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Via email to rule-comments@sec.gov

Florence E. Harmon, Esq.
Acting Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Re: Exchange-Traded Funds; File No. S7-07-08; Release Nos. 33-8901; IC-28193

Dear Ms. Harmon:

NYSE Arca, Inc. (the "Exchange")[1] appreciates the opportunity to comment on the Securities and Exchange Commission's ("Commission's) proposed Rule 6c-11 ("Proposal") to exempt exchange-traded funds ("ETFs") from certain provisions of the Investment Company Act of 1940 ("1940 Act") and rules thereunder. As the principal listing market for ETFs in the U.S., we work with ETF issuers and see firsthand the lengthy time frames and expense associated with the 1940 Act exemptive application process. This process has burdened ETF issuers with requirements that do not apply to issuers of other derivatively-priced securities, such as closed end funds and exchange-traded notes.

The Exchange commends the Commission for proposing more streamlined procedures for issuing ETFs. Eliminating the 1940 Act exemptive application process will make new investment opportunities available to investors faster and at a lower cost. The Proposal may also further competition by encouraging new and smaller issuers to introduce ETF products, further enhancing innovation and competition among ETF issuers.

In addition to reforming the exemptive process, the Exchange urges the Commission to streamline the approval process for the exchange listing of ETFs. As discussed in greater

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[1] NYSE Arca, an indirect, wholly-owned subsidiary of NYSE Euronext, is the listing venue for 324 ETFs and ETNs, representing 56% of all assets under management within the U.S. ETF marketplace.

detail below, the Commission's Division of Trading and Markets reviews each new ETF product in a manner similar to new standardized option products or structured products. ETFs were classified as "derivative products" by the Commission in 1998 and therefore are subject to the same regulatory standards as index options and hybrid securities. In contrast, however, closed-end funds are not deemed "derivative products." Given that ETFs are more like closed-end funds, the Commission should consider adopting rules, or permitting exchanges to adopt rules, that would eliminate the need for staff review of individual new ETFs.

I. Listing on a National Securities Exchange

The Proposal provides that an ETF that relies on Rule 6c-11 must be approved for listing and trading on a national securities exchange.[2] We agree that the proposed exemption should be limited to *exchange-listed* ETFs because of the significant role that exchanges play in providing a competitive and well-regulated ETF marketplace. Any other result would permit issuers to bring ETFs to market without the investor protections enforced by exchanges.

Not only is the trading on an exchange subject to surveillance, listing on an exchange means the ETF product has passed the scrutiny of exchange staff review, and met the exchange standards that are designed to promote investor protection and market integrity. For example, an ETF based on an index must meet the requisite test of market value and trading volume of the securities that are components of the index. As well, exchange listing standards require issuers to manage potential conflicts of interest such as requiring information barriers when an index is maintained by a broker-dealer of a fund advisor.[3]

The Commission also requests comment on whether the Proposal should make allowance for ETFs that are suspended or delisted.[4] Certainly for technical infractions of exchange listing rules, it is in the best interest of investors to permit an ETF issuer to continue to avail itself of Rule 6c-11 for a specified time period (*e.g.*, 60 or 90 days), absent circumstances that would require termination of an ETF based on provisions of the 1940 Act regulations. During this time, the issuer could cure the delisting and re-apply, or

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[2] Proposed Rule 6c-11(e)(4)(iii).

[3] *See, e.g.*, NYSE Arca Equities Rule 5.2(j)(3).

[4] The rules across exchanges contain similar delisting criteria, generally providing that an exchange will consider the suspension of trading and/or delisting if: (1) there are fewer than 50 record and/or beneficial holders of units for 30 or more consecutive trading days; (2) the value of the index or portfolio of securities on which the series is based is no longer calculated or available; or (3) such other event occurs or condition exists that, in the opinion of the exchange, makes further dealings on the exchange inadvisable. *See, e.g.*, NYSE Arca Equities Rule 5.5(g)(2).

request other appropriate relief from the Division of Investment Management. This is consistent with the Exchange's approach to ongoing listings compliance for public companies.

II. Re-examining the Requirements for Listing ETFs on Exchanges

Consistent with the review of the exemption process under the 1940 Act, the Exchange urges the Commission to review the exchange listing process of ETFs for ways to simplify and expedite the process. Without changes to the current regulatory requirements for listing ETFs, there will be unnecessary delays in bringing ETFs to market and uncertainty as to whether certain ETFs will obtain approval.

The last Commission review of the exchange listing process that affected ETFs was in 1998. The Commission issued its "New Products Release" where it introduced a more streamlined process for the approval of exchange listings of options and other derivative products. Importantly, the Commission deemed ETFs to be "derivative products" subject to the regulatory requirements of the release.[5]

Certainly, the New Products Release did expedite the exchange listing process for derivatively priced securities that had been subject to Commission approval under Section 19(b)(2) of the Securities Exchange Act of 1934 ("1934 Act"). Rule 19b-4(e), adopted in the New Products Release, has indeed expedited the ETF listing process; in recent years, far more ETFs have been listed pursuant to Rule 19b-4(e) (under the Exchange's generic ETF listing criteria in Rule 5.2(j)(3)) than approved under Section 19(b)(2) of the 1934 Act.

The Exchange is concerned, however, that the criteria that must appear in the generic listing standards for ETFs are not tailored to ETF products and are more appropriate for products such as options, which are not subject to the requirements of the 1940 Act. The inclusion of ETFs as "derivative products" in the New Products Release has required ETF listing criteria to contain numerical criteria that are more appropriate to leveraged derivative instruments that are susceptible to manipulation, and as such, must have standards for market integrity. Whether or not the Commission determines that ETFs should remain designated as "derivative products," we believe that exchanges can develop effective and less complex listing criteria for ETFs that would eliminate much of the need for staff review of new ETFs.

We recognize that a regulatory review of the exchange listing requirements will be a significant undertaking. At a minimum, however, the Exchange requests that ETFs be excepted from certain of the requirements set forth in the New Products Release, such as

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[5] Securities Exchange Act Release 40761 (December 8, 1998) ("New Products Release").

the requirement that the Exchange have a comprehensive surveillance sharing agreement ("CSSA") in place with foreign regulators[6] before listing an ETF based on a foreign index.[7]

In addition, the Exchange and other market participants have discussed with staff of the Division of Trading and Markets harmonizing the 1934 Act exemptive and no-action positions with respect to ETFs as a class of securities ("Class Letters").[8] If an ETF cannot rely on the Class Letters because it does not meet the numerical and other conditions therein, then it would be required to submit a separate exemptive/no-action letter. The Exchange urges the Commission: (1) to harmonize the numerical conditions included in the Class Letters with the generic listing criteria contained in exchange rules; and (2) to the extent the staff does not deem the Class Letter TP 07-07 to extend to ETFs investing in fixed-income securities, to provide class relief for fixed-income ETFs. We believe these modest steps would provide greater clarity to ETF issuers and reduce the burden associated with requesting exemptive/no-action relief.

III. Portfolio Transparency

The Proposal seeks to promote portfolio transparency by requiring an ETF relying on the proposed exemptions either to (i) disclose on its Internet Web site each business day the identities and weightings of the component securities and other assets held by the ETF, 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 the identities and

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[6] Such an agreement would not be necessary if the applicable foreign market were a member of the Intermarket Surveillance Group.

[7] While the Exchange appreciates the importance of establishing surveillance arrangements in connection with trading options based on foreign indexes, we do not view ETFs as posing the surveillance or potential manipulation issues associated with leveraged derivative securities. Because ETFs generally hold non-leveraged portfolios of equity or fixed income securities, they do not pose the same level of risk as leveraged derivative securities. In addition to being non-leveraged, ETFs are subject to diversification requirements under the 1940 Act, must hold constituent securities that are traded on exchanges with last sale reporting requirements and must comply with diversification requirements applicable to regulated investment companies under the Internal Revenue Code. *See, e.g.,* Securities Exchange Act Release No. 54916, December 11, 2006 (SR-NYSE-2006-70) (order approving listing of iShares Lehman Bond ETFs) at note 11. These characteristics dampen any potential manipulation and warrant the Commission removing application of the CSSA requirements to ETFs.

[8] *See, e.g.*, PowerShares Exchange-Traded Fund Trust (TP 07-07, October 24, 2006); Securities Industry Association (November 21, 2005).

weightings of the component securities and other assets of the index.[9] The Web page of the ETF or index provider, as the case may be, must be publicly accessible at no charge.

A. No Additional Transparency is Necessary

The Exchange does not agree that additional transparency requirements are necessary given the current levels of disclosure and the efficient pricing mechanisms at work in the trading of ETFs in the secondary market. First, for actively-managed ETFs, the Exchange's rules already require a daily disclosure of an ETF's portfolio.[10] For index ETFs, while there is no Exchange rule mandating a daily disclosure of the portfolio (with respective weightings), given the design of ETF products, there is today sufficient transparency of index-based ETF holdings. Participants who conduct creations or redemptions of ETF shares (banks and market makers), have access to the portfolio composition files for each ETF issue that are sent from the issuer to the National Securities Clearing Corporation each business day.[11] In some cases, the ETF provides publication of the entire portfolio and in other cases the ETF provides the disclosure of the Portfolio Deposit/Redemption basket (or "In Kind Basket") that is substantially similar to the entire portfolio. The transparency provided by these disclosures is critical to facilitating arbitrage, which helps keep the ETF share prices in line with the underlying index or portfolio value.

In addition to the disclosures to the primary market, most index ETFs disclose at least their top 10 holdings (with weightings) on their Web site and many provide substantially more information, including the full list of portfolio holdings and weightings.

The index provider for the ETF is another potential source of transparency. The index for which an ETF is based (or attempting to track) is defined by the index provider and the index components are available either by subscription with the index provider or

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

[10] NYSE Arca Equities Rule 8.600 requires that a Disclosed Portfolio be disseminated at least once daily and made available to all market participants at the same time. "Disclosed Portfolio," as defined in Rule 8.600, means "the identities and quantities of the securities and other assets held by the Investment Company that will form the basis for the Investment Company's calculation of net asset value at the end of the business day."

[11] The ability to conduct creations or redemptions of ETF shares each business day – the primary market for ETFs – creates arbitrage opportunities for large financial institutions. See the comments of Barclays Global Fund Advisors, Inc. for an excellent description of how the primary market for ETFs keeps the market price of ETF shares in line with the value of an ETF's underlying asset value. Letter from Ira P. Shapiro, Esq., Associate General Counsel, Barclays Global Fund Advisors, dated May 16, 2008, at pages 2-10 ("Barclays Letter").

qualified vendor. In some cases, the index provider makes the information available on the index provider's Web site.

With all of these sources of transparency, we are not aware of any shortcomings in the trading of ETFs because of a lack of transparency. On the contrary, we believe the current disclosure practices and requirements for index-based ETFs are appropriate and, in the case of transparent actively managed ETFs (not based on a specific index), the current disclosure of the portfolios holdings each day is sufficient.

B. Intellectual Property Rights of Index Providers

In considering this aspect of the proposal, the Commission must factor in the intellectual property rights of the index providers. Indices are developed, owned and maintained by index providers such as Standard and Poors and Dow Jones. As such, the index providers own the data that make up the index components and weightings. ETFs pay a fee to license the right to use the index data and methodology for the purpose of replicating performance.

Given the proprietary nature of the indices, the index provider often imposes conditions under which the index data can be disclosed. Therefore, to comply with the proposed Commission rule, the ETF sponsor would have to re-negotiate the terms of existing contracts with index providers, most likely at significantly higher cost. These higher costs would be passed on to investors, and worse, may prohibit certain products from being issued. Requiring free Web site disclosure will impose significant burdens on index providers and ETF issuers, who may be asked by index providers to compensate them for lost revenue if they are required to disclose index components at no cost.

We note as well that closed-end funds are not required to post portfolio information and index constituents' details in cases when the investment objective is to track an index performance. It would be patently unfair to require ETFs to provide such incremental index transparency when closed end funds have no requirement to disclose even their holdings on an ongoing daily basis.

C. Other Disclosures

We do support the proposal suggested by Barclays Global Fund Advisors, Inc. that recommends that index ETFs disclose their In Kind Basket, not their entire portfolio.[12] The practice is in place today for many existing index-based ETFs. These ETFs post daily on their Web site the identification and weightings of assets required to be included in the In Kind Basket. Daily disclosure of the In Kind Basket generally

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[12] *See* Barclays Letter at 13.

represents an optimized sample that is representative of the ETF's total portfolio. As the Barclays Letter points out, many index-based ETFs that publish only their baskets on a daily basis have been existence for some time, and trade in the secondary market as effectively as comparable ETFs that publish their full portfolios daily.

In addition, we agree that ETF issuers should be required to disclose free of charge on their Web site the prior day's NAV and the premium or discount of such price against NAV, as provided by proposed Rule 6c-11(e)(4)(iv). Such information, together with other available index or portfolio information described above, provides the necessary information to investors to assess ETF pricing against the underlying index or portfolio. Indeed, such information would far exceed the information required of closed end funds, for example, which provide only quarterly holdings information, lack a portfolio composition file (because there is no creation and redemption mechanism) and are not required to disseminate the premium or discount to NAV. It is well known and a widely observed market result that many closed end funds trade at a premium or discount, and are still suitable investment for investors.

IV. Creation Units

The Proposal would define "creation unit" such that at creation unit must be reasonably designed to "facilitate arbitrage."[13] The Commission states that this aspect of the Proposal is intended to require the issuers of ETFs to demonstrate that the creation unit size will promote an arbitrage mechanism.

We believe this requirement is unnecessary. ETF issuers have established creation unit sizes that they believe foster efficient and cost effective creations and redemptions in view of characteristics of the index or portfolio securities, including whether the ETF holds U.S. or foreign securities. In our view, ETF issuers have been successful in establishing creation unit sizes that permit efficient arbitrage and that are significant in size (generally, 50,000 shares per creation unit, but sometimes much higher), consistent with the anticipated initial price level of the issue, the issuer's ability to efficiently process creation and redemption orders and other factors. Furthermore, it is in the best interest of the ETF issuer to set creation units that will facility arbitrage. The characteristics of the creation units are best determined by the ETF sponsor with appropriate disclosure in the issuer's prospectus and other disclosure documents.

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[13] The Commission defines arbitrage as "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 purpose of taking advantage of a difference in the current value of basket assets and the current market price of the shares." Proposed Rule 6c-11(e)(3).

V. Unit Investment Trusts

The Exchange notes that the Proposal defines "exchange-traded fund" as a registered open-end management company. The first ETFs listed on an exchange were organized as unit investment trusts ("UITs") under the 1940 Act rather than open-end management companies and are among the largest and well-established ETFs. Although today there are very few ETFs organized as UITs, the nature of the exemptive relief that has been required for UITs under the 1940 Act is very similar to those ETFs not organized as UITs. We do not believe current or future ETF issuers that choose a UIT structure should be disadvantaged by not being included under the Proposal. Therefore, we recommend the definition of "exchange-traded fund" in the Proposal encompass ETFs organized as UITs.

VI. Prospectus and Product Description Delivery

The Proposal notes that the Commission recently issued the Enhanced Disclosure Proposing Release ("Release") relating to open-end management investment companies that would require specified information in a summary section of the prospectus.[14] The Proposal states that the Release would require open-end ETFs to include the summary section in their prospectuses and permit persons to satisfy their prospectus delivery obligations by making available the statutory prospectus on an Internet Web site. In addition, the Proposal specifies additional ETF disclosures to be included in the summary section of ETF prospectuses.

The Commission's approach balances the need to provide adequate disclosure to investors without unduly burdening broker-dealers to deliver a document (whether a prospectus or product description) to investors in connection with a secondary market trade. That said, it would be appropriate to provide that, for exchange-traded ETFs, access to the prospectus or summary prospectus on the ETF issuer's Web site constitutes delivery of the document to the investor, subject to the investor's prior consent to such delivery. An "access equals delivery" approach for these products will not jeopardize investor protection and would result in significant cost savings to ETF issuers and broker-dealers in view of the very high transaction volume in many ETFs.

VII. Dissemination of Intraday Value

The Commission proposes that an ETF issuer could rely on Rule 6c-11 only if an exchange disseminates the current value on a per share basis at regular intervals during the trading day (the "Intraday Value").[15] The rules of exchanges trading ETFs already

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[14] Proposal at notes 185-186 and accompanying text.

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

require that an Intraday Value be disseminated by one or more major market data vendors during regular trading hours, updated at least every 15 seconds (for domestic index and fixed income ETFs) or every 60 seconds (for ETF indexes containing non-U.S. stocks).[16] Similarly, for actively-managed ETFs, exchange rules require that an updated Portfolio Indicative Value be widely disseminated by one or more major market data vendors at least every 15 seconds during exchange trading hours.[17]

Given that exchange rules already require the publication of an Intraday Value, we do not see the need for a federal rule governing the practice. Allowing this requirement to be governed by exchange rules will allow the exchanges and the Commission more flexibility to modify the requirements as ETF products and the market develops.[18] That said, should the Commission adopt a federal requirement for the Intraday Value, the Exchange agrees that it must be the exchanges that disseminate the information. The Exchange is charged with conducting surveillance of ETF trading, including surveillance of dissemination of an updated Intraday Value and must be in a position to monitor the availability of the data.[19]

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[16] NYSE Arca Equities Rule 5.2(j)(3), Commentary .01. Such Intraday Values may be calculated by an exchange or by a third party (such as Bloomberg, L.P.), as selected by the ETF issuer. The calculation agent function is competitive, with a number of exchanges, market data vendors and other market participants in a position to conduct such calculations.

[17] NYSE Arca Equities Rule 8.600.

[18] The Proposal notes that regular dissemination of an Intraday Value enables market makers to engage in the arbitrage activities that determine the market price for the shares. Proposal at note 94 and accompanying text. The Exchange is not convinced that the Intraday Value is a meaningful pricing tool for investors in light of the availability of other pricing information. In fact, we believe that it is the transparency of the portfolios holdings which permit market makers and other professionals to arbitrage efficiently and not the regular dissemination of an Intraday Value. Some market participants may choose to generate an intraday value for their own use, using their own calculation methodology to include financing costs, capital costs, etc., in kind trading or arbitrage. Importantly, the intraday value generated by professionals is in real-time and not delayed by 15 or 60 seconds. For public investors, the Intraday Value is of utility only to prove that the arbitrage mechanisms of the primary market (creation and redemption of units) works to keep secondary prices for the ETF in line with the asset value of the trust. A public investor should not use the Intraday Value to determine the price at which the investor will buy or sell a particular ETF. The Intraday Value is evidence to the investor that the arbitrage of the primary market works to keep secondary prices for the ETF in line with the asset value of the trust.

[19] NYSE Arca Equities Rule 7.12, Commentary .04; NYSE Arca Equities Rule 7.34(a)(4).

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We thank the Commission for providing NYSE Arca the opportunity to comment on the Proposal. In the event you have any questions about any of NYSE Arca's views, please feel free to contact the undersigned at (212) 656-2062.

Sincerely,

Mary Yeager
Corporate Secretary
NYSE Arca, Inc.