IM Guidance Update

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MERGER OF TWO EXCHANGE-TRADED FUNDS

An exchange-traded fund ("ETF") registered under the Investment Company Act of 1940 ("1940 Act") is a unique type of investment company (or "fund") that operates and trades by virtue of exemptive relief granted by the Commission ("Exemptive Order").

The staff has received an inquiry regarding whether an ETF may merge with another affiliated ETF,[1] notwithstanding certain material representations made in the exemptive application underlying each Exemptive Order. Under the application, for example, an ETF issues and redeems its shares solely in creation unit aggregations through financial intermediaries (i.e., "authorized participants") in exchange for a set "basket" of instruments and cash, the identity of which has been previously made publicly available. In a merger under Rule 17a-8, however, an acquired fund would transfer substantially all of its assets to an acquiring fund, whether or not included in a published basket. In exchange, the acquiring fund would issue interests, not necessarily in creation unit aggregations, to the shareholders of the acquired fund, without going through authorized participants.

The staff notes that fund mergers effected in compliance with Rule 17a-8 are subject to disclosure, registration, shareholder approval and other requirements, as applicable, which are designed to protect the merging funds and their shareholders. In the view of the staff, although an ETF's Exemptive Order does not contemplate a merger of two affiliated ETFs, such a merger would not raise any new or different issues not addressed by the above-referenced existing requirements governing mergers of affiliated funds. Accordingly, the staff would not recommend enforcement action to the Commission under the provisions of the 1940 Act from which the relevant Exemptive Orders grant relief if two affiliated ETFs merged, so long as the merger meets the requirements of Rule 17a-8 and all applicable disclosure, registration, shareholder approval and other requirements.

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1 *See* Rule 17a-8 under the 1940 Act ("Rule 17a-8") for the definition of "merger."

This guidance relates solely to a merger of two affiliated ETFs as discussed above—the staff may take a different view with respect to other types of corporate reorganizations (e.g., a traditional open-end investment company merging, or converting, into an ETF). The staff expresses no view with respect to any other questions that such transactions may raise, including but not limited to the applicability of other federal or state laws, rules or regulations including Regulation M (17 CFR 242.100 – 05) or rules or regulations of any self-regulatory organization to such transactions.

This IM Guidance Update summarizes the views of the Division of Investment Management regarding various requirements of the federal securities laws. Future changes in laws or regulations may supersede some of the discussion or issues raised herein. This IM Guidance Update is not a rule, regulation or statement of the Commission, and the Commission has neither approved nor disapproved of this IM Guidance Update.

The Investment Management Division works to:

- protect investors
- promote informed investment decisions and
- facilitate appropriate innovation in investment products and services

through regulating the asset management industry.

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