On September 26, 2019, the Securities and Exchange Commission (the “SEC”) adopted Rule 6c-11 (the “Rule”) under the Investment Company Act of 1940 (the “1940 Act”), the long-awaited “ETF Rule.” ETFs that satisfy certain conditions will no longer be required to first obtain individualized exemptive orders from the SEC before launching and operating. The Rule will be effective sixty days after publication in the Federal Register, with a one-year transition period for compliance with the registration statement disclosure requirements.

After one year, the SEC will rescind existing ETF orders. This means that ETFs (other than a small group of ETFs discussed below) will no longer be able to operate under their individualized exemptive relief, which over time has subjected ETFs to inconsistent terms and conditions. Instead, these ETFs will operate under a standard set of conditions designed to create a consistent, transparent, and efficient regulatory framework that should facilitate greater competition and innovation.

Vedder Price will analyze the impact of the Rule on ETFs and their sponsors, and will publish a comprehensive guide for implementing the new policies and procedures required by the Rule. The guide will also discuss the impact of the Rule on the operations of existing ETFs and the imposition of additional costs and burdens that may flow from the Rule. In the interim, what follows is an overview of the primary provisions of the Rule that were adopted substantially as proposed, and the provisions that were modified in response to industry comments.
Provisions Adopted as Proposed

Scope

- **Applicability to certain ETFs.** Leveraged and inverse ETFs, ETFs organized as unit investment trusts ("UITs"), and ETFs organized as a share class of a fund that issues multiple classes of shares representing interests in the same portfolio, are not covered by the Rule. Prior exemptive orders for such ETFs will not be rescinded.

- **Classification of ETF shares.** Shares of ETFs relying on the Rule are classified as “redeemable securities” for various purposes under the 1940 Act and Securities Exchange Act of 1934 (“Exchange Act”). Shares of all ETFs are classified as redeemable for certain provisions of the Exchange Act.

- **No distinction between indexed-based and actively managed ETFs.** Under the Rule, both index-based and actively managed ETFs are subject to the same conditions.

- **No distinction between self-indexed and unaffiliated indexed ETFs.** Under the Rule, self-indexed ETFs are subject to the same conditions as ETFs with an unaffiliated index provider.

- **Rescission of certain prior exemptive orders.** Effective one year after the effective date of the Rule, exemptive orders granted to ETFs covered by the Rule will be rescinded.

Transparency and Disclosure

- **Portfolio holdings publication.** The SEC adopted a “full transparency” requirement as proposed. An ETF must disclose prominently on its website the portfolio holdings that will form the basis for the next calculation of net asset value ("NAV") per share, which must be disclosed each business day before the opening of regular trading on the primary listing exchange of the ETF’s shares.

- **No requirement to publish intraday indicative value.** Under the Rule, ETFs will not be required to publish an intraday indicative value ("IIV").

- **Bid-Ask spread publication.** ETFs must disclose on their websites information about median bid-ask spreads and certain historical information about the extent and frequency of premiums and discounts.

- **Cost disclosure.** Additionally, the Rule includes registration form amendments requiring additional disclosure regarding ETF trading information and related costs.

Custom Baskets

- **Custom baskets permitted.** Baskets that are composed of a non-representative selection of the ETF’s portfolio holdings are permitted, subject to certain disclosure requirements and potentially burdensome requirements to establish new policies and procedures for custom baskets.
Provisions That Were Not Adopted as Proposed or That Were Modified

Several provisions of the proposed rule were controversial and generated substantial industry feedback because they would have placed additional costs or operational burdens on ETFs. The SEC took these comments into consideration and made the following changes to the proposed rule. The changes primarily involved proposed requirements relating to transparency and disclosure provisions.

Transparency and Disclosure

- **Basket publication.** The Rule eliminates the requirement to publish on an ETF’s website a hypothetical basket that it would exchange for orders to purchase or redeem creation units based on the ETF’s next calculation of NAV. While this requirement was designed to facilitate arbitrage by providing market participants with timely information regarding the contents of a basket that the ETF would accept that particular day, the SEC agreed with commenters that the proposed published basket was speculative and that it would be costly to implement and unnecessarily burdensome, particularly because basket composition information is not used by secondary market investors.

- **Portfolio holdings disclosure.** The Rule eliminates the proposal to require an ETF to disclose its portfolio holdings before it starts accepting orders for the purchase or redemption of creation units. This “second” portfolio holding publication requirement would have been in addition to the general pre-trading requirement to disclose portfolio holdings.

- **Bid-Ask spread publication.** The Rule modifies the proposal to require disclosure on an ETF’s website of the median bid-ask spread disclosure over the most recent fiscal year to the most recent 30 calendar days.

- **Hypothetical bid-ask spread publication.** The Rule eliminates the proposal to require examples in an ETF’s prospectus showing how bid-ask spreads would impact the return of a hypothetical investment.

- **Interactive calculator.** The Rule eliminates the proposal to require an interactive calculator on an ETF’s website allowing an investor to customize hypothetical bid-ask spread calculations.

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