

SEC Adopts New Rule to Modernize Regulation of Exchange-Traded Funds

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Washington D.C., Sept. 26, 2019 —The Securities and Exchange Commission today announced that it has voted to adopt a new rule and form amendments that are designed to modernize the regulation of exchange-traded funds (ETFs), by establishing a clear and consistent framework for the vast majority of ETFs operating today. The adoption will facilitate greater competition and innovation in the ETF marketplace, leading to more choice for investors. It also will allow ETFs to come to market more quickly without the time or expense of applying for individual exemptive relief. In addition, the Commission voted to issue an exemptive order that further harmonizes related relief for broker-dealers.

“Since ETFs were first developed over 27 years ago, they have provided investors with a number of benefits, including access to a wide array of investment strategies, in many cases at a low cost,” said SEC Chairman Jay Clayton. “As the ETF industry continues to grow in size and importance, particularly to Main Street investors, it is important to have a consistent, transparent, and efficient regulatory framework that eliminates regulatory hurdles while maintaining appropriate investor protections.”

ETFs are hybrid investment products not originally allowed under the U.S. securities laws. Their shares trade on an exchange like a stock or closed-end fund, but they also allow identified large institutions to transact directly with the fund. Since 1992, the Commission has issued more than 300 exemptive orders allowing ETFs to operate under the Investment Company Act. ETFs have grown substantially in that period, and today there are approximately 2,000 ETFs with over \$3.3 trillion in total net assets. Investors use ETFs for a variety of purposes, including core components of long-term investment portfolios, investment of temporary cash holdings, and for hedging portfolios.

ETFs relying on the rule and related exemptive order will have to comply with certain conditions designed to protect investors, including conditions regarding transparency and disclosure. To help create a consistent ETF regulatory framework, one year after the effective date of the rule, the Commission is rescinding exemptive relief previously granted to certain ETFs, including those that will be permitted to operate in reliance on the rule. The rule and form amendments will be effective 60 days after publication in the Federal Register, but there will be a one-year transition period for compliance with the form amendments.

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FACT SHEET **Exchange-Traded Funds**

Highlights

The Commission voted to adopt a new rule and form amendments designed to modernize the regulatory framework for exchange-traded funds (“ETFs”). Rule 6c-11 will permit ETFs that satisfy certain conditions to operate within the scope of the Investment Company Act of 1940 (the “Act”), and come directly to market without the cost and delay of obtaining an exemptive order. This should facilitate greater competition and innovation in the ETF marketplace by lowering barriers to

entry. The actions announced today will replace hundreds of individualized exemptive orders with a single rule. The rule's standardized conditions are designed to level the playing field among most ETFs and protect ETF investors, while disclosure amendments adopted by the Commission will provide investors who purchase and sell ETF shares on the secondary market with new information. In addition, the Commission voted to issue an exemptive order that further harmonizes related relief from certain provisions of the Securities Exchange Act of 1934 (the "Exchange Act").

Scope of Rule 6c-11

Rule 6c-11 will be available to ETFs organized as open-end funds, the structure for the vast majority of ETFs today. ETFs organized as unit investment trusts (UITs), leveraged or inverse ETFs, ETFs structured as a share class of a multi-class fund, and non-transparent ETFs will not be able to rely on the rule.

Conditions for Reliance on Rule 6c-11

Rule 6c-11 will provide certain exemptions from the Act and also impose certain conditions. The conditions include the following:

- **Transparency.** Under rule 6c-11, an ETF will be required to provide daily portfolio transparency on its website.
- **Custom basket policies and procedures.** An ETF relying on rule 6c-11 will be permitted to use baskets that do not reflect a pro-rata representation of the fund's portfolio or that differ from the initial basket used in transactions on the same business day ("custom baskets") if the ETF adopts written policies and procedures setting forth detailed parameters for the construction and acceptance of custom baskets that are in the best interests of the ETF and its shareholders. The rule also will require an ETF to comply with certain recordkeeping requirements.
- **Website disclosure.** The rule will require an ETF to disclose certain information on its website, including historical information regarding premiums and discounts and bid-ask spread information. These disclosures are intended to inform investors about the costs of investing in ETFs and the efficiency of an ETF's arbitrage process.

Rescission of Certain ETF Exemptive Relief

To help create a consistent ETF regulatory framework, one year after the effective date of rule 6c-11 (discussed below), the Commission is rescinding exemptive relief previously granted to ETFs that will be permitted to operate in reliance on the rule. The Commission is also rescinding exemptive relief permitting ETFs to operate in a master-feeder structure, which very few ETFs currently utilize. However, the Commission is grandfathering certain existing master-feeder arrangements and preventing the formation of new ones, by amending relevant exemptive orders. The Commission is not rescinding exemptive relief that permits ETF fund of funds arrangements. Moreover, ETFs relying on rule 6c-11 that do not already have their own exemptive relief may enter into fund of funds arrangements as set forth in recent ETF exemptive orders, provided that they satisfy the terms and conditions for fund of funds relief in those orders, until such time as the Commission issues a rule governing fund of funds arrangements.

Amendments to Form N-1A and Form N-8B-2

The Commission is adopting several amendments to Form N-1A – the form ETFs structured as open-end funds must use to register under the Act and to offer their securities under the Securities Act. These amendments will provide more useful, ETF-specific information to investors who purchase ETF shares on an exchange. The Commission also is adopting amendments requiring that ETFs organized as UITs provide the same information to investors on Form N-8B-2 – the form ETFs structured as UITs must use to register under the Act.

Exemptive Relief and Interpretations Under the Exchange Act

In addition to the rule and form amendments under the Investment Company Act, the Commission is issuing an exemptive order that harmonizes certain related relief under the Exchange Act. In particular, the order provides exemptive relief to broker-dealers and other persons from certain requirements under the Exchange Act with respect to ETFs relying on rule 6c-11.

What's Next?

The rule, form amendments, and related exemptive relief will be published on the Commission's website and in the Federal Register. All will become effective 60 days after publication in the Federal Register.

The Commission is rescinding, one year after the effective date of rule 6c-11, those portions of prior ETF exemptive orders that grant relief related to the formation and operation of certain ETFs, including certain master-feeder relief. The Commission also is providing a transition period for the amendments to Forms N-1A and N-8B-2 of one year following the amendments' effective date.

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