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VIA ELECTRONIC FILING

Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Exchange-Traded Funds, Release No. IC-28193, File No. S7-07-08

Dear Ms. Morris:

This letter responds to the request of the Securities and Exchange Commission (the "Commission") for comment on (a) proposed new Rule 6c-11 under the Investment Company Act of 1940, as amended (the "Act"), that would exempt exchange-traded funds ("ETFs") from certain provisions of the Act and the Commission's regulations thereunder, (b) proposed new Rule 12d1-4 under the Act that would permit investment in ETFs by other registered investment companies to a greater extent than currently permitted, (c) proposed changes to the Commission's Form N-1A for open-end fund prospectuses to provide more useful information to investors in ETFs, and (d) other matters discussed by the Commission in the above-referenced release (the "Release"). Barclays Global Fund Advisors, Inc. ("BGFA")[1] commends the Commission for seeking to streamline the applicability of the Act to ETFs, which in recent years have become an increasingly popular investment option for investors[2] and a key component of U.S. stock

[1] BGFA and its affiliated investment management companies are among the world's largest institutional investment managers, and collectively are the world's largest provider of structured investment strategies such as indexing, tactical asset allocation and active quantitative strategies. BGFA and its affiliates manage over $2 trillion in assets for thousands of clients around the world. BGFA is an indirect majority-owned subsidiary of Barclays PLC, one of the world's leading global financial services providers. BGFA is the investment adviser to the iShares family of ETFs, which, as of April 30, 2008, was the largest family of ETFs in the U.S., with over 150 ETFs and a over $320 billion in aggregate assets invested in U.S. equity, international equity, and a variety of fixed-income asset classes. BGFA has provided investment advice to ETFs since 1996, when it became the subadviser to the WEBS family of ETFs sponsored by Morgan Stanley (subsequently reorganized into the iShares family of ETFs).

[2] As of year-end 1997, 2002 and 2007, total ETF assets equaled approximately $6.7 billion, $102.1 billion and $608.4 billion, respectively, according to the Investment Company Institute (Exchange-Traded Asset Reports, publicly available at http://www.ici.org/stats/etf).

markets.[3] BGFA believes that the exemptions from the Act that the Commission has previously granted[4] allowing ETFs to operate in a manner consistent with the Act have generally worked well, and many aspects of those exemptions have now become established market practice. BGFA strongly supports the Commission's goal of establishing regulations applicable to ETFs based on the experience gained from the existing exemptions. While BGFA has a number of technical comments and concerns relating to the Commission's proposals, BGFA believes the proposals (if modified as suggested herein) would effectively accomplish the Commission's goal of eliminating unnecessary regulatory burdens by permitting ETFs greater freedom to operate without the expense and delay of seeking individualized exemptive relief, while at the same time ensuring the protection of ETF investors.

Our comments first seek to address the "arbitrage mechanism" that, as described in the Release, the Commission believes keeps the market price of ETF shares near the net asset value ("NAV") per share of the ETF. BGFA proposes a slightly different explanation of why ETF shares trade at prices that reflect NAV, which we believe helps to frame several critical issues on which the Commission requested comments. We then offer a number of more detailed comments on particular aspects of proposed Rule 6c-11, proposed Rule 12d1-4, ETF disclosure issues and certain issues related to Rule 12d1-2 raised by the Release.

I. The Arbitrage Mechanism

The exemptive orders granted to existing ETFs presume that the secondary market prices at which ETF shares trade should approximate NAV and that, as the Commission stated in the Release, "[t]he ability of financial institutions to purchase and redeem creation units at each day's NAV creates arbitrage opportunities that may help keep the market price of ETF shares near the NAV per share of the ETF." The so-called "arbitrage mechanism" – the incentive for large financial institutions to buy ETF shares when those shares trade at a discount to an ETF's underlying asset value and to sell ETF shares when those shares trade at a premium to an ETF's underlying asset value – is

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[3] According to the National Stock Exchange, notional trading volume in U.S. ETFs reached a record monthly total of $2.23 trillion in January 2008, an increase of approximately 236% over January 2007. *See* http://www.nsx.com/marketdata_monthly_etf.html.

[4] As discussed in the Release, exemptive orders granting ETFs relief from the Act generally exempt ETFs from complying with two elements of the Act regarding redeemability of shares and certain affiliated transaction prohibitions. The exemptive relief applies to the definition of "open-end investment company" and Section 22(d) of the Act, which would otherwise require an ETF to redeem all shares at NAV each business day. The exemptive orders permit an ETF to redeem only shares tendered for redemption in large blocks by institutional investors known as "Authorized Participants", and to do so through in kind, rather than cash, transactions. In addition, Section 17(a) of the Act prohibits a fund from engaging in principal transactions with an "affiliated person", as defined in the Act. The exemptive orders permit an ETF to engage in principal transactions with Authorized Participants if, but only if, the Authorized Participants would be deemed "affiliates" solely through ownership of ETF shares (*i.e.*, not if they are otherwise affiliated with the fund sponsor).

indeed critical to understanding ETFs. Secondary market transactions in ETF shares by large financial institutions can accurately be described as "arbitrage" in the sense that they reflect attempts to make trading profit by exploiting price differences of similar financial instruments. Such transactions are generally not, however, "riskless arbitrage" – a risk-free transaction consisting of purchasing an asset at one price and simultaneously selling that same asset at a higher price, generating a profit on the difference.[5] BGFA is concerned that the historical use of the phrase "arbitrage mechanism" to refer to ETF secondary market pricing mechanics – together with the two different meanings of the term "arbitrage"[6] – may have caused the Commission to conceptualize secondary market trading of ETF shares to consist primarily of "riskless arbitrage",[7] which is not consistent with BGFA's experience. BGFA believes this has implications for a correct understanding of the factors necessary for ETFs to trade effectively.

Secondary market trading for most publicly-traded stocks in the U.S. is facilitated by numerous professional trading firms that supply market liquidity. Some professional trading firms that act as specialists or designated market makers in a stock may be obligated to perform this function in a particular security under exchange rules. Other professional trading firms also perform this function unofficially in order to seek trading profits – that is, they buy shares that they perceive to be trading at a price less than that which will be available at a subsequent time, and sell shares they perceive to be trading at a price higher than that which will be available at a subsequent time.[8] BGFA understands that many professional trading firms buy and sell stocks in this manner to exploit perceived opportunities created by short-term imbalances of supply and demand, and not necessarily based on any assessment of the stocks' underlying worth. To the extent that

[5] Some trading firms do specialize in high volume, electronic "riskless arbitrage" transactions in ETF shares. For certain ETFs that trade actively and invest in U.S. stocks, such transactions may constitute a significant portion of the trading volume. Generally, however, BGFA believes "riskless arbitrage" forms a minority of the total transactions in ETF shares.

[6] *See* arbitrage. InvestorWords.com. WebFinance, Inc. http://www.investorwords.com/245/arbitrage.html and riskless arbitrage. InvestorWords.com. WebFinance, Inc. http://www.investorwords.com/4300/riskless _arbitrage.html.

[7] See, e.g., proposed Rule 6c-11(e)(3), defining "creation unit", in which the Commission states that a creation unit "must be reasonably designed to facilitate the purchase (or redemption) of shares from the exchange-traded fund with an offsetting sale (or purchase) of shares on a national securities exchange at as nearly the same time as practicable for the purposes of taking advantage of a difference in the current value of basket assets on a per share basis and the current market price of the shares." As discussed in greater detail at Section II.A.4 of this letter, BGFA does not believe the purpose of a creation unit is to facilitate riskless arbitrage, but to provide notice to Authorized Participants of the number of shares in multiples of which an ETF will accept purchase or redemption orders. In BGFA's experience, purchases or redemptions of creation units do not necessarily result directly from riskless arbitrage transactions, but from the desire of an Authorized Participant (or an Authorized Participant's customer) to acquire or redeem shares for investment, trading or hedging purposes.

[8] Such firms may be large off-exchange market makers, firms that specialize in electronic trading, hedge funds or others.

such professional trading firms assume a risk of being "long" or "short" a stock through such trading activity, they may seek to hedge the risk wholly or partly by simultaneously taking an opposite position in a correlated asset, such as a futures contract or swap based on a market index, or by netting the exposure against other, offsetting trading positions. Professional trading firms typically adjust their trading and hedging positions continuously throughout the trading day in response to trading opportunities, customer transactions or other factors. This normal secondary market stock trading activity by professional trading firms, which is quite distinguishable from riskless arbitrage, occurs with respect to ETF shares as well.

BGFA believes that two factors unique to ETFs help facilitate even greater market efficiency and attract additional liquidity. These two factors are the portfolio transparency of ETFs and the fact that ETF shares may be created or redeemed at NAV at the end of each trading day.

Existing ETFs provide portfolio "transparency" in the sense that they disclose the contents of their portfolios daily either through publication of their entire portfolio or through dissemination of a Portfolio Deposit/Redemption basket (the "In Kind Basket") that is substantially similar to their entire portfolio, or both. Portfolio transparency is a means for permitting professional trading firms to readily ascertain the value of an ETF's portfolio relative to its current secondary market price,[9] which makes it easier for such firms to identify trading opportunities created by short term imbalances of supply and demand in the secondary market (which may result in secondary market prices trading at a short-term premium or discount to the value of the portfolio). Because such short-term imbalances can be readily identified by professional traders, they seize the trading opportunities that they present throughout the trading day, which results in secondary market prices closely reflecting underlying ETF portfolio value.[10]

[9] As discussed in greater detail later in this letter, BGFA believes that while portfolio transparency is the simplest means of permitting professional trading firms to readily ascertain the value of an ETF's portfolio relative to its current secondary market price, BGFA does not believe that full disclosure of portfolio holdings is a necessary condition for an ETF to trade at secondary market prices that closely reflect underlying portfolio value. BGFA believes that the ETF "arbitrage mechanism" can be achieved by any arrangement that permits market participants to assess an ETF's underlying value accurately, and to hedge trading exposures to the ETF, throughout the trading day.

[10] Existing ETFs have a consistent history of trading within a narrow range relative to the value of their underlying holdings. Academic research indicates the applicable premiums or discounts for domestic ETFs "are generally small and highly transient" while the premiums or discounts of international ETFs are "larger and more persistent" but nonetheless may still be performing according to expectations. *See* "Premiums-Discounts and Exchange Traded Funds", Robert Engle and Debojyoti Sarkar, The Journal of Derivatives, Summer 2006. Price discrepancies do not persist because the "arbitrage mechanism" of ETFs transmits price discovery information to the underlying stocks. *See* "Intraday Price Formation in U.S. Equity Index Markets", Joel Hasbrouck, The Journal of Finance, December 2003. When deviations between an ETF's secondary market price and its underlying portfolio value develop, academic research suggests this is often a result of price-changing information affecting ETF share prices before it is reflected in the prices of the ETF's underlying holdings. The deviation then results in the price sensitive information

Portfolio transparency also permits professional trading firms to judge the risks of being long or short ETF shares, and to hedge such risks, more simply than they are able to do with other stocks. Because professional trading firms know what is in the entire portfolio or In Kind Basket, they can, if they choose to do so, hedge their risk of being long or short ETF shares throughout the trading day very specifically by taking offsetting positions in the In Kind Basket (that is, for example, shorting ETF shares in response to customer orders for such shares while simultaneously purchasing the In Kind Basket to hedge the short exposure). A simultaneous, specific hedge using the In Kind Basket is essentially a riskless arbitrage. BGFA believes, however, that most professional trading firms do not consistently choose to hedge the risk of being long or short ETF shares by entering into simultaneous transactions in the In Kind Basket. Rather, in BGFA's experience professional trading firms, *including many* Authorized Participants,[11] hedge their trading exposure to ETF shares by taking offsetting, correlated positions in derivative instruments, which are often considerably easier to trade quickly than the In Kind Basket.[12] Many market participants treat ETF trading positions as part of a global trading book, and offset long or short trading exposures to ETFs against aggregated exposures to correlated futures, swaps, structured notes or securities incurred through other parts of their trading business. Because professional trading firms can judge the correlation risk of such hedges, they are frequently comfortable maintaining hedged long or short positions in an ETF's shares for time periods considerably longer than a single trading day.[13]

The fact that ETF shares may be created or redeemed at NAV at the end of each trading day makes it relatively simple for professional trading firms to unwind a hedged

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being transmitted to the prices of the ETF's underlying holdings through the ETF's arbitrage mechanism, as market professionals buy or sell the underlying holdings (or correlated assets) in response to the changing ETF secondary market price. See Note 28, *infra*

[11] An Authorized Participant is a professional trading firm that for its own reasons chooses to settle purchase and redemption transactions in ETF creation units (for its own account or for customers) directly with the ETF rather than through another professional trading firm. Authorized Participants may be specialists, market makers, brokers who clear trades for large institutional clients or specialized computer-based trading firms that trade in large volumes and prefer to manage their own transactions. An Authorized Participant must be a broker-dealer that has access to institutional clearing systems used to settle ETF share transactions in the primary market.

[12] The In Kind Basket for an ETF may consist of hundreds of individual securities and, to the extent that any of the securities included in the In Kind Basket are not exchange-traded (as is generally the case with fixed income securities), such securities are frequently not readily available through a single dealer. In addition, for ETFs that invest in non-U.S. securities, it may not be possible to trade the In Kind Basket during U.S. market hours. Accordingly, such ETFs require professional trading firms to hedge any ETF exposure acquired during U.S. market hours with instruments other than the In Kind Basket, and therefore generally do not permit riskless arbitrage transactions.

[13] This closely resembles the way professional trading firms manage the risk of positions that result from trading non-ETF stocks, but it may be simpler to judge the correlation risk of a hedge to a position in an ETF.

long or short position in ETF shares when it seeks to do so.[14] The ability of a professional trading firm to get out of a position relatively easily, at fair value, reduces the risk of establishing the position in the first place. In a competitive market, market makers will offer to trade at the narrowest spread[15] at which they can make adequate trading profits in order to attract trading volume from other market makers. Thus, market makers are encouraged to offer to trade ETF shares at prices that closely reflect the underlying value of the ETF's portfolio, given that they can readily get out of their trading position at the current NAV by purchasing or redeeming creation units. In the event that market makers do not maintain the best possible prices for ETF shares and spreads remain wide enough to be taken advantage of by other professional trading firms, "riskless arbitrage" transactions will generally take place and force spreads to narrow.

In summary, BGFA believes that the "arbitrage mechanism" of ETFs, as it is actually effected by market participants, does not consist of continuous "riskless arbitrage" transactions by arbitrageurs that are closed out through a creation or redemption transaction at the end of the trading day. Rather, the ETF arbitrage mechanism more closely resembles the way market makers and other professional trading firms manage trading positions in other stocks by maintaining and adjusting a hedge position in response to the buying and selling of shares. The mechanics of ETFs make maintaining and adjusting a hedge position relatively easy and riskless for sophisticated professional traders, which facilitates their ability to quote secondary market prices that closely reflect an ETF's underlying portfolio value. BGFA believes this understanding of ETF trading mechanics helps to answer certain questions posed by the Commission in the Release, as set forth below.

A. Necessary Conditions for an Effective Arbitrage Mechanism

Because BGFA's business is highly focused on ETFs, BGFA spends considerable time and effort trying to understand the secondary market dynamics that affect the trading of ETFs and how best to improve that trading experience for fund shareholders. Consequently, BGFA's views regarding the operation of the ETF "arbitrage mechanism" have evolved over time as it gains increased experience and expertise in these issues. BGFA currently believes that there are two essential factors that permit an ETF to trade

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[14] In the case of a long position in ETF shares, the position is unwound through a redemption transaction in which the ETF shares are delivered back to the ETF for the In Kind Basket, which (together with any offsetting derivative position that the trading firm used to hedge its long position in ETF shares) can then be sold. In the case of short position in ETF shares, the position is unwound through a creation transaction in which the In Kind Basket (which is either already held as a hedge against the short position in ETF shares, or is acquired with the proceeds of the liquidation of a derivative hedge) is delivered to the ETF in exchange for ETF shares, which are then delivered in settlement of the short position.

[15] The spread is the difference between the price at which market makers bid to purchase shares and the price at which they offer to sell them. The spread is part of the cost of transacting in any stock, including ETF shares, and represents market makers' price for providing liquidity in the stock. A narrow spread is generally indicative of a competitive, efficient trading market.

at secondary market prices that reflect fair underlying value, and that an ETF will trade in the secondary market at such a price so long as those two essential factors are present. Those two factors are what BGFA refers to as "valuation clarity" and "access".

"Valuation clarity" is any mechanism that permits market participants to assess an ETF's underlying value accurately enough throughout the trading day to hedge trading exposures to the ETF effectively. Disclosure of portfolio holdings, or a portion of portfolio holdings sufficient to assess the value of the full portfolio, [16] is the simplest (but not necessarily the only) means of permitting professional trading firms to readily ascertain the value of an ETF's portfolio relative to its current share price.[17]

"Access" encompasses two related but different concepts. First, with respect to the primary market for ETF creation units, it means that Authorized Participants must have the ability to locate assets required to be delivered in-kind to an ETF. [18] If Authorized Participants are unable to locate assets included in an ETF's In Kind Basket, purchases of creation units will not occur readily, which makes it more difficult for the market to adjust the supply of outstanding ETF shares to match increasing demand for the shares.[19] Second, with respect to the secondary market, it means that market makers and other professional market participants have to be able to construct an effective hedge that offsets the risks of being long or short an ETF's shares. The ability to construct an effective hedge is critical to a market makers' ability to accept the risk of taking and holding significant trading positions in ETF shares – which provides liquidity to the secondary market and helps keep supply-and-demand in line with the ETF's underlying

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[16] As discussed in greater detail in Section II.A.1 of this letter, BGFA does not believe that full disclosure of an ETF's holdings is necessary to achieve portfolio transparency, although it may be the simplest way of doing so.

[17] BGFA believes it is possible for an ETF that does not disclose any portion of its portfolio holdings frequently to have "valuation clarity" so long as market participants are otherwise able to ascertain the value of the portfolio reliably throughout the trading day. BGFA encourages the Commission to consider, through the exemptive application process under the Act, proposed ETF structures that would provide valuation clarity through means other than portfolio transparency.

[18] As discussed in greater detail in Section I.B of this letter, this does not mean that BGFA believes that ETF portfolio holdings need to be highly liquid. BGFA believes many less liquid or thinly traded securities can appropriately be included as components of In Kind Baskets so long as they are available for sale somewhere that Authorize Participants can identify when they desire to create ETF shares.

[19] As noted above, supply and demand for ETF shares is first held in balance by market makers providing liquidity and taking trading positions that offset temporary buy or sell imbalances. Market makers frequently "short" ETF shares to customers, which provides liquidity when demand for ETF shares temporarily exceeds supply and keeps the ETF share price from increasing above the ETF's underlying value. Market makers commonly close their "short" positions by purchasing shares when the supply of ETF shares temporarily exceeds demand. Alternatively, if trading opportunities do not permit a market maker to offset a "short" position by purchasing existing shares in the secondary market, the market marker can arrange to purchase creation units (that is, blocks of newly-issued ETF shares) if necessary to eliminate and settle the "short" trading position.

value.[20] If market makers and other professional market participants were unable to hedge a trading position in an ETF's shares, they would not commit capital to promote market liquidity in such shares.

BGFA believes that if valuation clarity and access are present, natural market mechanics will result in efficient secondary market pricing for ETF shares.

B. The Effect of Portfolio Liquidity on ETF Share Prices

The implication of the foregoing is that, if valuation clarity and access are present, an ETF may hold any type of asset in its portfolio. BGFA believes there is ample experience that demonstrates the shares of ETFs that hold relatively less liquid securities trade effectively in the secondary market.[21]

While BGFA believes the liquidity of portfolio holdings has relatively little, if any, impact on the premium/discount of secondary market prices relative to NAV for shares of an ETF that has valuation clarity and that may be hedged, BGFA also believes the liquidity of portfolio holdings does affect the spread at which market makers will trade an ETF's shares. The aggregate spreads of the underlying portfolio securities of an ETF will generally be reflected in the spreads of the trading prices of the ETF's shares.[22] This is because secondary market prices for an ETF reflect the costs to create new shares (which would be accomplished by buying and delivering the ETF's In Kind Basket), or by shorting ETF shares (which would be hedged by buying the In Kind Basket or a

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[20] The first condition for "access" would not be relevant to an ETF that issues or redeems shares for cash. The ability to transact in kind is not necessary for an ETF, but ETFs generally transact in kind because it is a cost- and tax-efficient means of moving securities in and out of an ETF's portfolio. The second condition for "access", however, has to be satisfied without regard to whether an ETF transacts in kind or in cash. In the case of purchases of creation units settled with cash, the ETF must be able to invest the cash in a portfolio which can either be inversely replicated or, more practically, hedged by market participants through derivatives such as swaps and futures.

[21] ETFs that hold less liquid or thinly traded securities trade much like ETFs based on traditionally more liquid asset classes. For example, compare the premium/discount history of the iShares Russell 1000 Index Fund (http://www.ishares.com/product_info/fund/overview/IWB.htm), which includes relatively actively-traded large-capitalization stocks, with that of the iShares Russell Microcap Index Fund (http://www.ishares.com/product_info/fund/overview/IWC.htm), which includes relatively thinly-traded small-capitalization stocks that represent approximately 3.2% of the market capitalization of U.S. equity securities. For a comparison involving ETFs that hold fixed-income securities, compare the iShares S&P National Municipal Bond Fund (http://www.ishares.com/product_info/fund/overview/MUB.htm), which invests in municipal bonds (which, as an asset class, has traditionally been characterized as less liquid and difficult to trade) with the iShares iBoxx $ Investment Grade Corporate Bond Fund (http://www.ishares.com/product_info/fund/overview/LQD.htm), which holds a portfolio of the most liquid investment grade corporate bonds.

[22] If spreads grew too wide, it would be an indication that the market found it too costly to create or hedge the ETF's shares, which could adversely affect the ETF's premium/discount history. BGFA is unaware of any ETF it advises ever having had such issues.

correlated equivalent instrument), to satisfy buying demand.[23] So long as the spread (*i.e.*, the cost of buying or selling) an ETF's shares is no greater than the spread of the In Kind Basket, ETF shareholders receive access to the underlying exposure at fair cost. In fact, in nearly all cases the spread of an ETF's shares is less – often substantially less – than the spread of the In Kind Basket. This is because ETF shares develop inherent liquidity just like other stocks. Professional market participants can net purchases and sales of an ETF's shares against each other, while hedging any exposures through correlated assets, without ever trading the underlying In Kind Basket.[24] This results in reduced transaction costs for them. Normal competition among market makers ultimately converts these reduced costs into narrower spreads.[25] It is for this reason – access to the underlying exposure at substantially reduced cost to acquiring that exposure directly – that ETFs holding relatively less liquid portfolio securities often offer a compelling benefit to shareholders.[26]

Accordingly, we do not believe the Commission should require ETFs to have greater portfolio liquidity than other registered investment companies. [27] BGFA

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[23] The same effect happens, with the opposite trades, in response to selling demand.

[24] In 2007, the twenty largest iShares ETFs all had secondary market trading volume substantially in excess of primary market issuance. The ratio of secondary market trading volume to primary issuance among these funds ranged from a low of 2.1:1, in the case of the iShares Dow Jones Select Dividend Index Fund, to 46.3:1, in the case of the iShares MSCI Brazil Index Fund.

[25] For example, since the inception of the iShares MSCI Emerging Markets Fund in April 2003 the spread of the ETF shares at the end of each of the last five calendar years has steadily reduced from $0.25 in 2003, $0.16 in 2004, $0.12 in 2005, $0.03 in 2006 to $0.01 in 2007 (less than 0.007% of the closing price on that day).

[26] For example, for the quarter ended March 31, 2008, based on an average quote size of 1000 shares the iShares MSCI Emerging Markets Fund (which invests emerging market stocks) had an average spread of 1 basis point versus 23 basis points for its In Kind Basket and the iShares Russell 2000 Index Fund (which invests in U.S. small capitalization stocks) had an average spread of 2 basis points versus 19 basis points for its In Kind Basket.

[27] BGFA notes the Commission already requires ETFs to have greater portfolio liquidity than other registered investment companies, both directly and through exercise of its regulatory oversight of exchanges. ETFs generally cannot operate as designed without obtaining exemptions and no-action relief from Section 11(d)(1) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and Commission Regulation M thereunder, from the staff of the Commission's Division of Trading and Markets. *See, e.g.*, PowerShares Listed Private Equity Portfolio, File No. TP 07-07, October 24, 2006; iShares S&P Global Consumer Discretionary Sector Index Fund, File No. TP 06-101, September 19, 2006. The relief provided by the Division of Trading and Markets has required ETF portfolio holdings to meet capitalization, diversification and trading volume requirements for many years.

In addition, because existing ETF exemptive orders (as well as Proposed Rule 6c-11) require an ETF to be listed on an exchange, ETFs must meet the conditions of exchange listing rules applicable to ETFs. Exchange listing rules – which are overseen and approved by the Commission – call for index-based ETFs to meet portfolio liquidity requirements. *See, e.g.*, Rules 1000, 1000A, 1002 and 1002A of The American Stock Exchange. The conditions of the relief provided by the Division of Trading and Markets is consistent

respectfully suggests that the Commission need not address ETF portfolio liquidity through the proposed rules. Any concerns about ETF portfolio liquidity should be addressed through disclosure, rather than imposing liquidity requirements for the securities that may be held by an ETF. Such requirements could have the unintended effect of depriving investors of the significant cost benefits of ETFs described above, by inhibiting ETFs from offering exposure to less liquid asset classes. [28] Appropriate prospectus disclosure relating to an ETF's portfolio liquidity – including any impact on spreads[29] – would be sufficient, as well as being consistent with the Commission's regulation of conventional open-end funds.

II. Comments on Details of the Proposals

BGFA believes the rule proposals generally capture the essential features of existing Commission exemptive relief under the Act applicable to ETFs. BGFA,

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with the conditions of exchange listing rules for fixed-income index-based ETFs, but not for equity index-based ETFs. In BGFA's opinion, current exchange listing requirements relating to portfolio liquidity are confusing and duplicative in light of other Commission requirements. *See* Letter from Ira P. Shapiro, Associate General Counsel of BGFA and its affiliate Barclays Global Investors, N.A., to Nancy M. Morris dated October 29, 2006 in connection with File No. SR-Amex-2006-78. Accordingly, BGFA does not believe adding additional portfolio liquidity requirements under the Act would further the Commission's goal of eliminating unnecessary regulatory burdens on ETFs.

[28] The arbitrage mechanism of ETFs promotes greater liquidity and more efficient pricing in an ETF's underlying holdings. The evidence from academic studies "overwhelmingly" indicates that new price information is generally first reflected in the prices for index-based exchange-traded derivative instruments such as futures, rather than the prices for the underlying cash index and its components. *See* "The Impact of Derivatives on Cash Markets: What Have We Learned?", Stewart Mayhew, Department of Banking and Finance, Terry College of Business, University of Georgia, October 27, 1999 (revised February 3, 2000) at Section 3.8.1, as well as other studies cited therein. More recent studies have found that index-based ETFs perform a similar role in price discovery and transmission of price information to underlying components, but may do so "in a more effective way" than futures because they are "more convenient trading vehicles" for large institutional traders and the ETF arbitrage mechanism promotes "quoting behavior" that is less affected by considerations other than efficient pricing. *See* "Basket Securities, Price Formation and Informational Efficiency", Lei Yu, Department of Finance, Mendoza College of Business, University of Notre Dame, November 2003 (revised March 25, 2005), at note 11, as well as other studies cited therein. *See also* "Intraday Price Formation in U.S. Equity Markets", Joel Hasbrouck, The Journal of Finance, December 2003. Accordingly, an ETF might be expected to trade at a "premium" to an intraday indicative value based on the current prices of its underlying holdings when there is positive price information that has not yet been incorporated in the prices of the underlying holdings, and at a "discount" when there is negative price information that has not yet been incorporated in the prices of the underlying holdings. This information transmission from ETF share prices to the prices of underlying securities results from professional trading firms quickly implementing relative value trades (buying the less expensive asset and selling the more expensive asset) between ETF shares and baskets of securities included in the ETF's portfolio (or correlated assets), which creates liquidity in the portfolio securities. BGFA therefore believes that portfolio liquidity requirements that seek to ensure that an ETF's holdings meet arbitrarily-defined liquidity tests *before* the introduction of the ETF unnecessarily inhibits the introduction of ETFs related to market segments that most benefit from the liquidity and price discovery benefits of ETFs.

[29] See Section II.C.3.c of this letter.

however, suggests that the Commission consider certain technical enhancements to the proposals, as discussed below. BGFA also suggests that the Commission modify the proposals to resolve several issues on which the Commission requested comments in the Release, but which the proposed rules currently do not address.

For the sake of clarity, BGFA has grouped its specific technical comments on the proposals into sections addressing (A) proposed new Rule 6c-11, (B) proposed new Rule 12d1-4, and (C) disclosure issues.

A. Proposed New Rule 6c-11

1. Portfolio Transparency. As noted above, BGFA believes that full transparency regarding an ETF's portfolio holdings is the simplest, most complete means of providing specialists, market makers, arbitrageurs and other market professionals with the valuation clarity they need to trade the ETF's shares in the secondary market in a manner that leads to secondary market prices that fully reflect the ETF's underlying value. Proposed Rule 6c-11 seeks to promote portfolio transparency by requiring an ETF relying on the proposed exemptions either to (i) disclose on its Internet Web site, which must be publicly accessible at no charge, each business day the identities and weightings of the component securities and other assets held by the ETF ("Portfolio Transparency Alternative A"),[30] or (ii) have a stated investment objective of obtaining returns that correspond to the returns of a securities index whose provider discloses on its Internet Web site, which must be publicly accessible at no charge, the identities and weightings of the component securities and other assets of the index ("Portfolio Transparency Alternative B").[31] While BGFA supports portfolio transparency as a goal of the proposed rule, BGFA believes that the two alternative methods of achieving portfolio transparency proposed by the Commission will not achieve this goal.

BGFA supports Portfolio Transparency Alternative A. To state a truism, the goal of portfolio transparency is best achieved through full portfolio disclosure. Portfolio Transparency Alternative A, however, would not be sufficient by itself. Not all index-based ETFs are able to disclose their full portfolio holdings each business day due to limitations imposed by index license agreements.[32] As the Commission recognized,

[30] Proposed Rule 6c-11(e)(4)(v)(A).

[31] Proposed Rule 6c-11(e)(4)(v)(B).

[32] Indices are a type of intellectual property owned by their sponsors. Index-based ETFs only have rights to use an index and the index's data to the extent they are licensed to do so by the index sponsor. While some index sponsors make their index data publicly available, others view their index data as proprietary and seek to make it available only to those who pay fees to use the data. Such index providers may permit ETFs to use the index data subject to limitations on republication of the data or any related data which effectively prohibit the ETFs from publishing the index components and weightings, as well as the ETFs' full holdings (which may closely resemble the index), on a daily basis.

proposed Rule 6c-11 therefore needs to provide another means of achieving portfolio transparency in addition to Portfolio Transparency Alternative A.

BGFA does not believe Portfolio Transparency Alternative B is an effective means of achieving portfolio transparency. First, if an ETF is restricted by the terms of its index license agreement from availing itself of Portfolio Transparency Alternative A, it is highly unlikely that the index sponsor would make its index data publicly available without charge.[33] Thus, the ETFs that will not be able to use Portfolio Transparency Alternative A will also most likely not be able to use Portfolio Transparency Alternative B either. Second, even if Portfolio Transparency Alternative B could be used, BGFA does not believe it would provide market professionals with the information they need to trade the ETF's shares in the secondary market in a manner that leads to secondary market prices that fully reflect the ETF's underlying value. Disclosure of the identities and weightings of component securities of an ETF's underlying index would provide ample visibility of the portfolio holdings of an ETF only if the ETF portfolio fully replicates its underlying index. Many index-based ETFs, however, use portfolio optimization, and therefore hold only a representative sample of the component securities (as described in many of the Commission's existing ETF exemptive orders).[34] That is, the index may include a large number of securities that the fund does not hold, or the index may weight its components significantly differently than the fund weights its holdings. In many cases, an ETF may hold securities that are not components of its index.[35] In other cases, an ETF – particularly an ETF seeking to track a sector or country index – may substantially misweight its holdings relative to its benchmark index to comply with tax diversification requirements.[36] In such cases, disclosure only of the components and weightings of the index will not, in BGFA's opinion, provide market

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[33] MSCI Inc, for example, discloses index membership (constituents), security weights, sector weights and country weights on a subscription basis only. See Question 2 "How can I download the security breakdowns, sector, or country weights of an index?" at http://www.mscibarra.com/support/ifaq.html#faq3.

[34] *See, e.g.,* Barclays Global Fund Advisors, et al, Investment Company Act Release No. 27608, Dec. 21, 2006 (notice). In the case of funds that follow very broad indices, it is often impractical for the fund to hold more than a small portion of the index components. For example, the iShares S&P National Municipal Bond Fund holds 100 bonds while its underlying index consists of 3225 bonds as of March 31, 2008. The Lehman Brothers U.S. Aggregate Index included 9175 components as of March 31, 2008, of which the iShares Lehman Aggregate Bond Fund held only 172 as of March 31, 2008.

[35] Many existing ETF exemptive orders require an ETF hold a specified weighting in index components (generally either 90% or 80%), but do not require the entire portfolio to consist of index components. *See, e.g.,* Barclays Global Fund Advisors, Investment Company Act Release Numbers 24394, April 17 2000 (notice) and 24451, May 12, 2000 (order). Normal indexing practices often require holding some non-index constituents.

[36] Tax diversification requirements generally limit a fund's largest holding to 25% of its portfolio. An ETF tracking a concentrated index with weightings above 25% must therefore underweight the largest index components and overweight other holdings relative to the index. *See, e.g.,* iShares Dow Jones U.S. Telecommunications Sector Index Fund (http://www.ishares.com/product_info/fund/overview/IYZ.htm), which substantially underweights AT&T relative to its benchmark index.

participants with sufficient understanding of the fund's holdings to be able to make markets effectively.

Accordingly, BGFA recommends the Commission delete Portfolio Transparency Alternative B from proposed Rule 6c-11 and replace it with another option that would be more feasible for ETFs to use and also better promote market efficiency. BGFA believes experience with existing ETF exemptive orders suggests a solution. Many of the existing index-based ETF orders require only that the funds disclose their basket assets, not their entire portfolios.[37] ETFs operating under these orders provide portfolio transparency by disclosing daily the identification and weightings of assets required to be included in the In Kind Basket. Contents of the In Kind Basket generally represent a *pro rata* slice or a optimized sample that is representative of the ETF's total portfolio.[38] We believe that daily disclosure[39] of the In Kind Basket, provided the In Kind Basket is a representative sample of portfolio holdings, promotes sufficient portfolio transparency to permit efficient secondary market trading.[40] Many index-based ETFs that publish only their baskets on a daily basis have been in existence for some time, and trade in the secondary market as effectively as comparable ETFs that publish their full portfolios daily.[41]

2. Listing on a National Securities Exchange and Dissemination of Intraday Value. In addition to transparency, proposed Rule 6c-11 includes two other important conditions: exchange listing and dissemination of intraday values.

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[37] *See, e.g.*, Barclays Global Fund Advisors, Investment Company Act Release Nos. 24394, April 17, 2000 (notice) and 24451, May 12, 2000 (order).

[38] The In Kind Basket includes both a basket of securities and an amount of cash (the "Cash Balancing Amount") that, together with the basket of securities, causes the value of the In Kind Basket to equal NAV. The Cash Balancing Amount effectively discloses the existence and value of any assets or liabilities of the ETF not reflected in the basket of securities. BGFA believes that disclosure of the magnitude of an ETF's liabilities is important information to market professionals, but is confident that market professionals understand that such information is already effectively disclosed.

[39] The Commission requested comment on whether disclosure should be required more frequently than daily. BGFA believes disclosure of portfolio holdings by any ETF more than once daily would be difficult to implement and would provide no clear incremental benefit to secondary market pricing of ETF shares.

[40] Currently, In Kind Baskets may be published and disseminated primarily through the processes of institutional settlement systems (such as the National Securities Clearing Corporation) used to facilitate settlement of purchases and redemptions of ETF creation units. While we do not believe that requiring the posting of the In Kind Basket on an ETF's Internet website would make the information more widely available to the market than currently, BGFA would not object to such a requirement if the Commission believed it was necessary to facilitate an appropriate level of portfolio transparency.

[41] For a comparison of premium/discount history, compare iShares MSCI Japan Index Fund (http://www.ishares.com/product_info/fund/overview/EWJ.htm), which publishes full portfolio holdings only as of the most recent previous month end, with iShares S&P/Topix 150 Index Fund (http://www.ishares.com/product_info/fund/overview/ITF.htm), which invests in a comparable index but publishes its portfolio holdings daily.

BGFA supports the exchange listing condition[42] provided that the Commission determines that there will be multiple exchanges competing to seek such listings. BGFA notes that in recent years many exchanges have come under the consolidated control of large public companies. In light of the evolving exchange environment, BGFA requests that the Commission, through its regulatory oversight of exchanges and exchange listing rules, monitor the extent to which this condition could, at some future date, potentially facilitate undue costs being imposed on ETFs (and, indirectly, ETF shareholders).

BGFA has similar concerns relating to the proposed condition relating to dissemination of intraday values.[43] Proposed Rule 6c-11 requires that intraday indicative values, on a per share basis, be disseminated *by a national securities exchange* at regular intervals during the trading day.[44] Such intraday indicative values are required by current ETF exemptive orders and exchange listing rules to be disseminated every 15 seconds[45]

[42] The Commission requested comment on whether proposed Rule 6c-11 should make allowances for ETF shares that are suspended or delisted. BGFA commends the Commission for recognizing that suspension or delisting could potentially occur as the result of highly technical requirements of exchange listing rules for ETFs – for example, an index-based ETF's change of underlying index to another, highly similar index, even if approved in advance by the ETF's board of directors and/or shareholders consistent with requirements of the Act, would trigger a need for the ETF to re-satisfy the listing exchange's liquidity requirements on a retroactive basis from the date of the index change. *See* Letter from Ira P. Shapiro, Associate General Counsel of BGFA and its affiliate Barclays Global Investors, N.A., to Nancy M. Morris dated October 29, 2006 in connection with File No. SR-Amex-2006-78. BGFA believes it would be appropriate for the Commission to provide relief in the event of failures to meet technical listing requirements that have limited consequence to protecting ETF investors. It is likely, however, that it would be very difficult to craft an exemption that proactively identifies all circumstances in which relief might be appropriate. BGFA therefore recommends that the Commission (1) use its oversight of exchange rules to encourage exchanges to build necessary flexibility into ETF listing requirements, and (2) be prepared to provide relief to ETFs based on individual circumstances when appropriate.

[43] BGFA believes that an ETF with portfolio transparency does not also require an intraday indicative value to be disseminated in order to achieve valuation clarity. Portfolio transparency is sufficient to permit market professionals to determine the current underlying portfolio value, and in BGFA's experience most market professionals calculate an ETF's underlying portfolio value using their own propriety methodologies rather than rely on the intraday indicative values disseminated generally. BGFA also believes that intraday indicative values are not the most useful indicator of current portfolio value to investors. *See* Note 92, *infra*. BGFA nevertheless supports the inclusion of an intraday indicative value requirement in proposed Rule 6c-11 because current ETF exemptive orders and exchange ETF listing rules approved by the Commission have established intraday indicative values as a market expectation and intraday indicative values may provide some ETF investors with information they find helpful.

[44] Proposed Rule 6c-11(e)(4)(i).

[45] Proposed Rule 6c-11(e)(4)(i) requires only that intraday indicative values be disseminated at "regular intervals during the trading day." BGFA applauds the Commission for seeking to permit the marketplace to determine the appropriate intervals for dissemination. BGFA notes, however, that the Commission's current ETF exemptive orders and exchange ETF listing rules approved by the Commission have already established intervals of every 15 seconds as a market standard. In BGFA's experience, it is possible to produce an intraday indicative value at intervals of 15 seconds or less on a wide variety of ETFs, and BGFA does not foresee any reason at this time it would seek dissemination of such values at wider

by national securities exchanges *or by other market data vendors and information providers.*[46] BGFA suggests that proposed Rule 6c-11 should not specify that intraday values be disseminated solely by national securities exchanges but should permit dissemination by any market data vendor or information provider capable of providing broad public access, including national exchanges. As noted above, many exchanges have come under the control of large public companies and, in BGFA's experience, exchanges now commonly compete with other financial market data vendors in a variety of ways. BGFA is concerned that, as currently drafted, the intraday value requirement of proposed Rule 6c-11 could result in exchanges having an effective barrier against competition from other financial market data vendors that is not justified by any considerations of investor protection or public policy. BGFA therefore suggests that Rule 6c-11 require only broad public dissemination of intraday indicative values.[47]

3. Affiliated Index Providers. BGFA notes the discussion in the Release of proposed Rule 6c-11's treatment of ETFs' potential use of affiliated index providers.[48] BGFA supports permitting ETFs to seek to track indices sponsored by affiliates,[49] and agrees that there is no need for the rule to include the terms of previous applications designed to prevent the communication of material non-public information between the ETF and the affiliated index provider. BGFA shares the Commission's view that existing securities laws and exchange rules already require funds and their advisers to adopt measures to prevent the misuse of non-public information. BGFA understands that these were included in previous applications at least partly to address concerns that use of an affiliated index provider might lead to indirect active management of an ETF portfolio by its sponsor, acting through the sponsor's affiliated index provider. While such concerns may have been reasonable before the Commission granted exemptions for actively

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intervals. BGFA would therefore recommend a mandatory interval of 15 seconds in the event the Commission determines establishing a mandatory interval for dissemination of intraday indicative values is desirable in Rule 6c-11.

[46] See, for example, NYSE Arca Equities Rule 5.2(j)(3) regarding disseminated information: "One or more major market data vendors will disseminate for each series of Units listed or traded on the Corporation an estimate, updated at least every 15 seconds during the Core Trading Session, of the value in U.S. dollars of a share of each series (the "Intraday Indicative Value")".

[47] Means of disseminating intraday indicative values other than through exchanges could potentially include other financial market vendors, such as Reuters or Bloomberg, or an ETF's Internet website. BGFA notes that if the Commission determines that intraday indicative values should be made available through exchanges, the Commission has ample regulatory authority, through its oversight of exchange rules, to require exchanges to republish information calculated and made widely publicly available by ETF sponsors or other financial market vendors.

[48] See Release at Pages 33-34.

[49] BGFA's affiliate, Barclays Capital, is a significant sponsor of indices. Currently, no ETF advised by BGFA may seek to track an index sponsored by Barclays Capital even though ETFs sponsored by parties unaffiliated with Barclays Capital do so.

managed ETFs, the terms of the prior applications seem unnecessarily burdensome in the context of a proposed rule that expressly permits direct active management.[50]

Indexes are typically licensed for use by ETFs in consideration for license fees paid to the index sponsor.[51] BGFA observes that the payment of index license fees to an affiliated index provider could be deemed to violate Section 17(a) of the Act, which prohibits any affiliated person of a registered investment company, or any affiliated person of such a person, from knowingly selling any property to such investment company.[52] BGFA respectfully suggests that if the Commission permits the use of an affiliated index provider through Rule 6c-11, it should clarify that Section 17(a) does not apply to license payments made to the affiliated index sponsor (whether made by an ETF directly or indirectly through its advisor, depositor or other affiliate). The ability to use an affiliated index provider only under circumstances where no license payment can be made for use of the affiliated index provider's intellectual property would not likely provide a meaningful benefit.[53] BGFA recommends that license fee payments by an ETF

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[50] Further, such terms appear designed to work in the context of specific applicants, each of which was an ETF sponsor that was seeking to use indices maintained by affiliates that had no prior business as index sponsors. Certain terms would be extremely onerous if applied to an index sponsor with an existing business based on clients other than the affiliated ETF. Specifically, one of the terms of the previous exemptive orders requires use of an independent calculation agent that is responsible for all index maintenance, calculation, dissemination and reconstitution activities. We note that these are functions normally performed by the index sponsor, not an independent third party calculation agent. Because indexes are compiled and calculated based on published rules and methodology, we see no reason to require an affiliated index sponsor to use an independent third party calculation agent. In fact, such a requirement creates the incentive for an index sponsor to license indices to unaffiliated ETF sponsors (which it would be able to do consistent with its existing operating model) but not to an affiliated ETF sponsor (which would cause it to have to outsource all of its index maintenance, calculation, dissemination and reconstitution activities). No investor protection considerations warrant this result.

[51] Such index license fees may be paid from fund assets or, as is the case with the iShares ETFs, may be paid by the ETF's sponsor from its revenues.

[52] The rights of an index sponsor to control use of the index are a form of intellectual property, and the licensing of such property for use by an ETF could constitute "selling". The Commission, however, has traditionally not sought to apply Section 17(a) in the context of intellectual property licenses (for example, trademark licenses that permit a fund to incorporate the name of its adviser or distributor in its own). The payment of a licensing fee by an ETF or its sponsor to an affiliated index sponsor should not raise issues under Section 17(a). The existence of an index license agreement, and some of the terms thereof, is generally disclosed to ETF investors in the ETF's prospectus. While index license fee payments are not necessarily specifically disclosed to shareholders, they are reflected in the total annual fund operating expense ratio of an ETF. In addition, index license fees are approved by an ETF's board of directors if paid out of ETF assets or are reviewed by the ETF's board of directors in connection with the annual approval of the advisory contract pursuant to Section 15(c) of the Act if paid by the ETF's investment adviser out of its fees.

[53] BGFA notes that the applicants who previously obtained exemptive relief from the Commission to use affiliated index providers did not seek relief from Section 17(a), presumably because they did not intend to make license payments to the affiliated index provider. As discussed in Note 50, *supra*, however, BGFA believes the circumstances of such applicants were unusual and the terms of the existing exemptive relief

or its sponsor to an affiliated index provider should be treated the same as payments by an ETF or its sponsor to an unaffiliated index provider.

4. Creation Units. Proposed Rule 6c-11(e)(3) defines a "creation unit" in a manner that requires a creation unit to "be reasonably designed to facilitate the purchase (or redemption) of shares from the exchange-traded fund with an offsetting sale (or purchase) of shares on a national securities exchange at as nearly the same time as practicable for the purposes of taking advantage of a difference in the current value of basket assets on a per share basis and the current market price of the shares." BGFA believes this part of the definition of "creation unit" is unwarranted, as in BGFA's experience the sole purpose of a creation unit is to define an amount of shares in multiples of which an ETF will accept purchase or redemption orders. Because most ETFs issue or redeem creation units only against delivery of In Kind Baskets that involve complex settlement procedures and have a significant monetary value, creation units are generally large blocks of shares.[54]

BGFA understands the Commission may have been seeking a way to define a creation unit in a manner that suggests a large amount of shares (an amount in the range of shares that might be used to effect an arbitrage transaction by a large trader) without specifying an exact minimum amount or dollar value of shares. BGFA agrees that specifying an exact minimum amount or dollar value of shares would be arbitrary and could impede the evolution of ETF business practices. BGFA does not believe it makes sense to require a creation unit to facilitate riskless arbitrage, however, because in BGFA's experience that has never been the purpose of a creation unit. We think purchases or redemptions of creation units result from a variety of motivations, which include the desire of an Authorized Participant (or an Authorized Participant's customer) to acquire or redeem shares for investment, trading or hedging purposes. BGFA therefore respectfully suggests that the Commission's definition of "creation unit" merely provide that the size of a creation unit must be appropriate to facilitate efficient settlement of shares by an "Authorized Participant", which BGFA suggests be further defined as a registered broker-dealer that is a member of institutional clearing organizations used for the settlement of creation and redemption transactions in ETF shares, and that has signed an agreement with an ETF or its distributor governing the purchase and redemption of

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would be unworkable for any index provider that has a business broader than licensing indices solely to affiliated ETFs. In particular, an index sponsor would likely face substantial issues licensing its indices for use by an affiliated ETF on no-fee terms significantly more favorable than existing license arrangements for the same index with other licensees.

[54] While the amounts differ among specific ETFs due to settlement practices relating to an ETF's underlying investments, creation units generally range from 25,000 to 600,000 shares. Assuming a per share value of between $25 and $100, this implies a creation unit value in the range of $625,000 to $6,000,000. In practice, however, iShares ETFs generally have creation unit values in excess of $1 million, and most typically have creation unit values of approximately $2.5 million.

creation units.[55] We believe this would accomplish the Commission's apparent purpose of requiring a creation unit to consist of an institutional-sized block of shares.[56]

5. Actively-Managed, Inverse and Leveraged ETFs. BGFA understands inverse and leveraged ETFs would be permitted by proposed Rule 6c-11 on the same basis as other index-based or actively-managed ETFs. BGFA supports the proposed rule encompassing index-based inverse and leveraged ETFs, which are shown by experience to work. Existing inverse and leveraged ETFs permit both "valuation clarity" and "access" so long as the market is informed of the leverage ratio in such ETFs' derivative-based portfolios. BGFA also supports the proposed rule encompassing unleveraged actively-managed ETFs. BGFA believes there is sufficient experience to conclude that the market will be able to trade such products effectively.[57]

BGFA is less certain that there is sufficient experience to judge whether the market would be able to trade actively-managed ETFs with leveraged or short portfolios effectively, or whether the conditions of proposed Rule 6c-11 adequately address such products. In particular, BGFA notes that existing index-based leveraged and inverse ETFs disclose their leverage ratios (which are generally implicit in their investment objective). BGFA suggests that, if actively-managed inverse and leveraged ETFs are to be permitted, Rule 6c-11 should require that an ETF that has short or leveraged exposure be required to disclose expressly the amount of leverage embedded in its portfolio each

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[55] Contrary to the Commission's belief expressed throughout the Release, in BGFA's experience ETFs and their principal underwriters do not transact in creation units with anyone other than large broker-dealers with access to institutional clearing systems. *See, e.g.*, Release at Page 53 (questioning whether more retail investors would be able to transact directly with an ETF that has smaller-sized creation units).

[56] BGFA does not support defining "creation unit" by reference to a specific amount or value that would be arbitrary and could unduly limit the operating flexibility of ETFs. If the Commission determines to include a requirement regarding the size of ETF creation units, however, the requirement should focus on a size reasonably designed to facilitate the efficient settlement of ETF creation unit transactions. BGFA believes reasonable amounts would be a creation unit that consists of at least 25,000 shares or a market value of at least $1 million. In BGFA's experience, creation units of this size permit efficient settlement without unduly restricting creations or redemptions.

[57] BGFA notes, however, that certain active strategies would be subject to substantial risk of frontrunning if conducted with full transparency to the market, and therefore actively-managed transparent ETFs may not be an effective means of delivering returns to shareholders who desire exposure to such strategies.

day.[58] BGFA is uncertain that, in the absence of such disclosure, such funds would have either valuation clarity[59] or access.[60]

6. Application of Section 17(a) to Authorized Participants. Proposed Rule 6c-11(d) would exempt a person who is an affiliated person of an ETF solely by reason of holding 5% or more of the ETF's outstanding voting shares, or is an affiliated person of such a person (an "Owner Affiliate"), from Sections 17(a)(1) and 17(a)(2) of the Act. This would effectively permit Owner Affiliates to engage in purchases and redemptions of creation units involving in-kind settlement. BGFA strongly supports this part of the rule proposal. BGFA believes that such an exemption (which is based on exemptions in existing ETF exemptive orders) is critical for ETFs to function effectively. Many ETFs have very large increases or decreases in outstanding shares as the result of normal daily business activity, and it may be difficult for market participants to anticipate when they become Owner Affiliates. In addition, market participants may amass large trading positions in ETF shares or underlying assets, and preventing in-kind settlement with such market participants could disrupt such market participants' ability to maintain effective secondary market pricing of ETF shares. Moreover, as discussed by the Commission in the Release,[61] because ETFs publish their In Kind Baskets each day and provide all persons either creating or redeeming creation units essentially the same terms, there is no meaningful opportunity for Owner Affiliates to achieve more favorable terms than other Authorized Participants or terms that disadvantage the ETF.

The Commission requested comment on whether the proposed relief should extend to parties that are affiliated persons of an ETF for other reasons – for example, a broker-dealer that is affiliated with an ETF's adviser.[62] BGFA sees no reason for limiting this exemption to Owner Affiliates and not extending the exemption to persons who may be affiliated persons for reasons other than ownership of ETF shares. As the Commission points out, the process ETFs use for in-kind transactions does not provide an opportunity for affiliated Authorized Participants to overreach the ETF or to seek different terms than

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[58] BGFA believes it is possible to calculate the amount of leverage in an index-based portfolio with sufficient accuracy by comparing the performance of the intraday indicative value versus the index. BGFA also believes it is possible to determine the leverage embedded in an actively-managed portfolio in real time based on the performance of the intraday indicative value, but that determining the leverage embedded in an actively managed portfolio would be less difficult and more accurate with disclosure.

[59] While the instruments held in the portfolio would be required to be disclosed each day, unless such disclosure includes detailed terms of swaps or other derivatives held it could be difficult for market participants to understand and value the effective portfolio exposure.

[60] BGFA believes it would be difficult to construct an effective hedge for an actively-managed inverse or leveraged ETF without understanding the current amount of portfolio leverage.

[61] See Release at Page 42.

[62] See Release at Page 43.

other Authorized Participants. The securities to be deposited for purchases of creation units or transferred to a redeeming Authorized Participant will essentially be the same[63] regardless of the Authorized Participant's identity, and are announced publicly at the beginning of each business day. Such securities are also valued at the same values as identical portfolio securities. As a result, in-kind purchases and redemptions provide no opportunity for any affiliated person of an ETF to effect a transaction detrimental to the other shareholders of the ETF. BGFA does not believe the nature of the affiliation affects these essential facts.[64]

7. Redemption of ETF Shares by a Fund Relying on Rule 12d1-4. BGFA believes the final sentence of proposed Rule 6c-11(d) is ambiguous, and recommends the Commission clarify its intent. Proposed Rule 6c-11(d) states that an investment company "that has acquired exchange-traded fund shares in reliance on [proposed Rule 12d1-4] may not rely on this paragraph with regard to the purchase of basket assets." We believe that, as drafted, this may create a permanent exclusion with regard to investment companies that have at any time relied on proposed Rule 12d1-4. BGFA is uncertain whether the Commission intended this result, or whether the Commission merely intended that an investment company that is currently relying on proposed Rule 12d1-4 should not be able to acquire assets through an in-kind redemption of ETF shares. BGFA notes that the amount of an ETF's outstanding shares changes over time, and as a consequence an investment company may rely on proposed Rule 12d1-4 and, later, no longer need to rely on Rule 12d1-4 because its holdings have come within the limits of Section 12(d)(1) (or *vice versa*).[65]

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[63] As the Commission notes, an ETF may accept cash in lieu of certain assets included in an In Kind Basket under certain circumstances – for example, if an Authorized Person has legal restrictions that prevent it from owning, and therefore delivering to the ETF, a particular asset included in an In Kind Basket. BGFA does not believe the ability potentially to substitute cash for certain assets included in an In Kind Basket with the permission of the ETF's adviser affords any opportunity for abuse or unfair advantage.

[64] A broker-dealer that is affiliated with an ETF's adviser could seek to pressure the ETF's adviser regarding the contents of an In Kind Basket *before* publication, but so could Owner Affiliates. BGFA does not believe this is a realistic concern in the context of an ETF with portfolio transparency, because highly sophisticated non-affiliated persons with interests in the ETF would have the opportunity to question whether the ETF's adviser was publishing an In Kind Basket not seemingly in the best interests of the ETF. Further, any such attempt to seek to pressure the ETF's adviser to manipulate the contents of an In Kind Basket would presumably violate other existing legal prohibitions. Should the Commission be concerned about such potential pressure by an affiliate, however, it could require that, in order to rely on the exemption afforded by the proposed rule, the affiliate must maintain and enforce written policies and procedures reasonably designed to prevent communications with an ETF adviser about the contents of an In Kind Basket prior to the In Kind Basket's publication. *See, e.g.*, Rule 100(b)(3) under the Exchange Act (affiliates of distribution participants must maintain and enforce written policies and procedures reasonably designed to prevent communications in order to rely on an exemption from market regulations).

[65] *See also* Section II.B.3 of this letter.

In addition, the use of the phrase "purchase of basket assets" in proposed Rule 6c-11(d) is confusing. To be consistent with the language found in the definition of "Basket assets" contained in proposed Rule 6c-11(e)(1), we recommend that the phrase "redemption of exchange-traded fund shares in return for basket assets" be used instead of the phrase "purchase of basket assets."

B. Proposed New Rule 12d1-4

BGI supports proposed Rule 12d1-4, which would permit investment companies to invest in ETFs beyond the limits otherwise permitted by Section 12(d)(1) of the Act. BGI believes that index-based ETFs [66] are a useful tool commonly used by other investment companies to pursue a variety of legitimate investment strategies that might otherwise be difficult to achieve.[67] Further, subjecting ETFs to the limits of Section 12(d)(1) would not appear to achieve the public policy goals for which Section 12(d)(1) was enacted – as stated in the Release, to prevent

> "pyramiding", a practice under which investors could use a limited investment in an acquiring fund to gain control of another (and potentially much larger) fund and use the assets of the acquired fund to enrich themselves at the expense of acquired fund shareholders. Control could be exercised either directly (such

[66] BGI believes that certain actively managed ETFs could be used to similar effect, but because actively managed ETFs have only recently been permitted to date there is extremely limited experience of other investment companies investing in actively managed ETFs.

[67] Index-based ETFs allow investment companies to buy or sell, in a single transaction, an instrument encompassing a large number of underlying holdings (often thousands) that collectively reflect a market segment (as determined by the sponsor of the index the ETF seeks to track). This enables investment companies to use index-based ETFs to obtain their desired exposures to various market segments very efficiently, and gives rise to a wide variety of uses, including:

- assembling a long-term diversified portfolio of index funds or to fill gaps in long or short-term portfolio allocations to active management strategies;
- obtaining temporary market exposure (for example, as a portfolio is transitioned among asset classes or to quickly expose large cash positions to a desired market segment); and
- because ETFs can be sold "short", they may hedge other positions held long – for example, an "active" mutual fund manager with a portfolio of large capitalization stocks can sell short an ETF that tracks an index of large capitalization stocks to hedge against potential market losses. This also allows ETFs to be used in "long/short" strategies – for example, holding an ETF that tracks an index of small capitalization stocks long while shorting an ETF that tracks an index of larger capitalization stocks in order to capture an expected performance discrepancy.

A number of these uses are similar to the way investment companies use financial futures contracts. Index-based ETFs can serve a function similar to financial futures contracts in that they allow investors to obtain long or short exposure to market indices quickly, but have several advantages compared to futures in that (a) there are liquid markets in a variety of index-based ETFs for which there is no equivalent liquid futures contract, (b) unlike futures, ETFs do not expire and therefore can be held for long periods at significantly lower cost than futures, (c) ETFs are not leveraged, (d) ETFs trade and settle like securities, and therefore do not require daily margining like futures, and (e) ETFs are "securities" for regulatory, tax and other purposes, and therefore present fewer administrative and compliance issues to many investment companies.

> as holding a controlling interest) or indirectly (such as by coercion through the threat of large scale redemptions. Congress also was concerned about the potential for excessive fees when one fund invested in another, and the formation of overly complex structures that could be confusing to investors.

As the Commission points out in the Release, its own views (as well as those of Congress) have evolved since the enactment of Section 12(d)(1), and the experience under exemptive orders issued by the Commission to permit investment by registered investment companies in ETFs in excess of the limits of Section 12(d)(1) has been positive. Indeed, not only have the abuses Congress envisioned when enacting Section 12(d)(1) not occurred,[68] but such exemptions have facilitated the growth of cost-effective asset allocation and target maturity mutual funds that invest principally through ETFs as well as other, innovative new mutual funds.

In light of the experience with fund-of-fund arrangements permitted by Commission rules under Section 12(d)(1), BGFA is concerned that proposed Rule 12d1-4 may be drafted in a manner that effectively prohibits economically beneficial arrangements. BGFA urges the Commission to consider broadening the type of arrangements permitted by proposed Rule 12d1-4, as set forth below.

1. Investments by ETFs in Money Funds and Money Market Instruments. Among the positive experiences with fund-of-funds arrangements cited by the Commission in the Release is Rule 12d1-1, which was enacted in 2006 to permit funds to invest in money market funds in excess of Section 12(d)(1) limits. Rule 12d1-1 permits funds, including ETFs, to sweep and commingle cash balances in money market vehicles in an efficient manner that could otherwise be difficult to achieve in light of Section 12(d)(1). As currently drafted, proposed Rule 12d1-4 does not appear to prohibit an ETF from relying on Rule 12d1-1 to sweep its free cash into a registered money market fund,[69] but does appear to bar an ETF from sweeping its free cash, pursuant to Rule 12d1-1, into unregistered money market vehicles relying on Sections 3(c)(1) and 3(c)(7) of the Act.[70] Given that such investments are expressly permitted by Rule 12d1-1, BGFA believes that Rule 12d1-4, as proposed, would have the effect of permitting registered funds other than ETFs to sweep free cash into unregistered money market vehicles relying on Sections

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[68] BGFA has never experienced an investor (of any kind) seeking to control or unduly influence an ETF. Moreover, given that many existing ETFs frequently experience large scale redemptions in response to normal market activity, it is difficult to see how an investor could effectively extract a concession (such as brokerage business) from an ETF by threatening such redemptions.

[69] BGFA understands that, strictly speaking, proposed Rule 12d1-4 imposes no limits whatsoever on an ETF, but merely provides an exemption for other funds seeking to invest in the ETF beyond Section 12(d)(1) limits if the ETF meets certain conditions set forth in the proposed rule. BGFA anticipates, however, that ETFs will seek to conform to the conditions of proposed Rule 12d1-4 to the extent feasible.

[70] Proposed Rule 12d1-4(a)(4)(ii).

3(c)(1) and 3(c)(7) of the Act while not permitting ETFs that wish to make the exemptions of Rule 12d1-4 available to shareholders to do the same. The iShares ETFs currently rely on Rule 12d1-1 to sweep free cash into unregistered money market vehicles relying on Section 3(c)(7) of the Act. BGFA respectfully submits that there would be no public policy benefit in prohibiting such reliance on Rule 12d1-1 by ETFs.

BGFA further notes that ETFs may also determine to invest their free cash directly and, to the extent that they do so, may wish to consider investing in asset-backed commercial paper the issuer of which relies on Sections 3(c)(1) or 3(c)(7) of the Act. It is BGFA's experience that a significant amount of asset-backed commercial paper that qualifies as an "Eligible Security" within the meaning of Commission Rule 2a-7 under the Act is structured in this manner. Again, BGFA respectfully submits that there would be no public policy benefit in effectively prohibiting such investments.

We therefore recommend that that Rule 12d1-4(a)(4) be revised either (A) to delete subsection (ii) or, alternatively, (B) to modify subsection (ii) expressly to permit investments authorized by Rule 12d1-1 or in instruments that are "Eligible Securities" within the meaning of Rule 2a-7.

2. Layering of Fees. As discussed by the Commission in the Release,[71] a principal concern relating to funds investing in other funds is whether shareholders would wind up paying excessive charges due to duplicative fees at the acquiring and acquired fund levels. Proposed Rule 12d1-4 reasonably addresses this concern by limiting the aggregate sales charges and services fees that may be charged, and BGFA supports this part of the proposed rule. BGFA does not believe that fees ETF sponsors earn for ETF management can reasonably be considered "duplicative" of fees charged at the investing fund level for active management or asset allocation.

3. Exemption for Redemption of ETF Shares. BGFA believes the conditions of the exemptions set forth in proposed Rule 12d1-4(b) do not reflect the realities of how ETFs operate and should be reconsidered.

Proposed Rule 12d1-4(b) would exempt redemptions of ETF shares by an acquiring fund from several sections of the Act. In order to rely on the exemptions, an ETF would be required (1) to receive a representation from the acquiring fund that none of the redeemed shares was acquired in excess of the limits of Section 12(d)(1)(A)(i) of the Act, and (2) to have no reason to believe that such representation was inaccurate.[72] These conditions assume an ETF knows the identity of redeeming shareholders. ETFs do not, and are therefore not in a position to seek the contemplated representation.

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[71] Release at Pages 76-78.

[72] Proposed Rule 12d1-4(b)(2)(i) and (ii).

ETFs accept redemption orders only from Authorized Participants, who are large broker-dealers. Authorized Participants may redeem shares that they own as principal, or may redeem shares acting as agent for a customer. An ETF does not know, and has no reason to know, whether an Authorized Participant is redeeming as principal or as agent for a customer.[73] The ETF is concerned only that it receives the appropriate amount of outstanding shares (which are cancelled) in connection with releasing redemption proceeds. An ETF – just like operating companies whose stocks trade on exchanges – does not necessarily know the identity and share balances of its current shareholders.[74] The fact that settlement of transactions in ETF creation units operates in this anonymous, wholesale manner through Authorized Participants, without direct, individual shareholder records, allows ETFs to settle sizable transactions efficiently,[75] as well as to have lower administration costs than most mutual funds. BGFA believes it would be unwise for the Commission to impose requirements inconsistent with this system, which meets the requirements of existing Commission orders and works well. Such requirements would serve little or no useful purpose, certainly none that would justify the increased costs to shareholders that would likely result.

Given that an ETF normally would not know that it was redeeming assets in kind to an investment company,[76] the proposed exemption might not be necessary in most cases. To the extent this part of the proposal implies a determination by the Commission that ETFs are deemed to have, or should have, knowledge to which they do not in fact have ready access, such an implicit determination could have significant, unforeseen consequences to the processes that have been established for processing and settling orders relating to ETF creation units. BGFA therefore suggests that the Commission simply mandate that an investment company that acquires ETF shares in reliance on Rule 12d1-4 sell such shares in the secondary market and not redeem its shares through an

[73] The relationship between an ETF and an Authorized Participant is fundamentally different than the relationship between a conventional mutual fund and an intermediary who sells the fund's shares. In the latter case, the intermediary signs a "Selling Agreement" or similar document with the fund's distributor under which the intermediary becomes the fund's (or its distributor's) agent for purposes of dealing with fund shareholders. An Authorized Participant, however, only agrees that if it chooses to place orders for ETF creation units, in its sole discretion, those orders and the settlement thereof will be subject to certain requirements. An Authorized Participant is not an agent of the ETF for any purpose, and is not required to disclose anything about customer transactions to an ETF.

[74] All shares of iShares ETFs are registered in the name of a nominee of The Depository Trust Company ("DTC"). Transfers of shares are effected by changing the share balances credited to the DTC members acting for the purchaser and seller. DTC members may act as principal or as agent for underlying beneficial owners. This method of establishing share ownership differs in some respects from conventional mutual funds, which do not settle through DTC, but is like the stocks of operating companies, which do.

[75] Several ETFs, including a number advised by BGFA, frequently experience daily creations or redemptions with values of billions of dollars.

[76] Sections 12(d)(1)(B), 17(a)(1), 17(a)(2), 57(a)(1) and 57(a)(2) of the Act all require conduct be done "knowingly" to be prohibited.

Authorized Participant acting as its agent. Alternatively, BGFA suggests that the Commission modify proposed Rule 12d1-4(b) to (1) make clear the exemptions are required only if an ETF or its distributor has actual knowledge that would otherwise result in a violation of the Act, and (2) permit an ETF or its distributor to rely on representations received from an Authorized Participant, rather than require such representations be received directly from an acquiring fund (as currently proposed).

4. ETF Funds of ETFs. Sections 12(d)(1)(F) and (G) of the Act permit registered investment companies to operate as "funds of funds", subject to the conditions of those Sections. BGFA understands that proposed Rule 6c-11 would permit an ETF to rely on Sections 12(d)(1)(F) or (G) to the same extent as any other registered investment company.[77] BGFA strongly believes that ETFs structured to hold other ETFs would facilitate greater market liquidity and efficiency, and lower ETF operating costs, each of which benefits investors. These benefits will result from the use of ETF shares in In Kind Baskets to replace potentially thousands of individual securities held by the acquiring ETF, which would greatly reduce the complexity of settling transactions in creation units (particularly for ETFs that hold non-U.S. securities) and attract more Authorized Participants; increased arbitrage trading activity; and opportunities to capture potential economies of scale with index-based ETFs that invest in related indices.

BGFA notes, however, that while proposed Rule 6c-11 would apparently permit ETFs to invest in other ETFs in a manner consistent with either Sections 12(d)(1)(F) or (G), proposed Rule 12d1-4(a)(i) would prevent such an ETF from being held by another investment company seeking to rely on Rule 12d1-4. BGFA understands that the Commission is concerned that doing otherwise could present the type of "complicated corporate structure of the kind that concerned Congress when Section 12(d)(1) was enacted" and, specifically, might make it difficult for an acquiring fund shareholder "to determine the nature and value of the holdings ultimately underlying his or her investment." Therefore, the purpose of proposed Rule 12d1-4(a)(i) is to "prevent[] shareholder confusion as to the nature of their investment in an acquiring fund by limiting the extent of those ETF investments."[78]

BGFA respectfully submits that a mutual fund seeking to obtain market exposure by purchasing shares of an ETF that happens to operate as a fund-of-funds presents very different considerations than the types of complex products that concerned Congress at the time it enacted Section 12(d)(1).[79] BGFA further respectfully submits that the concern

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[77] Release at Note 229. While the Commission notes that "the proposed rule" would limit an ETF's aggregate investment in other funds to no more than 10% of its assets, BGFA infers from the context that the Commission meant Rule 12d1-4 (not Rule 6c-11) as "the proposed rule" and therefore intended only that an ETF that invested greater than 10% of its assets in other funds would not be an eligible investment for an acquiring fund seeking to rely on proposed Rule 12d1-4.

[78] Release at Page 75.

[79] See Release at Notes 195 and 197.

that shareholders of funds that invest in ETFs might be unable to determine the nature and value of their investments is unsubstantiated – the Commission does not cite any evidence that suggests fund shareholders actually are troubled by this issue, or that any apprehension would be credible in the context of ETFs. Indeed, BGFA believes such a concern would be misplaced, and seems distinctly at odds with the realities of ETFs. Proposed Rule 6c-11 requires ETFs to maintain a high degree of portfolio transparency. Moreover, it is difficult to see how any mutual fund shareholder would have greater trouble understanding the nature of an ETF – including an ETF that invests in other ETFs – than any other stock or other exchange-traded instrument in which the mutual fund might invest.[80] To the extent that "looking through" complex fund-of-funds structures raises issues, those issues would seem to be substantially mitigated by the portfolio transparency and readily-ascertained value of ETFs.

As noted above, the Commission's rule proposals would not prohibit ETFs of ETFs, but would only prevent other investment companies from investing in such products beyond Section 12(d)(1) limits. Given the benefits that BGFA foresees in ETFs of ETFs, it therefore appears to us that the principal effect of Rule 12(d)1-4(a)(i) would be to construct a barrier that would inhibit investment companies (but not other investors) from taking full advantage of innovative and appealing investment products. In light of the fact that the public policy rationale for proposed Rule 12d1-4(a)(1)(i) advanced by the Commission in the Release is not well-founded and that proposed Rule 12d1-4(a)(1) could disadvantage investment companies relative to other investors, BGFA requests that the Commission reconsider the justification for this provision of the proposed rule.

5. Subadvisory Relationships with Funds that Rely on Rule 12d1-4. One of the principal conditions of proposed Rule 12d1-4 is that an acquiring fund may rely on the exemption only if none of its "investment advisers" "controls" the acquired ETF.[81] We believe that, as the quoted terms are defined in the Act and interpreted by the Commission's staff, this provision of the proposed rule might prohibit a fund that relies on Rule 12d1-4 to invest in ETFs as part of a long-term asset allocation strategy from retaining the ETFs' adviser as a subadviser to the fund to assist with the asset allocation strategy. This result is problematic for many asset allocation or "lifecycle"-type funds that would like to do precisely that.[82]

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[80] In this respect, BGFA submits that it would be substantially easier for a shareholder of a mutual fund to ascertain the value of an ETF of ETFs in which the fund was invested than the value of other investments routinely held by funds that are not exchange-traded.

[81] Proposed Rule 12d1-4(a)(1)(i).

[82] Several investment advisers (including BGFA) noted for their expertise with asset allocation (including lifecycle) funds are also significant sponsors of ETFs. This makes offering an asset allocation fund that invests through ETFs rather than physical assets (which may be more cost-efficient for shareholders) problematic for fund sponsors who lack internal asset allocation expertise.

The Commission has previously granted exemptive relief relating to this issue on many occasions. [83] As the Commission has recognized through these exemptive orders, in this context the fact that a subadviser may be deemed to "control" the acquired ETFs, in its capacity as their investment adviser, presents no opportunity for abuse if (1) the subadviser has not sponsored or organized the subadvised fund, (2) the subadviser does not own more than 25% of the outstanding voting securities issued by the subadvised fund, (3) the subadvisory arrangements with the subadviser are terminable by the subadvised fund, its primary investment adviser and/or its shareholders, subject only to a notice requirement; (4) the officers, directors and employees of the subadviser are not executive officers or directors of the subadvised fund; and (5) the subadviser is not an affiliated person of the subadvised fund by virtue of controlling, being controlled by or being under common control with the primary investment adviser. In light of the Commission's stated goal of eliminating unnecessary regulatory burdens, BGFA recommends that the Commission take this opportunity to revise proposed Rule 12d1-4 in a manner consistent with the conditions of these exemptive orders (which will avert the need for future applicants to seek identical orders).

6. Scope of Rule 12d1-4. Proposed Rule 12d1-4 would permit management investment companies, including business development companies ("BDCs"), and unit investment trusts that comply with the rule's conditions to invest in ETFs beyond the limits of Section 12(d)(1). The Commission notes that the existing exemptive orders on which proposed Rule 12d1-4 is based do not extend to BDCs, but suggests that including BDCs will not raise any concerns that Section 12(d)(1) was designed to address.

BGFA agrees that it is appropriate to extend the relief to BDCs, as the conditions of proposed Rule 12d1-4 seem reasonably designed to prevent the types of abuses at which Section 12(d)(1) was aimed. BGFA therefore supports including them within the proposed rules. BGFA questions, however, why the Commission proposes limiting the scope of Rule 12d1-4 to only certain types of enumerated investment companies, rather than including all investment companies subject to Section 12(d)(1). If, as BGFA believes to be the case, the conditions of the proposed rule are adequate for management investment companies, BDCs and unit investment trusts, we can discern no reason why such conditions would be inadequate for other types of investment companies, specifically companies that are subject to Sections 12(d)(1)(A)(i) and (B)(i) by virtue of Sections 3(c)(1) and 3(c)(7) of the Act. The Release cites no distinguishing factors or

[83] *See* In the Matter of First Trust Exchange-Traded Fund, *et al.*, Investment Company Act Release Nos. 27812 (April 30, 2007) (notice) and 275845 (May 30, 2007) (order); In the Matter of SSgA Funds Management, Inc. *et al.*, Investment Company Act Release Nos. 27511 (October 6, 2006) (notice) and 27543 (November 1, 2006) (order); In the Matter of Vanguard Index Funds, *et al.*, Investment Company Act Release Nos. 27314 (May 6, 2006) (notice) and 27386 (May 31, 2006) (order); In the Matter of SPDR Trust, Series 1, *et al.*, Investment Company Act Release Nos. 26392 (March 23, 2004) (notice) and 26419 (April 19, 2004) (order); and In the Matter of BLDRS Index Funds Trust, *et al.*, Investment Company Act Release Nos. 26386 (March 15, 2004) (notice) and 26415 (April 9, 2004) (order).

evidence justifying the disparate treatment of these investment companies from those proposed to be covered by the proposed rule.

BGFA respectfully suggests that the Commission either broaden the scope of the proposed rule to cover all investment companies subject to Section 12(d)(1) or articulate why the conditions of the proposed rule would not be adequate to address whatever issues might be raised by excluded types of investment companies.

7. Affiliated Brokers. Proposed Rule 12d1-4(c) would create an exemption that provides relief from enhanced Board reporting and recordkeeping requirements otherwise required by Section 17(e)(2) of the Act and Commission Rule 17e-1 thereunder if an acquiring fund that becomes an Owner Affiliate of an ETF trades with a broker-dealer affiliated with that ETF (which could therefore be deemed a second-tier affiliate of the acquiring fund). BGFA supports the proposed exemption, which it believes is appropriate because a broker-dealer affiliated with an ETF would not be in a position to take advantage of an acquiring fund that is a second-tier affiliate of the broker-dealer solely due to an investment by the acquiring fund in the ETF.

Proposed Rule 12d1-4(c) would not create a similar exemption that would benefit ETFs in parallel circumstances – that is, an acquiring fund that becomes an Owner Affiliate of an ETF is affiliated with a broker-dealer (which could therefore be deemed a second-tier affiliate of the ETF) with which the ETF may execute transactions (an "Indirect ETF/Broker Affiliation").[84] It is not clear that requiring an ETF to comply with the requirements Rule 17e-1 in the event of an Indirect ETF/Broker Affiliation would be practicable – an ETF would only be able to comply with Rule 17e-1 if it knew that the acquiring fund had become an Owner Affiliate and, as discussed in Section II.B.3 above, an ETF would not necessarily be aware of an acquiring fund's ownership position. Moreover, even if an ETF becomes aware of the affiliation,[85] subjecting an ETF to the requirements of Rule 17e-1 in such circumstances would not seem to serve any clear purpose. We note that proposed Rule 12d1-4(a)(1) would prohibit any broker-dealer affiliated with an acquiring fund (or its investment adviser or depositor) from seeking to control an ETF in which the acquiring fund invests. Given this requirement, it does not appear that a broker-dealer affiliated with an acquiring fund would be in a position to take advantage of an ETF that is a second-tier affiliate solely due to an investment position taken by the acquiring fund in the ETF. BGFA respectfully suggests that the Commission therefore either (1) conclude that no exemption from Section 17(e)(2) of the

[84] While many ETFs trade infrequently because they settle transactions in creation units in kind, all ETFs trade in the secondary market from time to time in order to effect changes in their portfolio required by (in the case of index-based ETFs) index changes or corporate actions or (in the case of actively-managed ETFs) active strategies.

[85] An ETF could become aware, or could be deemed to have knowledge, of information that is made publicly-available through disclosure by an acquiring fund of its ownership position in the ETF on the acquiring fund's Internet website or in reports to its shareholders or the Commission.

Act would be required in the circumstances of an Indirect ETF/Broker Affiliation, (2) broaden the scope of the exemption provided by proposed Rule 12d1-4(c) to cover ETFs in the circumstances of an Indirect ETF/Broker Affiliation, as well as the currently proposed exemption for acquiring funds in parallel circumstances, or (3) articulate why proposed Rule 12d1-4(a)(1) would not be adequate to address any concerns raised by an Indirect ETF/Broker Affiliation.

C. Disclosure Issues

BGFA commends the Commission for seeking to address the distinct disclosure issues presented by ETFs. BGFA agrees that Form N-1A should be modified to address ETF-specific disclosure issues, and agrees with many (but not all) of the Commission's ideas for doing so.

BGFA previously provided comments to the Commission on ETF disclosure issues presented by the Commission's proposal to streamline mutual fund disclosure generally.[86] BGFA recognizes that these are separate rulemaking proceedings, but believes many of its previous comments are also pertinent here. For the sake of brevity, BGFA has not reiterated all of its previous comments in this letter and refers the Commission to its earlier submission.[87] BGFA has focused its comments below on disclosure issues raised uniquely by the Release.

1. Product Descriptions. Although the ETFs advised by BGFA have received exemptive relief that permits the delivery of a product description rather than a prospectus for most secondary market transactions,[88] such ETFs do not rely on the exemptive relief and have always only made prospectuses available. This resulted from a number of factors, including that (a) the product descriptions produced by BGFA (but never used) were not significantly shorter or simpler than prospectuses, and (b) consequently, there were administrative difficulties and little cost-efficiency in producing product descriptions. BGFA therefore supports the Commission's approach of seeking to replace product descriptions with the proposed new summary prospectus so long as the summary prospectus is designed in a manner that accommodates ETF disclosure issues. In this regard, BGFA reiterates its prior comments in respect of the Enhanced Disclosure Proposing Release that the summary prospectus, as proposed, may not permit inclusion of information that could be deemed material with respect to an ETF and may require the inclusion of information that is not relevant.

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[86] *See* Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, Investment Company Act Release No. 28064 (Nov. 21, 2007) (the "Enhanced Disclosure Proposing Release").

[87] Letter from Ira P. Shapiro, Associate General Counsel of BGFA, to Nancy M. Morris dated February 28, 2008 in connection with File No. S7-28-07.

[88] See Release at Note 145.

2. Primary Market Issues. BGFA agrees with the Commission's view that it is appropriate to treat investors purchasing ETF shares in the secondary market as the intended recipients of ETF prospectus disclosure, and that such investors do not need to know information on how creation units are purchased and redeemed, the transaction fees paid in connection with primary market transactions and other information related to primary market issues. BGFA believes that including such information in the prospectus – and in particular attempting to fit such information in required prospectus fee tables and examples – creates confusing disclosure that is not helpful to investors.

BGFA further agrees that it is appropriate to include disclosure on how creation units are issued and offered to the public in the Statement of Additional Information. BGFA would also most likely continue to provide the information on creation unit redemption currently required by Item 6 of Form N-1A. BGFA finds that it is helpful to disclose the requirements relating to purchase and redemption of creation units in one place, and that occasionally persons who are not Authorized Participants refer to the disclosure in the Statement of Additional Information (typically because they are evaluating becoming an Authorized Participant or a service provider to an Authorized Participant). While BGFA believes it is appropriate to include this disclosure in the Statement of Additional Information, BGFA opposes the creation of a separate supplementary prospectus for Authorized Participants. The number of Authorized Participants (who are the only persons eligible to purchase creation units) is small,[89] and each Authorized Participant already has access to agreements setting forth detailed settlement terms and other materials that may be made available to them by an ETF, its principal underwriter or other service providers. BGFA therefore does not see a need for a supplementary prospectus for Authorized Participants that would justify the production and compliance costs that would be associated with such a document.

3. Information Appearing in the Prospectus

a. Total Returns. BGFA believes the Commission's proposal to require ETFs to report returns based on the market price of fund shares would be confusing and potentially misleading to investors. In addition to the difficulty that investors would likely have grasping the difference between two sets of reported returns, one based on NAV and the other on market prices, reporting two sets of returns would seem to serve no useful purpose. BGFA anticipates that the two sets of reported returns could look different for shorter time periods (one year) but would likely look substantially similar over longer time periods (five or ten years). Any differences would result primarily from deviations between NAV and an assumed "Market Price" on the first and last days of the

[89] The iShares ETFs have a total of 40 Authorized Participants. Many Authorized Participants only purchase and redeem creation units of a select group of the ETFs.

reporting period. Over longer time periods, any such deviations that might exist would be unlikely to affect reported return information meaningfully in annual percentage terms.[90]

For shorter time periods, a deviation between NAV and an assumed "Market Price" on the first and last days of the reporting period would be statistically more likely to affect return information reported in annual percentage terms – but would not necessarily reflect the actual returns achieved by investors who purchased in the secondary market on those days at prices other than the assumed "Market Price". Because ETF shares trade at varying prices throughout the trading day, even investors buying and selling shares on the same days as the beginning and end of the reporting periods would likely achieve slightly different total returns from the reported information, or from each other. One reason that ETFs appeal to investors is that, unlike conventional open-end mutual funds, they give investors choices regarding the prices at which shares are purchased or sold. An investor may seek to trade at any time throughout a trading day and may specify a precise price by submitting a limit order, or may prefer speed and certainty of execution and choose to submit a market order, or other permutations. Attempting to determine a hypothetical "Market Price" at which imaginary investors are assumed to trade ignores this reality, and therefore will produce a fictitious return calculation that will not reflect the actual returns of most real investors. The proposed definition of "Market Price" – the closing price – proposed by the Commission strikes BGFA as arbitrary and does not reflect the price at which most ETF shares trade.[91]

BGFA therefore believes the Commission's proposal is likely to produce two sets of return information that are generally too similar for the difference to be instructive, but are different enough in shorter time periods to be confusing. The lack of meaningful differentiation on the one hand, and potential confusion on the other, are accentuated by the fact that neither set of reported return information will accurately reflect the actual

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[90] BGFA analyzed NAV and "Market Price" total return data for a representative sample of iShares ETFs (including funds that invest in international stocks, which have the largest differences) using December 31, 2007 market prices and found that differences for one-year periods are typically less than 1% and for five-year periods are typically negligible. The largest annualized difference for the five-year period among the sample group of funds was 0.38%, for the iShares S&P Latin America 40 Index Fund. Other funds in the sample group that hold international stocks had much smaller differences, including iShares MSCI EAFE Index Fund (the largest international ETF) (0.20%), iShares S&P Global Energy Sector Index Fund (0.01%), iShares S&P Global 100 Index Fund (0.01%) and iShares S&P Europe 350 Index Fund (0.19%). No iShares ETF in the sample group that invested entirely in U.S. stocks had a difference of as much as 0.10% over a five-year period.

[91] BGFA reviewed the trading history for the most actively-traded iShares ETF, the iShares Russell 2000 Index Fund, and found that (1) trading volumes were spread throughout the trading day, with typically less than 20% of trading volume occurring within the last hour of trading, and (2) intraday prices typically fluctuated significantly, and the closing price was therefore not representative of other possible means of representing a daily price, such as the average of the high and low trades or a volume-weighted average price.

returns of an investor who bought or sold shares at any price other than the closing price on the period end dates.

b. Premium/Discount Information. While BGFA does not oppose providing the premium/discount information required by existing ETF exemptive orders, BGFA believes this information has limited benefit to investors, for a variety of reasons.

First, this information is inherently based on past time periods and is a "snapshot" view based on end-of-day prices. The intraday indicative value that ETFs are required to disseminate provides investors with an indication of the actual current premium/discount on a continuous basis throughout the trading day. This "real-time" information is more useful to an investor seeking to determine whether ETF shares are trading at a premium or discount to underlying value at the time of a trading decision.[92]

Second, BGFA believes the concept of premium/discount may not be an instructive way of thinking about ETF share prices in the secondary market. BGFA believes the premium/discount information required by current ETF exemptive orders assumes that the "correct" price for a fund is its NAV, and that an investor should be wary of trading at any other price. As discussed in the prior section, this ignores a basic reality of ETFs, which is that one reason ETFs appeal to investors is that they give investors more choices, and control, regarding the price they pay or receive. A thoughtful ETF investor may prefer to pay a premium or receive a discount relative to an ETF's intraday indicative value rather than wait for secondary market prices to reflect the intraday indicative value.[93] Focusing solely on premium/discount at the close does not

[92] While BGFA believes intraday indicative values are more useful to investors than historic premium/discount data, BGFA also believes intraday indicative values are not necessarily the most reliable indicators of the fair market value of an ETF. Intraday indicative values are generally based on the most recently available quotation or sale price and, particularly for ETFs that hold non-U.S. securities, may reflect stale prices that do not incorporate more recent information that has been disseminated since the most recent close of trading in the market where the underlying security trades. *See* "Premiums-Discounts and Exchange Traded Funds", Robert Engle and Debojyoti Sarkar, The Journal of Derivatives, Summer 2006. Academic theory suggests the most useful and reliable measure of the fair market value of the ETF is the actual current trading price of the ETF, which can be observed in real time and takes into account all known relevant market information. For this reason, when ETF share prices trade at a premium or discount to intraday indicative values, it is generally the ETF share price that is more "correct" (because it is forward-looking and discounts all known relevant market information) and the comparative (backward-looking) indicative value that is less "correct". The same is true for comparisons between ETF closing share prices and NAV on which premium/discount data is based – the ETF closing share price reflects all information then currently known in the aggregate by market participants, while the NAV reflects only the information then currently known (and able to be reflected in valuations) by the persons involved in determining the NAV.

[93] This can be illustrated by a hypothetical example, as follows: At the opening of the market, news is released that causes the broad stock market to trade up throughout the day. As a result, Broad Market ETF and Broad Market ETF's intraday indicative values are the following at the specified times:

lead to an informed understanding of ETF trading dynamics or how an investor's trading decisions may materially affect his or her returns. BGFA believes that the premium/discount information proposed by the Commission is a vestige of thinking about ETFs as if they were closed-end funds, or conventional open-end funds for which the NAV is the "right price" to transact.

Third, BGFA's Internet website experience suggests investors do not value this information highly.[94] Based on user information data for iShares.com for calendar year 2007, of the approximately 170,000 visitors each month, approximately 3000, or 1.7% used the website's premium/discount information tool. More importantly, our website data indicates that very few website visitors return to view this information more than once – 76% were one-time users of the tool, 20% used it 2 to 5 times, and less than 4% returned to the tool more than 5 times in the year. It seems logical to conclude this may be an indicator that the premium/discount information has little utility to investors.

If the Commission determines the premium/discount information has value and should be retained, BGFA suggests that the information be required only on an Internet website, and not also in prospectuses and shareholder reports. Duplicative disclosure strikes us as unnecessary and burdensome. The Commission is proposing to require both current premium/discount information (based on the prior day's closing price vs. NAV) on an Internet website and historical premium/discount information in prospectuses and shareholder reports. Because data in a prospectus speaks as of the prospectus date and therefore does not include the most recent information, we believe Internet website disclosure is preferable to prospectus disclosure. Accordingly, we suggest that it would be sufficient to reference the availability of the information on the Internet website in a

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	Broad Market ETF Price	Broad Market IIV	Premium
Open	$ 98	$ 98	0 %
10:00 a.m	100	99	1
11:00 a.m	101	100.3	0.7
1:00 p.m.	101.5	101	0.5
Close	101.5	101.5	0

Following the opening of the market, an investor that seeks immediate broad market exposure could either (a) place an order for a conventional index mutual fund that tracks the broad market index, which would be executed at that fund's NAV calculated as of the end of the day, or (b) purchase Broad Market ETF during market trading hours. An investor who does not want to risk paying higher prices later in the day could reasonably conclude that the best option is to purchase Broad Market ETF at 10 a.m. at a price of $100 per share. Despite having paid the largest premium experienced on Broad Market ETF shares during the day, such an investor would receive the best absolute price available to an investor seeking exposure to the broad market index that day.

[94] The premium/discount information currently required by ETF exemptive orders shows the frequency distribution of premium/discounts measured by number of days premium/discounts fell within specified ranges over a one-year period. While the Commission proposes extending the history to five-years in shareholder reports, BGFA is not aware of any reason, and the Commission does not cite any reason, to believe that a chart showing premium/discount information over five-year periods would be more informative than currently required information.

prospectus. In the absence of reliable information that indicates that investors value premium/discount information highly, BGFA believes it would impose costs on ETF shareholders not justified by any benefit to require such information for the five most recently completed fiscal years in shareholder reports.[95]

c. Summary Prospectus Expense Information. BGFA believes the Commission would serve ETF investors better by focusing on disclosure of information that is most relevant to an investment in an ETF. As the Commission pointed out in the Enhanced Disclosure Proposing Release, the key information that investors need with respect to a prospective fund investment may not be adequately conveyed if it is presented as part of a wealth of other detailed information. BGFA does not believe the Commission has appropriately focused on the particular expense information most noteworthy to an ETF investment.

The expense information required by the proposed disclosure rules encompasses a variety of costs and financial intermediary compensation which are typically associated with conventional open-end mutual funds. BGFA does not oppose the inclusion of any of this information, to the extent applicable to an ETF. ETFs, however, are not distributed in the same manner as conventional open-end mutual funds, and therefore typically do not have the types of expenses that arise from a conventional open-end mutual fund distribution model (such as sales loads or other payments to a financial intermediary intended to pay the intermediary for the sale of fund shares or services provided to fund investors). Because ETF shares trade like stocks, the costs of purchasing an ETF are more similar to the costs of purchasing a stock than a conventional open-end mutual fund. The principal transaction costs involved in purchasing (or selling) ETF shares are (a) any brokerage charges imposed by the investor's broker for effecting a transaction (which is established by the broker, not the ETF or its sponsor), (b) the spread (which is established by market makers, not the ETF or its sponsor), and (c) on larger transactions, the market impact of the transaction (which is established by the market, not the ETF or its sponsor).[96]

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[95] While BGFA is not able to predict the costs of including this information in shareholder reports precisely, BGFA believes that including the required information in shareholder reports would likely increase the size of each such report by a page or more. Over a large number of funds, this would likely cause certain shareholder reports to incur increased mailing costs (which are derived from a scale based on the weight of the mailed materials). Given that BGFA estimates over 3 million shareholder reports are mailed to iShares ETF shareholders annually, even an average mailing cost increase of a penny would involve substantial additional expense. Mailing costs are, of course, only one cost associated with producing this information in shareholder reports. While BGFA believes the per fund cost estimates cited on Page 96 of the Release are reasonably accurate in the context of the iShares family of ETFs, BGFA also notes that the iShares family of ETFs is significantly larger (in both assets and number of ETFs) than other ETF families and suspects that many other ETF sponsors would not be able to produce this information as efficiently on a per fund basis.

[96] Properly understood, brokerage commissions, spreads and market impact applicable to ETF transactions are not an additional charge applicable only to ETFs, but an externalization to fund shareholders of the trading costs that would otherwise occur within a fund if the fund received cash proceeds from issuing new

BGFA recommends that the Commission consider, at a minimum, requiring narrative disclosure explaining brokerage and spread costs.[97] Given that brokerage commissions are within the control of the investor rather than the ETF, BGFA believes it is appropriate for an ETF prospectus only to point out that brokerage commissions will be charged and will affect returns. It may also be appropriate to include an illustration.[98]

BGFA further recommends that, in addition to narrative disclosure, the Commission consider requiring numeric illustrative disclosure of spread costs. BGFA believes that spread costs are not well understood by most ETF investors despite the fact that, for retail-sized transactions, spread costs are generally the most significant transactional expense associated with buying or selling an ETF.[99] Spread costs vary significantly from ETF to ETF,[100] and may even be notably different for index-based ETFs that track identical indices.[101] BGFA believes these costs are not well understood

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shares that would subsequently have to be invested in portfolio securities. The expenses of turnover in ETF shares are borne by the trading shareholders, not allocated among other shareholders (as would be the case for a mutual fund that sells and redeems shares for cash).

[97] The iShares ETFs currently provide some narrative disclosure of these costs, although such disclosure is not expressly required by Form N-1A. See, e.g., Prospectus dated January 1, 2008 for iShares MSCI Emerging Markets Index Fund under "Principal Risks – Market Trading Risks – Costs of Buying or Selling Fund Shares" at page 6. BGFA is not aware of other ETFs that commonly provide similar disclosure currently.

[98] For example, an investor that pays a $9.95 brokerage commission to invest $1,000, $10,000, $25,000 or $50,000 would pay approximately 1%, 0.1%, 0.04% or 0.02%, respectively. Any illustration should make clear that it may not be advisable for investors to invest small amounts relative to applicable fixed brokerage commissions.

[99] For institutional-sized transactions, market impact typically is the most significant expense. ETF shareholders for whom market impact is a significant issue, however, generally are highly sophisticated. The impact (cost) of large transactions on the ETF share price is based on specific facts and circumstances and, while capable of estimation, may be difficult to disclose simply in a manner that is useful to ETF shareholders generally.

[100] The average spread applicable to an ETF's shares may vary over time as a result of the number of, and competition among, firms making a market in the ETF's shares. The spread charged is a function of a number of factors, which include both the costs of purchasing the ETF's In Kind Basket and the liquidity of the ETF's shares (more liquid ETF shares attract greater price competition among market makers). Spreads on ETFs can be less than a penny per share on very liquid ETFs, and substantially greater for less liquid ETFs. For illustration, an investor seeking to purchase 500 shares of iShares S&P 500 Index Fund, a very liquid ETF that typically trades at a spread of a penny, would bear implicit spread costs of $5 to invest $70,000 (at a recent price of $140 per share), while an investor seeking to purchase 1400 shares of iShares Russell Microcap Index Fund, an ETF that typically trades at a spread of approximately $0.05 cents, would bear implicit spread costs of $35 to invest a similar amount.

[101] For example, the iShares Emerging Markets Fund and the Vanguard Emerging Markets Stock ETF both seek to track the MSCI Emerging Markets Index. For the quarter ended March 31, 2008, based on average quote size of 1000 shares for the iShares ETF and 800 shares for the Vanguard ETF, the average spread of the iShares ETF was 0.01% while the average spread of the Vanguard ETF was 0.05%. BGFA presumes

by ETF investors at least in part because there is currently no prospectus disclosure or publicly-available source that allows easy comparison of spreads among ETFs.[102] BGFA recommends that the Commission consider requiring an ETF to state its annual average spread for the previous year, calculated as of a specified date. For purposes of fair comparability, disclosure of the annual average spread should be stated in percentage terms relative to an average-sized trade during the period.[103] The disclosure envisioned by BGFA would resemble the following:[104]

Average annual spread:	$0.10 per share
Average trade size (shares):	500 shares
Average share price:	$50.00
Average trade size (dollars):[105]	$25,000
Indicative spread cost per trade:[106]	$50.00
Indicative spread percentage:[107]	0.20%

D. Rule 12d1-2

BGFA strongly supports the Commission's proposal to include ETF shares among the permissible investments for affiliated fund of funds relying on Rule 12d1-2. We see

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that the difference in the spread reflects the greater liquidity in the secondary market for shares of the iShares ETF and the higher spread cost of the Vanguard ETF's In Kind Basket (0.25%) relative to the iShares ETF's In Kind Basket (0.23%).

[102] The size of executed orders and the average realized spread of executed orders, among other data, for each national market system stock (including ETF shares) is reported to the Commission by stock exchanges monthly pursuant to Rule 605 (formerly Rule 11Ac1-5) under the Exchange Act. Such reports are publicly-available, but do not present the data in a manner designed to be readily accessible for investors or that permits easy comparisons among ETFs.

[103] It would not be sufficient to merely disclose the spread cost in pennies per share traded because ETFs have different share prices, which results in ETFs that have identical spread costs expressed in pennies per share providing very different actual cost experiences for investors. For example, an investor in ETF X and an investor in ETF Y could both pay spread costs of $0.05 per share to purchase $10,000 of their ETF's shares. If ETF X costs $20 per share and ETF Y costs $100 per share the investor in ETF X would pay spread costs of $25 ($10,000 divided by $20 per share multiplied by $0.05), or 0.0025% of the amount invested. This is five times the spread costs of the investor in ETF Y, who would pay spread costs of $5 ($10,000 divided by $100 per share multiplied by $0.05), or 0.0005% of the amount invested.

[104] BGFA has inserted hypothetical data in the first three lines of the example disclosure for illustrative purposes.

[105] The average trade size in dollars would be defined as the average trade size in shares multiplied by the average share price.

[106] The indicative spread cost would be defined as average trade size multiplied by average annual spread.

[107] The indicative spread percentage would be defined as indicative spread cost per trade divided by the average trade size in dollars.

no basis for treating affiliated fund of funds that rely on Rule 12d1-2 differently than other funds that would be permitted to invest in ETFs beyond the limits of Section 12(d)(1) of the Act by relying on proposed Rule 12d1-4. We see no issues that would arise so long as such funds are required to comply with proposed Rule 12d1-4 to the same extent as other funds.

BGFA also strongly supports the Commission's proposal to allow funds relying on Section 12(d)(1)(G) to invest in assets other than securities. This will provide any such funds that seek to invest in futures and currencies as part of their asset allocation or hedging strategies with the necessary flexibility to do so without first seeking exemptive relief under the Act. We do not foresee that investments in assets other than securities by funds relying on Section 12(d)(1)(G) would raise any issues not already addressed by other requirements of the Act.

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We thank the Commission for providing BGFA the opportunity to comment on the Release, and we are eager to assist the Commission in any way we can to ensure that the rule proposals will benefit ETF investors. In the event you have any questions about any of BGFA's views, please feel free to contact the undersigned at (415) 597-2860.

Sincerely,

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Barclays Global Fund Advisors

cc: Hon. Christopher Cox
Hon. Paul S. Atkins
Hon. Kathleen L. Casey

Andrew J. Donohue, Director, Division of Investment Management
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