CARLTON FIELDS

SEC Proposes New Rule Impacting ETFs

October 01, 2018

On June 28, the SEC proposed new rule 6c-11 to allow open-end exchange-traded funds that satisfy certain conditions to operate without obtaining an SEC exemptive order. The proposed rule would apply to open-end ETFs, but would be unavailable to unit-investment trusts, multi-class ETFs, and leveraged or inverse ETFs.

Among other things, proposed rule 6c-11 would allow ETF sponsors to use “custom baskets” (baskets that do not reflect a pro-rata share of the fund’s portfolio or that differ from other baskets used in transactions on the same business day) in connection with creation unit purchases and redemption transactions with authorized participants. ETFs using custom baskets must adopt written policies and procedures for the construction and use of custom baskets that are in the best interests of the ETF and its shareholders.

Proposed rule 6c-11 also would require an ETF to disclose on its website:

- its portfolio holdings each day, and
- historical information regarding premiums and discounts and bid-ask spread information, designed to inform investors about the ETF’s arbitrage efficiency.

The SEC also proposed amending Form N-1A to require open-end ETFs to disclose certain ETF-specific information, including trading costs borne by secondary-market investors.

It is unclear whether the proposed rule would increase the use of ETFs in connection with variable insurance products. Historically, such use has been quite limited, because of, among other things, federal income tax constraints on using publicly traded funds as investment options under variable products. However, a final rule that makes ETFs more attractive could spur increased variable product use of ETFs, particularly in a “fund of ETFs” structure.

Related Practices

Financial Services Regulatory
Securities Transactions and Compliance

Related Industries

Securities & Investment Companies
Life, Annuity, and Retirement Solutions