

## The SEC Issues its Long-Awaited ETF Rule (Part 2) - What was Omitted

In a [previous post](#), we outlined the scope of new Rule 6c-11 (the "ETF Rule") which the U.S. Securities and Exchange Commission ("SEC") [approved](#) on September 26, 2019. In this post, we identify some conditions currently required in ETF exemptive orders that were not included in the ETF Rule.

- **Intraday Indicative Value:** Currently, exchange listing standards include a requirement that an intraday estimate of an ETF's NAV per share (an "intraday indicative value" or "IIV") be widely disseminated at least every 15 seconds during regular trading hours (every 60 seconds for international ETFs). The SEC did not include this requirement in the ETF Rule, observing that the IIV can be inaccurate for some ETFs, is not necessary to support the arbitrage mechanism, and is no longer widely used by market participants when conducting arbitrage trading. The SEC also noted that full portfolio transparency can provide the same benefits as IIV. Until changes are implemented to listing standards, however, a listed ETF must still have its IIV calculated and disseminated.
- **Marketing Disclosures:** The SEC did not adopt its [proposal](#) to require an ETF-specific Q & A description of the differences between an ETF and a mutual fund. The final ETF Rule also does not require an ETF to provide certain marketing disclosures such as identifying itself as an ETF in any sales literature or stating that individual shares may be purchased and sold only through a broker via a national securities exchange.
- **Fund-of-Fund Arrangements with ETFs:** [Section 12\(d\)\(1\)](#) of the Investment Company Act of 1940 generally limits the percentage of assets that registered investment companies may invest in other registered funds, sometimes referred to as "fund-of funds." The SEC has granted numerous exemptive orders to ETF sponsors to permit investment companies to invest in ETFs beyond the limits in Section 12(d)(1) subject to certain conditions. In adopting the ETF Rule, the SEC stated that it was not rescinding the Section 12(d)(1) relief included in the exemptive orders permitting these fund-of-fund arrangements. In addition, to avoid any disadvantage for new entrants into the ETF market, the SEC stated that ETFs relying on Rule 6c-11 that have not received exemptive orders may enter into fund-of-fund arrangements subject to the same conditions set forth in recent ETF exemptive orders. However, the SEC noted its [pending fund-of-funds rule](#) proposal and said that this relief will only be available until the effective date of the new Rule 12d1-4, if adopted.
- **Master-Feeder ETFs:** The SEC has previously allowed ETFs to operate as feeder funds in a "master-feeder" structure through exemptive orders granted under Section 12(d)(1). However, the final ETF Rule does not include exemptions for master-feeder ETFs. In addition, the SEC rescinded its existing master-feeder relief for any ETF not already relying on an exemptive order as of June 28, 2018. Any fund complex relying on its master-feeder order prior to that date may continue; however, the SEC is amending the exemptive orders to prevent the creation of any new master-feeder ETFs after that date. Any ETF interested in a master-feeder structure may still apply for an exemptive order.
- **Share Class ETFs:** The SEC declined to allow an ETF relying on Rule 6c-11 to operate as a share class within an open-end mutual fund in reliance on Rule 18f-3, because the rights and obligations of the ETF shareholders would differ from those of investor's in the fund's mutual fund share classes. Share class ETFs, which were originally pioneered by Vanguard, may still apply for an exemptive order.
- **Bid-Ask Spread and Interactive Calculator:** The SEC decided not to amend Forms N-1A and N-8B-2 to require an ETF to provide: (1) examples in the ETF's prospectus showing how bid-ask spreads impact the

return on a hypothetical investment for both buy-and-hold and frequent traders; and (2) an interactive calculator on the ETF's website that would allow an investor to customize the hypothetical bid-ask spread calculations to a specific investing situation. Commenters generally expressed concern about the administrative burdens of these proposals.

## What's Next?

As we noted in Part 1, the ETF Rule goes into effect sixty days after it appears in the Federal Register, which has not happened as of this post. One year following its effective date, except as explained above, the SEC will rescind the exemptive orders for any existing ETF that falls within its scope. In the meantime, check back here for additional discussion on issues related to the ETF Rule.

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