ETF Proposed Rule: Portfolio Holding Transparency

The following post gives an overview of the portfolio holding disclosure requirements contained in proposed Rule 6c-11 ("ETF Rule"). As further set forth below, the SEC is proposing full transparency of portfolio holdings and is not proposing to permit non-transparent or partially transparent ETFs (although they did request comment on the subject).

General Requirements

The ETF Rule would require an ETF to disclose its portfolio holdings that will form the basis for the calculation of its NAV per share as of the close of business on the prior business day. According to footnote 210 of the proposal, an ETF would not be permitted to reflect portfolio changes on anything but a T+1 basis. A T+1 basis means that any trades done in an ETF will be reflected in the next business day's portfolio holdings disclosure and calculation of its NAV rather than on the day of the trade.

Location of Disclosure: The portfolio holdings must be made available on the ETF's website, which must be publicly available and free of charge.

Frequency and Timing of Disclosure: Updated holdings must be disclosed before the opening of regular trading on the primary listing exchange of the ETF's shares and before the ETF accepts orders for the purchase or redemption of creation units.

Scope of Holdings: Portfolio holdings is defined to include securities, assets or other positions and therefore includes cash holdings, derivative positions and short positions.

Basis of Presentation: Portfolio holdings information would be required to be presented in the form set forth in Article 12 of Regulation S-X. This would generally be the same presentation as used for financial statement reporting and would include information such as description, amount, value and/or unrealized gain/loss.

Our Take

The ETF Rule generally seeks to standardize the disclosure of an ETF's portfolio holdings as well as standardize the format of such disclosure. The SEC's goal continues to be ensuring that market participants have the information they need to engage in arbitrage opportunities that will result in the market prices of the ETF being at or close to the NAV per share of the ETF. The ETF Rule generally represents two changes in the SEC staff's prior thinking on portfolio holdings disclosure. First, both index-based ETFs and actively managed ETFs will have to make their portfolio holdings public each business day. Previously, in the 2008 proposed ETF rule, the SEC would permit index-based ETFs to disclose the components and weightings in the index the ETF sought to track. However, such disclosure may not completely correspond to the holdings of the index-based ETF to the extent it is utilizing derivatives or a sampling methodology to track the performance of the index. In order to ensure a proper functioning of the arbitrage mechanism, the SEC proposes to move to complete portfolio holdings disclosure for both index-based and active ETFs. Second, the ETF Rule would standardize the format of ETF portfolio holdings disclosure via reference to Regulation S-X. This would result in ETF providers providing the same information, in the same format, with respect to their portfolio holdings, which should ensure consistent disclosure to market participants. Our next post will examine the portfolio baskets permitted by the ETF Rule.

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