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May 19, 2008

Nancy M. Morris, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Comments Submitted on Rule Proposal: Exchange-Traded Funds (File No. S7-07-08)

Dear Ladies and Gentlemen:

Thank you for the opportunity to comment on this proposed rule. Our firm has experience evaluating compliance programs of Exchange-Traded Funds ("ETF"s).[1] We have reviewed the rule proposal and offer comments that generally discuss the unique challenges that are presented to Chief Compliance Officers ("CCOs") and fund directors/trustees responsible for ETF compliance programs.

An exchange-traded fund (ETF) is in effect a "derivative" product that trades intra-day on stock exchanges at market-determined prices. The value and characteristics of an ETF share are related to the characteristics and value of the basket of securities in the underlying portfolio. A former SEC Director stated that the principal unique risks of ETFs are a fund's index tracking method; a fund's deviation between market price and NAV; and the independence and oversight of a fund's board of directors.[2] In addition, issues relating to the liquidity of fixed-income securities versus equity securities and issues associated with the creation and composition of fixed-income creation units present unique risks than those of a mutual fund.[3] There are also special risks associated with in-kind transactions. A chapter from the Investment Company Institute's 2007

[1] Brown & Associates LLC and Self Audit, Inc. provide regulatory services, compliance reports, reviews and self-assessment products for fund directors/trustees and financial services companies. We serve as independent compliance consultants and monitors for firms that have experienced regulatory issues.
[2] Regulatory Issues Involving Exchange Traded Funds, by Paul F. Roye presented to the American Stock Exchange Symposium on Exchange Traded Funds, January 14, 2002.
[3] Id.

ICI Fact Book provides analysis of Exchange-Traded Funds and Index Mutual Funds.[4] ETF's are also subject to the rules of the exchange on which their shares are traded.

The Financial Industry Regulatory Authority, Inc. ("FINRA"), provides guidance as to calculations of performance information for ETFs. FINRA notes that ETF performance must comply with the standardized performance requirements set forth in SEC Rule 482 under the Securities Act of 1933. [5] FINRA notes that the formula for computing standardized returns is based on the ETF's NAV as of the ending date of the performance period. FINRA takes the position that in addition to quoting standardized performance based on NAV, performance communications for ETFs must also include equally prominent disclosure of returns based on the closing market price of the shares for the same time periods as standardized returns (e.g. "these total returns are based on the closing market price of the ETF on [date]"). [6] More information on the SEC's expectation for performance calculations could be included in the final rule.

In addition to a prospectus and statement of additional information, ETF's provide Product Information summaries or product descriptions in lieu of a prospectus. It is important to note that these summaries be included and cross-referenced with the prospectus and statement of additional information for accuracy. The proposing release requires that broker-dealers would be required to deliver a prospectus meeting the requirements of Section 10(a) and the product description would be replaced by a summary prospectus.[7] In our view, this new delivery requirement would be difficult to monitor due to the nature of the secondary market transactions of ETF shares. Further it could cause investor confusion in that the mutual fund documents and the ETF documents would look identical.

The rule proposal includes the following description of the index provider: *Index provider is the person that determines the securities and other assets that comprise a securities index*.[8] In our experience, Index Providers are typically entities that are contractually engaged with the ETF in the form of a consulting agreement. Our compliance reviews have included an external review of the index provider, the consulting agreement and fees paid for the services. We also look to see whether the ETF's Board of Directors/Trustees approved the consulting agreement. The definition of the index provider could be expanded to include more specific guidelines for compliance professionals and note that a contractual arrangement must be present.

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[4] www.ici.org/stats/etf/index.html
[5] Rule 482 requires performance communications to include one-year, five-year and ten-year annualized total returns computed in accordance with a standard formula. www.finra.org
[6] Fall, 2001 Exchange-Traded Fund Performance, www.finra.org.
[7] Proposing release at page 48.
[8] Rule proposal 270.6c-11 (e) (7)

The SEC staff notes that the proposed rule does not include terms from previous applications that are designed to prevent the communication of material non-public information between the ETF and affiliated index providers.[9] We believe that the final rule should include the specific terms that require compliance for affiliated index providers.[10] In accordance with SEC Rule 38a-1, it is important for the SEC rules to include specific compliance-related requirements to assist chief compliance officers in executing their duties.

Finally, we note that derivatives are complex financial instruments that increase pressure on risk managers and compliance departments. ETFs require more sophisticated compliance programs to address the layered valuation issues[11] The final rule should include a discussion of the unique risks associated with the ETF structure and staff's expectations for CCO's, fund management and fund directors/trustees in on-going monitoring of ETF's compliance programs. In our view it is premature to allow the use of actively managed ETFs through this rule proposal.

The comments reflected herein represent solely the views, comments and concerns of the undersigned and do not necessarily represent the views of the undersigned's firm or the clients of firms.

Very truly yours,

Debra M. Brown
Brown & Associates LLC
Self Audit, Inc.

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[9] Rule proposal at page 33.
[10] Footnote 106 from the proposing release states: The terms are intended to address the potential conflicts of interest between the ETF adviser and its affiliated index provider, and include: (i) all the rules that govern inclusion and weighting of securities in each index are made publicly available; (ii) the ability to change the rules for index compilation is limited and public notice is given before any changes are made; (iii) "firewalls" exist between (A) the staff responsible for the creation, development and modification of the index compilation rules and (B) the portfolio management staff; (iv) the calculation agent, who is responsible for all index maintenance, calculations, dissemination, and reconstitution activities, is not affiliated with the index provider, the ETF or any of their affiliates; and (v) the component securities of the index may not be changed more frequently than on a specified periodic basis.
[11] Layers of valuation issues include valuation of the underlying portfolio securities, valuation of the creation units, and valuation of the discount between NAV and sale price.