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July 28, 2008

VIA ELECTRONIC MAIL (rule-comments@sec.gov)

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

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

Dear Ms. Harmon,

On behalf of our clients, Morgan Stanley & Co. Incorporated, JP Morgan Chase & Co., Merrill Lynch, Pierce, Fenner & Smith Incorporated and Goldman, Sachs & Co. (together, the "Firms"), we appreciate the opportunity to comment on the recent proposal published by the Securities and Exchange Commission (the "Commission") regarding exchange-traded funds ("ETFs").[1] While none of the Firms acts as sponsor for ETFs, each serves as authorized participant for multiple ETFs.

The Firms strongly support the Commission's efforts to streamline the approval process for ETFs (*i.e.*, proposed Rule 6c-11 under the Investment Company Act of 1940 (the "Act")) and the exemptive rules under Section 12(d)(1) of the Act (*i.e.*, proposed amendments to Rule 12d1-2 and proposed Rule 12d1-4) (together, the "Proposed Rules"). The Firms believe that ETFs provide important investment and trading benefits to clients and that it is in the best interest of investors to encourage further innovation by ETF providers. Notwithstanding their general support for streamlining the approval process, the Firms believe that the additional condition on fund redemptions included in proposed Rule 12d1-4(b), as part of the proposed safe harbor from Sections 12(d)(1) of Act, would be unduly burdensome and unnecessary. In addition, the Firms believe that the flexibility contemplated by proposed Rule 6c-11 to allow ETFs to use cash in the creation and redemption process, should also be retained as proposed and without the imposition of conditions on its use.

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[1] *See* Exchange-Traded Funds, Proposed Rule, SEC Release Nos. 33-8901 and IC-28193 (March 11, 2008), 73 Fed. Reg. 14618 (March 18, 2008) ("Proposing Release").

Conditions on Use of the 12d1-4 Exemption

As proposed, the safe harbor in the Proposed Rules from the sales limits imposed by Section 12(d)(1) of the Act is subject to the condition that ETFs, their underwriters, and broker-dealers who act as authorized participants not redeem, or submit orders to redeem, shares acquired by a fund that exceed the three percent limit in Section 12(d)(1)(A)(i). The Proposed Rules relating to the safe harbor contemplate that these entities obtain a representation from a fund, when it tenders ETF shares for redemption, indicating that none of the shares submitted for redemption were acquired in excess of the three percent limit. In order to take advantage of the safe harbor, the Proposed Rules also require that an authorized participant have "[n]o reason to believe" that the fund's representation is not true. According to the Proposing Release, the purpose of the representation is to prevent the fund from exercising a "controlling influence" over the ETF by threatening large scale redemptions.[2]

The Firms generally concur with the points made in the comment letter submitted by the Investment Company Institute (the "ICI"), dated May 19, 2008 regarding the proposed safe harbor and related conditions applicable to authorized participants suggested in the Proposing Release. The Firms agree with the ICI that the conditions imposed on ETFs, principal underwriters and broker-dealers relating to fund redemptions in connection with the proposed safe harbor are unnecessary. The funds are already prohibited from redeeming shares purchased in reliance on the 12d1-4 exemption, which should achieve the desired regulatory purpose.

The funds themselves, and not the ETF, the principal underwriters or broker-dealers, are in the best position to know their own ownership status. The Firms sell ETFs to multiple institutional clients and may not be in a position to track the ETF holdings of each fund client. Funds typically custody their holdings at third party, custodial banks so that an executing broker-dealer acting as authorized participant may not have visibility into the funds' holdings. Requiring broker-dealers, who have far less information about a fund's portfolio than the fund itself, to know each fund's ownership status before submitting a redemption order and to obtain representations from each fund imposes an unfair regulatory burden on the authorized participants and could potentially frustrate otherwise legitimate redemption activity.

Flexibility to Use Cash in lieu of Basket Assets

The Firms support the flexibility currently included in the Proposed Rules to allow the ETFs to issue and redeem ETF shares in exchange for the deposit or delivery of cash or assets other than the "basket assets." This flexibility has allowed authorized participants to participate in the creation and redemption process when they would otherwise be restricted from trading in one or more of the securities included in the underlying basket assets due to trading restrictions (*e.g.*, a security resides on an authorized participant's restricted list due to investment banking activities being conducted elsewhere within the firm). Participation by authorized participants in the creation and redemption process enhances the ability of these broker-dealers to provide efficient and favorable pricing for clients and other market participants. It also enables these

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[2] Proposing Release, Fed. Reg. at 14637.

broker-dealers to engage in *bona fide* arbitrage activity in the ETFs, which, as the Commission has recognized, is an important factor in ensuring that ETFs trade at or about their net asset value.[3]

The Firms believe that the process that allows ETFs to accept cash in lieu of securities for some or all of the basket assets has worked smoothly to date. The Firms urge the Commission not to impose additional conditions on the flexibility accorded to ETFs under existing exemptive orders. By structuring the Proposed Rules to rely on the judgment of the ETF adviser to determine whether or not to allow for substitution of cash for some or all of the securities in the basket assets, the Commission has already incorporated appropriate controls into the Proposed Rules to ensure that the interests of ETF holders are well protected and that cash is used only when it is in the ETF's own best interest to do so. The Firms urge the Commission to retain this flexibility without making further changes to these provisions.

Conclusion

In sum, although the Firms support streamlining the approval process, they urge the Commission to eliminate the obligations on the broker-dealers/authorized participants related to the proposed safe harbor in Rule 12d1-4. These requirements add no beneficial check or balance to the ownership process. Ultimately, if the Commission does retain ownership restrictions on funds relating to ETFs, it should be the obligation of the funds and not the broker-dealers, authorized participants or the ETF to ensure that the funds comply with these regulations. If the Staff is inclined to recommend that the Commission approve the conditions described in Rule 12d1-4(b) as proposed, the Firms would appreciate having an opportunity to meet with the Staff to discuss the issue further.

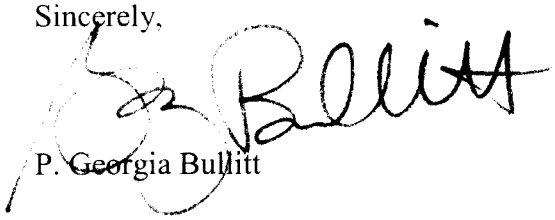
The Firms support the flexibility that the Staff has traditionally provided to ETFs to allow broker-dealers to substitute cash for certain basket assets. They recommend that the Commission not impose conditions on the use of cash, which has been critical to participants by allowing them to continue to participate in the creation and redemption processes without violating rules that would prohibit them from purchasing or selling certain stocks in the ETF's portfolio basket.

We appreciate the opportunity to provide comments on the Proposing Release. If you have any questions about our comments, please contact John McGuire at (202) 739-5654 or the

[3] Proposing Release, Fed. Reg. at 14620.

undersigned at (212) 309-6683.

Sincerely,



P. Georgia Bullitt

cc: The Honorable Christopher Cox, Chairman
The Honorable Paul S. Atkins
The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter

Andrew J. Donohue, Director
Robert E. Plaze, Associate Director
Division of Investment Management