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RECENT DEVELOPMENTS IN ETF REGULATION

A new rule adopted by the SEC allows many ETFs to operate without first obtaining exemptive relief. After addressing the ETF structure and regulatory framework, the authors describe the new rule in detail. They then turn to new exchange listing standards for ETFs, semi-transparent active ETF exemptive relief, and no-action relief for index-based funds to exceed diversification limits.

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In contrast to mutual funds and closed-end funds, U.S. exchange-traded funds ("ETFs") have a relatively brief history as a form of pooled investment vehicle. First introduced in 1993, ETFs possess characteristics of both open-end and closed-end funds and until recently required exemptive relief from certain regulatory requirements in order to operate as such. As the market for ETFs has grown, the regulatory landscape for these products has evolved, with a recent trend toward regulatory harmonization and operational flexibility for ETFs.

This article discusses recent regulatory developments relating to ETFs. First, it provides background regarding ETF structure and regulation. It then discusses a new rule adopted by the Securities and Exchange Commission that allows many ETFs to operate without first obtaining exemptive relief, as well as the recent adoption of exchange listing standards that fully implement the flexibility provided by the new rule. It next discusses the SEC's issuance of the first exemptive orders permitting the operation of actively managed ETFs that do not disclose their full holdings on a daily basis. Lastly, it discusses a recent no-action letter that, although not limited to ETFs, is significant for the ETF industry, given the number of ETFs that operate as index funds.

BACKGROUND

ETF Structure

ETFs are pooled investment vehicles that have certain characteristics of both mutual funds (*i.e.*, open-end investment companies) and closed-end funds. Shares of an ETF are listed on a national securities exchange and trade throughout the day at market price rather than net asset value ("NAV"), and can also only be purchased or redeemed from the ETF at NAV in "creation unit" aggregations (typically 25,000 shares or more) by large financial institutions referred to as "authorized participants;" all other investors buy and sell ETF shares on an exchange. Unlike mutual funds, however, shares are not individually redeemable; they may only be redeemed in creation unit aggregations and only by authorized participants. In many cases, ETFs transact

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INSIDE THIS ISSUE