

number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing will also be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2015-016 and should be submitted on or before July 8, 2015.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁸

Robert W. Errett,
Deputy Secretary.

[FR Doc. 2015-14833 Filed 6-16-15; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-75165; File No. S7-11-15]

Request for Comment on Exchange-Traded Products

AGENCY: Securities and Exchange Commission.

ACTION: Request for comment.

SUMMARY: The Securities and Exchange Commission ("Commission") is seeking public comment on topics related to the listing and trading of exchange-traded products on national securities

exchanges and sales of these products by broker-dealers.

DATES: Comments should be received by August 17, 2015.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/other.shtml>);
- Send an email to rule-comments@sec.gov, including File Number S7-11-15 on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov>), following the instructions for submitting comments.

Paper Comments

- Send paper comments to Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090.

All submissions should refer to File Number S7-11-15. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method of submission. The Commission will post all comments on the Commission's Web site (<http://www.sec.gov>). Comments are also available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available.

FOR FURTHER INFORMATION CONTACT:

Edward Cho, Special Counsel, at (202) 551-5508; Christopher Chow, Special Counsel, at (202) 551-5622; or Sarah Schandler, Special Counsel, at (202) 551-7145, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-7010.

Table of Contents

- I. Discussion
 - A. Introduction
 - B. The Types of ETPs
 - C. How Existing ETPs Function

- 1. Purchases, Sales, Creations, and Redemptions
- 2. Arbitrage Between an ETP's Market Price and Its NAV
- D. The Commission's Oversight of Exchange-Traded Products
 - 1. Exchange Act Exemptive and No-Action Relief for Existing ETPs
 - 2. Exchange Listing Standards and the Rule 19b-4 Process
 - 3. Broker-Dealer Sales Practices
- II. Request For Comment
 - A. Arbitrage and Market Pricing
 - B. Exchange Act Exemptions and No-Action Positions
 - C. Exchange Listing Standards
 - D. Broker-Dealer Sales Practices and Investor Understanding and Use of ETPs
 - E. Other

I. Discussion

A. Introduction

Exchange-traded products ("ETPs") constitute a diverse class of financial products that seek to provide investors with exposure to financial instruments, financial benchmarks, or investment strategies across a wide range of asset classes. ETP trading occurs on national securities exchanges and other secondary markets that are regulated by the Commission under the Securities Exchange Act of 1934 ("Exchange Act"),¹ making ETPs widely available to market participants, from individual investors to institutional investors, including hedge funds and pension funds.

The Commission approved the listing and trading of shares of the first ETP—the SPDR S&P 500 ETF ("SPY")—in 1992.² Since the SPY began trading on January 22, 1993, there has been enormous growth in the number, aggregate market capitalization, and variety of ETPs. The chart below depicts the growth of ETPs, both in number and market capitalization, since 1993.

As reflected in Figure 1 (below), from 2006 to 2013, the total number of ETPs listed and traded as of year end rose by an average of 160 per year, with a net increase of more than 200 in both 2007 and 2011. By comparison, from 1993 to 2005, the total number of ETPs listed and traded as of year end rose by an average of just 17 per year, with a net increase of 60 in 2000. The total market capitalization of ETPs has also grown substantially, nearly doubling since the end of 2009. Much of this growth has been in index-based ETPs.

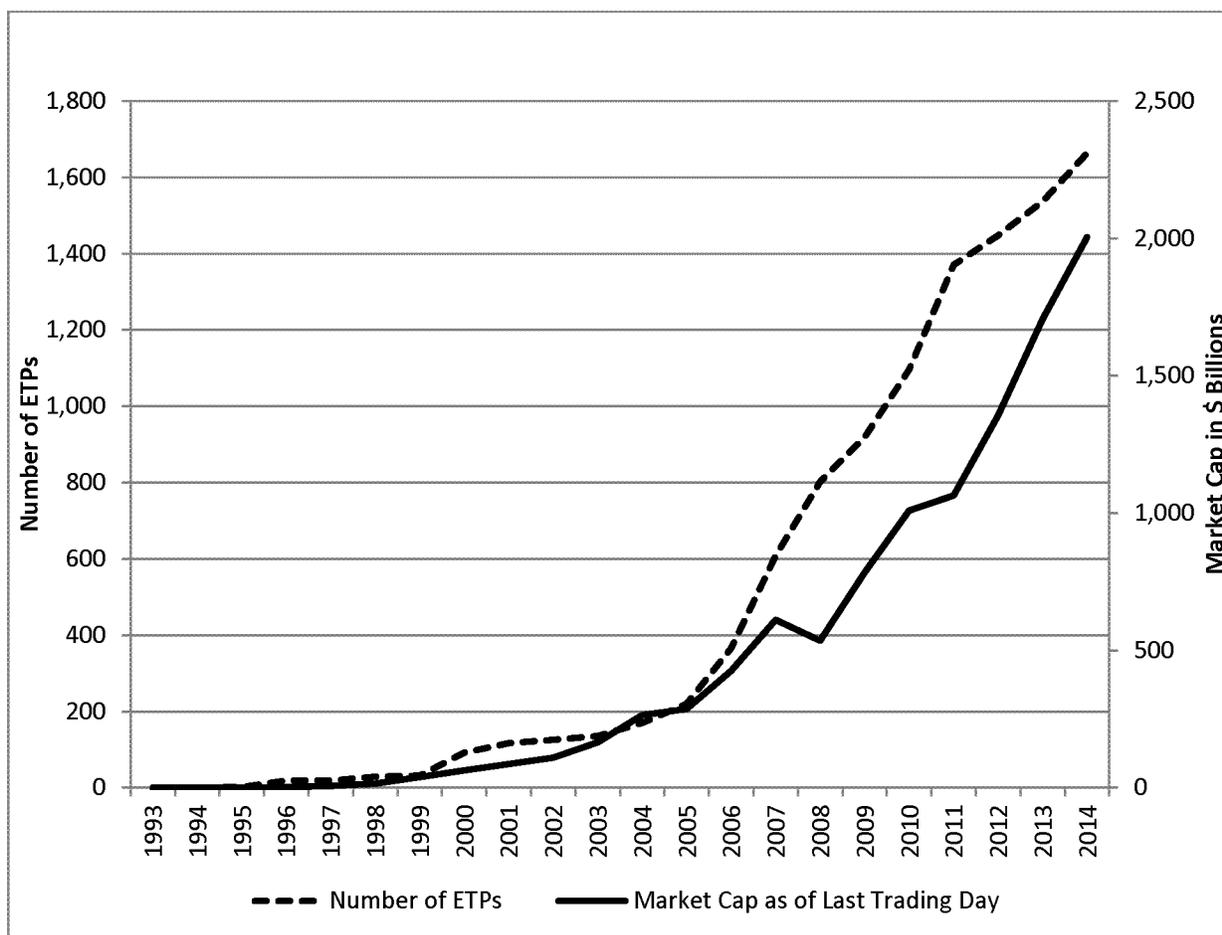
¹⁸ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78a *et seq.* Once listed on a national securities exchange, ETP shares also can be traded on Alternative Trading Systems (as defined in Rule

300 of Regulation ATS, 17 CFR 242.300) or in other over-the-counter transactions.

² See Securities Exchange Act Release No. 31591 (Dec. 11, 1992), 57 FR 60253 (Dec. 18, 1992) (SR-

Amex-92-18) (order approving the adoption of listing standards for Portfolio Depository Receipts and the listing and trading of shares of SPY pursuant to those listing standards).

Figure 1: Aggregate Market Capitalization and Number of ETPs, 1993–2014³

As of December 31, 2014, there were 1,664 U.S.-listed ETPs, and they had an aggregate market capitalization of just over \$2 trillion.⁴ Trading in these ETPs makes up a significant portion of secondary-market equities trading. For example, during 2014, trading in U.S.-listed ETPs made up about 16.7% of U.S. equity trading by share volume and 25.7% of U.S. equity trading by dollar volume.⁵

³ The figures underlying this chart were produced by an analysis by Commission staff of year-end market data obtained through subscriptions to Morningstar Direct and Bloomberg Professional services.

⁴ These figures reflect an analysis by Commission staff of market data obtained through subscriptions to Morningstar Direct and Bloomberg Professional services.

⁵ These figures reflect an analysis by Commission staff of market data obtained through the Commission's Market Information Data and Analytics System ("MIDAS"). The staff's analysis of MIDAS data also shows that approximately 32.4% of the trading activity (by share volume) in ETPs during 2014 took place on trading venues other than national securities exchanges, which is roughly comparable to the approximately 35.2% of

There has also been significant growth in the range of investment strategies that ETPs pursue. These strategies have expanded from exchange-traded funds ("ETFs") that track equity indices (such as the original SPY) to include, among other things: (i) ETPs that track other types of indices (such as those based on fixed-income securities or on derivatives contracts on commodities and currencies); (ii) actively managed ETPs that hold portfolios of equities, fixed-income instruments, foreign securities, commodities, currencies, futures, options, or other over-the-counter or exchange-traded derivatives;⁶ (iii) leveraged, inverse,

share volume in all equity trading that took place off an exchange in 2014.

⁶ See, e.g., Securities Exchange Act Release Nos. 50603 (Oct. 28, 2004), 69 FR 64614 (Nov. 5, 2004) (SR-NYSE-2004-22) (order approving the adoption of listing standards for Equity Gold Shares and the listing and trading of shares of the streetTRACKS Gold Trust, which was subsequently renamed the SPDR Gold Trust); 60064 (June 8, 2009), 74 FR 28315 (June 15, 2009) (SR-NYSEArca-2009-30) (order granting approval for the listing and trading of shares of the iShares Diversified Alternatives

and inverse leveraged ETPs;⁷ and (iv)

Trust); 68390 (Dec. 10, 2012), 77 FR 74540 (Dec. 14, 2012) (SR-BATS-2012-042) (order granting approval for the listing and trading of shares of the Sovereign Screened Global Bond Fund); 68871 (Feb. 8, 2013), 78 FR 11238 (Feb. 15, 2013) (SR-NYSEArca-2012-138) (order granting approval for the listing and trading of shares of the PIMCO Foreign Currency Strategy Exchange-Traded Fund); 68972 (Feb. 22, 2013), 78 FR 13721 (Feb. 28, 2013) (SR-NASDAQ-2012-147) (order granting approval for the listing and trading of shares of the First Trust High Yield Long/Short ETF); 70209 (Aug. 15, 2013), 78 FR 51769 (Aug. 21, 2013) (SR-NYSEArca-2013-60) (order granting approval to list and trade shares of the Market Vectors Low Volatility Commodity ETF and Market Vectors Long/Short Commodity ETF); and 71378 (Jan. 23, 2014), 79 FR 4786 (Jan. 29, 2014) (SR-NYSEArca-2013-137) (order granting approval to list and trade shares of the Merk Gold Trust).

⁷ Leveraged ETPs seek to achieve performance results, over a specified period, that are a multiple or an inverse multiple of the performance of the index or benchmark they track. Inverse ETPs (also called "short" funds) seek to deliver the opposite of the performance of the index or benchmark they track. Like traditional ETPs, some leveraged and inverse ETPs track broad indices, some are sector-specific, and others are linked to commodities, currencies, or some other benchmark. See U.S. Securities and Exchange Commission, Leveraged and Inverse ETFs: Specialized Products with Extra

ETPs employing market volatility, hedging, or options-based strategies.⁸

The increasing scope and complexity of ETP investment strategies in recent years have led to an increase in the number and complexity of requests by issuers for exemptive relief under the Exchange Act (to allow ETPs to be offered for sale on exchanges) and in the number and complexity of proposed rule changes filed with the Commission by exchanges seeking to establish listing standards for the securities of new ETPs. Accordingly, the Commission believes that this is an opportune time to seek public comment on topics associated with its oversight of the listing and trading of ETPs on national securities exchanges.⁹

B. The Types of ETPs

Although ETPs constitute a diverse class of financial products, for purposes of this Request for Comment they are classified into three broad categories.¹⁰

Exchange-Traded Funds (ETFs)

The first, and largest, category comprises ETFs, which are open-end fund vehicles or unit investment trusts that are registered as investment companies under the Investment Company Act of 1940 (“1940 Act”).¹¹ Like an open-end fund, an ETF pools the assets of multiple investors and invests those assets according to its

investment objective and principal investment strategies, and each share of an ETF represents an undivided interest in the underlying assets of the ETF. However, unlike open-end funds—shares of which are purchased or redeemed at the fund’s current net asset value (“NAV”),¹² which is typically calculated at the end of the trading day—ETF shares may be bought or sold by investors throughout the day through a broker-dealer at a market-determined price.¹³

Non-1940 Act Pooled Investment Vehicles

The second category comprises ETPs that, generally, are trust or partnership vehicles that are not registered under the 1940 Act because they do not invest primarily in securities. Examples of ETPs in this category include those that physically hold a precious metal or that hold a portfolio of futures or other derivatives contracts on certain commodities or currencies. Offerings of securities issued by ETPs in this second category are registered only under the Securities Act of 1933 (“Securities Act”) ¹⁴ and are not also registered under the 1940 Act.

Exchange-Traded Notes (ETNs)

The third category comprises exchange-traded notes (“ETNs”). ETNs

are senior debt instruments issued by financial institutions, and they pay a return based on the performance of a “reference asset”—an asset, market benchmark, or other investment strategy, such as the return on the S&P 500 Index, the performance of commodities or commodity indices, or the performance of the common stock of an individual public company. Unlike the other two categories of ETPs described above, ETNs are not pooled vehicles, and they do not hold an underlying portfolio of securities, futures, over-the-counter derivatives, or other assets. Offerings of ETNs are registered under the Securities Act, and the performance of the reference assets generally determines the amount owed by the issuer of the ETN to the holder of the ETN at maturity.

Market Statistics

To provide a general overview of the distribution of market capitalization and trading volume across broad categories of ETPs, the table below shows the number of ETP products (by underlying or reference asset and by type of ETP), their aggregate market capitalization, and the total value traded as of year end 2014.

ETPs BY UNDERLYING OR REFERENCE ASSET TYPE, AS OF YEAR END 2014 ¹⁵

Underlying or reference asset or strategy	Number	Total market cap (millions)	Total value traded in 2014 (millions)
Asset Allocation	36	\$7,435	\$14,380
ETF	34	7,402	14,344
ETN	2	33	36
Alternative Strategies	330	42,985	1,952,802
ETF	209	31,865	1,296,485
Non-1940 Act Pooled Investment Vehicles	25	4,727	142,465

Risks for Buy-and-Hold Investors, available at <http://www.sec.gov/investor/pubs/leveragedetfs-alert.htm>; see also Securities Exchange Act Release No. 52553 (Oct. 3, 2005), 70 FR 59100 (Oct. 11, 2005) (SR-Amex-2004-62) (order granting approval for the adoption of listing standards to accommodate leveraged ETFs and for the listing and trading of shares of the xtraShares Trust).

⁸ For example, recent ETPs have included an ETF that seeks to track the performance of the CBOE S&P 500 VIX Tail Hedge Index, see Securities Exchange Act Release No. 67485 (July 23, 2012), 77 FR 44291 (July 27, 2012) (SR-NYSEArca-2012-50); an ETF that writes covered call options on underlying ETPs that it owns, see Securities Exchange Act Release No. 67552 (Aug. 1, 2012), 77 FR 47131 (Aug. 7, 2012) (SR-NYSEArca-2012-55); an ETF that holds long and short positions in underlying ETFs and ETNs, see Securities Exchange Act Release No. 67559 (Aug. 1, 2012), 77 FR 47482 (Aug. 8, 2012) (SR-NYSEArca-2012-57); an ETF that holds a portfolio including equities, equity futures, and volatility-related instruments, see Securities Exchange Act Release No. 68158 (Nov. 5,

2012), 77 FR 67412 (Nov. 9, 2012) (SR-NYSEArca-2012-101); and an ETF that seeks to track the performance of an index of over-the-counter put options on volatile stocks, see Securities Exchange Act Release No. 69373 (Apr. 15, 2013), 78 FR 23601 (Apr. 19, 2013) (SR-NYSEArca-2012-108).

⁹ The Commission has previously sought comment on topics related to exchange-traded funds, most recently in 2008. See Exchange-Traded Funds, Investment Company Act Release No. 28193 (Mar. 11, 2008), 73 FR 14618 (Mar. 18, 2008) (proposed rule), available at <http://www.sec.gov/rules/proposed/2008/33-8901.pdf>. The Commission has not adopted the rule that was proposed in the 2008 release.

¹⁰ Recently, the Commission approved an exchange proposal to adopt rules that provide for the listing and trading of Exchange-Traded Managed Fund Shares (“ETMFs”), which would operate differently from existing ETPs. See Securities Exchange Act Release No. 73562 (Nov. 7, 2014), 79 FR 68309 (Nov. 14, 2014) (SR-NASDAQ-2014-020) (Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a

Proposed Rule Change, as Modified by Amendment No. 1 thereto, Relating to the Listing and Trading of Exchange-Traded Managed Fund Shares) (“ETMF Approval Order”). No ETMFs are currently listed or traded on an exchange, and this Request for Comment does not therefore address their listing and trading.

¹¹ 15 U.S.C. 80a-1 *et seq.*

¹² The NAV of an investment company is the net value of all the assets and liabilities in the investment company’s portfolio divided by the number of the shares issued by the investment company.

¹³ Closed-end funds are also registered 1940 Act investment companies that issue securities that are traded on an exchange, and they may pursue investment strategies similar to those of ETFs. The trading of closed-end funds differs from that of ETFs, however, in that closed-end funds do not operate with the creation and redemption mechanism that, as described below, helps to keep an ETF’s market price closely tied to the value of the assets it holds. See *infra* at Section I.C.

¹⁴ 15 U.S.C. 77a *et seq.*

ETPs BY UNDERLYING OR REFERENCE ASSET TYPE, AS OF YEAR END 2014¹⁵—Continued

Underlying or reference asset or strategy	Number	Total market cap (millions)	Total value traded in 2014 (millions)
ETN	96	6,392	513,852
Commodities	118	55,366	406,728
ETF	7	213	810
1940 Act Pooled Investment.			
Vehicles	38	50,880	390,213
ETN	73	4,273	15,705
International Equity	367	380,023	2,497,521
ETF	361	376,941	2,495,865
ETN	6	3,082	1,657
Municipal Bond	32	14,273	20,186
ETF	32	14,273	20,186
Sector Equity	297	304,588	2,782,522
ETF	281	293,673	2,764,385
ETN	16	10,915	18,137
Taxable Bond	217	290,245	1,000,086
ETF	214	290,219	1,000,037
ETN	3	26	49
U.S. Equity	267	909,677	8,581,038
ETF	252	907,557	8,579,330
ETN	15	2,119	1,707
Grand Total	1,664	2,004,591	17,255,263

C. How Existing ETPs Function

1. Purchases, Sales, Creations, and Redemptions

Most investors in an ETP buy and sell the ETP's securities in the secondary market, at a market-determined price, with other market participants, including other investors, broker-dealers, and market makers, on the other side of the transaction. The ETP securities that are listed for trading on an exchange ("ETP Securities") are either (i) shares issued by the ETP or (ii) in the case of ETNs (which are, as noted above, debt instruments issued by a financial institution), the debt instruments themselves.

Although most investors can buy or sell ETP Securities only in the secondary market through a broker-dealer, certain large market participants, typically broker-dealers, can become authorized participants ("Authorized Participants") with respect to most ETPs.¹⁶ Each Authorized Participant enters into a contractual relationship with the ETP issuer that allows it to engage in purchases and redemptions of ETP Securities directly with that issuer.

For almost all ETPs,¹⁷ the issuance and redemption of ETP Securities

operates in essentially the same manner.¹⁸ ETPs generally issue ETP Securities only in large aggregations or blocks (for example, 50,000 ETP shares) called creation units ("Creation Units"). Most ETPs are structured so that an Authorized Participant will purchase a Creation Unit with a portfolio deposit ("Portfolio Deposit"), which is a basket of assets (and sometimes cash) that generally reflects the composition of the ETP's portfolio.¹⁹ The ETP makes public the contents of the Portfolio Deposit before the beginning of the trading day.²⁰ Because the purchase price of a Creation Unit and its aggregate NAV must be equal, an amount of cash will be exchanged between the Authorized Participant and the ETP at the time of purchase when necessary to balance the value of the Portfolio Deposit with that

issue and redeem ETN units based on the value or performance of the underlying reference asset or benchmark. The issuance and redemption process for ETNs is generally performed by institutional investors, as issuers require issuance or redemption to occur in large blocks of ETNs (e.g., 25,000 to 50,000 ETNs). ETNs are issued and redeemed (where redeemable) solely for cash.

¹⁸ Some ETPs, however, do not permit regular creations after the initial public offering of the ETP, allowing only ETP redemptions. See, e.g., Securities Exchange Act Release No. 66930 (May 7, 2012), 77 FR 27817 (May 11, 2012) (SR-NYSEArca 2012-18) (APMEX Physical—1 oz. Gold Redeemable Trust).

¹⁹ Some issuers may allow or require Creation Units to be created for cash only.

²⁰ In most cases, ETPs publish the contents of their Portfolio Deposit through the National Securities Clearing Corporation ("NSCC"). The NSCC provides its members with several methods to access this information. See <http://www.dtcc.com/clearing-services/equities-trade-capture/etf.aspx>.

of the Creation Unit. After purchasing a Creation Unit, an Authorized Participant may hold the ETP Securities or sell (or lend) some or all of them to investors in the secondary market.

Similarly, for most ETPs, when an Authorized Participant wishes to redeem ETP Securities, it presents a Creation Unit to the ETP for redemption and receives in return a redemption basket ("Redemption Basket"), the contents of which are made public by the ETP before the beginning of the trading day. The Redemption Basket (which is usually, but not always, the same as the Portfolio Deposit) typically consists of securities or commodities and a small amount of cash.²¹ As with purchases from the ETP, redemptions to the ETP are priced at NAV,²² and an amount of cash will be exchanged when necessary to balance the value of the Redemption Basket with that of the Creation Unit.

When creation and redemption transactions occur wholly or partly "in kind"—in other words, when securities constituting the ETP's portfolio are exchanged for ETP Securities and vice versa—certain benefits can accrue to the ETP and its investors. In-kind exchanges generally result in lower trading expenses (because securities received or

²¹ Some issuers may allow or require cash-only Redemption Baskets.

²² Certain ETPs that hold physical commodities and are not ETFs redeem Creation Units, at the Authorized Participant's option, either for commodities with a value equal to the NAV of the Creation Unit or for cash at less than the NAV of the Creation Unit. See, e.g., Securities Exchange Act Release No. 66930, *supra* note 18.

¹⁵ These figures reflect an analysis by Commission staff of market data obtained through subscriptions to Morningstar Direct and Bloomberg Professional services. Figures are as of the last trading day of 2014.

¹⁶ ETNs, as credit instruments issued by a financial institution, do not have Authorized Participants.

¹⁷ ETNs may or may not be redeemable, and they employ different calculations and procedures to

delivered in kind do not need to be purchased or sold in the market by the ETP, thus avoiding brokerage fees) and lower taxable gains to shareholders (because appreciated securities are not sold but are delivered in kind to redeeming Authorized Participants).

2. Arbitrage Between an ETP's Market Price and Its NAV

Because of the creation and redemption mechanisms, most existing ETPs present market participants, including Authorized Participants, market makers, and institutional investors, with opportunities to engage in arbitrage, which generally helps to prevent the market price of ETP Securities from diverging significantly from the value of the ETP's underlying or reference assets.²³ Although most ETPs calculate and disseminate their official NAV only once per day as of the close of regular trading hours, market participants can use other methods during the trading day to calculate or approximate the value of the assets underlying or referenced by a share of an ETP.²⁴

For example, exchange listing standards require every currently traded, actively managed ETP to make daily disclosure of its entire portfolio.²⁵ Current exchange listing standards do not require similar disclosures for index-based ETPs, but the make-up and value of the underlying indices are widely available, and most index-based ETPs, as a matter of practice, make daily disclosure of their portfolios. With this information, market participants can access pricing data about an ETP's portfolio assets and perform their own calculations of the per-share value of that portfolio.

In addition, exchange listing standards require existing ETPs to publicly disseminate during the trading day an intraday indicative value ("IIV"), which is designed to provide investors with information on the value of the investments held by the ETP (or, in the case of an ETN, the reference assets).²⁶

²³ Arbitrage for ETNs may operate differently from that for other existing ETPs, because the in-kind creation and redemption process for most ETPs differs from the cash-only issuance and redemption process for ETNs. The Commission seeks comment on the operation of arbitrage for ETNs. See *infra* at Section IIA (Question 8).

²⁴ ETNs do not calculate a NAV because they do not hold an underlying portfolio of assets. See *supra* Section I.B. See also *infra* note 26.

²⁵ See, e.g., NYSE Arca Equities Rule 8.600(d)(2)(B)(i). An actively managed ETP does not seek to track the return of a particular securities index. Instead, an actively managed ETP's investment adviser selects investments designed to meet a particular investment objective or policy.

²⁶ See, e.g., NYSE Arca Equities Rule 5.2(j)(3), Commentary .01(c). The IIV is also referred to as an

The IIV is typically calculated and disseminated at least every 15 seconds during the trading day and is typically disseminated over the Consolidated Tape or via an exchange data feed. The IIV may or may not be based on the entire portfolio held by an ETP, and it may or may not be equal to the per-share value of an ETP's underlying portfolio or reference assets.²⁷

A simplified example of "riskless" arbitrage will help to clarify how the arbitrage process for existing ETPs is intended to work. If the shares of an ETP that uses an in-kind creation and redemption process begin to trade at a discount to the value of the underlying portfolio at any point during the trading day, arbitrageurs can capture this difference (minus expenses) by: (i) Purchasing ETP Securities in the secondary market in an amount equal to a Creation Unit while simultaneously selling short the securities or commodities in the Redemption Basket; (ii) redeeming the Creation Unit with the ETP at the end-of-day NAV (either as an Authorized Participant or through a relationship with an Authorized Participant), thereby receiving the securities or commodities in the Redemption Basket; and (iii) using the contents of the Redemption Basket to close out the arbitrageur's short position. Purchasing the ETP Securities and selling short the securities or commodities in the Redemption Basket also apply market pressure that tends, all other things being equal, to bring the

"Indicative Optimized Portfolio Value," "Intraday Value," or "Portfolio Indicative Value." Most ETN issuers also make publicly available on their Web sites or through third-party vendors a value called the closing indicative value, which is determined as of the close of each trading day. The closing indicative value, in contrast to the intraday indicative value, represents the value of the ETN at that point in time and is used to calculate the amounts due to investors at maturity or on redemption.

²⁷ For example, the IIV for some ETPs is based on the current value of the securities or cash required to be deposited in exchange for a creation unit, which may differ from the composition of portfolio holdings on any given day. See, e.g., Securities Exchange Act Release No. 67320 (June 29, 2012), 77 FR 39763 (July 5, 2012) (SR-NYSEArca-2012-44) (order granting approval for the listing and trading of shares of the iShares Strategic Beta U.S. Large Cap Fund and iShares Strategic Beta U.S. Small Cap Fund). The IIV for certain other ETPs is based on the current value of some, but not all, assets held in the investment portfolio. See, e.g., Securities Exchange Act Release No. 61881 (Apr. 9, 2010), 75 FR 20028 (Apr. 16, 2010) (SR-NYSEArca-2010-14) (order granting approval to list and trade partnership units of the United States Brent Oil Fund, LP, a commodity pool that seeks to track changes in Brent crude oil futures traded on the ICE Futures Exchange and that calculates and disseminates an IIV based solely on these futures contracts, excluding other crude-oil-related investments held in the portfolio).

ETP Security's market price closer to the value of the underlying portfolio assets.

Similarly, if the shares of this same ETP begin to trade at a premium to the value of the underlying portfolio, arbitrageurs may profit by: (i) Selling short the ETP Securities; (ii) purchasing the securities or commodities that make up the Portfolio Deposit; (iii) exchanging the Portfolio Deposit for a Creation Unit through an Authorized Participant; and then (iv) using the ETP Securities in the Creation Unit to close out the short position. Again, the sales of the ETP Securities and the purchases of the contents of the Portfolio Deposit apply market pressure that tends, all other things being equal, to bring the price of the ETP Securities closer to the value of the underlying portfolio assets.

Market participants can also engage in arbitrage activities that do not necessarily require them to engage in creations or redemptions. For example, if a market participant believes that an ETP is overvalued relative to its underlying or reference assets, the market participant may sell ETP Securities; buy the underlying or reference assets; and, if the trading prices move toward parity, close out the positions in both the ETP Securities and the underlying or reference assets. The market participant would thereby realize a profit from the relative movement of those trading prices without engaging in an ETP creation. Similarly, a market participant could buy ETP Securities and sell the underlying or reference assets in an attempt to profit when an ETP Security is trading at a discount to its underlying or reference assets. As discussed above, the trading of an ETP Security and its underlying or reference assets applies market pressure that may bring the prices of the ETP Security and those assets closer together.

D. The Commission's Oversight of Exchange-Traded Products²⁸

Before ETP Securities can be listed and traded on a national securities

²⁸ In addition to the exemptive or no-action relief provided with respect to the Exchange Act rules and regulations described *infra*, in 1998 and 1999 the Commission's staff provided no-action relief under Section 13(d) of the Exchange Act, 15 U.S.C. 78m(d), and Section 16(a) of the Exchange Act, 15 U.S.C. 78p(a), to certain funds registered under the 1940 Act with respect to the required filing of ownership reports by insiders and five percent beneficial owners of the shares of the ETFs. See Letter from James J. Moloney, Division of Corporation Finance, and Evan Geldzahler, Division of Investment Management, Securities and Exchange Commission, to Sam Scott Miller, Orrick, Herrington & Sutcliffe LLP, 1998 SEC No.-Act. LEXIS 1050 (Dec. 14, 1998) (providing no-action relief under Section 13(d) of the Exchange Act);

exchange, those securities and their issuer must comply with, or obtain exemptions from, several provisions of the securities laws. First, as with other securities, the offer and sale of ETP Securities must be registered under the Securities Act.²⁹ In addition, in the case of ETFs, certain relief from the requirements of the 1940 Act is necessary,³⁰ because ETFs differ from other open-end investment companies in that they issue and redeem shares only in Creation Units and their shares trade in the secondary market at market prices.

While ETPs are governed by various provisions of the securities laws, including the Securities Act and, in certain cases, the 1940 Act, the focus of this Request for Comment is on the listing of ETP Securities on an exchange and the trading of ETP Securities on exchanges and other venues. Therefore, in issuing this Request for Comment, the Commission seeks public comment relating specifically to the oversight of ETPs under the provisions of the Exchange Act and the rules thereunder, including both (i) the exemptive and no-action relief granted to ETPs under the Exchange Act and (ii) the requirement that a national securities exchange have

Letter from Anne M. Krauskopf, Division of Corporation Finance, and Evan Geldzahler, Division of Investment Management, Securities and Exchange Commission, to Stuart M. Strauss, Gordon, Altman, Butowsky, Weitzens, Shalov & Wein, 1999 SEC No-Act. LEXIS 500 (May 6, 1999) (“Select Sector SPDR Trust Letter”) (providing no-action relief under Section 16(a) of the Exchange Act). This no-action relief was based, in large part, on the representation that the trading prices of the ETFs did not deviate materially from their NAV. See *id.* Having stated its views on whether insiders and five percent beneficial owners of ETPs must file ownership reports under Sections 16(a) and 13(d) of the Exchange Act, the Division staff stated that it would not respond to further requests for no-action relief in this area unless the request presented a “novel or unusual issue.” See Select Sector SPDR Trust Letter, 1999 SEC No-Act. LEXIS 500, *9.

²⁹ For ETPs that are not registered under the 1940 Act, offerings of ETP Securities require the filing of a registration statement on Form S-1 or Form S-3, depending on the issuer. Depending on the form type used to register the offering, the staff of the Division of Corporation Finance may review the disclosures included in the registration statement and may issue comments. ETN offerings in many cases are made through takedowns off of effective shelf registration statements. For ETFs registered under the 1940 Act, offerings require the filing of a registration statement on Form N-1A. The staff of the Division of Investment Management reviews the information disclosed in the Form N-1A and may issue comments requesting that the issuer revise or expand its disclosures before the registration statement becomes effective.

³⁰ For an ETF to operate, it must first obtain an order under Section 6(c) of the 1940 Act for an exemption from Sections 2(a)(32), 5(a)(1), 22(d), and 22(e) of the 1940 Act and from Rule 22c-1 thereunder, and under Sections 6(c) and 17(b) for an exemption from Sections 17(a)(1) and 17(a)(2) of the 1940 Act.

Commission-approved listing standards applicable to the ETP Securities being traded.

1. Exchange Act Exemptive and No-Action Relief for Existing ETPs

The trading of ETP Securities on an exchange generally will require that the issuer obtain exemptive or no-action relief from various provisions of, or rules promulgated under, the Exchange Act. As explained more fully below, the normal operation of an ETP would usually violate these provisions absent relief.

a. Regulation M

Regulation M proscribes certain activities that may increase a security’s offering price (and so increase the offering proceeds); stabilize the market price of an offered security in order to avoid a price decline during the sales period or in the immediate aftermarket; or induce or attempt to induce prospective investors to buy in the aftermarket.³¹ Rules 101 and 102 of Regulation M generally prohibit distribution participants, issuers, selling security holders, and their affiliated purchasers from purchasing, bidding for, or attempting to induce others to purchase or bid for covered securities during the restricted period of a distribution of securities.³² Because most ETPs are in continuous distribution, meaning that they are continually creating and distributing new securities, this restricted period usually extends indefinitely.³³ Absent relief, the purchase of ETP Securities by an Authorized Participant (who would be considered a distribution participant), or by the issuer in the redemption process, would violate Rules 101 and 102 of Regulation M.

When it has granted relief with respect to Regulation M, the Commission has relied upon representations from ETPs that the continuing existence of effective and efficient arbitrage mechanisms help ensure that the secondary market price

³¹ See Amendments to Regulation M: Anti-Manipulation Rules Concerning Securities Offerings, Securities Exchange Act Release No. 50831 (Dec. 9, 2004), 69 FR 75774 (Dec. 17, 2004) (S7-41-04) (proposed rule).

³² 17 CFR 242.101 and 242.102. See also 17 CFR 242.100 (defining “distribution participants,” “selling security holder,” “affiliated purchaser,” and other terms for purposes of Regulation M). In addition to being promulgated under the Exchange Act, Rules 101 and 102 of Regulation M are also promulgated under the Securities Act and under the 1940 Act. See *Anti-Manipulation Rules Concerning Securities Offerings*, Securities Exchange Act Release No. 38067 at n. 10 (Dec. 20, 1996), 62 FR 520, 521 n. 10 (Jan. 3, 1997) (S7-11-96).

³³ See 17 CFR 242.100 (definition of “Restricted Period”).

of ETP Securities does not vary substantially from the ETP’s NAV or underlying index value.³⁴ The relief is based in part on an ETP issuer’s representation that the continuing existence of effective and efficient arbitrage mechanisms makes it difficult to manipulate distributions of ETP Securities. Relief for classes of ETPs relies on similar bases.³⁵ The consideration of effective and efficient arbitrage mechanisms for purposes of Regulation M, and the Commission’s overall consideration of ETPs, can take into account not only the end-of-day differences between an ETP Security’s closing market price and the ETP’s NAV, but also any intra-day premiums or discounts between the secondary market price of an ETP Security and the value of its underlying portfolio or reference assets.

In granting relief, the Commission also has relied on representations by ETP issuers that the characteristics of their proposed ETPs will mitigate against the types of abuses that Regulation M is intended to address.³⁶ In the case of ETFs, for example, this includes representations that the shares are issued by an open-end investment company or unit investment trust registered with the Commission under the 1940 Act and that the index underlying an index-based ETP has at least 20 different component securities to promote sufficient diversification. It also includes representations that those components have publicly available trade information, to facilitate the

³⁴ See, e.g., Letter from W. John McGuire, Morgan, Lewis & Bockius LLP, to Josephine Tao, Division of Trading and Markets, Securities and Exchange Commission, re: AdvisorShares Trust Actively-Managed ETF WCM/BNY Mellon Focused Growth ADR (June 18, 2010) (representing that a close alignment between market price and NAV is expected for the relevant ETP due in part to an effective and efficient arbitrage mechanism), available at <http://www.sec.gov/divisions/marketreg/mr-noaction/2010/advisorshares061810.pdf>. See also Letter from Josephine Tao, Division of Trading and Markets, Securities and Exchange Commission, to W. John McGuire, Morgan, Lewis & Bockius LLP, re: AdvisorShares Trust Actively-Managed ETF WCM/BNY Mellon Focused Growth ADR (June 18, 2010), available at <http://www.sec.gov/divisions/marketreg/mr-noaction/2010/advisorshares061810.pdf>.

³⁵ See Letter from James A. Brigagliano, Division of Trading and Markets, Securities and Exchange Commission, to Stuart M. Strauss, Clifford Chance US LLP, re: Class Relief for Exchange Traded Index Funds (Oct. 24, 2006) (“Equity Index-Based ETF Letter”) (noting that relief is only appropriate when the secondary market price of the ETF’s shares does not vary substantially from NAV), available at <http://www.sec.gov/divisions/marketreg/mr-noaction/etifclassrelief102406-msr.pdf>.

³⁶ See *supra* note 31 and accompanying text.

availability of sufficient information for arbitrage.³⁷

b. Exchange Act Section 11(d)(1) and Rule 11d1–2

Section 11(d)(1) of the Exchange Act generally prohibits a broker-dealer from extending or maintaining credit, or arranging for the extension or maintenance of credit, on shares of new-issue securities if the broker-dealer participated in the distribution of the new-issue securities within the preceding 30 days.³⁸ The Commission's view is that, because ETP Securities are distributed in a continuous manner, broker-dealers that sell these securities are thereby participating in the "distribution" of a new issue for purposes of Section 11(d)(1).³⁹ Further, if an ETF held a portfolio composed solely or largely of newly issued securities, there is a risk that Authorized Participants—rather than lending on, or arranging for lending on, the newly issued securities directly—could use the ETF structure to avoid the new-issue lending restriction.

The Commission has granted ETP issuers exemptions from, and the staff has issued no-action positions regarding, Section 11(d)(1) in circumstances in which these evasion concerns are reduced because: (i) the portfolio is sufficiently diversified that evasion becomes impractical;⁴⁰ (ii) the portfolio is composed of securities that are not subject to Section 11(d)(1) (*e.g.*, government securities);⁴¹ or (iii) the

portfolio is not composed of securities at all (*e.g.*, the product is an ETP that invests in commodities).⁴²

c. Exchange Act Rule 10b–10

Rule 10b–10 under the Exchange Act⁴³ requires broker-dealers to provide their customers with certain disclosures at or before the completion of a securities transaction, including the identity, price, and number of shares or units (or principal amount) of the security purchased or sold. As described above, ETP Securities are issued and redeemed only in Creation Units of a minimum size, and a Portfolio Deposit or Redemption Basket may comprise dozens or hundreds of securities. Because it would be administratively burdensome for broker-dealers to provide transaction confirmations for each security in a Portfolio Deposit or Redemption Basket, the Commission has issued exemptive relief from Rule 10b–10 to permit broker-dealers to omit this information with respect to ETPs, provided that (i) the Creation Unit is sufficiently large (at least 25,000 shares and \$500,000), (ii) it is probable that creation and redemption transactions are entered into only by sophisticated investors, and (iii) the broker-dealer provides the omitted confirmation information to customers upon request.⁴⁴

d. Exchange Act Rule 10b–17

Rule 10b–17 under the Exchange Act generally requires issuers to give notice 10 days in advance of certain specified actions (*e.g.*, a dividend distribution, stock split, or rights offering) relating to their securities, in accordance with the procedures laid out in the rule.⁴⁵ Generally this rule is relevant to an ETP when it must distribute cash—for example, income from fixed-income holdings or cash from a realized investment gain—to its shareholders. Because some ETP Securities are continuously being issued or redeemed,

issuers have represented that it is impractical to project, and to provide, some of the information required by Rule 10b–17 ten days in advance.⁴⁶ According to these issuers, particularly difficult are the requirements for the issuer to disclose (i) in the case of a distribution in cash, the amount of cash to be paid or distributed per share, and (ii) in the case of a distribution in the same security, the amount of the securities outstanding immediately before and immediately after the dividend or distribution and the rate of the dividend or distribution.⁴⁷

When the Commission has granted exemptions to permit these distributions to occur without ETP issuers providing 10-day advance notice of the two items of information noted above, this relief has been conditioned on the issuer providing the two items of information to the national securities exchange on which the ETP Securities are registered (pursuant to Section 12 of the Exchange Act) as soon as practicable before trading begins on the ex-dividend date, but in no event later than the time (on the day before the ex-dividend date) the exchange last accepts information relating to distributions.⁴⁸ The Commission has granted these exemptions because, other than receiving a delayed notice of these two items of information, market participants will have timely notice of the existence and timing of a pending distribution, as required by Rule 10b–17.⁴⁹ Further, under the terms of the exemption, the timing of the availability of the two items of information should allow market participants time to update their systems to reflect the accurate price of the ETP Securities before trading begins on the ex-dividend date.⁵⁰

e. Exchange Act Rule 14e–5

Rule 14e-5 under the Exchange Act⁵¹ is designed to prevent the manipulation

³⁷ See, *e.g.*, Equity Index-based ETF Letter, *supra* note 35. Broadly speaking, ETP sponsors seeking relief make the same representations as those made by similar products that have previously been granted relief.

³⁸ 15 U.S.C. 78k(d)(1).

³⁹ See, *e.g.*, Letter from Catherine McGuire, Division of Trading and Markets, Securities and Exchange Commission, to Securities Industry Association (Nov. 21, 2005), available at <http://www.sec.gov/divisions/marktreg/mr-noaction/sia112105.htm>.

⁴⁰ See, *e.g.*, Letter from Catherine McGuire, Division of Trading and Markets, Securities and Exchange Commission, to Securities Industry Association (Nov. 21, 2005) (conditionally exempting from Section 11(d)(1) an ETF that consists of a basket of twenty or more component securities, with no one component security constituting more than 25% of the total value of the ETF), available at <http://www.sec.gov/divisions/marktreg/mr-noaction/sia112105.htm>; Letter from Joseph Furey, Division of Trading and Markets, Securities and Exchange Commission, to W. John McGuire, Morgan, Lewis & Bockius LLP, re: AdvisorShares Madrona & Meidell ETFs (June 16, 2011) ("Madrona & Meidell Letter") (providing conditional staff no-action relief to ETFs whose portfolios consist of other diversified ETFs), available at <http://www.sec.gov/divisions/marktreg/mr-noaction/2011/advisorsharesmadrona061611.pdf>.

⁴¹ See, *e.g.*, Letter from James A. Brigagliano, Division of Market Regulation, Securities and Exchange Commission, to Richard F. Kadlick, Esq.,

Skadden, Arps, Slate, Meagher & Flom LLP, re: MACRO Securities Depositor, LLC (Dec. 22, 2006) ("MACRO Securities Depositor Letter") (providing conditional staff no-action relief), available at <http://www.sec.gov/divisions/marktreg/mr-noaction/macro122206-11d1.pdf>.

⁴² See, *e.g.*, Letter from James A. Brigagliano, Division of Market Regulation, Securities and Exchange Commission, to Michael Schmidtberger, Sidley Austin Brown & Wood LLP, re: DB Commodity Index Tracking Fund (Jan. 19, 2006) ("DB Commodity Index Tracking Fund Letter") (providing conditional staff no-action relief), available at <http://www.sec.gov/divisions/marktreg/mr-noaction/commodityidxtf011906.htm>.

⁴³ 17 CFR 240.10b–10.

⁴⁴ See, *e.g.*, Letter from Catherine McGuire to Securities Industry Association, *supra* note 40.

⁴⁵ 17 CFR 240.10b–17.

⁴⁶ See *e.g.*, Letter from Jeremy Senderowicz, Dechert LLP, to Josephine Tao, Division of Trading and Markets, Securities and Exchange Commission, re: ALPS ETF Trust, ALPS/GS Momentum Builder Growth Markets Equities and U.S. Treasuries Index ETF, ALPS/GS Momentum Builder Multi-Asset Index ETF, and ALPS/GS Momentum Builder Asia Ex-Japan Equities and U.S. Treasuries Index ETF (Dec. 18, 2012), available at <http://www.sec.gov/rules/exorders/2012/34-68459-letter.pdf>.

⁴⁷ These disclosures are required by 17 CFR 240.10b–17(b)(1)(v)(a) and (b).

⁴⁸ See, *e.g.*, Order Granting a Limited Exemption from Exchange Act Rule 10b–17, Securities Exchange Act Release No. 67215 (June 19, 2012), 77 FR 37941 (June 25, 2012) (TP–11–07) ("10b–17 Actively Managed ETP Exemption").

⁴⁹ See *id.*

⁵⁰ See *id.*

⁵¹ 17 CFR 240.14e–5.

of tender offers. In particular, Rule 14e-5 prohibits “covered persons”⁵² from purchasing or arranging to purchase any securities subject to a tender offer except as part of that tender offer.⁵³ This prohibition is in effect from the announcement of the tender offer until the expiration of the tender offer. An Authorized Participant acting as the dealer-manager of a tender offer for a component security is a covered person for purposes of Rule 14e-5.⁵⁴

The Commission has granted relief to various entities with respect to the application of Rule 14e-5 so that Authorized Participants may redeem Creation Units and purchase ETP Securities even though component securities may be subject to a Rule 14e-5 restricted period.⁵⁵ ETP issuers generally seek relief on the basis that: (i) Acquiring individual securities held by an ETP through redemptions of the ETP’s securities would be impractical and inefficient; (ii) facilitating a tender offer in a particular security included in a Portfolio Deposit by means of purchasing all of the specific portfolio securities constituting the Portfolio Deposit would be inefficient; and (iii) applying the Rule 14e-5 prohibition would impede the valid and useful market and arbitrage activity that would assist secondary market trading and improve the pricing efficiency of ETP

⁵² For purposes of Exchange Act Rule 14e-5, a “covered person” is defined as: (i) The offeror and its affiliates; (ii) the offeror’s dealer-manager and its affiliates; (iii) any advisor to any of the persons specified in (i) or (ii) whose compensation is dependent on the completion of the offer; and (iv) any person acting, directly or indirectly, in concert with any of the persons specified in (i), (ii), or (iii) in connection with any purchase or arrangement to purchase the securities or any related securities. See 17 CFR 240.14e-5(c)(3).

⁵³ Rule 14e-5 is designed to protect investors by preventing an offeror from extending greater or different consideration to some security holders outside the offer, while other security holders are limited to the offer’s terms, and by ensuring that large security holders do not demand greater consideration. See Securities Exchange Act Release No. 8712 (Oct. 8, 1969), 34 FR 15838 (Oct. 15, 1969) (order adopting Rule 10b-13, which was later redesignated as Rule 14e-5 in Securities Exchange Act Release No. 42055 (Oct. 22, 1999), 64 FR 61408 (Nov. 10, 1999)). In addition, Rule 14e-5 prevents purchases outside the offer that, depending on the conditions in the market and the nature of the purchases, may be fraudulent or manipulative in nature, such as purchases that are used to defeat a tender offer by driving the market price above the offer price or by otherwise reducing the number of shares tendered below the stated minimum. See *id.*

⁵⁴ See 17 CFR 240.14e-5(c)(3)(ii).

⁵⁵ See, e.g., Equity Index-Based ETF Letter, *supra* note 35, at 6. The entities to which relief has been granted include open-end investment companies that issue ETP Securities, the listing exchange and any other national securities exchange on or through which the ETP Securities may subsequently trade, and persons or entities engaging in transactions in ETP Securities.

Securities.⁵⁶ Moreover, the issuers generally represent that the type of trading described above does not result in the abuses that Rule 14e-5 was designed to prevent.⁵⁷ As a condition of the relief that has been issued, the issuer of ETP Securities generally also represents that the purchases or redemptions would not, in fact, be used to facilitate a tender offer.

f. Exchange Act Rules 15c1-5 and 15c1-6

Rule 15c1-5 under the Exchange Act⁵⁸ requires a broker-dealer to disclose to its customers if it has a control relationship with an issuer prior to a customer’s purchase or sale of the issuer’s securities. Rule 15c1-6 under the Exchange Act⁵⁹ requires a broker-dealer to disclose to its customer, at or before the completion of a transaction, that the broker-dealer is participating in the primary or secondary distribution of the securities that it is selling or purchasing for the customer’s account. Because applying these rules to all the securities in a creation or redemption transaction would be administratively burdensome for broker-dealers, and because creations and redemptions are consummated at prices that are fixed by the ETP, there appears to be little potential for a broker-dealer to manipulate the price of the securities in the creation and redemption transactions.⁶⁰ Therefore, the staff has stated that it will not recommend enforcement action to the Commission with respect to Authorized Participants’ compliance with Rules 15c1-5 and 15c1-6 in creation and redemption transactions if a broker-dealer executes transactions in shares of “Qualifying ETFs” without disclosing any control relationship with an issuer of a security in the Portfolio Deposit or Redemption Basket.⁶¹ The staff has similarly stated

⁵⁶ See, e.g., Letter from W. John McGuire, Bingham McCutchen LLP, to Michele M. Anderson and David Orlic, Division of Corporation Finance, Securities and Exchange Commission, re: SSgA Active ETF Trust (July 3, 2013), available at <http://www.sec.gov/divisions/corpfin/cf-noaction/2013/ssga-active-etf-trust-14e5.pdf>.

⁵⁷ See *supra* note 53.

⁵⁸ 17 CFR 240.15c1-5.

⁵⁹ 17 CFR 240.15c1-6.

⁶⁰ See, e.g., Letter from Catherine McGuire to Securities Industry Association, *supra* note 40.

⁶¹ A “Qualifying ETF” was initially limited to an ETF meeting certain conditions, including that it is issued by an open-end investment company or unit investment trust registered with the Commission under the 1940 Act; that it is listed and traded on a national securities exchange; that it comprises twenty or more diversified component securities, with no one component security constituting more than 25% of the total value of the ETF; and that it is managed to track a particular index, all components of which are publicly available. *Id.* Subsequent staff no-action positions have provided

that it will not recommend enforcement action if a broker-dealer executes transactions in shares of Qualifying ETFs without disclosing its participation or interest in a primary or secondary distribution of a security included within the Portfolio Deposit or Redemption Basket.⁶²

g. Class Relief

In connection with the application of the Exchange Act provisions described above, the Commission has issued a number of “class” exemptions to the trading of ETP Securities.⁶³ Class exemptions for ETPs from the Exchange Act provisions discussed above are generally issued only if the Commission and the staff have had experience with individual exemptions and no-action positions and have determined that class relief is appropriate.⁶⁴ In the case of exemptions, the Commission must also determine that a class exemption meets the statutory standard of being necessary or appropriate in the public interest and consistent with the protection of investors.⁶⁵ An ETP relying on a class exemption or no-action position must meet all of the conditions of the relevant Commission order or staff letter for the life of the product (or until the relief is no longer necessary), just as if the ETP had obtained its own individual relief. Class exemptions or no-action positions have been issued for equity index-based

no-action relief to more ETPs with respect to treatment as Qualifying ETFs. See, e.g., DB Commodity Index Tracking Fund Letter, *supra* note 42 (certain commodity-based exchange-traded trusts); MACRO Securities Depositor Letter, *supra* note 41 (an ETP holding government securities); Letter from Brian A. Bussey, Division of Trading and Markets, Securities and Exchange Commission, to W. Thomas Conner and Eric C. Freed, Sutherland Asbill & Brennan LLP, re: Ameristock ETF Trust (June 29, 2007) (certain fixed income ETFs), available at <http://www.sec.gov/divisions/marketreg/mr-noaction/2007/ameristock062907-msr.pdf>; Letter from James A. Brigagliano, Division of Trading and Markets, Securities and Exchange Commission, to Kathleen H. Moriarty, Carter, Ledyard & Milburn, re: Proshares Trust (Jan. 24, 2007) (certain ETFs tracking a multiple, inverse, or multiple inverse of an index), available at <http://www.sec.gov/divisions/marketreg/mr-noaction/2007/proshares012407-msr.pdf>; Letter from Josephine J. Tao, Division of Trading and Markets, Securities and Exchange Commission, to Richard F. Morris, Deputy General Counsel, WisdomTree Asset Management, Inc. (May 9, 2008) (certain actively-managed ETFs not tied to an index), available at <http://www.sec.gov/divisions/marketreg/mr-noaction/2008/wisdomtree050908-msr.pdf>; and Madrona & Meidell Letter, *supra* note 40 (certain ETFs whose portfolios consist of other diversified ETFs).

⁶² *Id.*

⁶³ See, e.g., Equity-Index Based ETF Letter, *supra* note 35.

⁶⁴ See Letter from Catherine McGuire to Securities Industry Association, *supra* note 40.

⁶⁵ See 15 U.S.C. 78mm(a)(1).

ETFs,⁶⁶ commodity-based investment vehicles that are not registered under the 1940 Act,⁶⁷ fixed-income index-based ETFs,⁶⁸ “combination” index-based ETFs,⁶⁹ ETNs,⁷⁰ and actively-managed ETFs.⁷¹ These orders and no-action positions cover a number of the Exchange Act rules and regulations described above.⁷²

2. Exchange Listing Standards and the Rule 19b–4 Process

Before ETP Securities can trade on a national securities exchange, that exchange must agree to list the ETP Securities for trading on its market, and it must have Commission-approved initial and continued listing standards that permit listing of that type or “class” of ETP Security.⁷³ ETP listing standards can be broadly categorized as either generic or non-generic.

Generic listing standards permit an exchange to list and trade specific ETP Securities of a broader class of ETPs without filing a product-specific proposed rule change with the

Commission.⁷⁴ When listing ETP Securities in this way, however, exchanges are required to file a notice with the Commission within five business days after trading commences.⁷⁵ Examples of ETP classes for which generic listing standards exist include what are commonly called index-based ETFs (which the exchanges’ rules call Investment Company Units, Index-Fund Shares, Portfolio Depository Receipts, or security-based Trust Issued Receipts), and certain ETNs (which the exchanges’ rules call Index-Linked Securities or Linked Securities).⁷⁶

Generic ETP listing standards approved by the Commission contain quantitative criteria with respect to components included in the ETP’s underlying or reference index or benchmark. With respect to underlying indices, these quantitative criteria provide minimum thresholds regarding trading volume, market capitalization, number of index components, and index concentration limits.⁷⁷ To mitigate the

potential for manipulation and other trading abuses, and to help maintain a fair and orderly market for the ETP Securities, these quantitative criteria are designed to help ensure a minimum degree of liquidity and diversification for the underlying or reference securities, assets, or instruments.

Non-generic listing standards permit an exchange to list and trade a specific ETP Security (within a class of ETPs) only after the exchange has filed and the Commission has approved a proposed rule change that is specific to the new ETP Security.⁷⁸ Because of their security-specific nature, non-generic listing standards typically do not contain generalized quantitative criteria for the components included in an ETP’s underlying or reference index or benchmark.

Exchanges seeking to adopt listing standards applicable to a new ETP product class—or to list and trade specific ETP Securities pursuant to existing non-generic listing standards for an ETP product class—are required to file proposed rule changes under Section 19(b)(1) of the Exchange Act⁷⁹ and Rule 19b–4 thereunder.⁸⁰ Once an

weight of the index; (4) that there be a minimum number of components in the index; and (5) that each component either be an exchange-listed NMS stock or, if a non-U.S. stock, be listed and traded on an exchange that has last-sale reporting. *See, e.g.,* BATS Rule 14.11(c); NASDAQ Rule 5705; NYSE Arca Equities Rule 5.2(j)(3), Commentary .01. With respect to ETNs, the generic listing standards also include minimum requirements relating to the issuer of the securities (*e.g.*, minimum tangible net worth and minimum amount of assets), which are designed to mitigate issuer credit risk. *See, e.g.,* BATS Rule 14.11(d); NASDAQ Rule 5710; NYSE Arca Equities Rule 5.2(j)(6).

⁷⁸ The ETP product classes that have non-generic listing standards include the following: Trust Issued Receipts based on investments in “investment shares” or “financial instruments,” Commodity-Based Trust Shares, Commodity Index Trust Shares, Commodity Futures Trust Shares, Partnership Units, Paired Trust Shares, Trust Units, Managed Fund Shares, Managed Trust Securities, and Trust Certificates. *See, e.g.,* BATS Rules 14.11(e)(3) (Trust Certificates), 14.11(e)(4) (Commodity-Based Trust Shares), 14.11(e)(6) (Commodity Index Trust Shares), 14.11(e)(7) (Commodity Futures Trust Shares), 14.11(e)(8) (Partnership Units), 14.11(e)(9) (Trust Units), 14.11(e)(10) (Managed Trust Securities), and 14.11(i) (Managed Fund Shares); NASDAQ Rules 5711(c) (Trust Certificates), 5711(d) (Commodity-Based Trust Shares), 5711(f) (Commodity Index Trust Shares), 5711(g) (Commodity Futures Trust Shares), 5711(h) (Partnership Units), 5711(i) (Trust Units), 5711(j) (Managed Trust Securities), and 5735 (Managed Fund Shares); NYSE Arca Equities Rules 8.200 (Commentary .02) (Trust Issued Receipts based on investment shares or financial instruments), 8.201 (Commodity-Based Trust Shares), 8.203 (Commodity Index Trust Shares), 8.204 (Commodity Futures Trust Shares), 8.300 (Partnership Units), 8.400 (Paired Trust Shares), 8.500 (Trust Units), 8.600 (Managed Fund Shares), 8.700 (Managed Trust Securities).

⁷⁹ 15 U.S.C. 78s(b).

⁸⁰ 17 CFR 240.19b–4.

⁶⁶ See Equity Index-Based ETF Letter, *supra* note 35.

⁶⁷ See Letter from Racquel L. Russell, Division of Trading and Markets, Securities and Exchange Commission, to George T. Simon, Foley & Lardner LLP, re: CurrencyShares British Pound Sterling Trust *et al.* (June 21, 2006), available at <http://www.sec.gov/divisions/marketing/mr-noaction/currencyshares062106-10a1.pdf>.

⁶⁸ See Letter from James A. Brigagliano, Division of Trading and Markets, Securities and Exchange Commission, to Benjamin J. Haskin, Willkie Farr & Gallagher LLP, re: Class Relief for Fixed Income ETFs (Apr. 9, 2007), available at <http://www.sec.gov/divisions/marketing/mr-noaction/2007/fitfclassrelief040907-msr.pdf>.

⁶⁹ See Letter from Josephine Tao, Division of Trading and Markets, Securities and Exchange Commission, to Domenick Pugliese, Paul, Hastings, Janofsky and Walker LLP, re: Combination ETFs (June 27, 2007), available at <http://www.sec.gov/Archives/edgar/vpr/07/9999999997-07-047147>.

⁷⁰ See, *e.g.*, Letter from Josephine Tao, Division of Trading and Markets, Securities and Exchange Commission, to Arthur S. Long, Davis Polk & Wardwell LLP, re: Deutsche Bank AG ETNs (Oct. 12, 2007) (“ETN No-action Letter”), available at <http://www.sec.gov/divisions/marketing/mr-noaction/2007/dbab101207.pdf>.

⁷¹ See 10b-17 Actively Managed ETP Exemption, *supra* note 48, and Division of Trading and Markets: Staff Legal Bulletin No. 9 “Frequently Asked Questions About Regulation M” (as revised Sep. 10, 2010) (regarding Regulation M), available at <http://www.sec.gov/interp/leg/mrslb9.htm>.

⁷² See *supra* Sections I.D.1.a through I.D.1.f.

⁷³ See 15 U.S.C. 78s(b) and 17 CFR 240.19b–4. The Exchange Act also permits an exchange to trade a security that is listed on another exchange. The non-listing exchange that trades the security is said to extend “unlisted trading privileges” (or “UTP”) to the security. *See* Section 12(f) of the Exchange Act, 15 U.S.C. 78l(f); Exchange Act Rule 12f–5 (17 CFR 240.12f–5) (providing that an exchange shall not extend UTP to a security unless the exchange has in effect a rule or rules providing for transactions in the class or type of security to which the exchange extends UTP).

⁷⁴ See 17 CFR 240.19b–4(e)(1). In 1998, the Commission issued a final rule setting forth the standards under which exchanges can list and trade “new derivatives securities products” (a category that encompasses ETPs) under “generic listing standards.” *See* Amendments to Rule Filing Requirements for Self-Regulatory Organizations Regarding New Derivative Securities Products, Securities Exchange Act Release No. 40761 (Dec. 8, 1998), 63 FR 70952 (Dec. 22, 1998) (S7–13–98).

⁷⁵ See 17 CFR 240.19b–4(e)(2)(ii). The required notice is filed on Form 19b–4(e). 17 CFR 249.820.

⁷⁶ See, *e.g.*, Securities Exchange Act Release Nos. 42787 (May 15, 2000), 65 FR 33598 (May 24, 2000) (SR–Amex–2000–14) (approving generic listing standards for ETFs called Portfolio Depository Receipts and Index Fund Shares); 45718 (Apr. 9, 2002), 67 FR 18965 (Apr. 17, 2002) (SR–NYSE–2002–07) (approving generic listing standards for Trust Issued Receipts); and 55687 (May 1, 2007), 72 FR 25824 (May 7, 2007) (SR–NYSE–2007–27) (approving generic listing standards for Index-Linked Securities). *See also, e.g.,* BATS Rules 14.11(b) (Portfolio Depository Receipts), 14.11(c) (Index Fund Shares), 14.11(d) (ETNs), and 14.11(f) (Trust Issued Receipts), available at http://batstrading.com/resources/regulation/rule_book/BATS_Exchange_Rulebook.pdf; NASDAQ Rules 5705 (Index Fund Shares and Portfolio Depository Receipts), 5710 (ETNs), and 5720 (Trust Issued Receipts), available at <http://nasdaq.cchwallstreet.com/NASDAQTools/PlatformViewer.asp?selectednode=chp%5F1%5F1%5F4%5F3&manual=%2Fnasdaq%2Fmain%2Fnasdaq%2Fdequityrules%2F>; NYSE Arca Equities Rules 5.2(j)(3) (Investment Company Units), 5.2(j)(6) (ETNs), 8.100 (Portfolio Depository Receipts), and 8.200 (Trust Issued Receipts), available at <http://nysearcrules.nyse.com/PCX/>.

⁷⁷ For example, with respect to equity-index-based ETFs, the generic listing standards generally contain the following requirements with respect to the underlying index: (1) That each component have a minimum market value; (2) that each component have a minimum monthly trading volume over the most recent six-month period; (3) that the index observe certain concentration limits (*e.g.*, that no component may exceed 30% of the weight of the index and that the five most heavily weighted components may not exceed 65% of the

exchange files a proposed rule change that complies with the Exchange Act, the rules thereunder, and the form governing such filings, statutory deadlines apply to Commission consideration of the filing.

Section 19(b)(2) of the Exchange Act, as amended by the Dodd-Frank Act,⁸¹ effectively requires the Commission to publish notice of a proposed rule change within 15 days of filing.⁸² In general, for proposals that must be approved by the Commission before they may take effect (such as a filing concerning a new ETP), the Commission is required to take action within 45 days (which can be extended by the Commission or the exchange for another 45 days) after the date of publication of the proposal in the **Federal Register**.⁸³ The Commission may, however, institute proceedings to determine whether to disapprove a proposal, in which case the Commission is required to take final action to approve or disapprove a proposed rule change no later than 240 days after the proposal is published in the **Federal Register**.⁸⁴ If the Commission fails to meet any of the deadlines for final action on a proposed rule change, that proposed rule change is, pursuant to the Exchange Act, deemed to have been approved by the Commission.⁸⁵

To approve an exchange's proposed rule change, the Commission must find that the proposed rule change is consistent with the applicable requirements of the Exchange Act and the rules and regulations thereunder.⁸⁶ The requirements imposed by the Exchange Act include those set forth in Section 6(b)(5), which provides that the rules of an exchange must be designed to do the following: (i) Prevent fraudulent and manipulative acts and practices; (ii) promote just and equitable principles of trade; (iii) foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities; (iv) remove impediments to and perfect the mechanism of a free and open market and a national market system; and (v) in general, to protect

investors and the public interest.⁸⁷ With respect to the listing standards for ETP Securities, most exchange filings in connection with proposed rule changes include a general description of the following: (i) the ETP and its permitted investments or reference assets; (ii) how the ETP will seek to meet its investment objective; (iii) whether and to what extent information is available to investors about the pricing and valuation of the ETP Securities, the ETP's underlying assets, and the relevant index or reference assets;⁸⁸ (iv) how the exchange will monitor trading in the ETP Securities; and (v) the information that will be available to investors about the ETP Securities.⁸⁹

⁸⁷ 15 U.S.C. 78f(b)(5). In addition, the proposed rule change must not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers or to regulate by virtue of any authority conferred by the Exchange Act matters not related to the purposes of the Exchange Act or the administration of the exchange. *Id.*

⁸⁸ For index-based ETPs, exchange rules generally require that the underlying or reference index or benchmark be calculated and disseminated throughout the trading day. The frequency of dissemination depends on whether the components are U.S. equities, foreign equities, or fixed-income securities. *See, e.g.*, Commentary .01(b)(2) to NYSE Arca Equities Rule 5.2(j)(3) (requiring that the current index value be widely disseminated every 15 seconds during the exchange's Core Trading Session for investment company units that track a U.S. equity index and every 60 seconds for investment company units that track an international or global equity index); Commentary .02(b)(ii) to NYSE Arca Equities Rule 5.2(j)(3) (requiring that the current index value for investment company units that track a fixed-income index be disseminated at least once per day). For ETNs, exchange rules generally require that the value of the reference assets be calculated and disseminated throughout the trading day. *See, e.g.*, NYSE Arca Equities Rule 5.2(j)(6)(B)(III)(1)(b)(ii) (requiring that the value of the commodity reference asset be calculated and widely disseminated on at least a 15-second basis during the exchange's Core Trading Session for commodity-linked securities). As noted above, most ETP issuers also make publicly available a closing indicative value that is determined as of the close of each trading day. *See supra* note 26.

⁸⁹ Exchanges are required by their listing standards to distribute information circulars or bulletins to exchange members relating to the listing of ETP Securities. *See, e.g.*, NYSE Arca Equities Rules 5.1(a)(2), 5.2(j)(3) Commentary .01(g), 8.100(c), and 8.600 Commentary .05. The information to be contained in these circulars is generally specified in a Commission order approving the listing and trading of new ETP Securities and typically includes: (a) The special characteristics and risks associated with trading ETP Securities; (b) the procedures for creations and redemptions of ETP Securities; (c) the exchange requirements relating to the members' obligations to learn the essential facts in connection with every customer prior to trading ETP Securities and other suitability requirements, such as information contained in guidance issued by FINRA with respect to the trading and sales of leveraged and inverse-leveraged ETPs and other complex securities products; (d) how information regarding the IIV is disseminated and the risks involved in trading ETP Securities outside of regular trading hours when an updated IIV is not calculated or available; (e) applicable prospectus delivery

3. Broker-Dealer Sales Practices

Broker-dealers, which are registered with and regulated by the Commission under the Exchange Act, are also subject to regulation by the self-regulatory organizations ("SROs") to which they belong—*e.g.*, FINRA and the exchanges. Both federal and SRO regulations impose duties on broker-dealers when dealing with their customers and, in particular, when recommending the purchase or sale of securities by their customers.⁹⁰ These duties include making suitable recommendations, engaging in fair and balanced communications with the public, disclosing conflicts of interest, and receiving fair compensation both in agency and principal transactions.⁹¹

In addition, a broker-dealer that recommends buying, holding, or selling an ETP, or an investment strategy involving an ETP, may be subject to additional or heightened scrutiny regarding ETPs with respect to brokerage customers, as described in FINRA guidance regarding complex products and non-traditional ETPs.⁹²

requirements; and (f) other information (*e.g.*, fees and expenses of the ETP and the time at which the NAV will be calculated and published daily). *See, e.g.*, Securities Exchange Act Release Nos. 65136 (Aug. 15, 2011), 76 FR 52037, 52040 (Aug. 19, 2011) (SR-NYSEArca-2011-24); 68390 (Dec. 10, 2012), 77 FR 74540, 74543 (Dec. 14, 2012) (SR-BATS-2012-042); and 70829 (Nov. 7, 2013), 78 FR 68482, 68485 (Nov. 14, 2013) (SR-NASDAQ-2013-122).

⁹⁰ *See e.g.*, Exchange Act Section 15(c) and FINRA Rule 2111.

⁹¹ *See, e.g.*, *A Joint Report of the SEC and CFTC on Harmonization of Regulation*, at 8 (Oct. 16, 2009), <http://www.sec.gov/news/press/2009/cftcjointreport101609.pdf> ("Under the federal securities laws and SRO rules, broker-dealers are required to deal fairly with their customers. This includes having a reasonable basis for recommendations given the customer's financial situation (suitability), engaging in fair and balanced communications with the public, . . . disclosing conflicts of interest, and receiving fair compensation both in agency and principal transactions. In addition, the SEC's suitability approach requires BDs [*i.e.*, broker-dealers] to determine whether a particular investment recommendation is suitable for a customer, based on customer-specific factors and factors relating to the securities and investment strategy. A BD must investigate and have adequate information regarding the security it is recommending and ensure that its recommendations are suitable based on the customer's financial situation and needs. The suitability approach in the securities industry is premised on the notion that securities have varying degrees of risk and serve different investment objectives, and that a BD is in the best position to determine the suitability of a securities transaction for a customer. Disclosure of risks alone is not sufficient to satisfy a broker-dealer's suitability obligation.")

⁹² *See* FINRA Notice to Members ("FINRA NTM") 12-03 (Jan. 2012) (Heightened Supervision of Complex Products). *See also* FINRA NTM 10-51 (Oct. 2010) (Sales Practice Obligations for Commodity Futures-Linked Securities); FINRA NTM 09-73 (Dec. 2009) (FINRA Reminds Firms of their Sales Practice Obligations Relating to

⁸¹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, § 916(a), 124 Stat. 1376, 1833-34 (2010).

⁸² 15 U.S.C. 78s(b)(2)(E).

⁸³ Certain proposed rule changes are entitled to become "immediately effective" upon filing, without prior Commission approval. *See* 15 U.S.C. 78s(b)(3)(A) and 17 CFR 240.19b-4(f) (setting forth certain limited conditions under which a proposed rule change may take effect immediately upon filing with the Commission).

⁸⁴ *See* 15 U.S.C. 78s(b)(2)(B)(ii).

⁸⁵ 15 U.S.C. 78s(b)(2)(D).

⁸⁶ 15 U.S.C. 78s(b)(2)(C).

II. Request for Comment

The Commission is soliciting public comment to help inform its review of the listing and trading of new, novel, or complex ETPs, including requests by ETPs for exemptive and no-action relief under the Exchange Act and filings by exchanges to adopt listing standards applicable to ETPs. The Commission is also soliciting comment regarding the ways in which broker-dealers, which are regulated under the Exchange Act, market these products, especially to retail investors. Finally, the Commission seeks comment on investor understanding of the nature and uses of ETPs, particularly by retail investors.

The Commission periodically has solicited public comment on issues relating to ETFs since their inception over two decades ago. In 2001, the Commission issued a Concept Release on Actively Managed Exchange-Traded Funds.⁹³ That release sought comment on a number of issues relating to actively managed ETFs, focusing in particular on the operation of actively managed ETFs as open-end investment companies and on the exemptive relief under the 1940 Act that would be required for such funds.⁹⁴ Then, in 2008, the Commission proposed and sought comment on a rule that would exempt ETFs from certain provisions of the 1940 Act and permit certain ETFs to begin operating without the need to obtain an exemptive order under the 1940 Act.⁹⁵ Once again, the focus of that release was on the operation of ETFs as open-end investment companies under the 1940 Act and on the exemptive relief provided to such funds under the 1940 Act.⁹⁶

Here, the Commission seeks comment on the treatment of a broader group of

products—ETPs, rather than just ETFs—and the Commission seeks public comment specifically with respect to its oversight of ETPs under the Exchange Act. As noted above, ETP trading makes up a significant percentage of equity trading in the United States.⁹⁷ And, while the Commission has gained extensive experience and familiarity with the topics discussed in the questions below, the Commission believes that it would be beneficial to engage broader public comment on these important topics.

To inform the Commission's review of new, novel, or complex ETPs under the Exchange Act, commenters are invited to provide their views regarding the listing and trading of ETP Securities, such as the manner in which ETP Securities are initially listed on a national securities exchange, the manner in which ETP Securities trade in the secondary market, and the exemptive or no-action relief that has been granted to ETPs under the Exchange Act. Commenters are further invited to provide their views regarding how broker-dealers (which are regulated under the Exchange Act) recommend and sell ETPs to investors, how broker-dealers fulfill their obligations to investors when they recommend and sell ETPs, and investors' understanding and use of ETPs. Commenters should be as specific as possible in their responses, explain the reasoning supporting those responses, and provide supporting data wherever possible.

A. Arbitrage and Market Pricing

As discussed above, existing ETPs trade at market prices rather than at a price based on NAV. When providing exemptive or no-action relief under the Exchange Act, the Commission and its staff have analyzed and relied upon the representations from ETP issuers regarding the continuing existence of effective and efficient arbitrage to help ensure that the secondary market prices of ETP Securities do not vary substantially from the value of their underlying portfolio or reference assets.

In the Commission's experience, the deviation between the daily closing price of ETP Securities and their NAV, averaged across broad categories of ETP investment strategies and over time periods of several months, has been relatively small. For example, the average absolute value of the daily difference between the NAV and the closing market price during a six-month period ending in December 2014 was just 0.21% for ETPs based on U.S. equities indices and 0.38% for actively

managed ETPs based on U.S. equities.⁹⁸ The respective figures for index-based and actively managed ETPs based on U.S. fixed-income securities were 0.26% and 0.19%.⁹⁹

Other types of ETPs have had a somewhat higher deviation between NAV and their closing price. For example, ETPs based on international indices had an average absolute value of daily difference of 0.52% between NAV and the closing price, while actively managed ETPs based on international fixed-income securities had an average absolute value of daily difference of 0.44% between NAV and the closing price during the six-month period studied.¹⁰⁰ These numbers, however, represent only broad averages with respect to end-of-day differences, and intraday premiums or discounts between an ETP's market price and the value of its portfolio or reference assets (or, for certain ETNs, the value of the note according to its terms) can be greater under certain circumstances.¹⁰¹ Moreover, these numbers represent broad averages, and the Commission seeks public comment and data in response to the specific questions below.

The Commission seeks comment with respect to all aspects of the arbitrage mechanism for ETPs, including the nature, extent, and potential causes of premiums and discounts across the wide range of ETP strategies and holdings. Additionally, in connection with its review of the listing and trading of ETPs, the Commission seeks comment on the trading of ETPs investing in less-liquid assets,¹⁰²

⁹⁸ The average of the *absolute value* of these differences is used because the closing market price of an ETP can deviate either above or below its NAV on any given day, and a calculation that allowed positive deviations to offset negative deviations would understate the extent of the deviations.

⁹⁹ Figures in this paragraph represent an analysis by Commission staff of market data obtained through a subscription to Bloomberg Professional services.

¹⁰⁰ The figures in this paragraph reflect an analysis by the staff of the Office of Analytics and Research in the Division of Trading and Markets of market data obtained through a subscription to Bloomberg Professional services.

¹⁰¹ As an extreme example, during the so-called "Flash Crash" of May 6, 2010, many ETP Securities temporarily traded at significant discounts to their NAV, even though their prices recovered before the end of the day. See Findings Regarding the Market Events of May 6, 2010, *Report of the Staffs of the CFTC and SEC to the Joint Advisory Committee on Emerging Regulatory Issues* (Sept. 30, 2010), available at <http://www.sec.gov/news/studies/2010/marketevents-report.pdf>.

¹⁰² As used in this release, "liquidity" generally refers to the ability of a market participant to buy or sell an asset immediately without significantly affecting the market price for that asset. Although

Principal-Protected Notes); FINRA NTM 09–31 (June 2009) (FINRA Reminds Firms of Sales Practice Obligations Relating to Leveraged and Inverse Exchange-Traded Funds); FINRA NTM 08–81 (Dec. 2008) (FINRA Reminds Firms of their Sales Practice Obligations with Regard to the Sale of Securities in a High Yield Environment); NASD Notice to Members ("NASD NTM") 05–59 (Sept. 2005) (NASD Provides Guidance Concerning the Sale of Structured Products); and NASD NTM 03–71 (Nov. 2003) (NASD Reminds Members of Obligations When Selling Non-Conventional Instruments).

⁹³ Concept Release: Actively Managed Exchange-Traded Funds, Investment Company Act Release No. IC–25258 (Nov. 8, 2001), 66 FR 57614 (Nov. 15, 2001) (S7–20–01), available at <http://www.sec.gov/rules/concept/ic-25258.htm>.

⁹⁴ In response, the Commission received 20 comment letters, which are available on the Commission's Web site at <http://www.sec.gov/rules/concept/s72001.shtml>.

⁹⁵ See Exchange-Traded Funds (proposed rule), *supra* note 9.

⁹⁶ In response to these proposals, the Commission received 25 comment letters, which are available on the Commission's Web site at <http://www.sec.gov/comments/s7-07-08/s70708.shtml>.

⁹⁷ See *supra* note 5 and accompanying text.

including fixed-income instruments, during periods of market stress.

1. Arbitrage mechanisms are designed to keep intraday trading prices of ETP Securities equal (or nearly equal) to the contemporaneous value of the underlying portfolio or reference assets. Do these mechanisms work better for some types or categories of ETPs? To what extent do arbitrage mechanisms help ensure efficient market pricing for ETPs throughout periods of market volatility, including times of market stress?

2. Do commenters believe that there are other mechanisms besides arbitrage mechanisms that do, or could, help ensure efficient market pricing of ETPs? Do other factors play a role in efficient market pricing of ETPs? If so, what are these mechanisms or factors, and how effective are they? Are these mechanisms or factors more effective for certain types or categories of ETPs? To what extent are these mechanisms or factors effective during periods of market volatility?

3. What characteristics of an ETP facilitate or hinder the alignment of secondary market share prices with the value of the underlying portfolio or reference assets? What characteristics of an ETP's underlying or reference assets facilitate or hinder the alignment of secondary market share prices with the value of the underlying portfolio or reference assets? Does liquidity in the market for an ETP's underlying or reference assets affect arbitrage, and if so, how and to what extent? Does the availability of current and historical pricing information, as well as trading history, for the underlying or reference assets affect arbitrage, and if so, how and to what extent? To what extent does the availability of correlated hedges for the ETP's underlying or reference assets affect arbitrage and pricing efficiency? To what extent does an ETP's use of a sampling methodology (investing in a subset of the components of an index) to track an index affect arbitrage and pricing efficiency? Does the use of over-the-counter instruments by an ETP affect the opportunity for market makers or other participants to engage in arbitrage, and if so, how and to what extent? Do non-synchronous market hours between an ETP and its underlying assets (e.g., international equities) affect the pricing of an ETP and the opportunity for arbitrage, and if so, how? Does the use of cash-only creation or redemption baskets and

certain fixed-income instruments, such as on-the-run U.S. Treasury securities, trade in markets with substantial liquidity, fixed-income instruments generally trade with less liquidity than equity securities.

variable cash fees affect efficient market pricing, and if so, how?

4. How closely do investors or other market participants expect the intraday trading price of ETP Securities to be aligned with the contemporaneous value of their underlying portfolio or reference assets? Do these expectations differ depending on the type of ETP, the nature of the underlying assets, or market conditions? What methods, if any, do investors use to determine whether the intraday trading price of ETP Securities closely tracks the value of their underlying portfolio or reference assets?

5. Do market participants conduct analyses of how well intraday prices of ETP Securities track the value of their underlying portfolio or reference assets? If so, how much weight do market participants place on such analyses?

6. Under what circumstances might the prices of ETP Securities not track (on an intraday, temporary end-of-day, or permanent basis) the value of their underlying portfolio or reference assets? Are there circumstances in which the price of an ETP's Securities, though different from its NAV, might be a more accurate measure of the value of the ETP's underlying assets? What are the implications for investors (both individual and institutional) and other market participants if intraday prices for ETP Securities do not closely track the value of their underlying portfolio or reference assets, either on an intraday, temporary end-of-day or permanent basis?

7. To what extent do arbitrage mechanisms affect trading in an ETP's underlying or reference assets? Does the answer vary depending on whether the underlying or reference assets are equities, fixed-income securities, commodities, derivatives, or another type of asset? If so, how?

8. To what extent do ETNs offer opportunities for arbitrage? How do market participants engage in arbitrage for ETNs? How is arbitrage affected by ETN issuers' ability to suspend and restart issuances of notes at their discretion? How are arbitrage opportunities affected when an issuer suspends the issuance of its ETNs? Are certain ETNs easier or more difficult to arbitrage due to the nature of the ETN's reference asset or index, and, if so, which ones?

9. As noted above, the IIV for an ETP is generally designed to provide investors information during the trading day on the value of the ETP's portfolio (or, in the case of an ETN, on the value of a reference asset or index). The IIV may be subject to various calculation methodologies. How does the

calculation of IIV vary, if at all, among ETPs? Does the calculation methodology depend on the class or type of ETP, and if so, how? Does the calculation methodology depend on the nature of the underlying portfolio or reference assets, and if so, how? Are certain IIV calculation methodologies more or less useful for investors, market makers, or other market participants?

10. To what extent do market participants make use of the IIV for an ETP based on less-liquid securities? If underlying assets trade infrequently or are priced only at the end of the trading day for purposes of NAV calculation, does an IIV that is disseminated every 15 seconds (as is currently the case) contain useful pricing information? Would a different dissemination frequency be more appropriate, and if so, what would that be?

11. Do investors or other market participants use intraday or closing indicative values for ETNs? If so, for what purpose? How does the intraday or closing indicative value differ from the market value of an ETN or its redemption amount?

12. How much disclosure about the contents of an ETP's underlying portfolio is necessary for arbitrage to function efficiently to keep the market price of an ETP aligned with the contemporaneous value of its underlying or reference portfolio? Please explain.

13. In the absence of daily portfolio disclosure for an ETP, could other mechanisms enable market makers or other market participants to make efficient markets in that ETP? If so, what are those mechanisms and how would they function? What, if any, information disclosure, characteristics of the ETP, or other circumstances would be necessary for those mechanisms to function?

14. Under what circumstances would an ETP suspend creations? Under what circumstances could an ETP (other than a 1940-Act registered ETF) suspend redemptions? What effect does this or could this have on arbitrage mechanisms or the market value of these products? How might suspension of creations or redemptions affect the ETP's continued compliance with the conditions of its exemptive and no-action relief under the Exchange Act? How would an ETP issuer be likely to respond to the suspension of creation or redemption activity by one or more of its Authorized Participants?

15. How do arbitrage mechanisms work in the case of ETPs with less-liquid underlying or reference assets? Are arbitrage mechanisms for ETPs with less-liquid underlying or reference assets effective and efficient in aligning

share prices with the value of the underlying portfolio or reference assets?

16. To what extent do arbitrage mechanisms help ensure efficient market pricing throughout rising and falling markets, including times of market stress, for ETPs with underlying or reference assets that are less-liquid? Do periods of market stress affect arbitrage mechanisms for such ETPs, and if so, how? Could there be a point at which the amount of ETP Securities outstanding relative to the amount of underlying or reference assets outstanding results in an imbalance that inhibits the redemption process during periods of market stress?

17. To what extent, if any, does trading activity in ETP Securities affect price discovery, price correlation, liquidity, or volatility in the ETP's underlying or reference assets? What role, if any, do ETP Securities that are based on less-liquid underlying securities have in providing additional price discovery for the underlying securities?

18. Should the listing exchange for an ETP have an obligation to monitor the effectiveness of that ETP's arbitrage mechanism? If yes, what should be the nature of that obligation?

B. Exchange Act Exemptions and No-Action Positions

The Commission believes it is useful and timely to examine the application of Rules 101 and 102 of Regulation M in the context of ETPs—particularly those ETPs with an underlying trust or other collection of underlying assets—given the increasing complexity of ETP investment strategies and the expansion of the types of underlying and reference assets and benchmarks. The Commission solicits comment on approaches for preventing manipulation of an ETP Securities distribution by persons who may have an incentive to do so in light of the nature, variety, and complexity of ETP investment strategies and ETP markets.

19. The staff has issued no-action relief from Rules 101 and 102 of Regulation M to ETNs in part on the basis of assumptions that the secondary market price for such products should not vary substantially from the value of the relevant reference index.¹⁰³ Given that the secondary market price of an ETN can substantially deviate from its reference assets when the issuer of that ETN suspends issuances, how should Rules 101 and 102 of Regulation M apply to such products? Should relief from these rules be limited to ETNs where there is a clear, independent

index, where there is no limitation on issuances or redemptions, or where an ETN's secondary market price does not vary substantially from the relevant reference index? What effect would such a change have? Are there any other relevant factors in this context? Are there any risks in maintaining the current relief for ETNs? What are the benefits of the relief? How should the Commission balance the risks against any benefits resulting from the ability of Authorized Participants to suspend issuances or redemptions? Should relief for ETNs contain different conditions than relief for other ETPs?

20. Because ETPs are in continuous distribution, they generally need, on an ongoing basis, to meet the conditions of the Regulation M relief that has been extended to them and to meet the representations made in seeking relief under Regulation M.¹⁰⁴ What would an ETP do if it could no longer meet one or more of these conditions or representations and could no longer rely on the relief? In such situations, would the ETP halt creations or, for ETPs not registered under the 1940 Act, redemptions? What effect would that have on the market for that ETP's securities? What would be the effect if this resulted in a halt or suspension of trading activity in the ETP Securities, or in the ETP Securities being delisted? How would investors be affected?

21. What purchasing activities do distribution participants (such as Authorized Participants) engage in during the distribution of ETP Securities? Are these activities limited to the purchasing of shares to accumulate a redemption unit, or are there other reasons for distribution participants to engage in purchases of ETP Securities?

The Commission also invites comment on the conditions pertaining to ETPs' exemptions from, and the criteria relied on by the staff in no-action positions regarding, Section 11(d)(1) of the Exchange Act and Exchange Act Rules 10b-10, 11d1-2, 14e-5, 15c1-5, and 15c1-6.

22. How well do the conditions of the ETPs' exemptions and the staff no-action relief from Section 11(d)(1) and Rule 11d1-2 thereunder, as discussed in section I.D.1.b above, achieve Section 11(d)(1)'s purpose of prohibiting broker-dealers from using favorable margin arrangements to aid in the distribution of securities in which they have an interest? Could different conditions be

more effective at achieving this purpose?

23. How often do ETP investors request detailed confirmation information, as discussed in Section I.D.1.c above, in creation and redemption transactions as provided for in the Commission's exemptions from Rule 10b-10 and the related staff no-action positions? What is the cost to broker-dealers of providing this information? Has the availability of modern information technology reduced these costs? Who bears those costs? Do ETP investors use and benefit from this information, and if so, how? What would be the effect of eliminating the exemptions and no-action relief from Rule 10b-10, thereby requiring broker-dealers to provide detailed confirmations to ETP purchasers in all transactions? What would be the effect of eliminating the requirement to send this information to ETP investors upon request? Could different conditions achieve the purposes of Rule 10b-10 at less cost or burden to broker-dealers? If so, what trade-offs would there be, if any?

24. Has Rule 14e-5, discussed in Section I.D.1.e above, affected the structure of ETPs and, if so, in what ways?

25. Authorized Participants generally have no-action relief from the requirements in Rules 15c1-5 and 15c1-6, as discussed in Section I.D.1.f above, to disclose the Authorized Participants' control relationships or interest in the distribution of securities that compose Portfolio Deposits and Redemption Baskets. Given the large number of securities included in many ETPs, would investors realize any benefit from receiving this information in creation and redemption transactions? What would be the cost of providing this information in all transactions or, alternatively, upon an ETP investor's request, and who would bear those costs? Has the availability of modern information technology made it easier or less costly to provide such information? Could different conditions for "Qualifying ETFs"¹⁰⁵ achieve the purposes of those rules at less cost or burden to broker-dealers? If so, what trade-offs would there be, if any?

C. Exchange Listing Standards

26. The exchanges (as SROs) and the Commission both have responsibilities with respect to determining whether the proposed listing and trading of ETP Securities is consistent with the Exchange Act and the rules and

¹⁰⁴ Conditions and representations concerning relief under Regulation M are discussed in section I.D.1.a, *supra*.

¹⁰⁵ See note 62, *supra*.

¹⁰³ See, e.g., ETN No-action Letter, *supra* note 70.

regulations thereunder.¹⁰⁶ Do commenters believe that these independent obligations, in practice, complement each other? Do commenters believe that these obligations overlap each other? To the extent that these obligations overlap, how do commenters believe they should be allocated between the exchanges and the Commission?

27. Do the business practices of an exchange with respect to attracting, listing, and trading ETP Securities differ from an exchange's business practices with respect to more traditional equity listing services? If so, how do these business practices align with the existing regulatory framework for exchanges as SROs?

28. Are current exchange listing standards (including standards with respect to component eligibility, diversification, and pricing) effective, given the increasing complexity of ETP investment strategies and the expansion of the types of underlying and reference assets and benchmarks? For example, do existing listing standards adequately address the use by ETPs of non-exchange-listed derivatives or of leverage?

29. Given the increasing complexity of ETP investment strategies and the expansion of the types of underlying or reference assets and benchmarks, what types of information do commenters believe would assist the Commission in evaluating whether a proposed rule filing by an exchange to list and trade a specific ETP is consistent with the Exchange Act?

30. Should certain characteristics of an ETP receive particular emphasis in the Commission's evaluation of whether a proposed rule filing related to that ETP is consistent with the Exchange Act? If so, which ones? For example, should the Commission's evaluation focus on the nature, characteristics, or liquidity of the specific investments,

holdings, indices, or reference assets of the ETP and on the public availability of information about these underlying or reference assets? Should the Commission's evaluation focus on the effectiveness or efficiency of the creation and redemption process in facilitating arbitrage opportunities with respect to an ETP? What other factors, if any, should the Commission consider in its evaluation of whether a proposed rule filing related to an ETP is consistent with the Exchange Act?

31. Exchange listing standards for ETP Securities often contain both initial listing criteria and continuing listing criteria. The initial listing criteria include requirements that must be met when ETP Securities are initially listed on an exchange. The continuing listing criteria include requirements that must be met on an ongoing basis. Should exchange listing standards always contain both initial and continuing listing criteria? Should initial and continuing listing standards for ETP Securities be substantially identical?

32. What, if any, is the appropriate role of an exchange that lists ETP Securities with respect to monitoring creation and redemption activity? For example, should the exchange be informed of an ETP's decision to suspend creations or redemptions during the trading day? If so, should the exchange be required to alert its members, investors, and other market participants?

33. What, if any, is the appropriate role of an exchange that lists ETP Securities with respect to monitoring or overseeing the calculation of IIV or NAV?

34. Do market participants believe that certain types of ETPs are more susceptible to manipulation than others? If so, please explain. To what extent, if at all, does the nature, characteristics, liquidity, or volatility of an ETP's underlying or reference assets affect the ETP's susceptibility to manipulation?

D. Broker-Dealer Sales Practices and Investor Understanding and Use of ETPs

The Commission seeks comment on the use of ETPs by investors and the ways in which ETPs are recommended or sold to investors, particularly retail investors. In particular, the Commission seeks comment on the extent to which individual investors buy or sell ETPs with complex investment strategies based on the recommendation of a broker-dealer and the extent to which individual investors understand the nature and operation of such ETPs. The Commission also seeks comment on how broker-dealers meet their

obligations to customers when recommending ETPs. While the questions below focus on broker-dealer sales practices, the Commission recognizes that investment advisers also play a role in the purchase or sale of ETPs by investors. Consequently, the Commission invites commenters to address the role of investment advisers in their responses, where applicable.

35. Do individual investors tend to buy and hold ETP Securities? Does the answer depend on the type of ETP (e.g., investment objective, structure, or type of underlying asset)? Do investments by individual investors tend to be solicited or unsolicited? Please explain and provide data where available. If solicited, are solicitations limited to certain categories of investors (e.g., retail investors or high-net-worth individuals) and certain types of ETPs? If so, which categories of investors receive solicitations and how are the parameters of the category determined—e.g., net worth, income, investment experience, options trading eligibility? In addition, which types of ETPs are recommended and what are the parameters being used to determine whether those ETPs should be recommended? Are individual investors purchasing ETPs on the basis of recommendations by brokers?

36. How effective are the suitability requirements applicable to brokerage accounts in addressing broker-dealer sales practices for ETPs in light of the breadth of available ETP options and the growing complexity of ETP investment strategies?

37. What methods do, or could, broker-dealers employ to meet their sales-practice and suitability obligations for ETP Securities?

38. Do investors have access to sufficient information to understand ETPs, how ETP Securities trade, the costs associated with trading ETP Securities, and how their prices and valuations are determined, particularly as ETPs encompass increasingly complex benchmarks, asset classes, and investment strategies? What is the source of information (e.g., exchanges, broker-dealers, market intermediaries, prospectuses, SEC releases, or investor alerts) available to investors? Are there ways to better enable investors to access information about the listing and trading of ETP Securities? If yes, what are they?

39. What roles, if any, should the exchanges have in communicating information about ETP Securities to their members, their members' customers, and the general public? Should the answer depend on whether the exchange is the listing exchange or

¹⁰⁶ Exchanges seeking to adopt listing standards applicable to a new ETP product class—or to list and trade specific ETP Securities pursuant to existing non-generic listing standards for an ETP product class—are required to file proposed rule changes on Form 19b-4. See 17 CFR 249.819. The instructions to Form 19b-4 state that an exchange filing the form must provide “a statement of the purpose of the proposed rule change and its basis under the [Exchange] Act and the rules and regulations thereunder applicable to the [exchange]” and this statement “should be sufficiently detailed and specific to support a finding that the proposed rule change is consistent with the requirements of the [Exchange] Act and the rules and regulations thereunder. . . .” To approve an exchange's proposed rule change, the Commission must find that the proposed rule change is consistent with the applicable requirements of the Exchange Act and the rules and regulations thereunder. 15 U.S.C. 78s(b)(2)(C). See also *supra* notes 79–89 and accompanying text.

an exchange that trades the ETP pursuant to unlisted trading privileges?

40. How do broker-dealers communicate information about ETP Securities to their customers? Are investors introduced to ETPs through information provided generally by broker-dealers (e.g., posted on a broker-dealer's Web site for all investors to consider)? Do broker-dealers provide information to investors regarding the type of investor for which a specific product is suitable and what holding periods are appropriate? Are there any other ways that broker-dealers should communicate information relevant to the ETP Securities to their customers? Do broker-dealers restrict or otherwise limit access by certain types of investors to certain types of ETP Securities? If so, please describe these restrictions.

41. Do broker-dealer communications concerning ETPs provide enough information for a retail investor to evaluate the facts concerning ETPs? Do the communications disclose the risks and benefits potentially associated with ETPs? Are those disclosures reasonably understandable for retail investors, and are they presented in a balanced manner? What types of broker-dealer communications about ETPs are most effective?

42. Are there specific aspects of ETP trading that should be communicated to investors to better inform their investment decisions (e.g., the specific risks of investing in certain products or that certain products may not be suitable for certain types of investors)? Are there types of risks in particular ETPs that should be highlighted? If so, in what way, and who should have the responsibility for communicating that information? When should that information be communicated (e.g., prior to making recommendations or prior to accepting a customer order)?

43. Should broker-dealers have additional responsibility to make available or provide information to investors about the risks of investing in ETPs with complex strategies prior to making a recommendation or accepting a customer order for such securities? What costs would broker-dealers incur in providing such information? Who would bear those costs? What costs do broker-dealers currently incur in providing information to customers about ETPs? Who bears those costs?

44. Do broker-dealer communications to investors about ETPs present any performance data? If so, how is that data presented? What types of disclosures accompany the performance data?

45. Are there aspects of ETP arbitrage mechanisms that should be prominently disclosed to investors? If so, how and

where? Do investors understand the arbitrage mechanisms of ETPs, and, if so, do they consider the effectiveness and efficiency of these mechanisms when making an investment decision? If so, how?

46. Do broker-dealers use the term "ETF" to describe all types of ETPs (as opposed to only those products registered under the 1940 Act)? If so, is this confusing to investors?

47. What use do investors or other market participants make of publicly available information such as the index value, IIV, NAV, or portfolio holdings of an ETP? Does the answer depend on the type of market participant? If so, why do certain market participants use certain information? If market participants do not use certain information, why not? Do the answers depend on the type of underlying asset?

48. Do investors understand what an ETP's IIV represents and what it does not? For example, do they understand that the IIV is not a "real-time" update of the NAV and that it is not the price at which they can purchase ETP Securities? Do investors understand how the IIV calculation method can differ from the method used to calculate NAV? Do investors understand that IIV may be a lagging indicator of actual portfolio values during periods of rapid price movements? Please describe the basis for any views expressed regarding the understanding of investors.

49. Do investors' expectations of the nature of the liquidity, the bid-ask spreads, and the market prices of an ETP holding less-liquid underlying securities differ from their expectations of the characteristics of those underlying securities? If so, in what ways do investors expect ETPs based on less-liquid securities to trade differently than the underlying securities themselves?

E. Other

50. The Commission notes that, over the years, there have been ETPs that have closed after being listed and traded for some period of time. What are the consequences to investors of the closure and liquidation or termination of an ETP?

51. How are the types and complexity of the investment strategies and investment objectives of ETPs, and the nature of the market for ETPs, likely to develop in the future? How might these changes affect the listing and trading of ETP Securities? How might these changes affect any underlying securities held by an ETP—for example with respect to liquidity, volatility, and capital formation?

52. As noted above, the total market capitalization of ETPs has grown significantly, nearly doubling since the end of 2009. What do commenters believe are the main reasons for this growth? Do commenters expect significant growth in the number, variety, and market capitalization of ETPs to continue? If such growth continues, how might that affect the exchanges' listing and trading of ETP Securities? How might this growth affect investors, broker-dealers, or other market participants?

53. The Commission provides market structure research, interactive data visualization tools, and advanced market metrics on its Market Structure Data and Analysis Web site, <http://www.sec.gov/marketstructure/index.html>. Users of the Web site and its data can, among other things, compare quoting and trading characteristics of ETPs to those of other equity securities. Have commenters drawn any observations or conclusions from this data about the listing and trading of ETPs? What effects, if any, does market structure have on the quoting and trading of ETPs? What effects, if any, does the quoting and trading of ETPs have on the general characteristics of current equity market structure? Do any specific aspects of current equity market structure facilitate or hinder the fair and efficient quoting and trading of ETPs? What types of additional information or data would commenters like to see regarding the quoting and trading characteristics of ETPs?

The Commission welcomes all comments and encourages commenters to discuss any other questions, issues, concerns, or data regarding the listing and trading of ETP Securities on national securities exchanges.

By the Commission.

Dated: June 12, 2015.

Brent J. Fields,
Secretary.

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