

MEMO# 22476

May 1, 2008

ICI Draft Comment Letter On The SEC's ETF Rule Proposal; Conference Call May 9th

[22476]

May 1, 2008

TO: ETF ADVISORY COMMITTEE No. 9-08
SEC RULES COMMITTEE No. 33-08
SMALL FUNDS COMMITTEE No. 15-08
UNIT INVESTMENT TRUST COMMITTEE No. 8-08 RE: ICI DRAFT COMMENT LETTER ON THE
SEC'S ETF RULE PROPOSAL; CONFERENCE CALL MAY 9TH

As we previously informed you, the Securities and Exchange Commission has proposed Rule 6c-11 under the Investment Company Act of 1940, which would permit certain exchange-traded funds to begin operating without obtaining exemptive relief from the Commission. [\[1\]](#) In conjunction with this proposed rule, the SEC has proposed amendments to its disclosure form for open-end investment companies, Form N-1A, to provide more useful information for ETF investors. The Commission also has proposed Rule 12d1-4 to permit investment companies to invest in ETFs to a greater extent than is currently permitted under the Investment Company Act. Exemptive relief from those restrictions has been granted to ETFs in the past. Finally, the Commission has proposed to amend Rule 12d1-2 to permit affiliated funds of funds to invest in unaffiliated ETFs and assets other than securities.

Based on comments received during our March 31st conference call on the proposal, the Institute has prepared the attached draft comment letter. The most significant comments are briefly summarized below.

Comments on the proposed rules are due no later than May 19, 2008. We will hold a conference call on Friday, May 9 at 2:00 EDT to discuss the draft letter. The dial-in number

is 888/566-6139 and the passcode is 10833. If you plan to participate on the call, please r.s.v.p. to Maureen Maher at mmaher@ici.org or 202/326-5823. If you are unable to participate on the call, please provide your comments to Mara Shreck at mshreck@ici.org or 202/326-5923 by May 12.

Proposed Rule 6c-11

The draft letter strongly supports the SEC's proposal to permit certain ETFs to begin operating without first obtaining exemptive orders from the Commission. More specifically, the draft letter:

- Supports the inclusion in the rule of both index-based and fully transparent actively managed funds;
- Recommends that, to satisfy transparency requirements, the rule permit funds to disclose either their entire portfolio or, for funds that track the performance of an index, their creation basket, provided the basket is an optimized sample of the portfolio;
- Agrees with the proposal not to require either disclosure of intra-day changes in an ETF portfolio or advance disclosure of portfolio trades;
- Supports the requirement that ETFs be listed on a national securities exchange, but recommends requiring that an ETF's intraday value be disseminated by a major market data vendor (which could be an exchange), rather than requiring such dissemination by an exchange;
- Requests clarification that an ETF is not prohibited by Section 17(a) or 17(e)(1) of the Investment Company Act from paying an index licensing fee to an affiliated index provider;
- Supports the proposed flexibility in the size of a creation unit, but recommends changes to the definition of creation unit;
- Recommends that the proposed relief from Section 17(a)(1) and (2), which would permit those persons that are affiliated with an ETF solely by reason of holding five percent or more of the ETF's outstanding voting securities to transact with the fund, be expanded to include those persons that are affiliated with the ETF for other reasons;
- Does not object to the elimination of the product description; and
- Suggests certain changes to the proposed revisions to Form N-1A for ETFs.

Exemptions for Companies Investing in ETFs

The draft letter also strongly supports the SEC's proposal to provide relief from the limits set by Sections 12(d)(1)(A) and (B) of the Investment Company Act for investment companies investing in ETFs. In particular, the draft letter:

- Strongly supports the Commission's approach of using the concept of "control," as defined under the Investment Company Act, to guard against potential coercive behavior by an acquiring fund, by creating a rebuttable presumption that an acquiring fund's beneficial ownership of up to 25 percent of the voting securities of an ETF does not constitute control over the ETF;
- Recommends limiting the scope of affiliates whose holdings must be included in the 25 percent calculation;
- Supports the proposed limitation on redemption of ETF shares by investing funds

relying on proposed Rule 12d1-4;

- Supports limiting the investments acquired ETFs can make in other investment companies, while recommending revisions to the adopting release and rule text to clarify certain aspects of the limitations; and
- Recommends that unregistered funds also be permitted to rely on the proposed rule.

Exemption for Affiliated Fund of Funds Investments

The draft letter strongly supports the proposal to include ETFs and “other assets” as permissible investments for affiliated funds of funds relying on Rule 12d1-2.

Mara Shreck
Associate Counsel

[Attachment](#)

endnotes

[1] See Institute Memorandum No. 22365, dated March 24, 2008, summarizing Exchange-Traded Funds, SEC Release Nos. 33-8901 and IC-28193 (March 11, 2008) ("Proposing Release"), available at <http://www.sec.gov/rules/proposed/2008/33-8901.pdf>.

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