

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-87110 / September 25, 2019)

ORDER GRANTING A CONDITIONAL EXEMPTION FROM EXCHANGE ACT SECTION 11(D)(1) AND EXCHANGE ACT RULES 10B-10, 15C1-5, 15C1-6, AND 14E-5 FOR CERTAIN EXCHANGE TRADED FUNDS

AGENCY: Securities and Exchange Commission

ACTION: Exemptive order

SUMMARY: The Securities and Exchange Commission (“Commission” or “SEC”) is issuing an order granting an exemption from compliance with certain provisions of the Securities Exchange Act of 1934 (“Exchange Act”) and the rules thereunder to broker-dealers and certain other persons engaging in certain transactions in securities of exchange-traded funds (“ETFs”) relying on rule 6c-11 under the Investment Company Act of 1940 (“Investment Company Act”).

EFFECTIVE DATE: This exemptive order is effective December 23, 2019.

FOR FURTHER INFORMATION, CONTACT: Darren Vieira, Special Counsel, Brandon Hill, Special Counsel, or Joanne Rutkowski, Assistant Chief Counsel, at (202) 551-5550; in the Division of Trading and Markets; Daniel Duchovny, Special Counsel, Office of Mergers and Acquisitions, at (202) 551-3440, in the Division of Corporation Finance; Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

I. Introduction

The Commission adopted rule 6c-11 under the Investment Company Act, which permits ETFs that satisfy certain conditions to operate without the expense and delay of obtaining an

exemptive order from the Commission under the Investment Company Act.¹ Rule 6c-11 is designed to create a consistent, transparent, and efficient regulatory framework for ETFs and to facilitate greater competition and innovation among ETFs.

While the relief under rule 6c-11 is limited to exemptions under the Investment Company Act,² commenters on proposed rule 6c-11 also recommended that the Commission harmonize with rule 6c-11 certain Exchange Act relief that ETFs currently rely on in order to operate, including relief from section 11(d)(1) of the Exchange Act and Exchange Act rules 10b-10, 15c1-5, 15c1-6, and 14e-5.³ Commenters expressed concern that the conditions that have been

¹ Exchange Traded Funds, Investment Company Act Release No. 33646 (Sep. 25, 2019) (“Rule 6c-11 Adopting Release”).

² In the Rule 6c-11 Adopting Release, the Commission also provided an interpretation of certain other Exchange Act rules containing exemptions for transactions in redeemable securities issued by open-end companies and unit investment trusts as follows:

After considering comments, we believe that it is appropriate to make all ETFs, including those that do not rely on rule 6c-11, eligible for the redeemable securities exceptions in rules 101(c)(4) and 102(d)(4) of Regulation M and rule 10b-17(c) under the Exchange Act in connection with secondary market transactions in ETF shares and the creation or redemption of creation units and the exemption in rule 11d1-2 under the Exchange Act for a registered open-end investment company or unit investment trust.

³ *See* Comment Letter of Blackrock, Inc. at 21 (Sept. 26, 2018) (“BlackRock Comment Letter”); Comment Letter of the Investment Company Institute at 32 (Sept. 21, 2018) (“ICI Comment Letter”); Comment Letter of Fidelity Management & Research Company at 12 (Sept. 28, 2018); Comment Letter of Dechert LLP at 8 (Sept. 28, 2018) (“Dechert Comment Letter”); Comment Letter of the Securities Industry and Financial Markets Association – Asset Management Group at 22 and 23 (Sept. 28, 2018) (“SIFMA AMG Comment Letter”); Comment Letter of Vanguard at 2 (Sept. 28, 2018); Comment Letter of WisdomTree Asset Management at 2 (Oct. 1, 2018); Comment Letter of the American Bar Association at 4 (Oct. 11, 2018); Comment Letter of John Hancock Investments at 5 (Oct. 1, 2018); and Comment Letter of Flow Traders US LLP at 2 (Oct. 1, 2018).

associated with Exchange Act relief are duplicative or, in some cases, inconsistent with other requirements applicable to ETFs.⁴

The Commission agrees that such relief could further reduce regulatory complexity and administrative delay, and eliminate potential inconsistencies between rule 6c-11 and the related Exchange Act relief that ETFs have obtained to operate.⁵ The Commission has considered the issues raised and believes that it is appropriate to grant relief from section 11(d)(1) and rules 10b-10, 15c1-5, 15c1-6, and 14e-5 because broker-dealers and certain other persons that engage in these transactions and satisfy the conditions below, as applicable, would not raise the issues or concerns that underlie those provisions. Accordingly, the Commission finds that it is necessary and appropriate in the public interest and consistent with the protection of investors to grant an exemption from section 11(d)(1) of the Exchange Act and Exchange Act rules 10b-10, 15c1-5, 15c1-6, and 14e-5, to broker-dealers and certain other persons, as applicable, that engage in certain transactions with ETFs relying on rule 6c-11, subject to the conditions below.

II. Background

An ETF issues shares that can be bought or sold throughout the day in the secondary market at a market-determined price. Like other investment companies, an ETF pools the assets

⁴ See, e.g., BlackRock Comment Letter. See also, e.g., ICI Comment Letter (“Currently, ETFs often must satisfy multiple and sometimes conflicting requirements from different divisions within the SEC.”). Commenters also expressed concerns about delays in obtaining such additional relief. See, e.g., SIFMA AMG Comment Letter I.

⁵ Although the exemption granted by this order applies only to transactions in securities of ETFs that meet certain requirements and conditions, the beneficiaries of the relief, other than the relief under Exchange Act rule 14e-5, are broker-dealers that engage in transactions subject to the relevant provisions of the Exchange Act and rules thereunder. The beneficiaries of the relief under Exchange Act rule 14e-5 are ETFs, the legal entity of which the ETF is a series, and authorized participants, as described below.

of multiple investors and invests those assets according to its investment objective and principal investment strategies. Each share of an ETF represents an undivided interest in the underlying assets of the ETF. Similar to mutual funds, ETFs continuously offer their shares for sale.

Unlike mutual funds, however, ETFs do not sell or redeem individual shares. Instead, “authorized participants” that have contractual arrangements with the ETF, or one of its service providers, purchase and redeem ETF shares directly from the ETF in blocks called “creation units.”⁶ An authorized participant may act as a principal for its own account when purchasing or redeeming creation units from the ETF. Authorized participants also may act as agent for others, such as market makers, proprietary trading firms, hedge funds or other institutional investors, and receive fees for processing creation units on their behalf.⁷ Market makers, proprietary trading firms, and hedge funds provide additional liquidity to the ETF market through their trading activity. Institutional investors may engage in primary market transactions with an ETF through an authorized participant as a way to efficiently hedge a portion of their portfolio or balance sheet or to gain exposure to a strategy or asset class.⁸ Redemptions from ETFs are often made in kind (that is, by delivering certain assets from the ETF’s portfolio), rather than in cash, thereby avoiding the need for the ETF to sell assets and potentially realize capital gains that are distributed to its shareholders. Similarly, ETF creations may be made in kind by delivering certain assets to the ETF’s portfolio, rather than solely delivering cash.

⁶ Rule 6c-11(a)(1) defines “authorized participant” as a member or participant of a clearing agency registered with the Commission, which has a written agreement with the ETF or one of its service providers that allows the authorized participant to place orders for the purchase and redemption of creation units. *See* Rule 6c-11 Adopting Release.

⁷ *See* David J. Abner, *The ETF Handbook: How to Value and Trade Exchange Traded Funds*, 2nd ed. (2016).

⁸ *Id.*

An authorized participant that purchases a creation unit of ETF shares directly from the ETF deposits with the ETF a “basket” of securities and other assets identified by the ETF that day, and then receives the creation unit of ETF shares in return for those assets.⁹ The basket is generally representative of the ETF’s portfolio,¹⁰ and together with a cash balancing amount, it is equal in value to the aggregate net asset value (“NAV”) of the ETF shares in the creation unit.¹¹ After purchasing a creation unit, the authorized participant may hold the individual ETF shares, or sell some or all of them in secondary market transactions.¹² Investors then purchase individual ETF shares in the secondary market.

By this order, the Commission is seeking to reduce the complexities and burden that may otherwise be associated with the ETF creation and redemption process, subject to appropriate conditions intended to ensure investor protections.

⁹ An ETF may impose fees in connection with the purchase or redemption of creation units that are intended to defray operational processing and brokerage costs to prevent possible shareholder dilution (“transaction fees”).

¹⁰ The basket might not reflect a *pro rata* slice of an ETF’s portfolio holdings. Subject to the terms of the applicable exemptive relief, an ETF may substitute other securities or cash in the basket for some (or all) of the ETF’s portfolio holdings. Conditions related to flexibility in baskets have varied over time. *See* Rule 6c-11 Adopting Release, at section II.C.5.

¹¹ An open-end fund is required by law to redeem its securities on demand from shareholders at a price approximating their proportionate share of the fund’s NAV at the time of redemption. *See* 15 U.S.C. 80a-22(d). 17 CFR 270.22c-1 (“rule 22c-1”) generally requires that funds calculate their NAV per share at least once daily Monday through Friday. *See* rule 22c-1(b)(1). Today, most funds calculate NAV per share as of the time the major U.S. stock exchanges close (typically at 4:00 p.m. Eastern Time). Under rule 22c-1, an investor who submits an order before the 4:00 p.m. pricing time receives that day’s price, and an investor who submits an order after the pricing time receives the next day’s price. *See also* 17 CFR 270.2a-4 (“rule 2a-4”) (defining “current net asset value”).

¹² ETFs register offerings of shares under the Securities Act of 1933 (the “Securities Act”), and list their shares for trading under the Exchange Act. Depending on the facts and circumstances, authorized participants that purchase a creation unit and sell the shares may be deemed to be participants in a distribution, which could render them statutory underwriters and subject them to the prospectus delivery and liability provisions of the Securities Act. *See* 15 U.S.C. 77b(a)(11) (defining the term “underwriter”).

III. Discussion of the Exemption

The Commission is granting a conditional exemption from Exchange Act section 11(d)(1) and Exchange Act rules 10b-10, 15c1-5, 15c1-6, and 14e-5 as discussed further below. The exemption should help to simplify the offering and operating process for ETFs. The exemption will provide relief to broker-dealers from these provisions of the Exchange Act with respect to ETFs relying on rule 6c-11.¹³ In order for a broker-dealer to rely on the relief, other than the relief from rule 14e-5, a transaction must involve an ETF that further satisfies the diversification requirement below. In addition, a broker-dealer relying on this relief must meet certain conditions specific to each applicable Exchange Act provision or rule. Finally, except as provided in Sections III.E.2 and III.F below, this relief does not apply to purchases or sales of ETF shares in the secondary market.¹⁴

The Commission is limiting relief under this exemption to transactions in securities issued by ETFs that rely on rule 6c-11 because the specific findings in support of the exemptive order are based, in part, on the conditions in rule 6c-11. The Commission believes that the portfolio and other transparency requirements in rule 6c-11, when combined with the conditions

¹³ Going forward, this exemptive order will provide exemptive relief from section 11(d)(1) and rules 10b-10, 15c1-5, 15c1-6, and 14e-5 in connection with transactions in securities issued by newly formed ETFs that rely on rule 6c-11. Commission staff will continue to consider requests with respect to the relevant Exchange Act provisions in connection with transactions in securities issued by newly formed ETFs that do not rely on rule 6c-11 or otherwise do not satisfy the conditions of this exemption.

¹⁴ As discussed below, this order provides an exemption from section 11(d)(1) for a Non-AP Broker-Dealer (defined below) that transacts in shares of an ETF that relies on rule 6c-11, exclusively in the secondary market, when it extends or maintains or arranges for the extension or maintenance of credit to or for customers on such ETF shares. This order also provides an exemption that allows certain specified “covered persons” with respect to a tender offer to engage in creation and redemption transactions with an ETF that relies on rule 6c-11 subject to certain conditions described below.

in this order, address the policy concerns underlying the relevant statutory provision and rules. For example, rule 6c-11 requires ETFs to disclose their portfolio holdings each day through their website. This portfolio transparency, along with the availability of information regarding ETFs through the National Securities Clearing Corporation (“NSCC”), other intermediaries, and the ETF itself, should provide customers engaging in creation or redemption transactions an opportunity to identify or inquire about potential conflicts of interest involving a component security a broker-dealer would otherwise be required to disclose. These requirements should also help customers determine if they should request that their broker-dealer provide any omitted information.

A. Reliance on Rule 6c-11

The exemption from Exchange Act section 11(d)(1) and Exchange Act rules 10b-10, 15c1-5, 15c1-6, and 14e-5 is only available with respect to transactions involving securities of an ETF relying on rule 6c-11. The rule defines an ETF as a registered open-end management investment company that: (i) issues (and redeems) creation units to (and from) authorized participants in exchange for a basket and a cash balancing amount (if any); and (ii) issues shares that are listed on a national securities exchange and traded at market-determined prices.¹⁵

Among the requirements to rely on rule 6c-11 are:

1. The ETF is structured as an open-end management investment company;
2. The ETF discloses portfolio holdings each business day on its website before the opening of regular trading on the primary listing exchange of the ETF’s shares in a standardized manner;

¹⁵ Rule 6c-11(a)(1). Under the rule, the term “basket” means the securities, assets, or other positions in exchange for which an ETF issues (or in return for which it redeems) creation units. *See id.* ETFs will therefore transact on an in-kind basis, on a cash basis, or both.

3. The ETF provides website disclosure of (i) the ETF's current NAV per share, market price, and premium or discount, each as of the end of the prior business day; (ii) a table showing the number of days the ETF's shares traded at a premium or discount during the most recently completed calendar year and calendar quarters of the current year; (iii) a line graph showing ETF premiums and discounts for the most recently completed year and calendar quarter of the current year; (iv) for ETFs whose premium or discount was greater than two percent for more than seven consecutive trading days, disclosure of this premium or discount, along with a discussion of the factors that are reasonably believed to have materially contributed to the premium or discount; and (v) the ETF's median bid-ask spread over the most recent thirty calendar days;
4. The ETF adopts and implement written policies and procedures that govern the construction of baskets and the process that will be used for the acceptance of baskets. If the ETF utilizes custom baskets, these policies and procedures must (i) set forth detailed parameters for the construction and acceptance of custom baskets that are in the best interest of the ETF and its shareholders, including the process for any revisions to, or deviations from, those parameters; and (ii) specify the titles or roles of the employees of the ETF's investment adviser who are required to review each custom basket for compliance with those parameters; and
5. The ETF preserves and maintains copies of all written agreements between an authorized participant and the ETF (or one of the ETF's service providers) that allow the authorized participant to purchase or redeem creation units.

Consistent with our approach in Rule 6c-11, the exemption provided by this order will be available regardless of whether the ETF is actively managed¹⁶ and without regard to the number of ETF shares in the ETF's creation or redemption baskets or the value of those creation and redemption baskets.¹⁷

B. Minimum Diversification Requirement

The exemption provided by this order from Exchange Act section 11(d)(1) and Exchange Act rules 10b-10, 15c1-5, and 15c1-6 is available only with respect to transactions involving an ETF that meets the diversification requirement applicable to a regulated investment company in Internal Revenue Code ("IRC") Sec. 851(b)(3)(B), 26 U.S.C. 851(b)(3)(B) (the "IRC diversification requirement").¹⁸ Diversification is a consideration with respect to each requirement from which the Commission is granting exemption in this order, except for rule 14e-5. Creation and redemption transactions in diversified ETFs involve the exchange of a basket that contains numerous securities, which in turn implicates disclosure requirements, as discussed below, under rules 10b-10, 15c1-5, and 15c1-6. At the same time, the composite nature of a diversified basket means that the securities of any one issuer will account for a relatively small

¹⁶ Rule 6c-11 Adopting Release, sec. II.A.2.

¹⁷ *Id.* at sec. II.C.1.

¹⁸ IRC Section 851(b)(3)(B) provides that a "regulated investment company" must have:

not more than 25 percent of the value of its total assets is invested in— (i) the securities (other than Government securities or the securities of other regulated investment companies) of any one issuer, (ii) the securities (other than the securities of other regulated investment companies) of two or more issuers which the taxpayer controls and which are determined, under regulations prescribed by the Secretary [of the Treasury], to be engaged in the same or similar trades or businesses or related trades or businesses, or (iii) the securities of one or more qualified publicly traded partnerships (as defined in subsection (h)).

share of the basket. Diversification thus should mitigate any conflicts that a broker-dealer would otherwise be required to disclose under rules 15c1-5 and 15c-6, and minimize the incentive for a broker-dealer to seek to use an ETF to evade the new issue lending restriction in Exchange Act section 11(d)(1).¹⁹

Diversification, together with the conditions discussed below, forms the basis for the Commission's conclusion that relief from section 11(d)(1) and rules 10b-10, 15c1-5, and 15c1-6 is necessary and appropriate in the public interest and consistent with investor protection.

C. Exemption from Exchange Act Rule 10b-10

Exchange Act rule 10b-10 generally requires a broker or dealer that effects a securities transaction for a customer to send to the customer, at or before the completion of the transaction, a written notification ("confirmation") disclosing certain information, including among other items, the identity, price, and number of share or units (or principal amount) of the security purchased or sold by the customer. The confirmation requirement provides basic investor protections by conveying information that allows investors to verify the terms of their transactions; alerting investors to potential conflicts of interest with their broker-dealers; acting as a safeguard against fraud; and providing investors a means to evaluate the costs of their transactions and the quality of their broker-dealer's execution.²⁰ When an authorized participant

¹⁹ A commenter on proposed Rule 6c-11 also noted that ETFs generally must comply with the IRC diversification requirement, which imposes a practical limit on the concentration of an ETF's portfolio. Dechert Comment Letter at 12-13. The commenter stated that it would be impractical and inefficient for a broker-dealer to utilize an ETF as a mechanism for distribution of a particular security or for accumulating substantial positions in one or more of an ETF's underlying securities in a magnitude that would trigger disclosure. *Id.*

²⁰ Exchange Act Release No. 34962 (November 10, 1994), 59 FR 59612, 59613 (November 17, 1994).

that is a registered broker-dealer (“Broker-Dealer AP”) engages in creation and redemption transactions for its customers, each tender or receipt of a component security as part of a basket is a purchase²¹ or sale²² of a security, and each purchase or sale requires confirmation pursuant to Exchange Act rule 10b-10.

The Commission is granting an exemption from Exchange Act rule 10b-10 that will allow a broker-dealer that is effecting an in-kind creation or redemption transaction on behalf of a customer to confirm the transaction without providing a contemporaneous statement of the identity, price or number of shares or units (or principal amount) of each component security tendered to or delivered by the ETF, subject to the following conditions:

1. Confirmation statements of issuance and redemption transactions in ETF shares will contain all of the information specified in paragraph (a) of rule 10b-10 other than identity, price, and number of shares or units (or principal amount) of each component security tendered or received by the customer in the transaction.
2. Any confirmation statement of an issuance or redemption transaction in ETF shares that omits the identity, price, or number of shares or units (or principal amount) of component securities will contain a statement that such omitted information will be provided to the customer upon request; and
3. All such requests will be fulfilled in a timely manner in accordance with paragraph (c) of rule 10b-10.

²¹ Exchange Act Sec. 3(a)(13).

²² Exchange Act Sec. 3(a)(14).

The requirement that confirmation statements include all of the information specified in paragraph (a) of rule 10b-10 other than the identity, price, and number of shares or units (or principal amount) of each component security tendered or received in the transaction preserves a customer's right to receive other important information from the confirmation about the terms of the customer's transaction at or before the completion of the transaction. The statement that the omitted information will be provided upon request informs the customer of the right to receive the omitted information. The requirement for a broker-dealer to fulfill such requests in a timely manner in accordance with paragraph (c) of rule 10b-10 clarifies that a broker-dealer must fulfill the request within a prescribed period (*i.e.*, within five business days of receipt of the request, or within 15 business days of a request pertaining to a transaction effected more than 30 days prior to the receipt of the request) so that customers can be assured that they receive the requested information in a timely manner.

The Commission also believes that, in general, information regarding ETFs is accessible through a variety of sources, including the NSCC, intermediaries and the ETFs themselves. The Commission believes that the conditions above will allow any customers who would like additional information regarding identity, price, or number of shares or units (or principal amount) to receive the information in a timely manner. This exemption reduces the burden that may otherwise be associated with creation and redemption transactions while preserving a customer's ability to access the omitted information upon request.

D. Exemption from Exchange Act Rules 15c1-5 and 15c1-6

Exchange Act rule 15c1-5 requires a broker-dealer effecting a transaction to disclose any control relationship with an issuer of a security that it purchases for or sells to a customer. Similarly, Rule 15c1-6 requires a broker-dealer to disclose its participation or interest in a

primary or secondary distribution of a security that it purchases for or sells to a customer. The Commission is granting a conditional exemption from Exchange Act rules 15c1-5 and 15c1-6 that will allow a broker-dealer that is effecting an in-kind creation or redemption transaction on behalf of a customer to effect that transaction without providing disclosure regarding a control relationship with an issuer or participation in a distribution of a component security tendered to or delivered by the ETF.

As discussed above, the composite nature of diversified ETF portfolios and the relatively small proportionate share of any component security in a basket mean that any individual ETF portfolio security that would be subject to disclosure under rules 15c1-5 or 15c1-6 will be a small portion of the portfolio. This diversification should reduce the impact that any potential conflicts of interest involving a component security that a broker-dealer may have and mitigate the concern that a broker-dealer could use an ETF to avoid disclosure of a conflict of interest that would otherwise be required to be disclosed under rules 15c1-5 and 15c-6.

Rule 6c-11 provides ETFs with flexibility to use custom baskets that contain a non-representative selection of the ETFs' portfolio securities.²³ To the extent the contents of custom creation or redemption baskets are negotiated between an authorized participant and the ETF, the customer, via the authorized participant, should have visibility into the contents of the basket. This visibility should provide a customer seeking to engage in creation or redemption transactions an opportunity to identify or otherwise inquire about control relationships with the

²³ If different baskets are used in transactions on the same business day, each basket after the initial representative basket would constitute a custom basket. *See* Rule 6c-11 Adopting Release, sec. II.C.5.

issuer or interest in a distribution of a component security that a broker-dealer would otherwise be required to disclose pursuant to these rules.

The exemption from rules 15c1-5 and 15c1-6 is subject to a further condition that requires the broker-dealer to provide any information to which a customer is entitled under rule 15c1-5 or 15c1-6 upon request and to fulfill such requests in a timely manner. The Commission believes that this condition will ensure that any customers who would like to access this information for any of the investor protections needs described above will be able to receive it.

Similar to rule 10b-10 above, the Commission believes that the general availability of information regarding ETFs through a variety of sources, including the NSCC, intermediaries and the ETFs themselves, supports this exemption. This access allows market participants that use basket information to obtain information regarding securities they will exchange in a creation or redemption transaction. The Commission believes that this information also should provide market participants seeking to engage in creation or redemption transactions an opportunity to identify or otherwise inquire about the control relationships or interest in a distribution that a broker-dealer would otherwise be required to disclose pursuant to these rules.

E. Exemption from Section 11(d)(1)

Exchange Act section 11(d)(1) generally prohibits a person that is both a broker and a dealer from extending or maintaining credit, or arranging for the extension or maintenance of credit, to or for a customer on any security (other than an exempted security) which was part of a distribution of a new issue of securities in which the broker-dealer participated. Because ETFs are in continuous distribution, broker-dealers effecting creation and redemption transactions on behalf of customers are participating in the distribution of new issue securities with respect to shares of ETFs, and thus are continuously subject to the restrictions of section 11(d)(1). Section

11(d)(1) issues arise both with Broker-Dealer APs and with broker-dealers who effect only secondary market transactions (“Non-AP Broker-Dealers”).

1. Conditions for Broker-Dealer Authorized Participants

As noted in section II above, a Broker-Dealer AP is a registered broker-dealer that has entered into a contractual arrangement with an ETF or one of its service providers that allows the Broker-Dealer AP to place orders for the purchase or redemption of creation units, but Broker-Dealer APs are not compensated by ETFs in connection with the creation or redemption of ETF shares. Broker-Dealers may have different reasons for becoming authorized participants, including for their own proprietary trading, to facilitate customer trades, to hedge or otherwise manage their own risk, or to arbitrage differences between the ETF’s market price and its NAV.

The Commission is granting an exemption from the new issue lending restriction in section 11(d)(1) for a Broker-Dealer AP that extends or maintains credit, or arranges for the extension or maintenance of credit, on ETF shares subject to the following two conditions:

1. Neither the Broker-Dealer AP, nor any natural person associated with such Broker-Dealer AP, directly or indirectly (including through any affiliate of such Broker-Dealer AP), receives from the “Fund Complex”²⁴ any payment, compensation, or other economic incentive to promote or sell the shares of the ETF to persons outside the fund complex, other than non-cash compensation currently permitted under

²⁴ For purposes of this order, a “Fund Complex” is the issuer of the ETF shares, any other issuer of ETF shares that holds itself out to investors as a related company for purposes of investment or investor services; any investment adviser, distributor, sponsor, or depositor of any such issuer; or any “affiliated person” (as defined in the Investment Company Act section 2(a)(3)) of any such issuer or any such investment adviser, distributor, sponsor, or depositor.

Financial Industry and Regulatory Authority (“FINRA”) rule 2341(l)(5)(A), (B), or (C) (“non-cash compensation”).²⁵

2. The Broker-Dealer AP does not extend, maintain or arrange for the extension or maintenance of credit to or for a customer on shares of the ETF before thirty days have passed from the date that the ETF’s shares initially commence trading (except to the extent that such extension, maintenance, or arranging of credit is otherwise permitted pursuant to rule 11d1-1).

The exemption permits a Broker-Dealer AP to accept only limited forms of non-cash compensation that do not present broker-dealers with the types of potential conflicts of interest in their sale of securities that section 11(d)(1) addresses.²⁶ This absence of any special compensation to distribute shares mitigates the potential conflicts of interest that section 11(d)(1) addresses. In addition, requiring a Broker-Dealer AP to wait thirty days before margining its customers’ ETF shares is consistent with the section 11(d)(1) prohibition against a broker-dealer extending credit on securities that were part of a new issue, if the broker-dealer participated in the distribution of the new issue securities within the preceding thirty days. Thus, this condition ensures that Broker-Dealer APs do not use credit to induce customers to buy ETF shares for at

²⁵ Non-cash compensation currently permitted under FINRA rule 2341(l)(5)(A), (B), or (C) is limited to:

- (A) Gifts that do not exceed an annual amount per person fixed periodically by FINRA and are not preconditioned on achievement of a sales target;
- (B) An occasional meal, a ticket to a sporting event or the theater, or comparable entertainment which is neither so frequent nor so extensive as to raise any question of propriety and is not preconditioned on achievement of a sales target; [and]
- (C) Payment or reimbursement by offerors in connection with meetings held by an offeror or by a member for the purpose of training or education of associated persons of a member, subject to certain conditions.

²⁶ See Exchange Act Release No. 21557 (Dec. 18, 1984), 49 FR 50172 at 50173-74 (Dec. 27, 1984) (available at: <https://cdn.loc.gov/service/ll/fedreg/fr049/fr049250/fr049250.pdf>).

least a 30-day period following launch of the ETF, similar to the prohibition against extending credit that applies to other types of new issue securities under section 11(d)(1).

2. Conditions for Non-AP Broker-Dealers

Many broker-dealers effect ETF securities transactions solely on the secondary market, whether for themselves or as agent for their customers. They do not enter contractual arrangements to effect creation or redemption transactions with the ETF or one of its service providers. Thus, these Non-AP Broker-Dealers have not undertaken to distribute ETF shares and generally do not receive any compensation for selling ETF shares, other than, in some cases, limited forms of non-cash compensation. Non-AP Broker-Dealers may reasonably be considered not to be participating in the distribution of new issue securities within the meaning of section 11(d)(1). However, to remove any ambiguity about the circumstances when Non-AP Broker-Dealers may offer margin on ETF securities the Commission is granting this exemption from section 11(d)(1).

The Commission believes this relief is appropriate because, as stated above, Non-AP Broker-Dealers do not engage in creation and redemption transactions with ETFs and, thus, may reasonably be considered not to be participating in the distribution of the ETFs' securities. In addition, this relief is subject to the condition that Non-AP Broker-Dealers do not (and their associated persons who are natural persons do not), directly or indirectly (including through any affiliate of such Non-AP Broker-Dealer), receive from the Fund Complex any payment, compensation or other economic incentive to promote or sell the shares of the ETF to persons outside the Fund Complex, other than non-cash compensation. For the foregoing reasons, the Commission believes it is necessary and appropriate and in the public interest and consistent with investor protection to grant this exemption.

F. Exemption from Rule 14e-5

Exchange Act rule 14e-5 prohibits “covered persons” from directly or indirectly purchasing or arranging to purchase any securities that are the subject of a tender offer (“subject securities”)²⁷ or any securities that are immediately convertible into, exchangeable for, or exercisable for subject securities (“related securities”)²⁸ except as part of such tender offer. The term “covered person” includes, among others, a dealer-manager of a tender offer and any person acting, directly or indirectly, in concert with other covered persons in connection with any purchase or arrangement to purchase any subject securities or any related securities.²⁹ Therefore, the prohibitions of rule 14e-5 may apply to authorized participants who are broker-dealers and acting as dealer-managers in tender offers, the ETF, and any legal entity of which the ETF is a series.

The Commission is granting a conditional exemption from rule 14e-5 to an ETF, the legal entity of which the ETF is a series, and authorized participants and any other persons who create and redeem shares of the ETF in creation units pursuant to contractual arrangements pertaining to such legal entity and the ETF, and who are covered persons with respect to a tender offer involving an ETF’s component securities. The conditional exemption will allow such persons (i) to redeem ETF shares in creation unit sizes for a redemption basket that may include a subject security or related security, (ii) to engage in secondary market transactions with respect to the ETF shares after the first public announcement of the tender offer and during such tender offer

²⁷ Exchange Act rule 14e-5(c)(7).

²⁸ Exchange Act rule 14e-5(c)(6).

²⁹ Exchange Act rule 14e-5(c)(3).

given that such transactions could include, or be deemed to include, purchases of, or arrangements to purchase, subject securities or related securities, and (iii) make purchases of, or arrangements to purchase, subject securities or related securities in the secondary market for the purpose of transferring such securities to purchase one or more creation units of ETF shares.

The exemption from rule 14e-5 is subject to the following conditions:

1. no purchases of subject securities or related securities made by broker-dealers acting as dealer-managers of a tender offer would be effected for the purpose of facilitating a tender offer;
2. if there is a change in the composition of a ETF's portfolio of component securities and a broker-dealer acting as a dealer-manager of a tender offer is unable to rely on the exception found in rule 14e-5(b)(5) for basket transactions because (i) the basket of subject securities or related securities contains fewer than 20 securities or (ii) the subject securities and related securities make up more than 5% of the value of the basket, then any purchases of an ETF component security by such dealer-manager during a tender offer will be effected for the purpose of adjusting a basket of securities in the ordinary course of its business and not for the purpose of facilitating a tender offer; and
3. except for the relief specifically granted herein, any broker-dealer acting as a dealer-manager of a tender offer will comply with rule 14e-5.

The Commission believes this exemption will facilitate the ability of authorized participants and others to engage in creation or redemption transactions between the public announcement of a tender offer and its expiration, thereby permitting the ETF to operate as intended for the benefit of its holders and as disclosed in publicly filed documents. The

conditions applicable to the relief will ensure that authorized participants and other recipients of the relief do not effect creation or redemption transactions during the relevant tender offer period in an effort to facilitate the tender offer. For the foregoing reasons, the Commission believes it is necessary and appropriate and in the public interest and consistent with investor protection to grant this exemption.

IV. Conclusion

In light of the above, and in accordance with Exchange Act Section 36, the Commission finds that conditionally exempting broker-dealers that engage in certain transactions in securities of ETFs that can rely on Investment Company Act rule 6c-11 from the requirements of section 11(d)(1) of the Exchange Act and Exchange Act rules 10b-10, 15c1-5, 15c1-6, and 14e-5 necessary and appropriate in the public interest, and consistent with the protection of investors.

THEREFORE, IT IS HEREBY ORDERED, pursuant to section 36 of the Exchange Act, subject to the conditions described in Sections III.A, B, and C above, that a broker or dealer is exempt from Exchange Act rule 10b-10 with respect to creation or redemption transactions on behalf of customers in securities issued by ETFs relying on Investment Company Act rule 6c-11.

IT IS FURTHER ORDERED, pursuant to section 36 of the Exchange Act, subject to the conditions described in Sections III.A, B, and D above, that a broker or dealer is exempt from Exchange Act rule 15c1-5 with respect to creation or redemption transactions on behalf of customers in securities issued by ETFs relying on Investment Company Act rule 6c-11.

IT IS FURTHER ORDERED, pursuant to section 36 of the Exchange Act, subject to the conditions described in Sections III.A, B, and D above, that a broker or dealer is exempt from Exchange Act rule 15c1-6 with respect to creation or redemption transactions on behalf of customers in securities issued by ETFs relying on Investment Company Act rule 6c-11.

IT IS FURTHER ORDERED, pursuant to section 36 of the Exchange Act, subject to the conditions described in Sections III.A, B, and E.1. above, that an AP Broker-Dealer in a particular ETF relying on Investment Company Act rule 6c-11 is exempt from section 11(d)(1) of the Exchange Act with respect to the extension or maintenance of credit, or the arranging of the extension or maintenance of credit, on securities issued by such ETF.

IT IS FURTHER ORDERED, pursuant to section 36 of the Exchange Act, subject to the conditions described in Section III.A, B, and E.2 above, that a Non-AP Broker-Dealer that effects transactions in shares of an ETF relying on Investment Company Act rule 6c-11, exclusively in the secondary market, is exempt from section 11(d)(1) when it extends or maintains, or arranges for the extension or maintenance of credit to or for customers on such ETF shares.

IT IS FURTHER ORDERED, pursuant to section 36 of the Exchange Act, subject to the conditions described in Sections III.A and F above, the ETF and other persons described in Section III.F are exempt from Exchange Act rule 14e-5 with respect to the transactions described in Section III.F above.

This exemption is subject to modification or revocation at any time the Commission determines that such action is necessary or appropriate in furtherance of the purposes of the Exchange Act. In addition, persons relying on this exemption are directed to the anti-fraud and anti-manipulation provisions of the federal securities laws, particularly section 10(b) of the Exchange Act and rule 10b-5 thereunder.

By the Commission.

Vanessa A. Countryman
Secretary

