

MEMO# 22543

May 20, 2008

ICI Comment Letter on SEC's ETF Rule Proposal

[22543]

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 16-08
ETF ADVISORY COMMITTEE No. 11-08
SEC RULES MEMBERS No. 43-08
SMALL FUNDS MEMBERS No. 33-08
UNIT INVESTMENT TRUST MEMBERS No. 9-08 RE: ICI COMMENT LETTER ON SEC'S ETF
RULE PROPOSAL

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 assets other than securities.

The Institute's comment letter on the proposal is attached, and is briefly summarized below.

Proposed Rule 6c-11

The 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 letter:

- Supports the inclusion in the rule of both index-based and fully transparent actively

managed funds;

- Recommends that 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;
- 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 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 letter:

- 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;
- Encourages the Commission to consider arrangements in which investors may benefit from the existence of an acquiring fund investing in an ETF that itself invests in other funds or ETFs;
- Recommends certain revisions and clarifications to the proposed restrictions on investments acquired ETFs can make in other investment companies; and
- Recommends that unregistered funds also be permitted to rely on the proposed rule.

Exemption for Affiliated Fund of Funds Investments

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

[Attachment](#)

[1] See Institute Memorandum No. 22365, dated March 24, 2008; see also *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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