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Ms. Nancy M. Morris, Secretary
Securities and Exchange Commission
100 F St. NW
Washington, DC 20549-9303
Rule-comments@sec.gov

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Dear Ms. Morris:

Here are my comments on the proposed rule to reduce regulatory burdens on the issuance of ETFs. In general, the proposal to simplify the process for issuing ETFs is a great step forward and such reform is long overdue. However, there is a serious problem in the ETF market that the Commission should address as it standardizes procedures for creating new ETFs. The large and protracted settlement failures in the trading of ETFs indicate that there is something wrong, either in the design of the ETF product or in the structure of secondary market trading.

The Commission should address the enormous settlement failures in the ETF Market.

When a seller fails to deliver a security on the normal settlement date, an owner of the security is effectively forced into making an involuntary stock loan to the seller. This violates one of the basic property rights of an owner, the ability to exclude others from the use of the property. In addition, it may deprive the buyer of the ability to earn stock lending revenue, as well as voting rights. The buyer may even have to pay higher tax rates on substitute dividend payments, which are taxed differently than normal dividends.

In response to numerous complaints, the Commission adopted Regulation SHO to reduce settlement failures. Under Regulation SHO, the Commission mandates special rules for securities in which failures to deliver exceed a certain “threshold” of size and length of failure.

As of this writing, over 100 ETFs and ETNs are on the Regulation SHO Threshold List.¹ These settlement failures affect some of the largest ETFs as well as the smallest. For example, the iShares Russell 2000 Index (IWM) experienced over 30 trading days in the year 2007 in which over 10 million shares failed. These failures were for over \$1 billion worth of shares each day. Similarly, the original SPDR Trust (SPY) experienced at least 10 trading days in 2007 with settlement failures of over a billion dollars per day.

Inclusion on the Regulation SHO Threshold List often makes it hard for investors, particularly retail investors, to engage in short sales. Many brokers will not take the effort to locate shares in order to execute short transactions in Threshold stocks. I have been personally told by my broker that shares were unavailable for shorting some ETFs on the Threshold List. Ease of short selling is one of the attractive features of ETFs, and thus the large settlement failures diminish one of the important features of this important product class.

Settlement failures may affect the market quality for ETFs.

Barriers to short selling may impact the pricing quality of the ETF, leading to more pricing errors relative to the underlying Net Asset Value (NAV) and wider bid-ask spreads. As the Commission itself notes on page 36 of the proposing release, “Impeding the ability of arbitrageurs to purchase and redeem ETF shares could disrupt the arbitrage pricing discipline, which could lead to more frequent occurrences of pricing premiums or discounts.” For this reason, the Commission should work towards efficient methods for reducing settlement failures in ETFs.

It is not clear why there are so many settlement failures in ETFs. Theoretically, anyone can create an ETF by presenting a creation unit sized block of the underlying shares (or sometimes the cash equivalent) to the sponsor of the ETF. Thus, there should never be failures larger than a creation unit in an ETF. Yet, casual inspection of the failure to deliver data released by the Commission indicates many instances of failures to deliver ETFs in the millions of shares.

Perhaps one reason is the fear of being deemed an underwriter, as mentioned in Note 22. The Commission may wish to establish a safe harbor in the rule so that normal arbitrage activity will not trigger this problem, even when other affiliates of a firm are recommending the securities.

¹ The appendix to this comment letter displays a partial list of the ETFs and ETNs on the list as of May 14, 2008. Also, I have attached a set of references to my other comment letters on short selling and settlement failures.

Smaller creation unit sizes may lead to fewer settlement failures.

The Commission requests comment on the size regulations for creation units. Given that larger creation unit sizes may make it harder for arbitrageurs to create shares to deliver against their short positions, it makes sense that reducing creation unit sizes may make it easier for arbitrageurs to deliver shares instead of failing.

Smaller creation unit sizes may lead to smaller tracking errors.

Although the larger ETFs track their underlying indices closely, some of the smaller ETFs experience larger tracking errors. Reducing the size of creation units may reduce transactions costs faced by arbitrageurs, thus creating more incentives for arbitrage to keep tracking errors small.

The Commission should let the issuers set creation unit sizes and fees.

I recommend setting the minimum creation unit rather small, and letting the market sort out what the most efficient size is. Sponsors of ETFs have a strong financial incentive to set the creation unit size and transactions fees at the profit maximizing level, which generally means at the asset maximizing level. Since investors will prefer ETFs with smaller spreads and lower tracking error, this means that the economic incentive is to create the most liquid ETF possible.

Given that the sponsors have the proper economic incentives to promote liquid ETFs, I don't think the Commission needs to worry about setting the size of creation units or imposing requirements on boards to worry about this. Putting an explicit requirement into the rule just adds to the compliance costs as the lawyers and regulators will have one more unnecessary box to check off in their inspections.

Creation unit size thresholds for exemptions in disclosure requirements should be set at 1,000 shares.

The proposals in the rule to provide various exemptions from disclosure for funds with creation unit sizes greater than 25,000 shares will create a *de facto* minimum of 25,000 shares. The Commission fears that a smaller creation unit size will lead to retail investors transacting too often directly with the fund company. Given that most retail trades are a few hundred shares at most, the Commission could safely set the threshold for disclosure exemption at 1,000 shares.

Respectfully submitted,

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References

Previous comment letters by James Angel, Georgetown University, on Regulation SHO:

<http://www.sec.gov/comments/s7-19-07/s71907-117.pdf>

<http://www.sec.gov/comments/s7-12-06/s71206-266.pdf>

<http://www.sec.gov/comments/s7-21-06/s72106-35.pdf>

<http://www.sec.gov/rules/proposed/s72303/jjangel011004.htm>

Comment on short selling in a public offering:

<http://www.sec.gov/comments/s7-20-06/s72006-7.pdf>

Appendix One:

Partial list of ETFs and ETNs on the Regulation SHO Threshold List on May 14, 2008

Symbol	Security Name
OIL	Barclays Bank PLC iPath Exchange Traded Notes Linked to Goldman Sachs Crude Oil Total Return Index
JEM	Barclays GEMS Index ETN
BSR	BearLinx Alerian MLP Select Index ETN
BLJ	BlackRock New Jersey Municipal Bond Trust
MCB	BRoad InDex Guarded Equity-linked Securities (Bridges) based on the value of S&P Midcap 400 Index
BRD	BRoad InDex Guarded Equity-linked Securities (BRIDGES) Based on the value of the S&P 500 Index
TAN	Claymore MAC Global Solar Energy Index ETF
HAO	Claymore/AlphaShares China Small Cap Index ETF
NFO	Claymore/Sabrient Insider ETF
FXA	CurrencyShares Australian Dollar Trust
FXE	CurrencyShares Euro Trust
DZZ	Deutsche Bank Gold Double Short ETN
FBT	First Trust Amex Biotechnology Index Fund
FXD	First Trust Consumer Discretionary AlphaDEX Fund
FXN	First Trust Energy AlphaDEX Fund
FFR	First Trust FTSE EPRA/NAREIT Global Real Estate Index Fund
FPX	First Trust IPOX-100 Index Fund
FRI	First Trust S&P REIT Index Fund
FYX	First Trust Small Cap Core AlphaDEX Fund
COW	iPath Dow Jones - AIG Livestock Total Return Sub-Index ETN
JJM	iPath Dow Jones - AIG Industrial Metals Total Return Sub-Index ETN
INP	iPath ETNs Linked to the MSCI India Total Return Index
BWV	iPath Exchange Traded Notes Linked to the CBOE S&P 500 BuyWrite Index
ICI	iPath Optimized Currency Carry ETN
IYR	iShares DJ US Real Estate
IAI	iShares Dow Jones U.S. Broker-Dealers Index Fund
FXI	iShares FTSE/Xinhua China
HYG	iShares iBoxx \$ High Yield Corporate Bond Fund
EMB	iShares JP Morgan USD Emerging Markets Bond Fund
GBF	iShares Lehman Government/Credit Bond Fund
CIU	iShares Lehman Intermediate Credit Bond Fund
JKL	iShares Morningstar Small Value
EWZ	iShares MSCI Brazil IX
BKF	iShares MSCI BRIC Index Fund
ECH	iShares MSCI Chile Index Fund

EFG	iShares MSCI EAFE Growth Index Fund
EIS	iShares MSCI Israel Capped Investable Market Index Fund
EPP	iShares MSCI Spain Index
EWP	iShares MSCI Spain Index
TUR	iShares MSCI Turkey Investable Market Index Fund
CMF	iShares S&P California Municipal Bond Fund
IXG	iShares S&P Global Financials Sector Index Fund
IGF	iShares S&P Global Infrastructure Index Fund
NYF	iShares S&P New York Municipal Bond Fund
PPF	iShares S&P U.S. Preferred Stock Index Fund
AIA	iShares S+P Asia 50 Index Fund
KIE	KBW Insurance ETF
DCR	MACROshares Oil Down Tradeable Shares
SLX	Market Vectors - Steel ETF
PLW	PowerShares 1-30 Laddered Treasury Portfolio
PQZ	PowerShares Active Alpha Multi-Cap Fund
PZD	PowerShares Cleantech Portfolio
DBE	PowerShares DB Energy Fund
DBO	PowerShares DB Oil Fund
DBP	PowerShares DB Precious Metals Fund
PIE	PowerShares DWA Emerging Markets Technical Leaders Portfolio
PVM	PowerShares Dynamic Deep Value Portfolio
PXE	PowerShares Dynamic Energy Exploration & Production Portfolio
PRN	PowerShares Dynamic Industrials Sector Portfolio
PEJ	PowerShares Dynamic Leisure & Entertainment Portfolio
PJG	PowerShares Dynamic Mid Cap Portfolio
PMR	PowerShares Dynamic Retail Portfolio
PTF	PowerShares Dynamic Technology Sector Portfolio
PTE	PowerShares Dynamic Telecom & Wireless Portfolio
PCY	PowerShares Emerging Markets Sovereign Debt Portfolio
PXH	PowerShares FTSE RAFI Emerging Markets Portfolio
PBD	PowerShares Global Clean Energy Portfolio
PKN	PowerShares Global Nuclear Energy Portfolio
PGJ	PowerShares Golden Dragon Halter USX China Portfolio
PIN	PowerShares India Portfolio
PPF	PowerShares International Listed Private Equity Portfolio
PSP	PowerShares Listed Private Equity Portfolio
PGX	PowerShares Preferred Portfolio
RRZ	Rydex Inverse 2x Russell 2000 ETF
RSW	Rydex Inverse 2x S&P 500 ETF
RMS	Rydex Inverse 2x S&P MidCap 400 ETF
XLY	Select Sector SPDR-Consumer Discretionary

EUM	Short MSCI Emerging Markets ProShares
PSQ	Short QQQ ProShares
XHB	SPDR Homebuilders ETF
CWI	SPDR MSCI ACWI ex-US ETF
GXC	SPDR S&P China ETF
GMF	SPDR S&P Emerging Asia Pacific ETF
GUR	SPDR S&P Emerging Europe ETF
GML	SPDR S&P Emerging Latin America ETF
GMM	SPDR S&P Emerging Markets ETF
GAF	SPDR S&P Emerging Middle East & Africa ETF
XME	SPDR S&P Metals & Mining ETF
XRT	SPDR S&P Retail ETF
SJP	Stock Market Upturn Notes Based Upon a U.S.-Europe-Japan Basket
UXI	Ultra Industrials ProShares
UKW	Ultra Russell MidCap Growth ProShares
UKF	Ultra Russell1000 Growth ProShares
UKK	Ultra Russell2000 Growth ProShares
SMN	UltraShort Basic Materials ProShares
FXP	UltraShort FTSE/Xinhua China 25 ProShares
SIJ	UltraShort Industrials ProShares
EEV	UltraShort MSCI Emerging Markets ProShares
SSG	UltraShort Semiconductors ProShares
VEA	Vanguard Europe Pacific ETF
VEU	Vanguard FTSE All-World ex-US ETF
BIV	Vanguard Intermediate-Term Bond ETF
DEM	Wisdom Tree Emerging Market High-Yielding Equity Fund
EPS	WisdomTree Earnings 500 Fund
EPI	WisdomTree India Earnings Fund ETF
DRF	WisdomTree International Financial Sector Fund
DBR	WisdomTree International Health Care Fund
DES	WisdomTree SmallCap Dividend Fund