend the industry committee create a **primer** (presenting the most basic elements) on analyzing ETFs, focusing on identifying key data aspects along with common definitions for the use of investors, regulators and academics.
 - This primer should specify where to get key information and how to utilize it. Identifying what is available and where to find it will start us in the right direction of increased engagement and involvement from academics in the ETF space, which should help further analyze this increasingly important area.
- h. Data and interface standardization is a first step – i.e., we encourage the formation of an industry group to identify a set of data and interfaces that are standardized and consistent, as noted earlier. Items would be very specific and well-defined in order to facilitate standardization and comparability. The FIMSAC recommends that these data include the following:
- **Portfolio Data**
 - ETF characteristics such as security name, unique identifier (ticker, SEDOL/CUSIP/ISIN), price (or assessed value), ETF benchmark declaration (i.e. “self-declared” or “third party”) and high-level information describing the attributes of the ETF or Fund (e.g. representative sampling approach for an index-based ETF/Fund, expense ratio, etc.)
 - Intraday indicative values (IIV) adjusted for staleness based on a generally agreed upon approach. We also recommend that premiums/discounts be appropriately described in situations where they may be less meaningful because of stale pricing and non-synchronous trading;
 - Key fund statistics (e.g. yield, duration, etc.) and distributions (e.g. by sector, rating, ten largest issuers, etc.);
 - ETF daily creation and redemption baskets (T+1), and information on unit size and fees.
 - **Trading Data**
 - Bid-offer spreads under standard, time-weighted methodology (see above);
 - Primary and secondary market volumes; and
 - ETF Holding data (T+1) including underlying security identifiers and weight (%), cash balance, accrued interest (bond funds), shorts, futures, swaps, etc. that are needed to estimate portfolio NAV;
 - Number of APs; Participation measures to track active APs;

- i. Centralized availability and access to data is important. We recommend that data should be made readily accessible to all industry stakeholders, on a non-discriminatory basis. Ideally this data should be made available using commonly adopted protocols, such as APIs to ensure that similarly situated market participants receive data using a common mechanism.
 - Market makers play an important role in the smooth functioning of the ETF market via their participation in the create/redeem process and the provision of secondary market liquidity. However, the lack of suitable data and common technology standards makes it difficult to assess whether the process works well, particularly under stress conditions, and to identify potential problems that need to be addressed. To this end, we recommend that intraday transactions data that identifies market maker trades and create/redeem order information be collected in a centralized fashion. We recognize the sensitive nature of the data and recommend that the information be made available with a delay (say one year or 18 months) for academic and industry research (similar to the TRACE dataset with masked AP/MM identity that is made available with a delay).